

China in Globalization




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skema EFMD EQUIS

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China in the global economy


- GDP= US\$9000 billion
- 2° GDP
- 2° global trade
- 3° FDI (\$100 billion)
- 25 enterprises in global Top 500 WTO since 2001
- Institutional Investor 2013= 23
- HDI = 101°
- GDP per capita \$8000 ppa



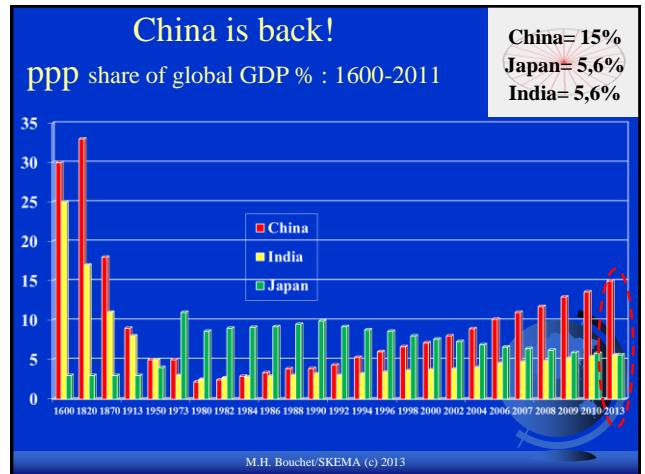
Source: WB & IMF/2013 M.H. Bouchet/SKEMA (c) 2013

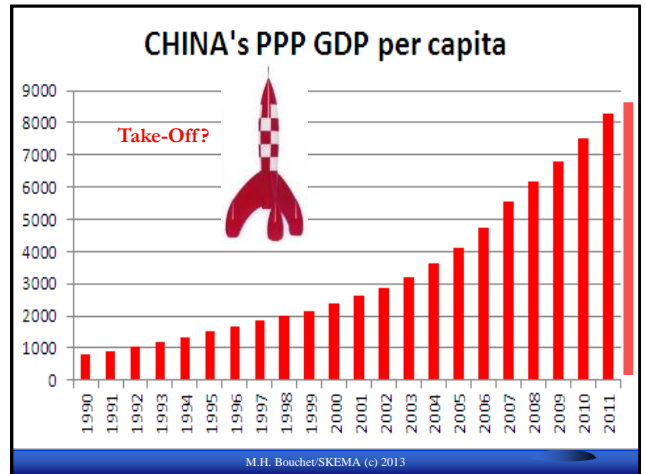
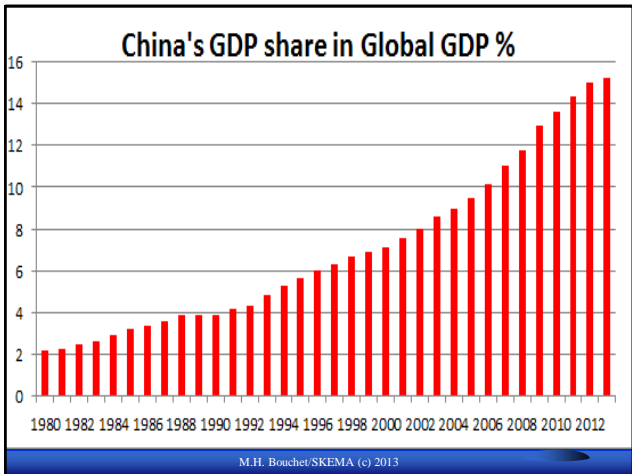
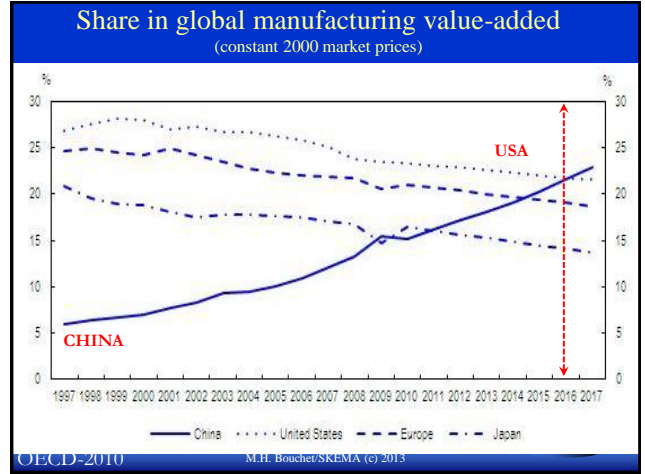
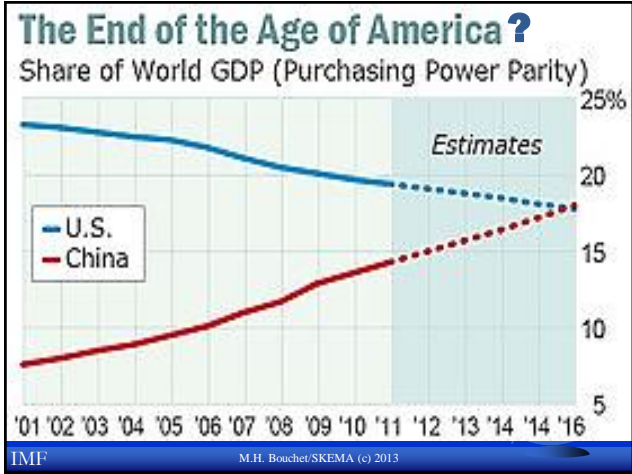
The « decoupling myth »

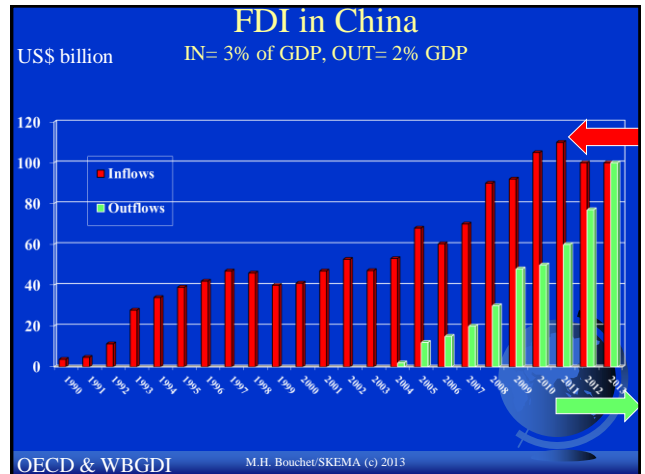
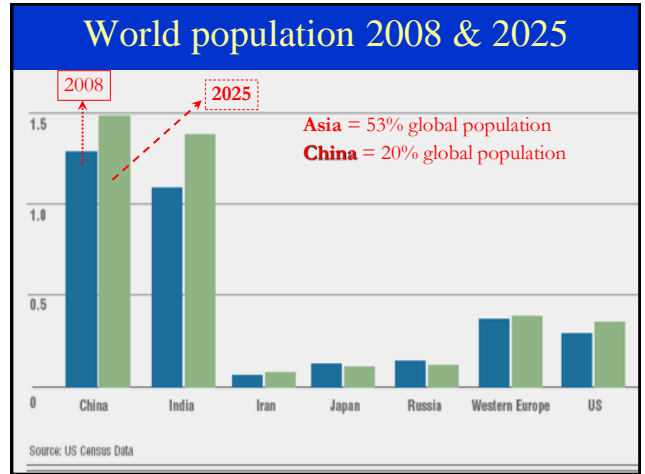
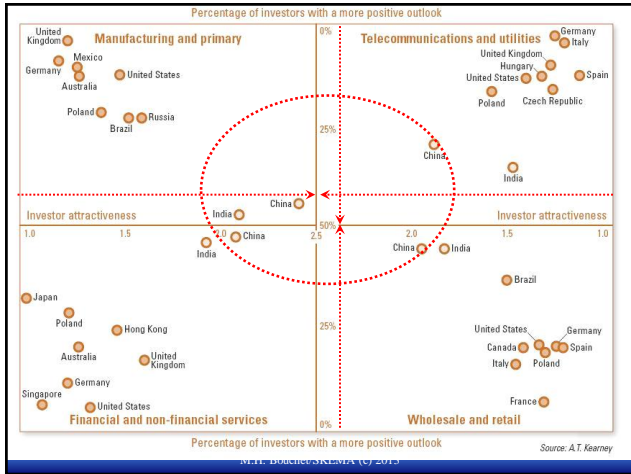
- With « only » 15% of global GDP, China cannot alone offset the impact of the **falling world demand** on developed countries! Global GDP 2011-13= 4%
- Global slowdown pushes down **commodity prices** (good for China), but it also **cut access to capital flows and FDI, and reduces 2008-13 export demand** (bad for China!)
- But with large official reserves and a current account surplus, China is in strong position to **fight back and to rebalance economic growth toward domestic consumption!**

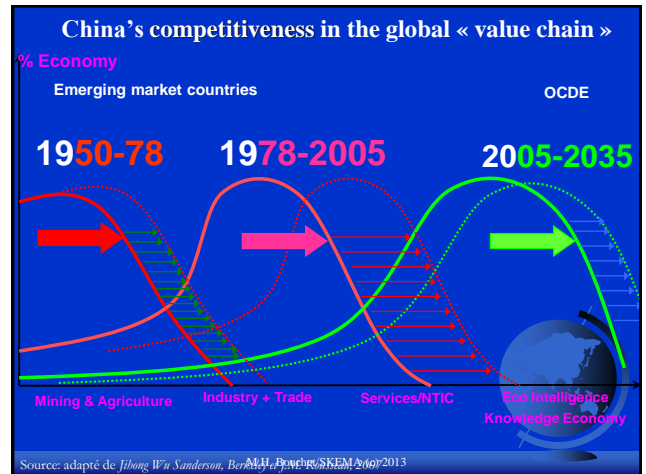
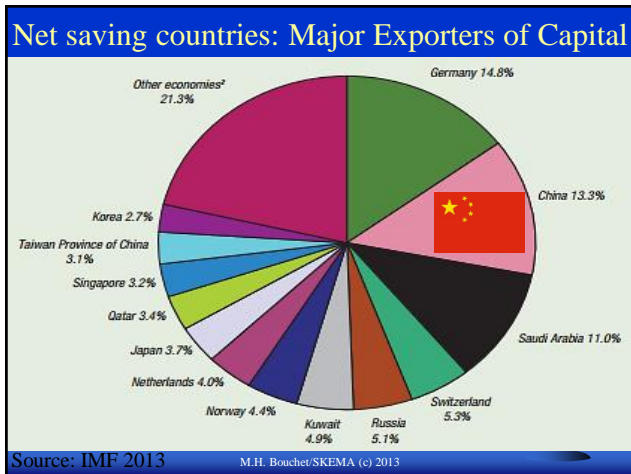
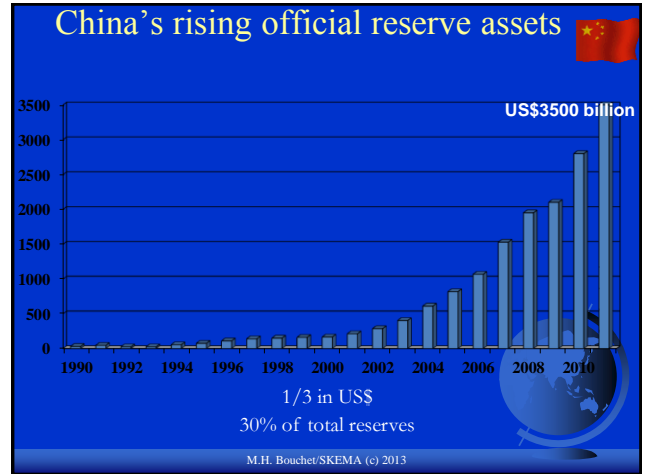
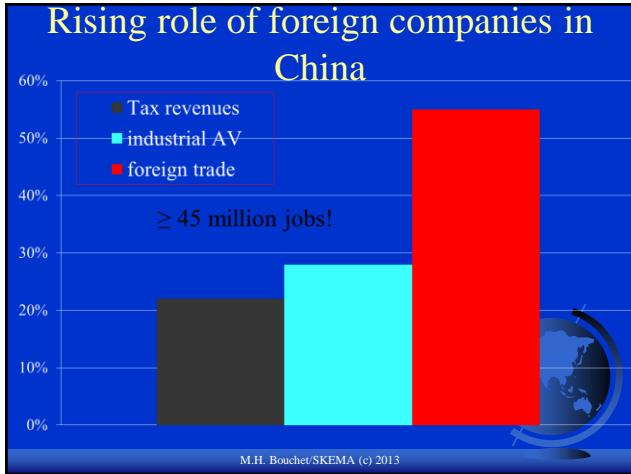


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Davos-WEF 2013 Competitiveness Index	
Switzerland	1
Singapore	2
Finland	3
Sweden	4
Netherlands	5
Germany	6
United States	7
United Kingdom	8
Hong Kong SAR	9
Japan	10
Qatar	11
Denmark	12
Taiwan, China	13
Canada	14
Norway	15
Austria	16
Belgium	17
Saudi Arabia	18
Korea, Rep.	19
Australia	20
France	21
Luxembourg	22
New Zealand	23
United Arab Emirates	24
Malaysia	25
Israel	26
Ireland	27
Brunei Darussalam	28
China	29
Iceland	30
Puerto Rico	31
Oman	32
Chile	33
Estonia	34
Bahrain	35
Spain	36
Kuwait	37
Thailand	38
Czech Republic	39
Panama	40

Brazil= 48
Mexico= 53
India= 59
Russia= 67
Vietnam= 75

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Where does **competitiveness** come from?

1. Low labor cost
2. Dynamic investment in R&D
3. Strong productivity
4. Efficient Infrastructure + Institution mix
5. Optimal Employment and Capital mix
6. Flexible exchange rate



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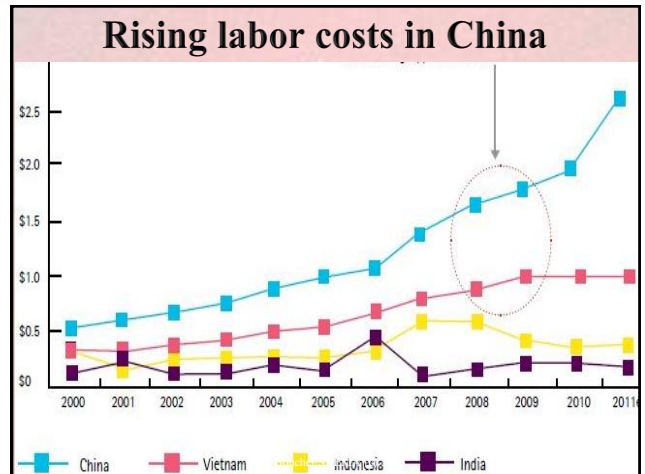
Average monthly salary in Asia in € in 2013

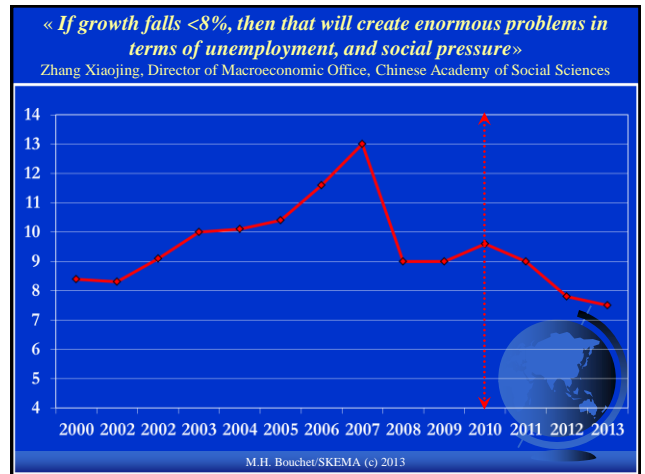
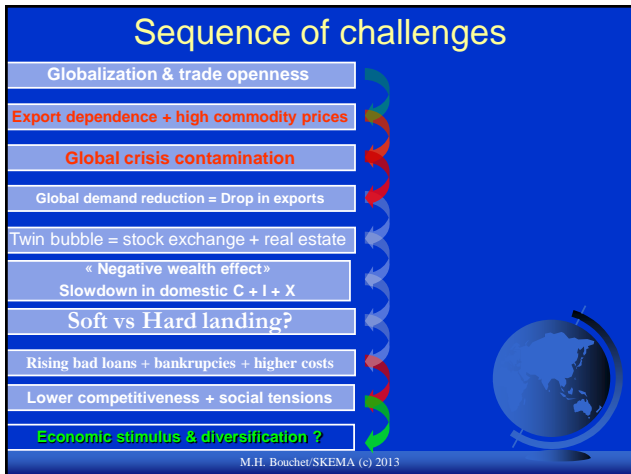
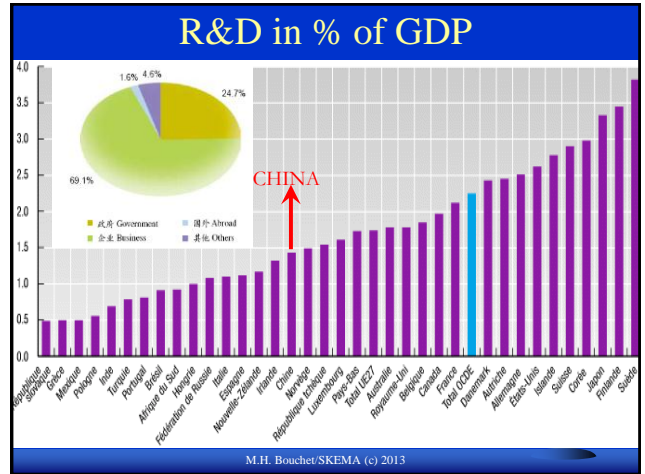
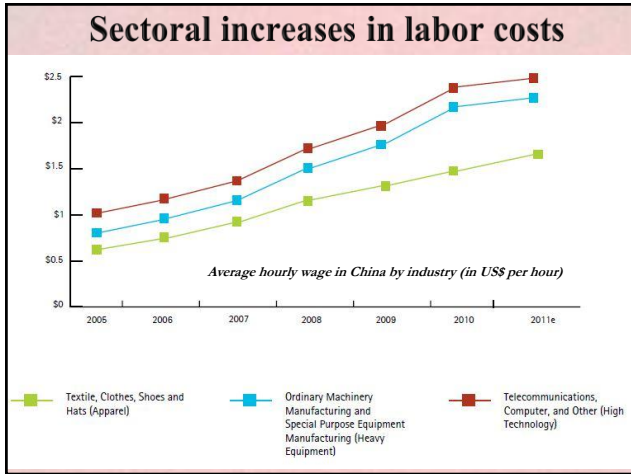
	Hanoi/ Saigon	Suzhou/ Shanghai	Singapore	Bangkok	Jakarta	Manilla	Kuala Lumpur	Delhi
Worker	90/110	200/250	470	120	65	230	340	90
Engineer	250/350	400/450	1400	450	200	350	670	500

Salary gap Asia/Europe

	Hanoi/ Saigon	Guangzhou/ Shanghai	Singapore	Bangkok	Jakarta	Manilla	Kuala Lumpur	Delhi
Worker	1 to 12	1 to 6	1 to 3	1 to 8	1 to 21	1 to 6	1 to 4	1 to 20
Engineer	1 to 12	1 to 8	1 to 2.6	1 to 8	1 to 18	1 to 10	1 to 5	1 to 6

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China's challenge= managing soft economic landing 09/2013: monetary easing + infrastructure projects

- ⌚ LT sustainable < potential > growth rate = <8%
 - ⌚ Negative impact of end of QE on Asia and on all EMCs
 - ⌚ Weaker external demand (EU/US/Japan)
 - ⌚ Lagged impact of earlier tightening measures
 - ⌚ Falling corporate profits
 - ⌚ Rising Yuan exchange rate
 - ⌚ Rising debt/GDP ratios
- ⌚ **Structural** turning point: inefficiencies of investment and government-led growth
 - ⌚ Structural shift from export and infrastructure to household consumption
 - ⌚ Demographic decline and shrinking working population
 - ⌚ Lower surplus labor and higher labor costs

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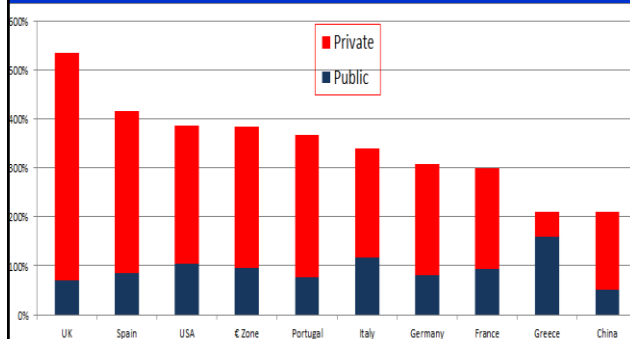
N°1 China's key **structural** challenge: the limit of funding growth with debt

1. Growing indebtedness due to bank-financed Investment: ratio of bank loans/GDP= 135% + Shadow banking and large NPLs
2. Declining rate of return of bank financed investment by SMEs (construction and infrastructure)

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China's growing debt dependency

Total debt (government + corporate + regions + households) shot up from 130% GDP in 2008 to 200%, more than Yuan 100 trillion



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n°2 Challenge: Growth is not a problem for China, but nor is the solution

- ⌚ **Demographics dominate** : Looming decline in working-age population (2022) and rising number of pensioners: **being old before being rich?**
- ⌚ End of cheap and abundant labor: From extensive to intensive growth model?
- ⌚ As agriculture surplus labor is exhausted, industrial wages rise faster, industrial profits are squeezed, and investment return falls

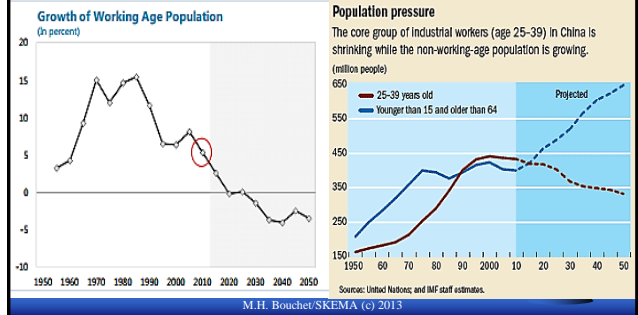
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China is on the verge of a major demographic shift

- China's economic rise has depended on a **vast supply of low-cost labor** but its working-age population is poised to decline, with big implications for China and the rest of the world.
- Worker demand for higher wages and better working conditions suggests the **onset of a structural tightening** in the Chinese labor market.
- Aggregate wage growth has remained about 15 percent during the past decade, and corporate profits have remained high. Wage growth lags productivity, resulting in rising profits:
- China has not **yet** reached the so-called **Lewis Turning Point** (1954), (at which it would move from a vast supply of low-cost workers to a labor shortage economy)

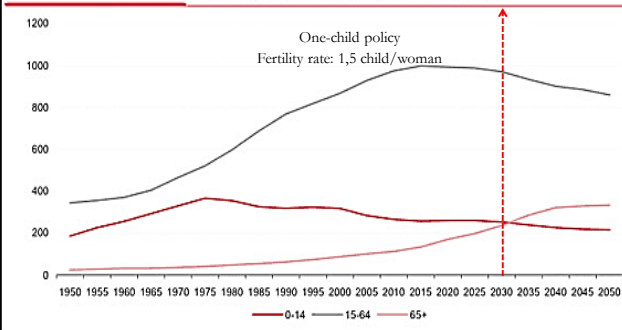
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Within a few years, the **working-age population** will reach a historical peak and then begin a sharp decline. Then the vast pool of low-cost workers—a core engine of China's growth model—will disappear. China's current fertility rate of **1.5 birth/woman** is among the lowest in the world, including in emerging Asia. The looming demographic changes are large, irreversible, and inevitable.



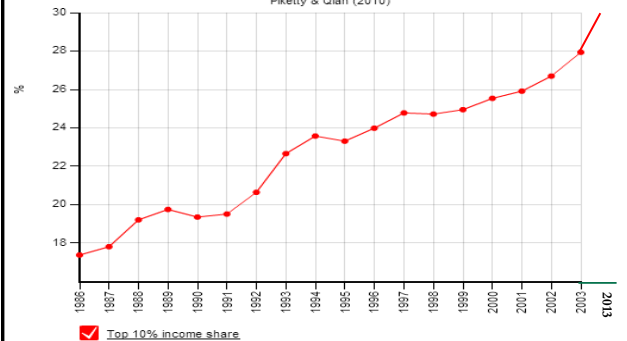
Aging population and looming labour shortage

Chinese working age population to plateau from 2015 (population 000,000s)



Richer but more and more unequal

Top income shares, China, 1986-2003
Sources: The World Top Incomes Database, <http://topincomes.g-mond.parisschoolofeconomics.eu/>
Piketty & Qian (2010)

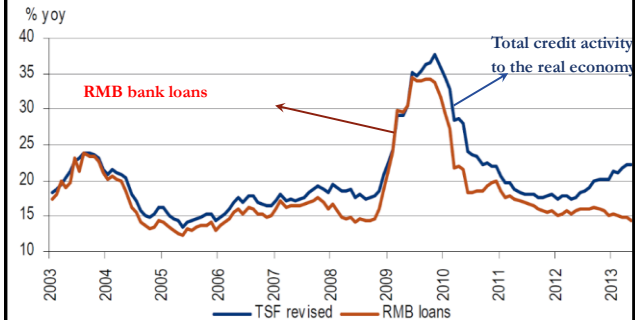


n°3 challenge: reforming and strengthening banking system

- Bank credit boom since 2008= rising problem loans = large bad debt write-offs
- China's banking sector is grossly inefficient, and its capital structure remains fragile. Outstanding loans are expected to have reached 200% of GDP at the end of Q2 2013, up from 130% in 2008
- Dynamic and cheap lending has created potential bubbles in housing, non-performing loans and asset prices, with wider income inequality between regions.
- The estimated \$1.6 trillion debt racked up by Chinese cities and local governments is a potentially big land mine. Local governments are not allowed to issue bonds or borrow from banks directly: SP financing vehicles with government assets (land) to borrow from state-owned banks and to fund real-estate infrastructure projects: Total loans outstanding to local governments financing platforms= R7660 b (o/w 26% with high default risk)

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Banking dis-intermediation: the rise of non-bank financial credit by the shadow financial system



Source: PBoC, BofA Merrill Lynch Global Research

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The burgeoning shadow banking system: opacity! I

- Shadow banking is huge, and its link to 'legitimate' banks is often underestimated: two-thirds of the Chinese financial system's impressive \$14 trillion growth since 2008 (= entire US commercial banking system) took place in the shadow system.
- Banks are not insulated from losses, but rather they are involved in three-quarters of shadow finance transactions. Much of banks' exposure to risky sectors (Chinese property bubble), is booked through manufacturing companies, which in turn have property subsidiaries, thus exposing banks even though it might not appear as such on the books.
- The NPL ratio is officially set at around 1%, though 36% of credit is outside of loan portfolios and bad assets can be unloaded at any time. Fitch uses an NPL ratio of 20% to 30% for the Chinese banking sector.

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The burgeoning shadow banking system II

- Around half of all new credit injected into the economy is provided by non-banks, up from 10% a decade ago.
- 1. The weakest link is **Trust products**. Chinese banks work closely with trust companies by repackaging trust loans to offer investors a higher yield than bank deposits. These products are mainly sold by commercial banks either at their branches or online. Many of the funds that were obtained through these channels went into real-estate development, infrastructure projects, the manufacturing sector and local government financing vehicles.
- 2. Banks use also off-balance sheets **wealth management products** to attract deposits, with mismatches between assets and liabilities and a lack of liquidity. WMPs account for roughly 16% of all commercial bank deposits. Around 85% of the wealth management products mature in 6 months or less.
- Banks are playing the role of 'middlemen' between the recipients and investors. Many WMPs are not even linked to any specific asset, rather, just to a pool of assets, whose cash inflows may often not match the timing of scheduled WMP repayments. To get a higher yield, the proceeds were invested in bonds.

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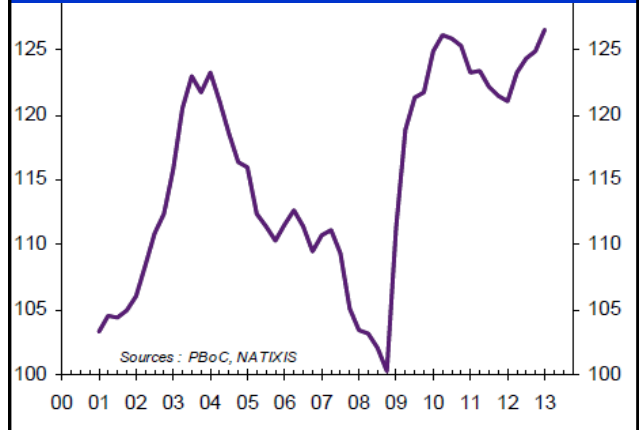
The burgeoning shadow banking system III

- 3. **Credit-guarantee companies (CGCs)** help small and medium-sized enterprises access credit, guaranteeing the credit quality of the SMEs, while pledging to pay for any losses in the event of a corporate default. The bank, assured that its loan is backstopped, can issue the loan through the CGC, effectively creating a credit default swap



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Bank credit/GDP ratio 2000-2013



n°4 Challenge: moving toward market-based exchange rate management

Effects of “undervalued” Yuan:

- Boosting Chinese exports competitiveness
- Dynamic FDI flows in China
- Expensive imports (energy, raw materials, capital goods)
- Yuan supply increases with inflationary pressures
- Burden on market-based free floating currencies: Dollar, Euro, Pound...
- Interest rate pressure



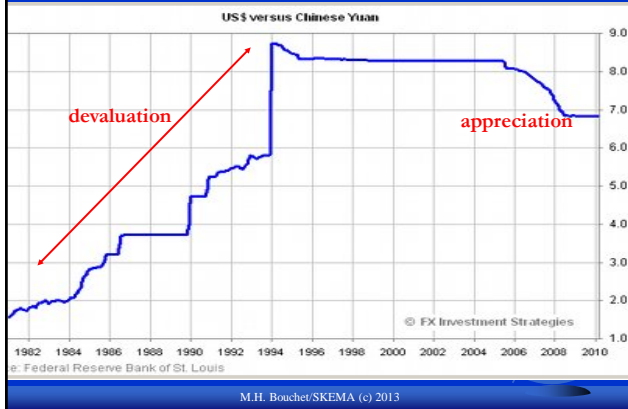
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Estimates of Yuan Undervaluation

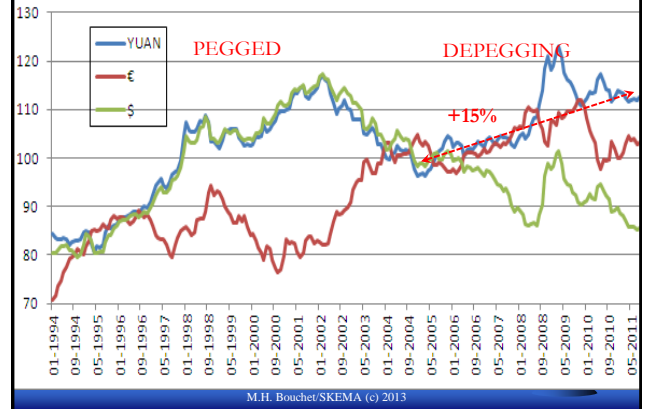
Source	Publication	Date	Percent Undervalued
IMF	PPP Level	2013	10%
Big Mac Index	The Economist	2010	48%
Preeg	MAPI	Sept. 2002	40%
Yang and Bajoux-Besnainou	Is the Chinese Currency Undervalued?	Nov. 2003	28% based on PPP (using 1985 as fixed base year)
Williamson	IIE lecture	Oct. 2003	> 25%
Anderson/UBS	The Complete RMB Handbook	Oct. 2003	Nearly 25% in real terms
US Congress Schumer	Testimony to Congress	Oct. 2003	27% >40%
JP Morgan	Thomson Reuters	2010/1990	13% re-valuation
Bhalla	Chinese Mercantilism: Currency Wars and How the East Was Lost	July 1998	10-15% as of 1998

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The Yuan under control 1980-2011



Yuan, €, \$ = Nominal effective exchange rates 1994-2011



Toward Yuan globalization despite NO capital account liberalization?

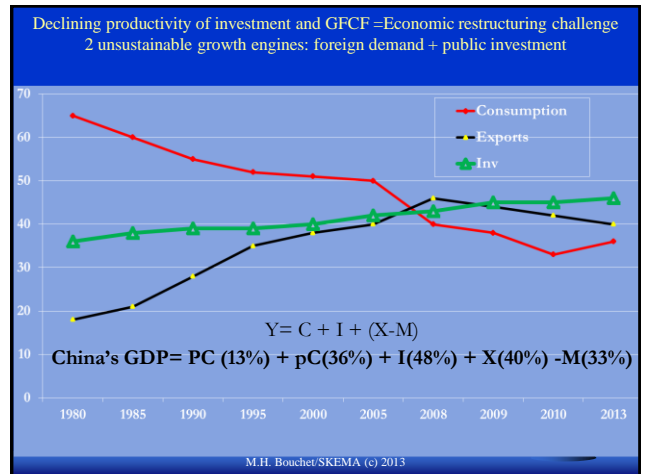
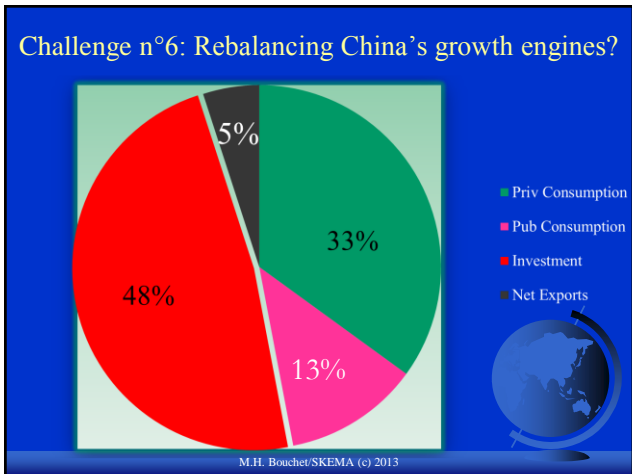
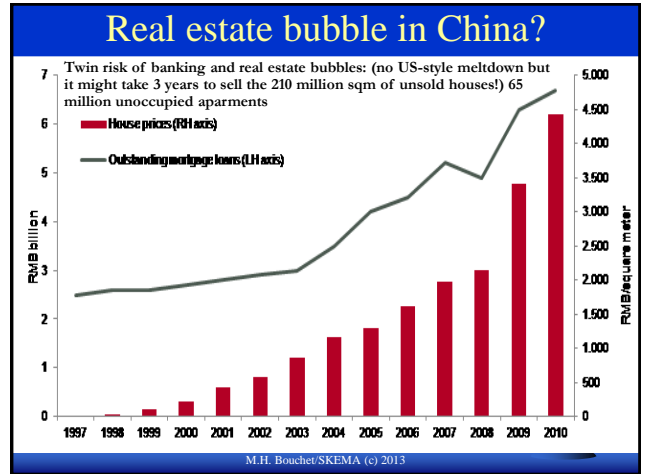
- ☞ Global use of the Yuan in trade settlements
- ☞ Rise in the offshore yuan market in HK, to reach close to 1,25 trillion Yuans of deposits by end 2013
- ☞ Pilot program to allow yuan cross-border lending by on-shore MNCs
- ☞ 11/2012: Standard Chartered launched the Renminbi Globalisation Index to cover three markets which dominate the offshore RMB business: Hong Kong, London, and Singapore

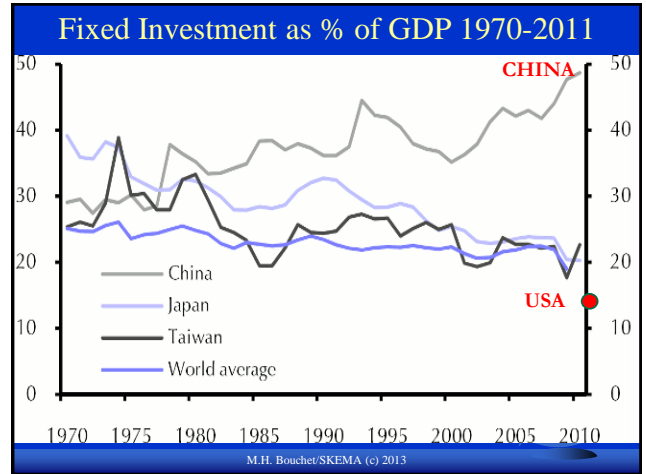
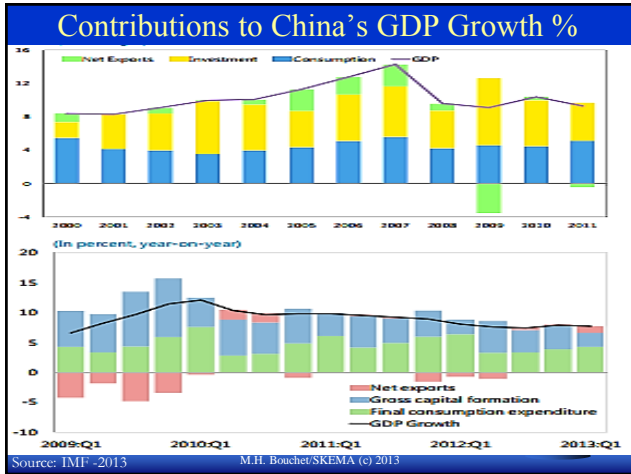
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n°5 Challenge: preventing asset price bubbles and cooling the overheated property market

- Negative real rate on bank deposits = rising real estate investments
- Home owners must make 20% deposit on RMB1 million house on average (minimum salary = RMB1000=€110)
- 70% of city residents own their homes
- Houses in Shanghai and Beijing = 15-20 times average annual salaries
- 2 new policy measures-2010-13: large public housing construction programme + introduction of property tax
- VIDEO: <http://www.youtube.com/watch?v=rPILhT1v7E&feature=youtu.be>

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Risks?

- ☞ No immediate hard landing: No financial & banking crisis without fiscal crisis
- ☞ Fast increase in Fiscal revenues of the state 2011-13
- ☞ Households savings = 20% of GDP
- ☞ SOEs hold large savings (no or little dividend distribution)
- ☞ But declining rate of return on investment (more and more investment just to stabilize growth at around 8%)



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