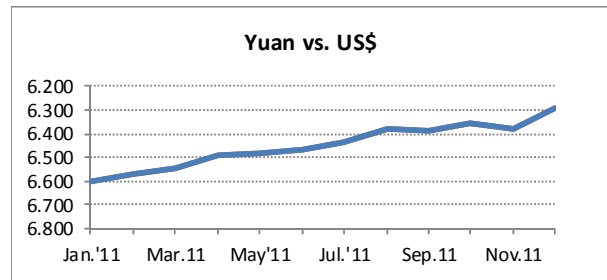


Country Risk Update – China

January 2012

Significant Recent Development

The People's Bank of China (central bank) appears to have shifted its policy emphasis from monetary tightening toward an easing bias as concerns over inflation diminish. At the end of November the central bank lowered its required reserve ratio for commercial banks by 50 basis points to 21%. It was the first reduction in three years and a sign that inflationary pressures are receding amid concerns about slowing economic growth.



Risk Outlook

Worryingly, the pace of China's economic expansion slowed in Q3 2011. Real GDP grew by 9.1% year on year (y/y) after rising by 9.5% y/y in Q2 and 9.7% y/y in Q1. Moreover, the outlook appears to have deteriorated further as 2011 drew to a close. This is evident from the latest quarterly business confidence survey undertaken by the People's Bank of China (central bank). Business confidence slipped to a positive net balance of 41.7 in Q4 2011, where a reading below 50 denotes a "pessimistic" assessment.

The survey indicates that Chinese exporters are concerned by the economic outlook in key markets, notably Europe - around a fifth of Chinese exports are destined for the EU's Single Market. Falling sales will undermine profit margins, as will the incessant rise in domestic labour costs, which is now a significant concern for Chinese firms. Other reasons for the drop in business confidence include reluctance, at present, on behalf of the authorities to launch a large fiscal stimulus programme and the weakening property market, caused in part by years of over-investment but also restrictions on residential house purchases.

The authorities, nonetheless, can support the economy with a relaxation of fiscal and monetary policies to prevent a larger economic squeeze from taking place. This is particularly so given the recent

fall in inflation to 4.2% y/y in November, which was accompanied by a moderation of inflation expectations according to the central bank's latest household survey. Bolstering state-led investment spending will help to counteract weaker export demand as a combination of fiscal and monetary easing keeps the Chinese engine running. Even so, in the light of slowing exports and tight bank credit abroad, we expect real GDP growth to decelerate in 2012 to around 8.4%. There is a small risk of growth falling below the symbolic 8% level for the first time since the Asian financial crisis of 1998.

Meanwhile, corruption remains a serious business risk in China. This is illustrated by the latest annual Corruptions Perceptions Index survey from Transparency International. China ranks 75th out of 182 countries surveyed, with a score of 3.6 on a scale of 0 (most corrupt) to 10 (least corrupt). The extent to which corruption affects daily life is underlined by a spate of recent scandals. One involves China's leading soccer officials, alleged to have bribed referees to fix matches. A second concerns a case of embezzlement by the head of Shanxi Coking Coal Group, China's largest state-owned coking coal producer. A third involves reports of over 15,000 public officials disciplined for corrupt practices in connection with state-funded construction projects.

Risk Level: Slight		Risk Trend: Stable		
Annual Avg. % change	2010	2011e	2012f	2013f
Real GDP growth	10.4	9.2	8.4	8.6
- IMF	10.3	9.5	9.0	na
- OECD	10.4	9.3	8.5	9.5
Inflation (CPI)	3.2	5.8	4.2	3.8
- IMF	3.3	5.5	3.3	na
- OECD	3.2	5.6	3.8	3.8
Current Acc. (% GDP)	5.2	4.5	4.0	3.5
- IMF	5.2	5.2	5.6	na
- OECD	5.2	3.1	2.6	2.1
Budget Bal. (% GDP)	-0.6	-1.4	-1.7	-1.5
Head of State:	President Hu Jintao			
Head of Government:	Prime Minister Wen Jiabao			
Ruling Party:	Chinese Communist Party			
Next Election:	March 2013 (local)			
Capital City:	Beijing (GMT +8 hours)			
Currency:	Yuan / Renminbi (managed float)			
GDP (USDbn)	5878.3	Doing Business		79
Population (m)	1313.4	Competitiveness		4.90
Bank Debt (% GDP)	6.3	Corruption		3.6
Economic Freedom	52.0	Corporate Tax (%)		25.0
Sources: BBC, IFES Election Guide, IMF, FT, MJE, OECD, The Times and; Index of Economic Freedom (The Heritage Foundation): 0-100; 100 is best Doing Business Ranking (World Bank): 1-183; 1 is best Global Competitiveness Score (World Economic Forum): 0-6; 6 is best Corruption Perceptions Index (Transparency International): 0-10; 10 is best Headline Corporate Tax Rate (Deloitte)				