Turning frosty
China’s growth cools as the US-China trade war heats up

降温
随着中美贸易战的持续升温，中国的经济增长放缓

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Introduction

1. The macro perspective

2. Financial derisking

3. A long-term perspective
The macro perspective

*Cooling growth, hardening politics*
The economic challenges are mounting

- Financial “derisking” continues, despite trade war concerns
- Growing trend towards state control & SOE consolidation hurts productivity
- Centre-region fiscal rebalancing still needs to be tackled
- Demographic ageing is now weighing on GDP growth
- “Easy” gains from urbanisation are largely realised already

Real GDP vs consumer price inflation

Source: The Economist Intelligence Unit.
Consumption – downgrading fears overplayed

• Retail sales growth has slowed
• Annual car sales set to fall in 2018; first time since 1990s
• Some “low-end” brands outperforming
• Concerns about “consumption downgrade”, but overplayed
• Incomes continue to climb ~8% p.a.
• We see real growth of 6.5% in household spending in 2019
Investment: slowing, slowing… contracting?

- Financing infrastructure increasingly challenging
- Government has loosened restrictions on local government infrastructure plans & stepping up bond issuance, but no return to 2016
- Property investment unlikely to surge again - but some exceptions

**Fixed-asset investment in infrastructure**

(% change, year on year)

- Jan 2015
- Jul 2016
- Jan 2017
- Jul 2018

*Note: Data are based on investment in the year to date and are non-seasonally adjusted. Source: National Bureau of Statistics.*
Financial de-risking

Not done yet
Efforts to rein in leverage lose traction

Chinese total debt to GDP ratio %

Debt-to-GDP ratio by sector (%)

Source: BIS.
Central bank moves to squeeze out some risk

- PBC approach has been to allow innovation, for 1-3 yrs then tighten
- Served well in boosting fintech & developing competition for big SOCBs
- But risk has grown in less regulated parts of the financial sector
- Key areas of concern include: BADs; trust products; P2P lending
- Biggest risks are around exposure to property prices & local govt projects
- Fear of social instability => Implicit state guarantee
We see some progress, but not a lot

- Government has limited tolerance for slower GDP growth
- Expect progress on:
  - Increasing FDI in finance via liberalisation
  - Eroding implicit guarantees
  - Slowing loan growth
- Expect less headway on:
  - Reducing overall leverage
  - Tackling exposure to property & LGFVs
  - Transparency
  - Resolution of bad debt

Lending will continue to outpace GDP

- Nominal GDP growth
- Bank lending growth

Lending will continue to outpace GDP
China vs US: Thucydides trap fears crystalize

• We see trade war being sustained until 2020 at least – probably longer

• US administration contains very hardliners & moderates. Trump a hardliner on trade

• Chinese leadership facing internal pressures too

• Trade tensions will seep into security clashes & broader strategic challenge

• Risk of new Cold War is high
A long-term perspective
*Outlook still positive, but risks are rising*
World’s 25 largest economies in 2030

• In our forecasts, China only overtakes the US as world’s biggest economy at market exchange rates in 2030

Nominal GDP, US$ trn. Source: The Economist Intelligence Unit.