Stability is the key ahead of China's Communist Party Congress

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China has adopted varying policies to maintain the economic momentum and keep everything stable ahead of the 19th National Congress of the Communist Party – sometimes tightening, sometimes easing.

Focusing on stability

The Chinese economy has been experiencing divergent trends in policy over the past year, and different sectors have responded with varying performance. There were numerous stimulatory measures: the government provided a fiscal boost by accelerating its spending from 8% to 18% between late 2015 and the end of 2016, and the People's Bank of China (PBoC), China's central bank, lowered banks' deposit and lending rates until November 2016. At the same time, the authorities eased lending standards for mortgages and cut auto sales taxes from 10% to 5%. However, domestic credit growth in China has slowed abruptly from 25% to 17% year-on-year over the past year. The auto tax was raised again to 7.5%, and since November, the PBoC started again raising interest rates, lifting the three-month Shanghai interbank offered rate (Shibor) and three-month repo rates by almost 200 basis points since the start of the year. In part the PBoC has been closely following the Fed to prevent the Chinese currency from depreciating; in part they have been keen to curtail a renewed surge of house prices. House prices in Tier 1 cities like Beijing, Shanghai and Guangzhou had increased by 28% year-on-year last September and had slowed to 13.5% by May 2017.

The main explanation for these seemingly contradictory policy moves is that the 19th National Congress of the Communist Party will be held in Beijing during the autumn. This is widely seen as a key opportunity for President Xi Jinping to consolidate his power, reshuffling the members of the Standing Committee of the Politburo and other key decision-making bodies, and nominating his loyalists to the top posts. Ahead of this Congress, the political imperative is to keep everything stable, and above all to maintain the economic momentum of the economy. This has necessitated a series of moves – sometimes easing, sometimes tightening – to prevent short-term problems from developing into full-blown crises.

Growth insufficient for world trade

Domestically the growth of real GDP was reported at 6.9% in the first quarter, marginally higher than the 6.7-6.8% growth reported during the four quarters of 2016. However, the Li Keqiang estimate of real GDP – named after China's premier and based on readily available data – has surged since late 2016, reflecting a temporary recovery of a number of basic industries such as steel, coal and electricity. On the external side, China's exports have also recovered from -7.4% year-on-year (on a three-month moving average basis in US$ terms) in October 2016 to 11% in May. Imports have recovered even more sharply to a peak of 25% in March, and slowing to 15.6% in May. Given that the recent upswing in imports may be associated with base effects stemming from commodity price weakness in late 2015 and early 2016 and currency movements over the period, we should be cautious about drawing any strong conclusions, but based on these data points, it does seem that the prolonged slump in world trade may at last be easing.

Since China is by far the largest emerging market and the biggest buyer of commodities on world markets, the growth – or lack of growth – of China's imports matters immensely to a large number of commodity exporters, both developed and emerging. If China can engineer a steady domestic recovery over the next year or two, the outlook for those commodity-exporting economies will improve considerably. However, in light of the continuing sub-par recovery in the developed western economies, it may not be possible for China alone to act as a global locomotive for all commodity-producing economies. For the year as a whole, I expect 6.5% real GDP growth and 2.1% consumer price inflation.

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East Asia relies on the West

Turning to the smaller, manufacturing economies of East Asia which are heavily involved in regional supply chains that include China, their outlook will depend far more on export improvements that result from the on-going business cycle upswings that are under way in the US and Europe than on a turnaround in the domestic Chinese economy. Korea, Taiwan and Hong Kong are only expected to grow at 2-3% this year, while the ASEAN economies are expected to grow at 4.8%. These real GDP growth rates are generally below past trends, reflecting the challenges faced by all export-oriented economies in a world of slow global trade growth.

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