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China: global slowdown helping to curb excessive growth

In 2007, the Chinese GDP expanded at a rate of 11.4% despite efforts by the Chinese authorities to cool down the economy. Growth was driven by investment and a surging trade surplus, but was supported by sound growth of private consumption as well. In 2008, the expected slowing down of the world economy and several administrative trade measures will put a certain brake on the expansion of exports. Also, government attempts to contain investment growth may become somewhat more effective. Yet private consumption will pick up due to fast rising incomes. Altogether, GDP growth is expected to decelerate in 2008, probably reaching 9.5%. However, if a certain 'decoupling' of the dynamic Asian economies from the downturn in the USA were to take place, growth may be even higher. On the other hand, there is a certain risk that an eventual crash on global stock markets will spill over to the Chinese stock market. Due to the large number of non-institutional investors in China, this may have a marked negative impact on private consumption and investment. The IMF estimates 10%, the World Bank and Chinese researchers less than 10% growth for 2008.

In 2009 and 2010, a certain recovery of the world economy will support Chinese exports, but as the government tries to follow a policy of qualitative (resource-saving) rather than quantitative growth, measures to contain growth may stay in place and the acceleration of GDP growth will be modest, probably not exceeding 10% in both 2009 and 2010.

Export-led growth losing steam

Looking at the demand side, net exports (exports of goods and services minus imports of goods and services) took a share of 8% in GDP and contributed about 2.7 percentage points to the overall GDP growth rate in 2007. Therefore, any deceleration of net exports will significantly lower overall growth. But it is most unlikely that net exports will expand at a similar pace in 2008, because of the already huge trade surplus and severe pressure from both the United States and the EU to increase imports and to contain exports. The expected slowing down of external demand will also affect Chinese exports and the excess liquidity and rising inflation will make the Chinese authorities more prone to letting the yuan further appreciate against the US dollar. Moreover, the anti-dumping measures taken by the US and the EU against certain Chinese products (such as steel, paper, leather shoes) as well as various administrative measures on the Chinese side to reduce exports will take effect in 2008 (e.g. reduced tax rebates for exporters, an export ban on coal, curbs on processing trade etc.).[1] On top of that, recent complaints regarding the quality and related health hazards of Chinese products (such as toys) may dampen exports. We assume that

[1] The EU has to remove all quota restrictions on textiles as of the beginning of 2008, but because of an agreement with China on voluntary export restrictions, trade experts do not expect exports to increase dramatically.

the contribution of net exports to GDP growth in 2008 will be less than 1 percentage point. However, if the decline of demand from important trading partners is only moderate and if service exports associated with the Olympic Games in Beijing get a very strong boost, a higher contribution of net exports is possible.[2] For 2009 and 2010, export growth will pick up somewhat, but not too fast.

Robust investment activity to continue

Investment (gross fixed capital formation) takes a share of about 40% in GDP, which is extremely high by international standards. In 2007, investment in fixed assets increased slightly faster (in nominal terms) than in 2006, despite various measures of the Chinese authorities to curb investment growth in an attempt to prevent overheating of the economy and to avoid the building-up of an asset bubble. For 2008, we expect only a slight slowdown of investment activity. Real estate and infrastructure investment will continue to grow fast, driven by longer-term forces such as urbanization and overall development. Investment in successful industries will hardly suffer under any further tightening of monetary policy and increased credit squeeze as there are ample profits available for finance. (Profits rose 37% on average in 2007.) However, investment will slow down in sectors with excess capacities, such as the leather & shoe industry, the steel industry and in certain parts of the electronics industry. Capital formation in 2009 and 2010 will follow a similar pattern. There is, however, a certain downward risk if external demand declines more strongly than expected and if a crash on the global stock markets should spill over to China.

New challenges for foreign investors

In 2007 foreign direct investment increased in USD terms (82.6 billion) but decreased in EUR terms, due to exchange rate movements. Part of last year's FDI inflows could be related to the new tax law which took effect on 1 January 2008, stipulating a unified corporate tax rate of 25% for all enterprises (formerly the rate for foreign investment enterprises had been 15% while that for Chinese enterprises 33%). However, enterprises registered before the end of the year 2007 will be taxed at the favourable rates for another five years. We therefore expect FDI flows to decline in 2008. But there are other measures that will negatively influence the investment climate in the medium run. A new 'Anti-monopoly Law', coming into force in July 2008, requires security checks on foreign mergers & acquisitions. Further, there is the fear that the new Labour Contract Law will be enforced more strictly on foreign enterprises and will put them in a less competitive position. Finally, the revised 'Foreign Investment Industry Catalogue', taking effect in December 2007, is geared towards a change in the existing sectoral structure of FDI, with stronger emphasis on services and high-tech production and away from simple, export-oriented traditional manufacturing enterprises.

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2 However, in China travel services typically take only a share of about 4% in the current account.

Higher incomes backing private consumption

Household consumption as a share of GDP has significantly declined over the past few years and took a relatively small share of about 36% in 2006.[3] For 2007, no data on private consumption are yet available. Taking retail trade turnover as a proxy, household consumption grew significantly faster in nominal terms (16.8%) than in the previous year, but growth probably slowed down in real terms due to higher inflation (retail prices: 3.6%, CPI: 4.8%), despite a substantial increase in real incomes. For the year 2008, we expect a slight acceleration of private consumption expenditure as the labour market – in particular for qualified labour – will remain tight and the new Labour Contract Law will help to enforce minimum wage levels. At the same time, high prices for agricultural products will support farmers' incomes. In 2009 and 2010 this trend may weaken somewhat.

Manufacturing affected most

On the supply side, the export-oriented manufacturing industry will be affected most by the slowing down of the economy. Services will be gaining relatively in the short and medium run. Agriculture will continue to grow less than the overall economy, but investment and urbanization will help to increase value-added per capita in the rural areas.

Special Note: A recent World Bank recalculation of purchasing power parities (PPPs) for more than 100 countries has led to a downward revision of China's GDP in PPP terms by 40%. The resulting smaller weight of China in the world economy in real terms has also led to a downward revision of world growth by 0.5 percentage points per annum in the years 2002-2007.[4]

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[3] Government consumption is comparatively small, reaching 14% of GDP in 2006.

[4] PPPs were extrapolated from price surveys in eleven major Chinese cities situated mainly in central and eastern provinces which may lead to a certain upward bias in average PPP and thus an underestimation of the real size of the Chinese GDP.

Table CN

China: Selected Economic Indicators

	2002	2003	2004	2005	2006	2007 1)		2008	2009 Forecast	2010
Population, mn pers., end of period	1,285	1,292	1,300	1,308	1,314	1,322		.	.	.
Gross domestic product, CNY bn, nom.	12,033	13,582	15,988	18,387	21,087	24,662		28,400	32,400	36,700
annual change in % (real)	9.1	10.0	10.1	10.4	11.1	11.4		9.5	9.7	10
GDP/capita (EUR at exchange rate)	1,212	1,126	1,094	1,374	1,606	1,794		.	.	.
GDP/capita (EUR at PPP - wiiw)	2,450	2,710	3,040	3,460	3,920	4,330		.	.	.
Industrial value added 2)										
annual change in % (real)	9.8	12.7	11.1	11.7	13.0	13.4		.	.	.
Agricultural value added										
annual change in % (real)	2.9	2.5	6.3	5.2	5.0	3.7		.	.	.
Retail trade turnover, CNY bn	4,814	5,252	5,950	6,718	7,641	8,921		.	.	.
annual change in % (real)	11.8	9.2	13.3	12.9	13.8	13.0		.	.	.
Total investment in fixed assets, CNY bn	4,350	5,557	7,048	8,877	11,000	13,724		.	.	.
annual change in % (nominal)	16.8	27.7	26.8	26.0	23.9	24.8		.	.	.
Employment total, mn pers., end of period	737.4	744.3	752.0	758.3	764.0	.		.	.	.
annual change in %	1.0	0.9	1.0	0.8	0.8	.		.	.	.
Staff and workers, mn pers., end of period 3)	105.6	104.9	105.8	108.5	111.6	111.7	I-IX	.	.	.
annual change in %	-2.2	-0.7	0.8	2.6	2.9	2.0	I-IX	.	.	.
Unemployment rate (urban) in %, end of per. 4)	4.0	4.3	4.2	4.2	4.1	4.0		4.3	4.3	4.2
Average gross annual wages, CNY 5)	12,422	14,040	16,024	18,364	21,001	22,222	I-IX	.	.	.
annual change in % (real) 6)	15.5	12.0	10.5	12.8	12.7	15.2	I-IX	.	.	.
Retail prices, % p.a.	-1.3	-0.1	2.8	0.8	1.0	3.8		.	.	.
Consumer prices, % p.a.	-0.8	1.2	3.9	1.8	1.5	4.8		5	4	3
General government budget, nat.def., % GDP										
Revenues	15.7	16.0	16.5	17.2	18.4	.		.	.	.
Expenditures	18.3	18.1	17.8	18.5	19.2	.		.	.	.
Deficit (-) / surplus (+), % GDP	-2.6	-2.2	-1.3	-1.2	-0.8	.		.	.	.
Refinancing rate of NB % p.a., end of per. 7)	2.7	2.7	3.3	3.3	3.3	3.3	I-IX	.	.	.
Current account, EUR bn	37.8	40.6	51.4	128.8	198.9	255.4		240	270	300
Current account in % of GDP	2.4	2.8	3.6	7.2	9.4	10.8		9.6	8.6	7.9
Gross reserves of NB excl. gold, EUR bn	273.1	319.3	447.7	694.2	810.0	1,038.2		.	.	.
Gross external debt, EUR bn	163.4	153.3	167.8	238.2	245.4	249.0	III	.	.	.
Gross external debt in % of GDP	11.8	11.8	11.8	12.5	12.2	.		.	.	.
FDI inflow, EUR bn 8)	52.6	41.6	40.3	63.3	62.2	60.3		50	.	.
FDI outflow, EUR bn 8)	2.7	-0.1	1.3	9.0	14.2	.		.	.	.
Exports of goods total, EUR bn 9)	347.6	387.3	435.5	609.3	771.3	888.7		.	.	.
annual change in %	15.9	11.4	12.5	39.9	26.6	15.2		.	.	.
Imports of goods total, EUR bn 9)	315.1	364.8	411.9	527.8	630.0	697.5		.	.	.
annual change in %	14.8	15.8	12.9	28.1	19.4	10.7		.	.	.
Trade balance of goods, EUR bn 9)	32.5	22.5	23.6	81.6	141.3	191.2		.	.	.
Average exchange rate CNY/USD	8.277	8.277	8.277	8.206	7.972	7.607		7.2	7.0	6.9
Average exchange rate CNY/EUR	7.753	9.366	11.276	10.261	10.015	10.426		11.5	10.5	9.7
Purchasing power parity CNY/USD, wiiw 10)	3.274	3.290	3.419	3.45	3.451	3.524		.	.	.
Purchasing power parity CNY/EUR, wiiw 10)	3.831	3.895	4.064	4.079	4.105	4.323		.	.	.

Note: CNY: ISO code for the Chinese yuan.

1) Preliminary and wiiw estimates. - 2) Including construction. - 3) Staff and workers (on duty) refer to persons who work in state-owned enterprises, urban collectives, shareholding ownership and foreign invested enterprises. - 4) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 5) 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. - 6) Staff and workers cost of living index is used as deflator for calculating real wage. - 7) Overnight rate. - 8) Annual data are net investments drawn from the Chinese balance of payments. 2007 data are gross investments given by the Chinese Ministry of Commerce. - 9) According to customs statistics. - 10) wiiw estimates based on the 2005 International Comparison Project benchmark (World Bank) .

Source: China Statistical Yearbook; China Monthly Statistics; China Daily etc.; wiiw forecasts.