



北京大学国家发展研究院
National School of Development

CHINESE ECONOMY

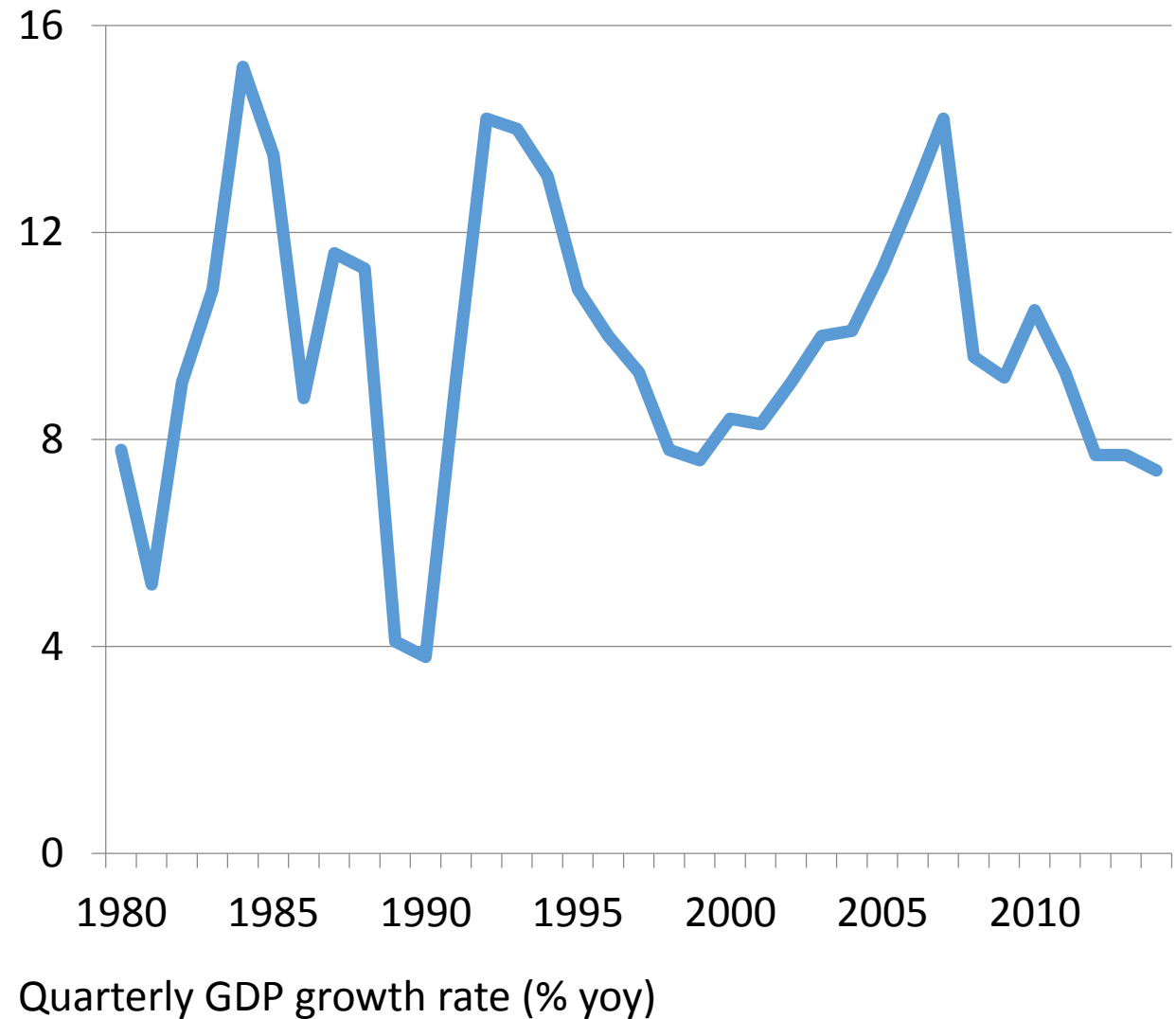
Transition Toward the New Normal

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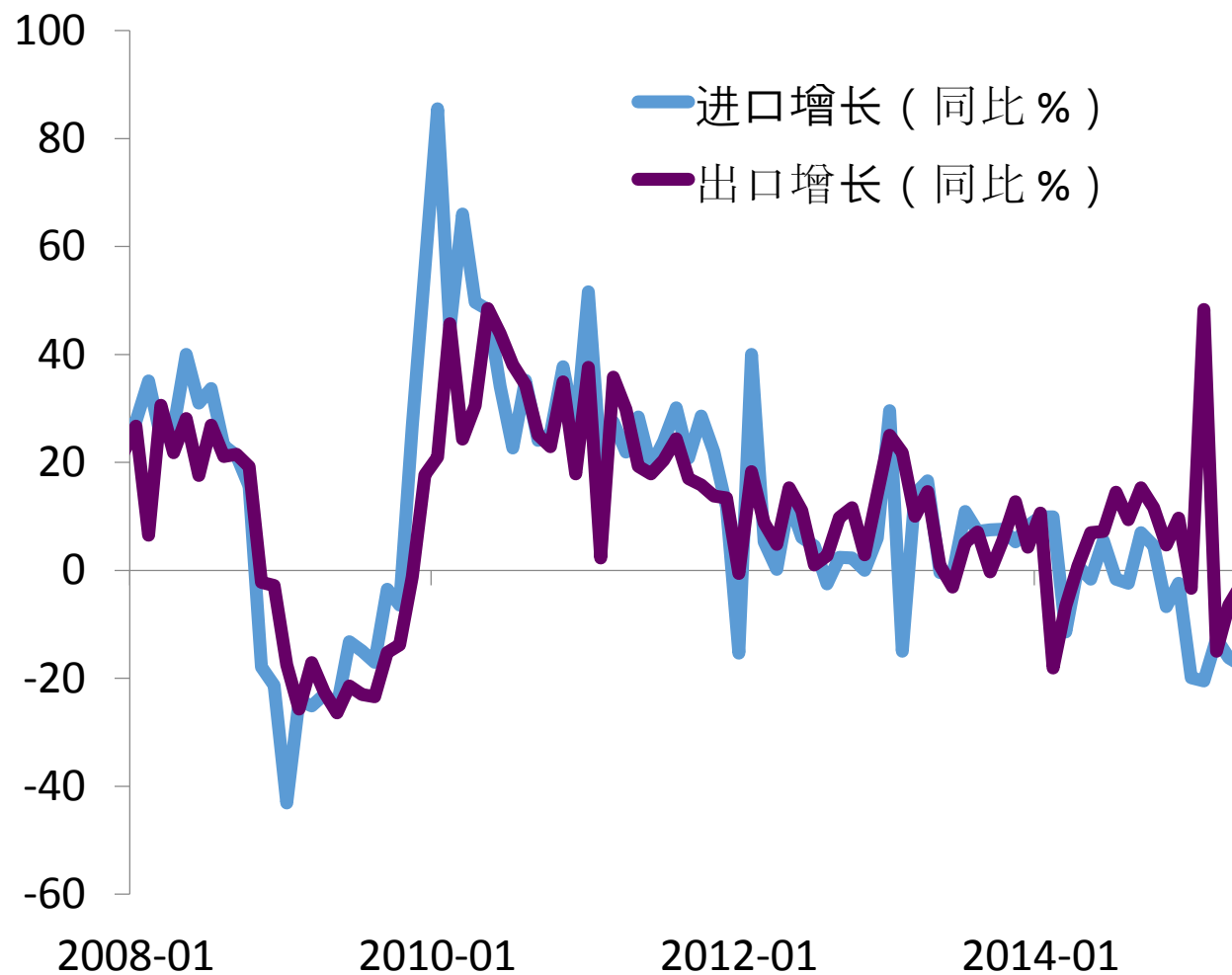
Growth continues to slow. But why?

- GDP growth averaged 7.4% in 2014 and fell to 7% in the first half of 2015
- This caused anxieties among policymakers and investors



There is cyclical factor

- Export growth moderated from 25% in the past to around 5% currently
- Chinese growth could pick up if the global economy recovers more strongly



Export (blue line) and import (purple line) growth (% yoy)

There is also a structural cause

- The growth potential is also moving to lower levels
- Most experts predict GDP growth to be at 6-7% over the next five years

Economists/Institutions	Predictions
World Bank/Development Research Center	2011-15: 8.6%; 2016-20: 7%; 2021-20: 5.9%; 2026-30: 5.0%
Asian Development Bank and Peking University	2011-20: 8.0%; 2021-30: 6.0%
Fang Cai and Yang Lu	2011-20: 7.2%; 2016-20: 6.1%
Justin Lin and Fan Zhang	2011-30: 8.0% actual performance: >7.0%

Various estimates of China's growth potential

The growth model needs to change

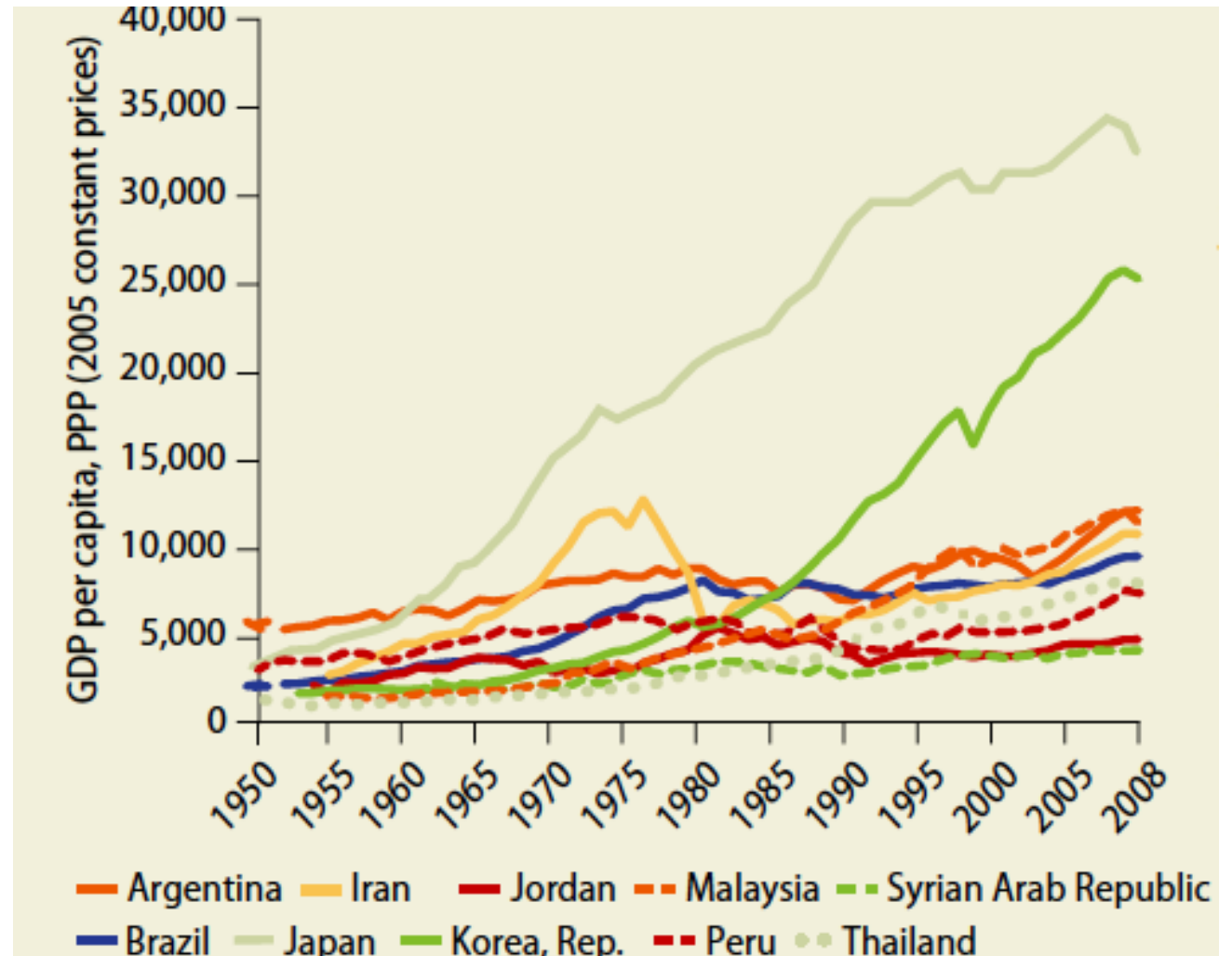
- Diminishing total factor productivity (TFP) means that the growth model needs a substantial reconfiguration

	1992-2001	2002-2007	2008-2010
Output	12.7	18.8	13.3
Labor	0.0	0.3	0.1
Capital	1.8	2.2	2.5
Material	9.4	15.1	10.5
TFP	1.5	1.2	0.2

Harry Wu (2014)

A typical middle-income trap text

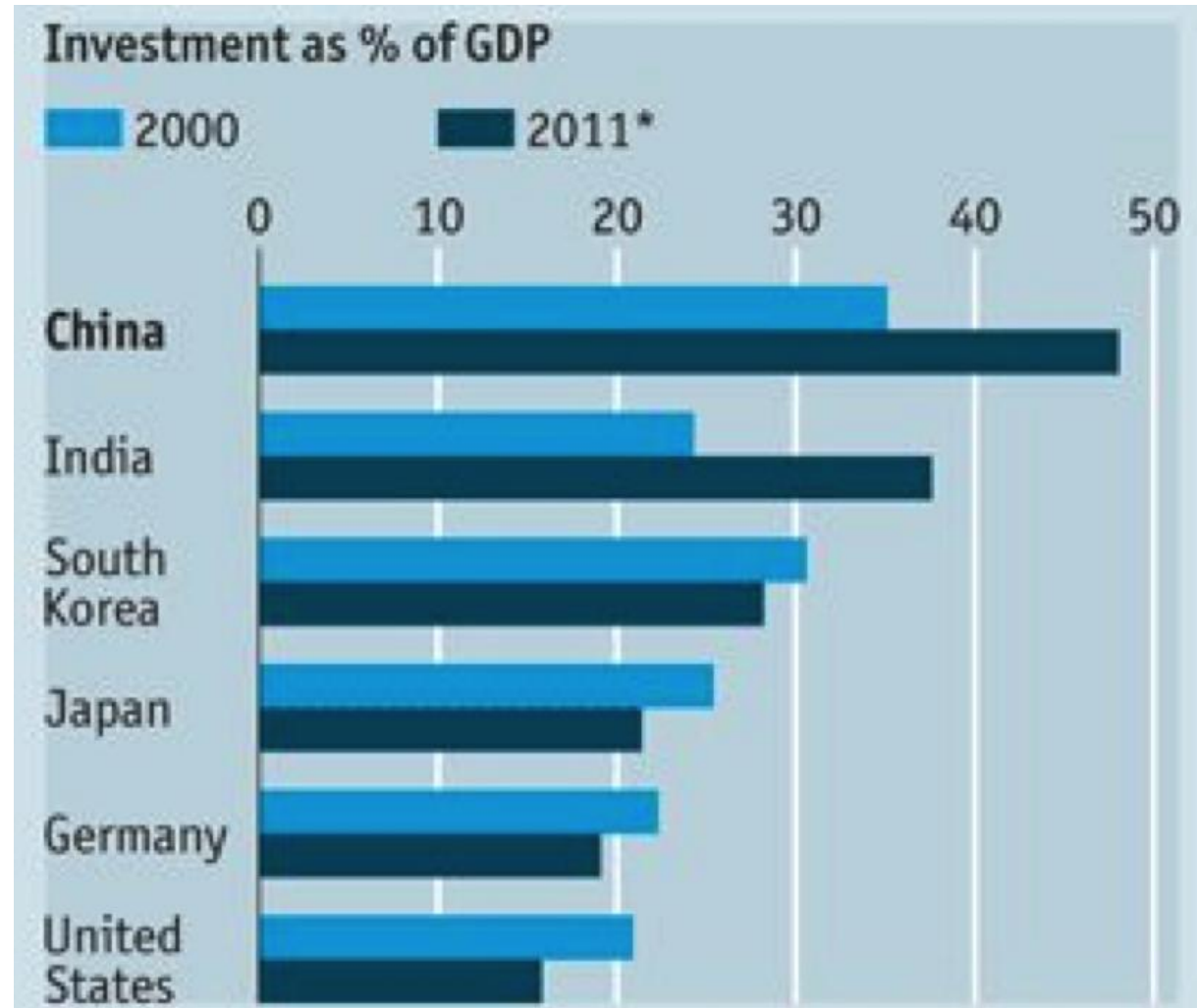
- After nearly four decades' rapid economic growth, cost base increased significantly
- Lower end labor-intensive manufacturing industries are quickly losing competitiveness



GDP per capita in PPP terms for various countries (World Bank 2013)

Factor market reforms lift costs even more

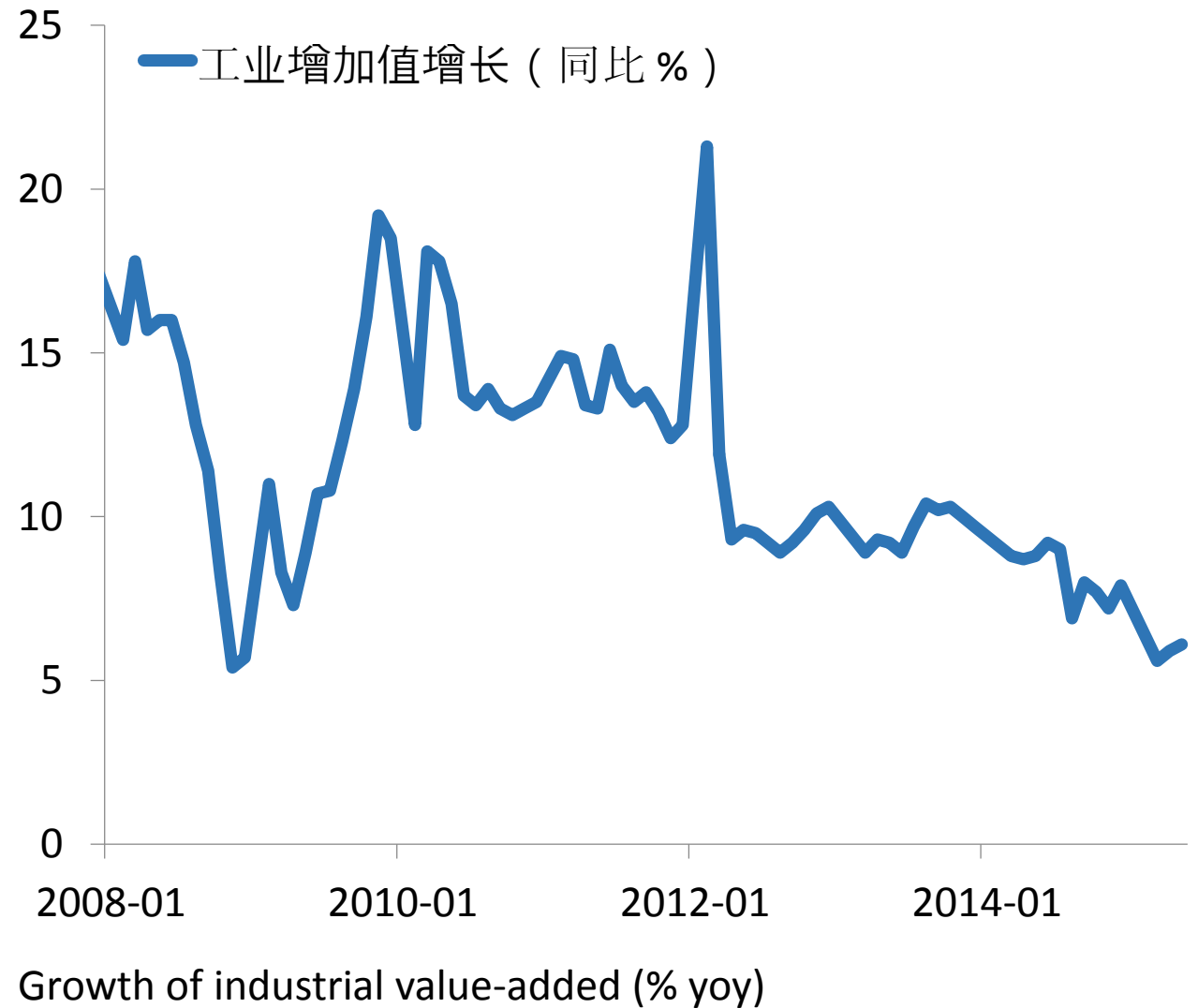
- A dual-track liberalization approach that freed product market completely but suppressed factor prices
- This strategy caused rapid economic growth and serious structural imbalance



Investment as % of GDP

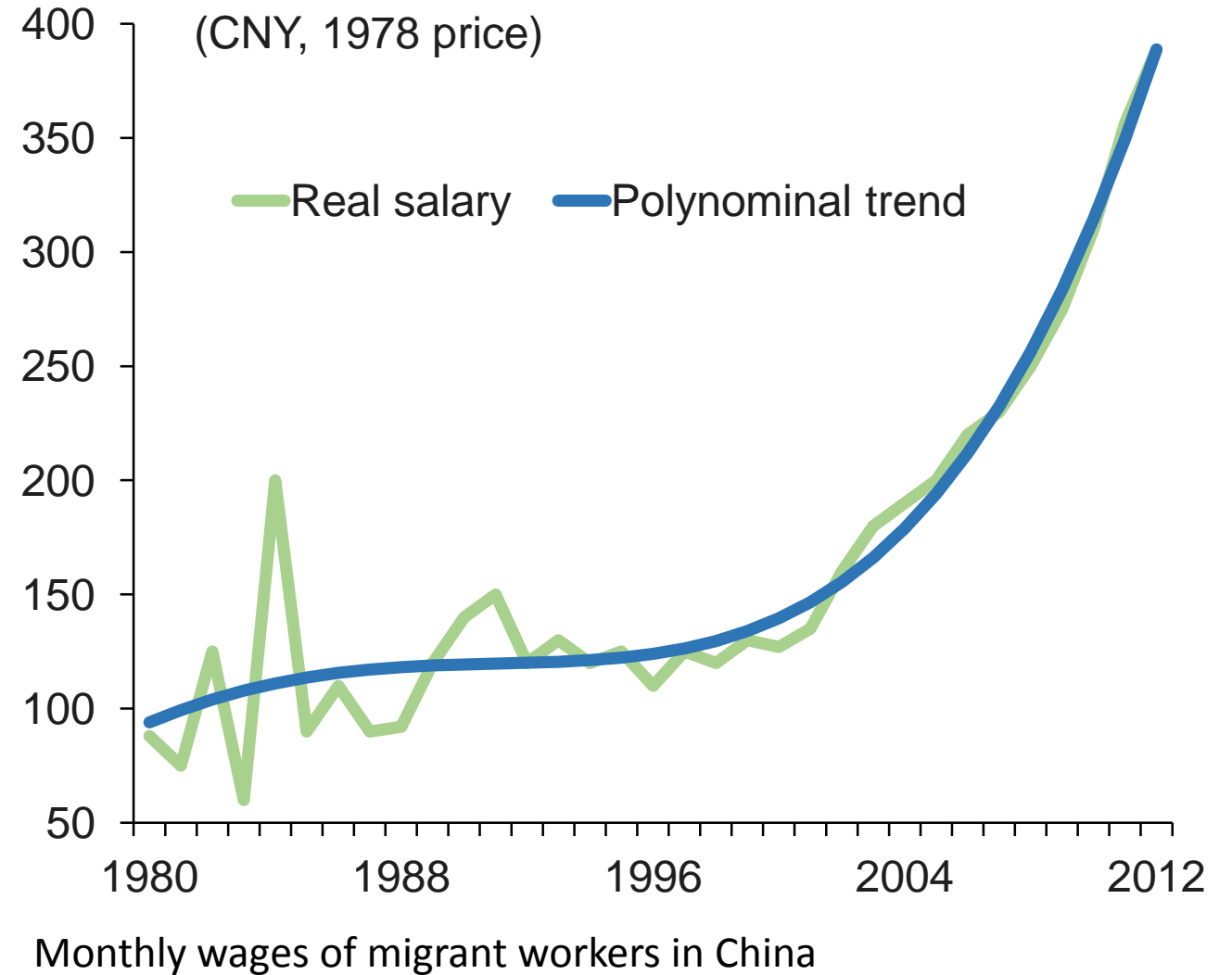
Any bottoming will be short-lived

- Until China develops new competitive pillar industries, downward growth pressure will continue



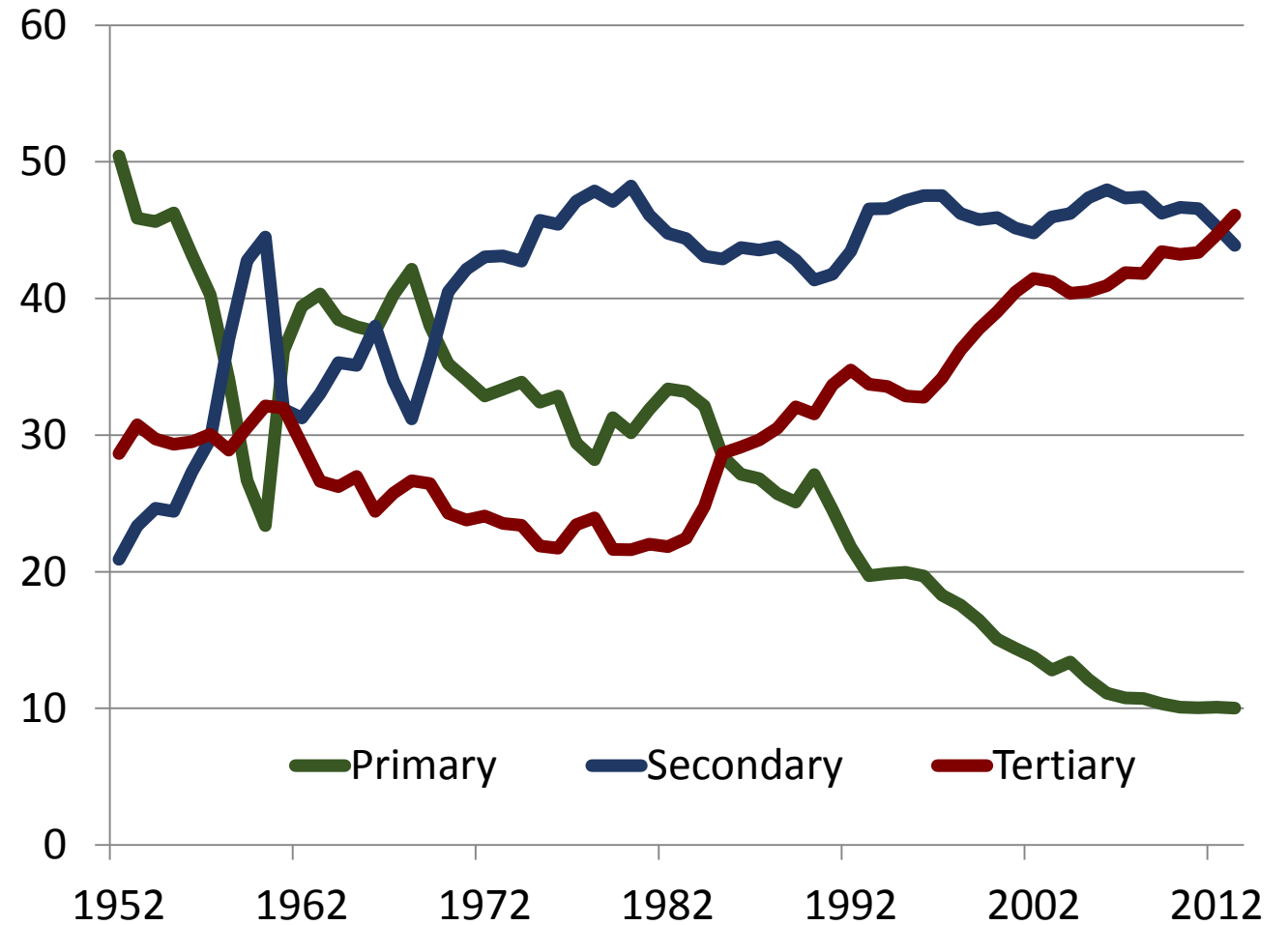
Good news: Job market robust

- Labor shortage and wage increase appear to be continuing



Structure is also improving

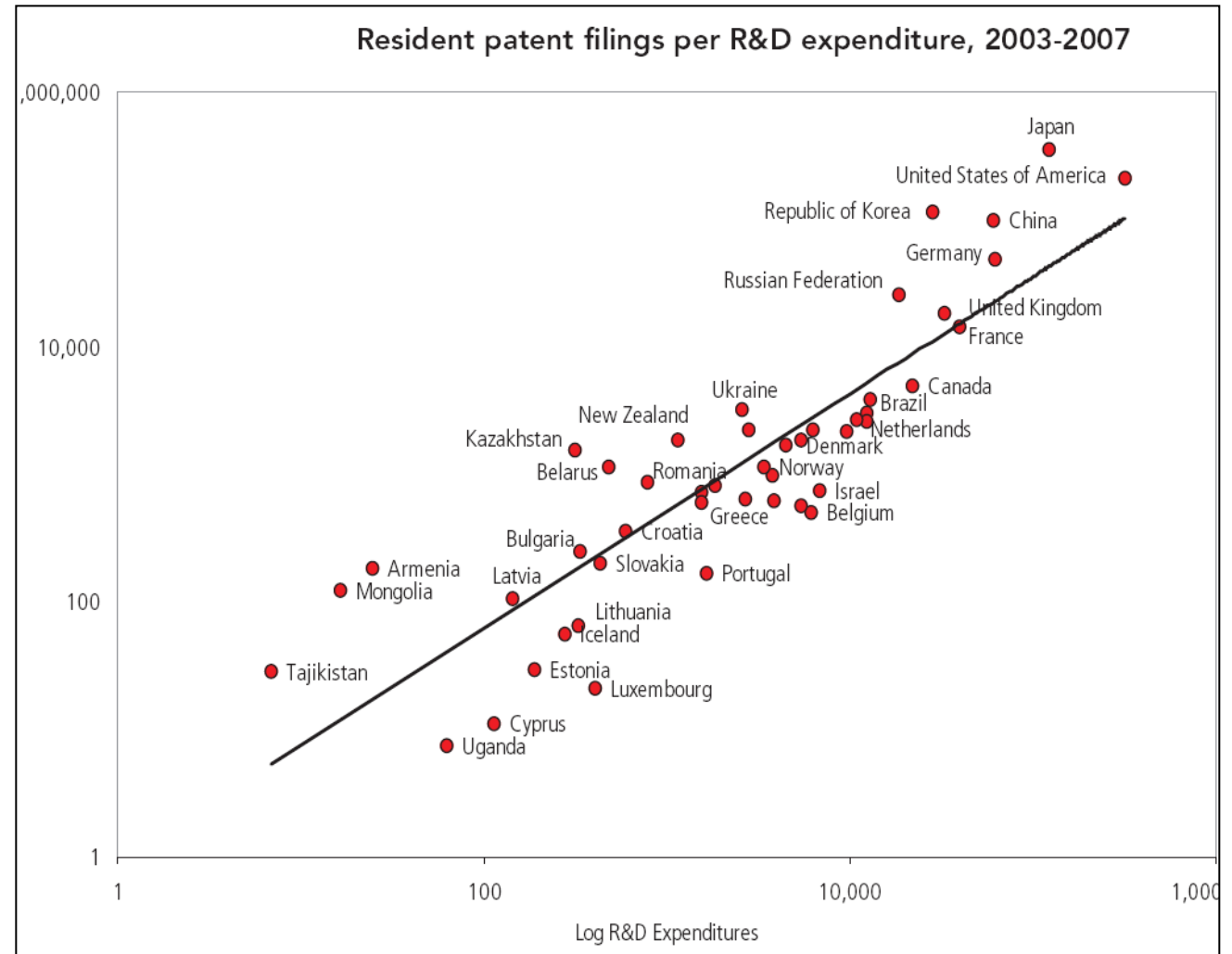
- New competitive industries emerging: Huawei, Lenovo, Xiaomi, Alibaba, etc
- It is inappropriate to guess growth performance based electricity data



Changing composition of the Chinese economy (%)

Can China innovate and upgrade?

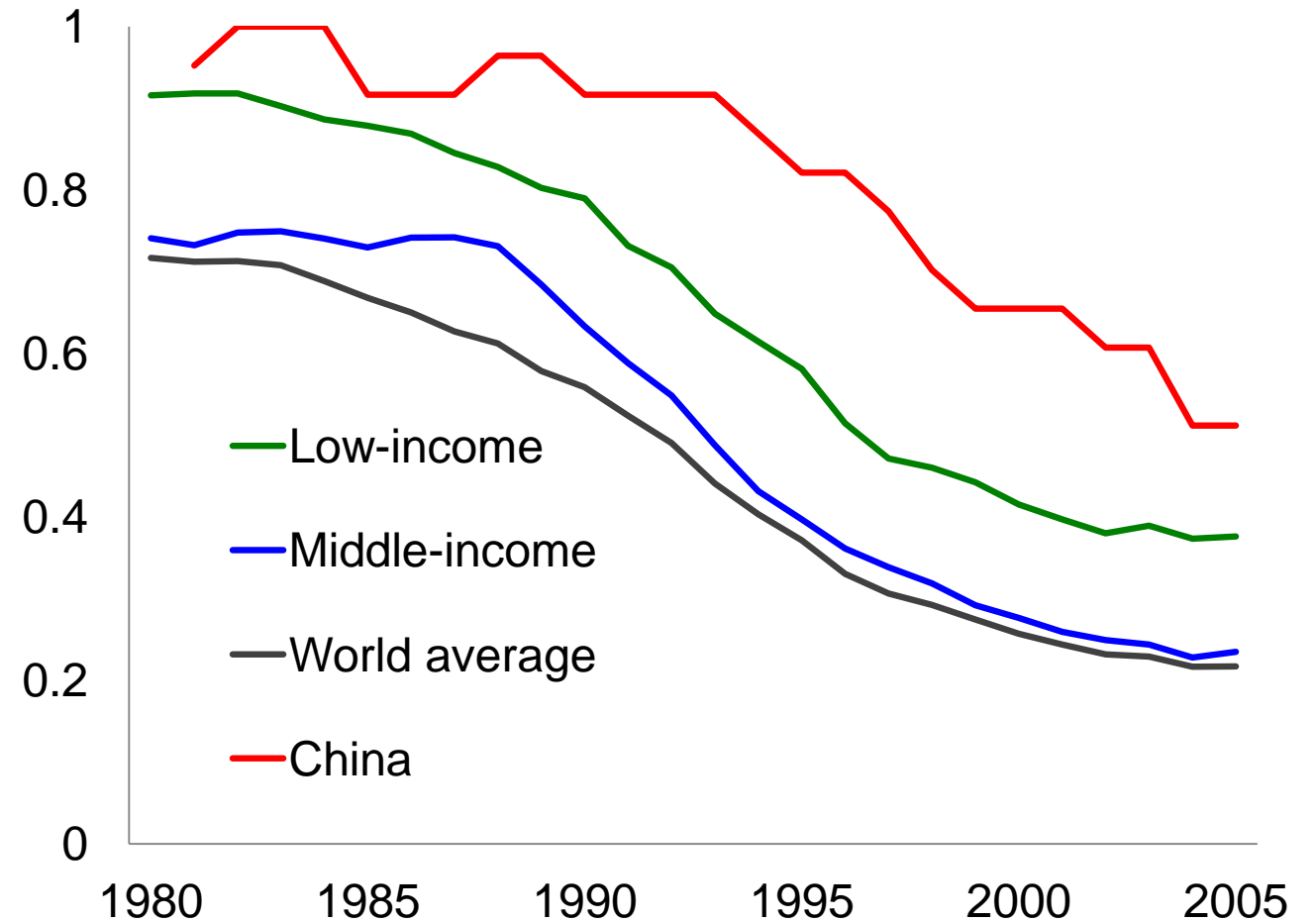
- Education and research (basic research, high education, migrant worker training)
- Financial services (investment funds, exit of SOEs)
- Legal environment (protection of intellectual property rights)



Resident patent filing/R&D expenditure (2003-2007)

Last leg of financial reforms

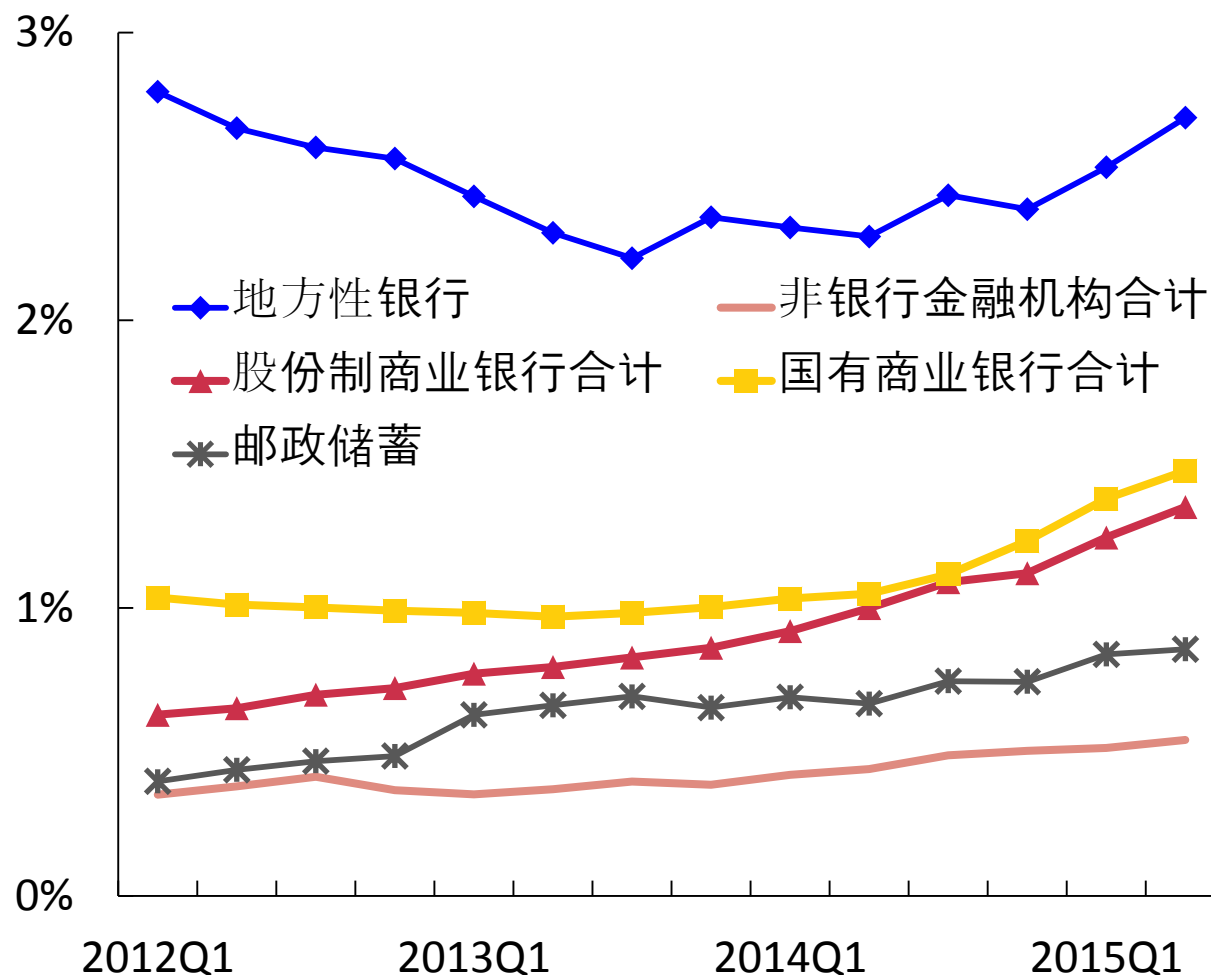
- China's past financial reform has been strong quantitatively but weak qualitatively
- The new agenda: lowering entry barriers, liberalizing market mechanism and improving regulation



Measure of financial repression (IMF)

What are the key risks?

- Will China experience a major financial crisis?
- Can zombie SOEs exit?
- Can China smoothly implement the one-belt, one road strategy?



NPL ratios of local banks, state-owned commercial banks, joint-stock banks & non-bank financial institutions (lines from top down in the above chart, %)

“New normal”?

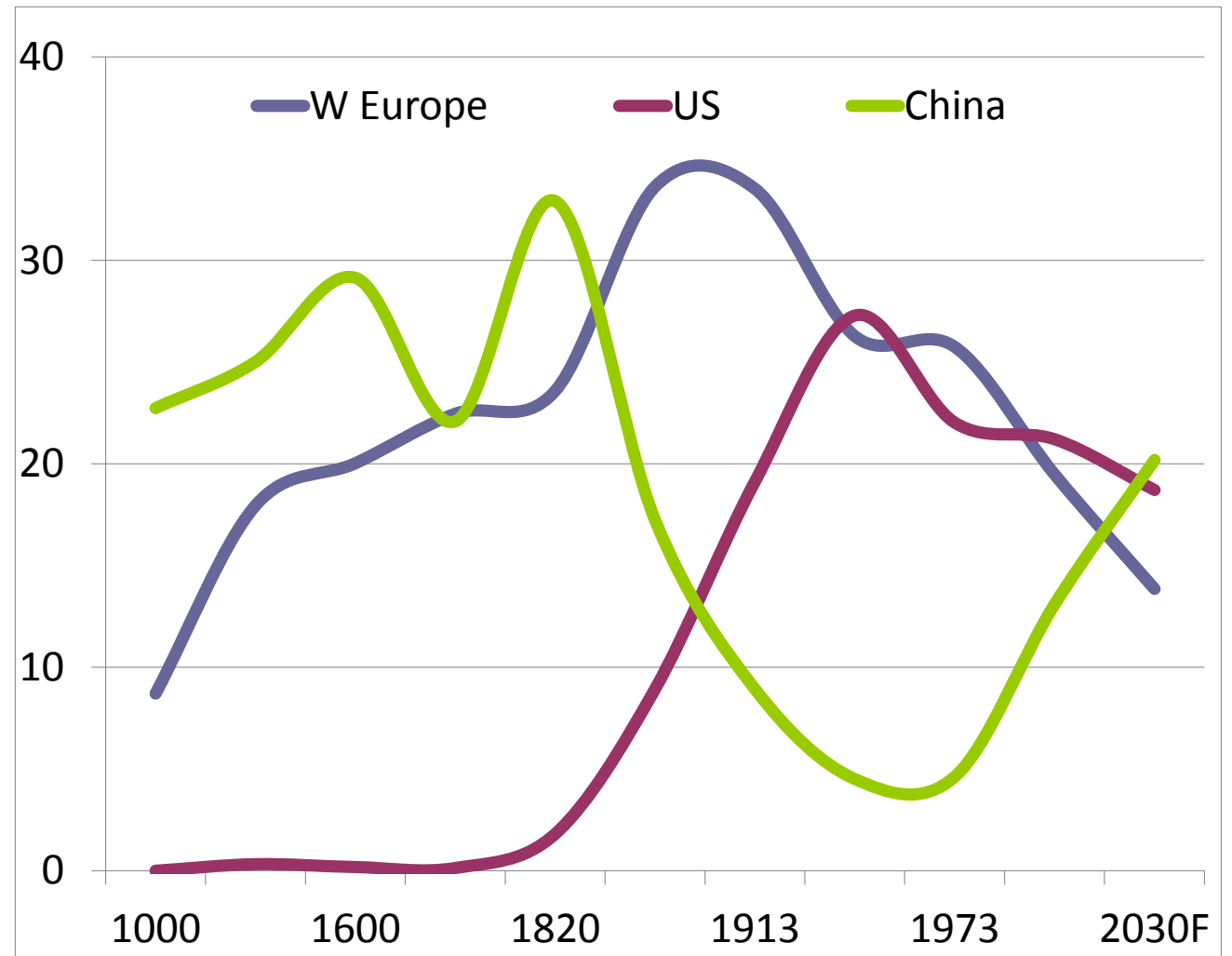


The transition from economic miracle to normal development:

- **Growth will likely decelerate further**
- Inflation pressure may continue to escalate
- Income distribution should improve
- **Economic structure may become more balanced**
- **Industrial upgrading should accelerate**
- Economic cycles may turn more volatile

Learning to be a global leader

- Angus Madison predicted that China would takeover the US economy in around 2030
- That might be brought forward by about 10 years
- But China as a new leader also need to learn and adapt, as illustrated by latest stock and foreign exchange market volatilities



Angus Madison (2006)

What does it mean for the world?



- Expecting the first China-induced external recession
- From the source of global disinflation to that of inflation
- From a major commodity consumer and manufacturing exporter to a consumer market
- Constantly forcing new international division of labor
- From holder of US treasuries to direct investor
- A new global player: RMB, BRICS Development Bank, Asian Infrastructure Bank, etc