ChinaIntelligence
Financial and business advice on China

themonthlydragon #11

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Official figures point to China growing more than the size of Switzerland in 2015, RMB challenges, cheap HK equities and the Disneyland Index

China's economic growth is slowing, but most signs point to a controlled slowdown, partially ensured by government stimuli. Given the size of the economy, however, the official absolute growth was larger than Switzerland's GDP in 2015. The RMB's exchange rate to the USD continues to challenge the authorities. As a result of the strong correction in Chinese equity markets this year, many Chinese companies listed in Hong Kong have become cheap, with some sectors trading at multiples near their 20-year lows.

HIGHLIGHTS

- *GDP: 2016 growth at around 6%*
- *RMB: further gradual weakness vs. the USD likely; the new trade-weighted index for the RMB, introduced by the PBoC, will become more visible*
- *PMI: at 49.4 in January, contracting for the sixth month in a row; weakness primarily in the manufacturing sector*
- *Interest rates: expect two more rate cuts of 25 bps each in 2016, after the six cuts since November 2014*
- *Overall: no meltdown, but the slowdown continues*

Q4 2015 GDP growth was officially stated at 6.8% yoy. This figure probably means two things: 1) it shows the trend correctly, namely a slowdown in growth, and 2) it overstates growth since the GDP deflator used is too low. Models trying to approximate China's GDP growth by looking at a variety of economic indicators currently point to a **true growth of the economy of between 4% and 6% at the end of 2015.** This confirms our own view that we are on a sliding path towards a GDP growth rate below 5% in China, which still is respectable, considering the size of the economy (see Chart #1 next page).

China still has the highest GDP growth rate of all major economies in the world, and it is growing much more in absolute terms than it did 10 years ago. Although growth rates have approx. halved, the economy is much larger than 10 years ago **(five times larger when measured in USD, three and a half times larger when measured in RMB).** Therefore, a **5% growth rate today has a bigger effect on the world** than a 10% growth rate did 10 years ago. According to the official numbers, China grew by the size of Switzerland's economy last year. If we assume a growth rate of 5% for 2015, China's economy still grew by the size of Norway's GDP.

So why all the fears about the «weak Chinese growth»? The concerns probably stem from too many people expecting the miracle to continue. They were hoping that China would save the world's economic growth. **China's GDP growth rate is a topic more discussed in the Western media than in China itself.** The Chinese measure prosperity by a large number of observations, including their own purchasing power (generally going up for the working population), the pension payments their parents and grandparents are receiving (generally going up)

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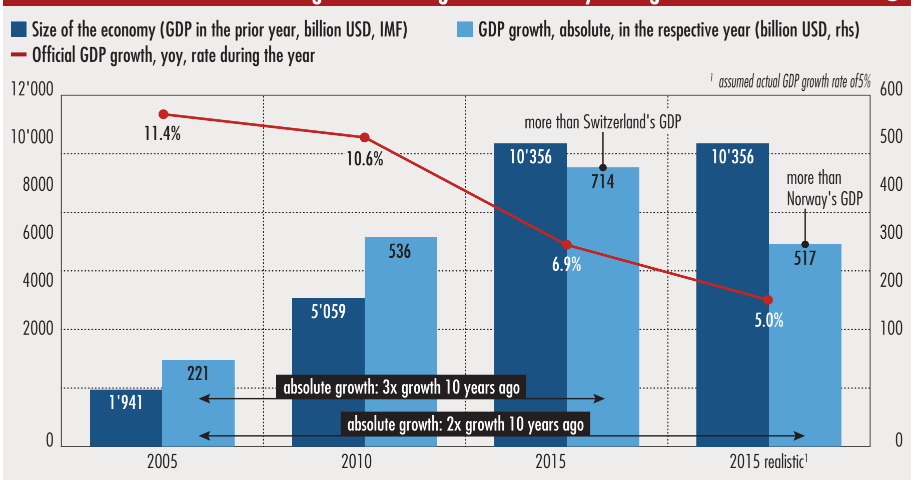
Much higher absolute growth than 10 years ago ❶



Source: IFM, National Bureau of Statistics / Chart: ChinaIntelligence

and the infrastructure being put in place (still expanding). So the growth figures (official or unofficial) are rather abstract to them, and maybe should be of less importance to the Western media as well.

The RMB exchange rate – a source of headaches

Evidence of and speculation about capital flight from China have been a hot topic recently. Capital flight is not new, but may have accelerated. Legal restrictions have been and are in place (limiting individuals to taking the equivalent of USD 50,000 out of the country, per capita per year), but enforcement of the law has been weak, to say the least.

Stability of the RMB's exchange rate is very important to Beijing, for a number of reasons. This is why the danger of an uncontrolled wave of capital leaving China, or an uncontrolled weakening of the RMB may trigger all conceivable measures, including tightened capital controls. Increased internationalization of the RMB also is important to policy makers, but the desire for stability will prevail. What should happen first, however, is a more skillful definition of the Chinese central bank's RMB strategy along with consistent communication to the markets. China cannot internationalize its currency successfully without better communicating to the financial markets.

Stability in general is a top policy objective – only a stable China can become more prosperous. But additional reasons make the RMB exchange rate important: 1) only around 25% of the cross-border trade is invoiced in RMB, the USD and HKD still dominate; thus, a pronounced, fast move in the RMB/USD exchange rate increases uncertainty for many companies; 2) a much weaker RMB makes the Chinese consumer poorer in terms of their purchasing power for goods from abroad or for travel abroad; this runs counter to the policy objective to increase consumption as a force in the economy.

Chinese companies listed in HK are becoming cheap

Profit growth for Chinese companies is likely to be uninspiring in 2016, providing no reasons for higher valuations short-term. Chinese equities have already lost nearly a quarter of their value so far this year. And Chinese companies listed in Hong Kong are becoming cheap, with the exception of the Technology sector, which remains expensive. The price/trailing earnings ratio of the Hang Seng Index currently is clearly below 10x and near its 10-year lows, the price/book multiples are approx. at 20-year lows for most sectors.

The only exceptions are the technology sector and some consumer staples. True, the «old economy» (e. g. financials and telecom) is valued at low levels for a reason. Growth prospects are uninspiring and the concerns about China's overall economic growth weigh on these sectors. But at some point the market may see things differently, putting a higher price on the strong market positions many of these companies have.

PMI shows weakness but no further deterioration, more stimulus expected

The official manufacturing PMI declined from 49.7 in December to 49.4 in January. The Caixin/Markit PMI, on the other hand, which tracks smaller companies, rose from 48.2 to 48.4. While both figures show a slight contraction, they do not point to further deterioration of the economic environment around year-end 2015.

The data for the coming months, although watched closely, will have limited significance because there always are distortions around the Chinese New Year holiday (in 2016, Monday, February 8 is the first day of the Chinese New Year). So it will be spring before a clear picture regarding the health of the Chinese economy emerges. We expect a controlled slowdown of economic growth. We also anticipate that the variety of stimulus measures by the government, including large liquidity injections into the economy, will stay in place to soften the impact of weakening growth. Benchmark interest rates probably also will be reduced further.

The Disneyland Index replaces the Big Mac Index

The Shanghai Disneyland will open in Pudong, next to Shanghai, this summer: undoubtedly a major event for every Chinese in the region below the age of 25. This project has been under development for years, so there are no surprises. What surprised some, however, were the ticket prices announced. A regular ticket for adults will cost 370 Yuan (prices on holidays and during the first few weeks after opening will be higher). This number provides an interesting basis for comparisons to randomly selected figures such as the monthly salary of a driver for a private company (approx. 5,000 Yuan), the price of a private Chinese lesson (approx. 150 Yuan) or a movie ticket purchased online (approx. 35 Yuan). (RMB 6.62 = CHF 1.00)

Disneyland Index ❷

Country	Disneyland ticket price (local ccy)	Disneyland ticket price (USD), at current FX rates	GDP/capita 2015 (USD, IMF estimate)
USA (Los Angeles), US$	99	99	55'904
France (Paris), Euro	84	93	37'728
Japan (Tokyo), Yen	6'900	59	32'480
Hong Kong, HK$	539	69	42'096
China (Shanghai), RMB	370	**56**	**8'280**

Source: ChinaIntelligence

Chart #2 shows the comparison to the levels of GDP per capita in the countries where Disneylands are located, providing a basis for ChinaIntelligence's own creation, a «Disneyland Index» (in analogy to the Economist's «Big Mac Index», which compares the prices of McDonald's Big Mac burger in various countries). Granted, very many people with elevated incomes live within a three hour's car radius from the Shanghai Disneyland. But the National Bureau of Statistics

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does not show massively higher average incomes in the Shanghai region compared to the national averages. So the conclusion of the «Disneyland Index» analysis is: **the Shanghai Disneyland is very expensive by local standards, which probably is exactly what is needed to fill the park.** This is a common phenomenon in many industries and consumer markets in China: after all, a gain in status by taking the kids or grandkids to Disneyland can only be achieved if the price is high enough!

The next monthlydragon will be published per April 1, 2016, since February 2016 is unlikely to produce much reliable data and noteworthy news due to the Chinese New Year holiday taking up the entire second week of February.

Important Indicators

	Jan 2016	Dec 2015	Sept 2015	June 2015	Dec 2014	Sep 2014
Quarterly GDP, growth yoy (%)	–	6,8	6,9	7,0	7,3	7,3
Retail sales of consumer goods, growth yoy (%)	–	11,1	10,9	10,6	11,5	10,8
Official Consumer Confidence Index	–	104,1 (Nov)	105,6	105,5	105,8	105,4
FTCR Labor Demand yoy Index	–	57,0	67,3	63,2	72,6	68,1
Real estate floor space newly started, growth yoy (%)	–	–14,0	–12,6	–15,8	–10,7	–,3
FTCR mom Home Price Index	–	58,0	59,5	61,0	51,5	50,0
CPI, growth yoy (%)	–	1,6	1,6	1,4	1,5	1,6
PPI, growth yoy (%)	–	–5,9	–5,9	–4,8	–3,3	–1,8
PMI manufacturing	**49,4**	49,7	49,8	50,2	50,1	51,1
Caixin/Markit PMI	**48,4**	48,2	47,2	49,4	49,6	50,2
Fixed-asset investments, growth yoy (%)	–	10,0	10,3	11,4	15,7	16,1
Required ReserveRatio (large banks) (%)	**17,0**	17,0	18,0	18,5	19,5	19,5
Benchmark rate for 1-year loans (%)	**4,35**	4,35	4,60	4,85	5,60	6,00
Benchmark rate for 1-year deposits (%)	**1,50**	1,50	1,75	2,00	2,75	3,00
New total social financing, growth yoy (%)	–	7,1	17,0	–6,8	35,0	–26,0
New bank loans, growth yoy (%)	–	19,4	21,5	22,7	44,0	9,0
Exports, growth yoy (%)	–	–1,4	–3,8	1,6	9,7	15,3
Imports, growth yoy (%)	–	–7,6	–20,5	–6,8	–2,4	7,0
Trade balance (USD billion)	–	60,1	60,3	46,5	49,6	30,9
Electricity consumption, growth yoy (%)	–	0,5	0,8	1,3	3,8	3,9
Freight Traffic, growth yoy (%)	–	4,3 (Nov)	4,1	4,2	7,1	7,7
Iron ore imprts (million tons)	–	96,3	86,1	75,0	86,9	84,7
Coal imports (millions tons)	–	17,6	17,8	16,6	27,2	21,2
Crude oil imports (million tons)	–	33,2	27,9	29,5	30,4	27,6
Bloomberg Commodities Index (BCOM)	**77.22**	78,56	87,82	102,69	104,33	118,69
CSI 300 (China Equity Index)	**2'946**	3'731	3'203	4'473	3'534	2'451
RMB trade-weighted, nominal, indexed (2010=100)	–	125,9	126,2	126,0	121,5	116,0
RMB / USD spot	**6.54**	6,49	6,36	6,20	6,20	6,15

Source: ChinaIntelligence

Key developments we expect for 2016/17

We expect political, economic and financial stability despite all the looming challenges. Regarding some key topics our expectations are:

- *GDP growth: 2016: around 6%, 2017: around 5.5%, below 5% for 2018–2020.*
- *Labor market: stable to slightly weaker, but with continued wage growth of between 4–7% p.a., at the lower end for high-wage earners, at the higher end for low-wage earners.*
- *Interest rates: two additional cuts in the benchmark rates in 2016, each by 25 bps.*
- *No big stimulus program, but a multitude of smaller and targeted measures and reforms to support the economy, including making ample liquidity available to the financial system.*
- *RMB: further weakness vs. the USD, leading to RMB/USD near 7.00 by year-end 2016.*
- *Retail sales growth: approx. 10% p.a.*

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