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.
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

- Financial sector
- Government
- Household
- Non-fin corporates

Q1 1996 Q1 2000 Q1 2004 Q1 2008 Q1 2012 Q1 2016

Source: PBOC, BIS, IMF, IIF.

Source: https://jeroenbloklandblog.com/2016/05/04/13-charts-on-chinas-debt-issue/
China debt ratio approaches danger level

% of GDP at end-September 2015

Source: Bank for International Settlements

Source: https://jeroenbloklandblog.com/2016/05/04/13-charts-on-chinas-debt-issue/
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

Nominal GDP growth, y-o-y

- **Leading service Six (35% of GDP)**
- **Heavy industry Six (16% of GDP)**
- **Rest of China (49% of GDP)**

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

MILLION METRIC TONS

- 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

- 1995: 3
- 1997: 6
- 1999: 9
- 2001: 11
- 2003: 14
- 2005: 15
- 2007: 19
- 2008: 24
- 2009: 35
- 2010: 37
- 2011: 46
- 2012: 61
- 2013: 73
- 2014: 95
- 2015: 106
<table>
<thead>
<tr>
<th>Rank</th>
<th>Bank</th>
<th>Country</th>
<th>Mkt. cap. $b, Jan. 15, 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Industrial &amp; Commercial Bank of China</td>
<td>China</td>
<td>237.97</td>
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<tr>
<td>2</td>
<td>HSBC</td>
<td>U.K.</td>
<td>207.34</td>
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<td>3</td>
<td>China Construction Bank</td>
<td>China</td>
<td>188.12</td>
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<tr>
<td>4</td>
<td>Wells Fargo</td>
<td>U.S.</td>
<td>185.06</td>
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<tr>
<td>5</td>
<td>JP Morgan Chase</td>
<td>U.S.</td>
<td>179.40</td>
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<td>6</td>
<td>Agricultural Bank of China</td>
<td>China</td>
<td>147.27</td>
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<td>7</td>
<td>Bank of China</td>
<td>China</td>
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<td>8</td>
<td>Citigroup</td>
<td>U.S.</td>
<td>129.97</td>
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<td>9</td>
<td>Bank of America</td>
<td>U.S.</td>
<td>125.24</td>
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<tr>
<td>10</td>
<td>Commonwealth Bank</td>
<td>Australia</td>
<td>105.77</td>
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</tbody>
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Source: http://www.relbanks.com/worlds-top-banks
# The World’s Top-10 Busiest Container Ports (2014)

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

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

EM Infrastructure Spending, Including Property


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.

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
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. BRIIIM = 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.
Made in China 2025

To promote breakthroughs in 10 key sectors:

1. Electrical equipment
2. Farming machines
3. New materials
4. Energy saving and new energy vehicles
5. Numerical control tools and robotics
6. Information technology
7. Aerospace equipment
8. Railway equipment
9. Ocean engineering equipment and high-end vessels
10. Medical devices

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!