The Chinese economy continues to slow. After reaching double-digit rates in 2010, economic growth has been on a downward trend and is now at its slowest pace since the global downturn. Given that China is the second-largest economy and largest exporter in the world, the slowdown has raised concerns. Conditions are expected to weaken further this year, with growth falling to around 6.4%, down from 6.9% in 2015 and 7.4% in 2014.

China’s slowdown is largely the result of excess investment, including housing. When the Xi administration took over in late 2012, there was a shift in reforming the economy toward a more sustainable growth model by transitioning from investment-led to consumption- and services-driven growth. The government implemented tightening policies to cool the nation’s housing market, discourage overinvestment and reduce the buildup of risky debt and shadow financing. These efforts contributed to a broad-based economic slowdown.

To cushion the slowdown, the government has eased its policy stance by cutting interest rates five times during the course of a year. China’s prime lending rate, which is now at a record low of 4.35%, has remained unchanged since November 2015 and there are no signs that it will be raised any time soon. Meanwhile, housing restrictions have also been eased, with down payments for second-time homes and some taxes being reduced. These efforts have helped boost activity in the housing market, with home sales and prices on the rise. Although housing activity has been concentrated in the large Tier 1 cities of Beijing, Guangzhou, Shanghai and Shenzhen, smaller cities are also seeing gains.
After experiencing a downward trend for around three years, housing investment growth has been on the rise since the beginning of this year. As the housing market continues to works its way out of its current oversupply problem, particularly in the lower-tier cities, housing construction and investment should pick up more rapidly. This trend is giving hope that the Chinese economy is approaching a trough and that growth should begin to stabilize over the next year or two.

Although housing investment growth is rising, China’s overall investment growth continues to decelerate; excess capacity in many of China’s major industries, including metals and mining, has caused overall fixed investment growth to drop to its slowest rate since 2001. While lower investment is crimping economic growth, it is also part of the government’s long term plan of transitioning from investment-led to consumption- and services-driven economic growth. As such, investment growth is expected to continue to decline until the economy stabilizes at its new long-run growth model.

While China’s overall investment outlook remains dim, the government’s objective to shift growth drivers to the consumer sector appears to be underway. The central bank’s stimulus efforts have resulted in significantly lower real borrowing costs over the last couple of years, leading to an increase in consumer spending. Household spending has particularly risen on durable goods that are often financed, including cars, appliances and furniture. The rise in household spending has prevented sharper declines in China’s economic growth. Conditions in the household sector are expected to continue gradually improving in the near term as the real estate market works its way out of its oversupply slump and the government maintains a more pro-growth stance.
Despite rising consumer spending, China is still dependent on external demand for growth; exports alone account for about a fifth of the country’s GDP. Following the government’s 3.3% devaluation last year, the Chinese yuan has been on a downward trend and experienced a sharp decline during the aftermath of Britain’s exit from the EU. The yuan is now at its lowest value since 2010 and will likely experience further downward pressure in the near term as uncertain global economic conditions continue to push foreign investors toward safe-haven assets.

Despite improving price-competitiveness from the weaker yuan, China’s exports growth has remained in negative territory for most of the last 15 months. Cooling economic conditions in the U.S., China’s leading export market, along with lower demand from Europe and Japan, have caused China’s exports growth to suffer. Although there is hope that China’s exports growth will strengthen as the yuan faces additional downward pressure, uncertain global economic conditions will likely prevent any significant improvement in external demand in the near term.

Meanwhile, the weaker yuan and lower investment growth continue to weigh on China’s imports growth, which has remained in negative territory for over a year and half. Imports have also been hit as a result of reduced commodity imports following lower oil prices. Imports are expected to continue to decline until the yuan, investment activity and commodity prices stabilize.

In short, the Chinese government is trying to find the balance between promoting a consumption-driven economy and avoiding a significant slowdown. Weak investment, along with declining exports, will continue to weigh on economic growth in the near term. The economy is expected to stabilize at a new lower average growth rate after oversupply issues are resolved over the next couple of years.