



# China Economic Update

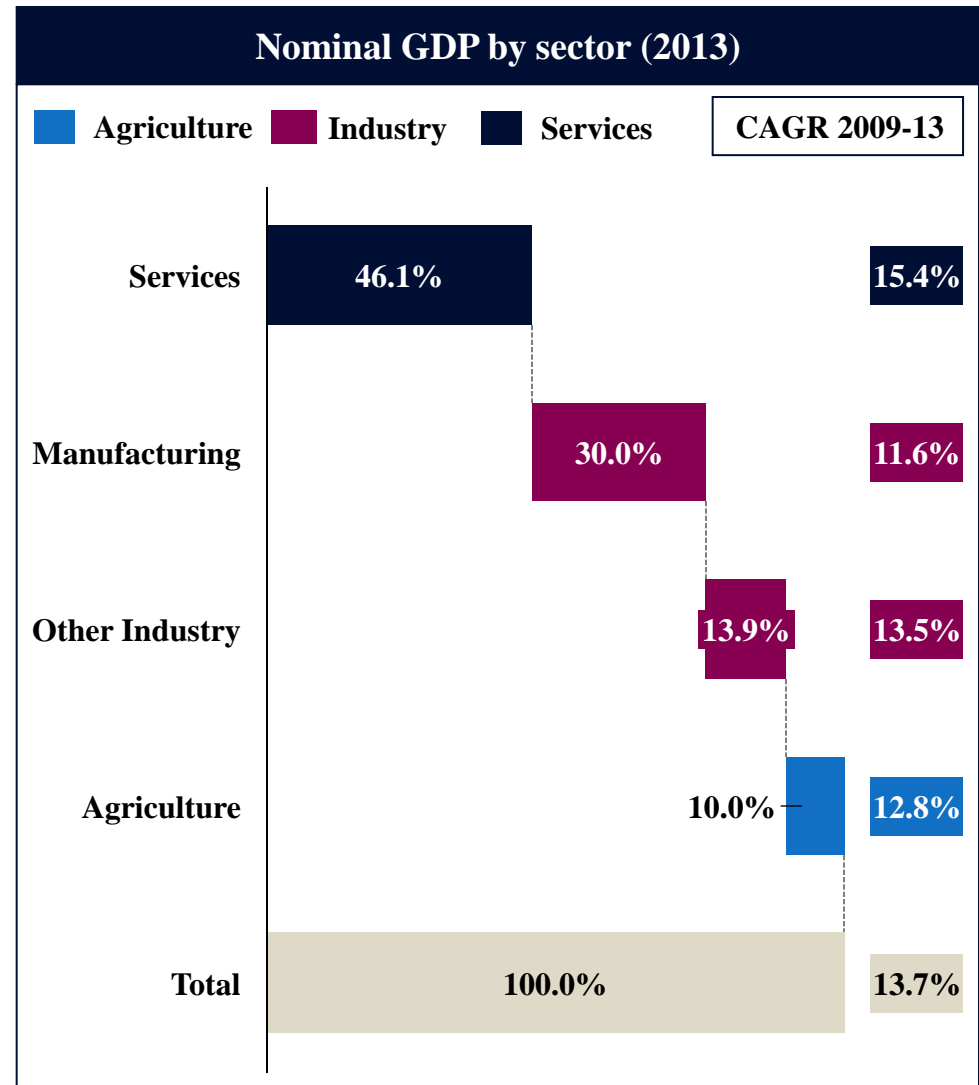
## QNB Group

September 2014

# China – Overview

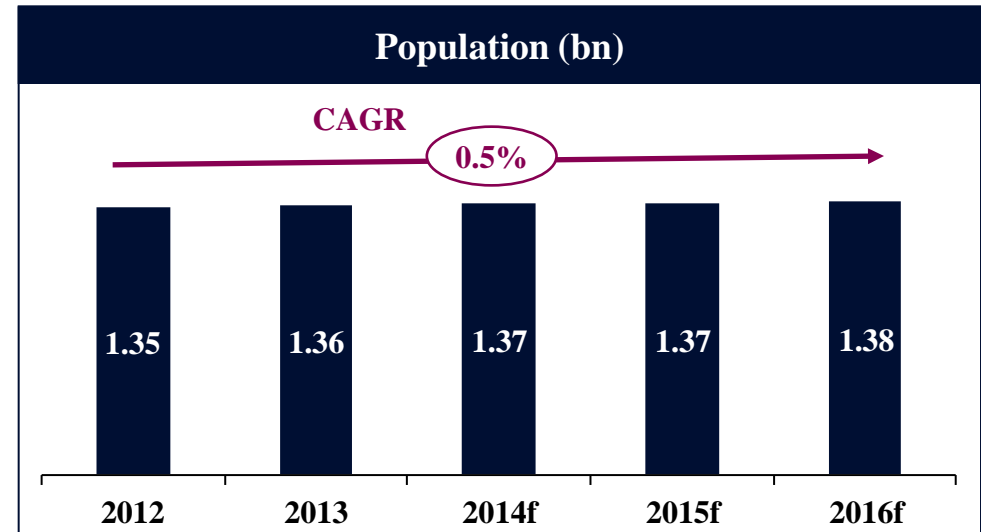
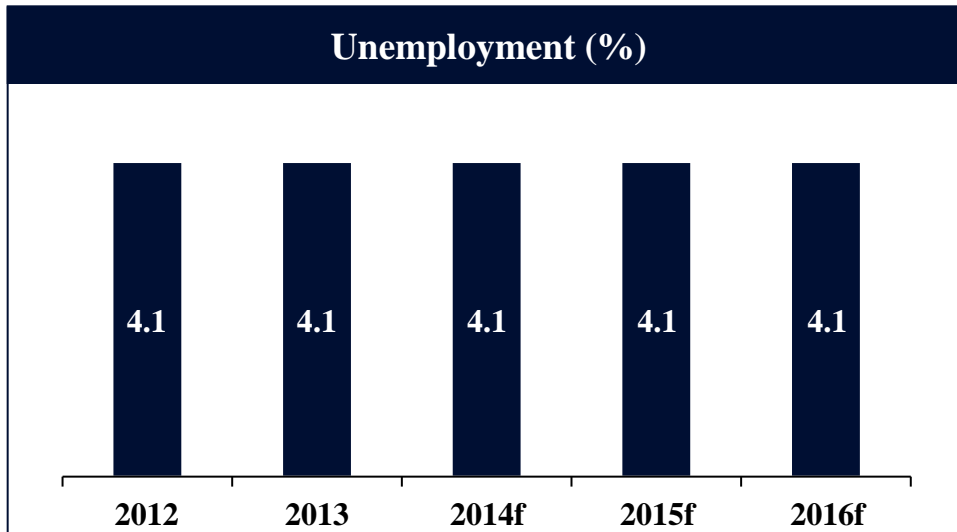
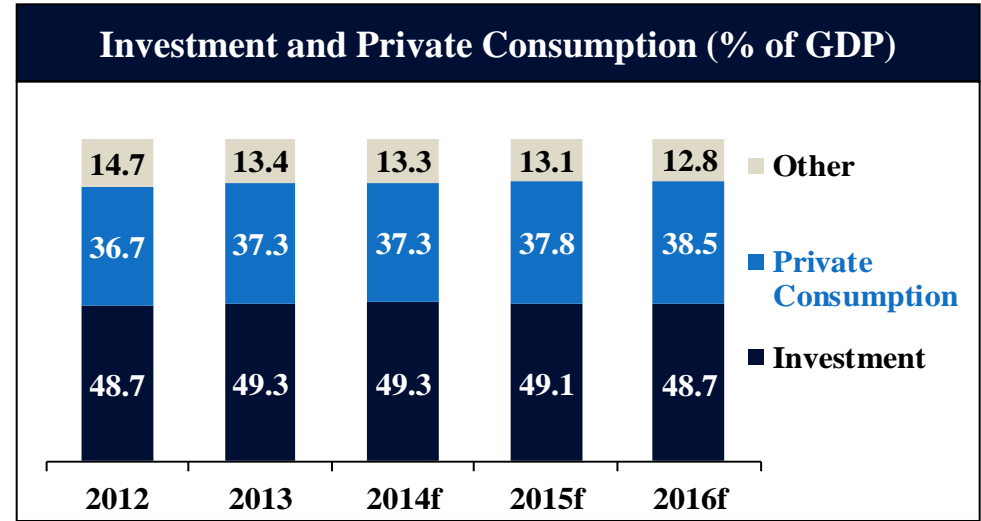
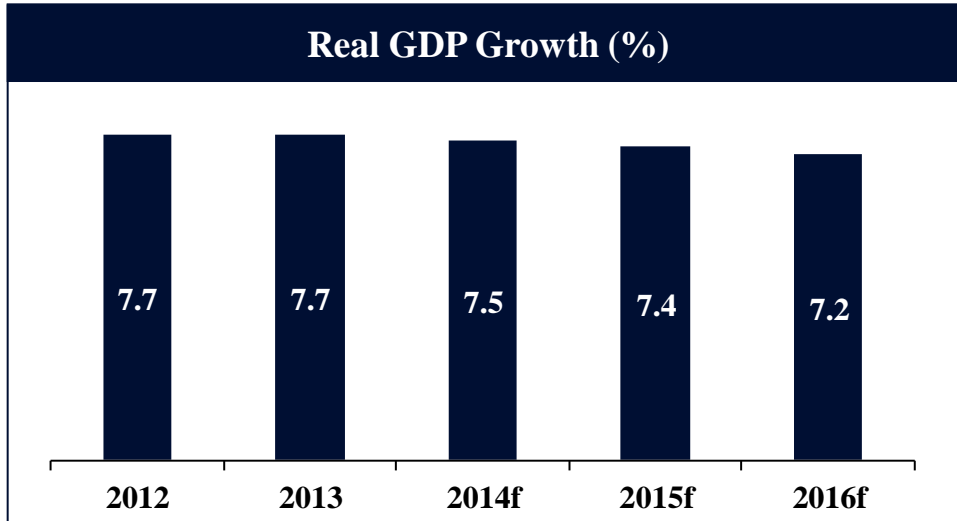
China has become the world's second largest economy after three decades of double digit growth, lifting over 500m people out of poverty and transforming itself into the world's factory, but over-investment has led to current excess capacity

Overview Data (2013)	
GDP (bn USD)	9,181
% GDP related to Services	46.1
Real GDP Growth (%)	7.7
Per Capita GDP (k USD, PPP)	9.8
CPI Inflation (%)	2.6
Current Account Balance (% of GDP)	2.1
FX Reserves (months of import cover, end-2013)	19.3
Exchange Rate (USD:CNY, end-2013)	6.1
Fiscal Balance (% of GDP)	-1.9
Government Debt (% of GDP)	22.4
Broad Money Growth (%)	13.7
Banking Assets (% of GDP)	268
3-Month Interbank Rate (%)	5.6
Population (m)	1,361
Population aged 15-64 Years (% share)	73.1
Population growth (%)	0.5
Unemployment (%)	4.1
Religion (% Muslim)	1.8
Doing Business Rank out of 189	96
Competitiveness Rank out of 148	29
Moody's Rating (Long-term FX debt)	Aa3



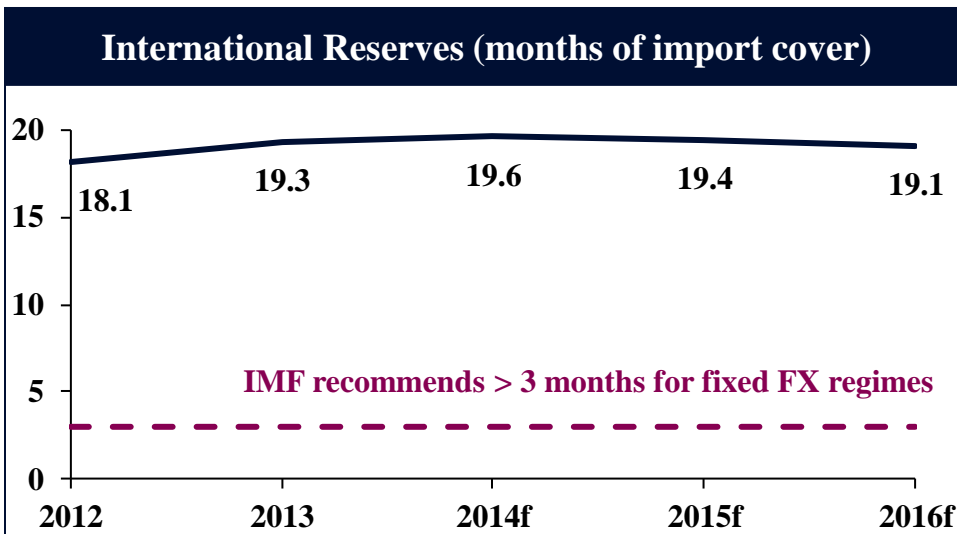
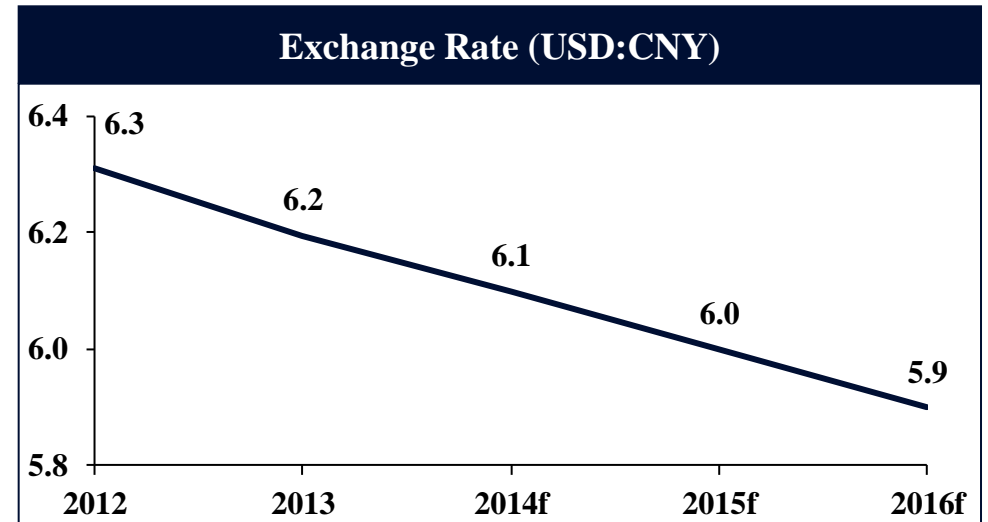
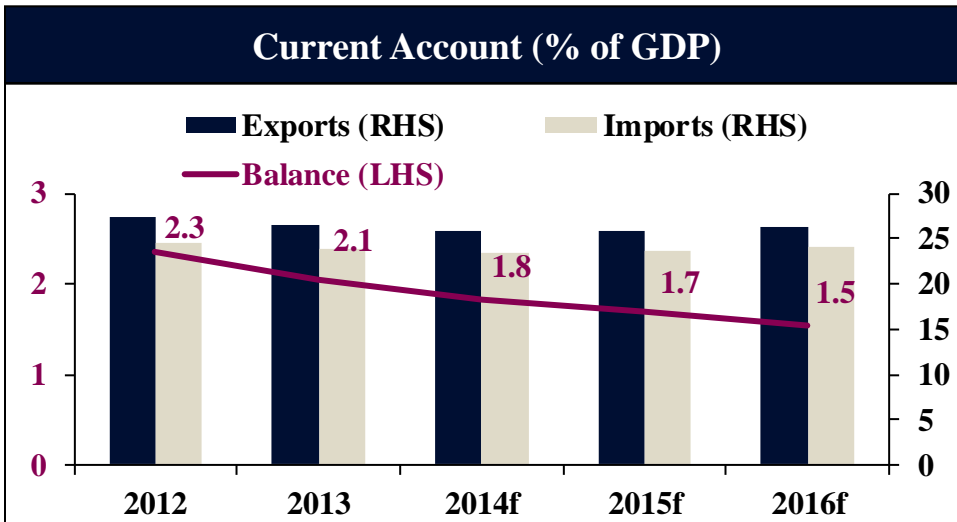
# China – GDP Growth

Growth is slowing, with the authorities guiding the economy away from investment and manufacturing towards domestic private consumption and services; unemployment should remain stable over 2014-16 on slow population growth



# China – Balance of Payments

The current account surplus should narrow with the shift from an export-focused to a consumer-based economy; the exchange rate is expected to appreciate, stabilizing international reserves; China is the largest exporter in the world

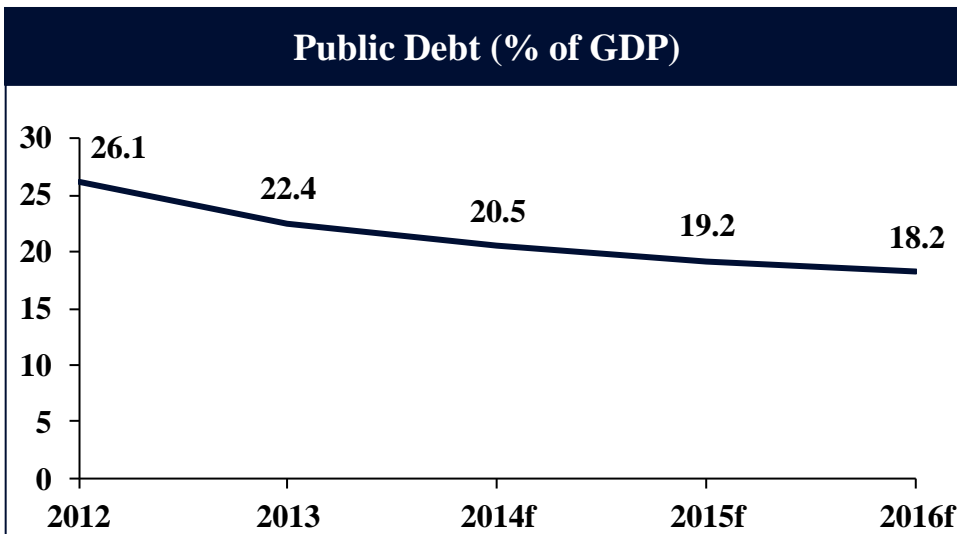
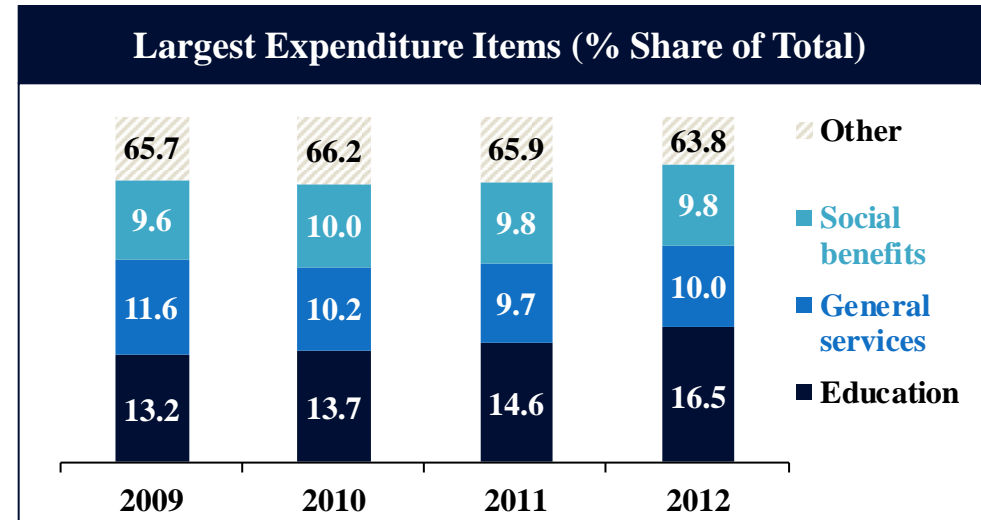
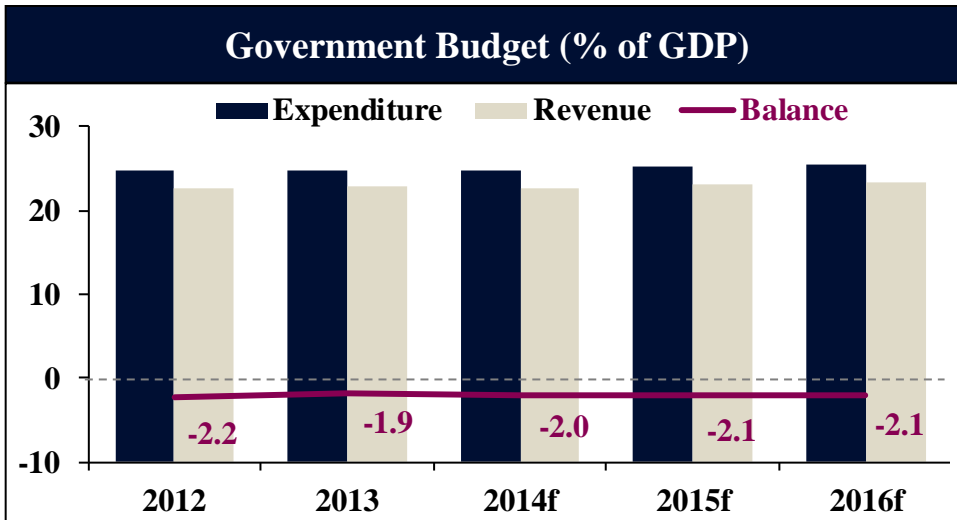


### Directions of Trade (2013)

Exports		Imports	
Destination	(bn USD)	Source	(bn USD)
Hong Kong	385	Korea	183
United States	369	Japan	162
Japan	150	United States	147
Korea	91	Germany	94
Germany	67	Australia	92

# China – Fiscal Policy

Fiscal policy aims to support economic growth while increasing education spending and other social benefits; the deficit is expected to widen marginally on a government stimulus to meet growth targets and debt to decline over the medium term

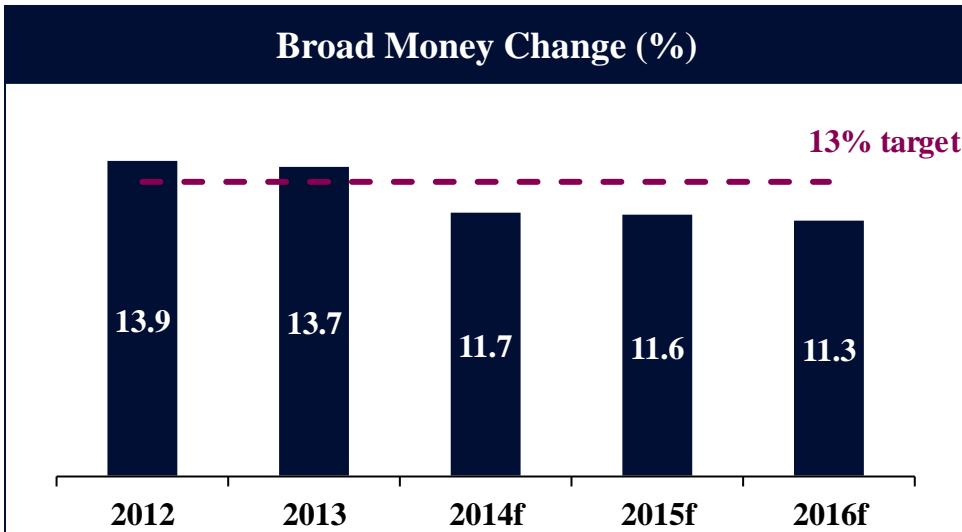
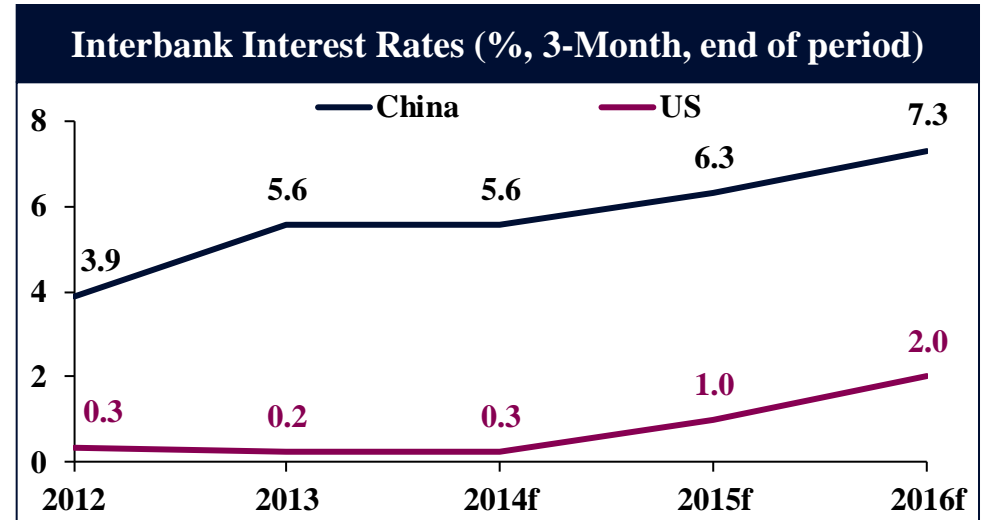
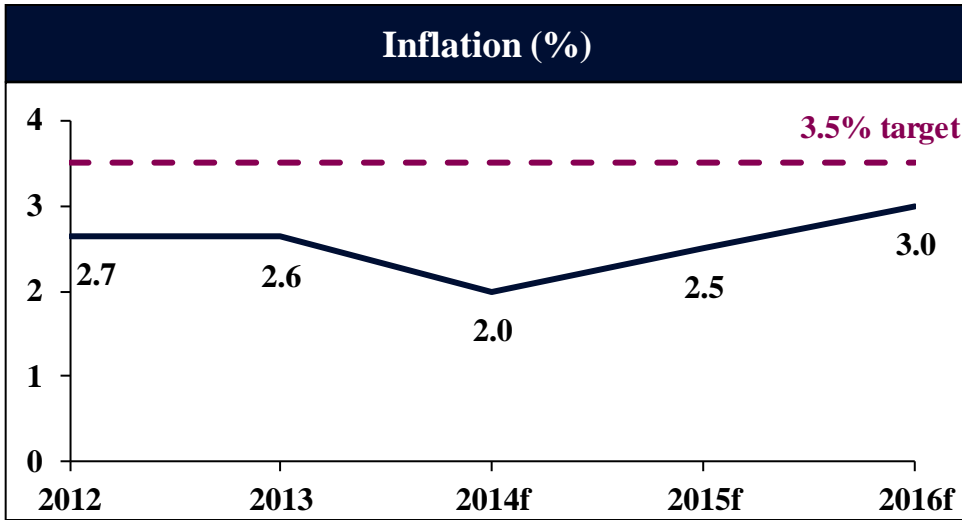


### Fiscal Policy

- Fiscal policy aims to support economic growth while increasing education spending and other social benefits
- Expenditure is expected to rise to 25.5% of GDP in 2016 (24.8% currently), with an increasing emphasis on education to support the transformation towards a more services-oriented economy
- The fiscal deficit is projected to widen marginally owing to a government stimulus to meet growth targets
- Public debt is low and should fall gradually as a share of GDP over the medium term

# China – Monetary Policy

Monetary policy targets both inflation and broad money growth; inflation is below target (~2.0%), leaving room for further monetary stimulus; interest rates are rising on the liberalization of lending rates with deposit rates to follow

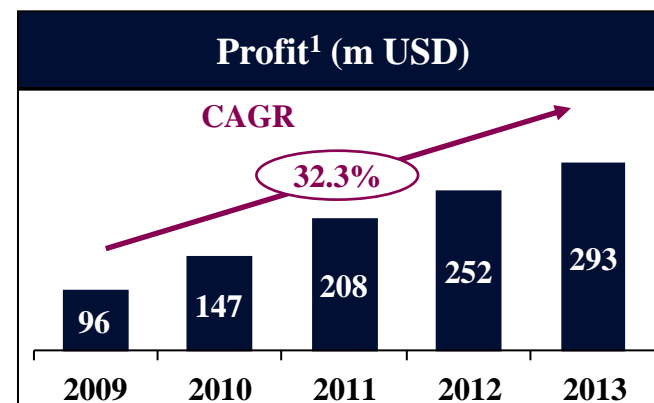
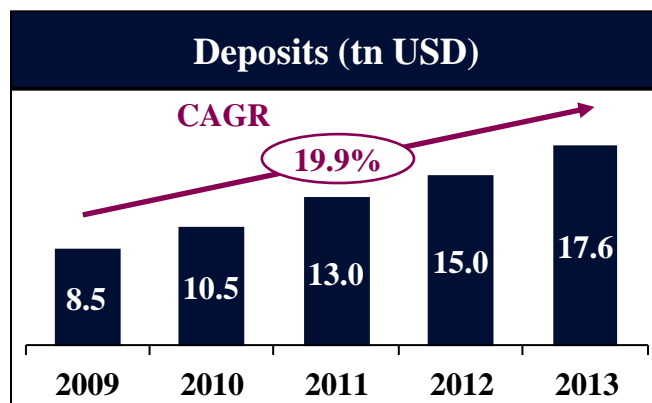
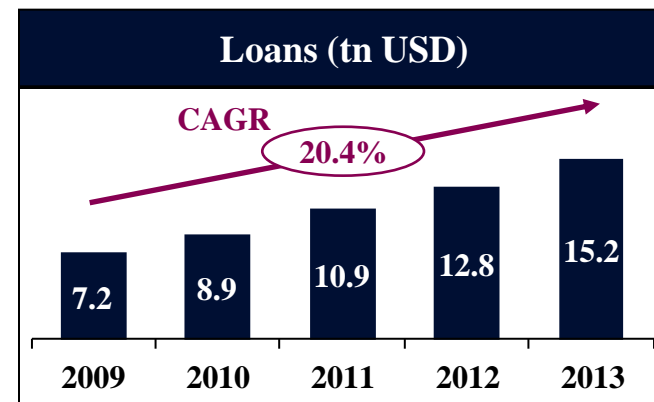
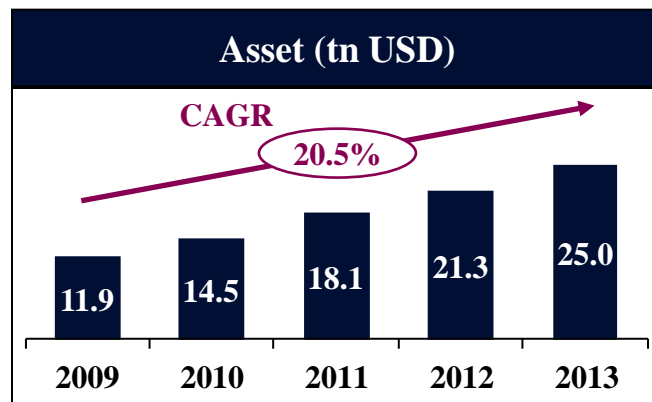
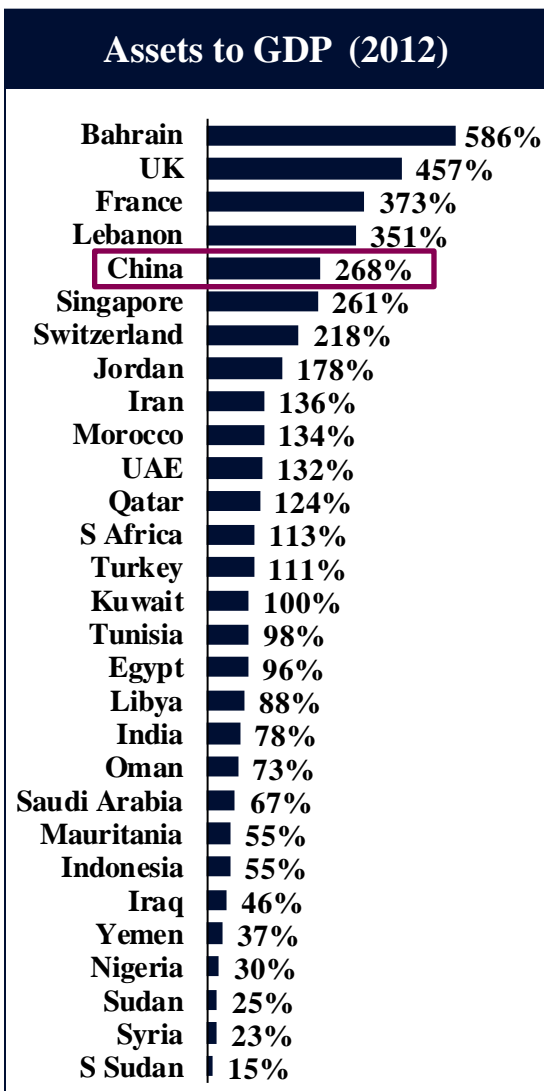


### Monetary Policy

- Monetary policy targets inflation of 3.5% and broad money growth of 13%
- Interest rates are rising on the liberalization of lending rates while deposit rates are likely to be liberalized in the near future
- Broad money growth and inflation are currently below target, leaving room for additional monetary stimulus
- Tight controls in the official banking sector have led to a rapid expansion of a large shadow banking system, which accounts for around one third of total domestic credit

# China – Banking Sector Overview

Growth in the banking sector has been rapid owing to the strong economy, but expansion is slowing in line with lower GDP growth, high asset penetration and controls to limit lending to certain sectors, including through shadow banking

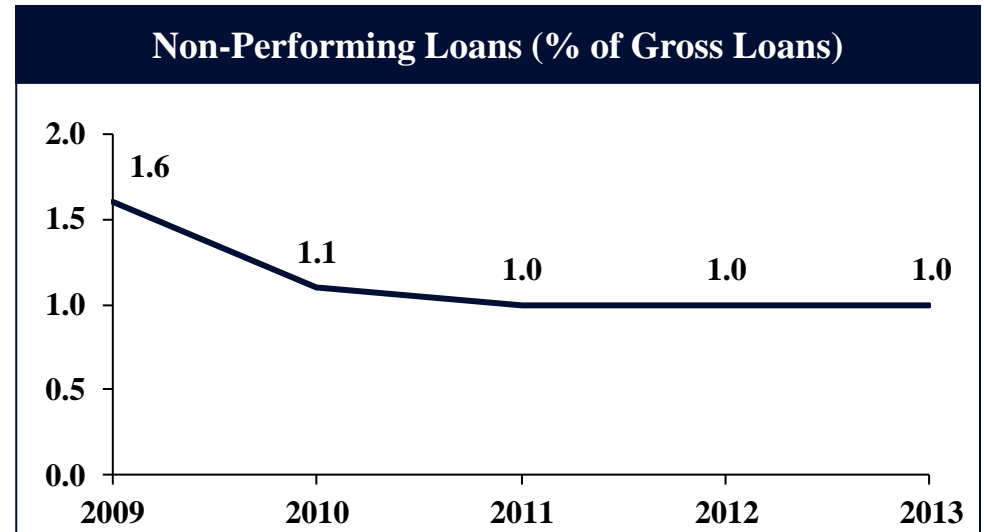
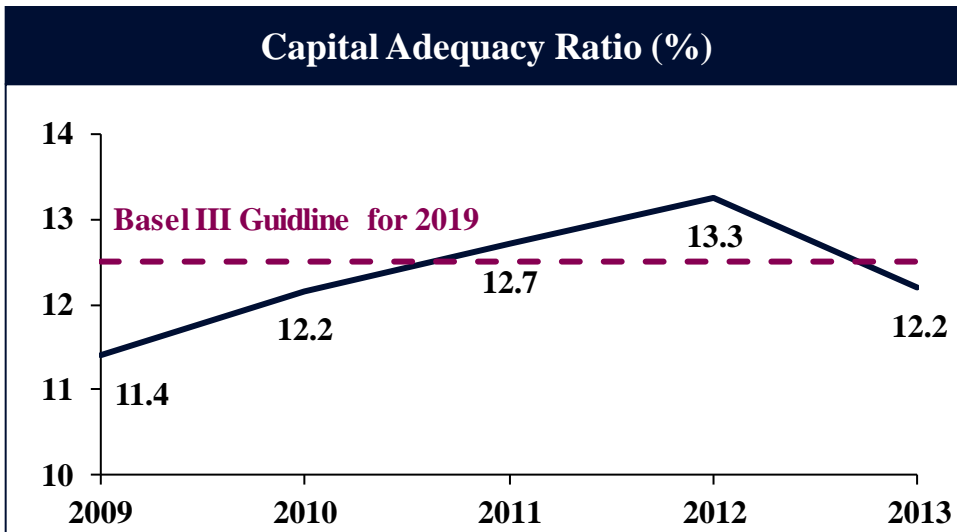
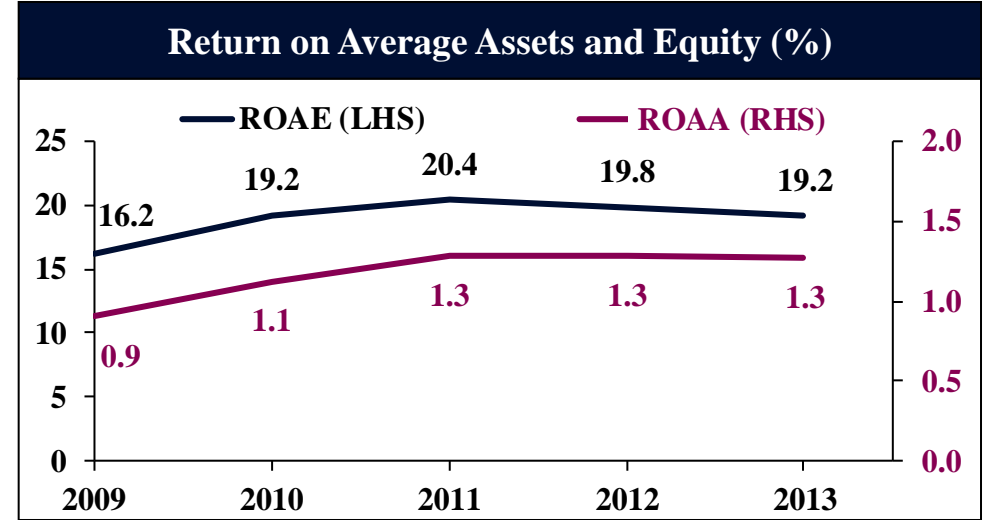
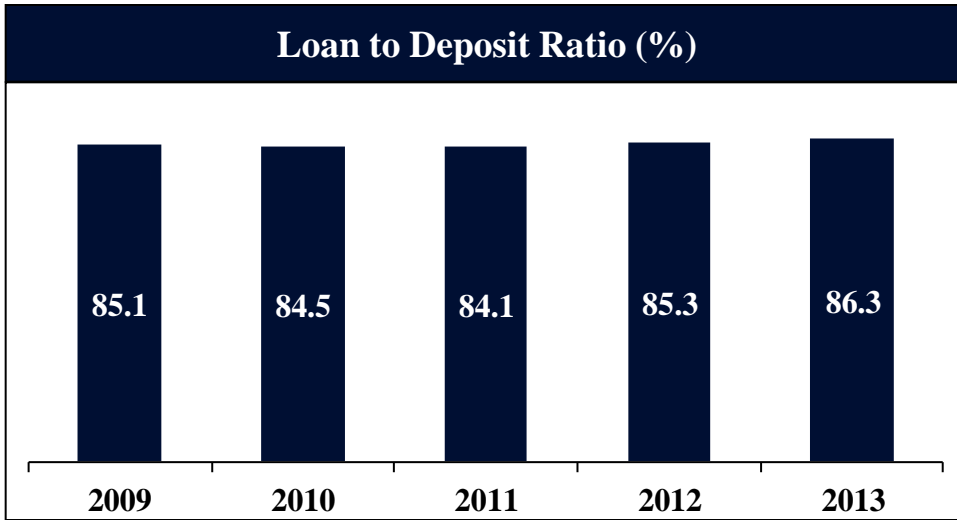


### Analysis

- Lending has grown faster than deposits over the last five years, due to caps on deposit rates
- Shadow banking has grown rapidly over the last few years to avoid limits on deposit rates leading to large unrecognized NPLs

# China – Banking Sector Ratios

The loan-to-deposit ratio has been rising as deposit growth is limited by the cap on deposit rates; profitability is moderate; capital buffers are low; NPLs are low although this masks high unrecognized NPLs in shadow banks





# China – Banking Sector Competitor Analysis

The top five banks are state-owned and account for over half of total assets; ICBC is the largest bank in the world; profitability is high among the top 5

**Financials for Top 5 Banks (2013)\***

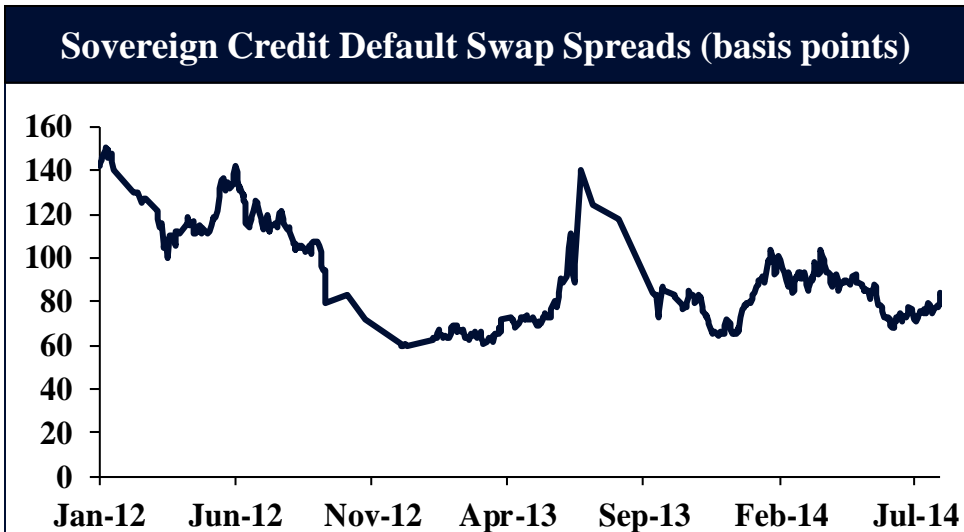
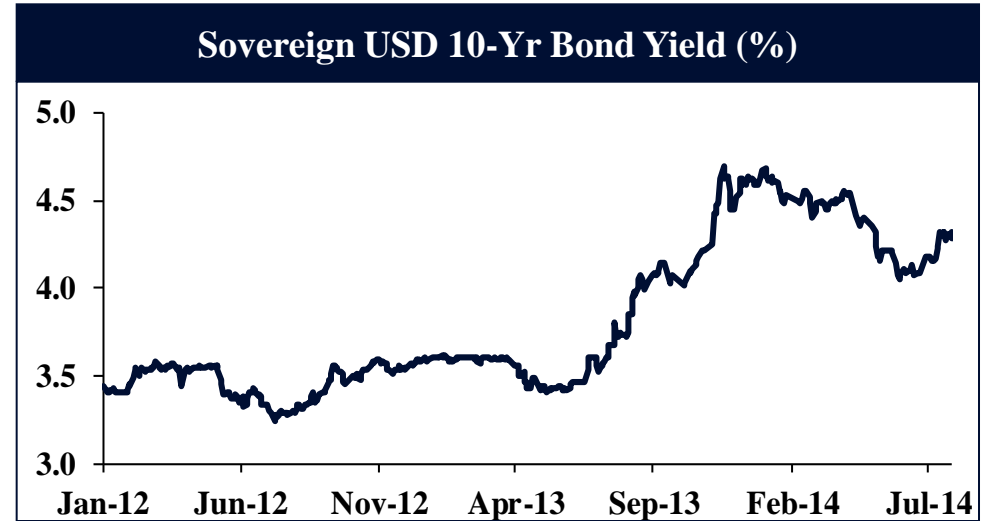
	Market Share by Assets (%)	Net Income (bn USD)	Equity (bn USD)	ROE (%)	Assets (tn USD)	ROA (%)	Loan to Deposit Ratio (%)	Non-Performing Loans (%)
<b>Industrial &amp; Comm. Bank of China (ICBC)</b>	<b>14.8</b>	<b>43.1</b>	<b>209.5</b>	<b>20.6</b>	<b>3.1</b>	<b>1.4</b>	<b>68</b>	<b>0.9</b>
<b>China Construction Bank Corporation</b>	<b>12.0</b>	<b>35.3</b>	<b>176.1</b>	<b>20.0</b>	<b>2.5</b>	<b>1.4</b>	<b>70</b>	<b>1.0</b>
<b>Agricultural Bank of China Limited</b>	<b>11.4</b>	<b>27.2</b>	<b>138.4</b>	<b>19.7</b>	<b>2.4</b>	<b>1.1</b>	<b>61</b>	<b>1.2</b>
<b>Bank of China Limited</b>	<b>10.9</b>	<b>26.8</b>	<b>157.6</b>	<b>17.0</b>	<b>2.3</b>	<b>1.2</b>	<b>75</b>	<b>1.0</b>
<b>China Development Bank Corporation</b>	<b>5.7</b>	<b>10.0</b>	<b>79.2</b>	<b>12.7</b>	<b>1.2</b>	<b>0.8</b>	<b>N/A</b>	<b>0.3</b>

## Analysis

- There are around 170 operational banks in China with a high level of government ownership and low levels of foreign participation
- The top 5 banks are all state owned and account for 54.9% of total assets; ICBC is the largest bank in the world by assets
- ROE and ROA are relatively high in comparison to the rest of the world; caps on deposit rates keep down funding costs and high state ownership benefits the top banks in particular with preferential access to government business
- However, profitability is likely to continue falling going forward owing to slowing growth; higher provisioning (there are high levels of unrecognized NPLs); higher funding costs as deposit rates are liberalized
- Shadow banking is estimated to have grown by over 40% in 2013 to around 196% of GDP as businesses and individuals seek higher interest rates for their savings as deposit rates are capped in the traditional banking system
- The planned opening of the banking sector to greater competition from the private sector could compress net interest margins as the authorities attempt to bring shadow banking into the regulated sphere, including some low-quality assets, which could lead to higher provisioning

# China – Financial Markets

Concerns about slowing growth have led to poor performance in the Shanghai stock exchange amidst higher bond yields; fundamental risks are viewed as low with narrowing CDS spreads and a stable ratings outlook



### Sovereign Ratings (July 2014)

	Rating	Outlook
Moody's	Aa3	Stable
Standard & Poor's	AA-	Stable
Capital Intelligence	A	Stable
Fitch	A+	Stable

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