

LNU's China Panel Survey No 19 - November 5, 2014

“Our (Growth-)Temperature Indicator falls to 4.6 – the second lowest number in ten years

Summary

Between October 20 and November 3, we made our regular biannual survey on the business cycle and some policy questions on China. Roughly 20 China experts participated, coming from Europe, North America and Asia. Our best thanks to all the survey participants.

✘ Our so-called **temperature indicator** for the Chinese economy **fell** visibly to **4.6** from 5.3 in April (10 = extremely overheated; 1 = deep recession). This is the second lowest number since this survey started ten years ago. Only around the peak of the global financial and economic crisis in spring 2009, a lower number was noted.

✘ The panel's **GDP projections** for China (average):
2014: 7.2 2014 q4: 7.0 2015: 6.9 (7.2 % in April 2014) 2015 q4: 6.7

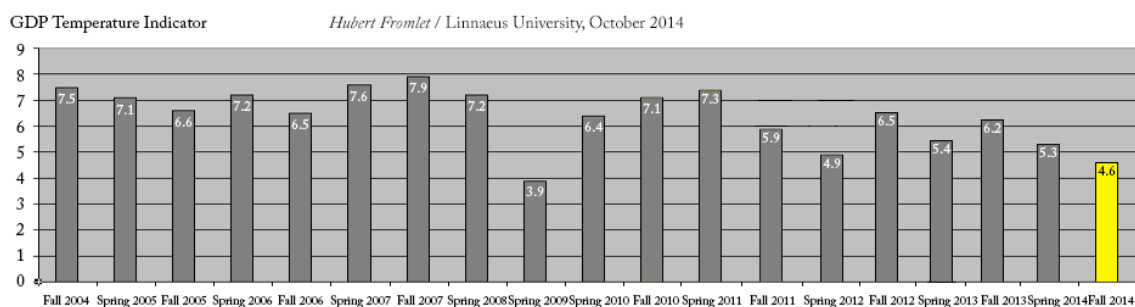
✘ There is an obvious downward bias in the GDP forecasts of the panel, i.e. that the probability of a different outcome will rather be on the negative than on the positive side.

✘ The largest **short-term risks** - within the next few years as seen by the panel - are (ranked): the (suspected) real estate bubble, different kinds of political/social tensions and unstable (domestic) financial markets.

✘ 46 percent of the participants expect the currency renminbi (RMB) to appreciate slightly (by 1-5 percent) in 2015; 38 percent see a more or less stable Chinese exchange rate. No panelist predicts a more remarkable strengthening of the RMB in the forthcoming quarters.

✘ 85 percent of our experts still feel concerned about the (assumed) overheated real estate market.

Hubert Fromlet



1. Our “Temperature Indicator” confirms downsizing of GDP growth - Chinese growth deceleration becomes increasingly obvious

Index result in November 2014 (average): 4.6 May 2014: 5.3 December 2013: 6.2 (10 = extremely overheated)

Own comment:

The ongoing downturn or downsizing of Chinese GDP growth is confirmed further by this China Panel Survey. In this context, one may define a *downsizing* as a voluntary development caused by intended policy changes (e.g. environmental priorities and transition periods for aiming at more domestic growth or more future-oriented investments at the expense of short-term action). Consequently, a *downturn* would incline an involuntary or exogenous development, in the current case as the result of weakened international demand for Chinese export goods. In my view, it seems to be at present a combination of both factors – with a higher negative growth impact coming from sluggish international demand.

2a. The panel’s prediction for China’s GDP growth (in percent)

2014:	7.2	(April 2014: 7.3)
2014 q4:	7.0	(April 2014: 7.3)
2015:	6.9	(April 2014: 7.2)
2015q4:	6.7	(April 2014: 7.1)

Own comment:

According to the China Panel, some slight further downsizing of GDP growth will occur in 2015, also compared to the forecasts from April 2014. But one should not believe that the average forecast numbers are based on high-quality time series from the statistical office (NBS) (certainly a well-taken remark that also a number of our panelists added in their comments). Statistical shortcomings are a weak point in all China forecasts. Real GDP growth may be even lower than shown in the forecasts above. We simply do not know enough about the real quality of Chinese GDP statistics (without neglecting that visible adjustments of GDP results may happen in our part of the world, too).

2b. Do you assume in your forecast for 2015 ... in %

☒ a weak and disappointing GDP-growth performance in the OECD area as a whole	38
☒ a gradual but relatively modest recovery in the OECD area as a whole	54
☒ a gradual but quite strong recovery in the OECS area as a whole?	8

Own comment:

There is no surprise in this answer. In other words: The panel does not count on a significant recovery of Chinese exports during 2015 given the above-mentioned international growth environment.

3. Where do you expect Chinese GDP growth mainly to come from in 2015? (Ranked)

First: Investment (public and private) *and* private consumption

Own comment:

The four first-mentioned answers were also in the top of our recent survey in April 2014 – then with a more obvious ranking order. This time, the considered main long-term risks are extremely close to each other. An interesting view is the emphasis on more ambitious productivity improvements – in literature known as the main fundamental source to economic growth (together with hours worked).

7. Do you expect the renminbi during 2015 against the USD (in percent)

<input type="checkbox"/> to appreciate slightly (by 1-5%)	46
<input type="checkbox"/> to appreciate more visibly (by >5%)	0
<input type="checkbox"/> to be stable	39
<input type="checkbox"/> to depreciate	15
<input type="checkbox"/> to fluctuate more strongly without clear direction	0

Own comment:

No survey participant concludes that a major RMB appreciation might be in the cards in the year to come – and only 15 percent see a depreciation of the RMB. But not even the exchange rate of the politically controlled RMB is easy to foresee.

8. Do you think there is still a dangerous price bubble on the ...

<input type="checkbox"/> stock market	Yes: 31 %	No: 69 %
<input type="checkbox"/> real estate market	Yes: 85 %	No: 15 %

Own comment:

According to our China Survey Panel, bubble risks on the stock market are currently judged as quite limited – but they are still quite pronounced when it comes to the real estate market. Compared to our previous survey in April, the numbers for the real estate market are still about the same whereas the view on Chinese stock markets has become somewhat more cautious. Both Hong Kong and worsening global growth conditions should have an impact on this limited change.

9. How would you rate the general confidence in the Chinese economy? (5 = very high; 1 = very low)

<input type="checkbox"/> 3 years from now:	3.3	(April 2014: 3.0)
<input type="checkbox"/> 5 years from now:	3.1	(April 2014: 2.9)
<input type="checkbox"/> 10 years from now:	2.9	(April 2014: 2.9)

Own comment:

Major fluctuations do not use to happen in this confidence part of our survey. In the short run, valuations around 3 probably reflect a satisfactory - but not very positive view

on the near-term future of the Chinese economy - and/or some degree of uncertainty. For longer time horizons - five and ten years ahead - the uncertainty factor probably plays a larger role than in the shorter perspective.

10. One year after the establishment of the Third Plenum's reform plans - do you have the feeling that China is on the right track to manage (most of) its 60 objectives - as planned - by 2020?

Yes: 23 % **No:** 77 %

Own comment:

There is a clear answer: Our panelists do not really believe that the (relatively) new Chinese political leaders can achieve all their ambitious reform goals by the year 2020. I share this conclusion. In my view – see, for example, my article “The Chinese Reform Process in a European Perspective” (Bulletin Bancaire et Financière, 2014, no 4, pp 311-323, Larcier) - there are too many *direct* goal conflicts in these 60 reform objectives. This phenomenon will most probably lead to delays and a substantial number of compromises. However, even more limited or relatively delayed progress would be better than no progress at all – not considering in this context the limited time horizon in certain reform areas which in specific cases may plead for considerable urgency.

11. Which three reform areas of from question 10 do you consider the most difficult ones? (Ranked)

- ✘ First: Financial market deregulation (opening of capital account included)
- ✘ Second: Fight against corruption
- ✘ Third: Change of the “old” growth model to more private consumption/private investment, *and* a new (local) tax system
- ✘ Fifth: Creation of a manageable real estate market
- ✘ Sixth: The environment

Own comment:

It should be observed that all the above-mentioned, very difficult reform areas also belong to the most important ones. Other areas that are reported to become complicated to reform or to establish are, for example, the political system, the SoEs, the officially strongly pushed urbanization process, and the liberalization of the hukou system for urban citizenship.

12. Where do you see average GDP growth during 2015-2020?

Answer: 5 ¾ percent

Own comment:

5 ¾ percent is almost half of the average GDP growth that was achieved during 20 years

from the early 1990s until the beginning of this decade. This makes the ongoing slowdown of potential growth very obvious.

Summarizing remarks

As shown above, average GDP growth during the remainder of this decade is predicted to be around 5 $\frac{3}{4}$ percent. This would imply a downturn of the Chinese growth rate to – may be – something like roughly 5 percent at the end of this decade. Such a dampened development would be remarkable.

But as I already pointed at: the *quality* of future Chinese economic growth will be more important in the future than statistical growth figures (particularly when combating the poor environment). On the other hand, reasonable GDP growth is needed for creating the financial resources for better social cohesion and a kind of acceptable social security system. Here we have, by the way, one of the real future goal conflicts.

Altogether: The 60 reform fields from the Third Plenum announced one year ago do not only mean major *challenges* for the Fifth Generation of Chinese Communist leaders – but also *opportunities* to lead China on a better track in the longer run. In this context, the outcome of Chinese reform policy will become very important to the Swedish economy and Swedish companies as well. This is why we all steadily should learn more about China.

Sure, short-term aspects and forecasts on China's economy should not be neglected by the Chinese and the foreign corporate sector all the same – and certainly not by global banks either. This view is underlined by this survey.

However, it should be reminded strongly:

Comprehensive structural improvements are decisive for the future of China, its people, its role in the global economy and, consequently, good microeconomic relations between Chinese companies and commercial partners from all over of the world.

Hubert Fromlet