

Monday, 10 November 2008

# Flash Notes

## China: A Massive Fiscal Stimulus Package

Ahead of a deluge of domestic data releases for October this week, China's State Council on Sunday approved a fiscal stimulus package worth RMB4tn (about US\$586bn) through end-2010 to boost domestic demand. The package will be implemented via 10 areas, with investments targeted at infrastructure, social welfare and other key sectors (see table) as part of a "active" fiscal policy response as G3 economies slump into a recession, and the extent and depth of the global recession remaining unclear. At the same time, China's central bank PBoC also officially shifted to "moderately easy" monetary policy stance, which came after a series of unexpected interest rate cuts since early September and reversing the official tight policy stance announced at end of 2007.

This fiscal expansion plan is truly massive in scale and sets the benchmark for others to follow. Even assuming that half of the RMB4tn is spent in 2009 and the remaining half in 2010, that alone accounts for about 8.9% of China's nominal GDP in 2007 of about US\$3.3tn. All in, the stimulus package is about 18% of China's GDP in 2007. In contrast, China's stimulus measure in 1998 during the Asian financial crisis was around 1.2% of GDP. Last week's announcements from Japan, South Korea and Malaysia were relatively small as well in comparison. For example, Japan's fiscal package of US\$270bn is about 6.3% of Japan's GDP and South Korea's plan was even smaller at US\$11bn or 1.1% of its GDP. More concrete announcements on how the fiscal initiatives will be spent are expected in the following months, with the first opportunity being the Central Economic Work Conference later this month.

While these measures are likely to improve investor sentiment at least temporarily, based on the size of the plan and the likelihood that other governments will follow up on similar policy response. However, it is unlikely to be able to fully arrest the global recession which is already underway as G3 economies head into a recession. This is because China's economy is only about US\$3.3tn in size, compared to the G3 economies' combined size of US\$35tn, or nearly 11 times China's economy. **However, the latest development is a positive step to shore up China's own domestic demand and we believe China's downside risk to growth has been reduced significantly, which helps support our call of about 8.3% real GDP growth for China in 2009. On the monetary policy front, we expect another 5 interest rate cuts from PBoC before mid-2009 to lend support to the fiscal policy initiatives. We look for the benchmark 1Y RMB lending rate to fall to 6.39% by end-2008, 5.85% at end-1Q09, and 5.31% at end-2Q09, from current level of 6.66%. For the currency, we continue to see RMB firming against the USD into 2009, but only moderately so to balance the impact on trade and capital flows. We are currently forecasting a moderate upside to the RMB at 6.70/USD by end-2008, 6.63/USD by end-2Q09, and 6.50/USD by end-2009, vs. current spot price of 6.82/USD.**

China: RMB4 Trillion Stimulus Package		
No	Areas of Focus	Measures
1.	Housing	Building more affordable and low-rent housing and speeding the clearing of slums. A pilot program to rebuild rural housing will expand. Nomads will be encouraged to settle down.
2.	Rural infrastructure	Speeding up rural infrastructure construction. Roads and power grids in the countryside will be improved, and efforts will be stepped up to spread the use of methane and to ensure drinking water safety. This part of the plan also involves expediting the North-South water diversion project. Risky reservoirs will be reinforced. Water conservation in large-scale irrigation areas will be strengthened. Poverty relief efforts will be increased.
3.	Transportation	Accelerating the expansion of the transport network. That includes more dedicated passenger rail links and coal routes. Trunk railways will be extended and more airports will be built in western areas. Urban power grids will be upgraded.
4.	Health and education	Beefing up the health and medical service by improving the grass roots medical system. Accelerating the development of the cultural and education sectors and junior high school construction in rural western and central areas. More special education and cultural facilities.
5.	Environment	Improving environmental protection by enhancing the construction of sewage and rubbish treatment facilities and preventing water pollution in key areas. Accelerating green belt and natural forest planting programs. Increasing support for energy conservation and pollution-control projects.
6.	Industry	Enhancing innovation and industrial restructuring and supporting the development of the high-tech and service industries.
7.	Disaster rebuilding	Speeding reconstruction in the areas hit by the May 12 earthquake.
8.	Incomes	Raising average incomes in rural and urban areas. Raising next year's minimum grain purchase and farm subsidies. Increasing subsidies for low-income urban residents. Increasing pension funds for enterprise employees and allowances for those receiving special services.
9.	Taxes	Extending reforms in value-added tax rules to all industries, which could cut the tax corporate burden by 120 billion yuan (about 17.6 billion U.S. dollars). Technological upgrading will be encouraged.
10.	Finance	Enhancing financial support to maintain economic growth. Removing loan quotas on commercial lenders. Appropriately increasing bank credit for priority projects, rural areas, smaller enterprises, technical innovation and industrial rationalization through mergers and acquisitions.

Source: www.gov.cn; UOB Treasury-Econ Research

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