

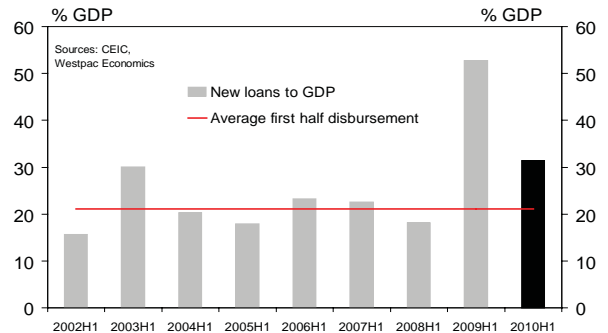
7 December 2009

- The administration has made it abundantly clear that they have no plans to alter the aggregate policy stance. Last week the cabinet reaffirmed its commitment to accommodative policy settings. **Phat Dragon** has been arguing that not only would counter-cyclical policy remain easy, but that the next fiscal cycle of five years would be initiated with an expansionary stance.
- Unless Chinese inflation begins to rise alarmingly (and there are no indications that it will) we will see no more than some modest tinkering around the edges on policy. By tinkering, **Phat Dragon** means policy innovations designed to influence activity in individual sectors, clusters or asset markets, rather than to put the brakes on aggregate demand. Indeed, sector specific administrative and regulatory measures have already been established in steel and investor housing. However, aggregate policy remains highly supportive of growth. Recent leaks have indicated that a lending target of around 68 trillion yuan (down from an estimated 92 trillion in new lending in 2009) will be put in place for 2010. Based on that figure, it is possible to infer the scale of the injection for the first half of 2010. The gross figure looks like it will be around 30% of GDP, down from 52% in 2009H1, but still the second largest on record.
- This lending expansion will have to be funded against a background of more stringent controls on bank capital adequacy. At present, all banks are expected to meet 8% capital adequacy ratios (CARs). The large banks are expected to raise that to 11%, with the smaller banks going to 10%. The ability to use hybrid securities or subordinated debt for this purpose has already been curtailed. That is why the equity market is nervous about a rush of capital raisings in coming months. One percentage point of CAR for the urban and major state banks would cost around 423 billion yuan in new equity - or 234% of total Shanghai market capitalisation. That is more than loose change.
- The central government deficit is currently just 2.7% of GDP, which is a similar level to the position after the run of negative growth shocks in the late 1990s and early 2000s. However, the current deficit is much more modest in the light of the government's substantially higher revenue share. In 1998, central government revenues were 11% of GDP against 20% today. Add to that the government's formidable cash position (upwards of 50% of GDP in FX reserves) and the greatly enlarged pool of captive domestic savings versus ten years ago, and the budget position looks decidedly timid.
- Premier Wen, China's chief economic policy official, had this to say after back-to-back high level visits from the US and the EU. "On the one hand some countries want the renminbi to appreciate, but on the other hand they engage in brazen trade protectionism against China. Their measures are a restriction on China's development." These lines are obviously calibrated for domestic political consumption, but if **Phat Dragon** were in Wen's position, he'd be pretty fed up too. *Memo to world:* the currency is the nominal anchor of Chinese monetary policy. The stance is accommodative. A trade weighted depreciation is consistent with that stance.
- **Stats of the week:** In the year to date, China has produced 5.7mt of noodles, enough to make 9 'two minute' packs for everyone on Earth.

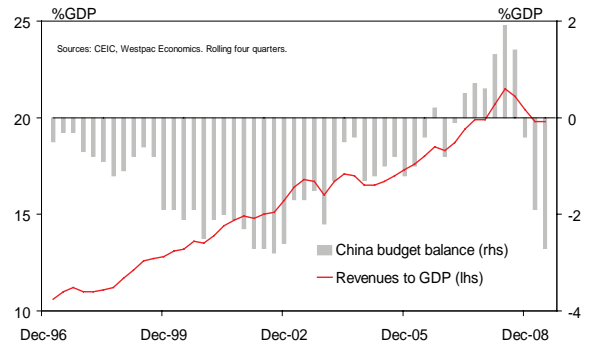
# Phat dragon

a weekly chronicle of the Chinese economy

## New loans to GDP: policy to stay easy



## The central government fiscal position



## Chinese monetary policy & inflation

