

LNU's China Panel Survey No 18 - 24 April 2014

Our “temperature indicator” for China falls to 5.3 - the third lowest number ever

Summary

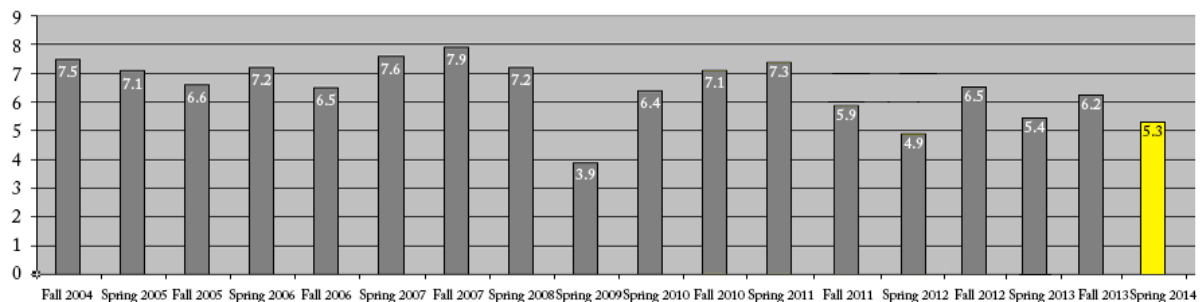
Between April 12 and April 22, we made our regular spring survey on the business cycle outlook and current structural conditions in China. Roughly 20 China experts participated, coming from Europe, North America and Asia. Cordial thanks from us at Linnæus University to all the China experts who regularly come back to us with their thoughtful answers. This spring, the survey “celebrates” its tenth anniversary.

- ✧ Our so-called “**temperature indicator**” for the Chinese economy **fell** slightly to **5.3** in April from 6.2 in December 2013 (10 = extremely overheated). This is the third lowest number since we started the survey exactly ten years ago. China's GDP-growth deceleration becomes obvious also in our own survey and concluding analysis.
- ✧ The panel's **GDP-growth projections** (average):
2014: 7.3 2014 q4: 7.3 2015: 7.2 2015 q4: 7.1
- ✧ 72 % expect the RMB to appreciate by 1-5 percent during July 2014-June 2015.
- ✧ 82 % think that there still is a dangerous price bubble on the Chinese real estate market.
- ✧ Confidence in the Chinese economy has weakened somewhat, both in the short and the longer run.
- ✧ *Some institutional aspects* (gradings 1-10; 10=very good)
 - trust in Chinese economic statistics: **4.9**
 - trust in corporate accounting: **3.8**
 - transparency of financial markets: **3.3**→ all in all: relatively poor institutional results.

Hubert Fromlet

GDP Temperature Indicator

Hubert Fromlet / Linnæus University, April 2014



1. Our “Temperature(GDP-growth)Indicator” falls to 5.3 - China’s growth deceleration becomes increasingly obvious

Result in May 2014 (average): 5.3 December 2013: 6.2 Juni 2013: 5.4

Own comment:

This survey on current GDP growth conditions confirms further what has been pointed at by the panel already three years ago when China’s GDP growth still was considerably higher: that the underlying GDP growth was about to weaken. In the meanwhile, this concern has become true. Index numbers at the current level indicate something like a 7-7 ½% GDP-growth rate – a growth rate that actually was noted in the first quarter of 2014 (7.4 %).

2a. The panel’s predictions for China’s GDP growth (%) - some further deceleration is expected

2014: **7.3** (June 2013: 7.5)

2014 q 4: **7.3** (June 2013: 7.3)

2015: **7.2**

2015 q4: **7.1**

Own comment:

One year ago, we raised the question whether China had entered a 7.5-percent growth trap. Today, one may talk at least about a temporary 6.5-7.5 percent GDP-growth trap. If such a development really means a development towards a so-called middle-income trap or still a kind of cyclical downturn because of insufficient foreign demand or even a combination of both factors, cannot be answered at this moment. Certain details ought to favor the latter alternative. Anyway, it would be appreciated to get better statistical information from the official China on this issue. (Improved) statistical quality and openness should be the melody of the future.

2b. Do you assume in your forecasts from the second half of 2014 until year-end of 2015

- ☒ a weak and disappointing GDP-growth performance in the OECD area as a whole **0 %**
- ☒ a gradual but relatively modest recovery in the OECD area as a whole **100 %**
- ☒ a gradual but quite strong recovery in the OECD area as a whole **0 %**

Own comment:

It is hardly possible to get a clearer answer to such a kind of survey question. All our panel

members assume a relatively modest recovery in the OECD area. This implies that any sizable move to slower or faster domestic growth of domestic demand in the traditional industrial countries also will have an impact on China's export performance and – thus – on the panel's GDP-growth prediction. But it is not a bold forecast that the officially envisaged transition from an export- and investment-driven GDP-growth model to mainly consumption-driven growth stimuli remains time-demanding - and cannot be achieved completely within a few years.

3. Where do you expect Chinese GDP growth during the forecasting period 2014-2015 mainly to come from? Please rank!

First: Investment (private + public)

Second: Private consumption

Third: Exports

Own comment:

Our panelists expect China's main growth stimulus to come from mainly private and public investments during our forecast period until the end of 2015. Private consumption remains on the second position. Some slight contribution may come from net exports as well – but without any strong signals.

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

2014: an upward bias 38 % 2015: a downward bias 62 %

2015: an upward bias 24 % 2015: a downward bias 76 %

Own comment:

The answers on the forecasting biases are consistent with the GDP forecasts: a slight downward bias can be noted. Consequently, our China Panel members are rather somewhat skeptical about China's growth prospects than optimistic.

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

First: Financial sector (private/local debt, shadow banks, real estate sector, overinvestment, etc.)

Second: Implementation of necessary reforms with – initially – growth-impeding effects

Third: Different kind of political complications/problems

Own comment:

All the above-mentioned risks that are linked to the financial sector dominate very clearly in the eyes of our panel. The two other risks that show up on position two and three are worth-while mentioning as well – but they receive much less focus by our panelists than the financial risks. Another problem in this context is the lagging transparency in the financial sector – an issue that is also taken up in question 13.

6. What are your three major long-term concerns about the Chinese economy – i.e. more than just a few years from now?

First: Environment

Second: Demography

Third: Different kinds of political and social problems

Own comment:

The results from the question of the main long-run risks reflect very well the risks that use to be summed in many papers and speeches aiming at a longer perspective. Another risk – very close to the “top 3” – should not be neglected: the possible failure of changing the Chinese macroeconomic growth model to a mainly consumption-oriented one.

7. Do you expect the renminbi during the period July 2014-June 2015 against the USD

	%
☒ to appreciate slightly (1-5%)	72
☒ to appreciate more visibly (>5%)	-
☒ to be stable	9
☒ to depreciate	-
☒ to fluctuate more strongly without clear direction	19

Own comment:

Despite the recently widened band for China’s daily currency fluctuations (+/- 2 % daily), most of our China experts continue to believe in slight future annual appreciations. But it can be noted that one fifth of our panel members assumes the currency RMB to fluctuate more strongly in the forthcoming year – without clear direction.

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

- | | | |
|----------------------|------------------|------------------|
| - stock market | Yes: 0 % | No: 100 % |
| - real estate market | Yes: 82 % | No: 18 % |

Own comment:

The China experts of this survey see currently no risk of a dangerous price bubble on the *stock markets* in Shanghai and Shenzhen (which seems plausible at this point when watching more recent trends). As regards the *real estate market*, however, concerns about a - possibly - bursting bubble are still there. In other words: there is still no reason for Chinese authorities to look more relaxed on price developments on the real estate market – if our China Panel makes the right conclusions. This is probably the case.

9. How would you rate the general confidence in the Chinese economy?

(5 = very high; 1 = very low confidence)

- | | | |
|--------------------------|------------------|-----------------|
| - 3 years from now: 3.0 | (June 2013: 3.4) | (Dec 2011: 3.7) |
| - 5 years from now: 2.9 | (June 2013: 3.1) | (Dec 2011: 3.4) |
| - 10 years from now: 2.9 | (June 2013: 3.0) | (Dec 2011: 3.0) |

Own comment:

There is no doubt that the panel's confidence in the short-run and the long-run future has been weakening in recent quarters. On the one hand, less positive economic information has reached analysts in China and abroad. On the other hand, analysts may nowadays receive somewhat more varying reports from and about China, partly due to the problems that are described in the documents from the Third Plenum. However, there is no numerical evidence for the latter hypothesis.

10a. Do you trust Chinese economic statistics?

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

- | | | |
|------------------------|------------------|------------------|
| April 2014: 4.9 | (June 2013: 4.3) | (Fall 2010: 4.4) |
|------------------------|------------------|------------------|

Own comment:

The result of this question has been quite poor ever since its start. In the past year, however, one can observe a slight improvement (which is confirmed by the answers to question 10b). But the level of 4.9 out of 10 is still poor. Further progress is highly desirable, both for China itself and the rest of the world, research included.

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

Yes: 63 % **No:** 37 %

11a. Do you trust Chinese corporate accounting?

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

April 2014: 3.8 (June 2013: 3.3) (Fall 2010: 4.2)

Own comment:

Despite some slight improvement in the past year, corporate accounting is still considered as quite poor. No improvement can be noted when looking a few years back, according to the panel (which more or less has been consisting of the same people quite some years back). This conclusion is consistent with the answers to question 11 b. If China really wants to deregulate the whole capital account much stronger efforts in corporate accounting are urgently needed.

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

Yes: 25 % **No:** 75 %

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

(10 = very good; 1 = very poor)

April 2014: 4.1 (June 2013: 2.8) (Fall 2010: 4.5)

Own comment:

Three well-known phenomena are confirmed by the panel's view on Chinese institutions. *First* – which is in line with relevant literature – that it usually takes a long time to significantly improve poor institutional conditions in a country. *Second* – and unfortunately – that this experience is confirmed in the applied case of China. *Third* – fortunately – that Chinese leaders clearly have recognized the necessity of institutional reforms in the plans that have been set by the Third Plenum last November. The big question remains, however: to what extent are all the institutional shortcomings part of the existing political and social system per se?

13. How would you rate transparency

(10 = very good; 1 = very poor)

- in **economy policy** in April 2014: **4.6** (June 2013: 3.3) (Fall 2010: 2.8)
- of **financial markets** in April 2014: **3.3** (June 2013: 3.4) (Fall 2010: 3.6)

Own comment:

It seems to be obvious that transparency in Chinese *economic policy* has improved somewhat during the past few years. This limited change to the better can probably be related to the intended change of the Chinese growth model to more consumption-based economic growth and the strategies and plans that came out of the Third Plenum; thus it will be very interesting to see to what extent Chinese leaders will report more detailed about the progress that hopefully will be made during the implementation process of all the planned improvements.

When it comes to the shortcoming in transparency of *financial markets* there is still not very much new to tell. It still seems to be a conundrum how the deregulation process of the capital account can be successfully coordinated with the necessity of making Chinese financial markets at the same time considerably more transparent.

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

- **the banking system** in April 2014: **3.5** (June 2013: 2.7) (Dec 2011: 3.8)
- **the stock market** in April 2014: **4.2** (June 2013: 4.3) (Dec 2011: 4.5)
- **the bond market** in April 2014: **2.9** (June 2013: 3.9) (Dec 2011: 4.2)

Own comment:

Marketization of financial markets has to proceed further. There is no doubt about this. Current survey numbers are by far too low, particularly when considering the necessary financial reforms at home. Ordinary savers, more advanced investors, borrowers, the central bank and a future deregulated capital account need much more marketization on domestic financial markets - without neglecting the risks.

15. Do you think that China can achieve clearly visible improvements by 2020, the evaluation year of the plans from the Third Forum?

Yes: 36 %

No: 0 %

Maybe: 64 %

Own comment:

The answers to this question give no clear outlook on the results of China's new reform policy. Sure, 36 percent believe that structural and institutional improvements will more or

less visibly happen by 2020 – but it seems to be very difficult to interpret the opinion of roughly two thirds of the panelists who just anticipate the possibility of “visible” improvements during the next six years. Certain doubts are certainly expressed implicitly by this answer.

Concluding comments

✧ The results of this new number of LNU’s China Survey Panel give a divided impression. There are a few more positive signals compared to previous surveys (no imminent bubble on the stock market, some very limited improvement of statistical quality from low a low level). Other results are rather discouraging (such as the slightly weakening numbers for the panelists’ confidence in the Chinese economy and the poor number for Chinese institutions).

✧ Altogether, there is quite some evidence given by our panel that China has do accomplish a lot of work in the next six (evaluation year of the Third Plenum) and eight years (end of the political mandate of the fifth generation of Communist leaders). The plans and strategies of the Third Plenum from November 2013 could serve as good guidelines. It could be a good idea that China specialists as carefully as possible try to follow up practical applications of the decisions that were made by the leaders of the Third Plenum in December 2013.

✧ Economic research has demonstrated in a number of convincing studies that improvements of institutional conditions have to be regarded as very crucial to sustainable good or satisfactory economic growth. This survey clarifies by a number of examples that China still needs considerable institutional progress – a conclusion that should be taken very seriously, particularly since institutional reforms are both difficult to implement and mostly very time-consuming.

✧ It should not be overlooked that most contributors to our China Panel Survey still feel very concerned about potential problems and instability in the financial sector – a sector in the Chinese economy that is characterized by completely insufficient transparency.

✧ *All in all: LNU’s China Survey Panel makes this time a (somewhat) more skeptical impression about the prospects for the Chinese economy than half a year or a year ago.*

Hubert Fromlet / Linnaeus University