

## ECON4033: Money and Finance in China

### Assignment 1: Short Answer

Please submit your report at the beginning of Week 7's class on (Friday) Oct. 22, 2021. Input your answers in the answer sheet provided on the iSpace if you so wish. Assignment 1 accounts for 30% of your final mark of this course.

1. The following table presents, at the provincial level, the top three and bottom three loan-to-deposit ratios and the respective shares of SOEs in output value and employment. It is argued that the information given in the table indicates a symptom of financial repression. Explain the logic behind this argument based on your understanding of the financial market in China.

*Loan-to-Deposit Ratios and SOE Shares in Selected Provinces,  
1988 and 1993*

Provinces	Loan-to-deposit ratio		SOE percentage shares (1993)	
	1988	1993	Industrial output value	Industrial employment
Top three <sup>a</sup>				
Jilin	1.9	1.9	75	100
Inner Mongolia	1.5	1.6	82	70
Heilongjiang	1.6	1.5	83	71
Bottom three <sup>a</sup>				
Fujian	1.2	1.0	40	42
Zhejiang	1.2	0.9	31	28
Guangdong	1.3	0.8	34	32

<sup>a</sup> Refer to ranks in loan-to-deposit ratio in 1993.

Sources:

- i. Loan-to-deposit ratios are from Lardy, Nicholas R. (1998). China's Unfinished Economic Revolution. Washington, D.C.: Brookings Institution.
- ii. SOE's output and employment shares are calculated from China Statistical Yearbook (1994).

**Total: 10%**

2. This question is related to investment in China.
  - a. Visit either of the following websites to download investment shares of GDP (%) of China and the U.S.. Generate a line chart to plot these two time series variables over time. (3%)

<https://databank.worldbank.org/source/world-development-indicators> , or  
<https://www.imf.org/en/Publications/WEO/weo-database/2021/April>

Note that, apart from the recent pandemic, the U.S. was officially in recession in 2001, 2008, and 2009, whereas China's economy also slowed down in 2002-2003 and 2008-2009 because of the SARS outbreak and the global financial crisis, respectively.

- b. Discuss the changes in the investment shares of GDP of the U.S. during recessions and link that to the traditional cash flow net present value approach discussed in the lecture notes. **(3%)**
- c. How can you explain the change in China's investment shares of GDP during economic downturns? Discuss whether the approach in (b) is applicable to China. Do you think that this is important to the economic development of the coming years? **(6%)**

**Total: 12%**

3. Consider the saving behavior in China.

- a. China's population during the next fifty years will become, on average, older. It is estimated that, by 2050, about 24 percent of the population will be over the age of sixty-four compared to only about 6.8 percent today. How would this affect the saving rate of China according to the life cycle theory of savings? **(3%)**
- b. What is the limitation of using household consumption theory alone to explain the high saving rate in China? **(2%)**
- c. A major theme in corporate finance is that when firms have "excess" cash they should pay it out to their shareholders. What are the implications of this concept for China's dividend policy and national savings and consumption? **(3%)**

**Total: 8%**