

# Corporate Network

## **China Redefined: The Journey to a New Growth Model**

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# Agenda

- Does the Chinese economy remain the Goldilocks Economy?
- China's challenge in coping with rising inflation risks
- China's transition to a new growth model



# The Riddle: Coexistence of Overheating and Underheating

## Signs of Overheating

- Inflation at decade high
- Asset inflation drives irrational behaviour and bubbles
- Currency is a source of excess liquidity
- Widening trade deficit

## Signs of Underheating

- Headline inflation caused primarily by food
- 30 million jobs must be created each year – massive slack in labour market
- Stock market has corrected significantly

# Concerns with China's Growth Model

Summary of Production Cost Distortions		
	RMB bn	Key Assumptions
1.Labor	203	Assuming the new labor law is fully enforced
2.Land	154	Assuming 20% of land sales revenue in 2006
3.Energy Costs	1632	Rmb 1572bn due to low resource taxes
4.Capital Costs	337	Assuming a 2ppt hike in policy rebates after financial liberalization
5.Environmental Costs	1080	Without considering the Rmb278.4bn pa maintenance fee
6.Other Costs	429	Equivalent to the amount of export tax rebates in 2006
<b>Total</b>	<b>3835</b>	<b>15.5% of 2007 GDP</b>

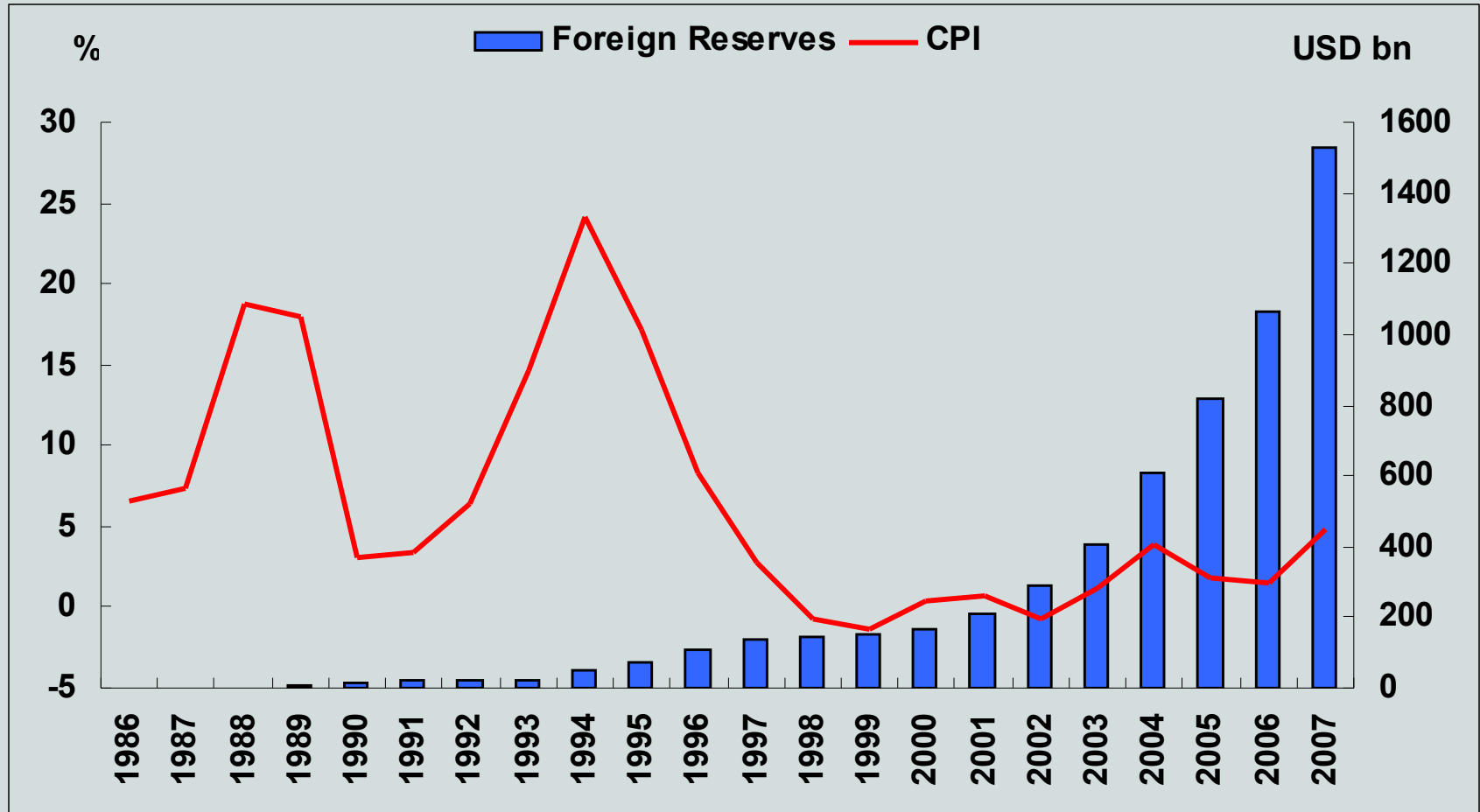
- China's current growth model clearly favours investment at the expense of consumption
- China's stance towards environment is "damage first, then repair"
- Recent jitters in financial markets
- Rise of regional competition (India and SE Asia)
- Is China facing the risk of run-away inflation?

Source: Estimated by CITI Group China Economist

# Stagflation in a Flat World

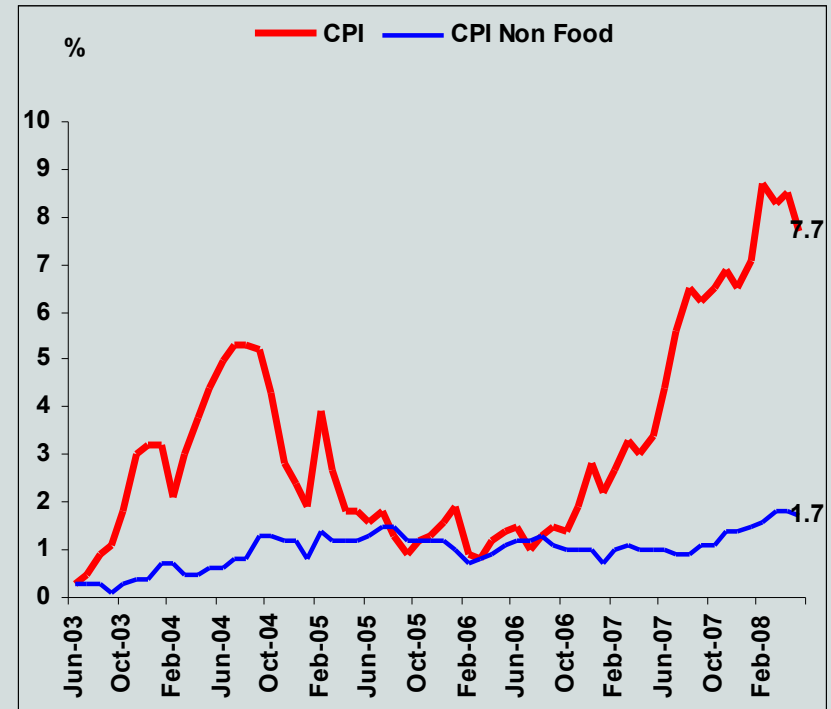
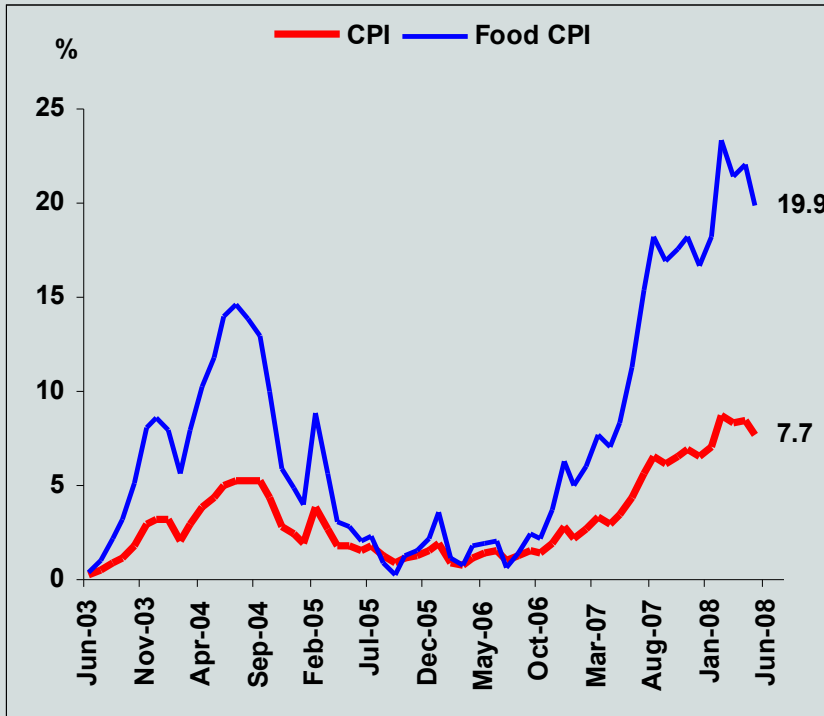
- “The sharp expansion of world trade is a new transmission mechanism driving the globalisation of inflation.”—Stephen Roach, June 2008
- As the key segment in the global production chain, China’s inflation means price shocks and lower living standards for the rest of the world.

# Is Inflation Caused by Currency Manipulation?



Source: CEIC

# Is Inflation Driven Mainly by Food?



Source: CEIC

# No Rice Riots from the Middle Class

- Current inflation has a completely different impact on Chinese people from inflation did in the late 1980s
- Rising income makes the middle class increasingly immune to high food prices



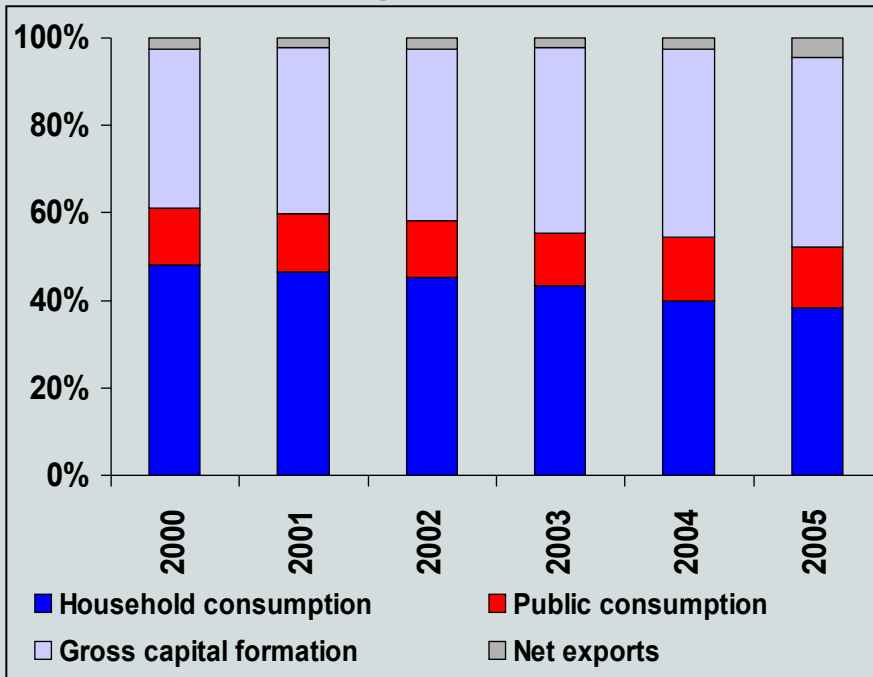
# China's New Skin



To understand China, we must be counterintuitive.

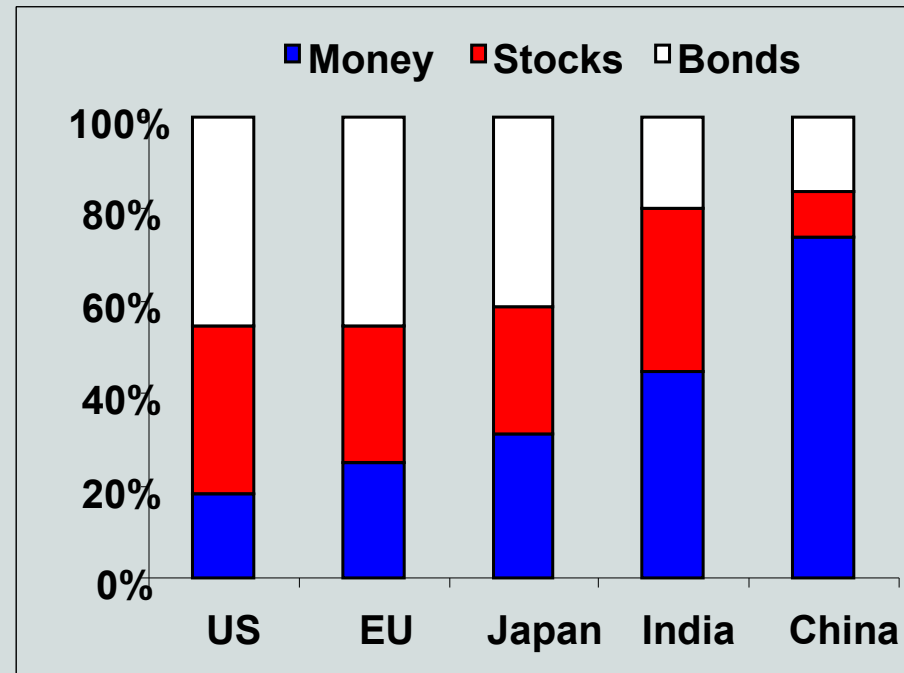
# The Next Challenge: Drive Domestic Growth on Two Fronts

## Makeup of the GDP



Need for increased consumption

## Distribution of Assets



Need to broaden investment opportunities

Source: CEIC

# Unseen Risks in China's Growth Trajectory

- Structurally high savings rate hides fragility and fault lines in the financial sector
- Policy bias towards growth (at the expense of inflation) may exacerbate income disparity
- Concerted push for political reform maybe pre-mature

# Conclusions

- China's size and savings rate deter genuine overheating
- China faces rising costs and growing protectionism.
- The economy is shifting to a new growth model.
- Ultimately, China's growth should be welcomed