



MACROECONOMIC PERFORMANCE

In 2007, the Chinese economy maintained a good momentum characterized by rapid growth, improved economic structure, good efficiency and improved living standards despite the increasing uncertainties in the international economic and financial performance and rising inflationary pressure in China. The GDP grew by 11.9 percent, marking a fifth consecutive annual growth at or above 10 percent. Due to a stronger upward pressure on price movement, the CPI rose 4.8 percent year on year.

In 2008, the domestic economic growth momentum will remain strong, and the national economy will continue to grow rapidly, but inflationary pressure will remain high. In terms of macroeconomic management, a prudent fiscal policy and tight monetary policy will be implemented to prevent structural price hike from becoming generalized inflation; a series of restructuring policies will be strengthened to conserve resources and protect the environment; more emphasis will be laid upon the improvement of people's livelihood, social harmony and the quality of economic development so as to strengthen the ability of the national economy to grow in a balanced manner.

Global Economic and Financial Performance in 2007

Global economic growth slightly slowed down In the first half of 2007, the global economic growth maintained a general stable momentum; however, in the latter half of the year, the growth slowed down due to the US sub-prime mortgage crisis. According to the estimate by the International Monetary Fund on January 29, 2008, the global economy grew 4.9 percent in 2007, 0.1 percentage point lower than 2006.

In a breakdown by countries, the US economy apparently slowed down. The GDP grew 2.2 percent, 0.7 percentage point lower than the previous year and the lowest since 2002. The Euro area faced downside risks, with GDP growing at 2.7 percent, 0.1 percentage point lower than a year before. The Japanese economic growth moderated to 2.1 percent, 0.3 percentage point lower than the previous year. But growth of major emerging economies and developing countries (regions) remained robust.

Inflationary pressure built up In order to deal with the liquidity crunch triggered by the sub-prime mortgage crisis and avoid a potential economic recession, from the latter half of 2007 the Federal Reserve took measures such as interest rate cuts,

emergency financing and discount rate cut to provide liquidity for the market. The European Central Bank and the Bank of England also provided extra liquidity through various measures to ease the credit crunch. As a result, the US dollar continued to depreciate against major currencies, and prices of primary commodities such as oil, gold and bulk agricultural produce went up substantially, exerting more inflationary pressure on the global market.

China's Economic Performance and Its Main Characteristics in 2007

In 2007, GDP grew 11.9 percent year on year to 24.95 trillion yuan. GDP growth registered or exceeded 10 percent for five consecutive years from 2003 (Figure 1).

The proportion of the tertiary industry increased slightly In 2007, the added value of the primary industry grew 3.7 percent. The total grain output posted 501.50 million tons, an increase of 3.5 million tons over 2006, marking the fourth year of bumper harvest since record began. The secondary industry enjoyed a growth of 13.4 percent in added value, contributing 48.6 percent to the GDP growth. Statistically large enterprises saw an increase of 18.5 percent in added value, an acceleration of 1.9

percentage points year on year. The added value of the tertiary industry increased by 12.6 percent. The three industries accounted for 11.3 percent, 48.6 percent and 40.1 percent of the GDP respectively, with the share of the tertiary industry rising for two consecutive years (Figure 2).

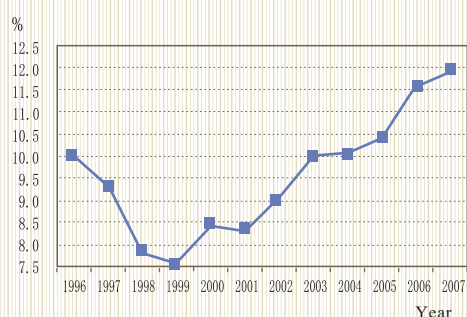
The contribution of net exports to economic growth continued to rise Because of high return on investment, sufficient liquidity and accelerated price increase of capital goods, investment picked up, with fixed asset investment growing 24.8 percent year on year, an acceleration of 0.8 percentage point over the previous year. With income increase in urban and rural

areas and the launch of a series of policies that encourage consumption, consumption growth accelerated. The total retail sales grew 16.8 percent, an acceleration of 3.1 percentage points. From 2000 to 2007, the contribution of consumption to economic growth (consumption growth as a ratio of GDP growth) declined from 65.1 percent to 39.7 percent (Figure 3). The trade surplus continued to surge, registering 262.2 billion dollars in 2007, or 84.7 billion dollars more than that in 2006 (Figure 4). From 2004 to 2007, the contribution of net exports to economic growth continued to grow rapidly from 6 percent to 21.5 percent.

Economic efficiency improved greatly Fiscal revenue, corporate profits and individual income grew across the board. The fiscal revenue posted 5.1 trillion, a year-on-year growth of 32.4 percent, including 4.6 trillion yuan of tax revenue, up 33.7 percent year on year, accounting for 88.9 percent of the total. Corporate profit rose considerably. From January to November, the statistically large enterprises achieved a profit of 2.3 trillion yuan, up 36.7 percent year on year, an acceleration of 6.0 percentage points from 2006. Personal income in urban and rural areas increased in acceleration. The per capita disposable income in urban China grew 12.2 percent in 2007, an acceleration of 1.8 percentage points, while the per capita net income of rural residents increased 9.5 percent, an acceleration of 2.1 percentage points.

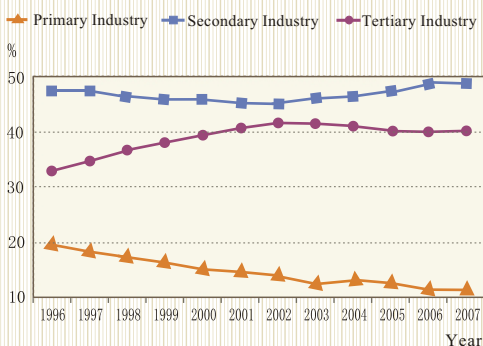
Driven by food prices, inflationary pressure mounted Price increase accelerated from November 2006, and the inflationary pressure built up. The CPI went up 4.8 percent in 2007, up 3.3 percentage points more than that in 2006. Food prices grew 12.3 percent due to the imported inflation, domestic supply shortage and other factors, pushing the general price index up by 4.0 percentage points, and became the major contributor to price hike (Figure 5). Producer Price Index (PPI) was up 3.1 percent in 2007 driven by a variety of factors including the weak dollar and price

Figure 1 GDP Growth, 1996~2007



Source: The National Bureau of Statistics of China. Figures in 2007 are preliminary ones.

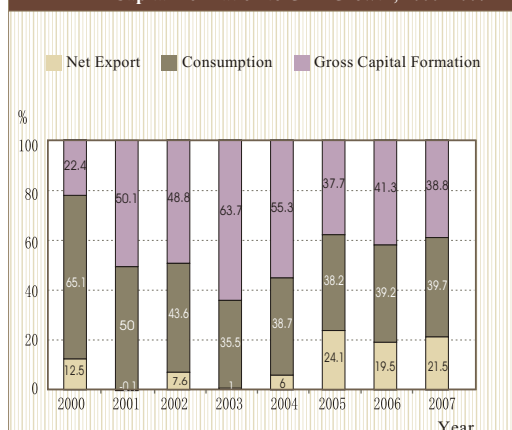
Figure 2 Composition of GDP by Industries, 1996~2007



Source: The National Bureau of Statistics of China. Figures in 2007 are preliminary ones.



Figure 3 The Shares of Export, Consumption and Gross Capital Formation to GDP Growth, 2000~2007



Source: The National Bureau of Statistics of China. Figures in 2007 are preliminary ones.

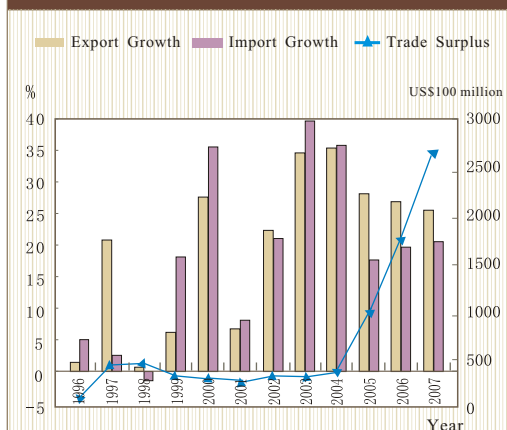
hike of primary commodities in the international market. Raw materials, fuel and power purchase prices were up 4.4 percent. The home sales prices grew rapidly, registering an increase of 7.6 percent in 70 large and medium-sized cities year on year, an acceleration of 2.1 percentage points.

Macroeconomic Outlook in 2008

The world economy will slow down The world economy is now facing many uncertainties. The worst impact of the sub-prime crisis is not over yet; the economic growth in the US, Europe, Japan and other major economies may slow down further. Prices of primary products including agricultural produce, energy and raw materials will continue to rise in the international market. The world economic slowdown and rising inflationary pressure will reduce external demand and increase the pressure of imported inflation, and may have many negative impacts on China's economic growth.

China's economy will continue to grow rapidly Although external demand has been an increasingly stronger driver in recent years, the Chinese economy is on the whole domestic demand-driven, and weaker external demand will not weigh

Figure 4 Export & Import Growth and Trade Surplus, 1996~2007



Source: The Statistical Communique of the 2007 National Economic and Social Development.

heavily on the economy. On the demand side, due to accelerating industrialization and urbanization, high return on investment and arrival of a new government, a dramatic investment slowdown is unlikely; with the effects of restructuring policies adopted in recent years unfolding and the Olympics effects, the consumption growth will remain stable; export growth is expected to decline further, import growth to accelerate and the trade surplus to decelerate. But on the whole, the processing and manufacturing industry of China has an established comparative advantage in the international division of labor, export will not slide substantially unless the world economy enters a severe recession.

On the supply side, important breakthroughs have been made in reforms of priority areas and key links; institutional and system environment improves remarkably; weak areas in the economic development and overall production capacity have been strengthened. All of these have improve China's ability of attaining stable growth.

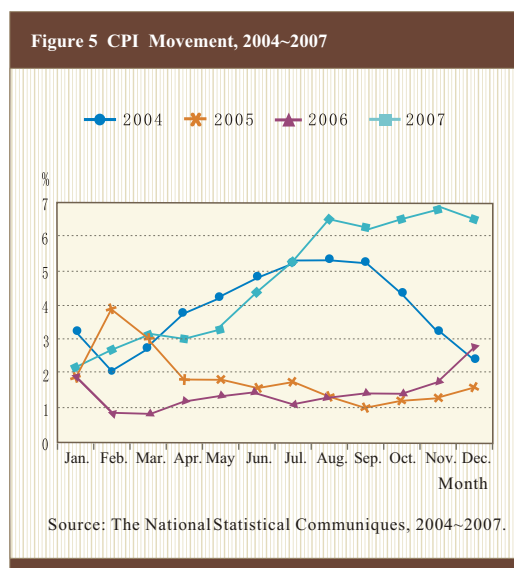
Inflationary pressure will remain strong In the context of increasing globalization and economic transformation, the current inflation has complicated reasons. One of the prominent features of this round of inflation is that it is driven by multiple factors including rapid economic growth, imported inflation,

supply shock and the adjustment of resources prices. In general, the current price hike result from the persistent price increase of bulk commodities in the international market and external price pass-through against the backdrop of China's further opening-up, global economic expansion and excess liquidity, and reflect the domestic economic imbalances and other deep-rooted problems. When there is a structural supply shortage of labor force in the domestic market and prices of resources increase, per unit production cost increase constitutes a cost-driven inflationary pressure. In the medium and long term, uncertainties in the price movement will remain, depending mainly on the international economic situations and domestic resources prices adjustment. Prices of bulk commodities in the international market will remain high due to the weak dollar and speculative activities; uncertainties remain in the domestic grain production; imported inflation and domestic supply constraint will weigh heavily on the price level. Going forward, close attention should be paid to the inflationary pressure.

A prudent fiscal policy and tight monetary policy will be implemented Despite increasing uncertainties in the world and domestic economic outlook, problems such as rapid investment growth, excessive

trade surplus and over supply of money and credit have been moderated, but the moderation is not yet solidly based. In particular, the inflationary pressure still remains strong. Based on this judgment, consistent macroeconomic policies will be pursued, with the top priority given to preventing rapid economic growth from overheating and preventing structural price hike from becoming a generalized inflation, in particular preventing price hike and curbing inflation; a prudent fiscal policy and a tight monetary policy will be implemented. The fiscal policy will be consistent and stable in order to fully play an important role in promoting economic restructuring and balanced development, and to considerably increase the expenditure on agriculture, rural areas and farmers, social security, medical service, education, culture, energy saving, emission reduction and low-rent housing construction. The monetary policy will focus on creating a monetary environment conducive to curbing inflation. A variety of policy instruments will be used to strengthen liquidity management, window guidance and credit policy guidance and encourage financial institutions to improve credit policy management and risk prevention. The role of the exchange rate in adjusting balance of payments, guiding structural adjustment and reining in inflation will be pursued, and foreign exchange administration will be improved to enhance the independence and effectiveness of monetary policy.

Intensify economic restructuring to strengthen the ability of the national economy to grow in a balanced manner In 2008, while curbing inflation and maintaining a stable and rapid economic growth, economic restructuring should be intensified to make new breakthroughs in addressing the root causes hampering a coordinated growth and to bring the balance of payments to an equilibrium. The current window opportunity of rapid economic growth and fiscal revenue increase should be seized to implement a mix of structural reform policies to expand consumer





demand by increasing the share of household income in national income, shifting to public finance, expanding the expenditure of public consumption and improving the social security system; to push forward the personal income tax reform and implement a fiscal and taxation regime conducive to scientific development; to regulate government savings, put in play the leading role of market mechanism in investment, guide private investment in medical care and public health, education and culture, increase supply of housing, and maintain

the healthy development of the real estate sector; to encourage enterprises to appropriately reduce the ratio of accumulation to improve the distribution relationship; to continue to forcefully adjust and standardize foreign trade, investment and industrial policies; to reform the pricing mechanism of resources, improve environmental protection and occupational insurance standards so as to promote the transformation of economic development mode.