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*Defense College*

## NATO DEFENSE COLLEGE FOUNDATION

### STRATEGIC TRENDS

January 2016

#### CHINA

##### **The changing reality of China's economy**

The Chinese economy appears to be slowing down and the confusion over China's currency policy and its commitment to reforms have alarmed the financial markets in recent weeks, as China's central bank allowed the Yuan to fall sharply in early January and then switched to aggressive intervention to stabilise it.

Nonetheless, concerns have mounted that the economy's troubles might be beyond Beijing's ability to fix them. Investors used to believe that the Chinese authorities were competent managers who would ultimately guide the economy to a more consumer-driven model but they are not so sure anymore and have provoked a huge capital outflow from China.

This lack of trust is not shared by Christine Lagarde, the International Monetary Fund's managing director, who expressed her confidence in China's capability to maintain its momentum. Speaking at the World Economic Forum in Davos, she said the country's politicians had shown "an unbelievable determination and ability to deliver" reforms. Lagarde admitted that the kind of reforms China will need to move to the next stage of development are a "massive undertaking", but she insisted it will happen.

Yet with a debt bigger than the US or Germany, many think that China's growth has become unsustainable. However, while growth is decreasing, people's incomes are raising and consumer sentiment is at its highest levels since 2008-09. Newly affluent Chinese consumers are growing in numbers and this expanding middle class is also increasingly younger and driving major consumption patterns.

While the consumer-led expansion might appear incongruous with the volatile stock market, the number of upper middle-class and affluent households is forecast to double to 100 million by 2020. That will account for 30% of all urban households, compared to 17% today and 7% in 2010.

There are of course areas of concern like the property market that is struggling with overcapacity. But on the whole the perspectives of China's economy are not as dim as they appear from macrodata. The fact is that the economic scenario is gradually changing with a growing middle class that has started spending more on services like education, entertainment and culture. Starbuck's decision to open 500 stores in China this year is quite emblematic in this respect. The world's largest coffee chain plans to create 10.000 jobs in China every year through to 2019 as it continues to expand in its largest market outside the USA.