Outlook of China Macro Policies in 2011

Sailing against the wind

Highlights

- **Macroeconomic policies to remain tightened before being eased in 2011.** Changes in inflation and economic growth will significantly affect the trend and pace of policymaking in 2011. We expect that inflation will show a trend from high to low in 2011, with inflation declining in the second half of the year. The robust economic growth momentum in the fourth quarter of 2010 will continue as we embark into 2011. Given the expected "high to low" inflation trend and robust economic growth in the beginning of 2011, which may result in overheating, policymaking will first be tight before being eased.
- **Monetary tightening to take place throughout the first half of the year before being moderated in the second half.** The fight against inflation will become the top priority of policymaking. Early in 2011, we expected that the Central bank might increase its tolerance of inflation, the possibility of which seems to be small now. China would still need to tighten credit and money supply in the first half of the year. We expect the deposit reserve requirement ratio to be raised at least by 0.5 ppt in the coming two to three months. From the second to the fourth quarters, the Central bank may further adjust the deposit reserve requirement ratio in each quarter. We expect about 2 more interest rate hikes in 2011, which will mainly take place in the first half of the year. The RMB may continue to rise by 5-6%. The policies will be eased to some extent in the second half of the year. First of all, with the exception of a possible interest rate hike in early July, it is unlikely for the Central bank to continue raising interest rates later on. The supply of money and credit will remain stable.
- **Public infrastructure investment to become subdued before rising.** Higher inflation in the first half of 2011 will make it necessary to slow down the pace of infrastructure development. The kick-off of projects subject to control of the government may be postponed. Nevertheless, investment in public infrastructure will not remain subdued throughout the year. The investment in infrastructure will fasten in the second half of the year. We expect the government to speed up the construction progress of infrastructure projects starting from the later part of second quarter.
- **To accelerate efforts in rolling out polices aimed at addressing the weaker sectors of the economy.** First, China will increase investment and stimulate development in the agricultural sector. Currently, the agricultural sector is a weak area of the Chinese economy. Second, new welfare housing will continue to experience a significant growth, with the growth rate likely to be doubled in comparison with 2010. Third, China will develop incentive policies to promote the development of the Central and Western regions.

CITICS macroeconomic forecast (%)

	2007	2008	2009	2010	2011F
GDP	14.2	9.6	9.2	10.3	9.5
CPI inflation	4.8	5.9	-0.7	3.3	3.8
PPI inflation	3.1	6.9	-5.4	5.5	4.9
Total fixed asset investment	24.8	25.5	30.1	23.8	23.0
Total retail sales of consumer goods	16.8	21.6	15.5	18.4	18.0
Exports	25.6	17.2	-16.0	31.3	16.4
Imports	20.6	18.5	-15.7	38.7	18.7
Interest rates (1-year deposit)	4.14	2.52	2.25	2.75	3.50
Exchange rate (RMB/USD)	7.31	6.83	6.83	6.62	6.22

	1Q'10	2Q'10	3Q'10	4Q'10	1Q'11 (F)	2Q'11 (F)	3Q'11 (F)	4Q'11 (F)
GDP	11.9	10.3	9.6	9.8	9.1	9.4	9.7	9.9
CPI inflation	2.2	2.9	3.5	4.7	4.7	4.2	3.8	2.9

Source: CS forecasts Note: Historical data were released by the National Bureau of Statistics

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Performance of stock or sector relative to MSCI-China over next 6 months after research publications

	Rating	Remark
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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