Hard or Soft Landing in China?
Navigating China’s Transition
to a Consumer-Driven Economy

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Focus on Education

28 MFEA STAR Awards for Excellence in Education
Bubble — Negative Press on China

Number of Articles Discussing the Potential of China’s “Hard Landing”

Source: Factiva all newspapers
BCA Research 2012
China’s GDP Growth Tends to Stabilize in Fifth Year of Leadership Transition Cycle

China Historical GDP Growth

<table>
<thead>
<tr>
<th>Period</th>
<th>Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978-1982</td>
<td>9.5%</td>
</tr>
<tr>
<td>1983-1987</td>
<td>15.9%</td>
</tr>
<tr>
<td>1988-1992</td>
<td>12.3%</td>
</tr>
<tr>
<td>1993-1997</td>
<td>10.2%</td>
</tr>
<tr>
<td>1998-2002</td>
<td>7.5%</td>
</tr>
<tr>
<td>2003-2007</td>
<td>11.8%</td>
</tr>
<tr>
<td>2008-2012</td>
<td>8.2%</td>
</tr>
<tr>
<td>Historical Average</td>
<td>10.1%</td>
</tr>
</tbody>
</table>

Source: IMF, Deutsche Bank 2012 estimate
Stay Tuned to the Big S-Curve

 Putting China in Perspective: China/U.S. (x, Current)

X-axis measures the equivalent year of U.S. when the level of demand was equal to that of China. Y-axis measures the current level of demand in China compared to the U.S.

2009 China GDP per capita = 1966 U.S. GDP per capita

An S-curve is a type of curve that shows a rapid, exponential increase in growth for a period of time, followed by a tapering or leveling off.

Source: Credit Suisse Chinese Strategy team
China Still Experiencing Strong Growth Momentum

Source: BCA Research 2012
Industry Relocation —
Going West and North

Industry Relocation – Going West and North

GDP: Rmb3,639 bn (10% of total) Employment: 98.5
person mn (13.1% of total) Exports: US$2.9 bn (2.4% of
total) Ind. output: Rmb1,530 bn (10% of total)

GDP: Rmb7,179 bn (20% of total) Employment: 92.9
person mn (12.4% of total) Exports: Us$50.4bn (42%
of total) Ind. output: Rmb3,132bn (20% of total)

GDP: Rmb3,057 bn (8.4% of total) Employment: 98.4
person mn (13.1% of total) Exports: US$2.4 bn (2%
of total) Ind. output: Rmb1,109 bn (7.2% of total)

GDP: Rmb3,908 bn (11% of total) Employment: 56.4
person mn (7.5% of total) Exports: US$34.8 bn (29%
of total) Ind. output: Rmb1,663 bn (11% of total)
Tipping Point
Impact is About to Be Felt Quite Soon

Half the cities in the network should be connected by 2012

% of cities connected to high-speed rail network

Source: Morgan Stanley Research
Emerging High-Speed Rail Hub Cities

Total passengers by 2020 (millions)

- Hangzhou
- Wuxi
- Guiyang
- Shenzhen
- Harbin
- Jinan
- Hefei
- Shijiazhuang
- Nanchang
- Xuzhou
- Lanzhou
- Nanning

Source: Morgan Stanley Research

Frank Holmes
High Speed Train, China
Now, the High-Speed Rail Will Change Everything…

- **Speed**: 180 miles/hour
- **Link**: 250+ cities
- **Span**: 24,000 miles
- **Add**: 1 billion miles of passenger throughput
- **Reach**: 700 million in population
- **Budget**: $300 billion

*Source: Morgan Stanley Research*
Misunderstanding China

Andy Rothman
CLSA China Macro Strategist
Shanghai

U.S. Global Investors, 2012
Exports - Less for GDP, more for jobs

Distribution of value for iPad

- Cost of inputs: Non-China labour 5%
- Cost of inputs: China labour 2%
- Cost of inputs materials 31%
- Apple profits 30%
- Distribution and retail 15%
- Unidentified profits 5%
- S.Korea profits 7%
- Japan profits 1%
- Non-Apple U.S. profits 2%
- Taiwan profits 2%

Source: PCIC, UC Irvine
GDP growth slower but healthy; less-export driven

Breakdown of GDP growth by expenditure approach

- 2012 forecast: 8.5% GDP growth, with a -0.5ppt net export contribution

Source: CEIC, CLSA Asia-Pacific Markets

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Exports a small share of manufacturing

FAI before 2011 include urban FAI only. FAI=Fixed Asset Investment. Source: CEIC

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Significant RMB appreciation since 2005

BIS effective exchange rates since January 2005

Source: BIS
Slower Rmb appreciation likely this year

China’s current account balance/GDP ratio

Source: CEIC, SAFE

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Despite an undervalued Rmb, China drives US exports

Growth in US exports to major markets, 2000 to 2011

- Over that time, China has gone from the USA’s 7th largest export market to No.3

<table>
<thead>
<tr>
<th>Country</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>541.8%</td>
</tr>
<tr>
<td>Germany</td>
<td>66.8%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>96.1%</td>
</tr>
<tr>
<td>Canada</td>
<td>57.0%</td>
</tr>
<tr>
<td>France</td>
<td>36.7%</td>
</tr>
<tr>
<td>S.Korea</td>
<td>56.3%</td>
</tr>
<tr>
<td>Mexico</td>
<td>77.4%</td>
</tr>
<tr>
<td>UK</td>
<td>34.6%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>6.1%</td>
</tr>
<tr>
<td>Japan</td>
<td>1.9%</td>
</tr>
</tbody>
</table>

Source: CEIC

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More privately driven investment growth

Private firms driving FAI growth for 24 consecutive months; plenty of SOE stimulus capacity
SOE share of FAI 33% in Feb12, 45% in 09, 58% in 04. SOE share of employment 19% in 2010, 61% in 90

FAI=Fixed Asset Investment. SOE=State Owned Enterprise. Source: CEIC
Still the world’s best consumption story

Urban household spending up 12% 4Q11 (11% 4Q10); rural up 23% 3Q11 (9% 3Q10)

Source: CEIC

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Income growth mitigates CPI, drives spending

Real urban income growth 7%+ for 11 years; rural income growth accelerating

Over last decade, real urban income up 173%; rural 120%; Shanghai minimum wage up 161%

Source: National Bureau of Statistics (NBS)

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A framework for future consumption

Strong growth in government spending on soft infrastructure

- 2011 spending: education up 28%, social security 22%; health care 33%; social housing 61%
- Over last five years, spending on health care up 382%, on education up 237%

Source: NBS, Ministry of Finance
FAI transition point this year

After 9 years of about 25% nominal YoY growth, FAI will rise by 21-22% in 2012

FAI=Fixed Asset Investment. Source: CEIC

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Far from bubbly

- 92% of buyers are owner-occupiers; 8% investors
- 23% of first-time buyers, 53% of investors pay all cash
- For those using mortgage, avg cash downpayment 44%
- Plain vanilla mortgages; home equity loans rare
- Prices rising in line with income over recent years
- Only 4% of sales in Tier 1 cities
- 67% of sales in Tier 3, where prices 70% below Tier 1

Source: CRR
New home prices up in line with income

Average selling price per sqm
Urban household disposable income (nominal)


Average increase in urban household disposable income and new home prices up in line with income.
When is the big easing coming?

The market may be disappointed . . .

Source: CEIC
Why no easing now? Not due to inflation

Food 62% of CPI rise. CPI this year 3.5-4% vs. 5.4% in 2011, while nominal income up over 10%

Source: CEIC, CLSA Asia-Pacific Markets
Not due to lack of political will or fiscal capacity

Fiscal rev rose 25% YoY in 2011 (21% in 2010), w central govt rev up 21%, local 29%

Source: NAO, CEIC
Industrial indicators solid

Growth of value-added of industry and power in line with 9%+ GDP growth in 2011, 8.5% in 2012

- Larger industrial firm profits up 25% YoY

Source: CEIC
Freight traffic healthy

Freight traffic up 16.3% YoY in February vs. avg 11.4% during the five pre-stimulus years

Source: CEIC
GDP growth slower but healthy; less-export driven

Breakdown of GDP growth by expenditure approach

- 2012 forecast: 8.5% GDP growth, with a -0.5ppt net export contribution

Source: CEIC, CLSA Asia-Pacific Markets
Only marginal easing coming

Inflation expectations & CPI have peaked; growth is cooling; stimulus withdrawal completed

- In recent months, loans stabilised at 15-16% YoY (vs 16% during pre-stimulus years)
- In recent months, M2 stabilised at 12-13% YoY (vs 17% during pre-stimulus years)

Source: CEIC
Fiscal stimulus IF exports collapse again

Source: CEIC, Bloomberg
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