



CHINA'S GROWTH TRANSITION

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Section I. Before the Crisis

Strong growth

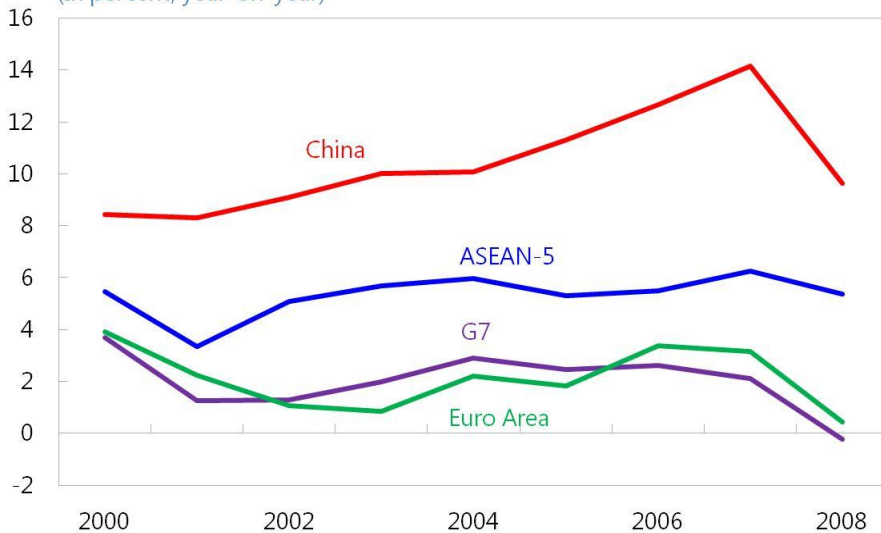
External and
internal imbalances

Vulnerability to
crisis.

Strong Growth Driven by Net exports

Real GDP Growth

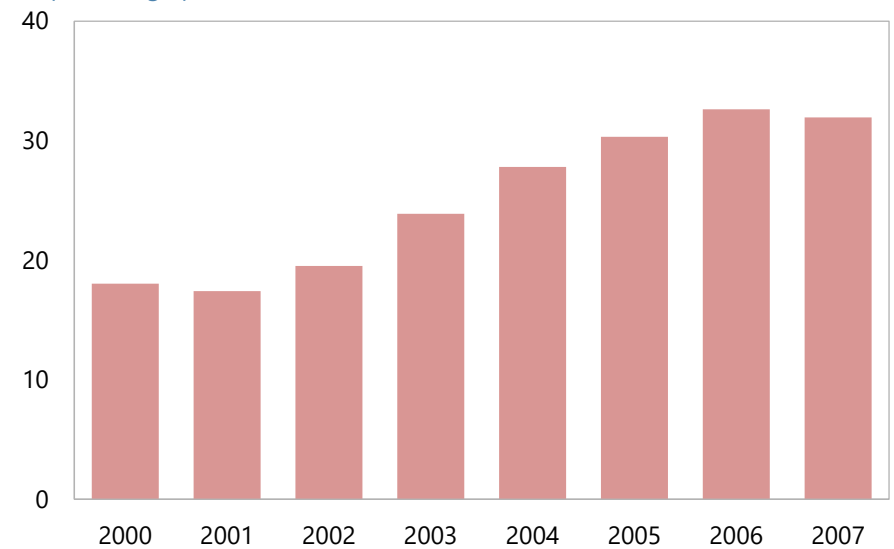
(In percent, year-on-year)



Source: World Economic Outlook.

Export/GDP Ratio

(In percentage points)

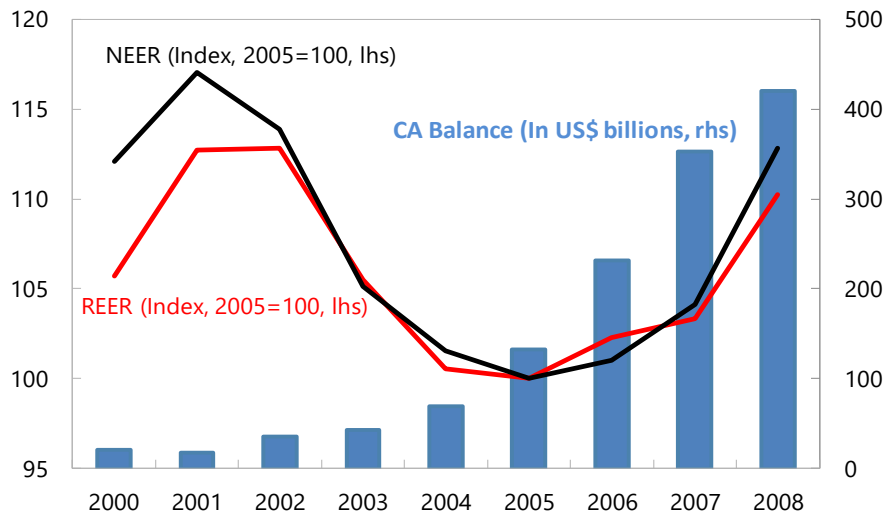


Sources: World Economic Outlook; and IMF staff calculations.

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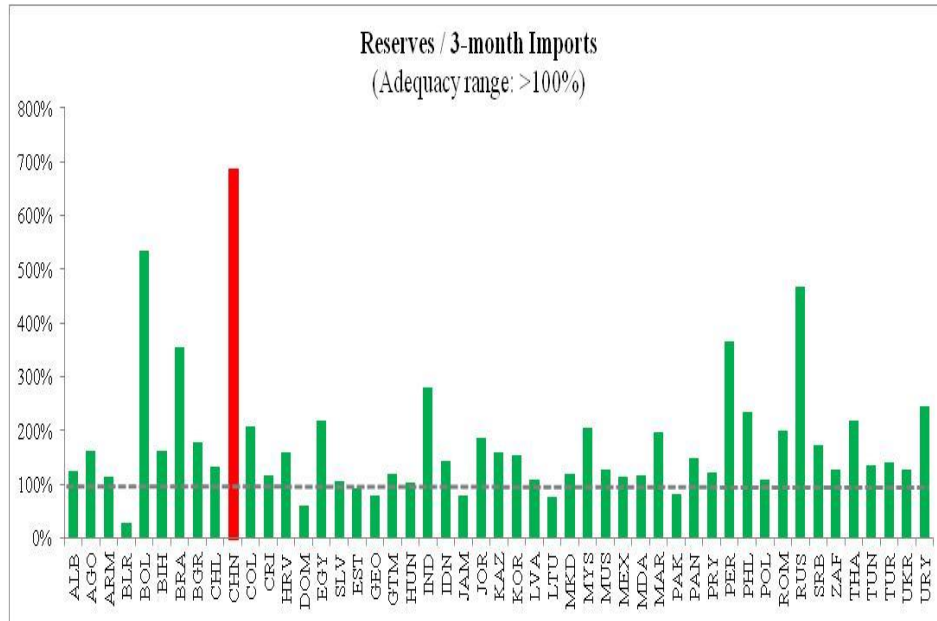
External Imbalance

Effective Exchange Rate and Current Account Balance



Sources: World Economic Outlook; and Global Data Source database.

Reserves / 3-month Imports
(Adequacy range: >100%)

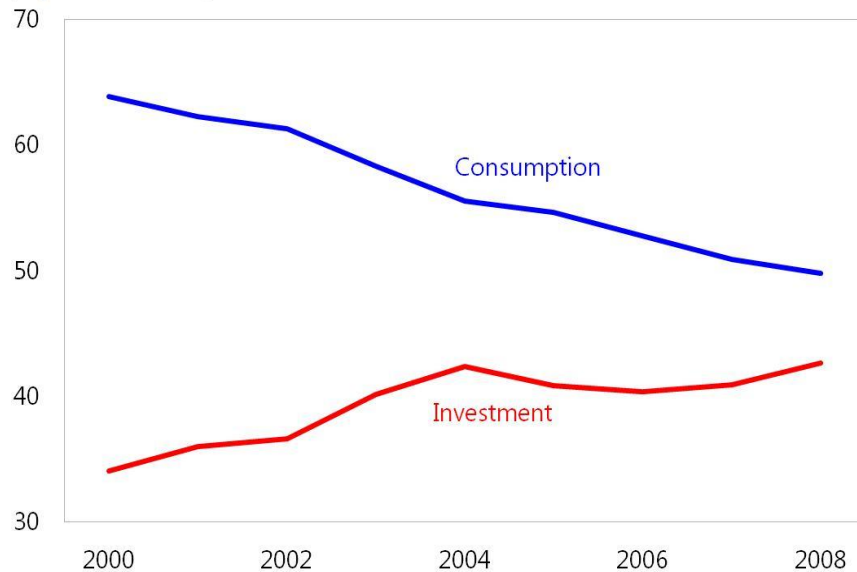


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Internal Imbalance: Consumption vs. Investment

Investment and Consumption

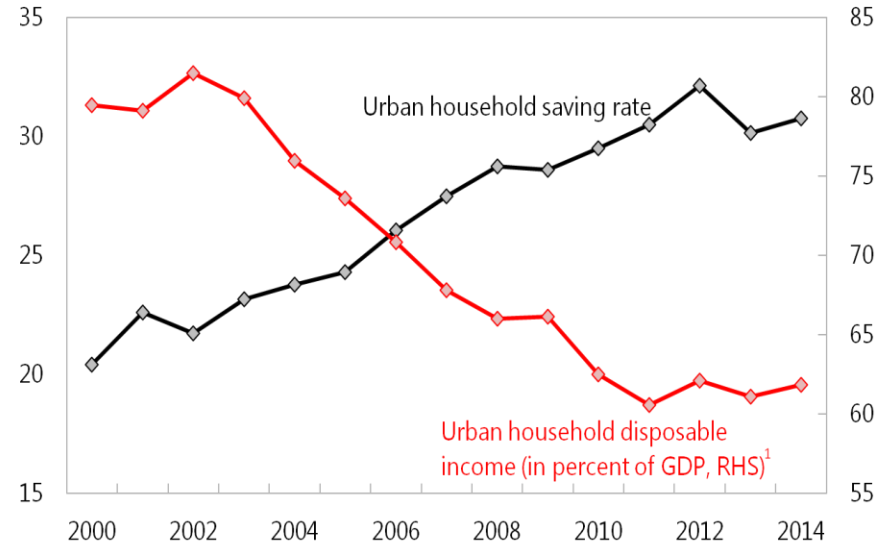
(In percent of GDP)



Sources: World Economic Outlook; and IMF staff calculations.

Falling Consumption

(In percent)



Sources: CEIC Data Company Ltd.; and IMF staff calculations.

¹Per capita as a share of per capita GDP; household survey.

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China Was Less Vulnerable: Compared with Other Countries

Financial system:

- 1) Limited spillover from other countries due to capital controls
- 2) Low NPLs

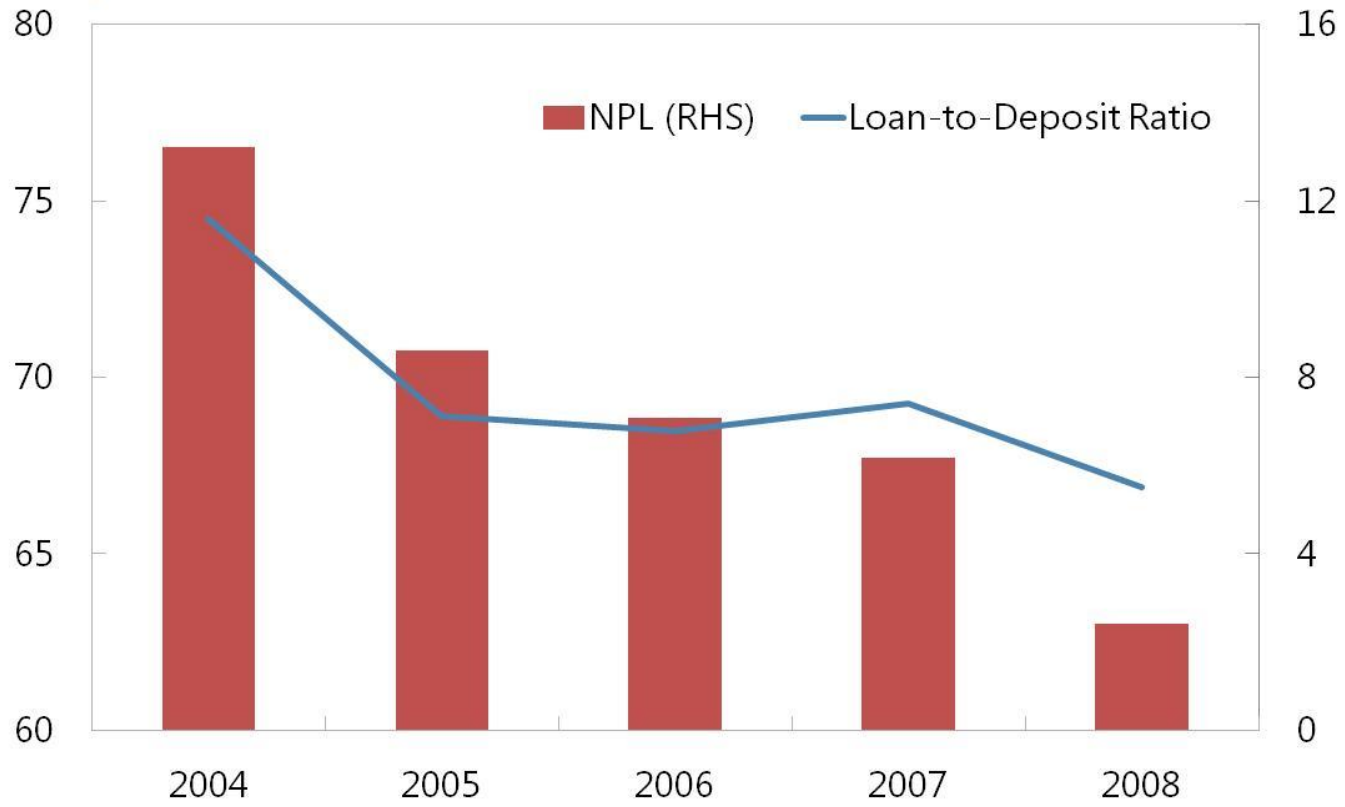
Fiscal: low deficit and debt;

Household: low debt.

Financial Sector Was Generally Healthy

Financial Sector

(In percent)

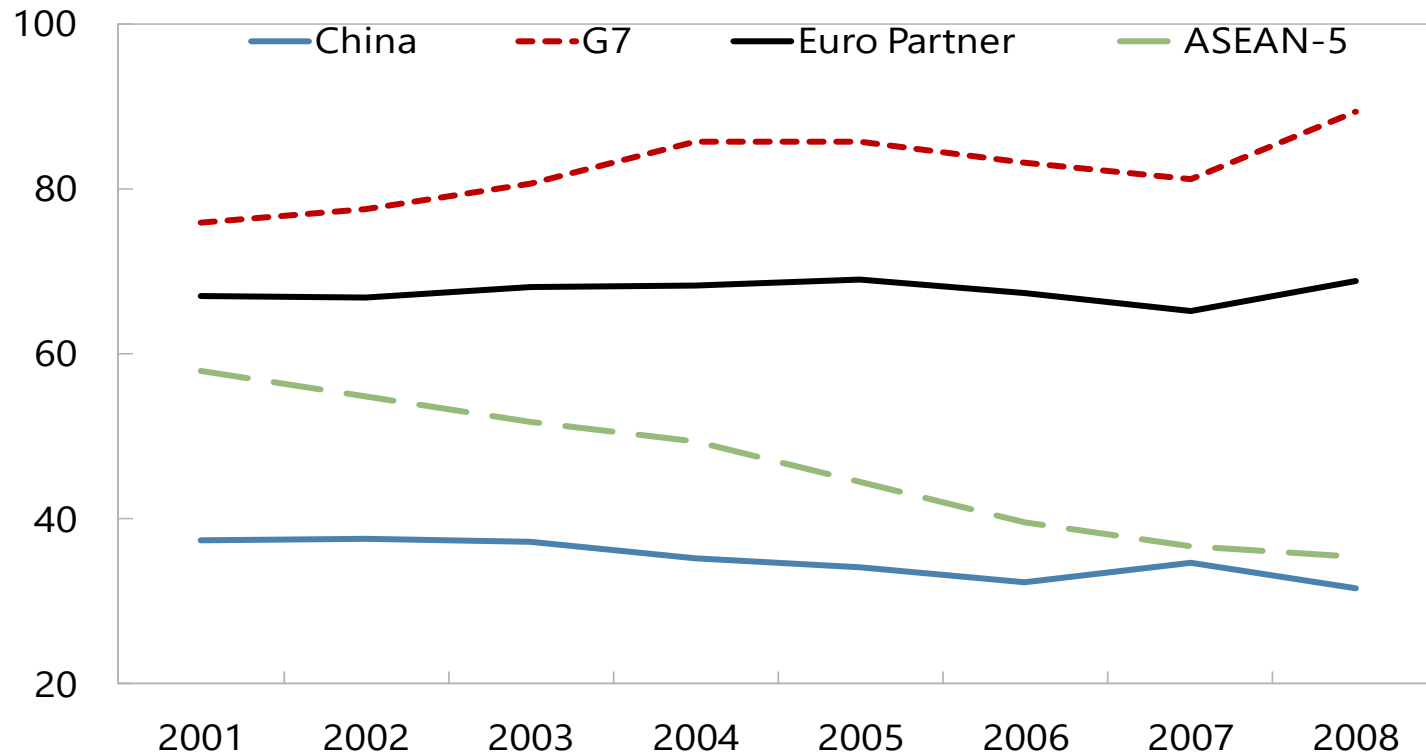


Sources: CEIC Data Company Ltd.; and IMF staff calculations 11/8/2017

Large Fiscal Space

Government Debt

(In percent of GDP)



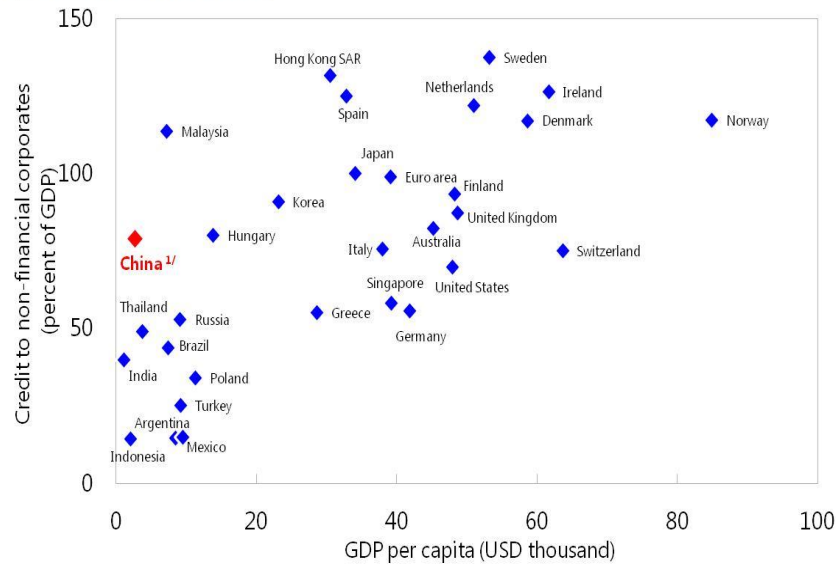
Source: World Economic Outlook (WEO).

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Relatively Low Debt Level

Credit to Nonfinancial Corporates and GDP per Capita

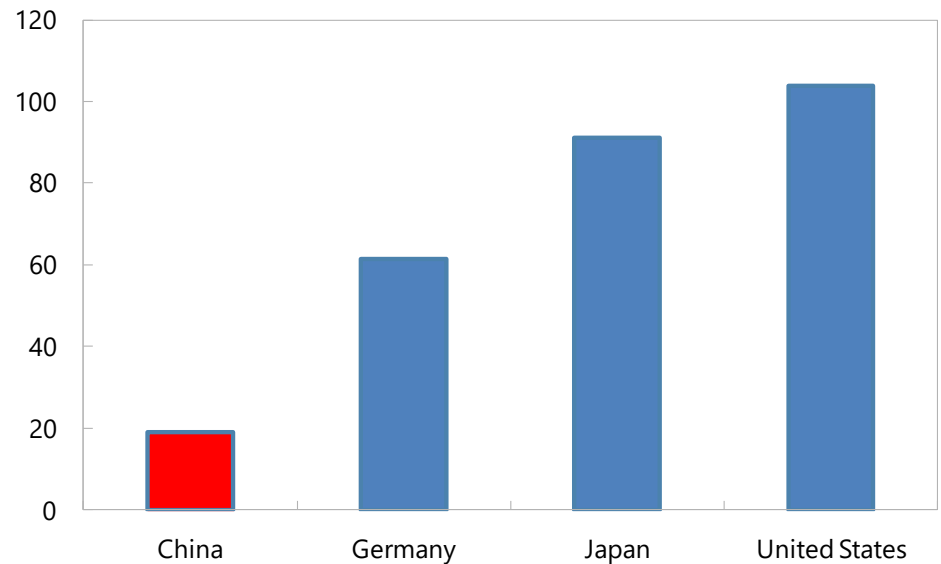
(Selected economies, 2007)



1/ Corporate debt for China is calculated as total social financing minus equity, LGFV borrowing and household loans.

Household Debt

(In percent of GDP)



Sources: OECD, CEIC Data Company Ltd.; and IMF staff calculations.

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Section II. The Crisis

Mainly hit the export sector

Deflation pressure

Weaker growth momentum

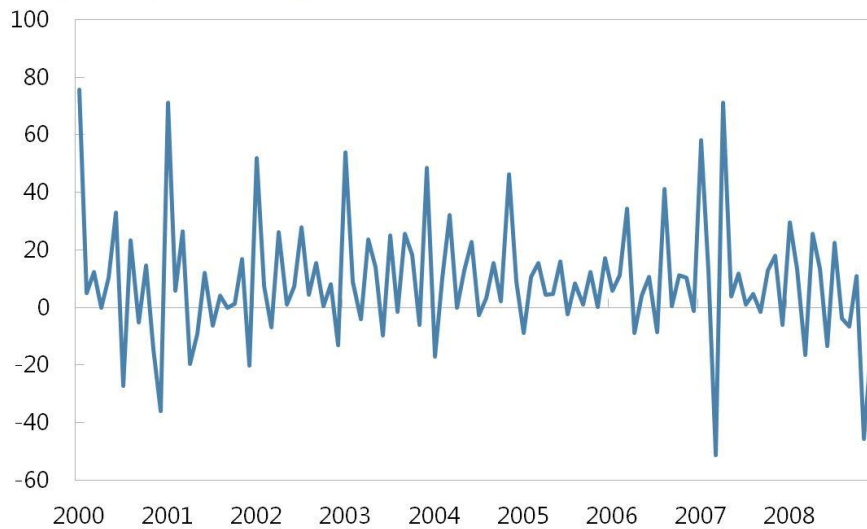
Capital flow relatively stable

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Drop in Exports

Exports

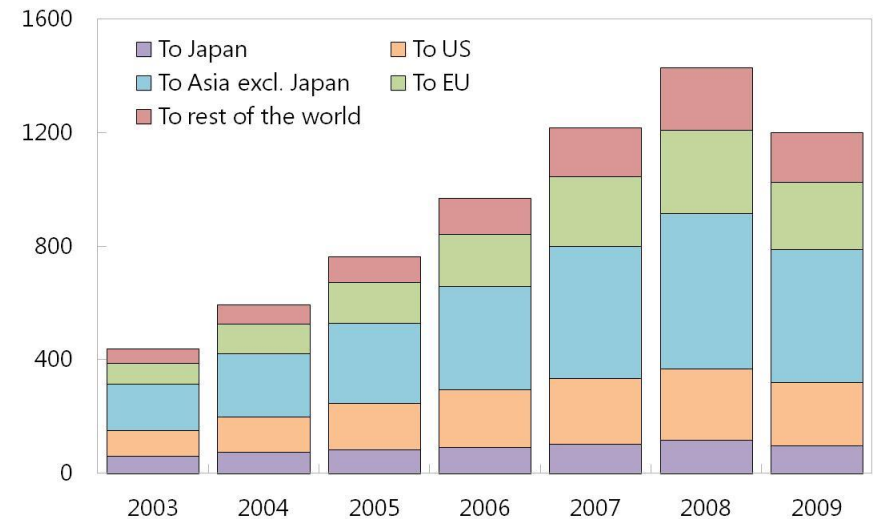
(In percent, year-on-year growth, saar)



Sources: CEIC Data Company Ltd.; and IMF staff calculations.

Export by Destination

(In billion of US Dollars)

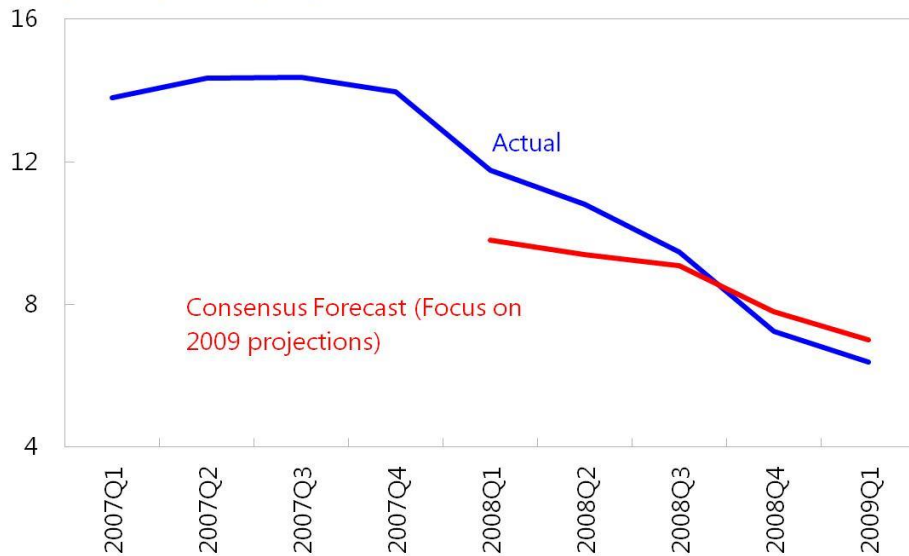


Sources: CEIC Data Company Ltd.; and IMF staff calculations.

Growth Momentum Weaker

Real GDP Growth

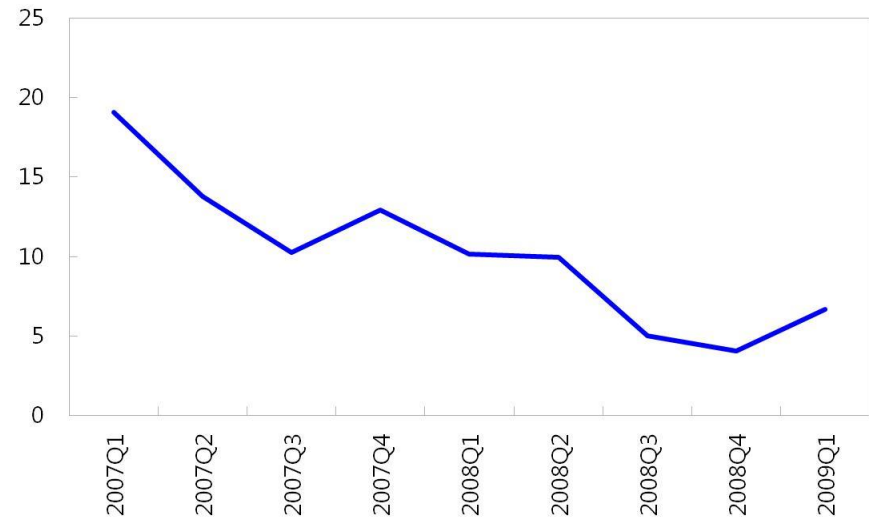
(In percent, year-on-year growth)



Sources: Consensus Economics, Inc.; CEIC Data Company Ltd..

Real GDP Growth

(In percent, quarter-on-quarter growth, saar)



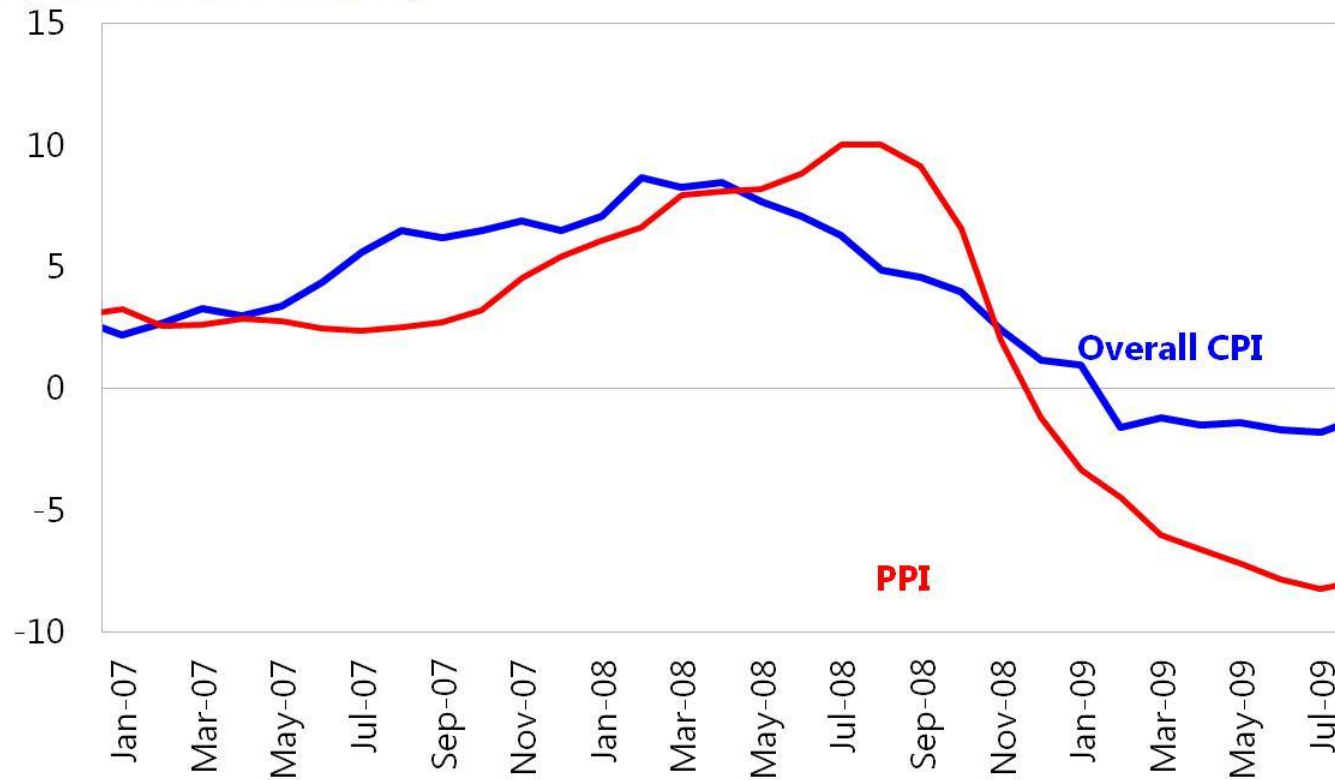
Source: World Economic Outlook (WEO).

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Deflation Pressure

CPI Inflation

(In percent, year-on-year)



Source: CEIC Data Company Ltd.

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Section III. The Quick and Strong Response— And Impact

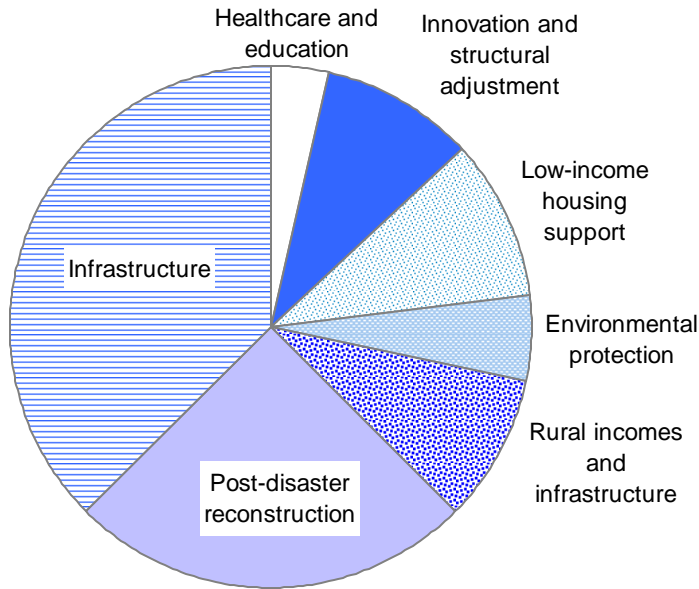
**Monetary: Expansion of quantity quota;
lower rates; credit guarantee scheme**

Fiscal: 4 trillion stimulus package

Support for key industries

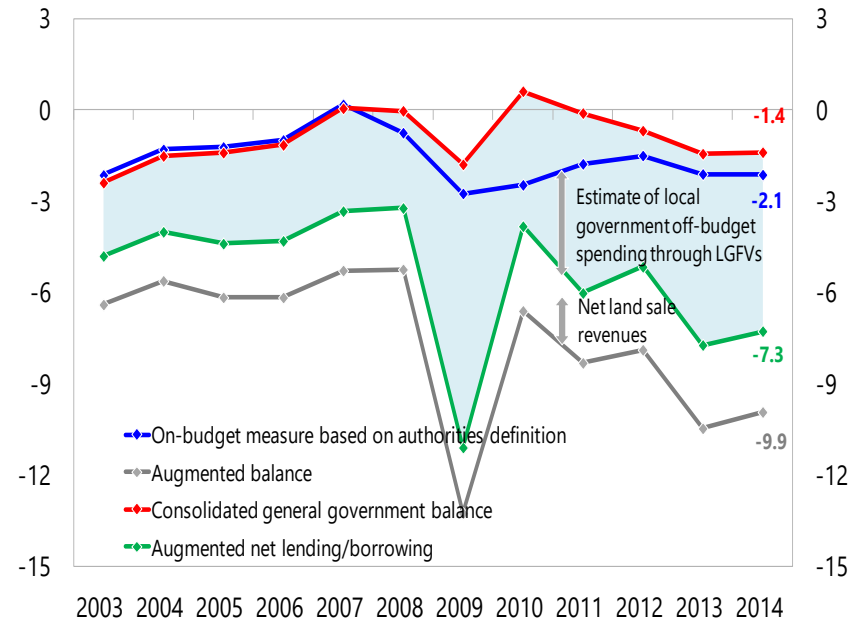
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Fiscal Stimulus



General Government Balance

(In percent of GDP; including state-administered SOE funds and social security)



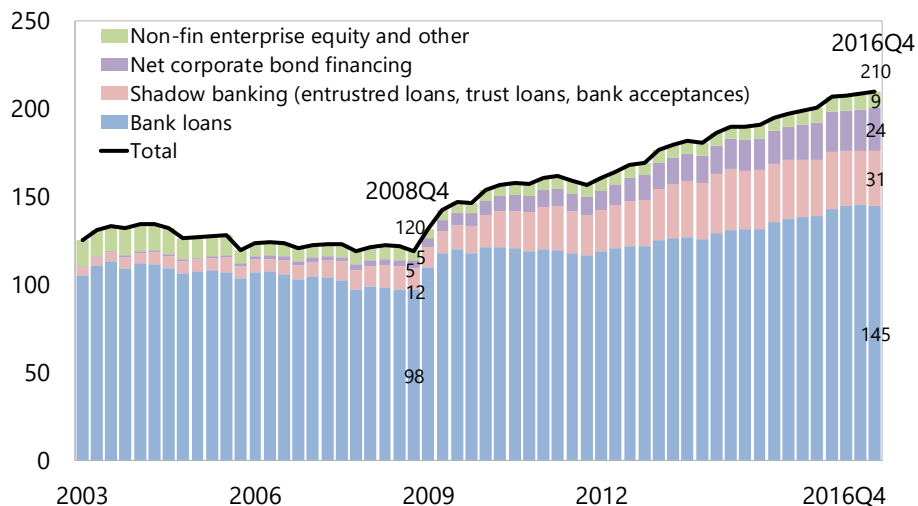
Sources: CEIC; and IMF staff estimates.

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Monetary Stimulus

Social Financing Stock

(In percent of GDP) ^{1/}

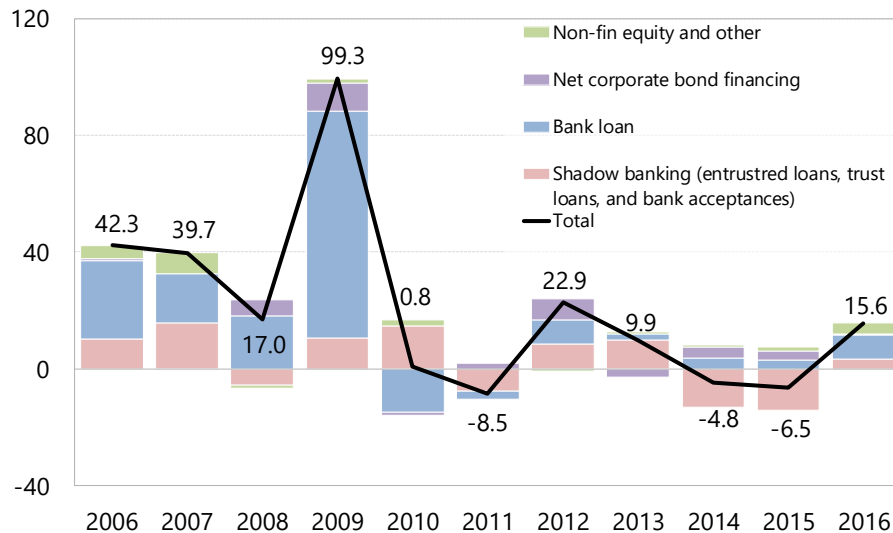


1/ In percent of 4Q rolling sum of quarterly GDP.

Sources: CEIC Data Company Ltd.; and IMF staff estimates.

Social Financing Flow

(In percent, year-on-year contribution to growth)



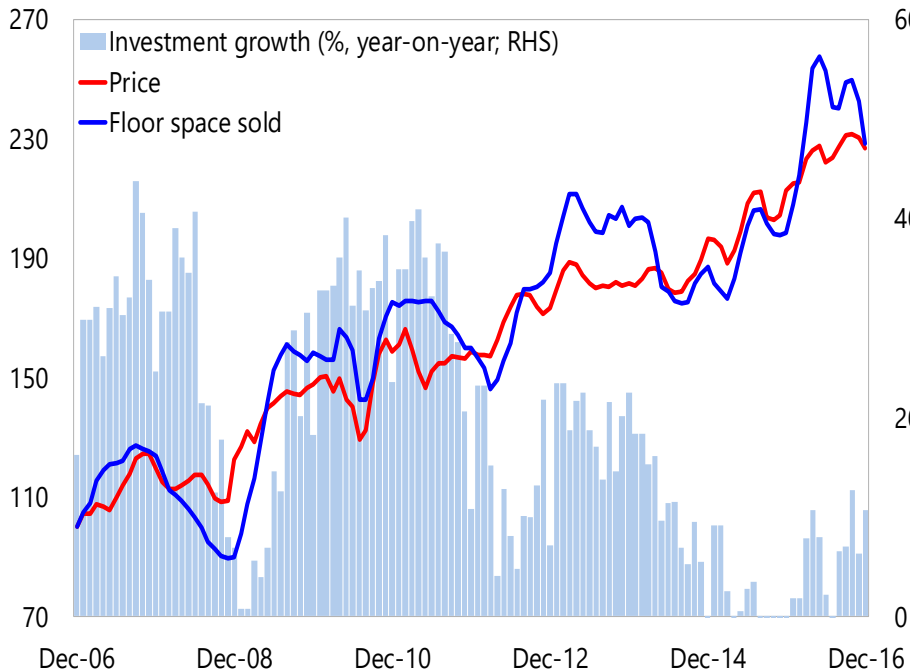
Sources: CEIC Data Company Ltd.; and IMF staff calculations.

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Support for Some Industries

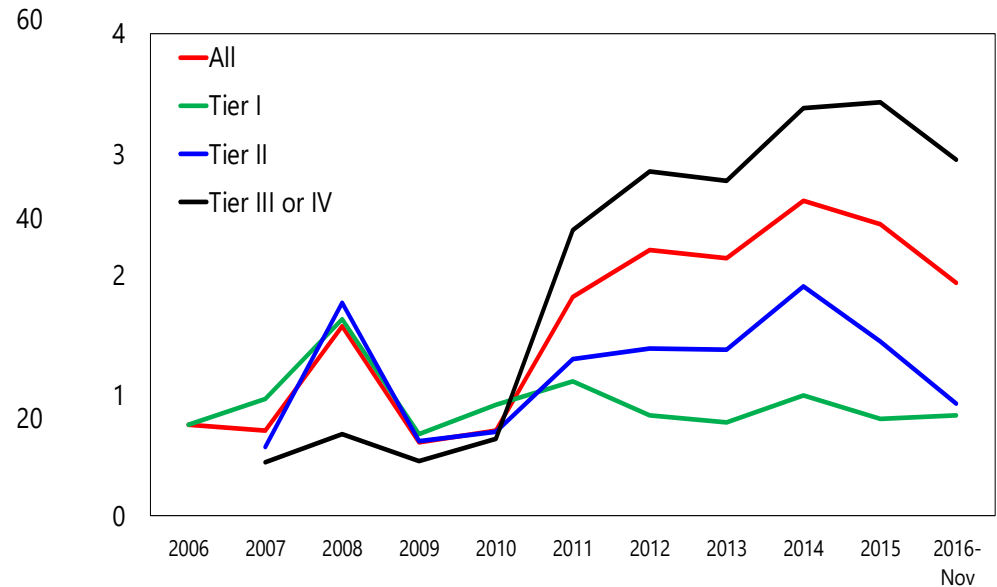
Residential Housing

(Dec 2006 = 100, sa, 3mma)



Residential Real Estate Inventory Ratio by Tier 1/

(In years)



Sources: Local Housing Administrative Bureau (Fangguanju), Wigram Capital Advisors, IMF staff calculations.
 1/Inventory is measured as floor space unsold; inventory ratio is measured as floor space unsold/sold.

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Impact of the Policy Response

Short-term

Stabilized
growth

Longer term: Mixed

Positive: Improved
external imbalance

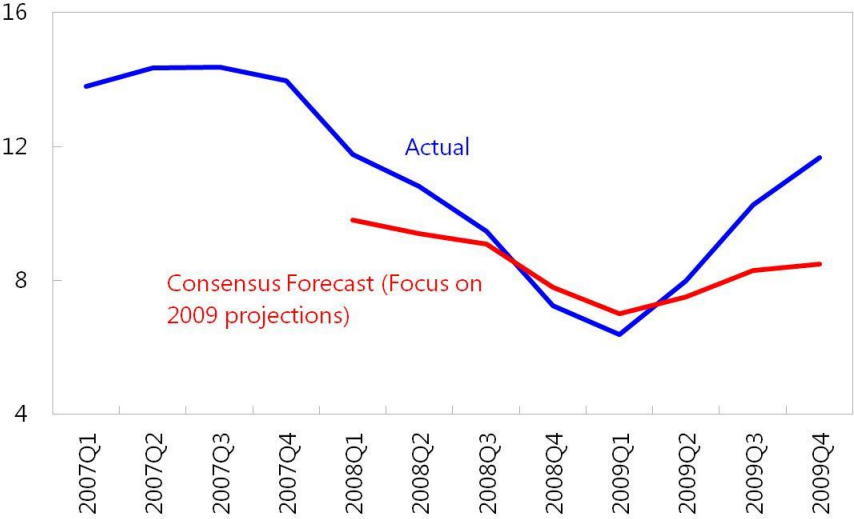
Negative: Domestic Imbalance

- 1) Dependence on real estate
- 2) Surging corporate debt
- 3) Overcapacity
- 4) Prolonged fiscal stimulus
- 5) Investment/Consumption mismatch
- 6) Environmental problems

Short-term Impact: Stabilized Growth Momentum

Real GDP Growth

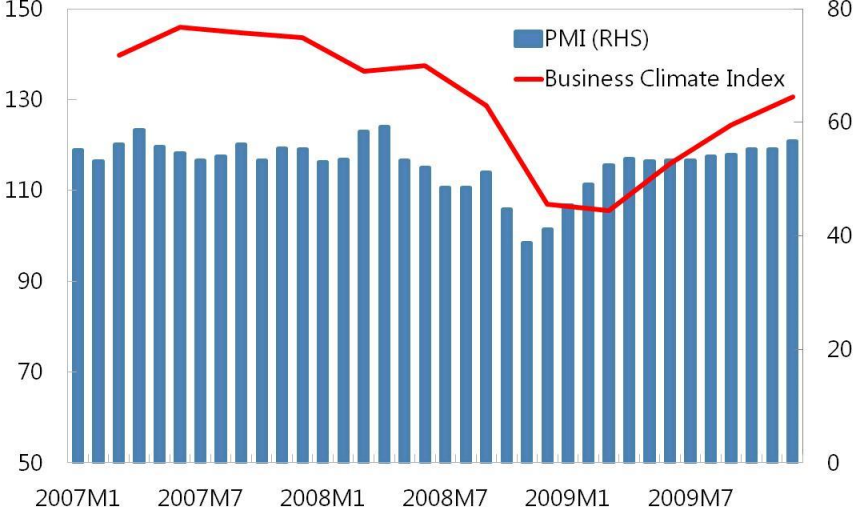
(In percent, year-on-year growth)



Sources: Consensus Economics, Inc.; CEIC Data Company Ltd..

Business Confidence

(Index)



Sources: CEIC Data Company Ltd.

Section IV. Rebalancing China's Growth Model

Third Plenum Reform Blueprint

Internal Imbalance: Challenge has Persisted

Elevated Financial Stability Risks

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Third-Plenum: Reform Blueprint

More balanced, sustainable growth, address vulnerabilities

Financial	Fiscal	External	Structural
Better pricing of risks	More social spending and less investment	Greater exchange rate flexibility	Competition and hard budget constraints
Improved access to financing	More efficient and progressive tax system	Gradual capital account liberalization	Faster urbanization

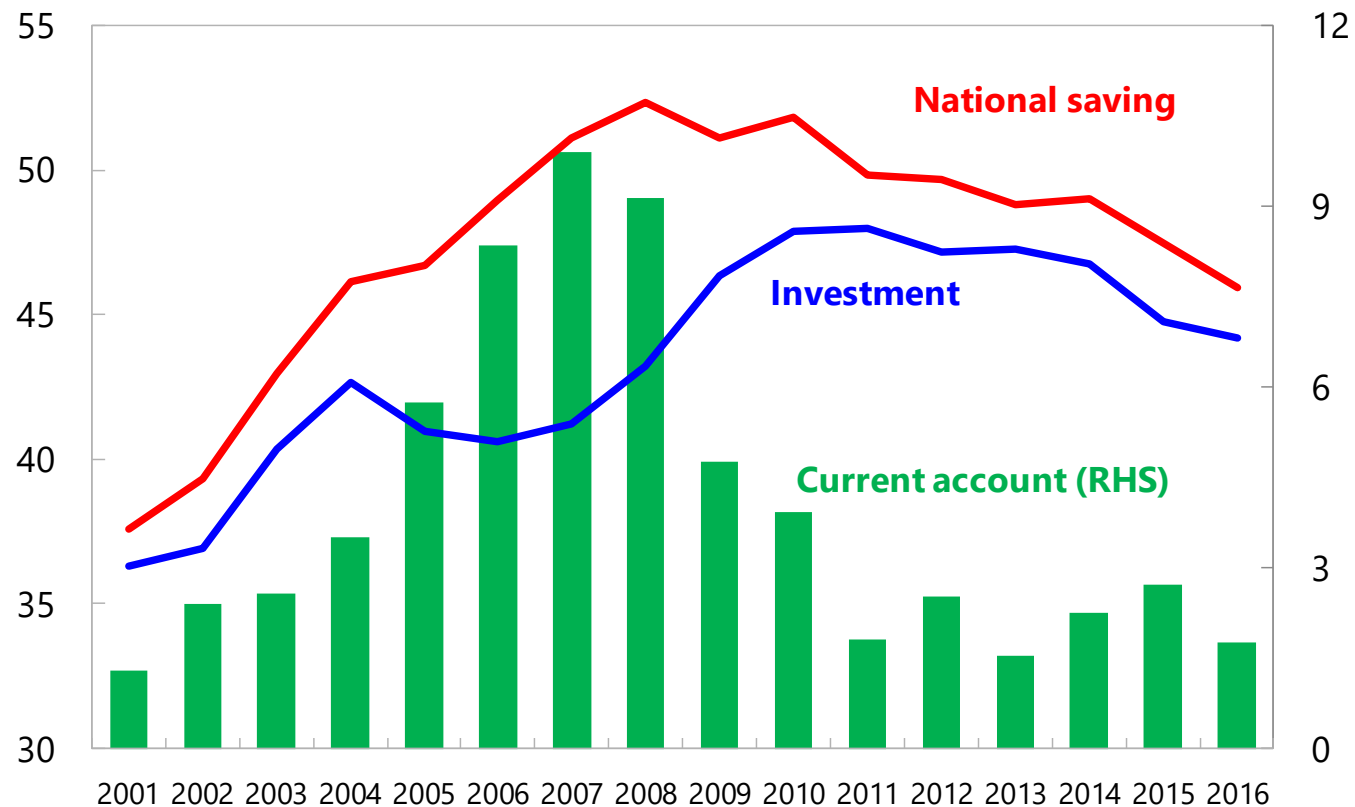
↓ **Higher productivity growth; more consumer-based,
Remove implicit guarantees, Intensify SOE reforms
Internationalize the renminbi**

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China has made progress in rebalancing away from external-led growth...

Investment and Saving

(In percent of GDP)

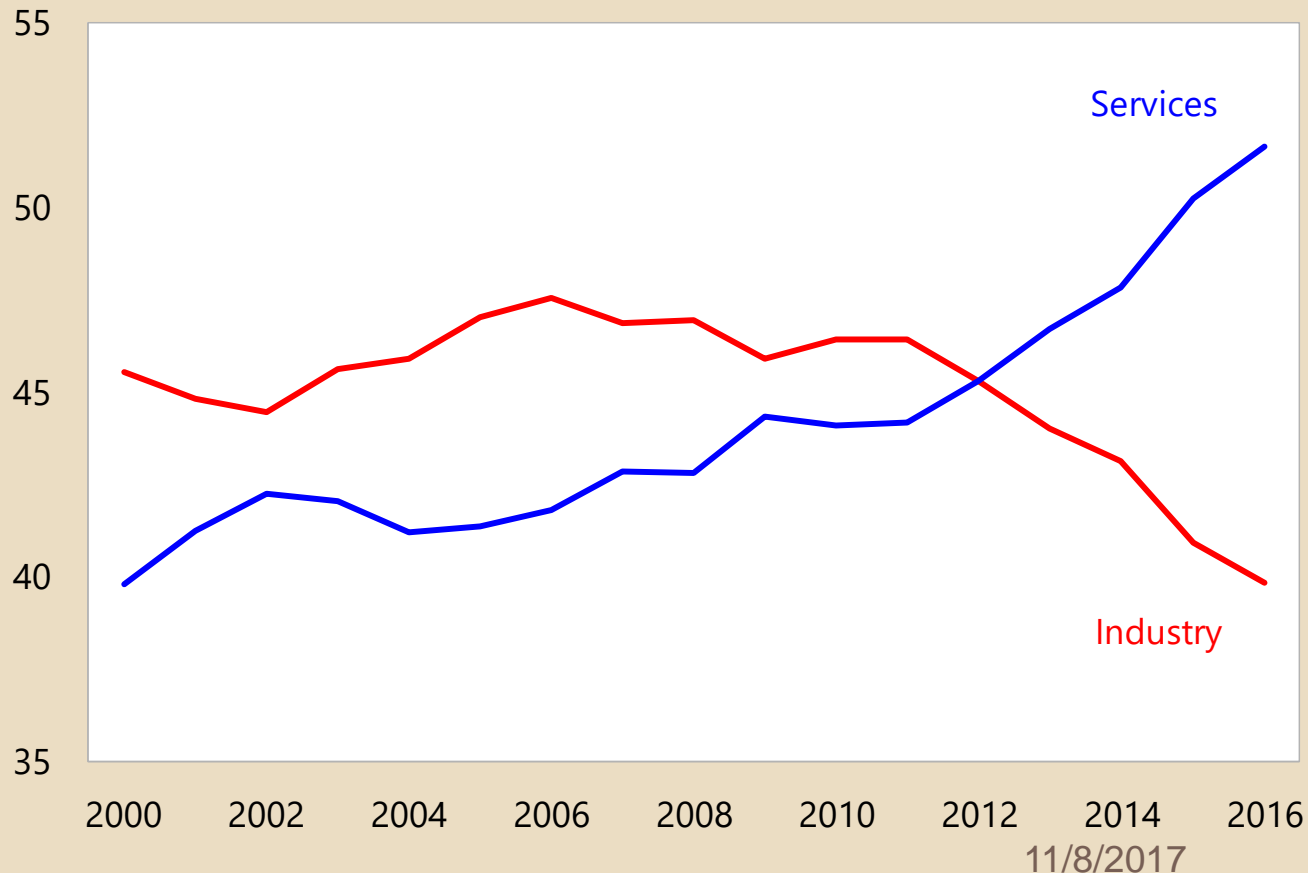


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...and moving toward a more service-dominated economy.

GDP by Production

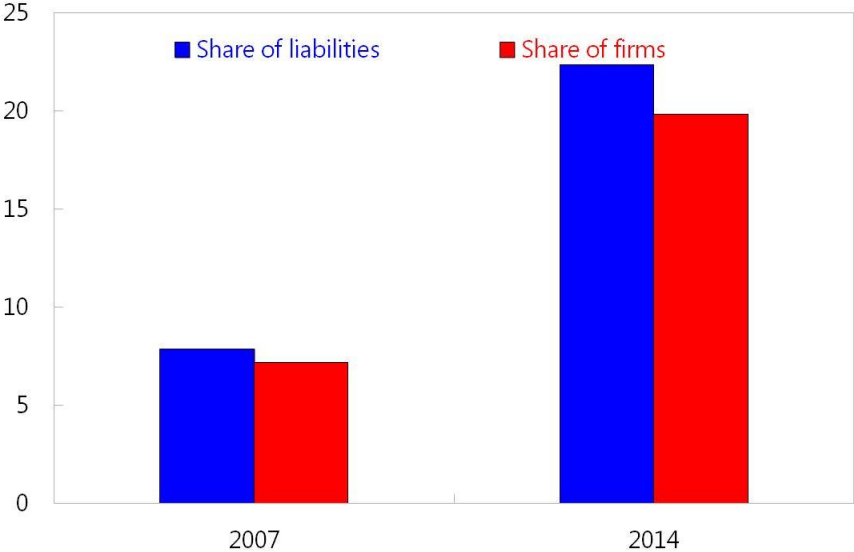
(In percent of nominal GDP)



Domestic Imbalance: Credit Growth

Corporate Leverage is #1 Risk

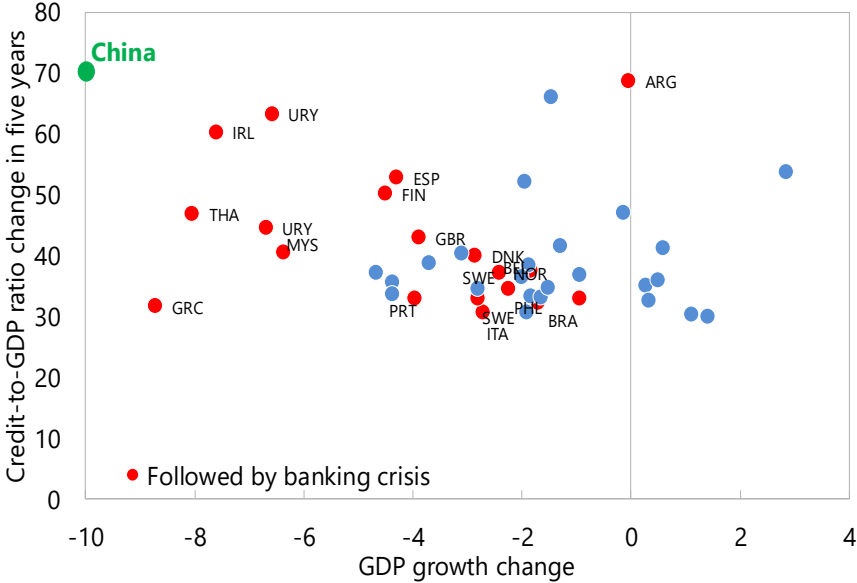
(Percent with interest coverage less than 1.5 times-listed nonfinancial firms)



Sources: WIND; and IMF staff estimates.

Credit Booms and Change in GDP Growth Rates

(In percentage points)

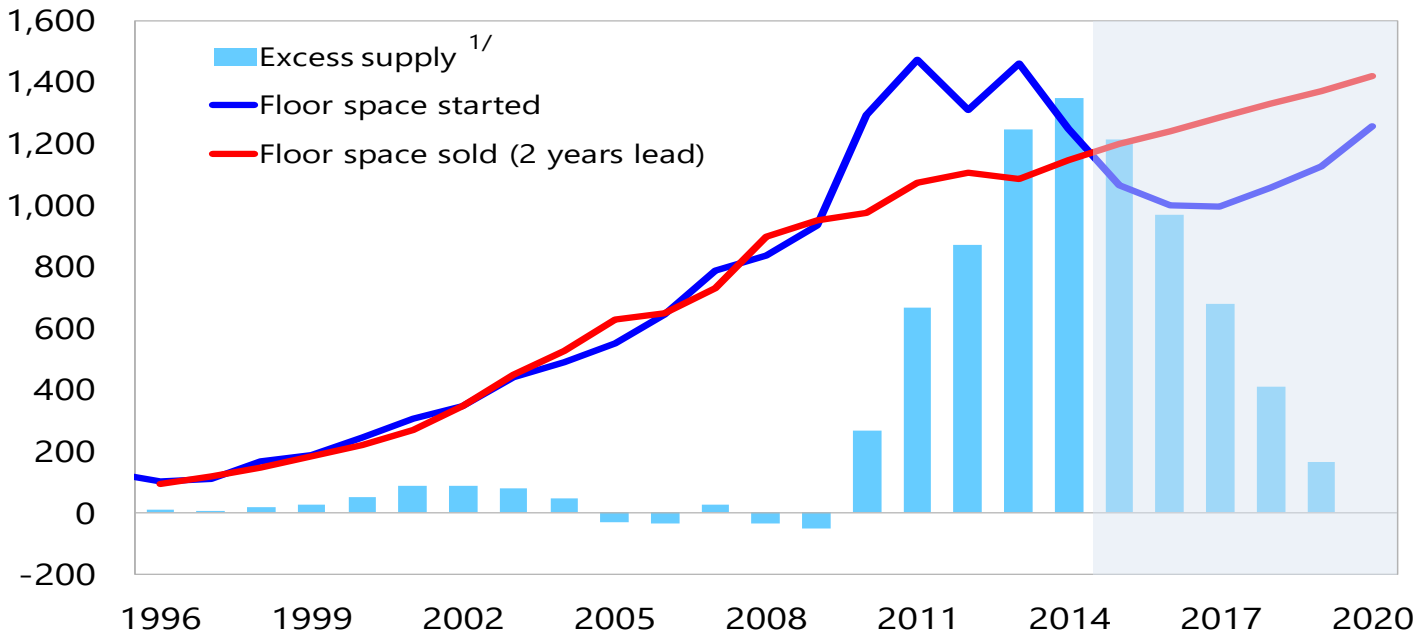


Source: IMF staff estimates and calculations.

Domestic Imbalance: Real Estate Bubble

Residential Market Overbuilding and Adjustment Scenario

(In millions of square meters)



Sources: NBS; and IMF staff calculations.

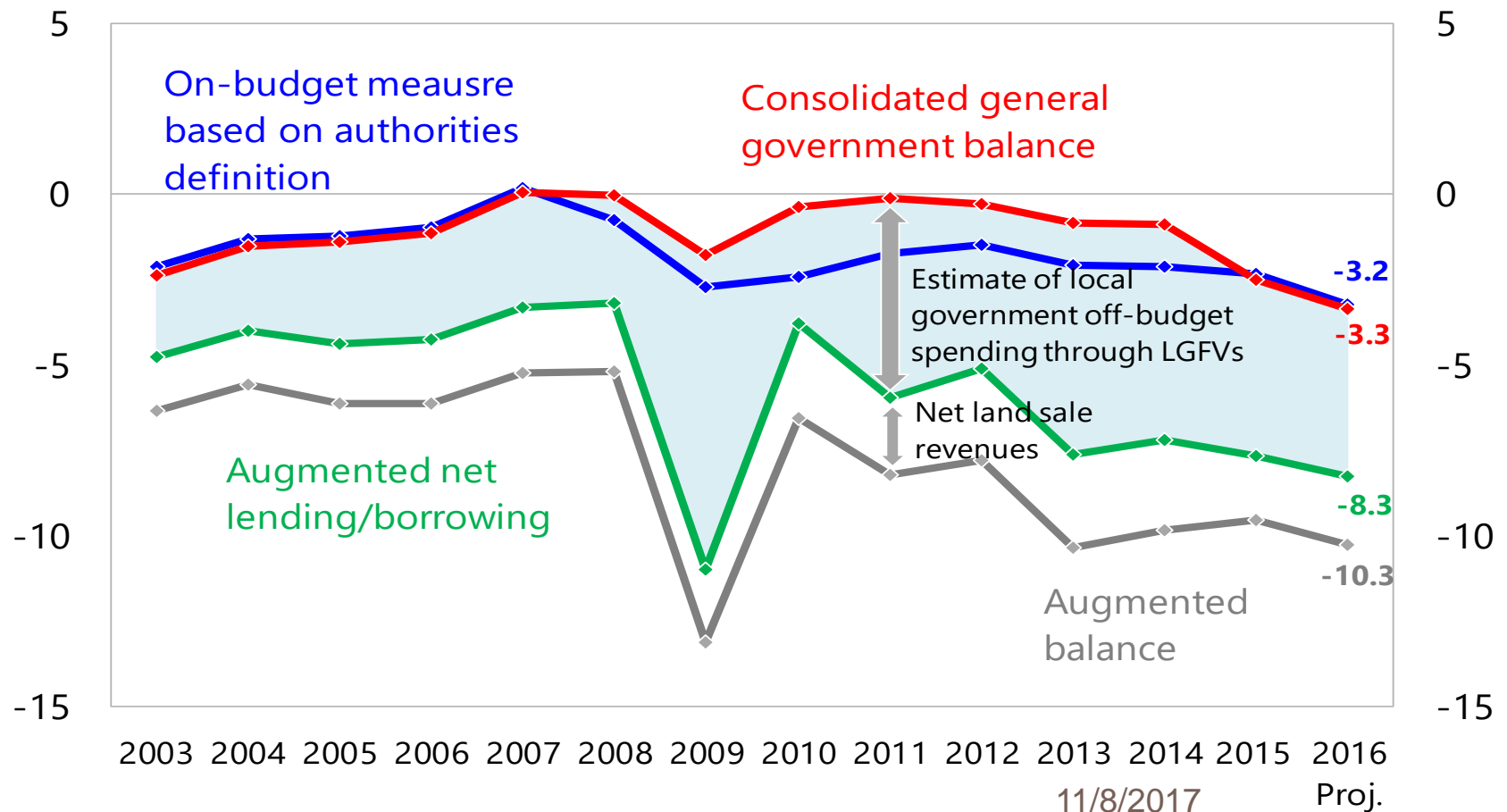
1/ Excess supply is measured as the difference between floor space started and sold (2 years lead).

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Domestic Imbalance: Fiscal

Fiscal Policy: Broadly Unchanged Stance

(Fiscal balance, in percent of GDP)



Sources: CEIC Data Company Ltd.; Authorities; and IMF staff estimates.

Domestic Imbalance: Overcapacity Sectors

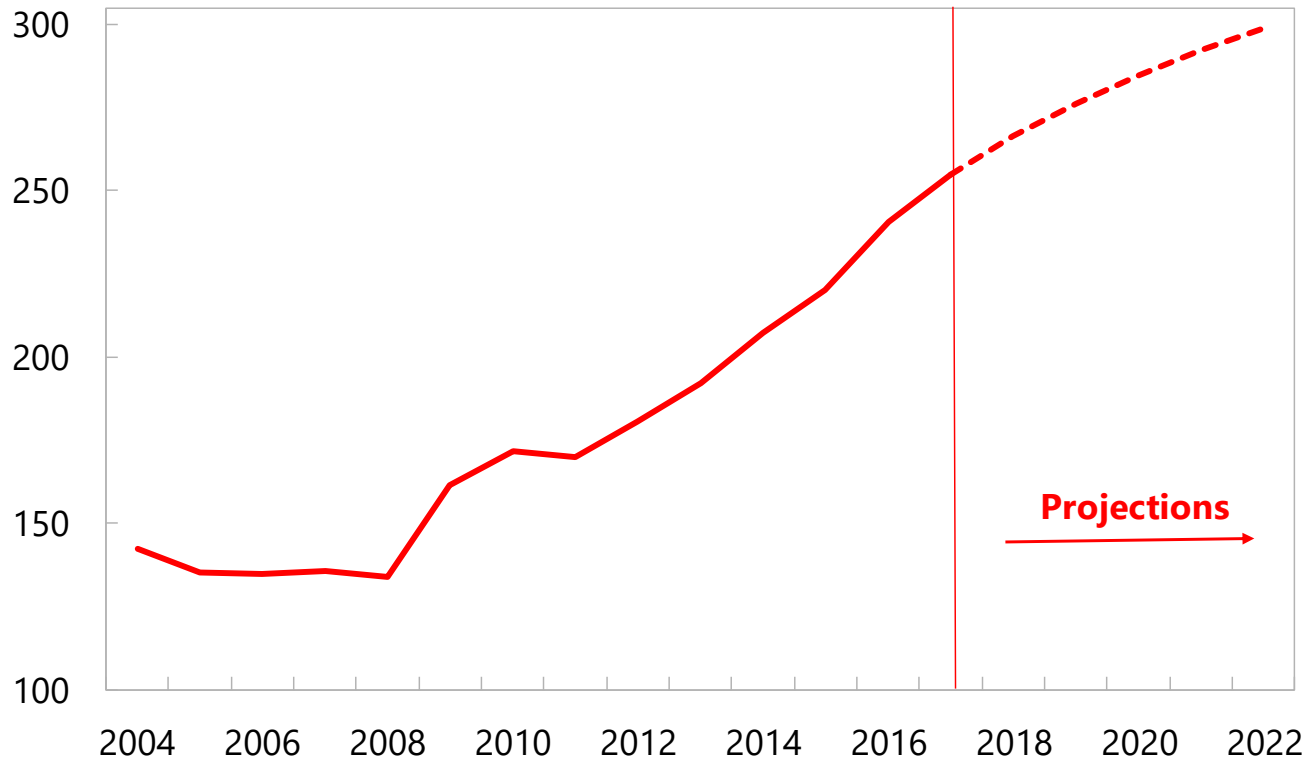
China: Market Share of Selected Industrial Production

<i>(In percent)</i>	2000	2014
Crude Steel	15.1	49.3
Cement	33.6	54.2
Aluminium	12.2	45.7
Refined Copper	20.2	34.7
Coal	26.9	44.6

The core economic problem: over reliance on debt

Non-Financial Sector Debt

(In percent of GDP)



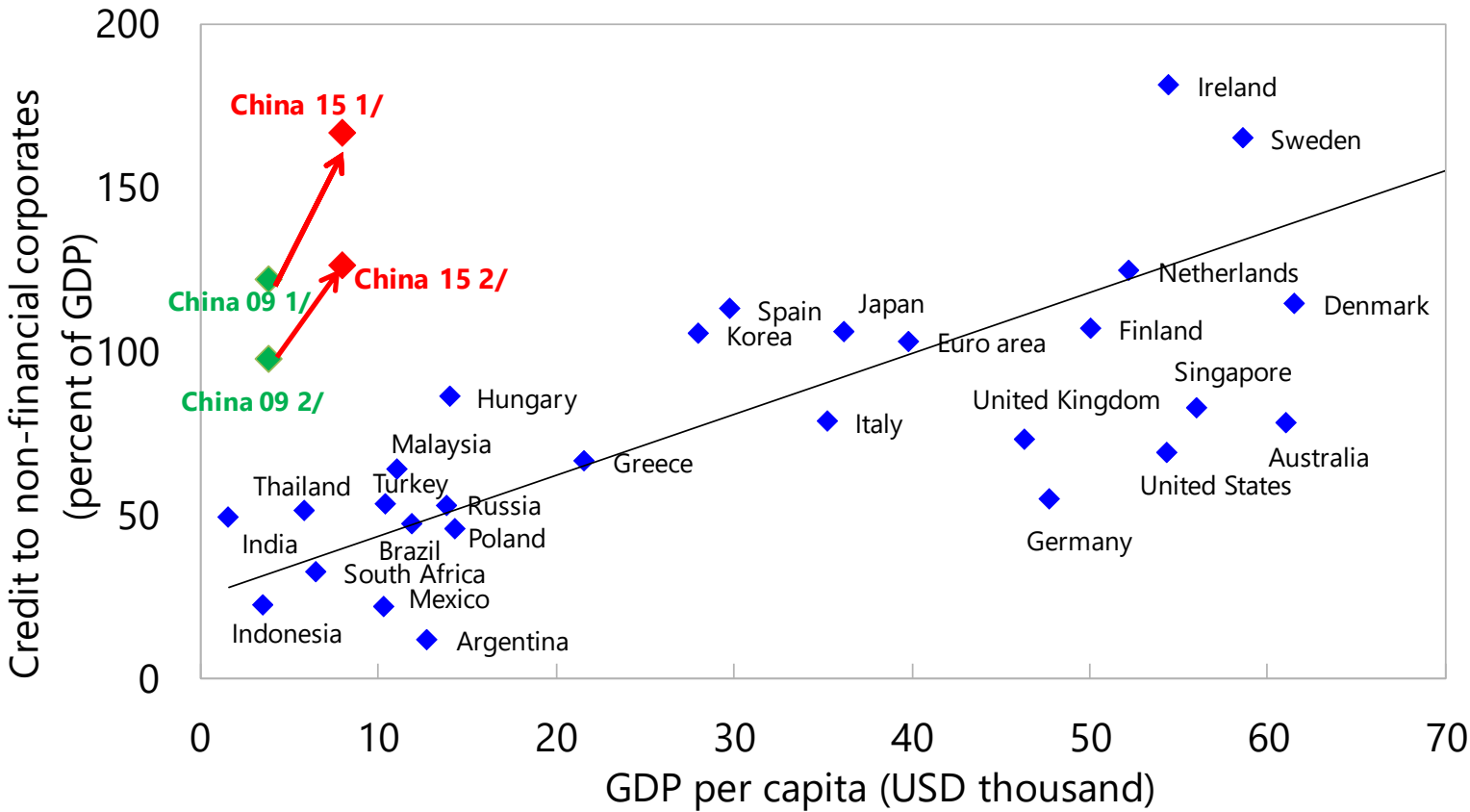
Sources: Haver Analytics; and IMF staff estimates.

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High Corporate debt relative to Comparators

29 Corporate Credit: High vs. Peers

(Selected economies, 2014)



Sources: Bank for International Settlements (BIS); and IMF staff estimates.

1/ Calculated as total social financing minus equity and household loans.

2/ Calculated as total social financing minus equity, LGFV borrowing and household loans.

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China Risks: Hard Landing in Regions, Two-speed economy

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Wide Regional Growth Disparity

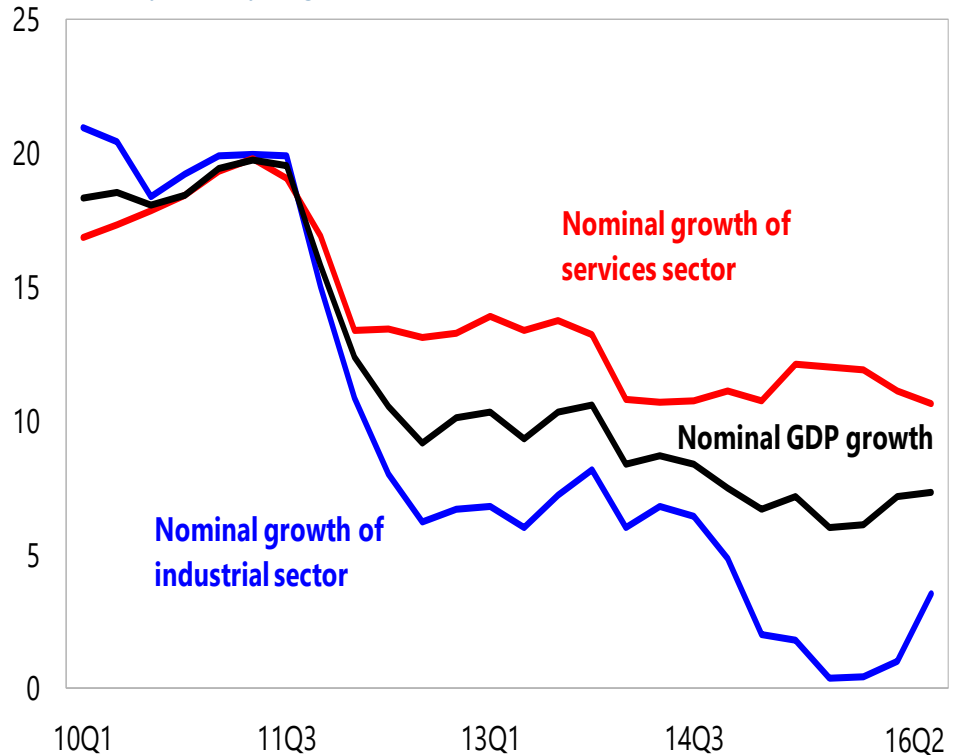
(In percent, year-on-year growth of nominal GDP, 2016H1)



Sources: CEIC Data Company Ltd.; and IMF staff estimates.

Two-speed Economy

(In percent, year-on-year growth)



Sources: CEIC Data Company Ltd.; and IMF staff estimates.

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Challenges to China's transition-- Have persisted since the Third Plenum

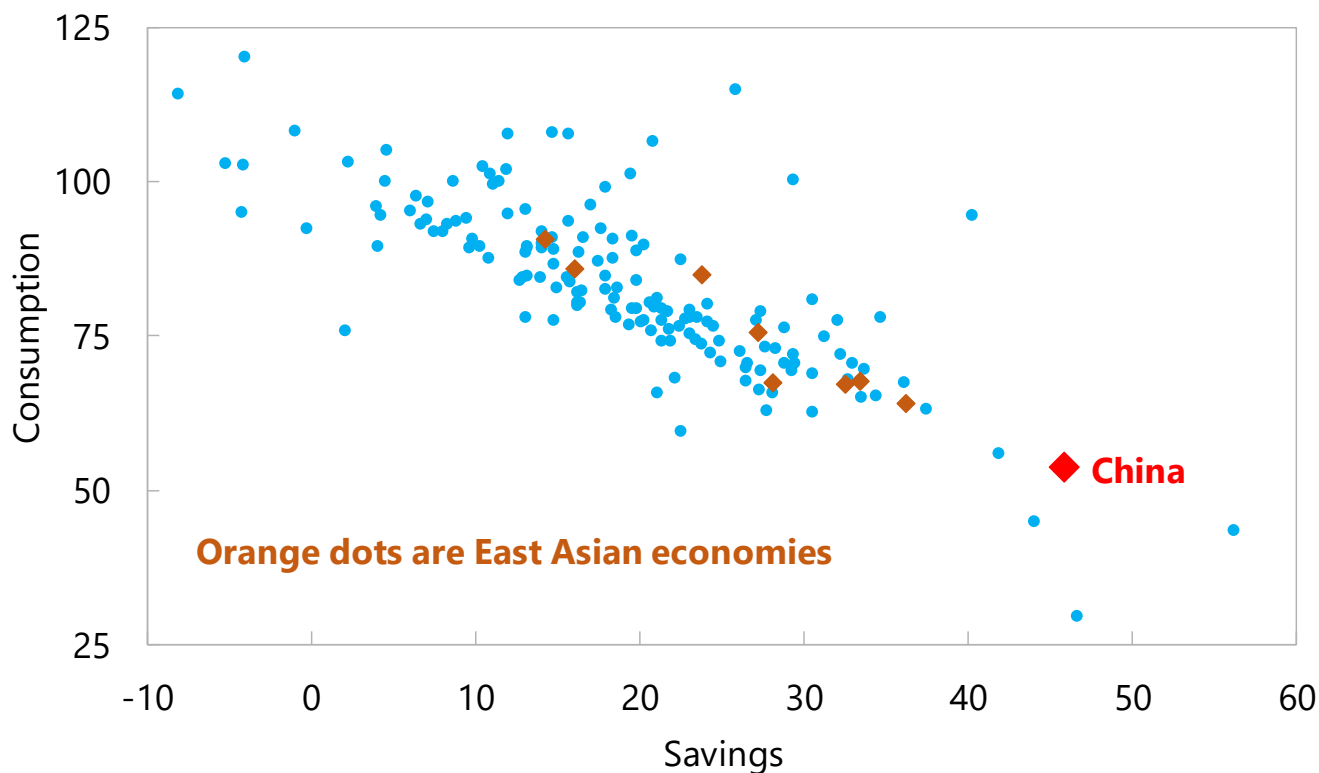
Key Issues:

1. Excessive National Savings
2. Large and Rising SOEs
3. Persistent Overcapacity Industries
4. High Corporate Debt
5. Financial Sector Complexity and Fragility
6. Reform of the Exchange Rate Framework

Structural Policy Issue 1: Much More Needed on Reducing Savings

China is Major Outlier in Savings and Consumption

(In percent of GDP, 155 countries)



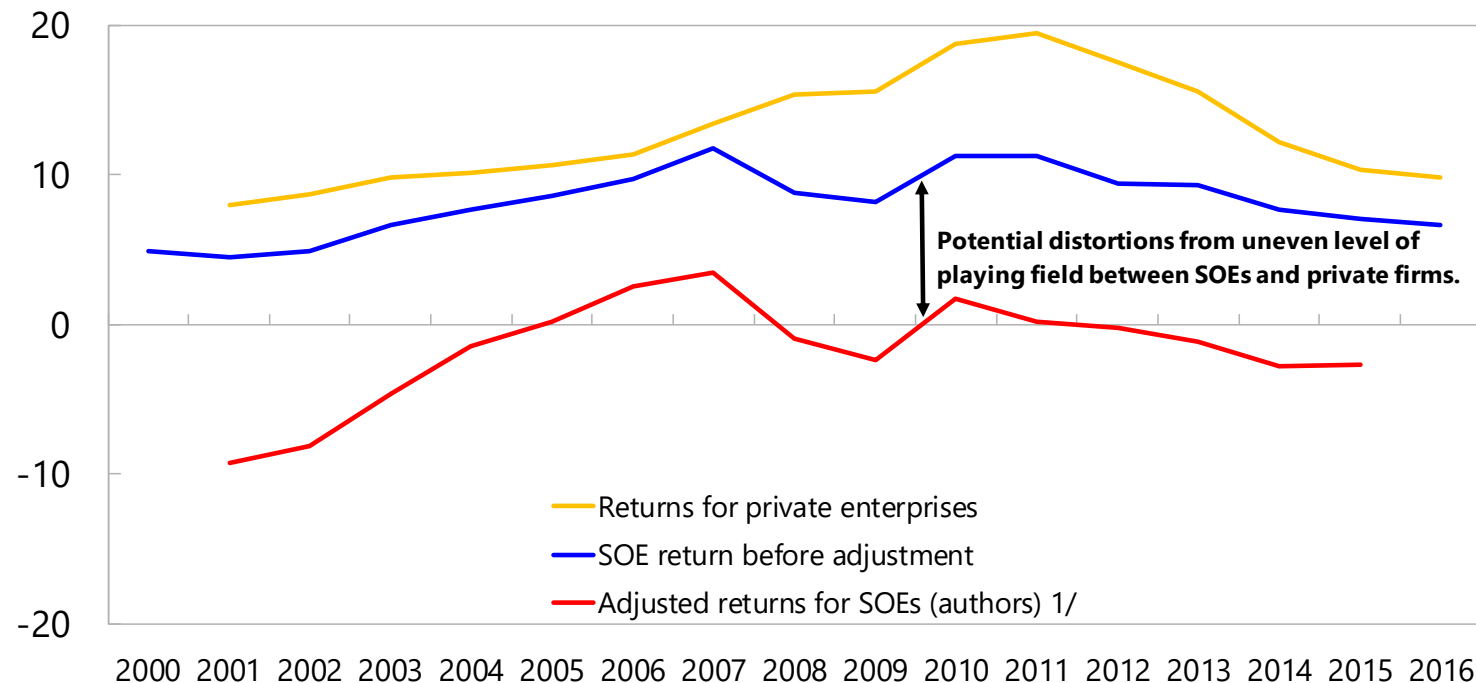
Sources: *World Economic Outlook (WEO)*; and IMF staff estimates.

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Structural Policy Issue 2: SOE Drag on the Economy Persists

Weak SOE Return on Equity

(Net return on total owners' equity; in percent)



Sources: Statistical Yearbook (2015); Unirule Institute of Economics (2015); and IMF staff estimates.

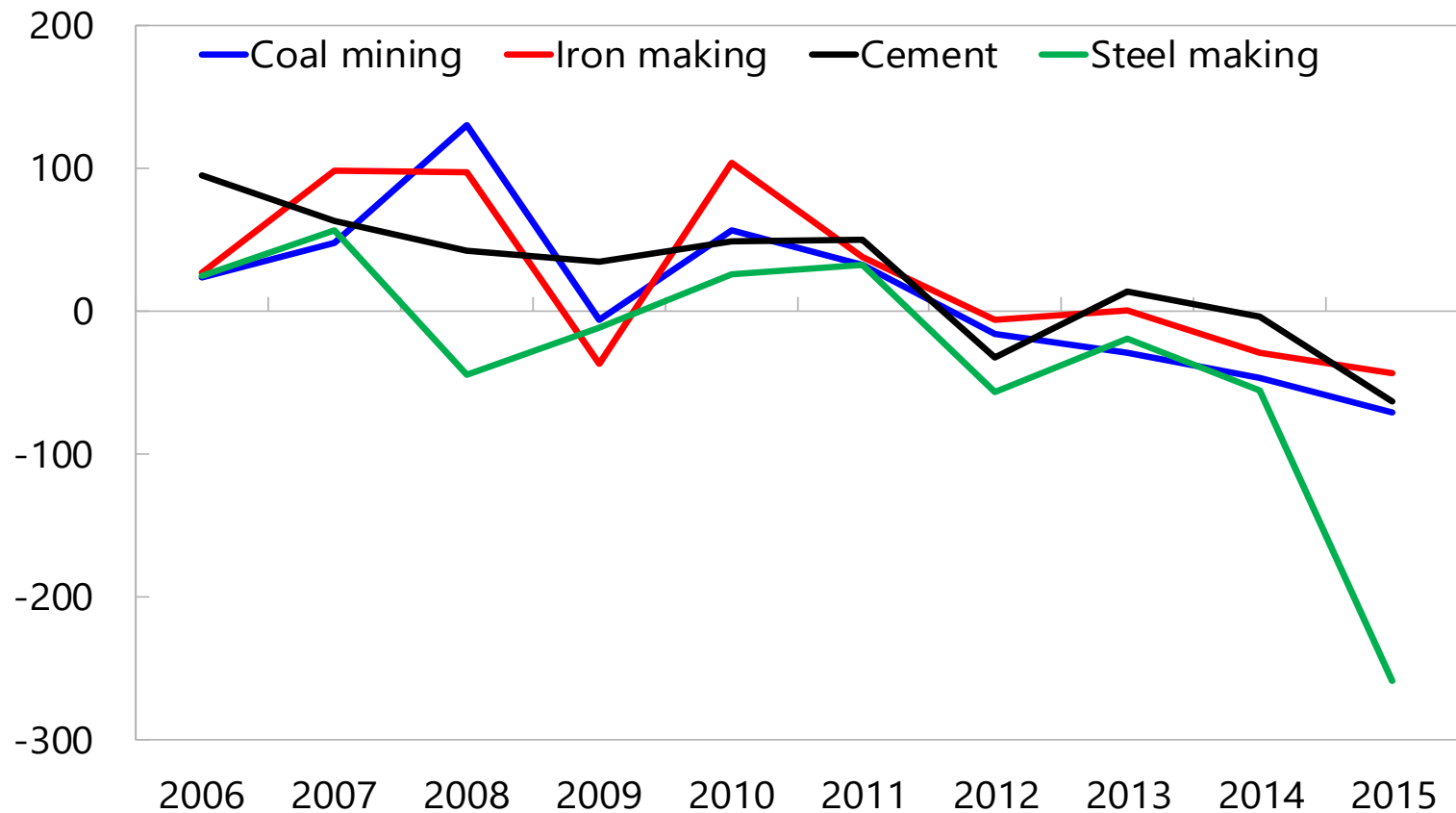
^{1/} Based on nominal profits of industrial SOEs net of fiscal subsidies, implicit support through the use of land and natural resources, and lower implicit financing cost.

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Structural Policy Issue 3: Underlying Drivers of Overcapacity

Industrial Profitability

(In percent, year-on-year growth)



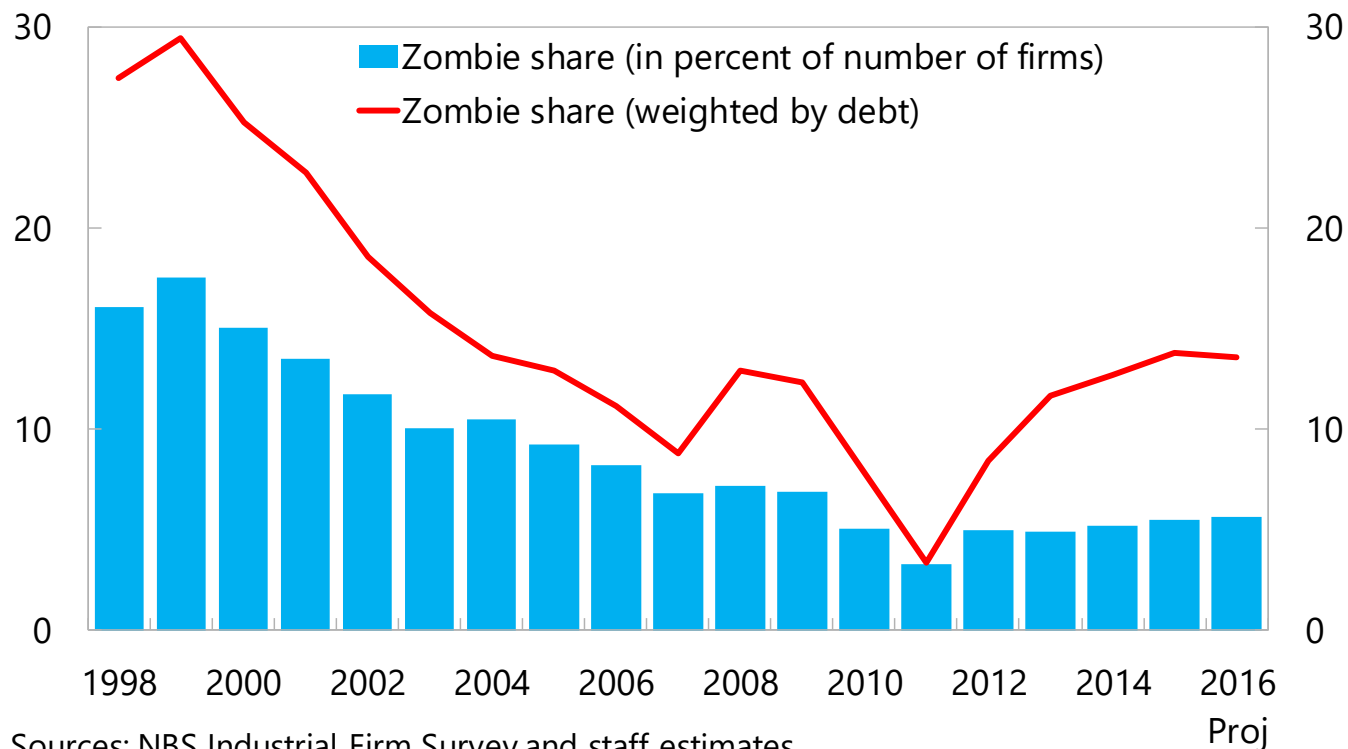
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Sources: CEIC Data Company Ltd.; and IMF staff calculations.

Structural Policy Issue 4: Directly Targeting Corporate Debt

Nonviable Zombie Firms are Rising Again 1/

(In percent of total industrial firms, weighted by number of firms and total liabilities)



Sources: NBS Industrial Firm Survey and staff estimates.

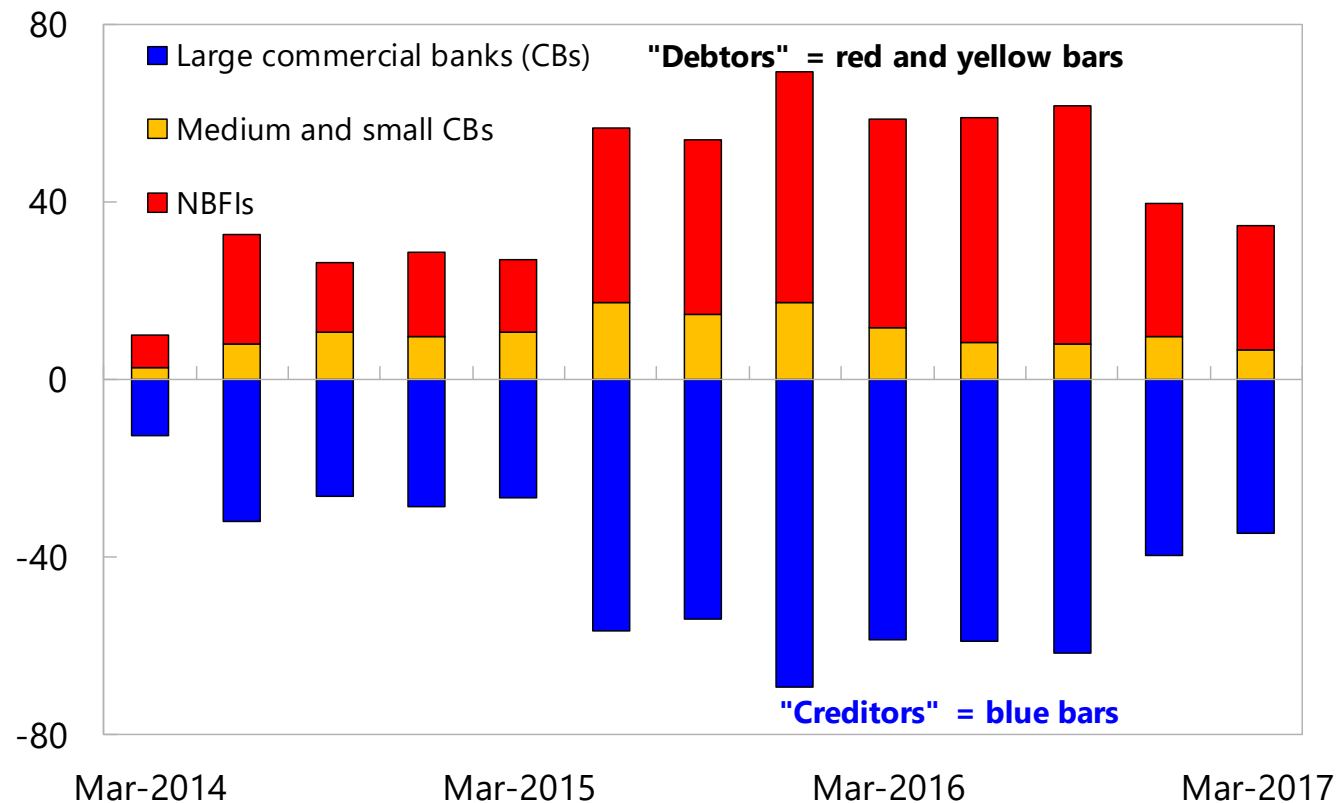
1/ Data for 2010 are missing and based on average of 2009 and 2011. Estimates are average between two definitions of zombies (State Council and Fukurama and Nakamura (2001)). Nonviable zombie firms are those whose liquidation value is greater than their value as a going concern, taking into account potential restructuring.

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Structural Policy Issue 5: Reducing Financial Sector Fragility

Large Banks Fund Small Banks, NBFIs in Wholesale Market

(In RMB trillion)



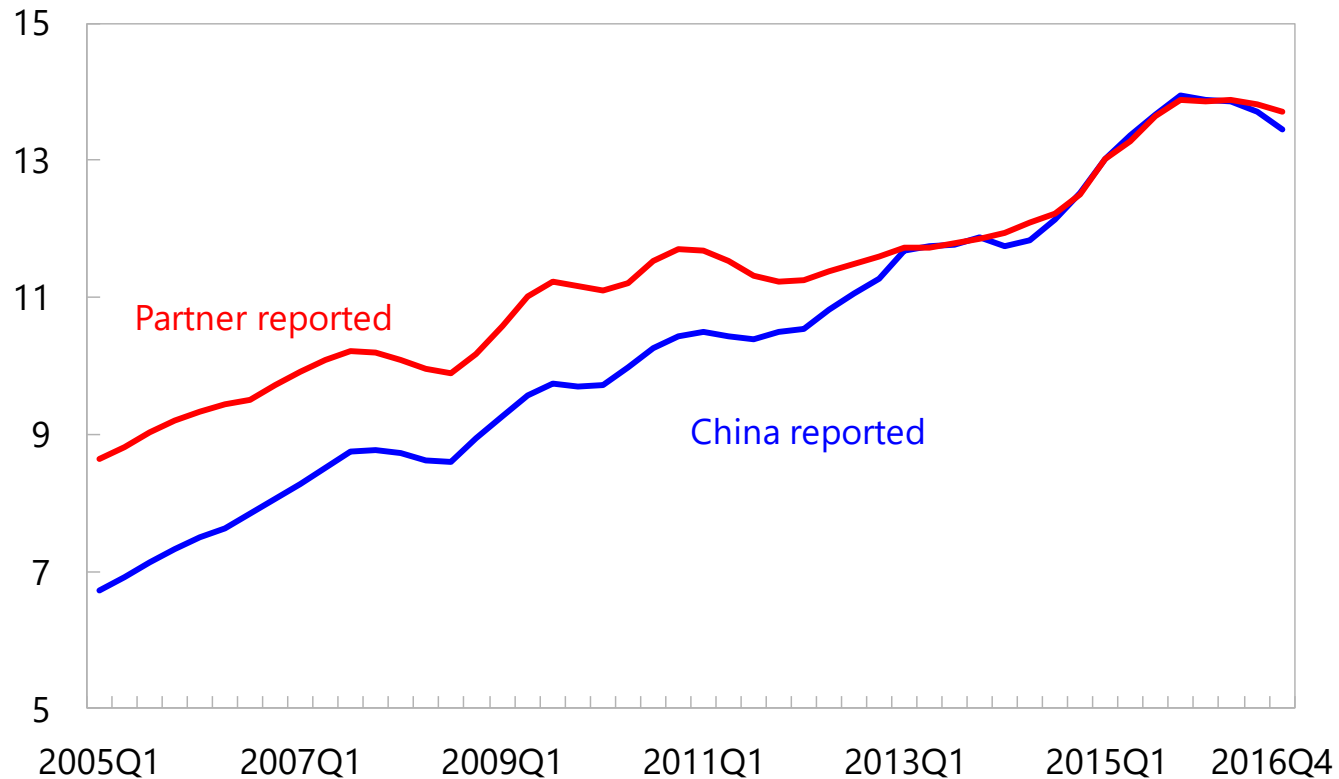
Sources: The People's Bank of China.

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Structural Policy Issue 6: Resuming Flexible Exchange Rate

Export Market Share

(In percent)



Sources: Haver Analytics; and IMF staff estimates.

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Section V. Recent developments

Stabilization of growth

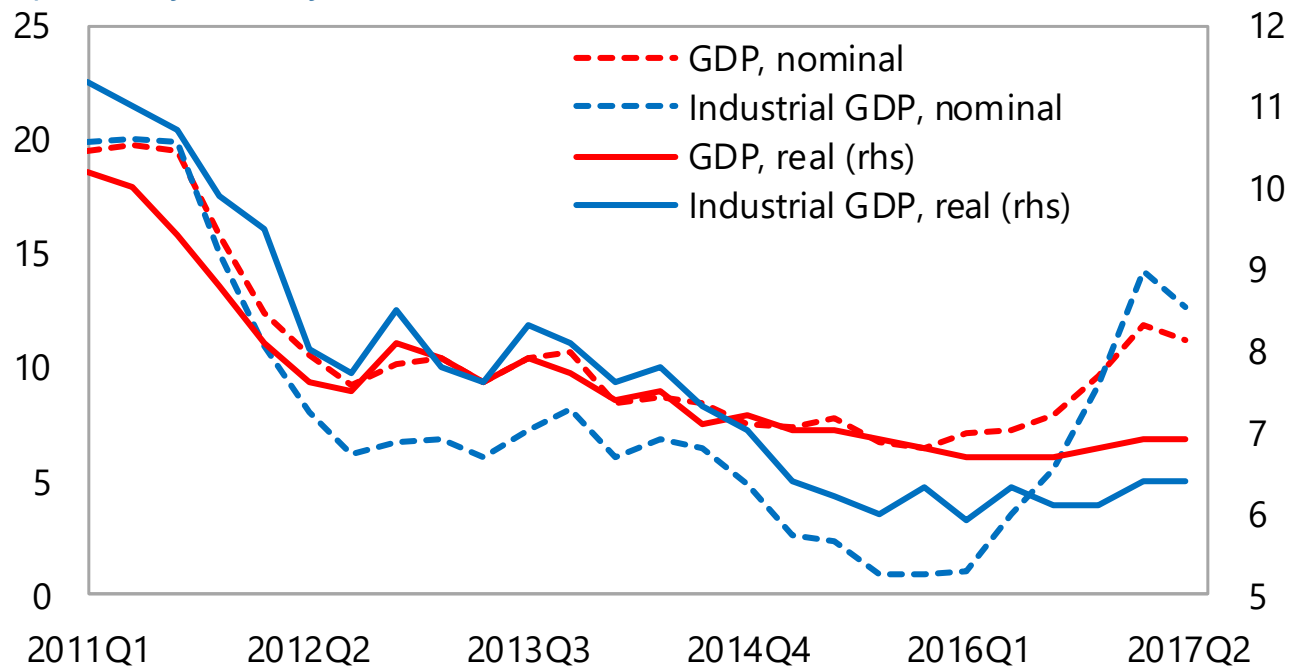
Renewed focus on
supervisory actions

Credit gap still large

China growth momentum: Has recently picked up

Real GDP

(In percent, year-on-year)



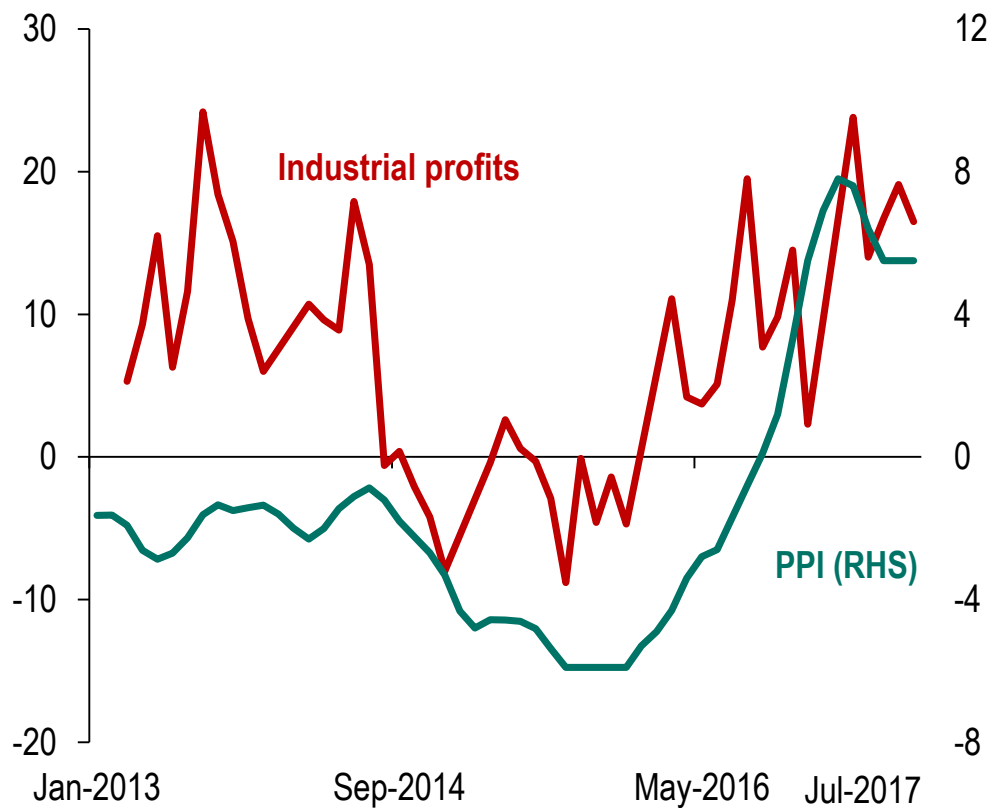
Source: Haver Analytics.

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What are the drivers of the pickup in China?

PPI Drives Recovery in Industrial Profits

(In percent, year-on-year growth)



Sources: CEIC Data Company Ltd...

Drivers

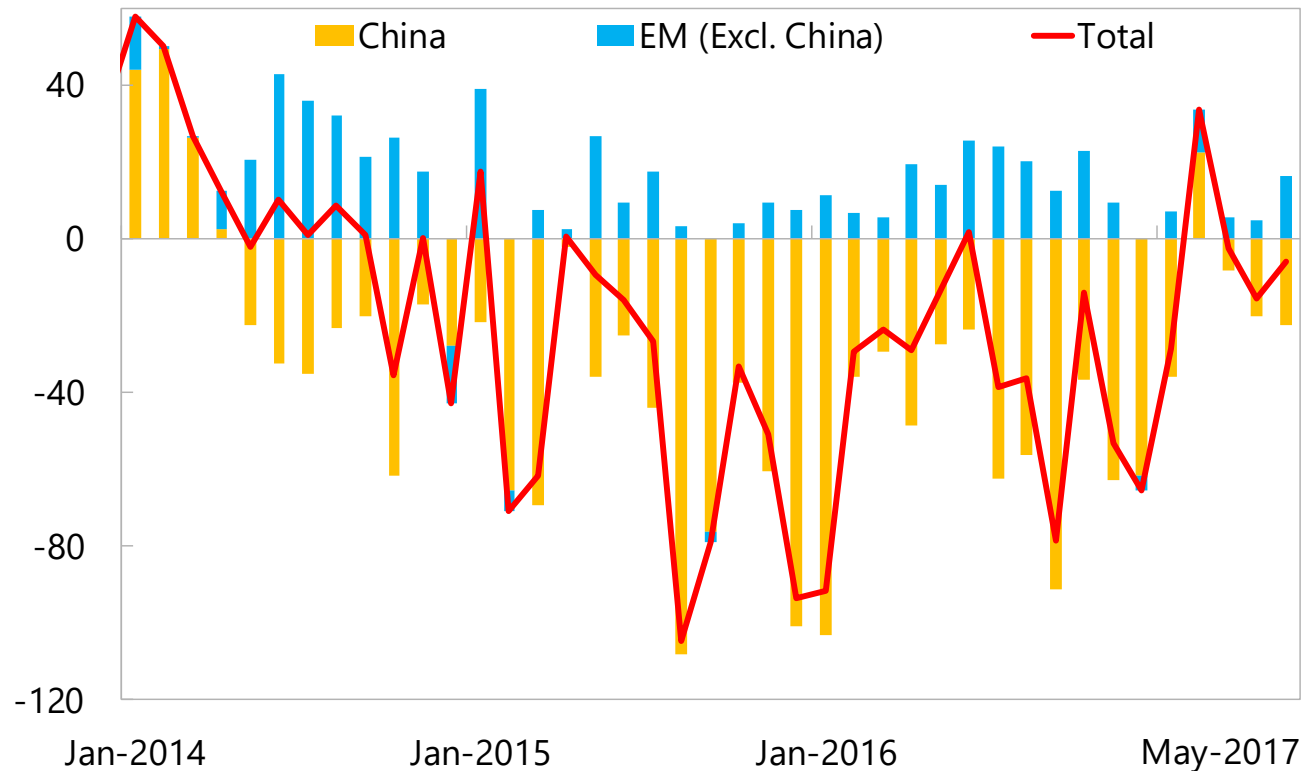
- External demand
- Real estate
- Stimulus
- Reform

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The growth pick up, and tighter capital controls: helped stabilize the capital account...

Capital Outflows Moderate Sharply

(In US\$ billion)

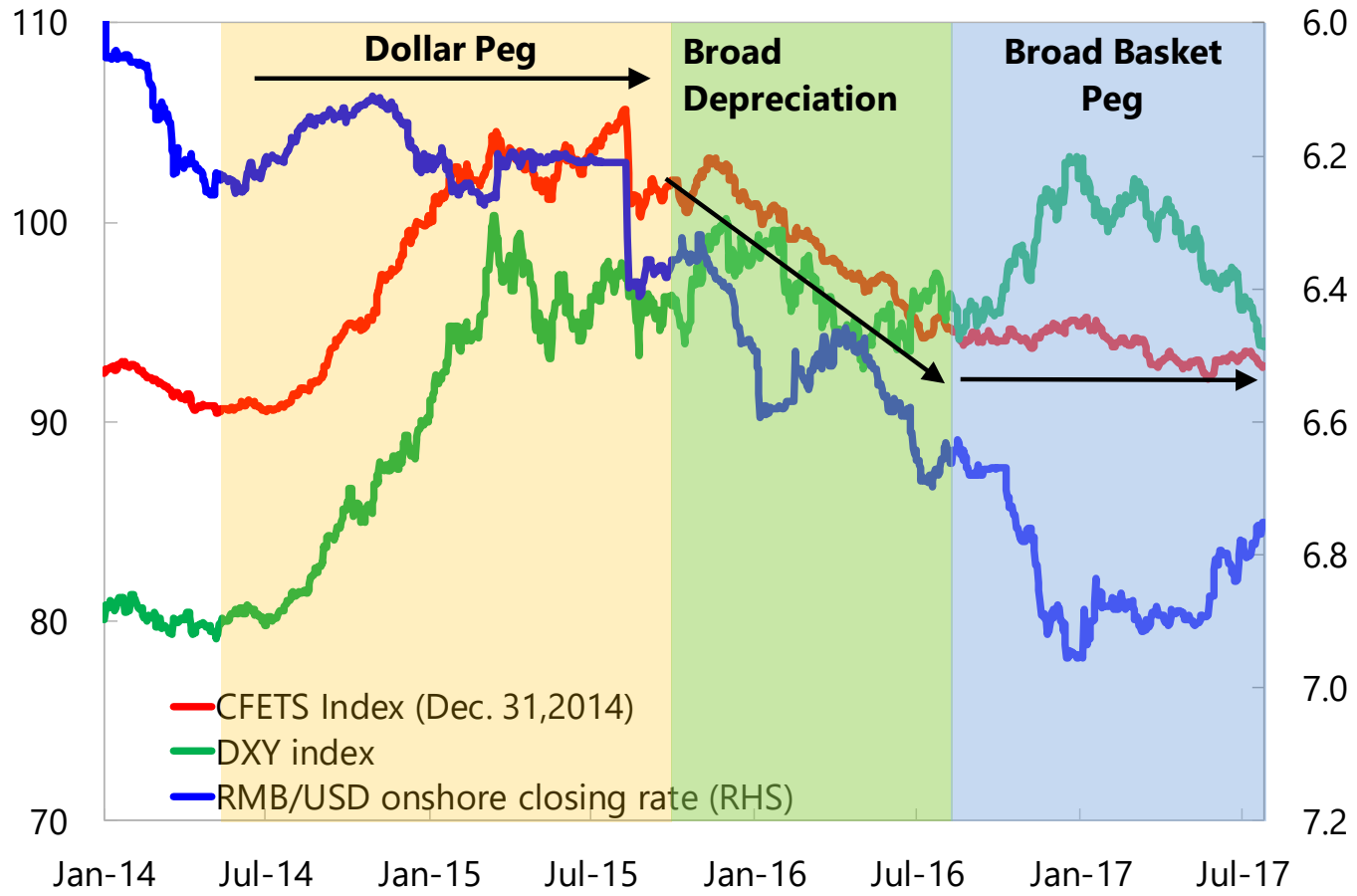


Sources: Institute of International Finance (IIF); and IMF staff estimates.

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...and the exchange rate

Daily Exchange Rate

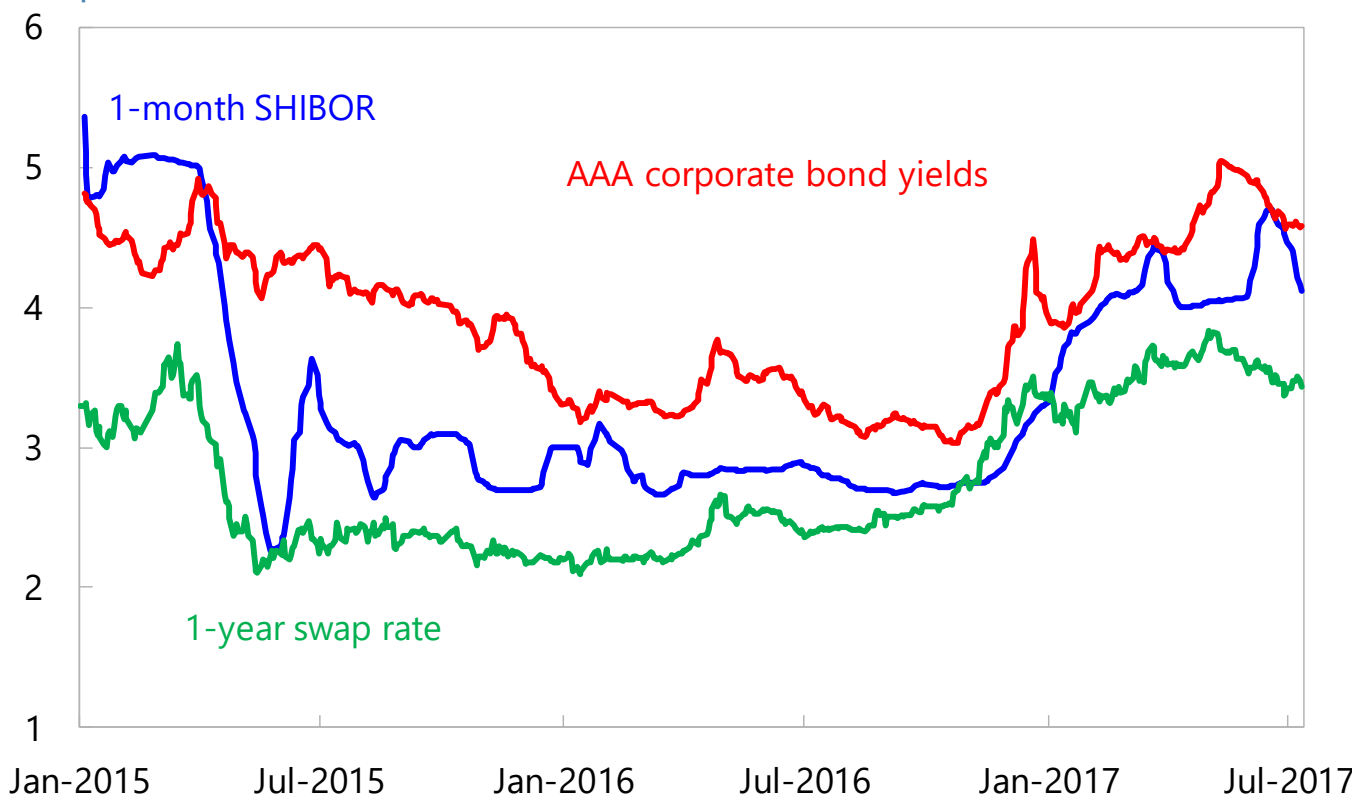


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Now, tighter supervisory actions: are tightening financial conditions...

Market Interest Rates

(In percent)



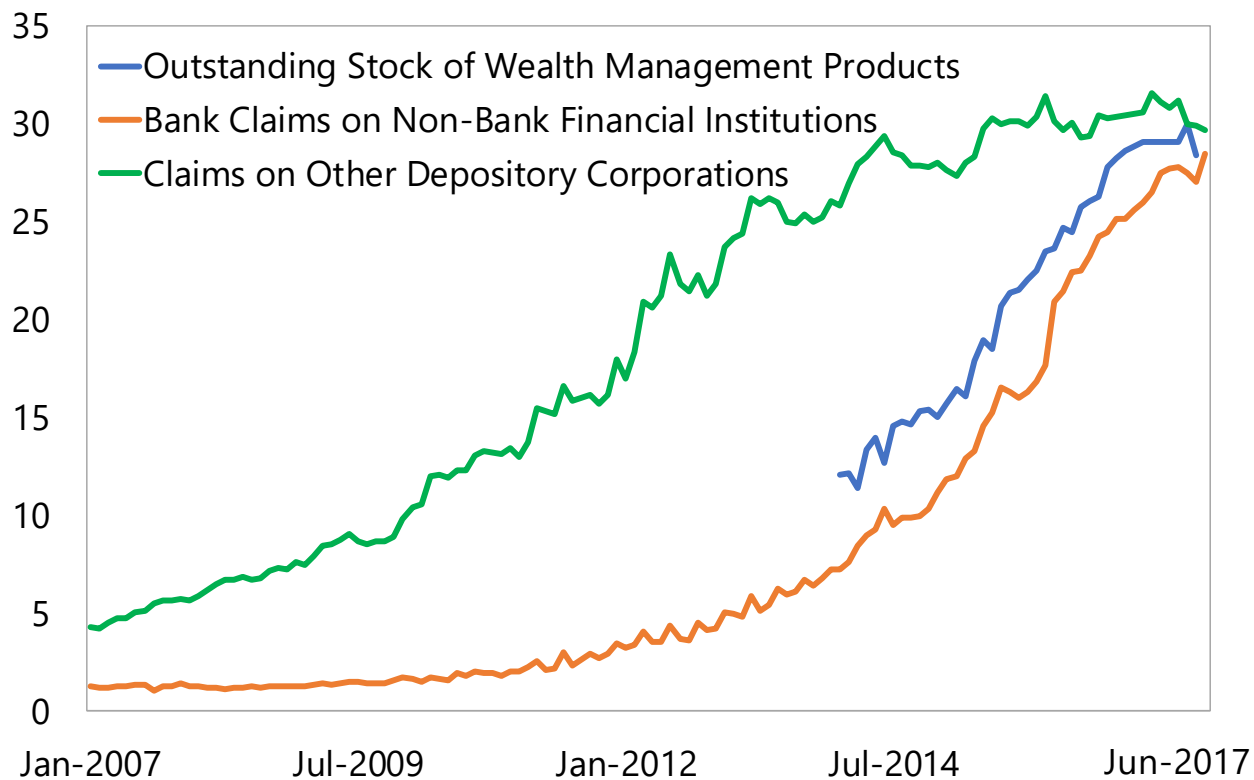
Sources: Bloomberg LP; CEIC Data Company Ltd.; and IMF staff estimates.

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...resulting in slower growth in intra-financial sector claims.

Intra-financial Sector claims

(In RMB trillions)



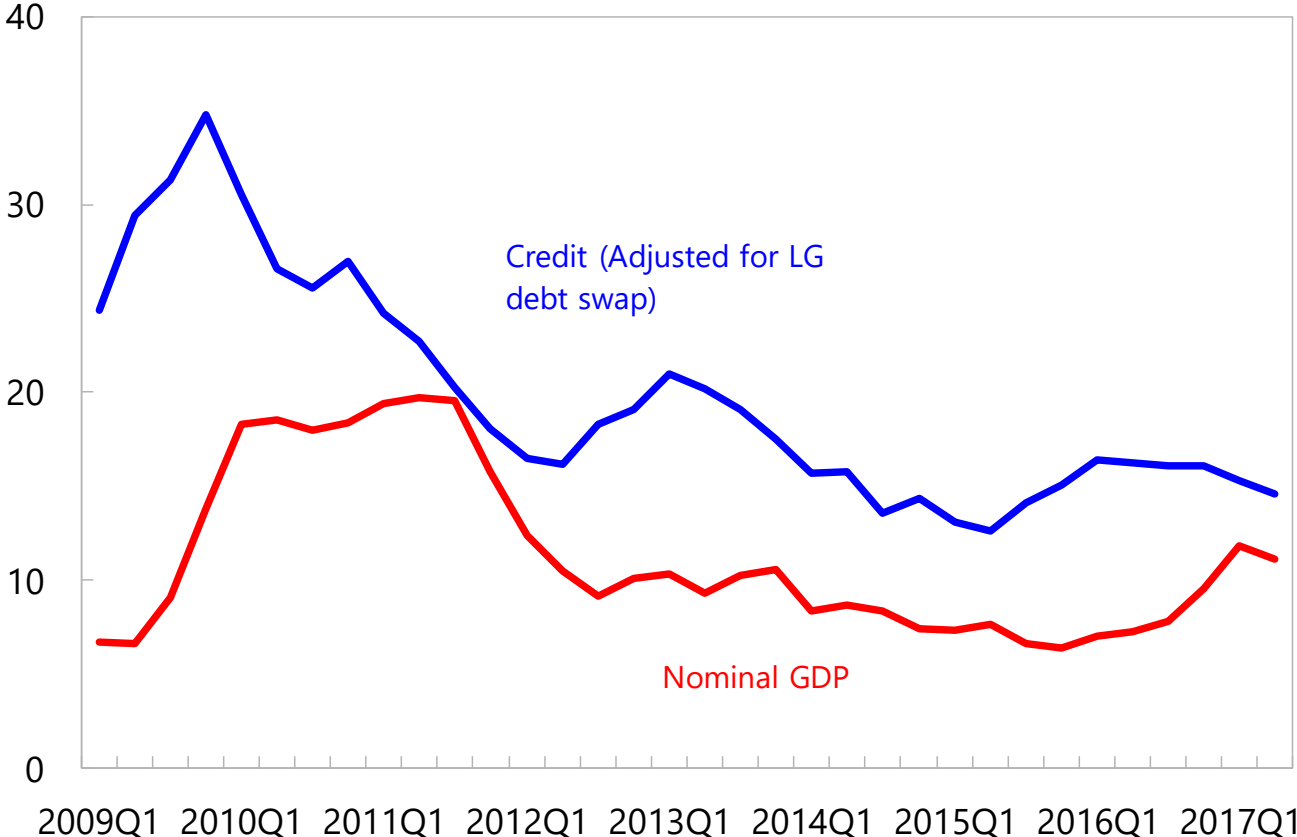
Sources: Haver Analytics.

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Credit to the real economy has also slowed marginally...

Credit

(Total Social Financing, in percent, year-on-year)

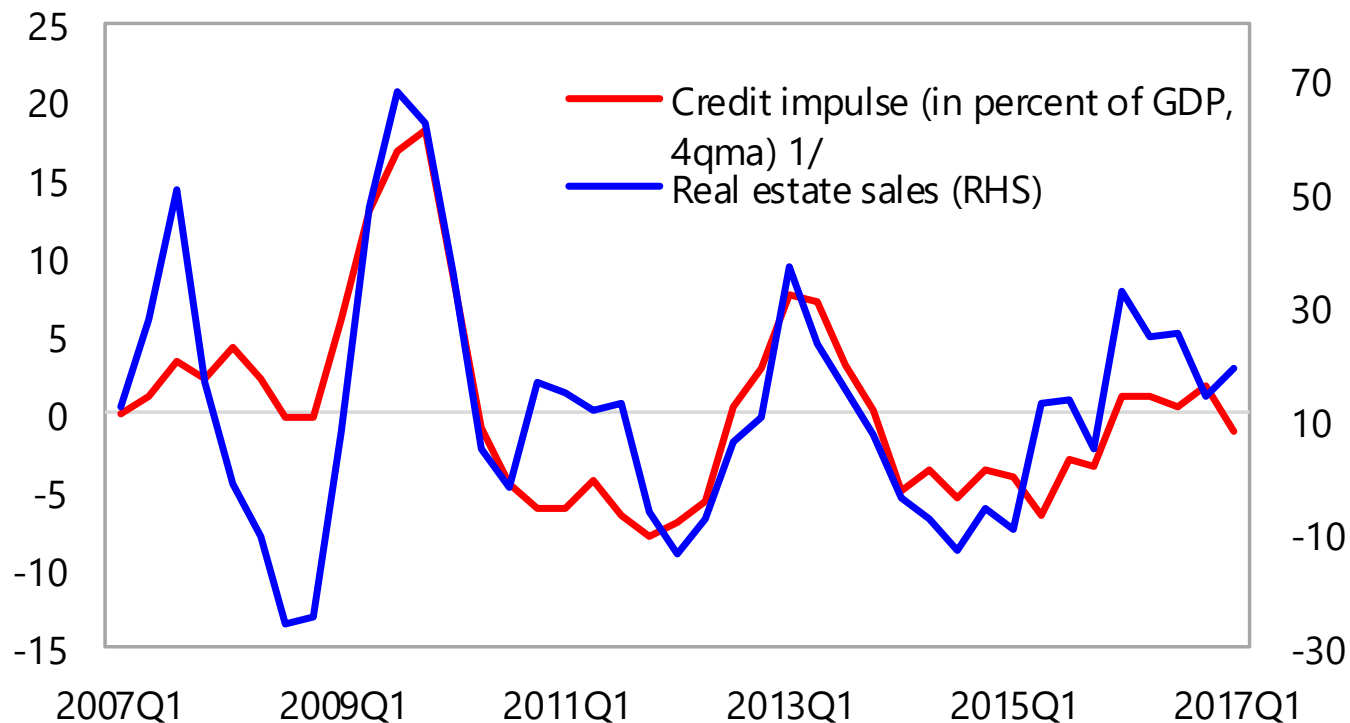


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...which is posing initial headwinds for real estate

Credit Impulse and Property Market

(In percent, year-on-year growth)



1/ Credit impulse is the change in the flow of adjusted TSF over the last four quarters relative to GDP.

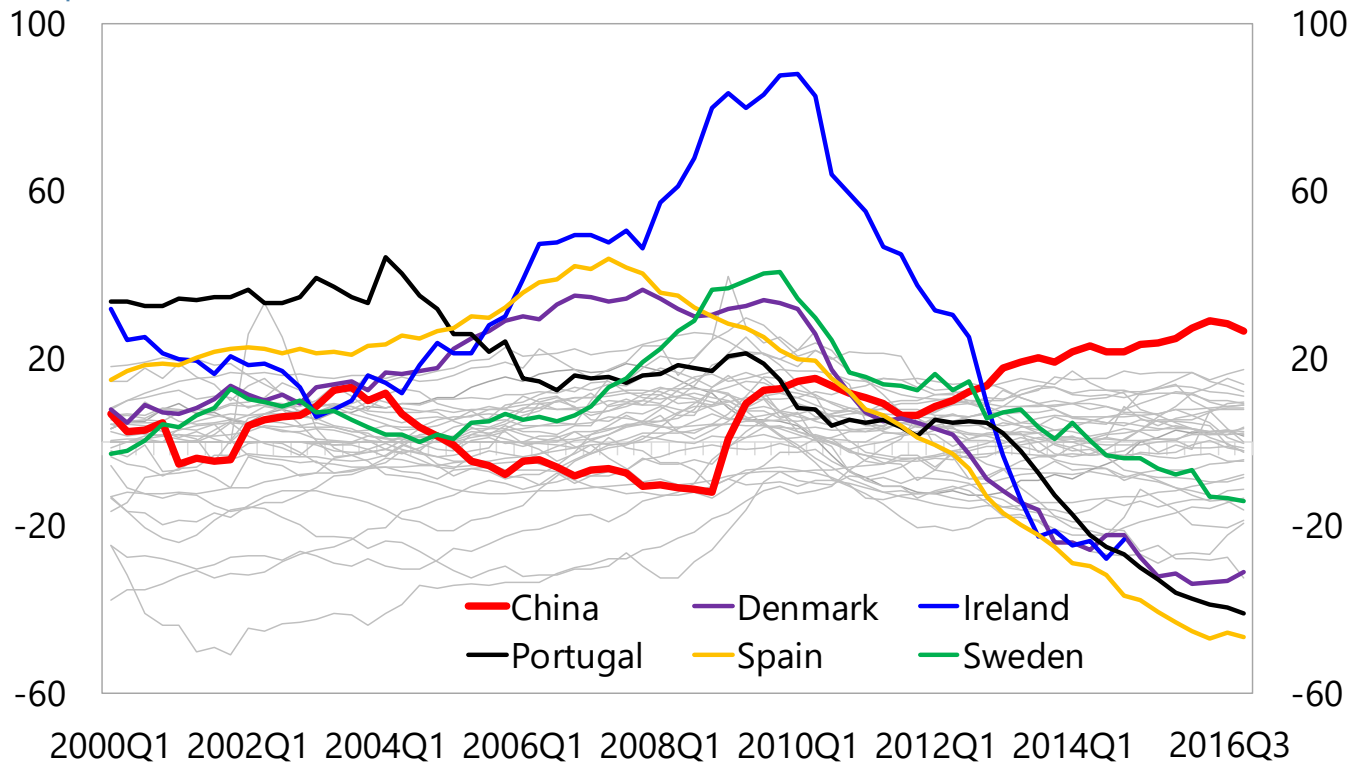
Sources: Haveranalytics and IMF staff estimates.

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Nonetheless, China's credit gap remains large

Credit Gap

(In percent of GDP)



Note: Based on credit to private non-financial sector.

Sources: Bank for International Settlements (BIS); and IMF staff estimates.

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Key Takeaways

- + **Rebalancing** underway
- + Authorities now **focused on financial stability**
 - Large stock of persistent **problems/internal imbalances/credit trends**.
- ? **Reforms** decisive & fast enough, sustained ?

Policy priorities: structural

- SOEs, banks, LG finances
- Less investment, more consumption
- New sources of growth

Outlook: policy dependent

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