BOFIT Forecast for China
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BOFIT China Team

BOFIT Forecast for China 2012–2014

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The pace of economic growth in China continues to be strong, despite a slight slow-down. China's GDP for 2012–2013 is expected to grow 8%, after which it will slow to 7% in 2014. The slowing pace of growth is a reflection of structural factors in the economy. Sorting out the problems caused by the credit bubble related to the earlier stimulus policy causes problems for the current economic policy. Continuing with the economic reforms forms another hard-to-manage political entity.

In 2011, economic growth in China slowed by over a percentage point to 9.2% and in the last quarter annual growth dropped just below the 9% mark. China's GDP was valued at USD 7 300 billion last year, which is approximately half that of the United States' GDP.

Data from the beginning of the year indicate that robust economic growth in China continues albeit at a slightly slower rate. This is a reflection of the difficult economic situation internationally and the country's relatively tight domestic economic policy as the credit bubble and the consequent growth in credit risk along with uncertainty concerning price developments make it difficult to loosen economic policy. Over the long term, the Chinese economy's massive demand for resources and structural factors will have a downward pull on the rate of growth. A limited supply of raw materials, the downturn in the working age population, and the excessive role of investments and the implied structural change indicate a slower rate of growth even if the world economy recovers.

Despite the slowing down, urbanisation and increased productivity offer the means for rapid growth in China. China's GDP growth for 2012–2013 will be in the 8% range, after which it will slow to be close to 7% in 2014. A controlled slowdown would balance the developments both within China and the rest of the world.

Still no signs of structural change

The crisis experiences by the world economy and the investment-led stimulus policy have increased China's dependency on investments, construction and manufacturing. There still have not been significant signs of the appearance of the anticipated changes towards consumer-led and service-dominated production. China's production structure is heavily biased towards manufacturing – in 2011 industry and construction's share of GDP was 47%, while services covered 43% and primary production 10% of the total.

Aggregate demand is dominated by investments as investment ratio has risen to over 45%, while private consumption has only a 35% share of GDP. According to data on retail trade, private consumption itself is growing rapidly as real income of households increased about 10% last year. The rapid growth in income can also be expected to continue. This is due to large nominal increases in minimum wages – already agreed between 9% and 23% – as well as downward turn in the country's working-age population. These steep adjustments to nominal wages require a continuing robust growth in productivity.

Although the role of investment will remain important over the forecast period, private consumption is expected to outstrip investment and be the main driver for economic growth. The investment ratio is finally expected to decline and private consumption to pick up, although this change will be slow.

Foreign trade imbalances get smaller

Last year, the growth rate of both import and export volumes slowed to about 10%. Due to price developments the value of imports increased faster than exports and the trade surplus was reduced by around USD 30 billion to USD 155 bilion. With the fall in the goods trade surplus the current account surplus was pushed down to less than 3% of GDP. In 2007, when disputes concerning global imbalances were most heated, China's current account surplus stood at 11% of GDP. During the forecast period, China's exports will only increase slightly faster than world trade. As the growth of imports is outstripping exports the current account surplus is expected to continue shrinking. However, the final result depends on developments in import and export prices.

Although China's currency reserves grew a further USD 330 billion in 2011, to USD 3180 billion, they shrank by USD 20 billion in the last quarter of the year. This is the first time since the end of the 1990s that China's currency reserves have dropped over any quarter. Although the reduction can mostly be explained by the weakening of the euro against the dollar, it also reflects the fact that, alongside the current account, there has been a balancing effect on the capital flows side. At the same time, fluctuations in the value of the yuan, in both directions, have widened. Last year the yuan strengthened nominally by almost 5% against the dollar, but this year the degree of strengthening will likely be less.

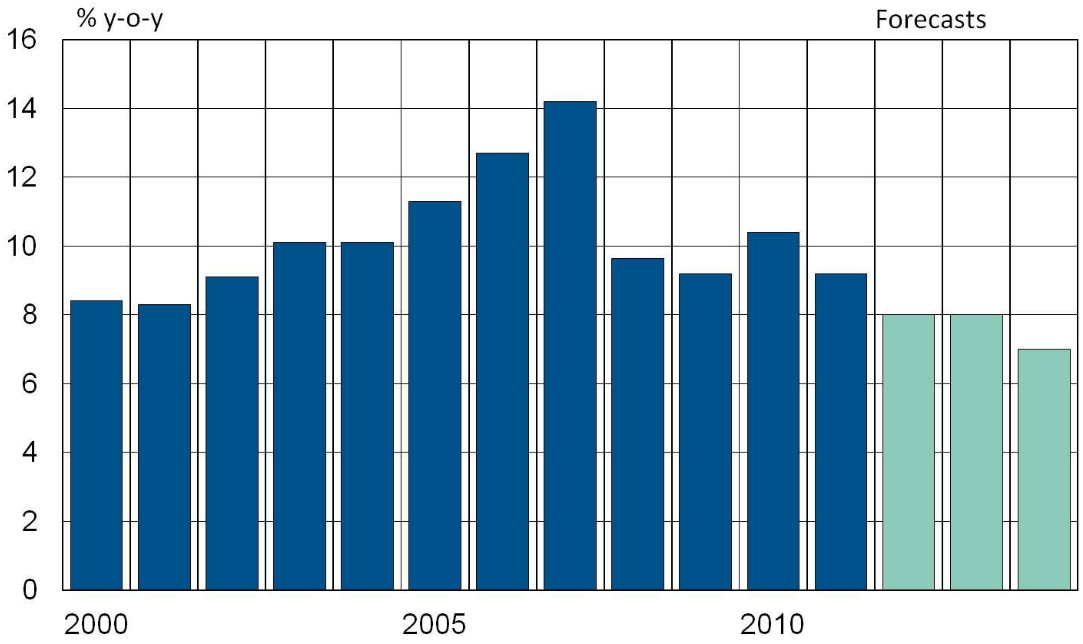
The fallout from the credit bubble and economic reforms causing problems

The process of curtailing the growth in the lending stock and slowing inflation have brought about room for manoeuvre in the country's economic policy. This year inflation is expected to be around 3–4% and the emphasis in the economic policy is shifting from warding off inflation to fostering growth. However, as a result of the 2009–2010 expansionary measures public debt rose to 50–80% of GDP and, in Chinese terms, still rapid inflation call for cautious changes in fiscal and monetary policy.

Europe's debt crisis causes China considerable grief but the country has also a plentiful supply of home-grown economic policy problems that it has to prepare for. The list is more or less the same as it has been earlier. After a steep rise, prices on the housing market are now on decline, and it is feared that this will have a dampening effect on the entire construction sector, so essential to the Chinese economy. The quietening of construction and the land market would hit local government income badly and their ability to survive rapidly increased indebtedness. At worst, the property sector's incipient problems will increase the banks' non-performing assets, which only serves to add to the government's responsibilities.

Changes in society and the economic system together form another hard-to-manage political entity. Liberalisation of currency regulations, opening up the domestic financial markets and an increased international use of the yuan are essential reforms from the perspective of competitiveness and repairing economic structures but problem-free implementation is widely acknowledged as being a difficult challenge. However, delaying reforms would increase the risk of abrupt change at a later date. An increase in industrial actions demanding pay rises and open opposition to abuse of power by local governments remind us of political risks.

China's GDP growth and the BOFIT forecast for 2012–2014, %



Sources: NBSC, BOFIT