Nature and sustainability of the Chinese economy

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Contents

- Review of Chinese economy
- Will the Chinese economy experience a hard landing?
- Prospects
China’s GDP growth: rapid and variable

Year-on-Year GDP Growth

Prev. yr = 100

Source: China National Statistics Bureau
Characteristics

- Rapid: the economic growth rate has averaged about 10% per year.
- Variable: the growth rate has reached as high as 15.2% (1984) and fallen as low as 3.8% (1990).
- Decreasing variation: over the latest business cycle, the rate of growth ranged from 7.6% (1999) to 14.2% (2007).
Contribution of demand to growth

Percent Contribution to GDP Growth by Components of Demand

Source: China National Statistics Bureau
Driving force: demand side

- High investment demand is major force contributing to GDP growth
- Contribution of investment has been too high since 2000
- The contribution of net exports decreased from 22.8% in 2005 to -37.4% in 2009, reflecting the re-balancing of the Chinese economy since the Global Financial Crisis
High investment share in GDP

Share of Investment in GDP

Source: China National Statistics Bureau
Re-balancing of the Chinese economy

Share of Net Exports in GDP

Source: China National Statistics Bureau
Driving forces: supply side

- Intensive capital input: high ratio of investment to GDP
- Labor shift from low productivity sector (agriculture) to higher productivity sectors
- Technological progress
- Opening up: integrating into the global market
- Market-oriented institutional reform: more efficient
Real estate bubble

- Plays a key role in rapid Chinese economic growth: local government depends on land revenue to finance infrastructure construction.
- Hides guarantees for local investment companies.
- Weakens the real economy: higher cost, higher interest rate, thus lower international competitiveness, and lower interest on real economy of entrepreneurs.
- Generates complaints from urban residents about high housing prices.
Challenges for the Chinese economy

Changing comparative advantage

- Weakening comparative advantage of labor intensive goods and services
- Slowing growth rate of exports
- Contribution to GDP growth turning negative
Challenges for the Chinese economy

Long–term structural issues

- Lower total factor productivity (TFP): source from structural change to technological progress
- Lower potential growth rate
- Aging population
Lower potential growth rate

- According to the experience of other advanced economies such as Japan and South Korea, after GDP per capita reaches 10,000-11,000 “international dollars”, the growth rate drops by 30%.

- China’s aging population and lower TFP will also lower the growth rate of GDP.
China’s GDP reached 24.8 trillion yuan in Q2 2013, up 7.5% year-on-year at comparable prices. In the first half of the year, the economy grew at a rate of 7.6%. Economic growth continues to slow down in the second quarter.

Source: Wind Information
In Q2 2013, consumption’s contribution to GDP growth was 45.2%; investment’s contribution rose to 53.9%; and net exports of goods and services accounted for 0.9%.
Understanding the slower growth of the Chinese economy

- Business cycle: bottom?

Plus:

- Long-term trend of declining growth rate

- It is unlikely that high growth (10%) can recur
China’s long-term economic growth

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<tr>
<td>GDP growth (percent per year)</td>
<td>9.9</td>
<td>8.6</td>
<td>7.0</td>
<td>5.9</td>
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<tr>
<td>Labor growth</td>
<td>0.9</td>
<td>0.3</td>
<td>−0.2</td>
<td>−0.2</td>
<td>−0.4</td>
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<tr>
<td>Labor productivity growth</td>
<td>8.9</td>
<td>8.3</td>
<td>7.1</td>
<td>6.2</td>
<td>5.5</td>
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Structure of economy (end of period, %)

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<tbody>
<tr>
<td>Investment/GDP ratio</td>
<td>46.4</td>
<td>42</td>
<td>38</td>
<td>36</td>
<td>34</td>
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<tr>
<td>Consumption/GDP ratio</td>
<td>48.6</td>
<td>56</td>
<td>60</td>
<td>63</td>
<td>66</td>
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<tr>
<td>Industry/GDP ratio</td>
<td>46.9</td>
<td>43.8</td>
<td>41.0</td>
<td>38.0</td>
<td>34.6</td>
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<tr>
<td>Services/GDP ratio</td>
<td>43.0</td>
<td>47.6</td>
<td>51.6</td>
<td>56.1</td>
<td>61.1</td>
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<td>Share of employment in agriculture</td>
<td>38.1</td>
<td>30.0</td>
<td>23.7</td>
<td>18.2</td>
<td>12.5</td>
</tr>
<tr>
<td>Share of employment in services</td>
<td>34.1</td>
<td>42.0</td>
<td>47.6</td>
<td>52.9</td>
<td>59.0</td>
</tr>
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</table>

Source: DRC.

Source: DRC & WB, *China 2030*
However, the possibility of a “hard landing” is low . . . Because:
Lack of inflationary pressure to tighten monetary policy:
Over the last 17 months, the change in the CPI has remained around 2.7% and the Producer Price Index (PPI) has been negative.

Source: Wind Information
Return to normal interest rates and reduced pressure in inter-bank money market:
After a dramatic increase at the end of June, the 7-day interbank rate declined, swinging between 3.65 and 4.51 in August.
Sufficient liquidity:
M2 growth minus real GDP growth and inflation was 3.7% in Q2, down 1.8 percentage points from the previous quarter.

Note: Liquidity = M2% - GDP% - CPI
Source: Wind Information
Low risk from short-term foreign debt:
As of Q1 2013, short-term debt accounted for 73.95% of China’s total external debt outstanding and 16.43% of foreign reserves. With roughly 75% of short-term external debt trade-related, a rise in its share will not pose a threat to the country’s external account.
Ample reserves to handle the impact of “hot money”:

As of June 2013, China’s foreign exchange reserves stood at $3.5 trillion, up $54.0 billion from the end of March. Gold reserves have remained at 33.9 million ounces. Moreover, the capital account is not fully convertible.

Source: Wind Information
Recovering demand:
China’s Purchasing Managers’ Index (PMI) stood at 50.3% in July, 0.2 percentage points higher than June and above the critical point. Meanwhile, the Non-manufacturing Business Activity Index rose 0.2 percentage points from the previous month to 54.1%.

Source: Wind Information
HSBC’s Manufacturing PMI for China rebounded to 50.1% in August, 2013, from 47.7% in July, standing above the critical point for the first time in four months.

Source: Wind Information
Continuing strength in the real economy:
In July, value-added by China’s heavy industry posted 10.3% year-on-year growth and power generation climbed 8.1%.

Source: Wind Information
Stable real estate market:
The Real Estate Climate Index (RECI) stood at 97.29 in June, up 0.03 from May. It averaged 113.2 in Q2 2013 and reached 97.39 in July. The Entrepreneur Confidence Index (ECI) hit 110.7 in Q2, up 1.9 points over the previous quarter.

Notes: RECI values above 100 indicate more positive climate and below 100 indicate more negative climate. ECI values above 100 indicate more optimism and below 100 indicate greater pessimism.
Source: Wind Information
Prospects

- In the short-run, the growth rate of the Chinese economy will be stable, possibly a bit above the 7.5% target set by the government late last year.

- A “hard landing” is not likely, although the economy faces many challenges.

- The Chinese government still has room for further expansionary policies, if needed.
Prospects

- China has enough reserves to handle external shocks.
- In the longer term, the growth rate may decline to 7% before 2020.
- Wide reforms and further opening-up by the government can be expected in the near term.
- Innovation and green growth will also be emphasized by the government.
Thanks!