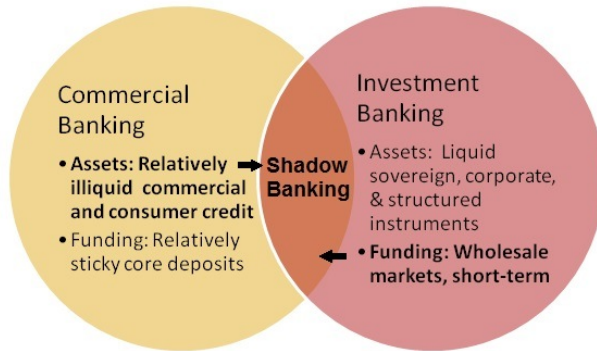


- **Shadow Banking and credit-driven growth in China**

The record credit expansion in China has reached its peak. Overall credit in the economy now stands at about \$23 trillion. One of the reasons for this unprecedented rise in credit is the **shadow banking system in China**, which is becoming increasingly prominent. Find out why in the next part of this series.

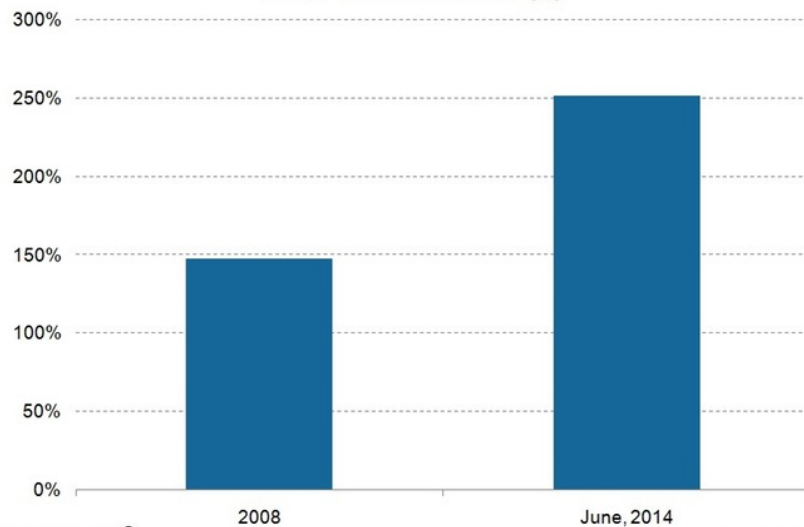
Shadow Banking



Market Realist[®]

- **The credit boom in China** Credit in China has grown by about 2.5 times since the financial crisis of 2008–2009. Overall credit in China has ballooned from \$9 trillion to \$23 trillion over the last five years. Credit in China is now twice as large as the country's GDP (gross domestic product). The overall credit-to-GDP ratio has surged from about 147% at the end of 2008 to over 250% this year in June.

China: Total Debt to GDP (%)



Market Realist[®]

Source: Standard Chartered

shocks and strengthen their consumption, which would also have an aggregate impact on household consumption. Our simulations suggest that China's current account surplus would decline significantly if the country increased its healthcare expenditure to a level comparable to that of Brazil, another fast-growing emerging economy. The decline in the country's current account surplus would mainly derive from a fall in the level of national savings. As such, the plans recently unveiled by the State Council to boost the social safety net programs will not only help reduce inequality, but also correct macroeconomic imbalances.

How Chinese saving and investment rates develop in the coming years is a matter of crucial importance not just for China but for the entire world economy. In China, as elsewhere, microeconomic reforms are important to correct macroeconomic imbalances. China needs to further reform its financial sector and increase public social security spending to shrink its surplus in the long term. These changes would also help the country get on a path of sustainable and equitable development.

Preview from Notesale.co.uk
Page 12 of 20

More recent trends also explain China's sharper-than-expected slowdown. The single most important development has been its credit binge. Total debt (including government, household and corporate) has climbed to about 250% of GDP, up 100 percentage points since 2008. This debt allowed China to power its economy through the global financial crisis but also saddled it with a heavy repayment burden. Most worrying, much of the credit flowed to property developers. China's inventory of unsold homes sits at a record high. The real-estate sector, which previously accounted for some 15% of economic growth, could face outright contraction. New property starts fell by nearly a fifth in the first two months of 2015, compared with the same period a year earlier. From this vantage point, the abruptness of China's current slowdown looks more cyclical than structural. A period of overheated economic growth tends to be followed by a correction. Not all cycles are created equal, however. Working off a credit overhang can take years. Given that China's financial system is mostly closed, it has little risk of an acute crisis, but the other side of the coin is that it might need even longer to clean up its bad debts.

Whereas previous leaders propped up growth whenever it slowed, Xi Jinping, China's president since 2013, has instead spread the gospel of the "new normal", by which he means less emphasis on growth and faster structural reform. The central bank has been hesitant to ease monetary policy. Changes to fiscal rules have made it harder for local governments to spend money. With consumer-price inflation running at a five-year low of 1.1% and producer prices deep in deflation, there is a case to be made that China's economy, restrained by the government, is performing below its potential. The good news is that neither the cyclical nor the policy explanations for China's slowdown are permanent. As the cycle turns and policy changes, the outlooks could improve. But the structural shifts in the Chinese economy are a different story. They will cap any rebound. Double-digit growth is most certainly a relic of China's past.