

# China Business Forecast Report Q1 2015

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## Abstracts

### Core Views

Beijing will continue to implement positive structural reform measures such as deposit rate liberalisation and local government fiscal reforms. That said, we believe that the People's Bank of China will also continue to ease policy in order to support economic growth, and that high debt levels are therefore unlikely to be addressed in the near-term.

Xi Jinping has largely consolidated his leadership position, and we believe that he is firmly in control of the Communist Party. This means that policy-making will remain highly centralised and generally cohesive over the medium term. While there remain divides on how to manage the economy, we continue to believe that the government will opt for the middle road of structural reforms with moderate monetary and some fiscal stimulus.

### Major Forecast Changes

Following the PBoC's surprise interest rate cut to 5.60% in November 2014, we believe that the central bank has tipped a significant shift in its monetary policy agenda. Past precedent suggests that more cuts will follow, and we have downgraded our end-2015 interest rate forecast to 5.20% as a result.

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Core Views  
Major Forecast Changes  
Key Risks To Outlook

### CHAPTER 1: POLITICAL OUTLOOK

SWOT Analysis  
BMI Political Risk Index  
Domestic Politics  
Abe-Xi Meeting: Little Reason For Cheer

Despite the fact that Shinzo Abe's first meeting with Xi Jinping on the sidelines of the recent APEC summit in China represents a tangible step forward in relations between the two Asian powers, we do not believe that it will lead to a significantly more cooperative relationship over the near-term. In particular, we find that domestic political realities will continue to inform relatively hard-line stances by both Abe and Xi.

Table: Political Overview

Long-Term Political Outlook

Major Challenges Over The Coming Decades

China faces myriad economic, social and environmental challenges over the coming decades that could seriously test the Communist Party of China's ability to govern. The best-case scenario for any eventual political transition would entail an elite-led liberalisation of the authoritarian system, while the worst-case scenario would involve a violent change of regime.

### CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis  
BMI Economic Risk Index  
Economic Activity  
Economy To Cool Further Despite GDP Outperformance

Despite the fact that real GDP growth of 7.3% year-on-year in Q314 was slightly better than consensus expectations of 7.2%, data continue to point towards an ongoing economic slowdown. We maintain our forecast for real GDP growth to slow further to 6.7% in 2015, and note that aggressive stimulus measures are off the table as long as the country's labour markets remain stable.

Table: Economic Activity

## Fiscal Policy

### Fiscal Reforms Represent Progress, But Challenges Loom

The Chinese government's liberalisation of the local government borrowing system will be a long-term boon for the economy. However, local governments may find it difficult in the near-term to meet their funding obligations while also rolling over rising levels of debt tied to unproductive assets.

Table: Fiscal Policy

## Currency Forecast

### Headwinds Piling Up Against CNY

While the Chinese yuan has defied broad US dollar strength over recent months, we see headwinds against the unit piling up over the coming quarters. With the PBoC exhibiting a dovish shift with its latest interest rate cut, we maintain our expectations for the unit to end 2015 at CNY6.2500/USD, representing a decline from the unit's current level of CNY6.1345/USD.

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## Monetary Policy

### PBoC Gets Aggressive As Growth Continues To Cool

The PBoC's surprise interest rate cut on November 21 signals rising concern over the economy's slowing growth trajectory. Given that the central bank has now made clear that it is willing to pursue more overt easing measures rather than the targeted ones that it had favoured previously, we believe that another interest rate cut may be on the cards in 2015. As such, we have downgraded our end-2015 central bank policy rate to 5.20%, implying another interest rate cut equivalent to 40bps from the current level of 5.60%.

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#### 6.0% Is The New 10.0%

China's economic growth in the coming decade will be much slower than in the last, as the savings rate declines, the economic liberalisation process slows, and population growth falls. These dynamics will result in real GDP growth averaging 6.0% over the next decade as opposed to the 10.1% average seen over the past decade. Private consumption will be a major outperformer, averaging growth of 8.1% and rising in importance as a share of GDP.

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