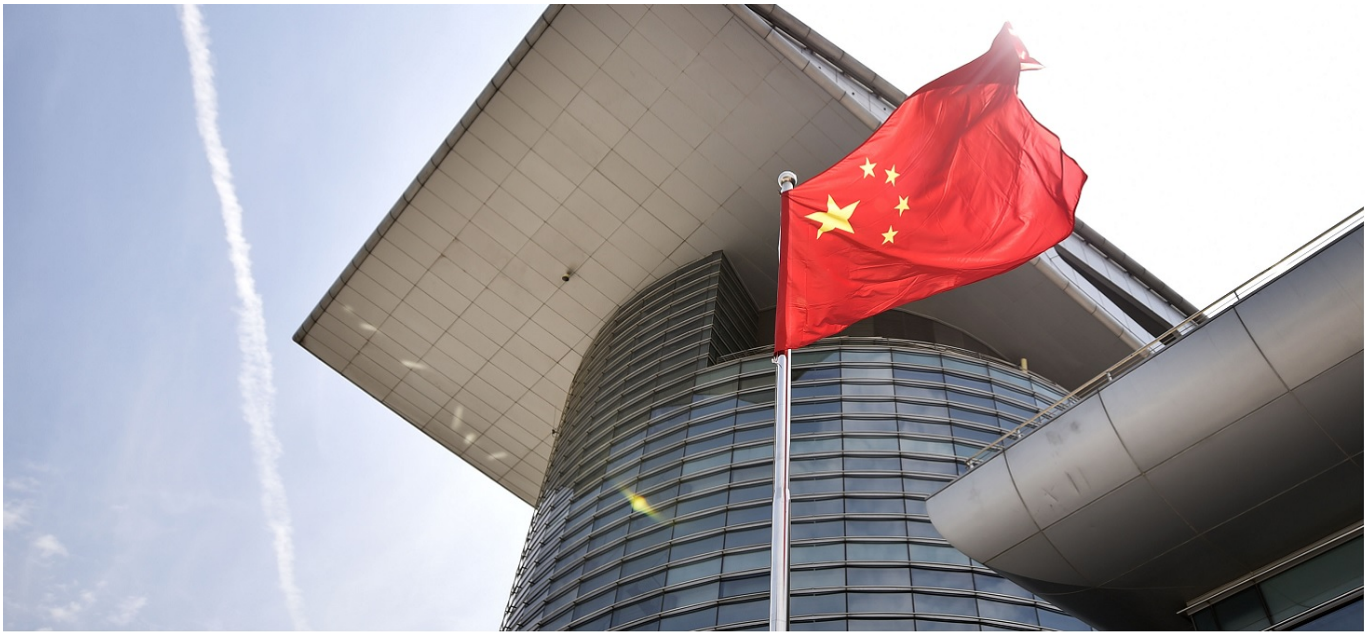

The economic and financial risks in China are real. (Keystone)

Market commentary

Is China's economy heading for trouble?

29 October 2018, written by Ellie Hession

Worries over the health of the Chinese economy and financial system have plagued financial markets for much of the past year. Chinese jitters were behind a plunge in global equities in early 2016 and the summer of 2015.

One year on from last summer's CNY devaluation, some concerns are justified. China is suffering from industrial overcapacity and rising debt. And the transition to a market-based exchange rate will be delicate. Still, we believe China can overcome these challenges, and has the policy tools to engineer growth of close to 6.5% a year.

House View

1. The world economy has become heavily reliant on Chinese growth, and disappointments can shake global markets.

- Between 2008 and 2015, China accounted for around 30% of global GDP growth in purchasing power parity terms.
- In the month after China changed its currency regime in August 2015, global equities fell 4% in USD terms.
- In early 2016, China worries were again behind an 11% fall in global stocks between the start of the year and mid-February.

2. China's old industries are already contracting and its financial system is vulnerable to rising debt.

- Fixed asset investment rose by 8.1% year-to-date versus a year ago in August, and private investment growth slowed to 2.1% year-on-year.
- Total debt has gone from 150% of GDP before the financial crisis to nearly 250% today.
- Capacity utilization rates have fallen sharply in a range of industries since 2008.

3. But China's government has the tools and determination to prevent a slowdown from turning into a crash landing.

- Retail sales growth has remained over 10% year-on-year. Consumption contributed 73% to Chinese growth in the first half, up from 60% a year ago.
- A closed capital account, stable reserves and a USD 256bn current account surplus mean China can manage its rising debts for now.
- China’s finance ministry has pointed out that government debt to GDP is low at around 40%, giving room for further stimulus or the capacity to bail out failing state companies.

Background

- China used as much cement between 2011 and 2013 as the United States used in the entire 20th century.
- China's consumers bought nearly 25 million cars in 2015, equivalent to Western Europe, South America, and Japan combined.

Anecdotes

Credit is becoming less effective at boosting growth. It now takes four yuan of new credit to boost GDP by one yuan, from a ratio of around 1-to-1 in the 2004–2007 period.

Investment view

CIO is overweight emerging market equities in global portfolios and overweight China within EM equity allocations. CIO forecasts USDCNY to climb to 6.80 in three and six, and to 7.00 in 12 months.

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Risk Information