

Economic

Credit Agencies:

Moody's: A1
S&P: A+
Fitch: A+

Nominal GDP (2009):

USD 4,909 bn

Population (2009):

1,333.5 millions

Total Trade / GDP (2009):

65.3%

Currency:

Yuan (Renminbi)

Exchange regime:

Pegged arrangement (USD)

Merchandise imports from Canada (2009):

CAD 9,016.1 mn

Main sources of Foreign Exchange (excl. FDI):

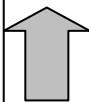
Manufactured exports

Main Merchandise Export Destination:

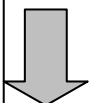
European Union (20%)

Main imports:

E&E equipment (24%)
Industrial M&E (21%)

Risks to the Outlook


Stronger recovery in G3



Over-tightening from Central Bank
Real estate bubble burst

June 2010

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Market Spotlight: Real GDP growth accelerated in Q1-10 to 11.9% y/y from 10.7% in the previous quarter. While the data includes base effects from the crisis, the underlying growth trend remains very strong, with growth rising to 11.6% q/q in Q1-10, up from 9.9% in Q4. Monetary tightening continues with the Central Bank clamping down on real estate speculation and bank lending, fuelling market concerns about potential bubbles in the property market. The latest export data was much stronger than expected, but the surge should be temporary, due to a change in taxation.

Recent performance: Real GDP growth accelerated in Q1-10 to 11.9% y/y from 10.7% in the previous quarter. While the data includes base effects from the crisis, the underlying growth trend remains very strong, with growth rising to 11.6% q/q in Q1-10, up from 9.9% in Q4. More recent data suggest a weakening in Q2, with industrial production slowing to 16.5% y/y from 17.8% and 18.1% the previous 2 months. The PMI index also weakened, with the output, new order and new export order losing components all losing steam in May. At the same time, recent data on retail trade, fixed assets investments, employment and wage increases all point to sustained domestic demand.

Fiscal policy: The government's massive fiscal stimulus program continues to be implemented, although the impact on growth in 2010 will be wearing off in coming quarters. Certain household incentive measures such as subsidies, tax breaks and trade-in schemes for cars and appliances will be continued. The official 2010 deficit is forecasted to be 2.8% of GDP, compared to 2.2% in 2009, although most of the economic support was done through directed lending from state banks, which is currently being curtailed. The central government overall fiscal position is strong with a low public debt (18% of GDP). While potential liabilities from local governments and state-owned banks aren't included and could result in a deterioration of sovereign indicators, any such deterioration would most likely be limited and thus manageable.

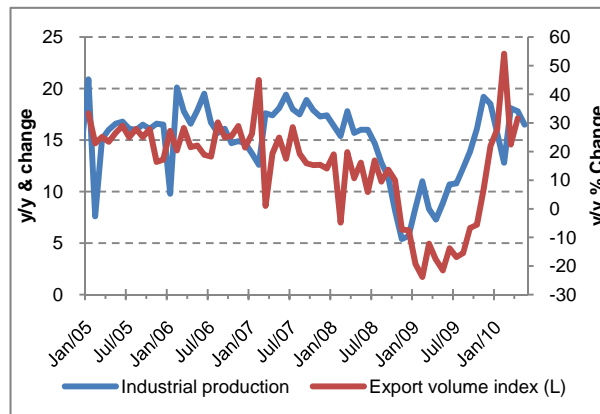
Monetary policy: Authorities continue to maintain their tightening bias, although mostly with the aim of curbing real estate speculation, as concerns over local property bubbles are mounting. The measures appear to be having an impact, with property sales in some key markets (Shanghai, Shenzhen and Beijing) plunging 60-70% y/y. However, inflation pressures continue to build from the lagged impact of M2 growth, which remains above trend despite slowing considerably from last year. Property prices have slowed down May but the double-digit y/y growth rate remains too high for comfort.

External sector: In 2009, China's trade surplus fell for the first time since 2003. Since bottoming in the first quarter of 2009, exports have rebounded quickly with improved external demand. However, imports have surged with strong domestic demand, resulting in the first monthly trade deficit since 2004 in March. The very favourable trade data release for May, with exports rising 48.5% y/y will certainly bring renewed calls for removing the peg to the USD. After staunchly opposing removing the peg to the USD earlier this year, authorities recently appeared more willing to move, but with the recent sovereign debt concerns in Europe, China's main export market, we expect authorities to maintain their wait-and-see approach. The export surge in May should be temporary, as some exports were most likely brought forward in anticipation of an expected cut in VAT export rebates. FX reserves now exceed USD 2.5 trillion, representing 19 months of import cover.

Outlook: The strong Q1 GDP figures suggest that our initial growth estimate for 2010 may be on the low end, but we still expect a weakening of growth in coming quarters, a view that the Central Bank appears to share as it warned of a slowdown in Q2 to 10-11% y/y from a weakening of manufacturing production and investment. Net export will also weaken as export demand from G3 economies falters from the withdrawal of their fiscal and monetary stimulus, especially in Europe with the decline of the euro versus the USD. Finally, the aggressive move by the Central Bank to curb bank lending and real estate speculation will also limit private investments.

Economic Indicators				
	04-08 avg.	2009	2010	2011
GDP (% growth, real)	11.0	8.7	8.8	9.5
Inflation	3.6	-0.6	3.5	3.2
Fiscal Balance (% of GDP)	-0.6	-3.0	-3.3	-2.6
Export growth (%)	26.8	-16.0	11.7	9.8
Import growth (%)	22.2	-11.4	15.0	9.7
Current Account (% of GDP)	8.0	5.8	5.0	4.5
Reserves (month of imports)	14.8	24.0	23.4	23.3
External Debt (% of GDP)	11.3	7.4	6.9	6.6
Debt Service ratio	2.6	2.3	1.7	1.6
Currency (end of period)	7.7	6.8	6.5	6.2

Sources: EIU, EDC Economics



Political

Political Structure

One-party rule

The Chinese Communist Party (CCP) rules at all levels of government. All other political organizations are illegal.

General Secretary of CCP and President

Hu Jintao

Premier

Wen Jiabao

Executive/Legislative Bodies (Government and CCP)

- State Council
- Politburo Standing Committee (PSC)
- Central Committee,
- National People's Committee (NPC)

Last Elections

- Presidential: March 2008
- State Council: March 2008

Next Elections

- 18th Party Congress: 2012

Press Freedom Survey:

- 2009 Score: 85 (Not Free)
- freedomhouse.org

Control of Corruption Index:

- 2008 Score: -0.44 (-2.5: Worst; +2.5: Best)
- worldbank.org

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General Political Environment: China is a one-party state with the Chinese Communist Party (CCP) controlling the government. The nine-person Politburo Standing Committee is the top decision-making body in China. President Hu came to power in 2002 and will step down in 2012 following his second and final term. The succession plan is already being developed as the CCP plans power transfers well in advance to avoid any destabilizing surprises.

Much of the government's attention throughout 2009 and 2010 has been devoted to the global economic downturn. Although China never entered into recession, the global economic downturn curtailed economic growth and left millions of workers unemployed in late 2008 and early 2009. Though there was a marked increase in social unrest in regions most impacted by the economic crisis, these localized incidents did not coalesce into a widespread anti-government movement (as feared by CCP leadership). This outcome, in large part due to the stimulus package, appears to have enabled the Chinese economy to maintain growth and in the process avert wider social unrest.

With China showing strong signs of exiting the downturn, Premier Wen's address at the Annual National People's Congress in March 2010 was not solely focused on the economy but also addressed other 'major problems' in the areas of education, healthcare, housing, and income distribution. Wen also mentioned the need to improve living standards of ethnic minorities, a clear sign of the government's concern over simmering ethnic tensions in Tibet and Xinjiang. The CCP appears to have also recognized the need to find policy solutions for income inequality and affordable housing, two areas which can undermine social stability.

Investment Environment: China's complicated commercial environment poses risks for foreign investors. Frustrations include the lack of legal protection for investor and intellectual property rights, inconsistent application of regulations and bureaucratic meddling. Recent high profile disputes between the government and multinational companies, including Rio Tinto and Google, have highlighted frustrations faced by some foreign companies doing business in China.

That said, China is working to encourage foreign investment by developing a more rules-based business environment. Recent changes include the passing of China's first-ever legislation protecting private property and an anti-monopoly law. While the passing of such legislation will provide further clarity to investors, implementation and enforcement of these and other changes is likely to be inconsistent across regions and industries for some time.

The government in May 2010 announced a new set of policies to encourage private sector investments in energy, infrastructure, public services and several other sectors that have been dominated by SOEs. The impact of these proposals on foreign investors remains unclear since these proposals were primarily aimed at promoting Chinese small and medium-sized enterprises.

Corruption is entrenched at all levels of government in China. Apart from the economic impact of corruption, the issue also has wider political risk implications. Demonstrations against local-level corruption and land seizures remain regular occurrences; over 87,000 in 2005 – the last year that the government released official figures. The CCP recognizes the importance of tackling corruption to ensuring its legitimacy and will continue with its anti-graft campaign.

Political Violence: Demonstrations against local corruption and land seizures, as well as protests related to rising levels of unemployment, especially post global economic crisis become more numerous but failed to pose a major threat to the CCP owing to their localized nature.

Ethnic tensions, on occasion have lead to violence and localized instability in some parts of China. For example, in July 2009 almost 200 individuals were killed in clashes between ethnic Uighur and ethnic Han groups and police in Xinjiang province. According to reports, clashes between the police and Tibetan demonstrations in 2008 resulted in over 100 deaths. The potential for future unrest exists given heightened inter-group tensions that remain.

China is deeply opposed to pro-independence sentiments in Taiwan. That said, economic and investment links between China and Taiwan have strengthened considerably since 2008 and this integration has greatly lessened the risk of armed conflict between the two.

Political Outlook: Political stability is still priority number one for the Chinese central government which views continued and regionally-balanced economic growth as the key to such stability. The government appears to have been successful in preventing any major social upheaval during the recent global downturn. Sporadic outbreaks of ethnic unrest highlights the inter-group tensions that remain in certain regions of the country, namely Tibet and Xinjiang; however, such unrest is unlikely to threaten overall political stability in China. The stated shift in government policy from stabilizing economic growth to the quality and sustainability of growth with a focus on social welfare among rural and minority segments of the population highlights the CCP's anxiety over a recently emboldened population.