

## CHINA

## 2003: A YEAR OF STRONG GROWTH

Despite the outbreak of SARS and the occurrence of numerous natural disasters, China achieved rapid economic growth in 2003. The GDP growth rate reached 9.1%, 1 percentage point higher than in 2002. More significant was the accelerating growth in the first and last quarters, with a GDP growth rate of 9.9%. The main driving force was soaring investment.

Investment has been the dominant economic growth engine in China. National fixed assets investment (FAI) rose 26.7% in 2003, against 16% in 2002 and the highest expansion since 1996. State-owned and other FAI rose 28.4%. The FAI/GDP ratio rose to 48%. Capital formation should roughly contribute over 80% of GDP growth in 2003. The rapid investment growth is partly attributable to local governments' political interests. Investment under central government for state-owned and other investment decreased by 4.6% in 2003, while local projects surged 36.2%.

Total actual FDI was US\$53.5 billion in 2003, a rise of 1.4% from 2002 but 11 percentage points lower than the rise in 2002. Contracted foreign investment, an indicator of future trends, rose 39% year-on-year to US\$115 billion.

In 2003, China's exports accelerated significantly, rising 34.6%, 12.3 percentage points higher than in 2002. This rapid growth was attributed to global economic recovery, the RMB's relative depreciation and the

effect of China's entry to the WTO. Multinational companies played a very important role in exports, accounting for 54.8% of total exports.

China's import growth rate was extraordinarily rapid in 2003, at 39.9%, against 21.2% in 2002. This growth rate outpaced the export growth rate. Therefore, the trade surplus shrank sharply to US\$25.5 billion in 2003, dropping 16% from 2002. The rapid import growth was supported by the tariff cut provided for in the WTO agreement and increasing domestic demand.

Owing to robust FDI inflows and a higher trade balance for many years, China's foreign reserves accumulated quickly, registering US\$403.3 billion at the end of 2003.

Total retail sales of consumer goods grew by 9.1% in real terms, slightly higher than in 2002. Both communication products and vehicle sales showed explosive growth again, registering 70.9% and 68.5% respectively.

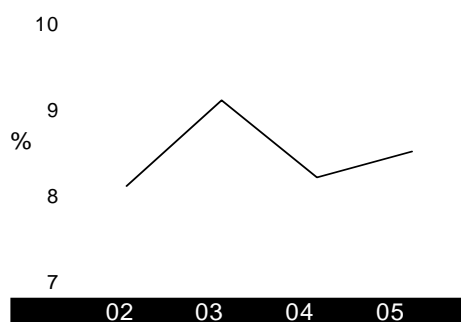
After twenty months of being negative, China's CPI became positive at the beginning of 2003. The CPI rose 1.2% year-on-year in 2003. Food prices, which make up more than 30% to the CPI indicators, were up to 3.4%, with grain rising 2.3%. This situation has connections with the recovery of overall demand since the beginning of 2003, and with the frequent outbreak of natural disasters such as floods and drought.

Bank loans and M2 grew rapidly. The Central Bank has taken some

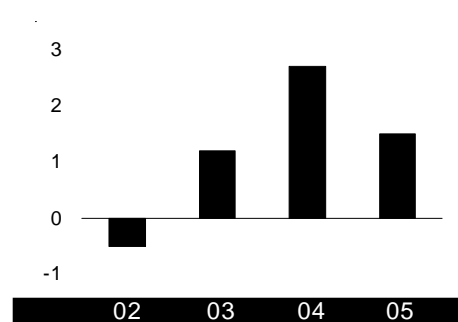
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National Development and Reform  
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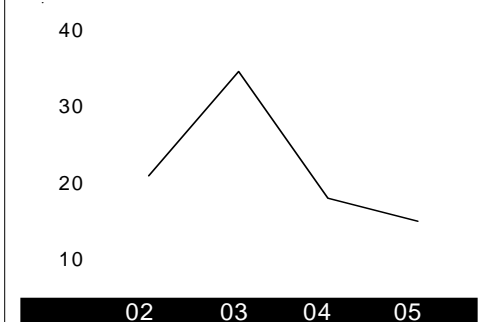
GDP growth



CPI inflation



Export growth



measures to control money supply and bank loans. In June 2003, the Central Bank tightened control over property sector loans. The 6% reserve requirement ratio (RRR) was raised to 7% from 21 September 2003. Monetary statistics suggest the effects of monetary tightening. Bank loans and M2 growth rates for December 2003 were down to 21.1% and 19.6% from August's 23.9% and 21.6%, respectively, which was the highest in 2003.

#### OUTLOOK FOR 2004–05

Due to a sharp increase in investment and a significant rise in raw material prices, the government is concerned that the economy might overheat, especially in certain sectors, such as steel, cement and aluminium, with investment growth rates of 96.6%, 121.9% and 92.9% respectively. The government has taken some measures to prevent further overheating and inflation, such as tightening bank loans and money supply.

China's economy will grow 8.2% in 2004—down 0.9 percentage points from 2003—and 8.5% in 2005.

Fixed assets investment is expected to remain the major driving force and to grow by 11.5% in 2004, significantly down from 26.7% in 2003. Negative factors in this forecast include the government's decreasing loans and decelerating money supply in order to prevent economic overheating. Positive factors include the government's policy of encouraging development of the private sector, and strong FDI inflow. FDI increased by 10.28% in the first two months of 2004 compared to the same period of 2003.

Consumption demand will accelerate slightly in 2004 and 2005. Supported by consumption-encouraging policies and increased per capita disposable income in urban and rural households, total retail sales of consumer goods have gradually accelerated since August 2003, indicating a recovery from SARS. Statistics indicate that the bird flu epidemic has reduced demand

for catering services and for meat, poultry and eggs. Retail sales of food, beverages and tobacco, including meat, poultry and eggs, rose 18.8% in the first two months of 2004, down 4 percentage points from the same period of 2003. But, because the epidemic has basically been controlled, the effects of bird flu will not be serious in the long term. Total retail sales of consumer goods grew by 10.5% in the first two months of 2004, 1.3 percentage points higher than in the same period of 2003. In addition, civil servants' salaries and pension have increased since the second half of 2003. For rural households, the agriculture tax rate will be reduced by 1 percentage point each year. These reforms will further increase farmers' income. All these factors will stimulate consumption, leading to a higher consumption growth rate of 7.6%.

China's export growth is expected to stay strong. Exports grew 34.1% in the first quarter of 2004, against 33.5% in the same period of 2003. The growth rate will reach 18% over the whole year. Strong export growth is supported by the strong competitiveness of Chinese-made goods and further global economic recovery. A negative factor is that the average 15% exports VAT rebate rate was cut by 3 percentage points to 12% in 2004.

Import growth will continue to exceed export growth in 2004, at 27.6%. Strong import growth is supported by China's strong domestic demand. Imports grew by 42.3% in the first quarter of 2004.

Overall, the trade surplus will shrink continually in 2004 and the net export contribution to GDP growth should be negative.

Due to rapid growth in money supply and bank loans, and price rises in some industries, especially raw materials industries, the monthly CPI has risen significantly since November 2003, at around 3%. An early sign of inflation, is apparent. China's CPI will increase by 2.7% in 2004 and 1.5% in 2005.

**Fiscal policy.** The government announced that it would implement the expansionary fiscal policy in 2004. The government has decided to continually issue special treasury bonds, but the amount will be reduced to 110 billion yuan in 2004 from 140 billion yuan in 2003.

**Monetary policy.** In regards to inflation and investment overheating, in February 2004 the central bank announced that the money supply growth rate would be at 17% in 2004, 2.6 percentage points lower than in 2003. It is expected that bank loans will decrease by 13% in 2004. Interest rates will be kept stable. The Central Bank believes that the current RMB exchange rate still fits China's economic conditions.

#### UNCERTAINTIES

The United States' economic recovery and other countries' intervention could strengthen the US dollar, to which the RMB is pegged. This would induce the RMB to appreciate relative to other currencies, other than the US dollar, thus weakening the competitiveness of Chinese-made goods and impacting on China's export growth.

Another issue is inflation. Domestically, soaring investment, particularly in steel, aluminium and cement, has induced a shortage of energy and transportation, and raw materials prices have risen sharply. This phenomenon has caused policy-makers some concern. The National Development and Reform Commission has recently taken measures to control investment in the steel, aluminium and cement sectors.