

LNU's China Panel Survey No 16 - June 2013

Our “temperature indicator” for China falls to 5.4 - the growth outlook for 2014 remains moderate

Summary

✧ Our so-called “**temperature indicator**” for the Chinese economy declined in June to 5.4 compared to 6.5 in December 2012 (10=extremely overheated). This is one of the lowest numbers since the start of this China indicator almost ten years ago. Around 20 *China experts* from Asia, North America and Europe participated once again in the survey.

✧ The panel's GDP projections (average):

2013: 7.6 2013q4: 7.8 2014: 7.5 2014q4: 7.3

Has China landed in a 7.5% GDP-growth trap. Or is it still a cyclical downturn?

✧ 92 percent of the panelists think that China will *appreciate* its currency by 5 percent or less in the forthcoming four quarters.

✧ 92 percent of our China experts believe that the *real estate market* is still threatened by a massive bubble.

✧ Some *institutional aspects* (gradings 1-10; 10=very good):

- trust in Chinese economic statistics: 4.3 trust in Chinese corporate accounting: 3.3
- the total institutional framework: 2.8 transparency of financial markets: 3.4

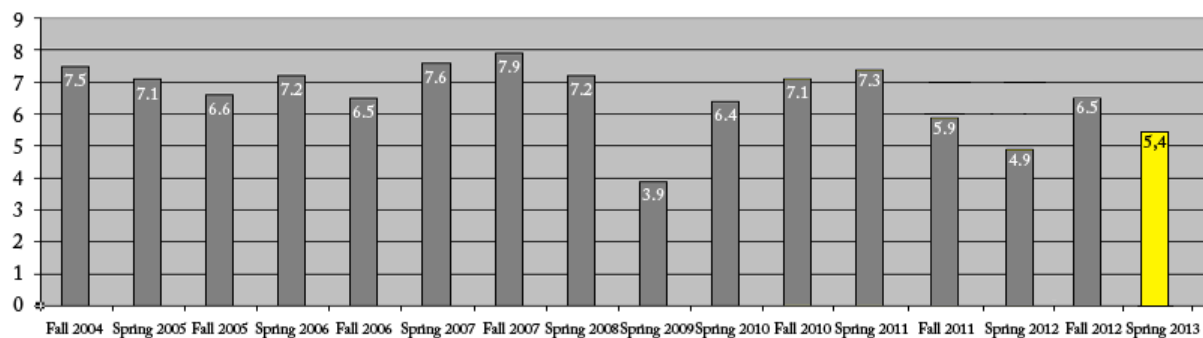
✧ The obviously preferred *reform areas* by the new Chinese political leadership:

1. Financial sector/Marketization in other areas 2. Social improvements 3. New growth model

Hubert Fromlet

GDP Temperature Indicator

Hubert Fromlet / Linnæus University, June 2013



1. Our “Temperature (GDP growth) Indicator” falls to 5.4 – growth is quite dampened

Result in June 2013 (average): 5.4 December 2012: 6.5

Own comment:

The result of our new survey on the Chinese “Temperature (GDP growth) Indicator” shows some disappointment. 5.4 is one of the weakest monthly results since we started this China barometer in 2004. We wrote already in December last year that “no significant strengthening was going on”. This view should be applied this time as well.

2 a. The panel's predictions for China's GDP growth - not too bad but no real improvement seen in the next quarters

2013: 7.6 %

2013 q4: 7.8 %

2014: 7.5 %

2014q4: 7.3 %

Own comment:

China seems to be in a kind of “*7.5 percent GDP-growth trap*”, at least during our forecasting period. This is substantially lower than was the case only three years ago. If this number reflects reality, the development will not be far from the growth trend the new political leaders would like to see - but probably at the lower or lowest end of what could be accepted. For this reason, some new growth stimuli cannot be ruled out in the second half of 2013. Question 2b gives further information on the main reason for the current growth problems in China.

2 b. Do you assume in your GDP forecasts during the one-year period 2013/II – 2014/I

- | | |
|--|------|
| - a continuously weak and disappointing GDP-growth performance in the OECD area as a whole | 62 % |
| - a gradual but relatively modest recovery in the OECD area as a whole | 38 % |

Own comment:

It appears obvious that our China experts assume quite a disappointing international growth environment in their forecasts on Chinese exports and - consequently - GDP growth. Without a doubt, domestic demand will be/should be the engine of (the moderate) GDP growth in the forthcoming quarters.

3. Where do you expect Chinese GDP growth during the forecasting period 2013/II - 2014 mainly to come from? (Please rank)

First: private investments

Second: investments

Third: net exports (not mentioned by all participants)

Own comment:

The answers to this question clarify further that domestic demand will remain the main growth driver for the time being. This is, by the way, what the new Chinese growth model should look like (a view that is not shared by all academic researchers). However, the downsizing of net exports as a GDP-growth contributor should not be regarded as a quick result of the new political leaders' changed growth strategy - but rather as the consequence of the current business cycle which to a great extent is characterized by strongly dampened global demand. But there is also the issue (risk) of the middle income trap. And it should be added that the new strategy of stronger GDP contributions from domestic demand must be regarded as a medium-term project. There is no quick fix in this respect.

4. Do you see for your own GDP forecast on China for

2013: an **upward** bias: 36 % - a **downward** bias: 64 %

2014: an **upward** bias 50 % - a **downward** bias: 50 %

Own comment:

There is also quite some uncertainty where the bias of the panel's China forecast is concerned, particularly with regards to 2014. This is in line with other impressions from this survey panel. A strong recovery is not seen any time soon. This growth environment should be considered by foreign companies with extensive activities in China, even if they so far have not been affected by the more dampened demand.

5. What are your three major short-term concerns - i.e. during the next few years - about the Chinese economy? (Please rank)

First: real estate bubble

Second: distortions in the financial sector

Third: social/political imbalances

Own comment:

The two largest concerns - the real estate bubble and the possible distortions in the financial sector - are obviously interlinked. All of the three main risks mentioned above can also be seen as possible major challenges in the longer term. There is no doubt that our panel regards the risks that are linked to the overheated parts of the real estate sector and financial institutions as the most worrisome.

6. What are your three major short-term concerns about the Chinese economy - i.e. more than 2-3 years from now? (Please rank)

First: instability in real estate and financial markets

Second: competitiveness of Chinese companies - including innovation capability and wage costs

Third: demography and politics/social issues - including the environment

Own comment:

The main long-term risks in China are obvious and in line with many quoted risk scenarios in China. I myself would have expected in this context a more visible risk position for government debt and institutional factors.

7. Do you expect the renminbi during the period July 2013-June 2014 against the USD

- to appreciate slightly (1-5%) 92 %

- to appreciate more visibly (>5%) 8 %

- to be stable -

- to depreciate -

Own comment:

The answers to this question are no surprise. The predicted, only slight appreciation in the forthcoming quarters are probably related to China's export weakness. This conclusion implies that a more solid global recovery could lead to a somewhat faster pace of appreciation than foreseen by the panel. But can we expect such a development? Probably not.

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

- the stock market Yes: 23 % No: 77 %

- the real estate market Yes: 92 % No: 8 %

Own comment:

The answers to this question indicate that also LNU's China Survey Panel remains worried about price developments on the real estate market. As far as the stock market is concerned, no real nervousness about valuations could be seen in this survey. But it is also important to look at governance indicators - as expressed in question 11 in this survey.

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

3 years from now: 3.4 (December 2011: 3.7)
5 years from now: 3.1 (December 2011: 3.4)
10 years from now: 3.0 (December 2011: 3.0)

Own comment:

Medium- and long-term confidence in the Chinese economy is quite satisfactory - though not high. Short-term confidence is somewhat lower than it was in, for example, December 2011. This probably has to do with increased openness and better skills in the Chinese economy.

10 a. Do you trust Chinese economic statistics?

(10=very much; 1=not at all)

June 2013: 4.3 December 2011: 4.9 Fall 2010: 4.4

Own comment:

Our panel still has quite some doubts about the quality of Chinese economic statistics. The recent doubt about export statistics is no coincident (as I have expressed before in a number of papers). More should - and could be! - done at a faster pace. This is also reflected in the answer to question 10b.

10 b. Have you seen any improvements in the past 2-3 years?

Yes: 55 % No: 45 %

11 a. Do you trust Chinese corporate accounting?

(10=very much; 1=not at all)

June 2013: 3.3 December 2011: 4.6 Fall: 2010: 4.2

Own comment:

The level of trust in Chinese corporate accounting is now even lower than it was in previous assessments. This is a bad sign. And this does not fit in with the plans of the new political leaders to open the capital balance much more ambitiously than envisaged by the former leadership. It is not compatible either with the official plans of turning Shanghai into a global financial center by 2020 and of giving the currency RMB the status of full convertibility. The latter issue has recently been mentioned by Prime Minister Li Keqiang as an important issue which the government will be coming back to in more detail later this year.

11 b. Have you seen any improvements in the past 2-3 years?

Yes: 22 % No: 78 %

12. How would you rate the total institutional framework in China?

(10=very good; 1=very poor)

June 2013: 2.8 December 2011: 4.9 Fall 2010: 4.5

Own comment:

The judgment of our China panel on the institutional framework of China looks like a disappointment since an all-time-low has been noted. The rating is too low for a country that is well on the way to turning global and in the meantime has achieved the status of the second largest economy in the world. On the other hand, one may add that China's institutional shortcomings also mean a considerable growth potential for the future if significant improvements can be achieved by the current, quite recently established generation of political leaders.

13. How would you rate transparency

(10=very good; 1=very poor)

- in *economy policy* **June 2013: 3.3** December 2011: 3.4 Fall 2010: 2.8
- of *financial markets* **June 2013: 3.4** December 2011: 3.3 Fall 2010: 3.6

Own comment:

The lack of transparency remains one of the weakest aspects of the economic institutional system. No major change has occurred in recent years. On the other hand, we know from research and experience that more visible institutional reforms always take time. China is, of course, no different in this respect. Furthermore, increased transparency also means loss of political influence, particularly in the case of China. This fact makes the whole issue very sensitive.

14. How would you rate the marketization of the financial system regarding (10=very high; 1=very low)

- the banking system **June 2013: 2.7** December 2011: 3.8
- the stock market **June 2013: 4.3** December 2011: 4.5
- the bond market **June 2013: 3.9** December 2011: 4.2

Own comment:

The results of this question demonstrate that financial markets still have a long way to go before reaching a financial system that is in line with conditions of global financial markets. There is a lot of academic research that underlines the importance of well-functioning financial markets for a country's economic development (Levine et al.) A great deal of work has to be done by China's political leaders to take China's financial institutions to a well-managed market system. On the other hand, the issue of *necessary* marketization of financial systems in emerging economies is increasingly discussed in research. Anyway: the weakness of the banking system is well recognized.

15. How sensitive is China to the ongoing European debt crisis?

(10=extremely sensitive; 1=not sensitive at all)

June 2013: 6.0 December 2011: 6.1

Own comment:

China is quite sensitive to the European crisis - but not as much as one might expect. Of course, China is also strongly linked to other Asian countries, the U.S. and the economic development in these parts of the world. No major change has occurred in the opinions of the panelists between December 2011 and June 2013.

16. Which three economic reform areas will be the visibly preferred by the new political leadership? Please try to rank!

First: Financial sector / Marketization in other areas

Second: Social improvements (security, health, pensions)

Third: New growth model to more domestic demand

Own comment:

Many other areas are mentioned by our panelists, such as regional disparities, distribution of income, transparency, corruption, etc. Education and the environment, however, remain - quite surprisingly - far down on the list. But the ranking can also indicate that a lot of challenges lie ahead for the new Chinese political leaders. The need to restructure and modernize the Chinese economy is becoming acute.

All this means that the fifth generation of Chinese leaders after WWII will have a much tougher job than the forth had in the past decade.

Hubert Fromlet / Linnaeus University

Filename: CHINA Survey Panel June 2013.docx
Directory: C:\tempo\HubertFromlet\chinapanel_2013_2
Template: C:\Documents and Settings\ETICH\Application
Data\Microsoft\Templates\Normal.dot
Title: LNU's China Panel Survey No 16 - June 2013
Subject:
Author: Hubert Fromlet
Keywords:
Comments:
Creation Date: 6/11/2013 6:48:00 PM
Change Number: 4
Last Saved On: 6/12/2013 4:55:00 PM
Last Saved By: etich
Total Editing Time: 19 Minutes
Last Printed On: 6/17/2013 1:33:00 AM
As of Last Complete Printing
Number of Pages: 8
Number of Words: 2 977 (approx.)
Number of Characters: 14 651 (approx.)