The end of property cycle will negatively affect land sales revenue, which comprises 30% of local government revenue. We expect the government to loosen controls on property markets in Q2 2018 to offset the impact of property cycle on investment and government finances.

New growth engines

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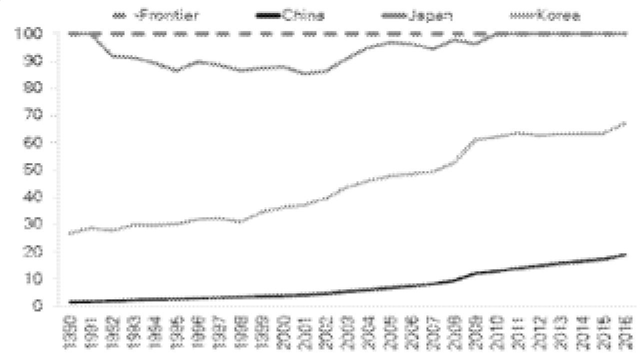
President Xi's Oct speech pointed to a number of sectors that could be developed in the next few years. We highlight two areas that could become renewed engines for China's growth: manufacturing industry and consumption upgrade.

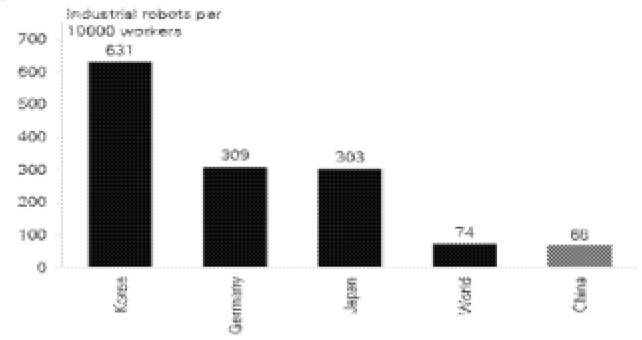
The advancement in the overall manufacturing sector is likely a long and gradual process. China is still far away from the production frontier; 2016 output per worker in manufacturing is only 20% of the frontier (e.g. Japan), and is comparable to Korea's level in 1990 (Figure 51). Robot density in manufacturing is still very low, measured by the number of industrial robots per 10,000 manufacturing workers (Figure 52). There is great potential for China to invest in manufacturing technology and equipment, though the process would likely take many years before China's manufacturers can catch up with their peers in developed economies.

Figure 51: Labor productivity index, manufacturing



Source: Deutsche Bank, Haver Analytics
Note: Frontier is defined as the highest labor productivity among all the OECD countries.

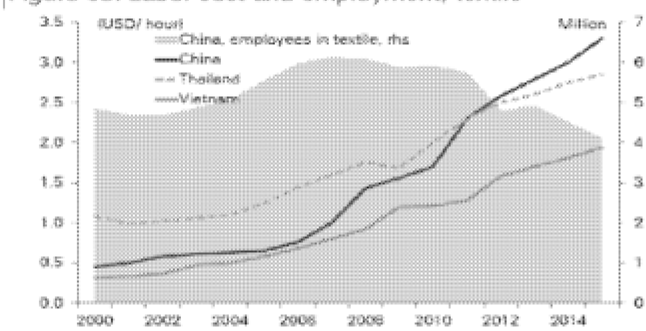
Figure 52: Robot density in manufacturing



Source: Deutsche Bank, WIND

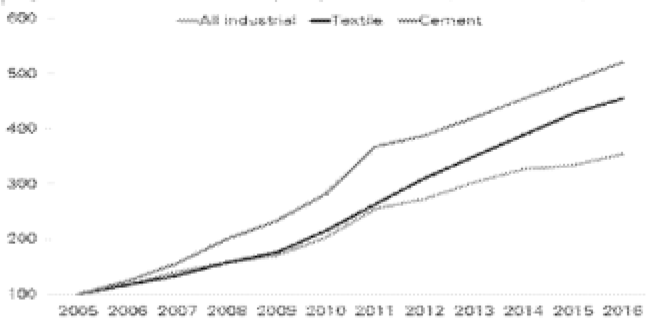
The upgrade in manufacturing will be uneven across industries. The first movers will be the traditionally labor intensive industries, who faces greater pressure from rising wages. Capital substitution for labor is already happening in industries such as textile and cement. As China's labor cost rose rapidly, workers are moving out from these traditionally labor intensive manufacturing sectors. Productivity is increasing fast in these industries through both technological improvements and shutdown of lower efficiency producers (Figure 53 and 54).

Figure 53: Labor cost and employment, textile



Source: Deutsche Bank Asia Consumer Research, Economist Intelligence Unit, US Census Bureau, WIND

Figure 54: Industrial output per worker (2005 = 100)



Source: Deutsche Bank, WIND
Note: Output per worker is calculated as average sales per worker.