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13 May 2009

Mainland China Budget for 2009

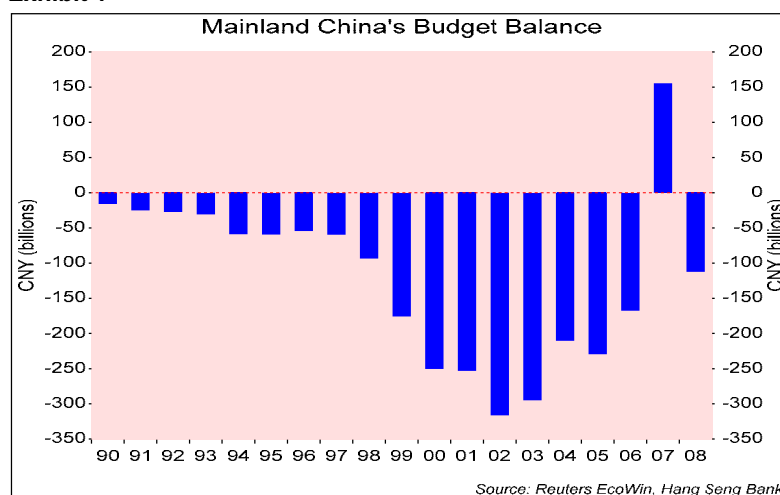
Mainland China's budget balance turned to a deficit of CNY111 billion, or 0.4% of gross domestic product (GDP), in 2008, from a surplus of CNY174 billion, or 0.7% of GDP, in 2007. The government expects the budget gap to widen further to CNY950 billion, or 2.9% of GDP, in 2009.

The larger budget deficit in 2009 is the result of expected slowing in government revenue growth rather than a substantial increase in public spending.

Total government revenue is estimated to grow by only 8.8% in 2009, after rising 19.5% in 2008 and 32.4% in 2007. Total government outlays are forecast to increase by 22.1%, smaller than a 25.9% rise a year before.

While the budget balance is likely to stay in deficit in the near-term, improving the fiscal position should remain a long-term budgetary objective. Otherwise, growing deficits could have negative implications for the economy.

Exhibit 1



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Mainland China's fiscal position had improved in recent years, with the balance in the general government account turning to a surplus of CNY174 billion in 2007 from a deficit of CNY315 billion in 2002 (Exhibit 1). As a percentage of GDP, the budget balance rose to 0.7% from minus 2.6% during the same period. This trend reversed last year, however, as the budget account shifted back to a deficit of CNY111 billion, or 0.4% of GDP, reflecting a slowing of government revenue growth as a result of an economic slowdown (Exhibit 2, 3).

Exhibit 2

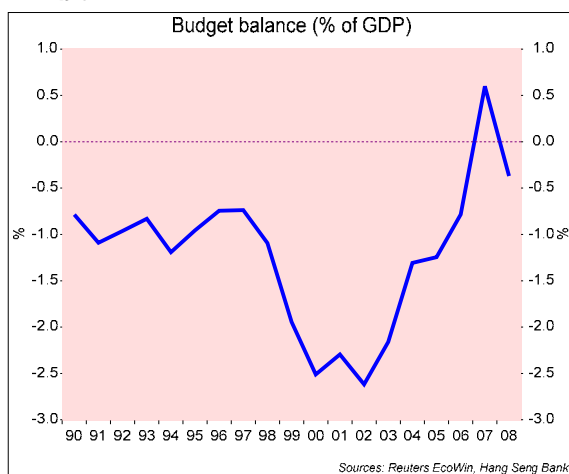
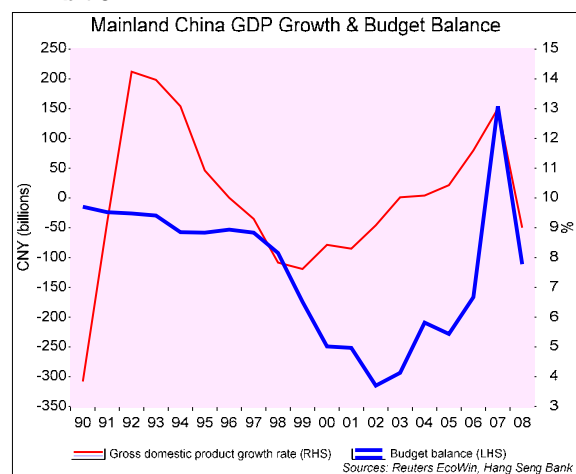


Exhibit 3



Budget deficit set to rise

The deficit problem is expected to persist in 2009, as the government projects the funding gap to rise to CNY950 billion, or about 2.9% of national income. Expenditure is expected to increase by 22.1% to CNY7,624 billion while revenue to grow by 8.8% to CNY6,674 billion (Exhibit 4).

Exhibit 4: The state budget (CNY in billions)

	2008	2009F	Change (%)
Revenue	6,132	6,674	8.8
Expenditure	6,243	7,624	22.1
Balance	-111	-950	755.8

Source: The government's budget statement 2008-09, Hang Seng Bank

In its budget statement for this year, the central government puts improving the low-income group's livelihood as its top priority. Representing about 58% of the total government expenditure, central government spending for 2009 would be mainly on the agriculture sector, healthcare, and education. Total expenditure on livelihood improvement and rural areas will grow by 25%, representing about a third of the central government spending (Exhibit 5, 6).



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Exhibit 5: A breakdown of state expenditure (CNY in billions)

	2008	Share (%)	2009F	Share (%)
Central government	3,632	58.2	4,387	57.5
Local governments	2,611	41.8	3,237	42.5
Total	6,243	100.0	7,624	100.0

Source: The government's budget statement 2008-09, Hang Seng Bank

Note: local governments' spending excludes transfers & subsidies from the central government and contributions to the central government

Exhibit 6: Central gov't spending on livelihood improvement & rural areas

(CNY in billions)	2008	2009F	Change (%)
Education, social security, etc.	560	728	30.0
Rural areas	596	716	20.2
<i>Sub-total</i>	<i>1,156</i>	<i>1,445</i>	<i>25.0</i>
Others	2,476	2,942	18.8
Total	3,632	4,387	20.8

Source: The government's budget statement 2008-09, Hang Seng Bank

Specifically, expenditure on agriculture, fisheries, and others is scheduled to rise 27.5% to around CNY345 billion. Investment in public housing will jump by 171% to over CNY49 billion, after rising 114% a year before. While spending on healthcare will go up by 38%, outlays on both social security and education will increase over 20% (Exhibit 7).

Exhibit 7: Central government spending by major areas

	2008			2009		
	CNY billion	Change (%)	Share (%)	CNY billion	Change (%)	Share (%)
Agriculture, fisheries, others	270.3	43.6	7.4	344.7	27.5	7.9
Social security	274.4	19.2	7.6	335.1	22.1	7.6
Social services	121.7	n.a.	3.3	131.4	8.0	3.0
Health care	85.4	28.6	2.4	118.1	38.2	2.7
Education	159.9	48.5	4.4	198.1	23.9	4.5
Public housing	18.2	114.3	0.5	49.3	171.0	1.1
Transportation	160.0	28.2	4.4	188.7	17.9	4.3
Environmental protection	104.0	33.0	2.9	123.7	18.9	2.8
Culture	25.3	20.0	0.7	28.0	10.7	0.6
Science and Technology	116.3	16.4	3.2	146.1	25.6	3.3
Military spending	410.1	17.7	11.3	472.9	15.3	10.8
Public security	87.6	9.3	2.4	116.1	32.6	2.6
Debt servicing	127.9	28.8	3.5	137.2	7.3	3.1
Others	1,670.9	n.a.	46.0	1,997.3	n.a.	45.5
Total	3,632.0	18.7	100.0	4,386.5	20.8	100.0

Source: The government's budget statement 2008-09, Hang Seng Bank





A slowing of government income is the reason of the bigger shortfall

It is not surprising that the budget deficit in 2009 will rise to nearly 3% of gross domestic product, given the CNY4,000 billion investment plan unveiled last November, under which 37.5% of the total expenditure would be spent on building public facilities such as roads, rails, etc. (Exhibit 8).

Exhibit 8: Allocation of expenditure of the CNY4,000bn plan

	CNY billion	Share (%)
Public housing	400	10.0
Rural construction	370	9.3
Infrastructure (rails, roads, etc.)	1,500	37.5
Education and social welfare	150	3.8
Environmental protection	210	5.3
Technology and investment	370	9.3
Quake rebuilding	1,000	25.0
Total	4,000	100.0

Source: Xinhuanet, Hang Seng Bank

What is surprising is that the budget deficit is not bigger. The CNY4,000 billion spending plan, followed by the CNY950 billion budget shortfall for 2009, suggested that the government was going to increase its outlays remarkably in an attempt to achieve its 8% economic growth target. However, this might not be the case given the 22.1% rise in the total government expenditure, which would even be lower than the 25.9% increase recorded a year earlier (Exhibit 9). Even if the item of military spending is excluded, the growth rate of total outlays is still set to decelerate.

Exhibit 9





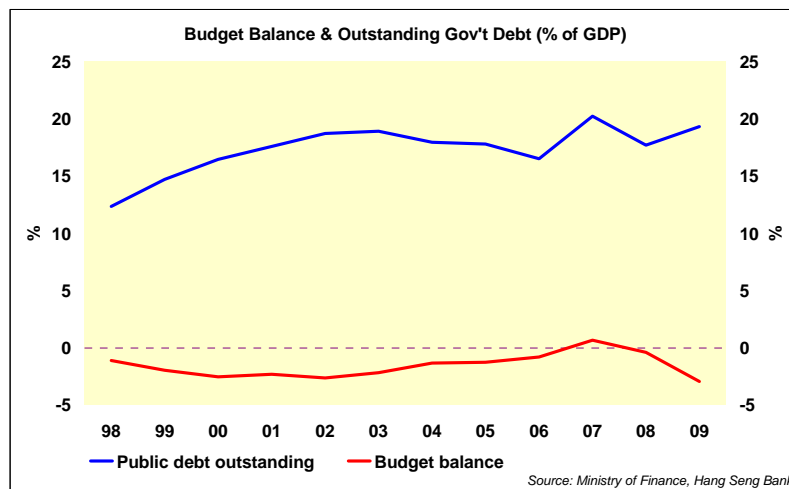
The slower growth in spending probably confirms some reports that the central government might only provide as little as CNY1,180 billion to the proposed CNY4,000 billion investment plan, with the rest being contributed by the private sector.¹ While this year's budget gap accounts for only 2.9% of GDP, delivering 8% growth will require a considerable rise in business investment and private consumption.

In fact, the bigger budget deficit for 2009 is largely a result of expected slowing in government revenue growth rather than a substantial increase in spending. Total government revenue is projected to grow only by 8.8% in 2009 after rising 19.5% in 2008 and 32.4% in 2007. The current economic slowdown is likely to reduce tax income further and thereby weaken the government's fiscal position.

Local governments are facing financial strains

The fiscal imbalance relative to the size of the economy in 2009 is large by historical standards. However, of this amount, CNY200 billion is the shortfall at the local government level. As the Budget Law prohibits local governments from incurring deficits, the central government will issue bonds on behalf of the local governments to finance the budget gap. In any case, the budget deficit would remain a challenge to local government entities if they have to achieve a balance of spending and revenues in the years ahead, as required by law. To repay the debt, the local authorities may have to raise taxes or reduce spending, which would have negative implications for the economy.

Exhibit 10



¹ See http://news.xinhuanet.com/video/2009-03/06/content_10954996.htm. Xinhuanet, 6 March 2009. “张平详解 4 万亿投资构成 一定不去搞重复建设”.





Long-term budget planning

The general government budget gap is likely to persist in 2010, as the economic slowdown will continue to exert downward pressures on tax revenue. But in the long-run, improving the fiscal position should be a key budgetary objective. Although the outstanding government debt is just about CNY6,300 billion, or 20% of national income (Exhibit 10), a growing budget deficit and higher levels of public debt would eventually push up the government's borrowing costs and erode investor confidence on the currency, adding uncertainty to economic growth over time. With the aging of the population and continued increases in health care costs, the fiscal challenge should not be under-estimated. Achieving fiscal sustainability is always of value to the economy.





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