Chapter 3
Forecast of China's Economy During 2015–2016

3.1 Assumptions of Exogenous Variables

3.1.1 Economic Growth Rates of the USA and the Eurozone

We expect the US financial situation to continue to improve through 2015. At the same time, driven by factors such as drop of the jobless rate and low oil prices, the growth of domestic demand in the US economy could overcome the adverse impact of the strong dollar and continue to recover steadily. On January 22, 2015, the International Monetary Fund (IMF) predicted that the USA will grow by 3.6 % in 2015 and that the growth rate will reach 3.3 % in 2016.

To overcome the pressure of deflation and boost the economy of the eurozone, the European central bank announced its quantitative easing (QE) policy on January 22, 2015. However, due to geopolitical reasons, the progress of structural reform is slow. The Greek political upheaval has further expanded the eurozone's political uncertainty, leading to the recovery being "weak and not balanced." We expect a 1.0 % economic growth for the eurozone in 2015, which is lower than the IMF forecast in January (1.2 %). For 2016, as the IMF forecast, the growth could be 1.4 % (Fig. 3.1).

3.1.2 Major Exchange Rates

In 2014, at the spot exchange rate, the RMB depreciated by 2.5 % against the dollar, and the median price depreciated by 0.36 % annually for the first time. In January 2015, the official PMI fell lower than 50, creating a new lowest in 19 months, indicating a slowdown of China's economic growth. As the China-US economic trend indicates, overall, the dollar is on an appreciation cycle now, but the possibility that

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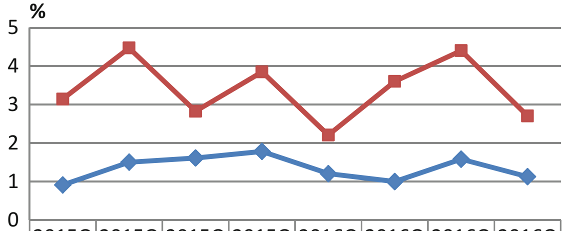


	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
EU17GDP_C	0.91	1.50	1.61	1.78	1.20	1.00	1.58	1.12
USGDP_C	3.14	4.47	2.83	3.85	2.21	3.60	4.40	2.70

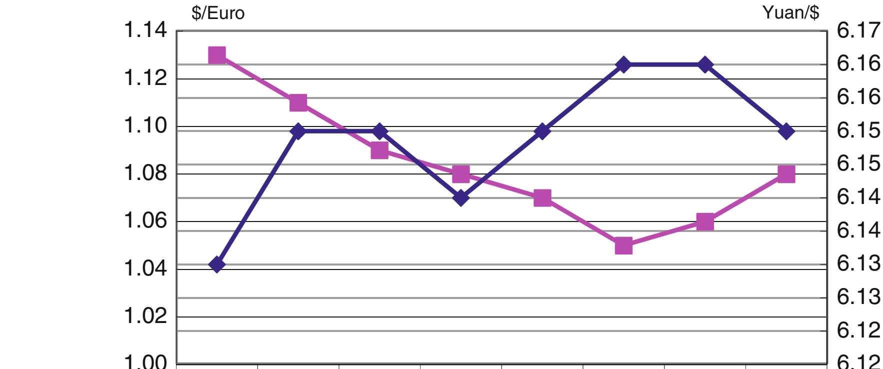
Fig. 3.1 Assumptions of growth in the USA and the eurozone (Note: EU17GDP_C denotes growth in the eurozone, while USGDP_C denotes growth in the USA)

the RMB appreciates by phases cannot be ruled out. We expect the exchange rate to fall from 6.13 yuan to 6.14 yuan (median) to the dollar in the year 2015; in 2016, it may fall slightly to 6.16 yuan and then return to 6.15 yuan (see Fig. 3.2).

Faced with the eurozone's economic growth and low inflation or even deflationary pressure, the European central bank launched the European version of QE—the purchase of 60 billion euros per month until September 2016 or until the eurozone inflation reduces to 2 %. Starting from March 1 this year, the QE will continue 19 months, bring in a total of 1.14 trillion euros, and newly add 950 billion euros. Given that the USA may raise its interest rates in the second quarter, the dollar would continue to be strong and the euro would further weaken; thus, we expect the euro to fall against the dollar to $1.08 by the end of 2015, to the lowest level of $1.05 by the second quarter of 2016, and to then get back to $1.08, affected by the expectation of QE exiting in September 2016 (Fig. 3.2).

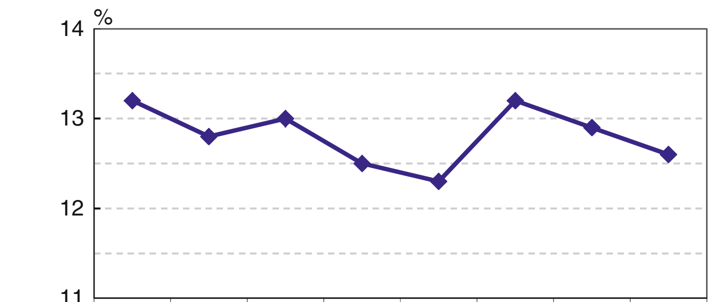
3.1.3 The Growth Rate of Broad Money Supply (M2)

In 2015, the Chinese economy could face a downward pressure and its prices may continue to fall. Thus, the velocity of China's monetary policy could slow down, and, as an important channel of currency, its foreign exchange might step into low-growth stages, the monetary policy transmission mechanism might possibly fail, and, while insisting on a steady tone, the central bank might maintain the preset of directional loose fine-tuning. After the central bank's announcement of reducing quasi on February 5, 2015, reducing quasi is likely to continue to drop one to two times a year and connect with the cut interest rates to stabilize growth. Given the expectation of the Federal Reserve raising interest rates in the second quarter of this year, the first half, especially the first quarter of the first half year, is a better time



	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3	2016 Q4
USDEURO	1.13	1.11	1.09	1.08	1.07	1.05	1.06	1.08
ER_W	6.13	6.15	6.15	6.14	6.15	6.16	6.16	6.15

Fig. 3.2 Assumptions of major exchange rates (Note: ER_W denotes the exchange rate of the RMB against the USD, and USDEURO denotes the exchange rate of the USD against the euro)



	2015Q 1	2015Q 2	2015Q 3	2015Q 4	2016Q 1	2016Q 2	2016Q 3	2016Q 4
M2	13.2	12.8	13	12.5	12.3	13.2	12.9	12.6

Fig. 3.3 Assumption of the growth rate of M2

window for monetary easing. Thus, the central bank is expected to cut interest rates by 25 basis points in the first quarter of 2015, the year the M2 growth rate is expected to rebound to 12.5 %. It will maintain this level basically in 2016, and the annual M2 growth rate will be 12.6 % (Fig. 3.3).

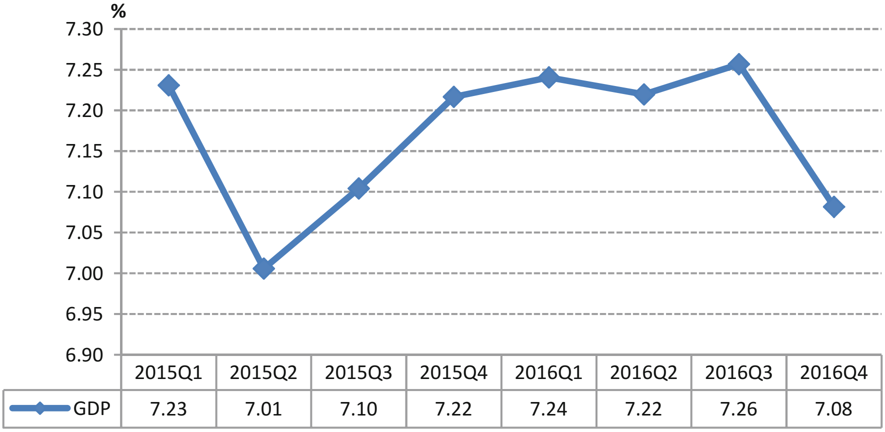
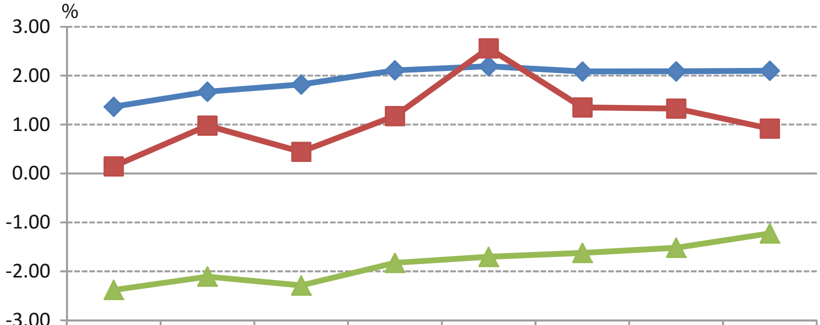


Fig. 3.4 Forecast of GDP growth rate (year-on-year basis)

3.2 Forecasts of China's Major Macroeconomic Indicators for 2015–2016

3.2.1 Forecast of GDP Growth

Assuming the above exogenous variables, the predictions based on CQMMs show that in 2015, China's GDP growth rate will continue to fall to 7.14, 0.26 % lower than that in 2014. By 2016, the GDP growth rate will rise slightly to 7.20 %. Subsequently it will fall but then reverse in a late recovery over the next two years. The main reason for this is that manufacturing still faces inventory pressure, the commercial housing construction area is also historically high, and the growth rate of investment will continue to fall. Under the influence of slow resident real income growth rate and the economic downturn, the final consumption support to the economy wanes. However, external market recovery will ease the pressure on the economic downturn to a certain extent. In 2016, the dividend of the comprehensively deepened reform of the system will gradually appear, and improvement in the external economic environment will improve China's economic growth to a certain extent. From the quarterly year-on-year growth rate shown in Fig. 3.4, we find that following the negative growth of the export in the first quarter of 2014 and a low base, the year-on-year growth rate of exports will rebound significantly. China's economic growth rate is expected to fall to 7.23 % in the first quarter of 2015. Then, from the base effect of the same period last year, the growth rate will further slow down to 7.01 % in the second quarter; following the export and investment recovery, the economy will then rebound to 7.10 % in the third quarter and continue to uplink to 7.22 % in the fourth quarter.



	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
CPI	1.37	1.67	1.82	2.11	2.19	2.09	2.09	2.10
P_GDP	0.15	0.98	0.45	1.18	2.56	1.35	1.33	0.92
PPI	-2.38	-2.11	-2.29	-1.83	-1.70	-1.62	-1.52	-1.22

Fig. 3.5 Forecasts of major price indices (year-on-year basis) (Note: CPI, P_GDP, and PPI denote consumer price index, GDP deflator, and producer price index, respectively)

3.2.2 Forecasts of Major Price Indices

The CQMM predicts that the CPI will rise by 1.74 % in 2015, a decrease of 0.26 % from 2014. By 2016, the CPI is expected to rise slightly to 2.12 %. By quarters (Fig. 3.5), because of weak demand, the CPI could fall to 1.37 % in the first quarter of 2015, and, following the rebound of consumption, could rise moderately to 1.67 % in the second quarter, further rise to 1.82 % in the third quarter, and continue to rise to 2.11 % in the fourth quarter.

The PPI in the next two years will continue to maintain a negative trend, but the decline is expected to gradually narrow. The PPI is expected to fall to −2.15 % in 2015 and could further narrow to 1.52 % in 2016. By quarters (Fig. 3.5), the PPI may fall to −2.38 % in the first quarter of 2015 and then recover to 2.11 % in the second quarter; the decline tends to narrow until the fourth quarter, when it will recover to −1.83 %. In 2016, as the pressure of backward production capacity drops and the enterprise management situation improves, the index will continue to rise, reaching −1.22 % in the fourth quarter.

In 2015, the GDP deflator (P_GDP) could rise to 0.70 % and further improve to 1.52 % in 2016. By quarters, it could rise to 0.15 % in the first quarter of 2015, continue to rise to 0.98 % in the second quarter, and, after an apparent fall, rebound until the fourth quarter to 1.18 %. In 2016, the index could show a tendency of low after high and then fall to 0.92 % by the fourth quarter (Fig. 3.5).

Overall, the Chinese economy is facing a downward pressure in 2015, but the economic growth rate is expected to be over 7.0 % and the full-year GDP growth rate is expected to be around 7.14 %. Inflation in China continues to drop beyond the current low level, and the CPI is expected to rise by 1.74 % through the year. We predict that under the gradually appearing effects of China's comprehensively deepened reform policy and the world economic recovery, the country's GDP growth rate will recover in 2016; the CPI growth rate will also increase.

3.2.3 Forecasts of Growth Rates of Other Major Macroeconomic Indicators

3.2.3.1 Export, Import, and Reserve Growth

The CQMM predicts that in 2015, the speedy relief of the US economic recovery and eurozone economic crisis will promote China's imports and exports to a certain extent. In 2015, based on the present price levels, China's total exports are expected to grow by 8.02, 1.94 % higher than that of 2014. The country's import growth will rise to 7.57 %, a significant increase of 7 % from 2014 (see Table 3.1). By quarters, China's year-on-year export growth in the first and second quarters of 2015 soars, respectively, to 11.49 % and 11.41 % from the previous year, falls slightly in the third quarter to 8.12 %, and reaches 9.62 % in the fourth quarter. The year-on-year growth in imports in the first quarter of 2015 could reach 4.89 %, rebound quarter by quarter, and rise to 10.45 % in the fourth quarter. Because of the increase in export growth rate, China's foreign exchange reserves could grow by 4.05 % in 2015. In 2016, following recovery of the external market demand, China's imports and exports will continue to grow steadily. At the current USD prices, the export growth rate is expected to reach 7.75 % and import growth rate expected to reach 6.11 %. China's foreign exchange reserves may grow by 3.09 % in 2016 (Table 3.1, Fig. 3.6).

3.2.3.2 The Growth Rate of Total Fixed Capital

The CQMM predicts that in 2015 (Fig. 3.7), on account of the weak real estate market and undigested excess production capacity and based on current prices, the urban fixed asset investment growth rate will be 10.65, 4.57 % lower than that in 2014. In 2016, following the recovery in manufacturing and a new round of urbanization, the demand for urban investment will increase further and the growth rate of urban fixed asset investment will rebound to 12.96 %. By quarters, the growth rate of urban fixed asset investment (present price) will slightly fall to 8.34 % in the first quarter of 2015 but gradually rise to 12.08 % by the fourth quarter. In 2016, except for the second quarter, it will be maintained at more than 13 %.

Table 3.1 Forecast of growth rates of exports and imports and foreign exchange reverse in 2015–2016 (Unit: %)

Time	Exports				Imports				Foreign Exchange Reserves
	At constant price	At current price	General trade at current price	Processing trade at current price	At constant price	At current price	General trade at current price	Processing trade at current price	At current price
2015	**10.12**	**8.02**	**7.09**	**10.02**	**8.89**	**7.57**	**7.80**	**12.67**	**4.05**
Q1	11.49	12.62	9.26	11.60	4.94	4.89	–1.49	21.15	–0.20
Q2	11.41	10.92	9.22	13.39	10.62	7.78	8.23	16.25	–1.34
Q3	8.12	4.61	4.84	7.94	10.08	7.17	10.75	8.34	1.89
Q4	9.62	4.70	5.33	7.54	9.96	10.45	14.41	6.39	4.05
2016	**9.68**	**7.75**	**8.48**	**7.32**	**8.16**	**6.11**	**8.41**	**3.65**	**3.09**
Q1	9.39	7.52	8.11	8.17	8.57	6.92	10.05	3.48	3.49
Q2	8.99	6.54	6.97	6.65	8.03	5.39	7.69	2.84	3.48
Q3	10.57	8.91	9.88	7.78	8.32	6.19	7.95	4.46	3.28
Q4	9.73	7.99	8.92	6.74	7.73	5.96	8.05	3.80	3.09

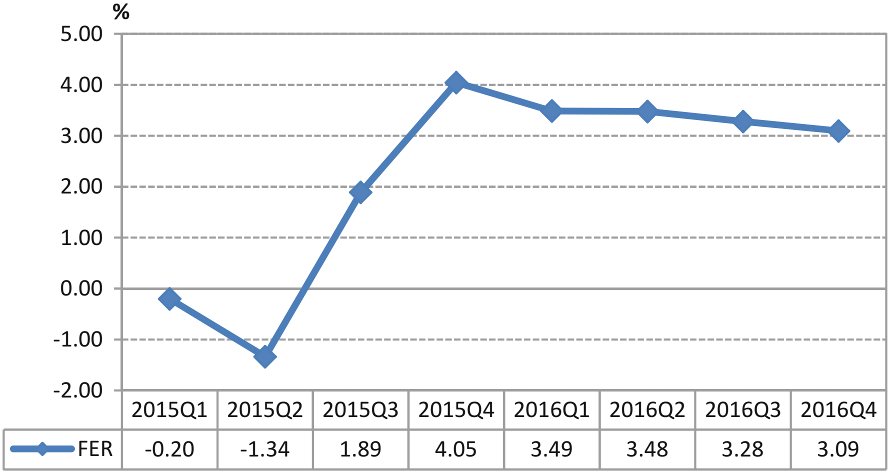


Fig. 3.6 The growth rate of reserves (year-on-year basis)

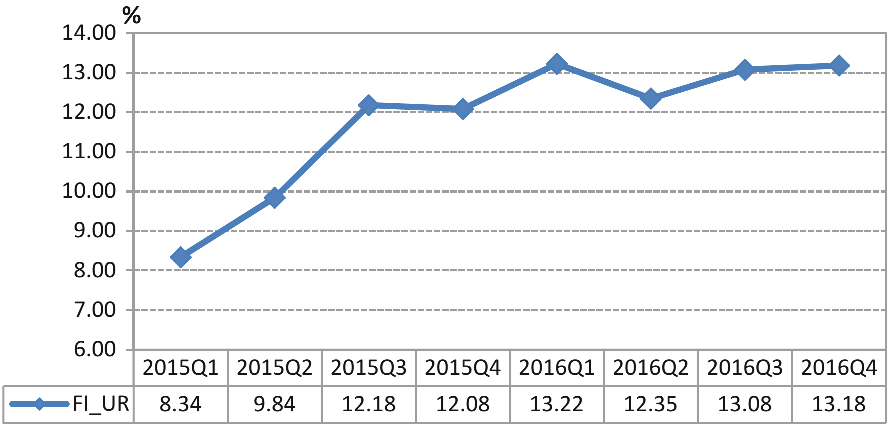
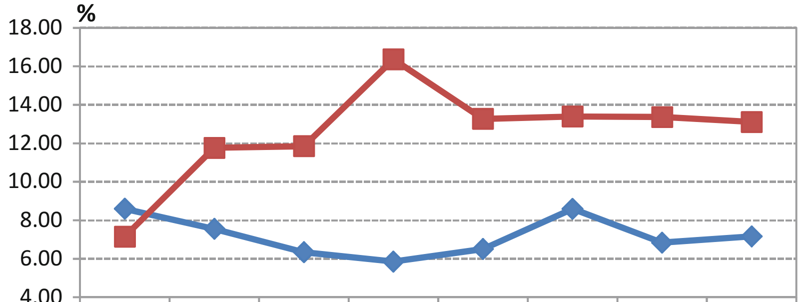


Fig. 3.7 The growth rate of total fixed capital formation (year-on-year basis) (Note: FI_UR denotes the growth rate of urban fixed capital formation at current prices)

3.2.3.3 The Growth Rate of Consumption

According to the CQMM prediction, in 2015, with the prices kept constant, the total consumption of residents will grow by 7.06 %, a decrease of 0.21 % from 2014; it would then rise slightly to 7.26 % in 2016 and maintain stability. In 2015, at the present price level, the total retail sales of social consumer goods will grow by 11.80 %, a decrease of 0.32 % from 2014, and rise slightly to 13.28 % in 2016.

By quarters, the growth rate of total residents' consumption (at constant prices) will peak to 8.60 % in the first quarter of 2015, then fall back quarter by quarter, and finally reach 5.86 % by the fourth quarter. In 2016, it will basically remain



	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
CON_D_C	8.60	7.55	6.34	5.86	6.51	8.60	6.84	7.16
RETAIL	7.16	11.76	11.85	16.37	13.27	13.39	13.36	13.11

Fig. 3.8 The growth rate of consumption (year-on-year basis) (Note: CON_D_C denotes the growth rate of resident consumption at constant price and Retail denotes the growth rate of retail consumer goods sales at current prices)

stable and reach the annual peak of 8.60 % by the second quarter and then fall back to 7.16 % by the fourth quarter. The growth of total retail sales of social consumer goods (present price) will improve every quarter of 2015, and driven by base effects of the previous year's fourth quarter, it will rise to 16.37 %. In 2016, the increase will be relatively stable and will remain between 13.1 and 13.4 % each quarter (Fig. 3.8).

In conclusion, we present the CQMM predictions as follows:

1. In 2015, it is the final year of the 12th five-year plan and the year the Chinese economy moves toward the new normal, the real estate market will continue to adjust, real estate investment and manufacturing will remain at the low end, and infrastructure investment will continue to play the role of palm of steady growth. Simultaneously, a transformation between the old and new mechanisms on account of various promotional reforms will produce a certain degree of uncertainty in economic growth. The expected economic growth rate of China in 2015 is 7.14 %, a slight decrease of 0.23 % from 2014, and the country's CPI is expected to rise by 1.74 %. If the economic growth rate stays over 7 % and the employment situation is basically stable, it will create favorable conditions for the Chinese government to achieve the goal of the 12th five-year plan and enter a new stage of development and to speed up the implementation of its comprehensively deepening reforms.
2. In 2015, it is the key year to comprehensively deepen China's reforms. Carrying out comprehensively deepening reform measures will optimize the allocation of resources, recycle the potential of economic growth, and stimulate the vitality of economic development. By accelerating the administrative examination and approval system reform, finance and tax reform, and financial reform and formulating the industry and regional planning policies intensively, the system will release further bonuses. The promotion of China's (Shanghai) reform

experience of free trade area can be copied, and the government's widely implemented negative listing management technique will further widen the space of private investment, improve the proportion of private investment, improve the quality and efficiency of economic growth, gradually enlarge the residents' income and consumption, and promote the economic growth transformation mode. The GDP growth rate is expected to increase by about 0.06 % in 2016 over the previous year.

3. In 2015, the eurozone will continue its weak economic growth, but the strong recovery of the US economy might promote the steady rise of China's imports and exports. Furthermore, at current prices, the total exports of China are expected to grow by 8.02 %, an increase of 1.94 % over the previous year. The growth rate of China's total imports could rise to 7.57 %, a significant increase by 7 % over the previous year, and, consequently, its trade surplus could further narrow down.
4. Following the decline in economic growth, all kinds of hidden risks would tend toward innovation, all kinds of risks that resolve high leverage and bubbles into the main characteristics will continue for a period of time, real estate investment will become weak, and the pressure of the manufacturing industry's liquidation could inhibit the growth of investment in fixed assets. However, with China's "One Belt and One Road" policy, its new strategy for urbanization, construction, and the rapid development of the equipment manufacturing industry, emerging areas such as high-tech industry will continue to promote the fast growth of investment in fixed assets. The expected growth of urban fixed asset investment in 2015 is 10.65 %, at current prices, down 4.57 % from the previous year. At the same time, the comprehensively deepening reforms in investment, trade, finance, services, state-owned enterprises, and so on, especially the system mechanism innovation, will also open up new investment options and attract social capital to participate in investment. The growth rate of urban fixed asset investment is expected to rise to 12.96 % in 2016.