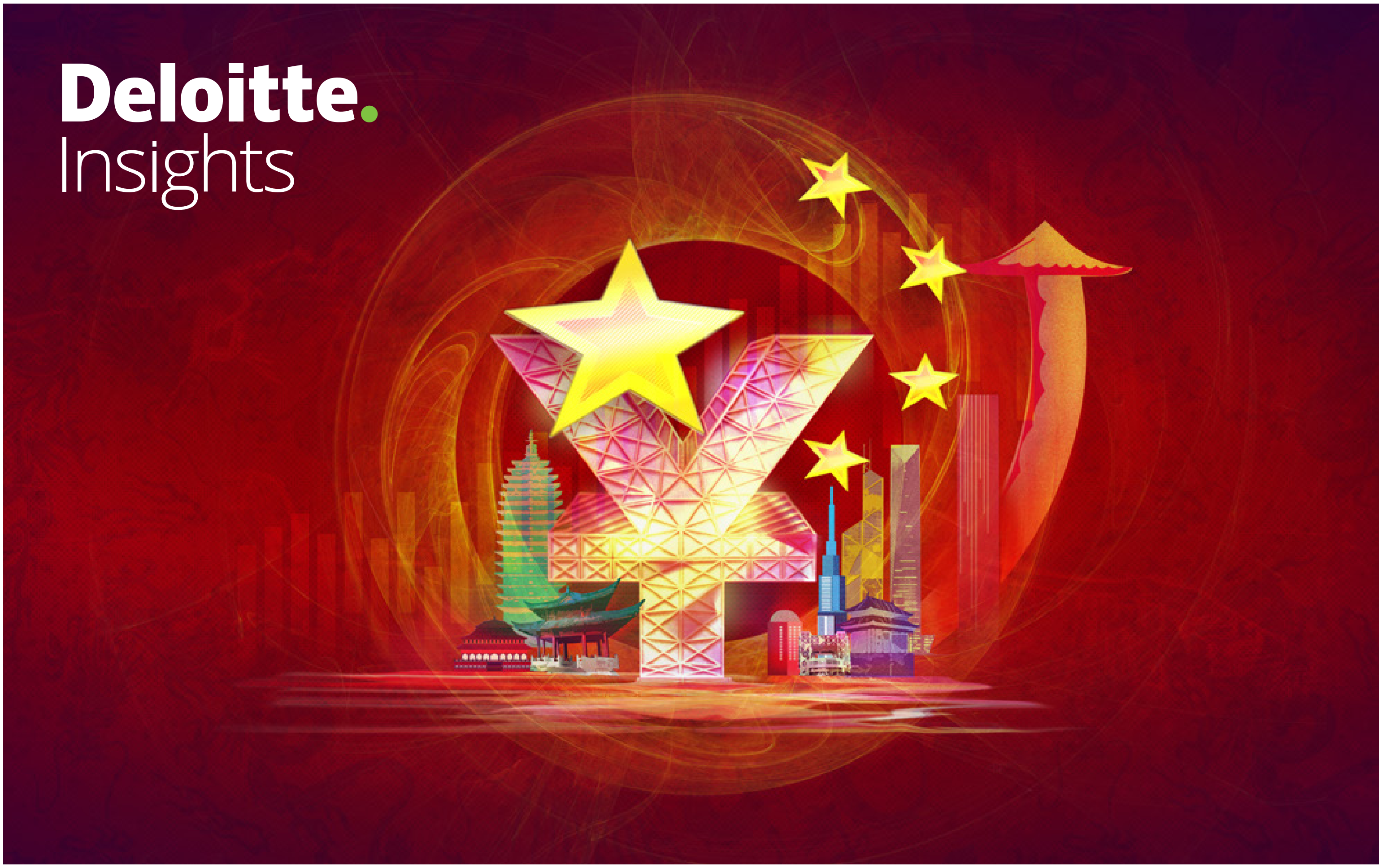

China

Slow, but steady

By: Ira Kalish

Introduction

China has reported a range of monthly economic statistics that provide some insight into the state of the economy. The latest data suggests some deceleration in economic activity, but continued moderately strong growth. Here are some details:

- Fixed asset investment decelerated. Specifically, investment in the first 11 months of 2017 was up 7.2 percent from the previous year, but lower than the 7.3 percent reported in the first 10 months. Private sector investment was up only 5.7 percent.[1] This continues a long-standing pattern in which investment by state-owned enterprises (SOEs) has risen much faster than private sector investment, reflecting the government's efforts to boost growth by encouraging state-run banks to lend to SOEs. Although this helps to stabilize overall growth, it can create longer-term problems. Specifically, private sector investment tends to generate a higher return and greater productivity gains than investment by the SOEs. Absent a revival of private sector investment, economic growth could decelerate further.
- Retail sales were up 10.2 percent in November vs. a year earlier, faster than the 10.0 percent increase in October, but slower than the growth seen in most of the previous year. Two

categories that grew at blistering rates were telecom (up 33.9 percent) and cosmetics (21.4 percent). Big-ticket items, however, didn't perform very well. Automotive was up only 4.2 percent and building materials were up only 3.6 percent.

- Industrial production was up 6.1 percent in November vs. a year earlier, slower than that during most of the past year. Output of electricity, gas, and water was up 4.5 percent, down from 9.2 percent in October. Mining output fell 1.7 percent, and manufacturing output was up 6.8 percent. Separately, the purchasing manager's index (PMI) for manufacturing indicates only modest growth in activity in the industry. This is disappointing at a time when the global manufacturing industry is accelerating and, in some countries, growing at a breakneck pace.
- In the first 11 months of the year, inbound foreign direct investment (FDI) was up 9.8 percent from the previous year. In November alone, FDI was up 90.7 percent from the previous year. Meanwhile, outbound FDI in the first 11 months of the year was down 33.5 percent from the previous year. This reflected the existence of capital controls through much of 2017. The shift in inbound and outbound FDI played a role in boosting the value of the currency in the past year.
- The main factors driving economic growth are investment in property and exports. Property investment is being fueled by government stimulus, while exports have been helped by a rebound in global demand.

Looking ahead, China's economy appears set for continued moderate growth in 2018. Consumer spending is growing at a moderate pace, fueled by continuing wage gains. State-driven investment, property investment, and exports all appear set for moderate growth, although a tightening of monetary policy could suppress property investment as has happened in the past. Indeed, monetary policy is likely to be tightened modestly, especially now that the US Federal Reserve is clearly on a path toward tighter monetary policy. Late in 2017, the People's Bank of China (PBOC) raised some key interest rates for the first time in almost a year, immediately following an increase by the US Federal Reserve. This action brings China's interbank rates to a level last seen in 2015. The PBOC only started to raise these rates in early 2017. The latest action reflects the cautiousness of the PBOC, but likely signals a desire to avoid a widening of the interest rate gap with the United States, lest such a gap generate capital outflows from China.

Meanwhile, China's foreign currency reserves continue to rise. In December, reserves were up $20.2 billion from the previous month, hitting $3.14 trillion, the highest level since September 2016 and the biggest month-on-month increase since July. Evidently, the continued imposition of capital controls has discouraged capital outflows. Thus, the central bank needn't sell reserves in order to stabilize the currency. Rather, the central bank has been able to accumulate reserves while the currency actually appreciated modestly. This might not go on for much longer since the government intends to ease capital controls in order to work toward its longer-term goal of having a globally traded currency. In addition, as the US Federal Reserve raises interest rates, it will create an incentive for capital to exit China. Still, the general zeitgeist seems to be that China is in good economic health and that its standing in the world is improving.

Longer-term issues

DEMOGRAPHICS

The Chinese Academy of Social Sciences (CASS), a leading government think tank that is often influential on policy matters, says that China is facing a population time bomb.[2] In a new report, it says that the country must reduce or eliminate birth control measures or face a serious problem in financing the needs of a rapidly aging population. The government did relax the one-child policy two years ago, but CASS says that this is probably not sufficient. The report notes that the working-age population has now declined for five consecutive years and that it is set to decline rapidly between now and 2050.

It also notes that life expectancy is increasing and that the elderly share of the population, having already risen considerably in recent years, is set to soar. So what should be done? CASS says that despite the government having eased restrictions on the number of children, rising living costs are deterring couples from having more children. Some Chinese researchers suggest that the government ought to provide support for couples meant to encourage more births. Failure to raise birth rates bodes poorly for economic growth in the coming decades.

UNEMPLOYMENT

In the past decade, the technology-based part of the Chinese economy has grown twice as fast as overall GDP, according to CASS.[3] It says that technology-based industries grew more than 16 percent per year in the last 10 years. In addition, the number of jobs created in technology industries increased 22 times faster than in the economy as a whole. The report says that this job growth creates "great potential to offset the layoff pressure brought by overcapacity cuts." While true in terms of overall numbers, it might not be the case that workers losing jobs at steel factories will have the skills required in the new technology jobs. Thus, while overall employment might stabilize as a result of the growth of technology-related industries, there remains the possibility that many redundant workers will be unemployable. A similar problem exists in other countries such as the United States. On the other hand, some of the jobs being created by new technologies do not require high levels of skill. The report cites ride-hailing applications as having created nearly 3 million jobs in the past year.

TRANSPARENCY

The International Monetary Fund (IMF) urged China to provide greater transparency about the volume and type of debt issued by local governments. It said that "China's official government accounts do not capture a large amount of fiscal spending delivered through off-budget units. Although progress has been made to legally separate off-budget units from the government, such units appear to not have been de facto separated from the government." The IMF is worried that a lack of transparency is concealing the true state of local government finances, an issue that has also been raised by ratings agencies. The government in Beijing says that local government debt amounts to about $2.4 trillion. Yet the IMF says that, because of the existence of local government financing vehicles and public-private partnerships, the true debt of local governments is much greater. Meanwhile, Beijing's National Audit Office accused several local governments of faking economic data in order to boost their estimate of government revenue and reduce their estimate of debt.

ENDNOTES

1. All data has been taken from the National Bureau of Statistics.
2. Wang Guangzhou, "'Two-child policy' to tackle aging population," Chinese Academy of Social Sciences, January 8, 2015.
3. Xie Yu, "China's new economy grows twice as fast as GDP and helps offset job losses, says top think tank," *South China Morning Post*, December 20, 2017.

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Ira Kalish is a specialist in global economic issues and the effects of economic, demographic, and social trends on the global business environment. He is a regular contributor to economics articles published on Deloitte Insights, and also writes for the annual Global Powers of Retailing and Consumer Products reports.

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