BOFIT Forecast for China
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BOFIT China Team

BOFIT Forecast for China 2011–2013

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Supported by a set of fiscal stimuli geared to promote investment, China was able to continue its rapid economic growth during the international financial crisis. In 2010, the Chinese economy grew by 10.3%. Owing to massive credit extension fuelled by the fiscal stimuli as well as inflationary pressures fed by rising food and commodity prices, Chinese economic policy has shifted in focus to curbing inflation via monetary tightening. As a result, growth in real GDP is expected to slow down to 9% in 2011 and to 8% in 2012–2013. In the forecast period, in addition to the recent uncertainties in the world economy, inflationary pressures and problems in the real estate sector are the greatest immediate risks to balanced economic development.

China's real GDP grew by 10.3% in 2010. As in the previous year, growth was fuelled mainly by investment, which accounted for a significantly larger part of growth than consumption. With the international financial crisis gradually subsiding, growth in investment, fuelled by the fiscal stimuli, will begin to decelerate and create both the space and need for a strengthening of private consumption. At the same time, the rate of growth in production will slow down. In 2011, China's real GDP is expected to grow by 9% and in 2012–2013 by some 8% pa, which is close to China's estimated output growth potential.

Last year, growth was largely in line with the previous BOFIT China forecast published in the early autumn. No new facts concerning the forecast period have emerged that would merit revision of our prior forecast. The National People's Congress of China has just approved a 5-year plan for 2011–2015, where the average annual growth target was reduced to 7%. For the 5-year period of 2006–2010, the goal was 7.5%, but actual average annual growth was 11.2%

Economic policy tightening will constrain growth

Despite last year's rapid growth, China is to a large extent only just recovering from the exceptional circumstances caused by the global crisis. After the peak in investment resulting from the fiscal stimuli and massive flow of credit to finance it, decision makers have had difficulty in curbing the expansion of credit growth. Inflationary pressures have intensified, which has been partly caused by the global rise in food and commodity prices. The last few months have seen rapid inflation by Chinese standards around a rate of 5%. The housing market is also characterised by great uncertainty, although price developments seem to have calmed down as a result of tightening measures undertaken last year. Initiated last year, the tightening of monetary policy is likely to continue in the current year until economic growth slows down to a level deemed appropriate for price stability.

In the forecast period, economic growth in China is based on domestic demand. Private consumption is supported by continued strong income development and appreciation of the yuan. Continued increases in nominal wages and the halt of growth in working-age population in the forecast period signal strong wage developments. Boosting domestic demand and the role of the service sector are key themes in the new 5-year plan approved in March. Private consumption has sunk to some 35% of GDP, which is exceptionally low even in China's own history. Public consumption accounts for 13% of GDP and has not undergone major changes.

The massive fiscal stimulation package designed to address the consequences of the international financial crisis resulted in a steep rise in investment, as reflected in the investment rate jumping from 43% in 2008 to 46% in 2010. In the forecast period, investment growth is expected to remain slower than consumption growth and the investment rate to move closer to the level prevailing before the crisis. However, investment demand will remain strong for years owing to urbanisation, establishment of infrastructure, partial transfer of labour-intensive industry inland, increase in technology and development of the service sector.

Chinese foreign trade has picked up rapidly from the slump around the end of 2008. Now the world's largest exporting economy, China's exports are expected to grow slightly faster than the 7% growth rate of world trade. Because China's GDP growth will be substantially faster than that of the rest of the world, China's import growth is expected to exceed export growth. Imports will be boosted by appreciation of the yuan.

China's current account surplus relative to GDP has shrunk steadily from 11% in 2007 to approximately 5% in 2010. Some tapering down may still be seen, but developments in the current account are very sensitive to price changes in foreign trade, which in turn are difficult to forecast.

Inflation and the real estate sector – the main concerns

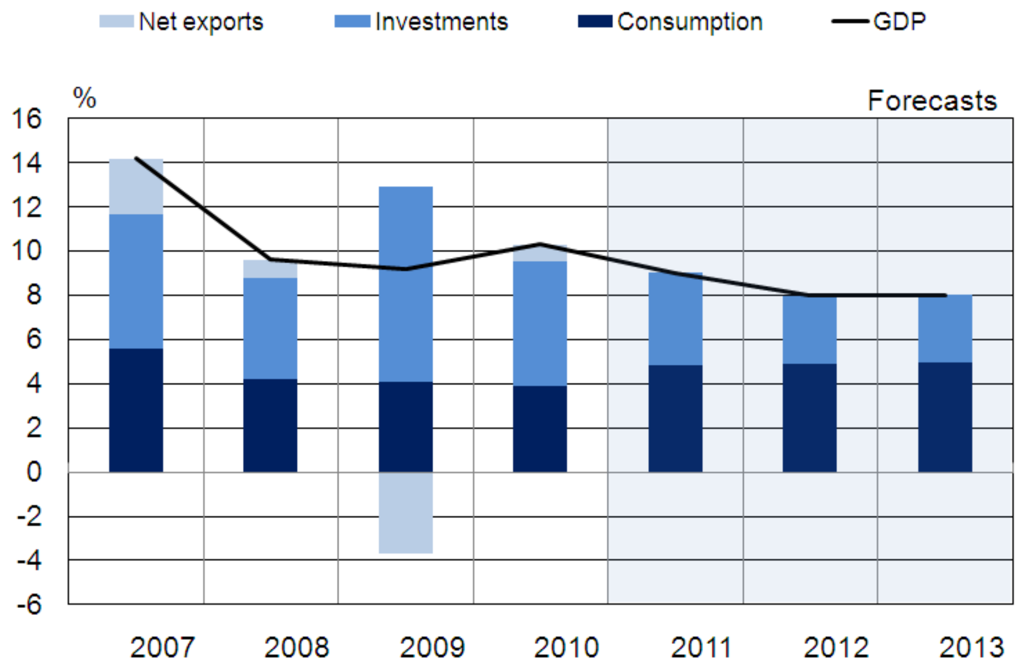
Amidst global economic problems, China gives the impression that it is adjusting to post-crisis life in a controlled manner. Once again, this is reflected in deviations of only one percentage point in the forecasts for China for the current year. Developments in the last few years do entail some problems, the most obvious of which are inflation and the real estate sector. Inflation has become the most important economic policy concern, because inappropriate timing of monetary policy tightening could lead to uneven growth. Chinese decision-makers have also been concerned about the impact of rising prices on overall peace in the society.

The unclear situation in the real estate sector will make it difficult to determine the setting for monetary policy. Although there is an incessant need for new housing, a large number of apartments may remain unsold. In this situation, a potential fall in prices could reduce construction activity and slow down economic growth. A quieter housing market would reduce the substantial income received by local government from the sale of land usage rights and thus make it more difficult for them to finance their much discussed social housing production. Problems in the real estate sector would also be reflected in the banking sector and banks' ability to finance other investment. However, the poor quality of statistics and major regional differences make it very difficult to evaluate the actual situation in the Chinese real estate market.

Wage developments are set to become an increasing focus of interest, possibly already by the end of the forecast period. We can already see a large number of companies relocating from China to countries with cheaper labour. With employees' powers of negotiation possibly being increased in the forecast period, along with already substantial increases in minimum wages, it will be interesting to observe whether productivity growth will be able to keep up with wage developments.

In January 2011, China's currency authorities announced that China will liberalise capital movements by 2015. Although the announcement was a natural continuation to the already liberalised currency regulations, forthcoming policy experiments in this connection may cause added uncertainty during the forecast period.

Chinese GDP growth and contributions of demand components, %



Sources: CEIC and BOFIT