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**CHINESE ECONOMY 2009:
LEADING THE WORLD ECONOMY OUT OF CRISIS**

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Executive Summary

1. The year 2009 was the most difficult year for the world economy in many decades. Most industrialised economies contracted by up to 6% in their gross domestic product (GDP).
2. China, on the contrary, managed to achieve a GDP growth rate of 8.7%, 0.7% higher than the original target, amounting to RMB 33.5 trillion, or \$4.91 trillion.
3. Its quarterly growth rate accelerated sharply from 6.1% in the first quarter, to 7.9% in the second quarter, 8.9% in the third quarter and 10.7% in the last quarter.
4. China may have overtaken Japan as the world's second largest economy in 2009 although some more conservative estimates suggest that it can only take place in 2010 due to the appreciation of the yen against the greenback.
5. Given the growth trends in China and the US, we predict that the former will be able to overtake the latter to become the world's largest economy by 2028. The more optimistic analysts suggest that this may happen sooner, in 2025, or even 2020.
6. China's real ambition is to become a middle-income economy by 2040, ten years earlier than Deng's plan made in the early 1980s.
7. Against the toughest trading environment in more than a decade, China achieved trade volume of \$2.21 trillion in 2009, just 13.9% less than the previous year.
8. Trade surplus declined by 34% to \$196 billion. Despite this, China surpassed Germany for the first time to become the world's largest exporting economy.
9. The total flows of cross-country investments in the world contracted sharply by 45% to \$923 billion, while China still managed to attract \$90.1 billion of foreign direct investments (FDI), down by only 2.56% from 2008.

10. In the meantime, China has become one of the world's major investing economies. Its total outward FDI was more than \$40 billion in 2009, while its total investment in foreign acquisitions and financial markets was about \$30 billion.
11. In the first half of the year, state budget revenue declined sharply, but recovered quickly in the second half, resulting in an annual rise of 11.7% to reach RMB 6.85 trillion.
12. Although some economic indicators implied the slowest growth in eight years, it was clear China had experienced a sharp V-shaped recovery, leading the world economy out of its deepest recession since the 1930s.
13. As China enters 2010, it faces some serious challenges. Its economic development model has been over-dependent on investment and exports while final consumption growth remains weak.
14. Excessive investments and massive bank credits have created dangerous bubbles in the housing market, creating the conditions for high inflation in the real economy.
15. Rising house prices will also aggravate the existing inequalities and social injustices, which may render Chinese society susceptible to the risk of becoming a highly polarised and inharmonious society like those seen in Latin America.
16. China's reluctance to let its currency appreciate has also generated significant tension with its major trading partners, especially the US and the EU. The resultant trade disputes can threaten China's sustainable growth.

Chinese Economy 2009: Leading the World Economy Out of Crisis

Shujie Yao and Dan Luo*

Chinese Economy in 2009: An Overview

- 1.1 On 1 October 2009, with a massive display of military hardware, China celebrated the 60th anniversary of the founding of the People's Republic. The 60th birthday is of great significance in Chinese culture, representing the culmination of a complete astrological cycle. This thereby marks the year 2010 as a new beginning.¹ In the past two years, amid the world's most serious financial crisis since the Great Depression in the 1930s, China's economic performance had been respectable. This demonstrates that China will be able to become the world's biggest economy in the foreseeable future.

- 1.2 In late September 2008, following the collapse of international financial giants such as Lehman Brothers, Fannie Mae, Freddie Mac and AIG, the world economy took a sudden and decisive turn for the worse. The increase in globalisation over the past decades makes China unable to fully decouple from this crisis. In the first half of 2008, China had still managed to keep its GDP growth at 10.4%, but that slowed to 9% in the third quarter, 6.8% in the fourth quarter and then to just 6.1% in the first quarter of 2009. Prior to the crisis, China had recorded two-digit growth rates for five consecutive years before 2007. The force of the downward pressure on China's growth was obvious and drastic.

- 1.3 In response, the government revised its macroeconomic target in 2009 to "guaranteeing GDP growth at 8%" and announced a huge two-year stimulus package worth RMB 4 trillion in November 2008. Investing heavily in infrastructure construction, agriculture, science and technology, environment protection, education and healthcare, the rescue package accompanied with other supporting

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¹ "The World in 2010, Leaders, Chill, China", *The Economist*, http://www.economist.com/theworldin/displayStory.cfm?story_id=14742173&d=2010, 13 November 2009.

efforts managed to restore GDP growth in the third and fourth quarters of 2009 to 8.9% and 10.7% respectively. This brought the annual growth rate to 8.7% for the whole year, or 0.7% higher than the planned target.² Meanwhile, the consumer price index (CPI) also moved back into positive territory, increasing by 0.6% in November and by 1.9% in December.³

- 1.4 Compared with a year ago, the country's industrial structure shifted slightly towards the services sector.⁴ The value added of agriculture, industry and services were RMB 3.6 trillion, RMB 15.7 trillion and RMB 14.3 trillion respectively, rising by 2.9%, 5.4% and 15.3% from the previous year.⁵ Although the importance of the agricultural sector in the national economy declined slightly again in 2009, grain production reached 531 million tons, registering a sixth consecutive annual growth.
- 1.5 After falling steeply from July 2008, industrial production started picking up rapidly from the second quarter of 2009 (Figure 1). In November and December 2009, China's industrial output rose sharply by 19.2% and 18.5% respectively, achieving an annual growth of 11%, or 1.9 percentage points lower than in 2008. Figure 2 depicts the relationship between industrial output and GDP growth rates over the period 1990-2009. As industrial production has been the backbone of the economy, its strong performance has been important to the country's growth momentum.
- 1.6 Meanwhile, China has become the world's largest producer of many key industrial products. Up until November 2009, it produced 2.7 billion tons of coal, 51.3 billion meters of clothes, 60.5 million tons of potassium fertilizer, 518 million tons of crude steel, 174 million personal computers and 93 million colour TV sets.⁶ It also produced two-thirds of the world's photocopiers, microwaves and shoes, 60% of mobile phones and 75% of toys.⁷

² Data Source: National Bureau of Statistics (NBS).

³ *Trading Economics*,
<http://www.tradingeconomics.com/Economics/Inflation-CPI.aspx?Symbol=CNY>.

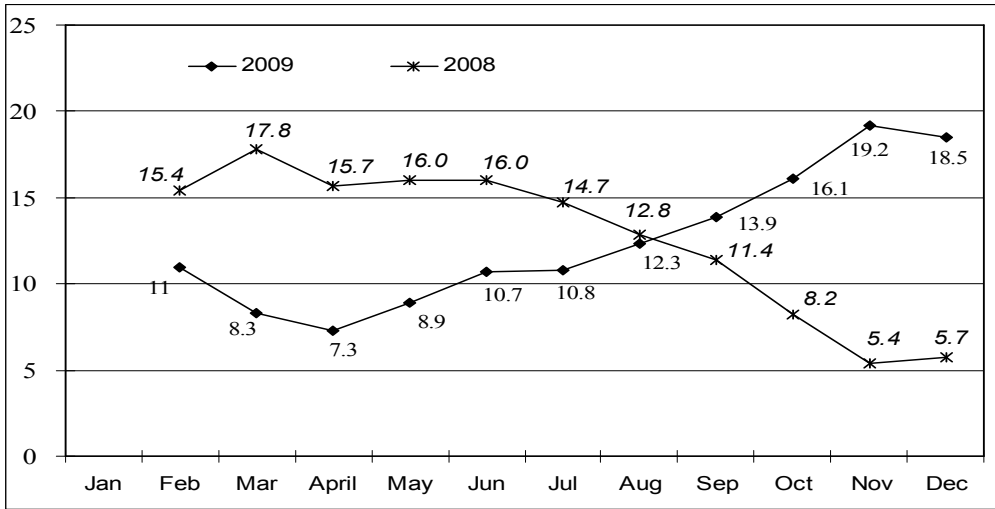
⁴ The composition of GDP in 2008 was: Primary industry: 11.3%, the Secondary industry: 48.6% and the Tertiary industry: 40.1%; while the composition of GDP in 2009 was: Primary industry: 10.6%, the Secondary industry: 46.8% and the Tertiary industry: 42.6%.

⁵ "China Fulfilled its Commitment, Achieving GDP Growth Rate of 8.7% in 2009", *Renmin Net*,
<http://finance.people.com.cn/GB/10813649.html>, 21 January 2010.

⁶ Data Source: National Bureau of Statistics (NBS).

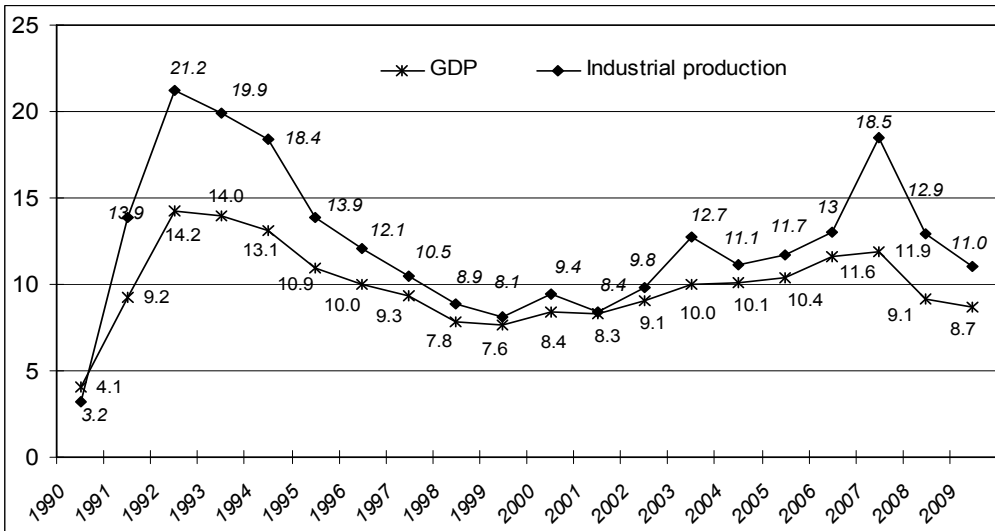
⁷ Yao, S. J. (2009), "China Emerges as A Global Power on 60th Birthday", Policy Paper, China Policy Institute, University of Nottingham, September 2009.

Figure 1 Monthly growth rate of industry production, 2008 and 2009 (%)



Source: National Bureau of Statistics, Monthly Statistics.

Figure 2 GDP and industrial production growth rates, 1990-2009 (%)



Source: China Statistical Yearbook, various issues, National Bureau of Statistics.

Export: Weathering World Contraction

2.1 In the past decades, the three main drivers of China's growth--export, investment and consumption--saw different changes in 2009. According to an IMF projection, total world trade volume contracted by 12.2% in 2009, and would regain a marginal

growth of 1% in 2010.⁸ The weakened US dollar and the contraction in US consumer spending hit China's exports hard from the second half of 2008, leading to a sharp decline in international trade.

- 2.2 The volume of exports and imports was \$2.21 trillion in 2009, down by 13.9% year-on-year. China's trade with its largest and second largest trading partners, the EU and US, fell by 14.5% and 11% respectively.⁹ In the meantime, trade surplus shrank for the first time in six years to \$196 billion, contracting by 34% compared with 2008. It is predicted that trade surplus will fall further by 15.5% in 2010 to \$184 billion although total trade will increase by 8.2% to \$2.31.¹⁰
- 2.3 As China's trade was dominated by low value-added processing manufacturing, weak export activities also slowed down imports significantly. As far as international trade was concerned, 2009 was the most difficult year for China after its ascension to the World Trade Organisation (WTO) in 2001.
- 2.4 Exports declined by 16% from a year earlier to \$1.2 trillion and imports fell by 11.2% to \$1.01 trillion over the same period.¹¹ This was China's first annual export decline after 1983 when it fell a mere 0.4%. The last time China experienced a negative growth of imports was at the rock bottom of the 1997-98 Asian Financial Crisis (Figure 3).

⁸ "Contractionary Forces Receding but Weak Recovery Ahead, World Economic Outlook Update", *IMF*, 8 July 2009.

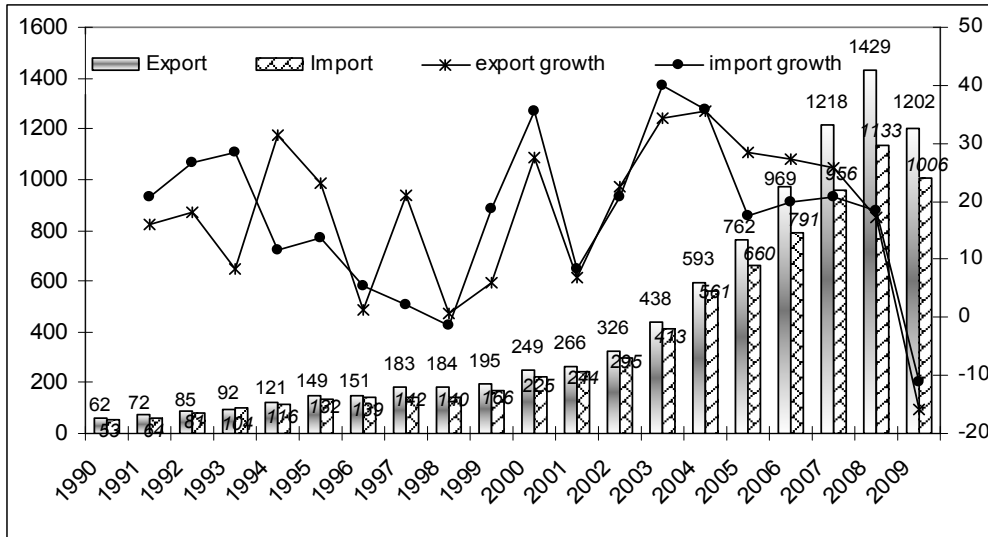
⁹ Wu, J. R. (2010), "World News: China's Exports Turn Upward in December --- Jump of 18% Marks the End of More Than a Year of Declines; Imports Also Soar, Fueled by the Country's Stimulus Programs", *Wall Street Journal (Eastern edition)*, New York, 11 January 2010.

¹⁰ "China to Maintain Trade Stimulus after Incentives Plays off", *Xinhuanet*, http://www.chinadaily.com.cn/bizchina/2009-12/23/content_9218549.htm, 23 December 2009.

¹¹ Ding, Q. F. and Xin, Z. M. (2009), "China may Surpass Germany as World's Biggest Exporter", *China Daily*, http://www.chinadaily.com.cn/china/2009-12/27/content_9234280.htm, 27 December 2009.

Figure 3 Exports and imports and their annual growth rates, 1990-2009

(\$ billion, %)



Source: China Statistical Yearbook, various issues; China daily: <http://www.chinadaily.com.cn>.

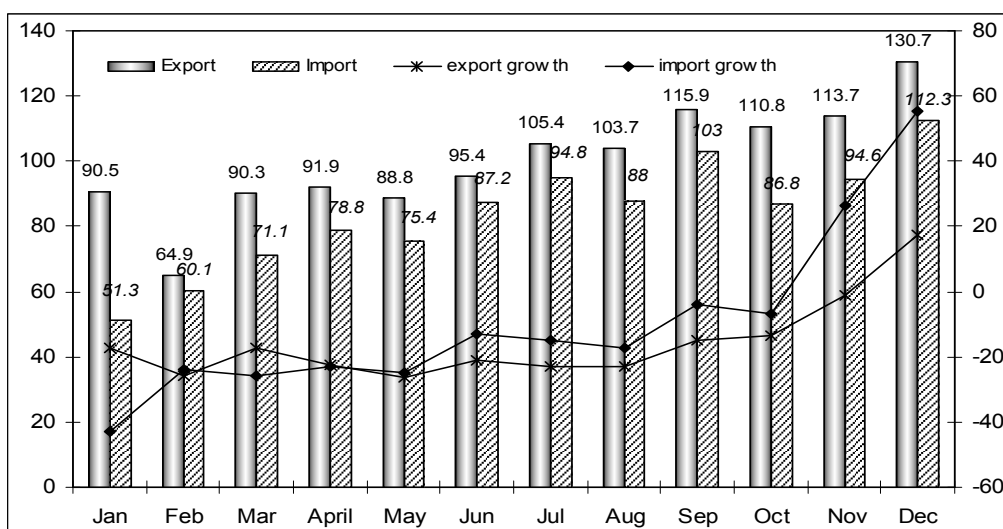
2.5 Helped by the turnaround of the world economy, exports started to bounce back from the second half of 2009, showing a sharp V-shaped recovery (Figure 4). While exports appeared to have turned the corner in December 2009, rising 18% year-on-year, imports grew at an even faster rate, up 56%, triggered by China's stimulus-fuelled appetite for raw materials.¹² According to the WTO, China, with a total export value of \$521.7 billion in the first half of 2009, had for the first time edged narrowly ahead of Germany in exports.¹³ The recovery momentum continued in the second half of the year such that China emerged as the world's largest exporter for the whole year.

2.6 In 1980, China accounted for 1% of the world trade. By 2009, this share has increased to 9%. Apparently, China's role in the world economy has been strengthened rather than weakened as a result of the financial crisis.

¹² Wu, J. R., 11 January 2010.

¹³ Exports value of Germany was \$521.6 billion during the January to June period of 2009.

Figure 4 Monthly exports and imports and growth rates in 2009 (\$ billion, %)



Source: China Statistical Yearbook, various issues; China daily: <http://www.chinadaily.com.cn>.

2.7 It is worth noting that with total sales of 870,000 units, China had surpassed the US as the world's largest market of vehicle sales in January 2009 for the first time, exceeding the US by 78,000 units.¹⁴ Stimulated by the government's tax breaks on small cars and subsidies on vehicle purchases in rural areas, total vehicles sales rose 18% in the first half of 2009 to 6.1 million from the same period last year.¹⁵ Such strong domestic demand continued to push car sales up by 72% year-on-year in October to 1.2 million units, far outpacing the 838,000 units sold in the US in the same month.¹⁶ Global carmakers are now increasingly targeting China as a key growth market.

¹⁴ "China becomes Biggest Auto Market", *BBC News*, <http://news.bbc.co.uk/1/hi/business/7880806.stm>, 10 February 2009.

¹⁵ Waldmeir, P. (2009), "Car Sales in China surge 48%", *Financial Times, London (UK)*, 10 July 2009, pg. 16.

¹⁶ China/EU, "Booming Sales Empower Chinese Motors", *Oxford Analytical Daily Brief Services*, 11 November 2009, pg.1. The total car sales in the whole year reached 13.7 million, up by 48% from 9.3 million in 2008, comfortably overtaking the US as the world's largest car consumer and producer (13.8 million units). McIntyre, D. (2009), "China Blows by US as World's Largest Car Market", *DailyFinance*, <http://www.dailyfinance.com/story/company-news/china-blows-by-u-s-as-worlds-largest-car-market/19274802>, 11 December 2009.

Domestic Investment, FDI, and Consumption

- 3.1 The second growth impetus--domestic investment--has long been the biggest contributor to China's growth. Its importance became more prominent in 2009 because of the government's huge fiscal stimulus package and a contraction of foreign investment. By the end 2009, accumulated investment in fixed assets had reached RMB 22.5 trillion, up by 30.1% from a year earlier, 4.6 percentage points higher than that of the previous year.
- 3.2 As emphasised by the stimulus plan, investment in railway construction in 2009 experienced the most significant rise of 67.5% while investment in road transportation increased by 40.1%. Meanwhile, investment in education, healthcare and social welfare were up by 37.2% and 58.5% respectively.
- 3.3 Due to the deep recession in the developed world, global FDI plummeted in 2009. The world total FDI inflows are expected to have contracted by 45% to \$923 billion by the end of 2009. FDI in developed countries and emerging markets were likely to have experienced a decline of 51% and 38% respectively.¹⁷
- 3.4 In contrast, China was still one of the top destinations of foreign capital. From 1979 to 2009, total FDI stock, stemming from over 200 countries and territories reached \$932 billion.¹⁸ In 2009, the actual utilisation of FDI reached \$90.1 billion, declining by only 2.56% from 2008 (Figure 5).
- 3.5 After a sharp decline in the first half of the year, the number of newly-approved foreign-invested enterprises and the inflows of FDI started to grow quickly from August 2009. In particular the actual use of FDI in December 2009 was as high as \$12.1 billion, rising by 103.1% compared with the same month in 2008.¹⁹ Such a positive trend will continue due to the improved economic conditions in other developed nations. China is expected to see a rise in FDI inflow by 10% in 2010.²⁰

¹⁷ "World Economy: Plunging FDI", *EIU ViewWire New York*, 29 July 2009.

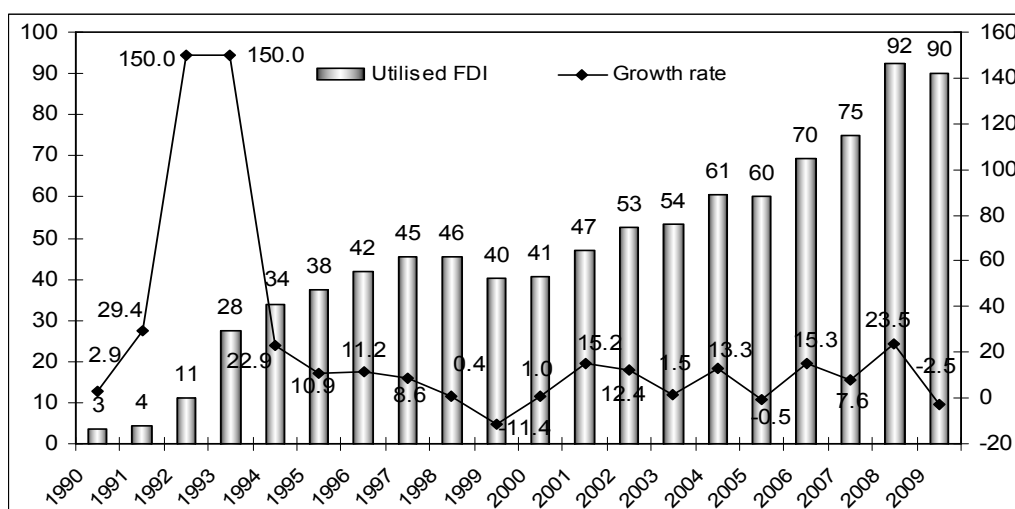
¹⁸ *China Statistical Yearbook*, various issues, National Bureau of Statistics, Statistical data.

¹⁹ *FDI Invest in China*,

http://www.fdi.gov.cn/pub/FDI_EN/Statistics/FDIStatistics/ExpressofForeignInvestment/t20091215_115868.htm, 15 December 2009.

²⁰ "Economic Data Forecast: FDI Inflow to China is Likely to Increase by 10% in 2010", *CCTV.com* <http://finance.cctv.com/20091225/101454.shtml>, 25 December 2009.

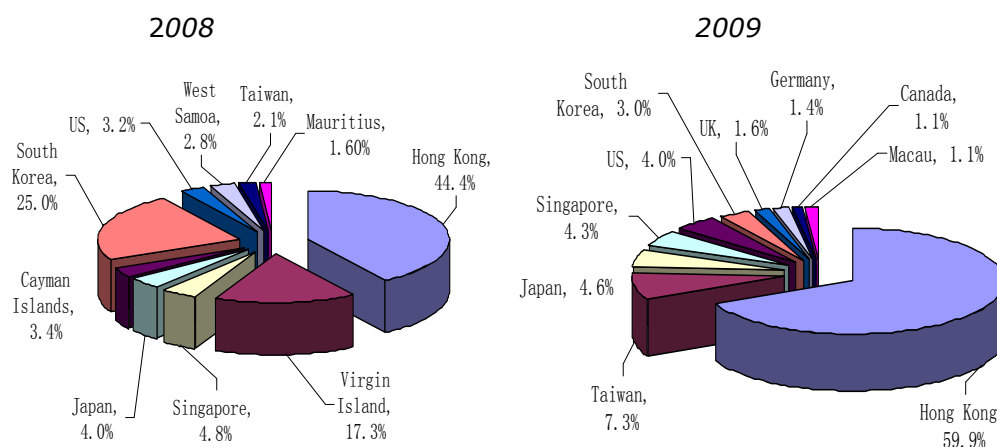
Figure 5 Total utilised FDI and the growth rate, 1990-2010 (\$ billion, %)



Source: China Statistical Yearbook, various issues; News Release of National Assimilation of FDI and CCTV.com.

3.6 The top ten FDI originating countries of 2009 changed significantly compared with the previous few years (Figure 6). China's three Special Administrative Regions became more important, accounting for two-thirds of the country's total utilised FDI in 2009. In addition, developed nations, such as the UK, Germany and Canada increased their investments, replacing those small islands to become China's most important investors.

Figure 6 Top 10 countries and regions with FDI inflows in China

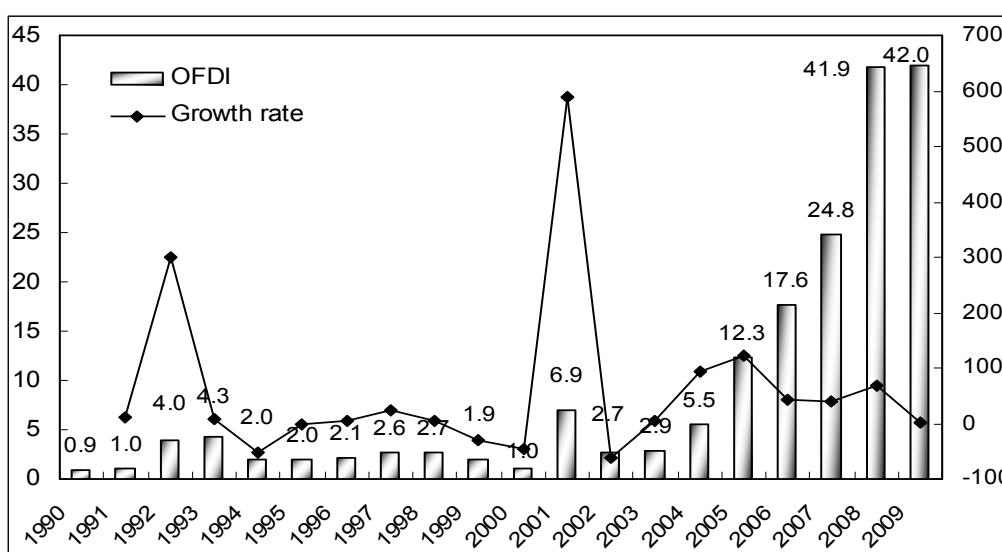


Sources: Source: News Release of National Assimilation of FDI, *FDI Invest in China*, various months, http://www.fdi.gov.cn/pub/FDI_EN/Statistics/FDIStatistics/default.htm.

Note: The figures are calculated as per actual input of foreign capital.

3.7 In the meantime, China's outward FDI (OFDI) surged in 2009. Invested directly in 112 countries and regions worldwide, non-financial investment reached \$32.9 billion in the first three quarters of 2009.²¹ In particular, investment in the third quarter was \$20.4 billion, higher than the aggregated value of the first two quarters, representing a rise of 190.4% year-on-year.²² China is expected to realise a total of \$42 billion non-financial investment in 2009, signifying the transformation of the country to an outward investing economy (Figure7).

Figure 7 China OFDI and the growth rate, 1990-2010 (\$billion, %)



Source: Ministry of Commerce, PRC.

3.8 The last but rapidly growing component of China's growth, personal consumption, experienced a much faster expansion in 2009. The average annual growth rate of personal consumption, proxied by total retail sales of consumer goods, was 13.4% in the past decade. In 2009, the growth rate was 15.5%, signifying the increased contribution of personal consumption to total GDP growth and the rising importance of the services sector.

²¹ Source: Ministry of Commerce.

²² "Non-financial Investment in China had Surpassed \$30 Billion in the First Three Quarters of 2009", Ministry of Commerce, <http://hzs.mofcom.gov.cn/aarticle/xxfb/200910/20091006583953.html>, 27 October 2009.

China amid the World Financial Crisis

- 4.1 While the key industrialised countries were suffering from massive economic shrinkage, China still managed to realize 8.7% GDP growth in 2009, implying that it was the biggest winner out of the crisis. The economic fundamentals of China were much better than those in the US, the EU and Japan for the following reasons.
- 4.2 First and foremost, the conservative attitude of Chinese banks towards investment in derivatives had limited their exposure to US mortgage-backed securities and consequently helped them maintain healthy and robust growth in the current volatile environment. Chinese commercial banks reported RMB 583.4 billion (\$85.79 billion) in after-tax profit in 2008, up by 30.6% year-on-year, outshining their foreign counterparts.²³ Led by ICBC (Industry and Commercial Bank of China), three of China's biggest SOBs (state-owned banks) were among the world's five most profitable banks in 2008.²⁴
- 4.3 In 2009, the reform of China's last but most troublesome SOB, Agricultural Bank of China (ABC), was also accelerated. Apart from the State Council's RMB 130 billion (\$19 billion) injection to reduce the banks' non-performing loans (NPLs) in October 2008, ABC had also raised another RMB 50 billion (\$7.3 billion) in the country's largest bond issue in May 2009, fully prepared for its expected IPO in Shanghai and Hong Kong in the near future.²⁵
- 4.4 In the meantime, the current crisis led share prices of some of the world's banking giants, such as Citigroup and Royal Bank of Scotland (RBS), to tumble. This enabled the three Chinese listed SOBs to overtake their American and European rivals to become the world's largest banks by market capitalisation in early 2009, only two years after they were listed on the Hong Kong and Shanghai stock exchanges.
- 4.5 When the economy started to pick up in 2009, the Chinese stock market and the share prices of banking stocks bounced back rapidly (Table 1). The share prices of CCB (China Construction Bank), BOC (Bank of China) and ICBC increased by 75%,

²³"China's Banks Take Number One Spot in 2008 Net Profits", *Xinhuanet*, http://news.xinhuanet.com/english/2009-04/14/content_11184476.htm, 14 April 2009.

²⁴ "China's Banks Consolidate Dominance of Asia", *The Banker*, London, July 2009.

²⁵ Anderlini, J. and Chen, X. (2009), "ABC Bond Sale Raises \$7.3 bn ahead of IPO", *Financial Times*, London (UK), 20 May 2009, pg. 20.

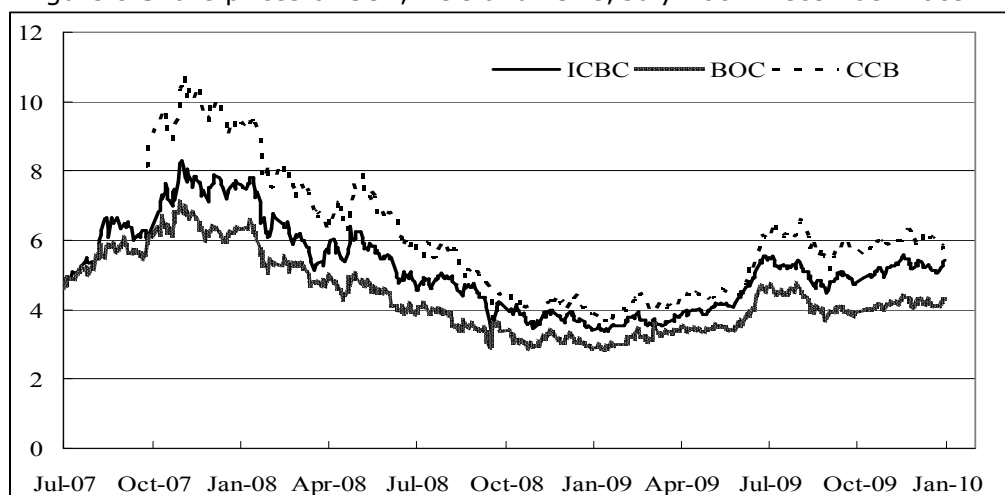
68% and 65% respectively from their lowest levels to the end of 2009, despite having not fully reverted to their peak in October 2007 (Figure 8).

Table 1 Major world stock indices and their changes over 2007 to 2009

Stock Markets	31-Dc-2007	31-Dec-08	31-Dec-09	07-08 (%)	08-09 (%)
New York	9,740	5,757	7,185	-40.9	24.8
London	6,456	4,434	5,413	-31.3	22.1
Paris	5,614	3,218	3,936	-42.7	22.3
Frankfurt	8,067	4,810	5,957	-40.4	23.8
Mumbai	20,287	9,647	17,465	-52.4	81.0
Singapore	3,482	1,762	2,898	-49.4	64.5
Sydney	6,104	3,461	4,561	-43.3	31.8
Hong Kong	27,813	14,388	21,873	-48.3	52.0
Shanghai	5,262	1,821	3,277	-65.4	80.0
Tokyo	15,308	8,860	10,546	-42.1	19.0

Source: <http://finance.yahoo.com>.

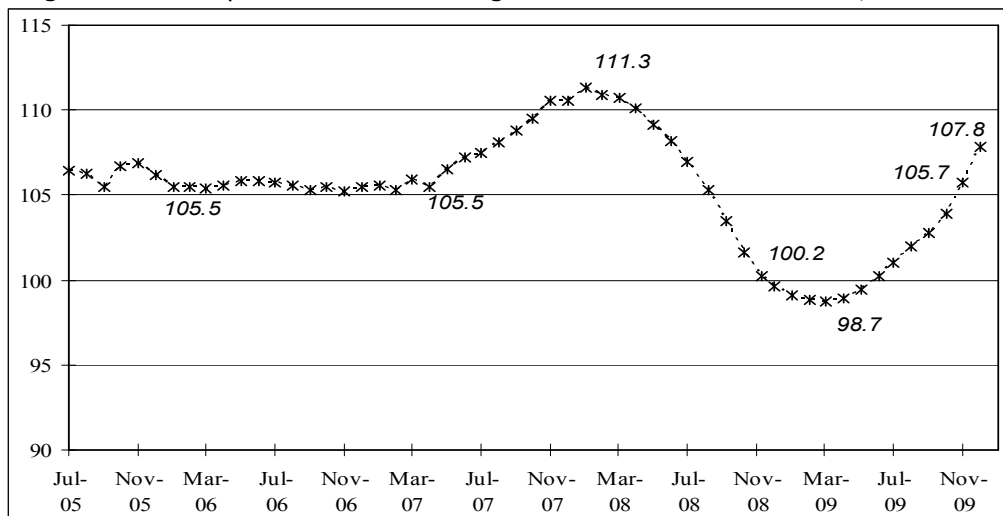
Figure 8 Share prices of CCB, BOC and ICBC, July 2007-December 2009



Source: Yahoo Finance, <http://finance.yahoo.com>.

- 4.6 Secondly, its strong economic performance in the past decade, high levels of trade surpluses and increasing FDI inflows helped China build up a large foreign exchange reserve, enabling it to deal with the crisis with more flexibility. Its fast expanding economy spurred income growth and consequently triggered the the Chinese real-estate market boom (Figure 9).

Figure 9 House price index of 70 large- and medium-sized cities, 2005-09



Source: National Bureau of Statistics.

- 4.7 Thirdly, unlike many advanced economies that entered the crisis with relatively weak structural fiscal positions that were further eroded during the crisis, China had a very good fiscal position. The fiscal deficit-to-GDP ratio of advanced economies is predicted to be as high as 8.9% in 2009 and to remain above 8% in 2010.²⁶ Whereas in China, although the prescribed dosage of the stimulus was very large--accounting for 14% of GDP in 2008--the expected total government deficit is expected to be just about 3% of GDP in 2009. Therefore, China could afford such an expansionary fiscal policy.²⁷
- 4.8 Finally, the Chinese government differs from the West in that it is capable of reacting swiftly to restore its economy. For all the criticisms of its political structure, China has time and again demonstrated to the rest of the world that its political and economic model can be an effective tool in its economic success, taking account of cultural and historical differences.²⁸ In the US, the failure of the Congress to unite

²⁶ "The State of Public Finance Cross-Country Fiscal Monitor: November 2009", *IMF, SPN/09/25*, 3 November 2009.

²⁷ Over the past decade, China maintained a low budget deficit ratio at less than 1%, and even after the stimulus, China's debt would only be around 20% of GDP, much lower than that of the advanced economies whose government debt can be more than 100%. Yu, Y. D. (2010), "Asia: China's Policy Responses to the Global Financial Crisis", *Journal of Globalization and Development*, 1(1): Art.12.

²⁸ Yao, S. J. (2009), "Investment: Think China, not Japan", *The Telegraph*, <http://www.telegraph.co.uk/finance/personalfinance/5357795/Investment-think-China-not-Japan..html>, 20 May 2009.

behind the proposed \$700 billion bailout led the Dow Jones Industrial Average Index to slip 564 points within a day.²⁹ Whereas in China, government reached the agreement of pushing out the RMB 4 trillion rescue plan rapidly and Premier Wen Jiabao had used every opportunity to build up confidence in China, and thereby maximising the positive effects of the stimulus package.

Opportunities Generated by the Crisis for China

- 5.1 Despite the negative impact on the economy, the current financial crisis presented China with a “once-in-a-century” opportunity to speed up its march towards becoming the world’s top economic entity. Due to the current financial crisis, China may have overtaken Japan as the world’s second largest economy in 2009 (Table 2), although some more conservative estimates suggest that China will only overtake Japan in 2010. Given the current trend of growth in China and the US, our estimate suggests that the former will be able to overtake the latter to become the world’s largest economy by 2028, although some more optimistic economists (e.g. Justin Yifu Lin) suggest that this may happen as soon as 2025, or even 2020.³⁰

Table 2 GDP in the top five economies (US \$ trillion)

GDP	US	Japan	Germany	China	UK
2005	12.38	4.55	2.79	2.29	2.24
2006	13.25	4.37	2.9	2.79	2.39
2007	13.84	4.38	3.32	3.47	2.77
2008	14.10	4.91	3.65	4.42	2.65
2009	13.73	5.13	3.16	4.91	2.62
2010 (IMF projection)	13.84	5.00	3.14	5.45	2.62

Source: TradingEconomics, <http://www.tradingeconomics.com>.

Note: Figures of 2009 and 2010 are calculated by the author based on the IMF 2010 Outlook. Japan’s GDP in 2009 would have been \$4.66 trillion if the yen had not appreciated against the dollar by 10% during the year, its nominal dollar GDP is estimated at \$5.13 trillion in 2009. China’s GDP would have easily surpassed that of Japan’s without considering the exchange rate fluctuations. Due to the yen’s sharp appreciation against the dollar and a stable RMB/\$ rate in 2009, China will need another year to overtake Japan as the second largest economy in the world.

²⁹ “Boston College: Failed Bailout Needs Leadership ‘Dream Team’”, *Business & Finance Week, Atlanta*, 18 October 2008), p. 358.

³⁰Lin, Justin (2010), “China will Overtake the US by 2025”, *China Review News*, <http://qb.chinareviewnews.com/doc/1011/9/5/4/101195401.html?coluid=0&kindid=0&docid=101195401&mdate=0112094939>, 13 January 2010.

5.2 Meanwhile, after a series of state supports, Chinese commercial banks have become more healthy and profitable. By the end of 2009, the NPLs/total loans ratio of SOBs had fallen to 1.80% while the same ratio of joint-equity and city commercial banks had also decreased sharply to 0.95% and 1.30% respectively (Table 3).

Table 3 NPLs in Major Chinese Commercial Banks (RMB billion and %)

Years	2003	2004	2005	2006	2007	2008	2009
All Banks	17.8%	13.21%	8.61%	7.09%	6.17%	2.42%	1.58%
	2,440	1,718	1,313	1,255	1,268	560.3	497.3
State-owned Banks	20.1%	15.6%	10.49%	9.22%	8.05%	2.81%	1.80%
	1,853	1,575	1,072	1,053	1,115	421	362.7
Joint-equity Banks	8.1%	5.0%	4.22%	2.81%	2.15%	1.35%	0.95%
	197	143	147	117	86.0	65.7	63.7
City commercial Banks	--	--	7.73%	4.78%	3.04%	2.33%	1.30%
	--	--	84.2	65.5	51.2	48.5	37.7

Sources: CBRC 2009- 2003; Bankscope 2003 and author's calculations.

Notes: NPL = non-performing loans. Figures in % measure the share of NPL in total loans. The values are absolute values of NPLs.

5.3 The strong financial position of Chinese commercial banks has enabled them to provide capital to domestic firms to make foreign acquisitions and deepen their foreign market penetration, as many world-renowned corporations became substantially undervalued during the crisis.

5.4 In June 2009, China's Minmetals took over most of the assets of Australian Oz Minerals for \$1.38 billion and later in August, Sinopec launched China's biggest-ever foreign oil bid for the Canadian oil company Addax, worth about \$7.5 billion.³¹ According to a report of Deloitte LLP, in the first three quarters of 2009, Chinese companies had already made 61 overseas deals worth \$21.2 billion.³² This signified the embarkation of Chinese firms on their new long march into the global economy.

5.5 The high-profile cases of China's automobile industry were also remarkable. Through Sichuan Tengzhong's acquisition of General Motors' Hummer brand in

³¹ Haggett, S., Bergin, T., Jordan, P., Bryan, V. and Sandle, P. (2009), "China's Sinopec to Buy Addax for C\$8.27 Billion", Reuters, <http://www.reuters.com/article/idUSTRE55N59I20090625>.

³²Trials and Tribulations of Foreign Mergers and Acquisitions, http://www.chinadaily.com.cn/bw/2009-12/28/content_9235097.htm, *ChinaDaily*, 28 December 2009.

October 2009, China gained a foothold in the North American car market.³³ This was followed by Geely Automobile, a 12-year-old Chinese carmaker, buying the 82-year-old luxury Swedish brand, Volvo Cars, from Ford, and Beijing Automobile Works' (BAIC) purchase of the production equipment and intellectual property of Saab in December 2009.³⁴

- 5.6 In addition, the crisis and subsequent declining exports forced Chinese companies to move up the technological ladder. Firms that had been less competitive and environmentally unfriendly were driven out of business during the crisis. Therefore, to maintain their sustainable and healthy growth in the future, many firms have rebalanced their geographical distribution, increased R&D investment and improved on the efficient usage of resources and energy.³⁵ Such a gradual shift away from its heavy reliance on low-cost exports will be tough but it will help China upgrade its industrial structure, laying a more favourable foundation for post-crisis competition.
- 5.7 Another potential impact of the crisis is that it helped China mitigate problems associated with regional inequalities. Over the past thirty years, preferential policies towards the coastal provinces enabled them to achieve a much higher growth rate than the inland and western regions. During the crisis, however, many firms in the coastal region collapsed because of the sharp shrinkage in exports. The government also increased its investment in central and western regions in the meantime, giving the inland regions a good opportunity to catch up faster in economic development.
- 5.8 In 2009, the fixed assets investment in eastern, central and western regions rose by 23.9%, 36% and 35% respectively while the industrial production measured in value-added increased by 9.7%, 12.1% and 15.5% respectively over the same period. This was the first time that the two inland regions had been able to outperform their eastern counterparts in investment and industrial production.
- 5.8 Other advantages and opportunities brought about by the crisis include reduced commodity prices which should benefit China's next phase of industrialisation and

³³ Simon, B, and Waldmeir, P. (2009), "GM Sells Hummer to China Industrial Business", *Financial Times, London (UK)*, 10 October 2009, pg.9.

³⁴ Dolan, M. and Shirouzeu, N. (2009), "Ford Agrees to Terms for Sale of Volvo Unit", *Wall Street Journal (Eastern Edition), New York, N. Y.*, 24 December 2009, pg. B.1.

³⁵ Yao, S. J. (2009), "China's Model Creates Economic Miracle", *China Daily*, http://news.xinhuanet.com/english/2009-10/18/content_12259342.htm, 18 October 2009.

urbanisation as it has become the largest consumer and importer of many raw materials. In 2009, crude oil imports rose 14% to 203.8 million tons, cementing China's place as the second-largest importer after the US. China's import of iron ore also rose by 42%, reaching 627.8 million tons.³⁶

5.9 In 2009, China was the only one of the world's 10 largest economies that was still expanding.³⁷ Along with India and Brazil, China is rebalancing the global geopolitical and economic power from the West to the East.³⁸ China is becoming more engaged with the IMF and other international organizations.³⁹ It agreed to buy \$50 billion worth of bonds, as part of a planned increase of \$500 billion in IMF resources.⁴⁰ The G20 is set to exert more influence on world economies and political affairs than the G8 and China has become the biggest and most powerful member among the emerging economies in the G20.

5.10 The increased international status of China was also reflected in the 2009 Copenhagen Summit. China has committed to reducing carbon dioxide emission intensity by 40-45% below the 2005 level by 2020.⁴¹ As economic growth in China is largely based on the primary industry, it was easily blamed for being insincere during the summit.⁴² However, the stand taken by China towards all participating countries showed exactly the opposite. Not only had China been willing to set an example in catering to demands for a difficult emission concession target for other poorer developing nations, but also through its action, China had leveraged on its position to bring together several major countries to an agreement that had almost failed. China now places itself at the centre of the international climate game and it will play a much more important role than it has ever before.

³⁶ Wu, J. R., 11 January 2010.

³⁷ The world's top 10 economies are based on the IMF 2008 statistics and their growth rates projected by IMF in 2009 are: US (-2.6%), Japan (-6%), China (8%), Germany (-6.2%), France (-3%), UK (-4.2%), Italy (-5.1%), Russia (-6.5%), Spain (-4.0%) and Brazil (-1.3%).

³⁸ Yao, S. J. and Zhang, J. (2009).

³⁹ Batson, A. (2009), "World News: Beijing Seeks More Influence in IMF", *Wall Street Journal (Eastern Edition)*, 3 July 2009, p. A. 8.

⁴⁰ Batson, A. (2009), "World News: China Willing to Buy as Much as \$50 Billion in IMF Bonds", *Wall Street Journal (Eastern Edition)*, New York, N. Y., 6 June 2009, pg. 7.

⁴¹ "Copenhagen Deal: Key Points", *BBC News*, <http://news.bbc.co.uk/2/hi/science/nature/8422307.stm>, 19 December, 2009.

⁴² Khor, M. (2009), "Blame Denmark, not China, for Copenhagen Failure", *The Guardian* <http://www.guardian.co.uk/commentisfree/cif-green/2009/dec/28/copenhagen-denmark-china>, 28 December 2009.

Challenges for China's Future Development

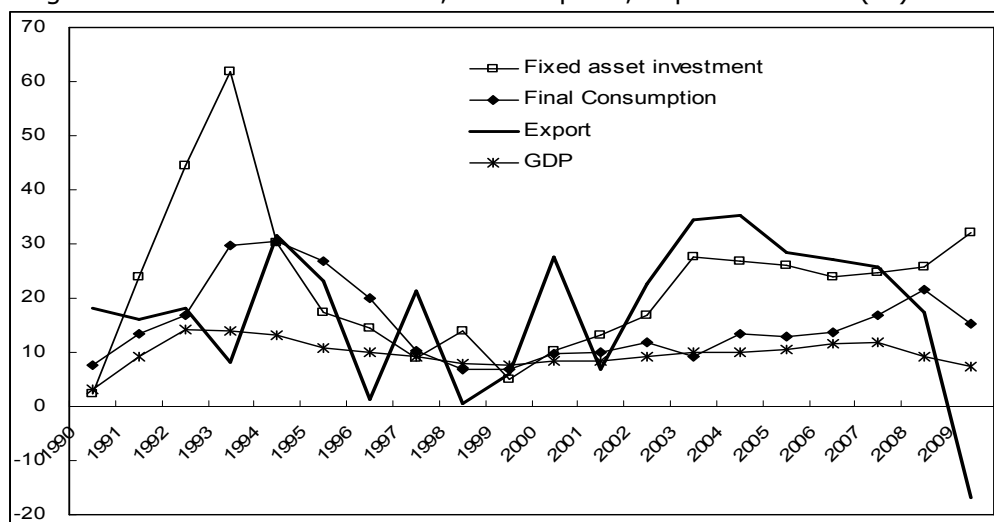
6.1 The global economic crisis has forced China to shift its growth dependency on exports towards domestic consumption. Over the past decades, China's growth had been primarily driven by investments and exports, rather than consumption. This trend became more distinctive from 2000 (Table 4). GDP growth has been more closely related to the sharp rise in fixed asset investment (FAI) and exports whereas the growth in final consumption has remained relatively flat (Figure 10).

Table 4 Share of FAI, final consumption and export to GDP (%), 2000-2008

	(FAI) / GDP	Export / GDP	Net export / GDP
2000	33.2	20.8	2.4
2001	33.9	20.1	1.8
2002	36.1	22.4	1.6
2003	40.9	26.7	1.9
2004	44.1	30.7	1.3
2005	48.5	34.2	4.6
2006	51.9	36.6	6.7
2007	53.4	36.3	7.8
2008	57.5	33.4	6.9
2009	67.0	24.4	4.0

Source: China Statistical Yearbook, various issues, National Bureau of Statistics.
Note: FAI: Fixed Asset Investment.

Figure 10 Growth of investment, consumption, export and GDP (%) 1990-09



Source: China Statistical Yearbook, various issues, National Bureau of Statistics.
Note: Final consumption is based on Total Retail Sales of Consumer Goods; the 2009 figures are based on first three quarters.

- 6.2 As part of the stimulus effort, China increased its already high level of FAI in 2009. According to the *National Bureau of Statistics*, FAI in 2009 increased by 30.1% from 2008 while the growth in personal consumption was just 15.5%. Regardless of the global financial crisis, China's current investment- and export-driven growth pattern is unsustainable.⁴³
- 6.3 China's large trade surplus with the rest of the world has been criticised by its trade partners, especially the US and the EU. These trading partners have pushed China to let the RMB appreciate against the dollar as a way of reducing its trade surplus, but due to the financial crisis, the RMB has been tightly pegged with a depreciating dollar for about two years. This has resulted in the rising number of trade conflicts and anti-dumping cases against China's exports. Trade measures have increasingly been aimed at Chinese goods, including a decision by the US to place duties on China-made tyres and steel pipes in November 2009 and the extension of EU import duties on shoes from China and Vietnam in late December 2009.⁴⁴
- 6.4 The RMB may have to appreciate slightly in 2010 to prevent any further trade conflicts. In reality, however, the exchange rate has been used as a political rather than an economic argument against China due to growing fears of its rising influence on the world economy and politics. Whether the RMB will be allowed to appreciate or not, China will still be able to achieve a sizeable trade surplus in the coming years due to its international competitiveness in manufacturing.
- 6.5 Environmental degradation is another threat to China's sustainable development. While people are benefiting from significant improvements in material living standards, pollution of the water system, air and soil is causing damage to their health and the environment, let alone climate change. The phenomenal increases in the production and consumption of motor vehicles, electricity, steel, coal, cement and the like have created, and will continue to, create huge damage to the environment. How the Chinese government and firms address these concerns will

⁴³ Yu, Y. D. (2010), "Asia: China's Policy Responses to the Global Financial Crisis", *Journal of Globalization and Development*, 1(1): Art.12.

⁴⁴"Beijing Denounces US Duties on Chinese-Made Pipes", *Reuters*
<http://www.nytimes.com/2009/11/07/business/global/07trade.html>, 6 November 2009.

not only affect China's image in the outside world but also influence its own people's confidence in the country's growth and prosperity.

- 6.6 The financial crisis has caused another potential problem. A significant increase in unemployment might hinder China's future development as well. The government stimulus package might be unable to generate enough employment even it did prop up GDP growth. The official urban registered unemployment rate rose to 4.3% in the first half of 2009, but the rate estimated by independent researchers was as high as 9%.⁴⁵
- 6.7 Rising unemployment directly threatens social stability and puts further pressure on the state finance. Thus far, the Ministry of Labour and Social Security estimates that some 10 million migrant workers have been forced to return home while over three million new university graduates are unlikely to find jobs.⁴⁶ Despite some of the positive signs of recovery in terms of GDP growth, share prices and international trade from the second half of 2009, high and rising unemployment in many developed nations would prolong the full recovery of the world economy in the next two years.
- 6.8 In addition, income inequality will continue to be one of the biggest threats to the country's future development. In 2009, urban per capita disposable income increased by 9.8% but rural per capita net income by just 8.5%. Maintaining an acceptable level of social stability is crucial to China in promoting economic growth. The "Xinjiang riots" in July 2009 and the "Tibet unrest" the year earlier have called for Chinese government's urgent response to the under-development issue of ethnic minority-concentrated regions. Such tensions should be carefully addressed by the Chinese authority so as to achieve its goal of building up a "harmonious society."

2010: Managing Financial Risks

- 7.1 Despite a significant recovery, the global financial environment in 2010 will still be weak. The Chinese banking industry remained relatively stable during the crisis, but

⁴⁵ Yao, S. J. and Zhang, J. (2009), "World Financial Crisis and Implications on China", Paper prepared for presentation at the international conference on the world financial crisis, University of Nottingham Ningbo Campus, 10-11 November.

⁴⁶ "China: Unemployment could Cost Beijing Dear", *Oxford Analytical Daily Brief Service*, 1, 5 January 2009.

continued interest rate adjustments and a sharp drop in foreign demand for Chinese goods impose greater downward pressure on their future operation. The ICBC posted a 2.9% rise in first-half year net profit, much lower than the 57% achieved over the same period in 2008.⁴⁷

- 7.2 Meanwhile, to support the government's stimulus, new bank loans surged in 2009, totalling more than RMB 9 trillion, doubling the amount in 2008.⁴⁸ ICBC's new loans in the third quarter more than doubled to RMB 144 billion from a year earlier while BOC issued RMB 388 billion worth of new loans in the same period, more than eight times it lent a year earlier.⁴⁹
- 7.3 Increased bank credit have directly induced another surge in housing prices. The housing bubble poses a dangerous threat to China's future growth. House prices in Beijing rose by 73% within one year. In China as a whole, it rose by 24%. In early 2010, house prices in Hainan Island rose by 30% in one single month.
- 7.4 The rising house prices have two serious consequences on the Chinese society. First, the housing market bubble may trigger a financial crisis within China if it is not contained as a bursting of the bubble would increase the amount of bank non-performing loans, leading to a crisis similar to that which took place in the US in 2007. Second, rising house prices would exclude low-income urban residents and rural migrant workers from the housing market. As a result, the country will become even more polarised and divided. Economic exclusion of the poor and low-income people is a threat to China's long term prosperity and social harmony.
- 7.5 The over-expansion of bank loans did not translate into correspondingly larger profits for banks as the government slashed lending rates faster than deposit rates at the end of 2008 to cope with the crisis. The net profits of ICBC, BOC and CCB in the third quarter of 2009 only rose by 19%, 19% and 18.6% respectively compared with the same period in 2008.

⁴⁷ "International Finance: ICBC Profit Rises, Lending to Slow", *Wall Street Journal (Eastern Edition)*, New York, N. Y., 21 August 2009, pg. C. 2.

⁴⁸ Cookson, R. (2009), "Prepare for Treacherous Ride as Risk Multiply in China", *Financial Times*, London (UK), 6 January 2010, pg. 20.

⁴⁹ Anderlini, J. (2009), "China's Banks See Rise in Net Profits", *Financial Times*, London (UK), 30 October 2009, pg. 17.

- 7.6 Although Beijing responded by enforcing several policies to limit speculative investments, reiterating a minimum down-payment ratio of 40% for everyone except first-time buyers, and ordering banks to rein in credit to property developers,⁵⁰ the outlook on Chinese banks is less certain as the huge jump in loans is unlikely to be sustained, not to mention the potential risk posed by bad debts and asset bubbles.⁵¹
- 7.7 Worse still, since the end of 2008, cash-strapped foreign banks had started to withdraw from the Chinese banks when the three-year lockup period expired. UBS sold its entire holding of a 1.3% BOC stake on 31 December 2008. This was quickly followed by BOA and RBS, which trimmed their 2.5% stake in CCB and 4.3% stake in BOC respectively in January 2009.⁵² Instead of relying on foreign expertise to build a world-class banking system, the Chinese banks need to map out plans for foreign divestment and to prepare for possible liquidity problems in the coming years.
- 7.8 The surge in China's lending poses substantial risks to the banks while excess liquidity might fuel speculation and lead to the formation of asset bubbles. Although the State Council has already adopted policies to tighten liquidity and new loans growth is expected to drop to RMB 7 trillion in 2010, the upward pressure on both inflation and interest rates due to the global economic recovery may still impose huge pressure on the stability of the Chinese financial system.⁵³

⁵⁰ Anderlin, J (2009), "Soaring Chinese House Prices Increase Fears of Property Bubble", *Financial Times, London (UK)*, 15 January 2010, pg.5.

⁵¹ "China's Surging Loans Boost Concern Economy Risks Asset Bubbles", *Bloomberg News*, http://www.bloomberg.com/apps/news?pid=20601087&sid=alY7X6_H9XXE, 9 July 2009.

⁵² Kjetland, R. (2009), "International Finance: RBS Is Weighing the Sale of Bank of China Stake", *Wall Street Journal, (Eastern Edition), New York*, 9 January 2009, p. C. 2.

⁵³ Cookson, R. (2009), "Prepare for Treacherous Ride as Risk Multiply in China", *Financial Times, London (UK)*, 6 January 2010, pg. 20.