

China and its Impact on the World

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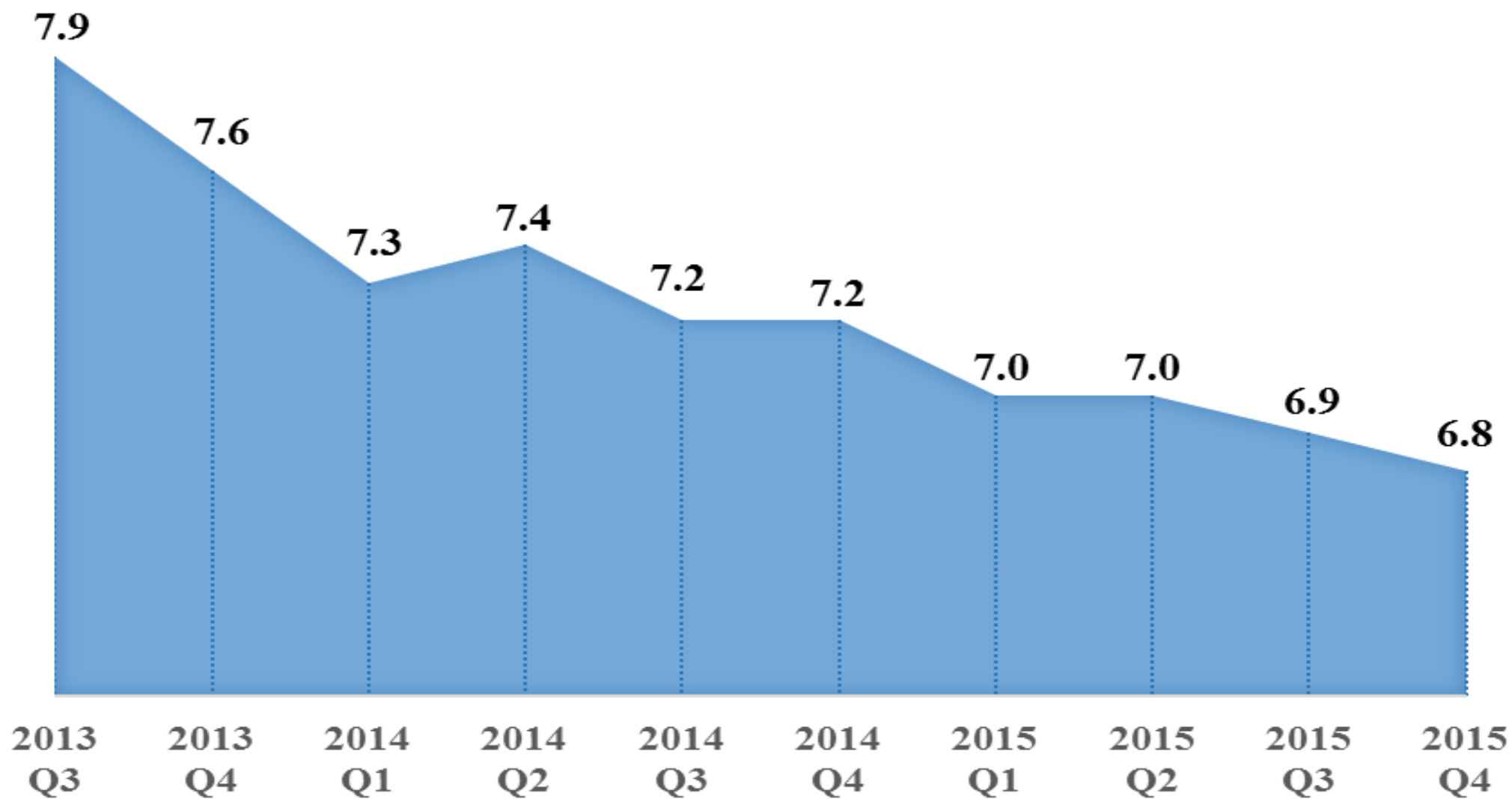
The Brookings Institution

September 6, 2016

Outline

- 1. The Current Economic Slowdown**
- 2. Political Context and Major Initiatives under Xi Jinping**
- 3. China's Development Model and Reform Prospects**

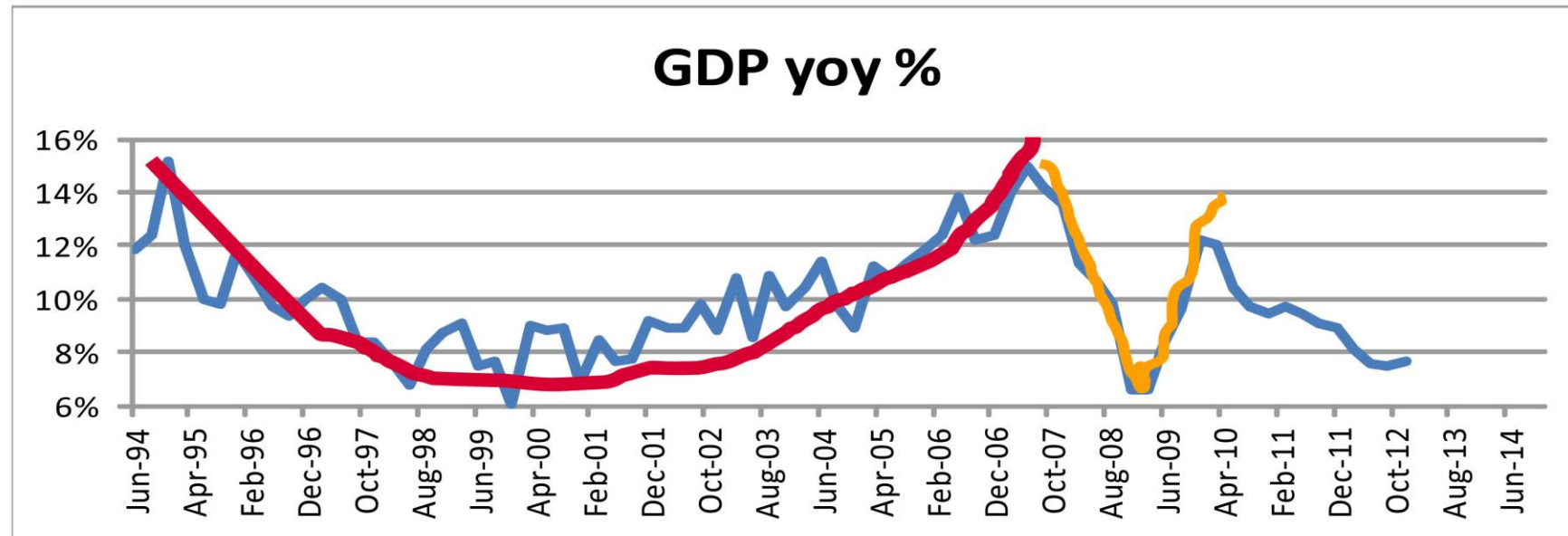
CHINA ECONOMIC SLOW DOWN



Source: China Statistic Bureau

Given limited policy response, this time around, growth recovery may look more like the U-shape trajectory between 98-01, rather than the V shape one in 09

This time, recovery may look more like 98-01, rather than 09



Source: CEIC

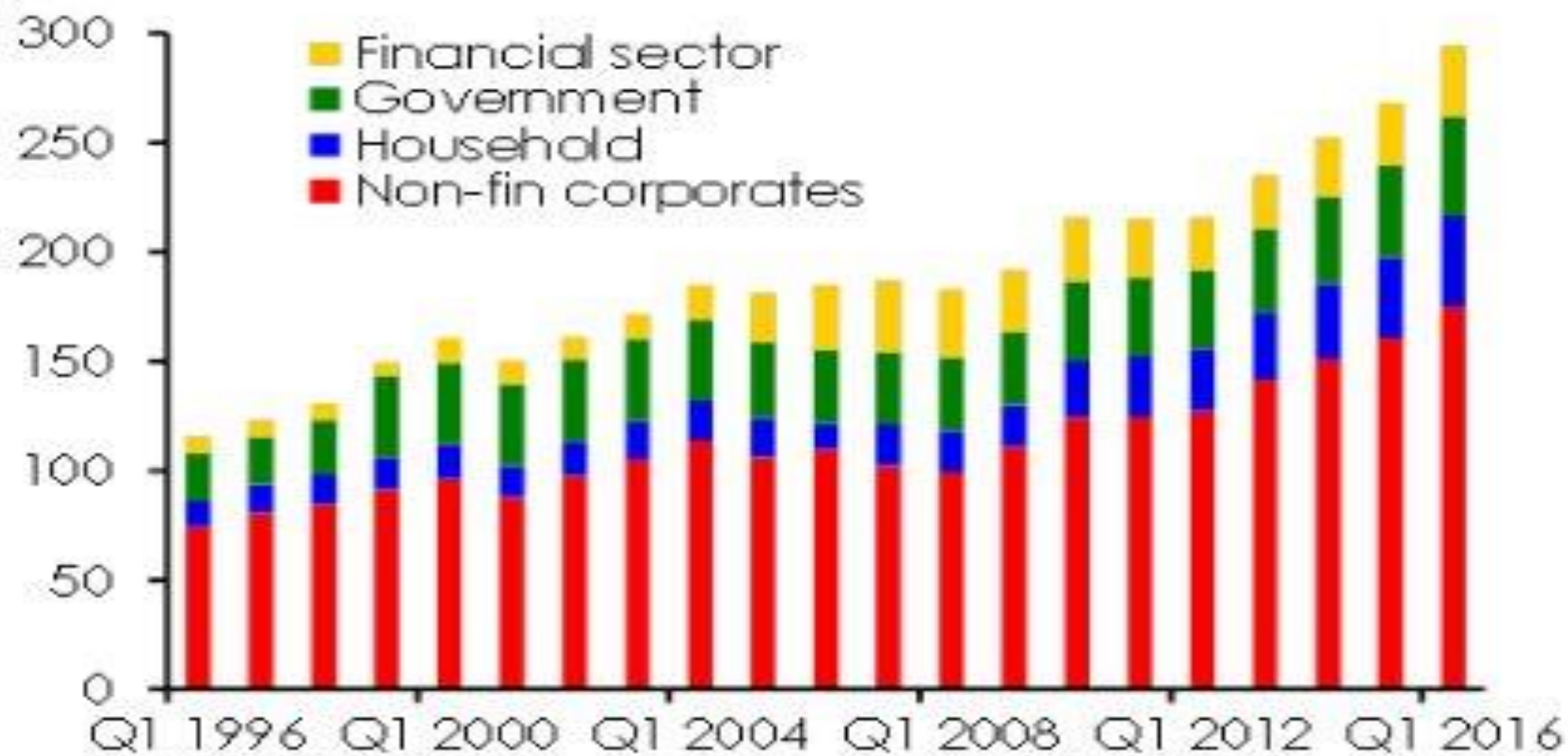
- **Causal Factors for Economic Slowdown**
 - Declining exports
 - Declining internal demand
 - Side-effects of anti-corruption
 - Capital outflow
 - Environmental protection
 - Macro economic control of real estate and infrastructure development
 - Increase of labor cost
 - Rebalancing/restructuring the Chinese economy
 - Constraints of State Capitalism/Interest Groups

Main Problems

- **Local and corporate debts**
- **Shadow banking**
- **Overcapacity**
- **Property bubble**

China: Total Debt-to-GDP

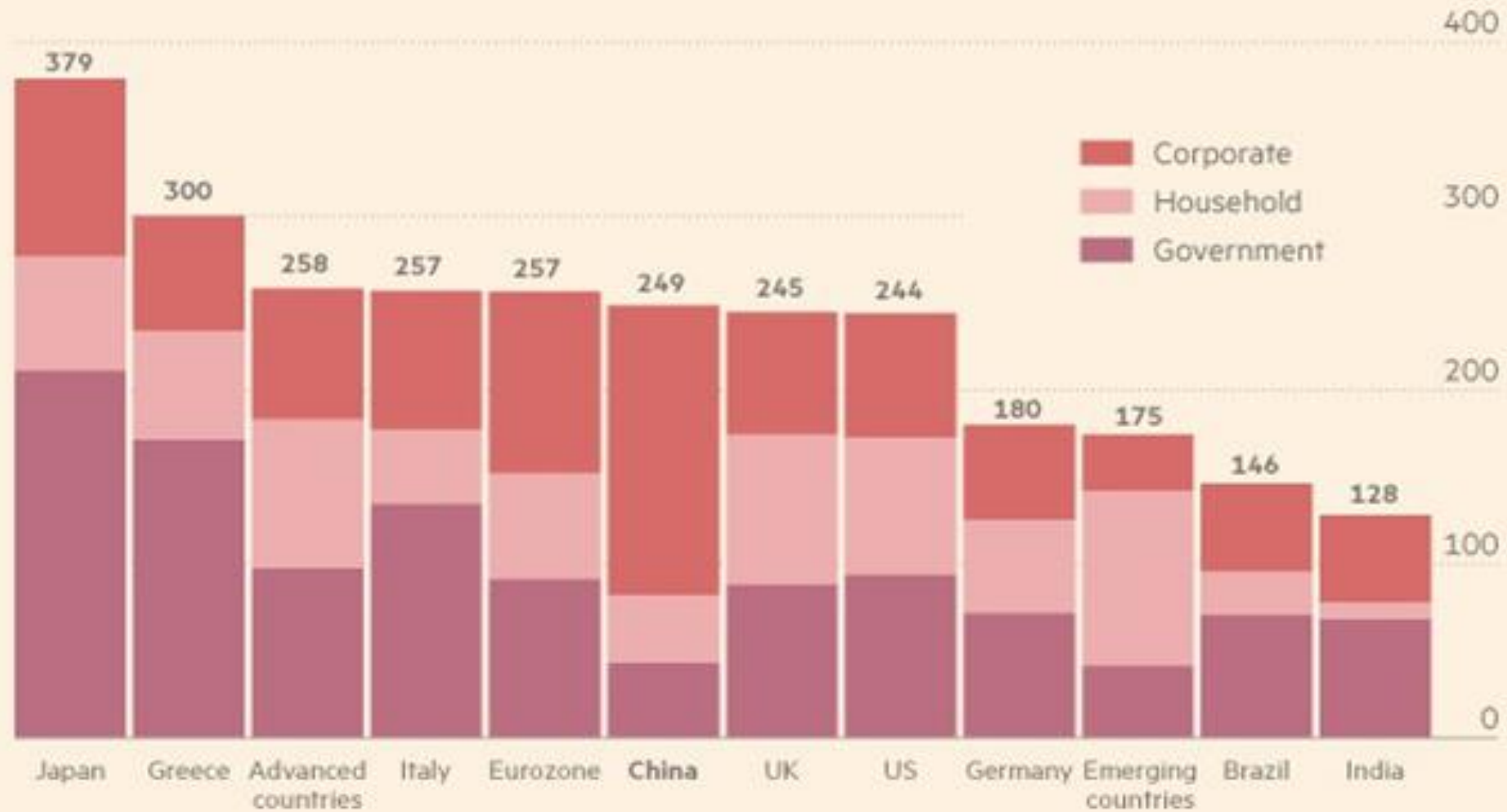
percent of GDP



Source: PBOC, BIS, IMF, IIF.

China debt ratio approaches danger level

% of GDP at end-September 2015



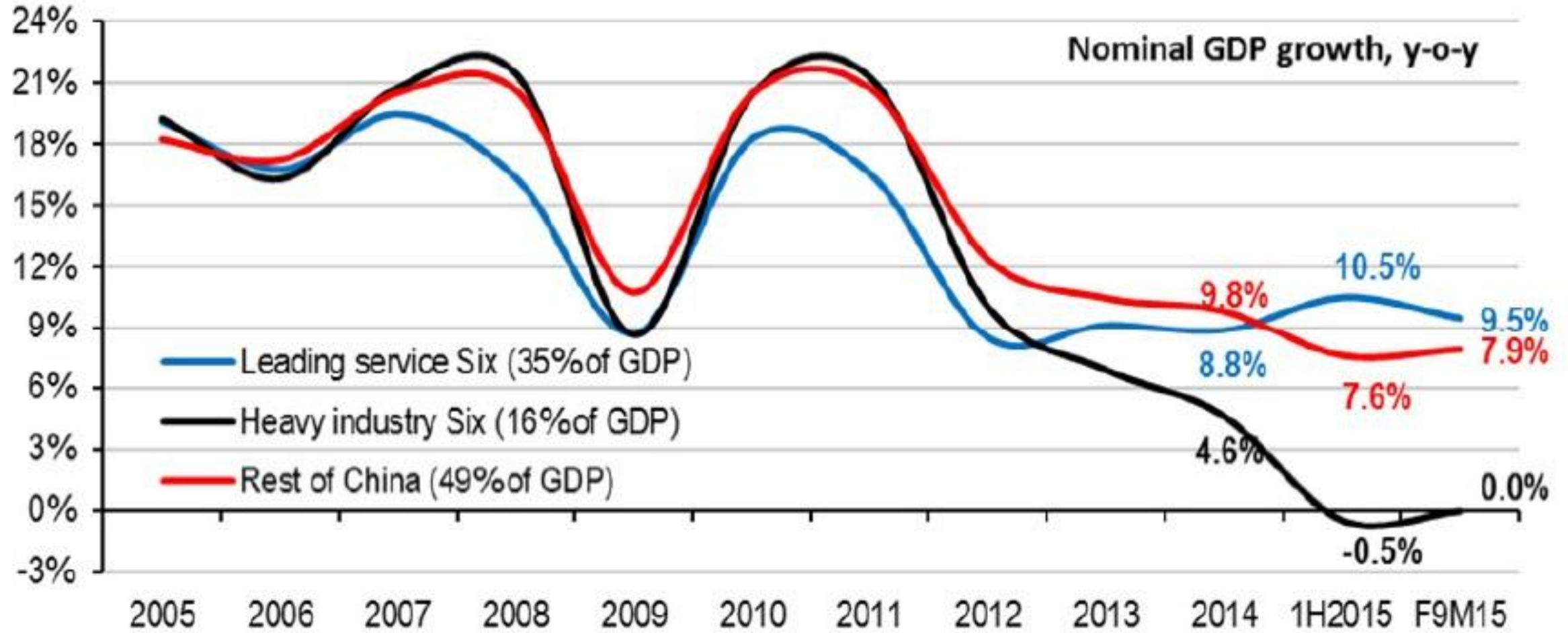
Source: Bank for International Settlements

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Overcapacity in Steel

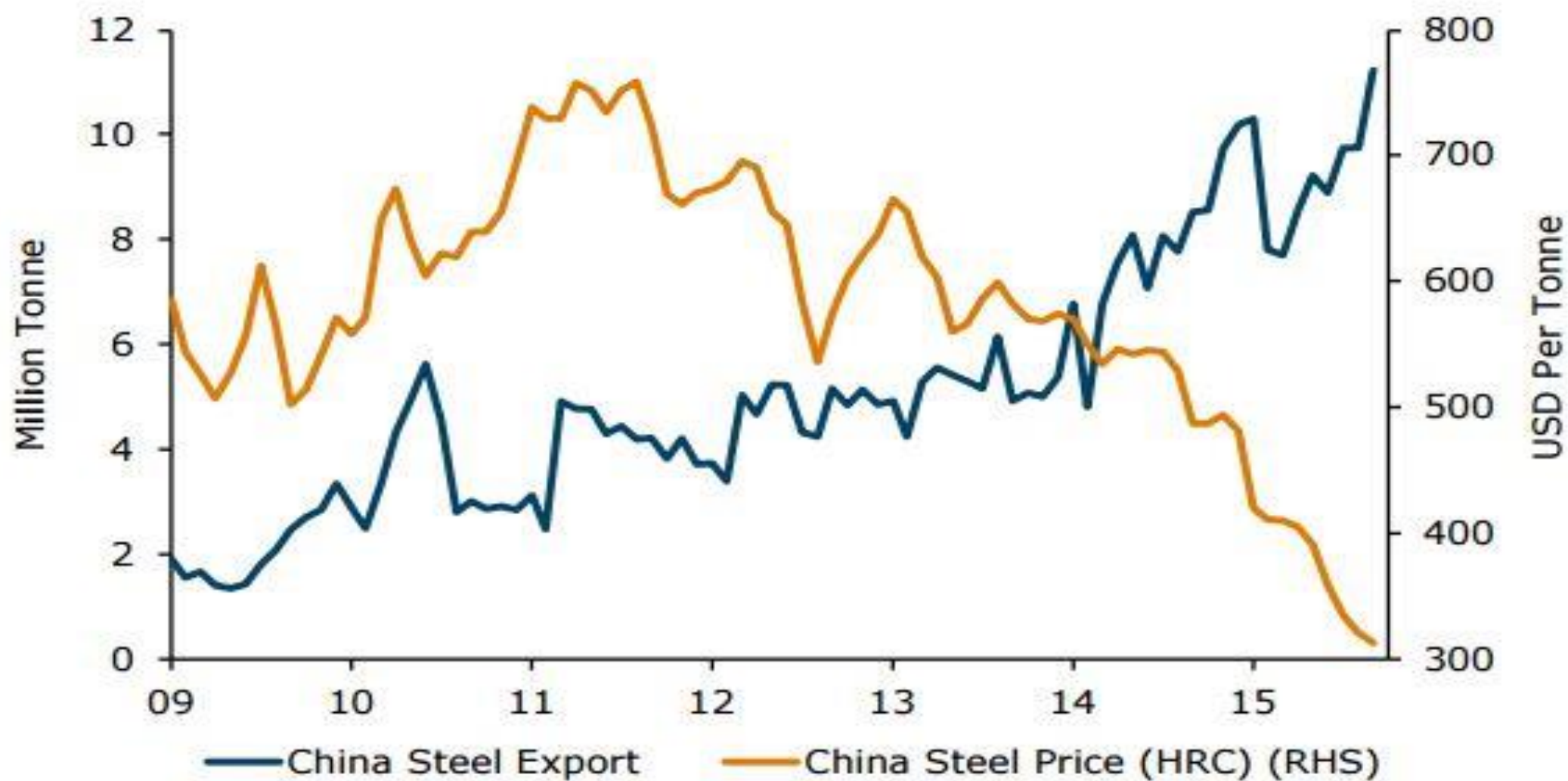
- China has produced half the world's supply of steel so far this year
- State support (cash grants, equity infusions, gov't-mandated M&A, preferential loans, all sorts of subsidies, tax benefits)
- China's steel industry has US\$500 billion debts
- Unemployment concern in northeast China
- Environment concern
- International pressure
- Debt-to-equity swaps

2: China is a multi-speed economy



Source: CEIC

FIGURE 4. CHINA STEEL EXPORT & CHINA STEEL PRICE



Source: Bloomberg, ANZ Research

China's Steel Demand and Production

■ Steel demand, million metric tons
■ Crude steel production, million metric tons

— Demand growth, year-on-year
— Production growth, year-on-year



* 2015 data is for January–November

Sources: WSA; NBS; Stratfor calculations

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Xi's promises at G20 last week regarding China's steel overcapacity:

- reduce water use, energy consumption, and CO2 emissions per unit of domestic gross product (GDP) by 23%, 15% and 18% respectively in the next 5 years.
- cut crude steel output by 100-150 million tons in the next 5 years, and close coal mines with around 500 million tons of capacity, and cut 500 million tons of capacity through coal mine restructuring in the next 3 to 5 years.

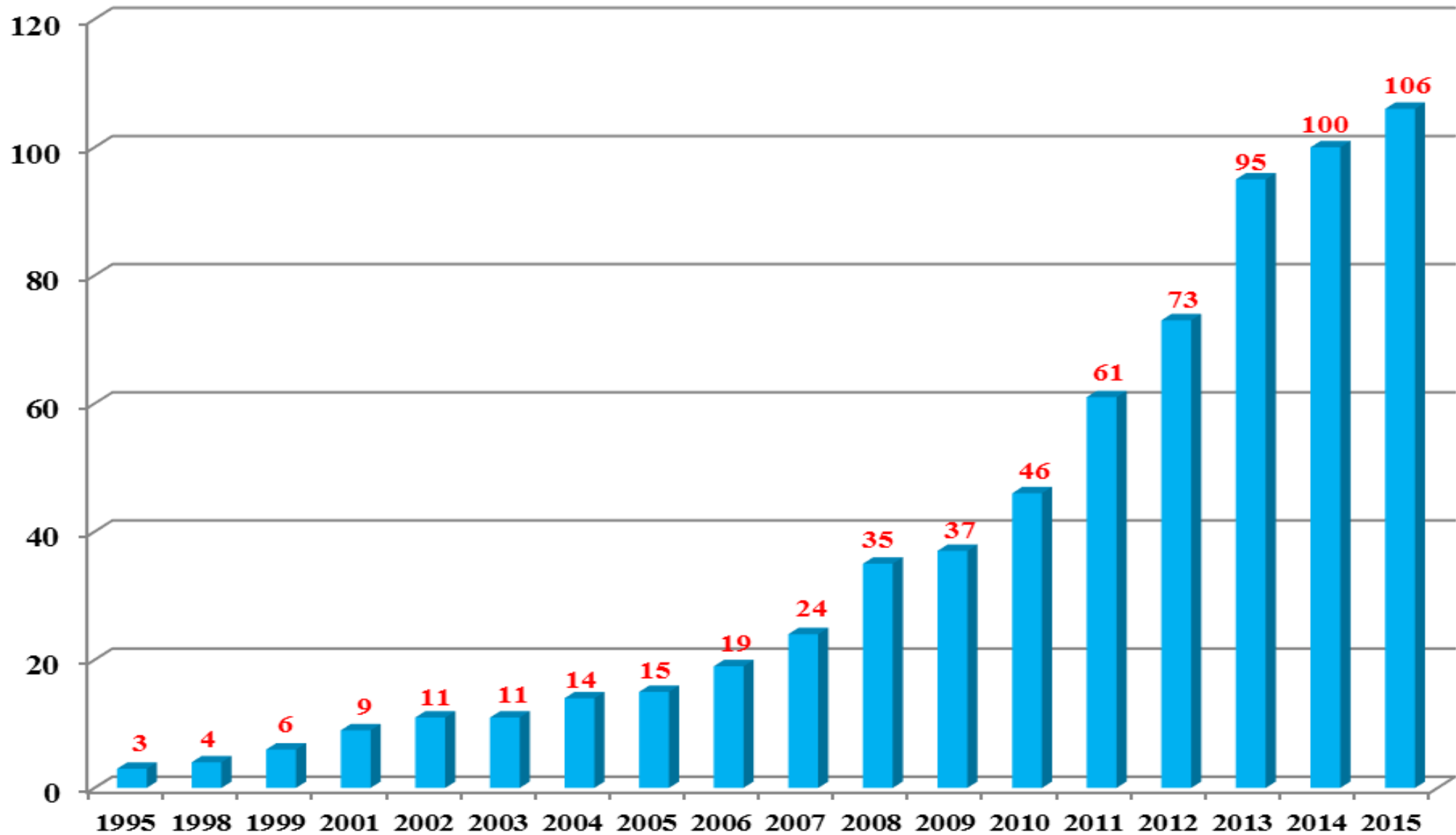
Xi's Main Initiatives

- **A big, bold, and broad anti-corruption campaign**
- **A strong move in consolidating power and tightening political control**
- **A large-scale military reform**
- **An ambitious market reform plan**
- **A new proactive foreign policy**

Xi' s Strong Anti-Corruption Campaign

- Fight against both the “flies” and “tigers”
- Changing behaviors of the “flies”
- Arrests of the “tigers”: more than 160 vice minister level leaders, 56 major generals or above, including 23 members of the new Central Committee
- Dismantling of the Railway Ministry and ongoing investigation of oil, telecommunication, utility industries

Chinese Company in the Global Fortune 500



The Top 10 Banks in the World by Market Capitalization (2013)

Rank	Bank	Country	Mkt. cap. \$b, Jan. 15, 2013
1	Industrial & Commercial Bank of China	China	237.97
2	HSBC	U.K.	207.34
3	China Construction Bank	China	188.12
4	Wells Fargo	U.S.	185.06
5	JP Morgan Chase	U.S.	179.40
6	Agricultural Bank of China	China	147.27
7	Bank of China	China	132.85
8	Citigroup	U.S.	129.97
9	Bank of America	U.S.	125.24
10	Commonwealth Bank	Australia	105.77

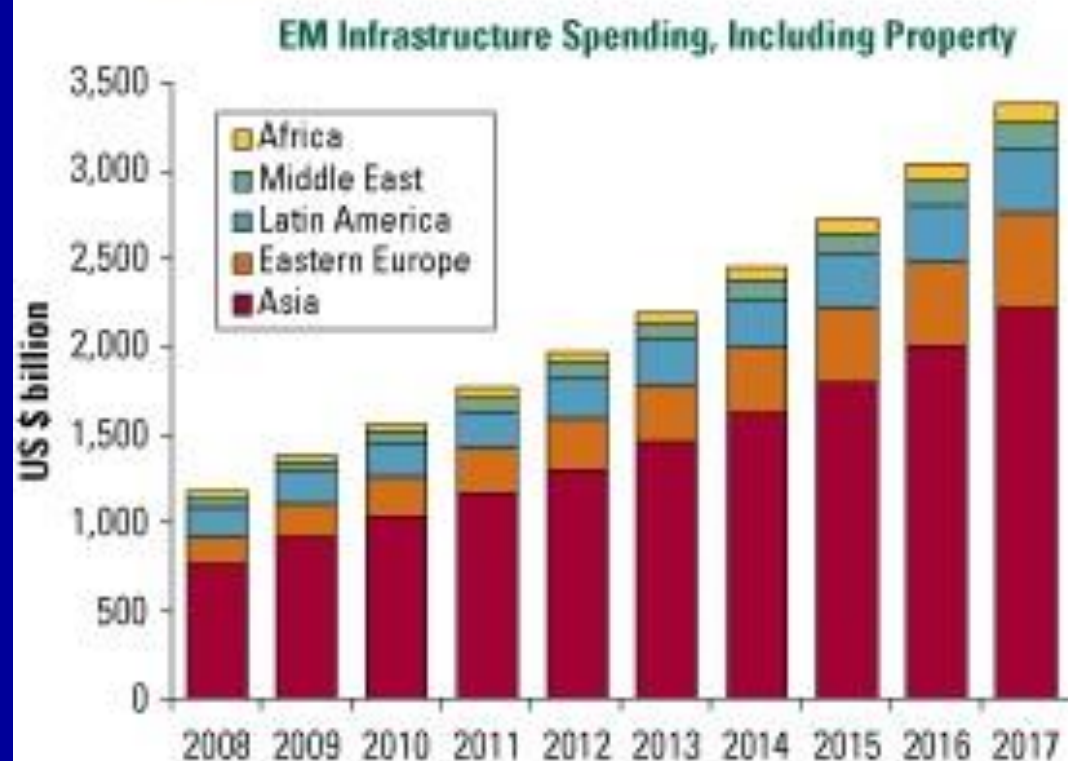
Source: <http://www.relbanks.com/worlds-top-banks>

The World's Top-10 Busiest Container Ports (2014)

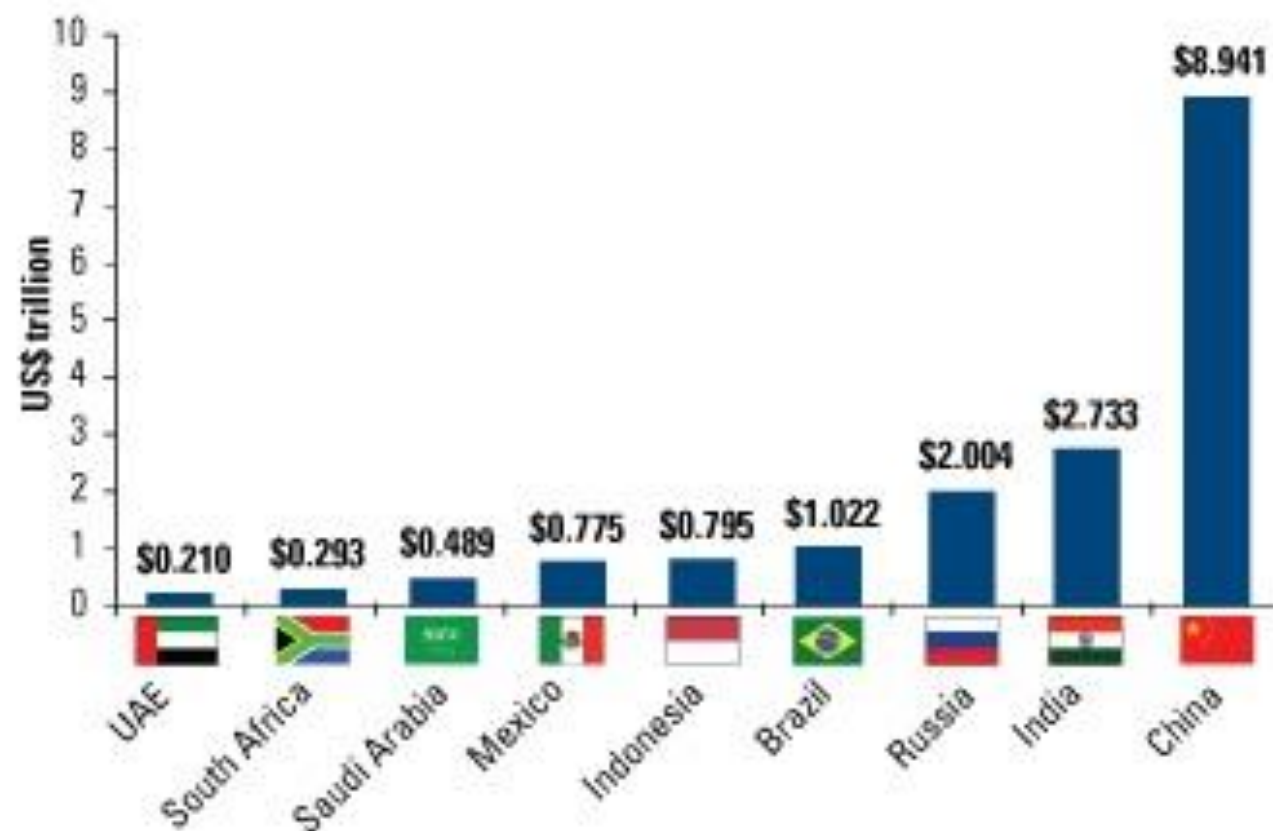
Rank	Port City
1	Shanghai, China
2	Singapore, Singapore
3	Shenzhen, China
4	Hong Kong, China
5	Pusan, South Korea
6	Ningbo-Zhoushan, China
7	Qingdao, China
8	Guangzhou Harbor, China
9	Jebel Ali, Dubai, United Arab Emirates
10	Tianjin, China

Source: *World Shipping Council*.

US\$21.7 trillion in EM Infrastructure Spend 2008-17e



EM Infrastructure Spending: 2008-17e – Key Country Breakdown



Source: Morgan Stanley Research, World Bank, Global Insight e=Morgan Stanley Research estimates

China's Enduring Challenges

China's Shortage of Natural Resources (% of the World)

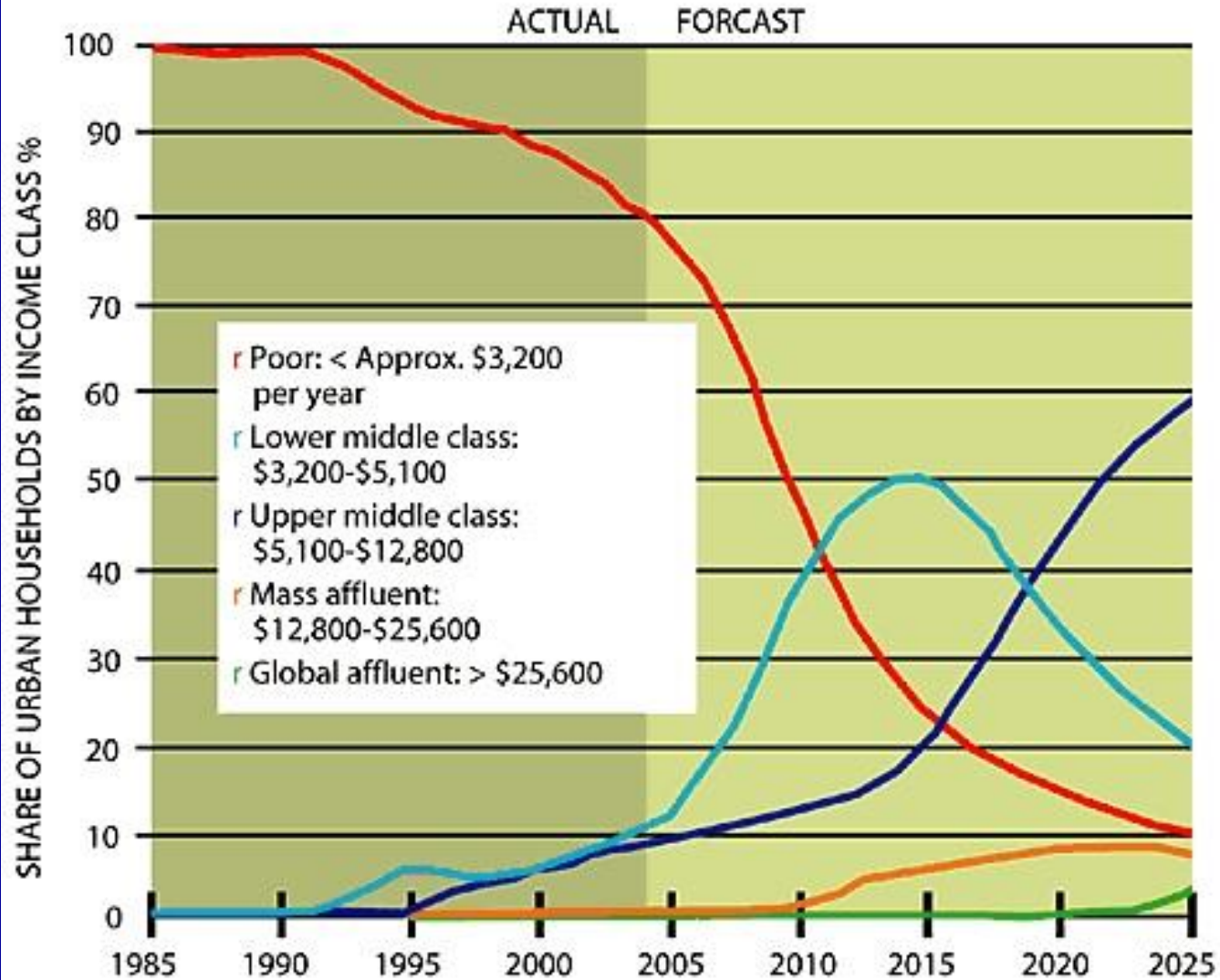
- **20% of the world's population**
 - **7% of the world's arable land**
 - **7% of the world's freshwater**
 - **3% of the world's forest**
 - **2% of the world's oil**
 - **1% of the world's natural gas**
-
- **among the 45 kinds of principal mineral reserves that China possesses, only six will be sufficient to meet the country's needs in 2020**
 - **Almost all major rivers and lakes are polluted, so were the air of the all major cities. All large and medium-sized cities are having shortage of water.**

China's Economic Strengths

- Recent economic miracle and the perception of China's rise
- Rapidly emerging middle class
- Large domestic market
- Huge state assets and foreign reserve
- State-of art infrastructure and transportation
- Distinct Chinese entrepreneurship
- Strong human resources
- Remarkable catch-up in science and technology
- Deep and broad integration with the outside world

Changing places

Investors are beginning to target China's interior in anticipation of a new middle-class market for consumer products.



Source: The McKinsey Global Institute, "From 'Made in China' to 'Sold in China': The Rise of the Chinese Urban Consumer," (November 2006), p. 48.

Economic Reform Strategy

1. Financial Liberalization

The establishment of the Shanghai Free Trade Zone

RMB as part of SDR Basket (2016)

2. Promotion of Private Firms and Service Sector

- public health
- education
- entertainment
- logistics
- green consumption

3. Urbanization

“The new engine of China’s economic growth”

- small city/town development vs. super urban cluster
- affordable housing vs. housing market
- the *hukou* system vs. socioeconomic tensions
- environment and resource

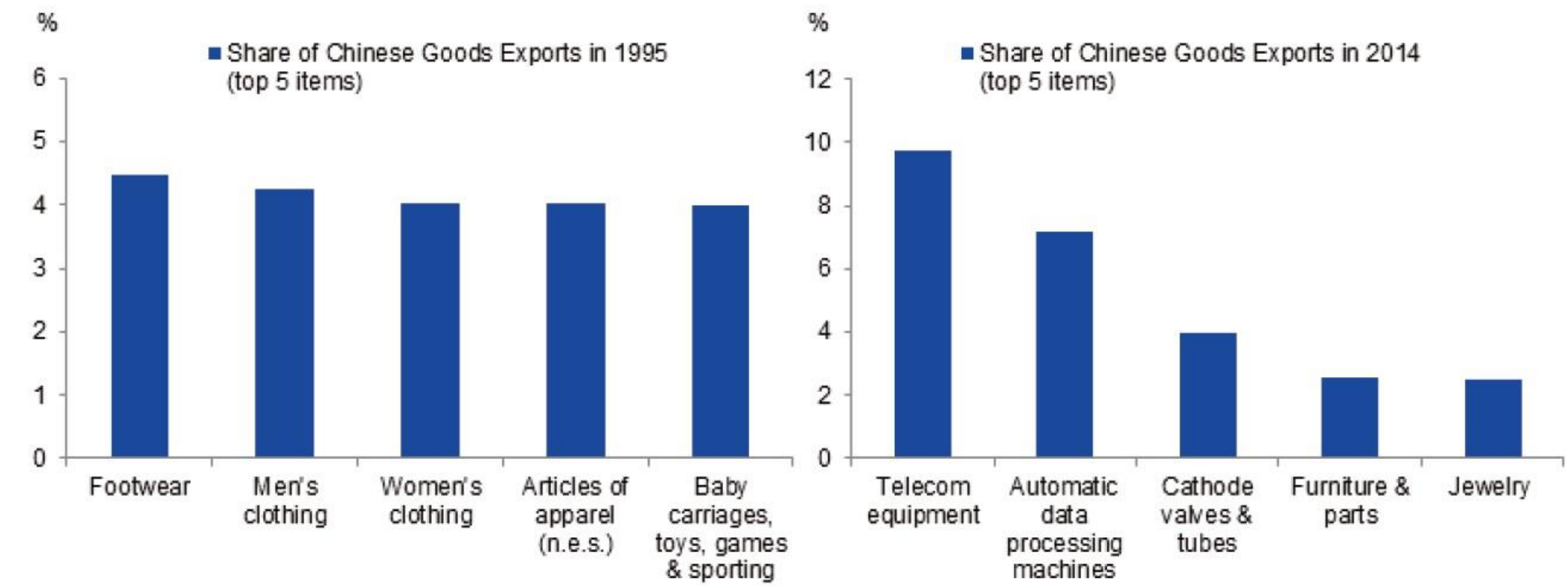
4. Go Global (AIIB and One Belt, One Road)

5. Moving Upward in Global Value Chains

China's "One Belt One Road" (New Silk Road)



Exhibit 3: Detailed trade data show that China has been moving up the export value chain



Source: UN Comtrade Database, Goldman Sachs Global Investment Research

Chart 1

Adding value

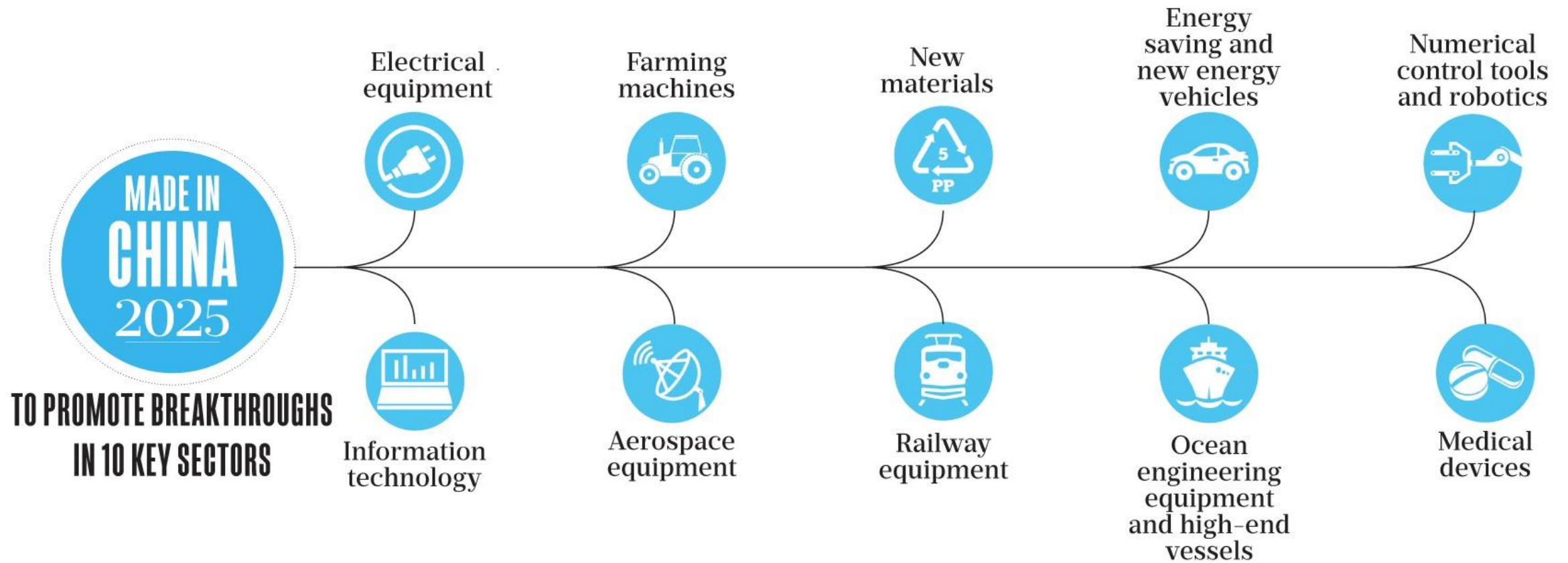
China and other developing and emerging market economies in supply-chain trade have been generating an increasing amount of value added in global manufacturing.

(value added, billions, 1995 dollars)



Source: Timmer and others (2013).

Note: East Asia includes Japan, Korea, and Taiwan Province of China. BRIIM = Brazil, Russia, India, Indonesia, Mexico, and Turkey. EU15 = Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and United Kingdom. North America = United States and Canada.



Source: HQ magazine 2015 edition.

Conclusion and Implications

1. Deal with China's mixed growth model of market reform and state capitalism
2. Don't separate economics from politics
3. Be cautious & be prepared for political risks/crises in China, but the risk for market collapse is low
4. Be aware of China's dilemma regarding growth and environment, its strengths and constraints, its domestic and foreign pressures
5. See China first and foremost as the world's largest market that has desperate need for resources
6. Understand President Xi's economic development strategy on both domestic and international fronts
7. Grasp the "big picture" of China's historical rise, its strive for technological innovation, its upward mobility in global value chains, and the ever-growing role of its middle class

Thank you!