GIC THINKSPACE

PERSPECTIVES ON

China's New Growth Model: Outlook and Impact

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This article presents takeaways from a panel at GIC Insights 2018, which explored the longer-term outlook for China, and China's relationship with the rest of the world. Our esteemed panellists were China Society for Finance and Banking President Dr. Zhou Xiaochuan, Bridgewater Associates Founder, Co-Chairman and Co-Chief Investment Officer Ray Dalio, Vice Mayor of Beijing Municipal Government Dr. Yin Yong, Avanda Investment Management Founding Partner and Chairman Ng Kok Song, and GIC Group Chief Investment Officer Dr. Jeffrey Jaensubhakij. GIC Insights is our annual flagship event that gathers a select group of prominent business leaders to deliberate over long-term issues pertinent to the international business and investment community.

China's efforts to create a more inclusive economy that gives greater play to market forces and more sustainable growth will involve a delicate balance of implementing reforms and maintaining demand and financial stability.

A GIANT'S REBALANCING – CHINA'S NEW GROWTH MODEL

The China of today juggles multiple transitions — a rebalancing of growth drivers away from external-led demand towards domestic-led demand, a tilt away from investment towards domestic consumption, and a shift away from manufacturing towards services. At the same time, it is managing a deleveraging process, following a period of rapid excess credit growth.

Across all these inter-related transitions, the Chinese government has allowed market forces to play a greater role, which is crucial for sustainable reforms. In the important case of State-Owned Enterprise (SOE) reform, we have already seen much progress, with a number of SOEs having already undergone corporatisation and a transition towards mixed ownership.

Despite multiple transitions and evolving external and internal conditions, China remains highly attractive as an investment destination, especially in the long term. It boasts a record of strong and stable growth, political stability unmatched by most countries, and an industrious population. It has also, on numerous occasions, demonstrated its inherent strengths, such as the ability to manage different types of crises, its long-term orientation, and the aspirations and determination of its 1.38-billion population.

KEEPING DEBT UNDER CONTROL

This does not mean that the path ahead is smooth. Debt servicing costs currently account for 15% of China's GDP, and will continue to pose issues for Chinese leaders going forward. The good news is that the decisive actions taken by the Chinese government have already stabilised the growth in the debt-to-GDP ratio. The predictions by "collapse theorists" – who generally stress uncontrollable debt levels – remain unfounded. China is unique from most countries dealing with high debt, in that it is an economy with significant savings surplus.

An important characteristic of leverage in China, which distinguishes it from its peers, is that the bulk of debt is denominated in their own currency. This gives them greater room for policy offsets in times of stress.

Nonetheless, China must apply its strengths to resolve its debt issues. Debt levels of local governments remain under-reported, as their presence in holding entities has sometimes led to it being mis-reported as corporate debt. While this is not an ominous sign in principle, especially if the debt incurred was for investments in education, healthcare, and insurance, the Chinese authorities need to do more to foster greater investor confidence. Education, healthcare, and insurance are all factors that support China's transition to a market-orientated, service-driven economy, but the opening of China's bond market will only achieve its full potential if buyers have confidence to place their capital in the market, with similar confidence that they will be able to draw them out later.

Ultimately, the criticism around China's ability to restructure its debt and capital markets will not stop its march towards becoming the driving force behind the emerging Asian Economic bloc – which is projected to grow at twice the pace of the rest of the world. In a decade's time, this singular bloc can be expected to fuel 35% of global GDP.

URBANISATION: A KEY DRIVER OF CHINA'S GROWTH

In China, investor confidence relates strongly to the republic's huge potential for growth, with urbanisation being a key factor. As at 2015, only 56% of China's massive population was registered in urban areas. As more of its people migrate into second- and third-tier cities, so will its future growth potential. An example of its business friendliness is Beijing, where new business registration processes have been reduced to under five days, down from an average of 23 before.

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GOING GLOBAL IN AN UNCERTAIN WORLD

The big uncertainty surrounding China's trajectory is geopolitics. This is partly a response to the rapid emergence of China and its competitiveness in key industries such as technology and artificial intelligence.

The bipartisan consensus that is emerging in Washington suggests that the ongoing, escalating tension in US-China relations could be prolonged. More broadly, populism has been on the rise both in the US and globally, leading to greater protectionism and nationalism, which could lead to adverse effects on political stability and investor confidence.

WHAT IT MEANS FOR THE GLOBAL COMMUNITY

Overall, two immediate investment implications arise from the above observations.

First, the sheer size of China and the prospect of its capital markets opening further mean that it remains a key investment destination in the long run, despite ongoing geopolitical tensions. The world will become more invested in China over time.

Second, while the Chinese economy is expected to grow in dominance over time, a transition away from the dollar as the global reserve currency is still not imminent, as it is a slow process. Nonetheless, the current short squeeze on the US dollar due to the growth in US-dollar debt and the large fiscal deficits is likely to put downward pressure on the dollar over the medium term.