

The Stimulus Program: China's Second Great Leap

How well did China weather the crisis?

- The internationally exposed portion of China's economy went into seizure in autumn 2008, and the government reacted with a panicked funding plan.
- Aggressive lending was the keystone of the plan. The 4T RMB direct stimulus spending was implemented behind plan, almost as an afterthought.
- The goals included replacing lost export demand with domestic demand, as with the “electronics to the countryside” subsidies. As the central government intervened with cash, its own authority and ownership stakes grew accordingly.
- The process reverted the banks to their more familiar role as utilities for distributing government cash and will precipitate a bailout whose dimensions are not yet understood. This has become dependably a once-a-decade event.

The 8% growth imperative



Because of the inefficient nature of Chinese growth, forward momentum above 5% is needed in order to generate wage and consumption growth of half that level. Without that, China cannot generate the deposit growth required to fuel investment.

Components of the Plan

- Direct fiscal stimulus, central and local
- Industrial plans with incentives to raise money from society to fund them
- The lending spree

Composition of the Stimulus Package

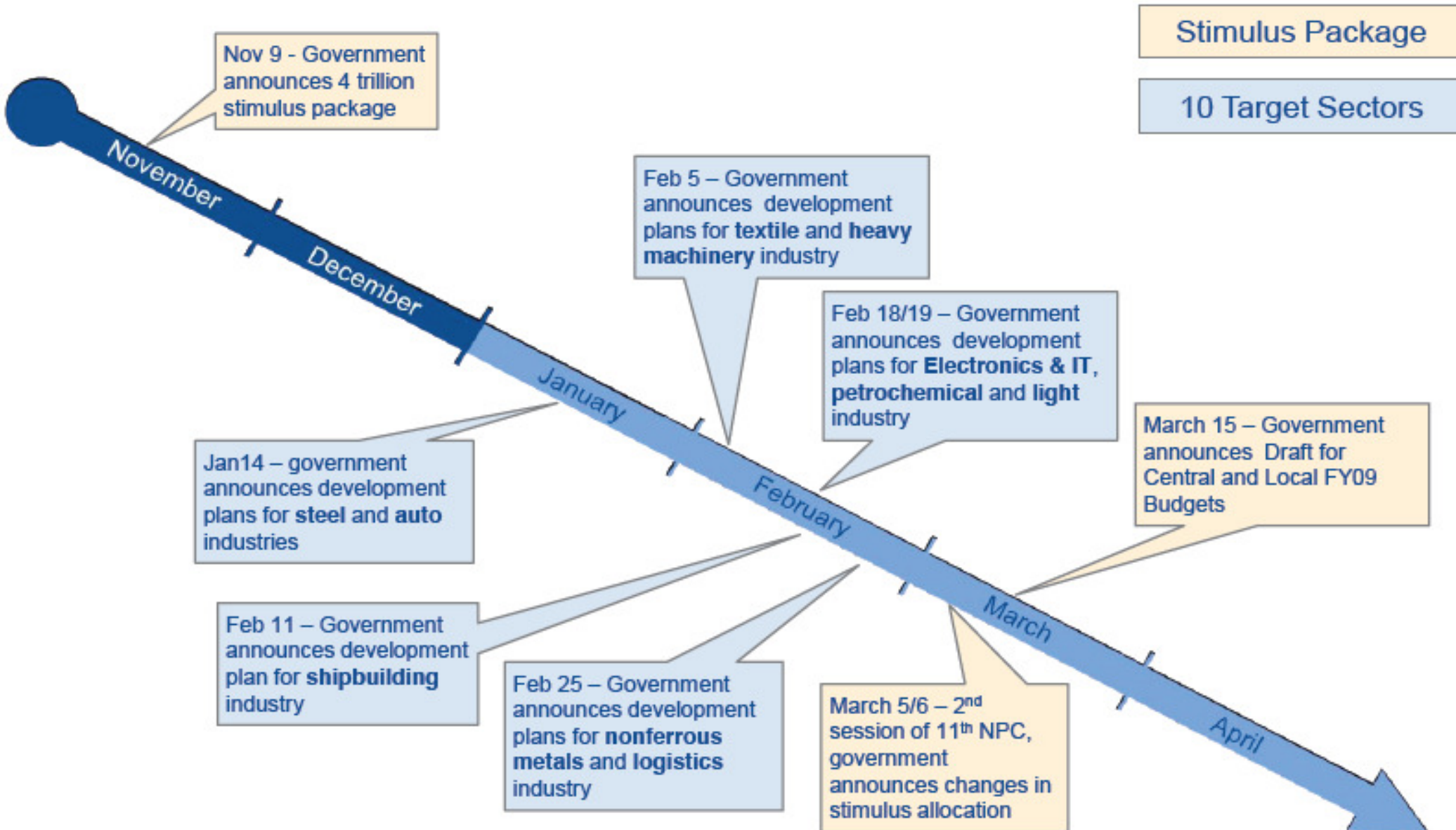
Sector	Amt Allocated (billions of RMB)
Transport and power infrastructure (railroads, roads, airports, electricity grids)	1,800
Earthquake reconstruction	1,000
Rural village infrastructure	370
Environmental investment; natural areas	350
Affordable housing	280
Technological innovation	160
Health and education	40
Total	4,000

Source: Barry Naughton, China Leadership Monitor No. 27:
“The Scramble to Maintain Growth”

Spending Components

- Direct fiscal stimulus by central government: 1.18 T
- 100 bln increment for Q4 2008
- Approved Local projects: 18 T

Timing of the Stimulus: 2008-2009



Spending was to be focused on:

- Transportation
- Construction of rural infrastructure
- Environmental protection
- Innovation and high-tech-oriented industrial restructuring
- Earthquake area reconstruction
- Value-added tax reforms
- Finance sector
- Public housing development
- Healthcare and education
- Low-income initiatives

How Local Governments Could Raise Money

- The RMB 200 billion bond program, initially undertaken by the Ministry of Finance on behalf of local governments, then directly by local governments
- Policy loans
- Local corporate bonds, including those issued by LGFVs

Central Government Fiscal Stimulus

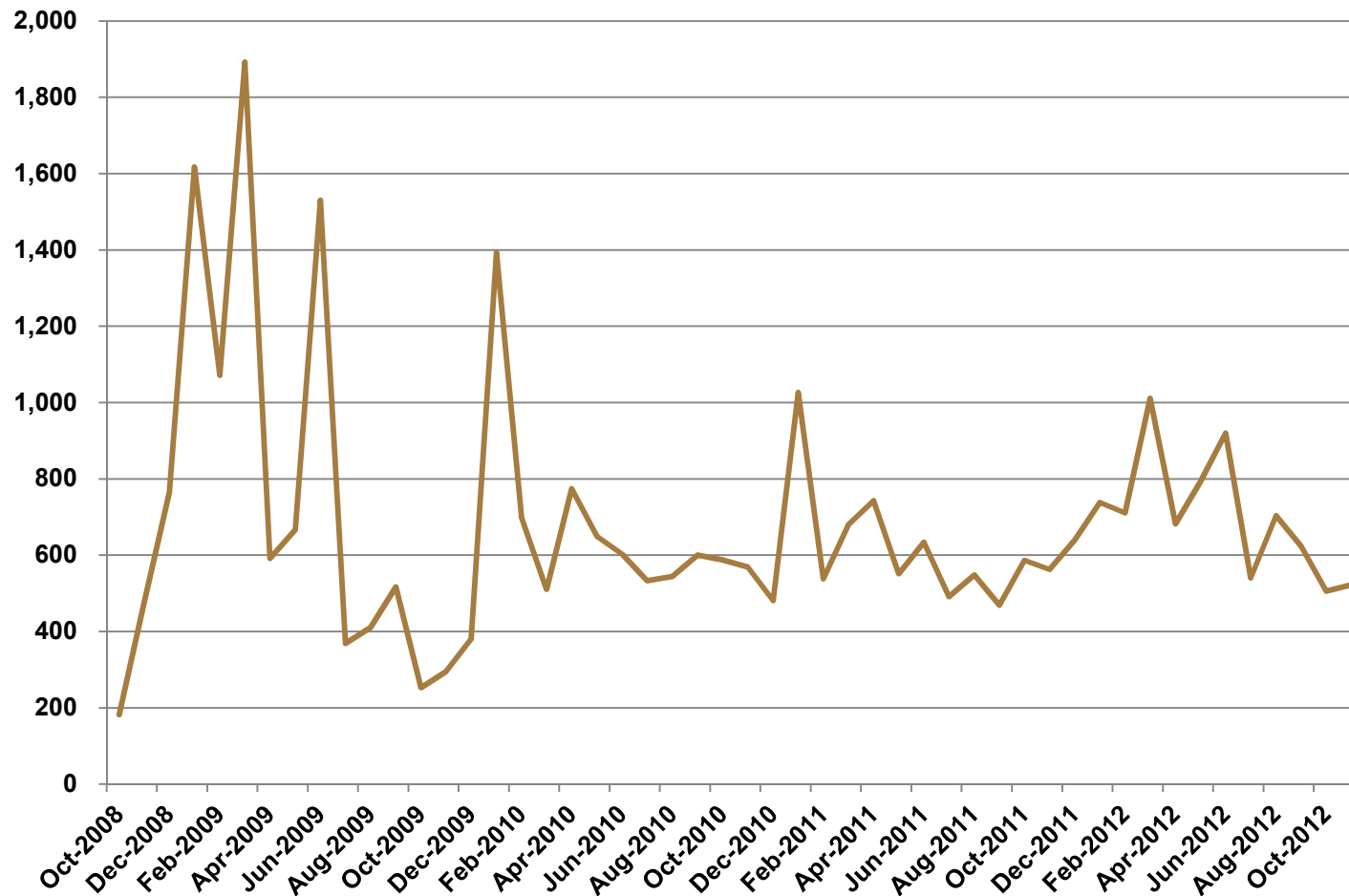
new spending, in bln RMB

Category	Total Originally Planned	Total New
Transport & infrastructure	1800	1500
Post-earthquake reconstruction	1000	1000
Affordable housing	280	400
Rural living standards & infrastructure	370	370
Technological innovation & industry restructuring	160	370
Environmental protection	350	210
Health & education	40	150

How it was budgeted

- The FY2009 budget contained a 3% deficit, of 950 billion, to pay for the stimulus.
- Budget represented a 24% spending increase over 2008.
- The biggest increases in spending were incurred at the local level.
- Biggest increases in public housing construction, public security, earthquake reconstruction, and increasing reserves of grains and edible oils.

The Real Money: Credit Explosion



New RMB loans started expanding like crazy in 2009.

Increasingly, credit is from non-bank sources

Year	Announced Target	Planned Growth	Actual Lending (bln RMB)	Actual Growth	Total Financing	Proportion of Non-Bank to Bank Financing
2000	¥969	7.79%	¥1,000			
2001	¥1,212	25.08%	¥1,300	30%		
2002	¥1,847	52.39%	¥1,847	42%	¥2,059	10%
2003	¥2,765	49.70%	¥2,765	50%	¥3,411	19%
2004	¥2,277	-17.65%	¥2,267	-18%	¥2,863	21%
2005	¥2,385	4.74%	¥2,354	4%	¥3,001	22%
2006	¥3,146	31.91%	¥3,152	34%	¥4,270	26%
2007	¥2,900	-7.82%	¥3,632	15%	¥5,966	39%
2008	¥4,904	69.10%	¥4,904	35%	¥6,980	30%
2009	¥5,000	1.96%	¥9,594	96%	¥13,911	31%
2010	¥7,500	50.00%	¥7,945	-17%	¥14,019	43%
2011	¥6,600	-12.00%	¥7,472	-6%	¥12,829	42%
2012	¥8,000	21.21%	¥8,270	11%	¥15,860	48%

Where the Money Went: The Industrial Plans

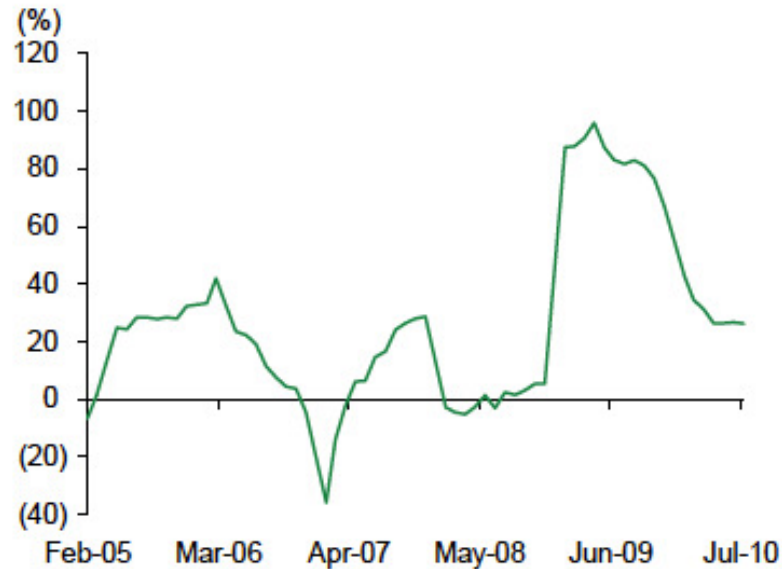
- Autos: lowered taxes and rebates for purchases
- Steel: subsidies for steel mills to vertically integrate with iron ore mines and logistics ports
- Textiles: tax rebates
- Heavy Machinery: tax incentives
- Shipbuilding: Government procurement
- Electronics & IT: accelerated procurement, consumer credits
- Petrochemicals: direct support for R&D
- Light Industry: higher export tax rebate, subsidies to makers of consumer electronics
- Nonferrous Metals: cheap loans
- Logistics: direct subsidies

Industrial Plans

- Focus on capital-intensive sectors
- Tax rebates, subsidies, preferential loans
- A mostly unsuccessful attempt to guide money that would be released throughout the bureaucracies

The Reality: Industrial Plans

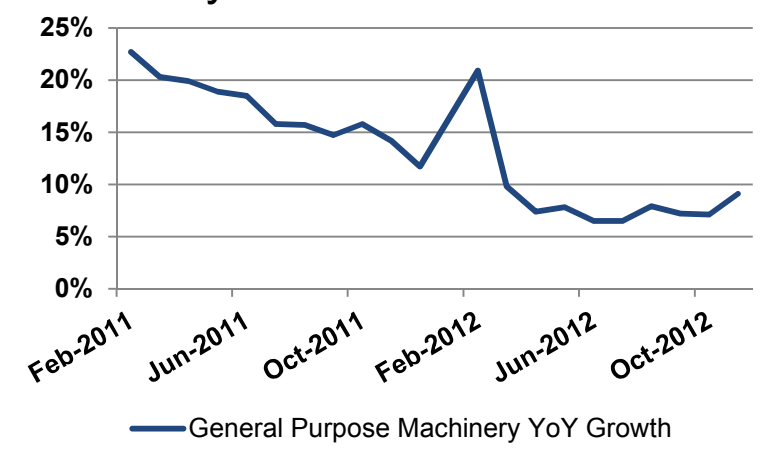
FAI planned investment in new projects surged in 2009 then dropped. Much of the capital was diverted to property.



Manufacturing FAI Growth 2012



Machinery FAI Growth 2011-2012



Where the Money Went: Infrastructure

Type	By 2005	2006-2010	end 2010	2011-2016
Highways (km)	41,000	65,000	74,000	108,000
Number of airports	142	186	175	230
Port Volume (bln tons)	3.4	5	5.6	7.8

Some of the Problems

- Rail: Investment rises rapidly, topping 1T RMB in 2010. But the system is plagued with cost overruns. No line's ticket sales justify the build-out. And graft has taken billions out of the system. The now-deposed Minister of Railways was reported to have nearly US\$3 billion in personal wealth.
- Development ones: proliferated unreasonably. The city of Suzhou alone has several dozen.
- Airports: 70% fail to cover their costs, and yet more are being built.
- Highways: Using a standard of 1.4 km per \$10,000 in GDP (CASS study), China already has 3x as much highway as the EU.
- Ports: New ports also are losing money, but more are being built.

Cost Overruns

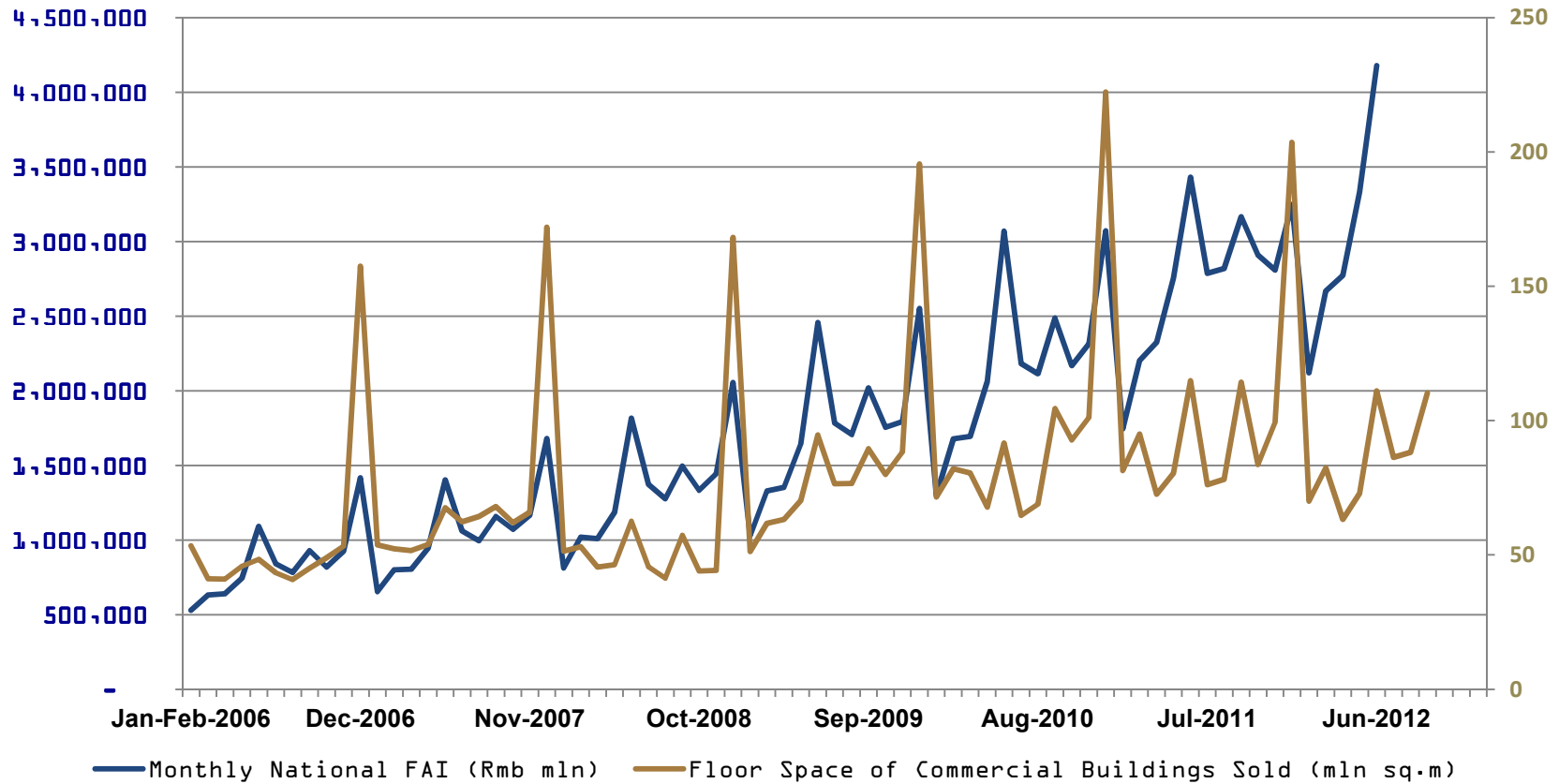
Unit: bln RMB	Original Budget	Actual Spending	Overruns
Beijing Olympics	13.0	19.3	48%
Guangzhou Asian Games	13.6	17.4	28%
The Three Gorges Project	90.0	180.0	100%
Hangzhou Bay Bridge	11.8	16.0	36%
Capital airport Terminal 3	25.0	27.0	8%
Jinghu (Beijing-Shanghai) High-speed Railway	92.0	220.0	139%
Wuguang (Wuhan-Guangzhou) High-speed Railway	68.0	116.0	71%
Guangzhou Railway Station	7.1	14.1	99%
Shanghai Harbor New City	120	200	67%
Chongqi Bridge	3.6	7.6	111%
Qinling Zhongnanshan Tunnel	2.5	3.2	28%
Wuhan Erqi Bridge	4.8	7.3	52%
AVERAGE			66%

Where the Money Went: Social Housing

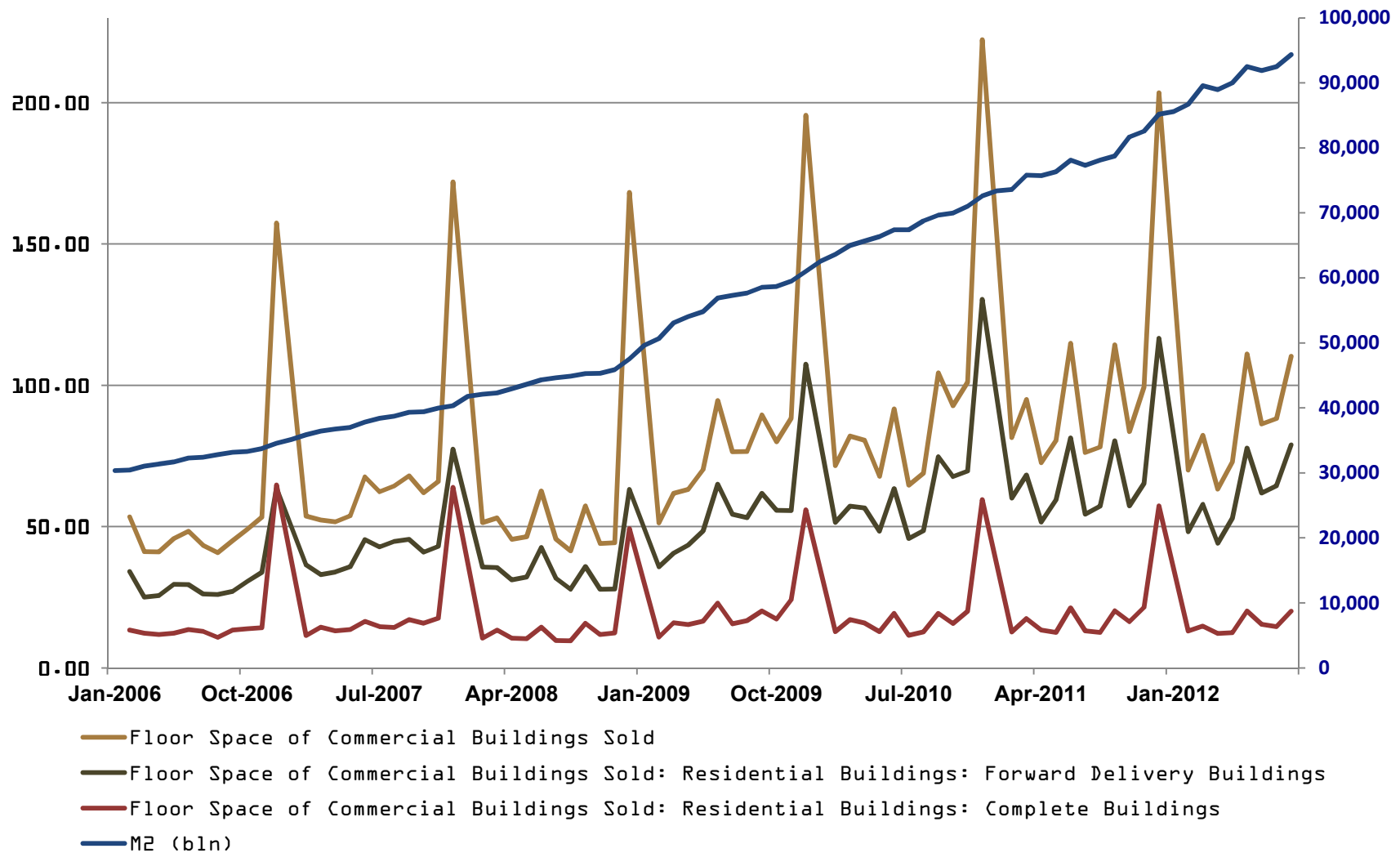
	Apartments New Starts (Mil)	Steel Demand MT
2010	5.9	12
2011	10.2	31
2012	9.6	39
2013	7.0	32

Source: MOHURD, J Capital

Where the Money Went: Commercial Housing



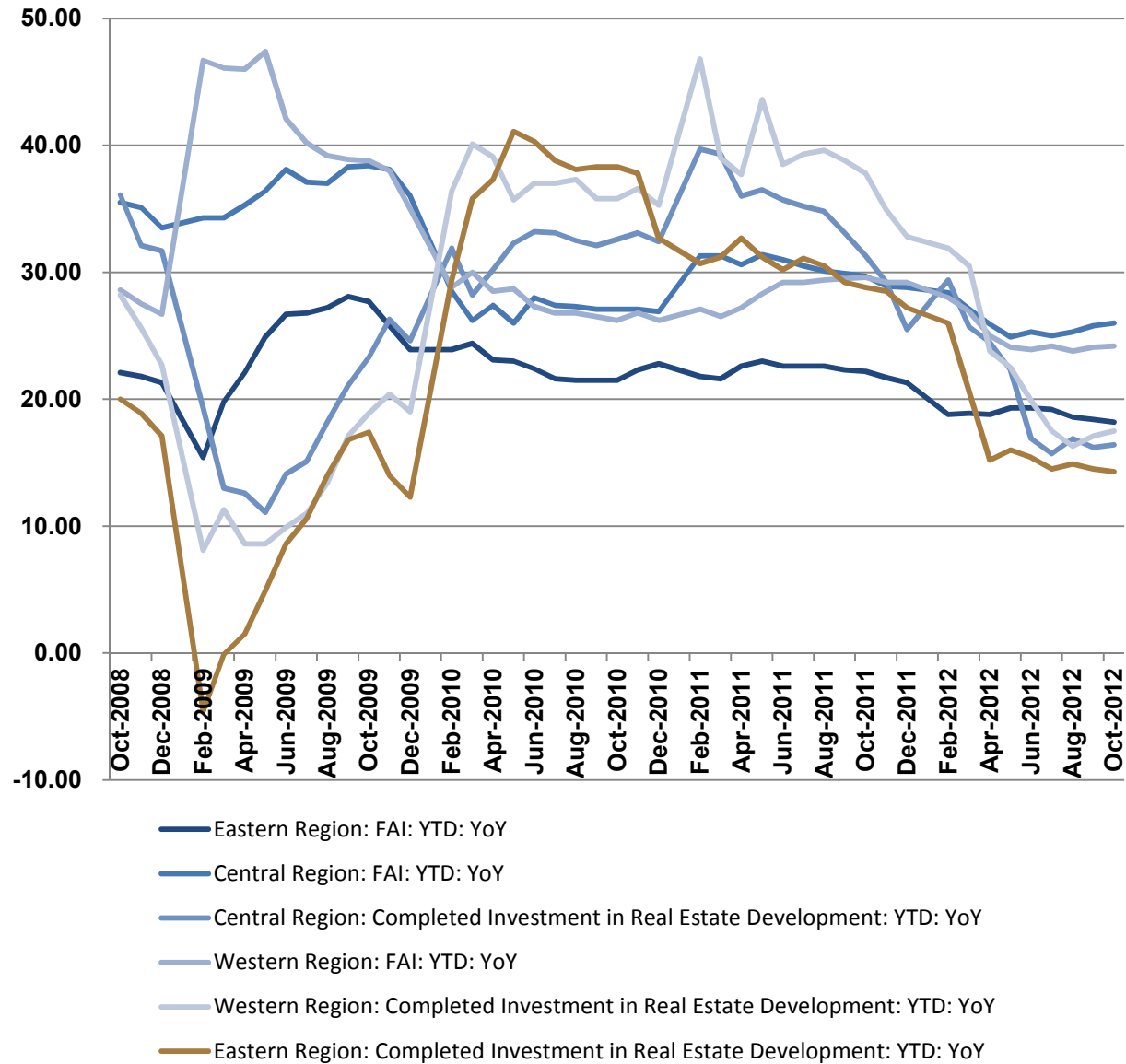
As the money supply shot up, so did construction of housing



New Cities



Percentage Growth in Real Estate Investment by Region



国进民退

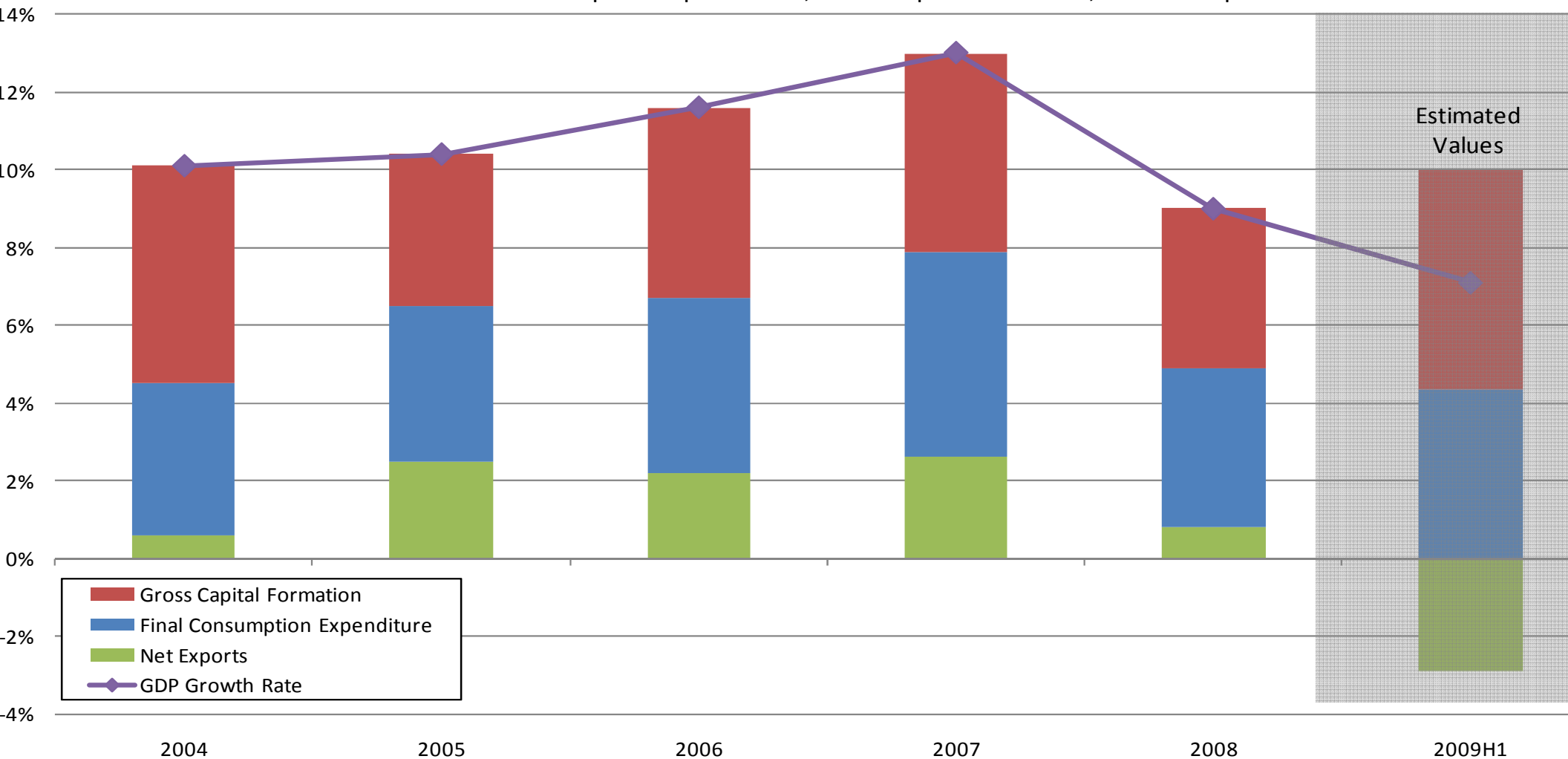
- Dramatic increase in state ownership of mining and resources
- Social housing program: state participation in property development
- In terms of capital, the proportion of SOEs in electric power and supply industries rose from 85.8% in 2005 to 88.2% in 2008.
- According to Unirule Institute, average return on equity for SOEs 2001-2009 was -6.3%. Average SOE tax burden: 10%. Average for private enterprises: 24%.

Collapse in net exports offset by capital formation, not consumption

With no significant growth to be expected in net exports for the foreseeable future, trend GDP growth in China will likely be markedly lower for the next several years.

Expenditure Based GDP Growth Accounting

Contributions from Final Consumption Expenditures, Gross Capital Formation, and Net Exports



Source: NBS Statistical Abstract 2008, The Conference Board estimates

2008 Olympics as a Model for New State Controls

- Tight visa controls
- Physical controls in host cities
- Mandates to reduce pollution: factory closing days, restrictions on driving, factories mandated to move to suburbs or consolidate in distant “industry bases”
- Information controls stepped up
- Massive capital investment managed through central office, foreign and private participation tightly restricted
- Process repeated for 2009 60th anniversary

Political Effects



• Hu's early reliance on party-military affiliated base promoted gridlock in civil/economic bureaucracies. Lack of rank-and-file control led to over-investment and slow decision-making processes.

• Promote national pride:

- Attempts to make more mature political decisions and stick to them under pressure
- Gao Yan case

• Chinese industry first:

- Promotion of the “step out” program
- More focus on acquiring technologies, less on attracting investment capital

• Tighter “guidance” of media:

- More control of important stories, crackdowns--Southern Metropolitan Daily case, Jiang Yanyong case, Youth Daily targeted for story of college students earning money from prostitution