China’s Economy in 2013: Preparation for reforms? Part 2

The real estate market and financial sector

Foreign analysts tend to believe that these two areas are the most problematic for the Chinese economy. It is necessary to note that Chinese statistics describe the real estate market in the country in much detail. It is worth recalling that there was a revival of sales in the second half of 2012 in China.

This tendency was observed in the whole 2013. In real terms, the growth of residential property sales amounted to more than 17%, in price – almost 27%.

Some overheating of the market is already evident in the prices for housing - a constant concern of the population and regulators (measures taken by the authorities to curb the speculative trend in real estate market often lead to unexpected results, for example, an increase in divorces in large cities, due to the additional tax burden introduced on a second apartment). We will add that the relationship between under construction and sold housing improved and is 4.2 versus 4.35 in 2012 (Table 3). However, the situation was much worse in 2010, when the index was 3.4.

Table 3.

<table>
<thead>
<tr>
<th>Selected Indicators of Real Estate Market in China in 2013</th>
<th>Million sq. m.</th>
<th>Growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real estate sales</td>
<td>1306</td>
<td>17.3</td>
</tr>
<tr>
<td>- Including housing</td>
<td>1157</td>
<td>17.5</td>
</tr>
<tr>
<td>Started construction</td>
<td>2012</td>
<td>13.5</td>
</tr>
<tr>
<td>- Including housing</td>
<td>1458</td>
<td>11.6</td>
</tr>
<tr>
<td>Total under construction</td>
<td>6656</td>
<td>16.1</td>
</tr>
<tr>
<td>- Including housing</td>
<td>4863</td>
<td>13.4</td>
</tr>
</tbody>
</table>

During the year, there were noted two failures in the Chinese financial system operations, when there were a lack of liquidity on the market and a sharp rise in interbank lending rates. Nevertheless, they did not last long, and generally, did not break the picture of gradual slowdown in M2 growth and the volume of new lending (approximately 900 billion per month in the first quarter, to 700 billion yuan in the third). The M2 index increased by 13.6% for the whole year (previous year’s level) and reached 110.7 trillion yuan (193% of GDP).

Total loans amounted to 76.6 trillion yuan (134% of the GDP) at the end of the year, an increase of 13.8% compared to the previous year.

Savings of the population exceeded 46.5 trillion yuan (an increase of 13.5%). The accumulated volume of consumer loans went up to around 13 trillion yuan - it increased by 2.5 trillion yuan for the one-year period.
In general, the credit system seems well balanced. At the same time, China’s mass media have repeatedly drawn attention to the problem of “bad loans” in the banking system. Their total volume exceeded 300 billion yuan (50 billion dollars). There are considerable doubts on the ability of local governments to pay the accumulated debts on time. Large Chinese enterprises have to pay more than $3 trillion yuan on issued corporate obligations in 2014. All these facts create a certain tension.

However, the low level of public debt, significant reserves and the presence in the state (including local governments) of major assets in the form of land and other property allow, in our opinion, to continue credit expansion quite actively, moreover, that the net savings of the population remain high.

The work on the creation of a kind of “constructed” (Shanghai, Shenzhen, Hong Kong) financial centers of a global level continues. Last year, there continued experiments with foreign exchange regime in the Shanghai Free Trade Zone. Decisions were taken about the beginning of registration of private banks.

Last year, Beijing has successfully implemented a policy of yuan internationalization. In October 2013, the share of the Chinese currency in international payments for goods and services reached 8.66% – against 81.1% for the U.S. dollar and 6.6% – for euros. There are countries that are leaders in yuan use. Here we can cite China, which accounts for 60% of the payments in Chinese currency, Hong Kong and Singapore, which are settlement centers on transactions with offshore yuan (generally, 32% of the turnover).

**Development trends**

For the first time in the history of the Chinese economy, the share of industry in GDP (44%), in 2013, was lower than the share of the services sector, which accounted for 46%. In other words, the gradual progress of the country continued towards a service rendering economic structure.

This trend indicates the gradual completion of the stage, where the main engine of economic development was the establishment of a comprehensive system of a national industry, as well as accelerated infrastructure construction. It was noted in the former Premier Wen Jiabao’s report, presented at the National People’s Congress session (March 2013), that over the past five years, there have been laid 19,700 km of new railways, including 9,000 km of high-speed tracks in China. Commissioned were high-speed railways: Beijing – Shanghai, Beijing – Guangzhou and Harbin – Dalian and other long-distance lines. Built were 609,000 km of new roads, including 42,000 km of expressways (which brought the total length to 95,600 km). There has been built the 31st new airport.

It is easy to assume that the starting phase will be characterized by some reduction in the share of savings, and an economic slowdown. Gradualism will give this trend a continued unevenness in the development of the regions – and the need to maintain high rates of savings for pulling up the inland and western regions; the rate of industrial growth in the inland and western regions in recent years is consistently higher than in the coastal provinces, where industrial capacity transference in the westward direction began – as well as an inevitable continuation of urbanization, motorization, mechanization of agriculture, etc.

China continues on the path of infrastructure, information, consumer and environmental revolution. During this movement there come into sharp focus complex social issues, including income inequality, the development of gaps between regions, pensions and health care, corruption, etc.

The new generation of leaders understands this very well. According to the discussions on ways of further development of the country, led in the process of preparation for Third Plenum of Communist Party of China Central Committee (November 2013) of the eighteenth convocation, Beijing is trying to follow a balanced economic path. The main line was determined to be the rather moderate liberalization of economic policy. This choice, in our opinion, was dictated by at least two imperatives. The first is the fight against corruption by reducing administrative barriers. The second is the consolidation of Chinese territories and the Foreign Diaspora on the issue of “China’s revival” (Chinese dream).

Reflecting the increased role of non-governmental sectors in the economy, the new path allows the state and the public sector (especially the major corporations and banks) to shift attention to some sharp internal problems (particularly the environmental), as well as to focus on the most promising areas, including the innovations economy, the creation of a global level financial center and continuing outward expansion. They expect to receive resources to carry out these tasks by selling a part of the public corporations portfolio.

Small and micro businesses are supported, which are stimulated through tax breaks, credit support, professional training programs, etc.
At the same time, society and the state focus on education and science spheres.

There is a characteristic proportionality between higher and secondary special education. Almost 7 million students applied for the higher education institutions in 2013, the total number of students exceeded 24.7 million. The same number of students applied for specialized secondary schools, where 19.6 million people already study.

Research and development expenses amounted to 1190 billion yuan in 2013 (about 2.1% of the GDP) and they grew by almost 15.6%. About 5% of this amount was directed to basic scientific research.

The total value of contracts on technology transfer amounted to 746 billion yuan in 2013 – 16% more than in the previous year. There have been launched 14 satellites and two manned spacecraft.

The implementation of major infrastructure projects retains its value and stimulates growth. An increase in the length of high-speed railways to 15,000 kilometers is expected by the end of 2015 – from the current 9,000 km. This ambitious program seems to be very effective: 1.3 million people use this type of transport daily.

Stable development of China demonstrated the possibility for the development of a vibrant economy in periods of sluggish external market conditions. This is of international significance. Thus, the authors of the report on Trade and Development, United Nations Conference on Trade and Development (UNCTAD, 2013), wrote directly about the impossibility of a return to pre-crisis strategies, export orientation due to stagnant demand in developed countries. They see the alternative in the development of domestic and regional demand in the decelerating countries, in the stimulation of private industry, working on these markets. Many developed countries have implemented this kind of program that has actually substituted imports.

Chinese experience in overcoming of the consequences of the financial crisis in the West (now it is already safely described as successful) attracted many by the stimulation of the real sector. It is this gap between stimulation and financial economy that is recognized by most experts as the main defect existing in many countries, characterized by their credit and financial systems. In order to overcome this gap, UNCTAD experts believe it is important to review the role of central banks in the development, and the deprivation of their independent status (by analogy with China). Among other recipes, it is necessary to point out the need to maintain a sufficient level of government spending on (at the expense of a budget deficit) consumption and employment.

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