Outlook for China’s economy

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Imports growing faster than exports – is China a potential engine of global growth?

- China’s imports are growing faster than its exports.
- The annual increment in China’s imports already comfortably exceeds Japan’s.
- Lehman Bros modelling, with 8% growth and unchanged elasticities, shows the annual increment in China’s imports will exceed the EU’s by 2011.
- This could happen sooner if China’s propensity to consume rises.

Source: Datastream
Imports growing faster than exports – especially from other Asian countries

Source: Datastream
China is a rapidly growing export market for other countries, especially in the same region.

- China’s imports have expanded from US$166 bn in 1999 to US$413 bn in 2003 - an average of 26% pa over the past 4 years.
- ASEAN and Taiwan are becoming increasingly integrated with China’s economy.
- Equipment suppliers such as Japan and South Korea had a very strong year in 2003.
- Raw materials suppliers (Russia, Australia) are doing well. Australia rates low in the chart because of 2 mediocre years in 2001-2002, but 2003 was strong.

Note: Figs in brackets are shares in China’s imports in 2003. Source: Datastream
China – the most important player in world steel

In 2003, China accounted for 23% of world steel production and 30% of consumption.

Source: International Iron and Steel Institute
China’s overheating – policies and risks

Symptoms of overheating
- Infrastructural bottlenecks
- Shortages of critical materials
- Upward pressure on prices

Risk factors present in China
- External crisis
- Property bubble
- Inadequate control mechanisms
- Excess capacity

Measures recently introduced
- The PBoC is seeking to reduce the supply of credit by –
  - Higher bank cash reserve ratios
  - Higher equity requirements for borrowers in steel, aluminium, cement and property
- New projects in steel, aluminium, cement will not be approved
- Banks to give priority to borrowers in coal, electricity, oil and transport infrastructure
- If provincial inflation above a certain level, prices to be frozen
Gross Fixed Capital Formation (GFCF) in China is high by historical standards

<table>
<thead>
<tr>
<th>Country</th>
<th>Period*</th>
<th>GFCF/GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>1969-1990</td>
<td>31.5</td>
</tr>
<tr>
<td>Sth Korea</td>
<td>1970-1983</td>
<td>27.7</td>
</tr>
<tr>
<td>Sth Korea</td>
<td>1983-1994</td>
<td>32.7</td>
</tr>
<tr>
<td>Japan</td>
<td>1960-1969</td>
<td>31.6</td>
</tr>
<tr>
<td>China</td>
<td>1979-1987</td>
<td>28.9</td>
</tr>
<tr>
<td>China</td>
<td>1987-1996</td>
<td>31.8</td>
</tr>
<tr>
<td>China</td>
<td>1996-2004</td>
<td>38.0</td>
</tr>
</tbody>
</table>

* Each period represents a doubling of GDP/capita

Source: IMF *International Financial Statistics*
China's electricity usage may be a better guide to economic growth than the GDP figures

- From 1991 to 1996 the growth of electricity usage was about four-fifths of GDP growth.
- This ratio was lower in 1997 and 1998, suggesting GDP growth may have been overstated.....
- ..... but since then, the growth of electricity usage has exceeded GDP growth, suggesting the economy has been stronger than reported.

Source: China Statistical Yearbook.
China may be heading into a slowdown, but the long term outlook is bright

- ANZ is forecasting 8.7% growth this year, in line with consensus.
- The impact of the slowdown will be in 2005, rather than 2004.
- Forecasts for 2005:
  - Official target: 7%
  - ANZ: 6%
  - Consensus: 7.7%
- Lower growth will allow some breathing space for expansion of power and transport to catch up with demand.
- If 2005 is worse than expected, government can re-open the fiscal tap.
- Long term outlook is positive, due to “creative destruction”:
  - Command economy institutions exposed to competition
  - Entrepreneurship encouraged
  - Open to foreign investment and technology
  - Workers moving from low to high productivity jobs