



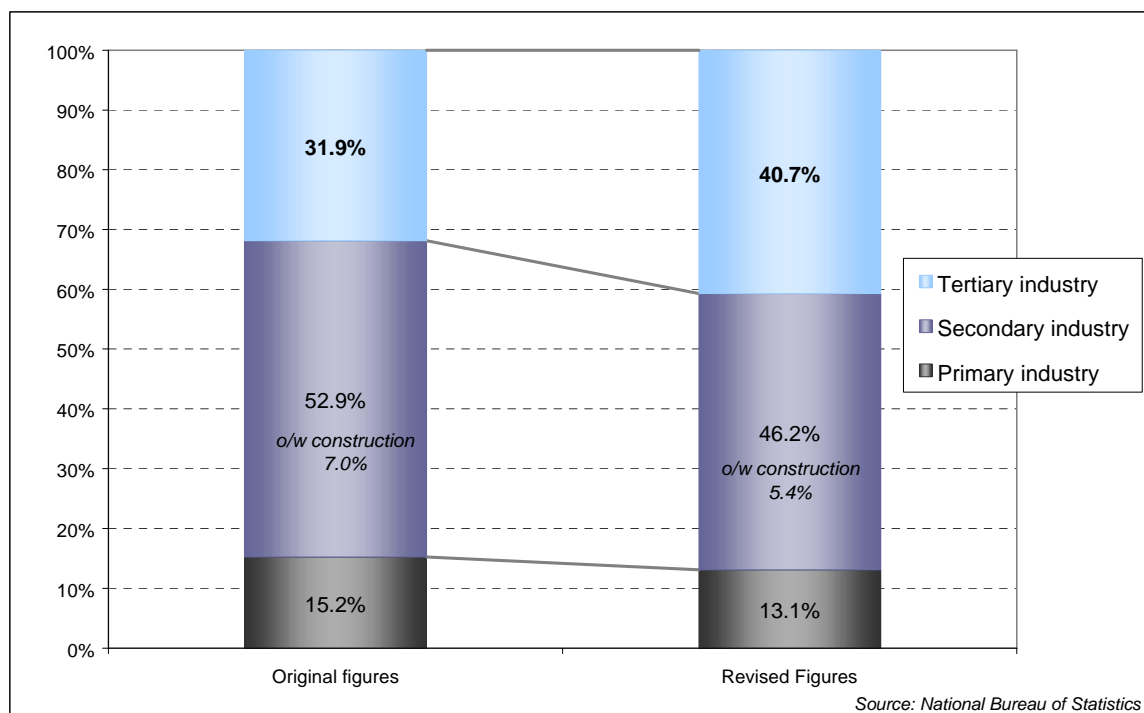
READING BETWEEN THE LINES OF CHINA'S NEW GDP STATISTICS

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The fresh changes in China's gross domestic product statistics have not made as much noise as what we could have awaited for. Maybe are people simply lost and somewhat resigned with the Chinese statistical apparel. Whatever the reason of this cautiousness, we wanted to make a summary and give some of our feelings, both qualitative and quantitative, on these changes.

Indeed, on December 20, 2005, the National Bureau of Statistics (NBS) has made a first move in answering critics about the reliability and consistency of Chinese economic statistics by raising China's 2004 overall GDP by 16.8% to RMB 15,988 bn (USD 1,973 bn). Taking into account these new data and incorporating the recent 2005 figures, China's RMB 18,232 bn (USD 2,230 bn) economy reaches 5% of the world economy and overtakes Italy (in 2004), France (in 2005) and the U.K. (2005) to become the 4th largest economy worldwide, behind the U.S., Japan and Germany, from a 7th rank in 2004 before this recent revision. The latter, based on the results of the new National Economic Census, translates a higher private and services sectors growth and contribution (the value of the latter has been raised by 48.7% to 40.7% of GDP for 2004, while the private sector should now represent close to two-thirds of GDP) and a more balanced breakdown from the demand side. The inclusion of non export-turned and few capital intensive sectors indeed implies a higher role for domestic consumption in global growth.

Chart 1. Composition of China's GDP in 2004
Original and revised breakdown





Based on this global re-estimation, the Chinese statistical authorities provided adjusted GDP growth rates over the 1979-2004 period 3 weeks later (on January 10, 2006). Since the former 1992 Census led to a revision of historical data from 1978 to 1992, one should have awaited a revision of data from 1993 to 2004. However, in this case, the 16.8% upward-revision of GDP would have implied an average +1.4 percentage points adjustment in annual GDP growth rate (putting 2004 growth close to 11%). Chinese authorities have then proceeded differently... and the average GDP growth for this larger period was revised to 9.6% against 9.4% previously. Changes for the most recent years are however more significant, with an average +0.5 percentage points revision over 1993-2004.

Table 1. GDP growth rates, 1993-2004
Original and revised figures

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Original figures	13.5	12.6	10.5	9.6	8.8	7.8	7.1	8.0	7.5	8.3	9.5	9.5
Revised figures	14.0	13.1	10.9	10.0	9.3	7.8	7.6	8.4	8.3	9.1	10.0	10.1

Source: National Bureau of Statistics

However, some statistical incoherencies remain - the new 9.6% annual average growth rate over 1979-2004, against 9.4% previously, leads to a cumulative increase of less than 5% only in total GDP! - and the new figures are undoubtedly still far from accurate. Nevertheless, despite lingering questions, such a revision is an incontestable improvement, but quite insufficient to fundamentally change our assessment on China's main economic issues:

- The relative levels of investment and credits (as a percentage of GDP) remain exceptionally too high. Based on the former end-2004 data, they respectively accounted for 45% and 167% of GDP. Taking into account the more recent estimates on the 2005 growth rates of each of these variables and, for investment, retaining the extreme assumption that the global 16.8% increase in GDP does not reflect into higher investment spending, we indeed obtain still worrying figures. On the one hand, growth in credits provided by the banking sector has decelerated to around 10% year-on-year in 2005H1, i.e. around the same rate than GDP (which is estimated to have grown by 9.9% over the whole past year). Therefore, banking credits still amount to 142% of GDP, highlighting a huge leverage effect, which reinforce micro vulnerabilities as the most unfavorable component of China's country risk. On the other hand, based on a growth rate of investment around 25% in 2005, the latter would still account for... 44% of GDP at end-2005, i.e. an almost similar level to the end-2004 one and an all-time record!

Table 2. Still worrying weights of investment and domestic credits
In % of GDP

	2004 former figures	2005 new figures
Domestic credits	167%	142%
Investment (GFCF)	45%	44%

Sources: World Bank, T-A-C estimates

- Our assessment about the issues China will face in the next couples of years is therefore intact (TAC has developed a comprehensive range of medium-term projection tools on China, that are available for in-depth scenario construction and strategic advisory services - interested customers are welcome to contact us at info@tac-financial.com). In one sense, this GDP revision further highlights how the Chinese authorities use economic information



as a political instrument: the Census results are not surprising since most developing countries have a gray economy, mainly in the services, at around 20% of GDP; but most of them also decide not to register it in the national accounts since it is difficult to assess its yearly evolutions; in that sense, this revision was once again a “Chinese exception”... and the best way to somewhat calm down investors’ fears before their Christmas break!

Opacity is then more than ever the keyword to characterize the Chinese statistics. To illustrate this, we made a simple estimate of GDP growth on a panel of large developing countries between 1970 and 2004¹. Our model includes an individual constant for each country, and GDP growth is explained by growth rates in consumption of two physical items: total primary energy and cement². The inclusion of a specific constant for each country allowed us to improve our model in capturing the Chinese exception. Indeed, only the Chinese individual constant proved statistically significant; furthermore, taken individually, our estimates match very well the long-run GDP growth profiles for all countries... except China. This simply further illustrates how the authorities are acting on statistics to smooth this growth profile, overestimating GDP growth during slowdowns (such as in 1997-1998) or underestimating it during phases of overheating fears (as since a couple of years).

Our model shows an interesting statistical quality (with a 85%+ adjustment coefficient or R^2 , which is particularly high when directly working on growth rates rather than on indices or volume). It reveals that, other things being equal, a 1 percentage point (p.p.) increase in primary energy consumption implies a 0.19 p.p. increase in GDP growth, while a 1 p.p. rise in cement consumption induces a 0.26 p.p. in the GDP growth rate. In other words, given the quality of our econometric model, monitoring the pace of expansion of these two variables allows to nicely assess / anticipate the dynamics of GDP in emerging countries³.

Then, betting that our model is true and that official statistics are false, next page is presented what GDP growth may have really been in China in the past since 1995. It first depicts a stronger impact of the Asian crisis than what official statistics indicate, with GDP growth having fallen to as low as 4-5% in 1998. Moreover, although GDP growth may have been closer to 11% than 10% in 2005, it has strongly decelerated from the 2002-2003 13-14% levels, which points to an earlier true “overheating” with compared with foreign investors and analysts’ fears, as clearly (and timely) predicted by the path of the country in our Cyclical Balance⁴. The latter so far indicates further but still limited deceleration in GDP growth this year that, overall, should remain around 10% this year, provided no accident occurs. A simple extrapolation of the “true” cyclical profile of Chinese growth would also tend to indicate that this year or next year China should reach a (limited) trough, before a further re-acceleration and certainly very high true growth rates in the following years. It also points out that the magnitude of true cycles has globally declined (not at a point of what the authorities want to signal), and that the under-estimation of growth rates over the recent years was not as strong as what some analyst declare.

¹ Our panel includes a geographically balanced set of countries: Argentina, Brazil, China, India, Indonesia, Poland, Russia, South Africa, Thailand and Turkey. We overall worked on more than 300 observations.

² Total primary energy includes oil, gas, coal and electricity. Data for this variable were derived from BP (<http://www.bp.com/genericsection.do?categoryId=92&contentId=7005893>), and data on cement consumption were provided by a private customer of T-A-C.

³ As an example, if cement consumption in China was to plunge by 10%, GDP growth would lose 2½ percentage points.

⁴ The Cyclical Balance is one out of the six Fundamental Balances that are part of T-A-C’s country risk monitoring and signalling quantitative system, so called **RiskMonitor**² (<http://www.tac-financial.com/crisk-RM-present.php>).



Chart 2. The truth on GDP growth in China, 1995-2005
Actual and estimated figures

