

EMBA – June 2016

ON CHINA

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INTRODUCTION

Gideon Rachman in Financial Times, 28 December 2015:

Not one global power is optimistic and even in America, which should be cheering, the mood is sour.

And the Chinese, on their hand, have a political anxiety rooted in president Xi Jinpings dynamic, but unpredictable, leadership.

The biggest common factor, Rachman says

”... a bubbling anti-elite sentiment, combining anxiety about inequality and rage about corruption that is visible in countries as different as France, Brazil, China and the US.”

HISTORY

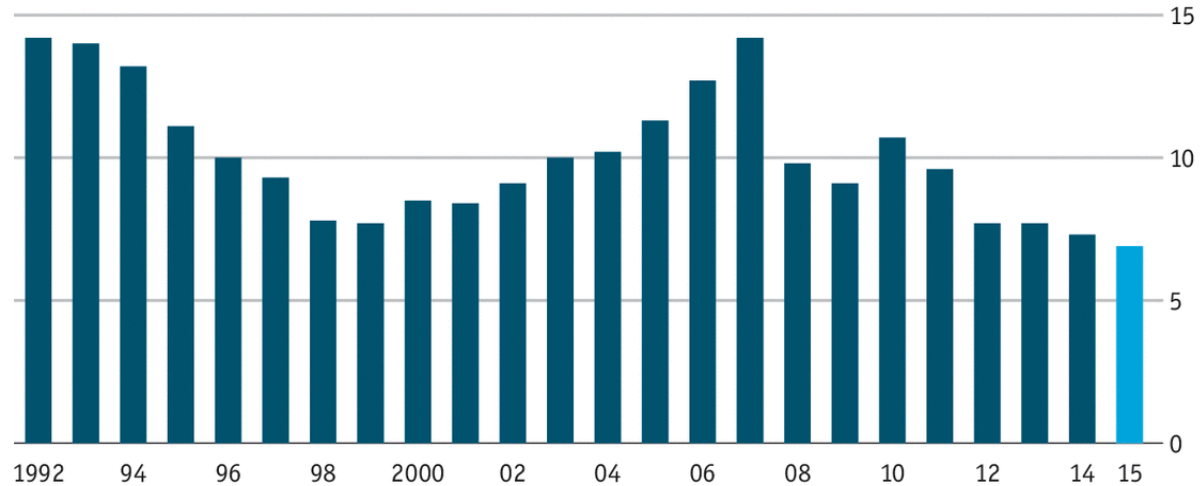
- 1978: Deng Xiaoping takes over. “Reform and opening up”
- 1989: Deng – and Tianamen Square incident
- 1999-2001: Zhu Rongji deals with the State Owned Enterprises (SOEs)
30 mill lost jobs
WTO member in December 2001,
along with new market opportunities

- 2008-2009: Seeds of today's problems planted. The financial crisis is met the old fashioned way: Debt-financed real investments
- 2012-2013: Xi Jinping shows charismatic, fearless and vigorous leadership
But words are not followed up by deeds
- 2015: Annus Horribilis of Economic Reform (Barry Naughton)

Less growth

China's GDP

% change on previous year



Source: Haver Analytics

Economist.com

Unstable markets

China's volatile stockmarket

Last updated: 11:45 (GMT) - Friday January 8th 2016

Friday 8th January 2016

CSI 300 stockmarket index

December 31st 2004=1,000

3,361



Exchange rate

Yuan per \$, inverted scale

na

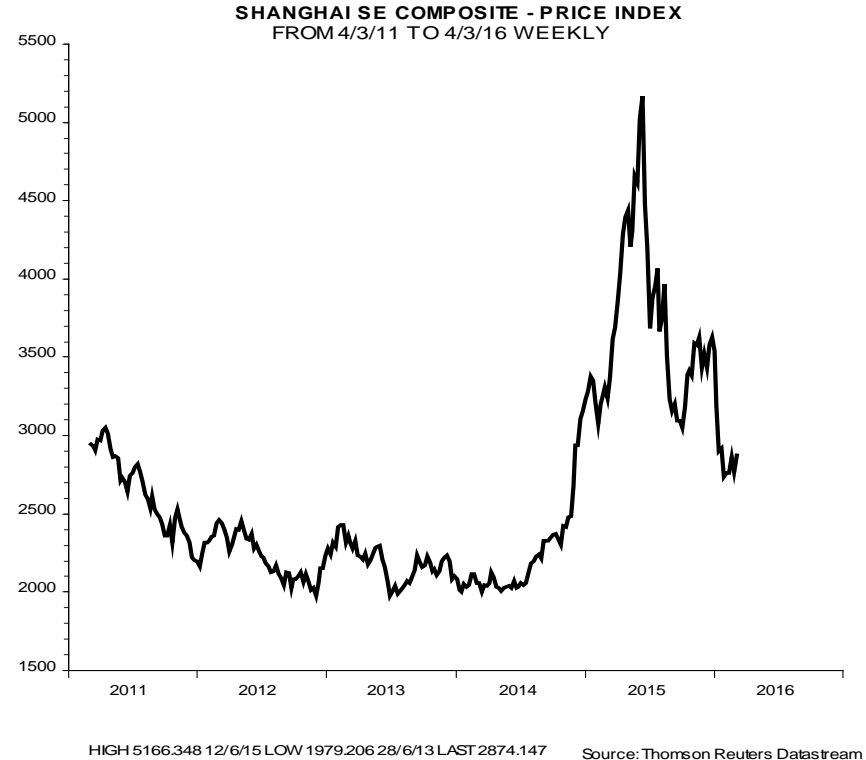


Stock market like a yo-yo

The «China Dream» abruptly ended.

Government funds purchased
remarkable amounts of shares.

No more short selling.

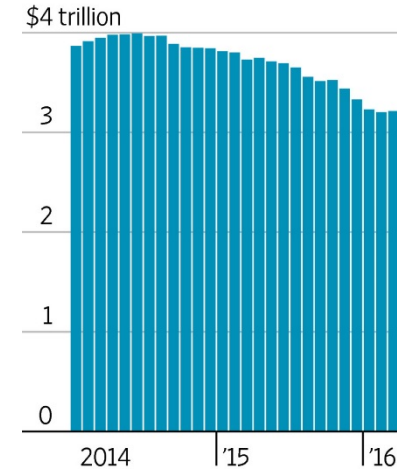


Paul Krugman: “... no clue what they are doing”

What happened and why?

Leaving China

China has tapped foreign-currency reserves to prop up its currency.



Sources: People's Bank of China; Wind Information

THE WALL STREET JOURNAL.

Some examples:

COSCO – with debt/equity ratio of over 200 percent.

Orders 11 new containerships – highly subsidized – deliverable in 2018

Loses 580 million dollar January-September 2015.

Overcapacity in shipbuilding. Overcapacity in the fleet.
Merge with China Shipping Group - the world's largest container line.
Increasing market share. But what about the debt? And the efficiency?
Hardly the solution to structural problems.

State-owned enterprises. Over 40 percent of those in deficit (2013).

ECONOMIC CHALLENGES

Inconsistent and unsuccessful economic policy over the past six to eight years.
Some of today's economic challenges

1. Short-term stimulus to keep growth from declining too much
2. Reform of SOEs to achieve long-term growth
3. Better functioning capital markets
4. Stop capital outflow

Ad 2) Reform of SOEs is imperative.

- Reduce surplus capacity. China's surplus capacity in steel corresponds to full capacity in the United States, Japan and Germany combined.
- CCP runs SOEs to too great an extent. Good for the nomenclature. Not for the economy.
- 2013 – good plans drawn up. But not put into effect.

- Zhu Rongji was a man of action. Prime minister, responsible for reform of SOEs, 1999-2002. 30 million jobs disappeared.

BUT: Entered WTO December 2001 – opened up new markets.

This time – new jobs in the service industry.

Up to 6 million jobs could disappear.

Concerned about mass riots (cf. what happened last time)

Ad 3) Has to use state finances to cover SOEs' losses (as 15 years ago).

Better allocation of credit.

Spot the difference

Return on assets of Chinese industrial enterprises*, by ownership type, %



Sources: CEIC;
Gavekal Dragonomics

*7-month centred
moving average

Economist.com

Ad 4) Last year, central bank (PBOC) reserves fell by 500 billion dollar, January and February, 100 billion more each month. Now, reserves are about 3,200 billion dollar. (Norwegian Pension Fund about 700 billion dollar)

Something has to give.

Either reintroduce capital flow control.

Or allow for a serious depreciation of the yuan.

Why so much capital outflow (even with current account surplus):

- Less return at home
- Diversification
- Depreciating yuan
- Anti-corruption campaign and people get anxious
- Anti-corruption campaign and people fear new regulations

THE POLITICAL CHALLENGES

China – 33 provinces, 1.3 billion people.

Contrasts to EU – 28 countries and “only” 500 million people.

Beijing and Brussels share many of the same challenges

“Tian gao, Huangdi yuan” – “Heaven is high, and the emperor is far away”

November 2013, new economic reforms

BUT: Lacks a “coherent framework for implementation”

State Council by Premier Li Keqiang, less power.

Two committees under Xi Jinping's leadership:

Finance and Economics

Deepening Reform

This gave CCP more influence than reform-keen bureaucrats.

THE GOOD NEWS FOR CHINA

More than 35 years with amazing growth.

Time for a brake?

Less favorable starting point these days in three areas

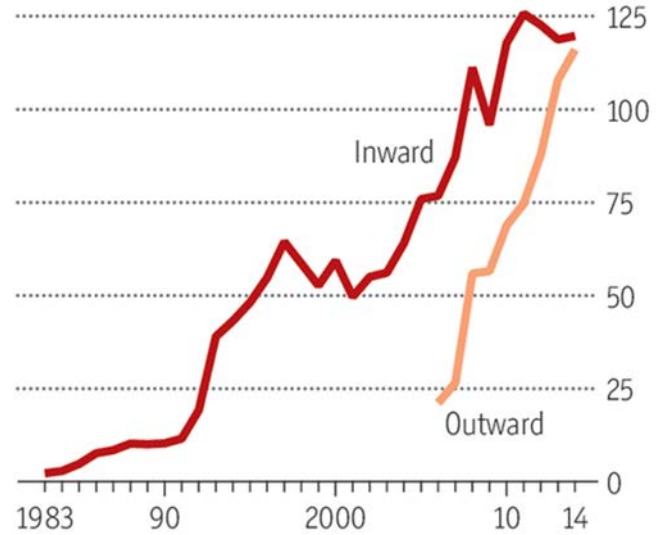
- Demographics
- Technological catch-up
- Export markets

FDIs go both ways.

New capacity in SOEs and steel,
"cutting edge green technology".

Go forth

China's foreign direct investment, \$bn



Sources: MOFCOM; Rhodium Group

Economist.com

Innovative and dynamic private enterprises within biotechnology, renewable energy and IT (Alibaba, Baidu, Huawei)

China established Asian Infrastructure Investment Bank (AIIB), where Norway also participates, to invest in infrastructure; roads, ports, airports, railway, cf. The new Silk Road.

Linking neighboring countries closer.

Comparable to the Marshall Plan 1948-1952.

THE NEED FOR A NEW ECONOMIC MODEL

From real investment- to consumption-driven growth

- More even income distribution
- Social safety net
- SOEs pay dividends to the state

Does that necessitate democracy in some shape or form?

In November 2013 – Third Plenum – Xi Jinping said

“... market forces would play a “decisive” role in the economy, but also said the Communist Party's hand needs to stay strong, contradictions that instead of giving a clear direction signaled a difficult road ahead for economic reforms.”

<http://www.wsj.com/articles/SB10001424052702304644104579193202337104802>

A 10-Year Climb, Then Short-Lived Freedom for the Yuan

China's currency marched higher for a decade, but last year's move by the government to let the currency move more freely led to chaos and a reversal of the liberalization.

