BOFIT Forecast for China
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BOFIT China Team

BOFIT Forecast for China 2011–2013

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Chinese economic growth has slowed slightly in the current year, owing to the tightening of monetary policy to curb inflation. Growth will however remain robust. In 2011, China's GDP should grow by 9% and in 2012–2013 by some 8% pa. The worsening economic situation in Europe and the United States poses a risk also for China. The problems in China's financial sector may escalate if economic growth in China slows significantly.

In 2010 China's GDP grew by 10.4%, but this year the growth rate has eased somewhat. In January–June, China's GDP grew by 9.6% pa, and indicators of production and foreign trade point to a further slowing of GDP growth during the summer. The slowdown in economic growth thus far has been in line with expectations as the pick-up in inflation has forced China to tighten its economic policy over the past year.

Despite the slowdown, China's economic growth will remain robust. In 2011, China's GDP will grow by some 9% and in 2012–2013 it is expected to grow by some 8%. The recent problems in Europe and the United States have however cast a new shadow also over the Chinese economy. The continuation of favourable economic developments in China thus requires a stabilisation of the situation in Europe and the United States, as they still account for 36% of Chinese exports.

Room for growth in private consumption demand

In recent years, China's strong economic growth has been based mainly on investment, which accounts for ca 45% of GDP. Growth in consumption is at least for now slower than GDP growth, but in future domestic consumption demand is expected to account for a larger portion of GDP growth. This projection is supported by a 9% increase in real wages in the first half of 2011 and political commitments related to a new 5-year plan approved in spring to raise minimum wages faster than the rate of growth in total output also in future. There is room for growth in consumption demand as household consumption has sunk to less than 35% of GDP, compared to some 45% ten years ago. However, changes in the structure of demand occur slowly, and in 2011 the growth contribution of investment may still exceed that of consumption demand.

In January–July, China's export volume was 12% higher and imports 11% higher than a year earlier. For 2011 as a whole, the growth rates are likely to decline to just below 10%, and so the growth contribution of foreign trade (net exports) will remain small. Exports and imports are expected to grow by some 10% pa also in future, although due to the rapid growth of the Chinese economy, imports are expected to grow slightly faster than exports. As a result, the growth contribution of net exports will remain small also in the coming years.

China's current account surplus-to-GDP ratio was cut by half during the crisis years at the end of the past decade, and in the past two years it has been approximately 5%. Some tapering down may still be seen, but estimates are highly sensitive to developments in prices of exports and imports. Although China's current account surplus may be in decline in relative terms, the net inflow of capital into China continues, and the country's foreign exchange reserves are still expanding. This process is fed by the uncertain situation in the United States and Europe and their accommodative monetary policy, as well as the favourable growth outlook for the Chinese economy and the expectations of a strengthening of the yuan.

In the current year, China has continued the monetary tightening initiated a year ago, by raising banks' reserve requirements and policy rates and via direct instructions to banks. Market interest rates have been on an upward trend already for a year. Growth of the lending stock and liquidity has slowed to 15% pa, ie to pre-crisis levels. Although the pick-up in inflation seems to have come to a halt in the summer, consumer prices rose in August by over 6% pa. The real interest rates on deposits are still strongly negative. So, although price pressures are expected to ease towards year-end, China is not expected to significantly relax its monetary policy in the short term, unless the growth outlook weakens in connection with the escalation of the problems in the global economy.

The strengthening of the yuan would dampen import price pressures and at the same time promote structural change by boosting households' real purchasing power. The real and nominal trade-weighted exchange rates of the yuan have however remained at approximately year-earlier levels, even though the yuan has continued to strengthen against the dollar.

Domestic factors emphasised in the risk assessment

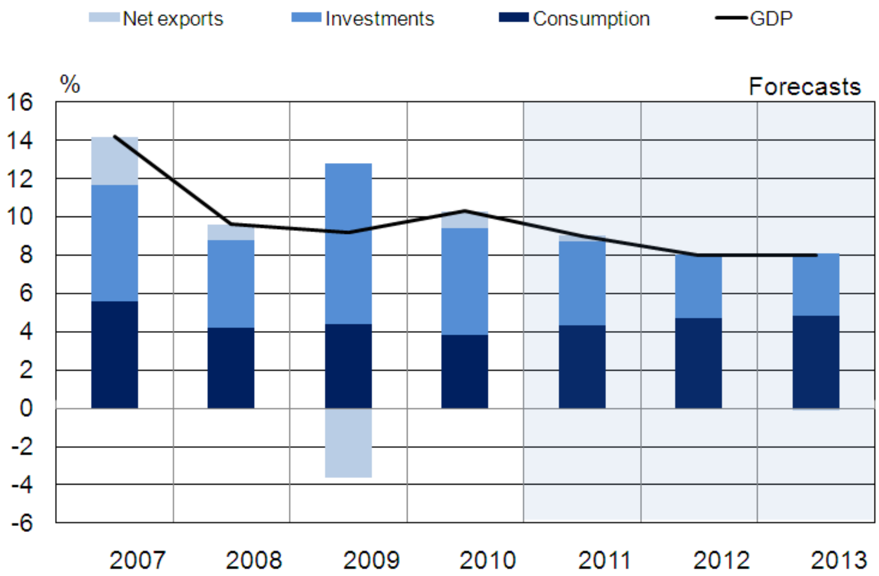
After the crisis years at the end of the past decade, China's economic performance and policy seem to be normalising in many respects; eg the rise in housing prices has partly slowed, as a result of policy measures. However, due to the size of the real estate sector and its extensive impact, the sector's hidden debt problems and possible price bubbles will dampen the economic outlook for some time yet. Moreover, uncertainties in the world economy and some new problems regarding internal developments are increasing the risk of weaker-than-forecast economic developments.

The latest concern also in China is the considerable increase in public sector debt, which will reduce the room for economic policy manoeuvring. Calculations published by the authorities in summer show that local government debt has risen rapidly, to ca 30% of GDP. A couple of years ago, the published figures on the whole public debt included only central government debt (20% of GDP), whereas public sector debt is currently estimated to range between 50 and 80%. According to credit rating agencies, due to the debt-servicing problems of the local government, the amount of nonperforming loans is already increasing, although this is not shown in the official statistics.

The increasing uncertainty in the banking and financial markets also relates to the growth of the grey financial markets. Banks have quickly learned to circumvent credit controls imposed by the authorities, and banks' off-balance sheet lending has more or less compensated for the slowing of growth in the official credit market. Many companies with savings or access to inexpensive bank loans have granted credit to small and medium-sized companies that do not have access to bank credit. The interest rate in the grey market is easily around 20%, whereas the regulated interest rate on loans is approximately 7%.

China has already taken major decisions to liberalise its currency regulations, which will expand the international role of the yuan. China is also gradually liberalising its domestic financial market. The reforms on the horizon are natural and necessary, but it is well known that financial market liberalisation entails knotty problems. We will get an idea of these problems in the course of the forecast period.

China's GDP growth and contributions of demand components, %



Sources: CEIC and BOFIT.