



# China Economy in 2012

## While facing the US-EZ contraction



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*Khazanah Megatrends Forum 2011, KL, Malaysia, September 2011*

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1. Economic performance: growth remains strong
2. Inflation: Having peaked out;
3. Housing price control: policy effective, price correction on the move;
4. Local government debts: a big challenges but not a crisis;
5. Facing US-EU contraction: no panic but looking for the bottom line;
6. Growth perspective: slowing but no hard landing;
7. RMB: reform through internationalisation.



# 2012: Political Power Transition



Paramount Leader = >

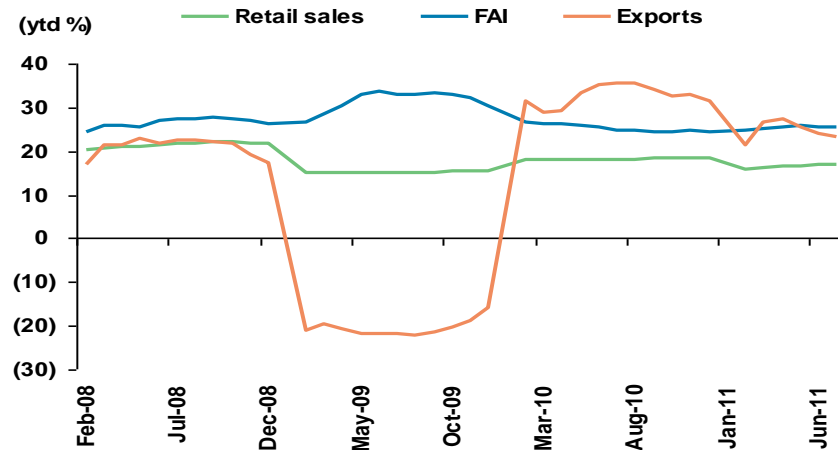


- ***Common interest is stability: political stability, social stability and economic stability;***
- ***Policy wise: conservative rather than aggressive;***
- ***Growth: balancing between risk control and growth retention***

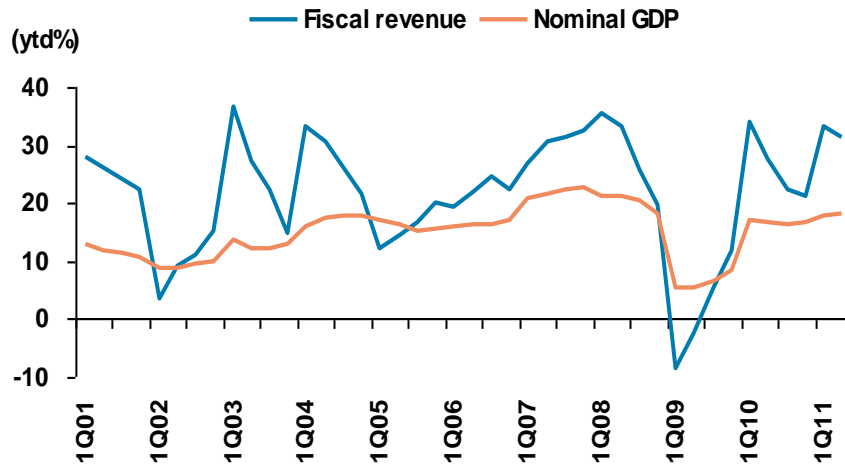


# Growth stronger than expected

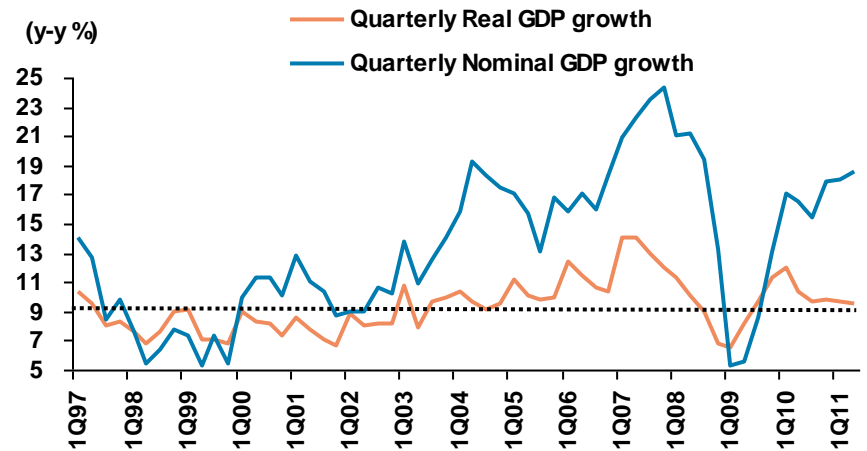
## FAI, retails and exports



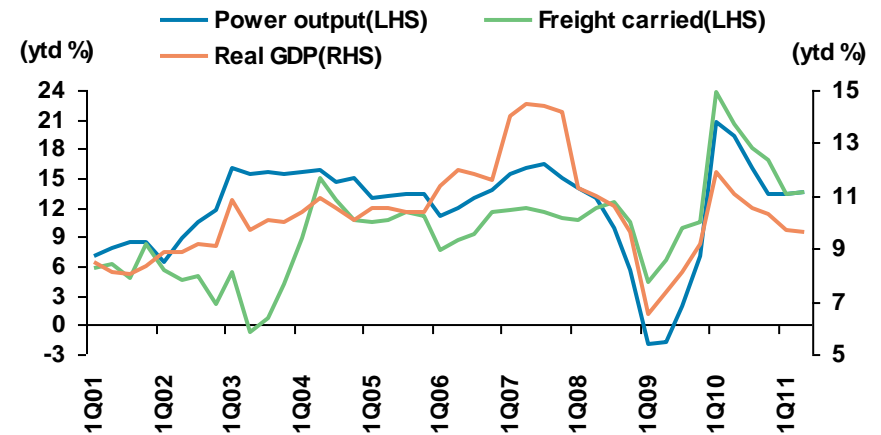
## Fiscal revenue growth robust



## GDP up 9.7% in Q1, 9.5% in Q2, and 9.6% in 1H11

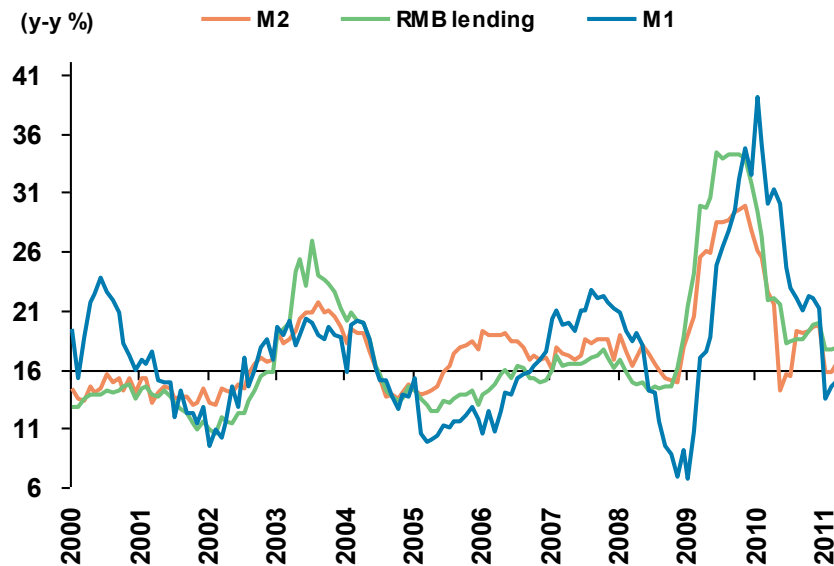


## Power output and freight carried held up

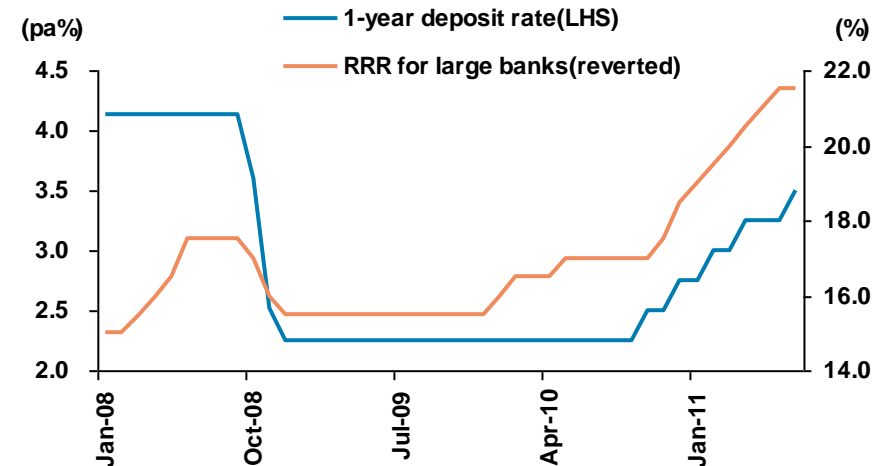


# Despite tight monetary policy...

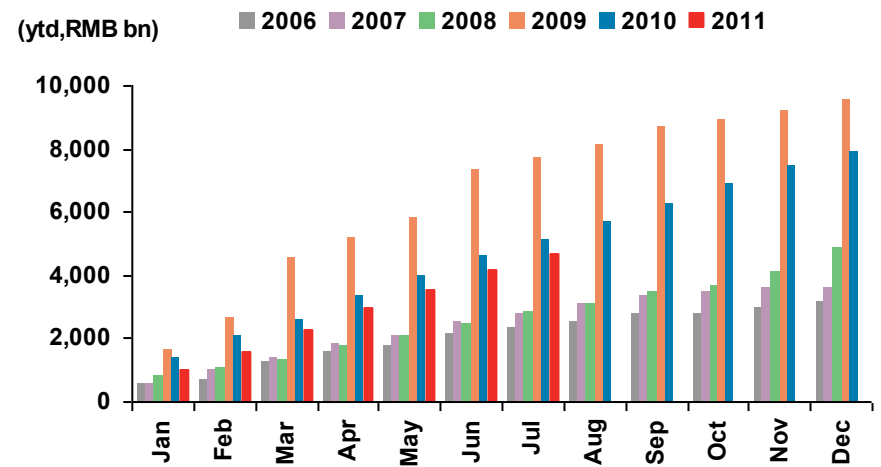
## Growth of lending, M2 and M1



## Hiking RRR and interest rates



## Tighter new loans than statistics



Sources: PBOC; BNP Paribas



# But offset by shadow banking and private lending

- PBOC official statistics: aggregate funding fell by 4.7% in 1H;
- But shadow banking and private lending substantially increased, estimate equivalent to 25-30% of total funding raising.
- Thus actual total funding might not be less than last year. M1, M2 and lending growth rate are less indicative than before because of RRR, and direct financing.

## Total financing: Rampant off-balance-sheet financing

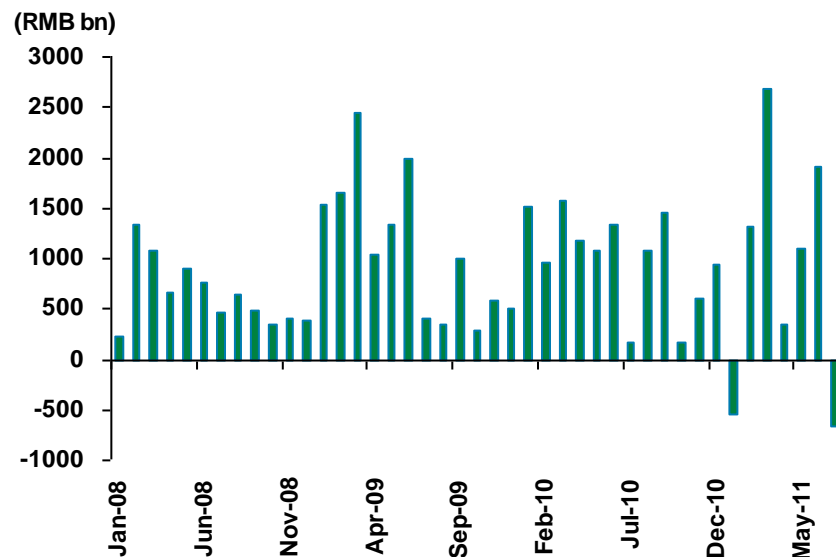
	1H11			2Q11			1Q11		
	(RMB bn)	(% share)	(y-y %)	(RMB bn)	(% share)	(y-y %)	(RMB bn)	(% share)	(y-y %)
<b>Aggregate fundraising</b>	<b>7760</b>	<b>100.0%</b>	<b>-4.7</b>	<b>3570</b>	<b>100.0%</b>	<b>-1.7</b>	<b>4190</b>	<b>100.0%</b>	<b>-7.1</b>
1.RMB loans	4170	53.7%	-9.7	1930	54.1%	-4.8	2240	53.5%	-13.6
2.Forex loans	336.1	4.3%	54.0	188.7	5.3%	651.8	147.4	3.5%	-23.7
3.Entrusted loans	702.8	9.1%	119.7	382.4	10.7%	127.8	320.4	7.6%	110.8
4.Trusted loans	91.3	1.2%	-84.8	82.2	2.3%	-78.8	9.1	0.2%	-95.7
5.Bankers' acceptance	1330	17.1%	-3.2	568.9	15.9%	22.1	761.1	18.2%	-16.2
6.Corporate bond	658.8	8.5%	1.4	203.7	5.7%	-46.7	455.1	10.9%	70.0
7. Non-Financial corporate equity	267.7	3.4%	11.4	111.9	3.1%	-3.0	155.8	3.7%	24.7

Sources: PBOC; BNP Paribas

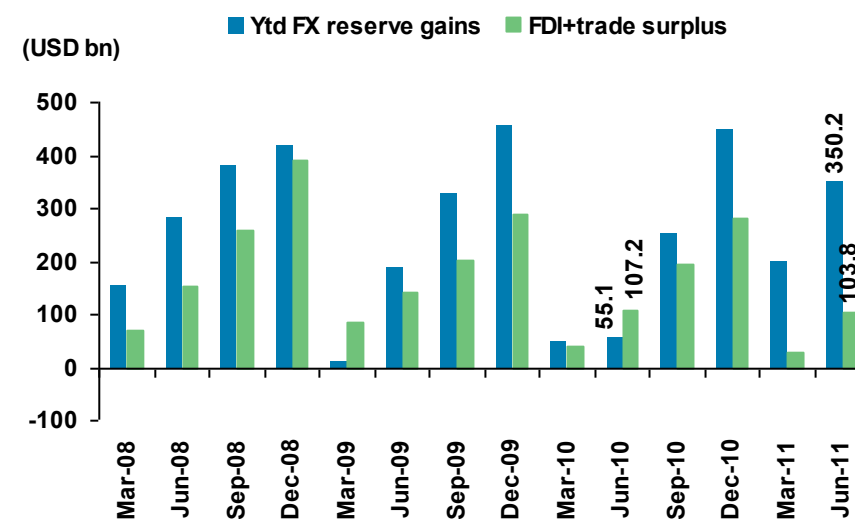


# Evidences 1: change in bank deposits and foreign reserves

## Deposits running out of banks



## Credit tightening invites foreign S-T capital

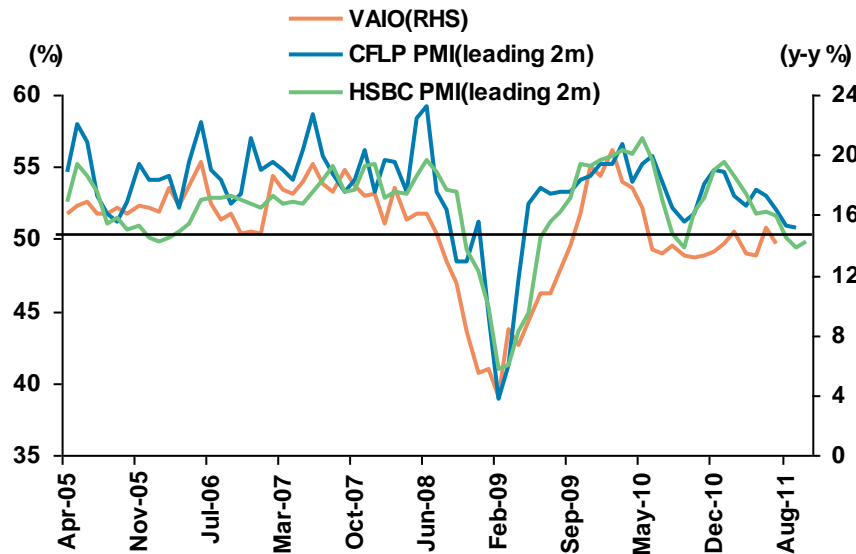


Sources: PBOC; NBS; BNP Paribas

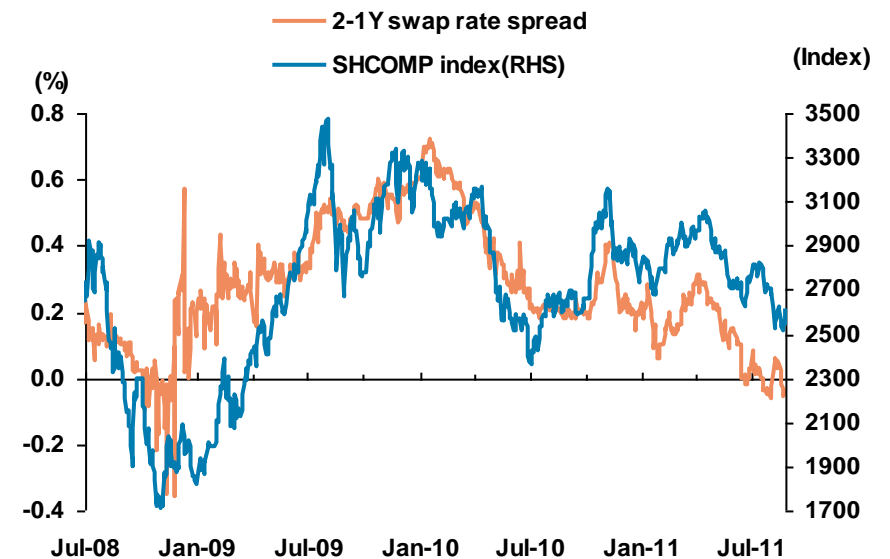


# However, hard landing concerns remain

## Economic confidence sliding



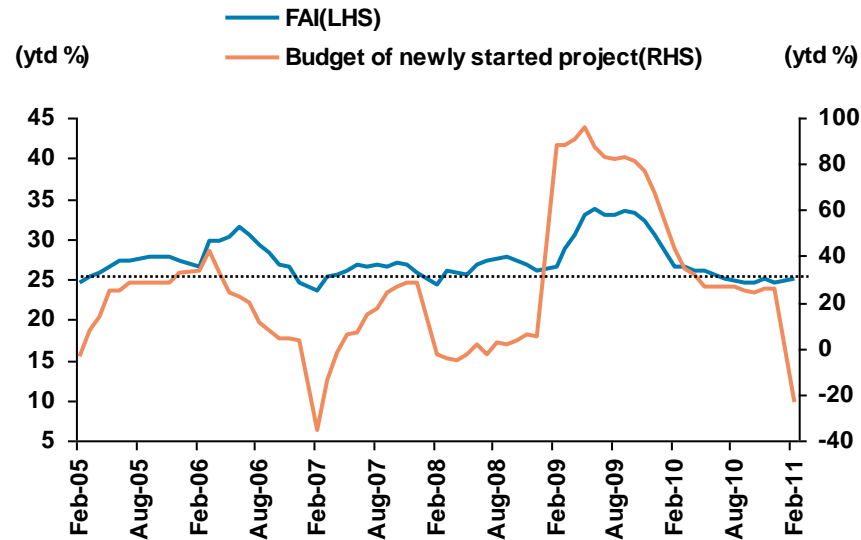
## CIRS, indicating battered confidence



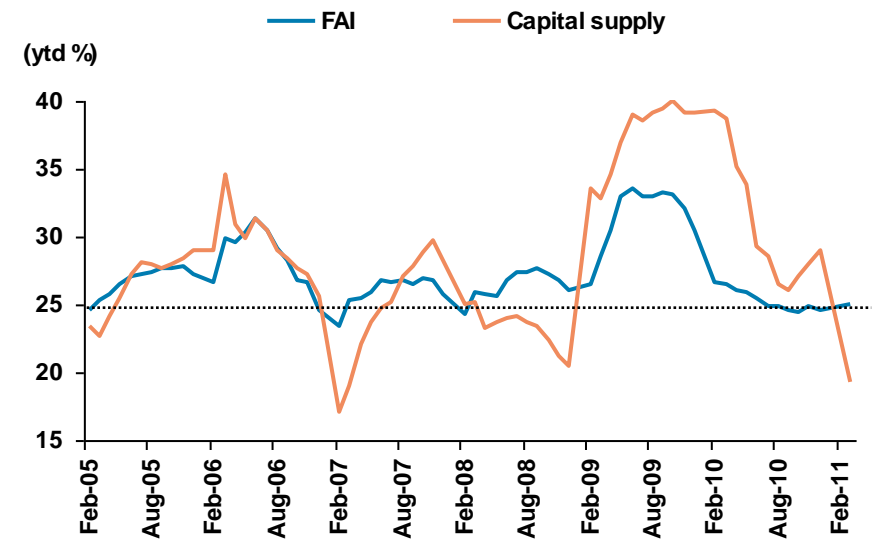


# Because 1: investment control

## NDRC hesitated new FAI approval

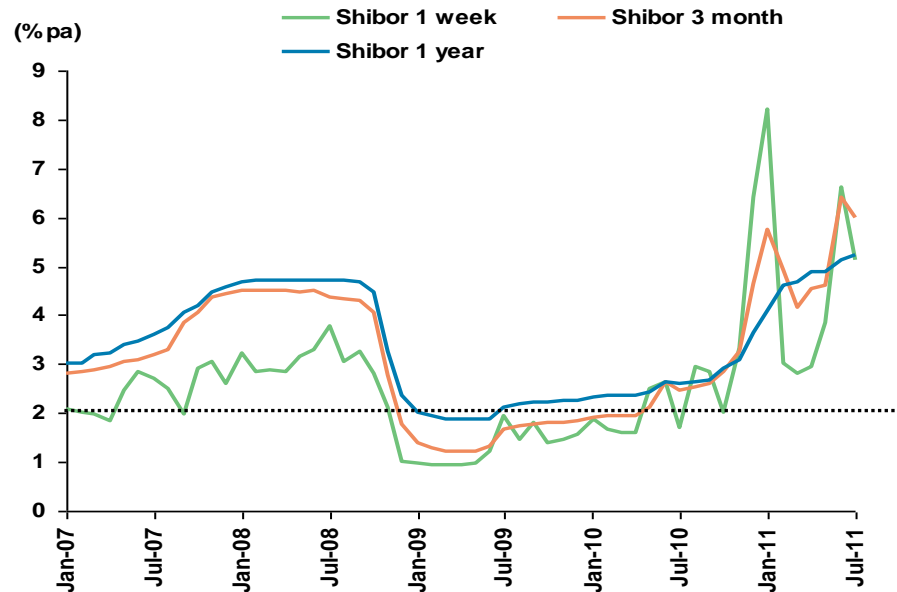


## Difficult to raise fund, because LGFPs



# Because 2: CBRC largely restricting lending conditions

## SHIBOR, 7 days, 3m and 1-y



### PBOC monetary policy:

1. M2 growth target 16% (19.7% in 2010; 27.7% in 2009 and 17.8% in 2008);
2. Hiking 6x RRR and 2x interest rate;

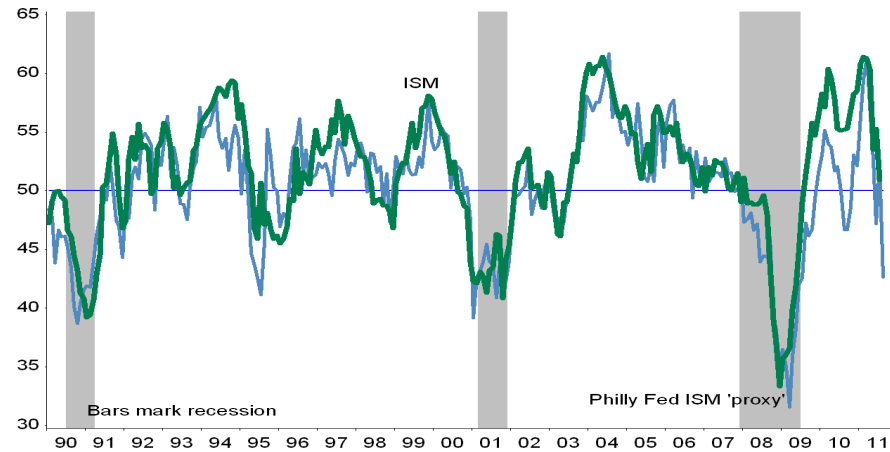
### CBRC credit restrictions:

1. Issued 2 measures and 1 guideline;
2. Housing mortgage loans because of housing purchase restriction;
3. Restricting property development loans (include trusted loans);
4. Rectifying LGFPs loans;
5. Off-balance loans back to on-balance sheet loans;
6. China's BSIII to be adopted (CAR 11.5%, 10.5%).

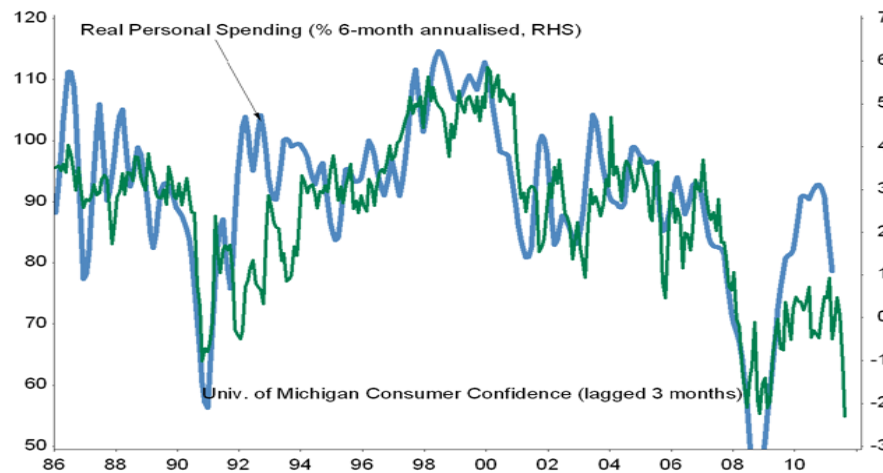


# Because 3a: US-EU contraction/recession pressing high

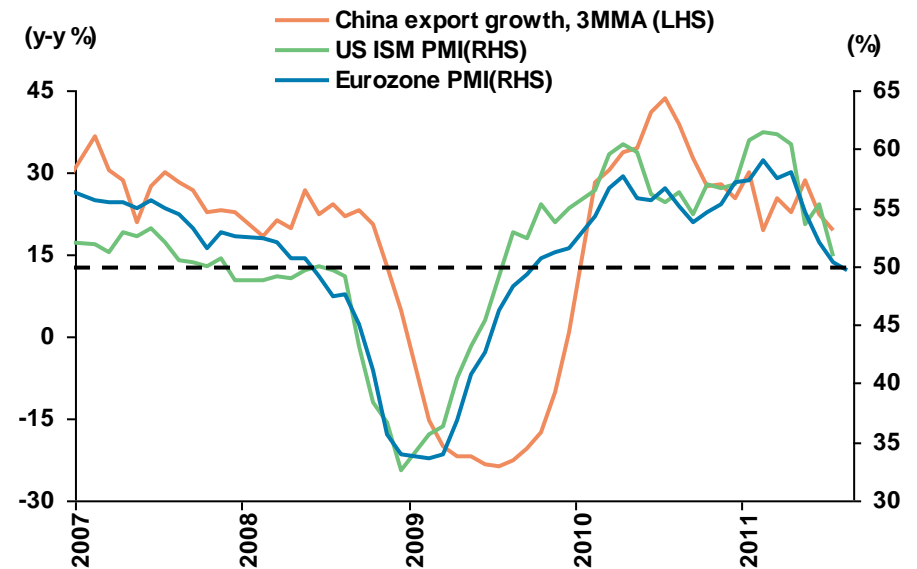
## Industrial production deteriorating



## Consumption going south

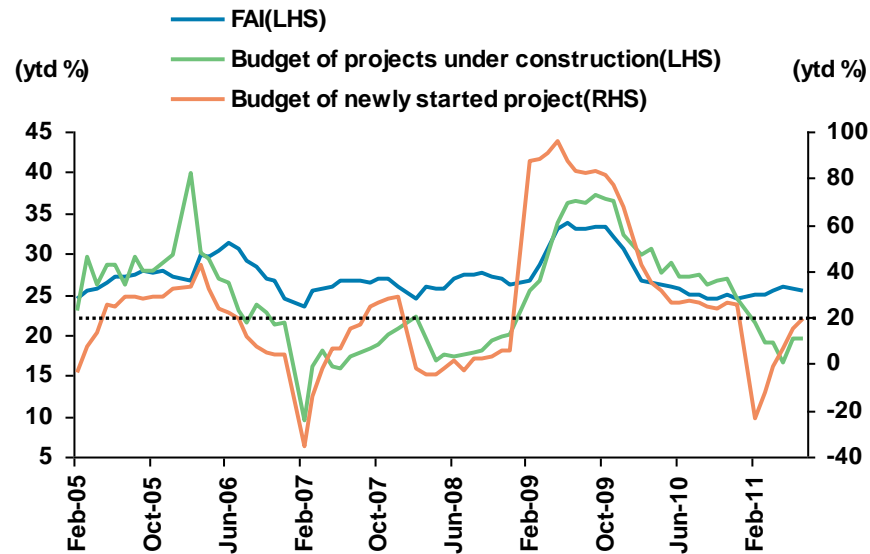


## Export is set to go down

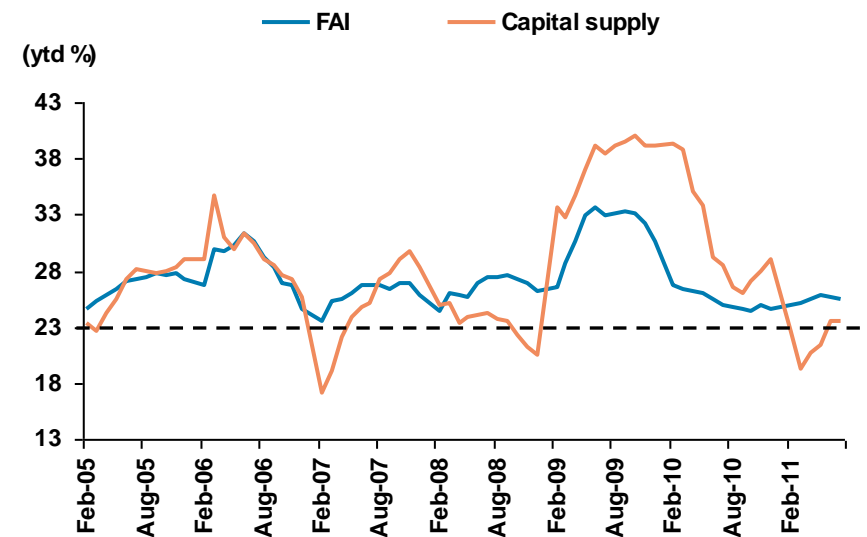


# In fact, China has already undertaken selective easing

## New projects approval accelerating



## Fund supply improving



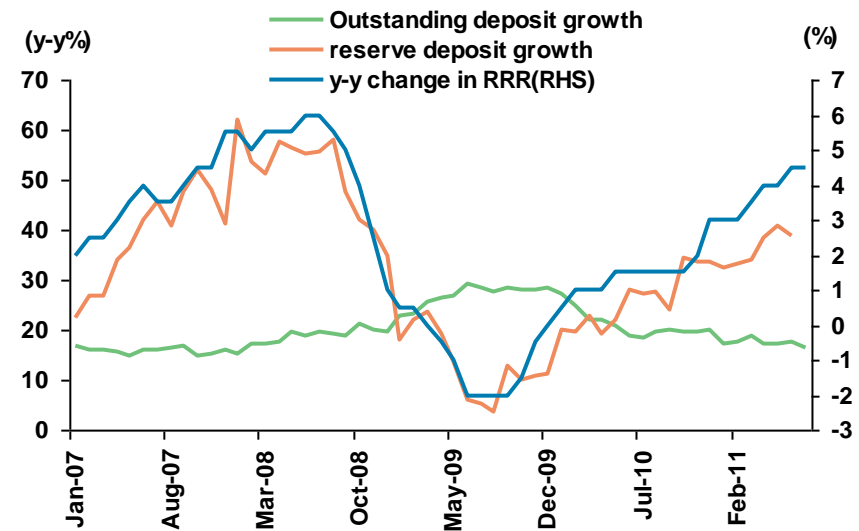
# More tightening measures, why?

## 3 New Measures in Aug

- PBOC expands required reserve base;
- CBRC intensifies shadow banking;
- MOHURD extends housing purchases to tier 2-3 cities

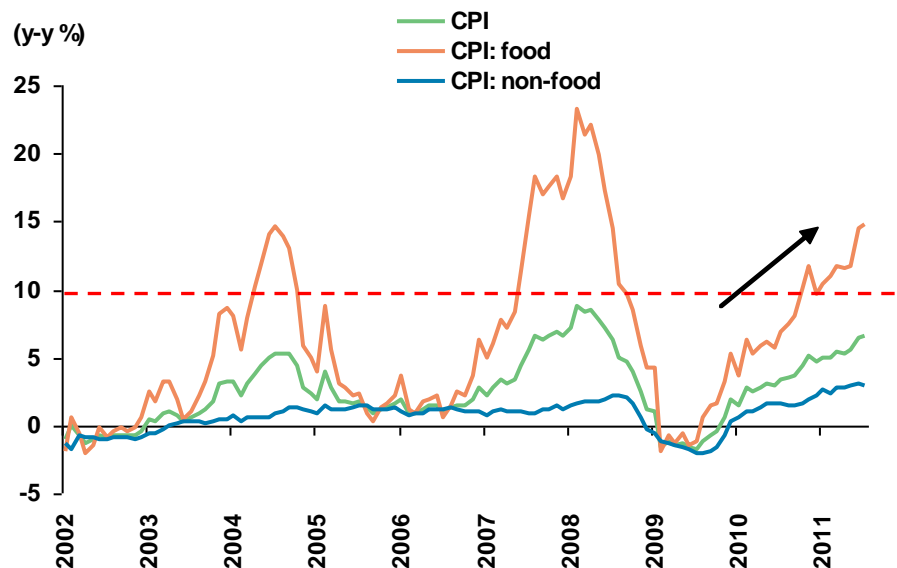
**Recent measures target at risk control, not growth. Also the authorities see the window opportunity before Q2 next year for continuing risk control.**

## Change in reserve deposits vs outstanding deposits



# Inflation control would remain

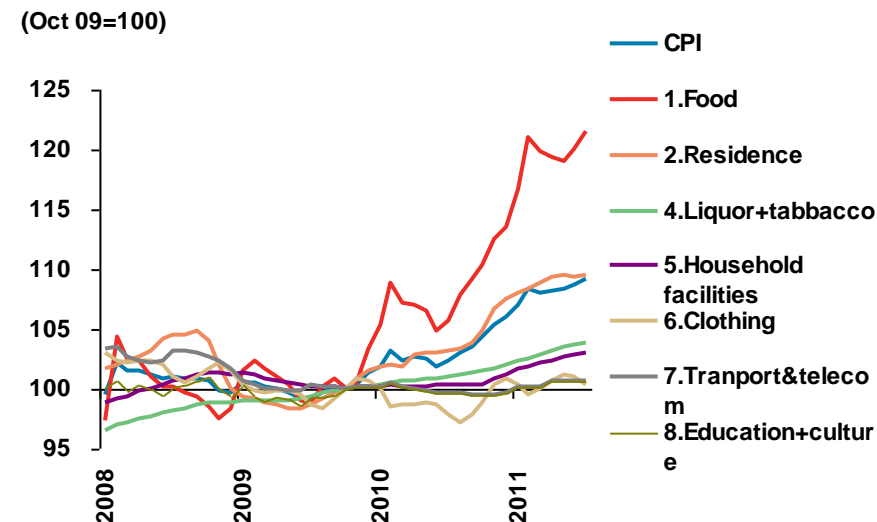
## CPI has peaked at 6.5% y-y in July



■ CPI surged to 6.5% in July and 6.2% in Aug. Food in hyper-inflation--14.8%, non-food inflation running to record high—2.9%

■ Food (4.38ppts) and housing price (1.08ppts) makes up 84.1% of CPI 6.5% in July. But non-food price also moves up to reflect the increase in costs

## Food and residence prices rose the most

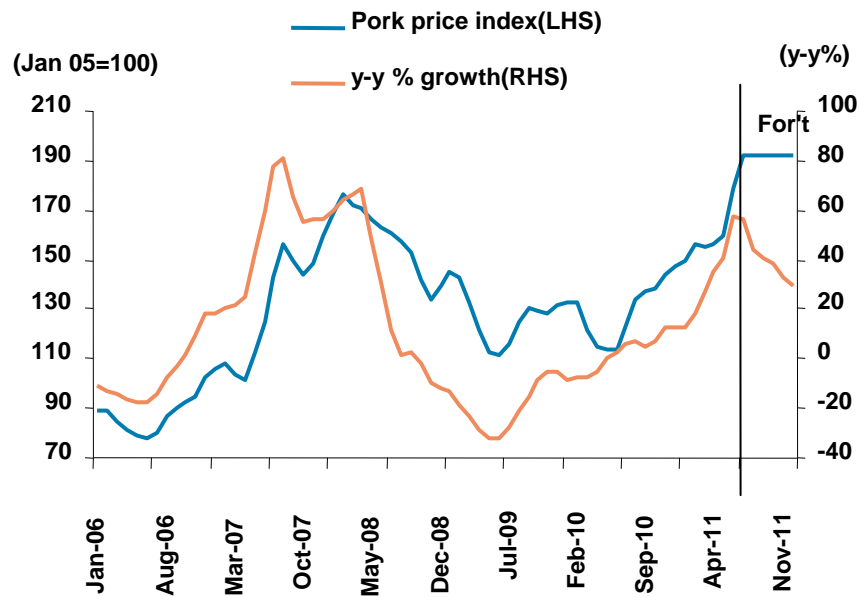


Sources: NBS; BNP Paribas

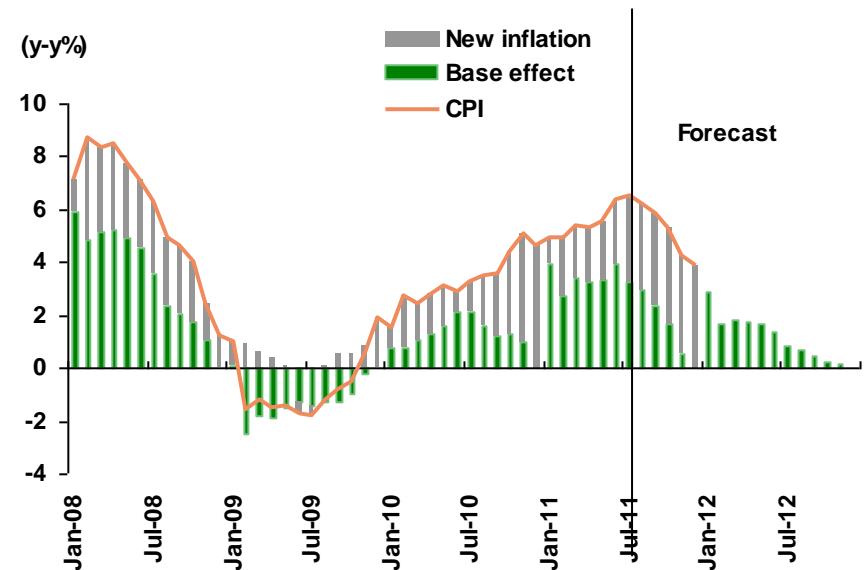


## But have peaked out...

Pork output decreased by 0.5% in 1H11 vs. 2.2% CAGR in 2006-10; 3-year production cycle; Pork price hiked 56.7% y/y in July, and 45.5% y/y in Aug; Hog-corn prices ratio > 9x;

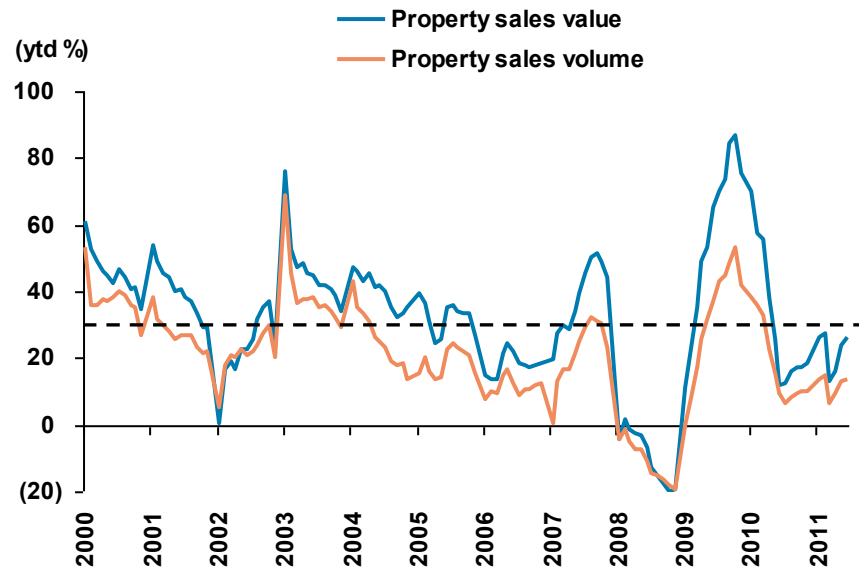


Base effects make up 3.4 pts or 60.7% of 5.6% CPI in 8M11; Low base effects would bring down CPI below 4% in 2012



# Housing price depression to be continued...

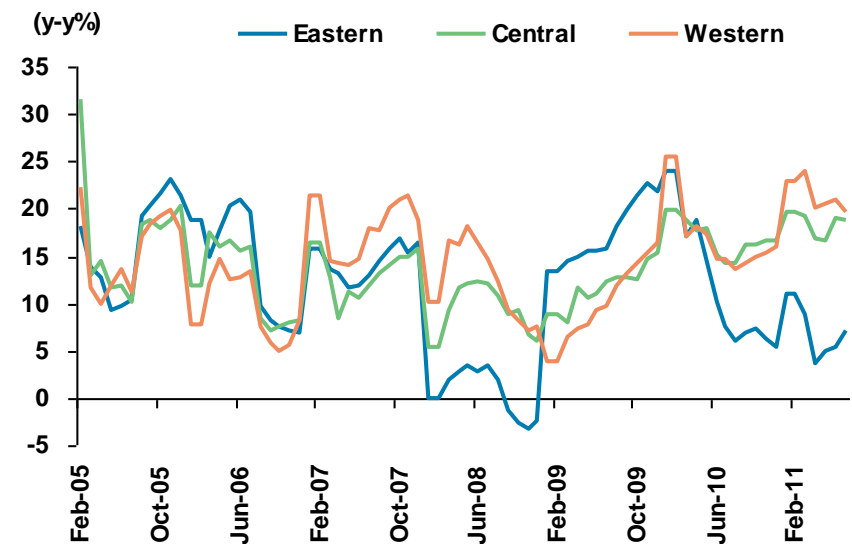
## Property sales value and volume



### Housing transaction contracting:

- Sales in sqm: up 13.6% 7M11 slowed from 42.1% in 09, and 35.8% in 3M10;
- Sales in value—26.1% 7M11 slowed from 75.5% in 2009, and 55.4% in 3M10.
- But investment retained 33.6%y/y, while capital supply growth down to 23.1% y/y in 7M11

## Property price correction in the move





# Local government debts, a big challenge, not a crisis

## Outstanding local government debts Rmb10.7t by 2010

	(RMB bn)	(% share)		(RMB bn)	(% share)
<b>1.Total Local govt debt</b>	<b>10,717.5</b>	<b>100.0%</b>			
<b><i>By govt level</i></b>			<b><i>By types of liabilities</i></b>		
- Provincial	3,211.2	30.0%	- Direct debt	6,711.0	62.6%
- Municipal	4,663.2	43.5%	- Gaurantee	2,337.0	21.8%
- County	2,843.1	26.5%	- Contigent(bailout liability)	1,669.6	15.6%
<b><i>By entities</i></b>			<b><i>By borrowing sources</i></b>		
- LGFV	4,971.1	46.4%	Bank loans	8468.0	79.0%
- Local govt and agencies	2,497.6	23.3%	Uplevel government lending	447.8	4.2%
- Fiscal-subsidized pub entities	1,719.0	16.0%	Bond	756.7	7.1%
- Public utilities	249.8	2.3%	Other borrowing	1045.0	9.8%
- Other entities	1,280.0	11.9%			
<b><i>By maturity profile</i></b>			<b><i>By usage</i></b>		
2011	2,624.6	24.5%	Urban Construction	3530.1	32.9%
2012	1,840.2	17.2%	Transportation	2392.4	22.3%
2013	1,219.5	11.4%	Land reserves	1020.9	9.5%
2014	994.1	9.3%	Social benefits	916.9	8.6%
2015	801.2	7.5%	Agriculture	458.4	4.3%
2016 and thereafter	3,237.7	30.2%	Environment protection	273.3	2.6%
			Covering local financial risk	111.0	1.0%
<b>2. Central govt debt</b>	<b>6,752.7</b>		Industrials	128.3	1.2%
<b>Total govt debt</b>	<b>17,470.2</b>		Energy	24.1	0.2%
<b>Total govt debt/GDP</b>	<b>43.9%</b>		Others	757.6	7.1%

Note: Local govt debts are 146.9% of budget revenues but 83.6% of comprehensive fiscal resources.



# Ample growth policy and flexible choices

**Premier Wen in his article Sept “Qiu Shi” Magazine Sept version:**

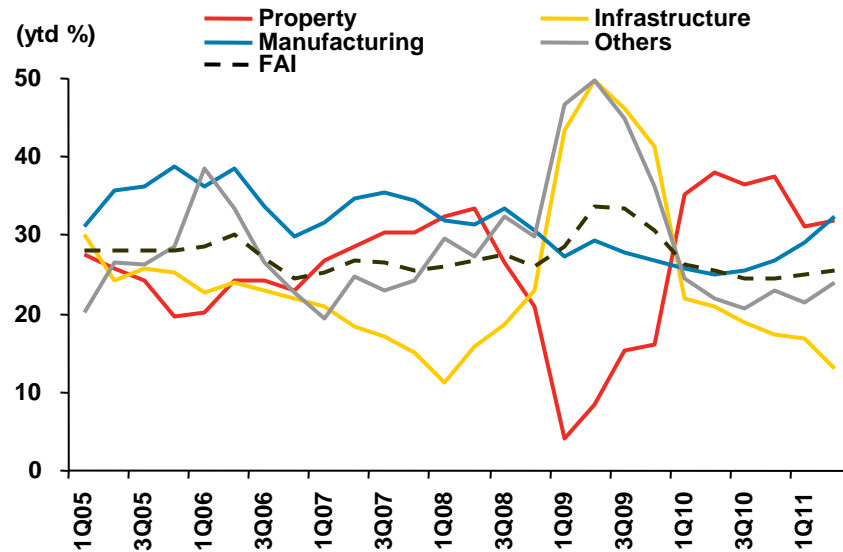
***while remains general macro policy unchanged in direction, continue to take inflation control as top priority, the government is aware the accumulative and lag policy effects on growth, economic policy must keep flexible with a forward looking action.***

- **To continue selective easing:** While CBRC continues rectifying irregular lending and restricting shadow banking, monetary authority needs to clear ways for regular credit lending; If bank liquidity drains, cutting RRR and reversing sterilization; kicking off local government bond issuance.
- **To adopt growth promoting package if GDP growth below 7% for two consecutive quarters.** It is less likely. Stimulus should be fiscal policy including to increase budget deficits and to cut taxes. Monetary policy to play a supporting role. Export growth would be protected so as to protect job security.
- **Investment still the policy target.** 1) Industrial/technological upgrading in the east; 2) Manufacturing development in the central and “Go-west” strategy; 3) Social housing; 4) Migrant worker-citizenship reform; 5) City drainage system renovation and pollution control; 6) Renovation to rivers, lakes, reservoirs and agricultural irrigation system; 7) Build more hospital and healthcare facilities; 8) More investment in kindergarten, primary and secondary schools.

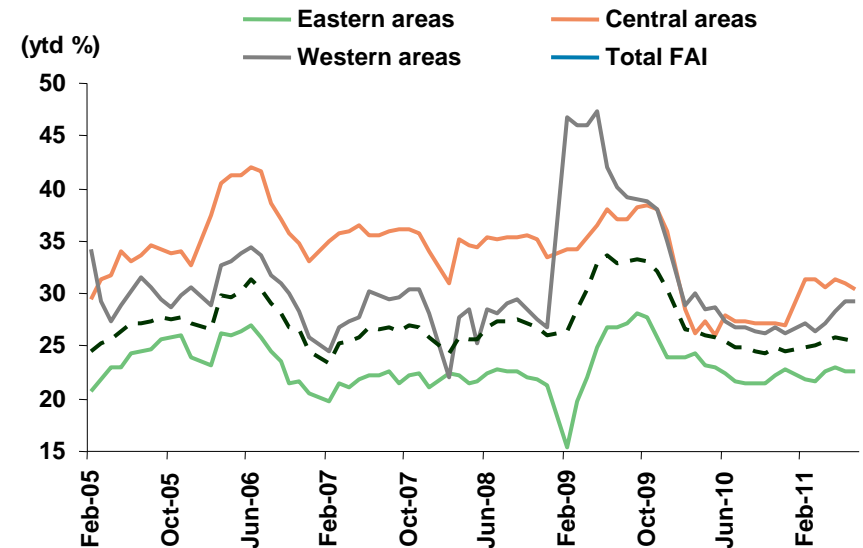


# Investment continues to be the determinant

## Live-oriented infrastructure and industrial upgrading

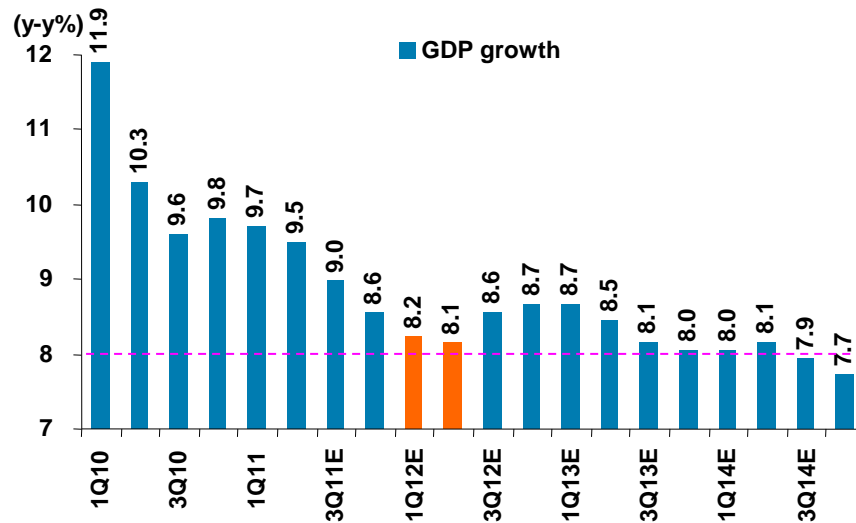


## Central and west regions, growth engines

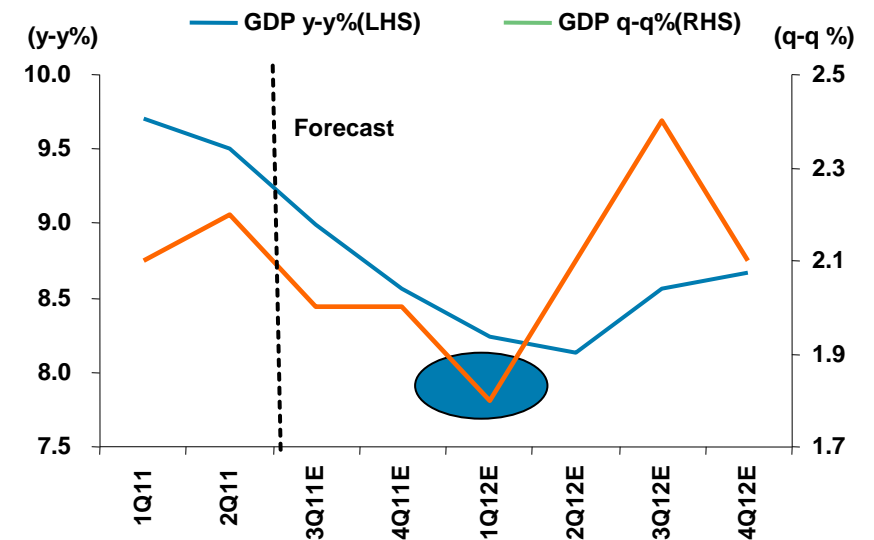


# 2012 GDP growth: base case: 8.5%; bull: 9.0%; bear: 7.8%

## Quarterly GDP growth forecast

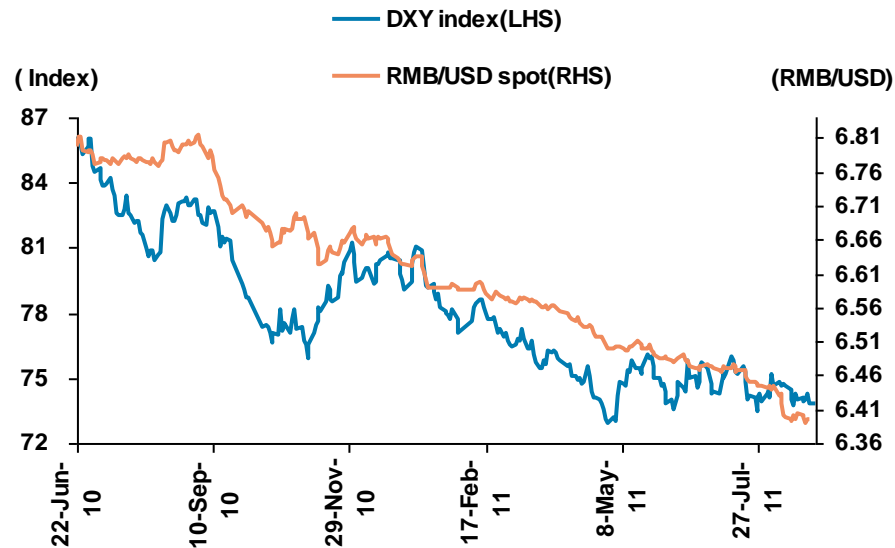


## Quarterly GDP growth

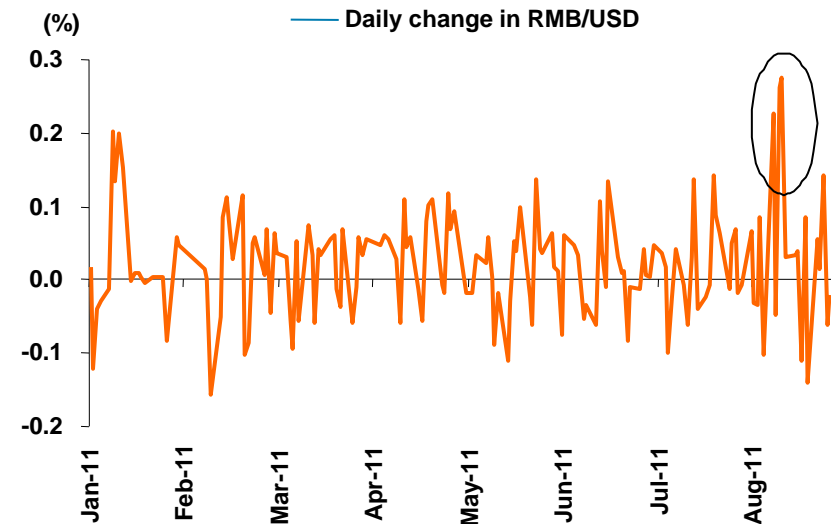


# Large and fast appreciation, China has never been interested

RMB/USD spot 6.3867 on 20 Sept,  
appreciated by 3.6% over 31 Dec 10, and  
6.5% y/y

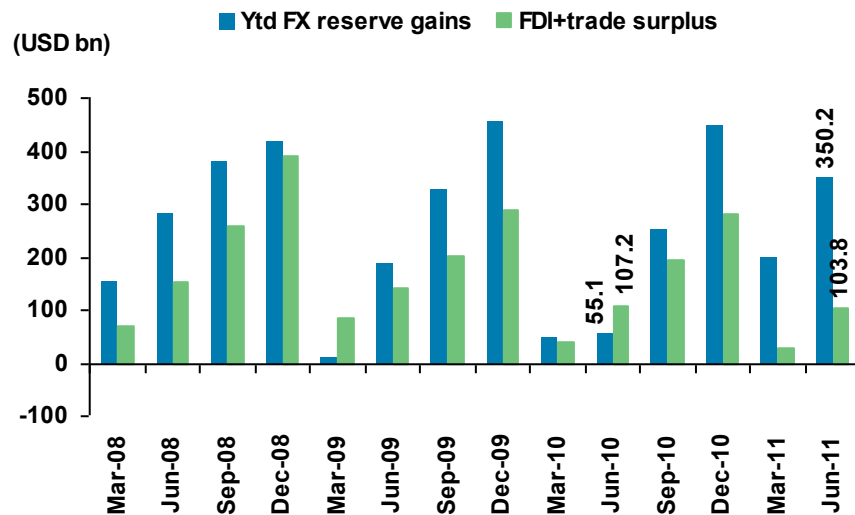


Daily floating never hit to the band limit of  
0.5%, 0.275% on 11 Aug 11 and 0.26% on 10  
Aug 11 as the largest ones...



# But China's dilemma is worsening...

FX reserves keep building, increased by US\$350b in 1H11, and outstanding US\$3.2tr by June 11



## Little alternatives for FX investment



# Possible solution: RMB internationalisation

- Through RMB int'l use (China is even reluctant to use the term of RMB internationalization).
- Measures and Progress:
  1. **Promoting RMB settlement in international trade.** From July 2009, ytd RMB settlement RMB1.48tr by June 11; Rmb506.3b in 2010, 5.5% of imports and 2.6% to national trade; Rmb957.6b in 6M11, 76% of which is goods trade, or 16.1% of imports and 6.6% of national trade. RMB trade settlement will apply to all company nationwide for both goods and service trade.
  2. **Developing HK into RMB offshore centre.** The central government would grant more liberty for HK financial institutions to do business in mainland China; HK stock ETF in Shanghai and Shenzhen bourses.
  3. **Providing more way for overseas RMB to invest back to mainland China.** More domestic financial institutions are allowed to issues RMB bonds in HK; more treasury bond issuance; RQFII; and RMB IPO in HK.
- Alongside the increase in overseas RMB, int'l market would gradually find RMB equilibrium rate, then China could merge its domestic rate, and transit RMB regime to a basic free floating system, possible by 2015.



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Unless otherwise specified, these recommendations are set with a 12-month horizon. Thus, it is possible that future price volatility may cause a temporary mismatch between upside/downside for a stock based on market price and the formal recommendation.

\*In most cases, the target price will equal the analyst's assessment of the current fair value of the stock. However, if the analyst doesn't think the market will reassess the stock over the specified time horizon due to a lack of events or catalysts, then the target price may differ from fair value. In most cases, therefore, our recommendation is an assessment of the mismatch between current market price and our assessment of current fair value.

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