A soft landing in the Chinese economy

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Slowing Down GDP Growth Rates

In the second quarter of 2012, Chinese economy grew **7.6%** percent, slowest rate in more than three years. IMF forecasts **8% growth rate for 2012,** which was revised from the last forecast of 8.2%, for the Chinese economy. The slow down in the GDP might continue in the third quarter.

Another important indicator is the growth in electricity consumption. The reliability of Chinese statistical data is subject to hot debate (it is generally accepted that the electricity consumption data is more reliable compared to GDP data in China). The year-on-year growth in the first two quarters of electric consumption was 5.5%, which was about 11% last year. Hence, we observe a drop of 6% in the year-on-year electric consumption growth in China.

The central bank is expected to cut the interest rates further in the third quarter. Another 25 basis points cut in the deposit and lending rates might be the next move of the Chinese Central Bank. In China interest rate market is controlled by the Central Bank. Another expectation is a 50 basis point cut in the reserve requirement ratio in the third quarter. We might observe the reserve requirement rate go down to 19% or below during 2012.

Further policy easing on the way

China's Central Bank has cut interest rates twice in the space of a month, accompanied by liberalization moves allowing banks to discount borrowing costs to help cushion the impact from the external economic downturn.

China's average consumer inflation is expected to slow to 3% in 2012 before ticking up to 3.3 percent in 2013, both of which are well below Beijing's full-year target of 4 percent set at the beginning of this year. The downward trend in the consumer price index gives higher flexibility for expansionary monetary policies by the Central Bank.

China seems to achieve a soft-landing; there is no sign of hard landing for the Chinese economy in 2012.

Three main factors that prevent the possibility of a "hard-landing" in China:

1) The downward trend in inflation and room for expansionary monetary policies. Inflation is expected to go down further in the Q3 from its current level of 2.2. There might be an increase in inflation in the Q4 due to expansionary monetary and fiscal policies.
2) Relatively stable property prices in most cities. According to a recent survey in 40 out of 72 cities, property prices started to slightly increase and bottomed out. Overall, during 2012

property prices in first tier cities dropped around 10%. However, currently the downward trend in property prices seems to be stabilized.

3) The big budget surplus and room for fiscal stimulus. Over the past 15 years, the growth in tax revenue has been quite rapid. But it was needed and was rooted in the tax reform of the mid 1990s. As can be seen in Figure below, the government debt to GDP ratio is relatively low in international standards.

Even though there is no expectation for a hard-landing, it is expected that Chinese economy will be growing at moderate rates in the coming years. The double digit growth rates might not be achieved for the coming years. Increasing labor costs and opening up of the Chinese economy may force the low-tech export industries to get out of the market. However, as the weight of high-tech and service industries increase in the total GDP, this transformation of the economy might run smoothly. Transformation of the economy towards higher value added products and service industries will be on the agenda of policy makers in China.

Summary

There has been a significant slow down in the Chinese economy; however there is still a lot of room for expansionary monetary and fiscal policies. Year-on-year growth of electricity consumption in China decreased to 5.5% from 11% growth rate, which shows the severity of the slow-down. Export led industries of China might face a grim outlook for the next two years. However, high-tech and service industries have better prospects for the coming years. These industries are expected to receive more support from the government. Considering the recent interest rate and reserve requirement cuts and credit expansion, which might be combined with fiscal expansion in the remaining two quarters of 2012, China is not expected to experience any crisis or "hard landing".

Monetary easing and fiscal stimulus is on the way to keep the growth rate at 8% in 2012.

We expect the Chinese economy to settle down to a growth path around 7.5%-8% for the next two years.