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China: economy showing signs of bottoming out

In the first quarter of 2009, the GDP expanded at a rate of 6.1%. Although this growth rate may look high by international standards, especially in the midst of the current global economic crisis, it represents a significant slowdown of the Chinese economy, which has started already in the last quarter of the previous year. Whereas GDP growth reached 9% for the full year 2008, it decelerated to 6.8% in the last quarter of the year. The deceleration of growth was triggered by a collapse of exports which led to a rapid slowdown of industrial production and, to a lesser extent, of services as well. To curb this development, the Chinese government has adopted a comprehensive set of stimulus measures to push up domestic consumption and investment.

Due to these stimulus measures taking effect, there are certain signs that the slowdown of the economy has already bottomed out at the end of the first quarter 2009 – but there are some negative developments as well. Under the assumption that the global economy is not deteriorating further and will probably pick up by the end of the year, we expect the Chinese economy to grow at a rate of 7% in 2009 and 8% in 2010. GDP growth in 2011 may exceed 8% but will remain below pre-crisis levels, since the capacity of China's major trading partners, in particular the USA, the EU and Japan, to absorb Chinese exports may still be lower than before the crisis, and China's attempts to switch from an export-oriented to a more domestically oriented development model will take some time.

Positive signs

The strongest positive signal comes from the development of fixed asset investment. Investment has increased by about 30% in the first quarter of this year, faster than in the same period last year. Monthly data for urban investment indicate that the positive trend has further accelerated in April and May, reaching year-on-year growth rates of 31% and 33% respectively.¹ The very high investment growth is pushed by public investment in infrastructure as part of a massive 'stimulus package' of the government (see Box 1) and related private investment. Investment in real estate, which typically takes about 25% of total investment and has suffered a strong deceleration in 2008, shows signs of recovery as well (see Figure 1).²

¹ As prices for fixed asset investment are stagnant or declining slightly, nominal and real growth rates are approximately the same.

² Also, property sales in major cities saw a strong rebound in April. Probably, expectations of falling house prices, which had held back demand in the last couple of months, have come to an end now.

Box 1

Stimulus measures

'*Stimulus Package*' (CNY 4000 billion, about EUR 400 billion* – of which the central government will contribute 30% and the local governments and other sources 70%). The amount will be spent during the years 2009 and 2010, on the following measures: accelerated reconstruction in Sichuan, which was hit by a devastating earthquake in May 2008 (25%); basic infrastructure such as roads, railways, water supply (37.5%); affordable housing (10%); improvement of villages (9.25%); public health and education (3.75%); restructuring of industry (14.5%). The latter measures are concentrated on 11 specified industries that are considered to be hit particularly hard by the crisis** and include, for instance, tax reductions and exemptions, deferring of social security contributions, tariff reductions on key inputs and interest subsidies. For each industry, a detailed stimulus plan will be released.

Consumer subsidies (CNY 400 million, about EUR 40 million). Subsidies are granted to farmers when buying household appliances such as TV sets, washing machines, microwaves, mobile telephones.

Stimulating car sales. The purchase tax on vehicles with engines of 1.6 litres or less, corresponding to 50% of the Chinese car market, has been halved. Subsidies (CNY 5 billion, about EUR 500 million) are granted to farmers who replace three-wheeled vehicles or outdated trucks with small, 1.3 litre or less engine vehicles. Farmers and rural residents who buy a new minivan or a light truck receive subsidies as well. There exist additional subsidies by local governments, e.g. in Chongqing, to buy locally produced hybrid cars.

New health programme (CNY 850 billion, about EUR 85 billion). This amount will be spent during the next three years to offer universal, accessible healthcare to Chinese citizens.

Stimulating measures for the construction sector. Down-payments for infrastructure construction projects and certain housing projects have been lowered.

Value-added tax reform. Due to this reform, CNY 120 billion (about EUR 12 billion) less taxes were paid by consumers in the first quarter of 2009.

Measures to support exporters. E.g. increased 'tax rebates', which allow enterprises to get back a higher share of money they have paid in value-added tax and cheap loans for SMEs to help them expand into international markets.

Consumer credits will be introduced for durable goods, travel and education.

* In the whole box the exchange rate applied is 10 CNY/EUR.

** Steel, shipbuilding, textile, machinery, IT, light industry (food, home appliances, paper making), petrochemicals, non-ferrous metals, logistics and automobile industry.

In line with the surge in investment, the amount of new loans virtually exploded during the first quarter of 2009, reaching CNY 4.6 trillion (EUR 516 billion), more than in the whole year 2008, when certain credit restrictions to dampen excessive growth had been in place.

Private consumption, which showed a significant deceleration of growth at the beginning of the year, is picking up. The growth rate of retail trade turnover (in real terms), which may be used as a proxy for consumer demand, has accelerated significantly in the past few months (see Figure 2). Notably, the growth rate of retail trade in the first quarter of 2009 (15.8%) was higher than in the same period last year (13.2%). Similar to investment, various government measures such as consumer subsidies have supported this development (see Box 1).

On the supply side, the manufacturing industry, which has suffered the heaviest slump of all sectors in the economy, seems to have hit the bottom eventually. The growth rate of industrial value-added had reached only 5.3% in the first quarter of this year, compared to 11.3% in the same period of last year. But value-added of industrial enterprises above a designated size³ has accelerated in recent months, although there is still some ambiguity (see Figure 2). The growth rate in April was again below that of March and the acceleration in May is somewhat biased because of the low base in May last year, due to the devastating Sichuan earthquake. Further on, power generation in China is still declining (-2.7% in May), which some experts take as a hint for over-reporting of manufacturing activities in the official statistics. But in support of a more positive view, the 'purchasing manager index of manufacturing' (PMI), a leading indicator for manufacturing production, has crossed the 50% line in March this year for the first time since June 2008 and has so far stayed above that mark, although a slight drop was observed in May.⁴ A reading of above 50 suggests expansion, while one below 50 indicates contraction. The overall PMI includes a package of sub-indices, such as a 'new orders index' and a 'new export orders index' – with the latter still remaining below 50 (see Figure 3).

The significant rebound of stock prices in China is interpreted as an indicator for a turn to the better as well. After continuous decline since October 2007, the Shanghai composite index (SSE composite) has started to rise again in January this year and until the end of May it gained 45% (see Figure 4). However, China experts argue that because of government interference and specific regulations on the Chinese stock markets, stock prices in China do not have the same quality as 'leading indicators' as in other countries.⁵

Negative developments

Chinese exports and imports keep shrinking and falling prices point to existing overcapacities in the economy. Unemployment has increased and will have a negative impact on incomes and the expansion of domestic consumption in the future.

Exports in euro terms declined at a rate of 7.7% and imports declined by 20% year-on-year in the first quarter of 2009. The decline was even more dramatic in dollar terms, reaching -20% and -31% respectively, compared to an increase of 21% and 29% in the first quarter of last year (see Figure 5). The contraction continued at a similar pace in April and May. As imports fell faster than exports until May, the trade balance improved significantly and the current account balance is expected to remain positive for the rest of the year.

³ This includes all enterprises with annual sales revenue over 5 million yuan (560,000 euro).

⁴ The PMI is surveyed jointly by the China Federation of Logistics and Purchasing (CFLP) and the National Bureau of Statistics and covers purchasing and supply managers of more than 700 manufacturers across China.

⁵ However, various other 'leading indicators' show a rising tendency as well. For instance, the 'Composite Leading Indicator' (CLI) for China, published by the OECD, which is designed to point to developments about six months in advance, has been rising since February in a row and the 'macroeconomic climate leading index' calculated by the National Bureau of Statistics of China showed a turn-around at the beginning of the year, too.

Producer prices began to fall in December last year, consumer prices and retail prices followed two months later. In the first three months of 2009, consumer prices declined by 0.6% and producer prices fell by 4.6% compared to the same period a year earlier. But while consumer price deflation seems to have stabilized to some extent, producer prices are decelerating further (see Figure 6). However, the steep fall of producer prices is not only a sign of supply exceeding demand, but has to be seen in the light of the extremely high world market prices for many industrial inputs such as crude oil and metals in the first half of 2008.

Although no exact figures are available on unemployment in China, a government survey conducted in February this year showed that, out of the 70 million migrant workers who went home during the Spring Festival, only 56 million returned; of these, only 45 million found a job. In addition, there are about 8 million registered unemployed in the cities and about 7 million fresh university graduates looking for a job.

Given the fact that no stimulus for the Chinese economy can be expected from external demand in the near future, the further development of the economy will have to depend largely on domestic forces, supported by government measures, to fill the external demand gap. In this light, a U-shaped recovery, or perhaps an 'asymmetric V-shaped' recovery, with a much flatter ascending than descending slope looks most likely. In case of a prolonged global recession, however, a W-shaped development path showing another downturn after some time of recovery cannot be excluded.

Selected data on China, 2007-2009

Figure 1

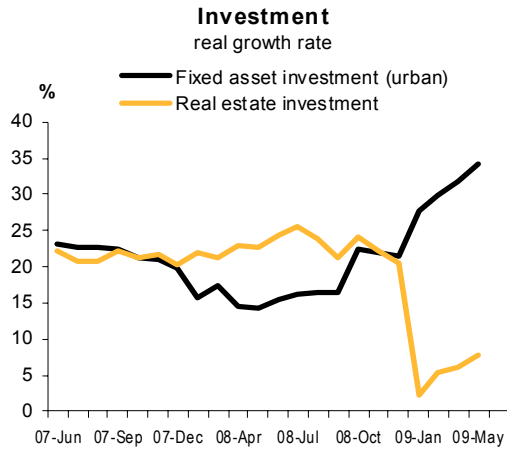


Figure 2



Figure 3

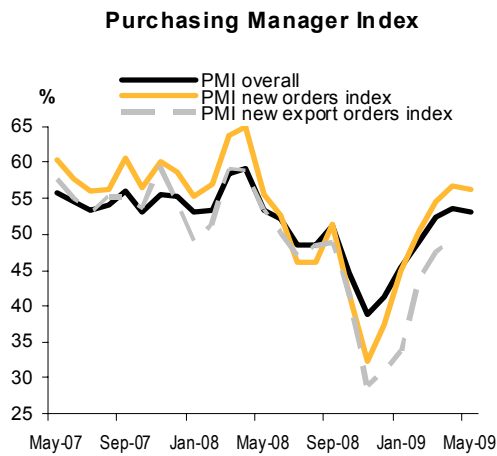


Figure 4

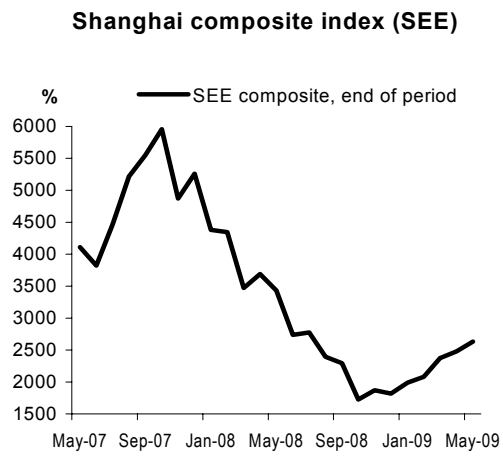


Figure 5

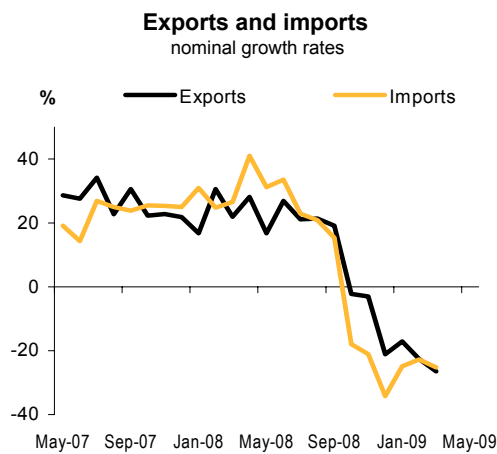
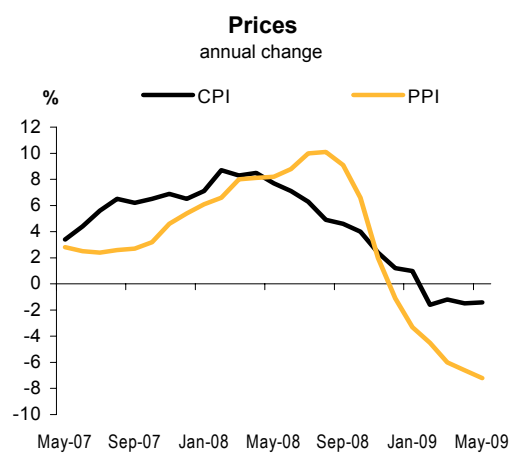


Figure 6



Note: * includes only enterprises enterprises with annual sales revenue of over CNY 5 million (EURO 560 000)

Source: National Bureau of Statistics, China Monthly Statistics, wiw calculations

Table CN

China: Selected Economic Indicators

	2005	2006	2007	2008 ¹⁾	2008 1st quarter	2009	2009 Forecast	2010	2011
Population, mn pers., end of period	1307.6	1314.5	1321.3	1328	.	.	.	.	.
Gross domestic product, CNY bn, nom.	18321.7	21192.4	25700.0	30067.0	6347.5	6574.0	32300	35200	38800
annual change in % (real)	10.4	11.6	13.0	9.0	10.6	6.1	7	8	8.2
GDP/capita (EUR at exchange rate)	1400	1600	1900	2200	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	3400	3900	4500	4900	.	.	.	.	.
Retail trade turnover, CNY bn	6717.7	7641.0	8921.0	10848.8	2555.5	2939.8	.	.	.
annual change in % (real)	12.9	13.8	13.0	15.7	13.2	15.8	.	.	.
Total investment in fixed assets, CNY bn	8877.4	10999.8	13723.9	17229.1	2184.5	2812.9	.	.	.
annual change in % (nominal)	26.0	23.9	24.8	25.5	24.6	28.8	.	.	.
Industrial value added									
annual change in % (real)	11.6	12.9	13.5	9.3	11.5	5.3	.	.	.
Agricultural value added									
annual change in % (real)	5.2	5.0	3.7	5.5	2.8	3.5	.	.	.
Construction value added									
annual change in % (real)	12.6	13.7	12.6	.	.	.	.	.	.
Employment total -reg., mn, end of period	758.3	764.0	769.9	.	.	.	.	.	.
annual change in %	0.8	0.8	0.8	.	.	.	.	.	.
Staff and workers, mn, end of period ²⁾	108.5	111.6	114.3	114.6	112.9	.	.	.	.
annual change in %	2.6	2.9	2.4	2.6	2.6	.	.	.	.
Reg. unemployment rate (urban), in %, end of per. ³⁾		4.1	4.0	4.2	.	.	4.6	4.3	4.2
Average gross annual wages, CNY ⁴⁾	18364	21001	25932	26265	26254	.	.	.	.
annual change in % (real) ⁵⁾	12.8	12.7	13.6	11.0	10.3	.	.	.	.
Consumer prices, % p.a.	1.8	1.5	4.8	5.9	8.0	-0.6	0.5	1	2
Producer prices in industry, % p.a.	4.9	3.0	3.1	6.9	7.4	-4.6	.	.	.
General government budget, nat.def., % GDP									
Revenues	17.3	18.3	20.0	20.4	.	.	20.6	.	.
Expenditures	18.5	19.1	19.4	20.7	.	.	23.5	.	.
Deficit (-) / surplus (+)	-1.2	-0.8	0.6	-0.3	.	.	-2.9	.	.
Base rate of NB % p.a., end of period ⁶⁾	3.3	3.3	3.3	4.1	4.1	2.8	.	.	.
Current account, EUR bn	128.8	198.8	271.4	287.4	.	.	230	260	260
Current account in % of GDP	7.2	9.4	11.0	9.9	.	.	6.3	6.8	6.3
Exports of goods total, EUR bn ⁷⁾	609.3	771.0	888.9	963.2	203.7	188.1	.	.	.
annual change in %	39.9	26.5	15.3	8.4	5.8	-7.7	.	.	.
Imports of goods total, EUR bn ⁷⁾	527.8	629.7	697.8	764.5	175.8	140.3	.	.	.
annual change in %	28.1	19.3	10.8	9.6	12.0	-20.2	.	.	.
Trade balance of goods, EUR bn ⁷⁾	81.6	141.2	191.1	198.7	27.9	47.8	.	.	.
Exports of services, BOP, EUR bn	59.5	73.2	89.2	99.2	.	.	.	.	.
annual growth rate in %	29.8	23.0	21.9	11.2	.	.	.	.	.
Imports of services, BOP, EUR bn	67.0	80.2	95.0	107.2	.	.	.	.	.
annual growth rate in %	26.6	19.7	18.4	12.9	.	.	.	.	.
FDI inflow, EUR bn ⁸⁾	63.3	62.1	101.0	99.7	18.2	16.7	60	.	.
FDI outflow, EUR bn ⁸⁾	9.0	16.8	12.4	36.1	.	.	44	.	.
Gross reserves of NB excl. gold, EUR bn	694.2	810.0	1038.2	1384.0	1065.0	1468.6	.	.	.
Gross external debt, EUR bn	238.2	245.4	253.8	266.5	.	.	.	.	.
Gross external debt in % of GDP	12.6	12.1	11.1	8.7	.	.	.	.	.
Average exchange rate CNY/USD	8.206	7.972	7.604	6.958	7.161	6.836	6.8	6.8	7.0
Average exchange rate CNY/EUR	10.261	10.019	10.418	10.315	10.754	8.923	9.0	9.0	9.5
Purchasing power parity CNY/USD, wiiw ⁹⁾	3.45	3.465	3.621	3.803	.	.	.	.	.
Purchasing power parity CNY/EUR, wiiw ⁹⁾	4.120	4.159	4.357	4.671	.	.	.	.	.

Note: CNY: ISO code for the Chinese yuan.

1) Preliminary. - 2) Staff and workers (on duty) refer to persons who work in state-owned enterprises, urban collectives, shareholding ownership and foreign invested enterprises. - 3) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 4) Average gross annual wages of staff and workers, defined as: total wages of staff and workers on duty per average number of staff and workers on duty. - 5) Staff and workers cost of living index is used as deflator for calculating real wage. For 2008 the consumer price index was used as a deflator. - 6) Overnight rate, 2008: September. - 7) According to customs statistics. - 8) Net investments drawn from the Chinese balance of payments. Quarterly data for 2008 and 2009 are gross equity investments in the non-financial sector as given by the Chinese Ministry of Commerce. - 9) wiiw estimates based on the 2005 International Comparison Project benchmark (Worldbank).

Source: National statistics (National Bureau of Statistics, Central Bank, China Daily etc). Forecasts by wiiw.