

Box 1

CHINA'S GROWTH OUTLOOK

Growth in China has moderated since 2010-11 as a result of the slowdown in the global economy and the measures taken by the authorities to curb demand following the large 2008-09 stimulus package. Available indicators suggest that growth has recovered in recent months and that activity will strengthen in the near term. However, the latest dip in growth has prompted questions as to whether this was a simple cyclical downturn or rather the start of rebalancing and a transition to slower trend growth rates in China.

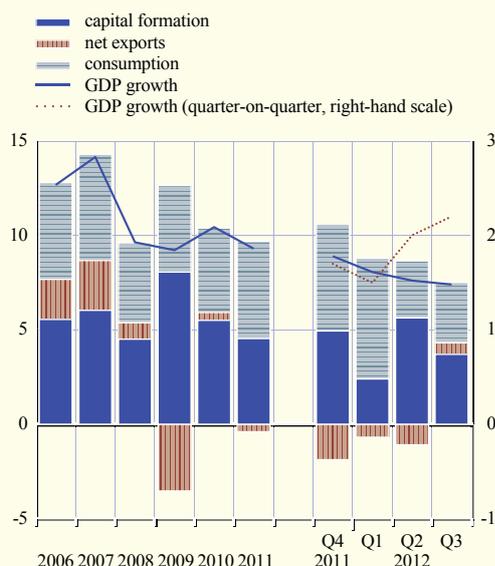
Recent indicators and the prospects for near-term growth

Growth in China slowed significantly in 2012. Indeed, in the third quarter of 2012 real GDP growth fell to 7.4% year on year, the seventh consecutive quarter of falling growth (see Chart A).



Chart A Contributions to real GDP growth

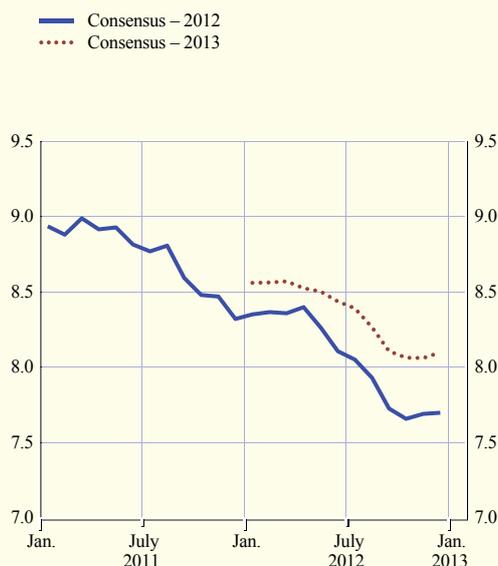
(annual percentage changes; percentage points)



Sources: CEIC. The latest observation is for the third quarter of 2012.
Note: Quarterly contributions estimated from year-to-date data.

Chart B GDP growth projections

(annual percentage changes)



Source: Consensus Economics. The latest observation is for December 2012.

However, quarterly growth strengthened to 2.2% in the third quarter of 2012. Growth momentum is now positive, and year-on-year growth is expected to increase in the last quarter of 2012. Private sector forecasts for growth in 2012 declined over the past twelve months, but have stabilised recently, while activity is expected to accelerate somewhat in 2013 (see Chart B).

While China appears to have achieved a soft landing, this comes despite the large internal imbalances – rapidly expanding money and credit, fast-rising property prices and a strong increase in investment – that were fuelled by the rapid policy response to the global downturn in 2008. Evidence of rebalancing in the economy remains limited. Investment made a smaller contribution to growth in the first three quarters of 2012, in particular compared with 2009, when government stimulus to counteract the effects of the financial crisis inflated the contribution of capital formation. However, the broad characteristics of China’s growth model remain in place, with investment being an important driver of growth (see Chart A).

Continued policy emphasis on rebalancing growth

In December 2012 China’s policy-makers laid down the economic policy priorities for 2013, which included sustainable growth based on innovation, higher productivity and concomitant industrial restructuring, continuing urbanisation, reforming the fiscal system to reduce tax burdens and broadening the social security net. In line with the new emphasis on quality, rather than speed, of growth, no official targets for GDP or inflation were set for 2013. However, press reports indicate that informal targets of 7.5% and 3.5% respectively were discussed, broadly in line with previous targets. Furthermore, fiscal policy is expected to remain mildly expansionary in 2013.

Over time, the implementation of structural reforms as outlined above should help to reduce existing internal and external imbalances, while laying the basis for continued high levels of growth in the medium term. However, there is still a long way to go. Some initiatives in relation to social security, labour markets and social housing have been brought forward. But residential construction aside, measures to curtail the national bias towards investment – i.e. the removal of many implicit subsidies benefiting Chinese industry – have still to be implemented. Chinese authorities recently increased banks' freedom to set their own deposit and lending rates, which should stimulate banking sector competition, lead to stronger internal risk management and reduce financial repression. Such incremental steps are welcome, but so far have not led to a large-scale overhaul of the financial system, which continues to rely both on price signals and quantitative, administrative measures. Given the scale of the challenges ahead, several years of additional structural reforms may be needed before they have a lasting impact on the growth model in China.

However, although structural reforms are expected to play only a limited role in the short term, authorities have become worried about possible imbalances in the economy and the implications of a large credit overhang. That suggests a policy bias towards smaller, more targeted government stimulus. Policy loosening during the latest slowdown has been modest compared with 2008-09. Money and loan growth remain in check, resulting in relatively tight financing conditions, in particular for SMEs. Likewise, most of the policies aimed at curbing speculation in the housing market are expected to remain firmly in place.

Overall, growth is expected to moderate gradually over the medium term in line with China's goal of rebalancing the economy. A return to the buoyant growth of the early part of the century, when growth in China averaged over 10%, is unlikely. According to the World Bank, potential growth will slow down to 8.6% in 2011-15 and to around 7% in 2016-20. Nevertheless, China's per capita GDP is still low at USD 5,400. Countries such as Japan, Korea and Taiwan experienced high single-digit growth for extended periods after they had reached a similar level of development.