Misunderstanding China

Global Economic Prospects

Peterson Institute for International Economics

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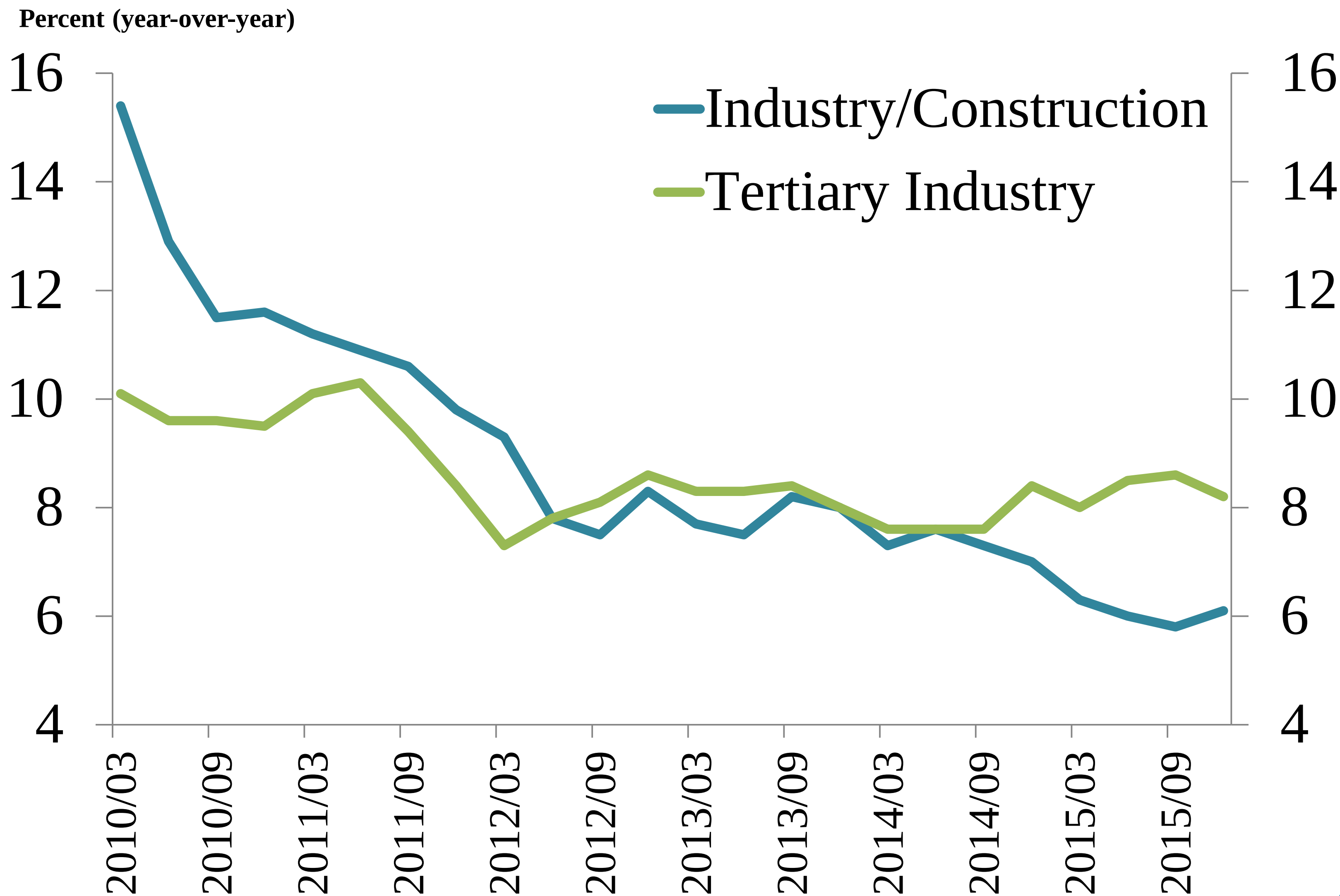
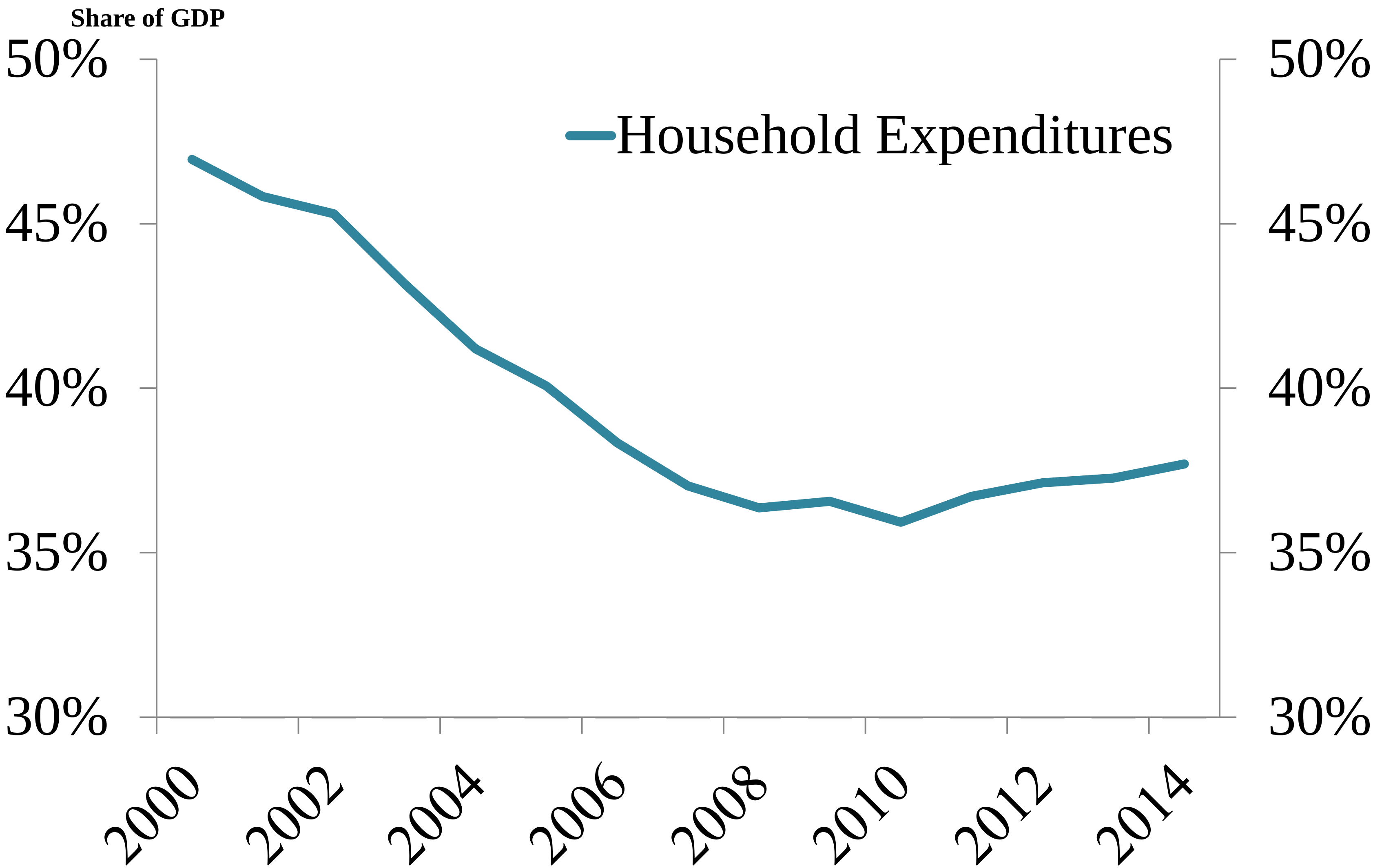
Growth of Industry/Construction and Tertiary Industry, 1Q 2010 – 4Q 2015



Source: China National Bureau of Statistics

Private Consumption Growth

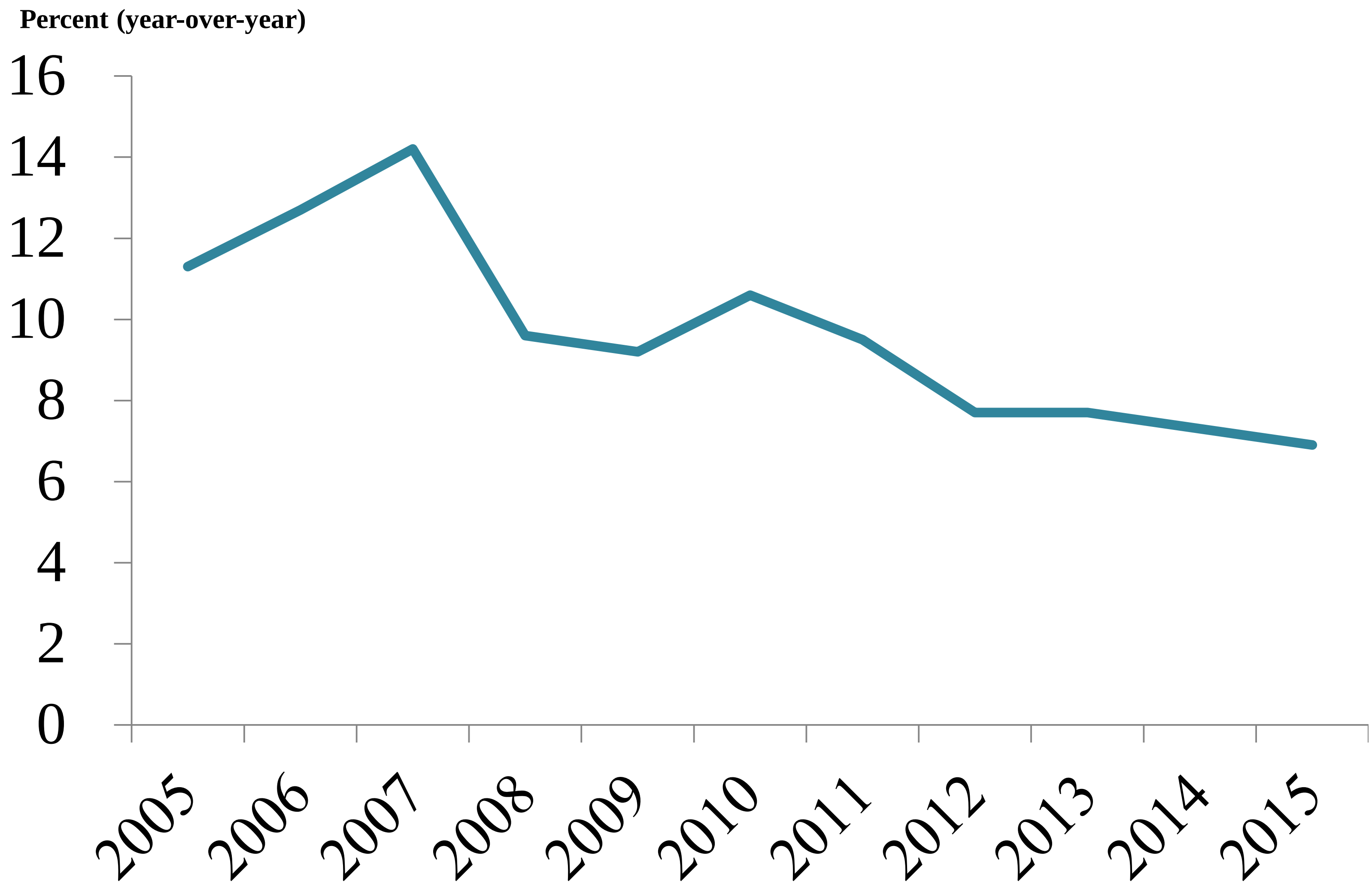


Source: China National Bureau of Statistics

Structural Drivers of the Transition

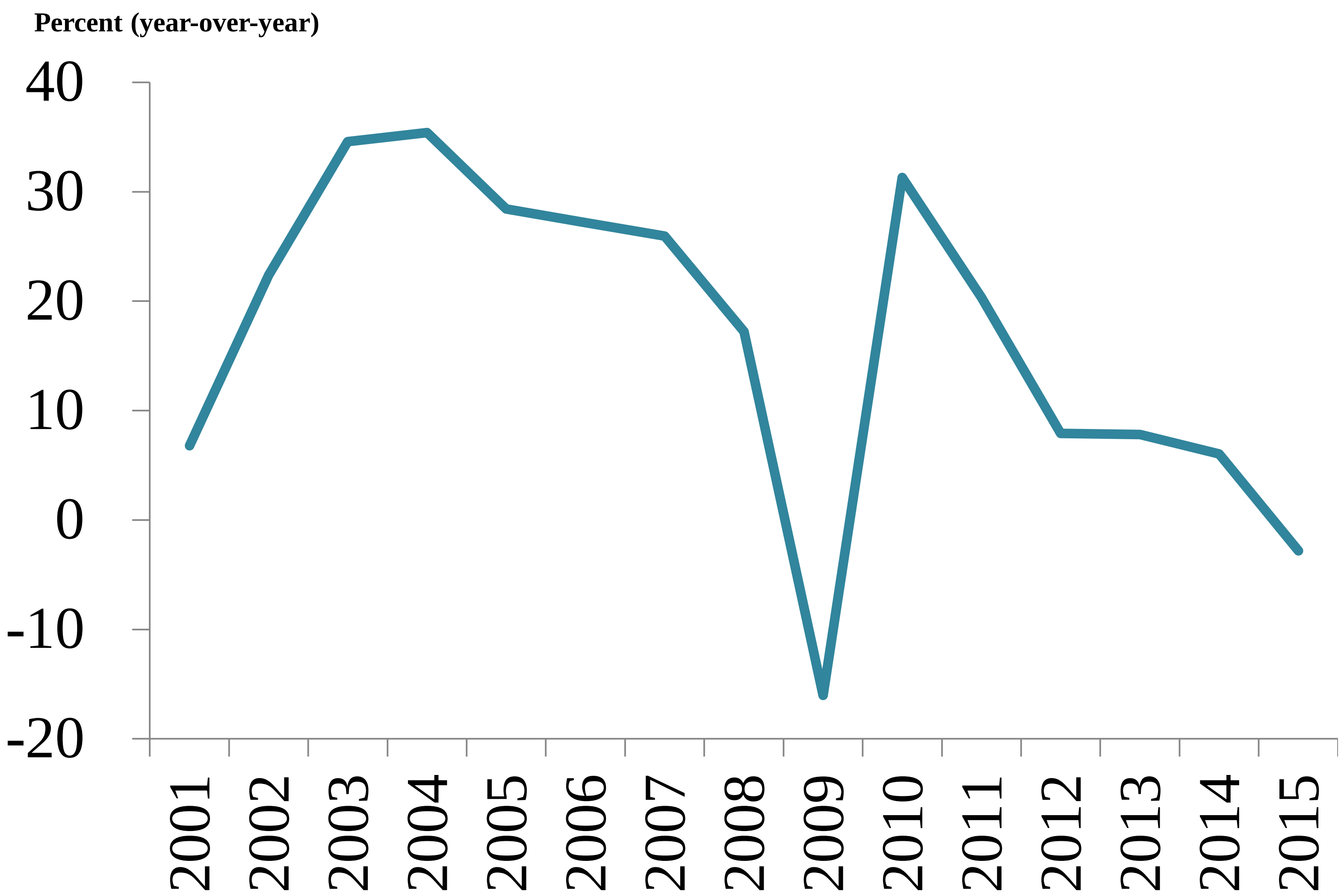
- Demographics
- Engel Curve --- upper middle income status
- Build out of social safety net
- No more undervaluation of the currency
- Relative labor intensity of services

Slowing GDP Growth, 2005 – 2015



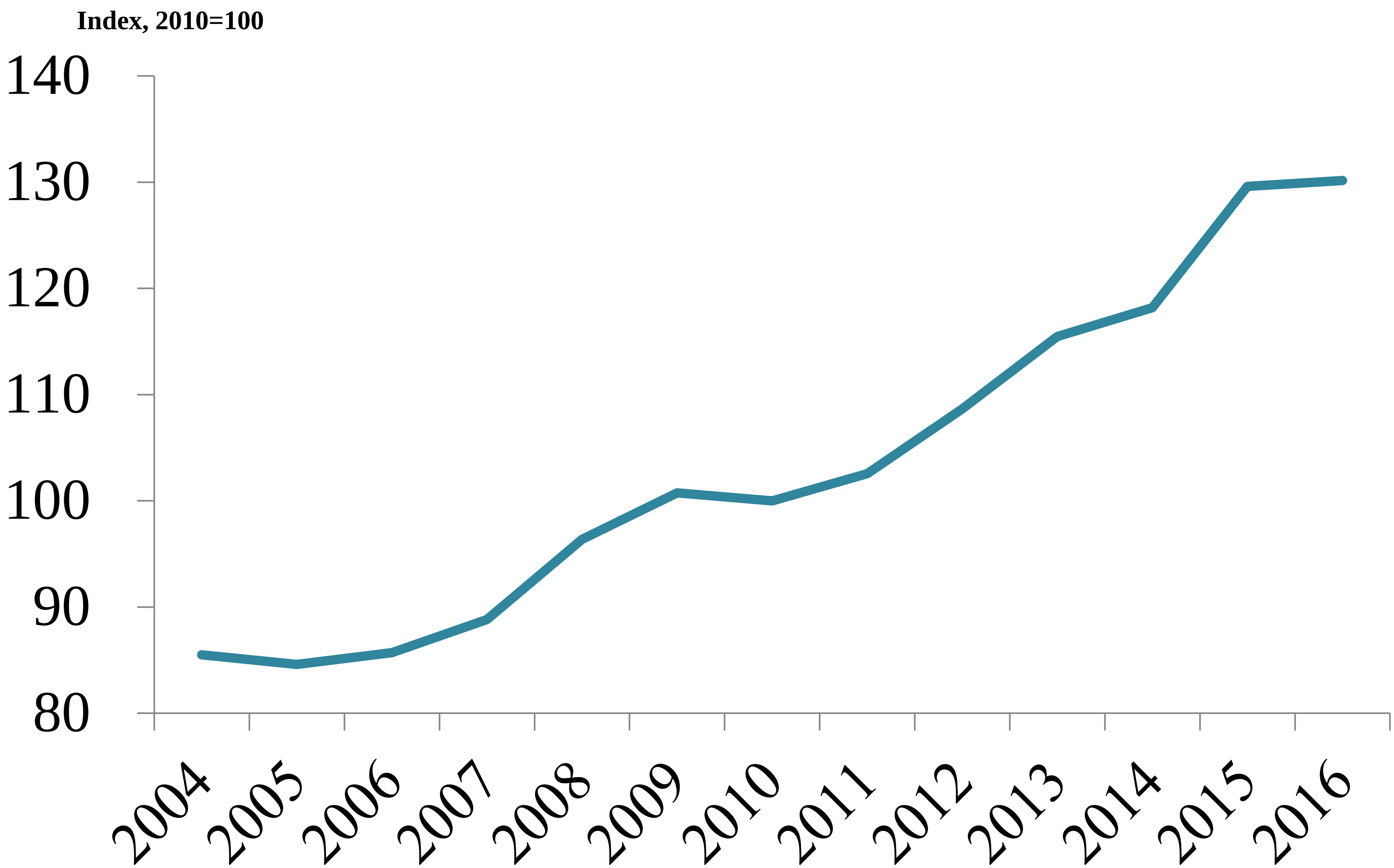
Source: China National Bureau of Statistics

China's Export Growth, 2001 – 2015



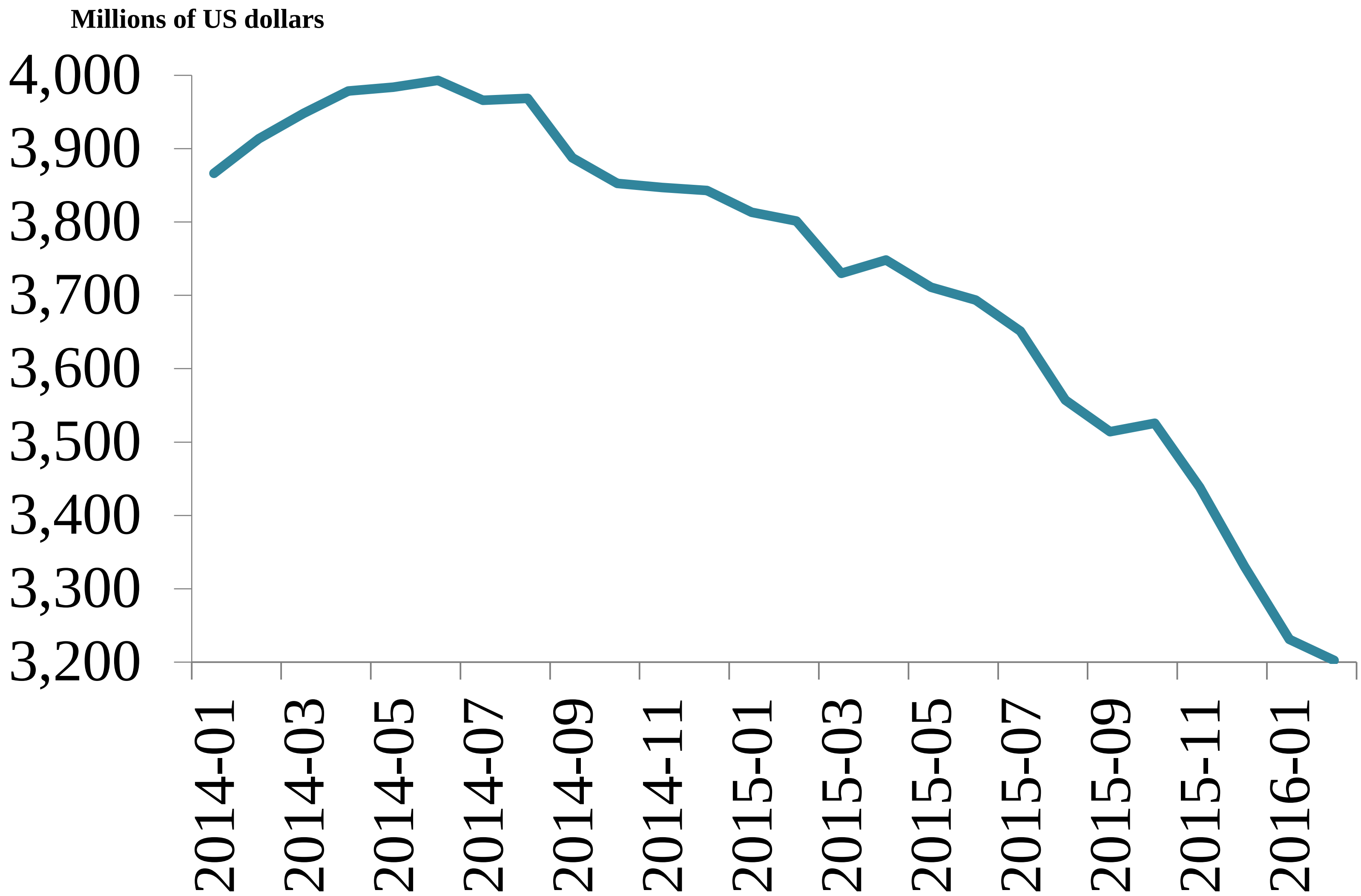
Source: China National Bureau of Statistics

RMB Real Effective Exchange Rate, 2004 – 2016



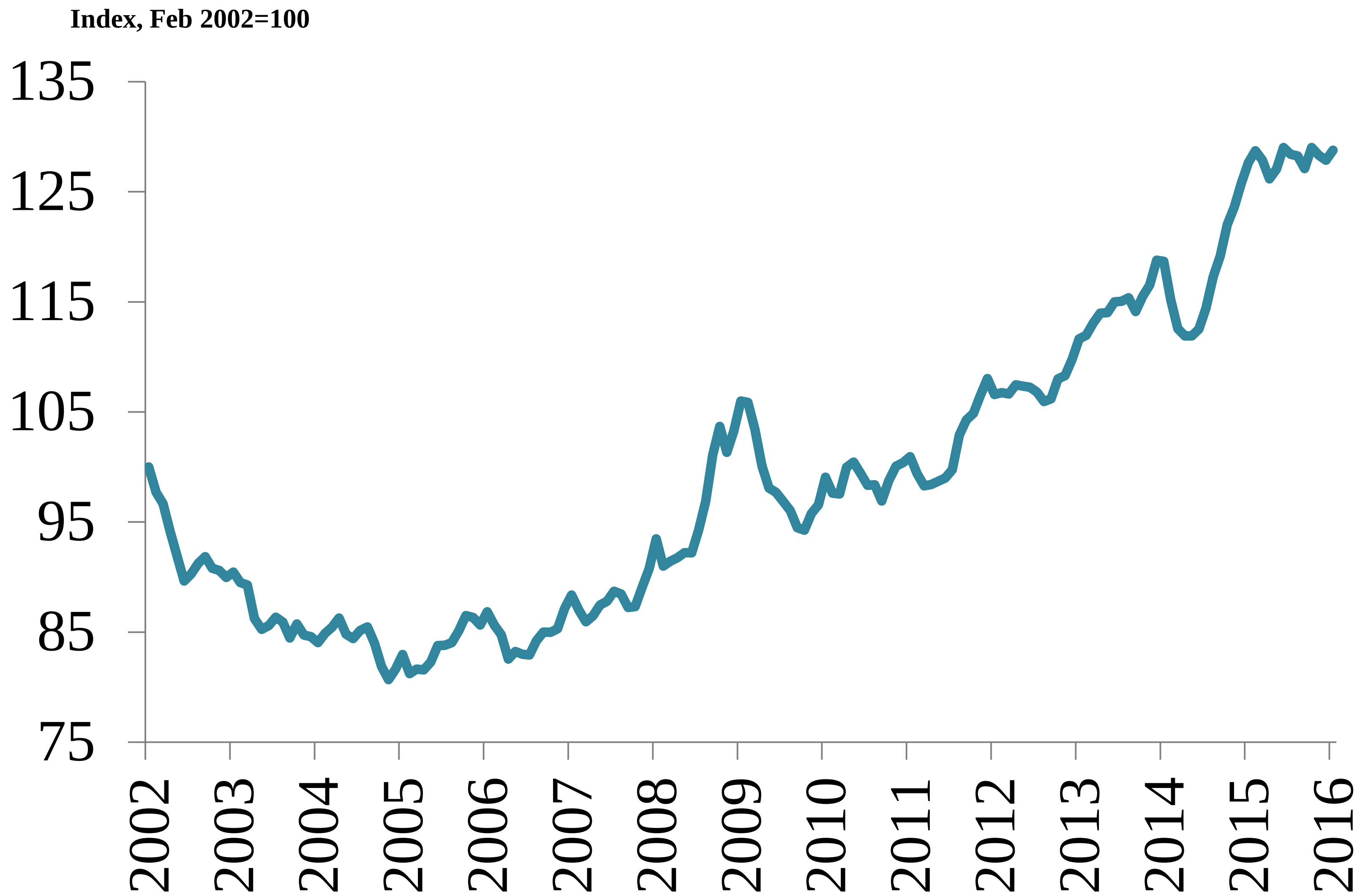
Source: Bank for International Settlements

Foreign Exchange Reserves, Jan 2014 – Feb 2016



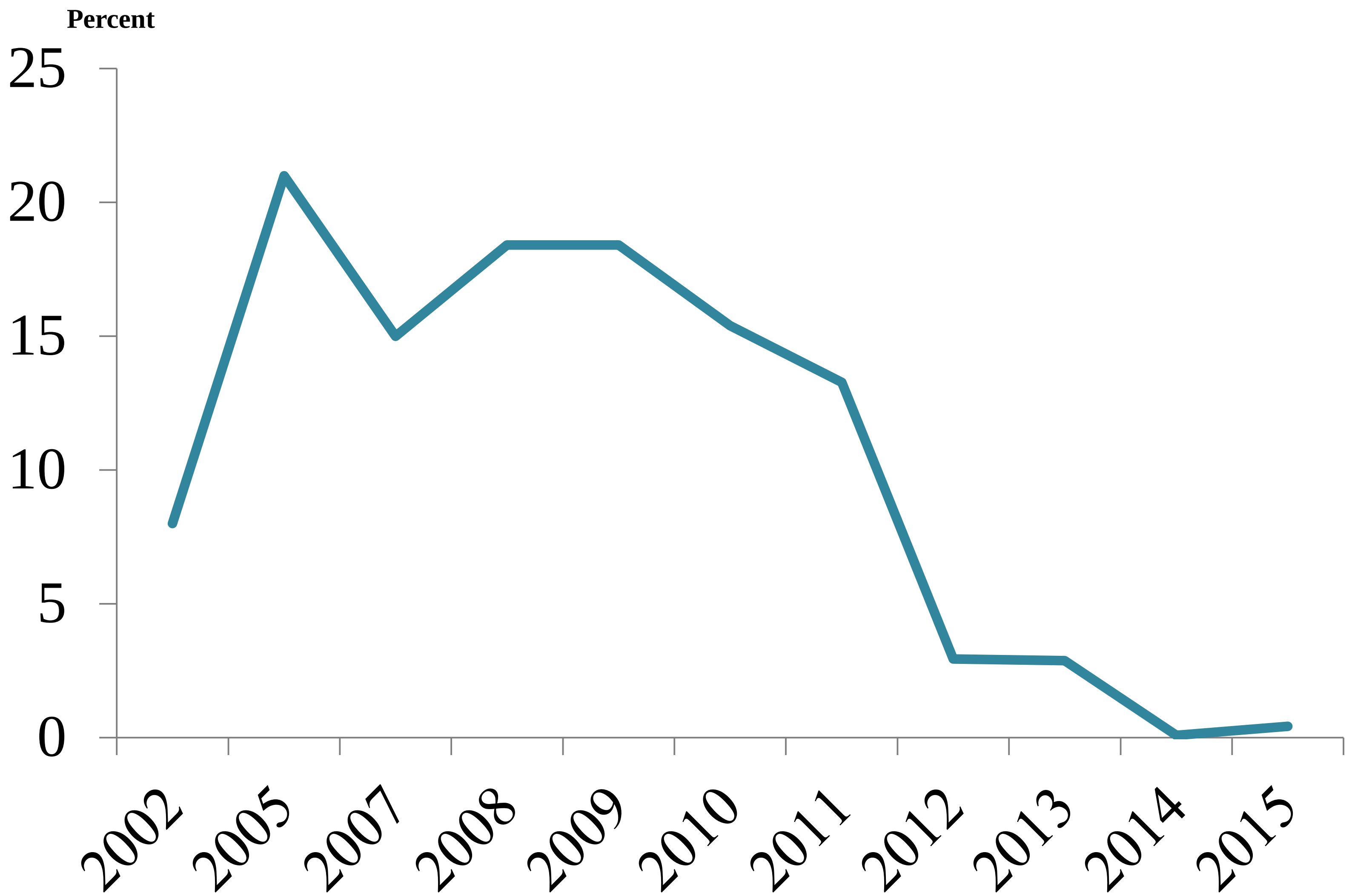
Source: People's Bank of China

RMB Real Effective Exchange Rate, Feb 2002 – Feb 2016



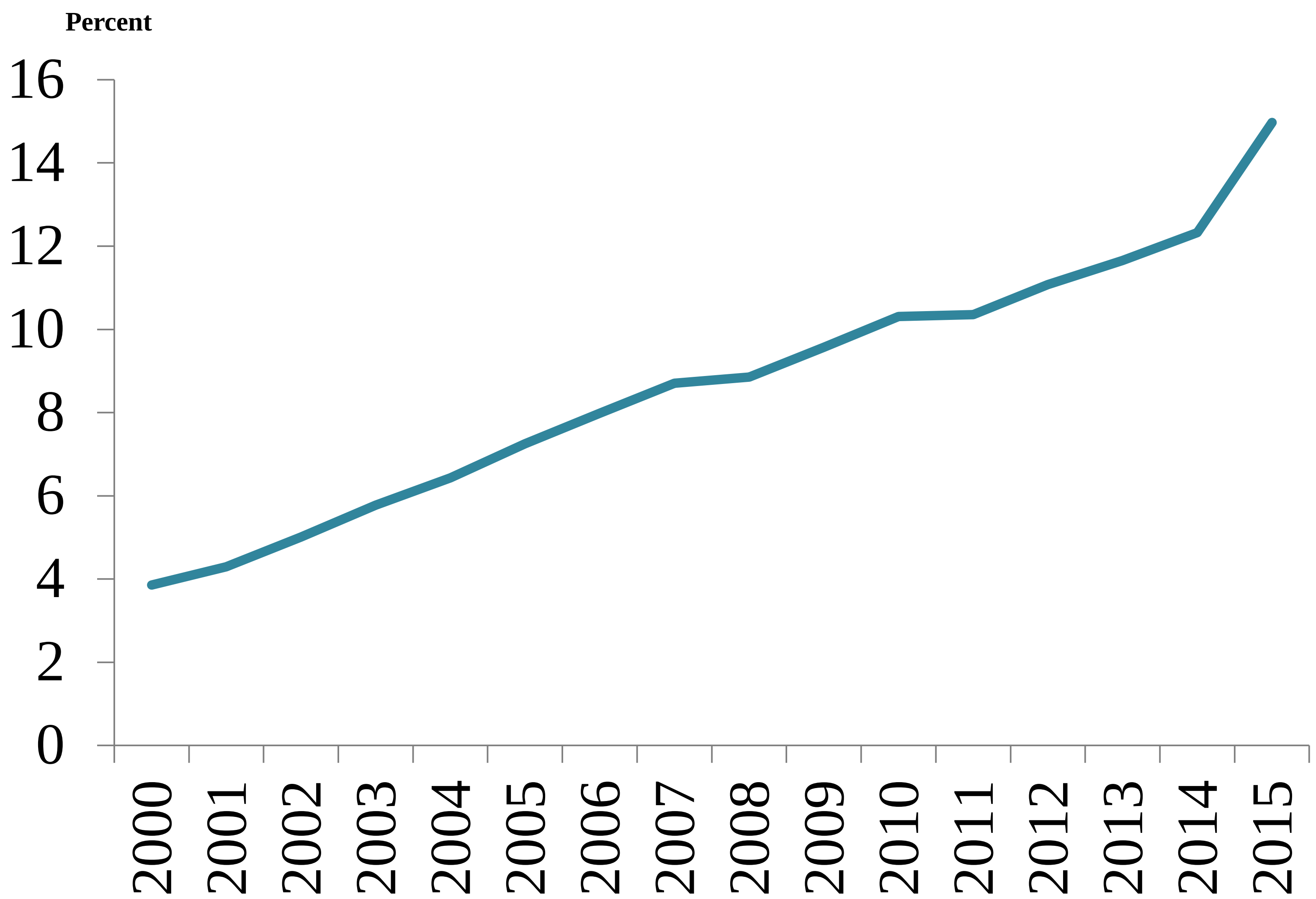
Source: Bank of International Settlements

Needed Appreciation to Eliminate Undervaluation, 2002 – 2015



Source: PIIE Policy Brief 15-20 by William R. Cline

China's Share of Global Exports, 2000 – 2015



Source: World Trade Organization

Official Foreign Exchange Reserves at the end of Jan 2016

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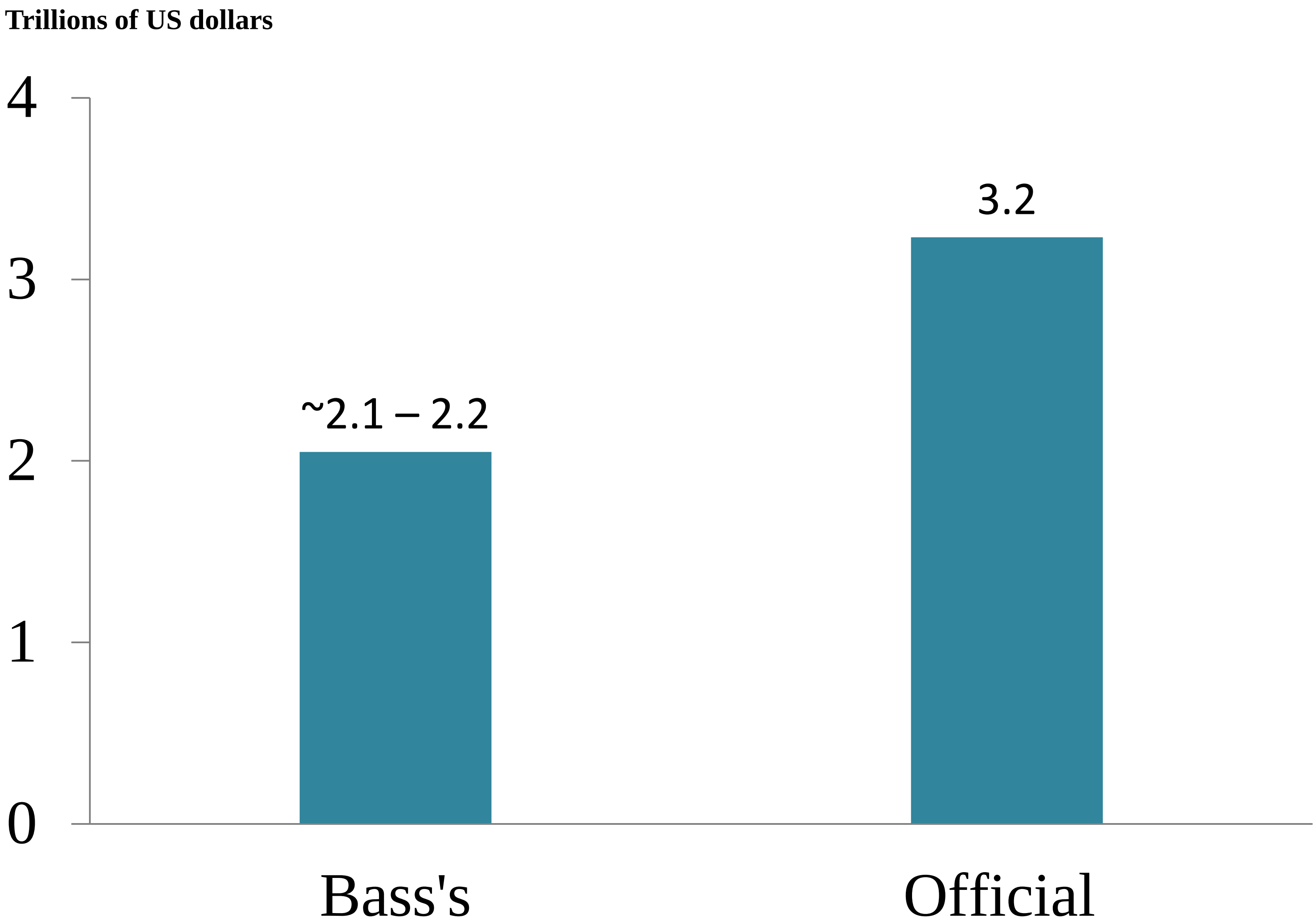
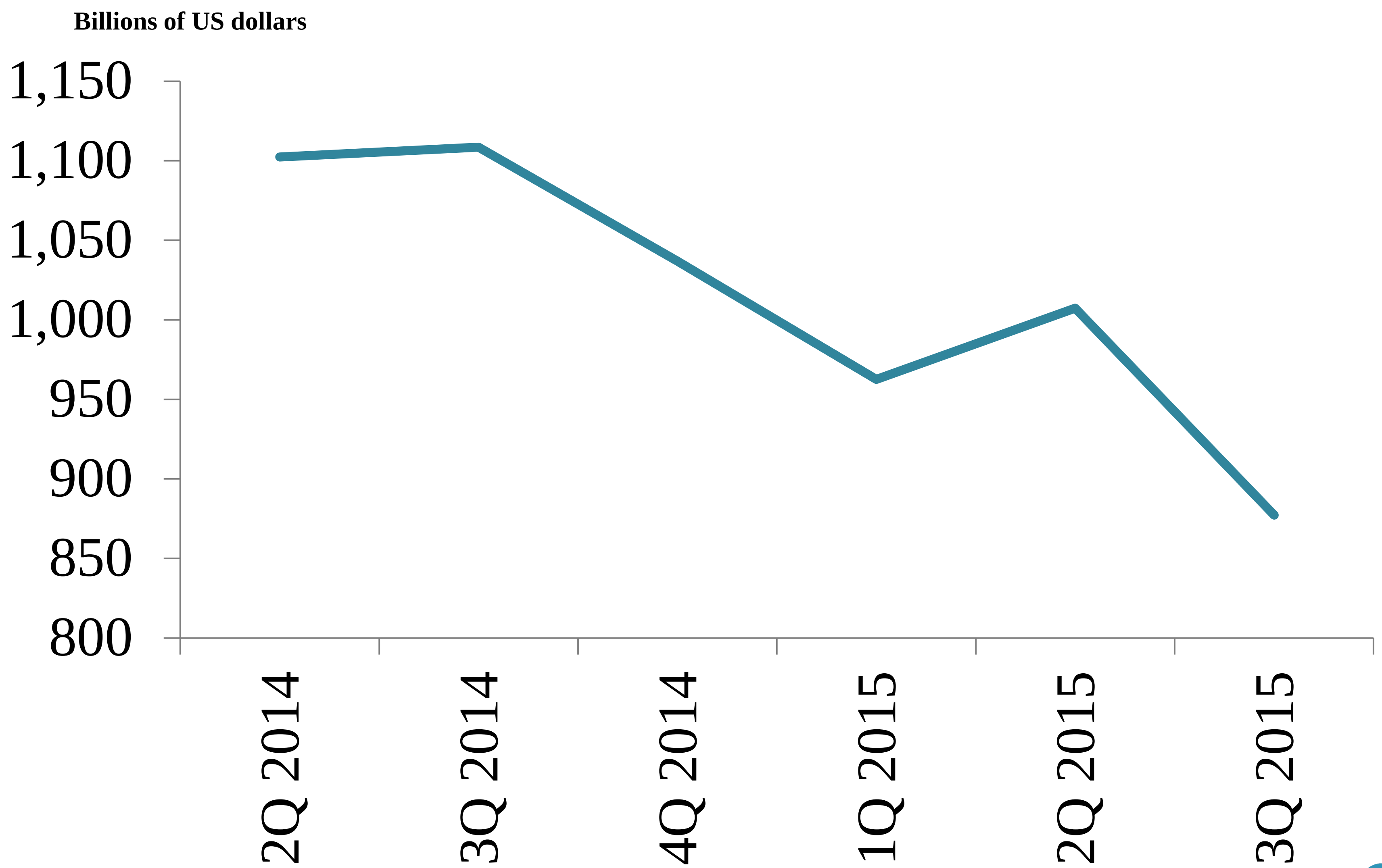


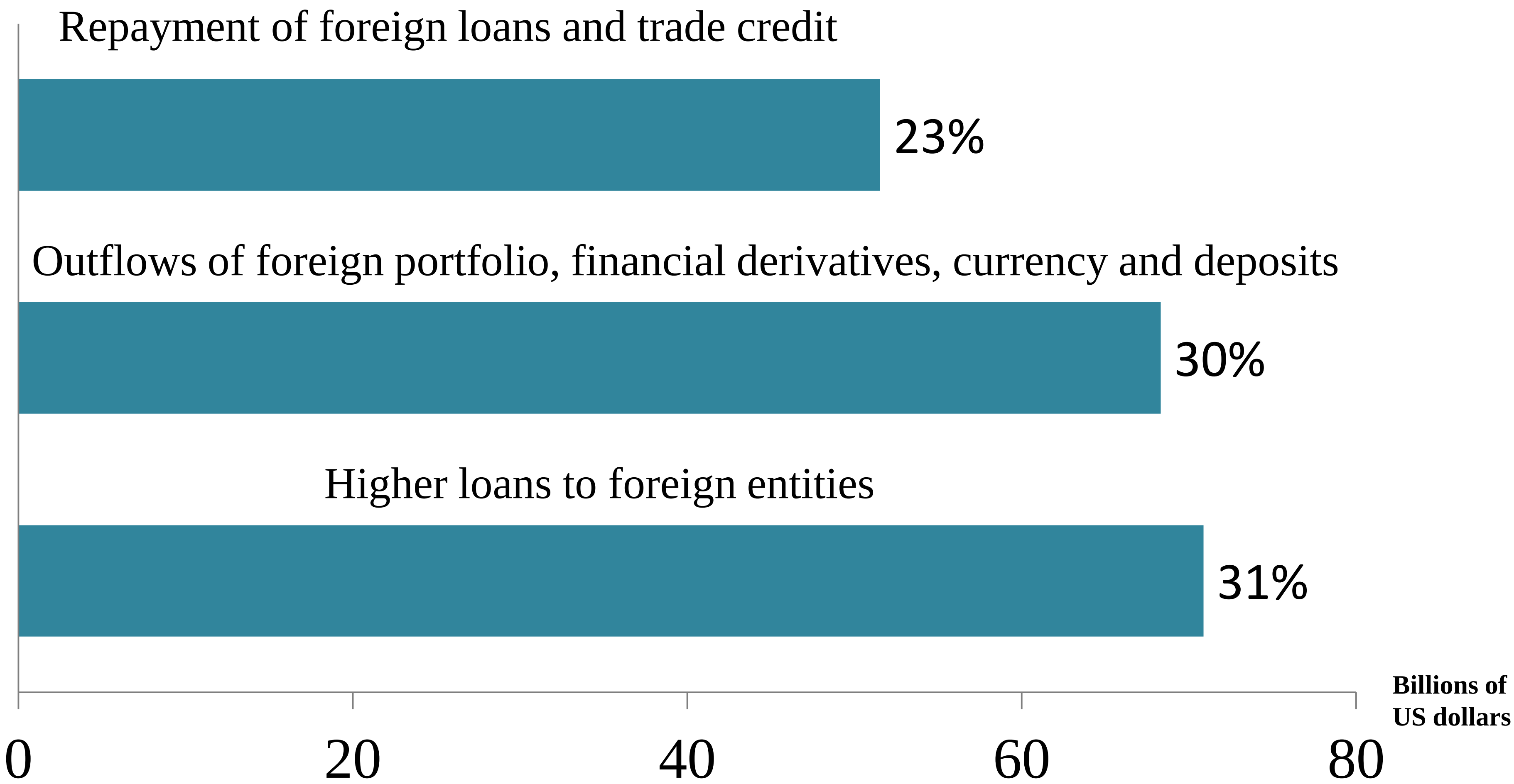
Source: Kyle Bass’s 2016 Letter to Investors, People’s Bank of China

Outstanding of Cross-Border Claims, 2Q 2014– 3Q 2015



Source: Bank for International Settlements

Components of Capital Outflows, 3Q 2015



Source: State Administration of Foreign Exchange, Oxford Economics

Takeaways

- Services and consumption are likely to remain the major drivers of China's economic growth.

- The assertion that authorities will engineer a large step devaluation of the currency to prevent a further economic slowdown is not well founded.

- The view that the decline in China's foreign exchange reserves is because panicked mainlanders are desperately seeking ways to get money out of the country is misinformed. Rather, the decline largely reflects the unwinding of the renminbi carry trade and Chinese companies paying off dollar debt, both of which are self-limiting. Thus the market is unlikely to force a large currency depreciation.