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## China: On the cusp of double-digit growth

China's economy expanded at a rate of 8.7% in 2009, exceeding the government's growth target of 8% as well as most forecasts made earlier in the year. Further on, GDP growth in 2008 was revised upwards (9.6%) after more detailed information on the services sector had become available and therefore the level of GDP in 2008 was also higher than previously assumed. The fast growth of the economy despite a big slump in exports was due to the massive stimulus measures taken by the Chinese government, driving investment in fixed assets and supporting private consumption, which largely compensated for the loss of foreign demand.

Despite great uncertainties still ahead, economists seem to have reached a certain consensus that the Chinese economy will grow at a moderately faster rate this year than in 2009. However, the question is to which extent the government will continue to prop up economic growth: some sectors have already shown signs of overheating by the end of last year, but others, such as the export-oriented light industries, are still operating below pre-crisis capacity levels. In November 2009, the government had pledged to maintain its pro-growth fiscal policy and to follow a moderately expansionary monetary policy in face of the still fragile global recovery. Meanwhile, however, the global outlook has further improved and signs of an asset bubble in China have appeared, foreign trade is expanding and both producer and consumer prices have ceased to fall. As a reaction, the People's Bank of China has already begun to tighten its monetary policy in January this year, by raising the reserve ratio and using open-market policy to siphon liquidity while leaving interest rates untouched. Under the assumption of external demand recovering but staying below pre-crisis levels, persistent proactive fiscal policy and a moderately tight monetary policy, we expect China's GDP to grow by 9.5% in 2010. Current IMF estimates (10%) and OECD projections from November last year (10.2%) are higher, but recent World Bank forecasts for China come up to 9% only. In a new report of the Chinese Academy of Social Sciences (CASS), GDP is expected to increase by 11.6% in 2010 if the Chinese government continues to fully implement the current fiscal and monetary stimulus measures, but growth may fall to 7.7% if the government exits the stimulus policies.<sup>1</sup>

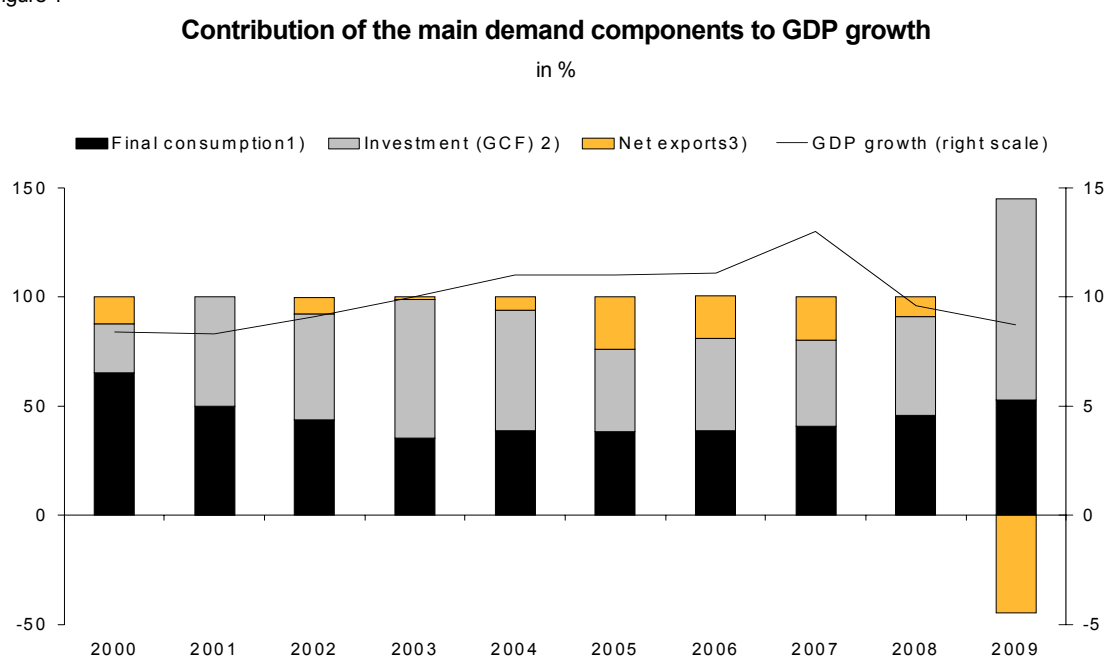
In 2011, given the further recovery of the world economy, we expect most government stimulus measures to phase out and exports to take over again as an engine of growth. Also, China's budget deficits and public debt are relatively small by international standards and fiscal consolidation will not have a similarly negative impact on private demand as assumed for many European countries and the US. We thus expect a slight acceleration of GDP growth. Finally, in 2012, with the global

<sup>1</sup> 'China's GDP to expand 11.6% in 2010: CASS', *China Knowledge*, 7 January 2010.

economy still in good shape, China's economy might reach a double-digit growth rate again, similar to the years before the crisis, probably at about 11%.

However, if the Chinese government is going to take its plans to switch from quantitative to more qualitative growth more seriously in the upcoming Five Year Plan 2011-2015, growth rates in 2011 and 2012 may be lower. Further on, the medium- to long-term development has to be seen in the light of China's attempts to gradually rebalance its growth pattern away from excessive investment and exports towards final consumption. The latter contributed only around 40% to GDP growth in the last couple of years, compared to 50-70% until the year 2000 (see Figure 1). But during the crisis, this trend was reversed.

Figure 1



Notes: 1) Private consumption and government consumption. - 2) Gross capital formation, including fixed capital formation and change in inventories. - 3) Net exports of goods and services

Source China Statistical Yearbook, 2009; *China Daily*, 3 February 2010.

Investment in fixed assets, the main driver of GDP growth in 2009, increased at a rate of 30% (in nominal terms), 6 percentage points faster than in 2008.<sup>2</sup> The acceleration of growth was even more impressive when taking into account that the 2008 investment figures were inflated while in 2009, the prices for investment in fixed assets declined by about 2%. Investment growth was pushed up by government-funded infrastructure projects such as railways, roads, water supply etc., but e.g. health

<sup>2</sup> The investment in fixed assets as reported here and in the Table on China's Selected Economic Indicators given below is not identical with gross fixed capital formation according to the national accounts, but derived from surveys and may include investments not yet completed.

care and social welfare as well. Manufacturing investment rose particularly fast in branches catering for the domestic market, such as non-metal mineral products including cement, glass and other construction materials (47%), different types of machinery (40-50%), medical and pharmaceutical products (42%) and transport equipment (34%), but was relatively weak in export-oriented light industries such as textiles, clothing, shoes and communication equipment. An important exception to this rule is the steel industry, struggling with overcapacities despite an enormous surge in domestic demand. For this year, we expect government-backed investment to stay high, but to increase at a slower pace than last year. However, with the global economy recovering, export-oriented industries will invest more while domestic market-oriented industries will continue to expand fast.

Real estate investment has recovered rapidly after a deep slump at the beginning of 2009 and expanded at about 18% over the year as a whole. But property sales increased even faster (42%) and property prices surged, raising consumer discontent and fears that an asset bubble was building up, driven by excess liquidity and speculation.<sup>3</sup> To contain this development, the government has already introduced several countermeasures.<sup>4</sup> Nevertheless, we expect real estate investment to remain robust during the years to come, because of persistent high demand backed by ongoing urbanization, rising incomes and high economic growth. The inflow of foreign direct investment in 2009 reached more or less the same amount (EUR 65 billion) as in the previous year (EUR 63 billion), but it has shown signs of picking up recently<sup>5</sup> (this observation is based on the data available, covering equity investment in the non-financial sector only). Given the acceleration of growth this year, we expect FDI to increase again, probably at a rate of 5-10%. Altogether, we thus expect investment in fixed assets to rise strongly but at a slower pace than last year, probably reaching 25% (in nominal terms).

Final consumption also expanded very fast and its contribution to GDP growth was significantly higher than last year, surpassing the 50% benchmark for the first time since 2001 (see Figure 1). Private consumption, the major component of final consumption, was backed by the relatively fast rise in real wages (14%) and the high growth of per capita net incomes of rural households in real terms (9%). Unemployment seems to have increased temporarily only. Altogether real incomes seem to have risen faster than GDP in 2009. On top comes a certain 'wealth affect' as the Chinese stock market gained 70% throughout the year and there exist far more than 100 million private stock holders in China. But household consumption was also supported directly by government measures in order to make up for the slump in external demand. These measures include subsidies for farmers when buying household appliances such as TV sets, washing machines, microwaves and mobile

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<sup>3</sup> According to the National Bureau of Statistics, property prices, measured in yuan per sqm, were up 24% across the nation on average. But in Shanghai, for instance, property prices surged 69% according to E-House (China) Holdings Ltd., a property-data provider.

<sup>4</sup> Interest rate discounts introduced at the end of 2008 to encourage residential housing sales were cancelled; lending to second-time buyers has undergone tightening; the minimum holding period for property purchasers to qualify for tax-exempt status when selling homes was extended from two to five years, and some provinces are experimenting with new types of property taxes (*China Daily*, 26 January, 2010).

<sup>5</sup> This observation is based on data already available for 2009, covering equity investment in the non-financial sector only.

phones; various measures to promote car sales such as tax reductions and subsidies for farmers and buyers of environmentally friendly cars; and the introduction of consumer credits for durable goods, travel and education. As a consequence, retail trade turnover expanded by 17% (in real terms), and for the first time after a long period, sales in rural areas grew faster than sales in the cities. Vehicles sales rose by 45%, the highest growth rate ever, and with 13.5 million vehicle sold China has become the largest automobile market in the world, followed by the USA (10.4 million). The prospects for consumption this year remain bright as employment is further improving and the government has decided to continue with its support policies for the rural population. Retail trade may expand by 17.5% (in real terms).

The foreign sector's contribution to last year's GDP growth was negative, for the first time since 1993, and was the largest negative contribution to growth (-45%) since China's economic reform and opening-up in 1978. Both exports and imports fell at double-digit rates in terms of US dollar and at 11.7% and 6.7% respectively measured in euro, due to the global financial and economic crisis. The trade balance shrank from EUR 202 billion to EUR 140 billion. However, exports and imports started to rise again at the end of 2009 and the worst seems to be over now. In fact, export-oriented light industries concentrated in the south of China, which had released millions of migrant workers in the spring of last year, have problems finding enough workers to fulfil their new orders. For the current year we expect Chinese exports to rise by 10% (lower bound). This is significantly less than before the crisis as China's major markets for final goods, namely Europe, the USA and Japan, are still depressed. However, fresh opportunities will arise from the 'China – ASEAN Free Trade Area' which came into force in January 2010 and from trade with other fast recovering economies. China's high economic growth compared to its major trading partners will lead to imports rising faster than exports, probably by 14%, which will cause a further decline in the trade surplus as well as the surplus on the current account. Most probably, this development will be supported by a gradual appreciation of the Chinese currency versus the US dollar.

In 2011, the global economy is expected to recover further, but growth will still stay below pre-crisis levels. China's exports are most likely to rise again faster (25%) than imports (20%), but at a somewhat slower pace than before the crisis, and the trade surplus will grow again. However, 2011 will be the year when the new Five Year Plan (2011-2015) will become effective, which will probably hold new efforts with respect to the transformation from an export-led development to more domestic market-oriented growth. Further on, as China is now the largest exporter worldwide and unemployment in the advanced economies is going to be a longer-term issue, protectionist pressure on Chinese exports is expected to intensify. Also, China might decide to revalue its currency, in the face of domestic inflation and rising raw material prices, in particular prices for oil. All this may dampen China's export growth in 2012, but lower import growth as well because of the high share of imports for processing trade.

Table CN

## China: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 <sup>1)</sup>	2010	2011	2012
	Forecast								
Population, mn pers., end of period	1299.9	1307.6	1314.5	1321.3	1328.0	1335.0	1342	1349	1356
Gross domestic product, CNY bn, nom.	15987.8	18321.7	21192.4	25730.6	31405.0	33540	38000	43000	48700
annual change in % (real)	10.1	10.4	11.6	13.0	9.6	8.7	9.5	9.8	11
GDP/capita (EUR at exchange rate)	1100	1400	1600	1900	2300	2600	.	.	.
GDP/capita (EUR at PPP - wiiw)	3000	3400	3900	4500	4900	5300	.	.	.
Retail trade turnover, CNY bn	5950.1	6717.7	7641.0	8921.0	10848.8	12530	.	.	.
annual change in % (real)	13.3	12.9	13.8	13.0	15.7	16.9	17.5	17	16
Total investment in fixed assets, CNY bn	7047.7	8877.4	10999.8	13732.4	17282.8	22500	.	.	.
annual change in % (nominal)	26.8	26.0	23.9	24.8	25.9	30.1	25	23	20
Industrial value added									
annual change in % (real)	11.5	11.6	12.9	14.9	9.5	9.5	9.5	11	12
Agricultural value added									
annual change in % (real)	6.3	5.2	5.0	3.7	5.5	4.2	.	.	.
Construction value added									
annual change in % (real)	8.1	12.6	13.7	12.8	7.1	9.5	.	.	.
Employment total -reg., mn, end of period	752.0	758.3	764.0	769.9	774.8	767.0	770	778	784
annual change in %	1.0	0.8	0.8	0.8	0.6	-1.0	0.3	1.0	0.8
Staff and workers, mn, end of period <sup>2)</sup>	105.8	108.5	111.6	114.3	115.2	115.1	.	.	.
annual change in %	0.8	2.6	2.9	2.39	0.8	0.4	.	.	.
Reg. unemployment.rate (urban), in %, end of per. <sup>3)</sup>	4.2	4.2	4.1	4	4.2	4.3	4.3	4.2	4.2
Average gross annual wages, CNY <sup>4)</sup>	16024	18364	21001	24932	29229	33029	.	.	.
annual change in % (real) <sup>5)</sup>	10.5	12.8	12.7	13.6	11.0	14.1	.	.	.
Consumer prices, % p.a.	3.9	1.8	1.5	4.8	5.9	-0.7	3.5	3	2
Producer prices in industry, % p.a.	6.1	4.9	3.0	3.1	6.9	-6.4	.	.	.
General government budget, nat.def., % GDP									
Revenues	16.5	17.3	18.3	19.9	19.5	19.8	.	.	.
Expenditures	17.8	18.5	19.1	19.3	19.9	22.8	.	.	.
Deficit (-) / surplus (+)	-1.3	-1.2	-0.8	0.6	-0.4	-3.0	-2.8	-2.0	-1.0
Public debt, nat.def., in % of GDP <sup>6)</sup>	18.5	17.8	16.5	20.2	16.9	24	.	.	.
Base rate of NB % p.a., end of period <sup>7)</sup>	3	3.3	3.3	3.3	2.8	2.8	.	.	.
Current account, EUR bn	51.4	128.8	198.8	271.4	289.5	210	150	250	300
Current account in % of GDP	3.6	7.2	9.4	11.0	9.4	6.1	3.7	5.2	5.2
Exports of goods total, EUR bn <sup>8)</sup>	435.5	609.3	771.0	888.9	971.9	861.4	950	1180	1390
annual change in %	12.5	39.9	26.5	15.3	9.3	-11.4	10.3	24.2	17.8
Imports of goods total, EUR bn <sup>8)</sup>	411.9	527.8	629.7	697.8	769.4	721.4	820	990	1130
annual change in %	12.9	28.1	19.3	10.8	10.3	-6.2	13.7	20.7	14.1
Trade balance of goods, EUR bn <sup>8)</sup>	23.6	81.6	141.2	191.1	202.5	140.0	130	190	260
Exports of services, BOP, EUR bn	45.8	59.5	73.2	89.2	99.9	88.2	.	.	.
annual growth rate in %	11.0	29.8	23.0	21.9	12.0	-11.7	.	.	.
Imports of services, BOP, EUR bn	52.9	67.0	80.2	95.0	108.0	100.8	.	.	.
annual growth rate in %	8.3	26.6	19.7	18.4	13.7	-6.7	.	.	.
FDI inflow, EUR bn <sup>9)</sup>	40.3	63.3	62.1	101.0	100.4	65	71	.	.
FDI outflow, EUR bn <sup>9)</sup>	1.3	9.0	16.8	12.4	36.3	43	.	.	.
Gross reserves of NB excl. gold, EUR bn	447.7	694.2	810.0	1038.2	1384.0	1665.2	.	.	.
Gross external debt, EUR bn	167.8	238.2	245.4	253.8	266.5	268.5	.	.	.
Gross external debt in % of GDP	11.8	12.6	12.1	11.0	8.3	7.9	.	.	.
Average exchange rate CNY/USD	8.277	8.206	7.972	7.604	6.945	6.831	6.6	6.4	6
Average exchange rate CNY/EUR	11.276	10.261	10.02	10.418	10.223	9.564	9.2	9.0	8.4
Purchasing power parity CNY/USD, wiiw <sup>10)</sup>	3.433	3.450	3.462	3.615	3.943	3.828	.	.	.
Purchasing power parity CNY/EUR, wiiw <sup>10)</sup>	4.075	4.120	4.149	4.348	4.820	4.788	.	.	.

Note: CNY: ISO code for the Chinese yuan.

1) Preliminary and wiiw estimates. - 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 2009 the consumer price index was used as a deflator. - 6) Central government debt only according to CIA Factbook. - 7) Overnight rate. - 8) According to customs statistics. - 9) Net investments drawn from the Chinese balance of payments. Data for 2009 are gross equity investments in the non-financial sector as given by the Chinese Ministry of Commerce. - 10) wiiw estimates based on the 2005 International Comparison Project benchmark (World Bank).

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