March 21, 2014

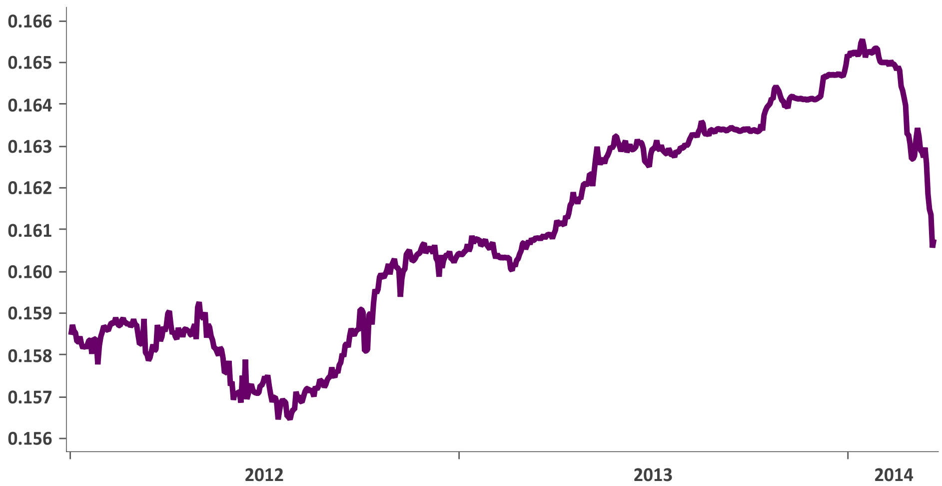
GLOBAL MACRO

China: desperately seeking growth drivers

How bad has the Chinese economy gotten to warrant such a firm reaction by Chinese authorities in recent weeks?

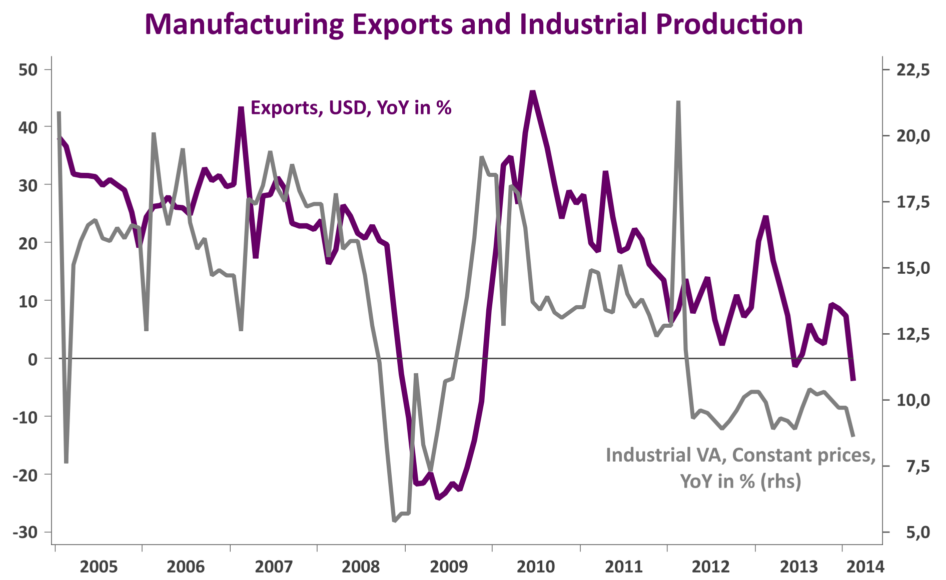
Since mid-January, the People's Bank of China has orchestrated a 3% fall in the yuan. Our suspicions of a shift in currency policy are being confirmed (for more information on this topic see: "Shift afoot in China?" published on February 28, 2014) and if such a move was intended to spark volatility to discourage capital inflows the strategy has certainly been successful. And the movement could well continue because China seems to be in disarray as it faces a major problem: mopping up excess private debt in the economy while maintaining growth. It is a tall task and growing evidence suggests that the 2014 GDP growth target of 7.5% is becoming less and less credible.

CNY per USD



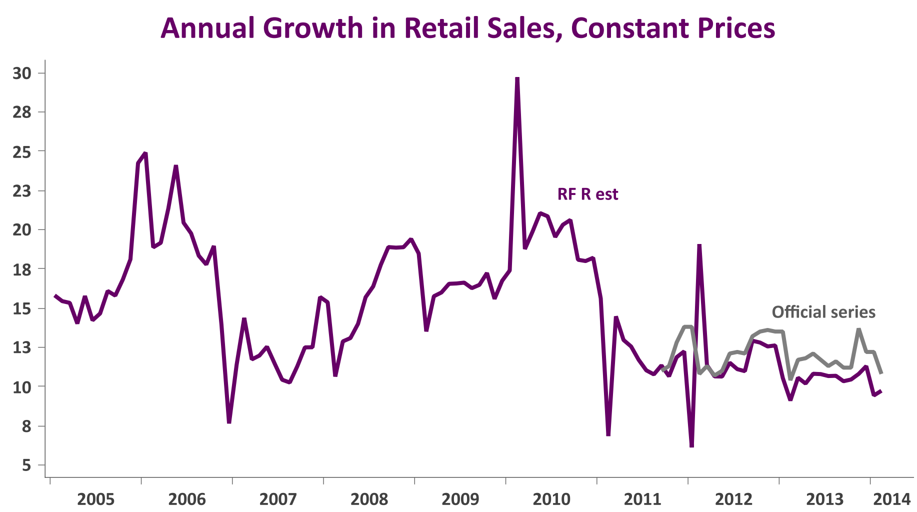
Sources: RichesFlores Research, Macrobond

Judging by the most recent indicators, the economic deterioration has picked up in recent months as attempts to root out shadow banking have had increasingly visible repercussions on the domestic economy.



Sources: RichesFlores Research, Macrobond

It appears the government is poised to loosen lending conditions so banks will lend to certain key sectors of the local economy, particularly home builders. Therein lies the crux of the problem: these measures fly in the face of the authorities' goal of encouraging deleveraging.



Sources : RichesFlores Research, Macrobond

Against such a backdrop, what other choice do the Chinese have but to look beyond their borders for growth? Probably none. The likelihood of a drop in the yuan thus looks increasingly likely.

Véronique Riches-Flores
contact@richesflores.com