



**China's Economy in Great Transition:**  
slowdown in short-term and long-term growth prospect

**大转型中的中国经济：**  
**短期增速下行与长期增长前景**

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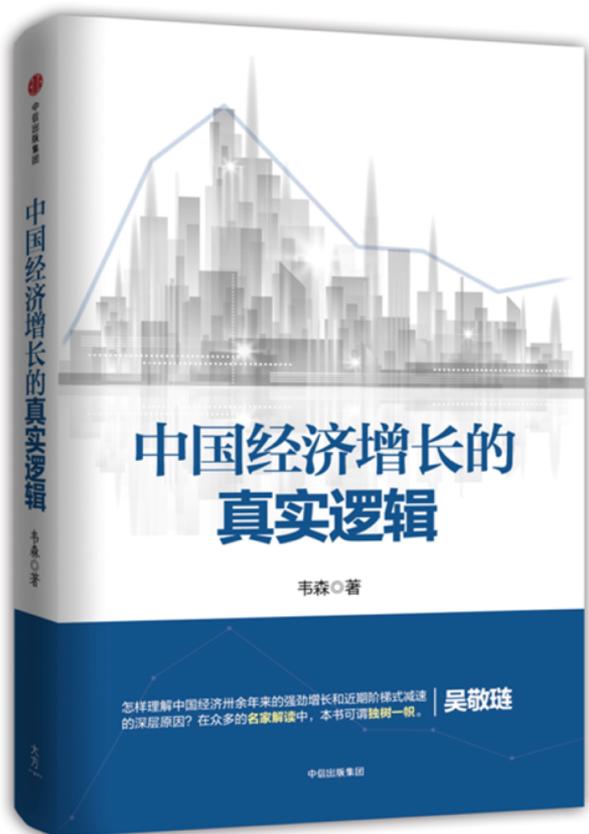
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- **2018 is the year of 40 anniversary of China's economic reform and opening-up, also is "Year of Wuxu" ("戊戌年", the other recent two were 1898 "戊戌变法" "1958 the Great Leap Forward"). Since 1978, China's Economy has been keeping a very high speed growth rate for 40 years but slowing down in recent years.**
- **Both China's economy and society are in a crossing road. What direction of China's economy and society is heading for?**



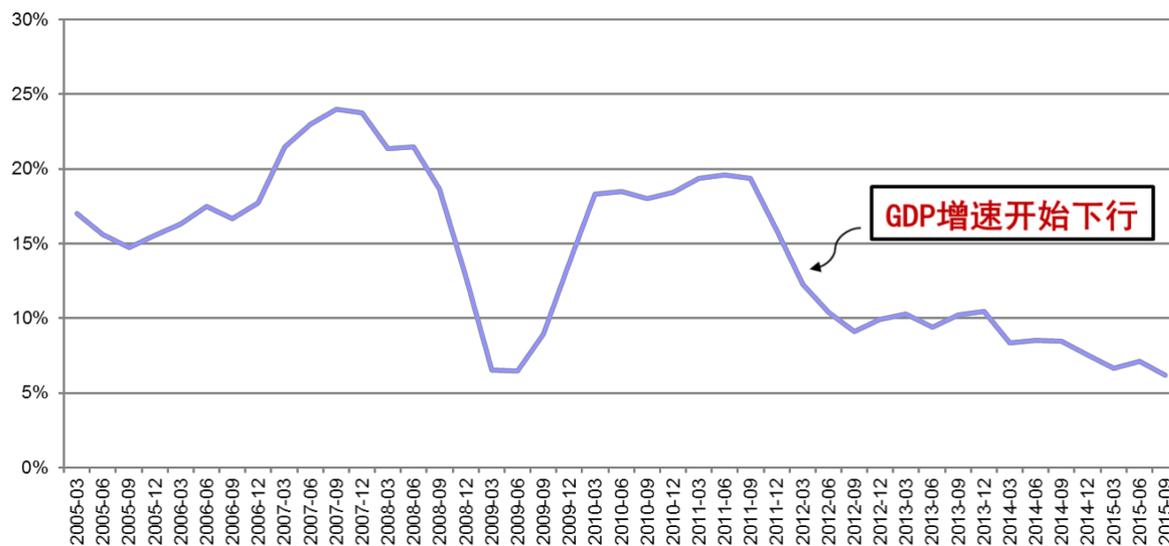
# In 2012, I wrote three articles on FT Chinese that China's economic growth was set to slow down. Why?



(1) Weisen Li: “China’s economy amid grand transformation” , 2012 -5 - 11

(2) Weisen Li: “Feel the pulse of China’s current economy” , 2012 - 8 - 4

(3) Weisen Li: “China’s economic growth clip in downward trend” , 2012 - 11- 5



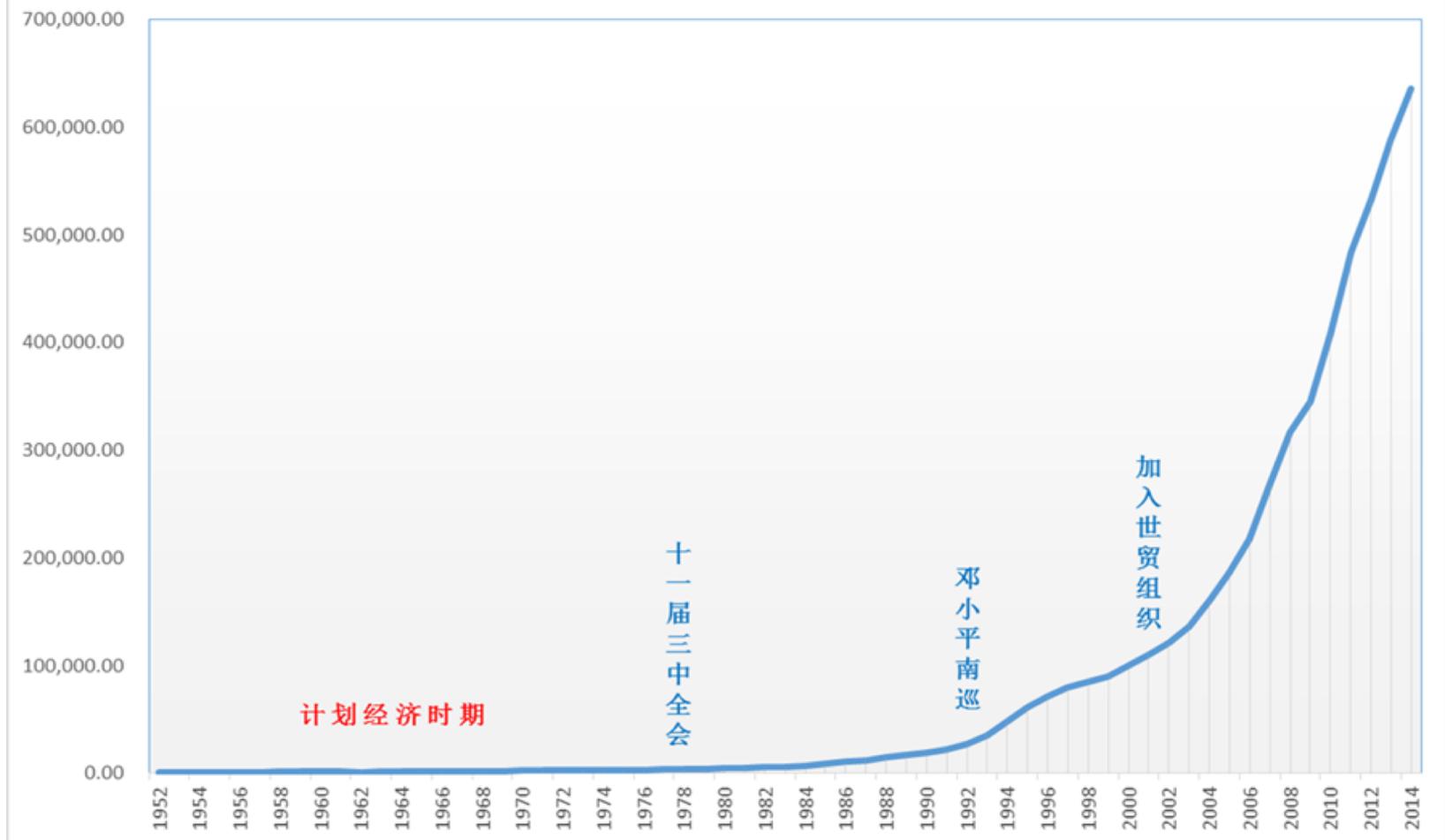
# Outline:

- (1) China's current economic situation and long-term growth prospect
- (2) Short-term overall risk for China's economy
- (3) Conclusions



1. China's current economic situation vs  
long-term growth prospect  
中国经济的当下格局与长期走势

## China's annual GDP (a hundred million)





**China's potential economic growth rate  
is gradually moving down**

## Three drivers behind GDP growth

**(1) Investment:** investment growth in various sectors in China has been declining

Investment mainly into public infrastructure but investments in property market is declining

The government started a new round of large-scale investment in public infra-structure in the second half of 2016, but source of investment funding seemed to be a problem recently

**(2) China's consumption:** growth has been declining since 2012

### **(3) Exports:** the absolute value of exports declined for two consecutive years

In 2015, China's foreign trade value dropped from US\$2.34 trillion in 2014 to US\$2.27 trillion, down US\$70 billion, or 1.8%. According to customs statistics, China's import and export value of goods in 2016 was 24.33 trillion yuan, down 0.9% from 2015. Among them, exports were 13.84 trillion yuan, down 2%, 2017 China's export rebound to 14.2% increase. But the US-China trade-war was broken out from March of 2018. Until August, China's export is still growing but there was some factors of "Rush Exporting" before USA impose high tariff before September.

## Outside factor: Global trade (volume) elasticity with respect to changes in global output has declined



Sources: IMF, CPB

# Inside factors: Chinese companies face four major challenges: Is export competitiveness declining?

- 1. Rising labor costs
- 2. Appreciation of the real value of RMB
- 3. Extremely high corporate loan rates and financing costs
- 4. Constantly rising tax levied by the government

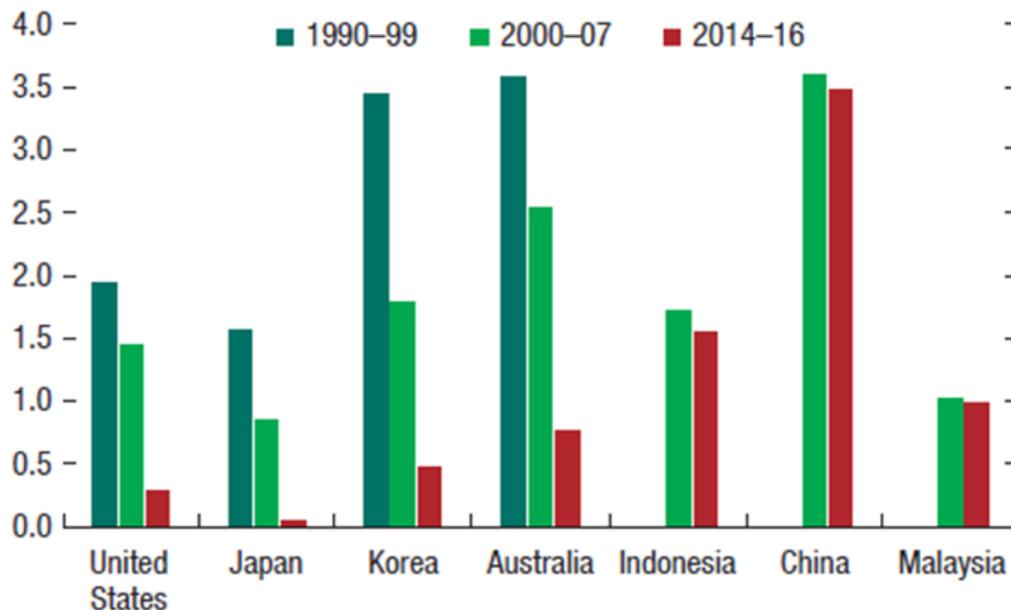
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- (1) Over the past 15 years, China's unit labor costs have been on the rise. The growth rate of the average annual wage of urban workers was of more than 13.5%.
  - (2) Although the exchange rate reform on August 11, 2015 made the RMB depreciate against the US dollar, the effective exchange rate of RMB appreciated, depreciated again after US-China trade war.
  - (3) Tax burden on Chinese enterprises tax: the turnover tax is too high! Corporate income tax is also high!

**The proportion of commercial tax against commercial profits is highest in China**

The main reason is not a high single tax or high narrow-caliber macro tax burden, but low profit margins of Chinese enterprises

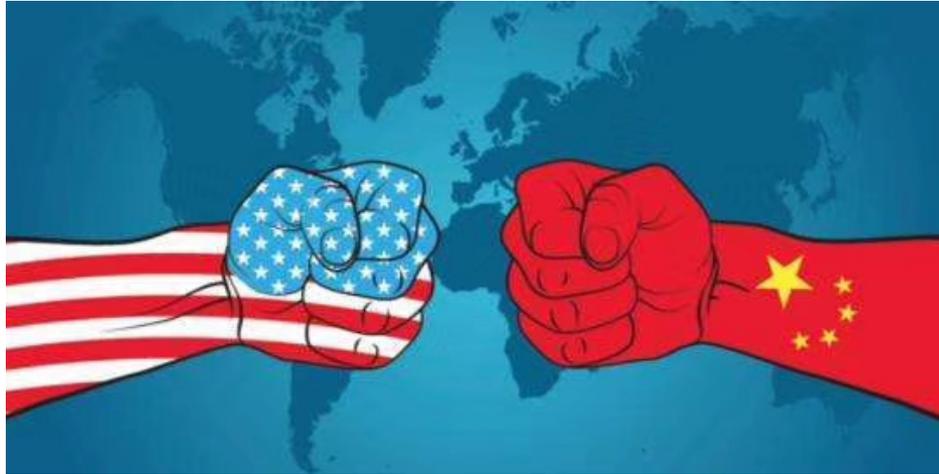
## (4) Loan rates and financing costs of Chinese enterprises are extremely high

**Figure 2.15. Selected Asia: Real Neutral Interest Rates**  
(Percentage points)



Sources: Haver Analytics; IMF, *International Financial Statistics*; and IMF staff estimates.

**In such an adverse situation of China's foreign trade  
USA's trade-war against China broke out in March**



**It is true that China's export and current account surplus and  
exporting destination mainly come from USA**

**China is mostly benefited from Globalization in the last 40  
years. China will be suffer a lot from US-China trade war**

# Potential impacts of US-China's trade war on China's economic growth:

- (1) further worsening China's exports
- (2) slowdown China's economic growth
- (3) because China takes 15.6% of world GDP and contributes 33.2% of world economic growth annually, and total GDPs of USA and China take about 40% of the world total, this trade will affect economic growth of the world greatly and may leads world economy into an recession?
- When and where USA and China come back to negotiation table?

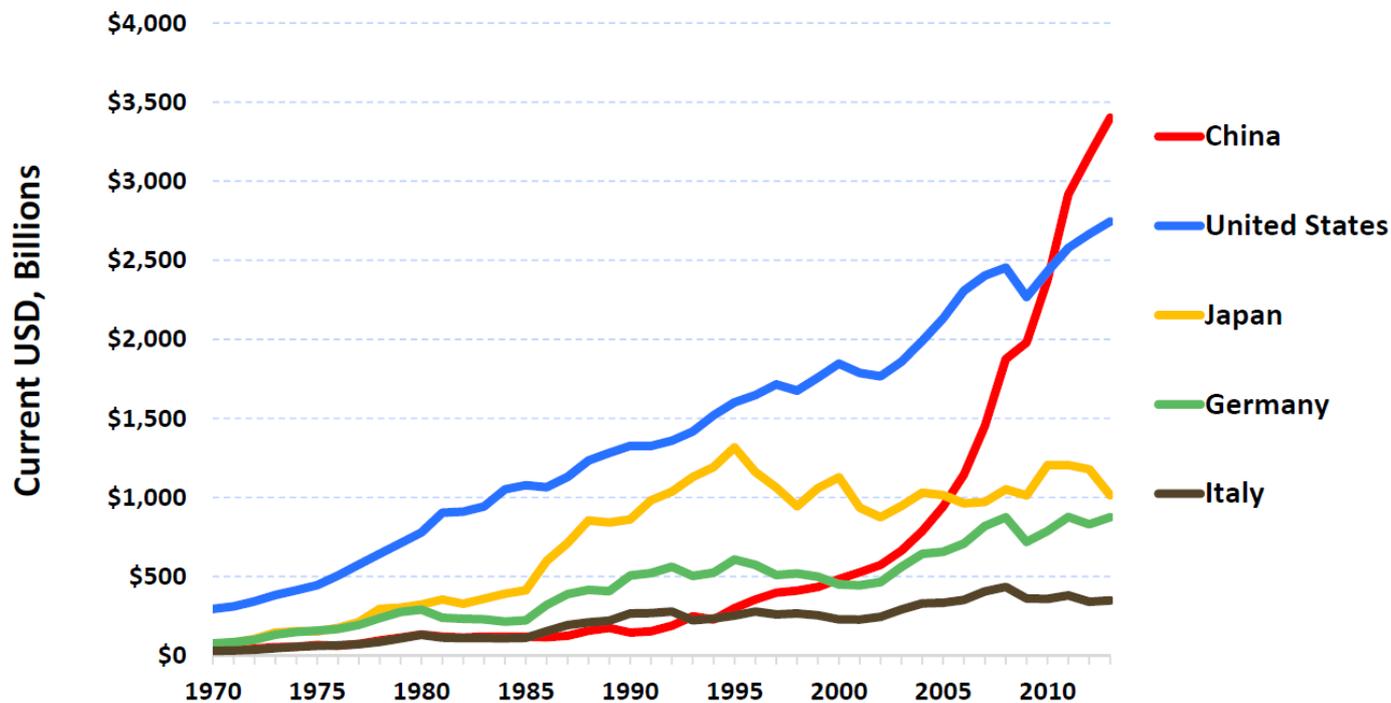
# In long time, will China's economic growth continue to rely on urbanization in the future?



- China's economy has entered **the middle-to-late stages of industrialization**. We don't expect to produce more steel, coal, oil, grain, and vehicles, and build more buildings, highways, and use more steel and cement to boost China's future economic growth. China's domestic and global resources and markets are not sufficient to keep pace with the rapid expansion of the Chinese entities!
- **Urbanization?**

# Has China entered the middle-to-late stage of industrialization during this round of technological revolution?

## Manufacturing output Top 5 Countries (1970-2013)

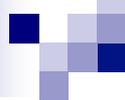


Source: United Nations



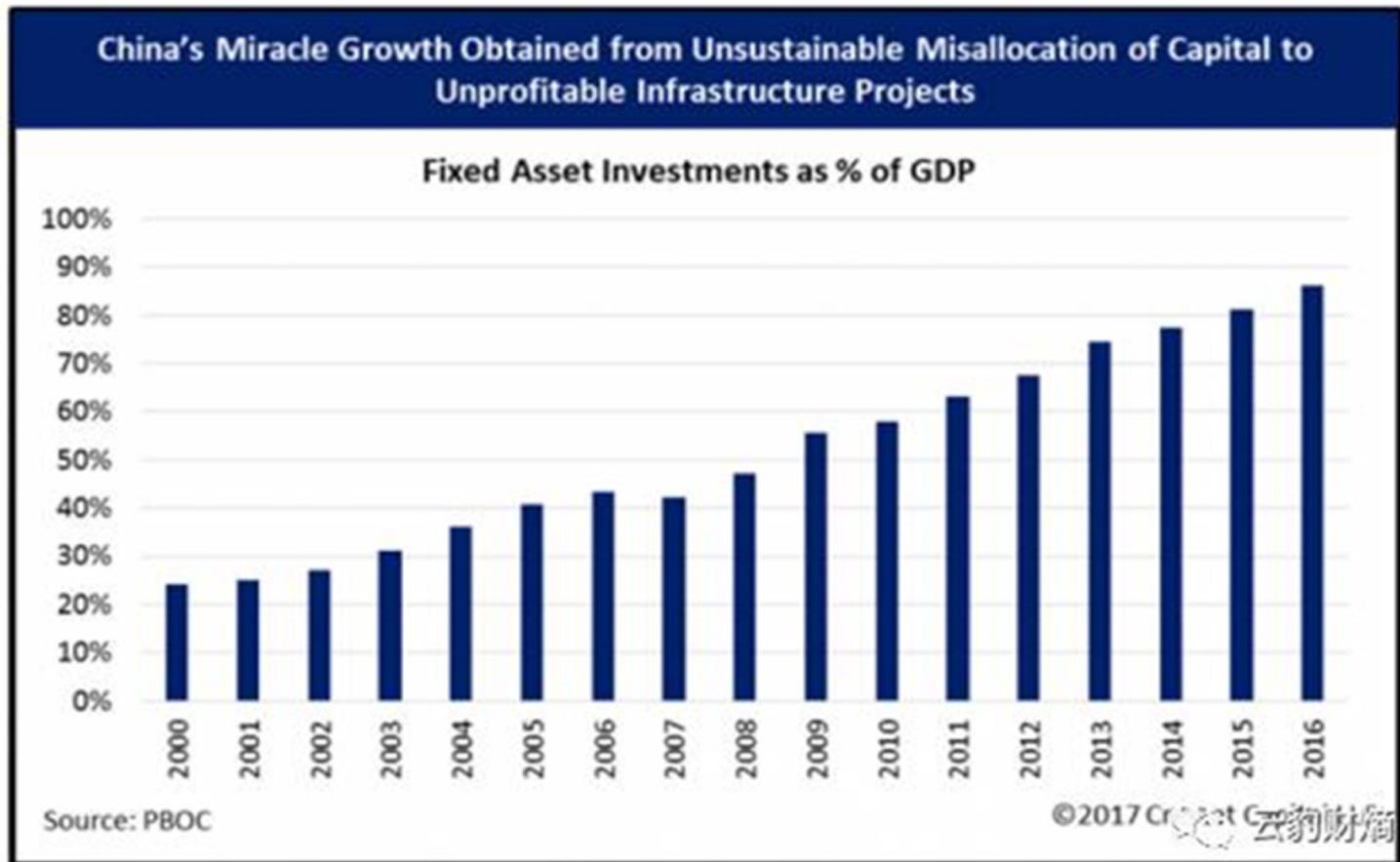
**After 4 years de-capacity, China's total output of steel, cement, glasses, aluminum and ship-building steel still take 50% of world total.  
over 300 products of China are No. 1 in the world**

**After Completion of Industrialization, growth rate of GDP in Japan, South Korea, Taiwan and Hong Kong all have a few L shape down steps**

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- **Continue to rely on increasing investment to bolster China's economy?**  
**China's investment rate is high: In 2015 China's total investment (excluding rural households) was 55.19 trillion yuan, accounting for 81.5% of GDP!!! In 2016 total investment was expected to be more than 60 trillion yuan. In 2017 it is expected to be as high as 67 trillion yuan. Infrastructure investment alone is expected to be more than 16 trillion yuan.**

**Realized value of China's total social fixed-assets investment:**  
**Will investment continue to increase, leverage to grow and risks to accumulate until the liquidation period comes?**  
**From 2012 to 2017, fixed assets investments takes 318 trillions**

**China's realized total social fixed assets investment has already accounted for 87% of GDP. Will there be any room for an additional increase?**



**From the global trend of TFP change, recovery from this crisis is more difficulty than ever before**

**China's investment in fixed assets becomes more and more inefficient, which is also reflected in the increasing disparity between growth of bank loan and GDP growth rate**

**China's ICOR is declining:**

**China's capital-output ratio is increasing.**

**ICOR reached above 6 times since 2015**

**Persistence of the productivity slowdown in the aftermath of the global financial crisis**

**Despite the increasing size of China's investment, its contribution to GDP growth continues declining, indicating that the return on investment is getting lower and lower**

**China's TFP is declining since 2012**



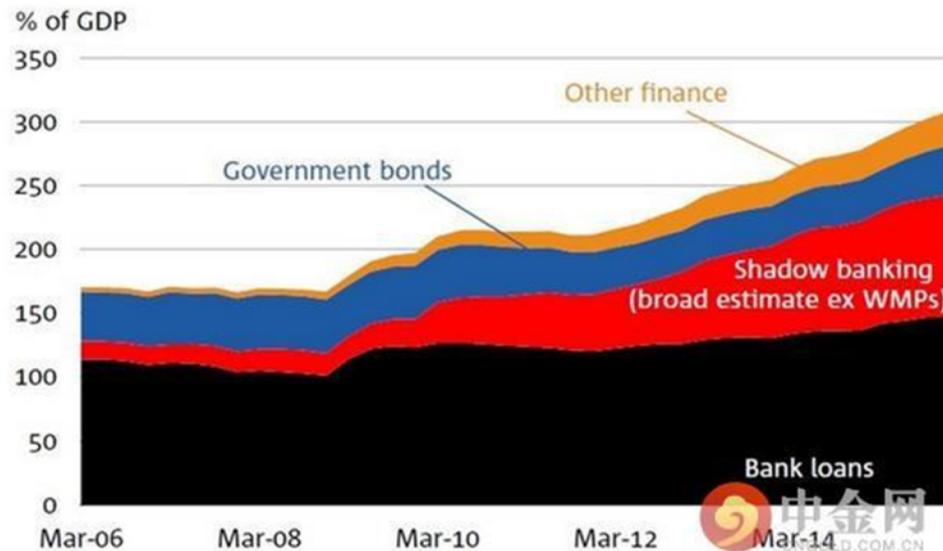
(2) Short-term overall risk for China's economy

**Accelerating leverage of China:**  
change of debt structure since 2007

Corporate debts account for the majority  
part of debts in China

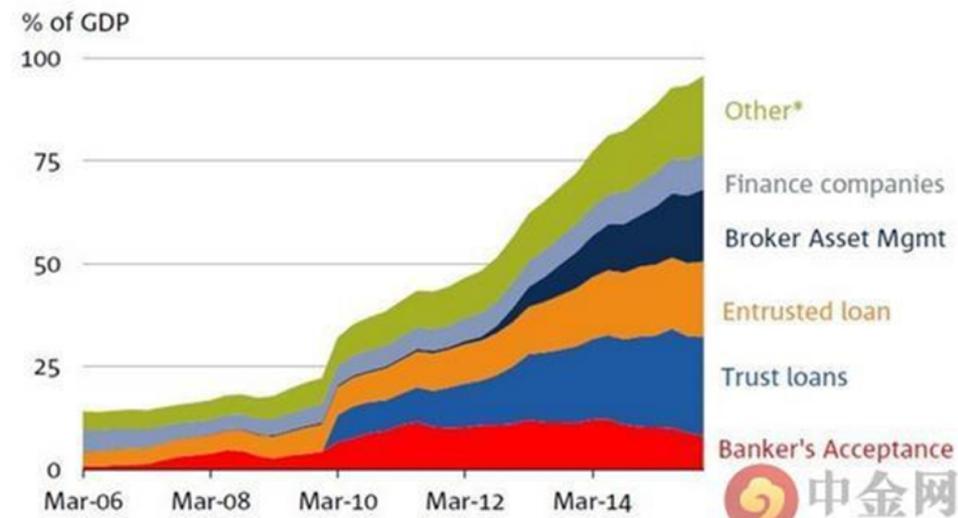
# China's debt structure

Our broad measure provides a much larger total for China's debt – at over 300% of GDP



Sources: CEIC, NAB Economics

Shadow banking has been the key contributor to China's debt growth over recent years



\* Other includes: lease finance, guarantee companies, microfinance, pawn shops and underground  
Source: CEIC, NAB Economics



**According to the data of a monthly report on the website of the Ministry of Finance on October 22, 2015, as of September 30, the total debt of Chinese state-owned enterprises had reached 77.7 trillion yuan.**



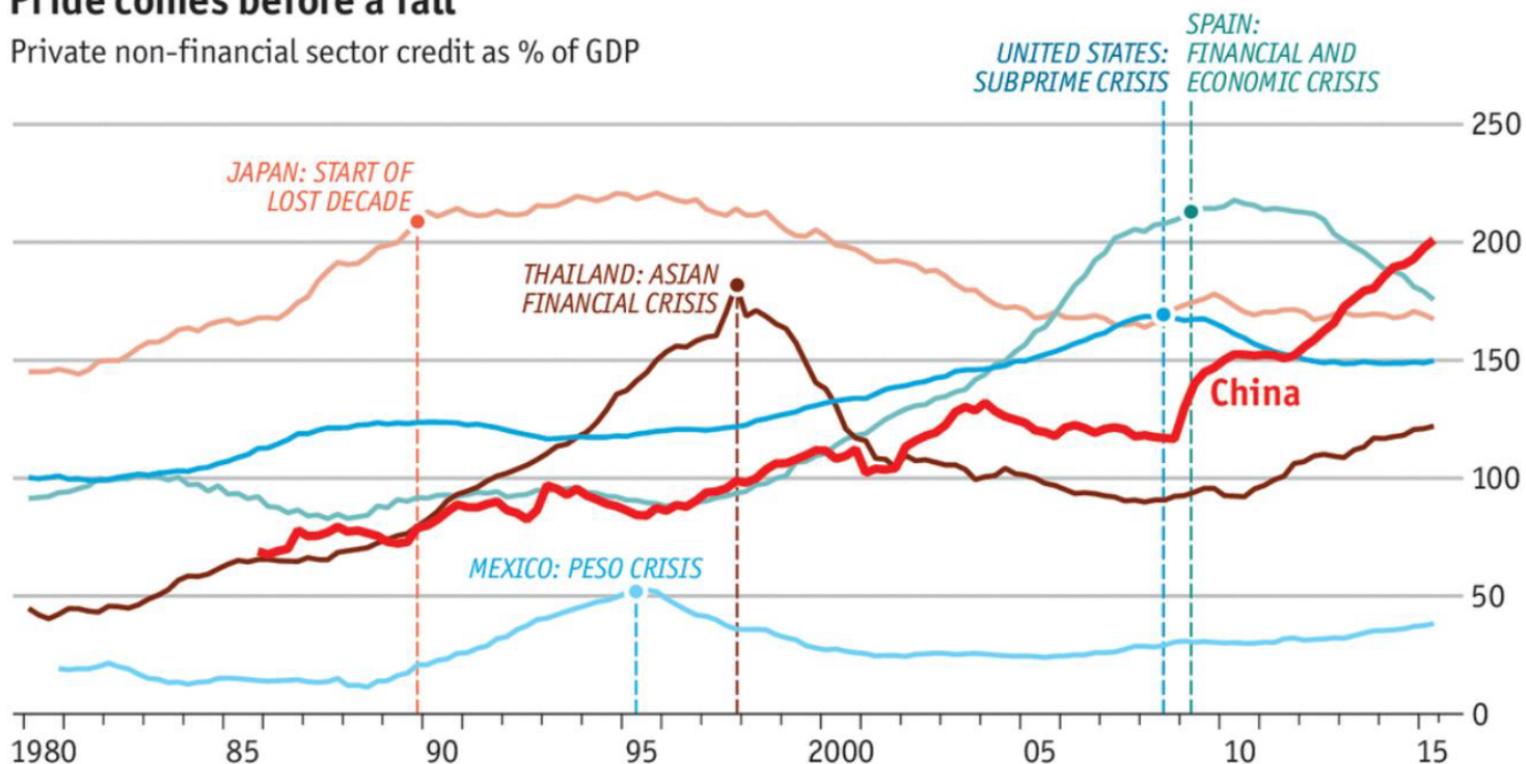
# What does re-leveraging mean to China's long-term economic growth?

Since 2012, China's bank loan interest has been greater than  
nominal GDP growth

# Private non-financial sector debt and financial crisis: Global experience and China situation

## Pride comes before a fall

Private non-financial sector credit as % of GDP



Source: BIS

# No Big Financial Risk in Short time?

## Three Safeguards for the Chinese Economy

- 1, **Saving** is still in excess of **Investment** (178 trillions all kind of banks saving deposits + surplus of current accounts ).
- 2, A substantial foreign reserve of about 3 trillions USD currently.
- 3, **The Required Reserve Ratio on Deposit** is still at a high rate of 15%, holding about 22 trillions Yuan in the PBC for commercial banks. On 30th June, 2018, the new “**The Deposit Insurance Act**” was promulgated by the State Council of China. Digital Money Era,
- 4, due to the money of accounts in the Banks, people cannot withdraw case from the Bank in the era of digital money.



## 3. Two Simple conclusions

- (1) The marginal return of capital generally declines. China's macroeconomic downturn is an inevitable trend. All of us should get prepared for it. We should not expect China's economic growth to stage a V-type or U-type rebound. In the next few years (including year 2017 ), China's economic growth may continue to slow down.
- (2) There may already be a huge “credit bubble” in China's economy. As the marginal return (or average profit margin) of capital drops in all industries, we should be alert to the risks in China’ s banking and financial sectors. The top priority of the government's macroeconomic policy is not to keep growth pace, but to prevent financial risks.
- (3) Broke-out of China’s trade war will affect China’s exports and economic growth hugely.
- (4) The most priority for China is deepening economic market – oriented reform and establish market economy with the rule of law.



**Thank you!**