BOFIT China Desk

BOFIT Forecast for China 2009–2011

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29.9.2009

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China's economy slowed significantly as problems arose in connection with exports and private investment, but thanks to a sizeable stimulus package, a quick turnaround was achieved. China's GDP is expected to grow by about 8% in both 2009 and 2010 and by slightly more in the last year of the forecast period, 2011. The massive increase in lending associated with the stimulus package could lead to imbalances in the Chinese economy, which might make economic policy more difficult and constrain growth. The current stimulus measures have only reinforced the investment- and export-orientation of the economy, while domestic demand continues to play a minor role.

The rate of growth of the Chinese economy dropped sharply in the fourth quarter of 2008. At bottom, in the first quarter of this year, real GDP growth was officially 6% pa. The slowing was due to a collapse of investments and exports in corporate sectors. A two-year stimulus package amounting to nearly USD 600 billion (13% of 2008 GDP) was announced in the autumn of 2008. This gave a major boost to government investment, which led to a swift turnaround in economic performance. In the January-June period, China's GDP grew more than 7% year-on-year, and the situation has improved further in the late summer months.

Due to faster-than-forecast growth and a quick recovery, our current forecast raises China's GDP growth for every year of the forecast period, from the forecast released a half-year ago. The forecast rates for both 2009 and 2010 are around 8%, with a jump to 9% in 2011, due to renewed growth of the world economy and private investment.

China's growth is still tied to investment

For the time being, China's economic growth depends largely on public-sector investment. Private consumption demand is also strong, as reflected in retail sales. But consumption plays a smaller role than investment in the Chinese economy, in sharp contrast to other countries.

China's export and import volumes were notably smaller in January-August than in the year-earlier period, but in monthly terms, trade has recovered fairly quickly from the nadir at the start of this year. Nonetheless, China's export volume will be much lower in 2009 than in the previous year; albeit it is expected to recover in the later years of the forecast period, in response to modest growth in Europe, USA and Japan. Import volume will also be smaller in 2009 than in the previous year, despite a recent binge of raw materials imports. Buoyed by persistently strong domestic demand, imports are set to recover faster than exports in the course of the forecast period. The take-off of processing trade could push both exports and imports above forecast levels.

In January-August of 2009, China's trade balance declined, both in USD terms and especially relative to GDP. Although the country's trade balance remains strongly in surplus, it is no longer expanding at the recent years' pace and could in fact shrink during the forecast period. China's focus on infrastructure investments means that its stimulus contribution to the world economy will be quite limited in the near term, except as an importer of raw materials.

Difficult economic-policy choices

Strong fiscal-monetary policy actions have produced quick results this year, but these entail sizeable risks. The investment package, based on rapidly expanding debt, has not only spurred production but has also caused share and real estate prices to rise, and the quality of commercial banks' loan portfolios supposedly have suffered. If private investment fails to take off as hoped for, keeping the economy on the present growth path will require additional stimulus and credit granting. The money stock is however growing at 28% pa, which is adding some inflationary pressure. Although, on an annual basis, prices are still declining, they did rise in August month-on-month, and discussions on when to tighten monetary policy have begun.

Although decision-makers are concerned about the rapid growth of the stocks of credit and money they are emphasizing the fact that economic growth is still not on a sustainable footing. The situation is difficult because of two major policy concerns: the intent is to use all means to prevent the growth of unemployment, but with households holding a huge amount of savings there is a clear need to provide protection from inflation. For the time being, the concern about economic growth and unemployment is in the forefront. At some stage, however, the growth of credit will have to be curtailed, which will serve to constrain economic growth during the forecast period.

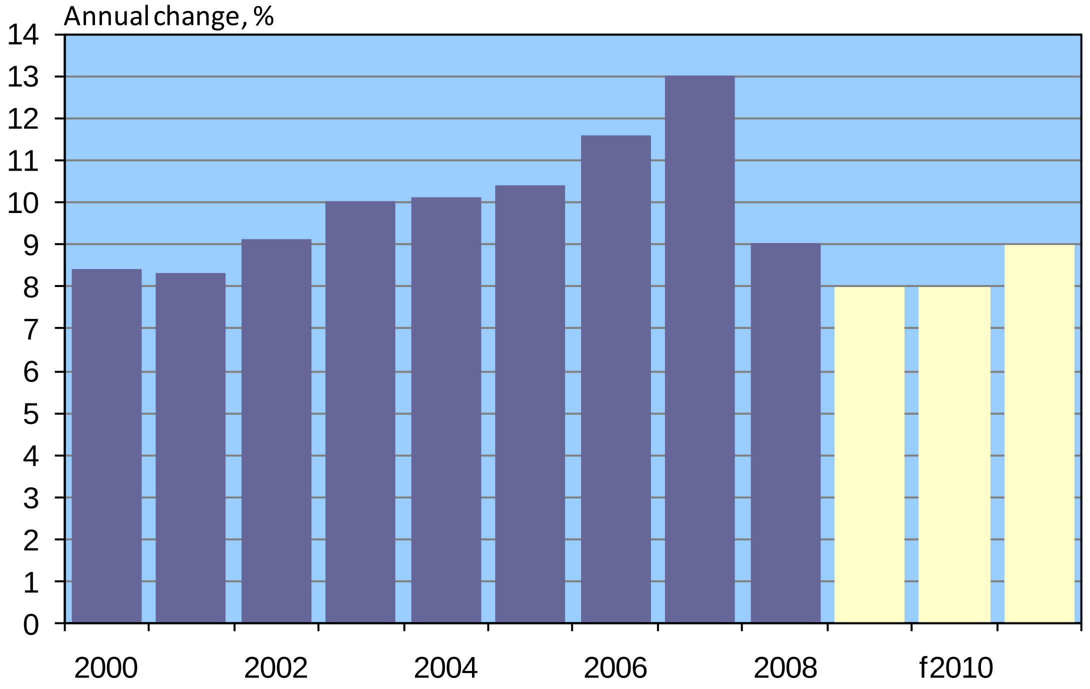
Trade relations between China and USA came to a head in September when the United States put in place some new protective import duties on car tyres. If the two sides fail to reach an agreement and halt the tendency to protectionism, there will be serious negative consequences for developments in China and other countries.

The structure of demand needs revamping

The current crisis may have destroyed China's traditional growth potential, as many exporting companies have moved to countries with lower costs and a part of the production capacity is aging because of lack of new investment. Despite this, the trend to urbanisation and related productivity growth could enable output to grow at a 8–10% annual rate for a long time yet. Rapid growth will be essential if the debt and financial-deficit problems faced by Chinese banks and the public sector are to be neatly cleaned up within the next decade.

A continuation of rapid growth will, however, require changes in the structure of China's economy. Given the size of its economy, China cannot continue to rely on exports and investment to drive its economic growth; instead, the role of domestic consumption demand will have to be upgraded. Unfortunately, the current stimulus measures have rather strengthened the old structures, as witnessed by the fact that the investment ratio (investments relative to GDP) is already approaching 44%.

Real GDP growth rate, %



Sources: China National Bureau of Statistics, BOFIT 2009–2011 forecast

Annual change in China's GDP and import volume, 2008–2011, %

	2008	2009f	2010f	2011f
GDP	9.0	8	8	9
Imports	7.0*	– 10	5	10

* forecast

Sources: China National Bureau of Statistics, BOFIT 2009–2011 forecast