

# **Economic Outlook of China:**

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HKIMR 13<sup>th</sup> Annual International Conference on the Chinese Economy

# “Is China hitting the wall?”

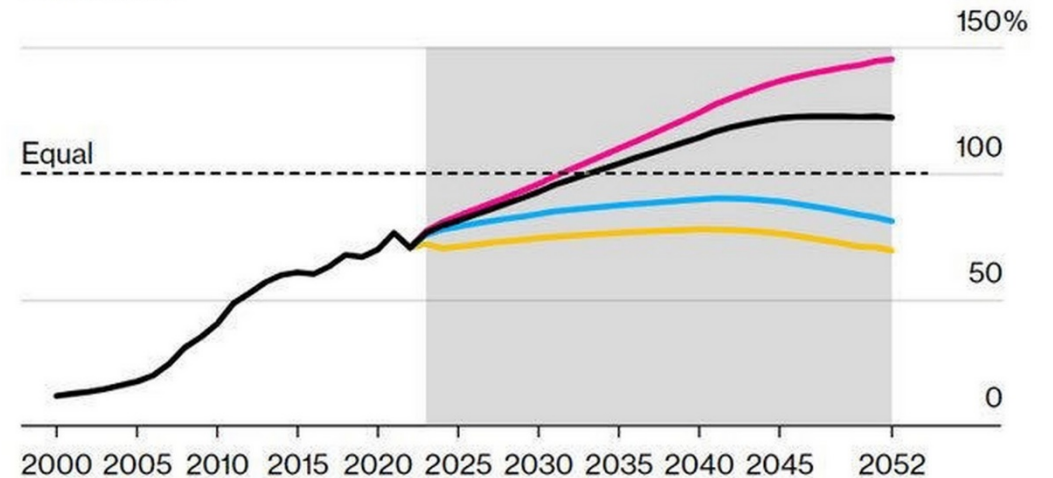
- Adam Posen  
“The end of China’s economic miracle: How Beijing’s struggle could be an opportunity for Washington”, *Foreign Affairs*, 2023.
- Lawrence Summers  
“People are going to look back at some of the economic forecasts about China in 2020 in the same way they looked back at economic forecasts for Russia that were made in 1960 or for Japan that were made in 1990”, interview with *Bloomberg*, August 18, 2023

## China's Economy Might Not Surpass US as Problems Pile Up

### Pile Up

China's nominal GDP as a percentage of the US

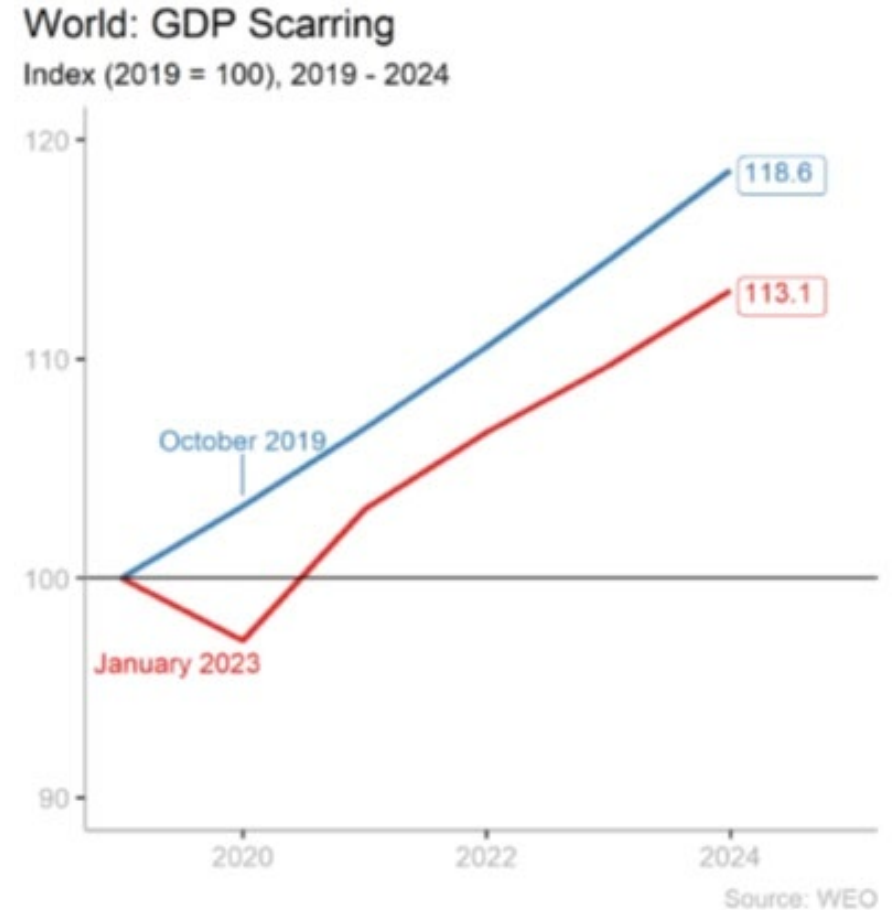
Base case Upside Downside Downside + Financial Crisis  
Forecast



Source: Bloomberg Economics

# What happened?

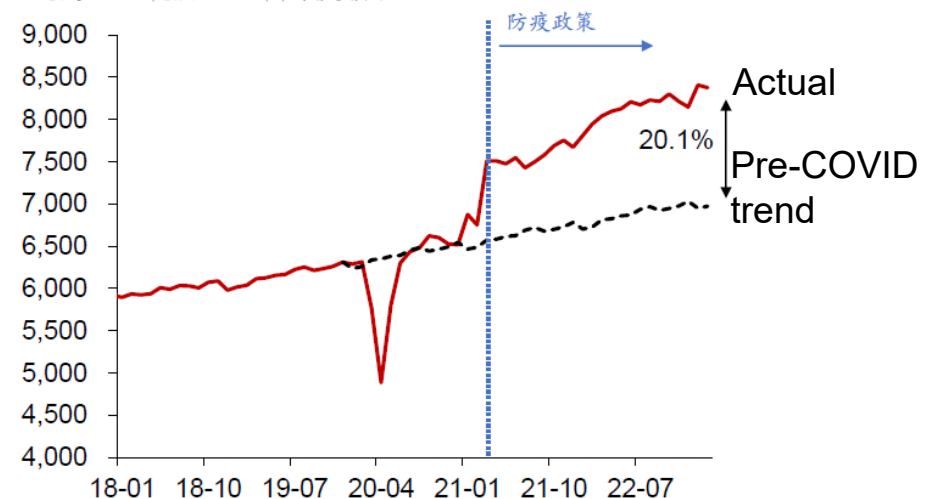
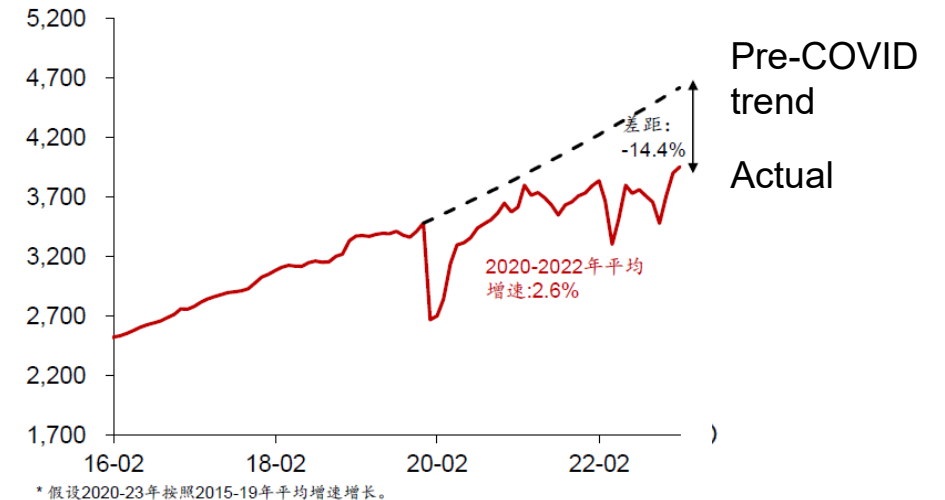
- Insufficient demand – cyclical
  - Balance sheet problems
  - Exports and the property sector
- Lack of confidence – structural
  - Geopolitics
  - Regulatory actions



The scarring effect, IMF estimates  
Source: IMF.

# Sluggish consumption

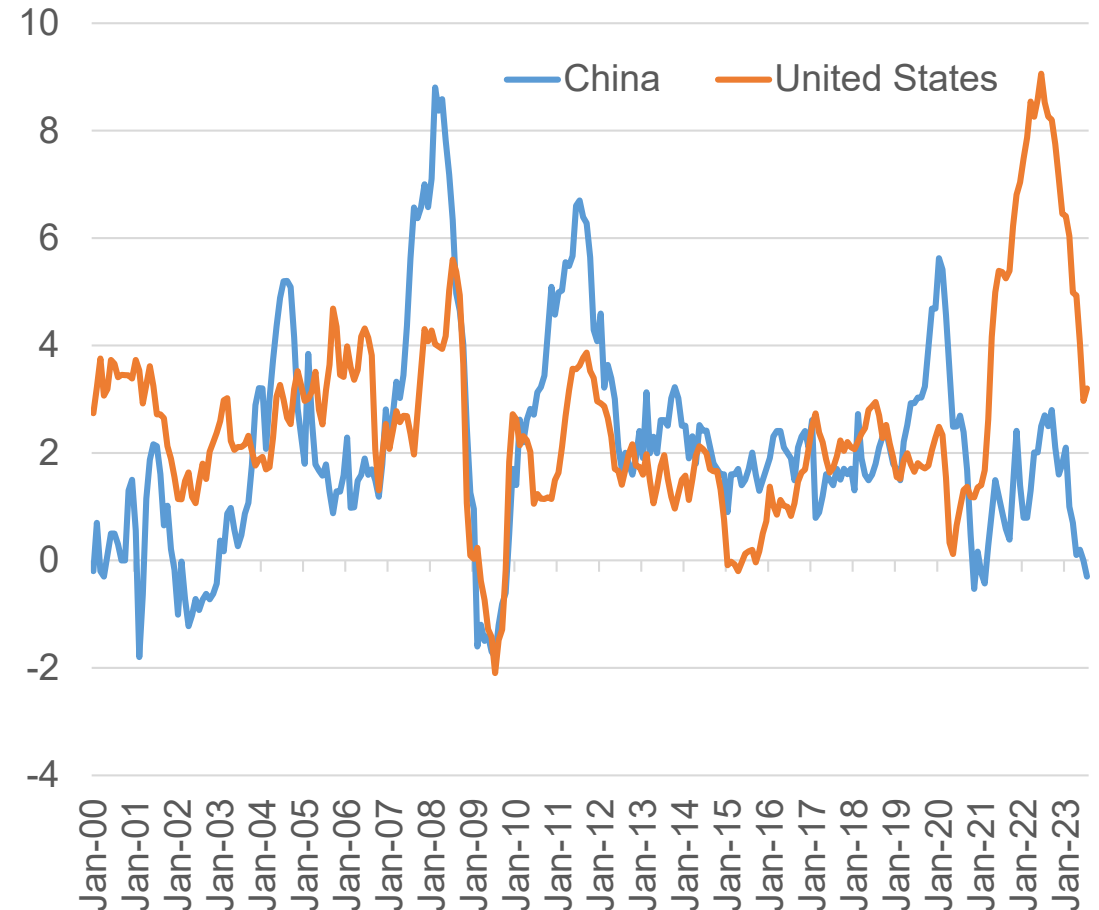
- The subsidy factor explains a large part of the difference of consumer spending in China and the US (right)
- “Going to Zibo for barbecue” during the May Day holiday was evidence of strong willingness but weak capability to spend (below)



Retail sales in China (top) and the US (bottom)  
Source: JP Morgan.

# Deflation, rather than inflation, risk

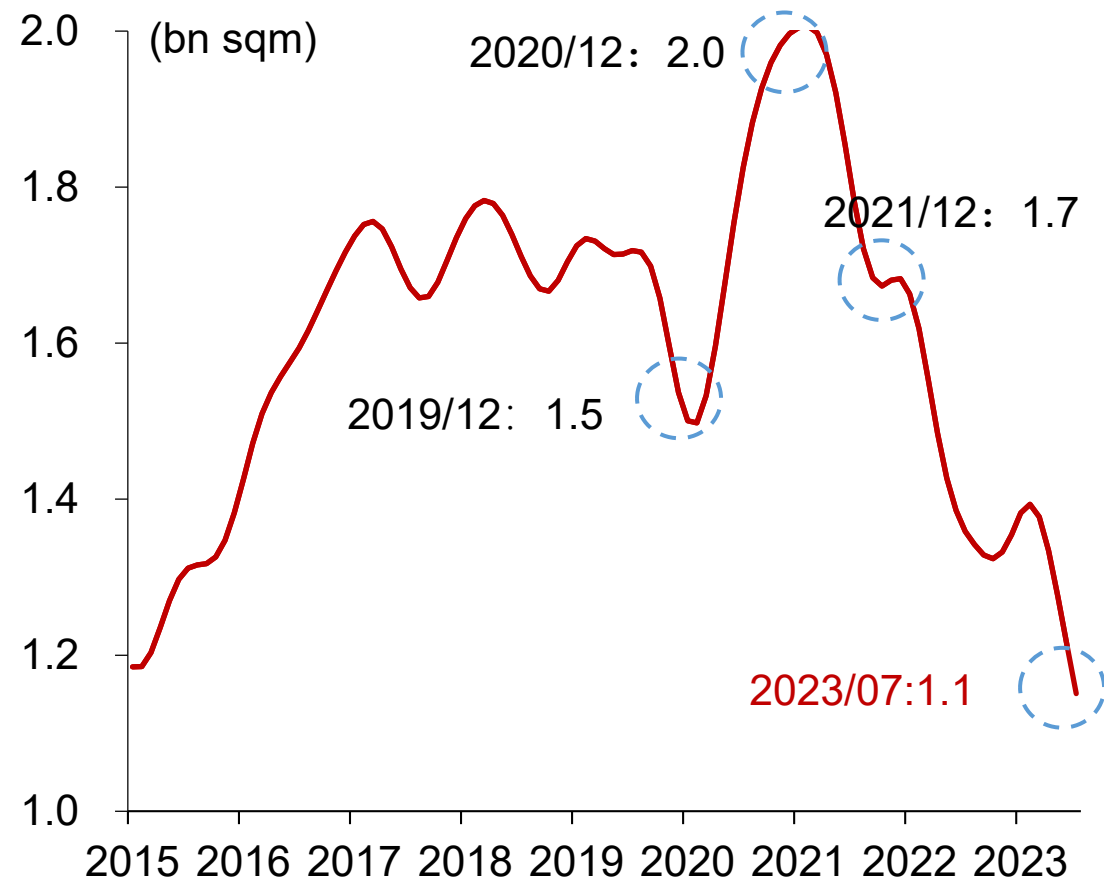
- Unlike in the US, CPI dropped recently, due to 1) excess capacity and 2) relatively tight monetary policy
- CPI fell from 0% in June to -0.3% in July, picked up to 0.2% in August and stayed flat in September



Consumer price indices in China and the US, Jan00-July23  
Source: BIS.

# Housing drag

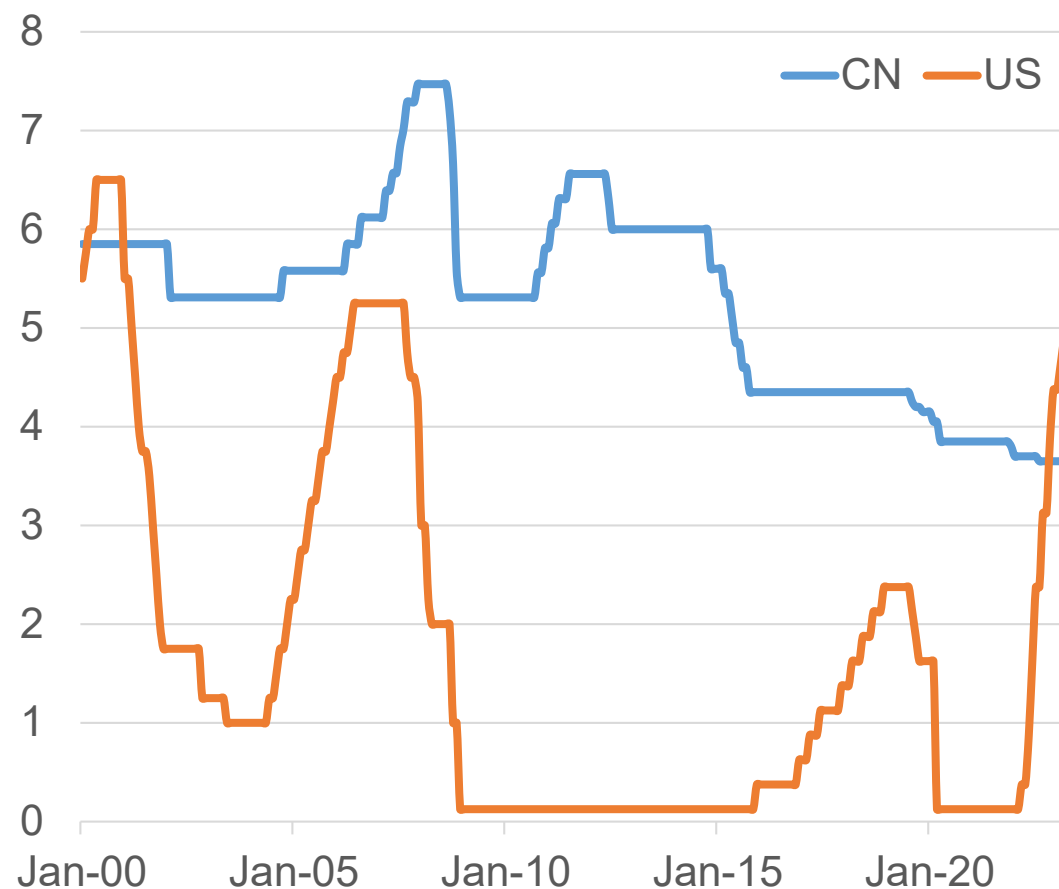
- Housing sales reached the peak at the end of 2020 and have since been on the way down
- Property developers, especially the private ones, face major funding difficulties
- New policy thinking about the property sector
  - Houses are for people to live in, not for speculation
  - The heavily leveraged business model of property development is unsustainable
- It's likely a drag on economic growth and household wealth but probably not a systemic financial risk



Commodity housing sales volume (monthly seasonally-adjusted annualized); Source: Wind, CEIC.

# Fiscal policy stimulus

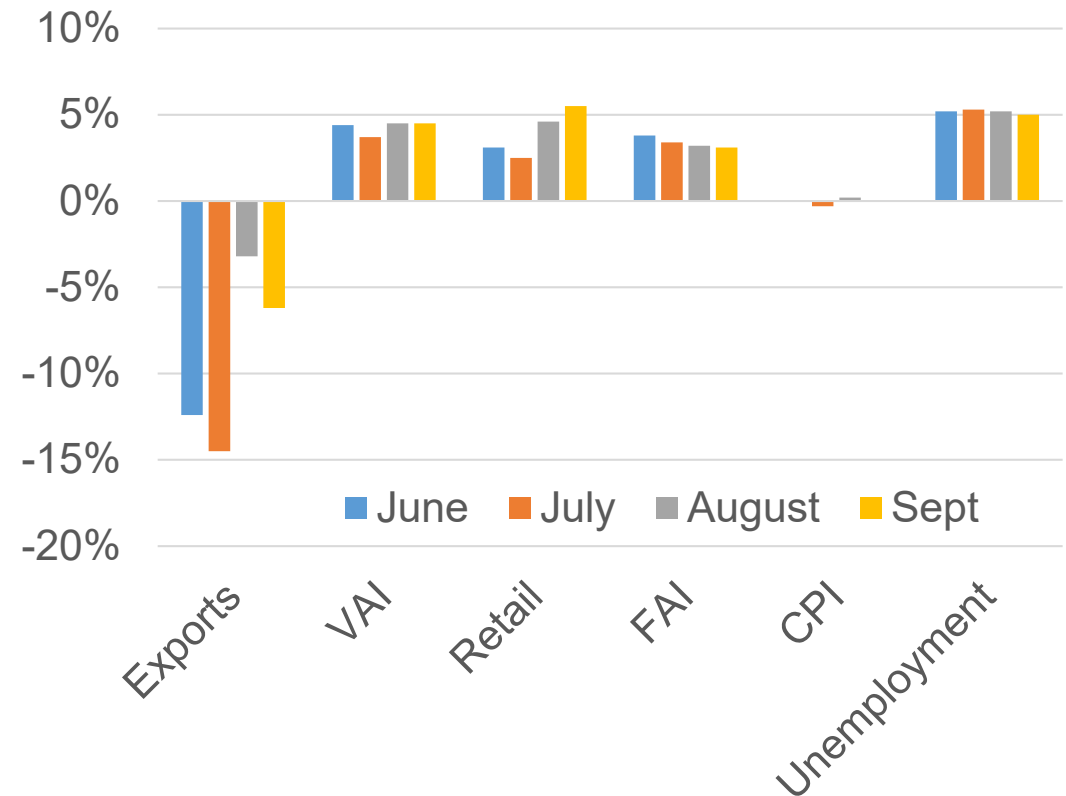
- On year-on-year terms, fiscal policy (expenditure-revenue) actually tightened from April
- On Oct 24, 2023, the NPC decided to increase central government debt issuance by 1 trillion yuan and local government debt issuance by 2.7 trillion yuan
- Local gov general expenditure rose by 3.5% (compared with plan of 5.2%) in first three quarters. It will probably increase by 18% in Q4, taking into account 500 bn additional spending.



Policy rates in China and the US, Jan00-July23  
Source: BIS.

# Bottoming out?

- Economic indicators weakened quite visibly from 2Q, especially in July, but started to improve in August and September
  - Exports
  - Consumption, production and investment
  - Inflation
  - Unemployment rate



Monthly economic indicators, June, July and August (% yoy)  
Source: National Bureau of Statistics.



# “The policy mix”

- The government issued a number of policies on private enterprises, foreign-invested firms and consumption to boost economic confidence
- For instance, the “31 articles” for private enterprises highlights
  - Importance of the private sector and fair competition
  - Equal entry barriers
  - Participation in key national projects
  - Protection of property rights and income rights

## (受权发布) 中共中央 国务院关于促进民营经济发展壮大的意见

2023-07-19 18:58:32 来源: 新华网

新华社北京7月19日电

中共中央 国务院关于促进民营经济发展壮大的意见

(2023年7月14日)

民营经济是推进中国式现代化的生力军，是高质量发展的重要基础，是推动我国全面建成社会主义现代化强国、实现第二个百年奋斗目标的重要力量。为促进民营经济发展壮大，现提出如下意见。

### 一、总体要求

以习近平新时代中国特色社会主义思想为指导，深入贯彻党的二十大精神，坚持稳中求进工作总基调，完整、准确、全面贯彻新发展理念，加快构建新发展格局，着力推动高质量发展，坚持社会主义市场经济改革方向，坚持“两个毫不动摇”，加快营造市场化、法治化、国际化一流营商环境，优化民营经济发展环境，依法保护民营企业产权和企业家权益，全面构建亲清政商关系，使各种所有制经济依法平等使用生产要素、公平参与市场竞争、同等受到法律保护，引导民营企业通过自身改革发展、合规经营、转型升级不断提升发展质量，促进民营经济做大做强，在全方位建设社会主义现代化国家新征程中作出积极贡献，在中华民族伟大复兴历史进程中肩负起更大使命、承担起更重责任、发挥出更大作用。

### 二、持续优化民营经济发展环境

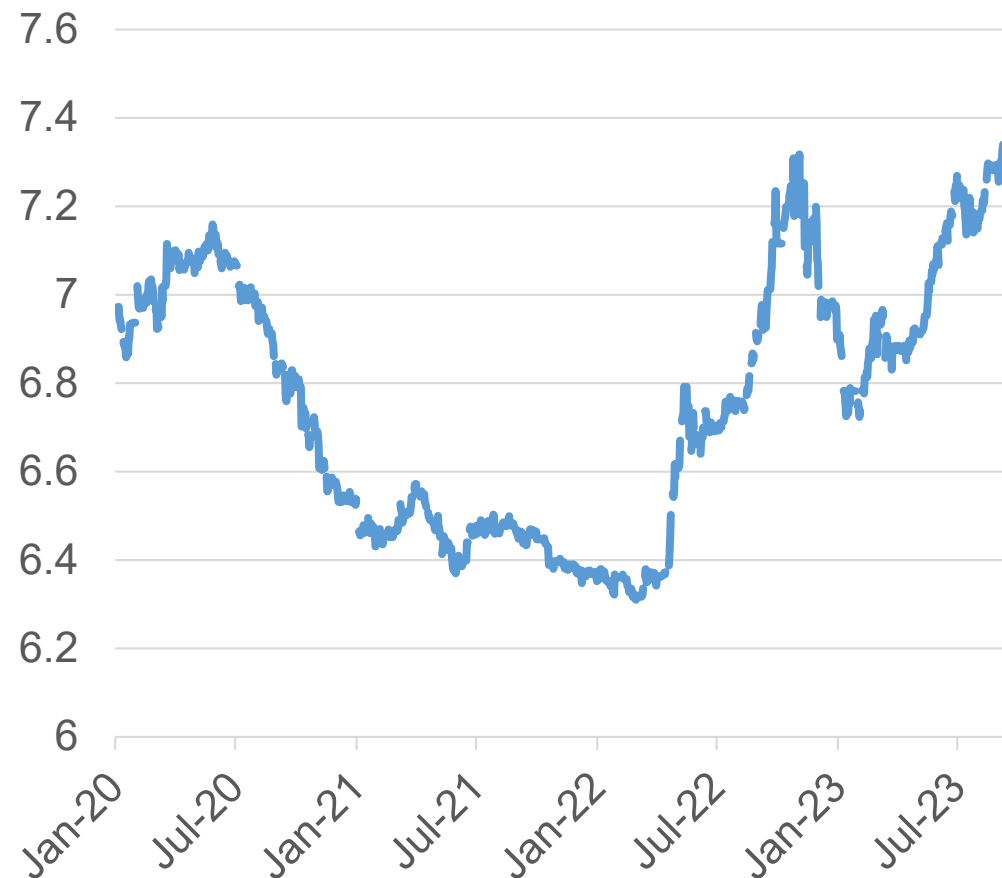
构建高水平社会主义市场经济体制，持续优化稳定公平透明可预期的发展环境，充分激发民营经济生机活力。

(一) 持续破除市场准入壁垒。各地区各部门不得以备案、注册、年检、认定、认证、指定、要求设立分公司等形式设定或变相设定准入障碍。清理规范行政审批、许可、备案等政务服务事项的前置条件和审批标准，不得将政务服务事项转为中介服务事项，没有法律法规依据不得在政务服务前要求企业自行检测、检验、认证、鉴定、公证或提供证明等。稳步开展市场准入效能评估，建立市场准入壁垒投诉和处理回应机制，完善典型案例归集和通报制度。

(二) 全面落实公平竞争政策制度，强化竞争政策基础地位，健全公平竞争制度，加大政策实施力度，坚决防止各类歧视性、排他性、排斥性政策做法，持续优化营商环境。

# Market sentiment remains weak

- Currency weakness reached new height in August
  - Earlier depreciation, such as that in February, was mainly the result of USD strength
  - Latest move, however, was driven by worries about the domestic economy
  - The central bank is already actively “managing” the exchange rate
- Currency also pulled back visibly in mid-September due to “intervention”



CNY/USD exchange rate, 2Jan 020-Oct 2023

Source: BIS.

# Policy pendulum

- Why weak sentiment?
- The so-called de-risking, not de-coupling, policy of the US
- “Small yards, high fence”
  - The Chips and Science Act, CFIUS and reverse CFIUS
  - Tariffs on imports from China
  - Supply chain: “China + 1”
- Policy reactions by China
  - Increased desire for self-reliance and greater concerns about national security



Secretary Yellen meeting a small group of economists during her recent visit to Beijing

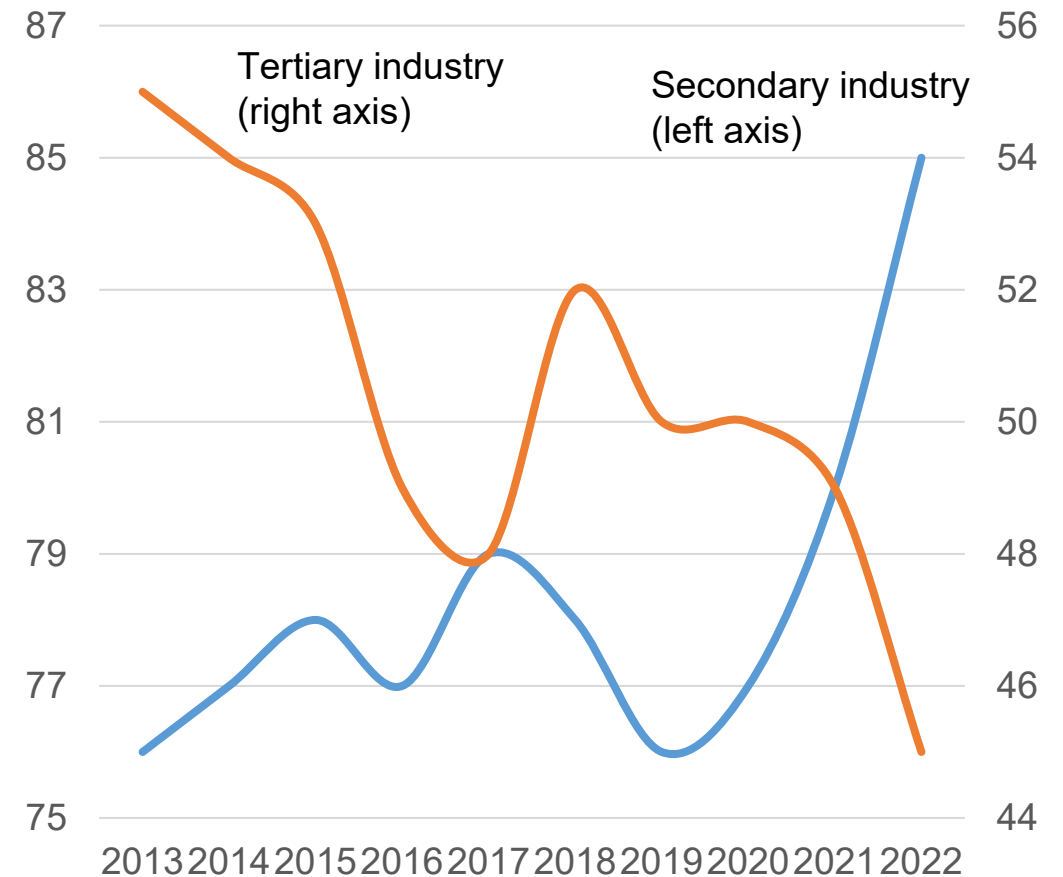
# Is partial decoupling a steady state?

- US “3C” China policy – collaborate, compete and confront
- The main challenges for implementing “Small yards, high fence” policy:
  - Populism, nationalism, fear and miscalculation



# The Chinese “small yards”?

- The government is more worried about national security and political stability and is willing to incur some costs for these
- But outside of these areas, policy restrictions are much less
- The national security concerns are global phenomenon, but they impose new restrictions on business activities



Shares of the private sector in total fixed asset investment, secondary and tertiary industries in China, 2013-2022

# Has the China miracle ended?

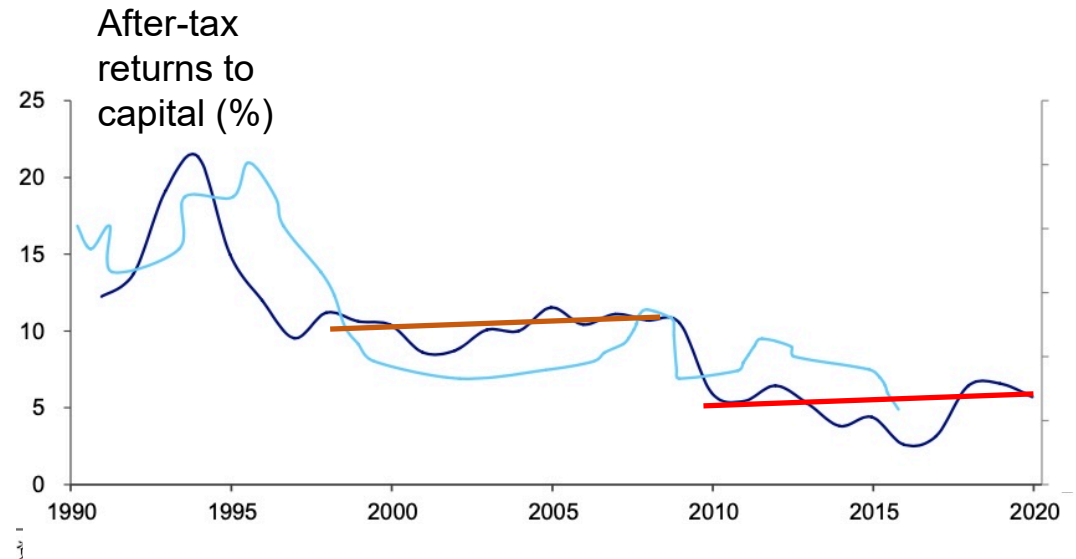
- Probably yes, as no miracle doesn't come to an end.
- Three important changes that the Chinese economy currently faces:
  - Significant increase of income (and cost) level
  - Rapid deterioration of external market conditions
  - Dramatic turn from demographic dividend to population ageing



“The China Miracle”, Justin Lin (1995); “Farewell, China Miracle”, Huang Yiping (2012); China 2049, David Dollar, Huang Yiping and Yao Yang (2020)

# But China is neither the Soviet nor Japan

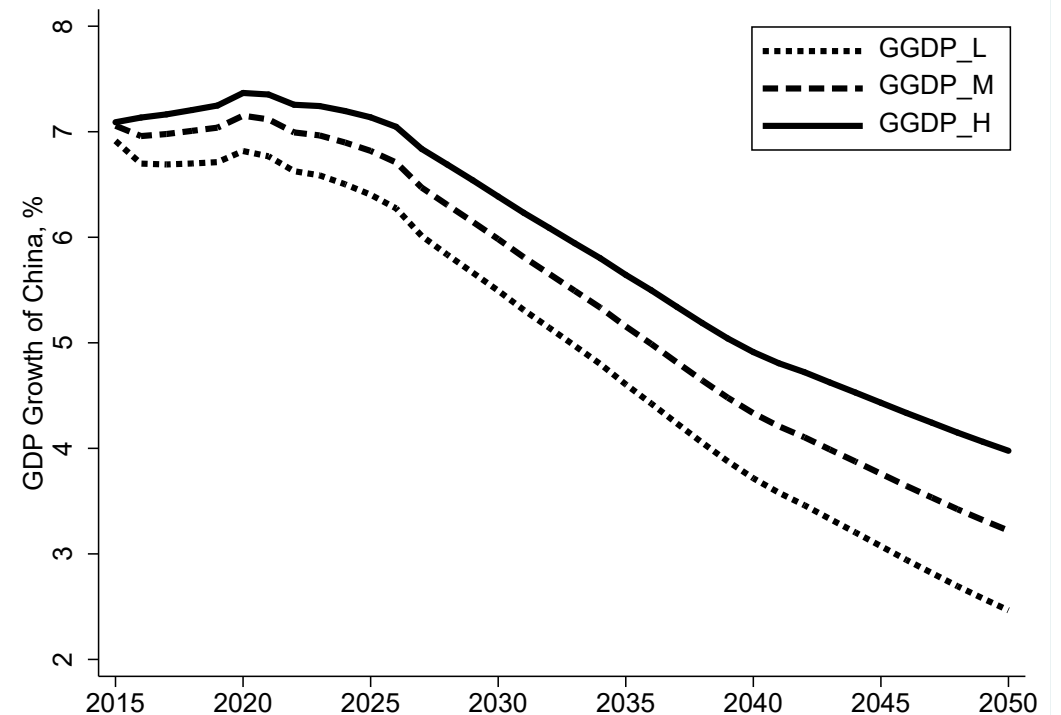
- Taking a look at the Summers narrative
- “No clear new driver of economic growth”
  - Very vibrant automobile, new energy, electronics and tech sectors
- “financial overhang”
  - Blow-up of property sector and local debt problems unlikely
- “The Party’s intervention in corporate affairs”
  - Policy flexibility as evidenced by the latest “policy mix”
- “Ageing problem”
  - Human capital index 65; AI and digital economy’s mitigation of some of the problems



After tax capital returns, 1990-2020 (%)  
Source: Haitong Securities.

# Growth slowing but not collapsing

- The Chinese economy is at an important crossroad
- Near term economic outlook faces major headwinds
  - Order numbers and confidence
- Trend growth is decelerating quickly
  - Demographics and new policy restrictions
- Growth likely will continue at modest pace
  - Key: policy and expectation



Projections of Chinese real GDP growth, 2020-2050 (%)  
Source: China 2049