# Chapter 2
# Quarterly Forecast for 2017–18

## 2.1 Assumptions on Exogenous Variables

### *2.1.1 Growth Rates of the United States and the Euro Area*

The US economy showed a strong rebound in the second half of 2016, and the economy was close to full employment. In 2017, after Donald Trump became the president of the United States, the market looked forward to his policies such as fiscal stimulus, tax cutting, capital return and so on, which would boost the US economy. Nonetheless, these policies would lead to inflation, and thus stimulus the interest rates raising expectations from the Federal Reserve, which further promote the dollar going stronger. According to the latest forecast by the International Monetary Fund (IMF) released on January 16, 2017, affected by the fiscal stimulus policy, the US economic growth in 2017 is expected to rise to 2.3% and further increase to 2.5% in 2018.

On the other hand, since the second half of 2016, the Eurozone's economic performance is also stronger than expected, the unemployment rate has dropped to a new low of seven years. The employment growth promotes the expansion of household consumption demand, and the economy appeared a moderate recovery trend. However, the structural problems of the euro area itself are not fully resolved. The Brexit will bring further impact, coupled with the Italian banks that are in trouble recently. In general, the Eurozone's economic and financial systems have not been not out of vulnerability. Those issues, such as the refugee problem and the intensified uncertainty of the general election in Germany, France, and the Netherlands, will have negative impacts on consumers and business confidence in the next two years. According to the latest forecast issued by IMF on January 16, 2017, the Eurozone's economic growth rates are both projected to be 1.6% /(see Fig. 2.1)/.



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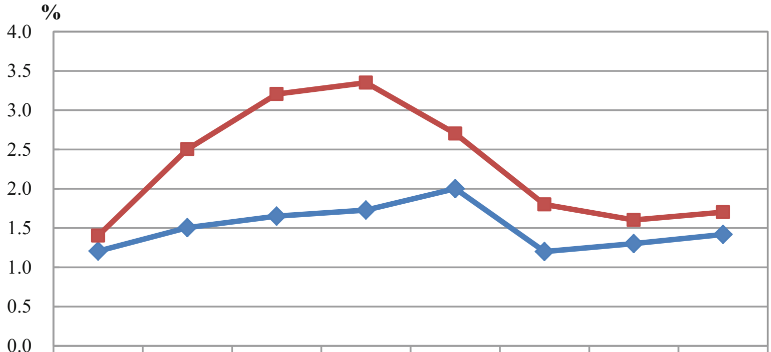


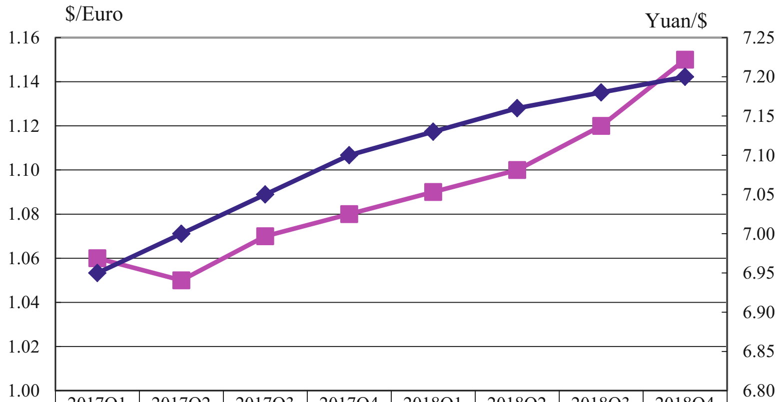

| | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 | 2018Q2 | 2018Q3 | 2018Q4 |
|---|---|---|---|---|---|---|---|---|
| EAGDP_C | 1.21 | 1.50 | 1.65 | 1.73 | 2.00 | 1.20 | 1.30 | 1.42 |
| USGDP_C | 1.40 | 2.50 | 3.21 | 3.35 | 2.70 | 1.80 | 1.60 | 1.70 |

**Fig. 2.1** Assumptions on GDP growth rate of the US and the euro. Seasonally adjusted. QoQ. *Note* EAGDP_C denotes real GDP growth rate in the euro area, USGDP_C denotes real GDP growth rate in the US. *Source* CQMM team assumptions

### *2.1.2 The Exchange Rates*

By the end of 2016, the RMB against the US dollar depreciated by 6.83% over the previous year, and the depreciation rate exceeded the sum of the past two years. In 2017, as China's economic growth will continue to slow down slightly, the dollar may remain strong, while the RMB has to bear depreciation pressures. The RMB against the US dollar is expected to depreciated to 7.10 by the end of 2017, down by about 3%. By the end of 2018, with the gradual stabilization of China's economy, the US fiscal deficit and rising inflation will be to a certain extent, the dollar index to continue to strengthen, the yuan against the US dollar exchange rate will be slightly depreciated to 7.20 (see Fig. 2.2).

The European Central Bank decided on December 8, 2016 to maintain the Eurozone current zero interest rate policy unchanged, for recovering the economy and coping with deflationary pressures. Both the expectation of the US dollar going strong and the various political and economic risks in Europe increasing are expected to be bad for the euro. The euro-dollar exchange rate in the first half of 2017 is expected to drop to 1.05 in the first half of 2017 and rebound to 1.08 in the second half as the euro zone's economic outlook improves. In 2018, as the euro zone's economy picks up, it is set to rebound to 1.15 (see Fig. 2.2).




| | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 | 2018Q2 | 2018Q3 | 2018Q4 |
|---|---|---|---|---|---|---|---|---|
| USDEURO | 1.06 | 1.05 | 1.07 | 1.08 | 1.09 | 1.10 | 1.12 | 1.15 |
| ER_W | 6.95 | 7.00 | 7.05 | 7.10 | 7.13 | 7.16 | 7.18 | 7.20 |

**Fig. 2.2** Assumptions on changes in exchange rates. YoY. *Source* CQMM team assumptions

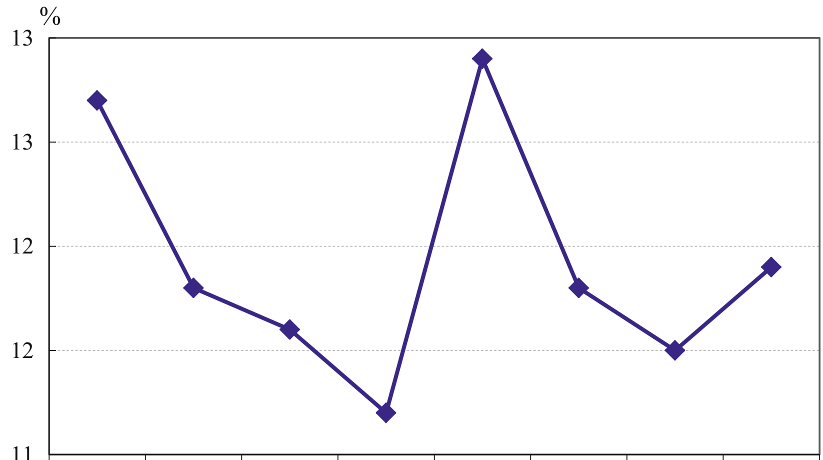
### *2.1.3 Growth Rate of the Broad Money Supply (M2)*

The Economic Work Conference by the CPC Central Committee in December 2016 made it clear that the monetary policy in 2017 is going to stay robustly neutral, maintain the stability of liquidity, and put that preventing and controlling financial risks into a more important position. Therefore, the monetary policy in 2017 should not only focus on the steady economic growth, but pay attention to the exchange rate changes, inflation, stock market, property market and other factors. Taking into consideration the control of asset price bubbles, CPI moderate upward, capital outflow, and the increasing pressure of devaluation of the renminbi, in order to maintain adequate liquidity and moderate growth in social financing, the broad money supply (M2) growth in 2017 is expected to rise by 11.2%, almost unchanged from the previous year. In 2018, the M2 is projected to slightly rebound to 11.9% (see Fig. 2.3).

## 2.2 Quarterly Forecast of China Major Macroeconomic Indicators in 2017–18

### *2.2.1 GDP Growth Rates*

Based on the above assumptions on exogenous variables in the China's Quarterly Macroeconometric Model (CQMM), it is forecast that China's GDP growth rate would be 6.64% in 2017, down by 0.06 percentage points over 2016. In 2018,




| | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 | 2018Q2 | 2018Q3 | 2018Q4 |
|---|---|---|---|---|---|---|---|---|
| M2 | 12.7 | 11.8 | 11.6 | 11.2 | 12.9 | 11.8 | 11.5 | 11.9 |

**Fig. 2.3** Assumptions on M2 growth rates. YoY. *Source* CQMM team assumptions

China's economic growth rate is expected to further drop to 6.59%, 0.05 percentage points lower than that of 2017.

The model predicts that there exist downward pressures on the economy over the next two years. First, the uncertainty of the external economy and the trend of de-globalization would continue to suppress the growth of China's exports of goods, expand the trade deficit, further reduce the trade surplus of goods, thereby weakening the contribution of the net outflow of goods and services to economic growth. Second, such growth mode that the total investment growth in 2016 was mainly drove by the rapid growth of investment in real estate and infrastructure is hard to sustain, and the private investment growth is difficult to significantly rebound in the short term as well. Given the capital outflow could not be effectively controlled, all the above-mentioned factors will suppress the investment growth. Third, the slowdown of the growth of urban and rural residents' real income would hinder the rapid growth of consumption, although the accelerated urbanization would to a certain extent support the expansion of consumer spending. In the next two years, with the gradual cutting of excess capacity, the structural upgrading of manufacturing, and the continued expansion of the tertiary industry, though China's economic growth is expected to edge down, the rate of decline is set up to gradually shrink.

Quarterly, the GDP growth is set to stay at 6.70% in the first quarter of 2017. Since then, the decline in real estate investment growth is expected to pull down the total investment growth, and thus increase the economic growth. The GDP growth in second quarter is expected to grow by 6.60%, rebound slightly to 6.64% in the third quarter, and increase by 6.62% in the fourth quarter. In 2018, the growth rates are expected to continue to show a high-low trend (see Fig. 2.4).

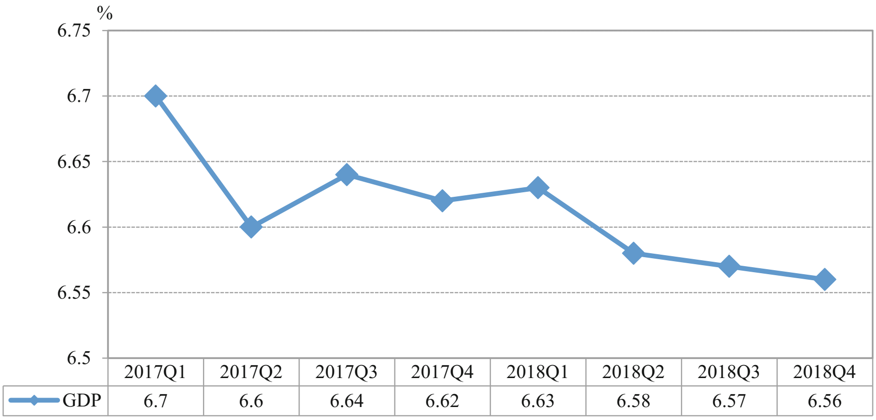


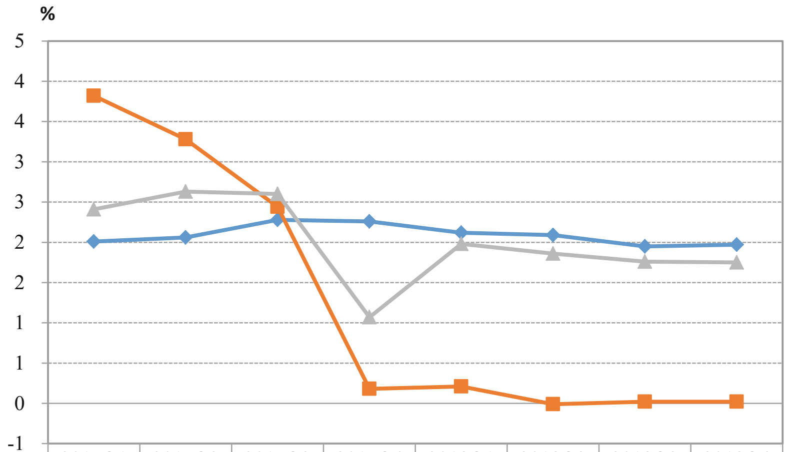

**Fig. 2.4** Projected GDP growth rates. YoY. *Source* CQMM team calculations

### *2.2.2 Major Prices Indices*

According to the CQMM forecasts, the Consumer Price Index (CPI) is projected to continue to rise moderately in the next two years. It is expected to rise by 2.15% in 2017, 0.15 percentage points higher than that in 2016. In 2018, it is set to drop slightly to 2.03%. With the acceleration of cutting overcapacity and rising international commodity prices expected, the producer price index (PPI) is projected to resume positive growth. The PPI is expected to rise by 2.41% in 2017, 3.81 percentage points higher than that in 2016. In 2018, with further decline in the domestic investment growth, the PPI is set to go up by 0.06%. The PPI's recovery to positive growth would help those enterprises with upstream means of production restore the growth of profits, and reduce the actual debt burden of enterprises. However, in the short run, as the new engines of economic growth has not formed and the economy continues to slow down, the PPI is expected to maintain a low rise.

Quarterly, the CPI is expected to increase by 2.01% in the first quarter of 2017 and rise by 2.06% in the second quarter. Driven by the rising PPI, the CPI is set to grow by 2.28% and 2.26% respectively in the third and fourth quarter. Due to continued economic slowdown, the CPI growth rate is projected to remain at around 2% in 2018. For the low base, the PPI is expected to be up by 3.82, 3.28 and 2.44% respectively in the first three quarters of 2017, and adjusted to 0.18% in the fourth quarter. Positively affected by the supply-side structural reforms, the PPI is set to remain stable in four quarters of 2018 (see Fig. 2.5).

In 2017, the GDP deflator index (P_GDP) is expected to grow by 2.17%, an increase of 1.04 percentage points over the previous year. It is 2018 will be slightly down to 1.84% in 2018. Forecast shows that the next two years, due to PPI "positive", and the basic stability of the CPI, the Chinese economy will be able to maintain a moderate and stable inflation rate, the possibility of high inflation is




| | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 | 2018Q2 | 2018Q3 | 2018Q4 |
|---|---|---|---|---|---|---|---|---|
| CPI | 2.01 | 2.06 | 2.28 | 2.26 | 2.12 | 2.09 | 1.95 | 1.97 |
| PPI | 3.82 | 3.28 | 2.44 | 0.18 | 0.21 | -0.01 | 0.02 | 0.02 |
| P_GDP | 2.41 | 2.63 | 2.6 | 1.07 | 1.98 | 1.86 | 1.76 | 1.75 |

**Fig. 2.5** Projected growth rates of price indices. YoY. *Note* P_GDP denotes the GDP deflator. *Source* CQMM team calculations

small. Quarterly, the first three quarters of 2017 affected by the base, the GDP deflator index will rise in the fourth quarter may be reduced to 1.7%. In 2018, four quarter changes show a high-low trend, basically consistent with the growth rate of GDP (see Fig. 2.5).

## 2.3 Growth Rates of Other Major Macroeconomic Indicators

### *2.3.1 Growth Rates of Exports, Imports, and Foreign Exchange Reserves*

In the next two years, the economic outlook in the major economies is still quite uncertain. Especially the risks of extreme trade protectionism possibly taken by the Trump government and the possible re-emergence of the new European debt crisis would further suppress China's export growth. Due to continued rise of the domestic wage, China's processing trade growth shrank rapidly, which further weakened the role of the RMB depreciation in pushing exports. In addition, as the upgrading of China's export products is difficult to complete in the short term, it is expected that in the next two years China's imports and exports would continue to slow down, but the rate of decline would be significantly narrowed.

According the CQMM forecasts, the total value of exports in RMB terms (measured at the current price) is expected to grow by 0.39% in 2017, 2.39 percentage points higher than that in 2016. The total value of imports is expected to increase by 5.07%, up by 4.47 percentage points over the previous year. Due to continued expected depreciation of the RMB, the total value of exports in current dollar terms (measured at current price) is set to fall by 5.11%, narrowed by 2.59 percentage points over the previous year. The total value of imports is projected to drop by 0.24%, narrowed by 5.26 percentage points over the previous year (see Table 2.1). In 2018, the total value of exports in dollar terms (measured at current price) is forecast to be down by 0.72%. Affected by the domestic industrial structure and consumption structure upgrading, the total value of imports is set to increase by 1.55% (see Fig. 2.6).

Quarterly, the total value of exports in dollar term (measured at the current price) in 2017 (current dollar value) is expected to continue to grow negative, but the decline is projected to gradually narrow from –5.21% in the first quarter to –3.09% in the fourth quarter, and in 2018 the decline is set to be further narrowed. Owing to the recovery in commodity prices and the devaluation of the RMB, the total value of imports is expected to grow slowly in 2017, with positive growth in the first three quarters but down by 4.08% in the fourth quarter for high base effect. In the last three quarters of 2018, due to continued depreciation of the RMB, year on year growth will begin to show negative growth. China's net exports in GDP in 2017 will fall to 3.6% of GDP (0.9%), down 0.9 percentage points from 2016.

In 2016, due to the capital outflow peak and the sharp depreciation of the RMB, China's foreign exchange reserves dropped by 0.32 trillion US dollars. Although more stringent foreign exchange control implemented since October 2016 has effectively decelerated the capital outflow, owing to economic slowdown, there still exists devaluation expectation of the RMB and pressure of capital outflow in 2017. Policy taken to maintain the stability of the RMB exchange rate is set to continue to spend China's foreign exchange reserves. Foreign exchange reserves are expected to fall to $ 2.88 trillion in 2017 and further to $ 2.86 trillion in 2018 (see Fig. 2.7).

### *2.3.2 Growth Rates of FAI*

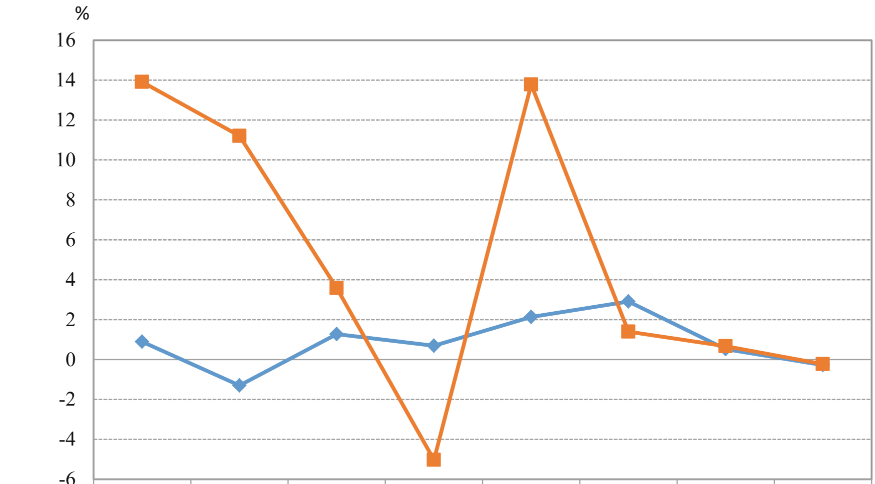
In the next two years, factors that inhibit investment growth still remain. The rapid growth of investment in real estate in 2016 is difficult to continue. The high debt of enterprises will continue to curb the growth of new investment. It is of low possibility that the growth of private investment rapidly rebound in the short term. According to the CQMM forecasts, the FAI (FAI) in urban areas in 2017 is expected to grow by 8.09%, down by 0.01 percentage point over 2016. It is projected fall to 7.65% in 2018, 0.44 percentage points lower than that in 2017 (see Fig. 2.8).

Gross fixed capital formation in real term is expected to increase by 6.32% in 2017, a slight increase of 0.12 percentage points over the previous year. It is set to

**Table 2.1** Projected growth rates of foreign trade (%)

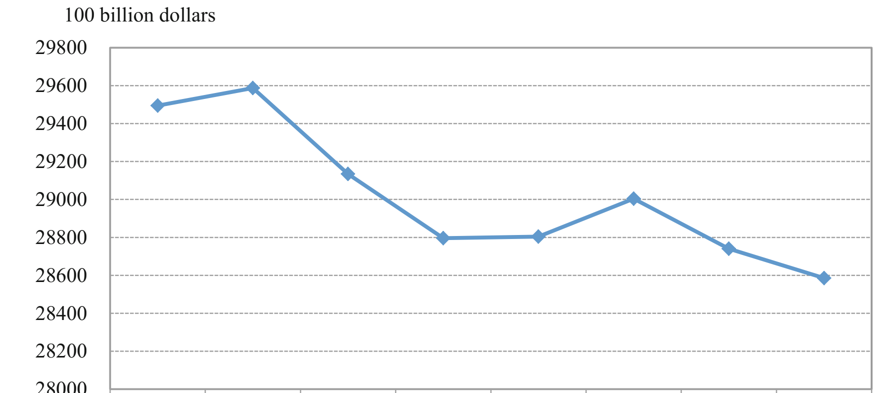
| | Exports | | | | Imports | | | | Net exports as a share of GDP |
|---|---|---|---|---|---|---|---|---|---|
| | Constant price/RMB | Current price/US dollars | General trade at current price/US dollars | Processing trade at current price/US dollars | Constant price/RMB | Current price/US dollars | General trade at current price/US dollars | Processing trade at current price/US dollars | |
| 2017 | **−0.98** | **−5.11** | **−7.19** | **−4.44** | **1.87** | **−0.24** | **3.54** | **−5.76** | **3.6** |
| Q1 | −1.57 | −5.21 | −11.97 | −1.69 | −0.06 | 0.75 | 2.02 | −1.57 | 4.42 |
| Q2 | −2.85 | −7.9 | −11.89 | −4.87 | 5.81 | 1.69 | 5.59 | −5.34 | 2.94 |
| Q3 | 0.17 | −4.25 | −3.7 | −5.6 | 3.75 | 1.03 | 4.99 | −7.26 | 3.36 |
| Q4 | 0.29 | −3.09 | −0.85 | −5.44 | −1.81 | −4.08 | 1.48 | −8.48 | 3.53 |
| 2018 | **0.5** | **−0.72** | **2.51** | **−4** | **2.45** | **1.55** | **4.25** | **−5.78** | **3.00** |
| Q1 | 1.73 | −0.44 | 2.63 | −3.61 | 12.09 | 10.9 | 17.41 | −5.12 | 2.78 |
| Q2 | 1.89 | 0.61 | 4.12 | −2.96 | 0.4 | −0.87 | 0.62 | −5.01 | 2.98 |
| Q3 | −0.37 | −1.3 | 1.86 | −4.5 | −0.33 | −1.15 | 0.68 | −6.23 | 3.10 |
| Q4 | −1.08 | −1.67 | 1.54 | −4.9 | −1.22 | −1.61 | 0.23 | −6.74 | 3.23 |

*Source* CQMM team calculations




| | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 | 2018Q2 | 2018Q3 | 2018Q4 |
|---|---|---|---|---|---|---|---|---|
| ex | 0.89 | -1.3 | 1.27 | 0.69 | 2.13 | 2.91 | 0.52 | -0.28 |
| im | 13.91 | 11.21 | 3.58 | -5.03 | 13.78 | 1.4 | 0.67 | -0.23 |

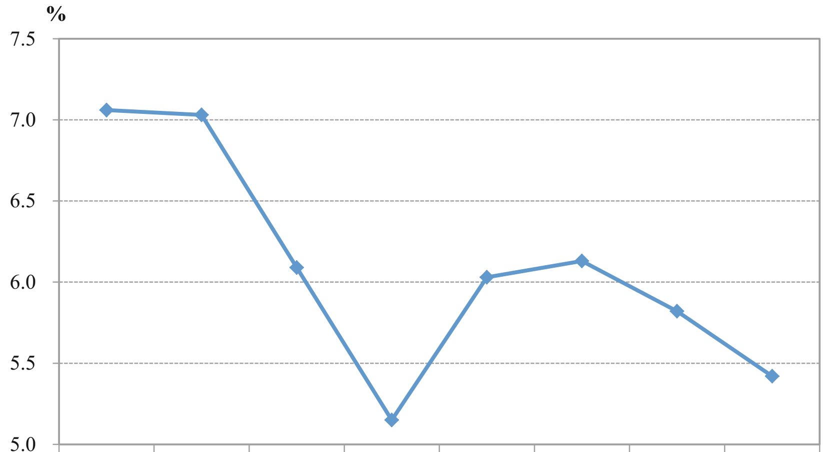
**Fig. 2.6** Projected growth rates of foreign trade (%), *Note ex* denotes the total value of exports; im denotes the total value of imports. *Source* CQMM team calculations




| | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 | 2018Q2 | 2018Q3 | 2018Q4 |
|---|---|---|---|---|---|---|---|---|
| FER | 29494.69 | 29586.85 | 29133.88 | 28795.60 | 28804.51 | 29003.99 | 28740.57 | 28585.39 |

**Fig. 2.7** Projected changes in foreign reserves. *Note FER* denotes foreign exchange reserves. *Source* CQMM team calculations

fall to 5.85% in 2018, 0.47 percentage points lower than that in 2017. Quarterly, affected by the start-up of the infrastructure projects, the fixed capital formation in real terms is forecast to grow by 7.06% in the first quarter of 2017. The next three quarters will continue to fall by 7.03, 6.09 and 5.15%.




| | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 | 2018Q2 | 2018Q3 | 2018Q4 |
|---|---|---|---|---|---|---|---|---|
| Ti_c | 7.06 | 7.03 | 6.09 | 5.15 | 6.03 | 6.13 | 5.82 | 5.42 |

**Fig. 2.8** Projected growth rates of fixed capital formation. YoY. *Note* Ti_c denotes real growth rate of fixed capital formation. *Source* CQMM team calculations

In terms of sources of funds for the FAI, the growth rate of funds from the budget is expected to be 23.88% in 2017 and slightly fall to 19.75% in 2018. That of funds from domestic loans is set to fall further to 8.73% in 2017 and 6.6% in 2018. That of investment from self-financing funds is forecast to recover to 7.84% in 2017 and fall to 53.3% in 2018. That of funds from other sources is expected to increase to 11.68% in 2017 and rise to 13.44% in 2018. Foreign FAI is projected to further fall by 27.74% in 2017 and the decline is set to narrow to drop by 7.9% in 2018 (see Table 2.2). In general, due to the decline in the growth of manufacturing and private investment, the structure of funds sources has changed. The growth of funds from domestic loans and foreign investment declined significantly, while that of funds from the budget and other sources increased slightly, and that of investment of self-financing funds recovered slowly. The growth rate of in-place funds for the FAI in 2017 is estimated to reach 9.41%, 3.61 percentage points higher than that in 2016. And it is set to fall to 7.90% in 2018.

### *2.3.3 Growth Rates of Consumption*

As China's economic growth slowed, the growth of residents' real income continued to edge down as well, and thus began to curb the rapid growth of consumption. In the next two years, given the urbanization of population maintain its growth, the consumption growth is expected to slow down. According to the CQMM forecasts, the household consumption at constant prices is set to grow by

**Table 2.2** Projected growth rates of total FAI by sources of funds (%)

| | Total | State budget | Domestic loans | Self-raising funds | Others |
|---|---|---|---|---|---|
| 2017 | **9.41** | **23.88** | **8.73** | **−27.74** | **7.84** |
| Q1 | 11.42 | 22.62 | 4.29 | −31.8 | 11.98 |
| Q2 | 7.64 | 21.12 | 7.78 | −49.31 | 6.7 |
| Q3 | 10.28 | 27.27 | 12.58 | −4.48 | 7.31 |
| Q4 | 8.4 | 24.47 | 10.51 | −10.69 | 5.57 |
| 2018 | **7.9** | **19.75** | **6.6** | **−7.9** | **5.73** |
| Q1 | 8.94 | 21.16 | 7.26 | −1.06 | 7.19 |
| Q2 | 7.68 | 19.38 | 6.45 | 0.5 | 5.49 |
| Q3 | 7.65 | 18.87 | 6.3 | −14.66 | 5.42 |
| Q4 | 7.35 | 19.68 | 6.39 | −14.94 | 4.84 |

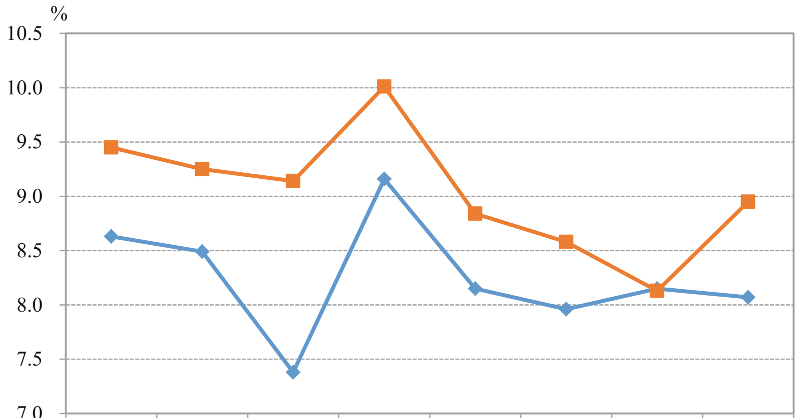
*Source* CQMM team calculations

8.41% in 2017, down by 0.59 percentage points over the previous year, and continue to drop to 8.08% in 2018, 0.33 percentage points lower than that of the previous year. In 2017, the total retail sales of social consumer goods at current prices is projected to increase by 9.45%, down 0.95 percentage points over the previous year, and decrease to 8.61% in 2018.

Quarterly, the growth of total consumption at constant prices is expected to slow down in the first three quarters of 2017, with an increase of 8.63, 8.49 and 7.38% respectively. Due to low base effect, the growth rate is set to be raised to 9.16%. The growth of the total retail sales of social consumer goods at current prices is projected to maintain the same trend as that of the final consumption of residents at constant prices. In 2018, the trend is expected to continue, while the quarterly growth rate is set to be lowered (see Fig. 2.9).

In summary, according to the CQMM forecasts, China's economic growth is projected to continue to edge down in the next two years, while its decline is set to narrow. Besides, inflation rate is expected to remain at a moderate and stable level.

1. China's GDP is expected to grow by 6.64% in 2017, down by 0.06 percentage points over 2016. The CPI is set to rose by 2.15%, 0.15 percentage points higher than that in 2016. The PPI is forecast to increase by 2.41%, up by 3.81 percentage points compared to that in 2016. The GDP deflator is forecast to pick up by 2.17%, 1.04 percentage points higher than that in 2016.
2. The growth of total investment has to face large downward pressure in that the growth of private investment is hard to rebound in the short term. The FAI in urban areas is expected to increase by 8.09%, 0.01 percentage point lower than that of 2016.
3. The decline in the growth of residents' income, which is caused by economic growth slowdown, has begun to inhibited consumption growth. The growth of household consumption is projected to slow down over the next two years. The total retail sales of social consumer goods at current prices are projected to grow by 9.45%, down by 0.95 percentage points over 2016.




| | 2017Q1 | 2017Q2 | 2017Q3 | 2017Q4 | 2018Q1 | 2018Q2 | 2018Q3 | 2018Q4 |
|---|---|---|---|---|---|---|---|---|
| con_d_c | 8.63 | 8.49 | 7.38 | 9.16 | 8.15 | 7.96 | 8.15 | 8.07 |
| Retail | 9.45 | 9.25 | 9.14 | 10.01 | 8.84 | 8.58 | 8.13 | 8.95 |

**Fig. 2.9** Projected growth rates of consumption. *Note* CON_D_C denotes real household consumption; RETAIL denotes real growth rate of total retail sales of consumer goods. *Source* CQMM team calculations

4. China's foreign trade situation is still expected to be grim in the next two years. The total value of exports measured by current RMB is set to grow by 0.39% in 2017, up by 2.39 percentage points over 2016. That of imports measured by current RMB is projected to increase by 5.07%, up by 4.47 percentage points compared with that in 2016. Devaluation expectation of the RMB is set to continue to lead to a net outflow of China's foreign exchange reserves. The foreign exchange reserves are projected to fall further to $ 2.88 trillion in 2017.

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