IMA ASIA

China Forecast Book
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ANALYST: Matthew Li, China Economist, Email: matthew.li@imaasia.com

TEL: (86 21) 2230 1795 and (86) 156 1894 8872

EDITOR: Richard Martin, MD

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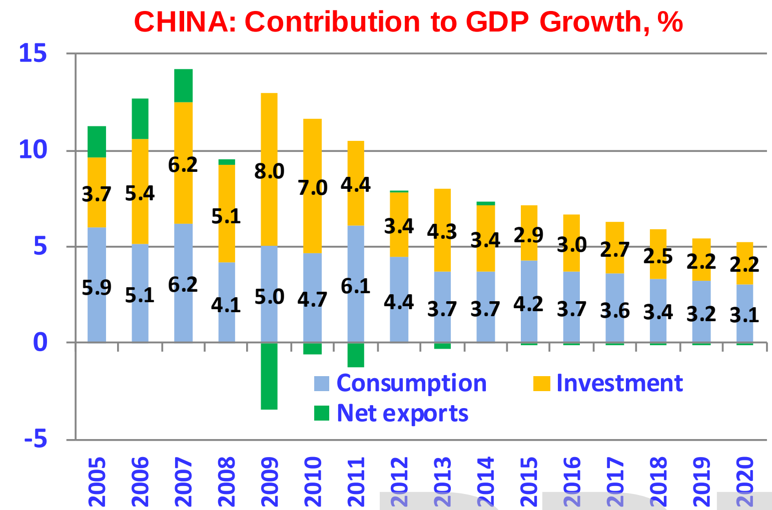
Summary



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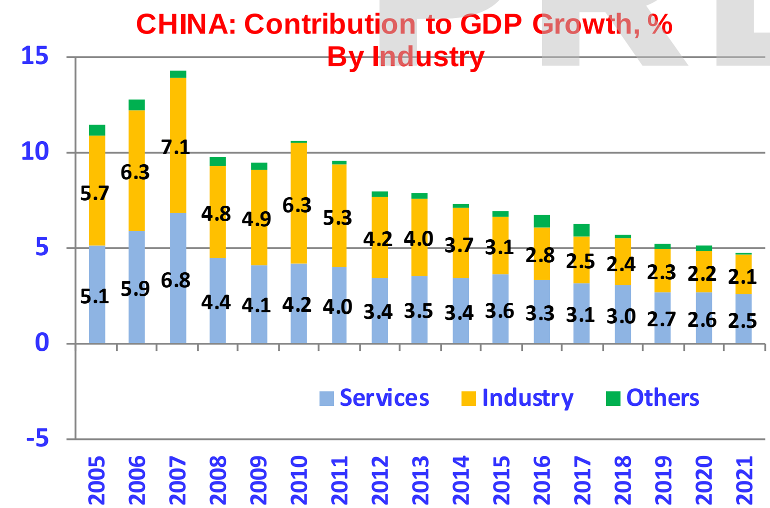

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The end of an investment boom, a falling trade surplus, and slower productivity gains will cut China's GDP growth to 5.9%pa for the 2015-20 period from 7.9% in 2010-15 and 11.3% in 2005-10. While demographic factors play a major role in the slowdown equally important are policies to rebalance from growth driven by fixed investment, manufacturing, and labour-intensive exports towards growth driven by consumers, services, and higher value-added industries.

Rebalancing is essential to contain the risk from surging debt levels and asset bubbles. Containing such risks requires a mix of short-term steps to boost demand, while major reforms are carried out to capital markets, state owned enterprises (SOEs), and the operation and funding of local governments. The risk of a China financial crisis remains high. Yet Beijing's greater control over the whole economy should prevent a crisis. However, a slower debt resolution process also slows growth.

Political factors are paramount in the decision to opt for a slow debt resolution process. Stability and sustained moderate growth are essential to President Xi and the Communist Party. At the same time, a major shift in power is underway, as a collectivist leadership gives ground to a more powerful paramount leader. That, too, is changing the operating environment for all firms in China, whether they are foreign or local.

China Historical Data

	2012	2013	2014	2015	2016
GDP, % real growth	**7.9**	**7.8**	**7.3**	**6.9**	**6.7**
GDP by Expenditure					
Personal consumption	8.6	7.1	8.3	7.9	7.4
Government consumption	8.7	7.4	4.4	9.2	6.3
Gross fixed capital expenditure	9.0	9.3	6.8	6.8	6.3
Merchandise Exports (in US$)	7.9	7.8	6.0	-2.9	-7.7
Merchandise Imports (in US$)	4.3	7.2	0.5	-14.3	-5.5
GDP by Production					
Manufacturing	8.9	7.6	6.9	6.4	6.1
Construction	9.8	9.7	9.1	4.3	6.6
Services	8.1	8.3	7.9	8.3	7.8
Key Indicator					
RMB/US$ (Year Avg)	6.31	6.20	6.14	6.23	6.64
RMB/US$ (Year End)	6.29	6.10	6.12	6.49	6.94
Population, millions	1,354	1,361	1,368	1,375	1,381
GDP/capita, US$	6,256	6,995	7,623	8,032	8,110
Inflation (CPI), %	2.6	2.6	2.0	1.4	2.0
PBOC 1-year loan rate (Year-end) %	6.00	6.00	5.60	4.35	4.35

China Forecast to 2021

	2017	2018	2019	2020	2021
GDP, % real growth	**6.3**	**5.8**	**5.4**	**5.2**	**4.9**
GDP by Expenditure					
Personal consumption	7.1	6.6	6.2	5.9	5.9
Government consumption	6.2	6.0	5.8	5.5	4.9
Gross fixed capital expenditure	5.9	5.5	5.1	4.7	4.3
Merchandise Exports (in US$)	1.8	2.4	2.6	2.9	3.2
Merchandise Imports (in US$)	2.0	2.7	5.0	6.0	6.0
GDP by Production					
Manufacturing	5.8	5.5	5.2	5.0	4.8
Construction	6.0	5.5	5.0	4.5	4.0
Services	7.7	6.7	6.2	5.8	5.5
Key Indicator					
RMB/US$ (Year Avg)	6.96	7.04	7.24	7.44	7.37
RMB/US$ (Year End)	6.98	7.10	7.39	7.50	7.24
Population, millions	1,388	1,395	1,402	1,409	1,416
GDP/capita, US$	8,333	8,875	9,251	9,603	10,364
Inflation (CPI), %	2.4	3.0	2.9	2.5	2.5
PBOC 1-year loan rate (Year-end) %	4.35	4.35	4.35	4.35	4.35

Market Perceptions

What our clients tell us:

About Competition….

"Competition is becoming more intense, disruptive and dynamic. Chinese entrepreneurs are flexibly leveraging use of digital technology and venture capital to compete with MNCs."

"In the FMCG space we are facing more competition from local firms, especially private firms. They've become far more competitive on product quality, cost control and marketing tactics."

"We still have better technology and more experience in high-value added areas than local firms." (A leading global service provider and high-end industrial component maker)

"More and more domestic firms have realized that low cost competition won't work in the future. Thus, they are more willing to invest in product quality. We find that local firms have started spending as much on software as they do on equipment."

What other organizations are saying:

"China's government should take steps to rein in credit that is increasing at a dangerous pace and cut off support to unviable state-owned enterprises, accepting the associated slower GDP growth. China's economy is forecast to expand 6.6 percent this year and 6.2 percent in 2017, down from growth of 6.9 percent last year." – **IMF (Oct 2016)**

"Economic growth is being supported by stimulus, but is set to edge down further to 6.1% by 2018. At the same time, risks are rising and the economy is undergoing transitions on several fronts." – **OECD (Nov 2016)**

"We see China's GDP growth sliding from 6.7% this year to 6.4% in 2017 and 6% in 2018, as another property downturn sees construction and related investment decelerate further, offset largely by a modest export recovery and government-led infrastructure investment. Consumption may slow modestly on slower income growth but should remain resilient." – **UBS (Nov 2016)**

Theme: Responding to the Trump Administration

- **Trump's "Bring back American manufacturing" will have a mild impact on "Made in China"**
- **Watch, however, for some renegotiation of Sino-US trade and investment relations**

Key issues: 1) A trade war will hurt both sides, but China most; 2) China has higher import tariffs than the US; 3) a US president has broad authority to impose punitive tariffs without seeking congressional approval.

Labour dynamics (cost, skills, availability), industrial agglomeration advantages (e.g. Pearl River Delta), global production & logistics evolution, and currency swings will **limit Trump's reshoring policy** to a few industries, such as "made in Mexico" cars and high-end electronics. **The impact on China manufacturing will be mild,** as China's mid/low manufacturing is mostly complementary to US industry and also increasingly focused on rising local demand.

Watch for: China to agree to lower import tariffs and to ease restrictions on US investment, as China won't want to risk to losing US market access. However, if a belligerent Trump presidency and nationalistic Xi leadership mishandle the bilateral relationship, a short-period trade war could be triggered, but wouldn't last long.

US Goods and Services Export to China (2015)				US Goods and Services Import from China (2015)			
Top Items	**USDbn**	**Share of Export to China**	**Share of US GDP**	**Top Items**	**USDbn**	**Share of Import from China**	**Share of China GDP**
Agricultural Products	20.0	12.4%	0.1%	Electrical Machinery	133.0	27.6%	1.2%
Aircraft	15.0	9.3%	0.1%	Machinery	104.0	21.6%	0.9%
Electrical Machinery	13.0	8.0%	0.1%	Furniture and Bedding	28.0	5.8%	0.3%
Machinery	12.0	7.4%	0.1%	Toys and Sports Equipment	24.0	5.0%	0.2%
Vehicles	11.0	6.8%	0.1%	Footware	17.0	3.5%	0.2%
Services	45.4	28.1%	0.3%	Services	15.9	3.3%	0.1%
Total	**161.6**	**100%**	**0.9%**	**Total**	**482.0**	**100%**	**4.4%**
China Average Import Tariffs on US Goods				**US Average Import Tariffs on China Goods**			
Agricultural Products	9.7%			Agricultural Products	2.5%		
Non-Agricultural	5.0%			Non-Agricultural	2.9%		