



## China 2018 Outlook

### Striving for a new growth model

China faces some structural challenges in the next five years. Global interest rates will likely rise. The labor force in China is shrinking. Property and infrastructure investments face constraints as growth drivers. Financial risks have reached alarming levels. Environmental constraints are also clear.

President Xi enters his second term. His speech in the 19th Party Congress suggests China will strive in the next few years for a new growth model – focusing more on sustainability and quality, and less on speed. We expect a change in policy over the next few years.

GDP growth will likely slow to 6.3% in 2018 and 2019, with risks balanced. Another round of regulation tightening has started to contain financial leverage and property speculation. We think GDP growth will likely slow in H1 to below 6.5%. This will lead the government to loosen property sector policy somewhat in Q2. Growth should rebound slightly in H2.

On policy front, China will likely keep the official fiscal deficit at 3% of GDP, but we expect growth of total fiscal spending to slow to 5% from 13% in 2017 (including central and local government funds). We see the PBoC keeping benchmark policy rates stable in 2018, with risk to the upside, particularly in H2. We expect the PBoC will cut RRR twice in H2 2018. We expect the USDCNY exchange rate at 6.70 and 6.90 at the end of 2018 and 2019 respective, as the shrinking current account surplus puts persistent pressure on RMB to depreciate.

The government will likely promote a few sectors as new growth engines such as advanced manufacturing and medium-to-high end consumption, as President Xi mentioned at the Party Congress. We will likely witness interesting innovation stories in some sectors, but it is not clear if they are big enough to change the macro picture in China. The outlook for structural reforms such as fiscal and SOE reforms in 2018 is uncertain.

Main risks to growth outlook come from inflation and interest rates. We think the market underestimates the risk of inflation in 2018 and 2019. If CPI inflation rises above 3% and stays elevated, and the Fed continues its rate hike cycle, we see upside risks to interest rates and downside risk to growth in China.

### Policy focuses more on risks and quality of growth

2017 has been a good year for China's economy. Growth was strong, particularly in consumption and the services sector. The property market boom continued in tier 3 cities. Supply side reforms paid off with improved industrial profits. Global economic environment was also supportive, with strong growth in Japan and Europe. Market volatility was subdued, and the RMB has been strong against a weak US dollar.

In 2018, the external economic environment is changing. Monetary conditions are tightening among major central banks (Figure 38). The peak of QE is now behind us: asset purchase programs of the ECB and the BoJ will reduce in size, and the Fed's balance sheet will shrink in 2018. Deutsche Bank economists expect four more hikes in 2018 and three in 2019. All these point to tighter liquidity and higher interest rates in the global economy.

*Courtesy of Deutsche Bank Asia  
Ph.D. economist's Zhiwei Zhang and  
Yi Xiong, the following outlook offers  
investors analysis of China's key  
themes in 2018. Excerpts in blue are  
directly from their outlook originally  
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