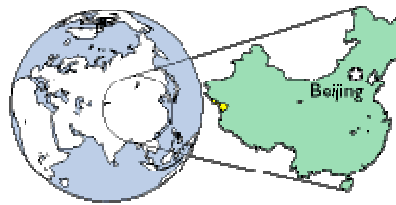


COUNTRY REVIEW

China (Update)



9 December 2009

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EULER HERMES COUNTRY RISK GRADE: B

**Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.**

Basic indicators

Selected economic indicators	2006	2007	2008	2009f	2010f
Nominal GDP (USD bn)	2,659	2,785	3,703	4,402	4,922
Population (mn)	1,335	1,346	1,357	1,367	1,378
GDP per capita (USD)	1,991	2,069	2,730	3,220	3,572
Real GDP growth (% yr/yr)	11.6	13.0	9.0	8.0	9.0
Inflation (% annual average)	1.5	4.8	5.9	-0.8	2.3
Fiscal balance (% of GDP)	-0.8	0.7	-0.4	-3.3	-3.5
Current account balance (% of GDP)	9.5	13.4	11.5	6.7	6.0
External debt/GDP (%)	12	13	9	8	6
External debt/Exports of goods & services (%)	30	25	21	25	21
Interest payments/Exports of goods & services (%)	1	1	1	1	1
Foreign exchange reserves (USD mn)	1,068,493	1,530,282	1,950,000	2,300,000	2,700,000
Import cover (months)	11.6	12.4	14.9	22.1	23.2
Exchange rate assumption, CNY:USD (av)	7.97	7.61	6.95	6.83	6.60
f: CRU central forecast					

Sources: National, IMF, World Bank, Euler Hermes Country Risk Unit

UPDATE

Aggressive monetary and fiscal expansion combined to restore real GDP growth to 7.9% yr/yr in Q2 and 8.9% in Q3 and with the strong momentum likely to have continued in Q4 overall growth for 2009 is set to reach the government's 8% target. The recovery from the sharp Q4 2008 yr/yr slowdown (when output probably stalled qtr/qtr) has been domestic demand driven, particularly investment growth, almost half of which in the first nine months was government-led, according to the World Bank. Resurgent housing sales have also contributed to a pick-up in construction though manufacturing investment has lagged, probably reflecting excess capacity and weak profitability. Personal consumption, though less strong than investment, has held up well, but has also received government support—tax breaks for small cars and subsidies for rural consumption of electronic appliances, for example—though falling prices have also helped. Net exports will make a significant negative contribution to growth in 2009, as real exports have slumped by more than imports.

Inflation has fallen rapidly. Indeed, on a yr/yr basis prices have been falling for much of 2009, but should turn mildly positive at year-end. Relaxation of monetary policy has resulted in a massive upsurge in M2 and credit growth, much of it directed towards government-led investment. According to the World Bank, in H1 infrastructure lending increased 42% yr/yr in H1, contributing around a half of the increase in new credit. Recent data, however, suggests that lending overall is becoming more subdued. Public spending has increased sharply, but there has also been a rise in revenues (partly increased tax collection) and the deficit will probably not be more than 3.5% of GDP. The fiscal deficit is unlikely to pose serious problems with a public debt-GDP ratio just over 20% of GDP. The expansion of bank lending may raise banks' non-performing loans at some point, but the authorities should have adequate resources if problems emerge.

The current account surplus will fall by almost half in 2009 to around 6.5% of GDP. Both exports and imports have fallen, but there has been a big fall in import prices, limiting the decline in the trade surplus. Net FDI flows remain positive, though inflows may have halved. The exchange rate has been held stable against the USD since mid-2008.

With growth restored to target, increasingly the debate will focus on when to ease back the stimulus. To a large extent this will depend on the nascent recovery of exports and by extension the sustainability of the global recovery, as the authorities are likely to adopt a wait-and-see approach, while keeping a close eye on some potential excesses. Medium-term, re-balancing away from exports and investment to domestic consumption will remain the cornerstone of policy and there have been some modest measures towards this end in 2009. In this context, exchange rate policy will probably shift towards gradual appreciation at some point in 2010.

Growth in 2010 is likely to be around 9%, with less impetus from government-led investment, as profitability in industry has turned positive again, net exports will improve and consumption growth should be maintained. Inflation should also remain low. The current account surplus will remain substantial (6% of GDP) and FX reserves will continue to rise, though less rapidly than prior to 2009. FX reserves still cover the entire external debt stock six times and external debt ratios remain very low.

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