showCASE
No. 41 | 28.08.2017

CASE – Centrum Analiz Społeczno-Ekonomicznych
CASE – Center for Social and Economic Research

Overview: In this week's showCASE, our experts take a closer look at China's robust economic growth and examine the true condition of the Chinese economy.

China's Economic Growth: Quantity over Quality

By: Katerina Hoskova, *CASE Analyst*

Source: Pixabay

In 2012, the National Congress of the Communist Party of China (NCCPC) has set a goal of doubling the 2010 GDP (10.6%) until 2020 to not only celebrate the 100-year anniversary of the NCCPC, but also to accelerate convergence with the USA, the biggest economy in the world. However, China has faced a slowdown since 2015. Hence, the policy makers have been tenuously trying to nurture the economy to fulfill the quotas of the party. As a result, the economy is flourishing on the outside, but remains malignant on the inside.

Based on the International Monetary Fund's (IMF) Chinese country report, the Communist Party of China (CPC) can be pleased with the current development of the economy. The IMF predicts that GDP will grow faster than expected, resulting in an increase of the IMF forecast from 6.2% to 6.7% in 2017, with a corresponding increase in average GDP growth from 6% to 6.4% over 2018-2020. However, the problem facing China is that its recent growth is of an "artificial" nature, as the government and the People's Bank of China (PBOC) have been purposely trying to stimulate the economy to reach the target, not caring about the quality of the economic output. Although, as the experience of communist economies in the 20th century shows, this approach might deliver numbers in the short run, in the long run it is unsustainable.

The fuel for this growth has been a steadily-growing debt, creating vulnerabilities for the Chinese government, as well as a lack of fiscal space in the case of a crisis. From 2008 to 2016, China's total debt quadrupled to the level of EUR 24 trillion. If the government keeps following this path and level of growth, it is expected that the debt-to-GDP ratio will grow from 235% to 300% by 2022. Such rapid growth is nowhere near sustainable, and without a correction, the economy would have to wean itself off of easy debt; this will be a true challenge for the credit-fueled economy.

However, not only the PBOC, but also President Xi Jinping himself is aware of the situation. The central bank stated that there is a need to stabilize the overall debt level and that it is ready to do so by using their own policy tools, while the President said that not only smaller banks and big private-sector companies, but also local government authorities and state owned enterprises (SOE) should be targeted. Although the positive economic outlook makes deleveraging attainable, achieving such a goal in a country which has been borrowing for decades to fund growth will be tricky. In particular, SOEs have been borrowing lavishly to sustain their otherwise mayfly life. For this reason, SOEs are on the top of the agenda, proposing various solutions such as consolidation of SOEs into a medium-sized group of national champions, partial privatization, forced bankruptcy of "zombie companies" or debt-for-equity swaps.

On August 23, brand new policies were introduced by the Premier to encourage deleveraging in the SOES, who saw combined profits grow by 16.4% y-o-y in the first seven months of 2017 (contrasted with a fall of 3.7% in the same period last year). State-owned enterprises will be reined in from new business activities to control debt, while companies which see profits growing will be forced to retire debt. Additionally, debt-for-equity swaps will be prioritized along with other new market-based swap models, and entities using swaps will be granted support to enlarge their funding channels.

Even though soaring debt is the biggest problem of the economy, it is not the only one. Chinese savings are very high, accounting for 46% of GDP, 26% points above the global average in 2015, but private investment in the economy remains stubbornly low. This points to major inefficiencies in the financial sector and an inability to translate savings into tangible investment. Moreover, savings rates are kept high by other policy failings, with low government social spending on health and pensions commensurate with China's income levels. Indeed, by streamlining the tax system, the government might be able to spend more on social protection, shrinking the inequality which is one of the highest in the world (the richest 1% owns one-third of the country's wealth, a reality attributed to the pervasive nature of politics in China's economic system).

China's policymakers seem to be aware of the rot at the heart of its economy and appear to be making plans to ameliorate the situation. However, the longevity of these policies may fail under sustained political pressure, as the communist need for growth and ground-breaking figures will likely prevail over sensibility. If the Chinese policy makers fall prey to their ideology, a growth engine of the global economy will be on the verge of breaking.

This week: Businesses are optimistic about the current and expected economic situation in Poland, the Central Statistical Office reported. The general business climate indicator in August stands at +7.4 in manufacturing, +5.2 in construction, +11.1 in wholesale trade, and +9.4 in retail trade. In services, the climate is especially buoyant for the finance and insurance sector, with the indicator as high as +32.3. Companies anticipate increasing demand and sales.

GDP (Q2 2017)

4.4% y/y (est.)

Up from 4.2% in Q1

Inflation (July 2017)

1.7% y/y

Up from 1.5% in June

Unemployment (Jun 2017)

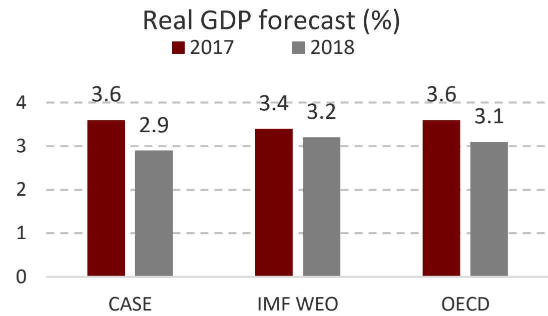
7.1%

Down from 7.4% in May

NBP Base rate

1.5%

From 2% Mar 2015



This week: Russia partnered with Turkey at the annual İzmir International Fair held on August 18-27. Officials from both countries used the fair to showcase their economic, political, technical, and trade cooperation as businesses signed preliminary agreements worth approximately USD 820 million. The countries seem to have moved closer economically, with Russia lifting the ban on Turkish agricultural products in June.

GDP (Q2 2017)

2.7% y/y (est.)

Up from 0.5% in Q1

Inflation (July 2017)

3.9% y/y

Down from 4.4% in June

Unemployment (July 2017)

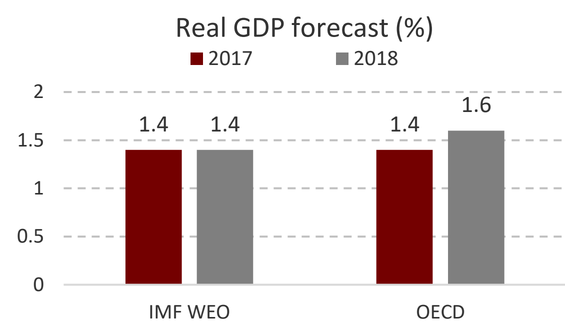
5.1%

Unchanged from June 2017

CBR Base rate

9 %

From 9.25%



This week: In August, the ZEW Indicator of Economic Sentiment reached the lowest point since October 2016. It currently stands at 10.0 points, which means that it has fallen further back from its long-term average of 23.9 points. The fall is associated with the scandal in the German automobile sector, lower-than-expected export growth, and the slackening German share index (DAX), which have led to increased nervousness in the German economy.

GDP (Q2 2017)

2.1% y/y

Up from 2.0% in Q1

Inflation (July 2017)

1.5% y/y

Unchanged from June

Unemployment (June 2017)

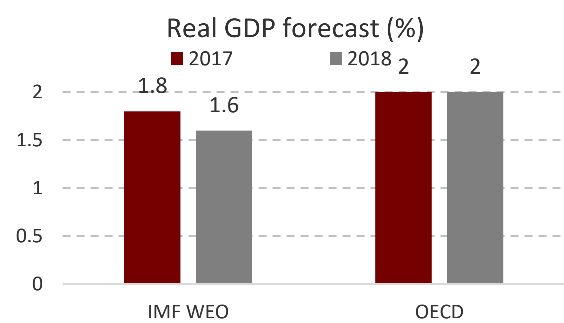
3.6%

Down from 3.7% in May

ECB Deposit rate

-0.4%

From -0.3% Dec 2015



This week: The National Bank of Ukraine (NBU) removed the remaining limitations on the withdrawal of funds from bank accounts on 24 August. Individuals are now able to withdraw unlimited amounts of foreign-currency-denominated cash and investment metals from current and deposit accounts. The NBU claims that the anti-crisis restrictions are no longer needed and the easing will have no effect on the foreign exchange market.

GDP (Q2 2017)

2.4% y/y

From 2.5% in Q1

Inflation (July 2017)

15.9% y/y

Up from 15.6% in June

Unemployment (Q1 2017)

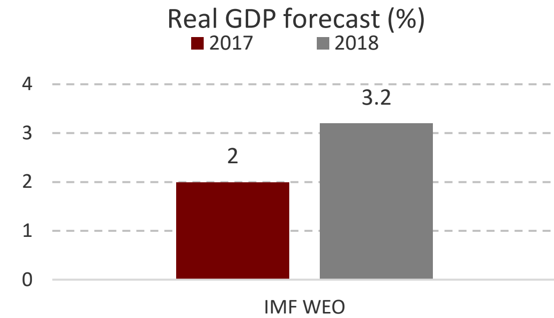
10.5%

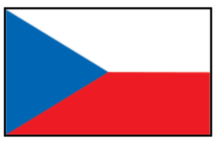
Up from 10.0% in Q4

NBU Base rate

12.5%

From 13.0% in May





This week: The Czech minimum wage will increase by 11% to reach CZK 12,000 gross (EUR 468) as of 1 January 2018. The 2018 minimum wage will represent 40.5% of the average wage. Prime Minister Bohuslav Sobotka called the increase inevitable given the current macroeconomic conditions. The present minimum wage (EUR 421) is the second lowest among V4 countries, behind Poland (EUR 453) and Slovakia (EUR 435).

GDP (Q2 2017)

4.5% y/y (est.)

Up from 3.0% in Q1 2017

Inflation (July 2017)

2.5% y/y

Up from 2.3% in June

Unemployment (Q2 2017)

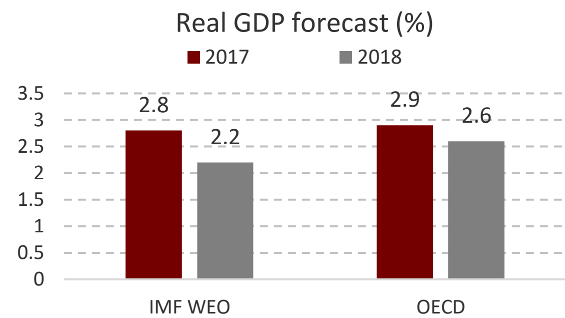
3.0% (est.)

Down from 3.4% in Q1

CNB Base rate

0.25%

From 0.05% (4 August 2017)



This week: According to the Hungarian Central Statistical Office, gross salaries increased by 14.4% (to EUR 977) in June y-o-y. The growth has been supported by the 15% increase of the minimum wage at the beginning of the year, and it is linked to labor shortage in Hungary. Minister of Economy Mihály Varga estimates that salaries will grow by 40% in the next six consecutive years.

GDP (Q1 2017)

4.2% y/y

Up from 1.6% in Q4

Inflation (July 2017)

2.1% y/y

Up from 1.9% in June

Unemployment (Q1 2017)

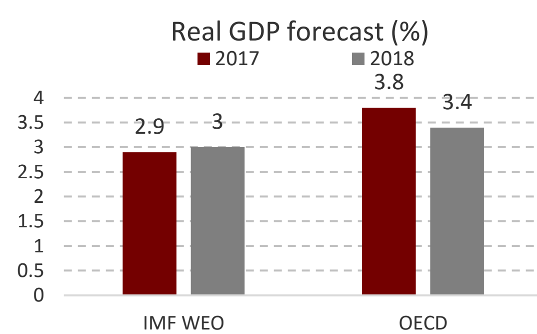
4.3%

Down from 4.6% in Q4

MNB Base rate

0.9%

From 1.05% May 2016



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The weekly online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly.

Our weekly online CASE CPI

Monthly CASE forecasts for the Polish economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, and foreign trade, current account balance, and the CPI.

CASE economic forecasts for the Polish economy
(average % change on previous calendar year, unless otherwise indicated)

	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices
2017	3.6	3.9	2.9	3.8	1.9
2018	2.9	3.0	2.7	3.7	2.0
	Nominal monthly wages	**Merchandise exports (USD, bn)**	**Merchandise imports (USD, bn)**	**Merchandise trade balance (USD, bn)**	**CA balance (USD, bn)**
2017	4.7	201.6	201.8	-0.2	-4.7
2018	3.5	211.3	213.1	-1.8	-5.9

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