

Chapter 2

China's Macroeconomic Forecast from 2015 to 2016

2.1 Assumptions on the Exogenous Variables

2.1.1 The Economic Growth Rates of the US and the Euro Area

Due to the continuous improvement of the household financial conditions, lower oil price and other factors, American economy, still facing weak global demands and the strong US dollar, will have a continuously increasing growth rate in the following two years. According to the forecasts made by IMF on 9th July, 2015, the growth rate of American economy will be 2.5 and 3 % in the following two years respectively, 0.6 and 0.1 % points lower than what was forecasted in April.

Quantitative easing monetary policy, lower oil price and the improvement of labor market are the main factors that boost the economic growth in the Euro Area this year. However, the Greece political changes and debt crisis might hamper the economic growth in the Euro Area. IMF forecasted that, the economic growth rate of the Euro Area would be 1.5 % in 2015 and might increase to 1.7 % in 2016 (Fig. 2.1).

2.1.2 The Main Exchange Rates

In the first half of 2015, because of the increasing expectations for raising interest rates in the US, the worldwide major currencies all encountered different degrees of depreciation with respect to the US dollar. In terms of the changes of the exchange rate of RMB against the US dollar in the second half of 2015, the economic slowdown is the main factor leading to the depreciation of RMB. However, the transformation and enhancement of the endogenous growth impetus of China's economy, which is due to the deepening of economic reform and upgrading of economic structure, together with the continuous acceleration of RMB globalization

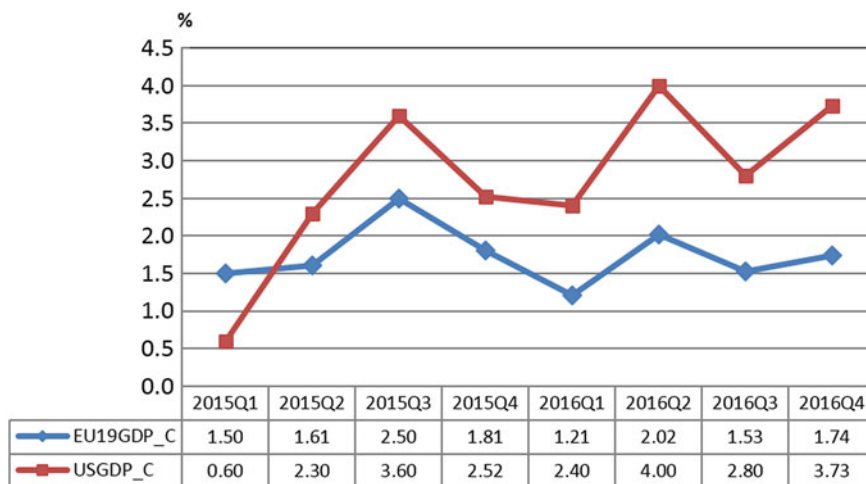


Fig. 2.1 The assumptive trend of the American and the euro area's quarterly economic growth rate (on the basis of year-on-year). *Note* EU19GDP_C denotes the economic growth rate of the Euro Area, USGDP_C denotes the economic growth rate of the US. *Data source* Forecasts made by IMF on 9th July, 2015 and assumed by the research team

in recent years, will keep the exchange rate of RMB stable. However, according to the unexpected formation mechanism adjustment of RMB central parity rate made by China's Central Bank on 11 August, 2015, which aims at improving its liberalization degree, the RMB central parity rate has been greatly adjusted downward. Therefore, the RMB central parity rate against the US dollar will fluctuate in the second half of 2015, and it will depreciate to 6.38 by the end of 2015 and to 6.40 at the end of 2016 (Fig. 2.2).

In the first half of the year, the expectations for raising interest rates in the US, together with the separation risk of Greece out of the EU, led to the continuous depreciation of the Euro with respect to the US dollar. In the second half of the year, even the Federal Reserve might increase interest rates by the end of this year, the risk of the economic growth rate of the Euro Area can still be greatly alleviated, and this is because of the agreement on the Greece debt issue achieved at the Euro Area summit on 13th July. The QE monetary policy implemented by the ECB since March this year can also account for this. The depreciation speed of the Euro is expected to slow down substantially. By the end of 2015, the exchange rate of the Euro with respect to the US dollar will drop to 1.07 and this level will be kept until 2016 (Fig. 2.2).

2.1.3 The Growth Rate of the Broad Money Supply (M2)

Starting from this year, China has shifted the monetary policy to be expansionary and has cut the interest rate and the reserve requirement ratio for three times

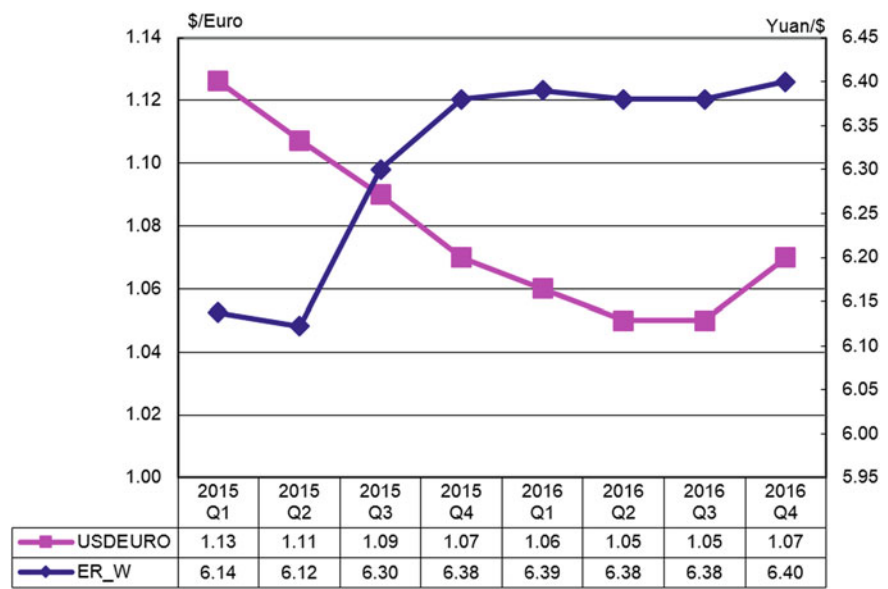


Fig. 2.2 The assumptive trends of the exchange rate of the US Dollar against the Euro and RMB against the US Dollar. *Note* USDEURO denotes the US dollar/Euro (*left axis*); ER_W denotes RMB/the US dollar (*right axis*). *Data source* Forecasts made by IMF on 9th July, 2015 and assumed by the research team

respectively in order to deal with the complicated domestic and world economic situation. However, because of the sluggish of the interest rate transmission mechanism, even though the banking system has excess liquidity, the decrease of the financing cost of the real economy was decreased not as expected. In the second half of the year, although the rise of the pork price can raise the CPI to some extent, it is forecasted that the annual CPI will not exceed the targeted level of 3 %. Meanwhile, the continuous decreasing trend of PPI will continue.

It is forecasted that the interest rate and the required reserve ratio will be cut once in the third quarter of 2015, and they might be 25 and 100 base points, respectively. The annual growth rate of M2 will be 11.9 % in 2015; it will remain at the level of 12 % in 2016 in general (Fig. 2.3).

2.2 Forecasts of Main Macroeconomic Indicators During 2015–2016

2.2.1 Forecasts of the Economic Growth Rate

With the assumptions on the exogenous variables, the forecasts based on the CQMM demonstrate that, China’s economic growth rate will be 7.10 % in 2015, a

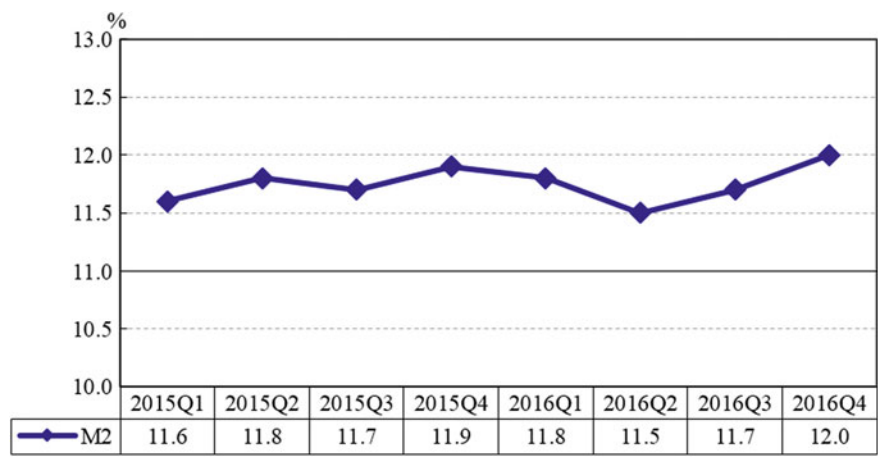


Fig. 2.3 The assumptive trend of the growth rate of M2. *Data source* Assumed by the research team

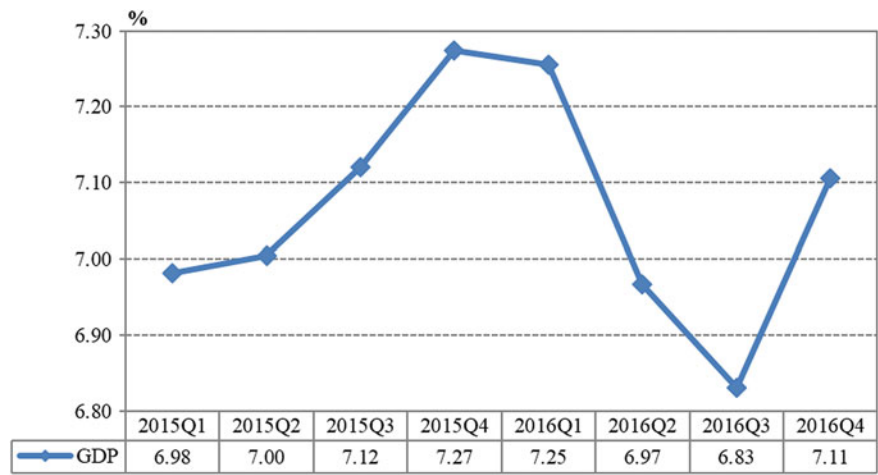


Fig. 2.4 GDP quarterly growth rate forecasts (on the basis of year-on-year). *Data source* Recalculated by the research team

decrease of 0.3 percentage points over the previous year. And it will go down to 7.04 % in 2016. Considering the quarterly year-on-year growth rate (Fig. 2.4), it is forecasted that the world market environment will be improved to some degree. The easing monetary policy and positive fiscal policy in domestic market will continue. Intensively promoted by all kinds of growth stability policies, GDP is forecasted to grow to 7.12 % in the third quarter of 2015; the growth rate in the fourth quarter has been expected to go back to 7.27 % and will remain at this level until the first quarter of 2016. Afterwards, the economy growth will descend to 6.83 % in the

third quarter of 2016 and then will bounce off slightly to 7.11 %. Despite that the uncertainty of export expansion and the investment decline caused by the production overcapacity will still cause downward pressure on China’s economy in the next two years, the economic reform deepening and economic structure upgrading will transform the driving force of growth, thus providing the main power for the stable growth of China’s economy.

2.2.2 Forecasts of the Major Price Indexes

(a) Consumer Price Index (CPI)

The model forecasts that, the CPI will increase to 1.62 % in 2015, a decrease of 0.37 percentage points over the last year; it will slightly go up to 2.14 % in 2016.

According to the quarterly analysis (Fig. 2.5), we find that affected by the price rebound of pork and other commodities, the CPI might go up to 1.73 and 2.16 % in the last two quarters of 2015, and then reach 2.55 and 2.31 % in the first two quarters of 2016.

(b) Producer Price Index (PPI)

The PPI will remain negative growth in the next two years, but the decline range is expected to be gradually narrowed. The PPI is expected to be −4.32 % in 2015 and might continue to be narrowed to −1.34 % in 2016.

Quarterly analyzed (Fig. 2.5), PPI might go to −4.68 and −3.45 % in the last two quarters of 2015, and then the decline range is gradually narrowed afterwards.

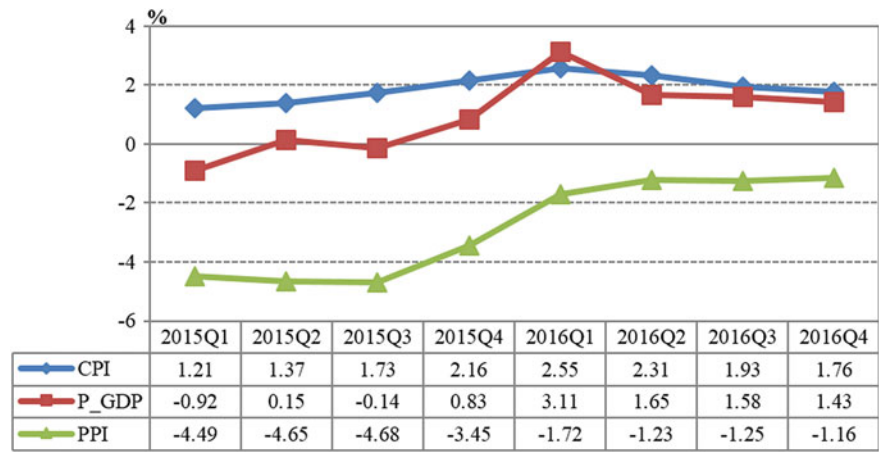


Fig. 2.5 Price indexes forecasts (quarterly year-on-year growth rate). *Note* CPI denotes the consumer price index; P_GDP denotes the GDP deflator; PPI denotes the producer price index. *Data source* Recalculated by the research team

In 2016, this indicator is expected to keep rising and might rise to -1.16% in the fourth quarter, with the improvement of world economic environment, the establishment and development of the Silk Road Economic Belt and the 21st Century Maritime Silk Road, the reduced pressure on obsoleting outmoded production overcapacity industries and the improvement of enterprise operation conditions.

In 2015, GDP deflator (P_GDP) might slightly decline to -0.02% but go back to 1.94% soon in 2016. According to the quarterly analysis, it will decline to -0.14% in the third quarter of 2015 and return back to 0.98% in the last two quarters of 2015. In 2016, this indicator will be higher at the beginning but hold the decreasing trend afterwards, finally falling to 1.43% in the fourth quarter (Fig. 2.5).

In a word, although the domestic economy faces the downward pressure in 2015, the economic growth rate is likely to achieve the targeted rate of 7.0% . It is forecasted that the annual economic growth rate is 7.10% . The inflation rate will be stable at low level, and the annual CPI is forecasted to increase by 1.62% . Affected by the slow release of “policy dividend” and structure adjustment, China's economic growth rate will have a slight decline in 2016 while the CPI growth will have a certain degree of increase at the same period.

2.2.3 Forecasts of the Growth Rates of Other Main Macroeconomic Indicators

(a) Imports, Exports and Foreign Reserve Forecasts

Nowadays, the global economy is still in the deep adjustment and the worldwide recovery is lack of power; The demand is weak, and thus the price of bulk commodity is continuously decreasing. In one word, the prospect is unclear. Affected by all of these uncertainties, the model forecasts that the gross export calculated in the US dollar and current price will increase by 1.87% in 2015, a decrease of 3.3 percentage points over the last year. The growth rate of gross import might decline to -11.47% , a large decrease of 12.2 % points compared to last year (Table 2.1).

According to the quarterly analysis, in the third quarter of 2015 export growth rate will decline to 1.57% compared to the same period of the last year. But the Central Bank suddenly adjusted the formation mechanism of the RMB central parity rate on 11 August, leading to a large depreciation of RMB and thus the expansion of export. Therefore, it will return slightly back to 3.38% in the fourth quarter. The import growth rate might reach the level of -8.56% in the third quarter of 2015 compared to the same period of last year, and the decrease range will be narrowed afterwards and then go back to -6.01% in the fourth quarter. The share of China's net export in GDP remains at the level of 2.47% in 2015.

Affected by the decrease of the export growth rate and the outflow of capital caused by the increasingly strong US dollar, the foreign reserve will go down to 3.62 trillion dollars in 2015. With the gradual recovery of global market demand, China's import and export will begin to recover and grow in 2016. The export

Table 2.1 Forecasts of the share of China’s import, export and net export over GDP from 2015 to 2016

Time	Export (%)				Import (%)				The ratio of net export over GDP (%)
	Constant price/RMB	Current price/US dollar	General trade current price/dollar	Processing trade current price/dollar	Constant price/RMB	Current price/dollar	General trade current price/dollar	Processing trade current price/dollar	
2015	5.05	1.87	4.50	-1.93	0.00	-11.47	-15.52	-8.33	2.47
The first quarter	6.01	4.62	11.78	-6.17	-8.61	-17.80	-21.78	-8.37	2.09
The second quarter	-0.73	-2.07	1.73	-8.53	-1.43	-13.48	-15.51	-12.59	3.01
The third quarter	5.71	1.57	2.90	2.28	5.40	-8.56	-13.76	-6.36	2.28
The fourth quarter	9.04	3.38	2.15	3.95	4.54	-6.01	-10.49	-6.33	2.64
2016	8.03	6.81	10.11	-0.16	4.90	3.72	6.98	-1.31	2.80
The first quarter	7.07	4.65	4.59	3.56	11.44	8.24	6.93	3.48	2.61
The second quarter	13.25	11.06	13.29	5.72	6.43	4.52	6.70	2.84	2.81
The third quarter	5.64	5.30	10.75	-4.85	0.77	0.62	7.16	-5.84	2.93
The fourth quarter	6.65	6.48	11.91	-3.54	1.98	2.05	7.12	-4.50	2.88

Data source Recalculated by the research team

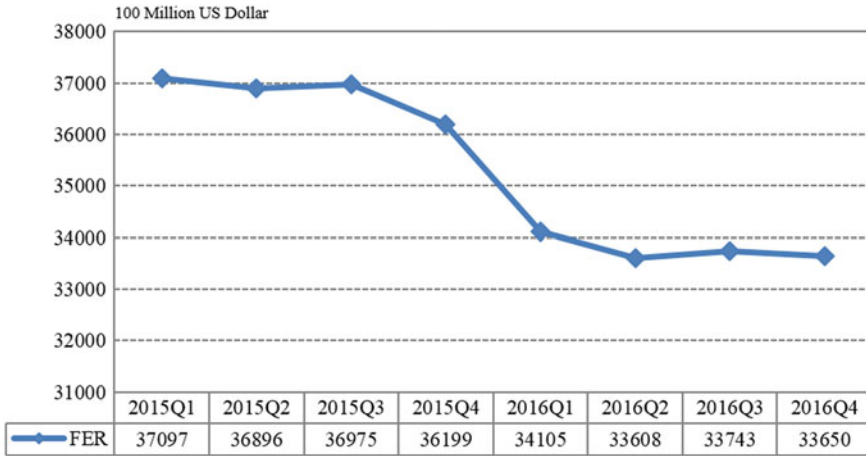


Fig. 2.6 Foreign reserve forecasts. Note: FER denotes the scale of the foreign reserve. *Data source* Recalculated by the research team

growth rate calculated in the US dollar and current price is forecasted to reach 6.81 % and the growth rate of import will be 3.72 %. The foreign reserve in 2016 might have a further decrease to 3.37 trillion dollars (Fig. 2.6).

(b) Forecasts of Growth Rates of the Fixed Assets Investment

Since the second quarter of 2015, the growth rate of industrial added value, fixed assets investment and real estate investment have been kept stable, but the excess supply of the real estate and the manufacturing production overcapacity still cannot be completely eliminated, thus the growth rate of fixed assets investment will continue to decrease in 2015. The growth rate of urban fixed assets investment calculated in current price will be 11.21 %, a decrease of 3.99 % points over last year (Fig. 2.7).

In 2016, the establishment of Silk Road Economic Belt and the 21st Century Maritime Silk Road, the integration of the Beijing-Tianjin-Hebei region and the rapid development of emerging fields such as the “Internet Plus” might support the fixed assets investment, and the growth rate of urban fixed assets investment is expected to be 10.68 %.

According to the quarterly analysis, the growth rate of urban fixed assets investment (current price) will increase to 11.72 % in the third quarter of 2015, and then, affected by base effects, it will decline to 9.61 % in the fourth quarter.

In 2016, since the second quarter, it will increase quarterly and reach the level of 13.41 % at the end of the fourth quarter.

(c) Forecasts of the Consumption Growth Rates

The gross household consumption of 2015 calculated at constant price is forecasted to increase by 6.79 %, a slight decrease of 1.23 % points compared to 2014. In 2016, it will slightly increase to 7.84 % and then remain stable.

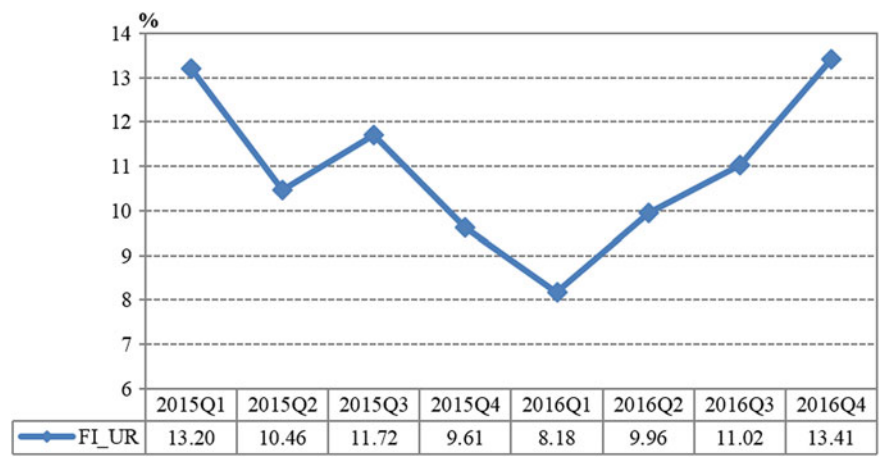


Fig. 2.7 The quarterly growth rates forecast of the gross fixed assets investment (on the basis of year-on-year). Note: FI_UR denotes the growth rate of the urban fixed assets investment (current price). *Data source* Recalculated by the research team

In 2015, the total retail sales of social consumption calculated in current price will increase by 10.07 %, a decrease of 1.90 % points compared to 2014. It will slightly increase to 11.98 % in 2016.

According to the quarterly analysis, the growth rate of gross household consumption at constant price will decline to 4.86 % in the fourth quarter of 2015, which is the bottom value of this year.

In 2016, the growth rate will be higher at the beginning but keep decreasing trend afterwards, reaching the peak point of 9.78 % in the second quarter and will fall back to 6.46 % in the fourth quarter.

The growth rate of total retail sales of social consumption calculated at current price keeps stable in 2015, and it will decrease to 8.81 % in the third quarter. The trend is relatively stable but with small increases in 2016, and the growth rates stay between 10.19 and 14.00 % for every quarter (Fig. 2.8).

To sum up, although the uncertainty of global market and the decrease of investment growth rates have caused the downward pressure on the economic growth, in the second half of the year, world economic environment will be improved and all kinds of domestic growth-stability policies will take effects, and deeper economic reform and economic structure will transform and enhance the growth impetus, which is expected to underpin the economy. China’s economic growth rate of 2015 will slightly decrease by 0.3 % points compared to 2014 and arrive at the level of 7.10 % in 2015. The CPI is forecasted to increase by 1.62 %. The economic growth rate will be steadily above 7 % and the employment situation will also be basically stable. All of these will continue to create favorable environment for deepening comprehensive economic reform and boosting the potential growth rate.

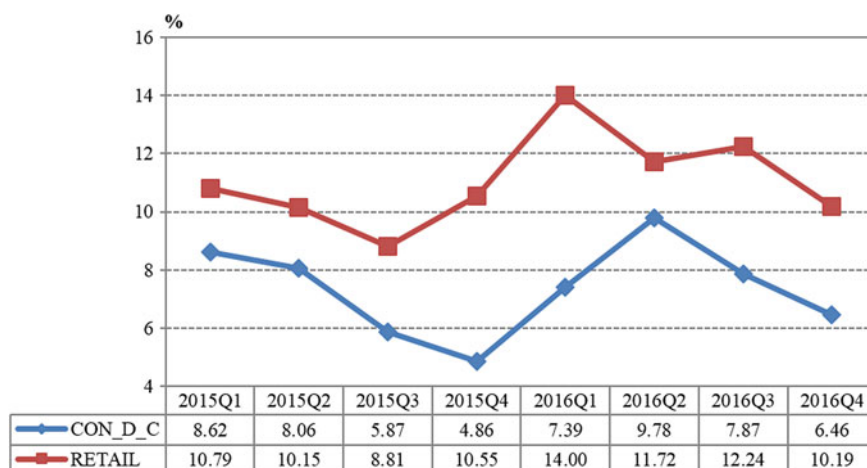


Fig. 2.8 Forecasts of the quarterly consumption growth rates (on the basis of year-on year). Note: CON_D_C denotes the growth rate of gross household consumption (constant price); RETAIL denotes the growth rate of total retail sales of social consumption (current price). *Data source* Recalculated by the research team

During this period of the 13th Five-Year plan (2016–2020), the reform of mixed-ownership will broaden the space for private investment, effectively integrate social resources and stimulate the economic growth. “Made in China 2050” and the adjustment policies of regional strategies will promote the labor productivity of the manufacturing. The acceleration of liberalizing of interest rates and the refining of capital market will improve the allocation efficiency of financial resources. Meanwhile, the implementation of the “Internet-plus-Strategy” will also improve the labor productivity in the tertiary industry. The reform of administrative review and approval, the implementation of the government “negative lists” management and so forth will all further stimulate China’s economic growth potential in the long term, creating favorable conditions for China’s economy growth to keep stable in the following five to ten years and to avoid the “middle-income trap”.

However, under the background of easy monetary policy in the first half of 2015, the allocation of credit resources in financial sector is inefficient, which is reflected by the sharp decline of the growth rate of the private investment and the poor circulation of monetary policy transmission mechanism. The industrial deflation has been existed for nearly four continuous years. The growth of the real income of urban and rural residents decreased, because of the decline of economic growth rate. The growth rate of fiscal income has also witnessed a rapid decrease. All the above facts will become the main factors suppressing the economic growth further in the short term.

Despite that the continuous increase of the share of the tertiary industry guaranteed the stability of employment situation in some degree, the labor productivity of the tertiary industry is still lower than that of the secondary industry for a long

period. How to rapidly increase the labor productivity of the tertiary industry during the adjustment period of industrial structure is vital to ensure a stable potential growth rate for China's economy in the following decade.

During the period of the 13th Five-Year Plan, the boost of labor productivity and the acceleration of growth of the real income of urban and rural residents play an important role in stimulating the growth potential. In the short term, the liberalization of interest rates is the key to refine the capital market and enhance the allocation efficiency of credit resources. Through the interest rates liberalization, the new credit resources can be effectively allocated in the private sectors where the productivity is higher, thus it can satisfy the demand of private investment expansion. In the long term, under the pressure of wage rise and the appreciation of RMB, the transformation and upgrade of China's manufacturing will greatly boost the labor productivity of the secondary industry. If the productivity of the tertiary industry cannot be improved correspondingly, then in the process of China's economy transferring from the secondary industry to the tertiary industry, the low labor productivity in tertiary industry will suppress economic growth inevitably and hinder the improvement of residential income. Enhancing the efficiency of financial sectors through the liberalization of interest rates and increasing the share of financial sectors over the tertiary industry can effectively narrow the productivity gap between the secondary industry and the tertiary industry. In this way, the transformation of China's economy is not only conducive to the enlargement of employment, but also helpful to the rapid increase of residential income, thereby promoting the transformation of China's economic growth pattern further.

In the next chapter, we first apply CQMM to make the simulation analysis about the possible macroeconomic effects resulted from the liberalization of interest rates in the short term, and then from the perspective of optimizing structure, we will investigate issues regarding the optimization of economic structure and the increase of the growth potential.

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