A China recovery is coming

China is in the midst of a dynamic economic and political transformation which if successful will remake the country into where it stood at the height of its global influence during the Qing Dynasty, writes Simon Hunt.

"When planning for a year, plant corn. When planning for a decade, build trees. When planning for life, train and educate people" - Chinese Proverb

China's economic future will be based on the growing middle class, on the building up of new industries, on refurbishing traditional manufacturing through robotics and other forms of automation, by successfully completing the restructuring of its bloated industrial sector, and by the continued requirement for new homes based on household formation and rising incomes. In short, China is transiting from being a domestic player into a major pawn on the global grand chessboard.

Politics is at the route of most developments globally, but especially so in China. There is a power struggle between the Chinese Youth League (CYL), which dominated the last government and to whom Premier Li belongs, and with President Xi's clique. The struggle is because the CYL's power base is in the provinces whilst President Xi's is in the centre, believing that it is the Party around which governance of the country should be built and that the CYL should be subservient to the Party. In many ways the route cause for the slow-moving process of reform and restructuring stems from the difficulty of implementing reforms which often run counter to what local governments want.

Even so, restructuring is advancing in a well thought-out and structured manner engineered by the President's advisors. Given the high level of indebtedness between companies in the numerous subsets of supply chains, any other way would result in economic implosion with dire consequences not just for China but for the global economy.

Finance approach

The bankruptcy of Dongbei Special Steel is a watershed in the restructuring of the SOE sector as it now shows that bankruptcy is an option for distressed SOEs and it shows that government owners and creditors are taking a more market orientated approach to resolving debt problems of defaulted SOEs. In the private sector, banks have been taking a firm line in withholding credit to financially distressed companies that have little chance of succeeding. It is why credit conditions remain very tight within the economic trenches and why distressed companies often fail to pay their bills.

It is against this background that China's economic profile and imminent recovery should be viewed. Slower trend growth was inevitable almost a decade ago based on the simple matrix of working age, propensity to employ and productivity. For instance, China's labour force fell from 758 M in 2005 to 753 M last year and should fall to 723 M in 2020 and 695 M in 2025. An 8% fall in the country's workforce over a decade is a staggering figure. No wonder China is investing so heavily in robotics numbering 2,711 M last year compared with America's 2,606 M, with implications for productivity and GDP per worker.

Shanghai in 1990 (top) and 2010, modern China never ceases to amaze

It does mean that China's trend GDP growth will slow from 11.2% in 2010 to about 6.0% last year to around 4.5% by 2020 and 4% in 2025. Even so, the RMB increase in China's economy last year was greater than it was in 2010 when GDP rose by 11.2%!

Two domestic developments will be the foundations for China's future growth. They are China's soaring middle class and continued growth in disposable income.

Table 1. China's Middle Class (Millions)

2003	2018	2023
376	587	744

Source: Various

By 2018 China's middle class will be larger than the current entire population of North America and by 2023 that of all Europe. What makes these numbers even more staggering is that with rising disposable income China's middle class's spending power should increase from around US$ 1.9 trillion in 2005 to some US$ 9.2 trillion by 2018 and to about US$ 17 trillion by 2023. More spending will be on leisure activities, recreation, state of the art appliances, travel and acquiring foreign assets including homes, e.g. in the UK's most upmarket real estates.

Table 2. Household Disposable Income

	2005	2015	2020	2025
Disposable Income $	5,811	13,281	18,024	23,544
Of which Savings	1,486	4,341	6,418	8,887
Spending	4,325	8,939	11,602	14,663

Source: Dr Clint Laurent, Global Demographics

The second development is the rise in disposable income from averaging 5.2% a year over the last decade to increasing by 6.7% a year over the coming ten years. Savings remain high but the propensity to spend will increase.

Table 3. Demand for Housing Space (Millions of sq m)

	2015	2020	2025	2030	2035
Urban	1,266	1,519	1,602	1,610	1,566
Rural	74	-330	-476	-550	-555

Source: Dr Clint Laurent, Global Demographics

There is a growing concern about bubbles reappearing in the housing market associated with surplus housing inventory. Official data tends to overestimate the level of unsold floor space since it includes floor space that has yet to be built but has merely received the necessary planning permission. Bubbles will always reoccur from time to time in an emerging market, but China has the resources and the means of ensuring that they don't burst. The important point is that there will be an ongoing demand for new housing.

China's economy is recovering. Accommodating monetary policy is being augmented by expanding the fiscal deficit which might include tax cuts. Construction is beginning to recover since total surplus inventory has fallen to the key seven-month level. The NDRC has released 25 infrastructure projects most of which were frozen earlier this year because cases of corruption were detected. Both wages and consumer spending continue to increase. In some key manufacturing sectors inventories have been reduced. Many private sector companies are now managing cash flow appropriately so are improving profitability. Investment will follow in 2017. Against this background real consumption of metals has begun recovering and will gather pace in 2017.

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