CHINA'S ECONOMY 2016/17: LOWER GROWTH AMIDST GREATER EXTERNAL UNCERTAINTY (II)

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Executive Summary

1. In 2017 China is bracing itself for the greatest ever external economic uncertainty since its reform and open-door policy in 1978.

2. China-US economic relations, the world's greatest bilateral economic relationship, are under serious challenge posed by the coming US President Donald Trump.

3. During his election campaign, Trump accused China of being a "currency manipulator" and promised to label China as such once he takes office, even though this notion has long been dated.

4. Trump also attacked China for "stealing American jobs" by dumping cheap exports to America and threatened to impose a punishing 45% tariff on China's imports. This could well unleash a trade war, with a potential lose-lose outcome and a lot of collateral damages to other Asian economies and even the global economy at large.

5. What is worrying Beijing and the world now is not whether Trump meant what he said, but how he would follow them through, and to what extent.

6. The continuing uncertainty has already created a sense of imminent crisis in China, which hurts investment and consumption. Any wind of a trade war or just a partial trade sanction would undermine the stability of China's financial market and add pressure to the Renminbi (RMB).

7. With the US dollar continuing to gather strength due to the prospects of more aggressive interest rate hike in the United States, the RMB had already devalued 7% in 2016.

8. RMB's continuing downward pressure due to serious capital flight has created a devaluation expectation that only begets more capital flight. To defend the RMB, the government has recently further tightened its capital control measures.

9. For the real economy, along with the economic slowdown is the rebalancing of the sources of economic growth. Consumption has now become China's major growth driver, accounting for 76% of its 6.7% gross domestic product (GDP) growth in 2016.

10. As China's economic growth is increasingly consumption driven and more service-oriented, its future growth potential will further come down because of lower productivity in most service activities. This will be offset by GDP growth of a higher quality.