

Central Economic Work Conference:

Balancing act

The Central Economic Work Conference chaired by President Hu Jintao and Primer Wen Jiabao has set out detailed guidelines for economic polices in 2010, emphasizing on balancing the needs for maintaining fast growth, adjusting economic structure and managing inflation expectations.

There is no major surprise from the annual Central Economic Work Conference that just concluded today, as the overall policy tone was already set in the Politburo meeting held on November 27. While maintaining the proactive fiscal policy and appropriately loose monetary policy next year, it puts more emphasis on speeding up structural adjustment to lift the quality and efficiency of growth and boosting domestic demand, in particular consumption. (Please read China Economic Spotlight: quality of growth becomes the main policy goal, published on November 30 2009). That said, there are some fresh new policy lines hinting the likely adjustments in the coming year. For instance, it is the first time that the policy makers stress to control the new construction projects to keep total investment growth at an appropriate level.

We summaries the main points of the statement as follows:

- No shift in the direction of macro policy but stressing to improve the macro policy to balancing the need for supporting growth, adjusting economic structure and controlling inflation expectations.

- 1) While maintaining the continuity of the expansionary policies, it should better manage the magnitude, pace and focus of the policy.
- 2) Fiscal expansion will focus more on education, healthcare and social welfare (Please read China Economic Insight: From Docks to Docs (and desk) published October 7 2009);
- 3) It will control new construction projects to keep total investment growth at an appropriate level.
- 4) No major shift in the direction of monetary policy. But the authorities should closely monitor the macro situations to better manage the credit growth.

-Speeding up structural adjustment to lift the quality and efficiency of growth. The focus will be boosting domestic demand, in particular consumer demand, while promoting urbanization and optimizing industrial structures are also important policy measures.

- 1) To boost consumer spending, it will intensify the national income distribution adjustment and continue to implement the current pro-consumption measures.
- 2) To promote urbanization, it will accelerate transferring qualified rural residents to cities, liberalize the household registration system (also known as Hukou), and strengthen the urban infrastructure construction.
- 3) To optimize industrial structure, it will develop the strategic new industries and promote technology upgrading.
- 4) It also stresses to continue the efforts of saving energy and reining in excess capacity.
- 5) Coordinated regional development will be part of the policy goal of achieving economic structural adjustment.

-Supporting a steady growth in exports and improving the balance of payments.

- 1) To support a steady recovery in exports, China will maintain the continuity and stability of policy related to external demand, develop exports to emerging markets, improve the value-added and competitiveness of exports products, and strictly prohibit the exports of resources products, energy intensive and high polluting products.

- 2) Meanwhile, the government hopes to increase imports to improve the balance of payments.
- 3) It emphasizes the quality and efficiency of using foreign direct investment (FDI) to make the FDI utilization serving the goals of innovation, industrial upgrading, coordinated regional development.
- 4) It will continue to support domestic enterprises to invest overseas.

- Emphasizing on job creation and people's welfare improvement. People's welfare is the ultimate goal of economic development. Thus, to improve people's welfare holds the key of boosting domestic demand and economic structural adjustment.

- 1) It will strengthen job creation by supporting labour-intensive enterprises, small and medium enterprises (SMEs), private economy, and services industries.
- 2) The government will provide more training to rural workers and guide college graduates to work in grass-roots organizations, inland provinces, SMEs or start up their own business.
- 3) It will accelerate the social security reform and medical care reform, build more public housing and investment more in education.

As the top policy makers are putting more emphasis on quality of economic growth, expanding fiscal spending to areas boosting consumer demand is the key policy focus while investment is no longer the top policy agenda for the coming years. The fiscal policy is also likely to need adjusting to slow the pace of new infrastructure projects should there be an overshooting in GDP growth to more than 10% and inflationary risk increases. We believe Beijing needs to continue to adjust its credit policy (through prudent lending rules, open market operations and moderate hikes in RRR and interest rates) to slow monetary growth from over 30% y-o-y this year to less than 20% y-o-y next year and loan growth moderating to 15-17% from more than 30% this year.

We think the risk to our 9.5% y-o-y GDP growth forecast for 2010 is on the upside. If exports recovery surprised on the upside to double-digit rate, China is likely to see GDP growth above 10% and CPI tops 3%, implying overheating risk. To contain the potential risk, we think China should slow down the pace of new infrastructure investment in response to the stronger-than-expected exports growth. China's strong recovery provides a golden opportunity to rebalance fiscal spending from infrastructure investment to pro-consumption areas such as health care, education and public housing. These efforts will encourage consumer spending and sustain a more balanced growth in the long run.

Hongbin QU-- Chief China Economist
Junwei SUN-- China Economist

Disclosure appendix

Analyst certification

The following analyst(s), who is(are) primarily responsible for this document, certifies(y) that the opinion(s), views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Hongbin Qu

This document has been prepared and is being distributed by the Research Department of The Hongkong and Shanghai Banking Corporation Limited ("HSBC") and is intended solely for the information of clients of HSBC and is not for publication to other persons, whether through the press or by other means.

This document does not provide individually tailored investment advice and should not be construed as an offer or the solicitation of an offer to buy or sell any securities or to participate in any trading strategy. The information contained within this document is believed to be reliable but we do not guarantee its completeness or accuracy. Any opinions expressed herein are subject to change without notice. HSBC may hold a position in, buy or sell on a principal basis or act as a market maker in any financial instrument discussed herein.

Economists are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Chinese Wall procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Additional disclosures

- 1 This report is dated as at 07 December 2009.
- 2 All market data included in this report are dated as at close 07 December 2009, unless otherwise indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Disclaimer

** Legal entities as at 22 October 2008'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Securities (Canada) Inc, Toronto; HSBC Bank, Paris branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Dusseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt S.A.E., Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; 'GR' HSBC Pantelakis Securities S.A., Athens; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv, 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler A.S., Istanbul; HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC, HSBC Bank Brasil S.A. - Banco Múltiple, HSBC Bank Australia Limited, HSBC Bank Argentina S.A., HSBC Saudi Arabia Limited.*

Issuer of report

The Hongkong and Shanghai Banking Corporation Limited

Level 19, 1 Queen's Road Central Hong Kong
SAR Telephone: +852 2843 9111 Telex: 75100
CAPEL HX Fax: +852 2801 4138 Website:
www.research.hsbc.com

The Hongkong and Shanghai Banking Corporation Limited ("HSBC") has issued this research material. The Hongkong and Shanghai Banking Corporation Limited is regulated by the Hong Kong Monetary Authority. This material is distributed in the United Kingdom by HSBC Bank plc. In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. This material is distributed in Japan by HSBC Securities (Japan) Limited. This material may be distributed in the United States solely to "major US institutional investors" (as defined in Rule 15a-6 of the US Securities Exchange Act of 1934); such recipients should note that any transactions effected on their behalf will be undertaken through HSBC Securities (USA) Inc. in the United States. Note, however, that HSBC Securities (USA) Inc. is not distributing this report, has not contributed to or participated in its preparation, and does not take responsibility for its contents. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. In the UK this material may only be distributed to institutional and professional customers and is not intended for private customers. It is not to be distributed or passed on, directly or indirectly, to any other person. HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC is authorized and regulated by Secretaría de Hacienda y Crédito Público and Comisión Nacional Bancaria y de Valores (CNBV). HSBC Bank (Panama) S.A. is regulated by Superintendencia de Bancos de Panama. Banco HSBC Honduras S.A. is regulated by Comisión Nacional de Bancos y Seguros (CNBS). Banco HSBC Salvadoreño, S.A. is regulated by Superintendencia del Sistema Financiero (SSF). HSBC Colombia S.A. is regulated by Superintendencia Financiera de Colombia. Banco HSBC Costa Rica S.A. is supervised by Superintendencia General de Entidades Financieras (SUGEF). Banistmo Nicaragua, S.A. is authorized and regulated by Superintendencia de Bancos y de Otras Instituciones Financieras (SIBOIF). Any recommendations contained in it are intended for the professional investors to whom it is distributed. This material is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. HSBC has based this document on information obtained from sources it believes to be reliable but which it has not independently verified; HSBC makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion are those of HSBC only and are subject to change without notice. The decision and responsibility on whether or not to invest must be taken by the reader. HSBC and its affiliates and/or their officers, directors and employees may have positions in any securities mentioned in this document (or in any related investment) and may from time to time add to or dispose of any such securities (or investment). HSBC and its affiliates may act as market maker or have assumed an underwriting commitment in the securities of any companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform banking or underwriting services for or relating to those companies. This material may not be further distributed in whole or in part for any purpose. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. (070905)© Copyright. The Hongkong and Shanghai Banking Corporation Limited 2009, ALL RIGHTS RESERVED. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of The Hongkong and Shanghai Banking Corporation Limited. MICA (P) 177/08/2009