

US\$1,000,000,000



(organized under the laws of the People's Republic of China)

**4.875% Notes due 2015**

The Export-Import Bank of China, or China Eximbank, is offering US\$1,000,000,000 principal amount of its 4.875% notes due 2015. The notes will constitute direct, unconditional, unsecured and unsubordinated obligations of China Eximbank and rank equally with other unsecured and unsubordinated public external indebtedness of China Eximbank. China Eximbank will pay interest on the notes on January 21 and July 21 of each year, beginning on January 21, 2006. Payments of principal and interest in respect of the notes will be made without deduction or withholding for any present or future taxes imposed by the People's Republic of China, or the PRC, unless such deduction or withholding is required by law, in which event, China Eximbank will pay such additional amounts as will result in the payment to the noteholders of the amounts which would otherwise have been receivable, had no such deduction or withholding been required. There is no sinking fund for the notes.

Pursuant to the Special Decree of the State Council of China dated March 19, 1994, the People's Bank of China, or the PBOC, the PRC central bank, is authorized and obligated to provide short-term loans to China Eximbank in the event that China Eximbank experiences any liquidity shortages. However, the obligation of the PBOC to make such loans to China Eximbank does not constitute a guarantee of the notes, and is not enforceable against the PBOC or the PRC government by, and does not confer any right under or in respect of the Special Decree upon, any noteholder.

On the date of issuance of the notes, the notes are expected to be rated A2 by Moody's Investors Service, Inc. and BBB+ by Standard & Poor's Ratings Group. These ratings do not constitute a recommendation to buy, sell or hold the notes and may be subject to suspension, reduction or withdrawal at any time by such rating agency.

China Eximbank has applied for the listing of and permission to deal in the notes on The Stock Exchange of Hong Kong Limited. China Eximbank expects the listing of the notes on The Stock Exchange of Hong Kong Limited to commence on or about July 22, 2005.

	<u>Per note</u>	<u>Total</u>
Price to investors(1) . . . . .	98.801%	US\$988,010,000
Initial purchasers' discount . . . . .	0.18%	US\$ 1,800,000
Proceeds, before expenses, to China Eximbank(1) . . . . .	98.621%	US\$986,210,000

(1) Plus any accrued interest from July 21, 2005 if settlement occurs after that date.

The notes have not been, and will not be, registered under the United States Securities Act of 1933, as amended, or the U.S. Securities Act, any state securities laws of the United States or the securities laws of any other jurisdiction. Unless they are registered, the notes may be offered only in transactions that are exempt from registration under the U.S. Securities Act, any state securities laws or the securities laws of any other jurisdiction. Accordingly, the notes are only being offered to qualified institutional buyers within the United States in reliance on Rule 144A under the U.S. Securities Act and non-U.S. persons outside the United States in reliance on Regulations S under the U.S. Securities Act. For further details about eligible offerees and resale restrictions, see "Underwriting" and "Transfer Restrictions."

It is expected that the notes will be ready for delivery in book-entry form only, through The Depository Trust Company, or DTC, and its participants, on or about July 21, 2005, the closing date. The notes offered by this offering circular may be cancelled at any time up to the closing date when subscription monies shall have been received and the notes issued.

*Sole Global Coordinator*

**Merrill Lynch Far East Limited**

*Joint Bookrunners*

**BNP PARIBAS      Citigroup      HSBC      Merrill Lynch Far East Limited**

*Joint Lead Managers*

**BNP PARIBAS      BOC International      Citigroup**  
**Goldman Sachs (Asia) L.L.C.      HSBC      Merrill Lynch Far East Limited**

*Co-Managers*

**Barclays Capital      Calyon      Credit Suisse First Boston      Daiwa Securities SMBC Europe      DEPPA BANK**  
**Deutsche Bank Securities      ICEA      JPMorgan Cazenove      Nomura Securities      Standard Chartered Bank**

This Offering Circular is dated July 14, 2005

This offering circular includes particulars given in compliance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited for the purpose of giving information with regard to China Eximbank. China Eximbank has made all reasonable inquiries and confirms that this offering circular contains all information with respect to China Eximbank, the PRC and the notes that is material in the context of the issue and offering of the notes, and that this information is true and accurate in all material respects and is not misleading, that the opinions and intentions expressed in this offering circular are honestly held, and that, to the best knowledge and belief of China Eximbank, there are no other facts the omission of which would make any of this information or the expression of these opinions and intentions misleading and that China Eximbank has made all reasonable inquiries to ascertain such facts and to verify the accuracy of all such information. China Eximbank accepts responsibility accordingly.

You should rely only on the information contained in this offering circular in making your investment decision. Neither China Eximbank nor any initial purchaser of the notes has authorized anyone to provide you with any other information. Neither the delivery of this offering circular, nor any offering, sale or delivery made in connection with the issue of the notes should at any time or in any circumstances imply that the information contained in this offering circular is correct as at any time subsequent to the date of this offering circular or constitute a representation that there has been no change or development reasonably likely to involve a material adverse change in the affairs of China Eximbank or the PRC since such date. No representation or warranty, express or implied, is made by the initial purchasers or any of their affiliates or advisers as to the accuracy or completeness of the information contained in this offering circular, and nothing contained in this offering circular is, or should be, relied upon as a promise or representation by any initial purchaser or its affiliates or advisers.

This offering circular does not constitute an offer of or an invitation by or on behalf of China Eximbank or the initial purchasers to subscribe for or purchase any of the notes and may not be used for the purposes of an offer to, or a solicitation by, anyone in any jurisdiction or in any circumstances in which such offer or solicitation is not authorized or lawful. The distribution of this offering circular and the offering of the notes in certain jurisdictions may be restricted by law. Persons into whose possession this document comes are required by China Eximbank and the initial purchasers to inform themselves about, and to observe, any such restrictions. For a description of certain further restrictions on offers and sales of the notes and the distribution of this offering circular, see “Underwriting.”

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The Stock Exchange of Hong Kong Limited takes no responsibility for the contents of this offering circular, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this offering circular.

Neither the United States Securities and Exchange Commission nor any state securities commission in the United States has approved or disapproved of these securities or determined if this offering circular is truthful or complete. Any representation to the contrary is a criminal offense.

Notwithstanding anything in this offering circular or any other document, China Eximbank, the initial purchasers, any potential investor and their employees, representatives and agents may disclose to any and all persons, without limitation of any kind, the United States tax treatment and any facts that may be relevant to the tax structure of the offering, provided, however, that this does not apply to any other information, the disclosure of which is otherwise limited, that is not relevant to understanding the United States tax treatment or tax structure of the offering (including the identity of any participant in the offering and information that could lead another to determine the identity of any participant in the offering), or any other information to the extent that such disclosure could result in a violation of any applicable securities law.

China Eximbank has made forward-looking statements within the meaning of Section 27A of the U.S. Securities Act and Section 21E of the United States Securities Exchange Act of 1934, as amended, or the U.S. Securities Exchange Act, in this offering circular. The words “anticipate,” “believe,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “forecast,” “seek,” “will,” “would,” and similar expressions, as they relate to China Eximbank, are intended to identify a number of these forward-looking statements. Forward-looking statements are statements that are not historical facts. These statements are based on China Eximbank’s current plans, estimates, assumptions and projections and involve known and unknown developments and factors that may cause China Eximbank’s financial condition and results of operations or business environment to be materially different from that expressed or implied by these forward-looking statements. Therefore, you should not place undue reliance on them. Actual results, performance or achievements may differ materially from the information contained in the forward-looking statements as a result of a number of factors, including changes in interest rates, exchange rates, PRC economic, political and social conditions, government fiscal, monetary and other policies as well as prospects of China’s continued economic reform. Forward-looking statements speak only as of the date they are made, and China Eximbank undertakes no obligation to update any of them in light of new information or future events.

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## NOTICE TO NEW HAMPSHIRE RESIDENTS

Neither the fact that a registration statement or an application for a license has been filed under Chapter 421-B of the New Hampshire Revised Statutes with the State of New Hampshire nor the fact that a security is effectively registered or a person is licensed in the State of New Hampshire constitutes a finding by the Secretary of State that any document filed under Chapter 421-B is true, complete and not misleading. Neither any such fact nor the fact that an exemption or exception is available for a security or a transaction means that the Secretary of State has passed in any way upon the merits or qualifications of, or recommended or given approval to, any person, security, or transaction. It is unlawful to make, or cause to be made, to any prospective purchaser, customer, or client any representation inconsistent with the provisions of this paragraph.

## NOTICE TO INVESTORS

*Because of the following restrictions, you are advised to consult legal counsel prior to making any offer, resale, pledge or other transfer of the notes offered hereby.*

Each purchaser of the notes offered hereby will be deemed to have represented and agreed as follows (terms used in this section shall have the meanings as defined in Rule 144A or Regulation S under the U.S. Securities Act:

- (1) You (A) (i) are a qualified institutional buyer, (ii) are aware that the sale of the notes to you is being made in reliance on Rule 144A and (iii) are acquiring such notes for your own account or for the account of a qualified institutional buyer, as the case may be, or (B) are not a U.S. person, as such term is defined in Rule 902 under the U.S. Securities Act, and are purchasing the notes in accordance with Regulation S.
- (2) You understand that the notes have not been registered under the U.S. Securities Act and may not be reoffered, resold, pledged or otherwise transferred except (A) (i) to a person who you reasonably believe is a qualified institutional buyer acquiring for its own account or the account of a qualified institutional buyer in a transaction meeting the requirements of Rule 144A, (ii) in an offshore transaction complying with Rule 903 or Rule 904 of Regulation S, (iii) pursuant to an exemption from registration under the U.S. Securities Act provided by Rule 144 thereunder (if available) or (iv) pursuant to an effective registration statement under the U.S. Securities Act and (B) in accordance with all applicable securities laws of the states of the United States and other jurisdictions.
- (3) The notes will bear a legend to the following effect, unless China Eximbank determines otherwise in compliance with applicable law.

THE NOTES EVIDENCED HEREBY HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933 (THE "SECURITIES ACT") AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (A) (1) TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (2) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT, (3) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE) OR (4) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT AND (B) IN ACCORDANCE WITH ALL APPLICABLE SECURITIES ACT AND (C) IN ACCORDANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND OTHER JURISDICTIONS.

The notes will be available only in book-entry form. The notes will be issued in the form of one or more global notes bearing the legend set forth above.

## STABILIZATION

In connection with this issue, Merrill Lynch Far East Limited (or any person acting on its behalf) may, to the extent permitted by applicable laws and regulations, over-allot or effect transactions with a view to supporting the market price of the notes at a level higher than that which might otherwise prevail for a limited period after the closing date. However, there is no obligation on Merrill Lynch Far East Limited (or any person acting on its behalf) to do this. Such stabilization, if commenced, may be discontinued at any time, and must be brought to an end after a limited period.

## CONVENTIONS

Unless otherwise indicated, all references in this offering circular to “China” or the “PRC” are to the People’s Republic of China; all references to “Hong Kong” are to the Hong Kong Special Administrative Region of the PRC; all statistical information in this offering circular relating to the PRC excludes information with respect to Hong Kong, the Macau Special Administrative Region and Taiwan; all references in this offering circular to government ministries, commissions and agencies are to those of China.

The fiscal year of China Eximbank and China ends on December 31. All annual information of China Eximbank and China is based upon January 1 to December 31 periods. Any discrepancies in any table between totals and the sums of the amounts listed in such table are due to rounding. Data not available are marked with “N/A.”

Unless otherwise indicated, all references in this offering circular to “Renminbi” or “Rmb” are to the lawful currency of China; all references to “U.S. dollar” or “US\$” are to the lawful currency of the United States of America. Solely for the convenience of the reader, unless otherwise indicated, translations of amounts from Renminbi to U.S. dollar or vice versa have been made on the basis of the rate of exchange set and published by the PBOC on March 31, 2005 for financial information relating to 2005 at Rmb 8.2765 = US\$1.00. On July 13, 2005, the exchange rate set and published by the PBOC was Rmb 8.2765 to US\$1.00. On July 13, 2005, the noon buying rate in New York City for cable transfers on that day of Renminbi as certified for customs purposes for the Federal Reserve Bank of New York was Rmb 8.2765 to US\$1.00.

In addition, the following rates of exchange between Renminbi and U.S. dollar as published by the PBOC on the last business day of the relevant year have been used in the preparation of financial information relating to the respective years:

2002 .....	Rmb 8.2773 = US\$1.00
2003 .....	Rmb 8.2767 = US\$1.00
2004 .....	Rmb 8.2765 = US\$1.00

For information relating to the foreign exchange system in China, see “People’s Republic of China — PRC Financial System — Foreign Exchange.” Unless otherwise indicated, historical accounts in Renminbi of foreign currency items are based on historical rates of exchange. See Note 1(d) in “The Export-Import Bank of China — Report of the General Manager (Accounting Department) — Notes to Financial Statements.” No representation is made that the Renminbi, U.S. dollar or any other currency amounts referred to in this offering circular could have been or can be converted into U.S. dollars, Renminbi or any other currency, as the case may be, at any particular rate or at all.

China is a participant in the General Data Dissemination System of the International Monetary Fund. However, China is not a subscriber to the Special Data Dissemination Standard of the International Monetary Fund. China has been modifying the methods it uses to calculate its statistical information in order to be more consistent with international standards. As a result, this offering circular contains data restated for prior years on the basis of such modified methods of calculation. China Eximbank uses the following terms in this offering circular as defined below:

- *Gross domestic product* or *GDP* means the total value of products and services produced inside China during the relevant period.
- *Gross national product* or *GNP* means GDP plus income earned by PRC nationals from products produced, services rendered and capital invested outside China, less income earned inside China by non-PRC nationals.
- *Gross output value* means the sum of the total (not incremental) values of products and services at each enterprise during the production process. Important characteristics of gross output value are: (1) it double-counts the value of products which pass through more than one enterprise during its production; (2) it is stated in current rather than in constant prices; and (3) it includes inventories.

- *Imports* are calculated based upon (1) for purposes of foreign trade, statistics reported to the PRC customs upon entry of goods into China on a cost, insurance and freight included, or CIF, basis; and (2) for purposes of balance of payments, statistics collected on a free on board at a given departure location, or FOB, basis.
- *Exports* are calculated based upon (1) for purposes of foreign trade, statistics reported to the PRC customs upon departure of goods from China on an FOB basis; and (2) for purposes of balance of payments, statistics collected on an FOB basis.
- *Per capita disposable income* means total actual income of an urban household after individual income tax.
- *Per capita net income* means total residual income of a rural household, during a certain period of time, after deduction of production costs, taxes and contractual fees.
- *Rate of unemployment* or *unemployment rate* is calculated as the percentage of the members of the urban work force who register with the local employment agencies as being unemployed. “Urban work force” means permanent urban residents who are (1) registered under the household registration system as urban residents; (2) between the ages of 16 and 50 (in the case of males) and between the ages of 16 and 45 (in the case of females); and (3) physically capable of working. China does not collect statistical data regarding rural unemployment or regarding persons residing in, but not registered as residents of, urban areas.
- *Rate of inflation* or *inflation rate* is measured by the year-on-year percentage change in the consumer price index, unless otherwise specified. The consumer price index is calculated on a weighted basket of consumer goods and services for the urban and rural areas, using a monthly averaging method. Year-on-year rates are calculated by comparing the average of the twelve monthly indices for the later period against the average of the twelve monthly indices for the prior period. See “People’s Republic of China — PRC Financial System — Inflation.”

For purposes of the statistical information set forth in this offering circular under the caption “People’s Republic of China” and unless otherwise indicated, (1) all annual rates of growth are average annual compounded rates; (2) except in the “People’s Republic of China — Public Finance” section, all rates of growth or percentage changes in financial data are based upon such data expressed in constant prices (i.e., prices as adjusted for inflation); and (3) all financial data are presented in current prices.

### **AVAILABLE INFORMATION**

To permit compliance with Rule 144A under the U.S. Securities Act in connection with sales of the notes, China Eximbank will be required under the fiscal agency agreement between China Eximbank and Citibank, N.A. as the fiscal agent to furnish, upon request, to a noteholder and a prospective investor designated by such noteholder the information required to be delivered under Rule 144A (d)(4) under the U.S. Securities Act unless at the time of the request China Eximbank is a reporting company under Section 13 or Section 15(d) of the United States Securities Exchange Act of 1934, as amended, or is included in the list of foreign private issuers that claim exemption from the registration requirements of Section 12(g) of the U.S. Securities Exchange Act (and therefore is required to furnish to the United States Securities and Exchange Commission certain information pursuant to Rule 12g3-2 (b) under the U.S. Securities Exchange Act). In accordance with the fiscal agency agreement, the fiscal agent also will make available for inspection by noteholders or, in certain cases, arrange for the mailing to such noteholders, certain reports or communications received from China Eximbank. See “Description of the Notes — Notices.”

## **ENFORCEMENT OF FOREIGN JUDGMENTS**

China Eximbank is a government policy bank organized under the laws of China, and substantially all of the assets of China Eximbank are located in China. As set forth under “Description of the Notes — Jurisdiction; Consent to Service,” China Eximbank will consent to the non-exclusive jurisdiction of any federal and state court in the Borough of Manhattan, The City of New York in respect of proceedings relating to the notes and will waive, to the fullest extent permitted by law, immunity from legal proceedings on grounds of sovereignty. China Eximbank has been advised by its PRC legal counsel, the Legal Department of China Eximbank, that there is doubt as to the enforceability in China of any actions to enforce judgments of United States courts arising out of or based on the notes, including judgments arising out of or based on the civil liabilities provisions of United States federal or state securities laws, primarily because there is no treaty or other arrangement or basis for reciprocal enforcement of judgments between China and the United States. China Eximbank has also been advised by its Legal Department that there is doubt as to the enforceability in original actions brought in Chinese courts of the civil liability provisions of United States federal or state securities laws. For additional information, see “Description of the Notes — Jurisdiction; Consent to Service.”



## SUMMARY

*This summary may not contain all the information that may be important to you. You should read the entire offering circular before deciding to invest in the notes.*

### **China Eximbank**

China Eximbank was established on April 26, 1994 pursuant to the Special Decree of the State Council dated March 19, 1994 as a policy-oriented statutory financial institution under the direct authority and full ownership of the State Council, the highest institution of the PRC government administration. It is the only government export credit agency in China. Pursuant to the Special Decree, China Eximbank operates on an autonomous basis and conducts its activities under the direct leadership of the State Council. China Eximbank is subject to the supervision and direction of the PBOC, the China Banking Regulatory Commission, the Ministry of Finance and the Ministry of Commerce with respect to its business activities.

The primary purpose of China Eximbank is to provide policy-oriented financial support for the export and import of capital goods and related services in accordance with the PRC government's industrial and foreign trade policies. China Eximbank aims to supplement commercial financing by absorbing some of the repayment risks that the commercial and private sectors are unable to absorb and by providing financing to PRC exporters and foreign importers when commercial and private financing is not available. China Eximbank may also engage in other lines of business approved by the PRC government. As an instrumentality serving the policy objectives of the PRC government, China Eximbank does not seek to maximize profits, nor is it an aid agency. Rather, it seeks to achieve moderate profitability while preserving capital as mandated in the Special Decree.

As one of China's policy banks, China Eximbank receives financial support from the PRC government. In addition to contributions to the capital of China Eximbank, the PRC government provides direct and indirect financial support for the business activities of China Eximbank. According to the Special Decree, sources of funds available to China Eximbank include: (a) capital contribution by the PRC government, (b) fiscal subsidies from the Ministry of Finance, (c) short-term credits provided by the PBOC, and (d) borrowings from domestic and foreign financial institutions, including debt securities issued overseas and financial debentures issued to domestic financial institutions. However, the financial support to China Eximbank from the PRC government does not constitute a guarantee of the notes, and is not enforceable against any PRC government entity by, and does not confer any right upon, any noteholder.

China Eximbank is also a designated on-lending agent for the PRC central government. China Eximbank has on-lent to Chinese end-users credits made available to the PRC central government by foreign governments and financial institutions. The PRC government has established an on-lending support fund which can be drawn on by China Eximbank to make payments to the foreign governmental lenders on behalf of the PRC central government before full collection of payments from the Chinese end-users.

China Eximbank acts as the only designated lending institution for the PRC central government in connection with concessional loans to borrowers in developing countries selected by the PRC government. China Eximbank is protected against any loss in principal with respect to its concessional loan operations by a concessional loan reserve fund established by the PRC government for the exclusive use of China Eximbank. As the lender of these concessional loans on behalf of the PRC government, China Eximbank receives fiscal subsidies from the Ministry of Finance to compensate for any losses resulting from interest rate differentials and administrative expenses on such concessional loans.

At present, China Eximbank has seven operational arms, namely, the banking department at its head office in Beijing, the Chengdu branch, the Dalian branch, the Nanjing branch, the Qingdao branch, the Shanghai branch and the Shenzhen branch. China Eximbank also has six domestic representative offices, located in Fuzhou, Guangzhou, Hangzhou, Harbin, Wuhan and Xi'an, and two overseas representative offices, one based in Paris, France servicing Europe and North Africa and the other based in Johannesburg, South Africa servicing the other parts of Africa.

The following table presents summary historical financial information of China Eximbank as of and for the years ended December 31, 2000, 2001, 2002, 2003 and 2004. Since this information is only a summary, you

should read the complete financial statements included under “The Export-Import Bank of China — Report of the General Manager (Accounting Department)” in this offering circular. This summary does not include any information from the balance sheet of China Eximbank’s on-lending operations, which is accounted for on a stand-alone basis. See “The Export-Import Bank of China — Report of the General Manager (Accounting Department) — China Eximbank Balance Sheets of On-lending Operations.”

	Year Ended or as of December 31,					
	2000 (in Rmb)	2001 (in Rmb)	2002 (in Rmb) (in thousands)	2003 (in Rmb)	2004 (in Rmb)	2004 (in US\$)
<b>Profit and Loss Statement</b>						
<b>Data:</b>						
Interest Income . . . . .	2,155,495	2,439,545	2,910,751	3,236,433	3,654,393	441,538
Total Income . . . . .	3,346,666	3,339,380	3,751,897	4,010,035	5,483,803	662,575
Interest Expenses . . . . .	2,224,572	2,415,759	2,656,093	2,813,452	3,620,617	437,458
Pre-tax Income . . . . .	158,765	109,994	149,976	125,911	96,113	11,613
Income After Tax . . . . .	106,928	44,859	63,636	39,104	40,117	4,847
<b>Balance Sheet Data:</b>						
Due from PBOC . . . . .	1,588,384	2,222,571	4,095,213	2,066,165	2,086,799	252,135
Due from Other Banks . .	445,971	2,536,681	1,490,528	5,847,632	5,536,923	668,993
Interbank Lending . . . . .	2,546,153	3,749,300	9,450,599	2,604,980	2,572,782	310,854
Loans . . . . .	57,934,310	72,726,631	89,477,955	103,995,816	125,285,878	15,137,543
Total Assets . . . . .	68,259,558	91,115,842	110,182,265	119,500,979	139,055,273	16,801,216
Bonds Issued . . . . .	57,078,593	74,153,433	98,870,883	100,559,273	120,227,850	14,526,412
Total Liabilities . . . . .	62,858,042	85,666,072	104,663,242	113,937,530	133,452,897	16,124,315
Owner’s Equity . . . . .	5,401,516	5,449,770	5,519,023	5,563,449	5,602,376	676,901

### People’s Republic of China

China is the third largest country in the world in terms of land area, occupying a territory of approximately 3.7 million square miles. China is also the world’s largest nation by population, with approximately 1,299.9 million people at the end of 2004. The capital of China is Beijing.

Over the past two and a half decades, China has implemented a series of economic reforms to revitalize its economy and improve living standards through the creation of a socialist market economy. In connection with these reforms, the Chinese government has lifted output controls on numerous agricultural and industrial enterprises, relaxed price controls on most products, and implemented policies designed to attract foreign investment and technology. The Chinese government has also introduced tax and fiscal reforms designed to improve the uniformity and fairness of China’s tax system and to formalize the distribution of tax revenues between the central and local governments. The Chinese government is continuing its efforts to reform its state-owned enterprises in order to increase their productivity, efficiency and profitability. In addition, the Chinese government has been reforming its financial system to improve its ability to manage monetary policy through macroeconomic policy tools, to strengthen financial institution supervision and to enhance risk control and transparency in China’s financial markets.

The following table presents summary historical information of China as of and for the years ended December 31, 2000, 2001, 2002, 2003 and 2004. Since this information is only a summary, you should read the complete disclosure included under “People’s Republic of China” in this offering circular.

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
<b>The Economy</b>					
GDP (in billions of Rmb) . . . . .	8,946.8	9,731.5	10,517.2	11,739.0	13,687.6
Real Annual GDP Growth Rate . . . . .	8.0%	7.5%	8.3%	9.5%	9.5%
Population (in millions) . . . . .	1,267.4	1,276.3	1,284.5	1,292.3	1,299.9
Per Capita GDP (in Rmb) . . . . .	7086.0	7,651.0	8,214.0	9,111.0	10,561.0
Annual Rate of Inflation . . . . .	0.4%	0.7%	(0.8)%	1.2%	3.9%
Urban Work Force Unemployment Rate (year end)	3.1%	3.6%	4.0%	4.3%	4.2%
Foreign Trade Surplus (in billions of US\$) . . . . .	24.1	22.6	30.4	25.4	32.0
Current Account Balance (in billions of US\$) . . . . .	20.5	17.4	35.4	45.9	68.7
Capital Account Balance (in billions of US\$) . . . . .	2.0	34.8	32.3	52.8	110.7
Foreign Exchange Reserves (in billions of US\$)(year end) . . . . .	165.6	212.2	286.4	403.3	609.9
<b>Public Finance</b>					
Government Revenues (in billions of Rmb) . . . . .	1,339.5	1,638.6	1,890.4	2,171.5	2,635.6
% of GDP . . . . .	15.0%	16.8%	18.0%	18.5%	19.3%
Government Expenditures (in billions of Rmb) . . . . .	1,588.7	1,890.3	2,205.3	2,465.0	2,836.1
% of GDP . . . . .	17.8%	19.4%	21.0%	21.0%	20.7%
Deficit (in billions of Rmb) . . . . .	(249.1)	(251.7)	(315.0)	(293.5)	(200.5)
% of GDP . . . . .	2.8%	2.6%	3.0%	2.5%	1.5%
<b>Internal and External Debt (year end)</b>					
Direct Internal Debt (in billions of Rmb)(1) . . . . .	1,302.0	1,561.8	1,907.9	2,126.1	2,880.3
% of GDP . . . . .	14.6%	16.0%	18.1%	18.1%	21.0%
Direct External Debt (in billions of US\$)(1) . . . . .	49.0	49.8	50.5	52.8	33.6
% of GDP . . . . .	4.5%	4.2%	4.0%	3.7%	2.0%
Total Internal Debt (in billions of Rmb)(2) . . . . .	2,130.1	2,496.0	2,989.3	3,395.7	4,397.3
% of GDP . . . . .	23.8%	25.6%	28.4%	28.9%	32.1%
Total External Debt (in billions of US\$)(2) . . . . .	145.7	170.1	171.4	193.6	228.6
% of GDP . . . . .	13.5%	14.5%	13.5%	13.7%	13.8%
Total Direct Debt (in billions of Rmb) . . . . .	1,707.6	1,974.0	2,325.9	2,563.1	3,158.4
% of GDP . . . . .	19.1%	20.3%	22.1%	21.8%	23.1%

- (1) Direct debt, whether internal or external, means debt incurred directly by the central government in the name of China.
- (2) Total internal debt and total external debt include direct debt and debt incurred by state-owned financial institutions and other enterprises.

### **Recent Credit Ratings**

*The credit ratings accorded to debt securities of China Eximbank or China by rating agencies are not recommendations to purchase, hold or sell the notes or any securities since such ratings do not comment as to market price or suitability for you. Any rating may not remain in effect for any given period of time or may be suspended, reduced or withdrawn entirely by a rating agency in the future if in its judgment circumstances so warrant, and if any such rating is so suspended, reduced or withdrawn, China Eximbank and China are under no obligation to update this offering circular.*

*China Eximbank.* Moody's Investors Service, Inc. has assigned an A2 senior unsecured debt rating to China Eximbank. Standard & Poor's Ratings Group has assigned a BBB+ long-term foreign issuer credit rating to China Eximbank.

*China.* Moody's Investors Service, Inc. has assigned an A2 foreign currency long-term debt rating to China. Fitch Ratings Inc. has assigned an A- long-term foreign currency debt rating to China. Standard & Poor's Ratings Group has assigned a BBB+ long-term foreign currency debt rating to China.

## The Offering

*This offering summary highlights information contained elsewhere in this offering circular. It is not complete and does not contain all the information that you should consider before investing in the notes. You should read this entire offering circular carefully.*

Principal Amount . . . . .	US\$1,000,000,000.
Interest Rate . . . . .	4.875% per year.
Maturity Date . . . . .	July 21, 2015.
Interest Payment Dates . . . . .	January 21 and July 21 of each year, beginning January 21, 2006.
Redemption or Sinking Fund . . . . .	None.
Form, Denominations and Registration . . . . .	Global note, registered in the name of Cede & Co., as nominee of DTC. The notes will be issued in minimum denominations of US\$100,000 or integral multiples of US\$1,000 in excess of US\$100,000.
Proposed Listing . . . . .	The Stock Exchange of Hong Kong Limited.
Ranking . . . . .	Equal with China Eximbank's other general, unsecured and un-subordinated public external indebtedness. The term "public external indebtedness" includes its foreign currency borrowings and guarantees having an original maturity of more than one year which may be quoted, listed or traded on any securities market outside mainland China. Such public external indebtedness does not include amounts owed to state-owned financial institutions in China. As of June 30, 2005, the amount of China Eximbank's public external indebtedness outstanding was US\$1.0 billion. As of June 30, 2005, China Eximbank had aggregate borrowings overseas with maturities of or over 365 days, including its public external indebtedness, of approximately US\$1.0 billion.
Limitation on Other Indebtedness . . . . .	None.
Credit Support . . . . .	The notes are not guaranteed by China. The PRC central bank, the PBOC, is obligated under the Special Decree to make advances in the event China Eximbank experiences any liquidity shortages. However, this does not constitute a direct guarantee from the PBOC or the PRC government, and the noteholders do not have any rights against the PBOC or the PRC government in respect of this support obligation.
Negative Pledge . . . . .	China Eximbank will not secure any other public external indebtedness unless it also secures the notes on the same terms.
Events of Default . . . . .	<ul style="list-style-type: none"><li>• China Eximbank fails to pay any amount of principal or interest in respect of the notes and the continuance of such failure for 30 days; or</li><li>• China Eximbank defaults in the performance or observance of any of its other obligations under the notes or the fiscal agency agreement and such default remains unremedied for 60 days following receipt by China Eximbank of written notice from noteholders of an aggregate principal amount of not less than 10% of the outstanding notes to remedy such failure; or</li></ul>

- China Eximbank defaults in the payment of principal or interest in excess of US\$25,000,000 (or its equivalent in any other currency or currencies) payable (whether upon maturity, acceleration or otherwise) in connection with its public external indebtedness (other than that represented by the notes), and the failure of China Eximbank to pay or validly reschedule (with the consent of the holders of such public external indebtedness) the payment of such public external indebtedness within 30 days of the date on which such payment has become due (including any applicable days of grace); or
- an order is issued or any other action is taken by appropriate authorities of or in China for the dissolution or merger or consolidation of China Eximbank (except where China Eximbank is the continuing entity) or for the transfer or assignment of the whole or a material part of its assets (except, in either case, where all the obligations of China Eximbank under the notes then outstanding are legally assumed by another agency designated by the State Council; provided that (i) such agency is a solvent financial institution organized and existing under the laws of China, (ii) such agency is controlled, directly or indirectly, by China, (iii) such agency assumes in writing all the obligations of China Eximbank under the notes, and (iv) immediately after giving effect to such transaction no event of default or event or condition that, with the giving of notice or the lapse of time or both, would become an event of default has occurred and is continuing); or
- China ceases to own at least 51% of China Eximbank; or
- unless the PRC central government fully guarantees or otherwise assumes the indebtedness, and all obligations of China Eximbank, evidenced by the notes and under the fiscal agency agreement, the PBOC (or the successor central bank of China) ceases or fails to provide the liquidity support stipulated in the Special Decree of the State Council (State Council Document No. 20 dated March 19, 1994) as in effect as of the date of issuance of the notes or the Special Decree is amended in a manner which prejudices the rights of the noteholders or ceases to be valid or effective.

Upon the occurrence and continuation of any event of default, each noteholder may declare the principal of its notes due and payable immediately by written demand given to China Eximbank and the fiscal agent at the office of the fiscal agent unless, prior to the receipt of that demand by the fiscal agent, all defaults have been cured.

Use of Proceeds . . . . . China Eximbank intends to use the net proceeds from the sale of the notes to fund foreign currency-denominated export credits extended by China Eximbank.

Further Issuances . . . . . China Eximbank may from time to time, without the consent of the holders of notes, create and issue further notes having the same terms and conditions as the notes in all respects, except for the issue date, issue price and the first payment of interest thereon. Additional notes issued in this manner will be consolidated with and will form a single series with the notes.

Transfer Restrictions . . . . . The notes have not been and will not be registered under the U.S. Securities Act and are subject to restrictions on transferability and resale. See “Transfer Restrictions” and “Underwriting.”

Fiscal Agent . . . . . Citibank, N.A.

Governing Law . . . . . The notes and the fiscal agency agreement are governed by the laws of the State of New York, except that all matters governing the authorization and execution by China Eximbank will be governed by the laws of China.

## THE EXPORT-IMPORT BANK OF CHINA

### Capitalization

As of March 31, 2005, the capitalization of China Eximbank was as follows:

	As of March 31, 2005	
	(Rmb)	(US\$)
	(in thousands)	
<b>Long-term Debt(1):</b>		
Foreign Debt .....	8,276,500	1,000,000
Domestic Debt .....	116,138,250	14,032,290
Total Long-term Debt(2) .....	124,414,750	15,032,290
<b>Capital Accounts:</b>		
Capital .....	5,000,000	604,120
Surplus .....	338,774	40,932
Undistributed Profits .....	(214,643)	(25,934)
Total Owner's Equity .....	5,164,837	624,036
Total Capitalization .....	129,579,587	15,656,327

(1) Long-term debt includes all debt with a maturity of one year or longer. This capitalization table excludes the portion of long-term debt maturing prior to March 31, 2006. As of March 31, 2005, China Eximbank had total outstanding long-term debt (including the current portion) of approximately Rmb 124.0 billion (US\$15.0 billion).

(2) The following table sets forth the principal repayment schedule with respect to outstanding long-term debt as of March 31, 2005:

Year	Rmb	US\$
	(in thousands)	
2005 .....	19,500,000	2,356,068
2006 .....	34,000,000	4,108,017
2007 .....	22,000,000	2,658,128
Thereafter .....	48,914,750	5,910,077

Unless otherwise disclosed in this offering circular, there has not been any material change in the capitalization of China Eximbank since March 31, 2005.

### Use of Proceeds

China Eximbank intends to use the proceeds of US\$986,210,000 from the sale of the notes, after paying its expenses related to this offering, to fund foreign currency-denominated export credits extended by China Eximbank.



## **Business**

### **Purpose and Authority**

China Eximbank was established on April 26, 1994 pursuant to the Special Decree of the State Council dated March 19, 1994 as a policy-oriented statutory financial institution under the direct authority of the State Council, the highest institution of the PRC government administration. It is the only government export credit agency in China. Pursuant to the Special Decree, China Eximbank operates on an autonomous basis and conducts its activities under the direct leadership of the State Council. China Eximbank is subject to the supervision and direction of the PBOC, the China Banking Regulatory Commission, or CBRC, the Ministry of Finance and the Ministry of Commerce with respect to its business activities.

The primary purpose of China Eximbank is to provide policy-oriented financial support for the export and import of capital goods and related services in accordance with the PRC government's industrial and foreign trade policies. China Eximbank aims to supplement commercial financing by absorbing some of the repayment risks that the commercial and private sectors are unable to absorb and by providing financing to PRC exporters and foreign importers when commercial and private financing is not available. Consistent with its purpose as an instrumentality of China's national economic development policy and in accordance with its articles of association and instructions and requirements of the State Council, China Eximbank's current principal activities include:

- extending credits in Renminbi and foreign currencies to exporters and importers of capital goods, such as mechanical and electric products, equipment systems, new and high technology products, manufactured in China;
- issuing guarantees to support financings by exporters and importers of capital goods, such as mechanical and electric products, equipment systems, new and high technology products, manufactured in China;
- extending credits and issuing guarantees to support establishment of manufacturing facilities overseas by PRC enterprises;
- extending credits and issuing guarantees to support exploration and development of resources overseas by PRC enterprises;
- extending credits and issuing guarantees to support construction of large projects overseas by PRC enterprises;
- extending concessional loans on behalf of the PRC government to developing countries selected by the PRC government;
- on-lending foreign government credits to PRC end-users as agent for the PRC central government; and
- engaging in international inter-bank lending, and organizing and participating in domestic and international lending syndicates.

China Eximbank may also engage in other lines of business approved by the PRC central government. As an instrumentality serving the policy objectives of the PRC government, China Eximbank does not seek to maximize profits, nor is it an aid agency. Rather, it seeks to achieve moderate profitability while preserving capital as mandated in the Special Decree of the State Council.

China, as a sovereign state, maintains diplomatic relations with 166 countries and trade and economic relations with over 235 countries and regions in the world. China Eximbank, as a government instrumentality executing and implementing China's foreign trade policies, is primarily engaged in trade related and other financing transactions involved directly or indirectly in these countries and regions. Some of these countries and regions do not have diplomatic or trade relations with other countries in the world and some of them may be subject to trade or economic sanctions imposed by such other countries. China Eximbank will continue to implement China's foreign trade policies and cannot assure you that China Eximbank will not continue to engage in such trade related and other financing transactions involving these countries and regions or that trade related or

other financing transactions involving these countries and regions will not increase in the future, pursuant to China's foreign trade policies. China Eximbank does not finance import or export of military arms or weapons.

At present, China Eximbank has seven operational arms, namely, the banking department at its head office in Beijing, the Chengdu branch, the Dalian branch, the Nanjing branch, the Qingdao branch, the Shanghai branch and the Shenzhen branch. China Eximbank also has six domestic representative offices, located in Fuzhou, Guangzhou, Hangzhou, Harbin, Wuhan and Xi'an, and two overseas representative offices, one based in Paris, France servicing Europe and North Africa and the other based in Johannesburg, South Africa servicing the other parts of Africa. China Eximbank closed its representative office based in Abidjan, Cote d'Ivoire, in 2004 due to security situation in that country. These branches and offices, located near various project sites, enhance China Eximbank's ability to implement its credit management policy and to improve monitoring of its credit projects.

### **Relationship with the PRC Government**

*Government Ownership.* As a PRC government instrumentality under the State Council, China Eximbank has no share capital, and no person other than the PRC government has, or can obtain, an ownership interest or equity participation in China Eximbank. China Eximbank has a registered capital of Rmb 5.0 billion, all of which has been contributed by the Ministry of Finance. In addition, because of China Eximbank's role in the implementation of the economic and industrial policies of China, the Ministry of Finance has confirmed that it will provide further support to China Eximbank through the provision of fiscal subsidies and additional capital. All of China Eximbank's net income is subject to disposal by the PRC central government for the benefit of the PRC.

*Government Supervision.* China Eximbank's operations are subject to the direct leadership of the State Council and to additional supervision of the PBOC, the CBRC, the Ministry of Finance, the Ministry of Commerce and the National Development and Reform Commission. Pursuant to the Special Decree, the articles of association of China Eximbank were adopted by the State Council and may be amended only with its approval.

At the end of each year, China Eximbank submits its annual credit and funding plans for the following year to the PBOC for approval. In addition, China Eximbank reports to the PBOC periodically with respect to the implementation of its annual credit and funding plans and any significant issues relating to its credit operations. China Eximbank's finance related activities are subject to the supervision and direction of the CBRC and PBOC. China Eximbank submits its semi-annual reports on its results of operations and annual financial statements to the Ministry of Finance for review and approval. The Ministry of Commerce provides guidance to China Eximbank with respect to China's policies on foreign trade and matters of foreign economic cooperation as well as policies on concessional loans made by China Eximbank. China Eximbank is subject to supervision of the Ministry of Finance on the foreign government credits on-lending business. The National Development and Reform Commission provides guidance to China Eximbank with respect to China's industrial policies and foreign investment policies.

The board of directors of China Eximbank was established with the approval of, and is responsible directly to, the State Council. The Special Decree provides that the board of directors shall have the ultimate policy-making power within China Eximbank and shall consist of the governor and vice governors of China Eximbank and representatives from various government agencies, including the National Development and Reform Commission, the Ministry of Finance, the Ministry of Commerce, the PBOC and others. The governor and vice governors of China Eximbank are appointed directly by the State Council. For more information about the functions of the board of directors and the governors, see "— Management" below. Since early 2000, like every other major state-owned financial institution, China Eximbank has been subject to on-site supervision of financial institution supervisors designated by the State Council.

*Government Support.* In addition to contributions to the capital of China Eximbank, the PRC government provides direct and indirect financial support for the business activities of China Eximbank. Following the submission by China Eximbank of its projected annual business operations and sources of funds for such business operations to the Ministry of Finance, the Ministry of Finance determines, on an annual basis in accordance with China Eximbank's funding requirements and in coordination with other relevant PRC central government agencies, the aggregate amount of financial resources to be made available to China Eximbank in support of its

credit activities. According to the Special Decree, sources of funds available to China Eximbank include: (a) capital contribution by the PRC central government, (b) fiscal subsidies from the Ministry of Finance, (c) short-term credits provided by the PBOC, and (d) borrowings from domestic and foreign financial institutions, including debt securities issued overseas and financial debentures issued to domestic financial institutions.

Pursuant to the Special Decree, the PBOC is authorized and obligated to provide short-term loans to China Eximbank in the event China Eximbank experiences any liquidity shortages. The obligation of the PBOC to make such loans to China Eximbank does not constitute a guarantee of the notes, and is not enforceable against the PBOC by, and does not confer any right under or in respect of the Special Decree upon, any noteholder. To the extent China Eximbank's actual liquidity needs in any fiscal year requires greater financial support on a longer term basis, China Eximbank will report this need to the PBOC, which will decide whether to increase the amount of long-term borrowings that China Eximbank is permitted to make during the year.

The Ministry of Finance also provides support to China Eximbank in the form of fiscal subsidies, which are allocated each year in the annual budget of the PRC, to compensate China Eximbank for losses incurred in making export credits at interest rates lower than its cost of funds and to cover administrative expenses of China Eximbank. Each year, the Ministry of Finance provides such subsidies in accordance with the relevant PRC central government policy to reflect the total policy-oriented credit operations of China Eximbank as well as its cost of funds.

*Designated Lender of Government Concessional Loans.* China Eximbank acts as the only designated lending institution for the PRC central government in connection with concessional loans to borrowers in developing countries selected by the PRC government. China Eximbank is protected against any loss in principal with respect to its concessional loan operations by a concessional loan reserve fund established by the PRC government for the exclusive use of China Eximbank. As of March 31, 2005, the reserve fund available for use by China Eximbank was Rmb 500.0 million to cover any losses in principal resulting from concessional loans. The PRC central government may approve increases to this reserve fund based on China Eximbank's operations. China Eximbank acts as the lender with respect to these concessional loans and also receives subsidies from the Ministry of Finance to compensate for any losses resulting from interest rate differentials and administrative expenses on such concessional loans.

*Government On-lending Agent.* China Eximbank is a designated on-lending agent for the PRC central government. China Eximbank has on-lent to Chinese end-users credits made available to the PRC central government by foreign governments and their financial institutions. The PRC central government has established an on-lending support fund that China Eximbank may draw on to make payments to the foreign governmental lenders on behalf of the PRC central government before full collection of payments from the Chinese end-users. The Ministry of Finance will, in consultation with China Eximbank, determine the amount of the on-lending support fund on an annual basis. In connection with its on-lending and management activities for such credits, China Eximbank is entitled to a fee payable by the borrower in the form of a commission. The on-lending business of China Eximbank is accounted for on an off-balance sheet basis under a separate statement. See “— Report of the General Manager (Accounting Department) — China Eximbank Balance Sheets of On-lending Operations” below.

## **Export Credit Operations**

China Eximbank's principal financing activity is the provision of export credits for the manufacture and export of PRC capital goods. Capital goods eligible for export credit financing currently include vessels, aircraft, machinery, heavy equipment, power plants, electric products, bio-technology and pharmaceutical products and technical services. China Eximbank also grants export sellers' credits to support overseas construction contracts and offshore investment projects undertaken by Chinese companies. China Eximbank extends export buyers' credits to foreign importers of China-made equipment, large electro-mechanic products such as ships, telecommunications equipment, power plants, and railways. Some overseas construction projects are also financed with export buyers' credits. Borrowers of export credits are Chinese exporters or sellers and foreign importers or buyers. Within the annual credit plan approved by the PBOC and in compliance with the PRC government's trade policies, China Eximbank enjoys autonomy in the selection of credit projects. As an instrumentality for

implementing the economic and trade policies of the PRC government, it coordinates with the Ministry of Commerce in the formation of its export support strategies. China Eximbank and its branches accept applications for credits directly from Chinese exporters and foreign importers (acting through their Chinese exporters). China Eximbank evaluates each project and makes its decision as to whether or not to approve the credit. Subject to its evaluation, China Eximbank also accepts recommendations from PRC governmental agencies for export credit support. At present, substantially all of the borrowers in China are state-owned or state-controlled enterprises (including joint stock companies), collectively owned enterprises, and equity and cooperative joint ventures majority-owned by Chinese interests.

All of China Eximbank's export credits are collateralized with credit enhancement arrangements, including guarantees from borrowers' sponsors, banks or affiliated companies and security interests in borrowers' real or other assets. Many of China Eximbank's credits are secured with one or more such credit enhancement arrangements. However, due to the nature of certain credit enhancement collateral securing China Eximbank's credit projects and the potential lack of liquidity of such collateral, there can be no assurance that, in the event of foreclosure of any such collateral, China Eximbank would be able to recover all or any part of the amount owed to it from the disposal of such collateral.

The following table sets forth a breakdown by currency of the total outstanding export credits extended by China Eximbank as of the dates indicated:

#### Total Export Credits Outstanding

	As of December 31,			As of
	2002	2003	2004	March 31,
	(in millions of Rmb)			2005
<b>Sellers' Credits</b>				
Renminbi .....	77,900	84,611	92,638	96,196
Foreign Currency .....	264	5,233	12,630	13,227
Subtotal .....	<u>78,164</u>	<u>89,844</u>	<u>105,268</u>	<u>109,423</u>
<b>Buyers' Credits</b>				
Foreign Currency .....	4,871	6,590	11,043	12,126
Total Export Credits .....	<u>83,035</u>	<u>96,434</u>	<u>116,311</u>	<u>121,549</u>

The following table sets forth the total outstanding export credits extended by China Eximbank as of December 31, 2002 and 2003, categorized by product type:

#### Total Outstanding Export Credits by Product Type (2002-2003)

	As of December 31,		As of December 31,	
	2002		2003	
	Amounts	% of Total	Amounts	% of Total
	(in millions of Rmb, except for percentages)			
Projects .....	18,527	22.3%	24,011	24.9%
Vessels .....	18,342	22.1	19,057	19.8
Spare Parts .....	15,150	18.2	14,668	15.2
Electric Products .....	10,438	12.6	12,750	13.2
Overseas Investments .....	5,936	7.1	9,739	10.1
Equipment .....	8,899	10.7	9,424	9.8
Non-electric Products .....	4,983	6.0	5,678	5.9
Technical Services .....	760	0.9	1,108	1.1
Total .....	<u>83,035</u>	<u>100.0%</u>	<u>96,434</u>	<u>100.0%</u>

Classification of export products is based on the catalog released by the PRC government. “Projects” include construction of power plants, bridges and highways, including procurement of materials, labor, technology and equipment; “Vessels” include newly built ships for export as well as foreign vessels overhauled at PRC shipyards; “Spare Parts” include vehicle spare parts and other spare parts; “Electric Products” include internal combustion engines, railroad engines, motor engines and electricity generators, consumer electronics, and computers; “Overseas Investments” include loans provided to PRC enterprises for purposes of investing overseas in foreign companies or acquiring foreign businesses; “Equipment” includes aircraft, vehicles, boilers, nuclear reactors, and other equipment; “Non-electric Products” include bio-technology products, pharmaceutical products and other non-electric products; and “Technical Services” include satellite launching services, transfer of technology, engineering designs and computer software programming.

In 2004, there were some internal modifications and adjustments to the statistical collection and treatment of export products financed by China Eximbank. China Eximbank made these modifications and adjustments to further refine its statistical collection process and to better manage its export credits. As a result of these modifications and adjustments in 2004 and 2005 (as reflected in the table below), “High-tech Products” also include high-tech electric products, such as telecommunication products, and non-electric products, such as bio-technology products, pharmaceutical products and other non-electric products; “Overseas Investments” also include loans provided to PRC enterprises for purposes of investing overseas in foreign businesses and in developing natural resources; “General Electric Products” also include internal combustion engines, railroad engines, motor engines and electricity generators, consumer electronics and computers; and “Equipment” also includes technical services.

The following table sets forth the total outstanding export credits extended by China Eximbank as of December 31, 2004 and March 31, 2005, categorized by product type:

**Total Outstanding Export Credits by Product Type (2004-2005)**

	As of December 31, 2004		As of March 31, 2005	
	Amounts	% of Total	Amounts	% of Total
	(in millions of RMB, except for percentages)			
High-tech Products . . . . .	31,075	26.7%	33,104	27.2%
Projects . . . . .	20,278	17.4	22,504	18.5
Vessels . . . . .	21,254	18.3	20,952	17.2
Overseas Investments . . . . .	14,712	12.7	17,596	14.5
General Electric Products . . . . .	15,988	13.8	14,193	11.7
Equipment . . . . .	<u>13,004</u>	<u>11.1</u>	<u>13,200</u>	<u>10.9</u>
Total . . . . .	<u>116,311</u>	<u>100.0%</u>	<u>121,549</u>	<u>100.0%</u>

The following table sets forth the original maturities of export credits as approved by China Eximbank during the periods indicated:

### Original Maturities of Export Credits

	Year Ended December 31,		
	2002	2003	2004
	(in millions of Rmb)		
<b>Sellers' Credits</b>			
Credits of up to One Year .....	13,467	19,254	20,237
Credits of One to Five Years .....	22,433	31,603	40,986
Credits of over Five Years .....	<u>4,827</u>	<u>9,882</u>	<u>11,708</u>
Total Sellers' Credits .....	40,727	60,739	72,931
<b>Buyers' Credits</b>			
Credits of up to Five Years .....	—	45	1,677
Credits of over Five Years .....	<u>1,956</u>	<u>5,359</u>	<u>13,185</u>
Total Buyers' Credits .....	<u>1,956</u>	<u>5,404</u>	<u>14,862</u>
Total Seller's and Buyers' Credits .....	<u>42,683</u>	<u>66,143</u>	<u>87,793</u>

The following table sets forth the actual export credit disbursements by China Eximbank for the periods indicated, categorized by export destination:

### Actual Export Credit Disbursements by Export Destination

	Year Ended December 31, 2002		Year Ended December 31, 2003		Year Ended December 31, 2004		Three Months Ended March 31, 2005	
	Amounts	% of Total	Amounts	% of Total	Amounts	% of Total	Amounts	% of Total
	(in millions of Rmb, except for percentages)							
Asia .....	13,154	29.4%	19,444	31.7%	25,054	37.1%	7,088	50.2%
Europe .....	9,329	20.8	7,888	12.9	14,756	21.9	2,462	17.4
North America .....	2,710	6.1	7,804	12.7	15,221	22.5	2,245	15.9
Africa .....	2,802	6.3	3,418	5.6	5,429	8.0	1,410	10.0
Latin Americas .....	1,726	3.9	1,725	2.8	6,672	9.9	762	5.4
Oceania .....	—	—	400	0.7	385	0.6	162	1.1
Multi-Destinations(1) ..	<u>15,058</u>	<u>33.6</u>	<u>20,583</u>	<u>33.6</u>	—	—	—	—
Total .....	<u>44,779</u>	<u>100.0%</u>	<u>61,262</u>	<u>100.0%</u>	<u>67,517</u>	<u>100.0%</u>	<u>14,129</u>	<u>100.0%</u>

(1) Since 2004, China Eximbank has further separated export credits with multiple destinations and grouped them under the respective regions.

The following table sets forth the actual credit disbursements by China Eximbank for 2002 and 2003, categorized by product type:

**Actual Export Credit Disbursements by Product Type (2002-2003)**

	Year Ended December 31, 2002		Year Ended December 31, 2003	
	Amounts	% of Total	Amounts	% of Total
	(in millions of Rmb, except for percentages)			
Spare Parts .....	8,376	18.7%	11,896	19.4%
Electric Products .....	8,081	18.0	11,795	19.3
Vessels .....	11,264	25.2	11,600	18.9
Projects .....	8,201	18.3	10,860	17.7
Overseas Investments .....	912	2.0	5,173	8.4
Equipment .....	4,261	9.5	5,032	8.2
Non-electric Products .....	3,683	8.2	4,559	7.4
Technical Services .....	—	—	348	0.6
Total .....	<u>44,779</u>	<u>100.0%</u>	<u>61,262</u>	<u>100.0%</u>

The following table sets forth the actual export credit disbursements by China Eximbank for 2004 and the first quarter of 2005, categorized by product type:

**Actual Export Credit Disbursements by Product Type (2004-2005)**

	Year Ended December 31, 2004		Three Months Ended March 31, 2005	
	Amounts	% of Total	Amounts	% of Total
	(in millions of Rmb, except for percentages)			
High-tech Products .....	23,998	35.5%	3,370	23.9%
Vessels .....	14,986	22.2	3,236	22.9
Overseas Investments .....	5,528	8.2	2,930	20.7
Projects .....	8,983	13.3	2,178	15.4
Equipment .....	4,954	7.3	1,284	9.1
General Electric Products .....	<u>9,069</u>	<u>13.4</u>	<u>1,131</u>	<u>8.0</u>
Total .....	<u>67,517</u>	<u>100.0%</u>	<u>14,129</u>	<u>100.0%</u>

The following table sets forth China Eximbank's 10 largest borrowers as of December 31, 2004:

### Ten Largest Borrowers

<u>Borrower</u>	<u>Total Outstanding Loan</u> (in millions of Rmb)
China Oil and Gas Exploration and Development Corporation .....	6,987
China Petroleum and Petrochemical Corporation .....	4,259
China Shipping Industry Trading Corporation .....	3,738
China Machinery Import and Export Group Corporation .....	2,992
China Machine and Equipment Import and Export Corporation .....	1,858
China Aviation Technology Import and Export Corporation .....	1,728
Shanghai Zhenhua Port Equipment Company Limited .....	1,716
China Sinochem Corporation .....	1,667
Dalian Shipbuilding Heavy Industry Company Limited .....	1,640
PetroChina International Engineering Company Limited .....	<u>1,407</u>
Total .....	<u><u>27,992</u></u>

The aggregate outstanding loans to these 10 largest borrowers accounted for approximately 26.6% of China Eximbank's total export credits as of December 31, 2004.

*Sellers' Credits.* China Eximbank extends sellers' credits to PRC exporters, as principal obligors, to finance the production and export of PRC capital goods and technical services. China Eximbank has also used this type of export credit to support projects undertaken by PRC entities overseas under arrangements such as build-own-transfer and build-own-operate. As of March 31, 2005, China Eximbank had a total of 760 outstanding sellers' credits and an aggregate principal amount of Rmb 109.4 billion outstanding.

To be eligible for sellers' credits provided by China Eximbank, each underlying export contract must have a value in excess of US\$1.0 million or equivalent; the capital goods subject to export must contain sufficient eligible PRC content as required by the Chinese laws and regulations; and the cash down payment by the foreign purchaser must generally be no less than 20% of the total contract price for a shipbuilding contract and 15% for other capital goods. Typically, sellers' credits are secured, among other things, by the payments receivable under the export contracts and by other credit-enhancement arrangements, such as guarantees and security interests in real and other property in China.

Sellers' credits may be made in either Renminbi or foreign currencies or both, depending on payment terms in the relevant export contracts. The foreign currency portion of sellers' credits is available only for financing the purchase and import of technology, components and raw materials necessary for the production of the exports. The original maturities of sellers' credits typically range from one year to 10 years. Loan agreements for sellers' credits typically require repayment in the currency in which the loan was denominated. Interest rates are determined with the approval of PBOC and the Ministry of Finance. At March 31, 2005, annual fixed interest rates of China Eximbank's export credits were between 3.78% and 4.50% for credits denominated in Renminbi and between 4.79% and 5.16% for credits denominated in U.S. dollars.

*Buyers' Credits.* Buyers' credits are extended by China Eximbank to foreign purchasers to finance their purchase and import of PRC capital goods and technical services. Depending on the structure of the export project, China Eximbank may lend directly to the foreign importer, or lend to a financial intermediary in the country of the importer, which would on-lend to the foreign importer. As of March 31, 2005, China Eximbank had a total of 102 outstanding buyers' credits and an aggregate principal amount of US\$1,465.2 million outstanding.

To qualify for buyers' credits, each underlying export contract must have a value in excess of US\$2.0 million or equivalent; the capital goods subject to export must contain sufficient eligible PRC content in accordance with the relevant PRC laws and regulations; and the cash down payment by the foreign purchaser must generally be no



less than 20% of the total contract price for a shipbuilding contract and 15% for other capital goods. Typically, buyers' credits are secured, among other things, by guarantees from reputable financial or governmental institutions located in the borrower's jurisdiction and are further backed by insurance policies against the borrower's country risk.

Buyers' credits are made in foreign currencies and are disbursed directly to the PRC exporter. The original maturities of such credits are typically less than 15 years. Interest rates are determined by reference to the Commercial Interest Reference Rate for the relevant foreign currency as provided by the Organization for Economic Cooperation and Development, or OECD, in its Arrangement on Guidelines for Officially Supported Export Credit. The OECD promulgates on a monthly basis interest rates and other terms with respect to buyers' credit lending by governmental and policy-oriented institutions of its member states. China is not a member of the OECD.

### **Chinese Government Concessional Loan Operations**

Commencing in May 1995, the State Council authorized China Eximbank to act as the sole lending bank in respect of the PRC central government's concessional loans to borrowers in certain developing countries. In such capacity, China Eximbank extends loans in its own name, acting as principal in respect of the concessional loans.

China Eximbank's concessional loan program is a part of the PRC government's foreign aid program and is subject to close coordination with the Ministry of Commerce. Under the program, China Eximbank offers credits with preferential terms primarily to developing countries selected by the PRC central government to assist in their economic development or to finance their purchase of PRC capital goods to be used in small and medium-sized manufacturing, infrastructure and other social welfare projects in such countries. In the past few years, China Eximbank has given priority to projects in natural resource exploration and high-tech industries, export of equipment and electric products and investments in the construction of plants and mills in the recipient countries. These concessional loans are usually preceded by a framework agreement between China and the government of such recipient country. China is typically represented by the Ministry of Commerce in the negotiation, execution and delivery of such framework agreements. Within the applicable framework agreement, China Eximbank negotiates with each borrower on the specific terms and conditions of each concessional loan. Borrowers in the concessional loan program can be divided into three categories:

- government agencies, such as the ministry of finance, of a recipient country for on-lending to the end-user;
- on-lending institutions, typically a bank in the recipient country, designated by the government of the recipient country and satisfactory to China Eximbank; and
- foreign or PRC enterprises.

Concessional loans, when made to the central government or a central government-sponsored financial institution of the recipient country, are generally based on such borrower's sovereign credit, usually without any other collateral arrangements. Concessional loans made directly to a foreign end-user or a PRC exporter must be supported by credit enhancement satisfactory to China Eximbank. In general, concessional loans are made in Renminbi and have a maturity of 10 years or longer. Despite China Eximbank's role as principal with respect to concessional loans, China Eximbank's activities in this area are undertaken on behalf of the PRC government.

China Eximbank generally funds its concessional loans from its own sources with the protection of the concessional loan reserve fund financed by the PRC central government against any potential principal loss. As of March 31, 2005, China Eximbank had Rmb 500.0 million in the reserve fund available to be drawn on by China Eximbank for losses incurred on the principal of its concessional loans. As of that date, the aggregate outstanding principal amount of the concessional loans made by China Eximbank was Rmb 7,413.8 million involving 43 developing countries as recipients. In addition, the fiscal subsidies by the Ministry of Finance compensate China Eximbank for any interest loss between the preferential interest rates under the concessional loans and its cost of funds.

## Foreign Exchange Guarantee Operations

China Eximbank is authorized under the Special Decree to issue foreign exchange guarantees to support export financings consistent with its export credit operations. Such guarantees include advance payment guarantees, performance bonds, bid bonds, quality guarantees and others. China Eximbank's guarantee operations are similar to its export credit lending operations, with similar eligibility requirements.

Similar to China Eximbank's export credit lendings, its foreign exchange guarantees typically cover 80% to 85% of the contract price of the relevant PRC exports. All of China Eximbank's guarantees are collateralized with counter-guarantees from the borrowers' sponsors, local banks or affiliated companies or with security interests in the borrowers' real or other properties. As is the case with its export credits, many of China Eximbank's guarantees are secured with several of these collateral arrangements. However, due to the diverse nature of the collaterals securing China Eximbank's guarantee projects and the potential lack of liquidity of such collateral, there can be no assurance that, in the event of foreclosure upon a credit, China Eximbank would be able to recover, if at all, the full amount owed to it from the disposal of such collaterals.

China Eximbank extends foreign exchange guarantees primarily in foreign currencies. All outstanding guarantees issued by China Eximbank have original terms of less than eight years.

The following table sets forth the aggregate amount of guarantees issued by China Eximbank outstanding at the time indicated:

	<b>Outstanding Guarantees</b>			<b>As of</b>
	<b>As of December 31,</b>			<b>March 31,</b>
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
	(in millions of US\$)			
Outstanding Guarantees . . . . .	1,402.8	1,934.3	3,485.7	3,663.0

The following table sets forth the types of guarantees, as percentages of the total number of foreign exchange guarantees, issued by China Eximbank during the periods indicated:

	<b>Types of Guarantees</b>			<b>Three</b>
	<b>Year Ended December 31,</b>			<b>Months</b>
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>Ended</b>
	(in percentages)			<b>March 31,</b>
				<b>2005</b>
Advance Payment Guarantees . . . . .	88.9	82.0	95.1	91.9
Performance Bonds . . . . .	6.8	14.1	3.6	8.1
Quality Guarantees . . . . .	—	0.9	0.2	—
Bid Bonds . . . . .	3.7	1.0	0.1	—
Others . . . . .	0.6	2.0	1.0	—

## Foreign Government Credit On-lending Operations

In 1995, China Eximbank was designated by the PRC central government as its principal on-lending agent for loans made by foreign sovereign lenders. These foreign sovereign loans support projects in transportation, municipal construction, electricity generation, industry, agriculture, postal and telecommunications and other sectors. Borrowers of these foreign loans are largely provincial governments and central government ministries in China. The outstanding credits China Eximbank on-lent to Chinese end-users as of March 31, 2005 were from 18 foreign governments and two financial agencies, the Nordic Investment Bank and Nordic Development Fund. In connection with its on-lending and management activities for such credits, China Eximbank is entitled to a fee payable by the borrower in the form of a commission. China Eximbank accounts for its on-lending business on an off-balance sheet basis. It presents such on-lending operations on a separate balance sheet, but consolidates them in its profit and loss statements. See “— Report of the General Manager (Accounting Department) — China Eximbank Balance Sheets of On-lending Operations” below.

Foreign governmental credits to the PRC central government are generally made pursuant to the terms of credit facilities negotiated by various PRC central government departments, such as the former Ministry of Foreign Trade and Economic Cooperation (now a part of the Ministry of Commerce) before late 1998 and subsequently the Ministry of Finance, on behalf of the PRC central government. The direct borrower under such credit facilities is typically the PRC central government, although the end-user of each credit or credit facility is typically a local enterprise or local governmental agency in China. As the principal on-lending agent for foreign governmental credits, China Eximbank assists the PRC central government in credit evaluation of the relevant PRC projects and end-users, monitors the use of proceeds and development of the relevant projects, disburses the credit proceeds to the end-user, collects payments of principal and interest from the end-user, and makes the necessary payments to the foreign governmental lenders on behalf of the PRC central government. Rights and obligations of the PRC central government, as the re-lender, and the PRC end-user, as the borrower, for an on-lent credit are usually set forth in a sub-credit or re-lending agreement, which provides for rights and obligations of the PRC end-users similar to those of the PRC central government as borrower under the foreign governmental credit agreement. The on-lending agreement also contains provisions relating to the rights and duties of China Eximbank as the on-lending agent of the re-lender.

China Eximbank is subject to limited credit risk as an on-lending agent of the PRC central government since the PRC central government remains the primary obligor under these foreign government credit facilities. China Eximbank is, however, required by the PRC government to make timely payments to the foreign governmental lenders on its behalf pursuant to the terms of such foreign government credit facilities. Such payments by China Eximbank are generally made out of funds it collects from the end-users pursuant to the on-lending agreements. Consequently, if an end-user fails to make its payments in a timely manner under the on-lending agreement, China Eximbank would usually use its own funds to make the necessary payments under the foreign governmental credit agreement. Where an event of default has occurred and is continuing under an on-lending agreement, China Eximbank is entitled to enforce its remedies on behalf of the PRC central government against the end-user. End-users of such foreign governmental credits, especially large facilities, are typically backed by guarantees from local governments, usually at the provincial level. Smaller facilities may be supported by other collateral arrangements satisfactory to the PRC central government and China Eximbank. To protect China Eximbank from such losses, the PRC government has established an on-lending support fund that China Eximbank may draw on to make payments to the foreign governmental lenders on behalf of the PRC central government before full collection of payments from the Chinese end-users. The Ministry of Finance, in consultation with China Eximbank, determines the amount of the on-lending support fund on an annual basis based on total losses suffered or anticipated by China Eximbank. See “— Report of the General Manager (Accounting Department) — China Eximbank Balance Sheets of On-lending Operations” below.

As of March 31, 2005, based on framework agreements concluded between the PRC central government and foreign sovereign lenders, the aggregate outstanding principal amount of borrowings by the PRC central government for which China Eximbank acted as the on-lending agent was US\$19.3 billion.

### **International Settlement**

China Eximbank provides international settlement services and corporate deposit services for its clients pursuant to arrangements under its loan facilities. As of March 31, 2005, China Eximbank maintained correspondent banking relationships with more than 144 banks in 100 countries and regions. In 2002, 2003 and 2004, China Eximbank’s international settlement volume totaled US\$517.9 million, US\$1,796.1 million, and US\$2,987.7 million, respectively.

### **Credit Evaluation, Approval and Monitoring**

China Eximbank has a credit management system that separates the decision-making process in credit evaluation from that of credit approval and monitoring with respect to its lending activities and its credit portfolio management, including, in each case, its guarantee programs. Before a credit or guarantee is granted, the ultimate credit decision-making power at the bank headquarters level rests with the Project Evaluation Committee of China Eximbank. At each branch of China Eximbank, a project evaluation committee at the branch is, however, able to make the pre-lending credit decision if it is within its scope of authorization. After a credit or guarantee is

extended, the ultimate decision-making power with respect to a loan facility evaluation rests with the Credit Asset Management Committee of China Eximbank. At the branch level, the post-lending evaluation is conducted by a risk management office. Each of the Project Evaluation Committee and the Credit Asset Management Committee is currently composed of the governor, one vice governor, the general manager of the Evaluation Department and nine representatives from other relevant departments. The presence of two-thirds of the members of each Committee constitutes a quorum, and a two-thirds majority of the members present may adopt resolutions for such Committee. For a diagram showing China Eximbank's organizational structure, see "— Management" below.

### ***Credit Evaluation***

China Eximbank has guidelines on credit evaluation for its lendings and guarantees. When the credit department at the bank headquarters receives an application for an export credit or a guarantee, such application will be subject to a three-step evaluation procedure as currently in force:

- preliminary evaluation by the relevant credit department, which will prepare a credit risk appraisal and a project feasibility study;
- further evaluation by the Evaluation Department; and
- final evaluation by either one or two vice governors or the Project Evaluation Committee depending on the size of the credit project.

Credit applications at the branch level, to the extent within the authorization of the branches, are also subject to a three-step evaluation procedure:

- preliminary review by its business office;
- further review by its evaluation division; and
- final decision by the branch project evaluation committee.

China Eximbank uses a grading system in its credit evaluation. The major factors China Eximbank takes into consideration before a credit is approved include:

- qualified PRC content of the export products;
- significance of the industry to the PRC national economy;
- quality of the export products;
- credit history and repayment capability of the borrower and its guarantors;
- quality of any security and other credit enhancement to be provided; and
- environmental impact assessment of the projects.

### ***Approval Procedures***

China Eximbank's approval procedures have evolved over the years as its loan portfolios have grown and branches have been established across China. Its current approval guidelines are as follows:

For seller's credit facilities (other than credits to finance overseas investments) in general, China Eximbank's banking department in Beijing has authority to approve any facility in a principal amount not exceeding Rmb 150 million and US\$15 million; its branches in Dalian, Nanjing, Shanghai and Shenzhen each has authority to approve any facility in a principal amount not exceeding Rmb 100 million and US\$10 million. China Eximbank's branches in Chengdu and Qingdao are currently not authorized to approve any seller's credit facility.

For seller's credit facilities (other than credits to finance overseas investments) of less than three years of maturity with a guarantee from one of the five largest PRC commercial banks, Agricultural Bank of China, Bank of China, Bank of Communications, China Construction Bank and Industrial and Commercial Bank of China, the banking department in Beijing and each branch in Dalian, Nanjing, Shanghai and Shenzhen has authority to

approve credit facilities in a principal amount not exceeding three times its general authorization. If a similar seller's credit facility is guaranteed by any other bank in China, the banking department in Beijing and each branch in Dalian, Nanjing, Shanghai and Shenzhen has authority to approve credit facilities in a principal amount not exceeding twice its general authorization.

Buyers' credit facilities not exceeding US\$10 million may be approved by the vice governor. Export credits over these limits will require approval of China Eximbank's Project Evaluation Committee. Credits for overseas investment projects below Rmb 100 million may be approved by the vice governor. Credits for overseas investment projects over Rmb 100 million will require approval of the Project Evaluation Committee. Any guarantee issued in connection with a credit facility is subject to the review process applicable to the credit facility, as described above. Chinese government concessional loans in a principal amount not exceeding Rmb 30 million may be approved by a vice governor in charge. Concessional loans of more than Rmb 30 million but less than Rmb 50 million are subject to the approval of the vice governor in charge as well as the governor. Concessional loans over Rmb 50 million must be approved by the Project Evaluation Committee.

### ***Environmental Impact Assessment***

Environmental impact is an aspect of China Eximbank's credit evaluation process. In November 2004, China Eximbank formalized its environmental approval procedures for its financings. As part of the credit evaluation for lending within or outside China, borrowers must submit documentation to China Eximbank to allow China Eximbank's credit appraisal team to make a determination whether to approve such financings. China Eximbank requires a credit project to be compliant with both local environmental standards and China Eximbank's internal guidelines on environmental compliance, which are based on China's environmental regulations. China's environmental regulations may differ from environmental regulations in other countries.

Under the Law on Environmental Impact Assessment effective September 1, 2003, companies embarking on environmentally sensitive projects within China must submit environmental impact assessment reports to the State Environmental Protection Administration at the relevant national, provincial or local levels. In accordance with this law, the State Environmental Protection Administration has published a catalog, which lists environmentally sensitive projects and specifies the requirements and coverage of their environmental impact assessment reports. The catalog currently lists many industries subject to this reporting requirement, including coal mining, oil and gas exploration and development, pulp mill, petroleum refinery, chemical and petrochemical production, machinery and equipment manufacturing, power generation and transmission, hydropower facilities, urban transportation infrastructure, waste disposal facilities, railways, highways, dams, ports, and nuclear facilities. A project company must engage an independent and qualified environmental appraiser to assess the environmental impact and to prepare the report for submission to the government. In addition, the law does not permit any project listed in the catalog to begin construction until government regulators are satisfied with the environmental impact assessment.

### ***Monitoring of Credit Projects***

China Eximbank's seven branches, six domestic representative offices and two overseas representative offices assist its head office in the overall operations within and outside China, especially in monitoring its credit projects. These branches and representative offices are located in the vicinities of most of China Eximbank's credit projects. They participate in collection of payments, gathering of information, updating project profile and monitoring the developments at project sites. Where China Eximbank does not maintain a presence, it uses correspondent banks in monitoring its credit projects. Pursuant to various agency agreements, correspondent banks are required to monitor the relevant credit projects on a continuous basis and submit periodic reports to China Eximbank. Correspondent banks also monitor the borrowers through control of funds, information reporting, payment collection, control of accounts, and other means. See "— Correspondent Banking" below.

As a part of China Eximbank's efforts to enhance its credit assets quality management and to standardize its risk control procedures, with effect from January 1, 2004, China Eximbank implements a risk-based asset

classification scheme formulated by the CBRC for commercial banks in China. This risk-based asset classification separates China Eximbank' credit assets into five classes:

- a credit is classified as “normal” where the borrower continues to fulfill its obligations to repay on a timely basis both principal and interest;
- a credit is classified as “watch” or “special mention” if China Eximbank becomes aware of factors which it believes may negatively impact the borrower's ability to repay the credit;
- a credit is classified as “substandard” where the borrower has failed to repay either principal or interest on a timely basis and it has become apparent to China Eximbank that the borrower is unable to rely on its revenues from operations to satisfy its repayment obligations;
- a credit is classified as “doubtful” where the borrower has failed to repay either principal or interest on a timely basis and China Eximbank anticipates incurring losses even after taking steps to enforce its rights in relation to any pledged or mortgaged assets securing the credit; and
- a credit is classified as “bad” or “loss” where China Eximbank believes that the recovery of all outstanding principal and interest is not possible and that only a very limited recovery is possible after all measures available to China Eximbank have been exhausted and all legal proceedings reasonably available to China Eximbank have been pursued.

See “People's Republic of China — PRC Financial System — Financial Sector Restructuring.” China Eximbank has established a system of risk surveillance over its loan portfolios to maintain real-time watch over possible irregularities and uncertainties.

### **Correspondent Banking**

In order to facilitate its credit monitoring operations in China, China Eximbank has signed master agency agreements with Bank of China, Industrial and Commercial Bank of China, Agricultural Bank of China and China Construction Bank. Through these arrangements, China Eximbank is able to access the national network of branches of these four largest commercial banks in China to monitor its export credits where China Eximbank does not maintain a branch or representative office.

In addition, as of March 31, 2005, China Eximbank established agency relationships with over 138 foreign banks, which have branch offices in over 100 countries around the world. These agency banks participate in China Eximbank's international settlement and letter of credit operations.

### **Non-Performing Loans and Loan Loss Reserves**

Pursuant to accounting regulations applicable to China Eximbank, overdue principal payments and overdue interest payments are treated separately for accounting purposes. See “— Report of the General Manager (Accounting Department) — Notes to Financial Statements.”

*Overdue Principal.* For provisioning and accounting purposes, China Eximbank treats “sub-standard, doubtful” and “bad” loans as non-performing loans pursuant to the five-category risk-based asset classification scheme formulated by the CBRC that China Eximbank has implemented since January 1, 2004. See “— Credit Evaluation, Approval and Monitoring” above.

Collection efforts generally are commenced as soon as a loan becomes sub-standard. Pursuant to accounting regulations applicable to China Eximbank as promulgated by the Ministry of Finance, China Eximbank continues to accrue interest on loans with overdue principal until the loan has become overdue for 90 days. Under the same accounting regulations and practice, a loan must be classified as a bad loan before it can be written off by China Eximbank and the aggregate write-offs during a year must be within the approved limit stipulated by the Ministry of Finance during the beginning of the year.

China Eximbank reports the condition of its loan assets to CBRC on an annual and quarterly basis. Because the aggregate loan portfolio of China Eximbank on its balance sheet also contains loan projects selected and designated by the PRC government, pursuant to the requirements of CBRC, China Eximbank reports the

condition of its own portfolio only and not the portfolio selected and designated by the government. As of the year-end of 2002, 2003 and 2004, China Eximbank's own loan portfolio amounted to Rmb 80.8 billion, Rmb 93.7 billion and Rmb 111.4 billion, respectively, which constituted approximately 90.3%, 90.0% and 89.0%, respectively, of China Eximbank's aggregate loan portfolio on its balance sheet. As of the year-end of 2002, 2003 and 2004, China Eximbank had non-performing loans (comprising all sub-standard, doubtful and bad loans of Rmb 6.7 billion, Rmb 6.5 billion and Rmb 5.9 billion, respectively), representing approximately 8.24%, 6.95%, and 5.28%, respectively, of its own outstanding loan portfolio as of the relevant year-end. China Eximbank maintains a loan loss reserve against potential defaults in the payment of loan principal. Recorded losses on loans are charged against this loan loss reserve. Pursuant to the Ministry of Finance regulations, China Eximbank maintains its principal loss reserve ratio at 1.0% of its total outstanding loans and other risk-weighted assets, such as equity and debt securities in its portfolio and inter-bank lendings, as of the end of each year. As of December 31, 2004, China Eximbank had a loan loss reserve of Rmb 1,406.8 million. As of March 31, 2005, China Eximbank had a provisional loan loss reserve of Rmb 1,727.5 million, subject to final adjustment at the year-end. As of the year-end of 2002, 2003 and 2004, with the approval of the Ministry of Finance, China Eximbank wrote off approximately Rmb 90.9 million, Rmb 128.0 million and Rmb 316.8 million, respectively, in aggregate principal amount of bad loans.

*Overdue Interest.* In accordance with the Ministry of Finance accounting regulations applicable to China Eximbank, after an interest installment has been overdue for 90 days, China Eximbank no longer accrues interest on the related loan on its financial statements. When the loan principal has become doubtful, China Eximbank will also stop accruing interest on the loan on its financial statements. For collection purposes, interest continues to accrue as an off-balance sheet item until paid or written off. Interest payments collected after the 90-day overdue period will be reflected in China Eximbank's profit and loss statement. In addition to such write-offs, China Eximbank does not and is not required to make provisions for any interest receivables. Write-off of defaulted interest does not require approval by the Ministry of Finance. When the principal amount of a loan is written off, the related interest receivables are also written off. As of the year-end of 2002, 2003 and 2004, China Eximbank wrote off approximately Rmb 18.5 million, Rmb 88.4 million and Rmb 103.9 million, respectively, in overdue interest. For information on other off-balance sheet interest write-offs, see "— Report of the General Manager (Accounting Department) — Notes to Financial Statements" below.

## Sources of Funds

In addition to its own capital and reserves, China Eximbank may obtain funds from a variety of sources, such as the issuance of Renminbi-denominated and foreign currency-denominated debt securities in the domestic and international capital markets, short-term borrowings from the PBOC, and borrowings from domestic and international financial institutions.

*Funding of Renminbi Loans.* Sources of funding available to China Eximbank for its Renminbi credits include capital contributed by the Ministry of Finance, borrowings from domestic financial institutions and short-term loans from the PBOC.

The following table sets forth the amounts of Renminbi funds obtained by China Eximbank from each of its principal sources of funding during the periods indicated:

### Sources of Funds for Renminbi Credits

Source of Funding	Year Ended December 31, 2002		Year Ended December 31, 2003		Year Ended December 31, 2004		Three Months Ended March 31, 2005	
	Amounts	% of Total	Amounts	% of Total	Amounts	% of Total	Amounts	% of Total
(in millions of Rmb, except for percentages)								
Capital Contributed by Ministry of Finance . . . . .	3,251	3.2%	3,251	3.2%	3,251	2.8%	2,424	2.1%
Domestic Financial Debentures . . . . .	97,500	96.8	99,000	96.8	112,000	97.2	112,000	97.9
Total . . . . .	<u>100,751</u>	<u>100.0%</u>	<u>102,251</u>	<u>100.0%</u>	<u>115,251</u>	<u>100.0%</u>	<u>114,424</u>	<u>100.0%</u>

During the three years ended December 31, 2004, the domestic financial debentures that China Eximbank issued had maturities of two to 10 years. All of its 10-year financial debentures were floating rate securities and had effective floating interest rates between 2.57% and 3.0%. Substantially all of its two-year to seven-year financial debentures were fixed rate securities and had fixed interest rates between 1.99% and 4.59%.

On April 15, 2005, China Eximbank issued Rmb 10.0 billion of financial debentures in the domestic interbank markets with a five-year maturity. On June 24, 2005, China Eximbank issued Rmb 12.0 billion of financial debentures in the domestic interbank markets with a seven-year maturity.

China Eximbank's primary source of funds denominated in Renminbi has been the issuance of financial debentures to domestic banking and financial institutions. Interest rates and maturities for domestic financial debentures are determined by the market forces. Each year, China Eximbank proposes to the PBOC a funding plan for the following year and seeks its approval of the proposal. The PBOC reviews this proposal based upon the PRC economic and industrial plans for such year. Since October 1998, China Eximbank has been issuing, through auctions in the domestic interbank markets, its Renminbi-denominated debentures.

Pursuant to the Special Decree, China Eximbank may also borrow short-term loans from the PBOC. See "— Relationship with the PRC Government — Government Support." The aggregate outstanding principal amounts of such short-term PBOC loans were Rmb 1,660 million at the year-end of 2002. These short-term PBOC loans were used to cover cash flow needs prior to the availability of long-term financing and were typically refinanced through the issuance of domestic financial debentures. China Eximbank had no short-term PBOC loans outstanding at the year-end of 2003 and 2004 and at March 31, 2005.

*Funding of Foreign Currency Loans.* China Eximbank relies on the following sources of funding for its credits denominated in foreign currencies: (i) capital denominated in foreign currency contributed by the Ministry of Finance; (ii) the issuance of debt securities denominated in foreign currencies; and (iii) foreign currency loans obtained from foreign and domestic commercial banks, including short-term credits from the domestic foreign exchange interbank markets. Foreign currency borrowings overseas of one-year maturity or longer are subject to the approval of the National Development and Reform Commission on a case-by-case basis. Short-term foreign currency borrowings overseas are subject to an annual quota approved by the State Administration of Foreign Exchange.

The following table sets forth the amounts of foreign currency funds obtained by China Eximbank from each of its principal sources of funding during the periods indicated:

#### Sources of Funds for Foreign Currency Credits

Source of Funding	Year Ended December 31, 2002		Year Ended December 31, 2003		Year Ended December 31, 2004		Three Months Ended March 31, 2005	
	Amounts	% of Total	Amounts	% of Total	Amounts	% of Total	Amounts	% of Total
(in millions of US\$, except for percentages)								
Capital Contributed by Ministry of Finance . . . . .	210.2	51.2%	210.2	42.4%	210.2	15.5%	310.2	16.5%
International Bonds . . . . .	199.9	48.8	199.9	40.3	994.1	73.4	993.1	52.8
Interbank Short-term Borrowings . . . . .	0.4	—	85.7	17.3	50.0	3.7	76.0	4.0
Syndicated Bank Loans . . . . .	—	—	—	—	100.0	7.4	500.0	26.6
Total . . . . .	<u>410.5</u>	<u>100.0%</u>	<u>495.8</u>	<u>100.0%</u>	<u>1,354.3</u>	<u>100.0%</u>	<u>1,879.3</u>	<u>100.0%</u>

*Funding of Concessional Loans.* China Eximbank relies on funds sourced from its available channels, such as its debenture offerings in China, to fund its concessional loan program. To protect China Eximbank against loan losses as a result of its concessional loan operations, the PRC government has established a concessional loan reserve fund for the exclusive use of China Eximbank. China Eximbank may charge any such loan loss to this fund. As of March 31, 2005, the concessional loan reserve fund had a balance of Rmb 500.0 million. The PRC government has also undertaken to compensate China Eximbank for any losses incurred by the bank in its concessional loan activities in excess of such reserve fund.



## **Risk Management**

China Eximbank's market risk exposures primarily consist of fluctuations in exchange rates and interest rates. Other than currency and interest rate hedge transactions necessary to manage its risk portfolio, China Eximbank does not engage in speculative trading activities.

*Currency Risk.* China Eximbank does not hedge exchange rate fluctuations between the Renminbi and foreign currencies and currently has no plans to do so. Under the current foreign exchange control system in China, China Eximbank may undertake current account foreign exchange transactions without prior approval from the State Administration for Foreign Exchange. Foreign exchange transactions under the capital account are subject to the registration requirements of the State Administration for Foreign Exchange. Over the years, China Eximbank has primarily relied on currency matching between its borrowings and lendings to minimize its currency exposure.

*Interest Rate Risk.* China Eximbank is exposed to interest rate risks arising from its borrowings as well as mismatches between its credit assets and liabilities. China Eximbank uses interest rate swaps, from time to time, to adjust its interest rate exposure, based on existing and anticipated market conditions. China Eximbank invests its foreign currency funds, before their disbursements to intended projects, in treasuries of the U.S., Japanese and Chinese governments and other investment grade debt securities.

## **Debt Repayment Record**

China Eximbank has never defaulted in the repayment of principal of or interest on any of its obligations.

## **Employees**

At March 31, 2005, China Eximbank had approximately 710 full-time employees.

## **Properties**

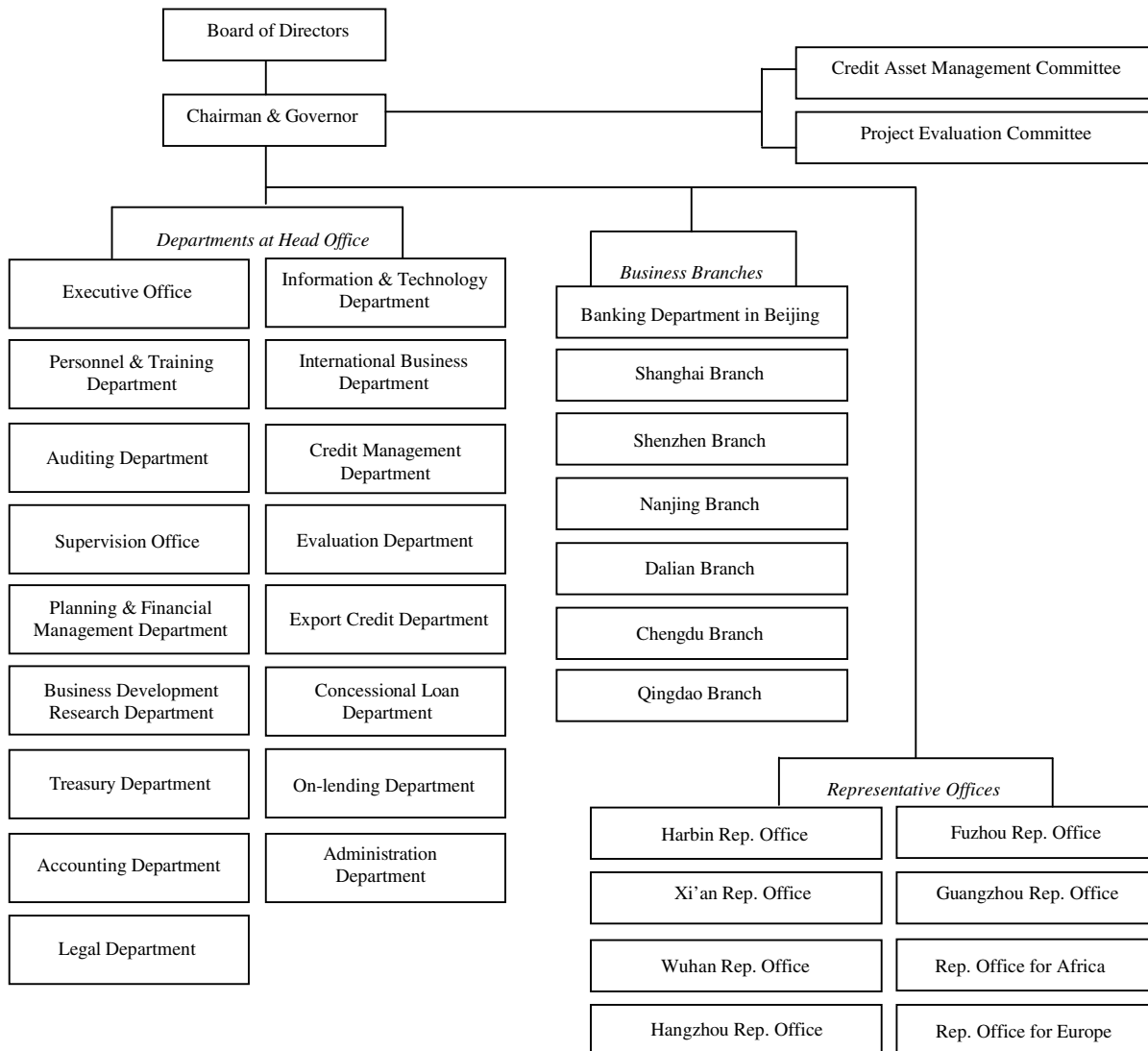
The head office of China Eximbank is located at 77 Beiheyuan Street, Dongcheng District, Beijing 100009, China. In addition to the head office, China Eximbank maintains offices located in premises owned or leased by China Eximbank.

## Management

The operations of China Eximbank are currently managed by a governor, five vice governors and two assistant governors under the leadership of a board of directors. The governor functions as the chief executive of China Eximbank, and the vice governors and assistant governors, who are each responsible for different areas of China Eximbank’s operations, assist the governor in the operation and administration of China Eximbank. The board of directors is the ultimate policy-making body within China Eximbank.

The Special Decree also provides for the establishment of functional departments within China Eximbank, under the leadership of the governor. Responsibility for certain functional departments is allocated to the vice governors and assistant governors, acting under the overall authority of the governor.

The organization of China Eximbank is as follows:



*Board of Directors.* The Special Decree provides that the main functions of the board of directors include: examining and determining China Eximbank’s long-term and medium-term development programs, operations and annual plans in accordance with the industrial and foreign trade policies of China; examining China Eximbank’s budget, financial statements and after-tax profit distribution scheme; and considering and deciding

important issues concerning national policies on export credits and export credit guarantees and credit risks. The board of directors reports to the State Council.

The Special Decree of the State Council provides that the membership of the board of directors shall consist of the governor and vice governors of China Eximbank and representatives from various government agencies, including the National Development and Reform Commission, the Ministry of Finance, the Ministry of Commerce, the PBOC and other central government agencies.

*Governor, Vice Governors and Assistant Governor.* China Eximbank's articles of association assign to the governor overall responsibility for the management of China Eximbank under the leadership of the board of directors. The articles of association set forth the following major responsibilities of the governor:

- managing the overall operations of China Eximbank;
- implementing the resolutions of the board of directors;
- overseeing the formation of China Eximbank's development programs, management policies and annual business plans;
- overseeing the formulation of China Eximbank's budget, financial statements and after-tax profit distribution plans;
- overseeing the development of China Eximbank's policies and procedures on personnel management and financial management;
- developing methods to streamline China Eximbank's organizational structure; and
- performing other duties delegated by the board of directors.

Pursuant to China Eximbank's articles of association, the governor and the vice governors of China Eximbank are appointed by the State Council. The governor and vice governors serve without fixed terms. Any change in the appointment of the governor or any vice governor of China Eximbank by the State Council will not have any material effect on the business, financial conditions and operations of China Eximbank.

The present governor, vice governors and assistant governors are as follows:

**Mr. Yang Zilin**, Governor. Mr. Yang was appointed as Governor and Chairman of the Board of China Eximbank by the State Council in March 1999. Prior to this appointment, Mr. Yang was Vice Chairman of the Executive Committee and Deputy Governor of the Industrial and Commercial Bank of China (1997–1999), Assistant President and Director of the Bank of China, Managing Director of the Bank of China, Chief Executive of Hong Kong–Macau Regional Office of the Bank of China, Vice Chairman of the Bank of China, and General Manager of the Bank of China Hong Kong Branch (1992–1997), General Manager of the Tokyo Branch (1989–1992), Representative and Chief Representative of Tokyo Representative Officer of the Bank of China; Deputy Director and Director of the General Affairs Department of the Bank of China (1980–1989). Mr. Yang received his undergraduate degree in 1968 and an honorary doctorate degree in Business Administration in November 1997.

**Mr. Su Zhong**, Vice Governor. Mr. Su was appointed as Vice Governor by the State Council in 2003. Prior to this appointment, Mr. Su served as Assistant Governor of China Eximbank (2001–2003) and General Manager of General Planning Department of China Eximbank (1998–2001). Mr. Su graduated from Tsinghua University in 1982.

**Mr. Zhao Wenzhang**, Vice Governor. Mr. Zhao was appointed as Vice Governor by the State Council in 1996. Prior to this appointment, Mr. Zhao served as Vice President of China National Technical Import and Export Corporation (1990–1996) and Chief Resident Representative of China National Technical Import and Export Corporation at its Japan Office (1986–1989). Mr. Zhao graduated from the Beijing Institute of Foreign Trade in 1968.

**Mr. Zhu Hongjie**, Vice Governor. Mr. Zhu was appointed as Vice Governor by the State Council in November 2001. Prior to this appointment, Mr. Zhu served as Assistant Governor of China Eximbank (2001),

General Manager of the Sellers' Credit Department of China Eximbank (2000–2001), General Manager of the Concessional Loan Department of China Eximbank (1998–2000) and General Manager of the Planning & Treasury Department of China Eximbank (1994–1998). Mr. Zhu graduated from Xiamen University in 1982.

**Mr. Zhao Xiaoyu**, Vice Governor. Mr. Zhao was appointed as Vice Governor by the State Council in September 2004. Prior to this appointment, Mr. Zhao served as Director-General of the International Department of Ministry of Finance (2002–2004), Executive Director of Asian Development Bank (1999–2002) and Alternate Executive Director of World Bank Group (1996–1999). Mr. Zhao received his undergraduate degree from Beijing Foreign Languages School in 1975, a Master's degree from Beijing University in 1982 and a diploma in George Washington University in 1984.

**Mr. Li Jun**, Vice Governor. Mr. Li was appointed as Vice Governor by the State Council in September 2004. Prior to this appointment, Mr. Li served as President of Shanghai Branch of China Eximbank (2001–2004) and Commissioner of Nanjing Auditing Office of Industrial and Commercial Bank of China (2000–2001) and Vice President of Jiangsu Branch of Industrial and Commercial Bank of China. Mr. Li received an undergraduate degree and an MBA degree.

**Mr. Li Gang**, Assistant Governor. Mr. Li was appointed as Assistant Governor by the State Council in September 2004. Prior to this appointment, Mr. Li served as General Manager of the Planning and Financial Management Department of China Eximbank (2003–2004), General Manager of the Accounting Department of China Eximbank (2002–2003) and General Manager of General Planning Department of China Eximbank (2001–2002). Mr. Li received an undergraduate degree and a Master's degree in economics.

**Ms. Liang Xiang**, Assistant Governor. Ms. Liang was appointed as Assistant Governor by the State Council in September 2004. Prior to this appointment, Ms. Liang served as General Manager of Export Credit Department of China Eximbank (2003–2004) and General Manager of Buyer's Credit Department of China Eximbank (2002–2003) and General Manager of Credit Department No. Two of China Eximbank (1999–2000). Ms. Liang received her undergraduate degree from Beijing Institute of Petrochemical Technology in 1982 and a Master's degree from China Central University of Finance and Economy.

## Financial Accounting Matters

The accounts of China Eximbank are not examined by external auditors. The Accounting Department of China Eximbank prepares annual financial statements (which consist of a balance sheet and a profit and loss statement) and submits them to the governor and vice governors of China Eximbank for approval. The financial statements are then submitted to the Ministry of Finance for review and approval. The National Audit Office has authority to examine China Eximbank's accounting procedures and the financial statements at any time. The financial statements of China Eximbank are available to the public. The present general manager in charge of the Accounting Department of China Eximbank is Ms. Yu Xiaoping.

China Eximbank's financial statements appearing in this offering circular under the caption “— Report of the General Manager (Accounting Department)” were prepared in accordance with the accounting principles and practices set forth in Financial Systems of Financial and Insurance Enterprises (as amended and supplemented) promulgated by the Ministry of Finance in accordance with the PRC General Financial Standards for Business Enterprises. Such principles and procedures are summarized in Note 1 of the Notes to Financial Statements in the Report of the General Manager (Accounting Department) and may differ in material respects from generally accepted accounting principles in other jurisdictions.

China Eximbank maintains separate accounts for its foreign currency items and translates such foreign currency items into Renminbi at the exchange rate set and published by the PBOC at the end of each year. The resulting exchange gains or losses are credited or charged to the results of operations.

China Eximbank records its marketable securities at cost. Gains and losses on such securities are not recognized until disposal of such securities. Under generally accepted accounting principles in certain other jurisdictions, marketable securities may have to be accounted for on the basis of the lower of cost or market.

According to the Financial Systems of Financial and Insurance Enterprises (as amended and supplemented) promulgated by the Ministry of Finance, China Eximbank includes in its financial statements its branches and representative offices after elimination of all intercompany transactions. China Eximbank does not have any subsidiaries and, therefore, does not publish any consolidated financial statements.

China Eximbank does not consolidate its foreign government loan on-lending operations into its financial statements because China Eximbank acts as an agent of the PRC central government in such operations. Such on-lending operations are recorded on a separate balance sheet. See “— China Eximbank Balance Sheets of On-lending Operations” below. However, the administrative fees and charges received, and the expenses incurred, by China Eximbank in connection with such on-lending operations are included in its profit and loss statement.

The Notes to Financial Statements accompanying China Eximbank's financial statements appearing in this offering circular constitute an integral part of China Eximbank's financial statements. China Eximbank has prepared these notes specifically for this offering circular. You should read China Eximbank's financial statements in conjunction with these accompanying notes.

### **Report of the General Manager (Accounting Department)**

I have examined the balance sheets of The Export-Import Bank of China (“China Eximbank”) as at December 31, 2002, 2003 and 2004 and the related profit and loss statements for each of the three fiscal years ended December 31, 2004 and the notes relating thereto. In my opinion, the financial statements are in conformity with the accounts of China Eximbank. Such financial statements were prepared in accordance with the accounting principles and practices set forth in Financial Systems of Financial and Insurance Enterprises (as amended and supplemented) promulgated by the Ministry of Finance applied on a consistent basis throughout the periods involved, and such financial information presents fairly and accurately the financial position and results of operations of China Eximbank, as at the dates and for the periods therein stated.

/s/ YU XIAOPING

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YU XIAOPING

*General Manager (Accounting Department)*

*The Export-Import Bank of China*

July 14, 2005

Beijing, The People’s Republic of China

## China Eximbank Balance Sheets

	As of December 31,			
	2002	2003	2004	2004
	(in thousands of Rmb)			(in thousands of US\$)
<b>ASSETS</b>				
Due from PBOC .....	4,095,213	2,066,165	2,086,799	252,135
Due from Banks .....	1,490,528	5,847,632	5,536,923	668,993
Interbank Lendings .....	9,450,599	2,604,980	2,572,782	310,854
Loans .....	89,477,955	103,995,816	125,285,878	15,137,543
Less: Provision for Doubtful Assets .....	1,023,751	1,104,585	1,406,816	169,977
Sundry Accounts Receivable .....	1,037,430	852,052	466,574	56,373
Fixed Assets .....	712,139	1,182,669	1,260,379	152,284
Less: Accumulated Depreciation .....	113,402	160,132	207,327	25,050
Construction in Process .....	270,000	—	—	—
Long-term Investment .....	2,110,535	3,420,172	2,509,821	303,247
Other Assets .....	2,675,019	796,210	950,260	114,814
Total Assets .....	<u>110,182,265</u>	<u>119,500,979</u>	<u>139,055,273</u>	<u>16,801,216</u>
<b>LIABILITIES</b>				
Interbank Borrowings .....	1,829,168	3,229,988	413,825	50,000
Other Current Liabilities .....	(1,410,630)	3,894,419	5,626,357	679,799
Guarantee Sum .....	1	406,326	784,098	94,738
Sundry Accounts Payable .....	1,589,273	2,142,894	2,712,441	327,728
Bonds Issued .....	98,870,883	100,559,273	120,227,850	14,526,412
Fiscal Subsidies .....	3,784,547	3,704,630	3,688,326	445,638
Total Liabilities .....	<u>104,663,242</u>	<u>113,937,530</u>	<u>133,452,897</u>	<u>16,124,315</u>
<b>OWNER'S EQUITY</b>				
Paid-in Capital .....	5,000,000	5,000,000	5,000,000	604,120
Capital Surplus .....	(6,367)	(6,493)	(6,535)	(790)
Earnings Surplus .....	319,624	335,533	345,309	41,722
Undistributed Profit .....	205,766	234,409	263,602	31,849
Total Owner's Equity .....	<u>5,519,023</u>	<u>5,563,449</u>	<u>5,602,376</u>	<u>676,901</u>
Total Liabilities and Owner's Equity .....	<u>110,182,265</u>	<u>119,500,979</u>	<u>139,055,273</u>	<u>16,801,216</u>

## China Eximbank Profit and Loss Statements

	Year Ended December 31,			
	2002	2003	2004	2004
	(in thousands of Rmb)			(in thousands of US\$)
<b>OPERATING INCOME</b>				
Interest Income . . . . .	2,910,751	3,236,433	3,654,393	441,538
Commissions and Other Income . . . . .	<u>841,146</u>	<u>773,602</u>	<u>1,829,410</u>	<u>221,037</u>
Total Income . . . . .	<u><u>3,751,897</u></u>	<u><u>4,010,035</u></u>	<u><u>5,483,803</u></u>	<u><u>662,575</u></u>
<b>OPERATING EXPENSES</b>				
Interest Expenses . . . . .	2,656,093	2,813,452	3,620,617	437,458
Commissions and Other Expenses . . . . .	595,881	636,771	1,263,981	152,719
Administrative Expenses . . . . .	187,738	241,261	299,874	36,232
Sales Tax and Surcharges . . . . .	<u>162,209</u>	<u>192,640</u>	<u>203,218</u>	<u>24,554</u>
Total Expenses . . . . .	<u><u>3,601,921</u></u>	<u><u>3,884,124</u></u>	<u><u>5,387,690</u></u>	<u><u>650,963</u></u>
Pre-Tax Income . . . . .	149,976	125,911	96,113	11,613
Less: Income Tax . . . . .	<u>86,340</u>	<u>86,807</u>	<u>55,996</u>	<u>6,766</u>
Income After Tax . . . . .	<u><u>63,636</u></u>	<u><u>39,104</u></u>	<u><u>40,117</u></u>	<u><u>4,847</u></u>



## Notes to Financial Statements

### 1. Summary of Significant Accounting Policies

#### (a) Basis of Presenting Financial Statements

Final financial accounts of China Eximbank for each accounting year are first submitted to its governors for approval no later than April 1 of the following year. China Eximbank's books and other accounting records are prepared by its Accounting Department. All of its accounting practices are subject to inspection by the Ministry of Finance and the National Audit Office.

China Eximbank's financial statements are prepared in accordance with the accounting principles and practices set forth in Financial Systems of Financial and Insurance Enterprises (as amended and supplemented) promulgated by the Ministry of Finance in accordance with the PRC General Financial Provisions for Business Enterprises. China Eximbank is also subject to Provisions Relating to Financial Administration of Policy Banks of China issued by the Ministry of Finance.

China Eximbank's foreign government loan on-lending activities, including the receipt and disbursement of such loans, payments received from the end-users and paid to the foreign sovereign lenders, as well as any loan losses are not included in the balance sheets of China Eximbank. China Eximbank, however, consolidates its on-lending operations in its profit and loss statements.

#### (b) Accounting Year

China Eximbank's accounting year is the calendar year, beginning on January 1 and ending on December 31.

#### (c) Basis of Accounting

China Eximbank uses the accrual accounting method. All profits and losses pertaining to the current accounting year are entered in the books for such year to reflect China Eximbank's financial position and results of operations. All amounts related to guarantee and similar instruments are carried as contingent liabilities before called on.

China Eximbank records its on-lending activities on a separate balance sheet on a cash basis.

#### (d) Reporting Currency and Foreign Currency Business

China Eximbank prepares its accounts in Renminbi and use the debit and credit double-entry system. Foreign currency denominated items are recorded separately, and the daily operations are booked in the original currency involved. Items under Owner's Equity (excluding Undistributed Profit) are translated into Renminbi at the exchange rate set and published by the PBOC on the day of book-entry. Other financial statement items denominated in foreign currencies are translated into Renminbi at the exchange rates set and published by the PBOC on the last business day of each accounting year. In these financial statements, the following rates of exchange as set and published by the PBOC between Renminbi and each relevant foreign currency were used:

<u>2002</u>	<u>2003</u>	<u>2004</u>
Rmb 8.2773 = US\$1.00	Rmb 8.2767 = US\$1.00	Rmb 8.2765 = US\$1.00
Rmb 8.6360 = Euro 1.00	Rmb 10.3868 = Euro 1.00	Rmb 11.2776 = Euro 1.00
Rmb 6.9035 = Japanese ¥100.00	Rmb 7.7360 = Japanese ¥100.00	Rmb 8.0401 = Japanese ¥100.00
Rmb 1.1671 = Danish Krone 1.00	Rmb 1.0660 = HK\$1.00	Rmb 1.0643 = HK\$1.00
Rmb 1.1906 = Norwegian Krone 1.00	Rmb 1.3952 = Danish Krone 1.00	Rmb 1.5161 = Danish Krone 1.00
	Rmb 1.2333 = Norwegian Krone 1.00	Rmb 1.3689 = Norwegian Krone 1.00

## Notes to Financial Statements — (Continued)

### 2. Notes to Balance Sheets

#### (a) *Due from PBOC*

This item represents China Eximbank's aggregate deposits with the PRC central bank on the balance sheet date.

#### (b) *Due from Banks*

This item represents China Eximbank's aggregate amounts on deposit with commercial banks in China and overseas on the balance sheet date.

#### (c) *Interbank Lendings and Borrowings*

Interbank lendings represent China Eximbank's aggregate lendings to domestic and overseas banks on the balance sheet date through the interbank markets. Interbank borrowings represent China Eximbank's aggregate borrowings from domestic and overseas banks on the balance sheet date through the interbank markets. All of these lendings and borrowings have maturities of less than one year.

#### (d) *Loans*

This item refers to the aggregate principal amounts of credits made by China Eximbank that remain outstanding on the balance sheet date.

#### (e) *Provisioning*

Pursuant to the Provisions on Financial Administration of Policy Banks of China issued by the Ministry of Finance, China Eximbank makes provisions at 1% of the aggregate amount of its year-end outstanding loans, equity and debt securities in its investment portfolio (excluding PRC treasuries) and interbank lendings.

#### (f) *Sundry Accounts Receivable and Payable*

Sundry accounts receivable consist of interest and other receivables held by China Eximbank on the balance sheet date, net of any receivables written off during the year. This item also includes disbursements of principal and interest made on behalf of the PRC government under the on-lending agreements with foreign lenders before reimbursement or subsidies from the Ministry of Finance. Sundry accounts payable consist of the current portion of interest payable by China Eximbank on its financial debentures, fees and commissions payable to correspondent banks, welfare benefits payable by China Eximbank to its employees and miscellaneous expenses payable by China Eximbank in connection with its operations on the balance sheet date. This item also includes principal and interest payments received from domestic borrowers under the on-lending arrangements before the payment due date under the on-lending agreements with foreign lenders.

#### (g) *Fixed Assets*

Fixed assets consist of China Eximbank's office building, apartment buildings and other office facilities. Fixed assets are recorded at their original cost. Depreciation is accounted for on an average basis using the straight-line method. Their estimated useful life is as follows:

- business premises for 30 years,
- non-business premises for 35 years,
- computers for three years,
- transportation equipment for six years, and
- communication equipment, security system, electric appliances, furniture and other assets for five years.

## Notes to Financial Statements — (Continued)

### *(h) Construction in Process*

This item primarily refers to China Eximbank's headquarters building at 77 Beiheyuan Street, Dongcheng District, Beijing, China. It qualified for inclusion in the fixed assets in 2002.

### *(i) Long-term Investment*

Long-term investment is stated at cost. It consists primarily of the investment by China Eximbank in the equity interest of the African Export-Import Bank as well as its investment in U.S. treasuries held over one year.

### *(j) Other Assets and Other Current Liabilities*

Other assets include China Eximbank's apartment buildings subject to subsidized sales to its employees, capital improvements to fixed assets and realized gains from swaps and foreign exchange trading. It also includes payments of principal and interest made by China Eximbank on behalf of its on-lent borrowers, which are reimbursable from such on-lent borrowers. Other current liabilities include primarily amounts of principal and interest payable by China Eximbank. It also includes repayments of principal and interest by on-lent borrowers under their on-lend agreements with China Eximbank before China Eximbank is required to use these funds to service its debt under its on-lend agreements with foreign lenders. Other current liabilities also include realized losses from swaps as a result of fluctuations in exchange rates.

### *(k) Guarantee Sum*

Guarantee sum consists of sums deposited at China Eximbank by its guarantee customers. Establishment of branch offices across China significantly increased China Eximbank's guarantee business on a year-on-year basis.

### *(l) Bonds Issued*

Bonds issued consist of China Eximbank's Renminbi-denominated debentures issued to domestic financial institutions within China and debt securities denominated in a foreign currency issued overseas.

### *(m) Fiscal Subsidies*

Fiscal subsidies consist primarily of reserve funds made available by the Ministry of Finance to support China Eximbank's operations, including Rmb 500.0 million of concessional loan loss reserve fund, the on-lending support fund determined on an annual basis by the Ministry of Finance as well as other subsidy funds.

### *(n) Capital Surplus*

Capital surplus consists of realized foreign exchange gains and losses. China Eximbank's registered capital includes US\$100.0 million in addition to Renminbi contribution by the government. Capital surplus was negative as of December 31, 2002, 2003 and 2004 due to the change in the exchange rate between the U.S. dollar and the Renminbi on such dates from the rate in the year when the Ministry of Finance contributed such U.S. dollar-denominated capital to China Eximbank.

## **3. Notes to Profit and Loss Statements**

### *(a) Interest Income and Expenses*

Interest income includes interest received by China Eximbank from its export credit operations and concessional loan operations, as well as its interest income on its deposits with, and lendings to other banks. Interest expenses include interest paid by China Eximbank on its debt obligations, including its borrowings from other banks.

## Notes to Financial Statements — (Continued)

### *(b) Commission and Other Income and Expenses*

Commissions and other income includes fiscal subsidy income received by China Eximbank, service charges paid by its customers and fees received from its guarantee operations, settlement services and on-lending operations. Fiscal subsidy in 2004 amounted to approximately Rmb 1.3 billion. Commissions and other expenses include fees and commissions paid to domestic and foreign correspondent banks and provisioning for non-performing loans and loan loss reserves.

### *(c) Administrative Expenses*

Administrative expenses include depreciation, employee salaries, and other administrative expenses.

### *(d) Sales Tax and Surcharges*

Sale tax is a revenue-based tax. China Eximbank is subject to 5% in sales tax on most of its operating revenue. Its head office and local branches pay their sales taxes separately in their own respective jurisdictions. In addition, China Eximbank is subject to city-construction levy and education surcharges.

### *(e) Income Tax*

China Eximbank is subject to a 30% national income tax and a 3% local income tax on basis of its adjusted taxable income. For the purposes of calculating the income tax base of China Eximbank, its taxable income is adjusted upward by amounts of non-deductible expenditures, such as the disposition by China Eximbank of apartment buildings to its employees during the PRC housing reform, depreciation of fixed assets and expenditures in employee welfare benefits. As there were greater upward adjustments of taxable income in 2003 than in 2004, the effective tax rate based on pre-tax income was greater in 2003 than in 2004. Income tax is paid by China Eximbank's head office at the end of each year.

## **4. Other Notes**

As of the year-end 2003, the total accumulative interest receivable since 1994 till the end of 1999 was written off from China Eximbank's off-balance sheet statement with the approval of the Ministry of Finance.

In 2002 and 2003, China Eximbank charged Rmb 68.0 million and Rmb 78.0 million, respectively, as non-operating losses, which represented the disposition by China Eximbank of its staff apartment buildings during the PRC housing reform. China Eximbank completed this staff housing program in 2003. As a result, in 2004, China Eximbank incurred no such non-operating losses.

The following balance sheets reflect the on-lending operations that China Eximbank conducted as an agent of the PRC central government as of December 31, 2002, 2003 and 2004. China Eximbank prepares these balance sheets on a stand-alone basis, separate from its financial statements.

### China Eximbank Balance Sheets of On-lending Operations

	As of December 31,			
	2002	2003	2004	2004
	(in thousands of Rmb)			(in thousands of US\$)
<b>ASSETS</b>				
Due from Banks .....	1,320,958	1,982,245	8,834,154	1,067,378
Accounts Receivable(1) .....	837,822	3,665,241	4,252,787	513,839
Interest Receivable(2) .....	3,185,968	3,886,011	4,077,983	492,718
On-lent Foreign Government Loans .....	137,107,146	147,062,635	150,075,817	18,132,763
Less: Provision for Doubtful Loans .....	—	—	433,000	52,317
Total Assets .....	<u>142,451,894</u>	<u>156,596,132</u>	<u>166,807,741</u>	<u>20,154,382</u>
<b>LIABILITIES</b>				
Accounts Payable(1) .....	5,020,906	1,700,151	1,460,101	176,415
Swap Capital(3) .....	(70,179)	10,808	—	—
Borrowings of Foreign Government Loans .....	137,308,784	154,699,070	165,168,798	19,956,358
Long-term Borrowings(4) .....	11,932	13,371	—	—
Total Liabilities .....	<u>142,271,443</u>	<u>156,423,400</u>	<u>166,628,899</u>	<u>20,132,773</u>
<b>OWNER'S EQUITY</b>				
Undistributed Profit .....	180,451	172,732	178,842	21,608
Total Owner's Equity .....	<u>180,451</u>	<u>172,732</u>	<u>178,842</u>	<u>21,608</u>
Total Liabilities and Owner's Equity .....	<u>142,451,894</u>	<u>156,596,132</u>	<u>166,807,741</u>	<u>20,154,381</u>

(1) Accounts receivable include amounts receivable from China Eximbank. Due to increased refinancing of on-lent loans by end-users in 2003, there was an increase in prepayments by some borrowers. China Eximbank used some of the prepaid funds to finance other projects as permitted under the loan agreements with foreign governmental lenders. Accounts payable include payments made by China Eximbank to foreign governmental lenders on behalf of the PRC central government before full collection of payments from the Chinese end-users.

(2) Interest receivable includes interest (excluding default interest) payable by Chinese end-users of on-lent loans, after deducting interest payable to foreign governmental lenders.

(3) Swap capital represents the net losses in book value between inflows and outflows of foreign currencies in swap transactions. As an item under liabilities, numbers in parentheses represent net swap assets.

(4) Long-term borrowings include commercial borrowings that come together with the foreign government loans extended to the PRC government as a package.

## PEOPLE'S REPUBLIC OF CHINA

### Overview

The People's Republic of China is one of the world's largest nations in terms of both land area and population. It was founded on October 1, 1949 and its capital is Beijing. Since its founding, the PRC has transformed itself from a largely agrarian, semi-feudal and semi-colonial society that existed prior to 1949, to a centralized economic and social system and, since 1978, to a more open and market-oriented socialist economy. In particular, the PRC government has embarked upon a series of market-oriented economic reforms since 1978 designed to:

- remove price controls;
- reduce government subsidies;
- encourage private and foreign investments;
- expand the role of privately owned enterprises in China's economy;
- liberalize foreign trade;
- improve China's social welfare system;
- ease capital inflows and outflows;
- strengthen China's financial system; and
- rationalize China's tax system.

In addition to these economic reforms, the PRC government has also made significant efforts to restructure its government systems.

China's real gross domestic product, or GDP, has grown by an average annual rate of 8.2% from 1998 to 2004, and in 2004, China's GDP at current exchange rates was the seventh largest in the world. At the end of 2004, China's foreign exchange reserves totaled US\$609.9 billion. In 2004, China's annual trade volume reached US\$1,154.8 billion, the third largest in the world.

### Geography

China is situated in the eastern part of Asia and borders Russia, Mongolia, Kazakhstan and Kyrgyzstan to the north, Tajikistan, Afghanistan, Pakistan, India, Nepal and Bhutan to the west, Myanmar, Laos and Vietnam to the south, and North Korea and the Pacific Ocean to the east. China extends approximately 3,400 miles from north to south and 3,100 miles from east to west, occupying a territory of approximately 3.7 million square miles, or one-fifteenth of the world's total land area. In terms of land mass, China is the third largest country in the world behind Russia and Canada.

China has a widely varied topography, with mountain ranges and highlands located generally in the west and plains and river basins located generally in the east. There are three principal river basins in eastern China: the Yellow River in the north, the Yangtze River in central China and the Pearl River in the south, each of which supports intensive agricultural, industrial and transportation activities. At the end of 2004, China had total arable land of 130.0 million hectares, or approximately 13.5% of its total area, and forestation of 175.0 million hectares, or approximately 18.2% of its total area.

China extends over tropical, subtropical, temperate and arctic zones. However, most of China's land mass and population are located in the temperate zone.

### Population

China's total population was approximately 542 million in 1949, and increased to approximately 1,299.9 million at the end of 2004, making China the world's most populous country. Industrialization and urbanization led to a large increase in China's urban population from approximately 10.6% of its total population

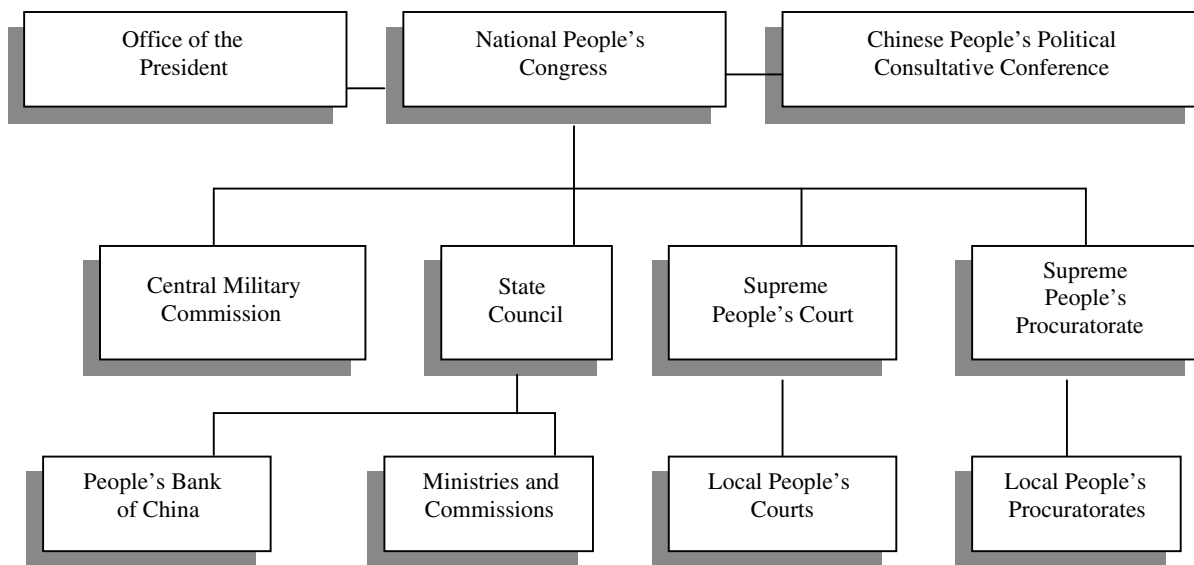
in 1949 to approximately 41.8% at the end of 2004. China's three largest cities are Chongqing (with 31.2 million people) in the west, Shanghai (with 17.4 million people) in the east, and Beijing (with 14.9 million people) in the north.

The increase in China's population has placed significant demands on its economy that have been difficult to satisfy in areas such as housing, education, social welfare, public transportation and employment. In order to control population growth, the government has adopted a policy of family planning and generally permits each couple to have only one child. This policy has contributed to the decline in the annual rate of population growth from 3.3% in 1963 (the highest annual growth rate since 1949) to 0.6% in 2004. At the end of 2004, people under 15 years of age represented approximately 21.5% of the total population of China, people from 15 to 64 years of age represented approximately 70.9%, and people from 65 years of age and older represented approximately 7.6% of the total population of China. The average age of the PRC population is expected to increase as a result of the lower population growth rate and the increased average life expectancy (71.4 years in 2004 compared to 36 years in 1949), which has primarily resulted from improved medical care and other factors.

### Government Structure

China has one of the world's oldest civilizations, with its origins in the second millennium B.C. The first unified Chinese state was established in approximately 200 B.C. under the Qin Dynasty. After the Opium War in 1840, Imperial China was transformed gradually to a semi-colonial and semi-feudal country. In 1911, a revolution led by Dr. Sun Yat-Sen overthrew the Qing Dynasty, the last dynasty in China, and established the Republic of China. On October 1, 1949, after a revolutionary struggle lasting dozens of years, the Communist Party of China founded the People's Republic of China.

The following chart shows the current organization of China's government system.



### Levels of Governmental Administration

China's government is organized in accordance with its Constitution. The highest level of governmental administration is the central government. The next level consists of the provincial government in each of China's 23 provinces, five autonomous regions (Guangxi, Inner Mongolia, Ningxia, Tibet and Xinjiang), four municipalities directly under the administration of the central government (Beijing, Chongqing, Shanghai and Tianjin) and two special administrative regions (Hong Kong and Macau). Below the provincial level, there are over 2,862 municipal and county governments and numerous townships.

### ***The National People's Congress***

The National People's Congress is the highest government authority. As of February 28, 2005, the National People's Congress was composed of 2,723 deputies elected by lower level people's congresses at provinces, autonomous regions, special administrative regions and the four municipalities, and 265 deputies elected by the armed forces. The National People's Congress normally convenes once every year in March and delegates many of its day-to-day responsibilities to a Standing Committee, which as of March 13, 2005, had 176 members. The Standing Committee meets regularly throughout the year and exercises legislative functions conferred by China's Constitution. Statutes adopted by the National People's Congress and its Standing Committee preempt laws enacted by lower level people's congresses. Both deputies to the National People's Congress and members of its Standing Committee are elected for a term of five years and may be re-elected. Any incumbent chairman and vice chairman of the Standing Committee may not serve more than two five-year terms.

The principal functions and powers of the National People's Congress include:

- enacting legislation;
- amending, interpreting and supervising the enforcement of China's Constitution;
- reviewing and approving the government's national economic and social development program and the state budget;
- approving the establishment of provinces, autonomous regions, municipalities and special administrative regions; and
- deciding on issues relating to war and peace.

Lower level people's congresses are also established in provinces, autonomous regions, the four municipalities, counties, other cities, municipal districts and townships. These congresses are the highest local governmental authorities in their respective local jurisdictions. Local people's congresses at and above the county level generally delegate many of their day-to-day responsibilities to their standing committees.

### ***Chinese People's Political Consultative Conference***

The Chinese People's Political Consultative Conference is an advisory and consultative body. It is not an organ of the government. The political consultative conference exists at each level of the government except for the township level and the special administrative regions. As of February 28, 2005, the Chinese People's Political Consultative Conference was composed of 2,304 delegates from the Communist Party of China, other political parties, individuals unassociated with any political party, and representatives from ethnic groups. The consultative body at the national level convenes once every year, typically right before the meeting of the National People's Congress.

### ***President***

The President of China serves as the country's head-of-state. The President is elected by the National People's Congress for a term of five years and an incumbent President may not serve more than two five-year terms.

The President's main functions and powers include:

- putting formally into effect statutes adopted by the National People's Congress;
- appointing and removing the Premier and principal members of the State Council in accordance with the decisions of the National People's Congress or its standing committee;
- receiving credentials from foreign diplomatic representatives;
- conferring national medals and titles of honor; and
- declaring war and proclaiming state of peace.



### ***State Council***

The State Council is the highest institution of government administration and is responsible to the National People's Congress. The State Council consists of a Premier, Vice Premiers, State Councilors, ministers in charge of ministries and commissions, an Auditor-General and a Secretary-General. The Premier has overall responsibility for the State Council and the execution of the executive functions of the central government. The Premier, Vice Premiers and State Councilors are elected by the National People's Congress for a term of five years and any incumbent may not serve more than two five-year terms.

The State Council's principal functions and powers include:

- adopting administrative measures, enacting administrative rules and regulations and issuing decisions and orders in accordance with China's Constitution and statutes;
- submitting proposals to the National People's Congress or its standing committee;
- exercising leadership over the central government ministries and commissions and local government administrative bodies;
- drawing up and implementing national economic and social development programs and the state budget; and
- directing all other matters of government administration, including the exercise of general oversight over ministries and commissions responsible for economic affairs, education, sciences, culture, civil affairs, public security, foreign affairs and national defense.

### ***Central Military Commission***

The Central Military Commission, currently with 11 members, directs China's armed forces. The chairman of the Central Military Commission is elected by, and is responsible to, the National People's Congress. The term of service of each member of the Central Military Commission is five years and may be extended through re-election.

### ***People's Courts***

The people's courts are the judicial bodies responsible for the administration of justice for civil, criminal, economic and administrative cases. The Supreme People's Court is the highest judicial body and supervises the administration of justice by local people's courts and specialized courts. The Supreme People's Court is responsible to the National People's Congress and its standing committee. The president of the Supreme People's Court is elected by the National People's Congress for a term of five years and an incumbent president may not serve more than two five-year terms.

### ***People's Procuratorates***

The people's procuratorates are responsible for the exercise of prosecutorial power and for the legal supervision of government administrative bodies. The Supreme People's Procuratorate is the highest body within the procuratorate system and supervises public prosecution work by local people's procuratorates. The Supreme People's Procuratorate is responsible to the National People's Congress and its standing committee. The Procurator-General is elected by the National People's Congress for a term of five years and an incumbent Procurator-General may not serve more than two five-year terms.

### ***Current Government Leadership***

In March 2003, the Tenth National People's Congress elected a new leadership for the Chinese government. The following table presents China's current principal leaders.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Mr. Hu Jintao . . . . .	62	President of China and Chairman of the Central Military Commission
Mr. Wu Bangguo . . . . .	63	Chairman of the Standing Committee of the National People's Congress
Mr. Wen Jiabao . . . . .	62	Premier of the State Council
Mr. Jia Qinglin . . . . .	65	Chairman of the Chinese People's Political Consultative Conference

In addition, the Tenth National People's Congress elected Mr. Xiao Yang as president of the Supreme People's Court and Mr. Jia Chunwang as Procurator-General of the Supreme People's Procuratorate. In March 2005, Mr. Hu Jintao was elected Chairman of the Central Military Commission.

### **Governing Party**

The Communist Party of China has been the governing political party in China since 1949 and, under its leadership, as provided by China's Constitution, a multi-party cooperative and political consultative system has continued to exist and develop. The Communist Party of China is led by a National Party Congress, which meets once every five years in plenary sessions, and by its Central Committee, which meets at least once every year. The Central Committee implements resolutions by the National Party Congress and elects a General Secretary and a Political Bureau, which is managed by a nine-member Political Bureau Standing Committee.

In November 2002, the National Party Congress elected a new leadership. Many of the party's leaders also serve in the government. Mr. Hu Jintao was elected the General Secretary of the Communist Party of China and a member of the Political Bureau Standing Committee. Messrs. Wu Bangguo, Wen Jiabao and Jia Qinglin were also elected members of the Political Bureau Standing Committee. In addition to these individuals, the Political Bureau Standing Committee includes Messrs. Zeng Qinghong, Huang Ju, Wu Guanzheng, Li Changchun and Luo Gan. In September 2004, Mr. Hu Jintao was elected Chairman of the Military Commission of the Central Committee of the Communist Party of China.

### **Government Reorganization**

In March 1998, the government announced plans to streamline its agencies in order to facilitate the transformation of the Chinese economy from a centrally planned economy to a market-oriented economy. The central government believes this restructuring will enhance its efficiency by further separating economic and social functions from governmental functions. As a result, the number of central government ministries and commissions was reduced from 40 to 29, the central government's staff was reduced by 50%, more than 200 central government functions were transferred to commercial enterprises, intermediary institutions and local authorities, and about 100 central government functions were reallocated among surviving central government agencies. In addition, more than 200 central government agencies were abolished. In February 2001, the central government further eliminated nine bureaus under the State Economic and Trade Commission. Local governments were also restructured accordingly. In March 2003, the central government dissolved the State Economic and Trade Commission, transformed the Ministry of Foreign Trade and Economic Cooperation into the Ministry of Commerce and reorganized the State Development and Planning Commission into the National Development and Reform Commission. The administrative functions of the former State Economic and Trade Commission were taken over partly by the Ministry of Commerce, partly by the National Development and Reform Commission and partly by the then newly established State-owned Assets Supervision and Administration Commission. Re-education programs and employment training programs were set up for government employees made redundant as a result of the government restructuring.

Since 1998, China has also taken steps to phase out involvement in business activities by the military, the police and other law enforcement departments. The purpose of this initiative was to provide greater equality of opportunity for all market participants in the economy and to reduce irregular market activities by military and law enforcement entities. Pursuant to the central government pronouncements, the State Economic and Trade Commission was put in charge of the transfer of such ownership interests and assets with the assistance of various other government agencies. By February 1999, the government completed the initial phase of such transfers. Since that time, enterprises formerly affiliated with the law enforcement departments have been undergoing an in-depth restructuring.

The government has also further separated governmental functions from business management by no longer permitting ministries and government agencies to engage in commercial operations. The initial transfer of ownership interests and assets from such ministries and government agencies has already been completed at the central government level. In 1999, local governments began to conduct a similar separation process.

In connection with the government reorganization, the State Council established a number of new departments to enhance the government's oversight of the economy, including the China Banking Regulatory Commission to regulate the country's banking industry, the Ministry of Commerce to regulate domestic and foreign trade, the China Insurance Regulatory Commission to supervise the country's insurance industry, the State Food and Drug Supervision Bureau to oversee the country's food and drug industry and the China Power Regulatory Commission to supervise the country's power industry and the State-owned Assets Supervision and Administration Commission to oversee the management of state-owned assets, including state-owned enterprises.

The government has also taken steps to eliminate various administrative licensing requirements and to improve efficiency in government administration. By June 30, 2004, the government had abolished or modified a total of 1,795 licensing requirements imposed by various ministries and commissions under the State Council. Many licensing requirements imposed by governments at the provincial level have also been eliminated or abolished. In July 2004, the Administrative Licensing Law of the PRC came into effect. This law aims at improving efficiency in government administration by eliminating and restricting unnecessary licensing requirements. According to this law, administrative licensing requirements may be imposed on limited matters and only by statutes adopted by the National People's Congress or its standing committee or, in the absence of statutes, by regulations or decisions of the State Council or rules promulgated by the people's congresses or governments at the provincial level.

## **Legal System**

China's legal system is a civil law system based on written statutes. Decided cases generally do not constitute binding precedents, although such cases are sometimes referred to for guidance. Though China is still in the process of developing a comprehensive system of laws, a significant number of laws and regulations dealing with general economic matters, foreign investment, protection of intellectual property, taxation, technology transfer and trade have been promulgated since the start of China's economic reform program in 1978. China's Constitution specifically permits foreign investment and provides for protection of the lawful rights and interests of foreign investors in China. China's Constitution was amended in 1988 and 1993 to provide for a "socialist market economy" and was further amended in March 1999 to recognize at the constitutional level that private ownership is an important part of China's socialist market economy and that private rights and interests are protected by law. The 1999 amendment also provided that China be governed by the rule of law. China's Constitution was further amended in March 2004. The 2004 amendment encourages the development of the private sector of the economy, promotes protection of private property, introduces a new requirement for the establishment of a comprehensive social security system and calls for respect for, and protection and preservation of, human rights.

All statutes in China are promulgated by the National People's Congress and its standing committee. The State Council, acting by itself or through its ministries or commissions, and people's congresses at the provincial levels are also vested with the power to promulgate rules and regulations which have the force of law.

The principal statute governing the judicial system is the Law Concerning the Organization of the Judicial System, which took effect in July 1979 and which was amended in September 1983. The principal statute

governing civil relations, including business transactions, is the General Principles of the Civil Code, enacted in April 1986. The Civil Code is divided into seven broad categories: general principles, civil law, contract, property, civil liability, remedies and special provisions governing foreign economic relations. The current main statute governing civil procedure is the Law on Civil Procedure, which took effect in April 1991.

All foreign individuals, enterprises and other entities are given the same rights and obligations as PRC individuals, enterprises and other entities in instituting or defending proceedings in courts. If, however, the rights and obligations of PRC individuals, enterprises or other entities to institute or defend legal proceedings are subject to any restriction in a foreign jurisdiction, then reciprocal restrictions may be imposed by PRC courts on the rights and obligations of the individuals, enterprises and other entities of such jurisdictions to institute or defend legal proceedings in China.

All civil cases are decided by the court on the basis of a majority vote of the judges sitting on a case and are subject to a two-tier procedure, with cases heard by a court of first instance, subject to review by appellate courts. Courts are divided into four levels: the Supreme People's Court at the national level, the High People's Courts at the provincial level, the Intermediate People's Courts below the provincial level and the Elementary People's Courts at the county level. Each level contains a criminal division, a civil division, an economic division and an administrative division. The Supreme People's Court, the High People's Courts and the Intermediate People's Courts each also have an intellectual property division. In addition, there are a number of maritime courts across China with jurisdiction over maritime matters. The Supreme People's Court is the highest court in China and is responsible for supervising all other courts.

If a PRC court is asked to recognize or enforce a judgment or ruling given by a foreign court, such judgment or ruling will be recognized and enforced only where there is an applicable international treaty or other arrangement or basis for reciprocal enforcement of judgments between China and the country of the foreign court. The enforcement of such foreign judgment or ruling, however, may not violate national security, state sovereignty or the basic principles of the laws of China, nor contradict public policy of China. China does not have such a treaty or other arrangement with the United States.

Foreign arbitral awards may be enforced in China pursuant to international treaties to which China is a party, most importantly the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, to which China acceded in 1987. Applications for enforcement in China are handled in accordance with the Chinese Law on Civil Procedure, which provides that an application for enforcement must be submitted to the Intermediate People's Court of the place where the party against whom the enforcement is sought is domiciled or where such party's property is located.

The Arbitration Law of China, which became effective on September 1, 1995, is applicable to trade disputes involving foreign parties. Under the Arbitration Law, the parties involved in such a dispute may, pursuant to their arbitration agreement, submit their dispute before an arbitration committee constituted in accordance with the Arbitration Law. The China International Economic and Trade Arbitration Commission, or CIETAC, established in Beijing under the auspices of the China Council for the Promotion of International Trade, is a major domestic arbitration organization in China charged with arbitrating foreign-related disputes. CIETAC's arbitration rules provide that it has jurisdiction over "contractual and non-contractual economic, trade and other disputes" under an arbitration agreement selecting CIETAC as the venue for arbitration. The CIETAC rules provide that an award rendered by it is final and binding on the parties. The Law on Civil Procedure also provides that a Chinese court may refuse to enforce a final award of CIETAC only if there are certain procedural errors relating to its jurisdiction over a given dispute or the failure by an arbitration tribunal to abide by the CIETAC rules. In addition, a Chinese court may refuse to enforce the award if the court determines that enforcing the award would be against public interest. Foreign-related maritime disputes are arbitrated by the China Maritime Arbitration Commission pursuant to arbitration rules formulated in line with the Arbitration Law.

The legal framework for China's banking system is primarily based on three statutes, the Law on the People's Bank of China, the Commercial Banking Law and the Law on Banking Regulation and Supervision. The government has also issued various rules and regulations to implement these statutes and international treaty obligations undertaken by the central government. For further information relating to China's banking system, see "PRC Financial System."

## **Foreign Relations**

As of the end of 2004, China had established diplomatic relations with over 166 countries and trade relations with over 235 countries and regions, more than 80 of which have signed trade agreements with China.

Although China has had and continues to have territorial disputes with its neighboring countries, it has successfully resolved some of these territorial disputes and believes that it can successfully resolve its outstanding territorial disputes by peaceful means.

## **International Organizations**

China is a permanent member of the United Nations Security Council (along with France, Russia, the United Kingdom and the United States). China is also a member of many other international organizations, including the World Trade Organization, the International Monetary Fund, the World Bank Group, the Asian Development Bank, the African Development Bank, and the Asia-Pacific Economic Cooperation forum.

China became a member of the World Trade Organization, or WTO, on December 11, 2001, but the implementation of its WTO commitments is generally subject to a five-year phase-in period. The government believes that China's entry into the WTO has brought both opportunities and challenges to the country. See “— PRC Foreign Trade and Balance of Payments — World Trade Organization.”

## **Hong Kong and Macau**

China resumed its sovereignty over Hong Kong on July 1, 1997 and over Macau on December 20, 1999. China applies a policy of “one country, two systems” to Hong Kong and Macau. The National People's Congress has incorporated this policy into the Basic Law of the Hong Kong Special Administrative Region and the Basic Law of the Macau Special Administrative Region. These Basic Laws, as quasi-constitutions for Hong Kong and Macau, provide for them to exercise a high degree of autonomy, except in the areas of defense and foreign affairs, and to enjoy legislative, executive and judicial power in accordance with the provisions of the Basic Laws and full economic autonomy for the 50 years following the transfer of sovereignty back to China. Both Hong Kong and Macau have their own financial regulatory authorities and legal currencies, and manage their own foreign exchange reserves.

## **Taiwan**

Taiwan is a province of China. The government has reiterated its policy to unify Taiwan with the rest of China.

## PRC Economy

### Overview

Since the start of its economic reforms in 1978, China has been transitioning from a centrally planned economy to a market-oriented economy. In particular, the central government has implemented reforms designed to remove price controls, reduce government subsidies, separate government from business management and commercial activities, encourage private and foreign investment, diversify ownership in the public sector of the economy, liberalize foreign trade, ease capital transfers, strengthen its financial system, improve its social welfare system and rationalize its tax system. As a result of these developments, China's real GDP has grown by an average annual rate of 8.2% from 1998 to 2004.

The main participants in China's economy are state-owned enterprises (which include enterprises wholly owned or otherwise controlled by the Chinese state), collectively owned enterprises, privately owned enterprises, and foreign-invested enterprises. Due to the rapid growth of the private sector in recent years, the contribution to the national economy by state-owned enterprises has declined. However, state-owned enterprises still dominate the country's key industries and employ a significant portion of China's urban work force.

In 2004, China's economy witnessed a 9.5% increase in its GDP growth. In order to prevent China's economy from expanding too fast, the government took measures to control money supply, credit availability, and fixed assets investment. At the same time, the government continued to rationalize China's economic structure by encouraging investments in bottleneck industries, such as energy and transportation, and by stimulating domestic consumption. The government has also continued to encourage development of China's service industry and agriculture. The government's goal is to achieve balanced and sustainable economic growth.

### Government Economic Objectives

The government manages the country's economy through five-year economic and social development plans. Each five-year plan establishes the general framework of the country's agricultural, industrial, financial and other economic and social policy during the five-year period. Although the central government's plans provide the guidelines for overall economic development, local governments have considerable autonomy with respect to the development of some sectors.

In March 2001, the National People's Congress approved the country's tenth five-year plan, which covers the period from 2001 to 2005. This plan calls for doubling the country's GDP by the year 2010 (over that of 2000) and achieving an average annual growth rate of 7.0%. In addition, the tenth five-year plan includes the following objectives:

- increase the international competitiveness of China's economic institutions through measures such as reorganization, merger or public listing of its state-owned enterprises;
- strengthen China's technological innovation by supporting education and research and development;
- keep the country's registered urban unemployment rate at no higher than 5.0%;
- develop China's western regions by improving basic infrastructure and other programs in these regions; and
- improve China's foreign investment environment in line with China's WTO commitments.

In March 2005, the National People's Congress approved the economic development plan proposed by the State Council for 2005. This plan includes the following objectives:

- continue to adjust economic development to maintain its stability and reasonable speed;
- increase grain output and raise income in rural areas;
- promote structural rationalization of its economy and facilitate industry upgrade;
- improve the way its economy grows and promote efficiency in resource consumption and environmental protection;

- coordinate inter-regional economic development across China;
- further open its economy up to the outside world and better utilize both domestic and international markets and resources;
- enhance employment and social welfare work and continue to improve people's living standards;
- enhance development of science, technology, education and public interest to build a harmonious society.

The government designed these development plans on the basis of its assumptions and estimates of future events and developments, including the state of overall economic and social developments in China. Therefore, the objectives, goals and targets contained in the plans are subject to uncertainties beyond China's control. The government may also adjust its plans if actual developments materially deviate from its previous assumptions and estimates. At present, factors likely to adversely affect China's economy include, among others:

- weakness of agricultural infrastructure and difficulty in increasing grain production;
- excessive investments in fixed assets under construction;
- imbalance between demand and supply of coal, power, oil and other resources and the resultant pricing pressure;
- inadequacy in education, health care and cultural development in rural areas;
- unemployment, wealth disparity and difficulties encountered by low income families.

### Major Economic Indicators

Over the years, China has experienced significant economic growth, largely as a result of the government's post-1978 economic reforms. As a result of these developments, China's real GDP has grown by an average annual rate of 8.2% from 1998 to 2004. In 2004, China's GDP grew 9.5% to Rmb 13,687.6 billion as compared to 2003. In China's urban areas, per capita disposable income in 2004 increased 7.7% over the previous year to Rmb 9,421.6, while per capita net income in China's rural areas increased 6.8% over the previous year to Rmb 2,936.4.

The following table sets forth selected annual data relating to the PRC economy for the periods indicated.

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
GDP (in billions of Rmb)(1) . . . . .	8,946.8	9,731.5	10,517.2	11,739.0	13,687.6
Population (in millions) . . . . .	1,267.4	1,276.3	1,284.5	1,292.3	1,299.9
Per Capita GDP (in Rmb) . . . . .	7,086.0	7,651.0	8,214.0	9,111.0	10,561.0
Exports (in billions of US\$) . . . . .	249.2	266.1	325.6	438.2	593.4
Imports (in billions of US\$) . . . . .	225.1	243.6	295.2	412.8	561.4
Current Account Balance (in billions of US\$) (year end) . . . . .	20.5	17.4	35.4	45.9	68.7
Foreign Exchange Reserves (in billions of US\$) (year end)(1) . . . . .	165.6	212.2	286.4	403.3	609.9
Total Industrial Gross Output Value (in billions of Rmb)(1) . . . . .	8,567.4	9,544.9	11,077.7	14,227.1	18,722.1
Total Agricultural Gross Output Value (in billions of Rmb)(1) . . . . .	2,491.6	2,618.0	2,739.1	2,969.2	3,623.9
Rate of Inflation . . . . .	0.4%	0.7%	(0.8)%	1.2%	3.9%

(1) Calculated at current prices.

Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.

The following table presents the amounts contributed to GDP by major sectors of the PRC economy on an annual basis for the periods indicated.

<b>GDP by Economic Sector</b>						
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>Percentage of 2004 GDP</u>
	(in billions of Rmb, except for percentages)					
Primary Sector(1) . . . . .	1,462.8	1,541.2	1,611.7	1,692.8	2,076.8	15.2%
Secondary Sector						
Industry(2) . . . . .	3,904.7	4,237.5	4,597.5	5,309.3	6,281.5	45.9
Construction . . . . .	<u>588.8</u>	<u>637.5</u>	<u>700.5</u>	<u>818.1</u>	<u>957.2</u>	<u>7.0</u>
Subtotal . . . . .	4,493.5	4,875.0	5,298.0	6,127.4	7,238.7	52.9
Tertiary Sector(3) . . . . .	<u>2,990.5</u>	<u>3,315.3</u>	<u>3,607.5</u>	<u>3,918.8</u>	<u>4,372.1</u>	<u>31.9</u>
Total . . . . .	<u>8,946.8</u>	<u>9,731.5</u>	<u>10,517.2</u>	<u>11,739.0</u>	<u>13,687.6</u>	<u>100.0%</u>

(1) Includes farming, animal husbandry, fishery and forestry.

(2) Includes mining, manufacturing and energy production and supply.

(3) Includes all other segments of the economy, including transportation, postal and telecommunications, retail sales, real estate, financial services, insurance, education, tourism, entertainment and other services.

Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.

The following table presents the annual real GDP growth rates by economic sector for the periods indicated.

<b>Real GDP Growth Rates by Economic Sector</b>					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in percentages)				
GDP . . . . .	8.0%	7.5%	8.3%	9.5%	9.5%
Primary Sector . . . . .	2.4	2.8	2.9	2.5	6.3
Secondary Sector . . . . .	9.4	8.4	9.8	12.7	11.1
Tertiary Sector . . . . .	8.1%	8.4%	8.7%	7.8%	8.3%

Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.

The following table presents selected annual data relating to the composition of gross domestic expenditures for the periods indicated.

<b>Gross Domestic Expenditures (GDE)</b>						
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>Percentage of 2004 GDE</u>
	(in billions of Rmb, except for percentages)					
Resident Consumption . . . . .	4,289.6	4,589.8	4,888.2	5,268.6	5,904.8	41.9%
Fixed Assets Investment . . . . .	3,262.4	3,681.3	4,191.8	5,130.4	6,135.9	43.6
Public Consumption . . . . .	1,170.5	1,302.9	1,391.7	1,480.8	1,638.2	11.6
Net Exports . . . . .	224.0	220.5	279.4	268.2	351.8	2.5
Inventories . . . . .	(12.4)	64.8	38.7	25.1	47.0	0.3
Total . . . . .	<u>8,934.1</u>	<u>9,859.3</u>	<u>10,789.8</u>	<u>12,173.0</u>	<u>14,077.6</u>	<u>100.0%</u>

Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.



Net exports of goods and services in 2004 accounted for approximately 2.5% of China's GDP calculated on the basis of the expenditure approach. Resident consumption and fixed assets investment in 2004 accounted for approximately 41.9% and 43.6% of China's GDP, respectively, calculated on the same basis.

China has one of the highest rates of savings in the world measured as a percentage of GDP. At the end of 2004, the total amount of household savings in both domestic and foreign currencies held by financial institutions in China (including foreign-funded institutions) was Rmb 12,619.6 billion, an increase of 14.0% over the previous year.

## **Primary Sector**

The primary sector includes farming, animal husbandry, fishery, forestry and related businesses. In 2004, it constituted approximately 15.2% of China's total GDP and its growth rate was 6.3% over the previous year. The GDP of the primary sector increased from Rmb 1,462.8 billion in 2000 to Rmb 2,076.8 billion in 2004, but its share in China's total GDP declined from approximately 16.4% to approximately 15.2% over the same period. This decline was due to relatively rapid growth in the country's secondary and tertiary sectors as well as a decrease in farmland as a result of growing urbanization. As of the end of 2004, the number of people employed by the primary sector was approximately 352.7 million, or 46.9% of China's total work force.

Agriculture remains a top priority in the government's development plans, as it not only is the basic lifeline of China's economy, but also supports China's vast rural population. When the government initiated its economic reforms in 1978, it established a "household contract responsibility system" for the country's farming population. Under this system, land formerly managed by agricultural collectives were contracted to farmers on a household basis for original terms of 15 to 25 years, renewable upon expiration. Farmers are obligated to sell a certain portion of their output to the state at prices set by the government, but may sell the excess in the open market. The household contract responsibility system has stimulated farm production and resulted in significant increases in grain and other agricultural output. Current government plans continue to call for increased investments in agriculture and further reform of the markets for agricultural produce. Measures recently taken by the government include:

- formulation of policies to support farming industry;
- strengthening of the over-all production capability of the agricultural sector;
- facilitation of adjustment in agricultural and rural economic structures;
- stabilization of pricing for agricultural products; and
- making more income-generating channels available to the rural population.

In 2004, the government abolished taxes on special agricultural products except for tobacco and implemented an annual reduction in agricultural tax by 1% or more from 2004. In 2005, the government decided to further reduce and eliminate the agricultural tax in most areas of China and to eliminate this tax nationwide by 2006. The government sponsored various programs to commercialize China's agricultural sector, diversify employment opportunities in rural areas and assist rural migration to urban areas. Annual per capita net income for rural households in China increased from Rmb 2,253.4 in 2000 to Rmb 2,936.4 in 2004.

The following table sets forth a breakdown of the annual gross output value of China's primary sector for the periods indicated.

<b>Gross Output Value of Primary Sector</b>					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	<b>(in billions of Rmb)</b>				
Farming .....	1,387.4	1,446.3	1,493.2	1,487.0	1,813.8
Animal Husbandry .....	739.3	796.3	845.5	953.9	1,217.4
Fishery .....	271.3	281.5	297.2	313.8	360.6
Forestry .....	<u>93.7</u>	<u>93.9</u>	<u>103.4</u>	<u>124.0</u>	<u>132.7</u>
Total .....	<u>2,491.6</u>	<u>2,618.0</u>	<u>2,739.1</u>	<u>2,969.2</u>	<u>3,623.9</u>

Source: *China Statistical Abstract of 2005, the National Bureau of Statistics of China.*

The following table sets forth the annual real growth rates of the major primary sector components based on gross output value for the periods indicated.

<b>Real Growth Rate in Primary Sector Gross Output Value</b>					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	<b>(in percentages)</b>				
Farming .....	1.4%	3.5%	3.9%	0.5%	8.5%
Animal Husbandry .....	6.3	6.3	6.0	7.3	7.2
Fishery .....	6.5	3.9	6.1	5.3	6.0
Forestry .....	5.4	0.2	7.1	6.9	2.0
Overall Growth .....	3.6%	4.2%	4.9%	3.9%	7.5%

Source: *China Statistical Abstract of 2005, the National Bureau of Statistics of China.*

## **Secondary Sector**

The secondary sector is composed of industry and construction. Industry includes mining, manufacturing and energy production and supply. In 2004, the secondary sector constituted approximately 52.9% of China's total GDP and its growth rate was 11.1% over the previous year. The secondary sector's GDP increased from Rmb 4,493.5 billion in 2000 to Rmb 7,238.7 billion in 2004, and its share in China's total GDP increased from approximately 50.2% to approximately 52.9% over the same period. This increase reflected growth in the country's secondary sector as a result of China's recent economic developments. From 1999 to 2003, the number of people employed by the secondary sector, as a percentage of the total work force, decreased from 23.0% to 21.6%, or from 164.2 million people to 160.8 million people. In 2004, the secondary sector employed 169.2 million people, representing 22.5% of the total work force.

### **Industry**

State-owned enterprises, including state-controlled enterprises, accounted for approximately 35.2% of China's industrial gross output value in 2004, compared to approximately 47.3% in 2000. While the growing importance of other forms of enterprise ownership, such as privately owned enterprises, has led to a relative decline in the contribution to GDP by state-owned enterprises, the state-owned or state-controlled enterprises still remain dominant in many industrial sectors, including heavy industry, telecommunications, energy and petrochemicals.

The non-state-owned sector has grown relatively rapidly over the years. During the five-year period from 2000 to 2004, the industrial gross output value of the non-state-owned sector grew from approximately Rmb 4,511.9 billion to approximately Rmb 12,125.0 billion. In 2004, the industrial gross output value of the non-

state-owned sector accounted for approximately 64.8% of China's total industrial gross output value compared to 52.7% in 2000.

In February 2005, the State Council announced its Proposals for Encouraging, Supporting and Directing Development of the Private Sector. These proposals aim at encouraging and supporting inflow of non-public funds into infrastructure facilities, monopolized sectors such as public utilities, and other industries and sectors. This policy also calls for increased financial support to the private sector.

The following table sets forth the annual real growth rates in industrial gross output value by ownership for the periods indicated. Data for 2004 are not available.

#### Real Growth Rate in Industrial Gross Output Value by Ownership

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
	(in percentages)			
Foreign-invested Enterprises . . . . .	32.9%	24.5%	22.7%	42.0%
Hong Kong, Macau & Taiwan Invested Enterprises . . . . .	15.5	12.9	18.7	25.9
Joint Stock Companies . . . . .	52.7	32.0	16.4	16.9
State-owned Enterprises . . . . .	9.6	7.8	8.2	14.1
Collectively Owned Enterprises . . . . .	(3.9)	(16.2)	(5.8)	(3.3)
Overall Growth . . . . .	16.9%	14.6%	18.2%	25.5%

Source: China Statistical Yearbook of 2004, the National Bureau of Statistics of China.

The following table presents annual data pertaining to industrial gross output value by ownership and industry type for the periods indicated. Some data for 2003 and 2004 are not available.

#### Industrial Gross Output Value by Ownership and Industry

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in billions of Rmb)				
<b>Ownership Type(1)</b>					
State-owned Enterprises(2) . . . . .	4,055.4	4,240.8	4,517.9	5,340.8	6,597.1
Foreign-invested Enterprises . . . . .	1,289.0	1,537.4	1,879.0	2,693.2	N/A
Joint Stock Companies . . . . .	1,009.0	1,269.8	1,411.9	1,801.7	N/A
Hong Kong, Macau & Taiwan Invested Enterprises	1,057.4	1,184.7	1,366.9	1,742.6	N/A
Collectively Owned Enterprises . . . . .	1,190.8	1,005.2	961.9	945.8	1,058.6
Total . . . . .	<u>8,567.4</u>	<u>9,544.9</u>	<u>11,077.6</u>	<u>14,227.1</u>	<u>18,722.1</u>
<b>Industry Type(1)</b>					
Light Industry					
Using Farm Products as Raw Materials . . . . .	2,107.0	2,360.5	2,714.1	N/A	N/A
Using Non-Farm Products as Raw Materials . . .	<u>1,302.5</u>	<u>1,403.2</u>	<u>1,621.5</u>	<u>N/A</u>	<u>N/A</u>
Subtotal . . . . .	<u>3,409.5</u>	<u>3,763.7</u>	<u>4,335.6</u>	<u>5,049.8</u>	<u>6,265.4</u>
Heavy Industry					
Manufacturing . . . . .	2,529.1	2,912.7	3,538.9	N/A	N/A
Raw Materials . . . . .	2,088.9	2,334.7	2,615.6	N/A	N/A
Mining and Excavation . . . . .	<u>539.9</u>	<u>533.9</u>	<u>587.7</u>	<u>N/A</u>	<u>N/A</u>
Subtotal . . . . .	<u>5,157.9</u>	<u>5,781.2</u>	<u>6,742.1</u>	<u>9,177.4</u>	<u>12,456.7</u>
Total . . . . .	<u>8,567.4</u>	<u>9,544.9</u>	<u>11,077.6</u>	<u>14,227.1</u>	<u>18,722.1</u>

- (1) Includes all state-owned industrial enterprises and non-state-owned industrial enterprises with an annual sales income of over Rmb 5.0 million.
- (2) Includes state-controlled enterprises with private equity from minority shareholders. Numbers under this item may overlap with those under the items entitled “Joint Stock Companies,” “Foreign-invested Enterprises” and “Hong Kong, Macau and Taiwan Invested Enterprises.”

Source: *China Statistical Yearbooks of 2001, 2003 and 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China.*

In 2003, industrial production recorded the fastest annual growth since 1995. Growth in heavy industry accounted for 65.5% of industrial growth in 2003, mainly due to four major heavy industry sectors, electronic communication equipment manufacturing, transportation equipment manufacturing, electric machinery and supplies manufacturing and metallurgy and chemical industry, which together accounted for 50.9% of the industrial growth.

The following table presents the annual gross output values for industrial segments for the periods indicated.

<b>Industrial Gross Output Value by Industrial Segment(1)</b>					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in billions of Rmb)				
Electric, Electronic and Communications Equipment	1,238.4	1,447.1	1,743.1	2,375.6	3,187.2
Chemical and Pharmaceutical Products	877.3	936.7	1,072.0	1,358.3	1,762.9
Smelting and Processing of Metals	691.3	807.6	909.2	1,357.1	2,113.2
Textile, Leather and Clothing	878.6	979.0	1,108.7	1,342.5	1,664.5
Energy Production	918.9	958.4	1,085.1	1,307.0	1,715.3
Food, Beverage and Tobacco	836.9	924.5	1,077.8	1,291.1	1,607.9
Transportation Equipment	536.5	647.5	835.9	1,121.4	1,349.3
Machinery	524.0	585.8	706.7	954.3	1,261.0
Petroleum Processing	442.9	458.8	478.5	623.5	851.2
Other Non-metal Mineral Products	369.3	402.6	455.7	565.3	742.7
Rubber and Plastic Materials	271.2	303.0	355.3	437.7	542.7
Paper, Paper Products, Printing and Furniture	257.7	296.5	343.1	427.3	529.5
Metal Products	254.0	285.2	329.4	385.7	525.1
Wood and Wood Products	77.8	85.3	94.0	99.3	130.6
Ferrous and Non-ferrous Ores and Metals	57.0	61.0	68.9	92.4	135.3
Non-metallic Minerals	35.7	37.4	41.9	48.7	61.9
Other	299.9	328.5	372.3	439.8	541.8
Total	<u>8,567.4</u>	<u>9,544.9</u>	<u>11,077.6</u>	<u>14,227.1</u>	<u>18,722.1</u>

- (1) Includes only enterprises with independent accounting systems that are regarded as separate economic units. For example, enterprises owned by government ministries that do not keep separate accounts and subsidiaries of enterprises not involved in the relevant industry segment are excluded from this presentation.

Sources: *China Statistical Yearbooks of 2001, 2002, 2003 and 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China; the Ministry of Finance.*

Economic growth in China during recent years has exerted considerable pressure on China’s supporting industries. Although foreign imports have alleviated some of the shortages, the lack of equivalent growth in the supporting industrial sectors, such as transportation, energy, steel and raw materials, has resulted in periodic production bottlenecks, shortages and supply imbalances, particularly in places enjoying faster economic growth such as China’s coastal regions and large cities. In order to address the shortages in basic industries and

infrastructure in China's overall economic development, the government in recent years has allocated substantial resources to important industries and infrastructure projects. In July 2004, the State Council announced its Decision on Reform of Investment System to deregulate private investment in infrastructure. This decision eliminated the requirement for government approval with respect to most infrastructure investments not involving government funds and relaxed rules relating to financing for infrastructure projects. Moreover, in an effort to optimize China's industrial structure, the government encourages introduction and development of new and high technology to replace and upgrade traditional industries. High technology industries, including telecommunications and electronics, have become an increasingly important part of China's economy.

Many of the state-owned enterprises suffer from low efficiency, outmoded technology, lack of market and profit driven focus, non-competitive products, over-staffing, poor management and lack of accountability. In 1997, there were 6,599 loss-making state-owned enterprises in the industrial sector and their total losses amounted to Rmb 83.1 billion. In 1997, the government proposed a rescue plan to relieve these loss-making enterprises from their predicament through reorganization, reform, debt-equity swaps and enhancement of corporate management. The government also provided significant financial support to these state-owned enterprises. For instance, the four state-owned commercial banks wrote off approximately Rmb 117.6 billion in bad loans to these enterprises from 1998 to 2000. By the end of 2000, the four state-owned commercial banks transferred nearly Rmb 1,400 billion of their non-performing loans to four asset management companies. Among these non-performing loans, approximately Rmb 240 billion was converted into equity in 578 state-owned enterprises. As a result, approximately 77.7% of the 6,599 large and medium-sized loss-making state-owned enterprises registered in 1997 were taken off from the list of financially troubled state-owned enterprises in 2000. The losses incurred by loss-making state-owned enterprises decreased from Rmb 83.1 billion in 1999 to Rmb 67.0 billion in 2004. State-owned enterprises collectively generated a net profit of Rmb 531.2 billion in 2004, representing an increase of 38.5% over 2003.

Since 1984, the government has significantly reduced or eliminated mandatory production quotas imposed on state-owned enterprises and pricing controls over most products, permitting these enterprises to sell a larger proportion of their products at prices generally determined by the market. Managers of state-owned enterprises have been granted more decision-making authority, including greater power with respect to the planning, production, marketing, capital-raising, expenditures, employment and compensation of employees. The government has also taken measures to enhance corporate governance at large state-owned enterprises. In a pilot program, the State Council restructured approximately 2,700 state-owned enterprises by the end of 2002 in an attempt to modernize their corporate management system. Many state-owned enterprises have been privatized or listed on domestic and international stock exchanges. Other enterprise reform measures include enactment of new laws and regulations to address the increasingly complex economic activities in China, such as the Bankruptcy Law of 1987 and the Company Law of 1994.

The government believes that the state-owned enterprise reform program must include liquidation through bankruptcy proceedings of companies that are not competitive, have a history of significant losses and have no possibility of recovery. In 1994, the government began a pilot project aimed at restructuring debt-ridden or loss-making enterprises. During 1996 and 1997, 1,774 enterprises were liquidated while 2,214 enterprises were merged.

In November 2002, the government announced further measures to reform its state-owned sector by allowing foreign investors to acquire equity interests in state-owned enterprises. These policy initiatives encourage state-owned enterprises to attract and work with foreign investors to establish modern enterprise systems, improve management structures, increase market compatibility and achieve sustainable growth. The government will continue to restructure China's state-owned enterprises, including liquidation of loss-making enterprises, and will continue to manage the process in order to minimize their negative impact on society, especially with respect to unemployment and the general standard of living.

Prior to the completion of the state-owned enterprise reforms, it is likely that the government will continue to provide significant additional support to such enterprises, their employees and creditors, and that state-owned commercial banks and policy banks will continue to provide loans to state-owned enterprises.

The following table presents information relating to mining and resources production for the periods indicated.

### Mining and Resources Production

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Coal (in millions of tons) . . . . .	1,000.0	1,160.0	1,380.0	1,667.0	1,956.0
Crude Oil (in millions of tons) . . . . .	163.0	164.0	167.0	169.6	175.0
Natural Gas (in billions of cubic meters) . . . . .	27.2	30.3	32.7	35.0	41.5
Electrical Power Generation (in billions of kilowatt hours) . . . . .	1,355.6	1,480.8	1,654.0	1,910.6	2,187.0
Pig Iron (in millions of tons) . . . . .	131.0	155.5	170.9	213.7	251.9
Steel (in millions of tons) . . . . .	128.5	151.6	182.4	222.3	272.8
Finished Steel (in millions of tons) . . . . .	131.5	160.7	192.5	241.1	297.2
Coke (in millions of tons) . . . . .	121.8	131.3	142.8	177.8	177.5
Timber (in millions of cubic meters) . . . . .	47.2	45.5	44.4	47.6	N/A
Cement (in millions of tons) . . . . .	597.0	661.0	725.0	862.1	970.0

*Source: China Statistical Yearbooks of 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China.*

*Energy.* According to the statistics published by the National Bureau of Statistics of China, China is the world's largest coal producer and relies on coal as its principal source of energy. China produced 1,956.0 million metric tons of coal in 2004. China also produced 175.0 million metric tons of crude oil and 41.5 billion cubic meters of natural gas in 2004. The aggregate investment in fixed assets in China's electric and heating power in 2004 was Rmb 480.9 billion, a 45.5% increase over 2003.

Increasing energy production continues to be a priority for China. China's electric power industry has experienced relatively rapid development in recent years, with total electric power generation reaching 2,187.0 billion kilowatt-hours in 2004. Currently, coal-fired electric power generation is the primary source of energy in China. However, China has been developing other sources of electric power generation. As of July 2004, nine nuclear power units were in commercial operation in China with an aggregate installed capacity of 7,010 megawatts. China has also been developing more hydroelectric power. In April 1992, the National People's Congress approved the construction of the Three Gorges Dam and related projects, including hydroelectric power generating facilities which are expected to have an installed capacity of 18,200 megawatts and an annual generation of 84.7 billion kilowatt-hours. This project is expected to take at least 17 years to complete. If completed according to current plans, the Three Gorges Dam will have the largest generating capacity among the world's existing hydroelectric facilities. The Three Gorges Dam will also help relieve the periodic flooding in certain provinces along the Yangtze River. Facilities established under the Three Gorges project started to store water and generate power in 2003. At the end of 2004, the aggregate investment in the Three Gorges project reached Rmb 111.4 billion and 11 generator groups were in operation.

In order to separate power generation and power transmission and to introduce competition into the power industry, the government formed two electric grid network companies, five power generation groups and four auxiliary power related companies in 2002. The China Power Regulatory Commission was established in March 2003 to supervise China's power industry. The creation of the China Power Regulatory Commission and the restructuring of the power sector ended the traditional administrative management in the power sector and introduced a new regulatory and management framework tailored to the requirements of a market economy.

In July 1998, the government established China National Petroleum (Group) Corporation and China Petrochemical (Group) Corporation as part of the asset reallocation and restructuring of China's petroleum and petrochemical industry. Both restructured companies are integrated oil companies with upstream and downstream operations in petrochemical production and marketing and exporting of oil and petrochemical products. In April and October 2000, PetroChina and Sinopec, operating subsidiaries of the two oil companies, completed their

respective initial public offerings in the international capital markets. In February 2001, CNOOC Limited, the largest Chinese offshore oil company, also completed its initial public offering in the international capital markets.

The following table presents China's annual energy production information and China's annual energy consumption for the periods indicated.

<b>Energy Production and Consumption(1)</b>					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Total Energy Production(%)					
Coal .....	66.6%	68.6%	71.2%	74.5%	75.6%
Oil .....	21.8	19.4	17.3	15.1	13.5
Electric .....	8.2	8.7	8.4	7.5	7.9
Natural Gas .....	<u>3.4</u>	<u>3.3</u>	<u>3.1</u>	<u>2.9</u>	<u>3.0</u>
Total .....	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
Total Energy Production (in millions of metric tons of SCE).....					
	1,069.9	1,209.0	1,383.7	1,599.1	1,846.0
Total Energy Consumption (in millions of metric tons of SCE).....					
	1,303.0	1,349.1	1,482.2	1,709.4	1,970.0

(1) Excludes bio-energy, solar, geothermal and nuclear energy. All fuels have been converted to Standard Coal Equivalent, or SCE, under which 1 kg of coal = 0.714 kg of SCE; 1 kg of oil = 1.43 kg of SCE; 1 cubic meter of natural gas = 1.33 kg of SCE. Hydroelectric power is converted to SCE based on coal required to produce equivalent thermal external-electric power. The amounts by which consumption exceeded production were covered by reserves and imports.

Source: *China Statistical Abstract of 2005, the National Bureau of Statistics of China.*

Electricity demand and consumption in the PRC have increased significantly over the past several years due to rapid economic growth and increased industrial activity. This increasing demand for and consumption of electricity have brought about a severe power shortage in the PRC. Since 2003, power shortages have plagued many provinces throughout the country because the rate of increase in demand for and consumption of electricity have far exceeded the corresponding rate of increase in power generation and supply.

In order to resolve the current imbalance between the demand for and supply of coal, power, oil, transportation and important raw materials, the government has taken measures to accelerate construction of large-scale coal mines, improve coal transportation, explore and utilize other power sources, improve power transmission network and increase production and importation of crude oil.

In order to promote the development and utilization of recyclable energy, increase energy supply and improve energy policy, China adopted its Law on Recyclable Energy in February 2005. According to this law, the government will give priority to the development and utilization of recyclable energy and encourage the establishment and development of a recyclable energy market. This law will take effect on January 1, 2006.

### **Construction**

The construction sector consists primarily of infrastructure development, commercial property development and residential housing development. In 2004, GDP attributable to the construction sector was Rmb 957.2 billion, representing 7.0% of China's total GDP and an increase of 8.1% over 2003. In order to address the demands of rapid economic growth and help maintain a high employment rate, the government continues to devote substantial resources to infrastructure projects such as public roads, railways, bridges, urban mass transit systems, water resource facilities, energy facilities and environmental facilities. See "— Public Finance — The State Budget." At the end of 2004, enterprises in the construction sector employed approximately 3.4% of China's total work force.

## Tertiary Sector

The tertiary sector is composed of services as well as other segments of the economy that are not included in either the primary or secondary sector, such as transportation, postal and telecommunications services, retail sales, real estate, financial services, insurance, education, tourism and entertainment. In 2004, the tertiary sector accounted for approximately 31.9% of China's total GDP, representing an 8.3% over the previous year. From 2000 to 2004, the total number of people employed by the tertiary sector as a percentage of the total work force increased from 27.5% to 30.6%, or from 198.2 million to 230.1 million. In the second quarter of 2003, however, China's tourism, entertainment, catering service and transportation industries experienced difficulties and suffered losses due to the outbreak of SARS. GDP attributable to the tertiary sector increased only 0.8% during that quarter. The growth of the tertiary sector in 2003 slowed down with a modest increase by 0.8% over the previous year due to the outbreak of SARS. In 2004, GDP attributable to the tertiary sector reached Rmb 4,372.1 billion, which represented an increase of 8.3% over the previous year.

The following table presents the proportion of GDP contributed by each segment of the tertiary sector on an annual basis for the periods indicated.

**Contribution of the Tertiary Sector to GDP**

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in percentages)				
Commerce(1) . . . . .	8.2%	8.1%	8.1%	7.9%	7.4%
Transportation, Postal and Telecommunications . . . . .	6.0	6.1	6.1	5.7	5.6
Other(2) . . . . .	<u>19.2</u>	<u>19.9</u>	<u>20.1</u>	<u>19.8</u>	<u>18.9</u>
Total . . . . .	<u>33.4%</u>	<u>34.1%</u>	<u>34.3%</u>	<u>33.4%</u>	<u>31.9%</u>

(1) Includes retail, wholesale and catering services.

(2) Includes insurance, financial services, real estate, education, tourism, entertainment and other services.

Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.

### Transportation

**Rail.** Rail is one of China's most important means of long-distance transportation, and in 2004, represented approximately 35.0% and 27.8% of total passenger and cargo transportation, respectively in terms of passenger-kilometers and cargo-kilometers transported. At the end of 2004, the central government owned and operated 61,015 kilometers of railroad tracks. In addition, local governments or sino-foreign joint ventures also owned and operated some railroad tracks. China is currently constructing additional railways in the western regions of China, including the Qingzang Railway from Qinghai to Tibet, which is 1,118 kilometers long, with 600 kilometers of tracks laid on perennial frozen soil and more than 960 kilometers located at over 4,000 meters above sea level. Construction of the Qingzang Railway began in June 2001 and is expected to be completed by 2007. By the end of 2004, the construction of Qingzang Railway had completed laying 743 kilometers of tracks, representing 66.5% of its total track length.

**Roadways.** At the end of 2004, there were approximately 1.9 million kilometers of paved roads. In addition, the mileage of highways reached 34,300 kilometers in 2004. All of the counties and almost all of the towns throughout China are now reachable by roads. Road transportation has become more important in recent years, representing approximately 53.6% and 11.3% of total passenger and cargo traffic, respectively, in 2004, in terms of passenger-kilometers and cargo-kilometers transported.

**Airlines.** Air transportation represented approximately 10.9% and 0.1% of total passenger and cargo transportation, respectively, in 2004, in terms of passenger-kilometers and cargo-kilometers transported. The distance covered by Chinese airlines on domestic and international commercial routes was approximately 2.0 million kilometers in 2004. Passenger air travel in China increased from 67.2 million passengers in 2000 to 121.2 million passengers in 2004. The State Council approved a Civil Aviation System Reform Plan in March



2002. This plan resulted in the establishment of three independent air transportation groups, China Airlines Group, China Eastern Airlines Corporation Limited and China Southern Airlines (Group), and three air service companies, including China Civil Aviation Information Group. These six group companies were established on the basis of nine commercial airlines and four air service companies, all of which were previously under the direct control of the General Administration of Civil Aviation of China, or CAAC. Their establishment marked an important step by the CAAC to separate these enterprises from the government. In January 1997 and July 1997, China Eastern Airlines Corporation Limited and China Southern Airlines (Group) completed their respective initial public offerings in the international capital markets. The CAAC now only serves as the regulator of civil aviation affairs in China. The Chinese airline industry is also undergoing a consolidation process, with a number of smaller airlines being merged into or acquired by larger airlines. In June 2002, the government issued regulations to further open the civil aviation industry to overseas investment. In December 2004, Air China Limited completed its initial public offering in the international capital markets.

*Waterways and Sea Transportation.* Waterway transportation represented approximately 0.4% and 59.7% of total passenger and cargo traffic, respectively, in 2004, in terms of passenger-kilometers and cargo-kilometers transported. There are four principal waterway systems in China: the Yellow River in the north, the Yangtze River in central China, the Pearl River in the south, and the Beijing-Hangzhou Grand Canal.

### ***Postal and Telecommunications***

Driven by China's rapid economic growth, the postal and telecommunications sector has experienced substantial growth in recent years, with total revenue increasing from Rmb 479.3 billion in 2000 to Rmb 979.1 billion in 2004. Furthermore, the number of telephones increased from 144.8 million in 2000 to 312.4 million in 2004. Mobile telecommunications services, data transmission and express mail services have also developed rapidly in recent years. In particular, the number of mobile subscribers increased from approximately 84.5 million at the end of 2000 to 334.8 million at the end of 2004 making China the country with the world's largest number of mobile subscribers. At the end of 2004, overall telephone penetration nationwide reached approximately 50.8% of China's total population and mobile phone penetration nationwide reached approximately 25.8% of China's total population.

Prior to 1994, government-controlled entities held a monopoly over China's telecommunications networks. In order to introduce competition into the telecommunications industry, the government has taken various measures since 1994 to break up the monopoly. The government initially reorganized the industry by permitting the establishment of a number of telecommunications companies. Subsequently, the government separated China's telecommunications business into four independent sectors: fixed line, mobile, satellite and paging. In October 1997, China, for the first time, permitted foreign investors to invest in the telecommunications sector through the initial public offering of China Mobile (Hong Kong) Limited, a mobile telecommunications operator in China, in the international capital markets. In June 2000, China Unicom Limited, another mobile telecommunications operator in China, completed its initial public offering in the international capital markets. In May 2002, the Chinese government separated China Telecom Group, a fixed line telecommunications service provider, into two companies, with the southern company retaining the name of China Telecom Group and assets and businesses in 21 provinces in southern and western China and the northern company retaining assets and businesses in 10 provinces in northern China and merging with China Netcom Corporation Ltd. and Jitong Network Communications Company Limited to form China Netcom Group. In November 2002 and November 2004, China Telecom Corporation Limited and China Netcom Group Corporation (Hong Kong) Limited completed their respective initial public offerings in the international capital markets.

In the past few years, the government has also adopted laws and regulations to encourage and regulate different forms of foreign investment in China's basic and value-added telecommunications businesses. China's commitments made in connection with its accession to the WTO will further open up China's telecommunications sector to foreign investment and competition.

## *Commerce*

Commerce includes retail, wholesale and catering services. Total sales of commodities increased from Rmb 9,944.6 billion in 2003 to Rmb 11,407.1 billion in 2004, an increase of 14.7%. Total retail sales of consumer goods increased from Rmb 4,584.2 billion in 2003 to Rmb 5,395.0 billion in 2004, an increase of 17.7%. In the past, state-owned enterprises conducted the majority of the businesses in the commerce sector. In recent years, the private sector has played an increasingly important role in this sector. For instance, total revenue of state-owned wholesale and retail enterprises was Rmb 1,562.1 billion in 1999, representing approximately 65.0% of the total wholesale and retail revenue nationwide. In 2003, revenue of state-owned wholesale and retail enterprises decreased to Rmb 1,375.9 billion, representing approximately 32.8% of the total wholesale and retail revenue in China. In the catering sector, state-owned enterprises generated Rmb 8.5 billion in revenue in 1999, or 24.0% of the total national catering revenue. In 2003, the catering revenue of state-owned enterprises was Rmb 7.0 billion, or 9.3% of the total national catering revenue.

China's WTO commitments call for the gradual phase-out of restrictions on foreign investment in retail businesses. Since China's entry into the WTO, foreign companies have been allowed to establish joint ventures in five special economic zones and eight cities in China to engage in retail services. Since the end of 2003, foreign investors were permitted to hold majority interests in such joint ventures, and more cities were opened to foreign investment and competition. Since December 11, 2004, China has permitted foreign investors to establish wholly foreign owned retail business in China and lifted all the geographic restrictions previously imposed on foreign investment in retail business.

## *Other*

This part of the tertiary sector includes insurance, financial services, real estate, education, tourism and entertainment. The government encourages the development of tourism, an industry that accounted for approximately 5.0% of China's GDP in 2004 with total revenue of Rmb 684.1 billion. As living standards in China improved, the number of domestic tourists traveling within China increased from 744 million in 2000 to 1,102 million in 2004. The number of Chinese traveling abroad also increased from 10.5 million to 28.9 million during the same period.

The real estate industry has been growing rapidly in China in recent years. This was primarily due to the continued economic growth in China as well as the government's housing reform program. In particular, total investments in real estate development was Rmb 1,315.8 billion in 2004, an increase of 29.6% over 2003. Total sales of commercial buildings reached Rmb 1,037.6 billion in 2004, an increase of 30.4% over 2003. Total completed floor space increased from 414.6 million square meters in 2003 to 424.7 million square meters in 2004, an increase of 2.4%. Total floor space of commercial buildings sold in 2004 was 382.3 million square meters, an increase of 13.4% over 2003.

## **Employment and Wages**

China had an urban work force of 264.8 million people at the end of 2004. In recent years, reforms at state-owned enterprises and migration of farmers into urban areas have added pressure on China's employment market. The government has called on all government agencies to foster better employment opportunities and to try to maintain China's unemployment rate at approximately 5% during the period from 2001 through 2005. State-owned enterprises employed approximately 25.3% of China's total urban work force at the end of 2004. The non-state-owned sector employed approximately 74.7% of the total urban work force at the end of 2004.

The following table presents annual information on China's employed work force for the periods indicated.

### Composition of PRC Employed Work Force

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in millions)				
Urban Work Force					
State Sector(1) . . . . .	81.0	76.4	71.6	68.8	67.1
Private Enterprises . . . . .	12.7	15.3	20.0	25.5	29.9
Self-employed Individuals . . . . .	21.4	21.3	22.7	23.8	25.2
Limited Liability Companies . . . . .	6.9	8.4	10.8	12.6	14.4
Collectively Owned Enterprises . . . . .	15.0	12.9	11.2	10.0	9.0
Joint Stock Companies . . . . .	4.6	4.8	5.4	5.9	6.3
Foreign-invested Enterprises . . . . .	3.3	3.5	3.9	4.5	5.6
Hong Kong, Macau & Taiwan Invested Enterprises . .	3.1	3.3	3.7	4.1	4.7
Other(2) . . . . .	<u>83.5</u>	<u>93.5</u>	<u>98.5</u>	<u>101.2</u>	<u>102.6</u>
Total Urban Work Force . . . . .	231.5	239.4	247.8	256.4	264.8
Rural Work Force . . . . .	<u>489.3</u>	<u>490.9</u>	<u>489.6</u>	<u>487.9</u>	<u>487.2</u>
Total . . . . .	<u>720.9</u>	<u>730.3</u>	<u>737.4</u>	<u>744.3</u>	<u>752.0</u>

(1) Includes state-owned enterprises, central and local governments and other public institutions.

(2) Includes employees at any other forms of enterprises not specified above, including cooperative enterprises and joint ownership enterprises.

Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.

China calculates its urban unemployment rate based on the percentage of the urban work force that registers with local employment agencies as being unemployed. China currently does not collect statistical data relating to rural unemployment or persons residing in, but not registered as residents of, urban areas.

The following table presents information relating to China's urban work force unemployment rate at the dates indicated.

### Registered Urban Work Force Unemployment Rate

	At December 31,				
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Total Number of Persons Unemployed in Urban Work Force (in thousands) . . . . .	5,950.0	6,810.0	7,700.0	8,000.0	8,270.0
Registered Urban Unemployment Rate . . . . .	3.1%	3.6%	4.0%	4.3%	4.2%

Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.

The registered urban unemployment rate in China has increased from 3.1% in 2000 to 4.2% in 2004, due in part to the government's decision to reform and privatize state-owned enterprise and to end guaranteed life-time employment for the employees of such entities. Further reforms of state-owned enterprises are expected to result in more unemployed and "idled" employees (those who keep their employee status but receive reduced compensation). At the end of 2004, there were approximately 8.3 million registered unemployed people in urban areas.

The government has launched various initiatives to address the increase in unemployed and idled workers. In 1996, the government initiated a "re-employment program" in 200 cities with more than 1,300 re-employment service centers established to provide job training and job opportunity information. In 2004, 5.1 million former employees of state-owned enterprises found new jobs. Since 1999, the government has been expanding the

coverage of national and local unemployment insurance schemes, which provided relief to 4.2 million people in 2004. In October 1999, the State Council promulgated the Rules of Minimum Living Standards for Urban Residents to provide relief to urban residents if their household income falls below their applicable minimum living standards. This program provided relief totaling Rmb 17.3 billion to 22.1 million people in 2004.

The following table presents information relating to average annual wages in China for certain sectors and certain types of enterprises for the periods indicated.

#### Average Annual Wages of Staff and Workers(1)

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in Rmb)				
<b>By Sector</b>					
Scientific Research . . . . .	13,620	16,437	19,113	20,636	23,593
Transportation, Postal and Telecommunications . . . . .	12,319	14,167	16,044	15,973	18,381
Government Agencies . . . . .	10,043	12,142	13,975	15,533	17,609
Education, Culture and Arts(2) . . . . .	9,482	11,452	13,290	14,399	16,277
Manufacturing Industry . . . . .	8,750	9,774	11,001	12,496	14,033
Primary Sector . . . . .	5,184	5,741	6,398	6,969	7,611
<b>By Ownership</b>					
Foreign-invested Enterprises(3) . . . . .	14,372	16,101	17,892	19,366	20,440
State Sector(4) . . . . .	9,552	11,178	12,869	14,577	16,729
Hong Kong, Macau and Taiwan Invested Enterprises . . . . .	11,914	12,544	13,756	14,691	15,727
Collectively Owned Enterprises . . . . .	6,262	6,867	7,667	8,678	9,814
Overall Weighted Average . . . . .	9,371	10,870	12,422	14,040	16,024

(1) Data concerning wages do not include the value of certain significant benefits, including benefits relating to housing, medical care and education, which were made available to employees by the government and other employers to a varying degree over the years.

(2) Data of 2003 did not include culture and arts.

(3) Not including Hong Kong, Macau and Taiwan invested enterprises.

(4) Includes state-owned enterprises, central and local governments and other public institutions.

Sources: China Statistical Yearbook of 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China; the Ministry of Finance.

The following table presents the percentage increases in average annual real wages (adjusted for inflation) in China for the periods indicated.

#### Change in Annual Average Real Wages

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in percentages)				
State Sector(1) . . . . .	10.9%	16.2%	16.3%	12.3%	11.1%
Urban Collectively Owned Enterprises . . . . .	7.6	8.9	12.7	12.2	9.5
Other(2) . . . . .	10.9	9.7	9.9	9.3	8.0
Overall . . . . .	11.4%	15.2%	15.5%	12.0%	10.5%

(1) Includes state-owned enterprises, central and local governments and other public institutions.

(2) Includes, among other things, privately owned enterprises and foreign-invested enterprises.

Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.

## **Housing Reforms**

In the past, staff and workers of state-owned enterprises and employees of the central and local governments and other public institutions, as part of their compensation, were provided with free or substantially subsidized housing. As part of the housing reform program, this practice ended in 1998. In a series of housing reforms, the government aims to establish a viable and affordable housing market, to stimulate domestic consumption and to gradually relieve the government and state-owned enterprises of the responsibility to provide public housing. In 2004, financial institutions increased their residential mortgage loans to approximately Rmb 1,600.0 billion, representing an increase of 34.1% from 2003. The aggregate investment nationwide in real estate development amounted to Rmb 1,315.8 billion in 2004, representing a 29.6% increase over 2003, of which investment in residential housing was Rmb 883.7 billion in 2004, representing a 30.4% increase over 2003. Due to China's large population, rapid urbanization and continued shortages of financial and other resources, the government expects that its housing reform will be a long and difficult process. The government, however, believes that the continued steady growth of the economy and the success of the government's reform programs in other areas will enable it to continue to make substantial progress in its housing reforms.

## **Social Security System**

China's social security system comprises pension, unemployment insurance and medical insurance. The system requires participation by employers, individual employees and the government. It provides benefits at different levels, combines social pooling with individual accounts under a unified administration, and provides benefits commensurate with the funding responsibilities. As part of the government reorganization initiated in 1998, the government established the Ministry of Labor and Social Security to implement and administer the social security system in China.

The nationwide pension system was initially established with the participation of state-owned and collectively owned enterprises, and has since expanded to cover employees at foreign-invested enterprises, private enterprises and self-employed individuals. As of December 31, 2004, 163.5 million urban employees and retirees participated in such pension programs. Total contributions to such pension funds nationwide amounted to Rmb 425.8 billion at December 31, 2004, of which a total of Rmb 350.2 billion was disbursed in 2004.

The on-going reforms of state-owned enterprises have resulted in an increasing number of unemployed and idled employees. China has been widening the scope of its national unemployment insurance scheme and has introduced various methods for improved allocation of unemployment benefits to address this situation. In January 1999, the government promulgated rules to require the establishment of unemployment insurance by every enterprise and institution in urban areas, including foreign-invested enterprises and privately owned enterprises. Contributions from individual employees, employers and government subsidies provided funding for the insurance programs. At the end of 2004, approximately 105.8 million people participated in unemployment insurance programs. Total contributions to unemployment insurance nationwide amounted to Rmb 29.1 billion at December 31, 2004, of which a total of Rmb 21.1 billion was disbursed in 2004.

The government has also implemented a nationwide minimum living standard program. In October 1999, the government promulgated a set of rules requiring local governments to make relief available to urban residents if their household income falls below minimum levels set for their geographical regions. At the end of 2004, all cities and counties were participants in the minimum living standard program, which provided relief totaling Rmb 17.3 billion to 22.1 million people in 2004.

The medical insurance system has also been subject to reform. In December 1998, the State Council issued an ordinance requiring all enterprises and institutions in urban areas to participate in the basic medical insurance scheme. The insurance scheme covers all urban employees and is financed through contributions by both employees and employers. The basic medical insurance scheme requires the establishment of an individual account and a social pooling account. At the end of 2004, approximately 124.0 million people had participated in the basic medical insurance scheme. Total contributions to the basic medical insurance nationwide amounted to Rmb 114.1 billion, of which a total of Rmb 86.2 billion was disbursed in 2004.

In September 2000, the government decided to establish a National Social Security Fund to be financed through appropriations of the state budget, proceeds from sales of state assets and funds raised through other means. This national fund will support existing social security networks in China as well as provide liquidity support to the national social security system and provide supplemental funding in the event of social security emergencies. The State Council has set up a National Social Security Fund Management Council to manage the social security fund. In December 2001, the Ministry of Finance and the Ministry of Labor and Social Security jointly announced rules, measures and administrative procedures to regulate investments by social security funds in capital markets and to establish standards for supervising managers of social security funds. At the end of 2004, 10 fund management companies had received permission to become the social security fund managers in China. By the same date, the national social security funds had accumulated approximately Rmb 165.7 billion in terms of net assets.

## **Environment**

China's rapid economic development has led to a range of environmental and ecological problems, including industrial and agricultural pollution, ocean dumping and water pollution, illegal waste disposal, depletion of forest resources and desertification. The National People's Congress promulgated the Environmental Protection Law in December 1989 to supersede the statute's predecessor version, the Environmental Protection Law (Trial Version) of 1979. In addition, China has passed laws on air, solid waste, water and noise pollution. China also continues to cooperate with international environmental initiatives. In accordance with the United Nations Conference on Environment and Development, China has proposed a number of programs and measures for environmental protection, which include energy-saving and environmental protection measures.

Currently, the central and local governments fund most of the forest development, environmental conservation and water and sewage treatment facilities. China also seeks funding from international and multilateral organizations in order to further develop environmental programs in areas such as water pollution, depletion of the ozone layer and deforestation. In addition, industrial enterprises generally must devote a percentage of their expenditures on environmental protection associated with their facilities. Under current government policies, enterprises that cause pollution in excess of emission or discharge standards prescribed by the central government are required to adopt corrective and remedial measures or face penalties or closure. In recent years, the government has ordered the suspension or closing of many enterprises that were classified as sources of serious environmental pollution. In 2003, a total of 11,499 companies were shut down or relocated by the government due to pollution problems. In 2003, the government ordered 27,628 polluting entities to complete their reparation and remedial work for environmental protection within a time limit set by the government. A total of Rmb 12.3 billion was used for such purposes during the same year. Nevertheless, implementation has lagged behind government regulatory initiatives. The government intends to continue its efforts to implement and enforce its environmental laws and regulations.

During the period between 1998 and 2002, the government spent a total of Rmb 580 billion for environmental protection and ecological development. This included six forestry-related ecological projects, such as reforestation of recovered farmland, protection of natural forests, and treatment and control of dust storm sources. In 2003, the government spent a total of Rmb 162.8 billion, or 19.1% more than it did in 2002, on environmental protection and ecological development. Of this total environmental expenditure in 2003, urban environmental infrastructure construction amounted to Rmb 107.2 billion and industrial pollution control amounted to Rmb 22.2 billion. By the end of 2004, 2,194 nature reservations had been established across China, with an aggregate area of 148.2 million hectares, or approximately 14.8% of China's total land area.

In September 2003, another important legislation on environmental protection, the Law on Environmental Impact Assessment, went into effect in China. This new law aims to further enhance the evaluation procedures with respect to environmentally sensitive projects during their feasibility study stages. In particular, this law sets forth an environmental impact assessment procedure that involves not only the relevant governmental agencies and project developers, but also industry and environmental experts as well as the public.

## **Foreign Investment**

Since China promulgated its first joint venture law in 1979, it has adopted a broad range of related laws, administrative rules and regulations, providing a framework for the conduct and regulation of foreign investment activities. These include the Law on Sino-Foreign Equity Joint Ventures (1979), the Law on Sino-Foreign Cooperative Joint Ventures (1988), the Law on Wholly Foreign Owned Enterprises (1986), the Contract Law (1999), the Trademark Law (1982), the Patent Law (1984) and the Copyright Law (1990). The government believes that providing a stable and receptive environment for foreign direct investment will accelerate the inflow of foreign capital, technology and management techniques.

Foreign investment, including investment from Hong Kong, Macau and Taiwan, in China can take a number of forms, including equity joint ventures, cooperative joint ventures and wholly foreign owned enterprises. These entities are commonly known as “foreign-invested enterprises.” In an equity joint venture, the Chinese and foreign partners share profits and losses in proportion to their respective equity interest, whereas in a cooperative joint venture, profits and losses may be distributed and shared in a different fashion as agreed by the joint venture partners. Cooperative joint ventures are not necessarily PRC legal persons although many cooperative joint ventures can attain such status. If a cooperative joint venture is not a PRC legal person, each PRC and foreign owner is responsible for taxes on the profits it derives from the venture and each owner is liable for its portion of any risks and losses. A wholly foreign owned enterprise is owned solely by one or more foreign investors.

In April 1995, the government promulgated the Provisional Regulations for the Establishment of Chinese Holding Companies by Foreign Investors to provide legal guidance to foreign investors who intend to engage in direct investments in China through wholly foreign owned enterprises or sino-foreign equity joint ventures. To assist foreign investors in identifying areas of investment consistent with China’s development needs, the government issued the Provisional Rules on Directing Foreign Investment and the Guidelines on Industries Open to Foreign Investment in June 1995. These provisions serve to identify industries in which foreign investments are permitted, encouraged, restricted or prohibited. In March 2002 and November 2004, the government updated the Guidelines on Industries Open to Foreign Investment respectively to comply with its WTO commitments with respect to foreign investments in specified industries. In July 2004, the State Council promulgated its Decision on Reform of Investment System to further simplify the foreign investment ratification process in China and give local governments greater authority in the approval process.

In 1998, the government eliminated all tariffs and import-related value-added taxes on certain raw material and equipment imports by foreign investors in investment projects encouraged by the government. The government also opened new industries to foreign investments such as petrochemicals, construction, mining, maritime transportation and certain service industries. In addition, the government streamlined the approval process for foreign-invested enterprises and prohibited local authorities from imposing arbitrary fees on foreign investors. In June 1999, the government announced a set of incentives to foreign investors in China’s high technology industry, including tariff exemptions, export rebates and income tax exemptions. To develop China’s western regions and balance inter-regional economic growth, the central government adopted policies and economic incentives to encourage foreign investments into the western regions of China.

The following table presents information regarding annual foreign direct investment in China for the periods indicated. Foreign direct investment does not include investments in PRC companies listed on the Shanghai and Shenzhen stock exchanges or investments in PRC companies listed on the Hong Kong and other foreign stock exchanges. The following table also excludes international leasing, compensatory trade, processing and assembly, and investments in debt securities issued by PRC entities.

### Foreign Direct Investment in China

	2000	2001	2002	2003	2004
	(in millions of US\$)				
Actual Investment(1)					
Wholly Foreign-owned Enterprises	19,263.9	23,873.4	31,725.0	33,384.0	40,222.0
Equity Joint Ventures(2) . . . . .	14,343.1	15,738.9	14,992.0	15,392.0	16,386.0
Cooperative Joint Ventures(2) . . . . .	6,595.8	6,212.2	5,058.0	3,836.0	3,172.0
Others . . . . .	512.0	1,053.1	968.0	893.0	850.0
Total . . . . .	40,714.8	46,877.6	52,743.0	53,505.0	60,630.0
Contracted Investment(3) . . . . .	62,379.5	69,194.6	82,768.0	115,070.0	153,479.0

- (1) Reflects amounts disbursed during the relevant period.
- (2) Represents amounts contributed by foreign investors.
- (3) Reflects amounts committed during the relevant period.

*Sources: China Statistical Yearbooks of 2002 and 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China; the Ministry of Finance.*

Foreign capital inflows, including foreign loans, foreign direct investment and other foreign investment reached US\$64.1 billion in 2004. During 2004, the contracted amount of foreign direct investment totaled US\$153.5 billion, representing a 33.4% increase as compared with 2003, while actual disbursements totaled US\$60.6 billion, representing an increase of 13.3% over 2003.



The following table sets forth information regarding the source of foreign direct investment by country or region for the periods indicated.

**Foreign Direct Investment by Country or Region**

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in millions of US\$)				
Hong Kong and Macau .....	15,847.3	17,038.4	18,329.3	18,116.7	19,544.7
Republic of Korea .....	1,489.6	2,151.8	2,720.7	4,488.5	6,247.9
Japan .....	2,915.9	4,348.4	4,190.1	5,054.2	5,451.6
United States .....	4,383.9	4,433.2	5,423.9	4,198.5	3,941.0
Taiwan .....	2,296.6	2,979.9	3,970.6	3,377.2	3,117.5
Singapore .....	2,172.2	2,143.6	2,337.2	2,058.4	2,008.1
Germany .....	1,041.5	1,212.9	928.0	857.0	1,058.5
Netherlands .....	789.5	776.1	571.8	725.5	810.6
United Kingdom .....	1,164.1	1,051.7	895.8	742.5	792.8
Australia .....	308.9	335.6	380.7	592.5	662.6
France .....	853.2	532.5	575.6	604.3	656.7
Canada .....	279.8	441.3	588.0	563.5	613.9
Italy .....	209.5	220.0	176.7	316.7	280.8
Thailand .....	203.6	194.2	187.7	173.5	178.7
Other Countries and Regions(1) .....	<u>6,759.2</u>	<u>9,018.0</u>	<u>11,466.8</u>	<u>11,635.7</u>	<u>15,262.4</u>
Total .....	<u>40,714.8</u>	<u>46,877.6</u>	<u>52,742.9</u>	<u>53,504.7</u>	<u>60,627.7</u>

(1) Includes more than 50 countries and regions with lower investment levels than those shown above.

Sources: China Statistical Yearbooks of 2002 and 2004, the National Bureau of Statistics of China; the Ministry of Finance.

## PRC Foreign Trade and Balance of Payments

### Foreign Trade

China's foreign trade has grown significantly since 1978 in terms of both value and range of products traded. Overall foreign trade policy is formulated by the central government. However, local governments and enterprises enjoy increasing autonomy in conducting foreign trade activities. Individuals and privately owned enterprises can now import and export goods. The government believes that China's accession to the WTO has further enhanced its trade relationships with other countries and regions.

The following table presents information relating to China's foreign trade for the periods indicated.

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in billions of US\$, except for percentages)				
Exports .....	249.2	266.1	325.6	438.2	593.4
Imports .....	225.1	243.6	295.2	412.8	561.4
Balance of Trade .....	24.1	22.5	30.4	25.4	32.0
Exports as Percentage of Imports .....	110.7%	109.2%	110.3%	106.2%	105.7%
Exports as Percentage of GDP .....	23.1%	22.6%	25.6%	30.9%	35.9%

*Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.*

China's total foreign trade volume increased from US\$ 851.0 billion in 2003 to US\$ 1,154.8 billion in 2004. China's exports in 2004 increased by 35.4% to US\$ 593.4 billion and its imports increased by 36.0% to US\$ 561.4 billion, each as compared with 2003.

During the initial years after 1978, Chinese exports consisted mostly of primary goods. As a result of rapid industrial growth and the inflow of foreign capital, manufactured goods have become China's major exports in recent years. The composition of imports has also changed in recent years as imports of manufactured goods have steadily outpaced imports of primary goods. China has implemented a number of measures to maintain export growth. These measures include:

- granting export and import licenses to more companies, including privately owned enterprises;
- expanding the diversity of China's trading partners, especially countries in Latin America and Eastern Europe;
- improving the quality of China's exports and adjusting its export product mix;
- accelerating value-added tax rebates for exported goods of certain industries; and
- providing export credit support.

As a result and also due to the gradual recovery of the Asian economies from the 1997 Asian economic crisis, China's foreign trade volume increased over the past five years. In October 2003, the State Council decided to reduce most, and eliminate some, of the value-added tax rebates for exported goods in order to, among other things, increase competition in the import and export industry.

The following table sets forth the composition of China's exports for the years from 2000 through 2004.

#### Composition of Exports

	<u>2000</u>	<u>% of Total</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>% of Total</u>
	(in billion of US\$, except for percentage)						
<b>Primary Goods</b>							
Food . . . . .	12.3	4.9%	12.8	14.6	17.5	18.9	3.2%
Mineral Fuels, Lubricants & Related Materials . . . . .	7.9	3.2	8.4	8.4	11.1	14.5	2.4
Non-Food Raw Materials . . . . .	4.5	1.8	4.2	4.4	5.0	5.8	1.0
Beverages & Tobacco . . . . .	0.8	0.3	0.9	1.0	1.0	1.2	0.2
Animal & Vegetable Oil . . . . .	0.1	0.0	0.1	0.1	0.1	0.2	0.0
Subtotal . . . . .	25.5	10.2	26.3	28.5	34.8	40.6	6.8
<b>Manufactured Goods</b>							
Machinery & Transportation Equipment . . . . .	82.6	33.1	94.9	127.0	187.9	268.3	45.2
Miscellaneous Products . . . . .	86.3	34.6	87.1	101.2	126.1	156.4	26.4
Textiles, Light Industry Products & Raw Materials	42.6	17.1	43.8	53.0	69.0	100.7	17.0
Chemicals & Related Products . . . . .	12.1	4.9	13.4	15.3	19.6	26.4	4.4
Products Not Otherwise Classified . . . . .	0.2	0.1	0.6	0.6	1.0	1.1	0.2
Subtotal . . . . .	223.7	89.8	239.8	297.1	403.6	552.8	93.2
Total . . . . .	249.2	100.0%	266.1	325.6	438.2	593.4	100.0%

Source: China Statistical Yearbook of 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China.

The following table sets forth the composition of China's imports for the years from 2000 through 2004.

#### Composition of Imports

	<u>2000</u>	<u>% of Total</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>% of Total</u>
	(in billion of US\$, except for percentage)						
<b>Primary Goods</b>							
Non-Food Raw Materials . . . . .	20.0	8.9%	22.1	22.7	34.1	55.4	9.9%
Mineral Fuels, Lubricants & Related Materials . . . . .	20.6	9.2	17.5	19.3	29.2	48.0	8.6
Food . . . . .	4.8	2.1	5.0	5.2	6.0	9.2	1.6
Animal & Vegetable Oil . . . . .	1.0	0.4	0.8	1.6	3.0	4.2	0.7
Beverages & Tobacco . . . . .	0.4	0.2	0.4	0.4	0.5	0.6	0.1
Subtotal . . . . .	46.7	20.7	45.7	49.3	72.8	117.3	20.9
<b>Manufactured Goods</b>							
Machinery & Transportation Equipment . . . . .	91.9	40.8	107.0	137.0	192.9	252.6	45.0
Textiles, Light Industry Products & Raw Materials	41.8	18.6	41.9	48.5	63.9	74.1	13.2
Chemicals & Related Products . . . . .	30.2	13.4	32.1	39.0	49.0	65.7	11.7
Miscellaneous Products . . . . .	12.8	5.7	15.1	19.8	33.0	50.2	8.9
Products Not Otherwise Classified . . . . .	1.7	0.8	1.7	1.6	1.3	1.5	0.3
Subtotal . . . . .	178.4	79.3	197.8	245.9	340.1	444.1	79.1
Total . . . . .	225.1	100.0%	243.6	295.2	412.8	561.4	100.0%

Source: China Statistical Yearbook of 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China.

The following table sets forth data relating to the geographic distribution of China's trade for the years from 2000 through 2004 with respect to the major continents and selected countries and regions within some of the continents. The destination of exports is determined by the immediate destination of goods exported from China and the origination of imports is determined by the immediate country, region or territory from which goods are transported into China.

### Geographic Distribution of Trade

	2000		2001		2002		2003		2004	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
	(in billions of US\$)									
Asia .....	132.3	141.3	140.9	147.1	171.3	191.7	222.6	272.9	295.5	369.5
Japan .....	41.7	41.5	44.9	42.8	48.4	53.5	59.4	74.1	73.5	94.4
Taiwan .....	5.0	25.5	5.0	27.3	6.6	38.1	9.0	49.4	13.5	64.8
Hong Kong(1) .....	44.5	9.4	46.5	9.4	58.5	10.7	76.3	11.1	100.9	11.8
Europe .....	45.5	40.8	49.2	48.4	58.3	52.0	88.2	69.7	122.4	89.0
Germany .....	9.3	10.4	9.8	13.8	11.4	16.4	17.4	24.3	23.8	30.4
France .....	3.7	4.0	3.7	4.1	4.1	4.3	7.3	6.1	9.9	7.7
United Kingdom .....	6.3	3.6	6.8	3.5	8.1	3.3	10.8	3.6	15.0	4.8
North America .....	55.3	26.1	57.6	30.2	74.3	30.9	98.1	38.3	133.2	52.1
United States .....	52.1	22.4	54.3	26.2	69.9	27.2	92.5	33.9	124.9	44.7
Latin America .....	7.2	5.4	8.2	6.7	9.5	8.3	11.9	14.9	18.2	21.8
Africa .....	5.0	5.6	6.0	4.8	7.0	5.4	10.2	8.4	13.8	15.6
Oceania .....	3.9	5.9	4.1	6.3	5.3	6.8	7.3	8.6	10.2	13.3

(1) A significant portion of trade with Hong Kong involves goods which are re-exported to third countries or are imports which have originated from third countries.

Sources: *China Statistical Yearbooks of 2002, 2003 and 2004, the National Bureau of Statistics of China; the Ministry of Commerce.*

Based on the immediate source of imports and the immediate destination of exports, China's largest trading partners in 2004 were the United States, Europe, Hong Kong and Japan.

To diversify its foreign trade market, China is seeking to develop relationships with new trading partners, such as countries in Latin America and in Eastern Europe. In 2003, China also entered into closer economic partnership arrangements with Hong Kong and Macau for the purpose of enhancing economic and trade exchanges between mainland China and Hong Kong and Macau. In order to expand trade and increase competition, the PRC government has over the years relaxed the qualification requirements for privately owned enterprises to import and export goods and services. Starting in 2004, China has further lifted restrictions on the foreign trade rights of domestic enterprises and individuals as well as foreign invested enterprises in China in compliance with its WTO commitments. The Ministry of Commerce recently promulgated the Exporter and Importer Registration Method under Foreign Trade Law, which replaced the previous approval requirement with a system based on a filing and registration process. Individuals can also conduct foreign trade under the new rule.

### Balance of Payments

Balance of payments measures the relative flow of goods, services and capital into and out of China as represented in the current account balance and the capital account balance. The current account balance tracks China's trade in goods and services. The capital account balance covers all transactions involving the transfer of capital into and out of China, including securities investments, direct investments and loans. The overall balance represents the sum of the current account and capital account balances. An overall balance surplus indicates a net inflow of foreign currencies while an overall balance deficit indicates a net outflow of foreign currencies. If the overall balance is positive, the surplus, which represents China's savings, finances the overall deficit of China's trading partners.

The following table summarizes China's balance of payments and related statistics for the periods indicated.

<b>Balance of Payments</b>					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in billions of US\$)				
<b>Current Account</b>					
Exports .....	249.1	266.1	325.7	438.3	593.4
Imports .....	<u>214.7</u>	<u>232.1</u>	<u>281.5</u>	<u>393.6</u>	<u>534.4</u>
Foreign Trade Balance .....	34.4	34.0	44.2	44.7	59.0
Non-Trade Balance .....	(20.2)	(25.1)	(21.8)	(16.4)	(13.2)
Transfer Balance .....	<u>6.3</u>	<u>8.5</u>	<u>13.0</u>	<u>17.6</u>	<u>22.9</u>
Current Account Balance .....	<u>20.5</u>	<u>17.4</u>	<u>35.4</u>	<u>45.9</u>	<u>68.7</u>
<b>Capital Account</b>					
Direct Investment .....	37.5	37.4	46.8	47.2	53.1
Portfolio Investment .....	(4.0)	(19.4)	(10.3)	11.4	19.7
Other Investment(1).....	<u>(31.5)</u>	<u>16.9</u>	<u>(4.1)</u>	<u>(5.9)</u>	<u>37.9</u>
Capital Account Balance .....	<u>2.0</u>	<u>34.8</u>	<u>32.3</u>	<u>52.8</u>	<u>110.7</u>
Overall Balance .....	22.5	52.2	67.7	98.7	179.4
Errors and Omissions .....	<u>(11.9)</u>	<u>(4.9)</u>	<u>7.8</u>	<u>18.4</u>	<u>27.0</u>
Changes in Reserves(2).....	<u>(10.5)</u>	<u>(47.3)</u>	<u>(75.5)</u>	<u>(117.0)</u>	<u>(206.4)</u>

(1) Includes inflows of trade credits, loans, deposits and other assets from foreign countries into China less outflows of trade credits, loans, deposits and other assets from China to foreign countries, which vary significantly from year to year.

(2) Numbers in parentheses represent increases in reserves.

Source: *China Statistical Abstract of 2005, the National Bureau of Statistics of China.*

From 2000 to 2004, China maintained a current account surplus in each year. The largest current account items are exports and imports. Non-trade balance account items include income and payments relating to international tourism, transportation, investment, banking, insurance and postal services. Transfer balance account items include unilateral money flows, such as repatriations, foreign aid and donations, as well as remittances from overseas Chinese.

### **Official International Reserves**

China has substantially increased its official international reserves in recent years. China's official international reserves include: (1) gold reserves; (2) reserves deposited with the International Monetary Fund; (3) special drawing rights at the International Monetary Fund; and (4) U.S. dollars and other convertible foreign currencies, the amount of which is subject to change.

The following table presents China's official international reserves at the dates indicated.

### Official International Reserves

	At December 31,				
	2000	2001	2002	2003	2004
	(in billions of US\$)				
Foreign Exchange .....	165.6	212.2	286.4	403.3	609.9
Gold Reserves .....	0.6	3.1	4.1	4.1	4.1
Reserve Position at the IMF .....	1.9	2.6	3.7	3.8	2.4
Special Drawing Rights .....	0.8	0.9	1.0	1.1	0.9
Total .....	<u>168.9</u>	<u>218.7</u>	<u>295.2</u>	<u>412.2</u>	<u>617.8</u>

Source: Annual Reports of the People's Bank of China of 2003 and 2004, the People's Bank of China.

The following table presents China's import coverage, which is derived by dividing the year-end balance of foreign exchange reserves by the total imports for such year and multiplying the quotient by 12, for the periods indicated.

### Import Coverage

	At December 31,				
	2000	2001	2002	2003	2004
	(in billions of US\$, except for import coverage)				
Foreign Exchange Reserves .....	165.6	212.2	286.4	403.3	609.9
Imports .....	214.7	232.1	281.5	393.6	534.4
Import Coverage (number of months) .....	9.3	11.0	12.2	12.3	13.7

Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.

The objective of the government's foreign exchange reserve policy is to maintain national reserves amounting to the equivalent in value of at least three to four months of imports. This policy conforms with international standards. The government intends to maintain its level of gold reserves at the current level and diversify its currency base. The U.S. dollar remains the primary foreign currency in the government's portfolio.

### World Trade Organization

China became a member of the WTO on December 11, 2001, but the implementation of its commitments is generally subject to a five-year phase-in period. The government believes that China's entry into the WTO has brought both opportunities and challenges. Foreign investment is largely focused on China's heavy industry, infrastructure, high technology and service industries. Although these investments help improve the overall efficiency and competitiveness of these industries, they are also creating competition for domestic companies in these sectors. In agriculture, foreign produce poses a challenge to China's farming industry. China's foreign trade is also witnessing an increase in capital-intensive and technology-intensive imports, which compete with domestic products in the relevant sectors. State-owned enterprises, however, have to undergo additional reforms to become more competitive in the marketplace. Foreign investors will also be able to merge with, acquire equity interests in, and form joint ventures with some of these state-owned enterprises.

In line with its WTO commitments, the government has promulgated new laws and amended existing ones:

- to permit foreign investment in China's service industry, such as telecommunications, financial services, insurance, retail services, tourism, securities investment and brokerage services, subject to certain foreign ownership limitations;
- to strengthen intellectual property protection;

- to gradually level the playing field for foreign and domestic investors; and
- to eliminate provisions in the current laws and regulations that are not compatible with China's WTO commitments.

Subsequent to China's entry into the WTO, the government has taken measures to readjust its import tariff to comply with its WTO commitments. Effective January 1, 2002, China reduced its import tariffs on approximately 5,300 items from an average level of 15.3% to 12%. In particular, the average tariff for industrial products dropped from 14.7% to 11.3%, and that for agricultural produce dropped from 18.8% to 15.8%. At the same time, China eliminated its import quotas for a number of items such as grain, wool, cotton, polyester fiber, acrylic fiber and fertilizer. Effective January 1, 2003, China further reduced its import tariffs on approximately 3,000 items, and lowered the average tariff level from 12% to 11%. Effective January 1, 2004, China reduced its import tariff on approximately 2,414 items and lowered the average tariff level from 11% to 10.4%. Effective January 1, 2005, China reduced its import tariff on approximately 980 items and lowered the average tariff level from 10.4% to 9.9%. China will continue to adjust its import quotas and tariffs in compliance with its WTO commitments. As of June 30, 2003, the government had eliminated over 150 administrative regulations and 800 provisions and policies relating to foreign investment and trade, and modified over 300 rules and regulations of similar nature.

In January 2002, the government set up a WTO information service desk and a WTO information service website providing WTO-related information to the public.

## PRC Financial System

China has in the past taken and is currently taking significant measures to reform its financial system in keeping with its transition from a planned economy to a market economy.

### The Central Bank

The People's Bank of China is the central bank of China and acts under the direct leadership of the State Council. In accordance with the Law on the People's Bank of China, adopted in 1995, the central bank is responsible for the formulation and execution of monetary and foreign exchange policies. The primary objective of the central bank is to promote monetary and financial stability by maintaining a prudent and reasonable exchange rate for the Renminbi and controlling inflation. In December 2003, China amended the Law on the People's Bank of China to strengthen the functions of its central bank in formulating and implementing its monetary policies.

The People's Bank of China regulates the money supply through its exclusive right to issue the Renminbi, adjust the discount rate and conduct open market operations, and through its management of the government's gold and foreign currency reserves. In addition, the People's Bank of China provides credit and rediscount facilities to banks in China. The People's Bank of China, through its foreign exchange regulatory arm, the State Administration of Foreign Exchange, also monitors and regulates external borrowings by Chinese entities. The People's Bank of China also supervised and regulated banking institutions in China until the China Banking Regulatory Commission was formed in April 2003. The China Banking Regulatory Commission is the principal regulator and supervisor of banks and non-bank financial institutions in China.

Previously, the principal instruments of monetary policy were credit ceilings, interest rate controls, Renminbi exchange rate controls and direct administrative intervention. However, the People's Bank of China is increasingly using open market operations to regulate the money supply. Under these open market operations, qualified commercial banks and other financial institutions are permitted to trade treasury securities and central bank securities with the People's Bank of China. The People's Bank of China decided to further expand the floating range of lending rates for financial institutions from January 1, 2004. The upper limit of the floating range of lending rates for commercial banks and urban credit cooperatives was increased to 170% of the basic lending rate set by the People's Bank of China. The upper limit for rural credit cooperatives was increased to 200% of the basic rate and the lower limit for financial institutions remained unchanged at 90% of the basic rate. In October 2004, the People's Bank of China removed the upper limit of lending rates for commercial banks and increased the upper limit of the floating range of lending rates for urban credit cooperatives to 230% of the basic rate. The government restructuring in recent years has further strengthened the authority of the central bank as the regulator of China's monetary policy by increasing its regulatory and supervisory efficiency and independence. The establishment by the government of the China Banking Regulatory Commission to take over the regulatory function of China's banks and other financial institutions from the People's Bank of China also constituted a part of the government's strategy to strengthen its regulatory role in the banking and financial sector. See "— Financial Sector Restructuring" below.

In April 1997, China established a 12-member monetary policy committee headed by the Governor of the People's Bank of China, which currently consists of top officials from the National Development and Reform Commission, the Ministry of Commerce, the Ministry of Finance, the State Administration of Foreign Exchange, the China Banking Regulatory Commission, the China Securities Regulatory Commission, the China Insurance Regulatory Commission and certain experts. The committee regularly meets to discuss major monetary issues and makes recommendations to the State Council concerning China's monetary policy.

In January 2003, the People's Bank of China issued a series of new regulations to combat money laundering. As part of its anti-money-laundering campaign, the People's Bank of China established an anti-money-laundering bureau in 2003 and an anti-money-laundering supervision and analysis center in August 2004. The anti-money-laundering supervision and analysis center is responsible for collecting, analyzing and reporting suspicious transactions, and the anti-money-laundering bureau decides whether to take action against reported transactions.



The following table presents the summary balance sheet of the central bank at the dates indicated.

### Summary Central Bank Balance Sheet

	At December 31,				
	2000	2001	2002	2003	2004
	(in billions of Rmb)				
<b>ASSETS</b>					
Foreign Assets (Net) . . . . .	1,518.9	1,935.1	2,324.3	3,114.2	4,696.0
Foreign Exchange . . . . .	1,481.5	1,885.0	2,210.7	2,984.2	4,594.0
Gold(1) . . . . .	1.2	25.6	33.7	33.7	33.7
Other Foreign Assets . . . . .	36.2	24.5	79.8	96.3	68.3
Central Bank Claims on:					
Government . . . . .	158.3	282.1	286.4	290.1	297.0
Deposit-taking Banks . . . . .	1,351.9	1,131.2	998.3	1,061.9	937.6
Special Depository Institutions . . . . .	N/A	N/A	230.5	136.3	104.8
Other Financial Institutions . . . . .	860.0	854.7	724.0	725.6	886.5
Non-financial Institutions . . . . .	11.0	19.6	20.7	20.6	13.6
Other Assets . . . . .	N/A	N/A	526.6	851.6	930.0
Total . . . . .	<u>3,900.1</u>	<u>4,222.7</u>	<u>5,110.8</u>	<u>6,200.4</u>	<u>7,865.5</u>
<b>LIABILITIES</b>					
Reserve Money . . . . .	3,649.1	3,985.2	4,513.8	5,284.1	5,885.6
Currency Issue . . . . .	1,593.8	1,686.9	1,858.9	2,124.0	2,310.4
Liabilities to Financial Institutions . . . . .	1,601.9	1,708.9	1,913.8	2,255.8	3,567.3
Bonds . . . . .	—	—	148.8	303.2	1,107.9
Foreign Liability . . . . .	N/A	N/A	42.3	48.3	56.2
Deposits of Government . . . . .	310.0	285.1	308.5	495.5	583.2
Owned Capital . . . . .	35.7	35.5	22.0	22.0	22.0
Other Items (Net) . . . . .	<u>(94.7)</u>	<u>(83.0)</u>	<u>75.4</u>	<u>47.4</u>	<u>210.6</u>
Total . . . . .	<u>3,900.1</u>	<u>4,222.7</u>	<u>5,110.8</u>	<u>6,200.4</u>	<u>7,865.5</u>

(1) Effective December 2001, the People's Bank of China adjusted the valuation of gold reserves, which resulted in the position changes for bullion and silver purchases.

Source: Annual Reports of 2002, 2003 and 2004, Quarterly Statistical Bulletin (Series 1) of 2005, the People's Bank of China.

## Money Supply; Credit

Since the start of China's economic reforms in 1978, there has been a rapid growth in total money supply and a similar increase in the level of monetary assets. This growth is attributable to, among other factors, the significant growth in the PRC economy, the increase in lending by PRC financial institutions and the inflation rate in the PRC. More recently, this growth is attributable to China's significant balance of payments surplus. Although the People's Bank of China has taken various measures to reduce money supply, these measures have not been able to fully offset this growth in money supply. The following table presents the volume of the money supply and year-on-year growth rates for the periods indicated.

<b>Money Supply</b>										
	<u>2000</u>	<u>Growth Rate</u>	<u>2001</u>	<u>Growth Rate</u>	<u>2002</u>	<u>Growth Rate</u>	<u>2003</u>	<u>Growth Rate</u>	<u>2004</u>	<u>Growth Rate</u>
(in billions of Rmb, except for percentages)										
M0(1) . . . . .	1,465.3	8.9%	1,568.9	7.1%	1,727.8	10.1%	1,974.6	14.3%	2,146.8	8.7%
M1(2) . . . . .	5,314.7	16.0	5,987.2	12.7	7,088.2	16.8	8,411.9	18.7	9,597.0	13.6
M2(3) . . . . .	13,461.0	12.3%	15,830.2	17.6%	18,500.7	16.8%	22,122.3	19.6%	25,410.7	14.7%

(1) Currency in circulation.

(2) M0 plus demand deposits.

(3) M1 plus time deposits, savings deposits and other deposits. Since June 2001, "other deposits" also include deposits by customers at securities companies for the calculation of M1.

Sources: *China Statistical Yearbook of 2004, the National Bureau of Statistics of China; Annual Report of 2004, the People's Bank of China.*

At the end of 2004, China's M0, M1 and M2 money supply was Rmb 2,146.8 billion, Rmb 9,597.0 billion and Rmb 25,410.7 billion, respectively, which represented a year-on-year growth rate of 8.7%, 13.6% and 14.7%, respectively.

The following table presents the allocation of total outstanding loans from financial institutions for the periods indicated.

<b>Allocation of Outstanding Loans from Financial Institutions(1)</b>					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
(in billions of Rmb)					
<b>Short-term Loans</b>					
Industrial Enterprises . . . . .	1,701.9	1,863.7	2,019.1	2,275.6	2,389.6
Commercial Enterprises . . . . .	1,786.9	1,856.3	1,797.3	1,799.4	1,707.2
Agricultural Projects . . . . .	488.9	571.2	688.5	841.1	984.3
Township and Village Enterprises . . . . .	606.1	641.3	681.2	766.2	N/A
Construction Enterprises . . . . .	161.7	210.0	274.8	300.2	278.0
Foreign-invested Enterprises . . . . .	305.0	326.4	269.7	256.9	N/A
Private Enterprises and Individuals . . . . .	65.5	91.8	105.9	146.2	N/A
Other Short-term Loans . . . . .	1,458.9	1,172.2	1,588.3	1,980.5	N/A
Medium and Long-term Loans . . . . .	2,793.1	3,932.8	4,864.2	6,340.1	7,670.7
Trust Loans and Designated Loans . . . . .	241.0	249.8	217.0	228.1	188.6
Other Loans . . . . .	328.2	325.2	623.4	965.2	1,193.3
Total . . . . .	<u>9,937.1</u>	<u>11,231.5</u>	<u>13,129.4</u>	<u>15,899.6</u>	<u>17,736.4</u>

(1) Financial institutions include, among others, the People's Bank of China, policy banks, state-owned commercial banks, postal savings agencies, other commercial banks, urban cooperative banks, rural credit

cooperatives, urban credit cooperatives, trust and investment companies, leasing companies and financial companies.

Source: *China Statistical Abstract of 2004 and 2005, the National Bureau of Statistics of China.*

At December 31, 2004, the aggregate amount of outstanding loans by all financial institutions reached Rmb 17,819.8 billion, representing an increase of 14.5% over 2003. In an effort to slow growth in the country's money supply, the People's Bank of China increased the required reserve ratio for commercial banks from 7% to 7.5% in April 2004.

## Inflation

Price reform commenced in 1979 when the government raised agricultural prices substantially and raised prices for textile products and certain raw materials moderately. In 1985, the government eliminated state-mandated prices on agricultural produce except for cotton and a limited number of staples (the price and distribution of which are still subject to overall government control) and has since then permitted an increasing number of raw materials and industrial products to be sold at market prices. In December 1997, the National People's Congress promulgated China's Price Law. Pursuant to this law, prices for most of the goods and services are determined by the market, except for a very limited number of goods and services, the prices of which will continue to be set under state pricing guidelines. Goods falling into this latter category generally consist of goods that are deemed critical for the development of the national economy and for people's daily life, goods made of raw materials of limited supply and key public utilities and public facilities. The government has also made efforts to stabilize the purchase price of grains from farmers in an attempt to prevent drastic deterioration of their income. Currently, prices for most goods and services are determined by market forces, and only 13 types of products are subject to government price controls.

China calculates its rate of inflation based on the year-on-year percentage change in the consumer price index. The consumer price index is calculated on a weighted basket of consumer goods and services for the urban and rural areas, using a monthly averaging method. Year-on-year rates are calculated by comparing the average of the twelve monthly indices for the later period against the average of the twelve monthly indices for the prior period.

The PRC economy experienced rapid growth between 1990 and 1996, with GDP increasing at an average annual rate of 10.2%. This rapid growth resulted in imbalances in the PRC economy for certain periods, especially with respect to inflation, which peaked at an annual rate of 24.1% in 1994. The government subsequently tightened its fiscal and monetary policy and the inflation rate declined to 2.8% in 1997. In 2004, China had a GDP growth rate of 9.5% and an inflation rate of 3.9%.

The following table presents rates of inflation as measured by percentage changes in the consumer price indices and the general retail price indices for the periods indicated.

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
<b>Consumer Price Indices(1)</b>					
Urban .....	0.8%	0.7%	(1.0)%	0.9%	3.3%
Rural .....	(0.1)	0.8	(0.4)	1.6	4.8
Overall .....	0.4	0.7	(0.8)	1.2	3.9
<b>General Retail Price Indices(2)</b>					
Urban .....	(1.5)	(1.1)	(1.5)	(0.4)	2.1
Rural .....	(1.5)	(0.4)	(0.9)	0.5	4.2
Overall .....	(1.5)%	(0.8)%	(1.3)%	(0.1)%	2.8%

(1) The consumer price index, or cost of living index, is calculated on the basis of a weighted basket of consumer goods and services for the urban and rural areas, respectively, using a monthly averaging method.

(2) The general retail price index is calculated on the basis of a weighted basket of consumer goods and industrial products for the urban and rural areas, respectively, using a monthly averaging method.

Source: *China Statistical Yearbook of 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China.*

Ever since the Asian financial crisis in 1997, the government has taken various measures to stimulate domestic consumption. Its active fiscal policy over the years has limited the deflationary trend. The government believes that, with the recovery of the world economy and the continued expansion of China's economy, deflationary pressure will be gradually alleviated.

### Overview of Financial Institutions

The majority of the assets in the PRC financial sector are held and managed by financial institutions owned or otherwise controlled by the central or local governments. The following table presents the assets of banks and non-bank financial institutions in China at the dates indicated.

	At December 31,				
	2000	2001	2002	2003	2004
	(in billions of Rmb)				
Deposit-taking Institutions(1): . . . . .	13,907.6	14,870.0	21,532.9	25,441.3	29,959.7
State-owned Commercial Banks(2) . . . . .	10,144.5	10,324.9	13,549.6	15,640.0	17,288.8
Other Commercial Banks(3) . . . . .	1,529.1	1,930.6	2,997.7	3,890.6	4,762.5
Rural Credit Cooperatives . . . . .	1,393.1	1,610.8	2,205.2	2,674.6	3,101.3
Urban Credit Cooperatives(4) . . . . .	679.5	780.0	119.2	148.7	180.0
Foreign-invested Banks . . . . .	34.4	45.2	288.1	333.1	513.7
Finance Companies . . . . .	161.6	223.7	408.1	495.6	489.9
Special-purpose Depository Institutions(5) . . .	1,010.7	1,146.1	1,544.2	1,796.4	1,966.9

- (1) Includes Agricultural Development Bank of China, urban commercial banks and rural commercial banks.
- (2) Consists of Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China and China Construction Bank.
- (3) Consists of Bank of Communications, CITIC Industrial Bank, China Merchants Bank, China Everbright Bank, Huaxia Bank, Industrial Bank, Guangdong Development Bank, Shenzhen Development Bank, Shanghai Pudong Development Bank, Minsheng Bank and Yantai Housing and Savings Bank.
- (4) Includes urban cooperative banks.
- (5) Includes trust and investment companies, leasing companies, policy banks such as China Development Bank and China Eximbank, none of which, unless specifically authorized, receives deposits from individual customers.

Source: *Quarterly Statistical Bulletin (Series I) of 2003 and 2005, the People's Bank of China.*

The People's Bank of China has revised its system of monetary and financial statistics in line with the IMF Manual on Monetary and Financial Statistics. As a result, the monetary statistics since 2002 will not be fully compatible with prior statistics. The revisions include:

- adjustments to the reporting institution, i.e. foreign-funded banks are classified as reporting institutions; policy banks are no longer classified as state-owned commercial banks; and urban commercial banks are listed separately from urban credit cooperatives;
- foreign currency business activities of domestic financial institutions have been included in the statistics; and
- rediscounts have been reclassified as borrowings from the central bank rather than as subtraction of claims on non-financial institutions.

The People's Bank of China began in 2003 to publish information on two additional types of deposit-taking banks, rural commercial banks and urban commercial banks. At the end of 2003 and 2004, urban commercial banks had total assets of Rmb 1,477.8 billion and Rmb 1,724.5 billion, respectively. Data about total assets of rural commercial banks is currently unavailable.

## **Banking Institutions**

The banking industry consists of policy banks, state-owned commercial banks, other commercial banks, cooperatives and other deposit-taking institutions. These entities are regulated principally by the China Banking Regulatory Commission. Banks and credit cooperatives established in China are also subject to regular audits by the National Audit Office and are required to provide the China Banking Regulatory Commission and the People's Bank of China with all information necessary for statistical and business regulation purposes. The Commercial Banking Law of the PRC, enacted in July 1995 and amended in December 2003, provides commercial banks with greater operational autonomy, prevents commercial banks from making investments in non-bank financial businesses, and protects customers' privacy and other interests. In May 2005, the People's Bank of China started to permit qualified financial institutions to underwrite the issuance of corporate short-term debt securities in the PRC inter-bank bond market. The policy is designed to enhance the capital management capabilities of approved financial institutions and to develop the PRC inter-bank bond market at the same time. The government is still in the process of restructuring the PRC banking system. See “— Financial Sector Restructuring” below.

*Policy Banks.* Pursuant to the government's financial reform program, the policy functions have been separated from the commercial functions of the former state-owned banks. As part of this process, the government established the China Development Bank, the Export and Import Bank of China, and the Agricultural Development Bank of China in 1994 to perform most of the new policy-based lending. These policy banks help implement the government's development strategies through their lending activities.

*State-owned Commercial Banks.* Prior to the 1978 economic reforms, the People's Bank of China was both China's central bank and its only significant commercial bank. In 1979, the rural banking function of the People's Bank of China was transferred to a newly established state-owned bank called the Agricultural Bank of China. The Agricultural Bank of China specialized in providing lending and other services to the agricultural and other rural sectors, such as township and village enterprises. In 1983, the government transferred the remaining commercial banking functions of the People's Bank of China to another state-owned bank called the Industrial and Commercial Bank of China. The Industrial and Commercial Bank of China specialized in providing loans and related banking services to industrial and commercial enterprises. The government also formed China Construction Bank, formerly known as the People's Construction Bank of China, which specialized in funding large infrastructure projects. In addition, the Bank of China specialized in foreign exchange transactions and financing international trade. These four state-owned banks formerly engaged in both commercial lending and policy-based lending and did not operate with the sole objective of making profits from their operations. Since 1994, they are no longer required to engage in policy-based lending. As of December 31 2004, these state-owned banks collectively accounted for approximately 57.7% of the total assets of financial institutions in China, and their performance has been a critical determinant of the overall performance of China's financial sector. The restructuring of the PRC banking system has significantly altered the role of these banks. See “— Financial Sector Restructuring” below. In recent years, these commercial banks have diversified their businesses beyond their original scope into other areas, including areas in which other state-owned commercial banks are active.

The primary sources of funds for the state-owned commercial banks are deposits, equity investments and other funds from the government. Borrowings from domestic capital markets and from international financial institutions and, to a limited extent, borrowings in the international capital markets are also important sources of funds for these banks. At the end of 2003, the government started to restructure Bank of China and China Construction Bank into joint stock corporate entities and made further capital injections into these two banks in an aggregate amount of US\$45 billion. In order to increase funding sources for commercial banks, the People's Bank of China and the China Banking Regulatory Commission promulgated and implemented the Administration Measures regarding Commercial Banks' Issuance of Subordinated Bonds in June 2004, which allows commercial banks to supplement its capital through issuance of subordinated bonds. Such measures also allow commercial

banks to hold the subordinated bonds issued by other commercial banks to the extent such holdings do not exceed 20% of their core capital. Bank of China and China Construction Bank completed their first subordinated bond offerings in July 2004. Through capital injection, disposal of non-performing loans, increase of risk reservation and other measures, these two banks' financial position, capital adequacy and assets have been enhanced. At the end of 2004, the capital adequacy of Bank of China and China Construction Bank was 8.6% and 12.0%, respectively, while the non-performing ratio of these two banks was 5.1% and 3.7%, respectively.

*Other Commercial Banks.* These are commercial banks in China that are not directly owned by the state, such as the Bank of Communications, China Merchants Bank, China Everbright Bank, CITIC Industrial Bank, Huaxia Bank, Guangdong Development Bank and Shenzhen Development Bank. There are also urban commercial banks and rural commercial banks that were converted from urban credit cooperatives and rural credit cooperatives. Some commercial banks are wholly or partially privately owned, such as China Minsheng Bank and Pudong Development Bank. As of the end of 2004, five commercial banks had listed their shares on Chinese domestic stock exchanges. All commercial banks are subject to supervision and regulation of the China Banking Regulatory Commission and the People's Bank of China.

*Rural and Urban Credit Cooperatives.* A large network of rural credit cooperatives exists in China's countryside. These rural credit cooperatives are largely an extension of the Agricultural Bank of China, and provide a limited range of financial services, such as taking deposits and providing seasonal credits to the rural sector. In August 2003, the China Banking Regulatory Commission directed that rural credit cooperatives in seven provinces and Chongqing begin their respective ownership reforms through diversified shareholding on an experimental basis, a measure taken to strengthen the management and risk control of such credit cooperatives. In November 2003, the State Council approved the experimental reform plan for implementation in these eight provinces and allocated an aggregate amount of Rmb 38 billion to support such implementation. At the end of 2004, the State Council expanded this experimental reform to 21 additional provinces and municipalities. In 2004, rural financial institutions, including rural commercial banks and rural cooperative banks, recorded a surplus for the first time with a total amount of Rmb 10.5 billion. There are also urban credit cooperatives in China. Urban credit cooperatives are controlled primarily by the Industrial and Commercial Bank of China and local governments, but they exist as independently operated banking institutions. These urban credit cooperatives perform limited banking functions for small enterprises and urban residents. Credit cooperatives are generally subject to supervision and regulation of the China Banking Regulatory Commission and the People's Bank of China.

*Other Deposit-taking Institutions.* Other deposit-taking institutions include PRC branches of foreign banks, sino-foreign joint venture banks and financial companies. By the end of 2004, there were 13 foreign-invested banks, 156 foreign bank branches and three foreign finance companies in China. Joint venture banks may engage in both Renminbi-denominated and foreign currency-denominated lending and special deposit-taking transactions with foreign-invested enterprises. These entities are subject to supervision and regulation of the China Banking Regulatory Commission and the People's Bank of China. Recently, China has allowed broader participation from a limited number of licensed foreign banks in certain Renminbi-related transactions in China. See "— Financial Sector Restructuring" below.

### **Non-Bank Financial Institutions**

In China, non-bank financial institutions include trust and investment companies (regulated by the China Banking Regulatory Commission and the People's Bank of China), insurance companies (regulated by the China Insurance Regulatory Commission), securities companies (regulated by the China Securities Regulatory Commission), asset management companies (regulated by the China Banking Regulatory Commission and the People's Bank of China), financial companies (regulated by the People's Bank of China) and financial leasing companies (regulated by the China Banking Regulatory Commission and the People's Bank of China). These institutions are audited regularly by the National Audit Office. The government has recently implemented further restructuring measures to place these non-bank financial institutions under closer supervision.

*Trust and Investment Companies.* Trust and investment companies, since their inception in the late 1970s, have been an important part of China's financial industry. Most of these companies are owned by local

governments. These companies primarily engage in the financing of joint ventures and other projects, including investments in equity and long-term debt. Some of the trust and investment companies engaged in international borrowings until the bankruptcy and liquidation of Guangdong International Trust & Investment Corporation in October 1998, after which the People's Bank of China conducted a nationwide re-examination of such institutions. At the end of 2000, there were 239 trust and investment companies in China. As a result of the nationwide re-examination, most of the former trust and investment companies have been restructured, merged or liquidated, with 59 companies remaining at the end of 2004. The People's Bank of China modified the Rules on Management of Trust and Investment Companies in June 2002, which set forth the permissible functions and business scope of these companies and their re-registration with and supervision by the People's Bank of China. The China Banking Regulatory Commission issued the Provisional Rules on Administration of Information Disclosure by Trust and Investment Companies in January 2005, which require trust and investment companies to disclose major operating information, such as financial statement, corporate governance, risk management and other key issues, to their clients and relevant beneficiaries on an annual basis. See “— Financial Sector Restructuring” below.

*Insurance Companies.* China's insurance industry has experienced rapid growth over the past decade. From 1999 to 2003, the average annual growth of the premium revenue of China's insurance industry reached 29.2%, among which, the average annual growth of the premium revenue of life insurance reached 36.3%. In 2004, the total premium revenue of China's insurance industry reached Rmb 431.8 billion, representing an increase of 11.3% over the previous year. Before 1986, the People's Insurance Company of China was the only insurance company in China. The number of insurance companies increased to 61 as of December 2004, among which foreign invested insurance companies reached 37. Major channels of investment available for insurance premiums are bank deposits, treasury bonds and investment funds. At the end of 2004, the aggregate amount of the bank deposits, treasury bonds and investment funds reached Rmb 1,125.0 billion, a 34.3% increase over 2003.

PICC Property and Casualty Company Limited and China Life Insurance Company Limited successfully completed their overseas listings respectively in 2003 and Ping An Insurance Company completed its overseas listing in 2004. Such listing improved their equity-ownership structures. Since China's entry into the WTO, China has permitted foreign life and non-life insurers and insurance brokers to provide services in Dalian, Foshan, Guangzhou, Shanghai and Shenzhen. Pursuant to China's WTO commitments, foreign life and non-life insurers and insurance brokers were permitted to provide services in ten additional cities by the end of 2003. In addition, there was no longer any geographic restriction on foreign insurance service providers since the end of 2004. As a step to fulfill its WTO commitment, China has promulgated the Regulations on Foreign-invested Insurance Companies, which came into effect on February 1, 2002.

As a result of the recent growth in the insurance industry, the government has been modifying the rules and regulations affecting the insurance industry. In 1995, the government adopted the Insurance Law of China. Since October 1998, insurance companies have been permitted to trade bonds in the interbank market. In November 1998, the China Insurance Regulatory Commission was established as the regulatory authority responsible for the supervision and regulation of the insurance industry, replacing the People's Bank of China. By February 2004, the China Insurance Regulatory Commission had established a nationwide supervisory system consisting of 36 representative offices throughout China. In January 2000, the China Insurance Regulatory Commission issued the Provisions on Management of Insurance Companies to regulate such matters as the establishment and operation of insurance companies in China as well as the issue of insurance policies and charge of insurance premiums. In August 2004, the China Insurance Regulatory Commission and the People's Bank of China jointly issued the Administration Measure on Overseas Investment of Foreign Currency Insurance Fund to allow deposits by Chinese insurance companies of their foreign currency insurance funds at foreign banks or to invest such funds in Chinese and foreign treasury bonds, other debt securities and money market products. These deposits and investments may not exceed 80% of an insurance company's foreign currency funds outstanding as of the end of its previous fiscal year. In October 2004, the China Insurance Regulatory Commission and the China Securities Regulatory Commission jointly issued the Provisional Rules on Administration of Stock Investment by Insurance Institutional Investors, which allows insurance funds to be invested in stock market directly. In order to enlarge the financing channel for insurance companies, the China Insurance Regulatory Commission issued the

Provisional Rules on Administration of Subordinate Debt of Insurance Company, which allows insurance companies to issue subordinated bonds.

In November 2000, the China Insurance Association was formed as a self-regulatory organization with the authority to adopt its own industry conventions and customs, subject to the supervision of the China Insurance Regulatory Commission.

*Securities Companies.* At the end of 2004, China had approximately 133 licensed securities companies, and 72 accounting firms licensed to provide accounting services in connection with securities transactions. Since China's entry into the WTO, foreign service suppliers have been permitted to hold an equity interest of up to 33.3% in a joint venture to conduct a domestic securities investment fund management business. By the end of 2004, foreign investors were permitted to hold up to 49% of such joint venture. In addition, foreign securities institutions were permitted to establish joint ventures, with foreign equity not exceeding 33.3%, to engage (without Chinese intermediaries) in the underwriting of shares listed on both Chinese and foreign stock exchanges as well as government and corporate bonds by the end of 2004. The PRC Rules on Foreign-invested Securities Companies and the Rules on Foreign-Invested Fund Management Companies went into effect on July 1, 2002. The Experiential Guideline on Corporate Governance of Securities Companies was promulgated at the end of 2003. The Guideline sets forth standards on the performance of board of directors and the supervision and regulation on the management of securities companies.

In order to broaden the financing options available to securities companies, the China Securities Regulatory Commission issued the Provisional Rules on Administration of Bonds of Securities Companies on August 29, 2003 (as amended on October 18, 2004), which allows securities companies to issue bonds to the public with a term of one year or more subject to the approval of the China Securities Regulatory Commission. In addition, the China Securities Regulatory Commission, the China Banking Regulatory Commission and the People's Bank of China jointly issued the Administrative Rules on Short Term Financing Debenture of Securities Companies on October 18, 2004, which allows qualified securities companies to issue short term financial debentures to qualified institutional investors in the inter-bank market with a term of less than 91 days.

*Asset Management Companies.* To improve the asset quality and risk management at financial institutions, the government established four asset management companies in 1999 to dispose of non-performing loans at the four state-owned commercial banks. At the end of 2000, approximately Rmb 1,400 billion of non-performing loans at these state-owned commercial banks had been transferred to the four asset management companies, which included debt-equity swap arrangements with 578 state-owned enterprises involving an aggregate of Rmb 240 billion of non-performing loans. Operations of these asset management companies are subject to the supervision of the People's Bank of China and the Ministry of Finance in accordance with the Provisions on Asset Management Companies promulgated by the State Council in November 2000. By the end of 2004, the four asset management companies had disposed of non-performing assets totaling Rmb 675.1 billion and recovered cash assets totaling Rmb 137.0 billion.

*Other Financial Companies.* Other non-banking finance companies in China include financial arms of large group corporations, automobile finance companies and lease-finance companies. These finance companies are subject to the supervision of the People's Bank of China on matters that relate to the government's monetary policies, and to the supervision of the China Banking Regulatory Commission on matters that relate to risk control and capital adequacy. As of June 30, 2004, there were 74 finance companies established by large corporate groups, which primarily engage in intra-group financing. These corporate group finance companies had, in the aggregate, assets of approximately Rmb 450.0 billion as of June 30, 2004. In keeping with the rapid development of automobile consumer credit in China, the China Banking Regulatory Commission approved the establishment of five automobile finance companies at the end of 2004, including GMAC-SAIC Automotive Finance Co., Ltd., a sino-foreign joint venture in Shanghai. In addition, as of August 31, 2004, there were 12 lease-finance companies in China, with aggregate total assets of Rmb 21.4 billion at the end of 2003.



## Financial Sector Restructuring

China is continuing to restructure its financial system to increase its ability to exercise effective control over monetary policy through macroeconomic policy tools and to improve supervision over the financial sector. The steps the central government has taken to achieve this goal include:

- establishing an effective monetary policy management system with the People's Bank of China as the central bank;
- establishing the China Banking Regulatory Commission as the primary regulator of China's banking industry;
- strengthening the China Securities Regulatory Commission's supervision of the securities industry;
- establishing the China Insurance Regulatory Commission to regulate China's insurance industry;
- improving the management at financial institutions;
- strengthening the risk management capability of financial institutions; and
- gradually opening up China's financial market to foreign capital and competition.

The adoption of the Law on the People's Bank of China in 1995 has strengthened and clarified the People's Bank of China's responsibilities as the central bank of China. Pursuant to a State Council decision in November 1998 in furtherance of the objectives of this legislation, all of the then existing provincial and municipal branches of the People's Bank of China were replaced by nine newly created regional branches. The new central banking system became operational on January 1, 1999. As a result of the financial sector restructuring, the People's Bank of China's ability to make credit available to non-bank financial institutions has been restricted.

The establishment of the National Unified Interbank Loan Trading System in January 1996 created a unified national interbank money market. Headquartered in Shanghai, the system had 656 members at the end of 2004. Its members are financial institutions (including banks, securities companies, finance companies and others) with authorization from the People's Bank of China to engage in the interbank Renminbi lending business in China. The National Unified Interbank Loan Trading System operates through a computer network connecting the members across the country. Since the inception of the interbank money market, China has been publishing its unified interbank interest rate based upon the weighted average of market quotations, known as CHIBOR. In June 2003, the National Unified Interbank Loan Trading System established an automated quotation system for negotiated instruments to provide quotation and information services to financial institutions regarding re-negotiation and repurchase of such negotiated instruments.

Interbank lending in Renminbi in 2004 totaled Rmb 1,455.6 billion, a 39.6% decrease over 2003.

In addition, the government has been actively and cautiously allowing greater participation by foreign financial entities in China's financial sector. By the end of 2004, there were a total of 169 branches, joint ventures and subsidiaries established by foreign banks in China with total assets of Rmb 513.7 billion. Upon its entry into the WTO, China lifted all geographic and customer restrictions on foreign currency business conducted by foreign banks. Furthermore, China has agreed to open an average of an additional four cities to foreign banks for local currency business each year following China's entry into the WTO and remove all geographic restrictions by the end of 2006. Currently, 18 cities in China are open to foreign banks for local currency business. With respect to customer restrictions on local currency business, foreign financial institutions were permitted to provide banking services to Chinese corporate customers by the end of 2003 and will be permitted to engage in retail banking services and retail Renminbi-related businesses no later than the end of 2006. In addition, since December 1, 2003, China has implemented a series of reforms of its banking sector. These policies are mainly aimed at:

- allowing foreign financial institutions to participate in the automobile finance sector;
- lowering operating capital requirements for foreign bank branches in China;
- streamlining the market access procedures for foreign financial institutions;

- increasing the percentage of equity that foreign investors may own in domestic financial institutions;
- encouraging qualified overseas strategic investors to participate in the restructuring and reform of China's banking sector, especially small- and medium-sized financial institutions; and
- allowing foreign investors to set up wholly foreign owned leasing and lease-finance companies in China.

In May 2004, the National Development and Reform Commission, the People's Bank of China and the China Banking Regulatory Commission jointly promulgated the Regulations regarding Foreign Debts of Foreign-owned Banks in China to make the regulations governing foreign debts and foreign exchange loans of both Chinese-owned banks and foreign-owned banks more consistent.

In 1998, the People's Bank of China started to use asset/liability ratios and other risk management measures to supervise and monitor commercial banks in place of its credit ceiling system. The newly established China Banking Regulatory Commission is continuing the efforts made by the People's Bank of China to monitor asset quality and enhance risk management of banking institutions in China. To more effectively quantify non-performing bank loans, the People's Bank of China and the China Banking Regulatory Commission require that assets of all Chinese banks be classified under five categories:

- "normal," where the borrower continues to fulfill its obligations to repay both principal and interest on a timely basis;
- "watch" or "special mention," where the lender becomes aware of factors which it believes may negatively impact the borrower's ability to repay the loan, even though such borrower continues to fulfill its obligations to repay both principal and interest on a timely basis;
- "sub-standard," where the borrower has failed to repay either principal or interest on a timely basis and it has become apparent to the lender that the borrower is unable to rely on its revenue from operations to satisfy its repayment obligations;
- "doubtful," where the borrower has failed to repay either principal or interest on a timely basis and the lender anticipates incurring losses even after taking steps to enforce its rights in relation to any pledged or mortgaged assets securing the loan; and
- "bad" or "loss," where the lender believes that the recovery of all outstanding principal and interest is not possible and that only a very limited recovery is possible after all measures available to the lender have been exhausted and all legal proceedings reasonably available to the lender have been pursued.

The government treats sub-standard, doubtful and bad loans as non-performing loans. The government is currently implementing this risk-based asset classification system at all banks in China. The government believes that the implementation of this system nationwide will bring China's banking system closer to international banking standards. Based on data released by the China Banking Regulatory Commission, at the end of 2004, the four state-owned commercial banks, the three policy banks and 12 joint stock commercial banks had outstanding loan assets in the aggregate amount of Rmb 15,227.1 billion, representing approximately 81.6% of all outstanding domestic bank loans on that date. Approximately 85.9% of the outstanding loans of these 19 banks belonged to the "normal" and "watch" categories; and the remaining 14.1% were considered non-performing loans. The non-performing loan ratio at the four state-owned commercial banks was approximately 15.6% at the end of 2004.

Since March 2000, the central government has launched further initiatives to enhance its supervision over major state-owned financial institutions. The government has set up a supervisory committee to inspect and monitor China's policy banks, asset management companies, state-owned commercial banks, insurance companies and securities companies. As of June 30, 2004, the State Council designated 14 supervisory committees to be stationed at 14 major financial institutions.

As part of China's financial sector restructuring, the government has allowed and will continue to allow insolvent and poorly managed financial institutions to either go bankrupt or be consolidated in accordance with the rules and regulations of China. Since 1997, the government has closed four financial institutions, including

China Agribusiness Development Trust & Investment Corporation, Hainan Development Bank, China Venturetech Investment Corporation and Guangdong International Trust & Investment Corporation.

Many banks in China, especially the four state-owned commercial banks, had a significant level of loans that are not current with respect to interest or principal payments and which may be classified as substandard, doubtful or bad under the five-category classification system. From 1998, the People's Bank of China reduced the reserve requirement ratio for banks from 13% to 7.5% to provide more liquidity to the banking system. The government also issued special government bonds in 1998 in the amount of Rmb 270 billion to re-capitalize the four state-owned commercial banks. The proceeds from the bond sale were injected into these banks as equity capital to improve their capital adequacy ratios and asset quality. Four asset management companies have been established by the government for the purpose of disposing of non-performing loans of state-owned commercial banks. At the end of 2000, nearly Rmb 1,400 billion non-performing loans at the four state-owned commercial banks had been transferred to these four asset management companies, including an aggregate of Rmb 240 billion subject to debt-equity swap arrangements with 578 state-owned enterprises. In June 2004, through a bidding process, Bank of China and China Construction Bank agreed to transfer an additional aggregate principal amount of Rmb 278.7 billion of non-performing loans to China Cinda Asset Management Corporation. Also, in June 2004, Bank of Communications transferred an aggregate principal amount of Rmb 41.4 billion of non-performing loans to the same asset management company. Until the successful completion of the financial sector reforms, the government will likely be required to provide additional support to financial institutions in China. The extent of this support will depend on a number of factors, including developments in the ongoing reform of the state-owned enterprises.

China is also continuing its efforts to improve the supervision of Chinese commercial banks. The China Banking Regulatory Commission has issued over 30 industry rules and regulations since its establishment in April 2003. These rules and regulations include, among others, the Risk Rating System for Joint Stock Commercial Banks, the Administrative Rules on Capital Adequacy of Commercial Banks, the Notice regarding Subordinated Term Debt Being Treated as Subordinated Capital and the Guidelines on Market Risk Management of Commercial Banks. In July 2004, the China Banking Regulatory Commission promulgated a Commercial Bank Due Diligence Guide for Credit Approval. The guidelines set forth detailed due diligence requirements and evaluation standards relating to solicitation and granting of credit, including requirements relating to client investigation, acceptance of credit applications, credit analysis and evaluation, credit decision and implementation, post-approval management and management of problematic credits. China has adopted the Capital Accord issued by the Basel Committee in 1988, commonly referred to as Basel I, which requires commercial banks to set aside 8% of their capital to cover credit risks. China supports recent efforts by the Basel Committee to revise the Basel I rules, commonly known as Basel II. Although China has indicated that it will not adopt all of the Basel II rules, China supports the objectives of the new rules and has adopted some of the approaches and processes contained in Basel II. China will continue to make efforts to gradually bring its banking regulation to international standards appropriate for the banking industry in China.

China amended the Law on the People's Bank of China and the PRC Commercial Banking Law in December 2003. The amended Law on the People's Bank of China strengthened the functions of the People's Bank of China in formulating and implementing monetary policies. The amended Commercial Banking Law expressly provided that the China Banking Regulatory Commission will have primary responsibility in supervising and regulating commercial banks, a role previously performed by the People's Bank of China prior to the establishment of the China Banking Regulatory Commission. The People's Bank of China will continue to perform its regulatory functions with respect to China's banking industry in its capacity as the central bank. In December 2003, China also enacted the Law on Banking Regulation and Supervision. It sets forth many basic rules regarding China's banking regulatory system, including the functions, power and responsibilities of China's banking regulatory authority.

In order to promote reform and stable development of China's capital markets, the State Council issued directives in January 2004 to encourage direct financing, establish unified securities markets and improve the registration and clearing systems for securities exchanges. The People's Bank of China, the China Securities Regulatory Commission and the China Banking Regulatory Commission jointly issued the Experimental Administrative Rules on Establishment of Fund Management Companies by Commercial Banks on February 20,

2005. These rules allow commercial banks to establish fund management companies to engage in the business of fund management. The People's Bank of China and the China Banking Regulatory Commission jointly issued the Experimental Administrative Rules on Securitization of Loan Assets on April 20, 2005. According to those rules, domestic financial institutions may engage in structured financings through the sale of securities backed by loan assets. Asset-backed securities are to be issued and traded in the inter-bank market. In early 2005, the State Council approved China Development Bank and China Construction Bank to be the first banks to conduct securitizations of loan assets and mortgaged loans respectively on an experimental basis.

In order to enhance the supervision and regulation of financial institutions and encourage financial innovations, the China Banking Regulatory Commission, the China Securities Regulatory Commission and the China Insurance Regulatory Commission jointly signed a memorandum in June 2004 to allocate financial regulatory responsibilities among themselves. The three agencies have also established a "joint regulatory meeting" scheme to enhance their cooperation.

## **Foreign Exchange**

Since January 1, 1994, the government has used a unitary managed floating rate system. Under this system, the People's Bank of China publishes a daily base exchange rate with reference primarily to the supply and demand of Renminbi against the U.S. dollar and other foreign currencies in the market during the previous day. Authorized banks and financial institutions are allowed to quote buy and sell rates for Renminbi within a specified band around the central bank's daily exchange rate. With the adoption of the managed floating rate system, the government announced that the People's Bank of China would attempt to balance the demand for and supply of foreign currencies in China and stabilize the Renminbi exchange rate through macroeconomic measures, including prudent management of monetary policy and interest rates, while still using open market operations. The government believes that the Renminbi exchange rate should reflect the fundamentals of China's economy and remain subject to normal market forces.

In April 1994, the government established the China Foreign Exchange Trading System in Shanghai to provide foreign exchange trading and settlement. The China Foreign Exchange Trading System is supervised and managed by the State Administration of Foreign Exchange in accordance with guidelines issued by the People's Bank of China. As part of China's financial sector restructuring, the government consolidated the operations of the various foreign exchange markets in China. Effective December 1, 1998, all swap centers ceased their operations and foreign currencies are now sold and bought only through the facilities of the China Foreign Exchange Trading System. Headquartered in Shanghai, the China Foreign Exchange Trading System also operates through a computer network connecting the members across the country. At the end of 2004, the China Foreign Exchange Trading System had 353 members, which are financial institutions (including their branches) authorized by the State Administration of Foreign Exchange to engage in foreign exchange business in China.

The government regulates access to foreign exchange and the ability to remit foreign exchange abroad. Although the Renminbi became fully convertible for current account items in 1996, access to foreign exchange for capital account transactions is still restricted. The State Administration of Foreign Exchange issued a notice in July 2003 with a view to reforming, on an experimental basis, the management of non-trade foreign exchange in Beijing, Shanghai and Shenzhen, where most of the multi-national companies have established their regional headquarters. The PRC government, however, has also been studying proposals toward the eventual full convertibility of Renminbi, including the possibility of the establishment of a Renminbi trading center in Hong Kong. With the approval from the State Council, the People's Bank of China agreed in November 2003 to provide settlement arrangements for relevant banks providing individual Renminbi deposit, exchange, bank card and remittance services in Hong Kong since January 2004 and in Macau since August 2004. Due to China's current stage of economic development and lack of necessary legal framework and regulatory and institutional infrastructure in this regard, the government's foreign exchange policy is intended to provide an orderly transition until the Renminbi gradually becomes fully convertible. The government will continue to rationalize its foreign exchange policy and will also endeavor to make sure that any measure to further relax its current managed floating rate system will be in line with the level of China's economic development and financial reforms.

Since the introduction of the managed floating rate system in 1994, the exchange rate of the Renminbi has generally been stable.

The following table presents (1) the People's Bank of China exchange rate, (2) the noon buying rate in The City of New York and (3) the exchange rate at the China Foreign Exchange Trading System between the Renminbi and the U.S. dollar (in Rmb per US\$) for the periods indicated.

Period	Exchange Rates											
	People's Bank of China Exchange Rate				Noon Buying Rate in The City of New York				China Foreign Exchange Trading System Rate			
	Period End	Average(1)	High	Low	Period End	Average(1)	High	Low	Period End	Average(1)	High	Low
2000 . . . .	8.2781	8.2784	8.2799	8.2768	8.2774	8.2784	8.2799	8.2768	8.2789	8.2795	8.2800	8.2770
2001 . . . .	8.2766	8.2770	8.2786	8.2762	8.2766	8.2770	8.2786	8.2676	8.2766	8.2770	8.2820	8.2668
2002 . . . .	8.2773	8.2770	8.2775	8.2765	8.2800	8.2772	8.2800	8.2669	8.2770	8.2769	8.2874	8.2665
2003 . . . .	8.2767	8.2770	8.2776	8.2771	8.2767	8.2771	8.2800	8.2765	8.2768	8.2770	8.2780	8.2760
2004 . . . .	8.2765	8.2768	8.2774	8.2765	8.2765	8.2768	8.2774	8.2764	8.2765	8.2767	8.2870	8.2761

(1) Determined by averaging the rates on the last business day of each month during the relevant period.

Sources: *The State Administration of Foreign Exchange; Federal Reserve Bank of New York; China Foreign Exchange Trading System; the Ministry of Finance.*

In an effort to develop and improve liquidity in the domestic foreign exchange market, on May 18, 2005, the People's Republic of China authorized certain domestic and foreign banks to provide continuous bid and offer prices to the market in respect of the following foreign currency exchanges: Euro to U.S. dollar, Australian dollar to U.S. dollar, British pound to U.S. dollar, U.S. dollar to Japanese yen, U.S. dollar to Canadian dollar, U.S. dollar to Swiss franc, U.S. dollar to Hong Kong dollar and Euro to Japanese yen.

## Securities Markets

China's two securities exchanges, the Shanghai Stock Exchange and the Shenzhen Stock Exchange, were established in 1990 and 1991, respectively. At the end of 2004, China had two securities clearing houses, approximately 133 licensed securities companies and 72 accounting firms providing securities-related accounting services. In May 2004, the Shenzhen Stock Exchange established a Small and Medium Enterprise Board as a subsection of its main trading board for the listing and trading of the shares of small and medium-cap high tech companies. At the end of 2004, there were 38 companies listed on the Small and Medium Enterprise Board with a total market capitalization of Rmb 41.3 billion.

Trading on both the Shanghai Stock Exchange and the Shenzhen Stock Exchange was originally limited to domestic investors and conducted only in Renminbi. These shares, known as A shares, continue to be restricted to domestic investors and qualified foreign institutional investors. In 1991, the government approved initiatives of the Shanghai Stock Exchange and the Shenzhen Stock Exchange to create B shares, a special category of shares available exclusively for investment by foreign investors. B shares are denominated and traded in U.S. dollars on the Shanghai Stock Exchange and in Hong Kong dollars on the Shenzhen Stock Exchange. With the goal of strengthening central control of B shares, the State Council published regulations governing B shares in December 1995, which replaced the prior local rules of the Shanghai Stock Exchange and the Shenzhen Stock Exchange. Under these regulations, issuers of B shares are required to seek approval from the China Securities Regulatory Commission for offerings of up to US\$30 million and from the State Council for offerings exceeding US\$30 million. Since February 2001, domestic investors have also been permitted to invest in B shares.

To comply with China's commitments to the WTO, the China Securities Regulatory Commission adopted measures to permit qualified foreign institutional investors, or QFIIs, to invest in China's securities markets. The People's Bank of China also issued rules to permit commercial banks to provide custodial services for securities investments by QFIIs. In addition, the State Administration of Foreign Exchange promulgated rules relating to foreign exchange transactions related to domestic securities investments by QFIIs. By the end of 2004, the China Securities Regulatory Commission had approved 27 foreign institutions as QFIIs and 4 foreign invested banks

and 7 domestic commercial banks as QFII custodians. The current PRC regulations permit QFIIs to invest in the following securities in China:

- domestic A shares,
- treasury bonds,
- convertible bonds and corporate bonds, and
- other financial instruments approved by the China Securities Regulatory Commission.

The government has also placed restrictions on investment by QFIIs. No single QFII may own more than 10% of the total equity in any issuer; neither may the aggregate investments by all QFIIs in any issuer exceed 20% of the total equity of the issuer. Investments by QFIIs in China are also subject to other foreign investment guidelines issued by the government.

Since 1992, the government has permitted large PRC companies, mostly state-owned enterprises, to be reorganized as joint-stock limited liability companies and to list their shares overseas. Shares listed on The Stock Exchange of Hong Kong Limited are known as H shares, and shares listed on the New York Stock Exchange are known as N shares. By the end of 2004, a total of 109 H share companies and 12 N share companies had completed overseas share listings on The Stock Exchange of Hong Kong Limited and the New York Stock Exchange, respectively. Some of these companies have listings on more than one foreign stock exchange. In addition, there have been a number of state-owned red-chip companies listed on stock exchanges overseas. Red-chip companies are holding companies incorporated overseas with substantially all of their operations conducted in China through their subsidiaries. The China Securities Regulatory Commission also adopted rules in March 2002 to permit foreign-invested enterprises in China to go public in domestic stock markets.

Although overseas offerings have attracted a substantial amount of foreign investment, the Shanghai Stock Exchange and the Shenzhen Stock Exchange continue to be the primary securities markets for Chinese companies. By the end of 2004, 1,377 companies were listed on the Shanghai Stock Exchange and Shenzhen Stock Exchange with an aggregate market capitalization of Rmb 3,705.6 billion. In addition, by the end of 2004, 54 mutual fund management companies had launched 161 funds (including close-end and open-end funds) with a total net asset size of Rmb 81.0 billion in close-end funds and Rmb 243.7 billion in open-end funds.

The following tables set forth the number of listed companies, the total market capitalization, including total tradable market capitalization, and the value of trading in equity securities on the Shanghai Stock Exchange and the Shenzhen Stock Exchange at the dates and for the periods indicated.

#### Number of Listed Companies

	At December 31,				
	2000	2001	2002	2003	2004
Shanghai Stock Exchange .....	572	646	715	780	837
Shenzhen Stock Exchange .....	516	514	509	507	540
Total .....	<u>1,088</u>	<u>1,160</u>	<u>1,224</u>	<u>1,287</u>	<u>1,377</u>

#### Market Capitalization

	At December 31,				
	2000	2001	2002	2003	2004
	(in billions of Rmb)				
Shanghai Stock Exchange .....	2,693.1	2,759.1	2,536.4	2,980.5	2,601.4
Shenzhen Stock Exchange .....	<u>2,116.0</u>	<u>1,593.2</u>	<u>1,296.5</u>	<u>1,265.3</u>	<u>1,104.1</u>
Total .....	<u>4,809.1</u>	<u>4,352.3</u>	<u>3,832.9</u>	<u>4,245.8</u>	<u>3,705.5</u>
Total Tradable Market Capitalization .....	<u>1,608.8</u>	<u>1,446.3</u>	<u>1,248.5</u>	<u>1,317.9</u>	<u>1,172.9</u>

### Value of Trading in Equity Securities

	At December 31,				
	2000	2001	2002	2003	2004
	(in billions of Rmb)				
Shanghai Stock Exchange .....	3,137.4	2,270.9	1,695.9	2,082.4	2,760.1
Shenzhen Stock Exchange .....	2,945.3	1,559.6	1,103.1	1,129.1	1,586.3
Total .....	6,082.7	3,830.5	2,799.0	3,211.5	4,346.4

Sources: China Statistical Yearbook of 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China; Quarterly Statistical Bulletin (Series 1) of 2005, Annual Reports of 2003 and 2004, the People's Bank of China; China Securities Regulatory Commission.

The following table sets forth the Shanghai and Shenzhen stock exchanges indices at the dates indicated.

### Domestic Stock Exchange Indices

	At December 31,				
	2000	2001	2002	2003	2004
<b>Shanghai Stock Exchange</b>					
A shares .....	2,192.38	1,712.54	1,419.12	1,569.13	1,330.19
B shares .....	89.55	171.53	113.51	104.94	75.65
<b>Shenzhen Stock Exchange</b>					
A shares .....	5,466.85	3,599.07	3,070.02	3,620.89	3,270.86
B shares .....	938.36	1,559.58	1,144.11	2,071.24	1,620.22

Sources: Shanghai Stock Exchange; Shenzhen Stock Exchange; China Securities Regulatory Commission.

The China Securities Regulatory Commission regulates the country's securities markets. In accordance with China's Securities Law, the securities regulator aims to develop the PRC securities markets into more mature markets through emphasis on standardization of operations, enhancement of market supervision, control of excessive speculation, manipulative trading and other fraudulent practices, enhanced disclosure and stable growth. In March 2001, the China Securities Regulatory Commission put in place an inspection system to ensure compliance by domestically listed companies with laws and regulations through regular inspections by professionals designated by the securities regulator. These routine examinations seek to verify:

- truthfulness, accuracy and completeness of disclosure,
- independence from controlling shareholders and affiliates,
- regularity of financial management and auditing process,
- actual use of offering proceeds, and
- other matters instructed by the China Securities Regulatory Commission.

At the end of 2003, the China Securities Regulatory Commission promulgated Provisional Measures on Sponsoring System for Public Offerings of Securities. This sponsoring system requires the sponsors and underwriters to be responsible for their recommendation of offerings to the public, for verifying the authenticity, accuracy, completeness of the information disclosed in the offering documents and for assisting issuers in establishing information disclosure systems. At the same time, the China Securities Regulatory Commission also enacted regulations to make its Offering Examination Committee more efficient, transparent and responsible in vetting listing candidates. The China Securities Regulatory Commission issued Certain Rules on Strengthening Protection on Interest of Holders of Social Public Shares on December 9, 2004, which permitted cumulative voting as an important measure to protect the rights and interests of retail investors.

Starting in October 1999, Chinese insurance companies were permitted by the State Council to purchase mutual funds from the primary market and trade them on the secondary market. China passed its Securities Investment Fund Law in October 2003 to regulate fund management companies and to better protect fund investors' rights and interests.

### Bond Markets

China's bond market consists largely of treasury securities, financial debentures and corporate bonds. In 1988, the Ministry of Finance started to use domestic securities trading markets for its treasury securities. Since 1991, secondary markets for treasury securities have been developed nationwide and treasury securities are now traded on the Shanghai Stock Exchange, the Shenzhen Stock Exchange, the interbank market and the over-the-counter market in China. Since 1994, the People's Bank of China has permitted banks to hold and trade treasury securities. The repurchase obligations market for treasury securities was opened in early 1994 and has been active since the second half of that year. In 1995, China successfully conducted its first dealer auction of short-term treasury securities and in January 1996 China successfully completed its first issue of one-year treasury bonds using a competitive bidding system. Treasury securities are currently underwritten primarily by Chinese commercial banks and distributed through their nationwide branch networks. These developments have improved the liquidity of treasury securities.

The following table sets forth the interest rate levels of treasury securities issued by the government during the periods and for the maturities indicated.

#### Treasury Securities Interest Rates

	Original Maturity			
	1 Year	5 Years	10 Years	30 Years
	(in percentages)			
2000 .....	2.35	3.00-3.50	2.55-2.87	—
2001 .....	—	2.86-3.36	2.77-3.05	—
2002 .....	1.91	2.22-2.74	2.54-2.70	2.90
2003 .....	1.98-2.55	2.45-2.63	2.80-3.02	—
2004 .....	2.35	2.83-4.42	4.86	—

Source: *Quarterly Statistical Bulletins (Series 1) of 2003 and 2005, the People's Bank of China.*

Corporate bonds constitute a small portion of the market at present. At the end of 2004, non-convertible bonds traded on China's stock exchanges totaled Rmb 399.2 billion, of which treasury and other government securities accounted for 90.8%, or Rmb 362.6 billion, and corporate non-convertible bonds accounted for 9.2%, or Rmb 36.6 billion. In addition, at the end of 2004, there were Rmb 34.6 billion of corporate convertible bonds traded on China's stock exchanges.

In order to further develop China's bond markets, the People's Bank of China, the Ministry of Finance, the National Development and Reform Commission and the China Securities Regulatory Commission jointly issued the Provisional Administrative Rules on Issuance of Rmb Bonds by International Development Institutions on February 18, 2005, which allows qualified international development institutions to issue Renminbi-denominated bonds in China's inter-bank bond market. The proceeds from these bond offerings would be used to provide medium- and long-term loans or capital contribution for construction projects in China.



## PRC Public Finance

The Ministry of Finance is the government entity responsible for developing and implementing the public finance policy of the government. The Ministry of Finance, among its other duties:

- prepares and implements the state budget;
- oversees the receipt and disbursement of budgeted revenues and expenditures;
- establishes taxation and financial accounting policies;
- administers China's borrowings from foreign governments and international organizations;
- engages in debt security offerings on behalf of the central government; and
- negotiates tax treaties with foreign nations.

Prior to 1979, China's public finance was highly centralized, with the central government controlling virtually all revenues and expenditures. The local governments implemented the central government's budgetary objectives and had little financial autonomy. Since then, the government has implemented fiscal reforms as part of its overall economic reform program. In 1994, as a result of a series of tax regulations, or 1994 Tax Regulations, adopted by the State Council, a uniform revenue-based tax for all enterprises and a uniform income tax for all domestic PRC enterprises were adopted throughout China. Also in 1994, a fiscal revenue allocation system was established between the central and local governments with respect to tax revenues. Under this fiscal revenue allocation system, taxes are divided into three categories: national taxes for the central government, local taxes for local governments, and shared taxes to be allocated between the central and local governments based on ratios prescribed by the State Council. As a result, the fiscal revenue allocation system provided the local governments with a degree of autonomy in managing local development and public services.

The PRC budgetary structure consists of two main components: the state budget and off-budget revenues and expenditures. The state budget includes both the central and local government budgets. The central government budget contains the revenues and expenditures of the departments and enterprises reporting directly to the central government, local government revenues submitted to the central government, and revenue rebates and subsidies provided to the local governments. The local government budgets include the general budgets of provinces, autonomous regions and municipalities under the direct jurisdiction of the State Council. Each local budget contains the revenue and spending plan of that local government and the budgets of the lower-level governments that directly report to it. Off-budget revenue items generally consist of miscellaneous government surcharges, income from funds earmarked for certain public projects, certain rural administrative charges and rural public facility levies. Off-budget expenditure items generally consist of miscellaneous government administrative expenses, certain expenditures in connection with public projects, rural administrative and public facility expenses, and certain funding adjustments made by the government. Off-budget revenues and expenditures are subject to varying degrees of regulation by the central government. The central government intends to phase out all off-budget items by incorporating them into the budgetary system. See “— Off-budget Items.”

As a result of the decentralization of the PRC economy, many revenue and expenditure items that were previously included in the state budget have become inapplicable and thus excluded. Under current Chinese law, only the central government may incur budget deficits.

### The State Budget

The government's fiscal year is the calendar year. The state budget process begins in September of each year when the State Budget Department of the Ministry of Finance receives the spending plans and revenue estimates submitted by ministries and agencies of the central and local governments for the following year. After reviewing these plans and estimates, the Ministry of Finance draws up a draft budget and submits it to the State Council. Upon approval by the State Council, the draft budget is sent to the National People's Congress for final approval. Pursuant to the PRC Constitution and Budget Law, the National People's Congress reviews and approves the budget for the central government. The Budget Law also provides for the review and approval by lower-level people's congresses of the relevant local government's budget.

Prior to 1994, the government financed budget deficits through a combination of credit from the People's Bank of China and domestic and international borrowings, accounted for as debt revenues. Since 1994, the government has financed its budget deficits only through domestic and international borrowings. These borrowings are no longer carried as revenues in the state budget.

The following table presents the main categories of government revenues and expenditures for the periods indicated and original budgeted revenues and expenditures for 2005.

<b>Government Revenues and Expenditures</b>						
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>Budget 2005</u>
	(in billions of Rmb)					
<b>Revenues</b>						
Tax Revenues . . . . .	1,258.2	1,530.1	1,763.6	2,001.7	2,414.2	2,647.8
Subsidies to State-owned Enterprises . . . . .	(27.9)	(30.0)	(26.0)	(22.6)	(21.8)	(23.0)
Other Revenues . . . . .	<u>109.3</u>	<u>138.5</u>	<u>152.7</u>	<u>192.4</u>	<u>243.2</u>	<u>300.7</u>
Total Revenues . . . . .	<u>1,339.5</u>	<u>1,638.6</u>	<u>1,890.4</u>	<u>2,171.5</u>	<u>2,635.6</u>	<u>2,925.5</u>
<b>Expenditures</b>						
National Defense and Government Administration . . . . .	299.5	364.0	468.7	534.6	626.4	701.7
Culture, Education, Science and Health Care . . . . .	273.7	336.1	397.9	450.6	512.3	597.7
Infrastructure Construction . . . . .	209.5	251.1	314.3	342.9	342.0	353.7
Innovation, Science and Technology Promotion Funds . . . . .	86.5	99.2	96.8	109.3	123.1	139.8
Policy-related Subsidies . . . . .	104.2	74.2	64.5	61.7	79.4	78.2
Other Expenditures . . . . .	<u>615.3</u>	<u>765.7</u>	<u>863.1</u>	<u>965.9</u>	<u>1,153.0</u>	<u>1,354.4</u>
Total Expenditures . . . . .	<u>1,588.7</u>	<u>1,890.3</u>	<u>2,205.3</u>	<u>2,465.0</u>	<u>2,836.1</u>	<u>3,225.5</u>
Deficit . . . . .	<u>(249.1)</u>	<u>(251.7)</u>	<u>(315.0)</u>	<u>(293.5)</u>	<u>(200.5)</u>	<u>(300.0)</u>

Sources: China Statistical Yearbook of 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China; the Ministry of Finance.

In 2004, total government revenues reached Rmb 2,635.6 billion, representing a 21.4% increase over 2003, and total government expenditures during the same period amounted to Rmb 2,836.1 billion. There was a fiscal deficit of Rmb 200.5 billion.

### **Revenues**

Until July 1994, most taxes were collected by the local offices of the State Bureau of Taxation and allocated between the central and local governments in accordance with established formulas. Pursuant to the fiscal reforms implemented in 1994, the tax administration was reorganized into the National Tax Administration and the Local Tax Administration. See “—Fiscal and Tax Reforms” below. Currently, the central government is responsible for collecting taxes assigned to the central government and taxes shared between the central and local governments. The local governments are responsible for collecting taxes assigned to them. Import and export duties and tariffs are collected by the General Administration of Customs and remitted to the central government. The following paragraphs describe certain government revenues by material account line items.

*Tax Revenues.* Since 1988, taxes on goods and services have made up a substantial portion of the government's tax revenues. Revenues from individual income tax have remained relatively insignificant. In 1994,

a series of new tax regulations came into effect. Under the new tax regime, a uniform value-added tax replaced the product tax, a consumption tax is now levied upon a variety of products at specified tax rates, and a business tax is now assessed on revenues derived from providing services. See “— Fiscal and Tax Reforms” below.

The following table presents government tax revenues for the periods indicated.

	<b>Tax Revenues</b>				
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in billions of Rmb)				
Value-added Tax . . . . .	455.3	535.7	617.8	723.7	901.8
Company Income Tax . . . . .	166.2	263.1	308.3	292.0	395.0
Business Tax . . . . .	186.9	206.4	245.0	284.5	358.1
Consumption Tax . . . . .	85.8	93.0	104.6	118.2	150.1
Tariff Duties . . . . .	75.1	84.1	70.4	92.3	104.1
Agricultural and Related Tax(1) . . . . .	46.5	48.2	71.8	87.2	90.2
Other . . . . .	<u>242.4</u>	<u>299.6</u>	<u>345.7</u>	<u>403.8</u>	<u>414.9</u>
Total Tax Revenues . . . . .	<u>1,258.2</u>	<u>1,530.1</u>	<u>1,763.6</u>	<u>2,001.7</u>	<u>2,414.2</u>

(1) The agricultural and related tax includes the agricultural tax, the animal husbandry tax, the tax on the use of cultivated land, the tax on special agricultural products and the contract tax.

Source: China Statistical Yearbook of 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China.

In 2004, total tax revenues were Rmb 2,414.2 billion, representing a 20.6% increase over the previous year.

*Subsidies to State-owned Enterprises.* This category refers to the government’s subsidies paid to state-owned enterprises for their losses. These subsidies consisted of forgiveness of indebtedness, or reduced or refunded government taxes or other charges. Historically, this line item was classified as negative revenue rather than expenditure.

*Other Revenues.* This category includes numerous smaller, special purpose fees, charges, surcharges (including land use fees from joint ventures and charges for state natural resources management), fines and penalties.

The following table sets forth the revenues received and retained by the central government and their percentages of the total government revenues for the periods indicated.

	<b>Central Government Revenues</b>				
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in billions of Rmb, except for percentages)				
Central Government Revenues . . . . .	698.9	858.3	1,038.9	1,186.5	1,447.6
% of Total Government Revenues . . . . .	52.2%	52.4%	55.0%	54.6%	54.9%

Source: China Statistical Yearbook of 2004, China Statistical Abstract of 2005, the National Bureau of Statistics of China.

In 2004, total central government revenues reached Rmb 1,447.6 billion, representing a 22.0% increase over 2003.

## *Expenditures*

The following paragraphs describe government expenditures by material account line items.

*Infrastructure Construction.* This category includes production and non-production capital investment. Production capital investment includes investment in all types of infrastructure and other projects.

*Innovation, Science and Technology Promotion Funds.* These expenditures are used to improve China's capital investments, help transform state-owned enterprises into profit-making organizations, develop new products and enhance technological innovation and development.

*Culture, Education, Science and Health Care.* This category includes expenditures on culture, education, health care, pensions, social welfare and natural disaster relief. Expenditures related to this category have increased substantially in recent years, principally due to planned increases in education, culture and health care allocations.

The following table sets forth the social security expenditures of the government for the periods indicated.

### **Government Social Security Expenditures**

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	<i>(in billions of Rmb)</i>				
Social Security Subsidies .....	<u>52.6</u>	<u>78.6</u>	<u>101.7</u>	<u>118.8</u>	<u>137.3</u>
Retirement Pension for Non-profit Institutions .....	<u>47.9</u>	<u>62.5</u>	<u>78.9</u>	<u>88.2</u>	<u>101.3</u>
Pension and Relief Funds for Social Welfare .....	21.3	26.7	37.3	49.9	55.8
Expenditure on Public Medicare .....	<u>21.5</u>	<u>24.0</u>	<u>25.2</u>	<u>28.2</u>	—
Total(1) .....	<u>143.3</u>	<u>191.8</u>	<u>243.1</u>	<u>285.1</u>	<u>294.4</u>

(1) From January 1, 2004, Expenditure on Public Medicare was no longer included in the Government Social Security Expenditures.

*Source: The Ministry of Finance.*

*National Defense and Government Administration.* Expenditures under this line item include expenditures for defense and national security and government administration. These expenditures have increased in recent years, principally due to salary increases, social security expenditures for armed forces, maintenance of military facilities, purchase of military equipment and anti-terrorism programs.

*Price Subsidies.* This category includes subsidies to producers of grain, cotton and related products, as well as direct food subsidies given to urban and rural residents.

*Other Expenditures.* This category includes funds to finance additional working capital of state-owned enterprises, geological prospecting expenses, certain expenses relating to industrial, transportation and commercial activities, financial support to agricultural production and interest payments for foreign and domestic indebtedness.

In 2004, total central government expenditures reached Rmb 1,827.4 billion, representing a 13.3% increase over 2003.

### *Debt Service*

The following table sets forth debt service payments by the government for the periods indicated.

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in billions of Rmb)				
<b>Internal Debt</b>					
Repayment of Principal .....	155.2	192.3	246.8	287.7	354.2
<b>External Debt</b>					
Repayment of Principal .....	2.8	8.4	9.5	7.6	12.9

*Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.*

### *State Budget as Percentage of GDP*

The following table presents government revenues (excluding proceeds from debt offerings) and expenditures (excluding debt repayments) as percentages of GDP for the periods indicated.

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in percentages)				
Central Government Revenues as % of GDP .....	7.8	8.8	9.9	10.1	10.6
Central Government Expenditures as % of GDP .....	6.2	5.9	6.4	6.3	5.8
Central and Local Governments(1) Revenues as % of GDP ...	15.0	16.8	18.0	18.5	19.3
Central and Local Governments Expenditures as % of GDP ..	17.8	19.4	21.0	21.0	20.7
Deficit as % of GDP .....	2.8	2.6	3.0	2.5	1.5

(1) Not including expenditures on local tax refund and subsidies of Rmb 466.8 billion, Rmb 601.5 billion, Rmb 736.2 billion, Rmb 824.0 billion and Rmb 1,037.9 billion in each of 2000, 2001, 2002, 2003 and 2004, respectively.

*Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.*

### *State Budget for 2005*

The Tenth National People's Congress approved the 2005 state budget on March 14, 2005, which contained the following key items:

- Rmb 353.7 billion for infrastructure construction, including an issue of Rmb 80.0 billion long-term treasury bonds, mainly for investments in existing infrastructure projects;
- Rmb 139.8 billion for research and development;
- Rmb 597.7 billion for culture, education, science and health care;
- Rmb 701.7 billion for national defense and government administration;
- Rmb 78.2 billion for price subsidies; and
- Rmb 1,354.4 billion to finance additional working capital of state-owned enterprises, geological prospecting expenses, certain expenses relating to industrial, transportation and commercial activities, financial support to agricultural production and interest payments for foreign and domestic indebtedness.

Under the 2005 state budget, total revenues are expected to be Rmb 2,925.5 billion, an increase of 11.0% over 2004. Of the total revenues, the central government revenues are expected to be Rmb 1,666.2 billion. Total expenditures under the 2005 state budget are expected to be Rmb 3,225.5 billion, an increase of 13.7% over 2004. Of the total expenditures, the central government expenditures are expected to be Rmb 1,966.2 billion. The deficit of central government finance for 2005 is expected to be Rmb 300.0 billion.

In preparing China's 2005 state budget, the government made the following assumptions, among others, about 2005:

- a real GDP growth rate of 8.0%;
- additional employment of at least 9.0 million people in the urban work force;
- unemployment rate of approximately 4.6%;
- inflation rate of approximately 4.0%; and
- growth of 15.0% in total trade volume.

These figures represent the government's forecast, as of the end of 2004, with respect to China's economy during 2005. While the government believes that its assumptions and targets were reasonable when made, some are beyond its control, and actual outcomes will depend on future events. Accordingly, no assurance can be given that economic results will not differ materially from these assumptions and targets.

### **Off-Budget Items**

Although the central government has maintained control over public finance in China, some revenues and expenditures of state-owned enterprises, local governments, central government agencies and certain public institutions have not been included in the state budget. Such revenues and expenditures are commonly referred to as "off-budget" items and are subject to varying degrees of control and regulation by the central government. Off-budget revenues and expenditures are not included in calculations of the budget deficit. However, certain off-budget revenues are subject to taxes levied by the central government to finance infrastructure construction.

Local governments and other institutions that incur such off-budget items are accountable to the National Audit Office, a ministry-level agency that reports to the State Council. In addition, the Ministry of Finance provides guidelines with respect to the approved usage of off-budget revenue.

The following table presents the off-budget revenues and expenditures for the periods indicated. Detailed off-budget information for 2003 and 2004 is currently not available.

### Off-budget Revenues and Expenditures (2000-2003)

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
	(in billions of Rmb)			
<b>Revenues</b>				
Administrative Departments .....	265.5	309.0	323.8	N/A
Policy-oriented Funds .....	38.4	38.0	37.6	N/A
Funds Raised at Village and Township Levels .....	40.3	41.0	27.2	N/A
Industry Authorities .....	5.9	6.0	7.2	N/A
Other .....	<u>32.6</u>	<u>36.0</u>	<u>52.1</u>	<u>N/A</u>
Total .....	<u>382.6</u>	<u>430.0</u>	<u>447.9</u>	<u>456.7</u>
<b>Expenditures</b>				
Administrative and Operative Expenditures .....	222.5	250.0	265.5	N/A
Pooling at Village and Township Levels .....	38.7	40.0	26.8	N/A
Capital Investment .....	42.6	35.0	26.0	N/A
City Maintenance .....	14.6	15.0	16.0	N/A
Other .....	<u>34.4</u>	<u>45.0</u>	<u>48.8</u>	<u>N/A</u>
Total .....	<u>352.9</u>	<u>385.0</u>	<u>383.1</u>	<u>415.6</u>

Source: China Statistical Abstract of 2005, China Statistical Yearbook of 2004, the National Bureau of Statistics of China.

In 1996, the State Council issued the Decision on Strengthening Management of Off-budget Funds, which defined the range of off-budget items and clarified the regulation of their management. Pursuant to the State Council decision, a number of infrastructure and social development funds, as well as various administrative fees and levies collected by local governments, have been incorporated in the local government budgets. Social security funds, pending the establishment of a national social security budget, are managed under the existing off-budget fund rules and regulations, and used only for earmarked purposes. The State Council's decision also authorizes the local people's congresses to supervise the collection and usage of off-budget funds by their respective local governments. The government intends to gradually incorporate the remaining off-budget items into the state budget.

### Fiscal and Tax Reforms

The government has over the years adopted numerous fiscal reform measures to facilitate the growth of the PRC economy and to reduce its deficit. The government also took measures to increase central government revenues as a percentage of total government revenues and to gain greater fiscal control. Central government revenues (excluding debt financing proceeds), which made up 41% of total government revenues in 1984, declined to 22% in 1993 and recovered to 56% in 1994 as a result of the financial and tax reforms begun in 1994.

These reforms started with the State Council's adoption of the 1994 Tax Regulations, which came into effect on January 1, 1994. Pursuant to the 1994 Tax Regulations, a uniform income tax rate of 33% now applies to all domestic PRC enterprises, a uniform 17% value-added tax (with certain exceptions such as value-added taxes for newspapers, books and fertilizer) replaced the product tax, a consumption tax is now levied upon a variety of products at specified tax rates, and a business tax is now assessed on revenues derived from providing services. In addition, since the adoption of the individual income tax law in 1980, a progressive individual income tax is now levied on all individuals with monthly income over Rmb 800. The 1994 Tax Regulations represent an important

restructuring of the PRC taxation system with the principal objective of introducing uniformity, simplicity and fairness into the taxation system.

As a result of the 1994 Tax Regulations, state-owned enterprises, like any other enterprise, are responsible only for the payment of relevant taxes to the state. They are no longer subject to certain charges and levies traditionally imposed on them, such as state budget regulation levy and special projects levy. State-owned enterprises became otherwise free to manage their after-tax profit. As the owner of the state-owned enterprises, however, the central government continues to participate in the distribution of their after-tax profits.

In 1994, the government established a fiscal revenue allocation system, under which the central and local governments would separately collect and retain their own specified taxes and share the revenue from certain other categories of taxes based on ratios prescribed by the State Council. As a part of this arrangement, taxation is divided into the following three categories:

- taxes for the central government exclusively, which include tariff duties, income taxes of state-owned enterprises under the central government, consumption taxes (including import-related consumption taxes), taxes imposed upon banks, non-bank financial institutions and insurance companies, and taxes on railroads;
- taxes for the local governments exclusively, which include business tax (except that business taxes applicable to state-owned banks and railroads would be payable to the central government), income taxes of state-owned enterprises under the local government and collectively owned enterprises, and individual income taxes; and
- taxes shared between the central and local governments, which include value-added taxes, stamp duties on securities transactions, taxes on natural resources and other similar taxes directly related to economic development.

In 2001 and 2002, the State Council further adjusted this fiscal revenue sharing arrangement by reclassifying corporate income taxes of all enterprises (other than state-owned banks, non-bank financial institutions, insurance companies and railroad owners and operators), as well as individual income taxes, as taxes to be shared between the central and local governments. The central and local governments will share these tax revenues according to ratios prescribed by the State Council.

To implement this dual taxation regime and to ensure the efficient collection of revenues due to the central government, the central and local governments have established separate tax collection systems. Under this system, the central and local governments are responsible for the collection of their own respective taxes, and the shared taxes are levied and collected by the central government and then shared between the central and local governments.

In 2004, total central government revenues accounted for approximately 54.9% of total government revenues, and central government expenditures amounted to approximately 64.4% of total government expenditures. In 2004, the central government transferred Rmb 1,037.9 billion of its revenues to local governments to enable them to make expenditures for specifically designated purposes. The government incurred a deficit of Rmb 200.5 billion in 2004 primarily because of continued substantial expenditures on infrastructure development in order to eliminate or relieve infrastructure bottlenecks that impede rapid economic growth. This deficit was financed through the issuance of government debt securities.

In 2004, on an experimental basis, the government started to allow qualified entities in certain industries (including the equipment manufacturing industry, the petrochemical industry and the metallurgical industry) in Northeast China to set off the amount of value-added tax paid by them to vendors on purchases of machinery and equipment against a certain part of the value-added tax payable by them to the government on their sales of products or services.



## PRC Internal and External Debt

*As used in this section, “external debt” or “external borrowings” means borrowings from sources outside China; “internal debt” or “internal borrowings” means borrowings from sources inside China; and “direct,” when used with reference to any debt or borrowings (e.g., “direct debt”), means debt incurred directly by the central government in the name of China.*

The State Council has appointed the State Development and Reform Commission to establish quotas for external borrowings. The State Administration of Foreign Exchange monitors and regulates compliance with these external borrowings through a registration process.

The Ministry of Finance is responsible for administering internal borrowings and external borrowings on behalf of the government from the domestic markets and the international capital markets, and bilateral loans from foreign governments and international organizations such as the World Bank and the Asian Development Bank. Under the Budget Law, local governments are not permitted to incur any indebtedness unless specifically authorized by the central government.

External borrowings by financial institutions and enterprises were historically managed by a “window” management system, under which the issuance or incurrence of debt required a quota from the State Development and Reform Commission and approval from the State Administration of Foreign Exchange. This system favored providing quotas and granting approvals to a limited number of pre-designated “window” companies. The window management system has been replaced by a credit management system, whereby the quotas and approvals will be granted to enterprises and financial institutions (including leasing companies) on the basis of their demonstrated capacity to repay the borrowings, their free-standing creditworthiness and China’s balance of payments situation. Unless otherwise expressly provided by the central government in the relevant debt issuance documents or other official PRC documents, borrowings by these entities are not guaranteed by, or otherwise entitled to any direct or indirect credit support from, the government.

Internal borrowings include the issuance of bonds by state-owned enterprises. The National Development and Reform Commission and the China Securities Regulatory Commission must approve their issuance of bonds within China.

### Debt Objectives and Structure

One of the primary goals of the 1978 economic reforms was to attract foreign funds and channel internal funds to help finance the restructuring and development of the PRC economy. For the first time since 1958, the central government resumed issuing internal debt to finance fiscal deficits in 1981. Since then, internal debt has also been issued to finance capital construction.

The government’s current policies are to:

- limit the external debt service ratio (i.e., with respect to any fiscal year, principal and interest payments on external debt divided by exports of goods and services) to 15% or less;
- limit the external debt to export earnings ratio (i.e., the outstanding amount of external debt divided by exports of goods and services) to 100% or less; and
- limit the ratio of the outstanding amount of external debt to GDP to 25% or less.

At the end of 2004, China’s external debt service ratio, external debt to export earnings ratio and external debt to GDP ratio were 3.2%, 34.9% and 13.9%, respectively.

The following table presents China's debt by category and as a percentage of nominal GDP for the periods indicated.

	<b>Debt</b>				
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
<b>Internal</b> (in billions of Rmb, except for percentages)					
Direct Internal Debt .....	1,302.0	1,561.8	1,907.9	2,126.1	2,880.3
% of GDP .....	14.6%	16.0%	18.1%	18.1%	21.0%
Other Internal Debt(1) .....	828.1	934.2	1,081.4	1,269.6	1,517.0
% of GDP .....	<u>9.3%</u>	<u>9.6%</u>	<u>10.3%</u>	<u>10.8%</u>	<u>11.1%</u>
Sub-total .....	2,130.1	2,496.0	2,989.3	3,395.7	4,397.3
% of GDP .....	23.8%	25.6%	28.4%	28.9%	32.1%
<b>External</b> (in billions of US\$, except for percentages)					
Direct External Debt(2) .....	49.0	49.8	50.5	52.8	33.6
% of GDP .....	4.5%	4.2%	4.0%	3.7%	2.0%
Other External Debt(2)(3) .....	96.7	120.3	120.9	140.8	195.0
% of GDP .....	<u>8.9%</u>	<u>10.2%</u>	<u>9.5%</u>	<u>9.9%</u>	<u>11.8%</u>
Sub-total .....	145.7	170.1	171.4	193.6	228.6
% of GDP .....	<u>13.5%</u>	<u>14.5%</u>	<u>13.5%</u>	<u>13.7%</u>	<u>13.8%</u>
Total Internal and External Debt (in billions of Rmb) ...	<u>3,336.3</u>	<u>3,903.9</u>	<u>4,408.0</u>	<u>4,998.1</u>	<u>6,289.4</u>
% of GDP .....	37.3%	40.1%	41.9%	42.6%	45.9%

(1) Includes debt incurred by state-owned financial institutions, enterprises, including enterprises owned or controlled by the central government.

(2) Since June 2004, foreign government loans on-lent by China Eximbank have been included in external debt of financial institutions instead of that of central government.

(3) Includes debt incurred by entities in China other than the central government and includes debt of China's policy banks, commercial banks, trust and investment companies and foreign-invested enterprises.

Sources: *China Statistical Yearbook of 2004*, *China Statistical Abstract of 2005*, the National Bureau of Statistics of China; the Ministry of Finance.

The following table sets forth the maturity profile of China's outstanding direct public debt (under the state budget) as of December 31, 2004:

	<b>Debt Maturity Schedule</b>				
	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Direct Internal Debt (in billions of Rmb) .....	387.1	427.6	393.6	349.0	369.3
Direct External Debt (in millions of US\$) .....	733.2	724.3	711.9	1,206.7	702.0

Source: *The Ministry of Finance*.

### Internal Debt

To finance fiscal deficits and infrastructure projects, the central government has issued debt securities that are classified as treasury securities, central government special bonds and inflation-indexed bonds. Treasury securities, which may only be purchased and held by PRC individuals, enterprises and institutions, are the major

component of the central government's internal debt. Treasury securities are currently underwritten by commercial banks and distributed through their nationwide branch networks.

Other internal debt includes bonds issued by state-owned enterprises and financial institutions.

The following table presents the internal debt of the central government and state-owned enterprises at the dates indicated.

	<b>Internal Debt</b>				
	<b>At December 31,</b>				
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(in billions of Rmb)				
Direct Internal Debt .....	1,302.0	1,561.8	1,907.9	2,126.1	2,880.3
Other Internal Debt					
Financial Bonds(1) .....	741.9	833.3	1,005.4	1,156.0	1,393.7
Corporate Bonds(2) .....	<u>86.2</u>	<u>100.9</u>	<u>76.0</u>	<u>113.6</u>	<u>123.3</u>
Total Internal Debt .....	<u>2,130.1</u>	<u>2,496.0</u>	<u>2,989.3</u>	<u>3,395.7</u>	<u>4,397.3</u>

(1) Bonds issued by state-owned financial institutions, including three policy banks.

(2) Bonds issued by enterprises (other than state-owned financial institutions), including enterprises owned or controlled by the central government.

Source: *The Ministry of Finance*.

### External Debt

Loans are the primary source of external debt. Non-trade loans accounted for approximately 79.7% of the total external debt outstanding at December 31, 2004. Commercial loans (i.e., loans obtained from any source on commercial terms), official primary government loans (i.e., loans obtained on favorable terms from foreign governments and international financial organizations including the World Bank and Asian Development Bank) and trade loans accounted for approximately 54.6%, 25.1% and 20.3%, respectively, of total external debt in the form of loans at December 31, 2004. The central government's current policy is to continue to seek loans from foreign governments and international financial institutions to finance infrastructure projects in China. At the end of 2004, the total outstanding external debt was US\$228.6 billion.

The Ministry of Finance, on behalf of the central government, has raised funds in the international capital markets through various debt securities and bond issues since 1993. The Ministry of Finance's principal objective is to set up benchmarks for other Chinese borrowers. Several state-owned financial institutions and enterprises have also issued debt securities in the international capital markets with the approval of the State Council.

Unless the central government expressly provides otherwise, the central government does not guarantee or provide any direct or indirect credit support to any entity in China. However, debtors that have their external debt registered with the State Administration of Foreign Exchange have the right to buy foreign currencies as permitted by the central government at the China Foreign Exchange Trading System rate in order to service the interest and principal payments on their registered external debt.

In 2001, in line with international practice, China revised its method of collecting and calculating its external debt information. These modifications cover the following aspects:

- the inclusion of external borrowings by foreign invested financial institutions in China in calculating the aggregate foreign debt incurred by Chinese entities;
- the exclusion of borrowings by domestic entities from foreign invested financial institutions in China in calculating the aggregate foreign debt incurred by Chinese entities and treat these borrowings as internal debts;

- the inclusion of all foreign trade credits to Chinese entities, including trade credits with less than three-month maturities, as foreign debt; and
- the inclusion of any current portion (less than one-year maturity) of indebtedness with an original maturity exceeding one year as short-term debt.

As a result, external debt information included in this offering circular for 2001, 2002, 2003 and 2004 differs from 2000.

The following table presents the long-term and short-term external debts of Chinese borrowers and their respective percentages of total outstanding external debt at the dates indicated.

#### External Debt by Maturity

	At December 31,				
	2000	2001	2002	2003	2004
	(in billions of US\$, except for percentages)				
Long-term Debt . . . . .	132.7	119.5	115.6	116.6	124.3
Percentage of Total Outstanding External Debt . . . . .	91.0%	70.3%	67.4%	60.2%	54.4%
Short-term Debt . . . . .	13.1	50.6	55.8	77.0	104.3
Percentage of Total Outstanding External Debt . . . . .	9.0%	29.7%	32.6%	39.8%	45.6%

Source: China Statistical Abstract of 2005, the National Bureau of Statistics of China.

The following table presents the total external debt by Chinese borrowers at the dates indicated.

#### External Debt by Borrower

	At December 31,				
	2000	2001	2002	2003	2004
	(in billions of US\$)				
Central Government(1) . . . . .	49.0	49.8	50.5	52.8	33.6
Foreign-invested Enterprises(2) . . . . .	46.5	35.2	33.2	37.8	44.6
Financial Institutions(1) . . . . .	35.6	34.4	36.3	37.6	66.0
Trade Credit(2) . . . . .	N/A	21.6	26.3	36.6	46.5
Foreign Financial Institutions(2)(3) . . . . .	N/A	17.0	15.0	20.9	31.6
Enterprises . . . . .	13.5	11.3	10.0	7.6	6.0
Others . . . . .	1.2	0.8	—	0.3	0.3
Total . . . . .	<u>145.7</u>	<u>170.1</u>	<u>171.4</u>	<u>193.6</u>	<u>228.6</u>

(1) Since June 2004, foreign government loans on-lent by China Eximbank have been included in external debt of financial institutions instead of that of the central government.

(2) Before June 2001, the category of foreign-invested enterprises included both foreign financial institutions and trade credit. In June 2001, separate categories were created for these two items.

(3) Including foreign banks and foreign non-bank financial institutions.

Sources: China Statistical Abstract of 2005, the National Bureau of Statistics of China; the Ministry of Finance; the State Administration of Foreign Exchange; the Ministry of Finance.

The following table presents the currency breakdown of China's external debt at the dates indicated.

	<b>External Debt by Currency</b>									
	<b>At December 31,</b>									
	<b>2000</b>		<b>2001</b>		<b>2002</b>		<b>2003</b>		<b>2004</b>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
	(in billions of US\$, except for percentages)									
US\$ . . . . .	96.2	66.0	115.5	67.9	113.6	66.3	126.8	65.5	148.4	64.9
Japanese Yen . . .	24.3	16.7	23.6	13.9	25.2	14.7	27.3	14.1	33.1	14.5
Other . . . . .	<u>25.2</u>	<u>17.3</u>	<u>31.0</u>	<u>18.2</u>	<u>32.6</u>	<u>19.0</u>	<u>39.5</u>	<u>20.4</u>	<u>47.1</u>	<u>20.6</u>
Total . . . . .	<u>145.7</u>	<u>100.0</u>	<u>170.1</u>	<u>100.0</u>	<u>171.4</u>	<u>100.0</u>	<u>193.6</u>	<u>100.0</u>	<u>228.6</u>	<u>100.0</u>

Sources: *China Statistical Abstract of 2005, the National Bureau of Statistics of China; the Ministry of Finance.*

### Debt Record

The central government has always paid when due the full amount of principal of, any interest and premium on, and any amortization or sinking fund requirements of, external and internal indebtedness incurred by it since the PRC was founded in 1949.

## DESCRIPTION OF THE NOTES

*The following summaries of some of the provisions of the notes and the fiscal agency agreement do not purport to be complete and are subject to, and are qualified in their entirety by reference to, all provisions of the notes and the fiscal agency agreement, including the definitions therein of certain terms.*

### General

The 4.875% notes due 2015 are to be issued under a fiscal agency agreement, dated as of July 21, 2005, between China Eximbank and Citibank N.A., as fiscal agent.

China Eximbank will issue the notes in an aggregate principal amount of US\$1,000,000,000, which will mature at par on July 21, 2015. The notes:

- will bear interest at 4.875% per year from July 21, 2005;
- will pay interest semi-annually in arrears in equal installments, on the basis of a 360-day year, consisting of twelve 30-day months, on January 21 and July 21 of each year, beginning on January 21, 2006 to be paid to the person in whose name each note is registered at the close of business on the preceding January 6 or July 6;
- upon issuance, will constitute direct, general, unconditional, unsecured and unsubordinated obligations of China Eximbank and will rank equally with each other and with all other general, unsecured and unsubordinated Public External Indebtedness of China Eximbank from time to time outstanding;
- will be issued in fully registered global form, without coupons, registered in the name of Cede & Co., as nominee of DTC, in denominations of US\$100,000 and integral multiples of US\$1,000 in excess of US\$100,000;
- will be recorded on, and transferred through, the records maintained by DTC and its direct and indirect participants, including Euroclear Bank S.A./N.V., or Euroclear, and Clearstream Banking, *société anonyme*, or Clearstream;
- will be available in definitive form only under certain limited circumstances; and
- will not have the benefit of any sinking fund for the amortization and retirement of the notes.

China Eximbank or the registrar, acting as China Eximbank's agent, will maintain a register that shows DTC as the owner of the global notes or, in the event that physical, certificated notes are issued, that shows the persons to which such physical, certificated notes are issued as the owners of such notes. Transfers of ownership of the notes and the right to payments of principal and interest thereunder may be made only through entries in the register.

### Payment of Principal and Interest

China Eximbank will make payments of principal and interest on the notes in U.S. dollars on any interest payment date or at maturity. Principal of and interest on the notes will be payable at the offices or agencies that China Eximbank maintains for such purpose, which initially will be the offices of the paying agents specified in the inside back cover of this offering circular. The payments will be made available by China Eximbank to the fiscal agent on the business day prior to such date. If any date for payment in respect of the notes is not a business day, the noteholder will not be entitled to payment until the next following business day. "Business day" means a day, other than a Sunday or Saturday on which banks in London and New York and at any applicable place of payment are not authorized or obligated by law or executive order to be closed. No further interest will be paid in respect of any such delay in payment. So long as the notes are in global form registered in the name of or held by DTC or its nominee, the fiscal agent will make such payments to DTC, which will receive the funds for distribution to the beneficial holders of the notes. If any notes are no longer represented by global notes, payment on the notes in definitive form may, at China Eximbank's option, be made by check mailed directly to noteholders at their registered addresses.

## Further Issues

China Eximbank may from time to time, without the consent of noteholders, create and issue further notes having the same terms and conditions as the notes in all respects, except for the issue date, issue price and the first payment of interest thereon, provided, however, that such additional notes do not have a greater amount of original issue discount for U.S. federal tax purposes (regardless of whether any holders of such additional notes are subject to U.S. federal tax laws) than the outstanding notes have as of the date of the issue of such additional notes. Additional notes issued in this manner will be consolidated with and will form a single series with the notes.

## Status of the Notes

The notes will be direct, unconditional, unsecured and unsubordinated obligations of China Eximbank. The notes will rank *pari passu* without any preference among themselves (whether by reason of priority of date of issue or otherwise) and at least equally with all other unsecured and unsubordinated Public External Indebtedness of China Eximbank from time to time outstanding. For the definition of the Public External Indebtedness, see “—Negative Pledge” below. As of June 30, 2005, the aggregate principal amount of Public External Indebtedness of China Eximbank that would rank *pari passu* with the notes was US\$1.0 billion. As of June 30, 2005, the aggregate principal amount of all borrowings by China Eximbank from overseas, including such Public External Indebtedness, was approximately US\$1.0 billion.

## Negative Pledge

So long as any of the notes remains outstanding, China Eximbank will not grant or permit to be outstanding any mortgage, charge, lien, pledge or any other security interest on any of its present or future assets or revenues to secure the payment of, or any guarantee or indemnity in respect of, any Public External Indebtedness unless such notes are secured by such security interest equally and ratably with such other Public External Indebtedness. This provision, however, will not apply to:

- any security interest on any property or asset existing at the time of acquisition thereof or to secure the payment of all or any part of the purchase price or construction cost thereof or to secure any indebtedness incurred prior to, or at the time of, such acquisition or the completion of construction of such property or asset for the purpose of financing all or any part of the purchase price or construction cost thereof;
- any security interest in existence on July 14, 2005 to the extent that it secures Public External Indebtedness outstanding on such date; or
- any lien arising by operation of law.

Any note authenticated and delivered pursuant to the fiscal agency agreement, as of any date of determination, will be deemed “outstanding” except:

- notes that have been cancelled by the fiscal agent or delivered to the fiscal agent for cancellation;
- notes that have become due and payable at maturity or otherwise and monies sufficient to pay the principal of and any interest on these notes have been paid or duly provided for; and
- notes in lieu of or in substitution for which other notes have been authenticated and delivered pursuant to the fiscal agency agreement.

“Public External Indebtedness” means any indebtedness of China Eximbank, or any guarantee or indemnity by China Eximbank of indebtedness, for money borrowed which,

- is in the form of or represented by any bond, note, debenture, debenture stock, loan stock, certificate or other instrument which is, or is capable of being listed, quoted or traded on any stock exchange or in any securities market (including, without limitation, any over-the-counter market) outside the mainland of the People’s Republic of China (without regard, however, to whether or not such instruments are sold through public offerings or private placements);

- has an original maturity of more than 365 days; and
- is denominated in or payable, or confers a right to receive any payment, in any currency which is not the lawful currency for the time being of the mainland of the People's Republic of China;

provided that Public External Indebtedness shall not include any indebtedness for borrowed money owed to a state-owned financial institution of China.

### **Definitive Certificates**

Notes represented in global certificates are exchangeable for certificated notes of like tenor as such global certificates in denominations of US\$100,000 and integral multiples of US\$1,000 in excess of US\$100,000:

- if DTC notifies China Eximbank that it is unwilling or unable to continue as the depository for such global certificates or if at any time DTC ceases to be a clearing agency registered under the United States Securities Exchange Act of 1934, as amended, at a time when it is required to be so registered, and, in each case, a replacement depository is not appointed within 90 days;
- if China Eximbank in its discretion at any time determines not to have all of the notes represented by global certificates; or
- if an event of default with respect to the notes entitling their holders to accelerate the maturity of such notes has occurred and is continuing.

### **Default; Acceleration of Maturity**

Any of the following events will be an event of default with respect to the notes:

- China Eximbank fails to pay any amount of principal or interest in respect of the notes on their due dates and the continuance of such failure for 30 days; or
- China Eximbank defaults in the performance or observance of any of its other obligations under the notes or the fiscal agency agreement and such default remains unremedied for 60 days following receipt by China Eximbank of written notice from noteholders of an aggregate principal amount of not less than 10% of the outstanding notes to remedy such failure; or
- China Eximbank defaults in the payment of principal or interest in excess of US\$25,000,000 (or its equivalent in any other currency or currencies) payable (whether upon maturity, acceleration or otherwise) in connection with its Public External Indebtedness (other than that represented by the notes), and the failure of China Eximbank to pay or validly reschedule (with the consent of the holders of such Public External Indebtedness) the payment of such Public External Indebtedness within 30 days of the date on which such payment has become due (including any applicable days of grace); or
- an order is issued or any other action is taken by appropriate authorities of or in China for the dissolution or merger or consolidation of China Eximbank (except where China Eximbank is the continuing entity) or for the transfer or assignment of the whole or a material part of its assets (except, in either case, where all the obligations of China Eximbank under the notes then outstanding are legally assumed by another agency designated by the State Council; provided that (i) such agency is a solvent financial institution organized and existing under the laws of China, (ii) such agency is controlled, directly or indirectly, by China, (iii) such agency assumes in writing all the obligations of China Eximbank under the notes, and (iv) immediately after giving effect to such transaction no event of default or event or condition that, with the giving of notice or the lapse of time or both, would become an event of default has occurred and is continuing); or
- China ceases to own at least 51% of China Eximbank; or
- unless the PRC central government fully guarantees or otherwise assumes the indebtedness, and all obligations of China Eximbank, evidenced by the notes and under the fiscal agency agreement, the People's Bank of China (or the successor central bank of China) ceases or fails to provide the liquidity



support stipulated in the Special Decree of the State Council (State Council Document No. 20 dated March 19, 1994) as in effect as of the date of issuance of the notes or the Special Decree is amended in a manner which prejudices the rights of the noteholders or ceases to be valid or effective.

If one or more of the events described above occurs with respect to the notes, each noteholder may declare the principal of the notes due and payable immediately by written demand given to China Eximbank and the fiscal agent at the office of the fiscal agent unless, prior to the receipt of that demand by the fiscal agent, all defaults have been cured.

China Eximbank will notify the noteholders and the fiscal agent promptly upon becoming aware of the occurrence of any event of default, but will not be obligated to furnish any periodic evidence as to the absence of defaults.

### **Repayment of Monies**

Any monies paid by China Eximbank to the fiscal agent in respect of any notes and remaining unclaimed at the end of two years after the principal of all notes shall have become due and payable (whether at maturity or otherwise) and monies sufficient therefor shall have been duly made available for payment shall, together with any interest made available for payment thereon, be repaid to China Eximbank. Upon such repayment, all liability of the fiscal agent with respect to such funds will cease, and the holder of such notes must look only to China Eximbank for any payment to which such holder may be entitled.

### **Additional Amounts**

All payments of principal and interest in respect of the notes will be made without withholding or deduction for or on account of any taxes, duties, assessments or governmental charges of whatsoever nature imposed or levied by mainland China or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by the law of mainland China. In that event, China Eximbank shall pay such additional amounts as will result in the receipt by the noteholders of such amounts as would have been received by them if no such withholding or deduction had been required, provided, however, that no such additional amounts shall be payable in respect of any note presented for payment:

- by a noteholder which is liable to such taxes, duties, assessments or governmental charges in respect of such note by reason of its having some connection with the mainland China other than the mere holding of such note; or
- by a noteholder who would not be liable for or subject to such withholding or deduction by making a declaration of identity, nonresidence or other similar claim for exemption to the relevant tax authority if, after having been requested to make such a declaration or claim, such holder fails to do so; or
- such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of November 26-27, 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- more than 30 days after the Relevant Date except to the extent that the relevant holder would have been entitled to such additional amounts if it had presented such note on the last day of such period of 30 days.

“Relevant Date” means whichever is the later of (i) the date on which the payment in question first becomes due and (ii) if the full amount payable has not been received in London by the fiscal agent on or prior to such due date, the date on which the full amount has been received and notice to that effect has been given to the noteholders.

For the avoidance of doubt, China Eximbank’s obligation to pay additional amounts in respect of taxes, duties, assessments and other governmental charges will not apply to (a) any estate, inheritance, gift, sales, transfer, personal property or any similar tax, duty, assessment or other governmental charge or (b) any tax, duty, assessment or other governmental charge which is payable otherwise than by deduction or withholding from payments of principal of, or interest on the notes; provided that China Eximbank shall pay all stamp or other

taxes, duties, assessments or other governmental charges, if any, which may be imposed by China or any political subdivision thereof or any taxing authority thereof or therein, with respect to the fiscal agency agreement or as a consequence of the issuance of the notes.

Any reference to principal or interest with respect to the notes will be deemed to include any additional amounts payable by China Eximbank in respect of such principal or interest.

### **Amendments and Waivers**

China Eximbank may at any time call a noteholders' meeting to seek their approval of the modification of or amendment to, or obtain a waiver of, any provision of the notes. This meeting will be held at the time and place determined by China Eximbank and specified in a notice of such meeting furnished to the noteholders. This notice must be given at least 30 days and not more than 60 days prior to the meeting. The fiscal agent may also call such noteholders' meeting for the same purpose after consultation with China Eximbank subject to the same notice requirements.

If at any time the holders of at least 10% of the aggregate principal amount of the then outstanding notes request the fiscal agent to call a meeting of the noteholders for any purpose, by written request setting forth in reasonable detail the action proposed to be taken at the meeting, the fiscal agent will call the meeting for such purpose. This meeting will be held at the time and place determined by the fiscal agent, after consultation with China Eximbank, and specified in a notice of such meeting furnished to the noteholders. This notice must be given at least 30 days and not more than 60 days prior to the meeting.

Only holders of notes and their proxies are entitled to vote at a meeting of holders. Holders or proxies representing a majority of the aggregate principal amount of the outstanding notes will normally constitute a quorum. However, if a meeting is adjourned for a lack of a quorum, then holders or proxies representing 25% of the aggregate principal amount of the outstanding notes will constitute a quorum when the meeting is rescheduled. The fiscal agent, after consultation with China Eximbank, will set the procedures governing the conduct of the meeting.

*Majority Consent.* The following actions require either: (1) the affirmative vote of holders of not less than a majority in aggregate principal amount of the outstanding notes represented at a duly called and held meeting of noteholders or (2) the written consent of the holders of not less than a majority in aggregate principal amount of the outstanding notes:

- for China Eximbank and the fiscal agent to modify, amend or supplement the terms of the notes or the fiscal agency agreement in any way; or
- for the noteholders to make, take or give any request, demand, authorization, direction, notice, consent, waiver or other action provided by the fiscal agency agreement or the notes to be made, given or taken by the noteholders.

*Unanimous Consent.* The following actions require the consent of the holder of each affected note:

- change the due date for the payment of the principal of or any interest on any note;
- reduce the principal amount of any note;
- reduce the portion of the principal amount that is payable in the event of an acceleration of the maturity of any note;
- reduce the interest rate on any note;
- change the currency in which or the required places at which any amount in respect of the notes is payable;
- shorten the period, if any, during which China Eximbank is not permitted to redeem the notes;
- change the terms under which China Eximbank is permitted to redeem the notes;

- reduce the proportion of the aggregate principal amount of the notes required to modify, amend or supplement the fiscal agency agreement or the terms and conditions of the notes;
- reduce the proportion of the aggregate principal amount of the notes required to make, take or give any request, demand, authorization, direction, notice, consent, waiver or other action; or
- change the obligation of China Eximbank to pay additional amounts under the notes.

*No Consent.* If both China Eximbank and the fiscal agent agree, they may, without the vote or consent of any noteholder, amend the fiscal agency agreement or the notes to:

- add to the covenants of China Eximbank for the benefit of the noteholders;
- surrender any right or power conferred upon China Eximbank in respect of the fiscal agency agreement or the notes;
- secure the notes pursuant to the requirements of the notes or otherwise;
- cure any ambiguity in, or cure, correct or supplement any defective provision of, the notes and does not adversely affect the interest of any noteholder; or
- amend the fiscal agency agreement or the notes in any manner which China Eximbank and the fiscal agent may determine which is not inconsistent with the notes and does not adversely affect the interest of any noteholder.

Any modification, amendment or supplement approved in the manner described above will be binding on all noteholders.

For purposes of determining whether the required percentage of noteholders is present at a meeting of noteholders for quorum purposes, or whether the required percentage of noteholders has approved any action, modification, amendment or supplement to the notes or the fiscal agency agreement, or whether the required percentage of noteholders has delivered a notice of acceleration of the notes, notes owned, directly or indirectly, by China Eximbank will be disregarded and deemed not to be outstanding, except that in determining whether the fiscal agent shall be protected in relying upon any action, modification, amendment or supplement, or any notice from noteholders, only notes that the fiscal agent knows to be so owned shall be so disregarded.

### **Regarding the Fiscal Agent**

China Eximbank has appointed Citibank, N.A., acting through its Agency & Trust Department at 5 Carmelite Street, London EC4Y 0PA, United Kingdom, as its fiscal agent, principal paying and transfer agent and registrar. The fiscal agency agreement contains provisions relating to the obligations and duties of the fiscal agent, the indemnification of the fiscal agent and the fiscal agent's relief from responsibility for actions that it takes. China Eximbank may replace the fiscal agent at any time, subject to the appointment of a replacement fiscal agent. China Eximbank may at any time appoint additional paying and transfer agents. China Eximbank, however, will at all times maintain a paying agent in The City of New York, which at present is Citibank, N.A., acting through its Agency & Trust Department at 111 Wall Street, 14th Floor, Zone 2, New York, New York 10005. China Eximbank will cause notice of any registration, termination or appointment of any paying agent, transfer agent or fiscal agent to be given as provided under "— Notices" below.

The fiscal agent is an agent of China Eximbank and is not a trustee for the holders of any notes. China Eximbank may maintain deposit accounts and conduct other banking transactions in the ordinary course of business with the fiscal agent and other paying agents. The fiscal agent will not have the same responsibilities or duties to act for any noteholder as would a trustee, except that monies paid to and held by the fiscal agent as payment of principal of or interest on the notes will be received and held by the fiscal agent in trust for the noteholders pursuant to the fiscal agency agreement and the notes.

In addition, the fiscal agency agreement is not required to be, and will not be, qualified under the United States Trust Indenture Act of 1939, as amended. As a result, the fiscal agency agreement may not contain all of

the provisions contained in an indenture qualified under this Trust Indenture Act that could be of benefit to the noteholders.

### **Transfer, Exchange and Replacement of Notes**

The notes may be transferred or exchanged at the offices or agencies maintained by China Eximbank for such purpose (which initially will be the offices of the transfer agents specified on the inside back cover page of this offering circular).

No service charge will be made for any registration of transfer or exchange of notes, but China Eximbank may require payment of an amount sufficient to cover any transfer tax or other similar governmental charge payable in connection therewith.

If a note becomes mutilated, defaced, destroyed, lost or stolen, China Eximbank may issue, and the fiscal agent will authenticate and deliver, a substitute note. In each case, the applicant for a substitute note will be required to furnish to China Eximbank and to the fiscal agent (or to any transfer agent at whose office the applicant presents the notes for exchange) an indemnity under which it will agree to pay China Eximbank, the fiscal agent and any other transfer agent for any losses they may suffer relating to the note that was mutilated, defaced, destroyed, lost or stolen. China Eximbank and the fiscal agent may also require that the applicant present other documents or proof. The applicant will be required to pay all expenses and reasonable charges associated with the replacement of the mutilated, defaced, destroyed, lost or stolen note.

### **Jurisdiction; Consent to Service**

China Eximbank will appoint Mr. Zheng Bailin, General Manager, Bank of China New York Branch, and his successors from time to time, as its authorized agent upon whom process may be served in any suit, action, or proceeding arising out of or based on the notes or the fiscal agency agreement which may be instituted in any state or federal court in the Borough of Manhattan, The City of New York, by the holder of any note and China Eximbank will irrevocably submit to the non-exclusive jurisdiction of any such court in respect of any such action. Such appointment will be irrevocable until all amounts in respect of the principal and interest due and to become due on or in respect of all the notes have been provided to the fiscal agent, except that if, for any reason, the authorized agent ceases to be able to act as such authorized agent or ceases to have an address in the Borough of Manhattan, The City of New York, China Eximbank will appoint another person in the Borough of Manhattan, The City of New York, as its authorized agent. China Eximbank is also subject to suit in competent courts in China.

In respect of any proceedings described above, China Eximbank will irrevocably consent to the giving of any relief and the issue of any process in connection with such proceedings, including, without limitation, the making, enforcement or execution (against any assets whatsoever of China Eximbank, irrespective of their uses or intended uses), of any order or judgment made or given in any such proceedings, and to the extent that China Eximbank may in any jurisdiction claim for itself or its assets, or have attributed to it or its assets, any right of immunity on the grounds of sovereignty from any legal action, suit, proceeding, execution, attachment or other legal process, China Eximbank will irrevocably agree not to claim and will waive such immunity to the fullest extent permitted by law. See “Enforcement of Foreign Judgments.”

### **Governing Law**

The fiscal agency agreement and the notes will be governed by, and construed in accordance with, the laws of the State of New York, except that all matters governing authorization and execution by China Eximbank shall be governed by the laws of China.

### **Notices**

All notices will be published in English in *The Wall Street Journal — Eastern Edition*. If at any time publication in such newspaper is not practicable, notices will be valid if published in an English language newspaper with general circulation in The City of New York. Any such notice will be deemed to have been given

on the date of such publication or, if published more than once on difference dates, on the first date on which publication is made. For so long as the notes are listed on The Stock Exchange of Hong Kong Limited and the rules of such exchanges so require, China Eximbank will also publish notices to noteholders in leading daily newspapers of general circulation in Hong Kong. China Eximbank expects that it will initially make such publication in the *South China Morning Post* in Hong Kong.

If the notes are represented by book-entry securities, notices will be sent to the relevant depositary, such as DTC, or its nominee as the holder of the global notes, and the depositary will communicate these notices to its participants in accordance with its standard procedures.

## GLOBAL CLEARANCE AND SETTLEMENT

### Global Notes

The notes will initially be issued in the form of registered note certificates in global form, without interest coupons, as follows:

- Notes sold to QIBs in reliance on Rule 144A will be represented by one or more global note certificates without interest coupons; and
- Notes sold in offshore transactions to non-U.S. persons in reliance on Regulation S will be represented by one or more global note certificates without interest coupons.

Upon issuance, each of the Rule 144A and Regulation S global note certificates will be deposited with the fiscal agent as custodian for DTC and registered in the name of Cede & Co., as nominee of DTC.

Ownership of beneficial interests in each global note will be limited to persons who have accounts with DTC, or the DTC participants, or persons who hold interests through DTC participants (including Euroclear and Clearstream). China Eximbank expects that under procedures established by DTC:

- upon deposit of each global note with DTC's custodian, DTC will credit portions of the principal amount of the global note to the accounts of the DTC participants designated by the initial purchasers; and
- ownership of beneficial interests in each global note will be shown on, and transfer of ownership of those interests will be effected only through, records maintained by DTC (with respect to interests of DTC participants) and the records of DTC participants (with respect to other owners of beneficial interests in each global note).

Beneficial interests in the Regulation S global note will initially be credited within DTC to Euroclear and Clearstream on behalf of the owners of such interests. On or prior to the 40th day after the later of the commencement of the offering and the closing date, which is referred to as the "distribution compliance period" in this offering circular, beneficial interests in the Regulation S global note may be transferred only to non-U.S. persons under Regulation S or QIBs under Rule 144A.

Investors may hold their interests in the Regulation S global note directly through Euroclear or Clearstream if they are participants in those systems, or indirectly through organizations that are participants in those systems. Investors may also hold their interests in the Regulation S global note through organizations other than Euroclear or Clearstream that are DTC participants. Each of Euroclear and Clearstream will appoint a DTC participant to act as its depository for the interests in the Regulation S global note that are held within DTC for the account of each of these settlement systems on behalf of its respective participants.

Beneficial interests in the Rule 144A and Regulation S global notes may not be exchanged for notes in physical certificated form except in the limited circumstances described below.

Each Rule 144A and Regulation S global note and beneficial interests in each Rule 144A and Regulation S global note will be subject to restrictions on transfer as described under "Transfer Restrictions."

### Exchanges between the Rule 144A and Regulation S Global Notes

Beneficial interests in one global note may generally be exchanged for interests in another global note. Depending on whether the transfer is being made during or after the distribution compliance period, and to which global note the transfer is being made, the fiscal agent may require the seller to provide certain written certifications in the form provided in the fiscal agency agreement.

A beneficial interest in a global note that is transferred to a person who takes delivery through another global note will, upon transfer, become subject to any transfer restrictions and other procedures applicable to beneficial interests in the other global note.

## **Book-Entry Procedures for the Global Notes**

All interests in the global notes will be subject to the operations and procedures of DTC, Euroclear and Clearstream. China Eximbank provides the following summaries of those operations and procedures solely for the convenience of investors. The operations and procedures of each settlement system are controlled by that settlement system and may be changed at any time. Neither China Eximbank nor the initial purchasers are responsible for those operations or procedures.

DTC has advised that it is:

- a limited purpose trust company organized under the laws of the State of New York;
- a “banking organization” within the meaning of the New York State Banking Law;
- a member of the United States Federal Reserve System;
- a “clearing corporation” within the meaning of the Uniform Commercial Code; and
- a “clearing agency” registered under Section 17A of the United States Securities Exchange Act of 1934, as amended.

DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between its participants through electronic book entry changes to the accounts of its participants. DTC participants include securities brokers and dealers, including the initial purchasers; banks and trust companies; clearing corporations; and other organizations. Indirect access to DTC’s system is also available to others such as banks, brokers, dealers and trust companies; these indirect participants clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly. Investors who are not DTC participants may beneficially own securities held by or on behalf of DTC only through DTC participants or indirect participants in DTC.

So long as DTC’s nominee is the registered owner of a global note, that nominee will be considered the sole owner or holder of the notes represented by that global note for all purposes under the fiscal agency agreement. Except as provided below, owners of beneficial interests in a global note:

- will not be entitled to have notes represented by the global note registered in their names;
- will not receive or be entitled to receive physical, certificated notes; and
- will not be considered the owners or holders of the notes under the fiscal agency agreement for any purpose, including with respect to the giving of any direction, instruction or approval to the fiscal agent under the fiscal agency agreement.

As a result, each investor who owns a beneficial interest in a global note must rely on the procedures of DTC to exercise any rights of a noteholder under the fiscal agency agreement (and, if the investor is not a participant or an indirect participant in DTC, on the procedures of the DTC participant through which the investor owns its interest in the global note).

Payments of principal and interest with respect to the notes represented by a global note will be made by the fiscal agent to DTC’s nominee as the registered holder of the global note. Neither China Eximbank nor the fiscal agent will have any responsibility or liability for the payment of amounts to owners of beneficial interests in a global note, for any aspect of the records relating to or payments made on account of those interests by DTC, or for maintaining, supervising or reviewing any records of DTC relating to those interests.

Payments by participants and indirect participants in DTC to the owners of beneficial interests in a global note will be governed by standing instructions and customary industry practice and will be the responsibility of those participants or indirect participants and DTC.

Transfers between participants in DTC will be effected under DTC’s procedures and will be settled in same day funds. Transfers between participants in Euroclear or Clearstream will be effected in the ordinary way under the rules and operating procedures of those systems.

Cross market transfers between DTC participants, on the one hand, and participants in Euroclear or Clearstream on the other hand, will be effected within DTC through the DTC participants that are acting as depositaries for Euroclear and Clearstream. To deliver or receive an interest in a global note held in a Euroclear or Clearstream account, an investor must send transfer instructions to Euroclear or Clearstream, as the case may be, under the rules and procedures of that system and within the established deadlines of that system. If the transaction meets its settlement requirements, Euroclear or Clearstream, as the case may be, will send instructions to its DTC depositary to take action to effect final settlement by delivering or receiving interests in the relevant global notes in DTC, and making or receiving payment under normal procedures for same day funds settlement applicable to DTC. Euroclear and Clearstream participants may not deliver instructions directly to the DTC depositaries that are acting for Euroclear or Clearstream.

Because of time-zone differences, the securities account of a Euroclear or Clearstream participant who purchases an interest in a global note from a DTC participant will be credited on the business day for Euroclear or Clearstream immediately following the DTC settlement date. Cash received in Euroclear or Clearstream from the sale of an interest in a global note to a DTC participant will be received with value on the DTC settlement date but will be available in the relevant Euroclear or Clearstream cash account as of the business day for Euroclear or Clearstream following the DTC settlement date.

DTC, Euroclear and Clearstream have agreed to the above procedures to facilitate transfers of interests in the global notes among participants in those settlement systems. However, the settlement systems are not obliged to perform these procedures and may discontinue or change these procedures at any time. Neither China Eximbank nor the fiscal agent will have any responsibility for the performance by DTC, Euroclear or Clearstream or their participants or indirect participants of their respective obligations under the rules and procedures governing their operations.

#### **Certificated Notes**

Notes in physical, certificated form will be issued and delivered to each person that DTC identifies as a beneficial owner of the related global notes only if:

- DTC notifies China Eximbank at any time that it is unwilling or unable to continue as depositary for the global notes and a successor depositary is not appointed within 90 days;
- DTC ceases to be registered as a clearing agency under the U.S. Securities Exchange Act at a time when it is required to be so registered and a successor depositary is not appointed within 90 days;
- China Eximbank, at its option, notifies the fiscal agent that it elects to cause the issuance of certificated notes; or
- if an event of default with respect to the notes entitling their holders to accelerate the maturity of such notes has occurred and is continuing.



## TAXATION

The following is a summary of anticipated tax consequences resulting from the ownership of Notes. This summary does not cover all the possible tax consequences relating to the acquisition, ownership and disposition of notes and is not intended as tax advice to any person. It is based upon laws as now in effect and as currently interpreted, which are subject to change. You should consult your tax advisors or other experts concerning the application of tax laws to your particular situation.

### United States Taxation

The following summary of certain United States federal income tax consequences to original purchasers of the notes relating to the purchase, ownership and disposition of the notes is based upon existing United States federal income tax law, which is subject to change, possibly with retroactive effect. This summary does not purport to discuss all aspects of United States federal income taxation which may be relevant to a particular investor in light of such investor's individual investment circumstances, such as persons holding notes as part of a straddle, hedging, or synthetic security transaction, or investors whose functional currency is not the United States dollar, or certain types of investors subject to special tax rules (e.g., financial institutions, insurance companies, dealers in securities or currencies, regulated investment companies, and tax-exempt organizations). In addition, this summary does not discuss any foreign, state or local tax considerations. This summary only applies to investors that hold notes as "capital assets" (generally, property held for investment) within the meaning of the United States Internal Revenue Code of 1986, as amended, or the Code, and that purchased the notes at their initial issue price. You should consult your tax advisors regarding the United States federal, state and local, as well as foreign income and other, tax considerations of investing in the notes.

\* \* \* \* \*

**The discussion of United States federal tax issues in this Offering Circular is not intended or written to be used, and cannot be used by any person, for the purpose of avoiding United States federal tax penalties that may be imposed on such person, and was written in connection with the promotion or marketing of the notes. You should seek advice based on your particular circumstances from an independent tax advisor.**

\* \* \* \* \*

For purposes of this summary, a "U.S. holder" means a beneficial owner of notes that is an individual who is a citizen or resident of the United States, a corporation (including an entity treated as a corporation for United States federal income tax purposes) created or organized in or under the laws of the United States, any state thereof or the District of Columbia, an estate whose income is subject to United States federal income tax regardless of its source, or a trust if a court within the United States is able to exercise primary supervision of the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust. In addition, certain trusts in existence on August 20, 1996, and treated as United States persons prior to such date that have elected to continue to be treated as United States persons also are considered U.S. holders. The United States federal income tax treatment of a partner in a partnership that holds notes generally will depend upon the activities of the partnership and the status of the partner. As used herein, the term "non-U.S. holder" means a beneficial owner of a note that is not a U.S. holder.

### *U.S. Holders*

Payments of interest on a note (including payments of additional amounts, if any) will generally be taxable to a U.S. holder as ordinary interest income in accordance with the U.S. holder's regular method of tax accounting. Such interest will constitute foreign source income for United States federal income tax purposes. In the opinion of Sidley Austin Brown & Wood LLP, special United States counsel for China Eximbank, interest on the notes constitutes income from sources outside the United States but, with certain exceptions, is treated separately for purposes of computing the foreign tax credit allowable under the United States federal income tax laws. If any foreign taxes were to be paid or withheld in respect of payments on the notes, a U.S. holder may be eligible, subject to a number of complex limitations, to claim a foreign tax credit.

A U.S. holder will generally recognize capital gain or loss upon the sale, exchange, retirement or other disposition of a note in an amount equal to the difference between the amount realized upon such sale, exchange, retirement or other disposition (other than any portion thereof attributable to accrued but unpaid interest) and such U.S. holder's adjusted tax basis in the note. A U.S. holder's adjusted tax basis in a note will generally equal such U.S. holder's initial investment in the note. Non-corporate taxpayers are subject to reduced maximum rates on long-term capital gains and are generally subject to tax at ordinary income rates on short-term capital gains. Capital gain recognized by a corporate taxpayer will be subject to tax at the ordinary income tax rates applicable to corporations. The deductibility of capital losses is subject to certain limitations.

### ***Non-U.S. Holders***

In the opinion of Sidley Austin Brown & Wood LLP and subject to the discussion of "backup" withholding below, interest on the notes is currently exempt from United States federal income tax, including withholding tax, if paid to a non-U.S. holder, whether or not such non-U.S. holder is engaged in a trade or business in the United States, unless:

- the non-U.S. holder is a corporation that is an insurance company carrying on a United States insurance business to which the interest is attributable, within the meaning of the Code, or
- the non-U.S. holder is an individual or corporation that has an office or other fixed place of business in the United States to which the interest is attributable, the interest is derived from the active conduct of a banking, financing or similar business within the United States or is received by a corporation the principal business of which is trading in stock or securities for its own account, and certain other conditions exist.

In addition, in the opinion of Sidley Austin Brown & Wood LLP, (a) subject to the discussion of backup withholding below, a non-U.S. holder will not be subject to United States federal income tax on any gain realized on the sale or exchange of a note, *provided* that such gain is not effectively connected with the conduct by the holder of a United States trade or business and, in the case of a non-U.S. holder who is an individual, such holder is not present in the United States for 183 days or more during the taxable year in which such gain is realized and certain other conditions are met, and (b) the notes are deemed to be situated outside the United States for purposes of United States federal estate taxation and are not includible in the gross estate for purposes of such tax in the case of a nonresident of the United States who was not a citizen of the United States at the time of death.

### ***Backup Withholding***

A 28% "backup" withholding tax and certain information reporting requirements may apply to payments of principal and interest on the notes made to certain noncorporate holders if such payments are made or are considered made in the United States (including payments on notes made by wire transfer from outside the United States to an account maintained by the holder with the fiscal agent or paying agent in the United States). If such payments are considered to have been made in the United States, non-United States persons are generally exempt from these withholding and reporting requirements (assuming that the gain or income is otherwise exempt from United States federal income tax) but may be required to comply with certification and identification procedures in order to prove their exemption from the requirements. Similar rules requiring reporting and withholding with respect to gross sale proceeds will apply to a non-United States person that sells a note through a United States branch of a broker and information reporting (but not backup withholding) will apply to a non-United States person who sells a note through (a) a non-United States branch of a United States broker, (b) a non-United States office of a broker that is a controlled foreign corporation for United States tax purposes; (c) a broker that is a foreign person 50% or more of whose income is effectively connected with a United States trade or business for a specified period or (d) a broker that is a foreign partnership if one or more of its partners are U.S. persons that own, in the aggregate, more than 50% of the income or capital interest in the partnership or if the partnership is engaged in a United States trade or business, in each case unless the holder proves an exemption from the requirement.

## **PRC Taxation**

In the opinion of the Legal Department of China Eximbank, PRC legal counsel to China Eximbank, the following summary accurately describes the principal PRC tax consequences of ownership of the notes by beneficial owners who, or which, are not residents of China for PRC tax purposes and do not conduct business activities in China. These beneficial owners are referred to as non-PRC holders in this “Taxation” section. Persons considering the purchase of the notes should consult their own tax advisors with regard to the application of PRC tax laws to their particular situations as well as any tax consequences arising under the laws of any other tax jurisdiction. Reference also is made to the tax agreement between China and the United States entitled “Agreement between the Government of the United States of America and the Government of the People’s Republic of China for the Avoidance of Double Taxation and the Prevention of Tax Evasion with respect to Taxes on Income” signed on April 30, 1984 and effective for taxable years beginning on or after January 1, 1987, or the U.S.-China ADT Agreement.

Pursuant to Article 19 of the Foreign Investment Enterprise and Foreign Enterprise Income Tax Law of China and Article 3 of the Individual Income Tax Law of China, an income tax is levied on the payment of interest in respect of foreign exchange loans, including bonds or notes, made to foreign corporations and non-resident alien individuals who, or which, do not conduct business activities in China. The current rate of such income tax is 20% of the gross amount of the interest. However, the tax so charged on interest paid on the notes to non-PRC holders who, or which, are residents of the United States for purposes of the U.S.-China ADT Agreement shall not exceed 10% of the gross amount of the interest pursuant to Article 10 of the U.S.-China ADT Agreement. China Eximbank has obtained on behalf of the noteholders from the State Bureau of Taxation of China an exemption from such income tax on the payment of interest in respect of the notes.

Non-PRC holders will not be subject to PRC tax on any capital gains derived from a sale or exchange of notes consummated outside China between non-PRC holders. No PRC stamp duty will be imposed on non-PRC holders either upon the issuance of the notes or upon a subsequent transfer of notes.

## **European Union Directive on Taxation of Savings Income**

The European Union has adopted a directive regarding the taxation of savings income. Subject to a number of important conditions being met, it is proposed that European Union member states be required from July 1, 2005 to provide to the tax authorities of other European Union member states details of payments of interest and other similar income paid by a person to an individual in another European Union member state, except that Austria, Belgium and Luxembourg will instead impose a withholding system for a transitional period unless during such period they elect otherwise.

## UNDERWRITING

China Eximbank intends to offer the notes through the initial purchasers named below. Subject to the terms and conditions contained in a purchase agreement among China Eximbank and the initial purchasers, China Eximbank has agreed to sell to the initial purchasers, and each of the initial purchasers, severally and not jointly, has agreed to purchase from China Eximbank, the principal amount of the notes listed opposite its name below.

<u>Initial purchasers</u>	<u>Principal Amount</u>
Merrill Lynch Far East Limited .....	US\$165,000,000
BNP Paribas Securities Corp. ....	165,000,000
Citigroup Global Markets Inc. ....	165,000,000
The Hongkong and Shanghai Banking Corporation Limited .....	165,000,000
BOCI Asia Limited .....	165,000,000
Goldman Sachs (Asia) L.L.C. ....	165,000,000
Barclays Bank PLC .....	1,000,000
Calyon .....	1,000,000
Credit Suisse First Boston (Europe) Limited .....	1,000,000
Daiwa Securities SMBC Europe Limited .....	1,000,000
DEPFA Investment Bank Ltd. ....	1,000,000
Deutsche Bank Securities Inc. ....	1,000,000
ICEA Capital Limited .....	1,000,000
J.P. Morgan Securities Ltd. ....	1,000,000
Nomura International Plc .....	1,000,000
Standard Chartered Bank .....	1,000,000
Total .....	<u>US\$1,000,000,000</u>

The purchase agreement provides that the obligations of the initial purchasers to pay for and accept delivery of the notes are subject to the approval of certain legal matters by their counsel, including the validity of the notes, and other conditions contained in the purchase agreement such as the receipt by the initial purchasers of officers' certificates and legal opinions. The initial purchasers reserve the right to withdraw, cancel or modify offers to investors and to reject orders in whole or in part.

China Eximbank has agreed to indemnify the initial purchasers against certain liabilities, including liabilities under the U.S. Securities Act, and to contribute to payments that the initial purchasers may be required to make in respect of those liabilities.

### **Commissions and Discounts**

The initial purchasers have advised China Eximbank that they propose initially to offer the notes to investors at the price listed on the cover page of this offering circular and to dealers at such price less a concession not in excess of 0.18% of the principal amount of the notes. After the initial offering, the price to investors, concessions and discounts may be changed.

### **The Notes Are Not Being Registered**

The initial purchasers, either directly or through their respective selling agents, propose to offer the notes for resale in transactions not requiring registration under the U.S. Securities Act or applicable state securities laws in the United States, including sales pursuant to Rule 144A and Regulation S. The initial purchasers will not offer or sell the notes except:

- to persons they reasonably believe to be qualified institutional buyers in the United States within the meaning of Rule 144A, or

- pursuant to offers and sales to non-U.S. persons that occur outside the United States within the meaning of Regulation S.

Each initial purchaser has severally acknowledged and agreed that, except as permitted by the preceding paragraph, it will not offer or sell any notes (i) as part of their distribution at any time, and (ii) otherwise until 40 days after the later of the date upon which the offering of the notes commences and the closing date, within the United States or to, or for the account or benefit of, U.S. persons. Each initial purchaser has agreed that, at or prior to confirmation of a sale of notes (other than a sale of notes pursuant to Rule 144A), it will have sent to each distributor, dealer or person receiving a selling concession, fee or other remuneration that purchases notes from or through it during the restricted period, a confirmation or notice setting forth the restrictions on offers and sales of notes within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the later of the commencement of this offering and the closing date, an offer or sale of the notes within the United States by a dealer (whether or not participating in this offering) may violate the registration requirements of the U.S. Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A under the U.S. Securities Act or pursuant to another exemption from registration under the U.S. Securities Act.

Each purchaser of the notes will be deemed to have made acknowledgments, representations and agreements as described under “Transfer Restrictions.”

### **No Sale of Similar Securities**

China Eximbank has agreed in the purchase agreement that, for a period of 180 days after the date of delivery of the notes, it will not, without the prior written consent of the initial purchasers, offer, sell, contract to sell or otherwise dispose of any of its debt securities that are substantially similar to the notes, including any convertible debt securities or exchangeable debt securities. China Eximbank may, however, issue debt securities with original maturities of less than one year.

### **Selling Restrictions**

#### ***United Kingdom***

Each initial purchaser has agreed that:

- it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity within the meaning of section 21 of the Financial Services and Markets Act 2000 (the “FSMA”) received by it in connection with the issue or sale of the notes in circumstances in which section 21(1) of the FSMA does not apply to China Eximbank; and
- it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the notes in, from or otherwise involving the United Kingdom.

#### ***Hong Kong***

Each initial purchaser has agreed that:

- it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any notes other than (a) to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance; or (b) in other circumstances which do not result in the document being a “prospectus” as defined in the Companies Ordinance (Cap. 32) of Hong Kong or which do not constitute an offer to the public within the meaning of that Ordinance; and
- it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the notes, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong)

other than with respect to notes which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance.

### *Singapore*

Each initial purchaser has agreed that it has not offered or sold, and will not offer or sell, any notes nor has it made and nor will it make, any notes the subject of an invitation for subscription or purchase and it has not circulated or distributed, and it will not circulate or distribute, this offering circular or any other document or material in connection with the offer or sale, or invitation for subscription or purchase of such notes, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor or other person specified in Section 274 of the Securities and Futures Act, Chapter 289 of Singapore, (ii) to a sophisticated investor, and in accordance with the conditions, specified in Section 275 of the Securities and Futures Act or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the Securities and Futures Act.

### *Japan*

Each initial purchaser has agreed that it has not offered or sold, and will not offer or sell, directly or indirectly, any of the notes in Japan or to any resident of Japan or to any persons for reoffering or resale, directly or indirectly, in Japan or to any resident of Japan, except (x) pursuant to an exemption from the registration requirements of the Securities and Exchange Law of Japan available thereunder and (y) in compliance with the other relevant requirements of Japanese law. As used in this paragraph, “resident of Japan” means any person residing in Japan, including any corporation or other entity organized under the laws of Japan.

### *European Economic Area*

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “Relevant Member State”), each initial purchaser has represented and agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “Relevant Implementation Date”) it has not made and will not make an offer of notes to the public in that Relevant Member State prior to the publication of a prospectus in relation to the notes which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive, except that it may, with effect from and including the Relevant Implementation Date, make an offer of notes to the public in that Relevant Member State at any time:

- to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities;
- to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or
- in any other circumstances which do not require the publication by China Eximbank of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer of notes to the public” in relation to any notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the notes to be offered so as to enable an investor to decide to purchase or subscribe the notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression “Prospectus Directive” means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

### ***Mainland China***

Each initial purchaser has acknowledged and agreed that it has not, directly or indirectly, offered or sold, and will not, directly or indirectly, offer or sell, any of the notes in mainland China to PRC investors; provided, however, that any PRC investor may purchase the notes when it has obtained all relevant PRC government approvals, including the approval of the State Administration of Foreign Exchange.

### ***General***

Each initial purchaser has agreed that it will not offer, sell or deliver any of the notes, directly or indirectly, or distribute this offering circular, or any other offering material relating to the notes, in or from any jurisdiction except under circumstances that will, to the best knowledge and belief of such initial purchaser, result in compliance in all material respects with the applicable laws and regulations of that jurisdiction (including any prospectus delivery requirements) and which will not impose any obligations on China Eximbank except as set forth in the purchase agreement.

### **Price Stabilization and Short Positions**

In connection with this issue, Merrill Lynch Far East Limited (or any person acting on its behalf) may, to the extent permitted by applicable laws and regulations, over-allot or effect transactions with a view to supporting the market price of the notes at a level higher than that which might otherwise prevail for a limited period after the closing date. However, there is no obligation on Merrill Lynch Far East Limited (or any person acting on its behalf) to do this. Such stabilizing, if commenced, may be discontinued at any time, and must be brought to an end after a limited period.

Neither China Eximbank nor any initial purchaser makes any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the notes. In addition, neither China Eximbank nor any initial purchaser makes any representation that the initial purchasers will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

### **Listing**

An application has been made to list the notes on The Stock Exchange of Hong Kong Limited. No assurance can be given as to the liquidity of, or trading market for, the notes.

### **Other Relationships**

The initial purchasers and their respective affiliates have engaged in, and may in the future engage in, investment banking and other commercial dealings in the ordinary course of business with China Eximbank. They have received and may receive fees and commissions for these services.

## TRANSFER RESTRICTIONS

Because of the following restrictions, purchasers are advised to consult legal counsel prior to making any offer, sale, resale, pledge or other transfer of the notes.

Each purchaser of the notes will be deemed to have represented and agreed as follows (terms used in this paragraph that are defined in Rule 144A or in Regulation S are used as so defined):

1. it is not an “affiliate” (as defined in Rule 144 under the U.S. Securities Act) of China Eximbank or acting on behalf of China Eximbank and (A) (i) is a qualified institutional buyer, (ii) is aware that the sale of the notes to it is being made in reliance on Rule 144A, and (iii) is acquiring such notes for its own account or the account of a qualified institutional buyer, or (B) (i) is outside the United States and (ii) is not a U.S. person;
2. it acknowledges that the notes have not been and will not be registered under the U.S. Securities Act or with any securities regulatory authority of any jurisdiction and may not be offered or sold within the United States except as set forth below;
3. it understands and agrees that if in the future it decides to resell, pledge or otherwise transfer any notes or any beneficial interests in any notes other than a Regulation S global note, such notes may be resold, pledged, or transferred only by an initial investor (i) to China Eximbank, (ii) to a person whom the seller reasonably believes is a qualified institutional buyer that purchases for its own account or for the account of a qualified institutional buyer in a transaction meeting the requirements of Rule 144A, (iii) in an offshore transaction meeting the requirements of Rule 904 of Regulation S under the U.S. Securities Act, (iv) pursuant to an exemption from registration under the U.S. Securities Act provided by Rule 144 under the U.S. Securities Act or (v) pursuant to an effective registration statement under the U.S. Securities Act, and in each such case, in accordance with any applicable securities laws of any state of the United States and any other applicable jurisdiction;
4. it agrees to, and each subsequent holder is required to, notify any purchaser of the notes from it of the resale restrictions referred to in clause 3 above, if then applicable;
5. it understands and agrees that (A) notes initially offered in the United States to qualified institutional buyers will be represented by Rule 144A global notes, and (B) notes offered outside the United States in reliance on Regulation S will be represented by Regulation S global notes;
6. it understands that the notes will bear a legend to the following effect unless otherwise agreed to by China Eximbank:

THIS NOTE HAS NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), AND, ACCORDINGLY, MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS EXCEPT AS SET FORTH IN THE FOLLOWING SENTENCE. BY ITS ACQUISITION HEREOF, THE HOLDER (1) REPRESENTS THAT IT IS A “QUALIFIED INSTITUTIONAL BUYER” (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) OR IT IS NOT A U.S. PERSON AND IS ACQUIRING THIS NOTE IN AN OFFSHORE TRANSACTION IN COMPLIANCE WITH REGULATION S UNDER THE SECURITIES ACT, (2) AGREES THAT IT WILL NOT, WITHIN THE TIME PERIOD REFERRED TO IN RULE 144(k) UNDER THE SECURITIES ACT AS IN EFFECT WITH RESPECT TO SUCH TRANSFER, RESELL OR OTHERWISE TRANSFER THIS NOTE EXCEPT (A) TO CHINA EXIMBANK, (B) INSIDE THE UNITED STATES TO A QUALIFIED INSTITUTIONAL BUYER IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT, (C) OUTSIDE THE UNITED STATES IN AN OFFSHORE TRANSACTION IN COMPLIANCE WITH RULE 904 UNDER THE SECURITIES ACT, (D) PURSUANT TO THE EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE) OR (E) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, AND (3) AGREES THAT IT WILL DELIVER TO EACH PERSON TO WHOM THIS NOTE IS TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND. AS USED



HEREIN, THE TERMS “OFFSHORE TRANSACTION,” “UNITED STATES” AND “U.S. PERSON” HAVE THE MEANINGS GIVEN TO THEM BY REGULATIONS UNDER THE SECURITIES ACT. THE FISCAL AGENCY AGREEMENT CONTAINS A PROVISION REQUIRING THE FISCAL AGENT TO REFUSE TO REGISTER ANY TRANSFER OF THIS NOTE IN VIOLATION OF THE FOREGOING RESTRICTIONS.

7. it acknowledges that China Eximbank and the initial purchasers and others will rely upon the truth and accuracy of the foregoing acknowledgments, representation and agreements and agrees that, if any of such acknowledgments, representations or warranties deemed to have been made by virtue of its purchase of notes are no longer accurate, it shall promptly notify China Eximbank, and if it is acquiring any notes as a fiduciary or agent for one or more accounts, it represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such account.

For further discussion of the requirements (including the presentation of transfer certificates) under the fiscal agency agreement to effect exchange or transfer of interests in global notes and of notes in certificated form, see “Description of the Notes” and “Global Clearance and Settlement.”

### **LEGAL MATTERS**

Certain legal matters with respect to the notes will be passed upon for China Eximbank by Sidley Austin Brown & Wood LLP, Hong Kong and Beijing, as to New York law and for the initial purchasers by Clifford Chance, Hong Kong, as to New York law. Certain legal matters under PRC law will be passed upon for China Eximbank by its Legal Department, Beijing and for the initial purchasers by King & Wood, Beijing.

**GENERAL INFORMATION**

China Eximbank has authorized the issue and terms of the notes pursuant to the approval of the National Development and Reform Commission of China dated June 1, 2005 and the resolutions of the board of directors of China Eximbank dated June 24, 2005. China Eximbank has obtained all necessary consents, approvals and authorizations in China in connection with the issue and performance of the notes, all of which are in full force and effect. For so long as any of the notes are outstanding, certified copies of the fiscal agency agreement, copies of the latest annual financial statements of China Eximbank prepared and examined in accordance with the accounting principles and practices set forth in the Financial Systems of Financial and Insurance Enterprises promulgated by the Ministry of Finance of China, as amended, copies of the articles of association of China Eximbank, copies of this offering circular, and copies of all amendments and supplements to this offering circular may be inspected during usual business hours at the specified office of the fiscal agent and each paying agent and the registered office of China Eximbank. Such documents will also be available for inspection during usual business hours at the offices of Sidley Austin Brown & Wood LLP in Hong Kong until August 5, 2005.

Save as disclosed in this offering circular, there has been no adverse change, or any development reasonably likely to involve an adverse change, in the condition, financial or otherwise, or in the earnings, business affairs or business prospects of China Eximbank since December 31, 2004, the date of China Eximbank’s latest financial statements, that is material in the context of the issue of the notes.

China Eximbank is neither involved in any litigation, arbitration or administrative proceedings against or affecting China Eximbank or any of its assets which are or might be material in the context of the issue of the notes nor aware of any such litigation, arbitration or administrative proceedings, whether pending or threatened.

The notes are expected to be accepted for clearance through DTC, Clearstream and Euroclear. The following table sets forth the Common Code, ISIN and CUSIP numbers for the notes:

	<b>Regulation S notes</b>	<b>Rule 144A notes</b>
Common Code .....	022507796	022507893
ISIN .....	USY23862AD09	US30216HAB50
CUSIP .....	Y23862AD0	30216HAB5

**REGISTERED OFFICE OF CHINA EXIMBANK**

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