Deloitte.
デロイト トーマツ

'This newsletter is translated from the Japanese edition distributed on May 25th.
Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.

Global Risk Watch Newsletter

China: inclined toward putting off hard structural policies?, etc.

Global Risk Watch Vol.38
31 May 2018

==

≪index≫

==

1. Overview Macroeconomic and Financial Risks (Trends & Topics)

 # China: inclined toward putting off hard structural policies? (Tsuyoshi Oyama, Partner/Head of Center for Risk Management Strategy (CRMS) at Deloitte Touche Tohmatsu LLC/Deloitte Asia Pacific Risk and Capital Management Leader)

In the US, the inflation rate has finally reached the FRB's target level of 2%. Against this, we now see both the upward trend in the US long-term interest rates as well as a strong USD, which then cause disruptions in the previously stable exchange rates of emerging economies. This is particularly true for those countries that have unstable economic or political situations (Argentina, Turkey, Poland, Brazil etc.) – some have seen their currencies drop precipitously, with some going so far as to request assistance from the IMF. Although capital outflows are as yet limited, we may see another round of currency market disruptions like that of the "taper tantrum" of 2013 should US long-term interest rates continue to climb.

Meanwhile, some soft data indicates that the pressures that have been gradually slowing the Chinese growth rate have recently softened. Last year, the Chinese government policies to address overinvestment led to a restraint on new capital expenditure. The high Chinese growth rate was maintained only thanks to strong consumer spending that was buoyed mainly by rising home prices. And yet, in 4Q 2017 the contribution from consumer spending to the GDP growth rate suddenly plummeted. A sudden drop on the growth rate was barely avoided thanks to the unexpectedly strong contribution of net exports. But this event has surely awakened us to the fact that the deceleration of Chinese economic growth rate is not a remote possibility.

In 1Q 2018, consumer spending once again strengthened and strong growth led by internal demand came back. One possible background reason for this –housing prices which had been stagnate have recently begun to turn upwards. In other words, the Chinese government might slightly loosen its policies that restrained the housing bubble after seeing the possibility of overkill to the Chinese business condition. On the monetary policy front, the PBOC has recently started loosening its policy slightly by lowering the deposit reserve ratio. We have also heard stories from media that while the manufacturing business sentiment worsened after strengthened enforcement of environmental regulations one month, conversely the next month that same sentiment had bounced back because of softening enforcement of those same environmental regulations.

In any event, while the Chinese government is still pursuing policies to address imbalances, they are also eager to maintain the current growth rate. When the business climate worsens even slightly, their “fine tuning” of policy relaxation is exposed. The new economic policy team lineup was announced at the beginning of this year was expected to aggressively pursue economic reforms at the cost of some growth deceleration. However, looking at actual policy implementation over some number of months after we entered into 2018, it seems like they are continuing to give the most importance to maintaining the current growth rate while at the same time being cautious when it comes to policy that corrects imbalances.

April’s YoY retail sales have once again fallen to historic lows. With the growing trade war with the US, China cannot easily rely on growth in net exports either. They imply that future imbalance corrections by the Chinese government may be on the milder side. For a global economy that worries about a second taper tantrum, the fact that the present Chinese economy will be unlikely to slow down soon is a cause for relief. At the same time, if China puts off addressing the imbalances to a later date it also means that there is a great risk to be answered for in the mid-to-long term.