



sales which is a very rational response to anticipated lower nominal growth by individual companies, but which could trigger a vicious cycle if it becomes a more universal objective by slowing growth in the broader economy which then feeds back to further capex cuts. As nominal growth rates continue to fall, debt levels at both the corporate and local government level are likely to rise unless Beijing is willing to follow through on its tough talk and actually enforce a hard budget constraint on potentially insolvent enterprises against opposition from local government. It is almost impossible in any scenario to envisage a significant level of reforms without the benefit of a currency devaluation to lubricate the process and inject liquidity into the corporate sector; the major question in our minds is whether this will eventually be an orderly or disorderly process.

Sentiment towards China will be volatile in 2014 with big tail risks

The net result of the Plenum has been exactly as the Chinese authorities intended, namely to boost confidence towards the economy, thereby ensuring a continual stream of finance which will support the debt driven growth model while the economic reforms begin to have an impact. The other key element is the extent to which the developed economies, in particular the US will revert back to the sort of import growth which helped the Chinese economy so much between 2002 and 2007. We do not believe that exports will come to the rescue in 2014, but our colleague Michael Spencer anticipates a major acceleration based on the recent pick-up in the US ISM survey and the Euro-area PMIs. In any event, sentiment towards China is likely to swing sharply among economists and investors alike as it has done for each of the past four years. We believe that there is a significant chance of a decisive break in a negative direction in 2014, but we would advise even those investors who are sceptical of our negative view to take a contrarian approach to the prevailing sentiment. At the moment given that the overwhelming majority of buy and sell-siders alike are relatively bullish, now should be a good time to adopt a more negative perspective.