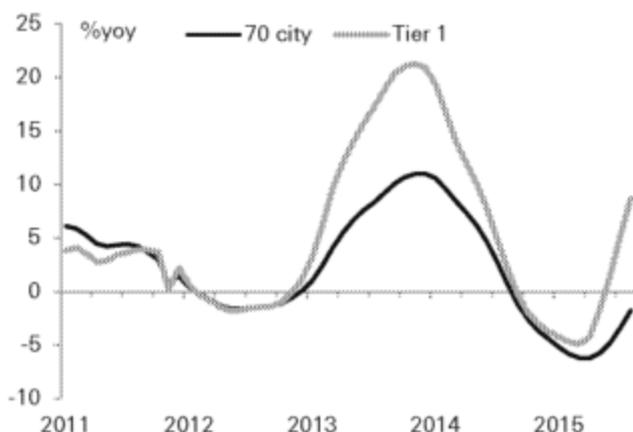


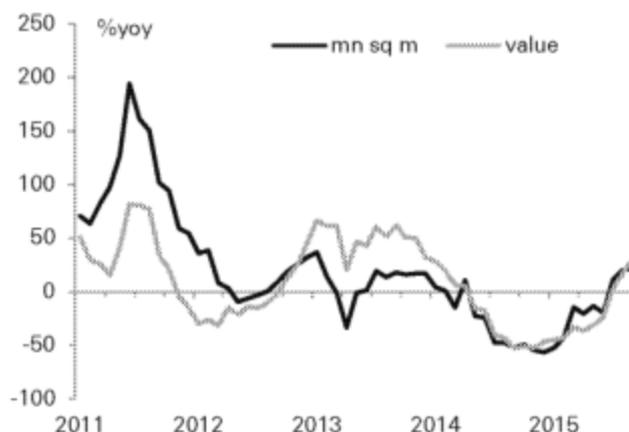


Figure 17: Property prices



Sources: Haver and Deutsche Bank Research

Figure 18: Land sales volumes and values



Sources: CREIS and Deutsche Bank Research

With rising property sales – year-to-date residential property sales in terms of square meters of space are up about 8% after having fallen 9% last year – and declining inventories (residential housing starts were down 14% last year and are down 18%ytd this year – developers are starting to prepare for the next cyclical recovery in investment. Land sales, measured both in physical and value terms are rising again.

These are encouraging leading indicators that broader property investment growth – which has been trending down for most of the last three years and is currently near all-time lows – could recover in early 2016, restoring an important source of growth to private domestic demand.

Conclusion

This note has set a relatively modest objective: debunking the idea that growth has suddenly slowed sharply in China. There is no evidence that a hard landing is underway in China. Instead, a gradual slowdown in growth partly for deep fundamental reasons seems likely to continue. Effective implementation of reforms of the kinds that we have discussed repeatedly in this forum – especially to the allocation of capital – could slow or possibly temporarily reverse the decline in potential GDP. In the near term, stimulus measures are likely to take growth very slightly higher in Q4 – our forecast is 7.2%yoy GDP growth. Upside risk exists to the 2016 outlook if the recovery in property markets that has been gathering strength over the past year leads to a recovery in property investment, something that in our experience very few investors expect ever to see again.

We remain skeptical of the hard landing argument because we don't see how it would occur. True, China's credit/GDP ratio is rising unsustainably. But it need not end in a crisis. A recovery in export demand or reforms to improve the allocation of capital could both allow GDP growth to be sustained at a relatively high level without relying on increased leverage. China's inherent advantages of a current account surplus, high net foreign assets (13 % of GDP) and low external debt burden (about 10% of GDP) offer a significant counterweight to the risks of a crisis posed by a high credit/GDP ratio.⁵ A 'sudden stop' of international capital of the kind that in the past has triggered emerging markets crises seems unlikely to cause a crisis in a country that has

⁵See Davis, Scott, Adrienne Mack, Wesley Phoa and Anne Vandenabeele, "Credit booms, banking crises and the current account," HKIMR Working Paper No. 29/2014, November 2014, for an explanation of just how important it is to have a current account surplus as a defense against a banking crisis.