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cutting through complexity

China

High Growth Markets country profile

China is the world's most populous country and the third largest economy. For much of the population, living standards have improved dramatically, while personal freedom has expanded in some areas, although political controls remain tight. Real gross domestic product (GDP) growth is expected to slow down to 7.2 percent in 2014, having reached 7.7 percent in 2013. Between 2014–2018, annual GDP growth should average 6.6 percent, with continued rises in private consumption. However, investment growth is expected to decelerate steadily in the same period.

Country overview

Geography and climate

- **Location:** located in Eastern Asia, bordering the East China Sea, Korean Bay, Yellow Sea and South China Sea, between North Korea and Vietnam
- **Climate:** extremely diverse, from tropical in the south of the country to subarctic in the north
- **Regions:** four municipalities, five autonomous regions and 23 provinces
- **Major cities:** Shanghai (16.6 million), Beijing (capital) (15.6 million), Chongqing (9.4 million), Shenzhen (9.0 million), Guangzhou (8.9 million)
- **Tier two cities:** Chengdu, Sichuan, Dalian, Liaoning, Hangzhou, Ningbo, Zhejiang, Kunming, Yunnan, Nanjing, Suzhou, Jiangsu, Qingdao, Shandong, Tianjin, Wuhan, Hubei, Xiamen, Fujian, Xi'an and Shaanxi

Political system

- **Type of government:** communist state
- **Capital:** Beijing

Population, language and religion

- **Population:** 1,355 million
- **Urban population:** 50.6%
- **Demographics:** 0–14 years: 17.1%; 15–64 years: 71.5%; 65 years and over: 9.4%
- **Median annual household income:** 6,962 US dollars (US$)
- **Official language:** standard Chinese or Mandarin
- **Prominant religions:** Buddhist, Christian and Muslim

Currency and central banking

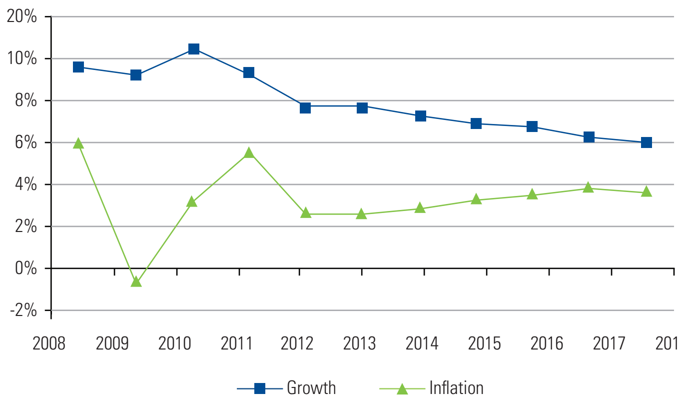
- **Local currency:** Chinese Yuan Renminbi (CNY)
- **Exchange rate:** 1 CNY=US$0.1620 (1 April 2014)
- **Interest rate (average annual rate):** 5.01% (2013); 4.63% (2012); 5.28% (2011); 2.66% (2010); 1.71% (2009)
- **Foreign exchange reserves:** US$3.8 trillion
- **Total debt (2013):** external US$784.8 billion; internal public debt: 31.7% of GDP (2013 estimate)

Business environment

Economic environment

- **GDP in 2013 was US$13 trillion and is expected to grow by 6.6 percent annually** between 2014–2018. Private consumption growth is set to remain rapid, while investment growth will steadily decrease. The median household income is expected to increase to US$11,639 by 2017.
- **Foreign direct investment (FDI) (billions):** inbound: US$171.5 (2008); US$315.0 (2013); US$283.2 (2018 forecast); outbound: US$56.7 (2008); US$150.2 (2013); US$259.0 (2018–forecast)
- **Exports free on board (FOB) (billions):** US$1,970.9 (2012); US$2,219.0 (2013); US$3,475.1 (2018 forecast)
- **Imports FOB (billions):** US$1,653.3 (2012); US$1,859.1 (2013); US$3,225.2 (2018 forecast)
- **Sector breakdown:** service sector: 46%; industrial sector: 44%; agriculture sector: 10%
- **Trade balance (billions):** surplus of US$317.6 (2012); US$359.9 (2013); US$249.8 (2018 forecast)
- **Stock exchanges:** SSE, CFFEX, DCE, SHFE, ZSE

GDP growth and inflation (average consumer price index (CPI))



Source: Economist Intelligence Unit, 2014

Investment climate

Key considerations

- **Fiscal and monetary policy:** China's government is facing a challenge to rebalance the economy, which is dangerously dependent on high levels of investment. Over the next 5–10 years the government will pursue a number of policies: financial liberalization; a program to improve the productivity of state-owned enterprises; reform of local government financing; centralization of control over the judicial system; and reform of the household registration (hukou) system. The government has reaffirmed its previous commitment to liberalize exchange rates, interest rates and the capital account. It also continues to reduce reliance on investment and move towards a more consumption-oriented model for economic expansion, while maintaining its push to expand public welfare provision.
- **Competition policy:** The first anti-monopoly law (August 2008) bans monopolistic arrangements and behavior. Although China continues to encourage mergers, merger and acquisition (M&A) of domestic enterprises by foreign investors may require approval, according to certain provisional rules. Approval is needed when at least one of the parties in the merger has annual sales of CNY1.5 billion (US$243 million) or more and holds 20 percent of the Chinese market; or when the Chinese partner is an industry leader. In 2012, China maintained price controls on natural gas, pharmaceuticals, tobacco and some telecommunications services.
- **FDI policy:** Thanks to its thriving domestic market, China will continue to be one of the top destinations for inward investment, although low wages are becoming less of a motivating force as the country becomes wealthier. The government encourages FDI, but is less openly supportive of foreign involvement in its services sector. During 2014–2015, rising costs in China mean that foreign investors may start to locate operations in other countries, in order to benefit from low-cost, export-oriented manufacturing. Restrictions on FDI in the Shanghai free trade zone (FTZ) are expected to be liberalized. Between 2016–2018, central and western China should increase their share of the country's FDI, due to ongoing policy incentives. The pilot to liberalize FDI regulations in Shanghai will be extended to other regions.
- **Foreign trade and exchange controls:** China's government continues to exclude foreign firms from a number of industries such as broadcasting and armaments. Opportunities for foreign investors are greatest in those sectors where domestic enterprises are weak, and underdeveloped markets are swiftly opening up. Chinese enterprises are also looking for joint-venture partners in natural resources and infrastructure. In 2014–2015, restrictions on two-way capital flows are expected to loosen, providing more openings for foreigners to invest in local securities. Domestic firms are encouraged to gain better access to overseas capital markets and acquisitions abroad. Between 2016–2018, capital account liberalization will continue steadily. If capital outflows accelerate too sharply, restrictions on outbound investments may be tightened temporarily.
- **Financing policy:** During 2014–2015, private sector access to financing should improve, and corporate bond issuance is expected to increase. Problems may re-emerge in the state-owned banking sector, leading to renewed government intervention. Liberalization of interest rates may start to relieve some of the distortions in China's financial markets.
- **Taxes**: The standard rate of corporate income tax is 25 percent. High- and new-technology enterprises face a preferential 15 percent tax rate. A preferential 20 percent tax rate applies for small enterprises with modest profits, as long as they do not engage in economic activity prohibited or restricted by the authorities. China has a progressive income tax system, with marginal rates as high as 45 percent, but tax evasion is rife. Indirect tax is the main source of tax revenue, but the burden will increasingly be shifted to direct personal taxation — particularly for high earners. In 2014–2015, the government is expected to expand a pilot scheme to replace the business tax on services with a value-added tax, lightening the tax burden on firms in the services sector.

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Sources: Economist Intelligence Unit, 2014; Central Intelligence Agency, 2014; China Business Review, 2014; World-Stock-Exchanges.net, 2014

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