Chinese Finance Association of America
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"Is China's Economy Heading for a Crash?"

On October 29, 2012, Chinese Finance Association of America (CFAA) successfully hosted Dr. Zhao Yue, Chief Economist of Chief Securities Limited, Hong Kong and a China macro economy expert for a CFAA Distinguished Speaker Series on the China economy outlook. Dr. Zhao shared with the audience his highly insightful views on the current challenges and opportunities of the Chinese economy and the potential solutions to the issues from both economic and policy standpoints. The feedback from the audience on Dr. Zhao's speech was positive. Some of them viewed Dr. Zhao's speech as one of the most interesting and insightful speeches of the year.

Dr. Zhao started with the central question of the night - is the Chinese economy entering a crash? The question was first raised by the investment community in mid-2011 when the overall GDP growth rate slowed down below its long term trend, with the following symptoms: (A) From a macro perspective, fixed asset investment dropped significantly after the effects of the stimulus measures injected in 2009 worn off. (B) From a micro perspective, corporate profit growth slowed down or became negative in Q1 and Q2 of 2012. (C) Real estate bubble, which had the potential of eventually destroy the banking sector. (D) Local government debt climbs to an alarming level.

Mr. Zhao then brought the subject into a historical context by comparing the path of Chinese economy since the early 1980s with other developed economies. He outlined the theory of 3-stage development for economies to move from a bipolar structure where agricultural sector and industrial sector are of comparable forces to a unipolar one where industrial sector dominates.

- At the first stage, agricultural population with relatively low productivity gradually migrates into manufacturing, leading to a boost in marginal productivity.
- With productivity levels and marginal compensation reach equilibrium between the agricultural sector and industrial sector, the economy enters the second stage, characterized by strong capital investments in equipment and other tangible assets.
- The third stage commonly starts with major financial crises such as the 1929-33 Depression in the US and the Japanese crisis of the early 1990s, where financial assets bubble then collapse. The economy reaches the post-industrial stage afterward.

Historical data shows that the first stage commonly lasts for about 20 years, with a GDP growth rate averages around 10%. Contrary to the belief of some doomsday sayers, Dr. Zhao considers the Chinese economy to be transitioning between the first two stages. Therefore a major financial crisis is still far away in the future.

Regarding the future outlook, Dr. Zhao considers an annual growth of 7-8% to be within reach, mostly from capital investments and technology advancement. The following are possible highlights of Chinese economy in the next few years.

- College educated, yet relatively affordable work force is plentiful for high-end service market.
- The overall economy will migrate from low-end manufacturing to high value-added, capital intensive industries, taking advantage of the excess capital and an educated labor force.

Regarding some structural issues that overseas analysts are concerned about, Dr. Zhao pointed out the special Chinese–style prescriptions these analysts often failed to conjure.

- The high level of indebtedness in the local governments would not lead to structural problems since the governments own overwhelming amount of resources in forms of state-owned enterprises, mining, fishing rights and land. The liquidation of such resources will be more than sufficient to fulfill its debt obligations without resorting to taxation.

- The deteriorating collaterals in the banking sector would not destroy the financial sector. Chinese financial authorities pioneered the method of bailing out large banks by purchasing their toxic assets from their balance sheets. This has been proven repeatedly to be effective by US and European financial regulatory authorities.

Dr. Zhao ended the conversation by pointing out some recent macro mistakes policy makers have made. First of all, some industries that are losing their competitive edge internationally due to structure reasons such as rising labor cost were inappropriately propped up. Examples include apparel fabrication, mining and metal sectors. The policy makers also slowed down the pace of Yuan appreciation in order to support such industries, leading to misallocation of resources. Secondly, Hi-tech industries with limited potential, such as solar energy, were promoted before the technology can be commercialized with scale. Thirdly, the policy makers overacted to the 2008 financial crisis with overpowering monetary policy measures, leading to excess production capacity in industries such as metal and mining, cement and coal. Lastly, boosting the domestic demand through real estate reform depressed the current consumption and consumptions in the near future.

About CFAA

Chinese Finance Association of America (CFAA) is an independent not-for-profit, non-partisan organization committed to promoting educational and cultural exchange among finance professionals between the United States and Greater China through facilitating communication and the exchange of ideas in the financial industry. Incorporated and headquartered in Chicago, Illinois, CFAA is aimed to serve Chinese finance professionals and others who are interested in the financial industry of Greater China. Please visit our website www.ChineseFinanceAssociation.org for more information about CFAA. To become a CFAA member, or to renew your CFAA membership and make your membership payment, please go to the membership section on our website. If you are interested in the volunteering opportunities at CFAA, please submit the volunteer and staff application form. For global career opportunities in finance, please visit our newly launched Online Job Center through our partnership with one of the leading global career placement companies eFinancialCareers.com.a