

China's Economic and Financial Outlook

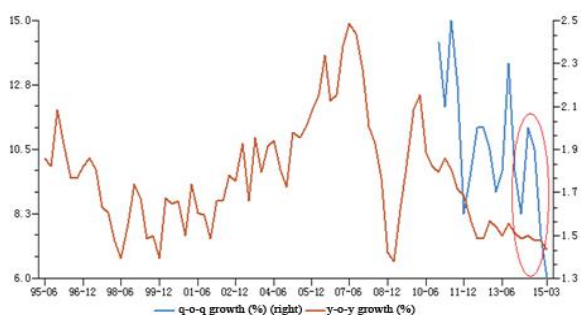
Q3, 2015 (Issue 23)

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Highlights

- China's economy continued to decline during the first half of 2015 affected by weak external demands, overcapacity and deleveraging. GDP of the first quarter grew by 7%, the slowest in the past 24 quarters. In the second quarter, growth in main economic indicators such as investment, consumption, export and industrial production continued to slow, with Q2 GDP expected to grow by around 6.8% and CPI around 1.3%.
- In the third quarter, we expect China's economy to stay steady and pick up a little bit under the influences of growth-stabilizing policies, easing of capital constraints and lower base number of last year. GDP in Q3 is predicted to grow by around 7%, while CPI may go up by about 1.5%. In spite of the recovering economy, the foundation for recovery is still weak, and the downward pressure is huge. Thus, we should adhere to growth-stabilizing policies.
- Against such a backdrop, we should continue to emphasize stabilizing economic growth and go all out to maintain the minimum growth rates. Proactive fiscal policy should be implemented more strongly and more effectively; greater efforts should be made to execute the expenditure budget; more policies should be launched to cut taxes and reduce fees; and local government debts should be steadily replaced with bonds. Various monetary policies should be flexibly employed to maintain moderately loose liquidity, realize reasonable growth of monetary credit and social financing scale and lower social financing cost.

China's Quarterly GDP Growth



BOC Institute of International Finance China Economic and Financial Research Team

Head of Team: Chen Weidong

Deputy Heads: Cao Yuanzheng

Zongliang

Members: Zhou Jingtong

Li Jianjun

Li Peijia

Gao Yuwei

Li Yan

Liang Jing

Chen Zhihua (BOCIM)

Contact: Zhou Jingtong

Tel.: 010-66592779

E-mail: zjtlucky@163.com

China's Economy Shows Signs of Bottoming and Continues to Pursue Steady Growth

-- China's Economic and Financial Outlook (Q3, 2015)

China's economy continued to decline in the first half of 2015 affected by weak external demands, overcapacity and deleveraging. GDP of the first quarter grew 7%, the slowest during the past 24 quarters. In the second quarter, growth in main economic indicators such as investment, consumption, export and industrial production continued to slow, with Q2 GDP expected to grow around 6.8% and CPI around 1.3%. Looking into the third quarter, we expect China's economy to stay steady and even pick up a little bit under the influences of growth-stabilizing policies, easing of capital constraints and lower base number of last year. GDP is expected to grow around 7% and CPI around 1.5%. In spite of the recovering economy, the foundation for recovery is still weak, and downward pressure is huge. Thus, growth-stabilizing policies should be stuck to. Against such a backdrop, we should continue to emphasize stabilizing economic growth and go all out to maintain the minimum growth rate. Proactive fiscal policy should be adopted to sustain the momentum of economic growth and increase economic returns. Greater efforts should be made to execute the expenditure budget. More policies should be launched to cut tax and reduce fees. Local government debts should be steadily replaced with local government bonds. Various monetary policies should be flexibly employed to maintain moderately loose liquidity, realize reasonable growth of monetary credit and social financing scale and lower social financing cost.

I. Economic review and outlook

I.1 Q2 economic review

I.1.1 China's economy showed signs of bottoming with increasing positive factors

China's economy continued to decline this year affected by weak external demands, overcapacity and deleveraging. The country's Q1 GDP grew 7%, 0.4 percentage point lower year on year, representing the slowest of the past 24 quarters. In the second quarter, growth of main economic indicators such as investment, consumption, export and industrial production slowed down. During the first five months, export, investment and consumption went down 3, 2.1 and 0.1 percentage points from the first quarter respectively; while industrial production dropped 0.2 percentage point from the previous quarter, and PPI saw a negative growth for 39 consecutive months. Given the operation results of our "China Macro-economic Climate Index System", we expect Q2 GDP to grow around 6.8%, lower than our previous forecast. The main reason is that the growth-stabilizing policies issued since last year, including newly approved projects, interest rate cuts and benchmark rate lowering, tax cut and fees reduction etc., have not completely taken effect.

Figure 1: China's quarterly GDP growth

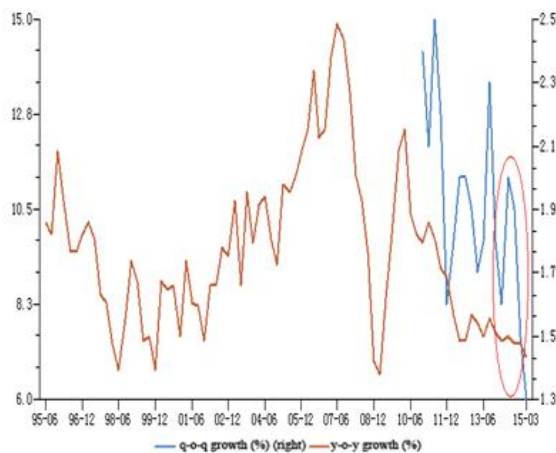
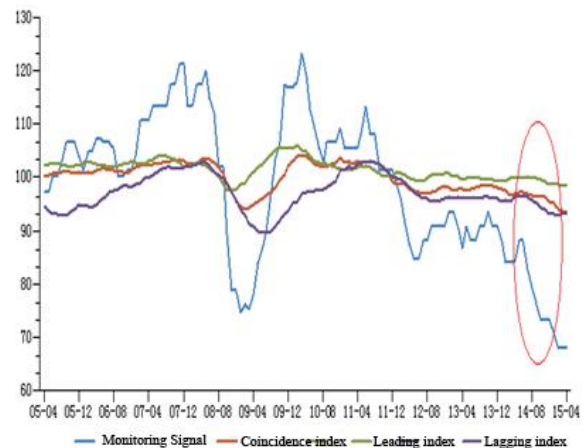


Figure 2: China Macro-economic Climate Index



Source: Wind, BOC Institute of International Finance

However, from the monthly data, we can tell that positive factors were increasing in May with accelerating growth in main economic indicators. Industrial production saw a growth rate of 0.2 percentage point higher than that in April, representing a faster growth for two consecutive months. Investment growth was about 0.6 percentage point higher than that in April, with manufacturing investment picking up 1.4 percentage points and real estate investment resuming 1.9 percentage points, especially. Consumption growth went up steadily by 0.1 percentage point from April. Growths of sold areas and sales volume of commercial properties picked up 8 and 11 percentage points, while decrease of exports dropped 3.4 percentage points from April.

I.1.2 Deflation pressure was eased and PPI saw a narrowed reduction

Prices stayed at a low level in general during the first half of this year, as such trend did not change in the second quarter. During the first five months, CPI went up 1.3% cumulatively, 1 percentage point lower year on year, but 0.1 percentage point higher over the first quarter, indicating easing deflation pressure.

Firstly, food price rise slowed in general, but prices of pork and vegetables were not low in low season. In May, food price went up 1.6%, the lowest during the past four months. However, pork price experienced the faster growth, marking a gentle “pork cycle”. In April and May, pork price went up 8.3% and 5.3% respectively, while it dropped 5.3% and 1.5% respectively in January and February. Meanwhile, price of vegetables rose 6.5%, a sharp contrast with the 2.5% drop during the same period of last year.

Secondly, prices of transportation, communication and services continued to fall. Affected by low oil price, prices of vehicle fuel and spare parts dropped 16.6% in the first five months, while there was a 0.8% rise in the same period of last year. During the first five months, price of means of communication went down 2.6%, 2.6 percentage points lower than the 5.2% drop in the same period of last year.

Figure 3: CPI fluctuates at a low level

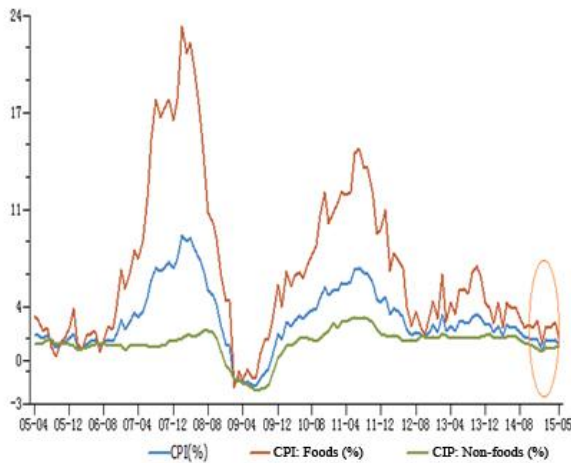
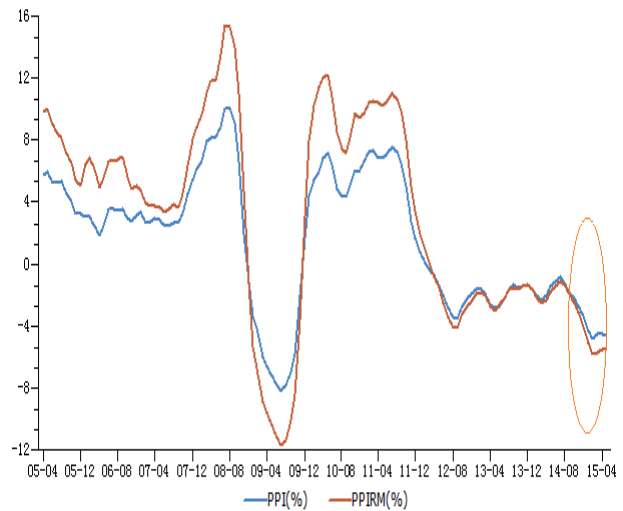


Figure 4: PPI negative for 39 consecutive months



Source: Wind, BOC Institute of International Finance

Thirdly, housing price saw a small growth. During the first five months, housing price went up 0.7%, remaining the level of the first quarter but falling 1.8 percentage points year on year. It is worth noting that the narrowed growth rate of housing price was mainly caused by the falling prices of water, electricity and fuel (from a 1.1% rise to a 2% drop) instead of renting price. As a matter of fact, renting price saw a general upward trend during the first half year, up 2.4% in the first five months, 0.1 percentage point higher than the Q1 growth rate.

Fourthly, PPI saw a negative growth for 39 consecutive months, maintaining the level of the first quarter. PPI had dropped for 39 consecutive months by May, the most lasting one since the reform and opening-up. During the first five months, PPI went down 4.6% cumulatively, remaining the level of the first quarter but 2.7 percentage points up year on year. By sub-sectors, the continuous negative growth of PPI is mainly ascribed to the substantially dropping PPI of the instrumental industry, in particular, mining and raw materials. During the first five months, PPI of the mining industry went down 19.2%, 13.8 percentage points higher year on year; PPI of the raw materials industry decreased by 8.5%, 5.6% percentage points higher than the drop of the same period last year. Compared with the big drop of capital goods prices, consumer goods prices remained stable, only slightly down 0.2% during the first five months, maintaining the level of the same period last year.

Table 1: Changes to increases in the eight categories of goods and services in the CPI basket (%)

Year	CPI	Of which: Foods	Tobacco and wine	Clothing	Household devices	Health care	Transportation and communication	Entertainment, education and culture	Housing
2011	5.4	11.8	2.8	2.1	2.4	3.4	0.5	0.4	5.3
2012	2.6	4.8	2.9	3.1	1.9	2.0	-0.1	0.5	2.1
2013	2.6	4.7	0.4	2.3	1.5	1.3	-0.4	1.8	2.8
2014	2.0	3.1	-0.6	2.4	1.2	1.3	-0.1	1.9	2.0
2014 (1-5)	2.3	3.4	-0.7	2.3	1.3	1.2	0.0	2.3	2.6
2015 (1-5)	1.3	2.0	-0.1	2.9	1.1	1.7	-1.7	1.4	0.7

Source: Wind, BOC Institute of International Finance

Table 2: Changes to PPI by sub-sectors (%)

Year	PPI	Capital goods	Capital goods			Consumer goods	Consumer goods			
			Mining industry	Raw materials industry	Processing industry		Foods	Clothing	General daily necessities	Consumer durables
2011	6.0	6.6	15.4	9.2	4.6	4.2	7.4	4.2	4.0	-0.6
2012	-1.7	-2.5	-2.4	-2.0	-2.7	0.8	1.4	2.1	0.9	-0.9
2013	-1.9	-2.6	-5.7	-3.1	-2.0	0.2	0.7	1.2	-0.1	-0.9
2014	-1.9	-4.3	-6.5	-3.2	-1.8	0.0	0.2	0.7	0.1	-0.8
2014 (1-5)	-1.9	-2.4	-5.4	-2.9	-1.9	-0.2	-0.03	0.8	-0.2	-0.9
2015 (1-5)	-4.6	-5.9	-19.2	-8.5	-3.5	-0.2	0.0	0.7	-0.4	-0.8

Source: Wind, BOC Institute of International Finance

I.1.3 Growth of consumption and investment slowed down, and growth rate of trade surplus dropped substantially

Firstly, growth of consumption slowed down year on year, but stabilized and steadily recovered quarter on quarter. Both nominal and real growth rates of consumption were 10.1% during April and May, down 0.5 and 0.7 percentage point from the first quarter respectively, of which consumption of household appliances, automobiles, daily necessities and office supplies went up at a much slower pace. However, on a quarter-on-quarter basis, consumption has started to recover: q-o-q annualized growth rate of consumption during April and May reached 9.6%, 0.6 percentage point higher than 9% of the first quarter.

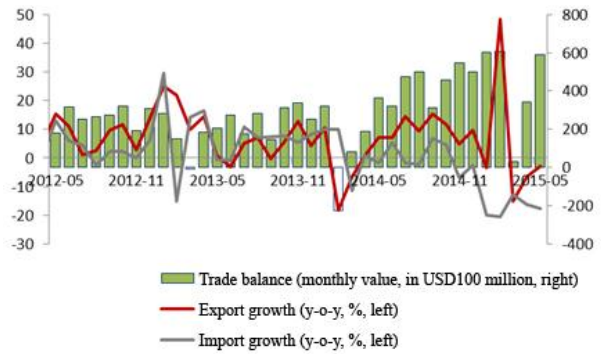
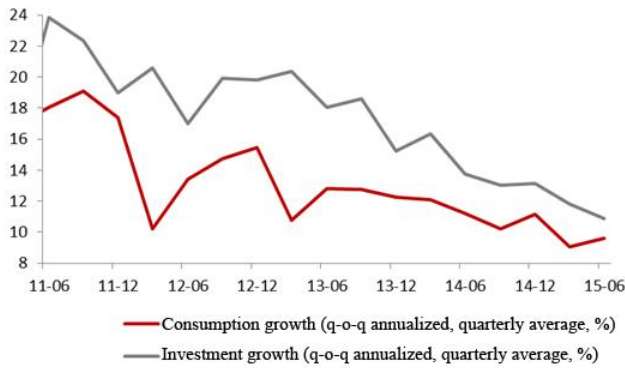
Secondly, investment growth maintained at a low level and was approaching the bottom. Nominal growth rate of investment during April and May was 9.8%, down 3.7 percentage points from the first quarter, and the real growth rate was predicted to drop at a similar rate. Different from the consumption trend, investment growth continued to slow as it fell for four consecutive months on a month-on-month basis. The q-o-q annualized growth rate of investment during April and May was 10.9%, down 0.9 percentage point from 11.8% of the first quarter. The continued dropping growth of investment was related to the slowing growth of real estate and manufacturing.

Thirdly, both imports and exports experienced negative growth, and expansion of trade surplus slowed down dramatically. Exports during April and May went down 4.5% year on year

with a growth rate 9.1 percentage points lower than that of the first quarter. Exports to US, Europe, ASEAN and India grew at a slower pace. Imports saw a year-on-year reduction of 16.9% but increased at a rate 0.7 percentage point higher than that of the first quarter. The big year-on-year drop of imports was connected with the greatly decreased price of bulk commodities. Because the decrease of exports was much smaller than that of imports, the trade surplus remained huge during April and May, up 74% year on year but much lower than the 6.1 times growth during the first quarter.

Figure 5: Growths of consumption and investment

Figure 6: Imports & exports, trade surplus

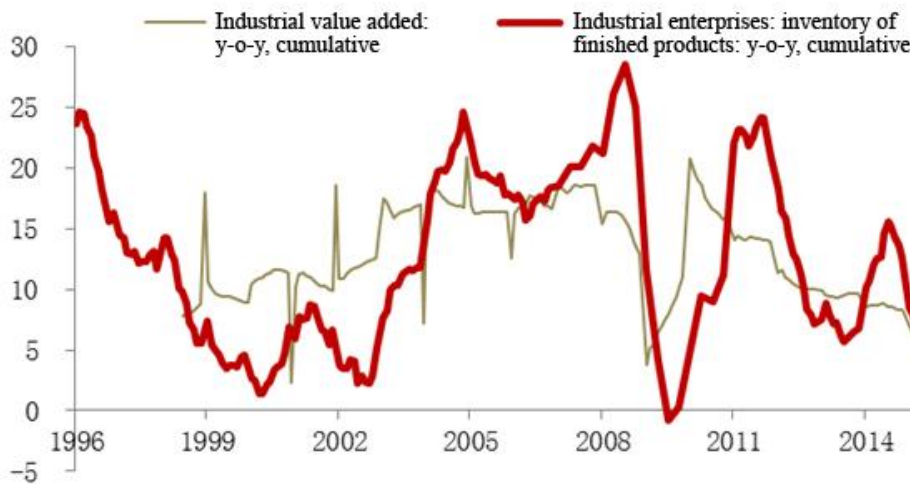


Source: Wind, BOC Institute of International Finance

I.1.4 Growth of industrial production continued to slow and diverged remarkably in different sectors

Affected by weakening demands and overcapacity, industrial production continued to slow during the first half year. From January to May, industrial value added went up 6.2% from the previous year, 2.5 percentage points down year on year. Industrial production was in the stage of passive de-stocking in general (Figure 7).

Figure 7: Industrial value added and inventory of finished products



Source: Wind, BOC Institute of International Finance

Purchasing Price Index of Raw Material (PIRM) dropped further than Producer Price Index (PPI), which meant costs of raw materials were going down in the industry. Meanwhile, the government has taken a series of measures since 2015 including lowering deposit reserve ratios twice, cutting interest rate twice, reducing taxes and cutting fees, so as to release enterprises' burden. The cost per RMB100 of income from principal businesses grew slower than last year. However, due to relatively faster increase of other costs such as human resources cost, the cost per RMB100 of income from principal businesses of April was still higher than that of the same period and the end of last year (Figure 8). The ratio of financial expenses to income from principal businesses dropped slightly year on year (Figure 9). However, with a high debt ratio, the ratio of interest expenses to income from principal businesses was still higher than that of last year (Figure 10). Sales of enterprises increased more slowly due to sluggish demands, and income from principal businesses during the first four months grew only 1.6% on a cumulative year-on-year basis. Higher costs and slowing income growth led to reduced profit. Profit of April saw a year-on-year growth of -1.3%, and the profit/income ratio of principal businesses went down 0.13 percentage point from the same period of last year to 5.27% (Figure 11).

Figure 8: Cost per RMB100 of income from principal businesses

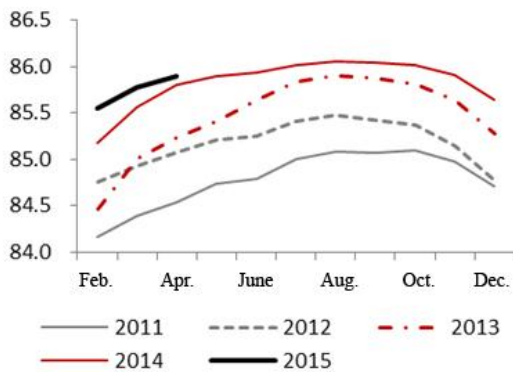


Figure 9: Financial expenses/income from principal businesses

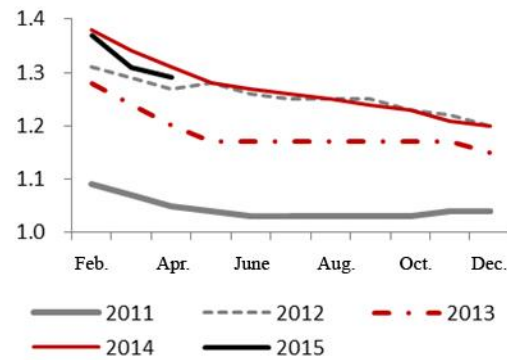


Figure 10: Interest expense/income from principal businesses

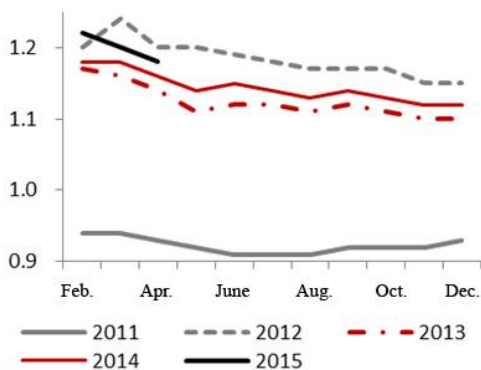
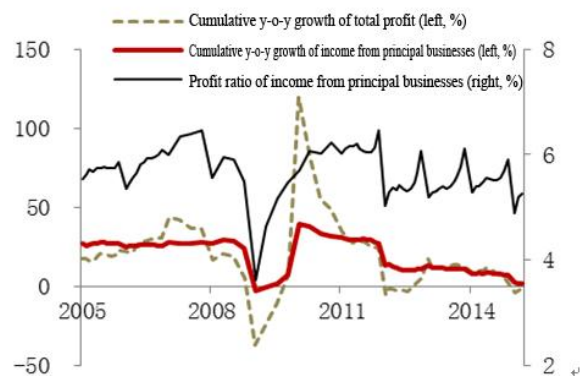


Figure 11: Income and profit of industrial enterprises



Source: Wind, BOC Institute of International Finance

Meanwhile, different industries showed divergent trends. Affected by the dropping international price of bulk commodities, industrial value added of the upstream mining industry saw the lowest

year-on-year growth rate, with profit growing negatively up to -40% in April. Outputs of raw coal, coke, iron ore and related products all experienced negative growths. The six energy-intensive industries were faced with overcapacity and big pressure caused by economic transformation, with their valued added growths and profits falling substantially. Outputs of crude steel, cement, flat glass and other overcapacity industries were declining. Manufacturing of consumer goods, equipment manufacturing and high-tech industries had satisfactory performances. In particular, closely related to the ten prioritized fields of “Made in China 2025” program, high-tech industries managed to maintain over 10% growth rates of industrial value added and profit.

Figure 12: Growth in industrial value added of different industries

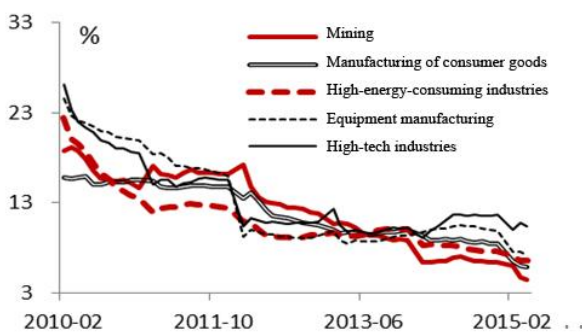
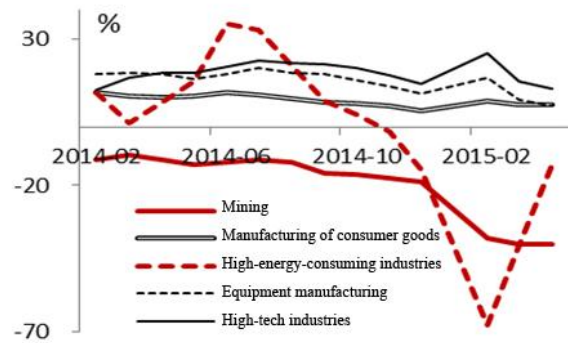


Figure 13: Growth in profit of different industries



Source: Wind, BOC Institute of International Finance

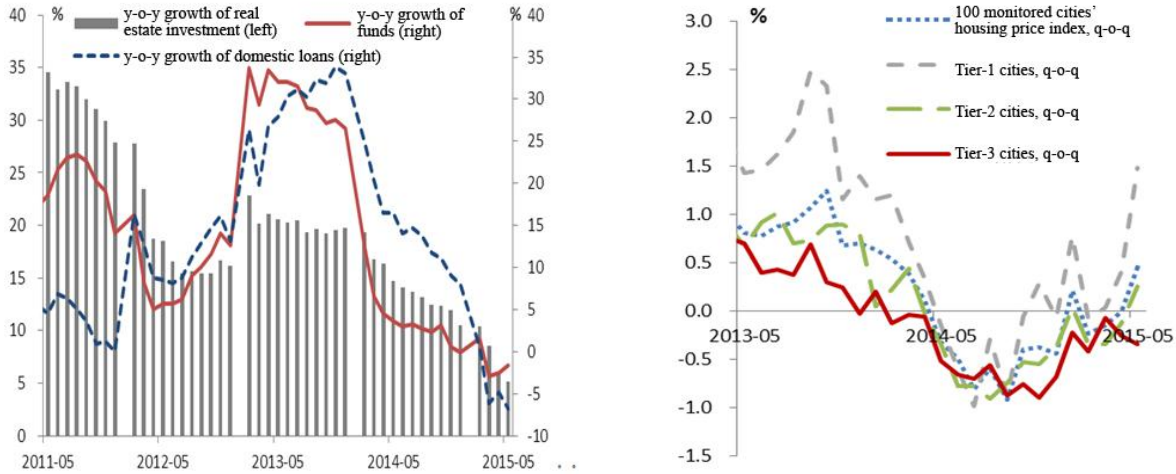
Given the facts that the industrial sector was still burdened with heavy costs, overcapacity was accumulating under sluggish demands and the industry was going through the de-stocking stage, the growth of cargo transports by road, rail and water continued to slow down from January to April. However, year-on-year growth rate of cargo transports of April started to recover, and quarter-on-quarter growth rate of industrial value added also picked up a little bit. PMI continuously climbed back to over 50 since 2015. In PMI, production level and new orders went up to 52.9 and 50.6, respectively. Industrial value added in the second quarter is expected to increase around 6% on a year-on-year basis.

I.1.5 The real estate market hit the bottom and stabilized

In the second quarter, the real estate market continued the downward trend in general: firstly, investments in the real estate sector continued to drop. From January to May, completed investments in real estate reached RMB3.2 trillion, representing a year-on-year growth of 5.1%, 3.4 percentage points lower than that of the first quarter. This was related to the lack confidence of real estate enterprises in investment and weak expansion of funding sources. During January and May, funding sources for real estate development went down 1.6% year on year, down 1.3 percentage points from the first quarter, showing signs of improvement. However, decrease in domestic loans continued to expand. From January to May, domestic property loans went down 6.8% year on year, 0.7 percentage point bigger than that of the first quarter (Figure 14). **Secondly, new property constructions were falling and areas in construction grew at a slower pace.** From January and May, new construction areas dropped 16% year on year, a year-on-year drop for 15

consecutive months; areas in construction increased by 5.3%, 1.5 percentage points lower than that of the first quarter.

Figure 14: Insufficient funds restrict investment growth **Figure 15: Housing prices diverge in different cities**



Source: Wind, BOC Institute of International Finance

During the second quarter, the real estate market hit the bottom and stabilized. Firstly, housing sales started to stop dropping. From January to May, housing sales areas went down 0.2% year on year, 9 percentage points smaller than that of the first quarter. Secondly, housing prices started to pick up. In May, quarter-on-quarter residential housing price index in the 100 monitored cities shifted from negative to positive, up 0.45%. By regions, housing prices of different cities showed divergent trends: housing price in tier-1 cities rebounded quickly, going up dramatically for three consecutive months and 1.48% month on month in May; housing price in tier-2 cities also stopped dropping and slightly recovered, up 0.25% month on month in May; housing price in tier-3 cities was still on the downward track, down 0.35% month on month in May, 0.09 percentage point higher than that of April (Figure 15).

I.2 Q3 economic outlook

I.2.1 Economic growth will bottom out and CPI increase will expand

Looking into the third quarter, we expect the economy to be stabilized recover slightly with favorable policies, easing of capital constraints and the low base number of last year.

Firstly, favorable policies are expected to show more effects. Since the second half year of 2014, the Chinese government has issued a series of measures to ensure stability and it further increased input recently. More central government investments have been arranged, mainly for renovation of power grid in rural areas, water irrigation, railway in the central and west parts etc. In addition to the seven project packages earlier, the government is actively planning four new-typed packages of emerging industries, enhancement of core competitiveness of manufacturing, modern logistics and city rail transport. Investment projects are expected to progress more rapidly, and earlier policies like the cuts of interest rates and deposit reserve ratios, tax cut and fees reduction will continue to

show their effects in the upcoming months.

Secondly, capital constraints can be further eased. As the first RMB1 trillion LGFV debt replacement is put in place and the second one is started, local governments' pressure of reimbursing principal and interests will gradually reduce. Besides, the housing market is recovering, which may increase land income of local governments. Given that, governments' investment capability will be enhanced. Meanwhile, PPP financing mode is activated. Recently, the government has proposed that financial institutions should build express channels and increase efforts in reviewing and approving major project loans. Easing monetary policy will channel capital to the real economy, releasing capital constraints of investments and enterprises.

Thirdly, base number of last year is another factor. In the third quarter of 2014, GDP grew 7.3%, 0.2 percentage point lower than that of the second quarter. Supposing other conditions remain unchanged, this will lead to a higher economic growth rate of Q3 this year.

Given all that, Q3 GDP should be around 7%, down 0.3 percentage point year on year but slightly up about 0.2 percentage point from the second quarter this year. It is worth pointing out that in spite of the slightly rebounding growth, the foundation for economic recovery is still weak, and economic downward pressure remains huge. Thus, growth-stabilizing policies have to be continued.

CPI of the third quarter is predicted to be at a low level, but to pick up slightly from the second quarter.

Firstly, "pork cycle" is arriving. Sharply compared with the slowed growth of beef price and drop of mutton price, pork price has increased remarkably recently, shifting from a 5.3% drop in January to a 5.3% increase in May. Though summer is a slow season of pork, pork price still tends to rise in the future due to the shrinking supply.

Secondly, carryover effects will disappear and rise of energy price will expand. This round of plummeting international oil price started from July last year. Price of vehicle fuel experienced a big drop during the first half year. The negative growth from January to May is greatly connected with the high base of last year's oil price. As the international oil price starts to pick up recently, the effect of high base of last year has disappeared, and the fall of vehicle fuel price is expected to drop substantially, even shifting from negative to positive growth in the next few months, which will remarkably affect CPI increase. On a month-on-month basis, fuel price increased by 4.7% in May.

Thirdly, drop of PPI will narrow. Due to accelerating infrastructure construction, improved demands and increased carryover effects, PPI drop is expected to further narrow, helping reduce the pressure of CPI.

On the whole, Q3 CPI will pick up a little bit and PPI drop will continue to narrow. CPI may go up around 1.5%, up 0.2 percentage point from the second quarter; PPI may go down about 3.8%, down 0.7 percentage point from the second quarter.

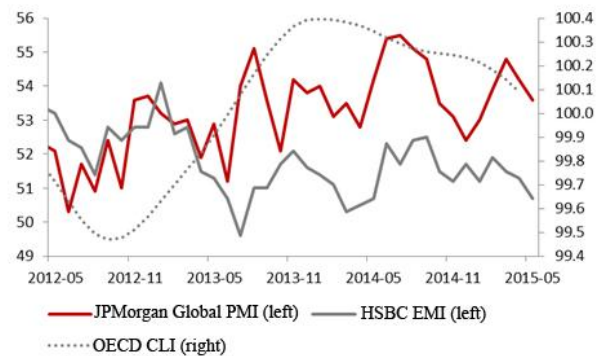
I.2.2 The foundation for steady consumption growth is quite solid, but investment and exports are hard to recover

Firstly, residents' income grows rapidly and consumers' confidence is boosted, sustaining steady growth of consumption. The residents' disposable income per capita of the first quarter increased by 8.1%, up 0.1 percentage point from the fourth quarter last year and 1.1 percentage points higher than GDP growth of the same period last year. CCI (consumer confidence index) of this April was 107.6, up 0.1 and 2.7 percentage points from the first quarter this year and the fourth quarter last year, respectively. The government has initiated consumption projects in six major fields, aiming to accelerate nurturing new-type consumption. Q3 consumption is expected to grow faster at a rate of about 10.4%.

Secondly, growth of paid-in investment slows and planned investment amount is insufficient, holding back acceleration of investment growth. Paid-in investment during April and May went up 4.6% year on year, down 2.2 percentage points from the first quarter. Specifically, fiscal funding, loans and self-raised funds experienced slower growth, while foreign capital saw a continued big negative growth. Planned investment of construction projects reduced 3% year on year with the growth rate 10 percentage points lower than that of the first quarter. Due to the central government's repeated cuts of interest rates and deposit reserve ratios, the real interest rate tends to go down recently, and planned investment of newly started projects will see an accelerating growth, which is good for investment growth. Investment growth is unlikely to recover sharply in the third quarter and the expected growth rate is about 12%.

Thirdly, the global economic climate is worsening, and the Export Leading Index (ELI) is going down, indicating great difficulties in exports. From the global economic climate, in April and May, manufacturing PMIs of the US and Japan dropped from the first quarter; HSBC Emerging Markets Index fell 0.5 from the first quarter to 51. As for China's export climate, the ELI went down 3.3 from the first quarter to 35.5 in April and May, and new export order index fell at the same time. In the third quarter, exports are expected to fall further and imports will see a remarkably narrowed reduction, down about 2% and 5% on a year-on-year basis, respectively.

Figure 16: Growths of paid-in investment and planned investment amount **Figure 17: Worsening global economic climate**



Source: Wind, BOC Institute of International Finance

I.2.3 Industrial production is expected to slightly pick up

PPI will continue to be negative, indicating serious domestic overcapacity and the necessity of carrying on industrial adjustments. As bulk commodities such as iron ore and coal fluctuate at low prices on the international market, China's mining industry is unlikely to improve and its profit will continue a big negative growth. Most energy-intensive industries are of overcapacity. Operating rates of coking enterprises, blast furnaces of steel plants, and float glass making are dropping with growing pressure of environmental protection. Therefore, energy-intensive industries expect undesirable output and profit. On the other hand, equipment manufacturing and high-tech industries, under the great support of the government and the guidance of "Made in China 2015" program, will maintain rapid growth. Besides, as a series of measures aiming at reducing enterprises' burden are further implemented such as streamlining the administration and delegating power to lower levels, tax cuts and fees reduction, railway, highroad, water irrigation and other major engineering projects will be started and progressed more rapidly. The "One Belt and One Road" strategic cooperation project is smoothly initiated. A number of LGFV debt replacement projects within the year provide funding for projects. Given all that, Q3 industrial value added is predicted to grow about 6.5%.

I.2.4 Housing sales are gradually recovering, but it still takes time to fully stabilize.

In the third quarter, housing sales will slightly pick up due to gradual recovery of investor confidence, relatively ample funds and increased supports of local governments for use of housing provident funds. However, as it takes time to restore investors' confidence in real estate, new housing construction projects and paid-in investment still maintain at a low level and tier-3 and tier-4 cities still need time to absorb the current inventory, the possibility of full recovery of the real estate market is quite slim. We expect real estate investments to grow about 6.5% and housing prices to continue diverging with stable recovery in tier-1 and tier-2 cities and narrowed drop in tier-3 and tier-4 cities in the third quarter.

II. Financial review and outlook

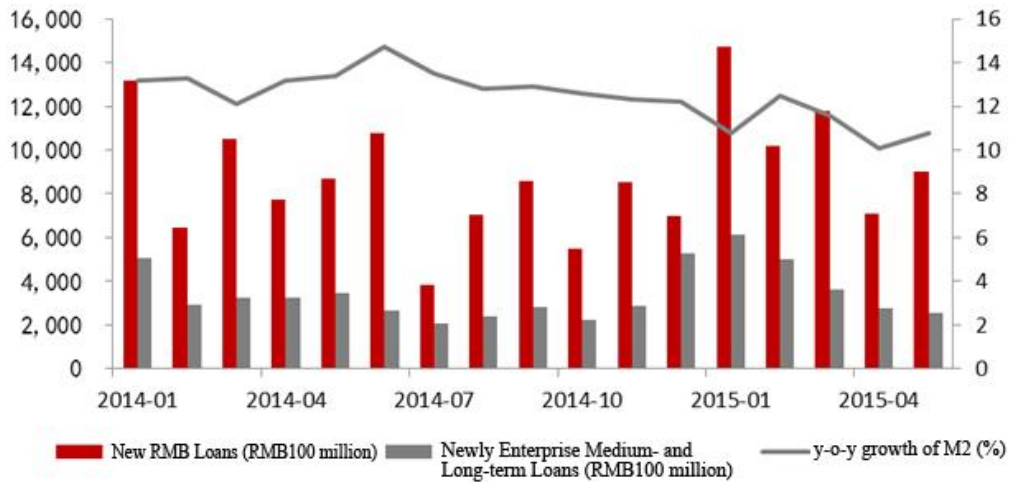
II.1 Q2 financial review

II.1.1 Growth of monetary credit fell before picking up, and proportion of off-balance-sheet financing dropped

The end of May 2015 saw the M2 balance standing at RMB130.74 trillion with the year-on-year growth rate of 10.8%, 0.7 percentage point higher than 10.1% at the end of April. M2 growth stabilized and even recovered in May, which can be mainly ascribed to two reasons: firstly, the central bank has cut interest rates and deposit reserve ratios and carried out PSL (pledged supplementary lending); secondly, funds outstanding for foreign exchange gradually stabilized.

In the second quarter, new RMB loans saw a steady increase of RMB710 billion in April and of RMB900.8 billion in May, down RMB66.6 billion and up RMB30 billion on a year-on-year basis, respectively. Specifically, enterprise medium- and long-term loans witnessed a smaller increase of RMB277.6 billion and RMB254.8 billion in April and May, down RMB45.8 billion and RMB93.1 billion on a year-on-year basis, respectively.

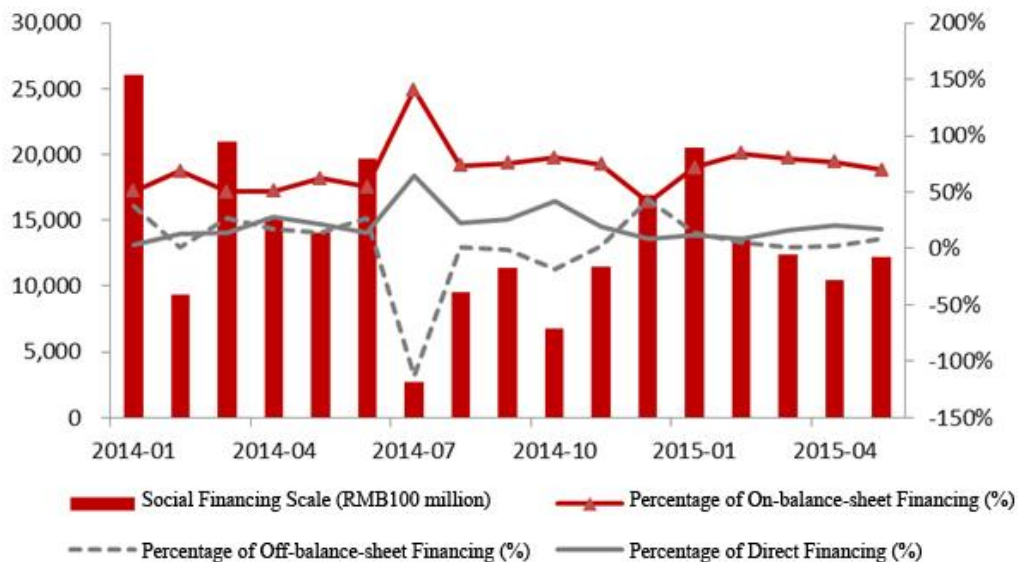
Figure 18: Changes to the growth of monetary credit



Source: Wind, BOC Institute of International Finance

Aggregate social financing grew moderately by RMB2.3 trillion in April and May, down from RMB2.9 trillion during the same period of last year. RMB loans still occupied a big part in aggregate social financing, up to 69.8%. Off-balance-sheet financing took a small part, 2.1% in April and up to 8.9% in May. Sluggish off-balance-sheet financing was related with the enhanced supervision and prevention of financial risks by regulators. Direct financing gained a bigger weight, up 4.8 percentage points from March to 20.5% in April, but went slightly down to 17.3% in May.

Figure 19: Structure of aggregate social financing



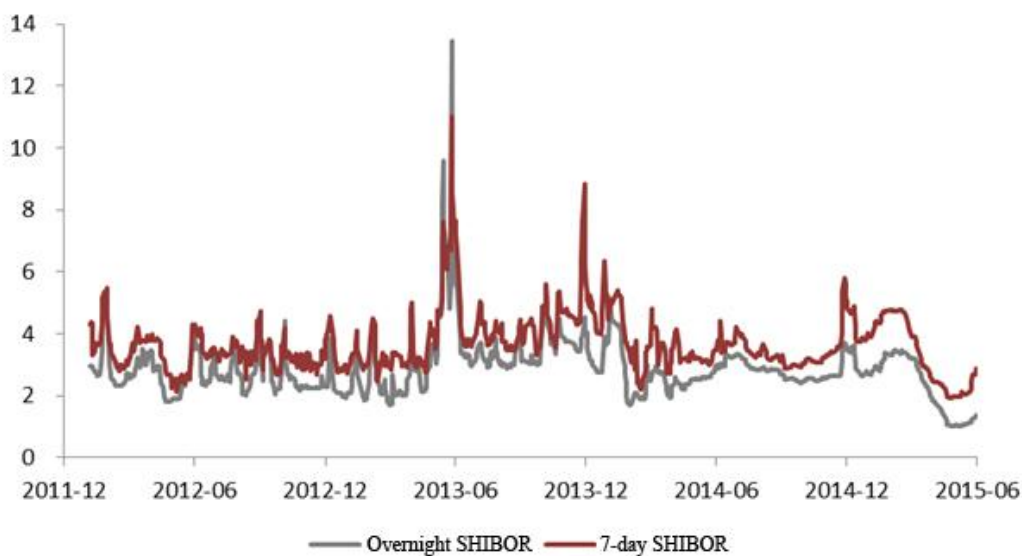
Source: Wind, Institute of International Finance BOC

II.1.2 Interest rate of the money market fell before rising and liquidity remained ample

The central bank has adopted various tools to maintain sufficient liquidity within the money market

since the second quarter, resulting in a general fall of interest rates. Firstly, it injected liquidity into the market. The central bank has lowered the required deposit reserve ratios by one percentage point in general for financial institutions and brought down the deposit reserve ratios of certain financial institutions by certain amount, which were expected to release nearly RMB1.5 trillion of liquidity. Secondly, reverse repo rate was brought down continuously, with the 7-day rate down 40BPs from March to 3.35%. In addition, the central bank also lowered the PSL interest rate from 4.5% to 3.1%. Thirdly, in addition to lowering benchmark rates of deposits and loans in March, the central bank once again cut financial institutions' benchmark rates of deposits and loans by 0.25 percentage point on May 11. On May 20, the overnight SHIBOR and 7-day SHIBOR went down 177 and 225 BPs from the end of March to 1.03% and 1.93%, respectively. Since the beginning of June, though overnight SHIBOR and 7-day SHIBOR increased a little bit, overnight SHIBOR and 7-day SHIBOR on June 24 were 1.3380% and 2.8080%, remaining at record-low levels.

Figure 20: Trends of overnight SHIBOR and 7-day SHIBOR



Source: Wind, BOC Institute of International Finance

II.1.3 The bond market went up slightly in general with expanding interest spread

In the second quarter, stimulated by multiple favorable policies such as interest rate cuts, benchmark rates lowering and eased bond issuance, the bond market went up slightly with expanding interest spread. Firstly, issuance continued to increase within the bond market with bond index slightly going up. On June 23, the ChinaBond Aggregate Index went up 3.5 from the end of March to 159.3 (Figure 21). Secondly, short-term interest rates went down rapidly. Since the beginning of June, the yield to maturity (YTM) of one-year T-bond has dropped to below 2%, a new historic low. Thirdly, interest rate spread between long-term and short-term bonds continuously expanded. On June 15, the interest rate spread between 10-year and 1-year bonds even reached 202 BPs, the highest since 2010, and maintains at about 190 BPs currently (Figure 22).

Reasons for the expanding interest rate spread include: firstly, rising capital cost of commercial

banks restricted the buying of long-term bonds. It is preliminarily estimated that under the current debt ratio, 10-year T-bond yield has to stay above 3.4% if a commercial bank wants to gain small profits from holding T-bonds (the estimation is made based on the ratio of interest payment to deposits of 1.96% of the “Four Big Banks” in 2014 and the lowest average interest rate spread of 1.45% since 2007). Secondly, capital flows into the stock market and great increase in bond supply had an adverse impact on the willingness to hold long-term bonds.

Figure 21: China Interbank Composite Bond Index

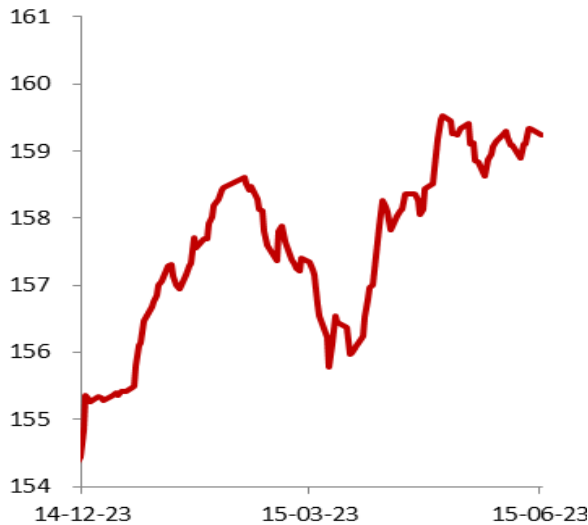
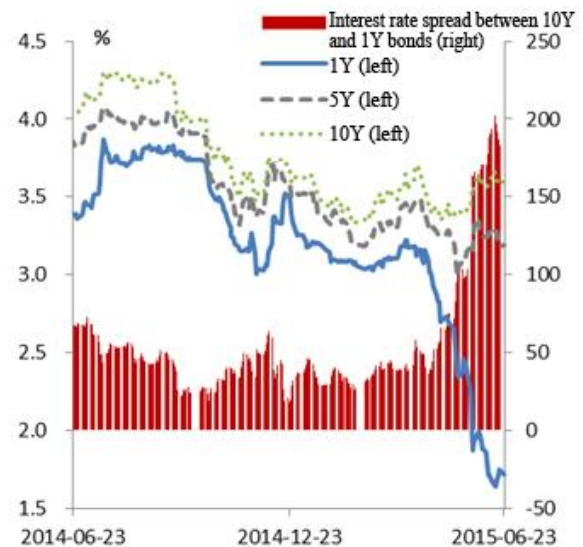


Figure 22: Changes to the yield curve and interest rate spread of T-bonds



Source: Wind, BOC Institute of International Finance

II.1.4 SSE and SZSE stock indices rose with large fluctuations and the turnover of the stock markets increased substantially.

Since the second quarter this year, the stock indices have showed a relentless rising momentum, but the SSE Composite Index and the SZSE Component Index started to go up with large fluctuations after reaching 4500 points and 15000 points. On June 23, the SSE Composite Index went up by 22.1% from the end of the previous quarter to close at 4576 points; the SZSE Component Index rose by 21.9% from the end of the last quarter to close at 16046 points. Since the beginning of this year, the Growth Enterprises Market (GEM) has performed well, continuing the substantial increase from the first quarter with the GEM index up by 45.4% from the end of the last quarter to close at 3394 points on June 23 (Figure 23). Meanwhile, the turnover of the stock markets rose substantially. The cumulative and daily turnovers of the stock markets went up by 454.7% and 434.2% to RMB102.5 trillion and RMB1 trillion respectively from January to May this year. The end of May saw China's stock market value standing over USD10 trillion and the Shanghai Stock Exchange has become the world's third largest stock market.

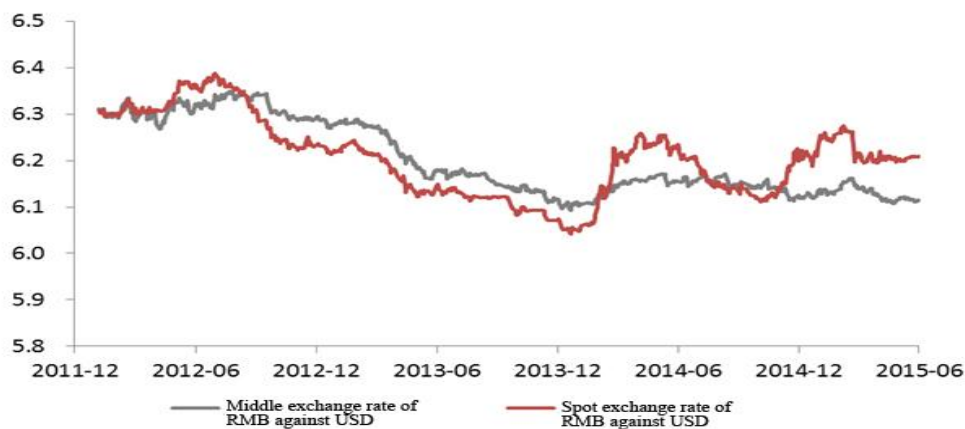
Figure 23: Movements of SSE Composite Index, SZSE Component Index and GEM Index

Source: Wind, BOC Institute of International Finance

II.1.5 RMB-USD exchange rates remained stable in general with mild fluctuations

In the first quarter, RMB depreciated against USD. The downward trend stopped in the second quarter and the exchange rates remained stable in general. On June 23, middle rate of RMB against USD rose slightly by 0.5% from the end of March to 6.1119. The RMB-USD spot exchange rate has been fluctuating mildly, depreciating slightly by 0.1% from the end of March to close at 6.2068 on June 23. The RMB-USD exchange rates managed to stay stable in the second quarter, mainly because US Dollar Index went weak, down by over 3% in April. Against such a backdrop, the middle rate of RMB against USD hit new record highs frequently. It closed at 6.1079 on May 18, a new record high since February 19, 2014. In addition, improvements in cross-border capital flow also backed the stable value of RMB to some extent.

Figure 24: Movements of RMB exchange rates against USD



Source: Wind, BOC Institute of International Finance

II.2 Q3 financial outlook

II.2.1 Money supply and credit growth will remain stable

The government's work report for this year set the yearly expected growth target of M2 at around 12%. It could be higher depending on economic development needs in practice. Generally speaking, the monetary policy for the second half of this year will keep at an appropriate level. Though money supply of April and May failed to reach the yearly target of 12%, the central bank lowered the deposit reserve ratios of deposit-taking financial institutions by one percentage point to 18.5% in April. As the policies start to show effects, M2 is expected to recover in the next few months.

For the purposes of maintaining stable economic growth and funding the real economy, the growth rate of RMB credit this year will not be lower than that of last year, between 13% and 14% hopefully, and new RMB loans will be around RMB11 trillion. With increasingly stricter regulation, off-balance-sheet financing will not see a big increase and the aggregate social financing will remain stable.

II.2.2 Money market will remain stable in general and interest rates will pick up slightly

Interest rates of the current money market stay at record-low levels and there is little space for

further drop during the second half of this year. Firstly, under the downward trend of funds outstanding for foreign exchanges, it's still possible for the central bank to lower deposit reserve ratios to fill the gap in monetary base. Secondly, the Ministry of Finance has recently launched the second RMB1 trillion debt-for-bond swap program, which requires support of ample liquidity. Thirdly, the money market interest rates are becoming key indicators of the central government's guides on interest rates. The central bank will replenish liquidity through various monetary policy tools in due course so as to create a looser monetary environment and to further guide market expectations. Meanwhile, since it is of great importance to channel funds to the real economy, the central bank will further cut down short-term liquidity to supplement long-term liquidity, reduce renewal of matured MLF (mid-term lending facility) and expand the scale of PSL (pledge supplementary lending), resulting in a slight increase of the money market interest rates.

II.2.3 The bond market will continue to go up with more fluctuations

Favorable factors for the bond market in the third quarter mainly include: firstly, liquidity will remain ample. China's economy is facing big downward pressure, making it less likely for the government to tighten the monetary policy. Secondly, the stock market fluctuates in a wider range with risks accumulating. Thus, institutional investors are more willing to hold bonds. Thirdly, risks of local government bonds are lowered obviously. Since the second quarter, the government has issued a series of policies in favor of the bond market, including the four dedicated guides of the National Development and Reform Commission (NDRC) on bond issuance, the newly added RMB500 billion of credit asset securitization, the joint statement by three ministries and commissions in support of subsequent financing for LGFV projects, the NDRC's easing conditions for issuing enterprise bonds etc. These policies help mitigating risks of existing local government debts. Fourthly, overseas institutions are allowed to participate in bond repo, which widens the source of funding. Averse factors include: firstly, as IPOs are increasing, high expected returns will draw tremendous funds back into the stock market. Secondly, the large scale of LGFV debt replacement will affect banks' ability of holding bonds. Generally speaking, the bond market will continue to go up but with more fluctuations in yields.

II.2.4 The stock market is expected to go higher or to enter "slow bull"

In the upcoming days, the stock market is expected to enter the "slow bull" mode with accelerating divergence among individual stocks. Firstly, China's mixed ownership reform and reform on stock issuance registration will further boost the market. Secondly, there is still space and possibility for further lowering deposit reserve ratios and interest rates, and liquidity will remain loose in general during the second half of this year. Thirdly, pressure of capital outflow is abating due to the steady RMB-USD exchange rates in recent days. Big market fluctuations recently resulted in a slower growth of new retail investors entering the stock market. Under the unabated downward pressure of the economy, the stock market might shift from "quick bull" to "slow bull".

II.2.5 RMB-USD exchange rate will remain stable in general and probably continue fluctuating in a narrow range.

The RMB-USD exchange rate will remain stable in general without big depreciation or appreciation in the third quarter. Firstly, the continued surplus in current account is beneficial for keeping RMB exchange rates stable. Secondly, China is striving for RMB's inclusion into the SDR

(Special Drawing Right) basket, thus, it is a top priority of China's decision makers to maintain stable and strong RMB-USD exchange rates before the IMF's review in October 2015. Thirdly, as China accelerates the liberalization of capital account this year, keeping strong RMB exchange rates can prevent substantial capital outflow after capital account is liberated. Besides, the approaching USD interest rate hiking cycle, unabated economic downward pressure and expected loose monetary policy will jointly squeeze the space for RMB appreciation. Given that, RMB is expected to continue fluctuating in a narrow range.

Table 3: Forecasts on China's main economic and financial indicators in Q3 2015 (%)

Indicator	2011 (R)	2012 (R)	2013 (R)	2014 (R)	2015		
					Q1(R)	Q2 (E)	Q3 (F)
GDP	9.3	7.7	7.7	7.4	7.0	6.8	7.0
Added value of industrial enterprises above designated size	13.9	10	9.7	8.3	6.4	6.0	6.5
Fixed asset investment	23.8	20.6	19.6	15.7	13.5	10.1	12.0
Total retail sales of consumer goods	17.1	14.3	13.1	12.0	10.6	10.1	10.4
Export	20.3	7.9	7.9	6.1	4.6	-3.0	-2.0
Import	24.9	4.3	7.3	0.4	-17.6	-16.0	-5.0
Consumer Price Index (CPI)	5.4	2.6	2.6	2.0	1.2	1.3	1.5
Producer Price Index (PPI)	6.0	-1.7	-1.9	-1.9	-4.6	-4.5	-3.8
Broad money supply (M2, end of period)	13.6	13.8	13.6	12.2	11.6	11.0	11.5

Source: BOC Institute of International Finance

III. Orientation of macro economic policies

III.1 Proactive fiscal policy to be implemented more strongly and effectively

Under huge economic downward pressure, proactive fiscal policy should be carried out more strongly and effectively.

Firstly, execution of budget expenditure will be accelerated and funds will be raised through multiple channels. The central government will further speed up executing budget expenditure

and raise funds through multiple channels during the second half of this year. Specific measures will be taken to make overall arrangements for the use of fiscal funds so as to drive major infrastructure projects. Commercial banks will be encouraged to support funding needs of existing projects in construction as required to ensure orderly progress. Low-cost funds will be provided for China Development Bank in the form of PSL to support the construction of affordable housing projects. Various measures will be taken to attract private capital into PPP (Public-Private Partnership) projects such as setting up funds, tax preference, bonus, transfer payment etc. LGFV debt replacement programs will be advanced to relieve the spending pressure of some local governments and to spare more money for key projects.

Secondly, tax cuts and fees reduction will be stepped up to enhance support for the real economy. Firstly, policies of cutting taxes and reducing fees will be developed so as to deliver more supports to small and micro-enterprises, startup innovation and new products, new businesses and new business modes. Secondly, in addition to the existing related policies, the scope of commodities with export rebates will be expanded to other products with overcapacity. Thirdly, China will strive to complete the “business tax-to-VAT” reform to address repeated taxation in the construction sector, real estate sector, financial sector, life services etc. to make new progress in the fiscal and taxation system reforms.

Thirdly, LGFV debt replacement will be advanced actively but prudently to mitigate financial risks of local governments. The second RMB1 trillion debt-to-bond swap program will be put in place actively. Meanwhile, efforts will be made to speed up the building a normalized local government’s borrowing and financing system, exercise limit-based management of local government debts, set up risk assessment and pre-warning mechanisms for local government debts, advance the building of comprehensive government financial reporting system on the accrual accounting basis, develop and release basic governmental accounting rules and release measures and operational manual for preparation of government’s financial reports.

III.2 Monetary policy to be more flexible to pursue stable growth

In consideration of unabated economic downward pressure, existing deflation risk, low-speed growth of funds outstanding for foreign exchange, tight financing for infrastructure investment etc., monetary policy should be more flexible and well targeted. Firstly, monitoring on seasonal fluctuations of funds outstanding for foreign exchange will be strengthened and monitoring results will be used as an indicator of gap in monetary base supply. Secondly, analysis and evaluation on the effects of earlier deposit reserve ratio and interest rate cuts will be made, and further cuts will be conducted in due course according to actual needs in economic operation to encourage lowering financing costs for enterprises and promote steady growth. Thirdly, structured monetary instruments such as SLO (Short-term Liquidity Operation), SLF (Standing Lending Facility), MLF (Mid-term Lending Facility) and PSL (Pledged Supplementary Lending) will be utilized to tighten part of short-term liquidity and increase long-term liquidity for small and micro-enterprises, scientific and technological innovation, agro-related activities, infrastructure etc. Fourthly, issuance of bonds and stocks will be increased to expand the scale of direct financing, in a bid to ensure this year’s social financing increment will not be less than last year’s.

III.3 Investment policy to focus on breaking funding and project bottlenecks

In the third quarter, it is imperative to break funding bottleneck if stabilizing and accelerating

investment growth is achieved. Firstly, the use of budgetary funding will be speeded up, the fund use of key projects will be urged and the fiscal capital stock will be revitalized. Secondly, banks' loans to infrastructure construction, people's livelihood and emerging industries will be increased. Thirdly, thresholds of some industries will be further lowered to attract more private capital and foreign capital. Fourthly, financing modes as IPO, follow-on offering, bond issuance and private replacement will be encouraged.

In addition to taking various measures to increase financing, investment policies should also facilitate the launching of more investment projects as soon as possible and accelerate project construction. Firstly, concurrent prior approval and project approval should be promoted to quicken the approval process. Secondly, investment project packages should be improved and adjusted on a dynamic basis, and the construction of major projects should be accelerated. Thirdly, projects related to "One Belt and One Road", Beijing-Tianjin-Hebei integration and Yangtze River Economic Belt should be encouraged and supported to start construction as early as possible.

III.4 Foreign trade policy to prioritize promoting import-export balance

It is quite difficult to stabilize foreign trade growth in the third quarter, and emphasis should be placed on promoting import-export balance and giving equal importance to import and export. Firstly, proactive policy should be implemented to increase imports of consumer goods and high-tech products urgently needed in the domestic market. Secondly, exports of home-made equipment manufacturing products should be increased. Thirdly, unreasonable fees during import and export should be canceled or regulated.

III.5 Real estate control to focus on both boosting demands and stabilizing investments

Firstly, commercial banks should be encouraged to increase risk tolerance for property loans and more loans should be extended to real estate development in tier-1 and tier-2 cities following the principle of differentiated credit. Secondly, conditions for withdrawing housing provident funds should be eased, cross-province and cross-city withdrawal should be allowed, contributions to housing provident funds should be boosted and linkage of contribution, custody and use of housing provident funds should be encouraged. Thirdly, various measures should be employed to lower housing inventories in tier-3 and tier-4 cities, encourage real estate enterprises to rent properties in hand in lieu of selling them, lower thresholds for accessing housing provident funds, relax restrictions on house buying for *Hukou* and grant tax subsidies.

IV. Topical analysis

Topic 1: How to view the current economic downward pressure

Since the beginning of this year, China's economy has continued the slow-down trend of last year with GDP growth down from 12.4% in the first quarter of 2010 to 7% in the first quarter of 2015. Judging from major economic indicators such as investment, consumption, import & export and industrial production, China is still facing a huge economic downward pressure. This part will be dedicated to analyzing where the downward pressure comes from, why it occurs and how to deal with it in the future.

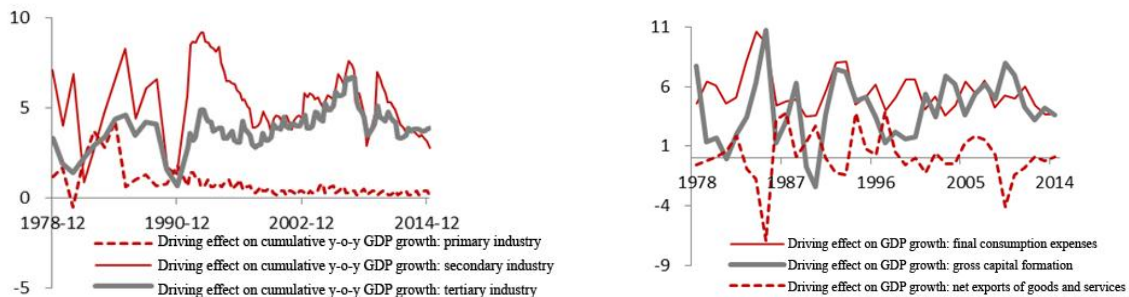
IV.1 Where the current economic downward pressure comes from?

By industries, the primary industry served as a stable engine for GDP in recent years, while the role of the tertiary industry gradually reduced to a certain level. The slowed GDP growth is mainly affected by the secondary industry (the industrial sectors in particular), with its driving effect on the cumulative year-on-year GDP growth down from 6.1 percentage points in 2010 to 2.8 percentage points in the first quarter of 2015 and that of the industrial sector down from 5 percentage points in 2010 to 2.4 percentage points in the first quarter of 2015.

By three major demands, with the recovery of external economy, the net export is exerting a positive effect on China's GDP. The driving effect of final consumption has dropped from 5 percentage points in 2010 to 3.7 percentage points in 2014. Fixed capital formation is a main factor for the slowed GDP growth, driving it up 6.6 percentage points in 2010 but only 3.4 percentage points in 2014.

Thus, the current economic downward pressure is mainly caused by the substantially dropping growths of industrial production and investment activities.

Figure 25: Impacts of three major industries on GDP **Figure 26: Impacts of three major demands on GDP**



Source: Wind, BOC Institute of International Finance

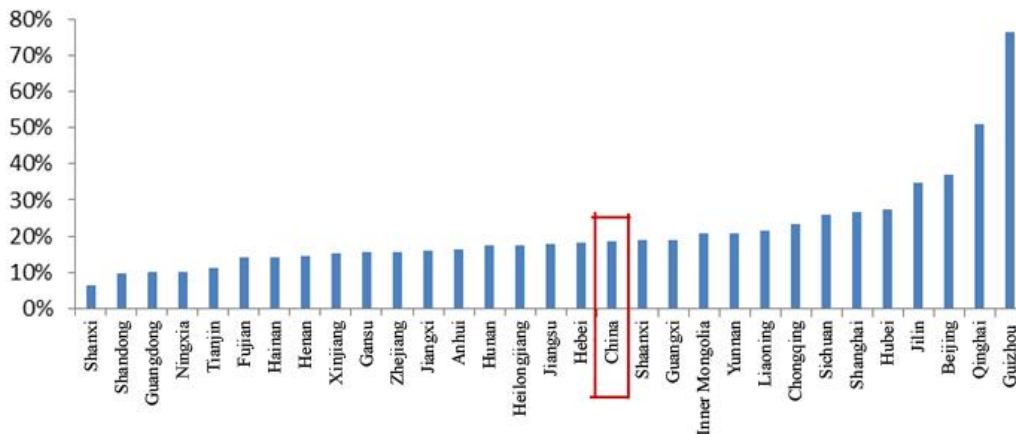
IV.2 Main causes of downward pressure

The substantially falling growths of industrial production and investment are due to three major factors:

Firstly, serious overcapacity. Since 2003, China has been facing overcapacity almost every year, from traditional industries like iron and steel, electrolytic aluminum, cement, auto-making to strategic emerging industries like photovoltaic and wind power. This has something to do with “production surge” as a result of enterprises’ upbeat attitude in industrial prospect and market demands, enterprises’ over participation as well as with the country’s industrial policies. Since the 2008 financial crisis, overcapacity has become a prominent issue, which is due to short-term factors such as sluggish external demands in the wake of the financial crisis and excessive domestic investments. But the main reason lies in the fact that major changes have taken place to the environment of China’s industrial sectors and our potential economic growth rate is dropping under new normal. Thus, it is difficult to absorb overcapacity by a new round of rapid economic growth.

Secondly, debt risks are piling up to a high level. Local government debts have the serious sustainability problem. In 2014, the percentage of local governments' matured debts in local fiscal revenue reached 18.6%, and even up to 76.3% in some areas. Local governments faced a huge pressure of reimbursing lending principal and interests. As local financing vehicle companies have been cleared off, the percentage of using city construction investment bonds for debt repayment is on a big rise. About 34.55% of funds raised from newly issued city construction investment bonds are used to reimburse old debts in 2014, up 14.74 percentage points from 2013. On one hand, weak demands and lowered income of governments and enterprises lead to a large amount of funds to be used for sustaining existing debts, limited sources of investment funding and lowered investment willingness and ability of enterprises and governments. On the other hand, LGFV is closely related to shadow banking. This problem, if handled inappropriately, may give rise to systematic financial risk, resulting in further economic downturn.

Figure 27: Percentage of matured debts in provincial governmental income in 2014



Source: Wind, BOC Institute of International Finance

Thirdly, we are exploring and building a new development model in the transitional period. As China's economy shifts into the new normal, profound changes are taking place in economic development conditions and environment. Partial economic transform is turning into comprehensive and in-depth reform, increment-oriented reform to stock revitalization-oriented reform, and from embracing changes to proactive participation in transformation. Such changes can by no means be done overnight. China is at the crucial stage of comprehensive reform, in urgent need of building a new development model and facing big pressure of economic, political, cultural and ecological adjustments. These are reflected by the current huge economic downturn pressure. Local governments, as the policy executor, play a key role. As the GDP-oriented incentive mechanism is changed, local governments must have their role and behaviors changed substantially. How to adapt to these changes and how to solve overstepping, absence and malposition of governmental functions are of vital importance to economic development.

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IV.3 Countermeasures

Firstly, various measures need to be taken to absorb overcapacity. The market mechanism should be brought into play in stimulating M&A and reorganization of businesses, and direct governmental interventions on industries must be minimized. Governmental administration and services should be improved. Assessment and pre-warning mechanisms on industrial overcapacity information should be set up. “One-vote veto” mechanism should be enhanced for setting environmental standards. Enterprise exit mechanism should be refined. The government should play a guiding role, encouraging enterprises to conduct technological innovation through fiscal and tax policies, accelerating the implementation of the “Made in China 2025”, channeling investments to middle and high-end industries and promoting transformation and upgrading of the manufacturing sector. It is advisable to encourage enterprises to go global, absorb overcapacity and improve our business layout on the international markets by implementing the “One Belt and One Road” strategy.

Secondly, long-term and short-term measures should be combined to mitigate debt risks. In the short run, it is important to make thorough assessment on and overall planning for local government debts, issue supporting policies, step up regulation, and actively but prudently advance LGFV debt replacement and issuance of local government bonds, so as to lower the risk of concentrated maturity of debts. Moderately eased monetary policy should be adopted to ameliorate financing conditions for real economy. In the long run, it is necessary to sort out the fiscal charges relationship between the central and local governments and reform the fiscal and taxation system. Building of a multi-tiered capital market should be accelerated.

Thirdly, long-term comprehensive reforms should be carried out steadily. There must be a comprehensive and long-term strategic layout for future development and reforms. It is important to specify the role of government, set boundary between the roles of government and market, further improve the government performance appraisal system and relevant laws and regulations, and form a local government behavior pattern suitable for the new normal.

Topic 2: Estimation of infrastructure investment scale and impacts of the investment

China is facing increasing economic downward pressure and great difficulties in stabilizing growth. Thus, infrastructure investment is crucial in realizing this year's economic growth target. This part will estimate scale, contribution rate and impact of infrastructure investment on GDP growth and analyze its role in stabilizing growth this year based on the country's investment policy, project approval, new construction and increase in paid-in capital.

IV.1 Estimation of infrastructure investment's impact on China's economic growth

Infrastructure investment is an important component of fixed asset investment (accounting for about 22% in 2014) and can affect capital stock and effective demands of an economy. In the long run, infrastructure investment will relieve economic growth bottlenecks and secure economic development. In the short run, growth of infrastructure investment in economic downturn helps stabilizing growth and mitigating economic volatility.

Table 4: Estimation of impact of infrastructure investment on china's economic growth

Year	Contribution rate of fixed asset formation	Driving effect of fixed asset formation on GDP (percentage point)	Fixed asset formation ratio (%)	Percentage of infrastructure investment in fixed asset investment (%)	Contribution rate of infrastructure investment	Driving effect of infrastructure investment on GDP (percentage point)
2005	32	3.5	99	30	10	1.1
2006	41	5.2	91	29	12	1.5
2007	41	5.8	87	27	11	1.6
2008	48	4.6	84	26	12	1.2
2009	84	7.7	79	28	24	2.2
2010	62	6.6	75	27	17	1.8
2011	42	4.0	71	22	9	0.9
2012	40	3.1	65	21	8	0.6
2013	52	4.0	60	21	11	0.8
2014	47	3.5	56	22	10	0.8
2015E	45	3.1	51	24	11	0.7

Source: Wind, BOC Institute of International Finance

China's economic growth slowed down in the wake of the 1998 Asian financial crisis. The central government at that time increased input into infrastructure, thereby preventing economic slump and laying down a foundation for a new round of booming economy after 2002. China's economy was severely hit by the 2008 global financial crisis. The government initiated the RMB4 trillion investment stimulus plan, a big part of which went to infrastructure. This move effectively stabilized the economy.

It is estimated that contribution rates and driving effect of infrastructure investment on GDP growth fluctuated quite a lot in the past ten years. The contribution rate of infrastructure investment to GDP growth was only 8% in 2012 and 24% in 2009. Its driving effect on GDP growth reached as high as 2.2 percentage points in 2009 but only 0.6 percentage point in 2012. During 2011 and 2014, infrastructure investment made an average contribution rate of 9.5% and drove 0.8 percentage point on average of GDP growth.

IV.2 How large will infrastructure investment be in 2015?

In the past half of this year, China prioritized the target of growth stabilization and launched seven major project packages, a big part of which are dedicated to infrastructure construction. Apart from the seven major packages, railroad investment will stay above RMB800 billion, and input into water conservancy projects under construction will exceed RMB800 billion, according to the central government's report for this year. The NDRC has shortened the process of project review

and approval. As of June 10, 34 projects with an investment amount of over RMB720 billion had been approved. Meanwhile, NDRC also released 1,041 promoted PPP projects with a total scale of about RMB2 trillion, and encouraged private capital to participate in them.

Due to these favorable policies, infrastructure investment has delivered a rapid growth. During the first five months, it went up 18.7% year on year to RMB3.8 trillion, with the growth rate 7.3, 8.7 and 13.6 percentage points higher than general investments, manufacturing investment and real estate investment, respectively. However, compared with the first quarter, the second quarter witnessed a remarkably slowed increase in infrastructure investment during April and May (4.2 percentage points). The main reasons are as followed: firstly, growth rates of investments in water conservancy, environment and public facilities dropped sharply by 6.2 percentage points from the first quarter. Secondly, investments in transportation, warehousing & postal service and production & supply of electricity, heating power, gas and water also saw their growth down by 2.6 and 2.7 percentage points from the first quarter, respectively.

Table 5: Estimated scale of infrastructure investment in 2015

Item/Year	2014	Jan.-May 2015	2015, estimated
Infrastructure investment	RMB11,217.4 billion (20.3%)	RMB3,799.5 billion (18.7%)	RMB13,500 billion (20.3%)
Water conservancy, environment and public facilities management	RMB4,627.4 billion (23.6%)	RMB1,563.1 billion (16.3%)	
Transportation, warehousing and postal service	RMB4,298.4 billion (18.6%)	RMB1,471.9 billion (21.2%)	
Production & supply of electricity, heating power, gas and water	RMB2,291.6 billion (17.1%)	RMB764.5 billion (18.8%)	
Investment in rail, road and water transports	RMB2,526 billion (12.6%)	Jan.-Apr.: RMB493 billion (15.1%)	
Railway investment	RMB808.8 billion (12.6%)	Jan.-Apr.: RMB132.2 billion (22.6%)	Over RMB800 billion
Road investment	RMB1,546.1 billion (12.9%)	Jan.-Apr.: RMB321.4 billion (12.7%)	
Water conservancy investment	RMB488 billion	Jan.-Apr.: RMB112.4 billion (allocated by central budget) (42.2%, investments in projects in construction)	Over RMB800 billion (scale of investments in projects in construction)
Approved by NDRC: infrastructure construction projects		As of June 10: over RMB720 billion, 34 projects	
Projects welcoming private capital	80	1,041 promoted PPP projects with a total investment of RMB2 trillion	

Source: Wind, BOC Institute of International Finance

Considering governmental policies adopted this year, project review & approval, construction progress and paid-in capital, this year's infrastructure investment is expected to reach about RMB13.5 trillion, representing an increase of around 20.3%. In addition, growth rates of

investments in real estate and manufacturing might fall further than that of infrastructure investment this year, with the latter estimated to take up 24% of total fixed asset investment, up by about 2 percentage points from 2014.

IV.3 Is it enough to stabilize growth by infrastructure investment?

Since both nominal and real growth of consumption slowed down, its driving effect on GDP will decrease by around 0.1 percentage point this year. Given a large scale of trade surplus, net exports in goods and services may see its driving effect on GDP growth slightly up by around 0.1 percentage point this year. Under this context, considering that inventory investment makes a steady contribution to GDP growth, **it is necessary to keep the fall in driving effect of fixed asset investment (and then fixed capital formation) on GDP growth within 0.4 percentage point, if we want to realize a 7% GDP growth rate.**

Table 6: Growth of investments in different sectors (%), their percentages in total investments (%) and their driving effect on GDP growth (%)

Year	Manufacturing			Real estate			Infrastructure			Others	
	Growth	Percentage	Drive	Growth	Percentage	Drive	Growth	Percentage	Drive	Percentage	Drive
2014	13.5	33	1.2	10.5	25	0.9	20.3	22	0.8	20	0.6
2015E	10.0	33	1.0	3.0	23	0.7	20.3	24	0.8	21	0.6

Source: Wind, BOC Institute of International Finance

Based on the analysis above, infrastructure investment will make a contribution of about 11% to GDP growth and drive GDP growth up 0.8 percentage point this year, remaining the level of last year. That is to say, when real estate investment increases by no less than 3% and manufacturing investment grows by no less than 10%, the infrastructure investment scale estimated in this part can help GDP grow 7%. However, once manufacturing investment growth slows down further or real estate investment growth plummets in the next few months, the infrastructure investment scale estimated herein is hard to ensure a 7% GDP growth rate. In this case, relevant investments should be further expanded.

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