

Economics in Brief



No. 88, 7th October 2015

China's shift is the right approach, some worries are exaggerated

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China's protracted economic boom has drawn to a close. The current growth rate of 'only' around 7% p. a. is also the Chinese government's own target for 2015. Many economic partners who have benefited from the Chinese boom are now worried. How should the 'new normality' be assessed? Below we argue the following two points:

(1) China's shift and cooling-off is generally good for the country itself.

(2) The rest of the world should not mourn the past so much and instead actively explore the emerging new opportunities.

China's previous development path has not been sustainable

It is true that the economic boom has hugely increased people's standard of living. Nevertheless, the growth was not sustained by private consumption but by exports and investment. Both are not problematic as such but in the case of China they conceal some aspects that are cause for concern.

Without a doubt, China's high export volumes document solid achievements in the quest for technological progress and higher competitiveness. In part, however, they result from questionable economic policy measures, especially the artificial undervaluation of the renminbi (RMB) of sometimes as much as 30%. This has harmed foreign competitors but has ultimately not aided China itself either, as the exchange rate distortions have given rise to areas of production that would otherwise not be competitive (exporting enterprises and those that substitute imports). Apart from that, this exchange rate policy is also a cause for China's enormous current account surplus of

more than 10% of GDP up to 2007 which, in turn, must be seen in close connection with the global economic crisis.

The high macroeconomic investment is based on domestic savings or, in other words, on foregoing consumption. High savings are probably not always voluntary but an expression of deficits in the social area. Many Chinese are unable to adequately protect themselves through insurance from elementary life risks such as disease, unemployment and age. In addition, the one-child policy has prevented people from having many children as a form of social security (as is done elsewhere). Thus, a high savings rate is the only form of protection left. Recent developments also include declining productivity and a falling contribution of investments to growth, illustrated by reports of an oversized infrastructure (roads, airports) and empty housing units (even ghost cities). As these investments have also been financed via bank loans, topics to worry about today also include a large portfolio of bad loans.

China's environmental policy is not sustainable either. The country is the world's biggest carbon emitter and local air, soil and water quality is also poor.

China is already changing course

The government sees these problems and has not only promised but already introduced many reforms. The following changes deserve to be mentioned. The undervaluation of the RMB has ended; the current account surplus has dropped significantly; the social security systems are being expanded; loan interest rates in the financial sector have been liberalised and a deposit insurance scheme has been created; environmental regula-

tions are being followed more rigorously and renewable energies are being used to an increasing extent, and the one-child policy has been relaxed decisively. Much remains to be done to complete these reforms but it would be unrealistic to expect the transition to occur overnight in a single step.

However, other issues have also been perceived from outside in a distorted manner, such as the stock market turmoil in the summer of 2015, which ultimately does not pose an overly high risk for China itself nor for the rest of the world.ⁱ

New prospects for China's trading partners are definitely interesting

China's 'new normality' already comes with many changes that significantly affect a number of countries (trade flows, commodity prices etc.). Germany will have to adapt too but has so far held up well. Since 2010 (when China's economy began to cool off), German exports to China have grown significantly by a further 40%. Germany is competitive in areas where Chinese demand will continue in future as well: industrial pollution control, power plant technology, complex problem solutions (energy transition) and vehicles. Good opportunities for German business also exist in developing China's consumer goods industry and opening the market for life insurance and banks. ■

ⁱ See Rehbock, T.: Latest developments in China: tricky, but no reason to panic (just yet). KfW Research Focus on Economics No. 104, 19th August 2015, https://www.kfw.de/PDF/Download-Center/Konzernthemen/Research/PDF-Dokumente-Fokus-Volkswirtschaft/Fokus-englische-Dateien/Fokus-Nr.-104-August-2015-China_EN.pdf