

# China + Economics

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## Growth Outlook

The latest economic data out of China continues to show that growth is comfortably within the government's preferred range of being above an annualised rate of 7%:

- + for the first half it was up 7.4% year on year
- + manufacturing is still expanding according to both official and unofficial PMI measures
- + retail sales growth has slowed considerably but remains strong, increasing 12.1% year on year
- + corporate profits are also recovering, including in the steel sector
- + inflation remains low, only 2.3% in July
- + external sector is strengthening with exports up 14.1% in July over the prior year. This is at least partly due to the recovery of the US economy.
- + Also contributing to the economy are selective policy easing and micro stimulus packages.

Unfortunately, debt overhang in the shadow-banking sector for many private sector firms and among local and municipal governments has constrained investment as balance sheets are being repaired. These, together with greater uncertainty about the economic outlook and oversupply, are forcing an adjustment in the property sector.

Positively, leverage over property is much less in China than say in the US, Australia or Europe and as such a general crash in the sector is less likely. Some property developers have exited the sector and others will follow.

Clearly growth is softening and high levels of local government and shadow banking indebtedness continue to be a drag on the economy. Whilst this could potentially become a significant issue, the Government has demonstrated that it has both the appetite and the capacity to resort to stimulus if and when necessary, albeit in a much more measured way than in the past.

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## Economic Reform

Last November's 60 point Decision on Reform raised expectations that the Government was preparing to push hard on implementing reforms, especially much needed ones in areas of deregulation, interest rate and capital account liberalisation and allowing the private sector to play a much greater role in the economy.

Almost a year on, announcements far outweigh specific actions and a great deal of hesitancy is now entering senior officials' statements on the course of reform. Worryingly, with levels of indebtedness and falling marginal returns on investment, deeper reform is necessary to sustain economic growth over the medium term.

A factor in the underwhelming efforts on the reform front has been President Xi Jinping's anti-corruption campaign which has stifled efforts of officials reluctant to find themselves on the wrong side of the campaign. This has created an atmosphere of uncertainty and apprehension. If the announcement of a formal investigation into former Standing Committee member Zhou Yongkang

marks the end of the political phase of the campaign, then the atmosphere is likely to become more relaxed and thus more conducive to pushing ahead with reform implementation.

Looking forward, domestic economic pressures and a leadership that understands the necessity of more far-reaching economic reform are likely to see increased efforts to introduce reform now that political power has been consolidated.

## **Medium to longer-term outlook**

The conditions that have underpinned China's exceptionally high rates of growth for decades remain, albeit to support lower and more sustainable rates of growth.

The factors that will continue to contribute to growth include:

- + some 250 million people to move to cities over the next 20 years
- + China remains a relatively poor country in per capita income terms, just 14% of US per capita income
- + helps to offset ageing problem by increasing labour productivity
- + knitting together isolated and disparate local economies into a single national economy and easing transport constraints – still today 60% of all freight movements comprise just one commodity: coal
- + huge potential to raise productivity by reforming China's constipated, antiquated financial system.

Given Xi Jinping's consolidation of power and the likelihood of reforms now being pursued more vigorously, China's medium to long-term growth outlook remains highly attractive.

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