



China and emerging Asia lead the global recovery

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May 2009, Beijing

Please see analyst certification(s) and important disclosures on the back page.

Our view on the outlook

- China

- ▶ Improvement is spreading from leading to coincident indicators
- ▶ Policy stimulus to accelerate growth recovery in 2H09
- ▶ Long-term growth trend unchanged
- ▶ Capital inflow pressures likely to re-emerge, while external assets are likely to be diversified

- Emerging Asia

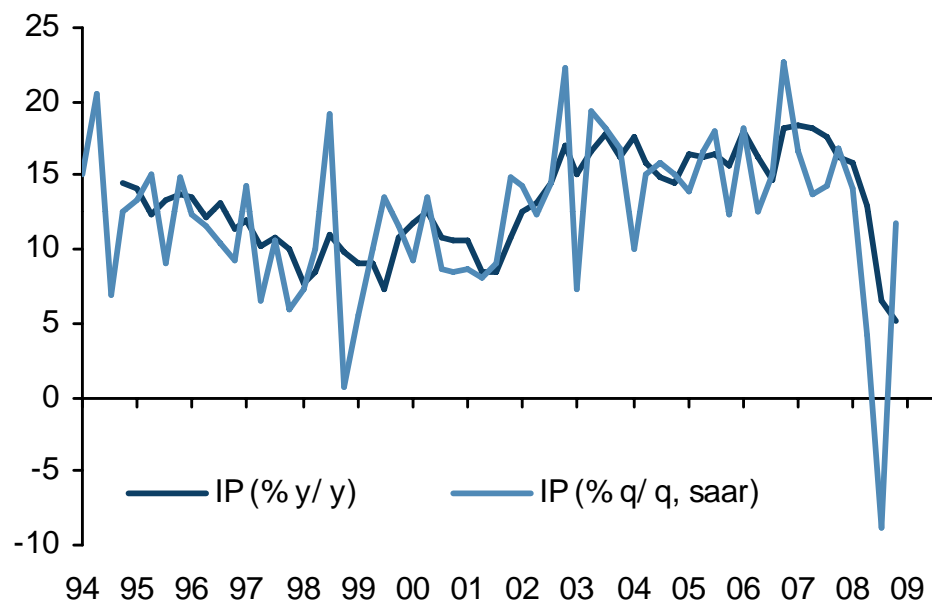
- ▶ Growth to recover in 2H09
- ▶ Supported by growth in main trading partners, inventory dynamics and terms of trade improvements

China: Current conditions

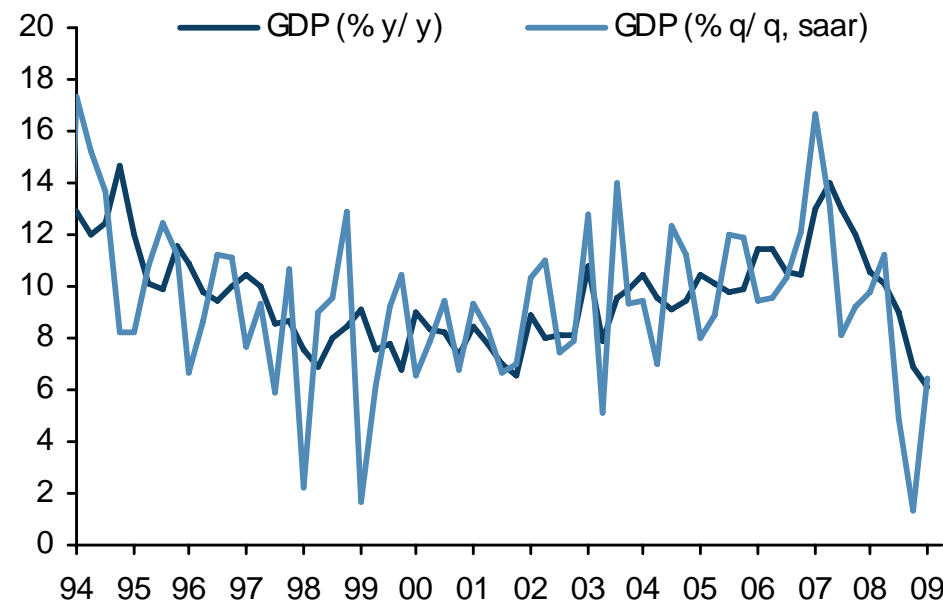
1) Growth likely bottomed in 4Q08

- Industrial production and real GDP growth rebounded on a q/q basis

Industrial production rebounded strongly in 1Q...



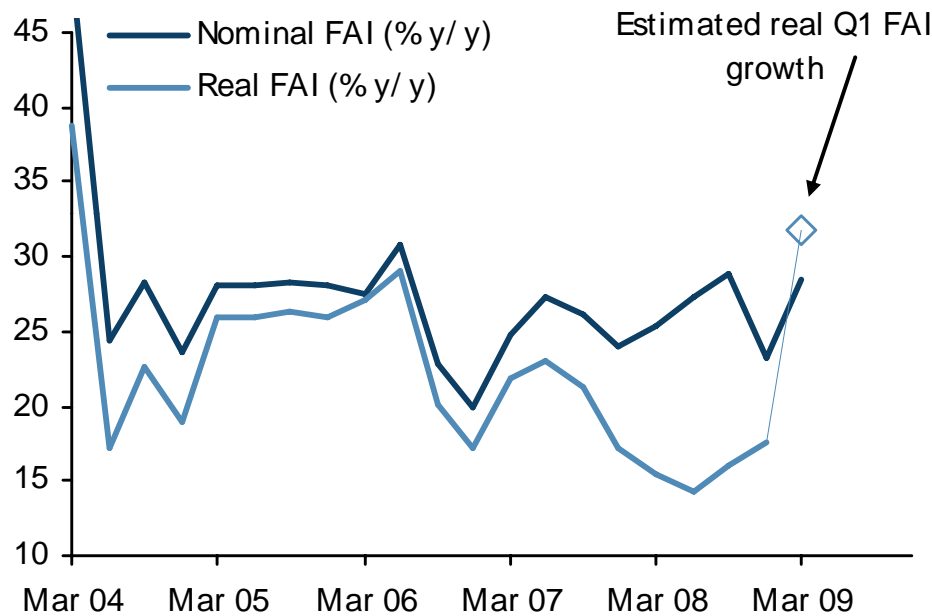
... leading to a similar pattern in GDP growth



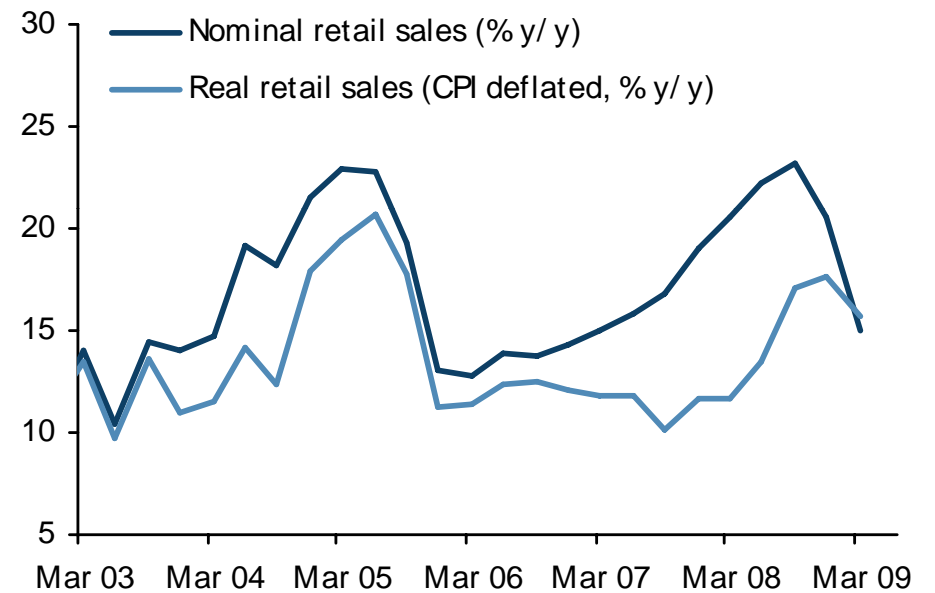
China: Current conditions

2) Investment growth picked up, but consumption growth slowed

Real fixed asset investment growth improved markedly...



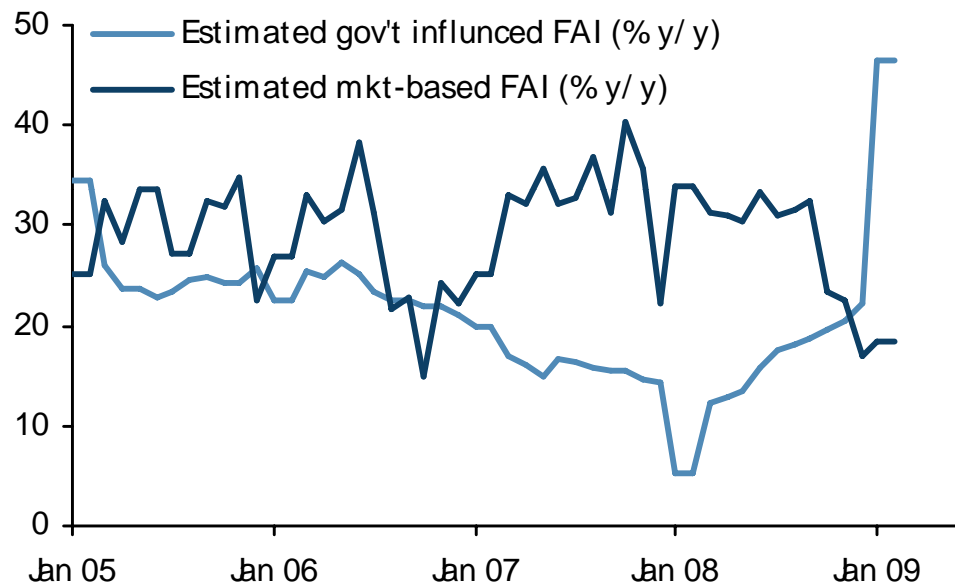
... while real retail sales growth slowed



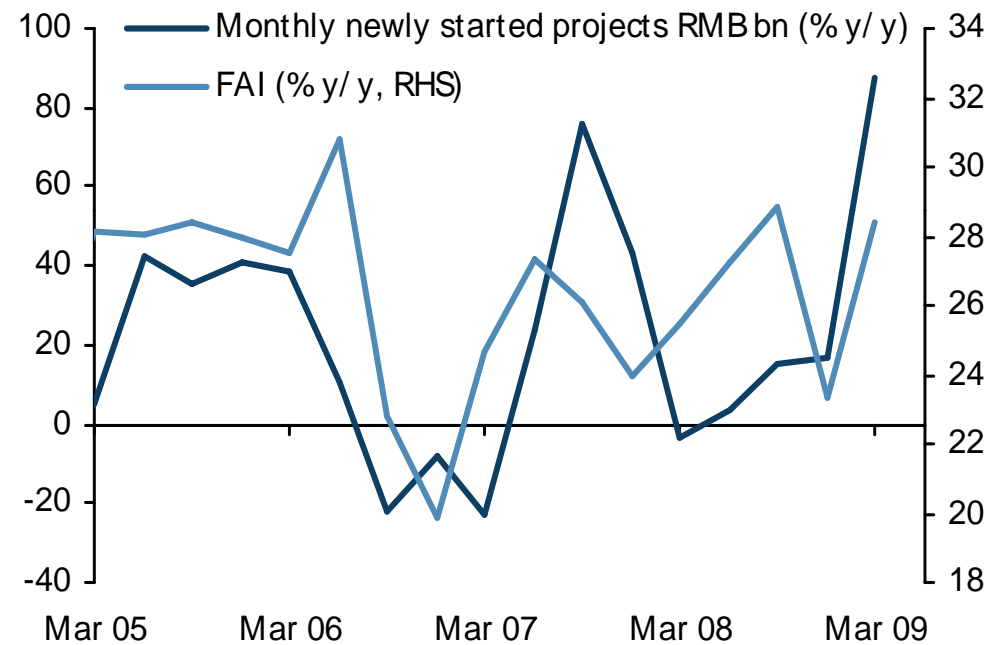
China: Current conditions

3) Government-related investment led the recovery

Growth in government-related and private investment diverged



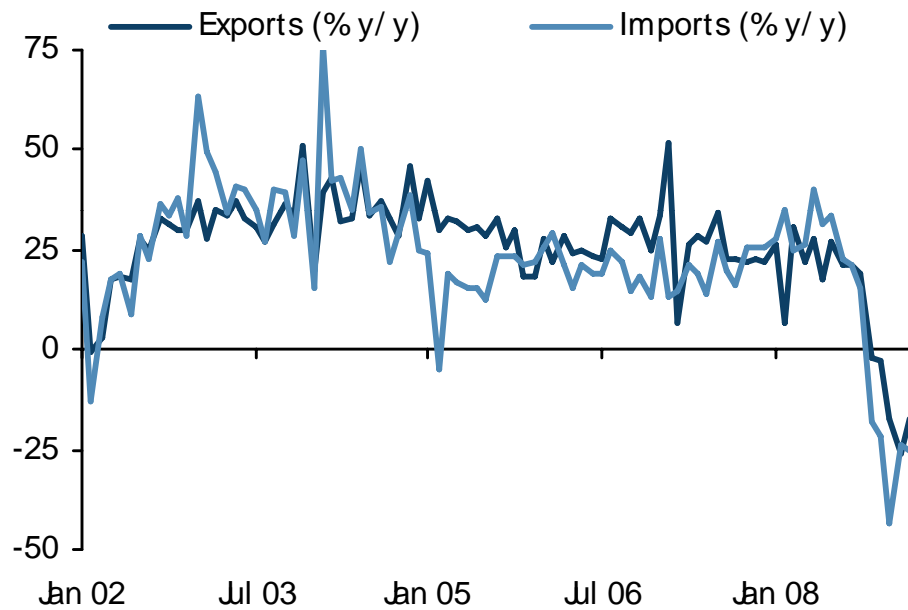
Spending on newly started projects rose sharply



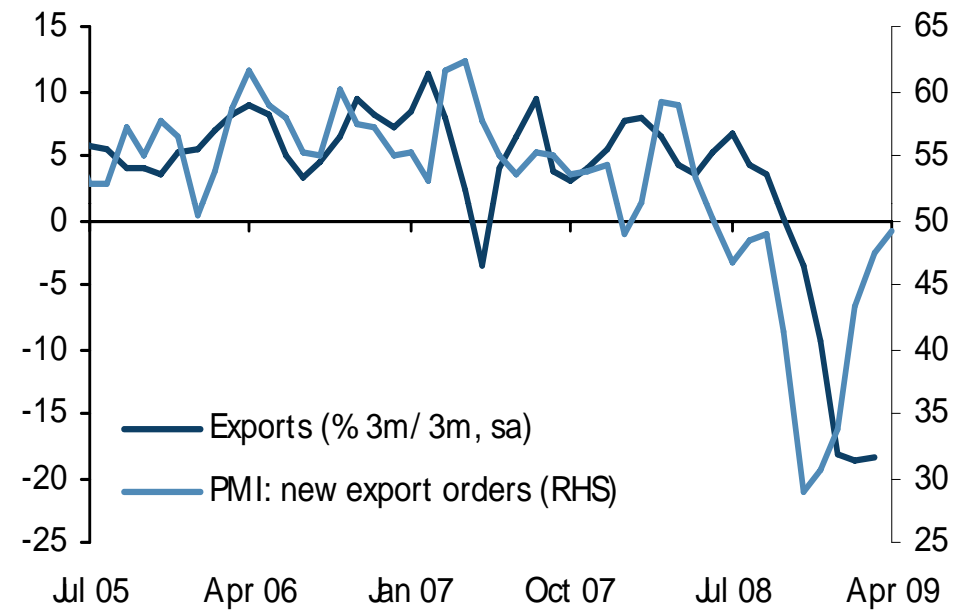
China: Current conditions

4) External demand has continued to contract

Both export and import growth plunged...



... but the fall in export orders has slowed



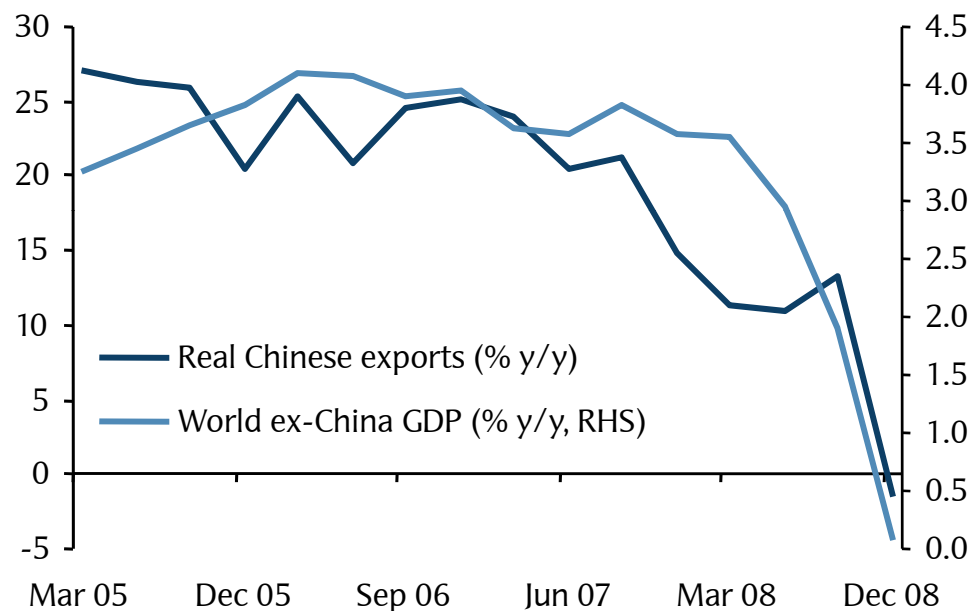
China: Shifting forces driving growth

Shifting forces	Reversal?
External demand	Not yet
Property market & sectoral excess capacity	Not yet, takes time to absorb
Inventory adjustment	Likely in H1 if not in Q1
Terms of trade	Yes, significant improvement
Fiscal & monetary policy	Yes, large stimulus

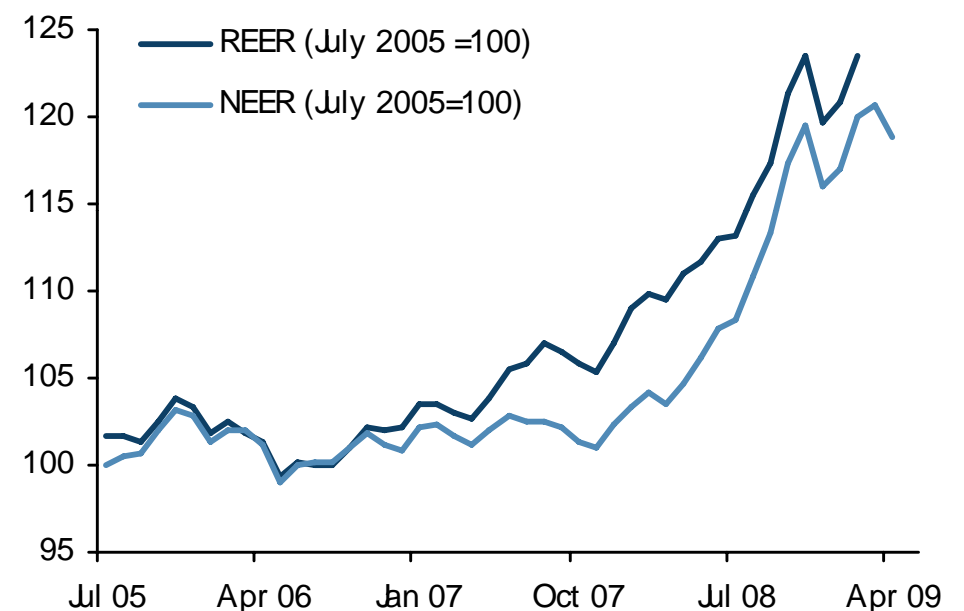
China: Shifting forces driving growth

1) Falling external demand, coupled with REER appreciation

Real exports tracked global GDP growth



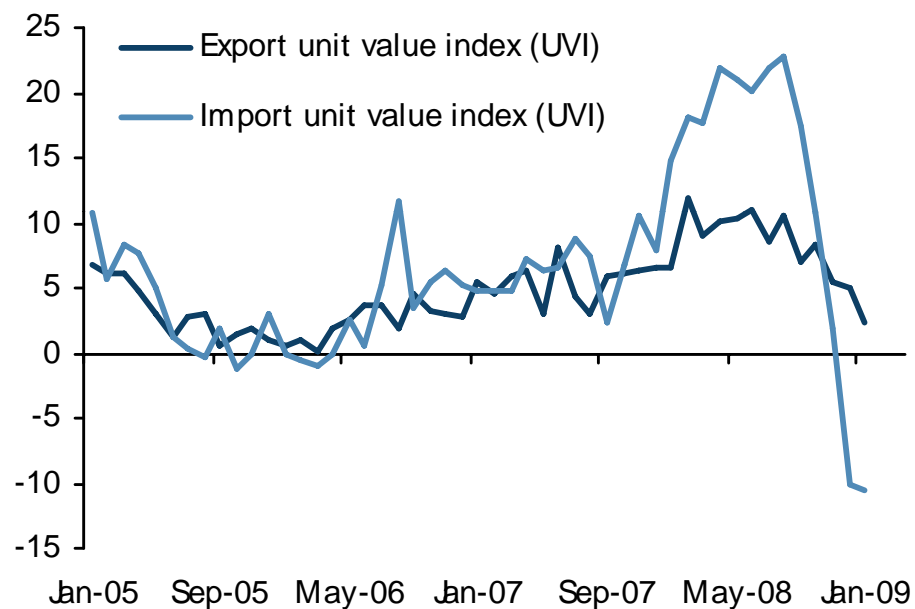
CNY REER has appreciated 20% since early 2005



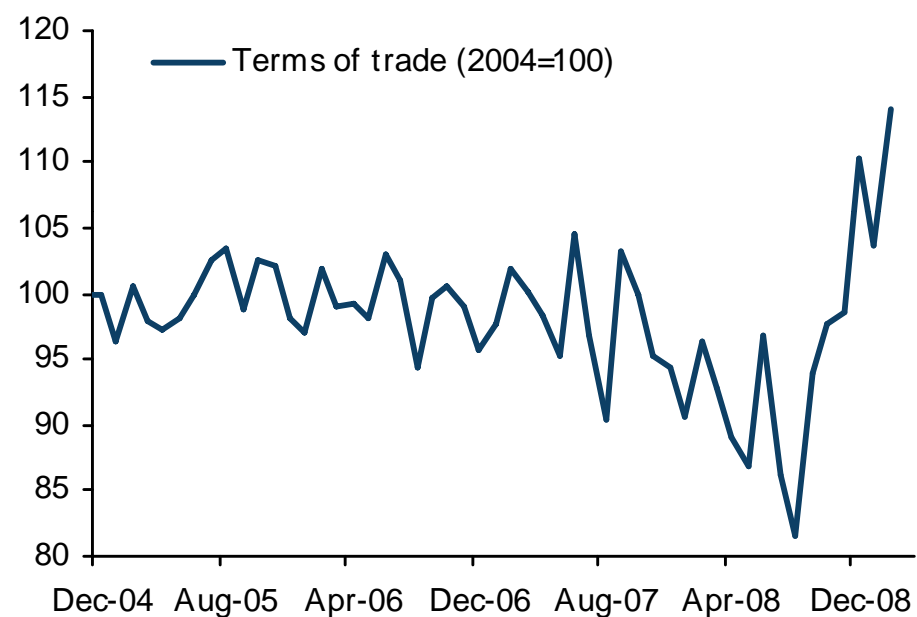
China: Shifting forces driving growth

2) Sharp swing in the terms of trade

Import prices have dropped sharply recently...



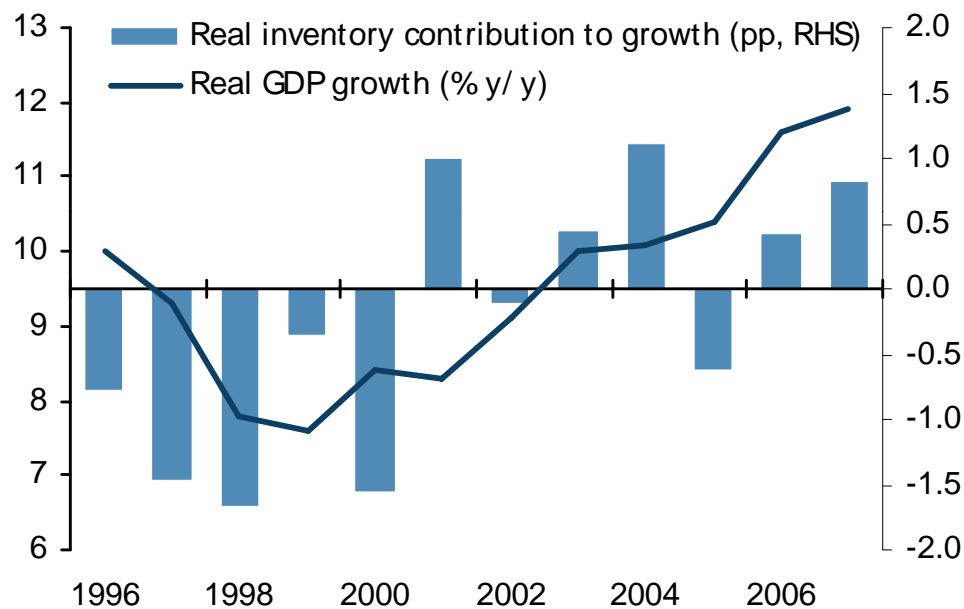
... improving the country's terms of trade



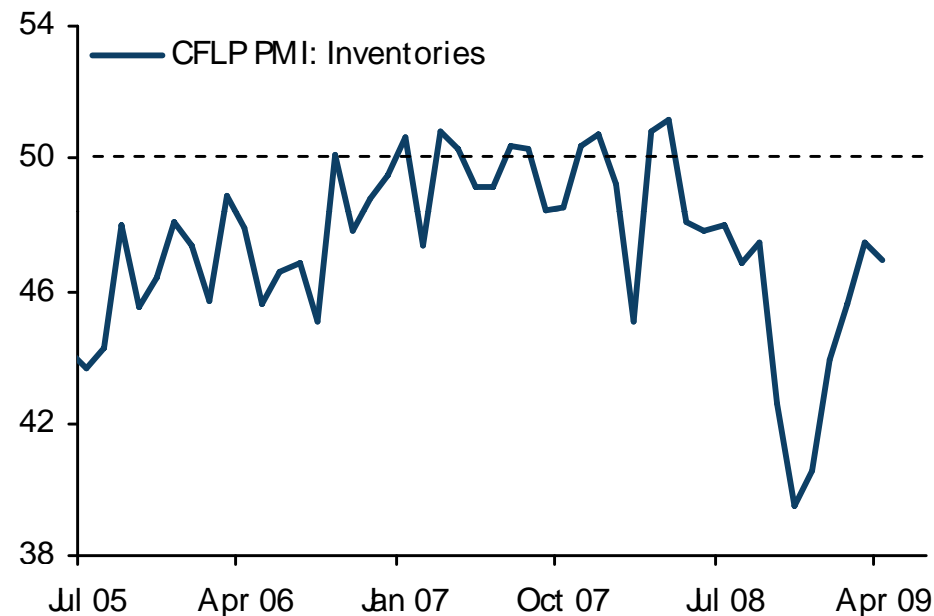
China: Shifting forces driving growth

3) Pro-cyclical inventory adjustment

Inventory adjustments tend to be pro-cyclical



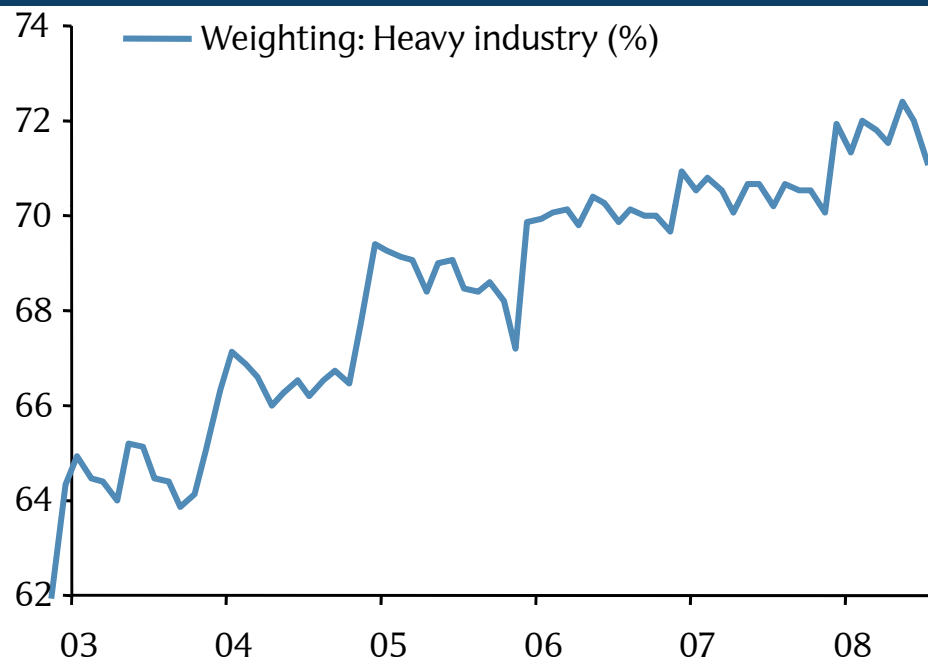
Firms reduced inventories in recent months



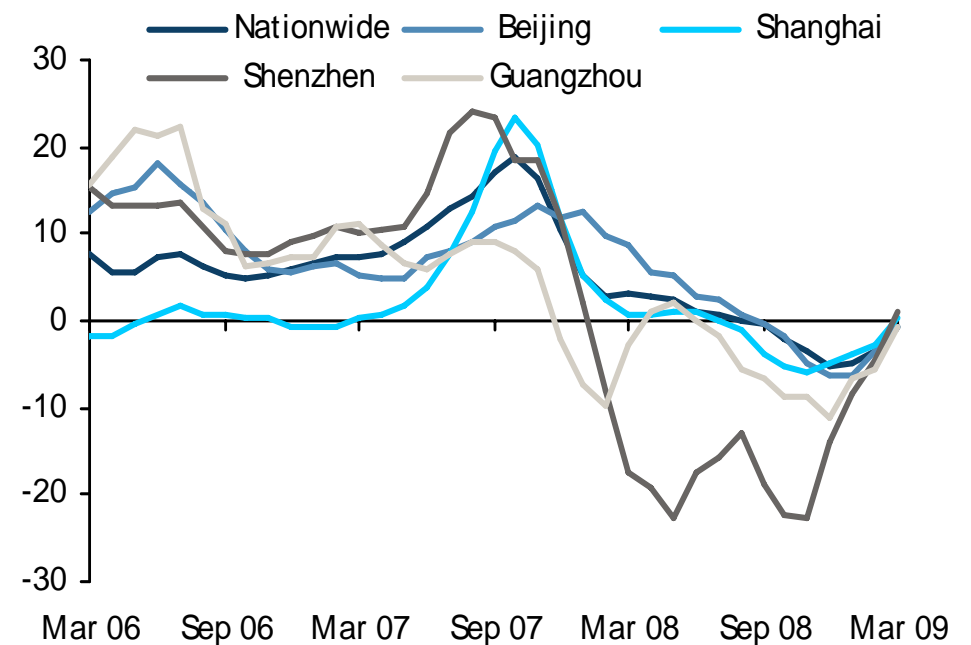
China: Shifting forces driving growth

4) Excess capacity in some sectors exacerbates growth cycle

Heavy industry has accounted for an increasing share of industrial production



Property prices continued to fall

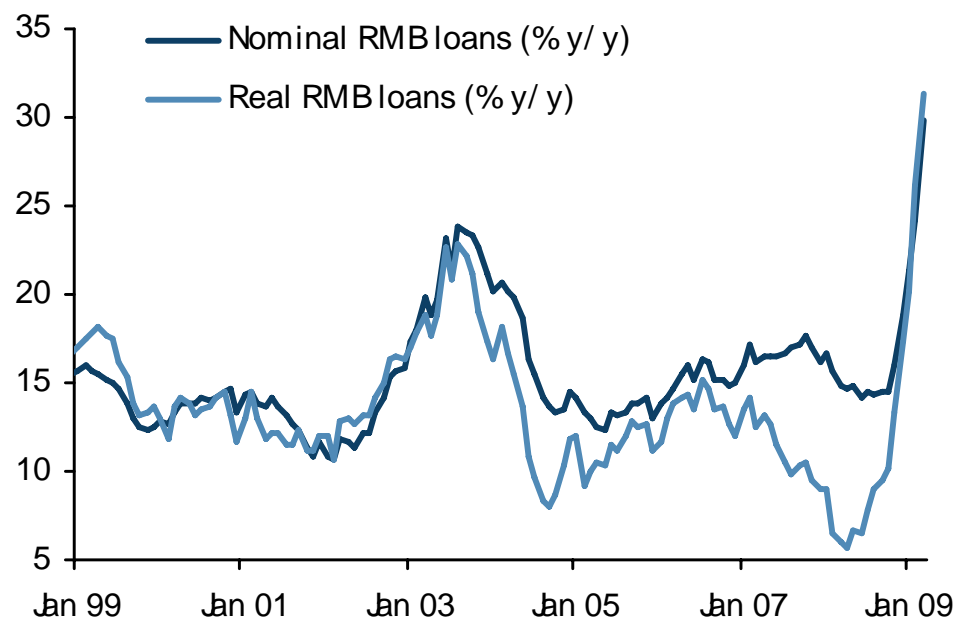


China: Shifting forces driving growth

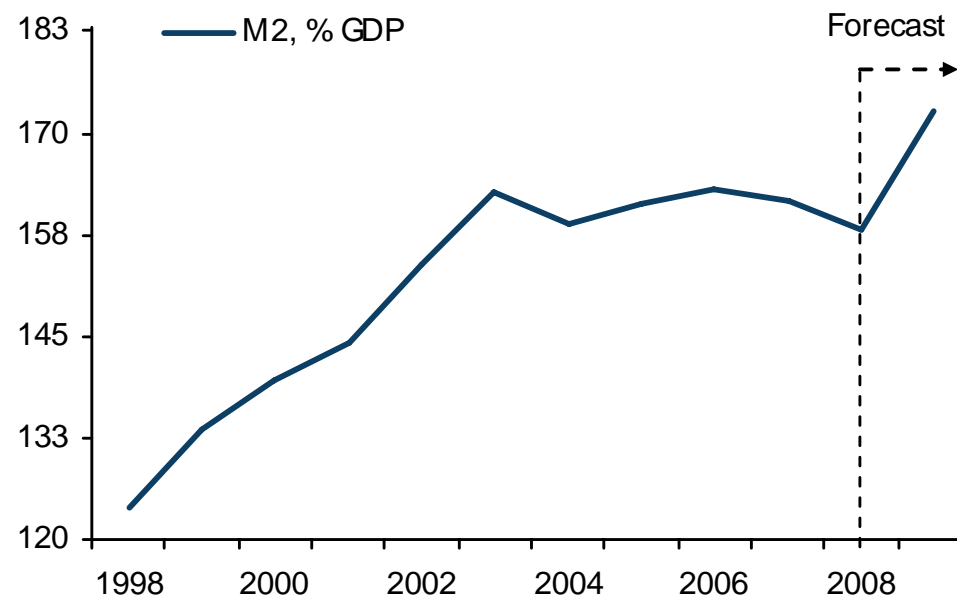
5) Reversal of monetary policy

- Cut of 216bp in the benchmark 1y lending rate since September 2008
- Quantitative easing powered by credit growth
- A marked rise in M2/GDP ratio implies a significant easing of monetary conditions

Credit growth picking up strongly...



... and is expected to boost M2 growth

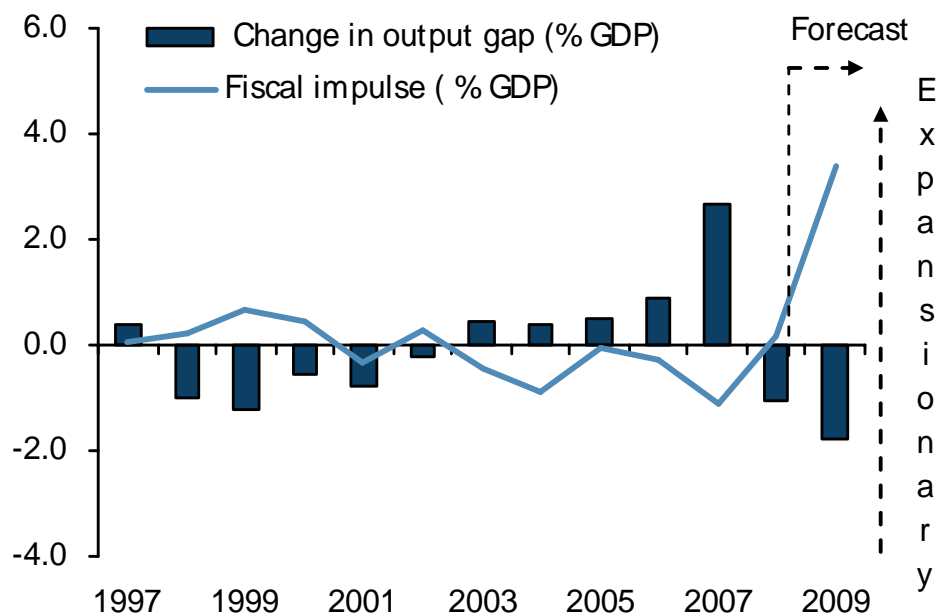


China: Shifting forces driving growth

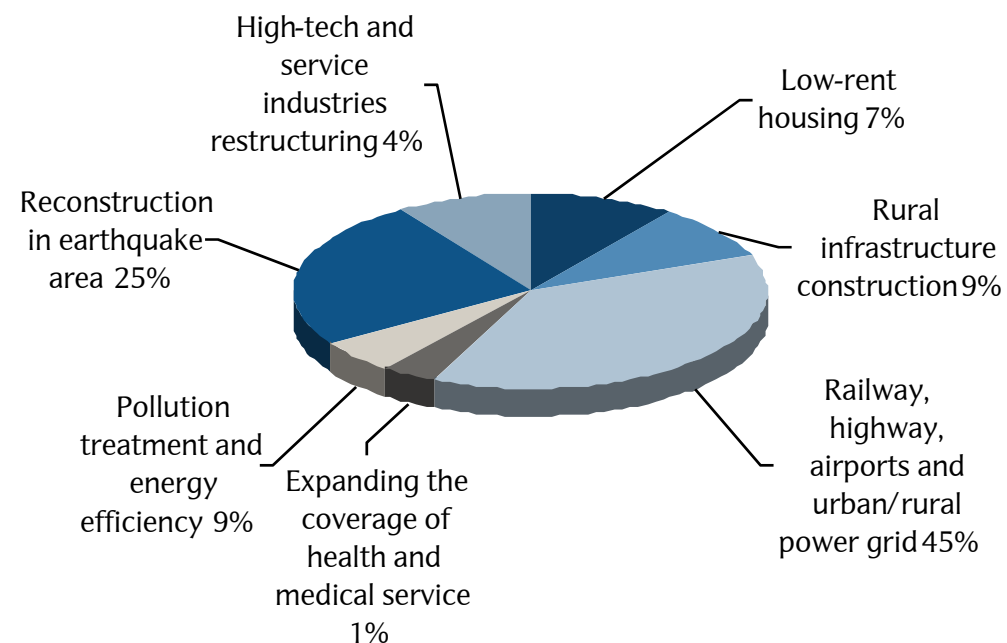
6) Reversal of fiscal policy

- CNY4trn (USD586bn) spending package
- Recent measures shift spending from investment to transfer payments and social protection
- We estimate fiscal stimulus to boost growth by 3.5pp in 2009

Fiscal impulse



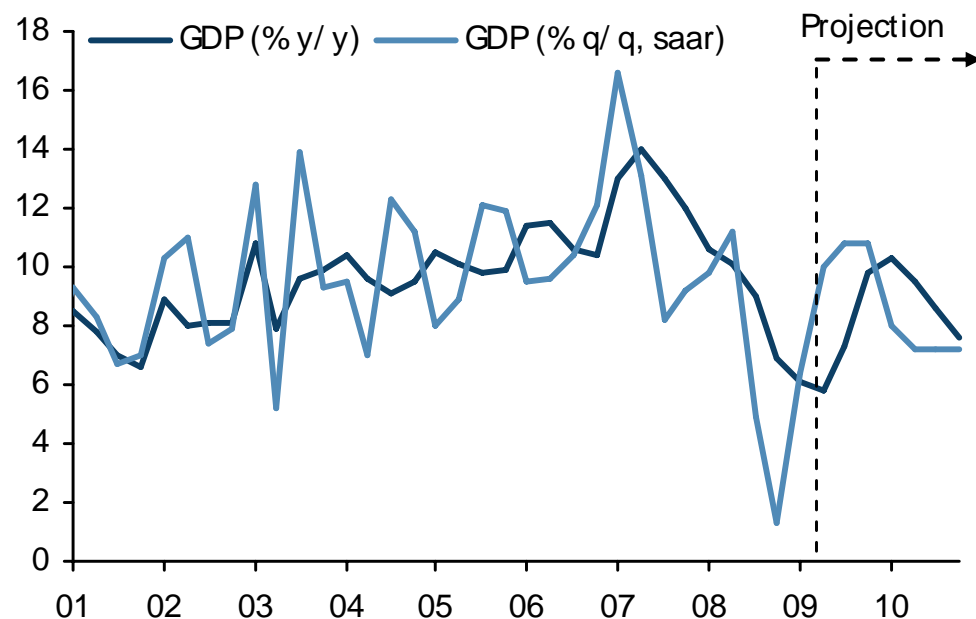
Composition of the CNY4trn investment package



China: Outlook in 2009

- Growth to accelerate in 2H, giving average growth of 7.2% for 2009
- The balance of risks tilts toward the upside

Growth is expected to recover in 2H...



... but with broad-based slowdown for 2009 as a whole

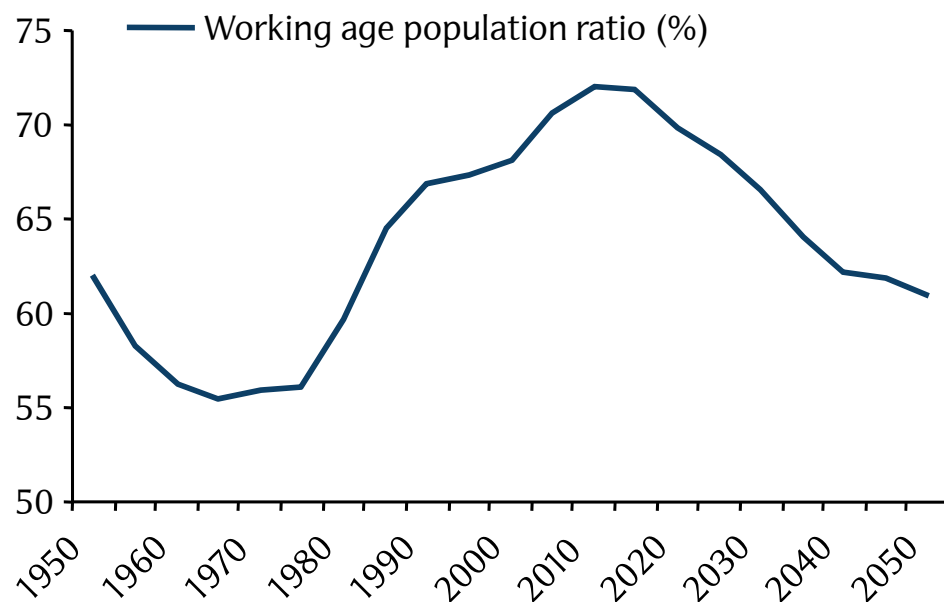
	2007	2008	2009F	2010F
GDP contribution (pp)				
Consumption	5.0	3.9	3.6	4.3
- Private consumption	3.7	2.8	2.1	2.9
- Government consump	1.3	1.1	1.5	1.4
Gross Capital Investment	5.4	3.8	4.1	4.1
Net Exports	2.6	1.3	-0.5	0.6
Real GDP	13.0	9.0	7.2	9.0

China: Longer-term growth trend unchanged

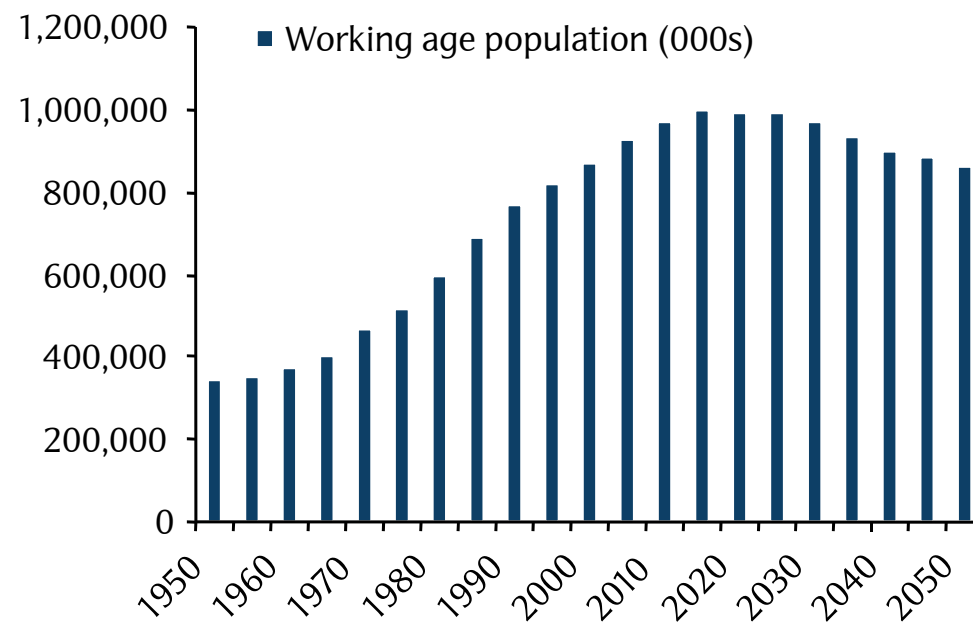
1) Working-age population

- Working-age population ratio will reach a peak around 2015
- The working-age population is not projected to decline until about 2030

Working-age population ratio set to reach 72% by 2015



Working-age population is projected to rise to nearly 1bn by 2015

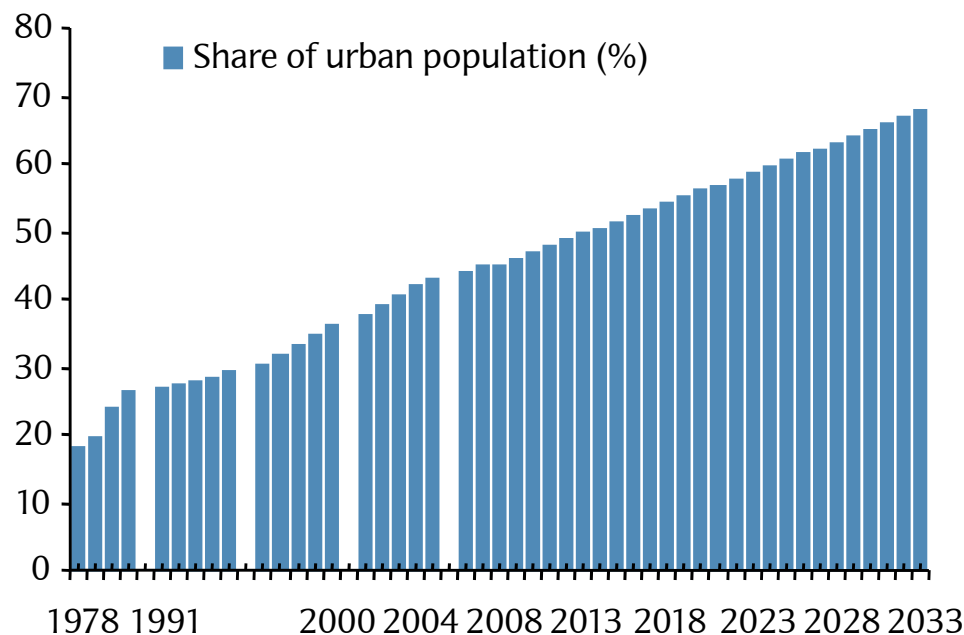


China: Longer-term growth trend unchanged

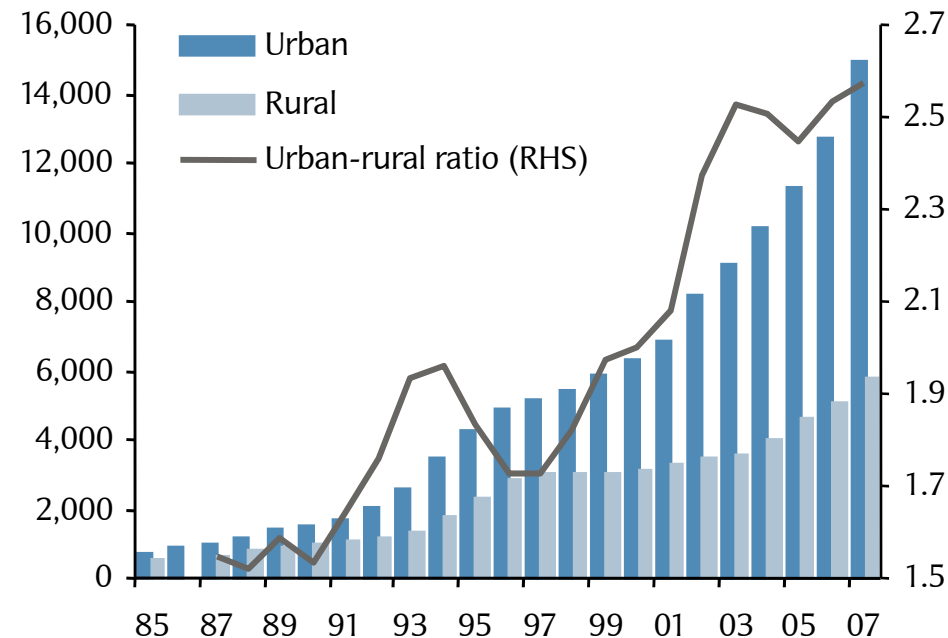
2) Urbanisation has a long way to go

- Urbanisation ratio is still low compared with developed countries
- Urban-rural income gap is large, providing incentives for migration

Urban population ratio is currently about 40%



Urban-rural income gap remains large (CNY)

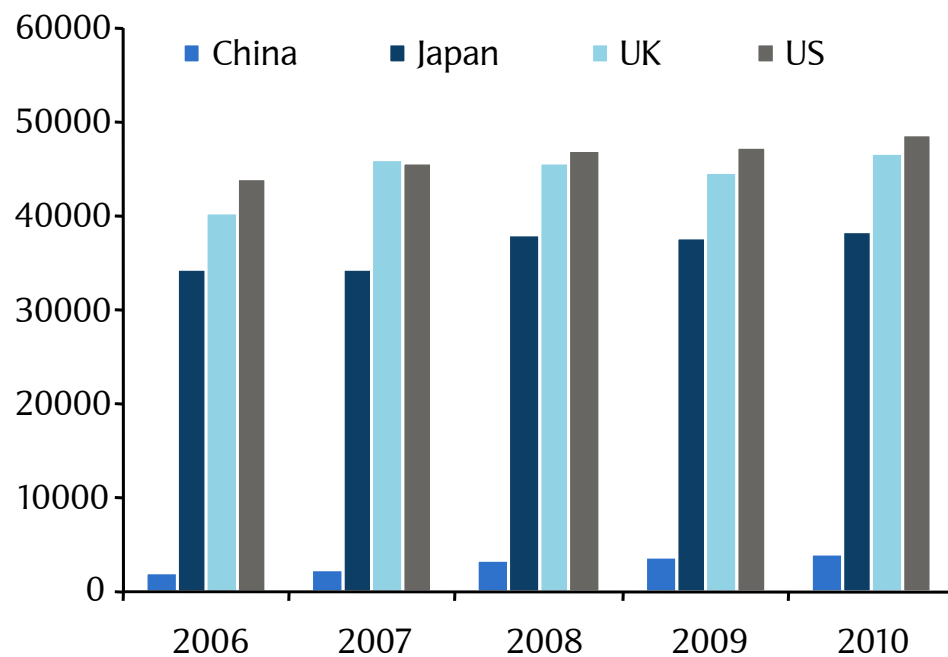


China: Longer-term growth trend unchanged

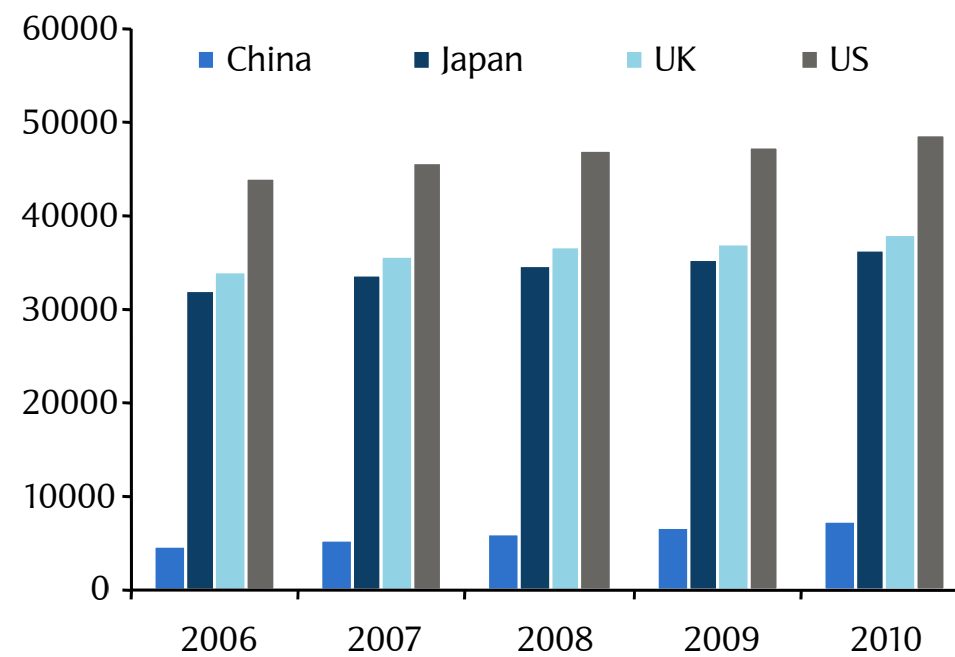
3) Catch-up remains an important force

- China's per capita GDP is much lower than is typical in developed countries
- The catch-up process will continue to be a driver of relatively fast growth

GDP per capita (USD) measured at the market exchange rate



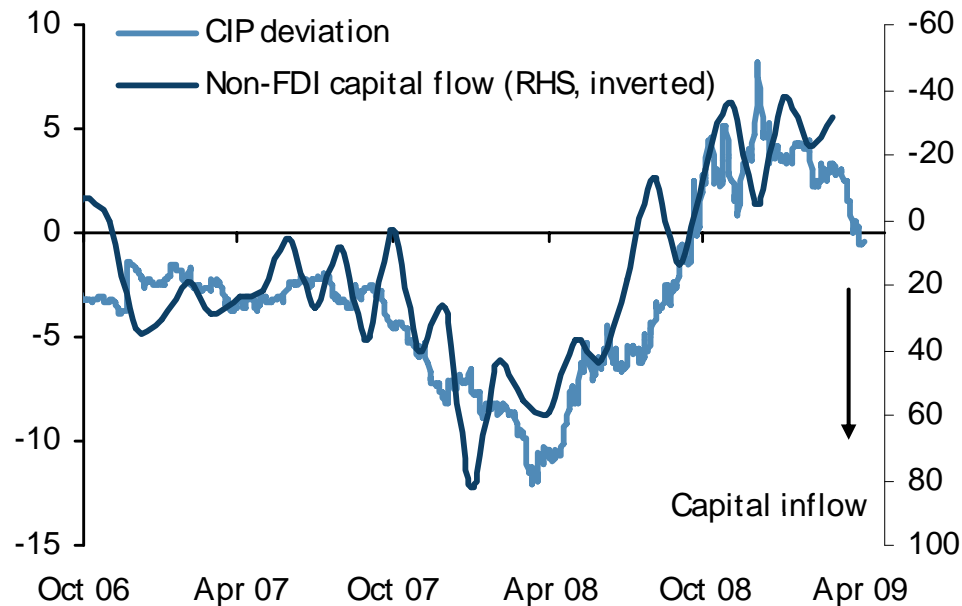
GDP per capita (USD) measured at PPP-based exchange rate



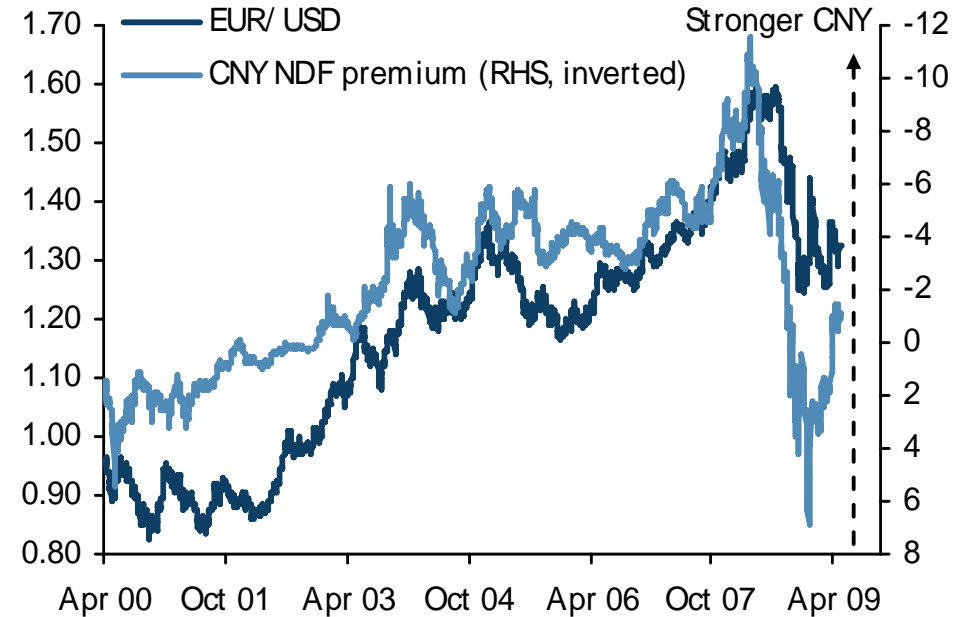
China: Capital inflow pressure likely to re-emerge...

- The pressures for inflows and outflows are roughly balanced currently
- Domestic growth recovery and a weaker USD likely lead to inflow pressures over the course of 2009

CIP deviations correlate with estimated non-FDI flows



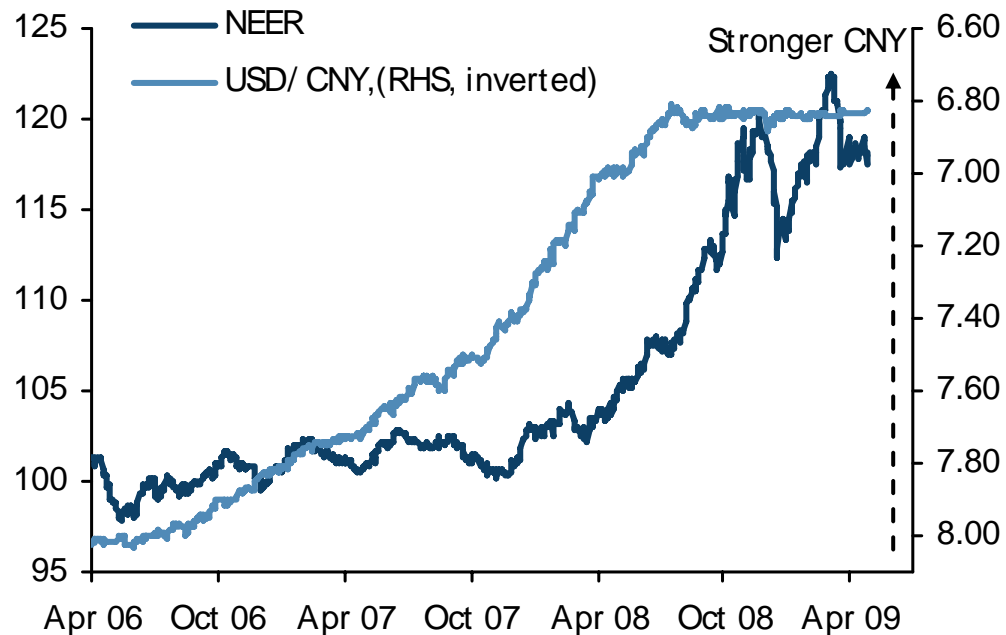
EUR/USD tends to affect the CNY forward rate



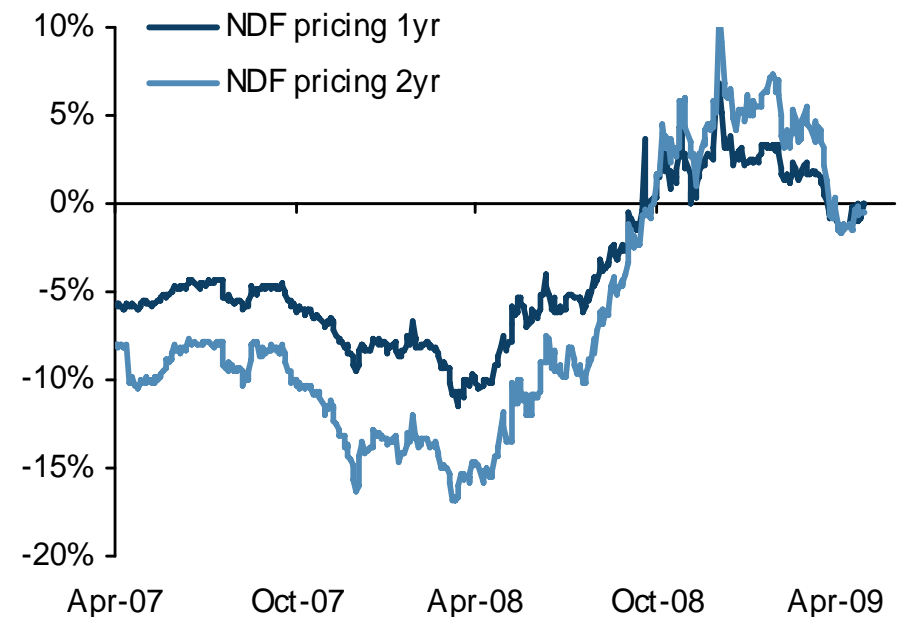
...implying a stronger CNY

- Referencing the CNY to a basket is likely to rise over time
- USD/CNY rangebound in the near term with a strong tone for the CNY
- A break from the USD/CNY range is likely to be associated with a stronger CNY

The pace of CNY appreciation has slowed sharply...



... and was quickly reflected in NDF pricing



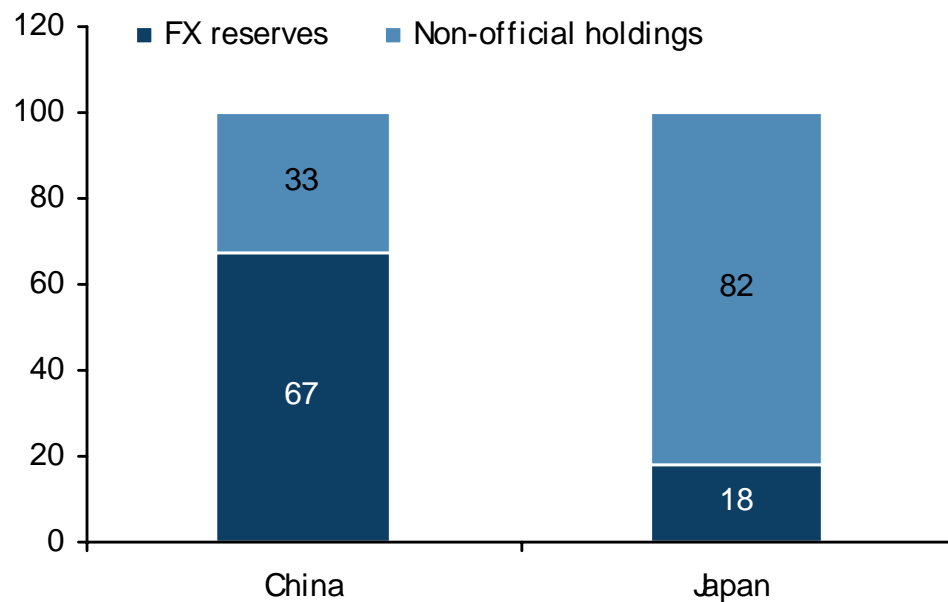
China: The case for diversification of external assets

- The structure of China's external capital is imbalanced with a concentration in official holdings and a “long debt, short equity” asymmetry.
- A reduction of the concentration in debt instruments and official holdings would improve the long-term risk-return balance of China's external assets.
- The pace of diversification is likely uncertain, as the current structure of external capital reflects factors that go beyond the narrow sense of FX reserve management.
- Nevertheless, at a conceptual level, we hold a view that a shift towards risky assets in China's external investments would help boost risk appetite in global markets.

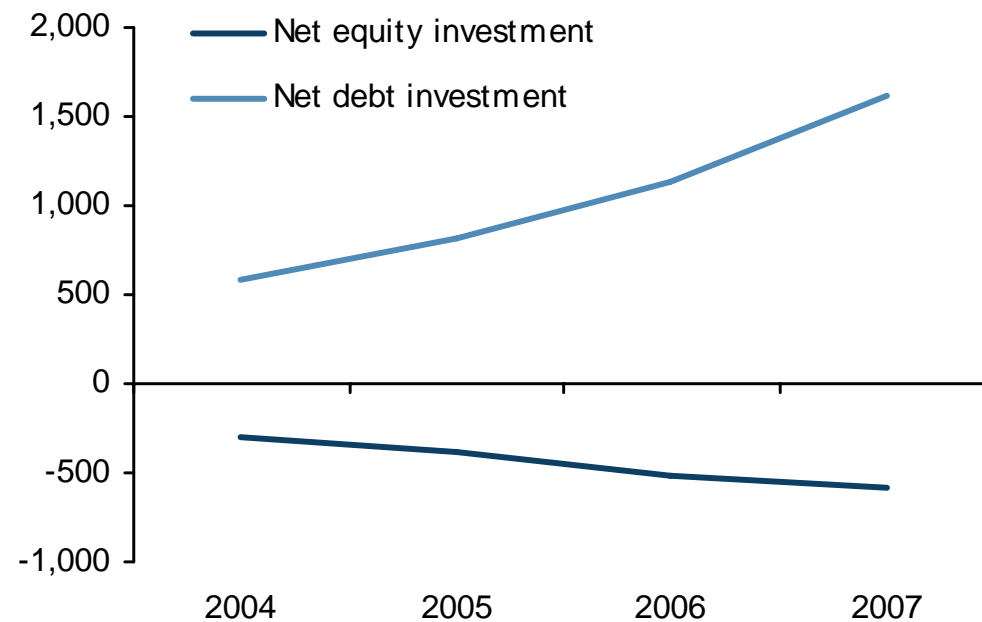
China: Imbalances in the structure of external capital

- Concentration of external assets in the official sector
- A “long debt short equity” asymmetry

Composition of external assets



A growing “long debt, short equity” asymmetry (USD bn)



China's net external assets are much smaller than Japan's

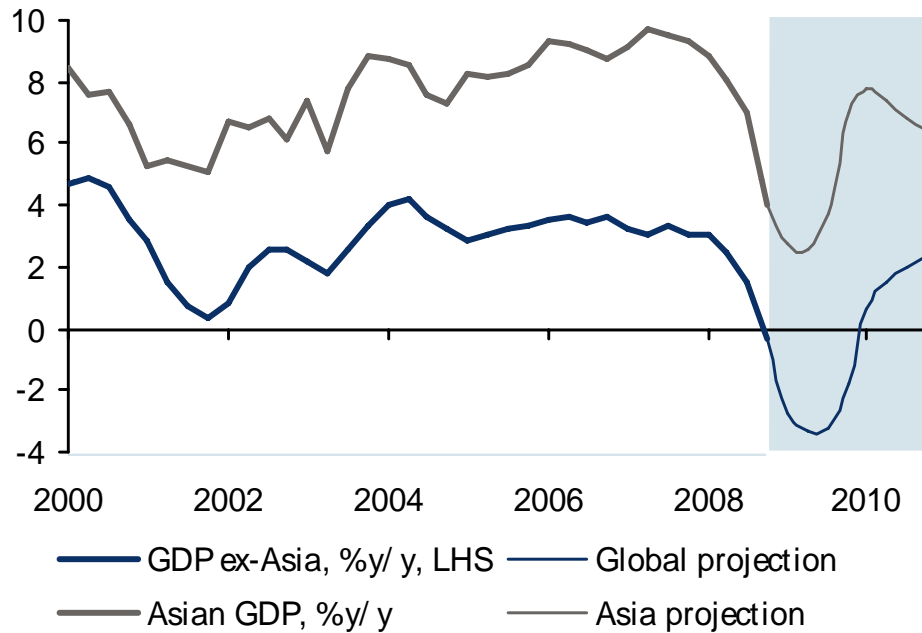
	China	Japan
As of end 2007		
		USD bn
Net external assets	1,022	2,195
FX reserves	1,535	967
Non-official net external assets	-513	1,228
		% of GDP
Net external assets	29	42
FX reserves	43	19
Non-official net external assets	-15	24

Emerging Asia: 2H09 recovery in place

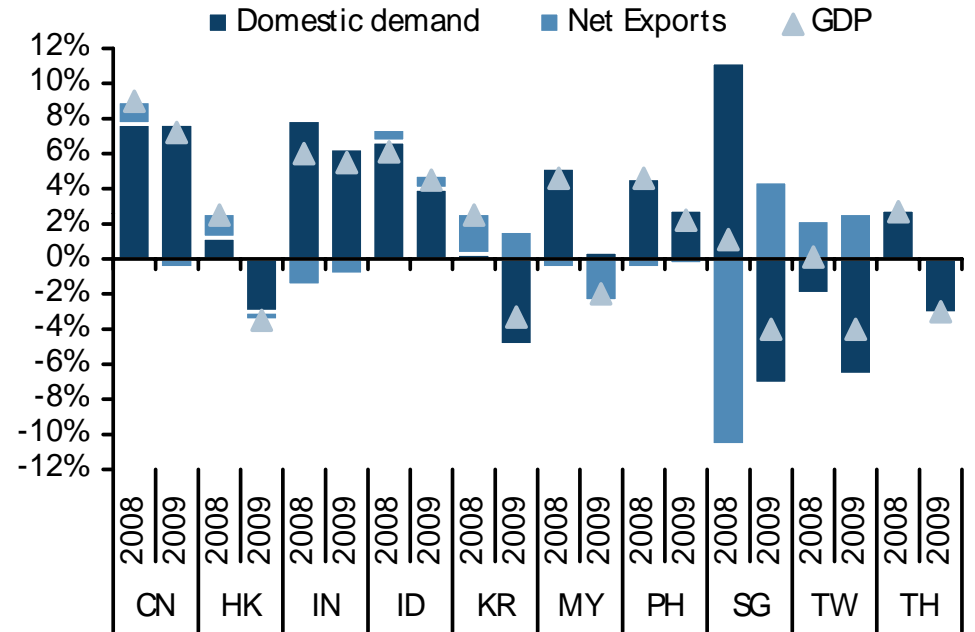
	GDP growth						GDP growth		
	% over previous period, saar						% annual change		
	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	2008	2009	2010
PR China	4.9	1.3	6.4	10.0	10.8	10.8	9.0	7.2	9.0
Hong Kong, SAR	-2.8	-8.0	-3.2	-2.4	-0.8	0.0	2.7	-3.5	2.5
China, Taipei	-7.8	-21.2	-0.9	6.0	3.0	2.7	0.1	-4.0	4.0
India	7.4	0.4	6.0	5.0	8.0	8.5	6.0	5.5	6.0
Indonesia	6.4	-0.4	-3.7	0.5	8.0	7.0	6.1	4.5	5.0
Malaysia	-0.7	-9.3	-9.5	5.9	3.6	8.8	4.6	-2.0	3.5
Philippines	4.8	4.0	0.7	2.1	4.2	4.5	4.6	2.2	4.0
Singapore	-2.1	-16.4	-5.8	2.1	9.9	7.2	1.1	-4.0	4.0
South Korea	2.2	-22.8	0.4	2.3	2.9	2.9	2.5	-2.5	3.7
Thailand	1.7	-24.4	-2.0	3.5	5.9	6.2	2.7	-3.0	4.0
Japan	-1.4	-12.1	-19.3	3.7	4.0	2.4	-0.6	-6.7	1.4
EM Asia	4.1	-3.7	3.7	6.7	7.6	8.3	6.6	4.3	6.8
EM Asia (ex China and India)	0.8	-14.2	-2.1	2.6	4.4	4.5	3.1	-1.2	3.8
Global	1.2	-5.5	-5.4	0.5	2.5	3.7	2.9	-1.5	3.2

EM Asia leads the global recovery

The recovery in EM Asia is expected to come slightly earlier and more aggressively than elsewhere

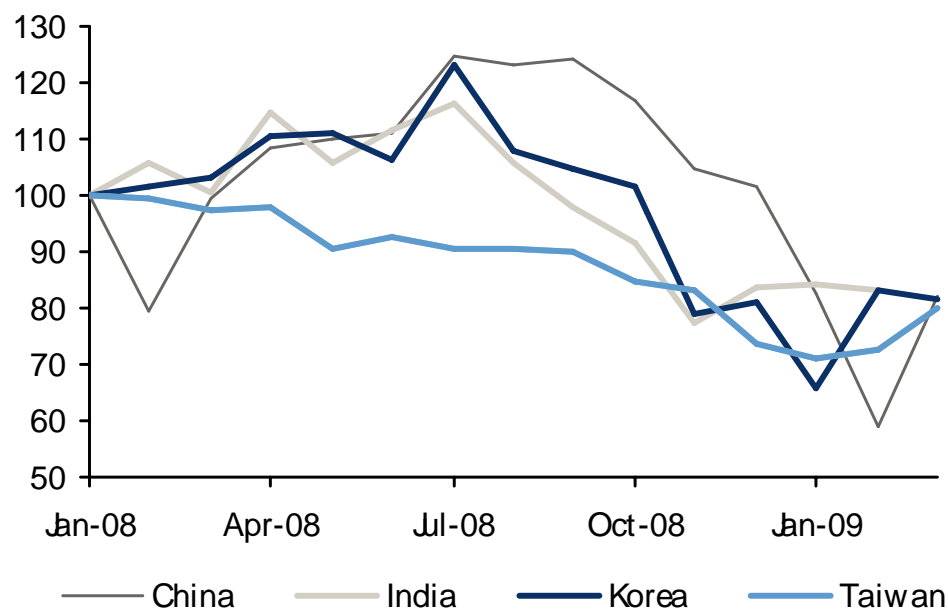


... but the damage of the collapse in 2H08 and 1Q09 means Asia will post weak calendar 2009 growth

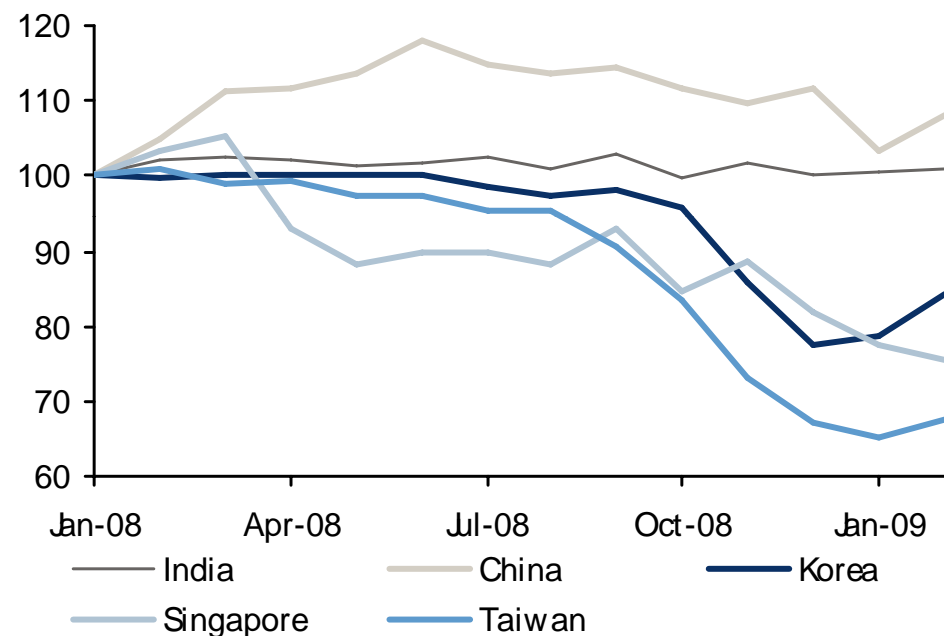


Emerging Asia: Industrial production starting to recover due to export stabilisation...

Exports slumped in 3Q08 but recently have shown signs of revival (sa)

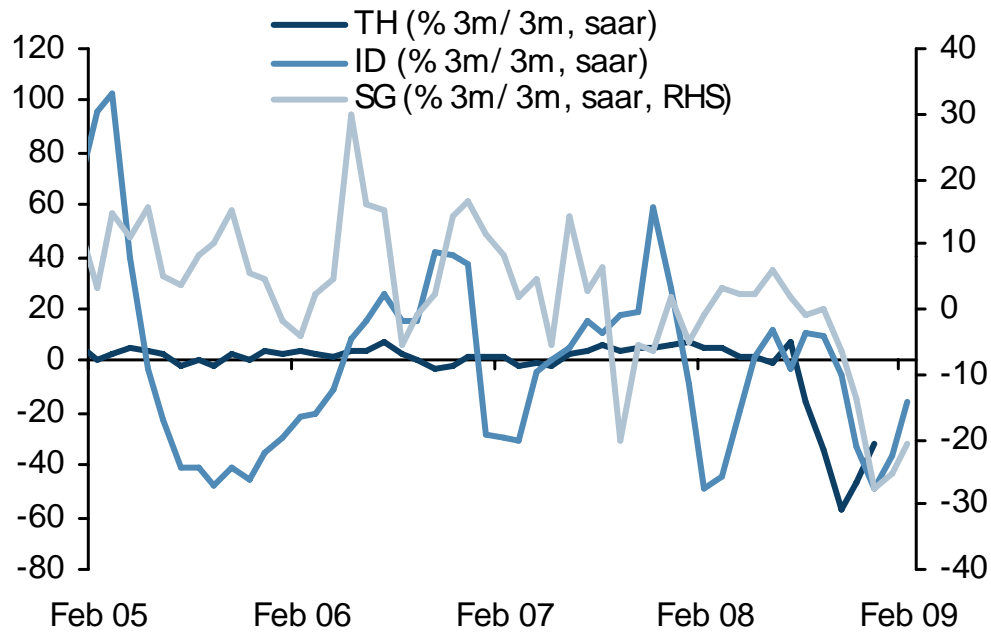


Industrial production slumped in 4Q08 but in recent months production has started to revive (sa)

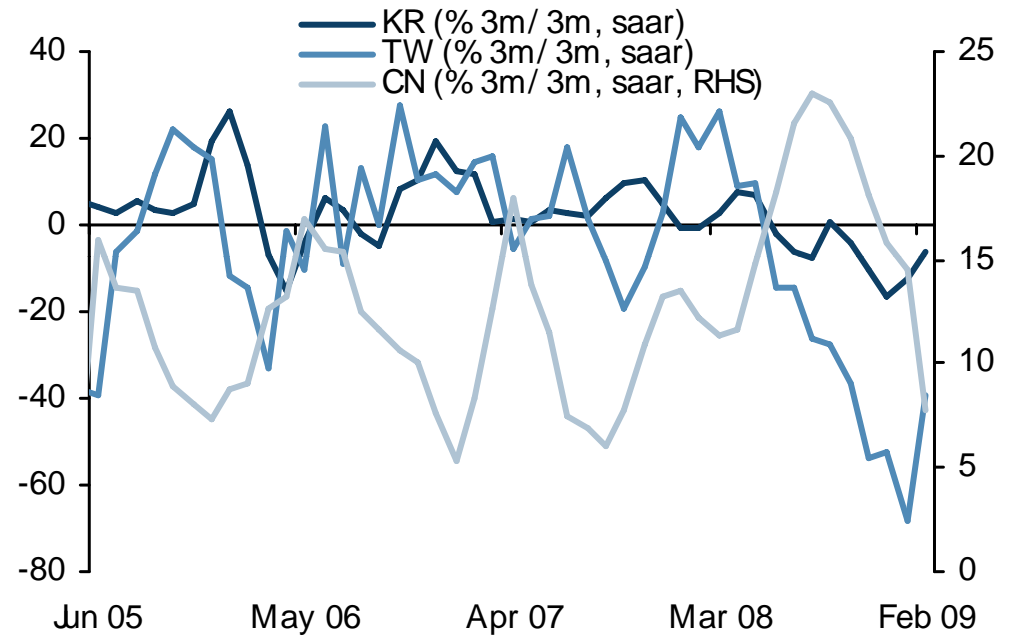


... modest recovery in real retail sales, which is being supported by ...

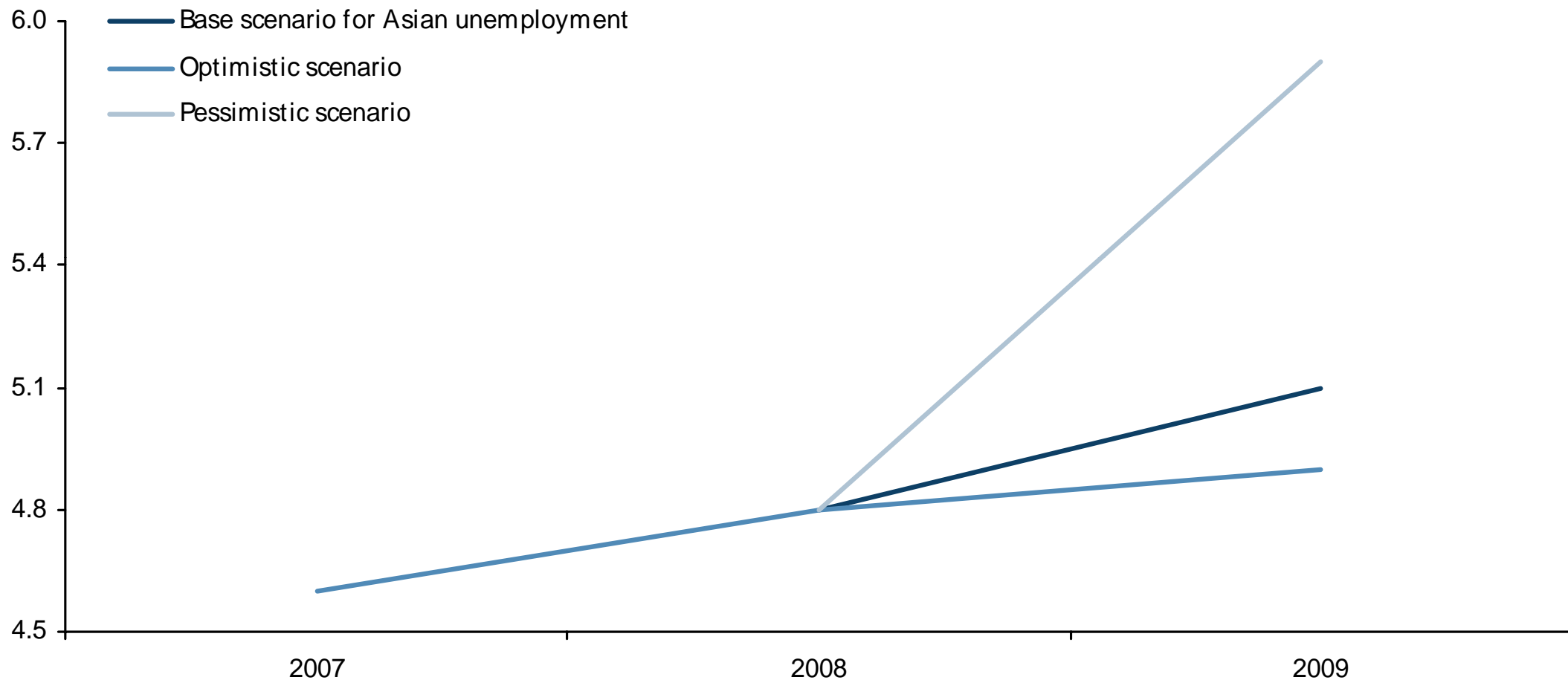
Real retail sales seems to have bottomed out...



... and the momentum is turning up



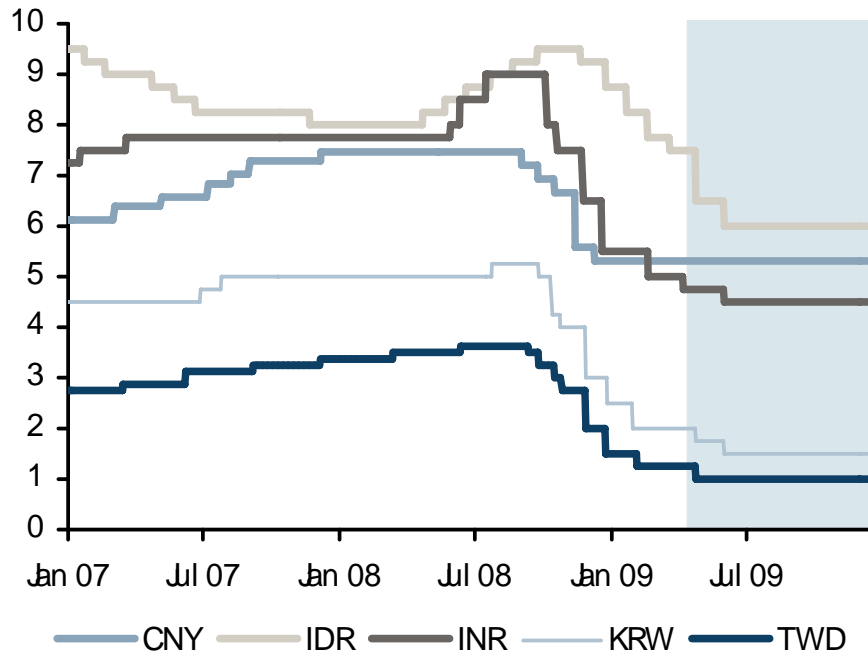
... tolerable unemployment rates



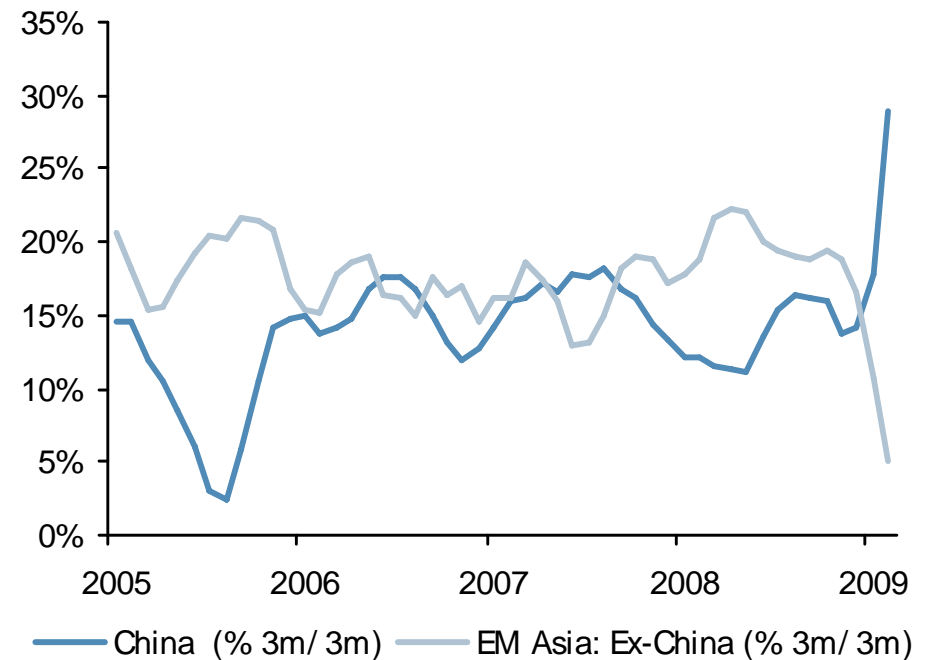
Emerging Asia: Monetary stimulus is already being felt

- Easing cycle drawing to a close.
- Inflation trend is drifting lower; but deflation is unlikely to be a major concern.
- Asian banks appear relatively healthy due to low levels of gearing.

Policy rate cuts are drawing to a close



Monetary expansion most apparent in China



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