Special Bulletin

<u>A Japanese Perspective on the International Energy Landscape (412)</u> January 24, 2019

2018 Chinese Economic Growth at 6.6% with Sharp Deceleration Seen in 2nd Half

Ken Koyama, PhD
Chief Economist, Managing Director
The Institute of Energy Economics, Japan

On January 21, the National Bureau of Statistics of China released major economic indicators for 2018 outlining Chinese economic conditions. Among them was gross domestic product worth 90.3 trillion yuan ($13.3 trillion) for the year, posting a real economic growth rate of 6.6%. The growth rate, though exceeding the government target of 6.5%, was the lowest in 28 years since 1990 when the 1989 Tiananmen Square incident affected economic growth.

A quarterly growth trend in 2018 indicated a clearly gradual deceleration from 6.8% in the first quarter to 6.7% in the second, 6.5% in the third and 6.4% in the fourth. Particularly, the fourth quarter growth of 6.4% was the lowest in a decade since the first quarter of 2009 when growth was affected by the global recession following the collapse of Lehman Brothers in September 2008.

The economic growth deceleration came as tighter economic policy following the brisk growth in 2017 was combined with the U.S.-China trade war that deteriorated and intensified in the second half in a manner to affect overall economic activities including investment, production and consumption. Particularly, major components of the current Chinese economy were seriously affected, including domestic demand-related consumption and imports, as well as production that slowed down on the trade war.

The Chinese government came up with a 4 trillion-yuan economic stimulus package in response to the economic slowdown after the Lehman collapse, taking advantage of infrastructure and other investment to achieve a rapid economic recovery. However, the large-scale stimulus package led to some adverse effects including excess production capacity plaguing the Chinese economy later, as well as a debt overhang in which debt expanded at local governments and state-owned companies that undertook infrastructure investment.

As a result, how to address excess debt and production capacity has become a key challenge in China's economic policy, leading the government to explore a domestic demand-driven economy. In 2018, the tertiary industry's share of GDP expanded to 52% indicating that services grew dominant in the Chinese economy. Consumption's share of GDP also increased to 76%. Under such economic structure, drops in consumption, exports and production through the escalation of the U.S.-China trade war have become a grave problem for China today.

For example, China's retail sales have reportedly declined rapidly since November last year. Imports decreased substantially toward the end of last year, with wholesale price hikes sagging, signaling weak consumption. Then, vehicle and smartphone production decreased year on year. In the second half of 2018, production of these products, robots and machine tools posted substantial year-on-year decreases. The deterioration coincided with the intensification of the U.S.-China trade war, indicating weakening sales. The sharp production decline may lead to concerns about economic deterioration, which could further cool down consumption.

Infrastructure development utilized for stimulating the economy after the Lehman collapse has caused the abovementioned debt overhang and cannot be easily mobilized at present. Rather, slack infrastructure investment at the local government level has been contributing to the slowdown. Some economists suspect that Chinese economic growth could be lower than the published level of 6.6%. In any case, the Chinese economy is in serious condition, prompting the government, the business world and experts in China to seriously explore the possible counter measures on what to do with the current problems.

On January 22, the International Monetary Fund (IMF) released its latest World Economic Outlook (WEO) forecasting that China’s economic growth would decelerate from 6.6% in 2018 to 6.2% in 2019 and 2020. Many experts in and outside China predict its economic growth in 2019 at levels a little above 6%. If growth slips below 6% on the further escalation of the U.S.-China trade war and the deterioration of China’s domestic economy, Beijing may have no choice but to desperately mobilize all possible measures to stimulate the economy.

The latest IMF WEO forecast global economic growth in 2019 at 3.5%, representing a downward revision of 0.2 percentage points from October 2018. While the U.S.-China trade war has continued to escalate, economic deceleration has been expected in Europe, resource-rich countries and emerging economies, prompting the IMF to become conscious of downside risks for the world economy and update its outlook. However, the forecast growth rate of 3.5% represents “normal cruising growth” rather than low growth. Nevertheless, uncertainties are lingering about the future environment for the world economy. At a time when China and the United States are waging a trade war after driving global economic growth, no optimism can be warranted about the future course of the world economy.

Global economic deceleration will exert various grave effects on international energy markets. Serious effects are likely to affect oil, natural gas/LNG, coal, renewable energy and nuclear markets. Particularly, China’s energy demand expansion pace will attract global attention.

Economic and oil demand/import trends in China would be one of the most important factors for the outlook for crude oil prices for this year. The other factors include OPEC-plus production trends and policy, U.S. shale oil production expansion and Iranian oil exports. Given that China’s LNG demand expansion has exerted a decisive impact on the supply-demand balance in the global LNG market, China’s gas demand and LNG procurement trends would be important for predicting the global gas market supply-demand balance and investment decisions. Similarly, China would have decisive influence on global coal trade and prices.

Furthermore, future electricity demand in China will variously influence renewable energy expansion and nuclear power plant construction in which China has played a globally leading role. Chinese demand for each energy source will influence its energy mix and have various implications for its environmental policy involving both climate change and air pollution. Structural talks involving the U.S.-China trade war will attract attention for the immediate future. China’s economic trend under the trade war in 2019 will remain a matter of grave concern to the world.

Contact: report@tky.ieej.or.jp
The back issues are available at the following URL
http://eneken.ieej.or.jp/en/special_bulletin.html