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China should address downward pressure in 2018[1]

In 2017, the Chinese economy rebounded more significantly than expected. There is now general anticipation that growth in 2018 will fall slightly compared with that of 2017, but that it will remain stable at 6.5 percent or above. However, there are some factors that could lead to downward pressure on investment and consumption in 2018.

First, investment growth has shown negative growth recently. Judging from the notional fixed-asset investment, the year-on-year growth in the first 11 months of 2017 was 7.2 percent, 1.1 percentage points lower than in the same period of 2016. Due to the significant increase in producer price index (**PPI**) growth in 2017, the drop in real investment growth in 2017 is quite worrying. The real investment growth rate in the first three quarters of 2017 dropped to 2.2 percent year-on-year, while in the same period of 2016, this figure was 9.5 percent year-on-year. On a quarterly basis, the real investment rate in the third quarter of 2017 fell by 1.1 percent year-on-year, the first time that negative growth has been recorded in more than a decade.

Given that corporate profitability improved in 2017, why have nominal and real investment growth continued to decline? At least two aspects can explain it: The industries that saw a substantial improvement in profitability were mainly the ones

[1] Posted in:《Global Times》

burdened with overcapacity; in the context of cutting overcapacity, large-scale investment expansion has been restrained. Also, a sharp rise in costs was a big problem for downstream industries, causing them to lose their investment enthusiasm.

Second, there has been a lot of stimulus from fiscal subsidies for technical reform. In 2017, new financial subsidies and industrial investment funds greatly stimulated investment in technological transformation. The former refers to the substantial increase in subsidies for technology improvement from the **Ministry of Finance** and the **Ministry of Industry and Information Technology**, and the latter refers to the increase in technical investment by local governments through industrial investment funds. According to statistics provided by Zero2IPO Research Center, as of June 2017, the number of government investment funds set up by the central and local governments has exceeded 1,013 (most of which are industrial investment funds) and the accumulated paid-in investment has exceeded 1.91 trillion yuan ($292.6 billion).

The money from industrial investment funds and various types of direct financial subsidies for innovation stimulated investment growth in technological transformation in 2017. This stimulus not only raised the base of the corresponding investment in 2017, but is also an overdraft on investment demand in the future.

Whether it is industrial funds or financial subsidies, they are all driven by the government, and this can easily lead to policy dependence. If the policy support in 2018 weakens, this factor will become a force dragging down the growth rate of overall investment.

Third, a decline in the median income growth rate and increasing household leverage are curbing consumer spending potential.

In terms of the growth rate of per capita disposable income, the median growth rate has dropped significantly. In the years prior to 2016, the median growth rate of per capita disposable income for urban households was greater than the GDP growth rate most of the time. However, since the end of 2016, the growth rate of median income has dropped markedly. As of the third quarter in 2017, the median income growth rate has not only lagged behind the per capita income growth in quarterly terms, but has also continued falling below the cumulative year-on-year growth rate of GDP.

This indicates that the income gap in society is expanding, and those with high incomes have a lower marginal propensity to consume. Therefore, this factor will restrict future consumption growth, and the contribution to GDP from consumption will be restrained. Also, the sharp rise in household debt may curb spending power in the future. Since 2012, the household sector has seen its debt ratio rise continuously and the space for a further increase in debt among Chinese people is relatively limited.

In addition, considering non-traditional residential loans from online sources and other private lending from informal systems, the actual debt ratio among residents may be even higher. The rapid rise of debts among ordinary consumers has not only raised concerns about financial risks, but could also inhibit future consumption.