China – the biggest economy in the world

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The new normal

The importance of China for the global economic and financial system continues to grow at a rapid pace. Last year the country set a new milestone by becoming the world's biggest economy. The total value of goods and services produced in a year exceeds that of the United States. Thus, at 30% China accounts for the largest contribution to global economic growth.

Transformation

The goal for economic growth in 2015 is 7%. The most recent, disappointingly weak economic data suggest that this target may not be achieved. The Chinese economy has been going through a long-term process of transformation. Economic growth, driven by exports and especially investment and financed by very high credit growth, is currently being put on a sustainable basis. In the long run, plans are for both consumption and the service sector to account for the lion's share of economic output, the way it is customary in a modern economy. This is the only way stagnation can be averted on medium income levels. Liberalisation is part and parcel of this process. The relevance of a state-planned economy will shrink for the benefit of a market economy. This process will be accompanied by the fight against corruption.

Fine-tuning

In order to prevent the intentional reduction of economic growth to sustainable levels and the legacy of the credit and investment boom (i.e. bad debt and unprofitable projects) from causing a "hard landing", the Chinese government will countersteer in case of disappointing economic data. For example, in the past months the key-lending rates and the minimum reserve requirements have been cut, while the budget deficit has been expanded. The capital requirements for property purchases have been loosened as well.

Internationalisation

The rise of China also manifests itself in the establishment of an own multilateral development bank, which many Western countries are also participating in.
In line with this scenario, the guidelines for capital movement have been thinned out, and the internationalisation of the Chinese currency continues. The renminbi may soon attain the status of full convertibility. Whether the Chinese currency will also be taken into the currency basket for the IMF currency, i.e. the special drawing right, further down the line only depends on political arguments.

Financial markets

The internationalisation of the renminbi implies that it is not in China's best interest to participate in the global depreciation race. Also, the weight of Chinese equities and bonds in global indices will increase. This will support equities, even though the earnings development is currently negative. Another important issue, a reserve currency requires a large, liquid fixed income market. Given that the yields in China are clearly above those of other reserve currencies, a rising issue volume of Chinese bonds should cause no problems.

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