QNB Economics
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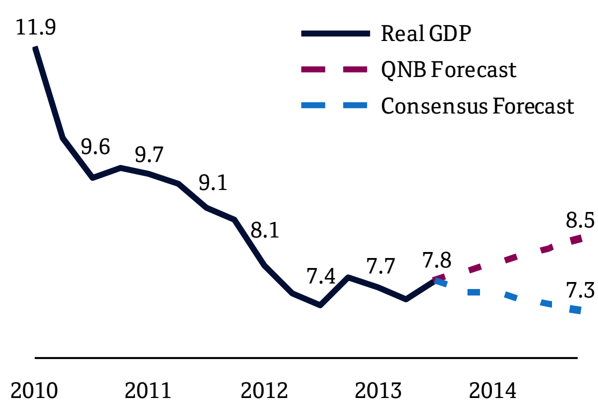
After A Soft Landing, China is Taking Off Again, According to QNB Group

Rather than the hard landing that many feared in 2012 and early 2013, the Chinese economy seems to be taking off again based on the latest indicators. The authorities have taken measures to mitigate some of the risks earlier this year, including concerns about excessive credit. With the recent announcement of a major reform package and positive economic news, the Chinese economy is likely to grow 8.0%–8.5% in 2014, according to QNB Group. This is the result of the ongoing transformation from an export–oriented to consumer–based economy.

China Real GDP Growth (2010–14)
(%, year–on–year)



Sources: Bloomberg and QNB Group forecasts

Since 2010, China's economy has slowed. Real GDP growth had fallen from over 10% to 7.4% in Q3 2012 as exports remained relatively weak on sluggish global demand. However, since then growth has stabilized and the most recent indicators show stronger growth ahead. The Purchasing Mangers' Indices (PMIs) for November 2013 beat market expectations and pointed to steady expansion in services and manufacturing sectors. Industrial production and investment are both expanding, despite overcapacity, suggesting higher growth ahead. Retail sales growth was strong in October, expanding 13.3% year–on–year, continuing its upward trend throughout 2013. The latter is an important indication that China is succeeding in transforming its economy toward domestic consumption.

There is some concern that strong credit growth, fuelled by government economic stimulus measures following the global financial crisis, could end into a banking crisis. The value of bad loans has risen for eight consecutive quarters to end–September 2013. The government is reportedly preparing measures to constrain lending by strictly enforcing an existing lending cap, which has been bypassed by banks through the shadow banking system up to now. The central bank has also tried to restrain lending by restricting liquidity in the banking system, causing a mini–credit crunch in June and pushing up short–term interest rates. China's broadest measure of new credit fell by more than estimated in October to well below the average over the last two years. Nevertheless, government efforts to rein in credit growth as well as higher interest rates do not seem to have had a significant negative impact on economic activity.

Over the medium term, growth will be determined by the success of an array of reforms announced on November 12 after the Plenary Session of the Central Committee of the Communist Party. The measures aim to give the invisible hand of free markets a stronger role in resource allocation, liberalize exchange rates and capital controls, spur private investment in state–owned enterprises, encourage local governments to issue bonds while tightening controls on regional finances, fighting corruption, and ease the one–child policy while making urbanization easier. Stockmarkets responded positively to the announcement of the reform plans, rising by over 6% from before the meeting until after the details of the reform plan were announced in November 18.

According to QNB Group, the reforms will be positive for long–term growth, but implementation will be complex. The relaxation of capital controls and liberalization of the exchange rate should help encourage foreign investment. This should also support the continued steady appreciation of the Chinese currency, the Renminbi. In October 2013, the Chinese Yuan overtook the Euro to become the second–most traded currency in global trade finance according to the Society for Worldwide Interbank Financial Telecommunication. All these factors should present good opportunities for foreign investment into China going forward.

Overall, QNB Group believes the Chinese economy is ready for another growth acceleration next year, after a brief slowdown in 2013. This is part of the long-term economic transformation of the Chinese economy from export-oriented to consumer-based. This transformation has large implications for the global economy, including a prominent role for the Chinese Renminbi as an international currency going forward.