



China Desk has been set up in EEPC Head Office at Kolkata. A number of articles containing general information including country profile, economic overview, bilateral trade etc. of China will be appearing in alternate issues of Info Bulletin. Members may kindly give their suggestions, valuable inputs.

(Continued from Issue dated 21st September, 2005)

Macroeconomic Policy Developments

The long-term goal of the Government is to raise per capita GDP to \$ 3,000 by 2020, from \$ 840 in 2000, and to quadruple GDP in this period, which requires growth of at least 7.2% annually. Although continued rapid expansion looks achievable, challenges need to be overcome. Rapid growth and structural changes, while resolving many problems, have created new ones : increasing income inequalities, weaknesses in the social security system, rising regional disparities, and environmental pressures. At the National People's Congress (NPC) in March 2004 the Government affirmed that sustaining strong economic growth would remain a priority, but it also started to address some of these problems to achieve more balanced and equitable development.

The latest NPC, in March 2005, set out the following targets for 2005 : GDP growth of around 8%; 9 million new jobs for urban residents and keeping the registered urban unemployment rate under 4.6%; inflation held to 4% or less; and a sound balance of payments.

Fiscal policy will be tightened further, now that pump priming is not needed to maintain economic growth. The issuance of long-term government bonds was limited to CNY 110 billion in 2004, a reduction from the budgeted amount of CNY 130 billion, partly so that there would be less available for capital construction. Issuance will be reduced further this year, to CNY 80 billion. The budget deficit target for 2005 is CNY 300 billion, narrower than CNY 319.8 billion in 2004.

Expenditure priorities were shifted in 2004 from infrastructure construction to agriculture, education, health care, and social security. Poorer central and western regions received greater attention, as did rundown industrial locations, and areas where ethnic minority groups live. The Government speeded up a trial of a change in the value-added tax (VAT) for some enterprises, to allow those in Jilin, Liaoning, and Heilongjiang provinces to claim tax deductions when buying new machinery. The trial will be expanded to more provinces. To assist farmers, the Government decided in March 2004 to abolish agricultural tax within 5 years. By end-January 2005, 23 out of 31 provinces and municipalities had done this. The aim now is to end the tax throughout the country in 2006.

Administrative measures taken in 2004 to rein in investment in sectors considered to be overheated included an order to curb

credit expansion and investment in the overheated sub-sectors; restrictions on the transfer of arable land to non-agricultural use; and addition of industries to the restricted-investment list. The Government is expected to adopt more market-oriented pricing measures to control and direct investment from this year.

Since the second half of 2003, PBC has taken steps to tighten monetary policy, including : curbing real estate lending by raising the proportion of capital that developers must contribute to a project to 30%, and raising the cost of loans for investment in second houses; raising commercial banks' reserve requirement ratio from 6% to 7.5%; removing the ceiling on most commercial lending rates; and increasing the benchmark interest rate on 1-year loans from 5.31% to 5.58% and the rate on 1-year deposits from 1.98% to 2.25%. As the first rate rise since 1995, this October 2004 move signalled that the monetary authorities will use interest rates to cool the economy when necessary. During its annual meeting in January 2005, PBC announced that it would maintain its tighter stance, pointing to continuing inflationary pressures and a risk that growth in investment might surge again. PBC set its 2005 M2 growth target at 15%, slightly higher than the actual increase of 14.6% in 2004, and committed to using monetary levers such as interest rates to achieve the macroeconomic goals.

Speculation that the yuan may be allowed to appreciate was triggered in 2004 by the weakening US dollar, surging exports to the US and euro zone, and rising foreign exchange reserves. The International Monetary Fund called for greater exchange rate flexibility through a widening of the narrow band in which the yuan can move, and the G7 group of industrial countries said that it also favours more flexible exchange rates for Asian nations. While the Government stated its commitment to a long-term goal for a more flexible system, the current official stance is for a gradual transition to a more flexible exchange rate regime that does not put at risk macroeconomic stability and the financial system.

The PRC's stock markets performed weakly in 2004, even as stock prices rebounded in most other Asian markets. An overhang of non-tradable state-owned shares and a relatively opaque stock-pricing system hurt the domestic stock market. In an effort to revive new share issues, the China Securities Regulatory Commission introduced a new pricing system for initial public offerings from January 2005. It also will promote better corporate governance and information disclosure by listed companies.



EEPC INDIA



Progress was made in SOE reform in 2004. The State-owned Assets Supervision and Administration Commission continued its efforts to strengthen its supervision over 178 major central SOE groups and improve the management of SOEs nationwide. The commission tightened policies on management buyouts and stated that privatizations should be carried out through open and competitive bidding. Efforts to repair state-owned commercial banks continued when the Government injected \$ 45 billion of its foreign exchange reserves into the Bank of China and the China Construction Bank to strengthen their balance sheets and prepare them for stock market listings.

For the private sector, the Government issued guidelines to improve the legal, policy, and market environment. More industries and sectors were opened to non-state capital, and financing channels were widened for private enterprises.

Three years after WTO accession, the PRC has reached its goal in terms of cutting trade tariffs, with the general tariff level lowered from 15.6% in 2001 to 10.1% in early 2005. Non-tariff barriers have also come down, with the number of quota-administered commodities reduced to 52 on the export side (from more than 100 in 2001) and eight on the import side (from 26). In services such as banking, insurance, and securities, the PRC has met its WTO commitments on time. Over the past 3 years, the country has revised more than 2,300 national laws and regulations that ran counter to WTO rules. A series of laws and related regulations on the protection of intellectual property rights, including legislation on trademarks, patents, copyright, and protection of computer software, has been passed or revised. However, enforcement remains difficult.

(Source : Asian Development Bank)

Economic Outlook for 2005-2007 and medium-term trends

Major Economic Indicators - Outlook

Item	2005	2006	2007
GDP growth	8.5	8.7	8.9
Gross domestic investment/GDP	44.7	43.8	41.0
Inflation rate (consumer price index)	3.6	3.3	3.2
Money supply growth	14.1	13.7	14.6
Fiscal balance/GDP	-0.9	-0.7	-0.2
Merchandise export growth	20.4	14.8	12.5
Merchandise import growth	22.1	19.6	14.1
Current account balance/GDP	1.2	0.4	-0.2

The economy is likely to achieve its targeted soft landing, with GDP expected to grow by 8.5% in 2005, 8.7% in 2006, and 8.9% in 2007. Manufacturing and construction, hampered by bottlenecks in energy and transportation, land constraints, and reduced levels of investment, will slow. The growth rate of industry overall is

forecast at 9.3-10.1% over the 3 years. Agriculture will expand by 4.1-4.6%, reflecting government efforts to support rural production and farmers' incomes. The opening of more services to external competition should ensure continued growth of around 8% for this sector. More emphasis on developing agriculture and services will benefit job creation and poverty reduction.

Investment in fixed assets is expected to grow by about 18% in 2005, slowing from 2004's rapid 25.8% expansion, and by about 13% in 2006-2007. Overheated sub-sectors face the biggest cutbacks. However, curbing investment growth will be difficult in some industries, such as construction, where substantial work is in progress. Also, private sector investment is likely to grow rapidly and foreign investment looks set to remain strong. Rising labour costs and labour shortages in coastal areas may persuade some investors to move factories to inland provinces.

Consumption will maintain double-digit growth rates, but these will be significantly lower than the rates for investment. Surging investment in the past 2 years has raised the proportion of capital formation to GDP to about 45%, the highest since 1994, while the proportion of total consumption in 2004 fell to 55%, the lowest since 1978. Over the past 25 years, periods of extraordinarily high investment, without support from high levels of consumption growth, have resulted in excess production capacity and have been followed by sharp declines in economic growth. This time, the authorities are reducing investment growth and taking steps that should stimulate private consumption-raising rural incomes is an example.

The growth rate of exports is forecast to fall to 12-20% in 2005-2007 from over 30% in 2004, largely for the following reasons : growth in industrial nations will slow; major trade partners may well take more protectionist and anti-dumping action against PRC exporters; and rising labour costs and high oil prices will raise costs for exporters. Import growth is expected to outpace that of exports as more sectors are opened to foreign competitors and as domestic demand remains strong. Consequently, the trade surplus will decrease over the forecast period. The current account will maintain a small surplus of 0.4-1.2% of GDP in 2005-2006, but move to a 0.2% deficit in 2007.

Inflation is forecast to step down to 3.6% in 2005, 3.3% in 2006, and 3.2% in 2007. Prices of electricity and coal will rise. Production costs have been pushed up by higher prices of energy and raw materials, and some of this will flow through to prices of final products. Labour costs, too, will edge up as the economy maintains rapid growth. These upward price pressures will be eased in part by overcapacity in many industrial sub-sectors and by smaller price rises for grains.

(Source : Asian Development Bank)

(To be continued at Issue dated 19th October, 2005)