FOCUS · Back to a hard landing for China

It is now becoming relatively normal for the press and quite a few analysts to use the expression «hard landing» every time China publishes weaker figures than expected. This March was no exception. Given this context of recurring alarm bells, it is advisable to carry out a calmer analysis that helps to put these figures into perspective, so as not to enter a spiral of gloom.

First of all, we should look at the indicators that have caused the current commotion. Indeed, the growth rates of industrial production, investment in urban fixed capital and retail sales have fallen for the January-February period compared with 2013 (in year-on-year terms: 8.6% compared with 9.7%, 17.9% compared with 19.6% and 11.8% compared with 13.1%). However, several mitigating factors should be taken into account. Firstly, the calendar of festivities for the lunar New Year has distorted this comparison to the detriment of the current year. Secondly, month-on-month growth rates are still positive and excellent in all three indicators. And thirdly, the upward revision of growth in retail sales and sales of consumer goods for the whole of 2013 (from 11.4% to 13.1%) has been a positive point ignored by most media articles. On the external front, the strength of exports in January, up by 10.6% year-on-year, was dimmed by their weakness in February (–18.1%). But once again it is difficult to make out whether the export figures for January and February as a whole were actually poor since the distortion produced by the New Year celebrations must be added to suspicions of overbilling for exports during the first four months of 2013. Imports, on the other hand, were strong in both January and February (+10% year-on-year), which still comes as a surprise, albeit a positive one, given the somewhat weaker context for demand we ourselves expected. The purchasing managers' index (PMI) for manufacturing fell in February for the third consecutive month but remained above 50, the threshold for expansion, while the PMI for the services sector rose to 55.0 points, its highest in three months.

Given this situation, the decision to slightly devaluate the currency, the recent relaxation in monetary conditions, the first bond default by a Chinese company and the words of the Prime Minister, Li Keqiang, acknowledging that this will be a difficult year are all additional elements that numerous analysts have highlighted when talking about an imminent hard landing. However, in our opinion these events must not be interpreted negatively but rather the opposite. The devaluation has been accompanied by a widening in the range of fluctuation of the yuan, in line with the financial liberalisation announced by the new government and which, together with the relaxation of monetary interest rates, will act as a stimulus. The first corporate default is another sign of the country's shift towards a «more market-oriented» model whose corrective effect should serve to improve the efficiency of resource allocation. Moreover, the Prime Minister has approved a substantial GDP growth target for 2014: 7.5%. Given the hegemonic role still played by the state on the levers for growth (at least in the short and medium term), this target should be taken very seriously.

Undoubtedly, it is difficult to gauge the appropriate growth rate for activity within a situation of unprecedented structural change such as the present. The Chinese economy has been undergoing a soft landing for some time, so far with notable success. This moderation is taking place within a transformation of the growth model where consumption and services are becoming increasingly important compared with the foreign sector and investment in infrastructures. It is true that the country is facing significant risks, created during the years of strong growth such as the debt of local administrations and other local organisations, the rise in shadow banking and possible asset bubbles. The government's strong determination to shift towards a new model of development, less distorted and more sustainable, as well as its capacity to ensure this transition is gradual, are crucial elements that must be watched closely. There cannot be many doubts regarding the government's intent: the categorically reformist statements issued during the Communist Party's Third Plenum last November have already been confirmed by specific steps in the right direction. Our opinion is favourable regarding the economic authorities' capacity to act in the short term. The country's low inflation means that expansionary monetary policy measures can be applied (in spite of the prudence announced by the central bank), while the relatively controlled level of public debt, together with the large reserves accumulated, leaves significant room to manoeuvre in the fiscal sphere. Moreover, China has shown skill in using macroprudential policy to put a halt to any potential financial instability. All this suggests that the announcement of an imminent collapse seems premature.

Relative weakness of the Chinese economy

Year-on-year change (%)

	Latest figure	2013
GDP	7.7	7.7
Industrial production	8.6	10.2
Retail sales	11.8	13.1
PMI manufacturing (index)	50.2	50.8
Exports [1]	4.4	7.9
Imports [1]	8.0	7.3
Investment [2]	17.9	19.6
Bank credit	14.2	14.5
Consumer prices	2.0	2.6
Real estate prices [3]	10.8	11.5

Notes: *1. Cumulative over 12 months. 2. Cumulative investment in urban fixed capital; 3. Average new house prices 100 cities.*

Source: *"la Caixa" Research, based on data from national statistics offices, Thomson Reuters Datastream and the China Real Estate Index System (CREIS; SouFun.com).*