

China Watch

Economic Research Department

February 2010



China's stronger-than-expected Q4 GDP outturn brought full-year growth to an impressive 8.7%, well ahead of the authorities' original target. As such, China has succeeded in sustaining growth in the face of an unprecedented external shock, which has helped Asia to regain its place as the world's fastest growing region. Attention is now turning to risks of overheating and rising inflation, prompting the authorities to begin reining in rapid liquidity and credit growth. At the same time, the authorities' medium term objective is to rebalance China's demand from one driven by investment and exports toward private consumption.

Looking to 2010, we expect China's growth momentum to continue. However, the pace should not be too brisk (9.3%), as the prompt response of the monetary authorities and bank regulators seeks to reduce the risks of overheating.

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1. Executive Summary

- China's Q4 GDP grew at a blistering pace of 10.7 percent year-on-year (y/y) amid rapid credit growth and gradually improving external demand. This brought full-year growth to 8.7% in 2009, stronger than market expectations and well ahead of the authorities' original 8.0% target. Growth was mainly driven by strong fixed asset investment and domestic consumption, which were supported by the government's massive stimulus package and record-high credit growth, as well as a rebound in external demand (see Box 1 on the international environment).
- Inflation began to pick up in Q4, albeit from very low levels. Both the consumer and producer price indices returned to positive territory within the quarter, registering 1.9% y/y and 1.7% y/y, respectively in December. The rise in inflation was due in part to base effects, as well as severe winter weather disruptions, changes in utility and energy prices, and rising food and commodity prices. Overall, inflationary pressures remain subdued given slack in the economy (we estimate a negative output gap in 2010). Nevertheless, the government is appropriately mindful of rising inflationary expectations, especially given recent fast credit growth.
- Loose monetary conditions over 2009 mainly resulted from the authorities' exceptional stimulus measures. Over last year new loan creation hit RMB 9.59 trillion, foreign exchange reserve reached a record level of \$2.4 trillion, and the nationwide property markets rebounded strongly, increasing risks of asset bubbles and inflation. The authorities have now begun to tighten monetary policy through hikes in the required reserve ratio (RRR), so as to drain excess market liquidity.
- The outlook for the banking sector remains good in 2010, helped by better earning prospects due to higher pricing power and still-strong loan growth. Asset quality remains stable in China's commercial banks. Higher capital adequacy requirements will necessitate capital raising efforts by banks, but this should benefit the system for the medium term (see Box 2, which assesses the impact on banks of tightening measures).
- In the near term, we expect further monetary tightening measures given the current strong growth momentum, including more hikes in the RRR and measures to curb bank lending, followed by increases in interest rates beginning in Q2 and a resumption of some currency appreciation (4% against the USD for the full year). We expect full-year economic growth to maintain at a moderate pace of 9.3%.
- Over the longer term, it will be important for China to rebalance its pattern of growth from one based on exports and investment toward one based more on private consumption. Pension reforms are one of the ingredients toward meeting this longer term goal. The lack of retirement security is one reason why China has become a nation of savers. Establishment of a universal pension system covering a wide population in urban and rural areas, could finally lower people's precautionary saving while boosting domestic consumption (see Box 3 on reforms to the pension system).
- Two risks dominate the outlook. First, in the near term, rising inflation expectations and property price bubbles due to high market liquidity pose a dilemma for the government. On the one hand, the authorities need to forestall these risks, while on the other hand continuing to provide support for the economy given the uncertain global economic outlook. As the external sector is still not on a solid footing, there is fear that a too early government exit could cause the economy to lose growth momentum.
- The second risk stems from an imbalanced economic structure, whereby growth has been over-dependent on fixed asset investment. A large part of such investment has come from loans to state-owned enterprises under the fiscal stimulus package, raising concerns over future non-performing loans. Although the government is mindful of the need to rebalance growth, and has already begun efforts to shift policy support from investment to consumption in 2010, the transition will take time.

2. Recent Economic Developments

2. 1. GDP Growth and Economic Activity

China's Q4 GDP growth registered a stronger-than-expected 10.7% year-on-year (yoy) (BBVA: 9.9% in Q4), bringing full-year growth to 8.7% for 2009 (BBVA: 8.3% in 2009) well ahead of the authorities' original 8.0% growth target (Chart 1). Growth was driven by the government's massive stimulus package and record-high credit growth, which helped support strong fixed asset investment and domestic consumption. Meanwhile, exports rebounded as external demand improved. A low comparison base in Q4 2008 also contributed to the high GDP growth outturn. Looking forward, we expect growth momentum to continue in 2010 at a moderate pace of 9.3%, as the prompt response of monetary authorities and bank regulators to restrain credit growth begins to take effect.

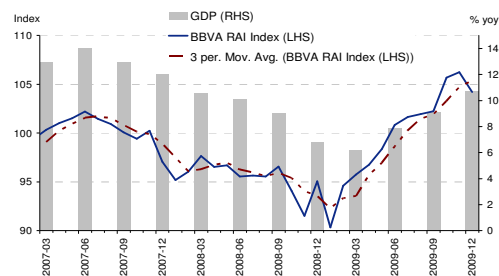
The manufacturing sector continues to improve with the recovery of the export sector (Chart 2). Industrial output rose by 11% for the full year, and for December alone, industrial output increased by 17.9% yoy. China's manufacturing purchasing manager index (PMI), the leading indicator for the manufacturing sector, has been steady above the expansion-contraction threshold of 50 since March 2009. It registered a reading of 55.8 in January 2010, albeit moderating from 56.6 in December, still indicating an expansion in the manufacturing sector should continue in the following months.

Meanwhile, exports have been also struggling out of contraction. Although exports for the whole year decreased by 16% year-on-year, the monthly data has kept improving. December's strong rebound of 17.7% yoy further confirmed a solid recovery path of exports. The recovering exports should also help to mitigate overcapacity problems in certain industrial and manufacturing-related sectors.

Total retail sales, a proxy for consumption, maintained a steady growth rate of 15.5% in 2009, with an accelerated growth of 17.5% yoy in December, boosted by the government's stimulus package and rise in household incomes (urban household disposable income per capita was up 8.8% for the year) (Chart 3). Among durable goods and large purchases, auto sales surged 32.3% to 10.3 million vehicles in 2009, reflecting strong momentum in private consumption. Looking ahead, we expect growth momentum of retail sales to pick up this year, as the government's stimulus measures would shift from emphasis on infrastructure development to support for consumption.

The strong momentum of fixed asset investment was maintained at nominal 30.1% yoy in 2009, while the pace of growth moderated in Q4 (Chart 4). In real terms, December's FAI growth registered 18.8% year-on-year, lower than November's 26.9% and October's 39.8%. Thanks to the government's close monitoring of potential bubbles in the property market, FAI in real estate has begun to decelerate, with real growth of only 4.75% yoy in December, down from November's 14.2% yoy and October's 39.6%.

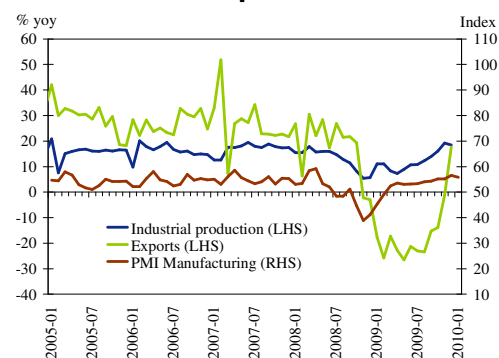
Chart 1: Real GDP growth and BBVA Real Activity Index



Note: BBVA Real Activity Index is a composite of monthly indicators used to track quarterly GDP.

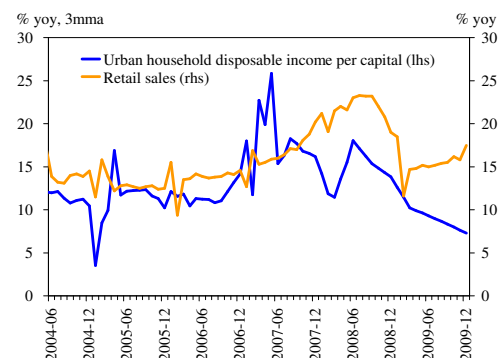
Sources: CEIC and BBVA estimates.

Chart 2: Industrial production and exports



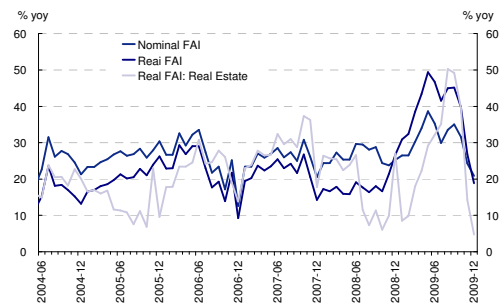
Sources: CEIC and BBVA estimates.

Chart 3: Retail sales and income



Sources: CEIC and BBVA estimates.

Chart 4: Fixed asset investment



Sources: CEIC and BBVA estimates.

2.2. External Trade

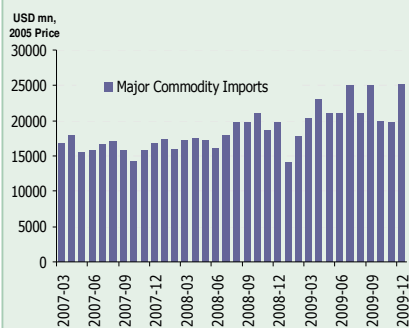
In 2009, China's exports and imports fell by 16% yoy and 11% yoy respectively amid sluggish external demand, resulting in a trade surplus of \$196.1 billion for the full year. However, exports held up better than those of its competitors during the global recession. It overtook Germany to become the world's largest exporter and its share of world exports jumped to almost 10 percent. Throughout this period, the currency remained closely fixed to the USD.

In spite of full-year negative growth, both exports and imports improved gradually from the beginning of the year, and yoy rates of growth turned positive. In December, exports grew by 17% and import growth surged to 56%, beating predictions in the market by a wide margin. The trade surplus registered USD 18.43 billion in December (Chart 5). The upturn in exports is consistent with the notable recovery in global aggregate demand (see Box 1).

By destination, exports to the EU, China's largest market, expanded by 10.2% yoy in December from -8% in November (Chart 6), while exports to the US were up by 15.9% yoy in December, reversing a contraction of -1.7% in November. (The US ISM headline PMI, an indicator of the economic health of the US manufacturing sector, has stayed above the expansion-contraction threshold of 50 for the past 5 months, and Q4 GDP growth rose sharply, underlining the current strength of the US recovery). Given these trends, we expect a further rise in demand for China's exports in the coming months (Chart 7).

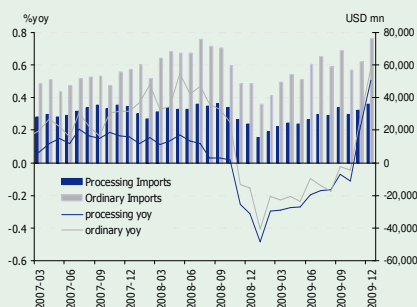
The strong rebound in imports has been driven by China's improving domestic demand and infrastructure spending under the massive stimulus policies. The rise in imports has given an important lift to other Asian economies, especially to exporters of intermediate goods and commodities (Charts 8 and 9). China's processing imports, which could also serve as an indicator of expected external demand (processing imports are used for production of final export goods), have also been rising. In December, processing imports registered a robust rebound of more than 50% yoy (Chart 10).

Chart 9: China Real Major Commodity Imports



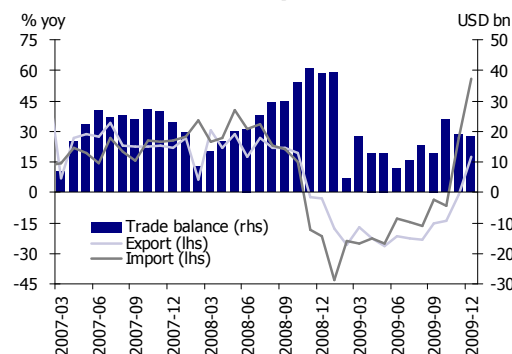
Sources: CEIC and BBVA estimates

Chart 10: Processing and Non-Processing Imports



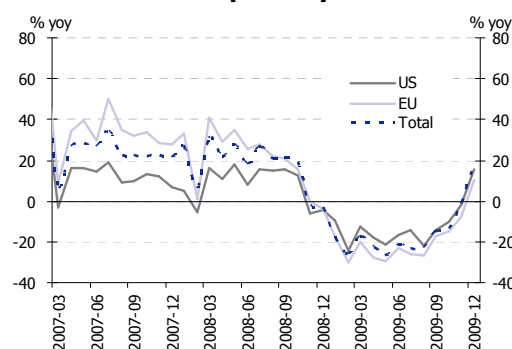
Sources: CEIC and BBVA estimates

Chart 5: Trade performance



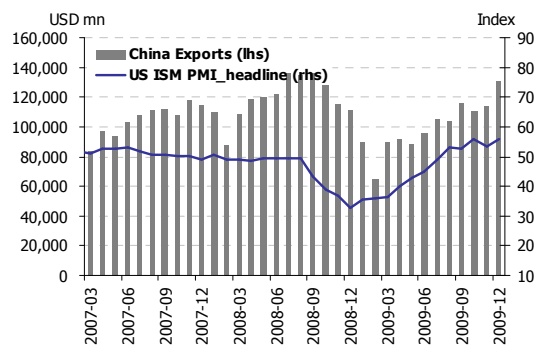
Sources: CEIC and BBVA estimates

Chart 6: Exports by markets



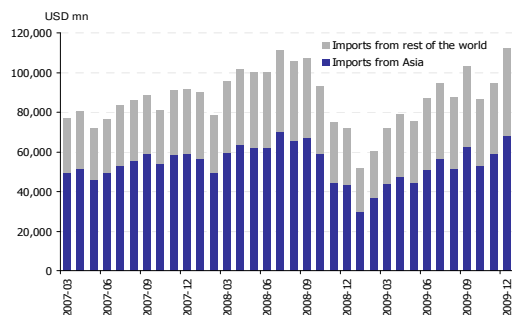
Sources: CEIC and BBVA estimates.

Chart 7: China Export Level and US PMI



Sources: CEIC and BBVA estimates.

Chart 8: China Imports from Asia and Rest of World



Sources: CEIC and BBVA estimates.

Box 1: International Environment

Global prospects improve...

Clearer signs of global recovery have been emerging since the middle of last year. The sensation of free fall prevalent at the end of 2008 and in early 2009 has given way to relative stability and, in some cases, moderate growth.

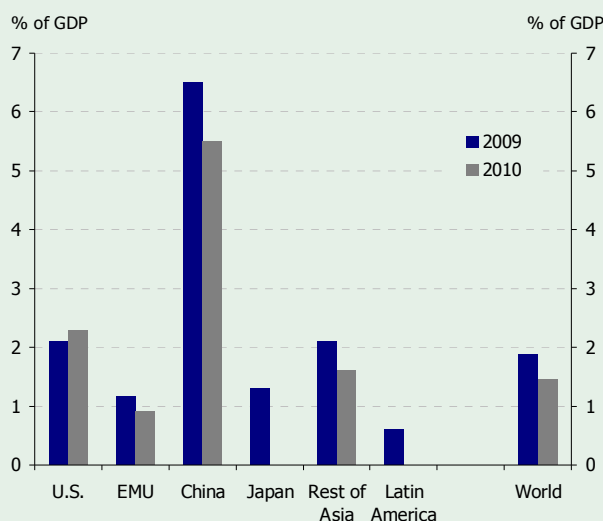
The change in the trend owes much to the exceptional stimulus measures adopted in most economies (Chart 1.1).

... although risks remain in advanced economies.

Nevertheless, the fundamentals of the world economy continue to be fragile and risks of a renewed downturn remain present (Chart 1.2). The main risk is a premature withdrawal of stimulus packages, above all in the most advanced economies, and uncertainty over whether private-sector spending can replace public spending as the main driving force of recovery. Weak job creation brings additional headwinds for the recovery, and fears of sovereign debt problems are also generating jitters. For these reasons, the biggest challenge now faced by economic policy is the timely and well-planned withdrawal of the public, fiscal and monetary support programs.

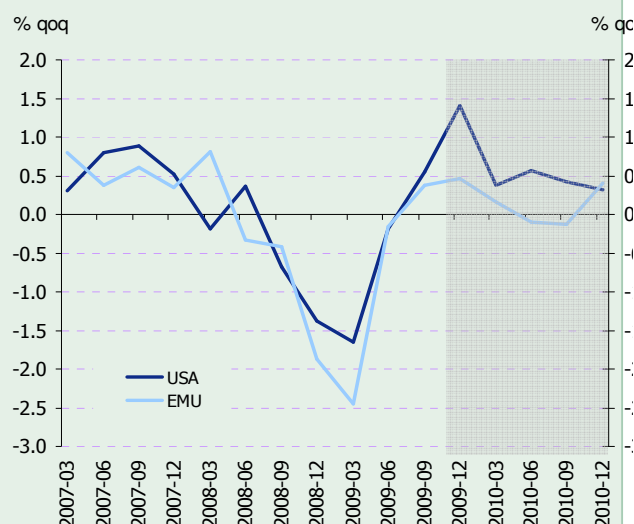
In this situation, the most probable scenario would point to maintenance of low official rates for an extended period, as it does not appear likely that there will be a significant upturn in inflation, given the high productive capacity available. Over time, central banks will gradually try out possible alternatives to bring their liquidity policies back to normal when the timing comes.

Chart 1.1: Fiscal and budget programs: relative size



Sources: BBVA estimates

Chart 1.2: USA and EMU: GDP Growth



Sources: BBVA estimates

Emerging economies are the motor of global growth...

Economic recovery is uneven. In general terms, emerging economies are on a more solid path to recovery than developed ones (Chart 1.3). This can be explained by a number of factors that have set these economies

apart and have made it easier for them, with the exception of Emerging European countries, to cope with more expensive funding markets and the contraction in economic activity and employment. Such factors include the following: their lower exposure to the financial crisis; the success of the fiscal and monetary stimulus packages implemented after the start of the crisis; the rise in commodity prices in recent months; the modest recovery in world trade after its collapse at the end of 2008; and, perhaps most importantly for stable long-term growth, the earlier efforts made in many of the countries to promote macroeconomic stability.

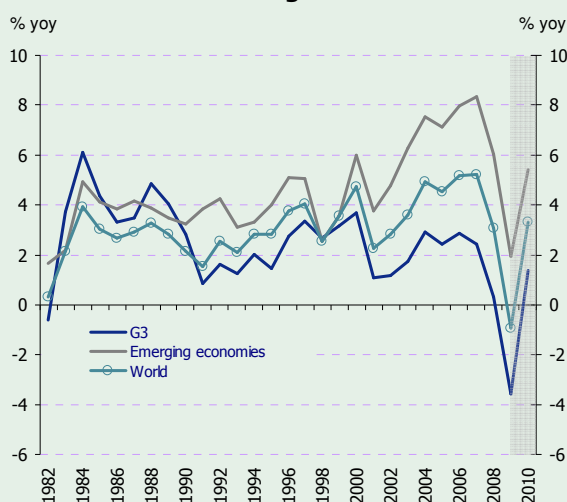
Among developed economies, the U.S. appears to be in a better position than Europe. In particular, the fiscal stimulus in the U.S. will have a relatively greater impact than in Europe on growth over the coming years. The most probable scenario for the U.S. economy is moderate growth, as there is no certainty whether the private sector will recover its high level of sustained growth once the public stimulus ends. In addition, questions such as unemployment or the public accounts are still sources of obvious concern.

In Europe, the fiscal stimulus will be comparatively lower in 2010, and will vary among countries. The recovery in economic activity will also be delayed by the greater rigidity in the European labor market.

The uneven economic recovery is also reflected in the performance of stock markets in the three regions, with emerging economies leading in three regions, the US in the middle, while EMU lagging behind (Chart 1.4).

Signs of recovery in activity are already clear in emerging countries, although with some notable variations. China, as this edition of the China Watch makes clear, has already returned to high growth rates, partly as a result of extremely rapid increases in credit and other stimulus measures. In Latin America, most countries are already showing signs of positive growth in the third quarter. However, there is more risk in the situation of Emerging Europe economies, which are weaker in macroeconomic and financial terms.

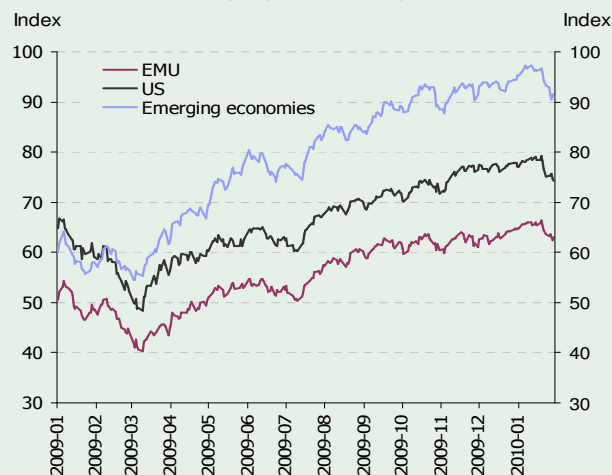
Chart 1.3: GDP growth forecast



Sources: BBVA estimates

Chart 1.4: Equity Markets

(July 2007=100)



Sources: Datastream and BBVA estimates

Commodity prices recover in this more positive context

Strong demand, especially from China, and the prospects of a recovery in developed countries in 2010, has greatly supported commodities, which began to recover together with the equity markets. In recent months, the fall in risk aversion and the weakness of the dollar have attracted financial investment to these markets and supported a recovery in prices. This has eased the pressure on public funding felt in some emerging economies at the start of the year, and given additional support to the appreciation of the currencies of those countries that are rich in natural resources.

2. 3. Inflation

China's inflation rate began picking up in Q4 of 2009 (Chart 11). After headline CPI in November registered the first positive increase of 0.6% yoy since early 2009, December's CPI accelerated by more than expected to 1.9% yoy. For the whole year 2009, the average CPI edged down by 0.7%. The faster-than-expected CPI increase in December was mainly driven by food prices, which contributed 1.7 percentage points, partially on the base effect and partially on disruptions to supply from recent severe snowstorms, while non-food prices still remained well contained, with a contribution of 0.15% to CPI yoy growth. Considering last year's low comparison base, we expect the overall CPI to further pick up in the coming months.

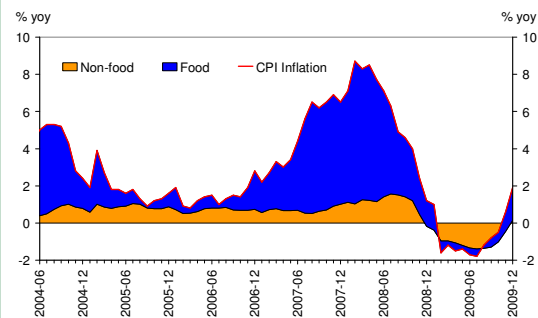
On the upstream cost front, the producer price index (PPI) for 2009 fell by 5.4% year on year, while December's PPI also reverted to positive growth of 1.7% yoy from consecutive twelve months' contraction, with PPI for industrial goods rebounding to 2.0% yoy from November's -2.7% and PPI for consumer goods rising to 0.8% yoy from November's -0.2% (Chart 12).

The recent rebound of PPI inflation is not only due to base effects, but also due to rising international energy and commodity prices on increasing global demand (Chart 13). In the last quarter of 2009, the prices of imported base metals, iron and steel continued rising during recent months; in December, prices of base metals came at 16.9% out of the year-long deflation (Chart 14).

Nevertheless, given overcapacity in segments of the manufacturing sector and rising labor productivity, we expect the pass-through from PPI to CPI to be mild in the near future. Furthermore, we estimate China's output gap to remain negative in 2010, and this should help limit inflationary pressures.¹

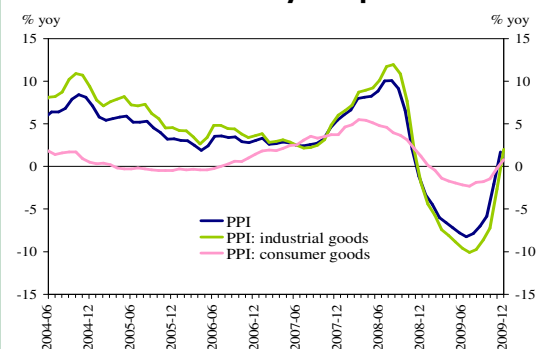
¹ According to our estimation, China's potential GDP growth is 9.9% in 2010, and we expect actual GDP growth of 9.3%, resulting in a negative output gap. We will elaborate on our potential GDP estimates in future publications.

Chart 11: CPI inflation



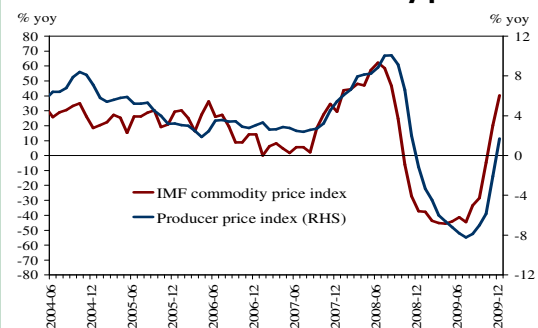
Sources: CEIC and BBVA estimates.

Chart 12: PPI by components



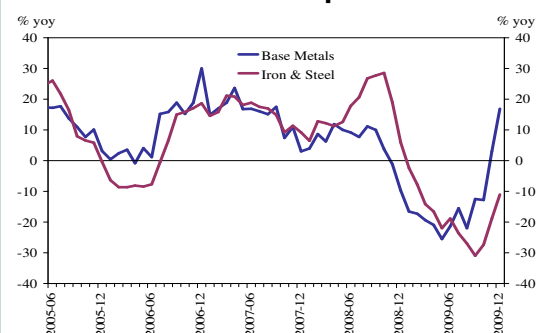
Sources: CEIC and BBVA estimates.

Chart 13: PPI and commodity prices



Sources: CEIC and BBVA estimates.

Chart 14: Prices of imported metals

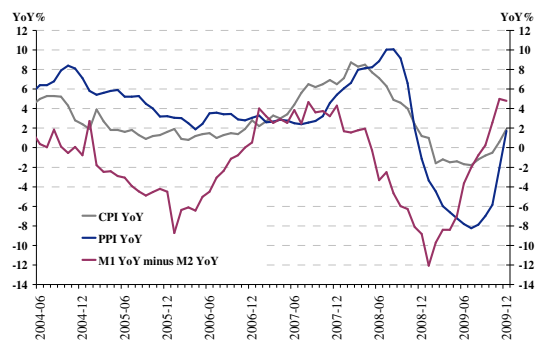


Sources: CEIC and BBVA estimates.

Another leading indicator for inflation, the difference between M1 and M2 that usually precedes CPI and PPI by several months as shown in Chart 15, has eased from its rising trend in December. It implies economic activities are moderated relatively, and will mitigate inflation pressure.

Accordingly, policymakers have incorporated inflation expectations management as one of their objectives, and have started to tighten liquidity by cracking down on speculation in the property market and curbing rampant loan growth.

Chart 15: M1-M2 difference and inflation



2.4. Fiscal Policy

To help counter the effects of the global slowdown, China implemented one of the G20's largest fiscal stimulus packages. Announced in November 2008, the package consisted of RMB 4 trillion in spending, heavily weighted to investment projects, and to be spread out over 2009 to 2010.

About 45% of the funds (or RMB 1.8 trillion) in the package were to be allocated to investment in transportation network, and 25% (RMB 1 trillion) to spend on the Sichuan post-earthquake reconstruction. While there are investments on environmental protection and investment on medical services, culture and education, the funds are relatively small, only accounting for RMB 390 billion or less than 10% of the total fund. In addition, the government has committed to providing more affordable housing for low income population. This spending is equivalent to 108% of fixed asset investment in the construction and real estate sector (Table 1).

With respect to financing, the central government is committed to putting up 30% of the funds (equivalent to RMB 1.18 trillion, or 19% of 2008 fiscal revenue), with the rest to be covered by provincial governments and mostly by Chinese banks, seen from the RMB 5 billion increase in long term loans in 2009 (Table 2).

The overall fiscal position has remained healthy. As of November 2009, China had run a fiscal surplus of RMB 700 billion, and the total deposit in central bank amounted to RMB 3.1 trillion. Hence, we believe China has ample resources to continue the RMB 4-trillion package, but will also have to weigh further stimulus against the need to achieve a balance between stimulus and overheating.

Indeed, spending was below previous plans in 2009, as the National Development and Reform Commission only approved RMB 280 billion for central government investment projects, leaving RMB 200 billion to 2010 (Chart 16). Given the growth momentum achieved so far, it is possible that stimulus plans and investment projects could be curtailed in 2010. Nevertheless, we expect an active fiscal policy in 2010 to be maintained, given the authorities' stated efforts to avoid a premature exit. The thrust of the stimulus package is likely to shift from supporting infrastructure investment to boosting consumption, including policies to raise incomes (especially for rural residents), some reduction in taxation, and continued spending on the social safety net, including the pension, education and medical systems.

Table 1: The RMB 4 trillion fiscal stimulus package

	RMB billion	Percentage
Affordable housing for low income population	280	(7%)
Rural infrastructure facilities and programs to boost rural income	370	(9%)
Investment in transportation network	1,800	(45%)
Investment on medical services, culture and education	40	(1%)
Spending on ecology protection	350	(9%)
Technical innovation and economic restructure	160	(4%)
Sichuan post-earthquake reconstruction	1,000	(25%)
Total	4,000	(100%)

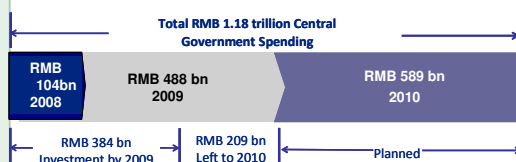
Sources: State council, China.

Table 2: Government Planned Stimulus Spending Schedule

	Central government	Local Government	Total Government
Oct-Dec2008	104	249	353
2009	488	1,165	1,653
2010	589	1,406	1,995
Total	1,180	2,820	4,000

Sources: NDRC and BBVA estimates

Chart 16: Central Government Stimulus Spending Progress



Sources: State Council and BBVA estimates

2. 5. Monetary and Financial Conditions

After a sharp surge in broad money (M2), December's M2 growth eased modestly to 27.7% yoy compared to November's 29.7% yoy. Loan growth also slowed in December to 31.7% yoy, from November's 33.8% yoy and October's 34.2% yoy (Chart 17).

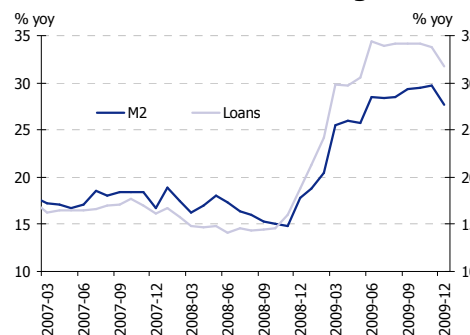
For the full year 2009, new loan creation hit a record level of RMB 9.59 trillion (31.7% yoy). The surge in credit growth and market liquidity has raised government concern over risks of asset price bubbles and rising inflation expectations. A further rise in credit in early January prompted the central bank to raise the Required Reserve Ratio (RRR) by 50bps, several months earlier than expected in the market (Chart 18). RRR adjustment has been adopted in the past and has proved to be an effective tool to tighten bank lending. The recent hike is expected to drain RMB 300 billion liquidity from the market. In addition, the central bank also enhanced its open market operations to absorb liquidity, and in January, it raised the reference yield rates for central bank bills as a signal of its tightening measures (Chart 19).

On the monetary policy front, we see two phases of tightening: the first is likely to consist of further increases in the RRR and other measures to rein in credit growth and liquidity, such as "window guidance", open market operations, and credit quotas. We anticipate the second phase to begin in Q2, consisting of one or two hikes in the policy rate during the remainder of the year. One of the reasons for a delay in interest rate increases is the authorities' worry about generating hot money capital inflows.

China's stock market performance is highly correlated with the stance of monetary policy. In 2009, thanks to ample liquidity, China's stock market returns were outstanding, with a return of 80%, beating most markets but ranking last in the BRIC countries (Chart 20). The performance within the year, however, was uneven. In the first half, the stock market rose steadily, but the second half was marked by greater volatility (Chart 21). In the near term, the earlier-than-expected monetary tightening, together with fund raising pressure from banks, has created headwinds for stock market

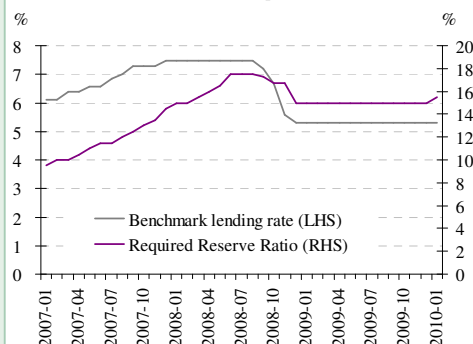
Similarly, China's real estate market recovered rapidly from the second quarter of 2009, and became an important driving force for economic recovery during the downturn (Chart 22). Property prices rose by 7.8% yoy in December, up from 5.7% yoy the previous month. Among China's 70 largest cities, Shenzhen witnessed the sharpest gains, up 18.9% yoy in December.

Chart 17: M2 and credit growth



Sources: CEIC and BBVA estimates.

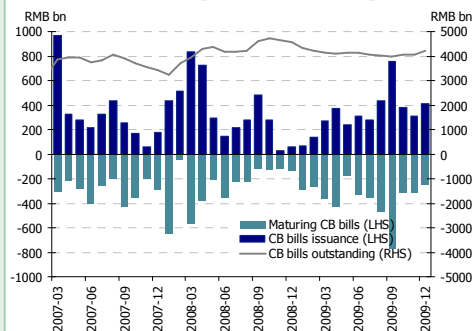
Chart 18: Policy rate and RRR



Note: RRR is 16% in large banks, 13.5% in rural cooperatives, and 14% in rest banks, respectively.

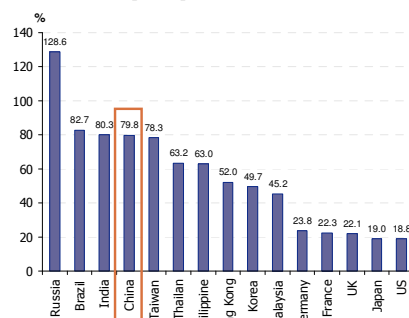
Sources: CEIC.

Chart 19: Open market operation



Sources: CEIC and BBVA estimates.

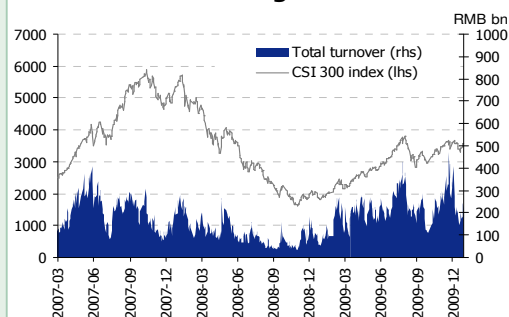
Chart 20: Major Stock market ranking by 1-year return



Sources: CEIC and BBVA estimates.

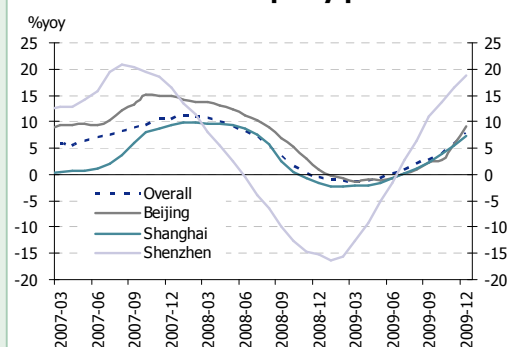
The booming housing market has triggered concerns about the possibility of an asset price bubbles. To forestall such risks and to maintain affordability of housing, the State Council started tightening lending standards, including reinstating a strict rule for second home purchases in January by doubling the down payment requirement to 40%. Together with re-imposition of a property sales tax for selling within five years implemented in December, the measures previously implemented to stimulate the housing market are phased out gradually to rein in speculative buying. To date, the measures are relatively mild, as the authorities wish to avoid hitting the brakes too hard. This should help engineer a soft landing for housing prices.

Chart 21: Stock market slumps and trading shrinks



Sources: CEIC and BBVA estimates

Chart 22: Property prices



Sources: CEIC and BBVA estimates.

Box 2: How will Chinese banks fare in a tighter credit environment?

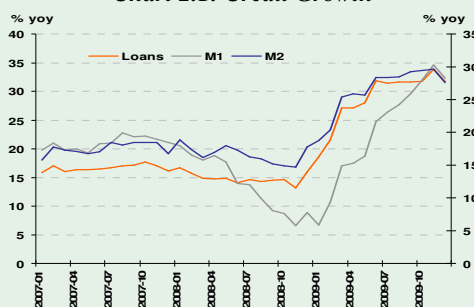
Recent Development in Credit Growth

China's banks registered record-high new loan creation of Rmb9.6tn in 2009 (an increase of 31.7% yoy). Rapid loan growth was the outcome of the fiscal stimulus and loose monetary policy initiatives implemented since late 2008 to mitigate the effects of the global financial crisis. In comparison, banks lent out just RMB 4.17 trillion in 2008.

The credit spree erupted in the first half of 2009 as the credit ceiling was lifted. Thereafter, credit growth moderated in the second half of the year, and in December growth of credit, M1 and M2 all started to decline (Chart 2.1) as the CBRC began restraining banks out of a concern that too rapid loan growth could result in an increase in non-performing loans (NPLs) in future. The moderation later in the year was also partially due to seasonality, as Chinese banks usually front-load loans early in the year to realize more interest income. Loans approved in 4Q09 were released in January 2010, and the credit spree began anew, with new loans very likely reaching above RMB 1.3 trillion for the month alone. Fearful of the asset bubbles and rising inflationary expectations fueled by rapid credit growth, the PBOC began to tighten the monetary stance with a 50 bps increase in required reserve ratio (RRR) and the regulator warned banks to maintain a reasonable pace and quality of lending.

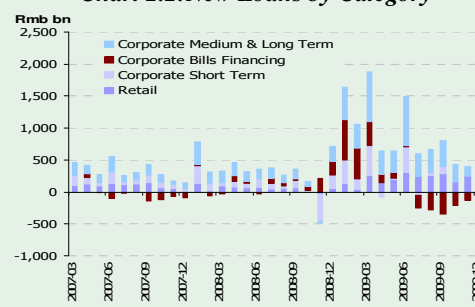
The composition of new short-term loans consisted mainly of bill financing in the first half of 2009, but as most of them expired 3-6 months later, they have been replaced by short-term loans. In the last quarter, both short term loans and bill financing have been reduced but retail loans and mid- and long-term loans continued to increase (Chart 2.2). Loans associated with the property sector (mortgage and development loans) have witnessed rapid growth rates for the whole year, and consequently their share in total loans rose from 16.2% in Q1 to 18.5% by year-end. In 2009 17.8% of new loans were extended as mortgages (RMB 1.7 trillion), and its share surged to a level above 50% in the last quarter thanks to the strong turnaround of the housing market, and also partially due to households' strong willingness to take advantage of incentive schemes prior to the removal of property sector stimulus measures (Chart 2.3 & 2.4).

Chart 2.1: Credit Growth



Sources: CEIC.

Chart 2.2: New Loans by Category



Sources: CEIC.

Chart 2.3: Real Estate Related Loans



Sources: CEIC.

Chart 2.4: New Mortgage Loans Extended



Sources: CEIC

Outlook for China's Banking Sector

In contrast to previous years, the regulator has not revealed targets for M2 in 2010, but CBRC Chairman Liu Mingkang indicated that it would be appropriate to reduce new loans to RMB 7.5 trillion from RMB 9.6 trillion last year. This would result in loan growth of 19%, down from almost 32% in 2009. In the coming year, we expect the liquidity environment for banks to be somewhat tighter than last year, but still favorable with improved interest margins, higher pricing power, stable asset quality and still-strong GDP growth.

1. NIM will be enhanced

The following factors should drive up net interest margins (NIMs) in Chinese banks:

- Although further RRR hikes will rein in banks' loan growth, it will also improve banks' pricing power by limiting supply side.
- Hikes in the PBoC's benchmark lending rate could increase NIMs. In the coming round of interest rate hikes, we expect asymmetric hikes to loan and deposit rates in favor of banks, which should widen lending margins. Even under symmetric interest rate hikes, a typically fast rate adjustment on the lending side compared to a more sluggish pace in time deposits can also benefit margins.
- Rising inflation expectations have resulted in continued migration of time to demand deposits, which is helpful to improve the net interest margin (NIM) given that demand deposits have a lower interest rate.
- In 2010, banks are likely to prefer traditional loans more than bill financing, considering the credit ceiling and economic effect, so net interest margin should be enhanced.

There is, however, likely to be some negative impact from the tightening environment, which would translate into higher interbank rates and bond yields, which could cause downward re-pricing risk for interbank and securities assets in the near term. Nevertheless, we believe the overall effect should be positive for Chinese banks.

2. Capital replenishment

Chinese banks' aggressive credit growth in 2009 has deteriorated their CARs rapidly. Even though Chinese banks are likely to have met the minimum CAR of 11% or 10% in 2009, going forward, if loans were to grow at 19% in 2010, as expected, Chinese banks will need to raise additional capital. Capital raising efforts could have significant implications for share prices in the Chinese stock market.

How much capital is needed in Chinese banks? To assess this, we have designed a baseline scenario in which we estimate that listed banks will need RMB 234 billion for capital replenishment in 2010, with BOC and ICBC in leading positions. CNCB would need RMB 8 billion extra capital to meet the required CAR of 11%. If commercial banks increase their CARs to 13% for large banks and 12% for smaller banks, the extra capital requirement would amount to RMB 484 billion based on our baseline assumptions (Table 2.1).

In the capital replenishment process, there is one major risk that Huijin and MOF (for state-owned banks) or strategic investors (for shareholding banks) will not participate in capital raising plans, which could severely hit confidence from other investors and weaken stock prices.

Assumptions for our baseline scenario:

- The CAR ratio in 2010 is improved to 12% for state-owned large banks and 11% for share-holding banks respectively, 1 percentage point higher than the required ratio.
- The dividend payout ratio in 2009 is downsized by 10 percentage points from the average level of 2007-2008, and will be maintained through 2010.
- We employ total outstanding loans as proxy for risk weighted assets, estimating that total outstanding loans in listed banks reached RMB 23 trillion as of 2009, and assume the same growth rate of 19% for all listed banks in 2010, while the net profit growth rate is at the same pace as loan growth of 19%.

Scenario A assumes no dividend payout in 2009 due to capital shortage, and Scenario B assumes CAR is improved to 13% for large banks and 12% to smaller banks. The remaining assumptions are the same.

This calculation is based on a 19% loan growth rate. If commercial banks expand their loan books at a slower pace or their profits rise faster than assumed, commercial banks would be able to need less capital to meet the required adequacy ratio.

Table 2.1: Projection of extra capital needed to replenish capital in Chinese listed banks

	Baseline Scenario			Scenario A			Scenario B			Risk Weighted Assets		Net Profit	
	Capital needed	CAR09	Payout ratio 09	Capital needed	CAR09	Payout ratio 09	Capital needed	CAR09	Payout ratio 09	2010	2009	2010	2009
ICBC	64	11.7	42.7	12	12.6	0.0	131	11.7	42.7	6,670	5,605	143	111
BOC	102	10.9	38.7	71	11.6	0.0	158	10.9	38.7	5,629	4,730	93	78
CCB	4	11.9	11.3	-8	12.1	0.0	60	11.9	11.3	5,593	4,700	123	103
BOCom	11	12.2	16.1	7	12.4	0.0	33	12.2	16.1	2,172	1,826	33	28
CMB	15	10.4	7.0	14	10.5	0.0	29	10.4	7.0	1,405	1,180	19	16
CNCB	8	10.9	14.2	6	11.1	0.0	20	10.9	14.2	1,196	1,005	16	14
SPDB	13	10.1	1.5	13	10.1	0.0	24	10.1	1.5	1,086	912	15	12
CIB	6	10.4	9.0	5	10.6	0.0	15	10.4	9.0	839	705	14	11
SDB	12	8.5	-	12	8.5	0.0	16	8.5	-	437	368	5	5
Listed banks	234	11.3	26.4	132	11.8	0.0	484	11.3	26.4	26,326	22,786	489	411

Sources: Wind and BBVA estimates.

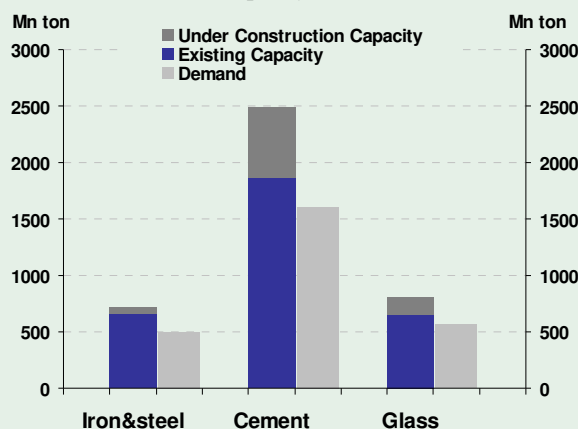
3. Will overcapacity increase NPLs?

The economic recovery to a large extent has been led by the massive government-led stimulus and investment. This may add to overcapacity problems in certain manufacturing sectors. The National Development and Reform Commission (NDRC) has cited 6 industries as having overcapacity, e.g. steel, cement, plate glass, coal chemicals, poly-silicon, and wind power equipment. Chart 2.5 shows the degree of overcapacity in steel, cement and glass sectors as estimated by the NDRC.

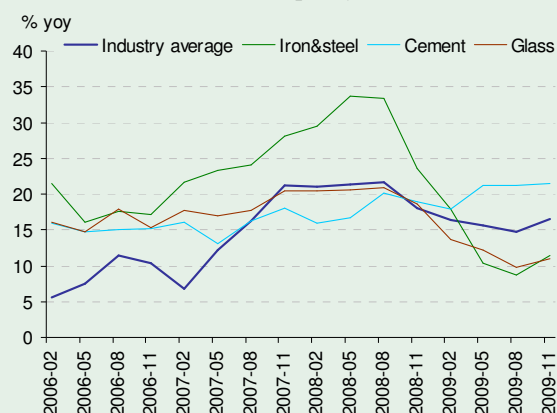
Overcapacity has been caused by insufficient demand which was dampened by the global crisis. Government stimulus, and associated construction of government-led projects may increase demand in these sectors, and a recovery of external demand should help ease the overcapacity problem.

In fact, due to a slow expansion in these sectors already (Chart 2.6), overcapacity would be mitigated. The steel and glass industries have registered a lower growth rate than the average for other industries, while growth in the cement sector has been relatively more stable. Asset growth in the steel sector has been relatively rapid since mid-2008, however, which might result in some degree of overcapacity. Consequently, profit margins in the steel industry have fallen sharply due to diminishing demand. Hence, with the exception of the steel industry, there is no clear evidence yet of extreme overcapacity in other sectors since they are growing at a pace close to industry averages.

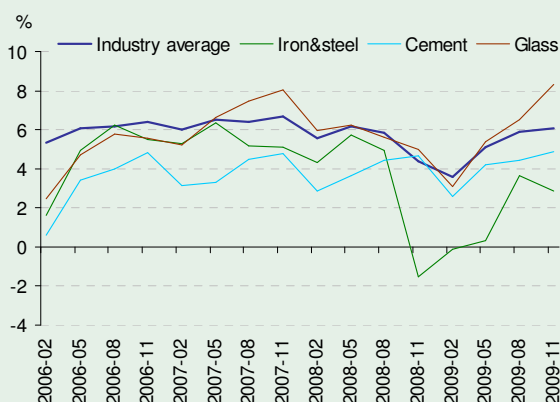
Currently boosted by robust investment from the stimulus package, profit margins and sales growth in these industries have all increased, and are even higher than pre-crisis level (Charts 2.7 and 2.8). Looking forward, as the economic recovery strengthens, we would expect profit margins to improve further. Companies in these industries should generate sufficient earnings to cover their loan payments, so the current overcapacity won't affect loan quality significantly.

Chart 2.5: Overcapacity in certain industries

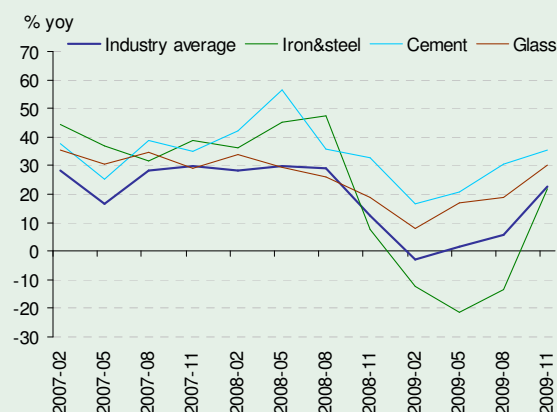
Sources: NDRC

Chart 2.6: Assets YoY growth in industries with overcapacity

Sources: CEIC

Chart 2.7: Profit margin of industries with overcapacity

Sources: CEIC

Chart 2.8: Sales Growth of industries with overcapacity

Sources: CEIC

4. Non-performing loans remain low

Chinese banks had experienced a very high level of NPLs during the 1990s, most of which were concentrated in the state-owned banks by policy lending, but they addressed them through a successful restructuring. The success in NPL reduction was largely a result of a government sponsored transfer of a total RMB 3.3 trillion NPLs from the banking system to Four Asset Management Companies (AMC) and the Chinese Ministry of Finance (Table 2.2).

The total amount of NPLs of all banks fell from RMB 560 billion in 2008 to RMB 497 billion in 2009, and the corresponding NPL ratio fell from 2.42% in 2008 to 1.58% in 2009. The decline was mainly due to the write-offs and strong loan growth. However, the huge increase in bank lending during the past year would make any country nervous about a sharp increase in future NPLs. Will China repeat its history?

Based on previous experiences after banking restructuring, some similarities can be drawn from the current credit cycle and the 2000-2003 credit expansion (Chart 2.9). Since the NPL cycle usually lags the real economy by one to two years, the 2000-2003 episode showed that NPLs increased RMB 164 billion from 2004Q2 to 2005 Q1 (during this period, there were no NPL transfers to AMCs). If we take NPL transfers into consideration (adding back to the reported NPLs, as in Chart 2.10), the NPL expansion period would extend to 2005Q4, which represents a two year lag for NPL formation after the corresponding credit expansion cycle. In the current credit expansion cycle, more than 50% of the new loans so far are concentrated in medium and long term infrastructure loans, so it may take

longer than 2 or 3 years for NPLs to fully emerge, because long term loan borrowers usually need to pay only interest in the first 2 or 3 years and pay the principal after the project is constructed.

In terms of the potential NPL size, NPLs increased around RMB 350 billion in the last round of credit expansion from 2004Q2 to 2005Q4. In fact, the literature on early indicators of banking crisis is in broad agreement that rapid credit growth is the best warning signal of a NPL crisis. Considering the record high credit growth in 2009, the potential NPLs should be higher than the figure in last round and might double the current level of RMB 497 billion. Indeed, Chinese banking system is expected to generate about RMB 600~800 billion per year and the new NPLs could be recognized across 3-5 years, so Chinese banking system has enough capacity to absorb such cost and it will not be affected the systematic stability.

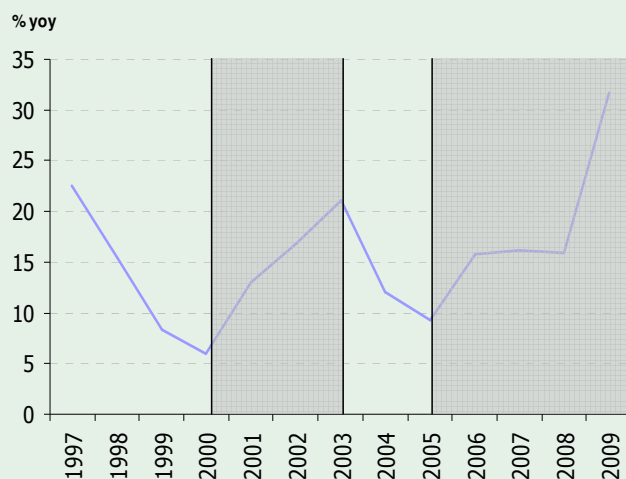
However, this projection is based on the assumption that Chinese economy is going to expand well. If the economy goes into a second dip, NPL problem should deteriorate significantly. This should be a risk for Chinese banking system in mid-term.

Table 2.2: Chinese banks' NPL transfer

Year	From Banks	Acquirer	NPL Face Value, RMB bn	Percentage of outstanding loans
1999	Big four	Four AMC	1,400	14.9
2000–2001	BOC, CCB, CDB	Cinda	45	0.4
2004	BOC, CCB, BOCOM	Cinda	320	1.8
2005	ICBC	Four AMC	459	2.4
2005	ICBC	Ministry of Finance	246	1.3
2008	ABC	Ministry of Finance	800	2.6
Total			3,270	

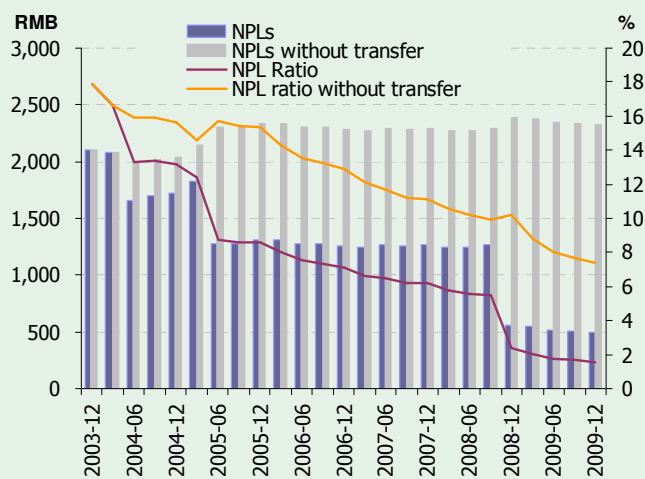
Sources: BBVA estimates

Chart 2.9: Credit Cycle



Sources: CEIC

Chart 2.10: NPL and NPL Ratio



Sources: CEIC

Conclusion

Additional tightening measures are expected in the near term, such as further increases in reserve requirements, loan growth ceilings and hikes in benchmark interest rates. We believe these measures are appropriate in order to maintain financial stability of the banking system. The outlook for the banking sector is still bright in 2010: better earnings prospects driven by higher pricing power and still-strong loan growth is envisioned, although capital-raising to comply with the tighter capital requirements may cause fluctuation in stock market share prices.

Overall, we expect stable asset quality for China's domestic banks in 2010 along with our forecast of an economic recovery. Infrastructure loans are longer-term and thus will be less likely to emerge as NPLs in the short-term. In the medium-term, China's banking system should be able to digest rising credit costs, assuming banks' net interest margins continue on a recovery path and overall economic activity in China continues to rebound. Moreover, the regulator's prudential regulation such as capital adequacy, reserve requirement and a broad spectrum of risk management strengthening measures should also mitigate the risk of a systemic banking crisis.

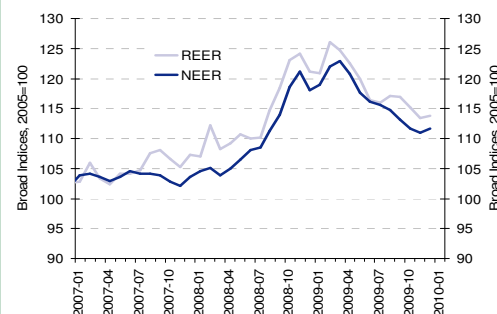
2. 6. Exchange rate and capital flows

China's authorities have so far resisted international pressure to allow appreciation of the Yuan. The currency has been broadly pegged to the USD since July 2008, at around 6.83 per dollar, after an appreciation of 21% during the previous three years. The real effective exchange rate (REER, which is trade-weighted) depreciated by 6.1% in 2009 (Chart 23). Meanwhile, across Asia, most other currencies appreciated against the USD in 2009 (Chart 24). Given the evolution of the USD, China's REER is at about the same level as it was pre-crisis, in mid-2008.

Expectations of renewed appreciation can be seen in the forward NDF market (Chart 25). Anticipation of eventual appreciation has generated capital inflows. This, together with a large current account surplus, has led to a further large accumulation of foreign exchange reserves, which hit \$2.4 trillion at end-2009, an increase of USD 453 billion for the year, of which the trade surplus and FDI account for USD 196 billion and USD 90 billion respectively. By our estimate, the residual, after accounting for valuation changes, implies "hot money" capital inflows of \$15-20 billion per month on average in Q4 (Chart 26).

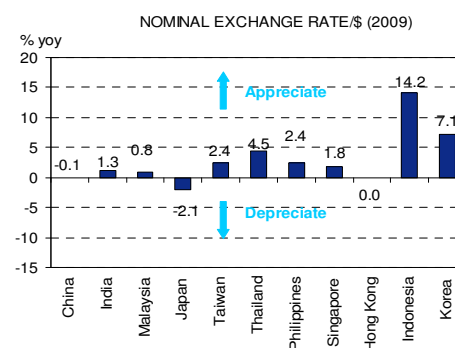
As part of its monetary tightening measures, we expect the government to allow some currency appreciation during the course of 2010. At this juncture, we expect the RMB to be at around 6.54 per USD by end-year, an appreciation of 4%. The timing will likely depend on continued strength in exports and relations with major trading partners.

Chart 23: RMB Effective exchange rate



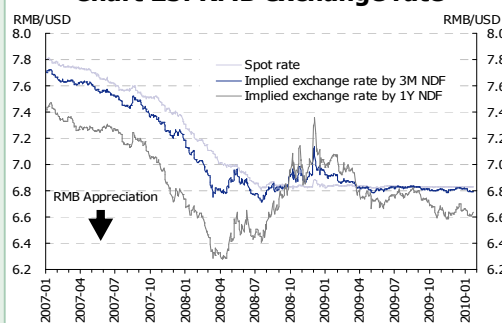
Sources: BIS and BBVA estimates

Chart 24: Nominal exchange rate of Asian currencies



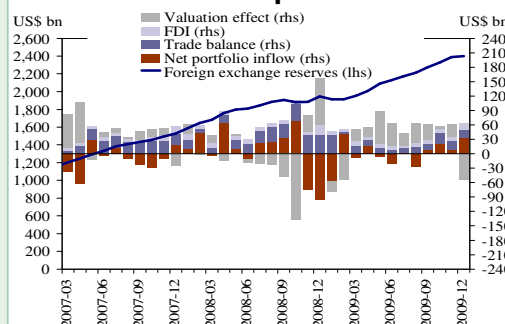
Sources: Datastream and BBVA estimates

Chart 25: RMB exchange rate



Sources: Datastream, CEIC and BBVA estimates

Chart 26: Capital flows



Sources: CEIC and BBVA estimates.

3. Economic Outlook and Prospects

Looking ahead, we expect China's strong growth momentum to continue into 2010, led by a rebound in net exports and further strength in private consumption (Tables 3 and 4). We expect full-year growth of 9.3%, assuming the authorities' monetary tightening measures are successful in restraining the strong Q4 growth momentum. Upside risks to the forecasts could materialize if credit growth is not restrained or if our expectations of sluggish global demand prove to be on the low side.

On the policy front, the focus is gradually shifting from measures to ensure high economic growth in the short term, to achieving sustainability over the longer term. We expect fiscal policy to remain growth-supportive in the coming year, with increasing emphasis on "rebalancing" by boosting domestic demand, in particular private consumption, and sustaining growth in the coming years. Similarly, we expect monetary policy to remain accommodative but with efforts, already underway, to forestall asset price bubbles by reining in liquidity. The recent hike in the required reserve ratio (RRR) marks a turning point for monetary policy in our view, and we expect further hikes in the RRR during the remainder of the year, along with window guidance, credit ceilings, and efforts to cool housing prices. We expect increases in the benchmark interest rate beginning around the second quarter of 2010, along with renewed currency appreciation against the USD.

Over the longer term, the challenge for China's policy makers as noted above is to implement reforms to rebalance the pattern of growth from one based on exports and investment toward one based more on private consumption, as the share of private consumption in GDP is a relatively low 35% in China, compared with an average of 57% in the rest of Asia (Chart 27). Strengthening the social safety net, in particular the pension and health care systems should help reduce the need for precautionary savings and thereby boost consumption. Similarly, ongoing efforts to promote consumer finance can also help. There is also ample scope for improving productivity in the private sector through further liberalizing interest rates and price controls, and easing investment policies and market entrance thresholds of various sectors. Reform of monopoly industries and guarantees of the rights and interests of the investment of small and middle enterprises would enhance private investment.

Risks and Uncertainties

Although we anticipate strong and stable economic growth in 2010, a number of risks and uncertainties to the outlook warrant attention.

First, rising inflation expectations and looming asset bubbles due to high market liquidity post a dilemma for the government. They will need to maintain support for the economy under a still-uncertain global context on the one hand, while seek to forestall overheating and asset price bubbles on the other hand. This is the key policy challenge in the year ahead.

Second, China's growth model and the resulting economic

Table 3: Forecast of GDP Growth

GDP Real Growth by Components (YoY%)			
	2009	2010F	2011F
GDP	8.7	9.3	8.9
Private Consumption	8.6	8.8	10.1
Public Consumption	11.7	9.4	8.4
Investment	17.2	9.5	6.2
Exports	-39.4	12.5	33.2
Imports	-4.7	9.7	16.3

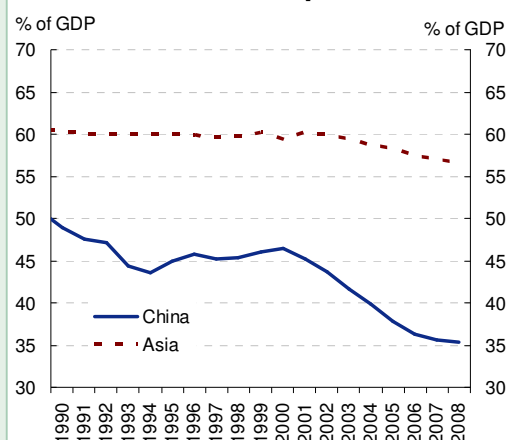
Sources: National Bureau of Statistics of China and BBVA estimates.

Table 4: Forecast of Contribution to GDP Growth

Contribution to Real GDP Growth (Percentage Point)			
	2009	2010F	2011F
GDP	8.7	9.3	8.9
Consumption	4.6	4.4	4.7
Private	3.1	3.1	3.5
Public	1.5	1.3	1.1
Investment	8.0	4.5	2.9
Net exports	-3.9	0.5	1.2

Sources: National Bureau of Statistics of China and BBVA estimates.

Chart 27: Consumption Ratio



Note: The consumption ratio of Asia was the average weighted by Gross domestic product based on purchasing-power-parity (PPP) in 2000.

Source: CEIC, IMF and BBVA estimates

structure are still imbalanced. As in the past, the most significant source of GDP growth in 2009 came from fixed asset investment, a large part of which over the past year was financed by credit given by state-owned banks to state-owned enterprises under the fiscal stimulus package. Such state-driven investment creates risks of overcapacity and eventual non-performing loans. The authorities have stated their awareness of this issue, and are seeking to reorient the drive of growth gradually from policy-supported investment, toward a self-sustaining private consumption in 2010. The transition, however, will take time. Moreover, given that the rebound in exports has just begun, the recovery is not yet on a solid footing given still-fragile external demand. Hence, a premature full exit from policy stimulus could cause China's growth to lose momentum.

BOX 3: What can be done to further improve China's pension system?

Pension reforms are one of the key ingredients for meeting the longer term goal of rebalancing China's pattern of growth from one based on exports and investment toward one based more on private consumption. The lack of retirement security is one reason why China has become a nation of savers.

The UN defines a society as aging when population aged 65 and above exceed 7% of the total population (or aged 60 and above exceeding 10%). The ratio of aged 60 and above in China was 10% in 2000, and the ratio will rise to 12.5% by 2010, which means by the UN definition, China is already an aging society. Furthermore, in five years, China's baby-boom generation will start to retire. This is why China must begin now to strengthen its pension system.

Structure of China's Pension System

For the past 20 years, the Chinese government has gradually transformed the so-called "iron rice bowl" era in which retirement was financed by state-owned enterprise, into a three-pillar social security system, which comprises social pooling, individual accounts and a voluntary retirement plan. Table 3.1 provides a summary of this three-pillar system (also see Chart 1). In 2000, the National Social Security Fund (NSSF) was founded as a fund of last resort. A voluntary plan, the enterprise annuity (EA) system, was founded in 2004.

Table 3.1: Three-Pillar Summary

Pillars	Contributions		Benefits
State Sponsor Pillar Ia	<u>Employee</u> Nil	<u>Employer</u> ~20%	Pillar I is a mandatory system and includes two tranches: Pillar Ia is essentially a social pooling contribution made up by employers and operated on a pay-as-you-go basis (PAYG). The fund is tightly held by Provincial social security bureaus. Retirement benefits are based on average local wages, indexed with individual wage and years of employment
State Sponsor Pillar Ib	<u>Employee</u> 8%	<u>Employer</u> Nil	Pillar Ib is an individual account scheme contributed only by employees after January 1, 2006. Pension based on accumulated contributions and age specific actuarial factors.
Private Sector Pillar II	Varied		Pillar II, Enterprise Annuity, was set up by employers according to Ministry of Human Resource and Social Security (MOHRSS) Regulations 20 and 23 in 2004. Pillar II is therefore fully funded and can be managed by private companies.
Private Sector Pillar III	Varied		Pillar III includes other supplementary pension plans and personal savings. Pillar III is voluntarily contributed based on personal choice and usually is managed by insurance companies through pension insurance schemes.

Sources: BBVA ERD

The ideal replacement ratio for three pillars:

Pillar 1: Social security, replacement ratio 50%-60%

Pillar 2: Enterprise annuities, replacement ratio 20%-30%

Pillar 3: individual savings, replacement ratio 10%

Recent progress

In early 2009, Premier Wen's government work report mentioned a continuation of efforts to improve the basic pension system, implement a fully-funded pilot scheme for individual accounts, provide an advance pooling system at the provincial level, and issue regulations on pension transfers and portability. At the same time, a rural pension trial would be implemented to cover 10% of cities and counties. The work report emphasized an overhaul of Pillar I, rather than reforms to Pillars II and III.

1. Marginalized Rural Pension System Revisited

Prior to 2009, the rural population was marginalized in the national pension system. In 1991, the Ministry of Civil Affairs (MOCA) implemented a basic rural pension plan at the county level, but the system depended on

contributions by farmers themselves. By the end of 1997, 82 million rural dwellers participated in the plan. In 1998, the State Council transferred the authority for rural pension policy from Ministry of Civil Affairs to Ministry of Labor and Social Security (later as Ministry of Human Resource and Social Security). Since the reform priority for China pension system at that time focused on the urban work force, it resulted in a marginalization of the rural pension system. Consequently, participants in the rural pension plan dropped dramatically to 57 million in 2007 (Chart 3.2).

In 2009, China launched a new pilot rural pension plan covering 10% of counties, to be fully spread throughout the whole nation by 2020. As a result, farmers are eventually meant to enjoy the same guaranteed incomes later in life as their urban counterparts. Under the program, rural residents over 16 can take part in the new rural insurance scheme. The pension system has social pooling and individual accounts, and is paid by farmers, collective benefits and government subsidy together. When participants reach age 60, they will be able to receive a monthly endowment in varying amounts according to their own contributions and local areas' income standards. It is similar in form to the urban pension system, but differs from the old system which depended solely on farmers' contributions, and which lacked sufficient funding to be effective.

Despite double-digit growth in recent years, the economic imbalance between the rural and urban areas persists. The income gap between urban and rural residents has further widened, and increasing rural income has been a priority for the central government's agenda. In this year, the central government has just put agricultural sector in its No.1 policy document for 2010 as it has always been in the past. Extending pensions to rural residents could be one milestone policy to narrow the gap and meanwhile boost rural consumption to some extent.

2. Urban pensions can be transferred

New rules about urban pensions took effect from January 1 and will allow migrant and urban workers to transfer funds from their pension accounts to different provinces if they move. Sixty percent of pensions of social pooling accounts and 100% of pensions of individual accounts can be transferred along with employee, and the employee can receive basic pension payment according to the income standard in the new region after retirement.

Previously, workers who left their jobs and moved to work in another province could only transfer funds in their individual accounts contributed by themselves, while the large part in social pooling accounts contributed by employers was left in the local government. The reform is a milestone for the country's pension insurance history, and should help to boost the country's economy by encouraging cross-regional flow of workers.

3. No tax concession for personal contribution in EA

The State Administration of Taxation has clarified there are no tax concession for employees' contributions to enterprise annuity plans. Instead, employees' contributions to their pensions will now be added to their normal taxable income and taxed at the corresponding rate, while employers' pension contributions will be treated as separate income and taxed at a corresponding rate. Market participants had widely expected personal tax deductions to be implemented as an incentive for the establishment of enterprise annuity plans, as a result, the different policy than expectation might dampen their enthusiasm to set up EA. It appears, rather, that the government's focus is on Pillar I, to enlarge the coverage of the basic pension system, than on deepening the enterprise annuity market.

The cap on employers' contributions to an employee's pension is one-twelfth of the employee's salary in the past year, and the upper limit for the combined payments of the employee and the employer is one-sixth of the employee's salary during the same period. But tax concessions are only available for employers' contributions, which is tax deductible up to 5% of payroll. As a comparison, the deduction rate is 15% in the USA, 18% in Canada, and 20% in Australia. Clearly, the current tax regime has not yet provided an extensive tax benefit and therefore offers little in the way of incentives. In addition, enterprise annuities are more strictly controlled. It is not surprising that EAs have developed at a much slower pace than expected (Chart 3.3). The China Insurance Regulatory Commission has predicted EAs will increase at a rate of RMB 100 billion per year and reach RMB 1 trillion in 2010. At current rates of increase, however, this target seems less likely to achieve.

Further development

Another challenge concerns sustainability and matching between pension assets and liabilities. This is an evolving issue and hinges on capital market development. Currently, most pension assets are under the custody of the local social security departments, only earning a risk-free return on treasury bonds and deposits in banks. With inflation, the real return could be negative, and it is difficult to imagine that the pension system can be sustainable if its liabilities are growing at a faster pace than its assets. Eventually, such funds are likely to be permitted to participate in the capital market, and we believe the NSSF experience can provide a good example.

Several provinces have signed an asset management contract starting from 2006 with NSSF which guaranteed a minimal return to the funds, of not less than the deposit interest rate. These funds are pooled together with NSSF funds and have the same return as NSSF. According to NSSF annual report, total money entrusted to NSSF from these provinces was RMB 32.7 billion in 2008, which is only a small part for the individual account at a national level.

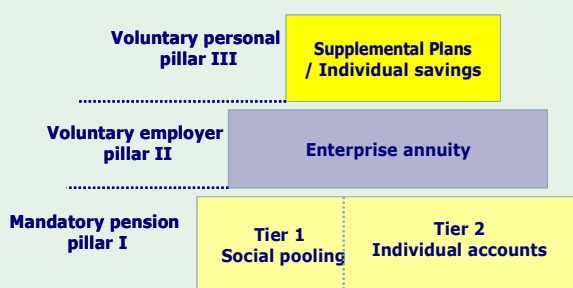
China's social security fund has enjoyed an average annual return of 9% in the last nine years. Thanks to the rise of the Chinese stock market, the NSSF registered a surprisingly high return during 2006 to 2007 (Chart 3.4), but a loss of 6.8% in 2008, still outperforming most investors in the market. The performance in 2009 came out at 16.1%.

The model of outsourcing management to NSSF could be a better way to maintain asset value than deposits in banks for the pension fund. If going further, to involve other asset managers into this field can be another option, since it provides a competitive environment and can have a better return to pension assets.

Conclusion

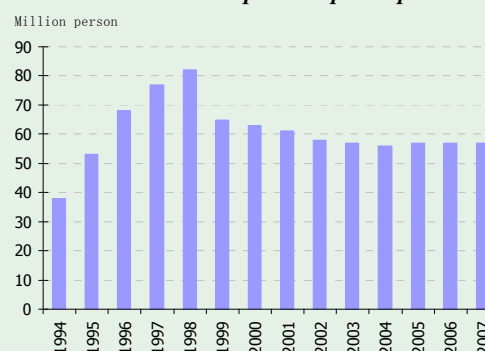
To sum up, pension reform in China is still far from complete, but the direction of policy is in the right direction. Meanwhile, further efforts and time are needed to construct a universal pension system covering a wide population in urban and rural areas, and finally to lower people's precautionary saving while boosting domestic consumption.

Chart 3.1: Three Pillar Pension System in China



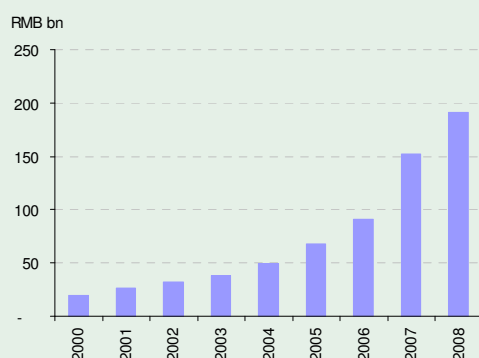
Sources: BBVA ERD

Chart 3.2: Rural pension participants



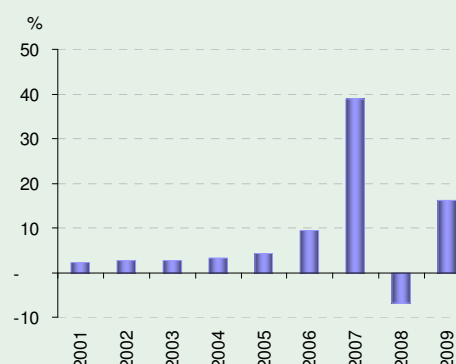
Note: MOHRSS and BBVA estimates

Chart 3.3: Enterprise Annuity Growth



Note: MOHRSS and BBVA estimates

Chart 3.4: NSSF investment return



Sources: NSSF

Appendix: China Statistical Table

	Unit	2005	2006	2007	2008				2008	2009				2009
					Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	
Domestic economy														
Nominal GDP	RMB billion	18,321.8	21,192.4	25,730.6	6,347.5	7,125.1	7,330.0	10,602.0	31,404.5	6,574.0	7,411.7	7,795.5	11,753.6	33,534.8
	USD billion	2,239.1	2,662.3	3,391.4	886.1	1,024.3	1,071.3	1,550.2	4,518.8	961.8	1,085.3	1,141.5	1,721.2	4,910.7
Real GDP growth	% yoy	10.4	11.6	13.0	10.6	10.1	9.0	6.8	9.6	6.2	7.9	9.1	10.7	8.7
CPI	% yoy	1.8	1.5	4.8	8.0	7.8	5.3	2.5	5.9	-0.6	-1.5	-1.3	0.7	-0.7
External economy														
Exports	% yoy	28.4	27.2	25.8	21.2	22.2	23.0	4.3	17.4	-19.7	-23.5	-20.5	0.1	-16.0
Imports	% yoy	17.6	19.9	20.8	28.9	32.7	25.8	-8.9	18.5	-31.0	-20.5	-11.7	22.7	-11.2
Trade balance	USD billion	102.0	177.5	262.7	40.9	57.0	84.8	115.1	297.8	62.2	33.9	38.6	61.4	196.1
Current account balance	USD billion	160.8	249.9	371.8	n.a.	n.a.	n.a.	n.a.	426.1	n.a.	n.a.	n.a.	n.a.	n.a.
	% of GDP	7.2	9.4	11.0	n.a.	n.a.	n.a.	n.a.	9.4	n.a.	n.a.	n.a.	n.a.	n.a.
Balance of payment	USD billion	207.0	247.0	461.7	n.a.	n.a.	n.a.	n.a.	419.0	n.a.	n.a.	n.a.	n.a.	n.a.
	% of GDP	9.2	9.3	13.6	n.a.	n.a.	n.a.	n.a.	9.3	n.a.	n.a.	n.a.	n.a.	n.a.
Foreign exchange reserves ^{1/}	USD billion	818.9	1,066.3	1,528.2	1,682.2	1,808.8	1,905.6	1,946.0	1,946.0	1,954.0	2,131.6	2,273.0	2,399.0	2,399.0
	% of GDP	36.1	39.3	43.4	43.8	43.8	44.0	42.3	42.3	42.4	45.7	48.0	48.9	48.9
External Debt	USD billion	281.0	323.0	373.6	393.0	427.0	442.0	375.0	375.0	336.7	360.6	386.8	n.a.	n.a.
	% of GDP	12.4	11.9	10.6	10.9	10.6	10.4	8.7	8.7	7.3	7.7	8.2	n.a.	n.a.
Fiscal														
Expenditure	RMB billion	3,393.0	4,042.3	4,978.1	950.7	1,337.5	1,354.6	2,616.5	6,259.3	1,281.1	1,609.2	1,630.0	n.a.	n.a.
Revenue	RMB billion	3,164.9	3,876.0	5,132.2	1,597.1	1,883.7	1,413.9	1,238.3	6,133.0	1,464.2	1,933.4	1,754.3	n.a.	n.a.
Fiscal balance	RMB billion	-228.1	-216.3	154.0	646.5	546.2	59.3	-1,378.1	-126.2	183.1	324.2	124.3	n.a.	n.a.
Fiscal balance	% of GDP	-1.2	-1.0	0.6	10.2	7.7	0.8	-13.0	-0.4	2.8	4.4	1.6	n.a.	n.a.
Monetary														
M2 growth	% yoy	17.6	16.9	16.7	16.3	17.4	15.3	17.8	17.8	25.5	28.5	29.3	27.7	27.7
Loans growth	% yoy	13.0	15.1	16.1	14.8	14.1	14.5	18.8	18.8	29.8	34.4	34.2	31.7	31.7
Benchmark lending rate	% pa	5.6	6.1	7.5	7.5	7.5	7.2	5.3	5.3	5.3	5.3	5.3	5.3	5.3
Benchmark deposit rate	% pa	2.3	2.5	4.1	4.1	4.1	4.1	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Required reserve ratio ^{2/}	%	7.5	9.0	14.5	15.5	17.5	16.5	13.5	15.0	13.5	13.5	13.5	13.5	13.5
RMB/USD exchange rate	(period-end)	8.1	7.8	7.3	7.0	6.9	6.8	6.8	6.8	6.8	6.8	6.8	6.8	6.8
	(period-average)	8.2	8.0	7.6	7.2	7.0	6.8	6.8	6.9	6.8	6.8	6.8	6.8	6.8
Socio-economic indicators														
Population	Person (million)	1,307.6	1,314.5	1,321.3	1,323.0	1,324.7	1,326.4	1,328.1	1,328.1	1,328.1	1,328.1	1,328.1	1,328.1	1,328.1
Urban	% of total	43.0	43.9	44.9	n.a.	n.a.	n.a.	45.7	45.7	n.a.	n.a.	n.a.	n.a.	n.a.
Rural	% of total	57.0	56.1	55.1	n.a.	n.a.	n.a.	54.3	54.3	n.a.	n.a.	n.a.	n.a.	n.a.
GDP per capita	RMB	14,012.2	16,122.2	19,473.8	4,797.8	5,378.7	5,526.2	7,982.8	23,646.2	4,949.9	5,580.7	5,869.7	8,849.9	25,250.2
	USD	1,712.4	2,025.4	2,566.8	669.8	773.2	807.7	1,167.2	3,402.4	724.2	817.2	859.5	1,296.0	3,697.5
Energy														
Energy Production	SCE Ton mn	2,058.8	2,210.6	2,354.5	538.8	642.3	650.7	628.0	2,460.0	571.6	706.2	737.8	n.a.	n.a.
Energy Consumption	SCE Ton mn	2,246.8	2,462.7	2,655.8	n.a.	n.a.	n.a.	n.a.	2,850.0	n.a.	n.a.	n.a.	n.a.	n.a.
Per Capita Energy Consumption	SCE Kg	179.9	194.7	203.3	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Per Capita Electricity Consumption	KWH	216.7	249.4	274.9	n.a.	n.a.	n.a.	n.a.	2,588.8	n.a.	n.a.	761.0	748.4	2,755.1

Sources: National Bureau of Statistics, World Bank and staff calculations.

Note: 1) The quarterly figures for "% of GDP" are using the annualized GDP figures.

2) In January 2009, the RRR for small and medium sized banks was raised to 14% while the RRR for the big six was raised to 16%.

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