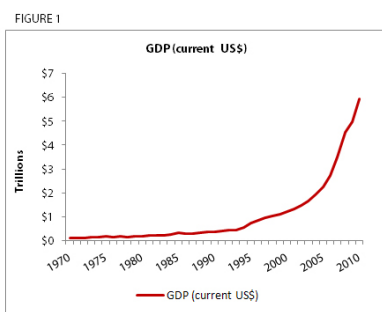


China Five Years At A Time

The People's Republic of China has stopped at nothing to foster economic growth while maintaining an environment of social stability, largely as a result of an economy that left the country in shambles in the aftermath of the Cultural Revolution of the late 1970s. Post-Mao reforms strategies relied upon the classic export-led model of economic development for growth. The success, or miracle, of this manufacturing, investment and export-led dynamic over the last 30 years is exponentially undeniable (Figure 1). Approved in March 2011, China's 12th Five Year Plan presents a shift in catalysts to help its economy avoid hitting the proverbial wall.



The next phase of China's development strategy can be best described as pro-consumption. As the most populous country and the second largest economy in the world, this shift in economic drivers will have consequential implications for China, and producers in the metals and energy sector.

The next phase of China's development strategy can be best described as pro-consumption.

What a difference 5 years makes

The clearest distinction between the 12th and 11th FYP is the adjustment in its economic structure to facilitate an expansion of domestic demand for the long-term. Difference in how key targets are now categorized showcase a sharpened interest in achieving economic development as opposed to simply growing. For example, past indicators like average GDP growth per person are no longer a designated metric, in fact, it's been removed completely. While the percentage of urbanization is now seen as a factor contributing to economic development as opposed to just a structural goal. Language used in the 12th FYP also reflects a change in government priorities. Specifically, terms like '*jihua*', meaning plan, have been replaced by general expressions like '*guihua*', meaning vision and guideline. This broadening of vocabulary shifts the focus away from attaining concrete numerical targets to revealing more fundamental principles of sustainable economic growth.

Structural weakness

Despite the differences, many measures in the 11th plan still reside in the 12th. Five years ago, Premier Wen Jiabao painted the Chinese economy as strong on the surface, but beneath, it was increasingly being affected by the 'four uns' – unstable, unbalanced, uncoordinated, and unsustainable. As a result, both plans attempt to address the following challenges stemming from the neck-breaking economic growth experienced: (1) export-led growth – unsustainable; (2) consumption as a share of GDP too low (high propensity to save) – unbalanced; (3) socioeconomic inequalities are growing – unstable; and (4) need to move up the manufacturing value chain – uncoordinated.

Implementation with a grain of salt

In practice, provincial and municipal governments and industry regulators draft parallel plans following the release of the national FYP. To better align priorities at the local with the national level, FYPs distinguish between restricted '*yueshuxing*', and expected '*yuqixing*', targets among its key indicators. To underscore the importance of restricted targets, career progression is effectively tied to meeting

Country Profile

The People's Republic of China

Population: 1.34 billion (2012 estimate)

Age structure: 0 – 14: 17.6% | 15 – 64: 73.5% | 65+: 8.9% (2011)

Labour force: 816.2 million (2011)

GDP (US\$): 5.93 trillion (2010)

GDP real growth rate: 9.2% (2011)

Source: CIA World Factbook

The 12th Five Year Plan ("FYP")

To align the economy with top policy goals and to express this directive through the government, China began implementing FYPs in 1953. FYPs are a series of social and economic development initiatives designed and shaped by the Communist Party of China. They provide key indicators to the direction and changes in the development philosophy from the highest bureaucratic level. For regulators and provincial officials, it provides them with guidance and hard objectives that will influence their overall priorities. China's 12th FYP attempts to transform its time-honoured economic development pattern by turning towards internal private consumption to endogenously drive-up demand potentially weaning itself off of exports. Furthermore, the restructuring encourages the development of the service sector, shifting to higher value-added manufacturing, conservation of energy and more aggressive environmentally friendly initiatives. The three key aspects of the FYP's industrial policy are: (1) focus on scientific development; (2) government support of the seven strategic emerging industries; and (3) construction of transportation and energy infrastructure.

The Capital Lab : strategic investor relations and business development. www.thecapitallab.com.

Contact: Belinda Labatte at belinda@thecapitallab.com for more information | Phone 647.436.2152 or visit us at 76 Richmond Street East, Suite 330 Toronto, Ontario, corner of Richmond and Church.

these *hard* targets, with expected targets as *soft* targets realized through market forces with government backing. Consequently, the motivation to fulfill restricted objectives is more powerful. According to government figures, for the 11th FYP, seven out of eight restricted goals were met or exceeded and 11 out of 14 for the expected goals. Hard to refute statistics like that, but future results will be met with skepticism as restricted targets clearly breed a preference of getting things done at any cost over the quality or the sustainability of the process.

Roll up your sleeves: the specifics of the FYP

Specifically a number of key indicators were set in place in the 12th FYP:

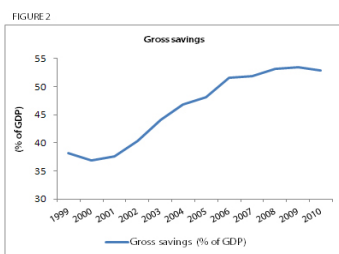
- 4% expansion of the service sector as a percentage of GDP
- Increase annual disposable income - urban disposable income to greater than US\$4,413 and rural to greater than US\$1,284
- Raise minimum wages substantially (by no less than 13% on average) and hold inflation at or below 4%
- Construction of 36 million affordable urban housing units
- Raise R&D spending from 1.75% to 2.2% of GDP
- Boosting minimum education attainment
- Increasing the number of patents per 10,000 people (arguably not specific and does not address quality of patents)

The first half of goals aid in generating a windfall of discretionary income for its 1.3 billion consumers, while the latter half increase the global competitiveness of its domestic firms.

Further to employment, seven strategic emerging industries (SEI) were designated as key economic drivers to creating sustainable growth for China's future development from low end manufacturing to higher-value industries in the 12th FYP. These industries are: (1) clean energy technology; (2) next-generation information technology; (3) biotechnology; (4) high-end equipment manufacturing; (5) alternative energy; (6) new materials; and (7) clean energy vehicles. The 12th FYP established a clear measure of growing these seven industries to account for 8% of GDP by 2015.

Saving for a rainy day

The framework for this transition is based on moving incremental income away from savings towards spending, subsequently spurring demand further, which will ultimately support current employment and wage levels and demand for imported goods. Theoretically it works, but realistically, the most uncontrollable and arguably the most important variable in the 12th FYP is trying to change a nation's natural propensity to save (Figure 2). Hiking wage rates is a necessary step towards a consumer-led growth strategy, but it



is not enough to guarantee a shift towards consumption. The effects of this tactic will not be evident five or even ten years from now as habits are innately entrenched, and may take a generation. If this precautionary savings trend persists, it will become exceedingly difficult for China to achieve its pro-consumer mandate. (See The Wall Street Journal article on the same issue published this month and entitled: [Internal-Consumption Engine Poised to Rev?](#))

Not easy being green, but growth will follow

China's 12th FYP marks another turning point with its prioritization and measures towards environmental policies. Compared to past alterations, the 12th FYP is China's greenest. Not only has the absolute number of goals towards environment and energy efficiency grown, but so has their level of ambition. Key indicators dealing with consumption management – like reduction in carbon emissions per unit of GDP, or reduction in energy intensity per unit of GDP – were emphasized for the first time. A restricted target of non-fossil fuels consisting of 11.4% of total energy consumption by 2015 attest to its ambition. Latest statistics (2010), account non-fossil fuels for 8.3% of total energy consumption. However, with coal's dominance as an energy source (about 70%) and rising demand (rose 9.7% in 2011 over 2010), this non-fossil fuel commitment becomes ever more daunting. Moreover, an annual domestic output target of 3.9 billion tonnes of coal was set by 2015. With actual GDP rates consistently outpacing its target rates, coal exporters are positioned to benefit from rising imports needed to fuel these economic growth spurts. A very realistic possibility as output of coal already grew by 0.3 billion tonnes between 2010 – 2011 alone.

According to the Rhodium Group, this increase in appetite for clean energy generates a need to produce 320 to 380 gigawatts of non-fossil energy over the next decade. This considerable effort into renewable energy and continuing industrialization will keep the demand for base metals healthy. Over 2011, imports of crude oil and iron ore grew 6% and 11%, respectively. As for copper, in January 2012, China imported 413,964 tonnes of copper, up 13.3% from the previous year. More impressive, a record high 508,942 tonnes was imported in December, an astonishing 47.7% increase from the same month in 2010.

What this means to producers:

- Energy efficiency does not necessarily mean a turn away from fossil fuel consumption
- Urbanization is poised to continue and now viewed as a key factor to economic development and a restricted target
- Changing a country's propensity to save is key – but will take generational shift in consumption patterns
- FYPs have historically met their targets. These plans are relevant and useful, and have proven to be good indicators of China's economic development.

The Capital Lab : strategic investor relations and business development. www.thecapitallab.com.

Contact: Belinda Labatte at belinda@thecapitallab.com for more information | Phone 647.436.2152 or visit us at 76 Richmond Street East, Suite 330 Toronto, Ontario, corner of Richmond and Church.

