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# Insight Perspectives

Economic and political update

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## By Invitation: China's Development of Wind and Solar Power in and beyond the 13th Five Year Plan

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Insight Perspectives

Economic and political update

The Insight Perspectives newsletter is produced by Insightview.eu Ltd (Private Limited Company), Denmark, and is published on a monthly basis.

The editor-in-chief is Carsten B. Pedersen. If you are interested in subscribing to the newsletter, send your contact details to info@insightview.eu

The Insight Perspectives newsletter provides a summary of what happened in the month under review, plus articles about "special issues" in the global economy.

The newsletter attaches importance to identifying and analyzing current and future trends in the global economy, financial market and politics.

All articles will be linked to external sources and Insightview.eu, which includes more charts, maps, data and elaborating comments.

## What readers say about Insightperspectives

**Nina Smith**, Professor, **Aarhus University**, School of Business and Social Sciences Departm. of Econ. and Business. Former chairman of the Danish Economic Councils.

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*"This is actually a very good newsletter if you want to get quickly informed about major economic issues all over the world"*

**Flemming A. Jørgensen**, Vice President, **Danfoss** Group Treasury & Insurance

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*"Insightperspectives is a valuable supplement to the daily stream of information, received from banks and the various other providers of news and market analysis. It puts the issues discussed into context and provides a view on the long term implications, which can easily get lost in the daily flow of information"*

**Ole Damgaard-Nielsen**, Managing Director, **Inter IKEA** Treasury

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*"Insightperspectives provides an easily understandable summary of the financially most important events, news and developments around the world."*

**Jesper Alsing**, CEO, Value **Invest Asset Management S.A**.

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*"Insightperspectives brings an independent viewpoint on important economic, political and financial events. Thoughtful insights - I read regularly"*

**Peter Bundgaard**, CEO, PM and founding partner of **BLS Capital Management**

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*The editor of Insightperspectives is simply the best macroeconomist I have ever experienced. For more than a decade I have been a reader of his thoughtful analysis that comes with an edge. This is the only macroeconomic analysis you will need to be able to follow global trends that can make a difference in your own day-to-day decision-making, whether in business or investments.*

# Global economic and political update

In many countries around the world, the monetary illusion seems to be fading, which has put a lid on the stock market. In most developed countries, policy rates are already close to zero, which is also why monetary policymakers have little fuel left to support their economies the next time monetary stimulus is needed. This will have negative growth implications further down the road with the exception of the countries that used the latest economic crisis as an opportunity to solve their economic imbalances.

On the other hand, this does not seem to be an immediate problem in the developed countries as the short-term growth outlook continues to herald moderate growth. In the United States, the economy is still showing solid short-term growth momentum although there are no signs yet that this will release a wave of corporate spending. Unfortunately, there are signs that the opposite may be the case – read more in the USA section.

Insightview growth forecast

| | USA | China | EMU | Japan | S. Korea | Germany | Brazil | France | UK | Italy | Spain | Portugal | India |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2014 | 2.4% | 7.5% | 0.9% | -0.1% | 3.3% | 1.6% | 0.2% | 0.2% | 3.0% | -0.4% | 1.4% | 0.9% | 7.0% |
| **2015** | **2.4%** | **6.4%** | **1.7%** | **1.7%** | **2.3%** | **1.9%** | **-0.8%** | **1.2%** | **2.2%** | **0.8%** | **2.9%** | **1.6%** | **7.5%** |
| 2016 | 1.9% | 6.1% | 2.0% | 1.8% | 2.1% | 2.0% | 0.2% | 1.2% | 1.7% | 1.0% | 2.3% | 1.5% | 7.7% |
| 2017 | 1.7% | 6.0% | 1.7% | 1.5% | 2.2% | 1.8% | 1.0% | 1.1% | 1.6% | 0.9% | 1.9% | 1.5% | 7.6% |

Interestingly, it seems that something is finally moving in the right direction in the Euro-zone. This is the case even though the ruling Syriza party in Greece, unfortunately, did not have the guts to take the country out of the monetary union. In return, Brussels, or more precisely Germany, which means finance minister Schäuble, finally drew a line in the sand. This time Greece was forced to accept an even worse deal than the one that the Greek people rejected in the latest referendum – read more in the article, The agreement that nobody wants: Grexit remains the most likely outcome, on page 15.

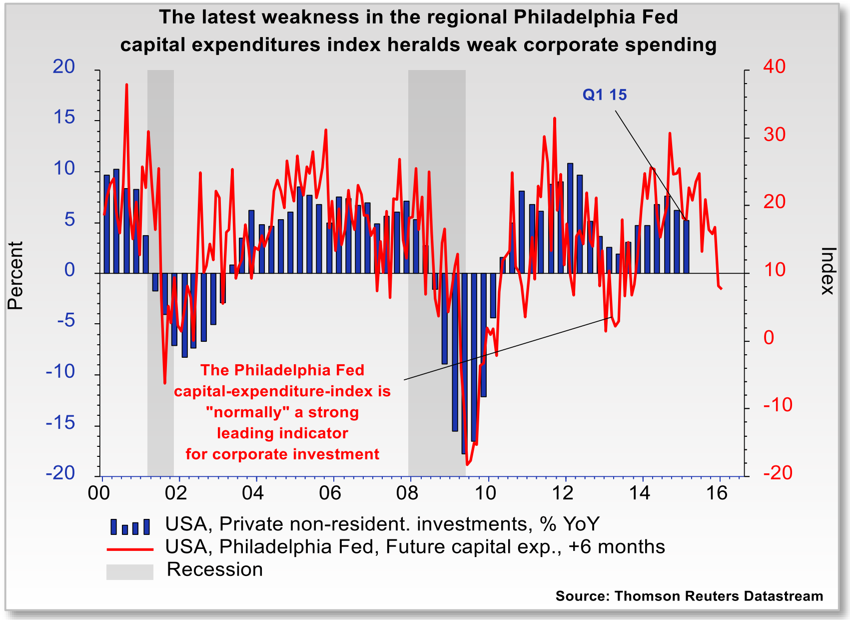
In China, the Communist Party was showing signs of panicking in July, at least according to some Western observers. This was the case after the stock market was down as much as 30%. But the authorities in Beijing acted no differently from how policy-makers behaved in the developed world since late 2008. Beijing's intervention will, however, not derail China's path of economic reforms, but it does show that the mainland's reform process will be bumpy – read more in the article, Stock market sell-off will intensify the reform process; but Beijing is walking a tightrope, on page 19.

In the coming months, the world will get a much better insight into where China is headed, as policymakers in Beijing are intensifying discussions about the 13th Five Year Plan – read more in the article: By Invitation: China's Development of Wind and Solar Power in and beyond the 13th Five Year Plan, on page 24.

## USA – Strong short-term growth but weak corporate spending gives rise to concern

The current flow of economic data out of the United States continues to show a highly ambiguous picture. The majority of economic indicators still show solid growth, at least in the second half of 2015. The leading ISM service index rose in June to 56.0 from 55.7 in the previous month. The same positive trend was seen in the national manufacturing ISM survey. The combined ISM surveys indicate annual growth in 2015 in the range of 2.5% to 3.0% (Insightperspective's 2015 growth forecast is 2.4% - see page 2).


Other surveys published in July, however, are harbingers of more manufacturing weakness. The headline index in the regional Philadelphia Fed survey fell relatively sharply to 5.7 in July from 15.2 in the previous month (the survey is more volatile but highly correlated with the national manufacturing ISM survey). Furthermore, the Philadelphia Fed employment index fell in July to minus 0.4 from +3.8 in June. In July, consumer sentiment also fell but from an elevated level, according to the University of Michigan Consumer Sentiment Index. More worryingly, the small business sentiment index from NFIB plunged to 94.1 in June from 98.3 in the previous month, which was clearly a disappointment.




At this stage, more regional manufacturing weakness gives rise to some concern. Insightperspectives has not foreseen slower US growth until 2016; this will be the consequence of having front-loaded "future growth" due to an ultra-loose monetary policy since 2008, which is expected to hit back with a vengeance. Furthermore, the US economy will see headwind from historically high income disparity (read the September 2014 edition, Is US inequality becoming excessive?) Unfortunately, these are also worries that appear to be reflected in the regional Philadelphia Fed survey; in July, the capital-expenditure-index fell again to 7.7 after a steep decline to 8.1 in June from 16.8 in May (strong correlation with corporate spending in the quarterly GDP report).

The above-mentioned fact leaves the Federal Reserve in an awkward situation, as the central bank has no "monetary ammo" left after failing to raise policy rates as the economy regained momentum. This does not, however, change Insightview's expectations that the Federal Reserve will raise policy rates in the second half of 2015 (normalisation), which has also been indicated by more FOMC-members over the last few weeks.

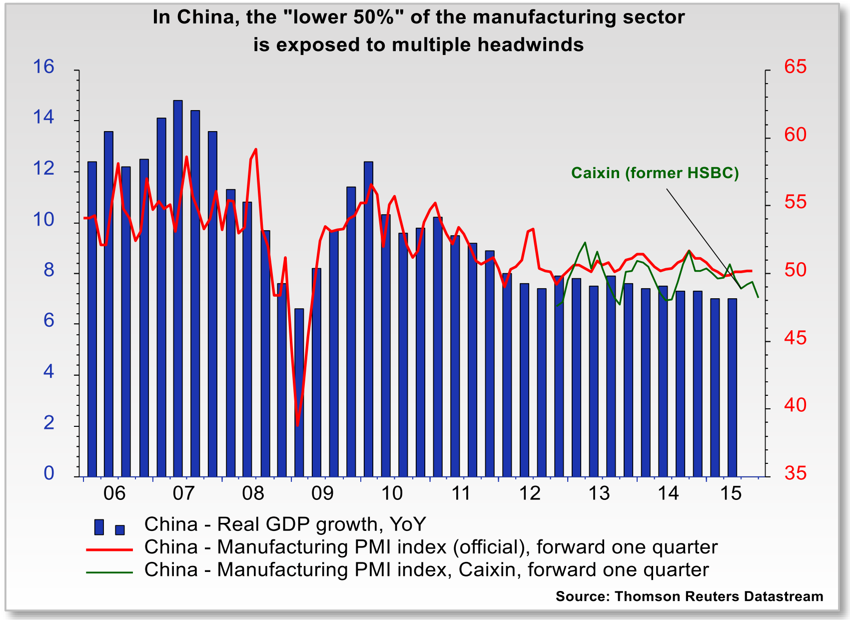
The problem is, of course, that economic uncertainty is increasing outside the United States. In the Euro-zone, policymakers are kicking the can down the road – read the article, The agreement that nobody wants; Grexit remains the most likely outcome as Merkel talks about debt relief, on page 15; and in China, more economists now worry that the mainland stock market collapse may hit the broader economy - read the article, Stock market sell-off will intensify the reform process; but Beijing is walking a tightrope.

## China – Soaring tier-1 home prices but slow-down in manufacturing gains momentum

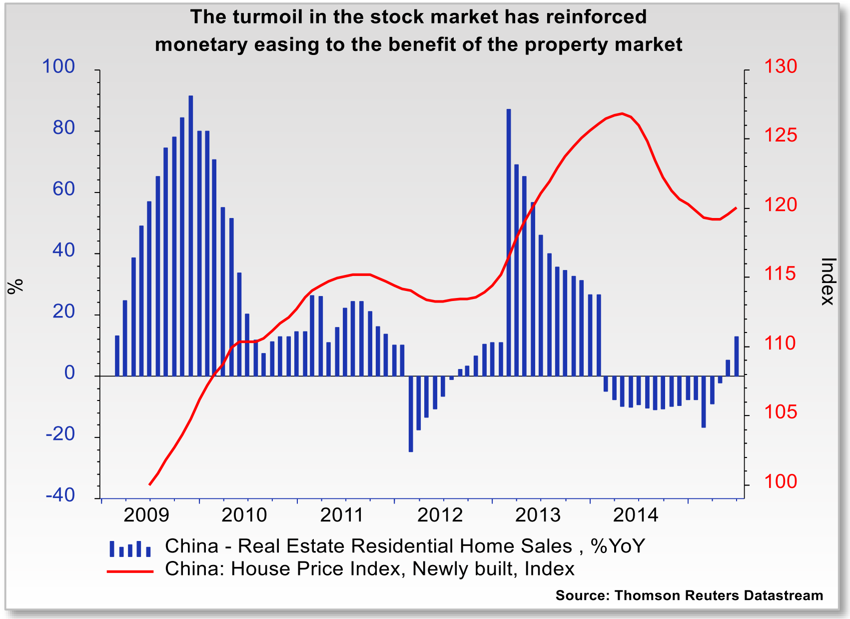
The Chinese economy showed relatively strong "official" growth in the second quarter of 2015 expanding by 1.7% quarter-on-quarter after 1.4% in Q1. The economy rose 7.0% year-on-year, which was exactly what the political leadership "promised" earlier this year. The growth rate was higher compared to market expectations of 6.8% and much stronger than reflected by far weaker alternative growth indicators such as "cargo handled at major seaports" or "cargo handled by China railways".

In fact, the quarterly GDP report was so strong that Beijing had to reassure the financial market last week that this was "real" growth data rather than dictated by policymakers. This probably did not help much after another report showed that the mainland's power consumption in the first half of 2015 rose at the slowest rate in 30 years.

In China, the housing market has benefited strongly from Beijing's efforts to keep the economy afloat (growth above 7%). Last week, this was also visible in a strong house price report from the National Bureau of Statistics, NBS, which covers 70 cities on the mainland. In June, the newly-built-house price index rose 0.4% month-on-month based on Insightview's population-weighted price index (NBS does not calculate a national price index).




Prices fell month-on-month in 33 of 70 cities, which was fewer than the 40 cities in the previous month. On a national level, prices are still down 4.8% year-on-year but after declining 5.6% in May. Prices in tier-1 cities rose 2.5% month-on-month while prices in tier-2 and tier-3 cities barely moved or fell. The steepest increase was yet again seen in Shenzhen (+7.1% month-on-month) while prices also rose strongly in Shanghai (2.0%) and Beijing (1.3%).



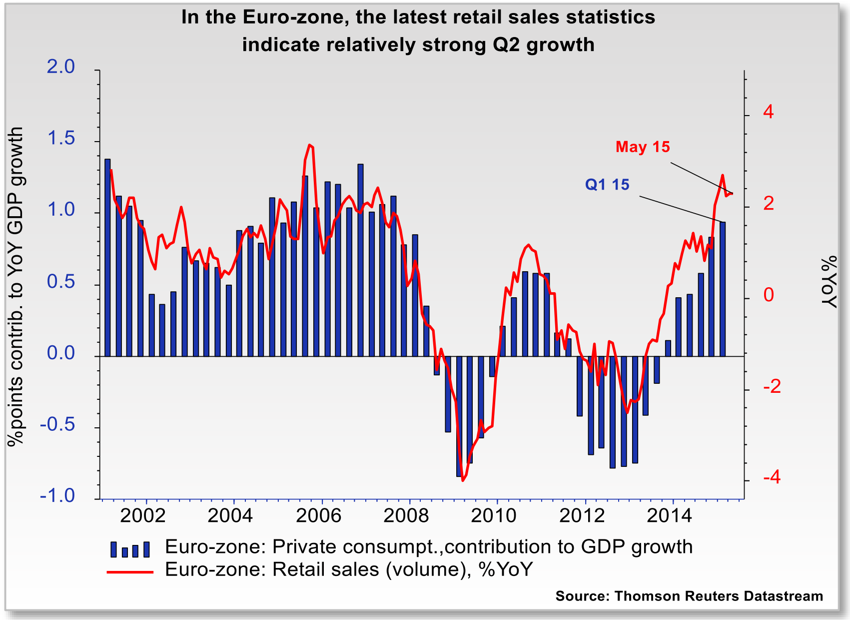

The question is now, admittedly, whether the latest turmoil in the stock market will have any significant impact on the property market. Insightperspectives believes the impact will be minor when it comes to tier-1 cities - read also the Mingtiandi article, Chinese Move Out of Stocks into Real Estate in Q2. On the other hand, the impact for tier-3 and below could be severe as the "Chinese stock market fever" hit these cities relatively late (many households entered the stock market very late).

Anyhow, Beijing will do whatever is needed to keep house prices firm as the real estate market has a far bigger economic impact on growth than the stock market. For more details on the Chinese economy and the implications of the latest turmoil in the stock market, read the article, Stock market sell-off will intensify the reform process; but Beijing is walking a tightrope, on page 19.

## Euro-zone – Favorable environment supports growth

The Euro-zone remains on track towards relatively solid growth in 2015. First of all, monetary policy remains very accommodative and will probably stay so in the foreseeable future as the ECB will do whatever it takes to keep the euro project afloat. This is also needed after yet another crisis in Greece revealed a lack of unity among the core member countries about the future direction of the monetary union - read the article, The agreement that nobody wants; Grexit remains the most likely outcome as Merkel talks about debt relief, on page 15.

In the short run, the Euro-zone economy will also benefit from the fact that this newsletter's fear about another liquidity-driven mini-rally in global commodity prices, The Perfect Storm, so far has proved to be unfounded. Instead, energy prices have continued their downward trend. This is good news, not least for European households who have no bargaining power. If energy prices continue to stay low, this means Euro-zone growth will not only surprise in the second half of 2015; but economic strength may continue going into the first quarter of 2016.




The latest Euro-zone statistics showed that retail sales (volume terms) rose 2.4% year-on-year in May, which is associated with a 1.3 percentage point contribution from private consumption to annual GDP growth.

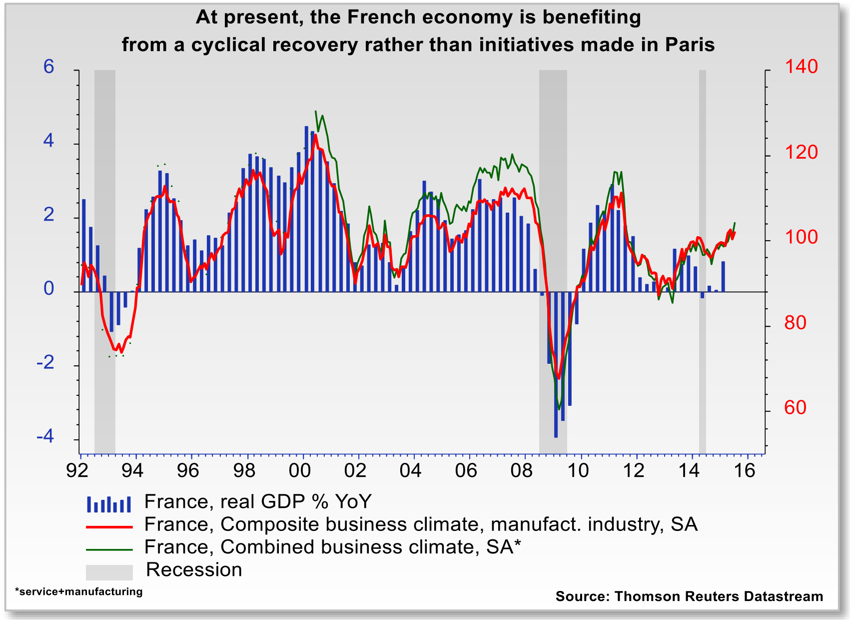
Interestingly, retailer sentiment is improving to a particular extent in the reforming member states. In June, the Portuguese retailer sentiment index (source: EU Commission) jumped to 5.5 from 1.7 in May, which was the highest level since May 2001; and the Spanish index has been at an all-time high for some time now. Furthermore, the leading Irish consumer sentiment jumped in June to the highest level since February 2006. More interestingly, even the French economy sees some tailwind – see more in the next section.

## France – Cyclical tailwind but missing reforms will make recovery short-lived

In France, the headline index in the benchmark manufacturing business survey from the statistical office, INSEE, rose in July to 102 from 100 in the previous month. The biggest improvement was seen in a sharp increase in the export-orders-book index to minus 8 from minus 14 in the previous month, although this will probably not have a big impact on the broader economy (the French export sector accounts for only 20% of GDP).

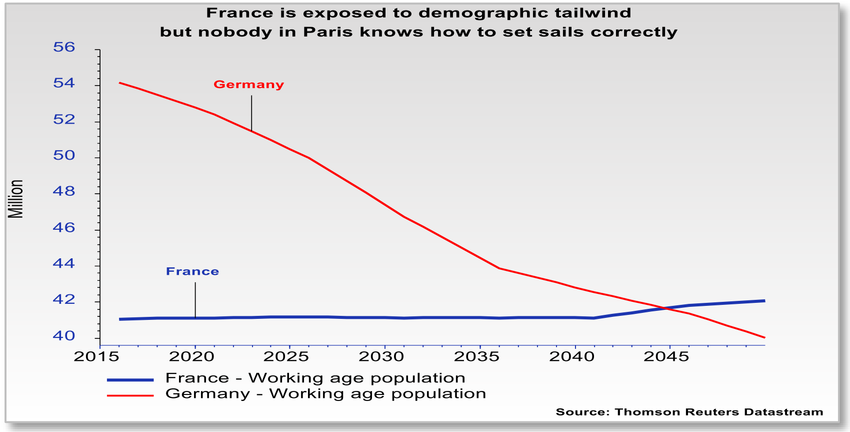
Nonetheless, Insightperspectives raises the 2016 growth outlook for the French economy to 1.2% from 0.9%. This is predominantly based on the fact that

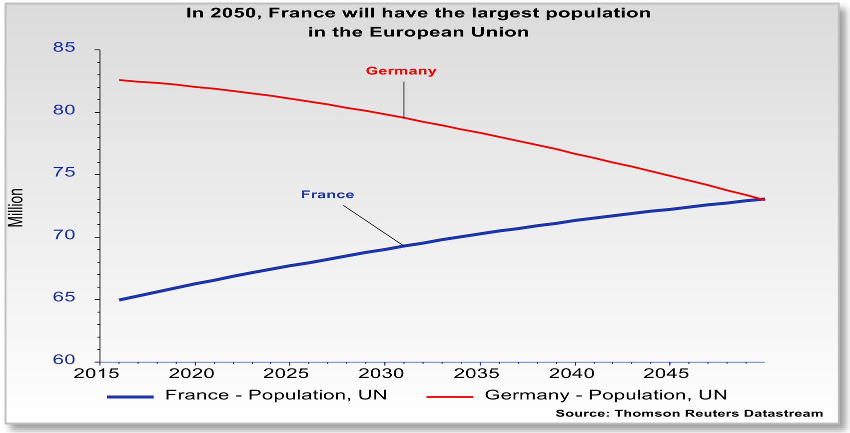
France is benefiting from an unprecedented monetary policy provided by a European Central Bank "going Italian". This was also reflected in INSEE's service sentiment index, which continued to improve in July to the highest level since July 2011.




But neither President Hollande nor any of his predecessors have launched any pronounced measures to reform the French economy. Unfortunately, this will put a lid on future growth and will do very little to improve the situation in the labour market in the long run.

This is a pity as France is exposed to structural tailwind from favorable demographics. In contrast to Germany, the French population is increasing and may become the biggest population in the European Union by 2050.



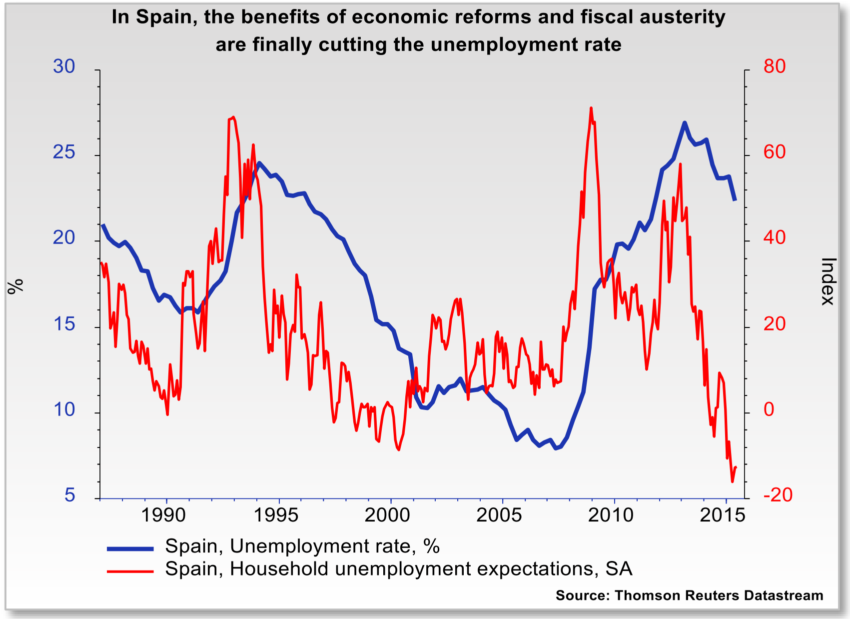




Furthermore, France's working-age population will increase in the coming four decades while Germany's working-age population will decline by 15 million people. But as it is always the case in France, secular tailwind is useless unless one knows how to set the sails correctly! Apparently, this is not yet the case in Paris!

## Spain – Unemployment declines to lowest level since 2011

In June, the total number of seasonally adjusted unemployed people in Spain fell by 94,727 month-on-month, which was down 329,000 compared to the same month in 2014. In the second quarter, the unemployment rate (not seasonally adjusted) fell sharply to 22.4% from 24.5% in Q2, 2014. This was the lowest level since Q3, 2011. There is no doubt that the current level is still far too high; but other indicators point towards more labour market improvement.

This is very positive news for the Euro-zone, not least when taking the Greek crisis into consideration. In Spain, the far-left-party, Podemos, has lost ground in opinion polls since Brussels' dispute with Athens intensified. Last week, this trend was confirmed by an opinion poll showing that support for Podemos has declined to 15% following support as high as 30% a few months ago. The crisis in Greece has made many Spaniards think twice before they are willing to make leeway for Podemos to take power after the upcoming national election. This is the case after Podemos' sister-party, Syriza, nearly triggered a collapse in the Greek economy since it took office in January.




Granted, the political establishment in Spain does not really deserve a second chance after all political parties appear to have been involved in the ongoing national corruption scandal. On the other hand, the alternative, a Podemos government, will be a catastrophe now that Spain is finally on the right path, having followed the recipe of fiscal austerity and economic reforms since the global crisis erupted.

## South Korea – On the edge of launching unconventional stimulus measures?

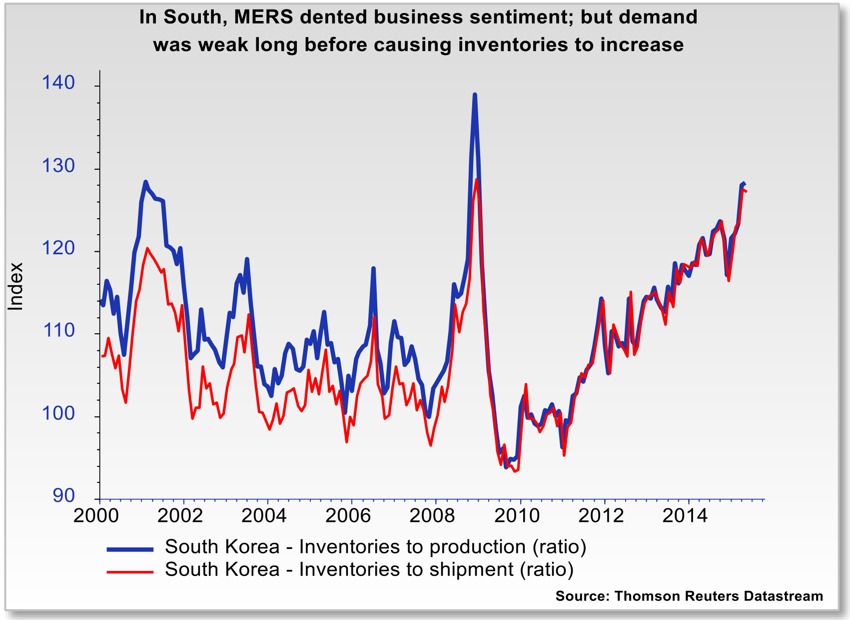
The South Korean economy is under heavy pressure. This was reflected in last week's GDP report. In the second quarter of 2015, the South Korean economy rose only 0.3% quarter-on-quarter, which was up 2.2% compared to the same quarter in 2014. This was very much in line with this newsletter's growth forecast outlined in the 2015 Outlook (see the January edition), but it was much lower compared to market consensus at the beginning of the year.

The South Korean economy has, of course, been under pressure from MERS. However, this is not the main factor behind economic weakness. The South Korean economy is suffering from a beggar-thy-neighbour-policy around the world, not least in neighbouring Japan. The real exchange rate of the won, has appreciated strongly in the last five years. In addition, South Korea's biggest trading partner, China, is slowing.

The outlook for South Korea and other Asian economies does not look encouraging, at least not for the second half of 2015. The Chinese economy is probably weaker than reflected in the latest second quarter GDP report. Last week, this was also visible in South Korean trade data. In the first 20 days of July, South Korean exports plunged by 8.6% year-on-year , while imports fell by 16.5%.

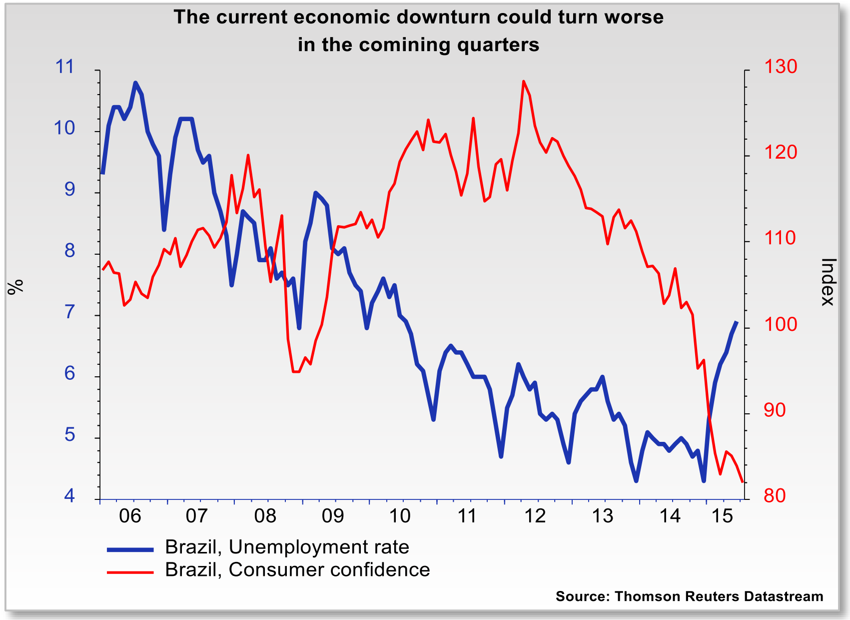

Indeed, the best leading indicators show that the South Korean economy will slow even more in the coming months. Lately, the inventories-to-shipment ratio in the manufacturing sector rose to the highest level since January 2009. This occurs at the same time as manufacturing business sentiment fell in June to the lowest level since April 2009.

This is also why the Bank of Korea remains on a path of more monetary easing and the government in Seoul will launch more fiscal stimulus packages. In fact, South Korea and other Asian countries may, further down the road, be "forced" to launch unconventional stimulus measures similar to what the ECB and Japan have done in the last few years. This will be the case not least if the US economy proves far more fragile than currently assessed – read more in the USA section.




## Brazil – The next crisis in the financial market?

In February, Insighperspectives described the Brazilian economy as being in free fall. This has been confirmed in the last few months. Unfortunately, the situation is not improving, which was reflected in a survey published last week. In July, Brazilian consumer confidence fell to an all-time low of 82.0 from 83.9 in June. This comes after another report showed a sharp increase in the unemployment rate to 6.9% in June compared to 6.0% in June 2014. This was the highest level since June 2010.




In Brazil, president Dilma Rousseff has messed everything up as she failed to reform the economy and consolidate fiscal finances during the good times. Perversely, Mrs. Rousseff finally launched long overdue fiscal tightening measures after the latest national election. The problem now is that this is reinforcing the economic downturn at the same time as global commodity prices have turned lower, which has forced finance minister Joaquim Levy to cut back on his fiscal savings measures.


Unfortunately, this has also triggered more sell-off of the Brazilian currency, the real, thereby making it difficult for the central bank to ease monetary policy. The currency is no longer overvalued, but annual inflation is still running at 8.9%, which is the highest level since December 2003. This is the case even though, since March 2013, the central bank has raised policy rates from 7.5% to 13.75%.

Brazil is in an extremely difficult situation and features all the ingredients to become the next global financial crisis. The economy is in recession; earlier this week, a poll showed president Rousseff's approval rating at the lowest level ever recorded (Mrs. Rousseff faces impeachment due to corruption). The problem for Brazil is that even though China is expected to ease monetary policy more aggressively in the coming months, which should support the commodity market, there still seems to be an overhang in the commodity market, at least according to the latest price movements.

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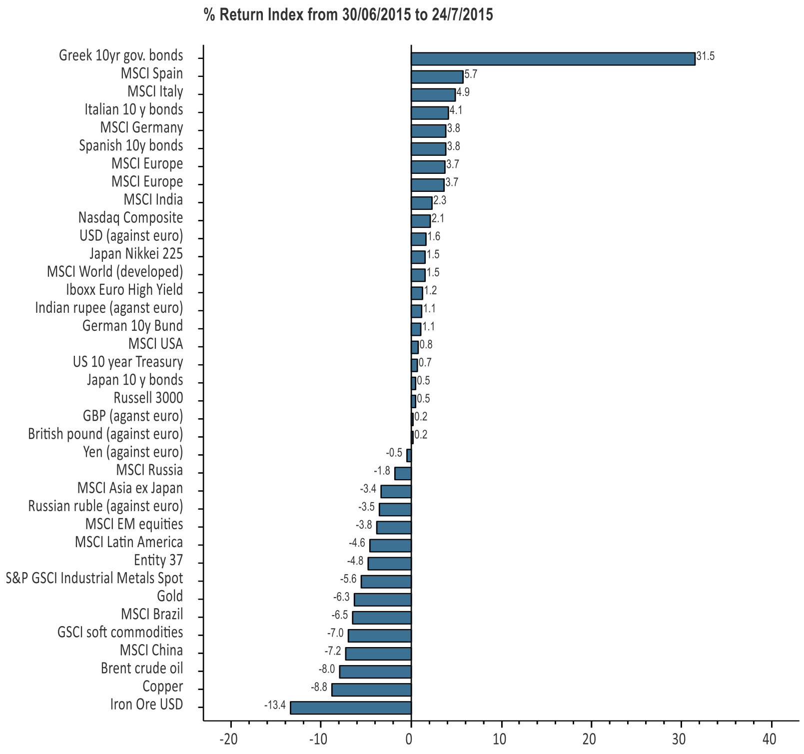
# Financial Market Update

In July, volatility in the Chinese stock market continued although a somewhat "panicking" Beijing came to its rescue – read more in the article, Stock market sell-off will intensify the reform process; but Beijing is walking a tightrope, on page 19. This was, however, not enough to prevent the MSCI China index from declining by 6.1%, while the local Shanghai stock market index fell by 3.6%.

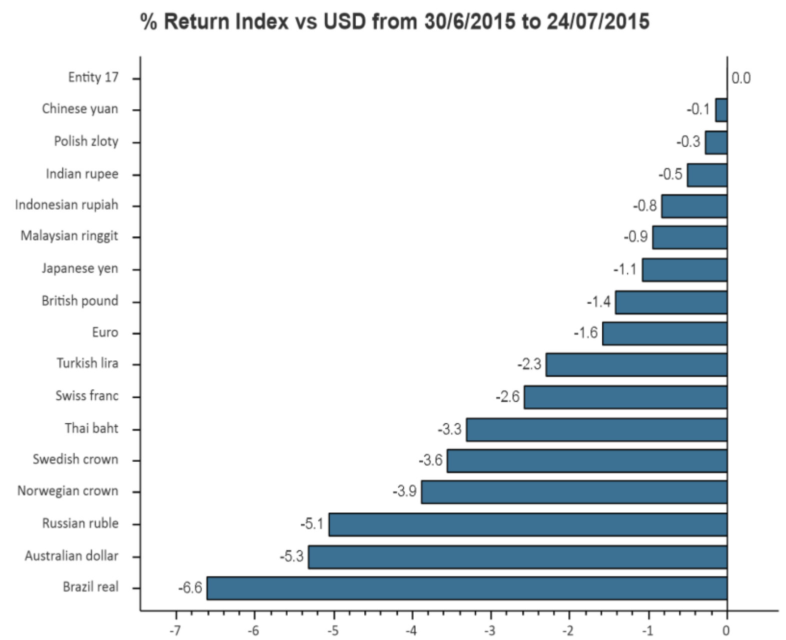
On the other hand, yet another compromise between Greece and Brussels propelled European stock market prices - read more in the article, The agreement that nobody wants: Grexit remains the most likely outcome, on page 15. The MSCI Spain index jumped by 5.7% while the MSCI Italy index rose 4.9%. The Greek bond market also benefited strongly although it is probably only a question of when the next Greek crisis will erupt; it is clear that Greece will soon again need another rescue package.

In July, the biggest loser was the commodity market. The S&P/GSCI industrial metal price index plunged by 5.6%. Iron ore prices fell by nearly 13%. Indeed, there seems to some kind of supply overhang", which has added significant downward pressure on commodity prices. The fact that China and other countries are on a path of more aggressive monetary easing and fiscal expansion has not been enough to stabilise prices.




Source: Thomson Reuters Datastream

The oil price fell sharply (minus 8%) as well after the Iranian nuclear agreement now seems to be a done deal, although the United States Congress has not yet approved the bill. This could add as much as 500,000 barrels per day to the oil market.




Source: Thomson Reuters Datastream

In the foreign exchange market, the Australian dollar was among the biggest losers as uncertainty about future growth on the Chinese mainland increased in July. The Aussie fell by 5% against the US dollar. The Brazilian real was also under pressure from domestic weakness as well as falling commodity prices. The real fell by 6.6%. The Norwegian crown fell by 3.9% against the US dollar.

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**EU**

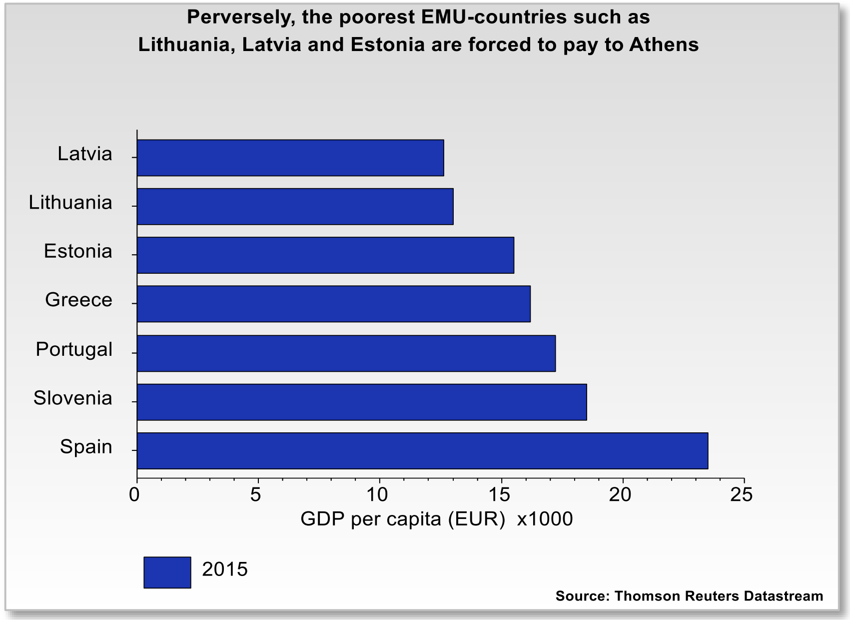
# The agreement that nobody wants: Grexit remains the most likely outcome

This article was pre-published on July 20, 2015

In the last few weeks, policymakers in the Euro-zone have done nothing to disguise the fact that they have absolutely no clue about how to escape an economic mess created by a fundamentally fragile monetary union. Initially, the EMU was seen as a political project. At present, however, the project seems to create more division in Europe after Brussels was yet again "forced" to provide a rescue package to Greece. The agreement, which apparently nobody wants, looks more like a straitjacket not only to Greece, but to the other EMU countries as well.


Self-contradiction has prevailed among European policymakers, which has provided plenty of ammunition to Euro-skeptics. The new Syriza government in Athens accepted a deal with Brussels, which was even worse than the compromise turned down by the Greek people in a referendum called by the government in Athens (after Prime Minister Alexis Tsipras advised the Greek people to vote no).

Self-contradiction was also visible in Berlin where the German finance minister voted yes to the rescue package even though Mr. Wolfgang Schäuble made clear that the best option for Greece would be Grexit. Interestingly, this was also an assessment supported by the former SPD finance minister, Per Steinbrück.



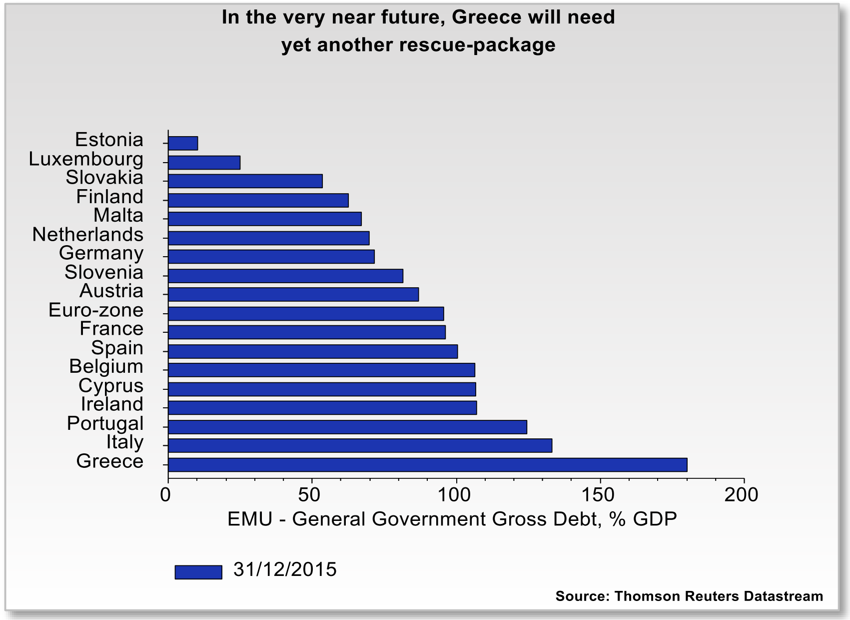

The ultimate self-contradiction was when IMF said that it supported the deal with Greece. At the same time, IMF-chief Largarde, a former French finance minister, also insisted that a Greek hair cut would have been a far better outcome. Interestingly, this was an assessment also shared by Mr. Schäuble and even Chancellor Merkel, although they stress that this will have to be outside the EMU (debt hair cut is illegal in the EMU and the same is also the case for the International Monetary Fund).

On Friday, the German Bundestag decided, not surprisingly, to pass the third Greek rescue package. This was due not least to strong support from Chancellor Merkel's coalition partner, SPD, although five Social Democrats voted no (including Per Steinbrück). More worryingly from Chancellor Merkel's point of view, this time a record 60 parliament members from the ruling CDU/CSU (one in five) voted no while five members abstained from voting. This is a bad omen as Greece may soon need yet another rescue package - read the Die Welt article, Steinbruck rechnet fest mit viertem Hilfspaket.

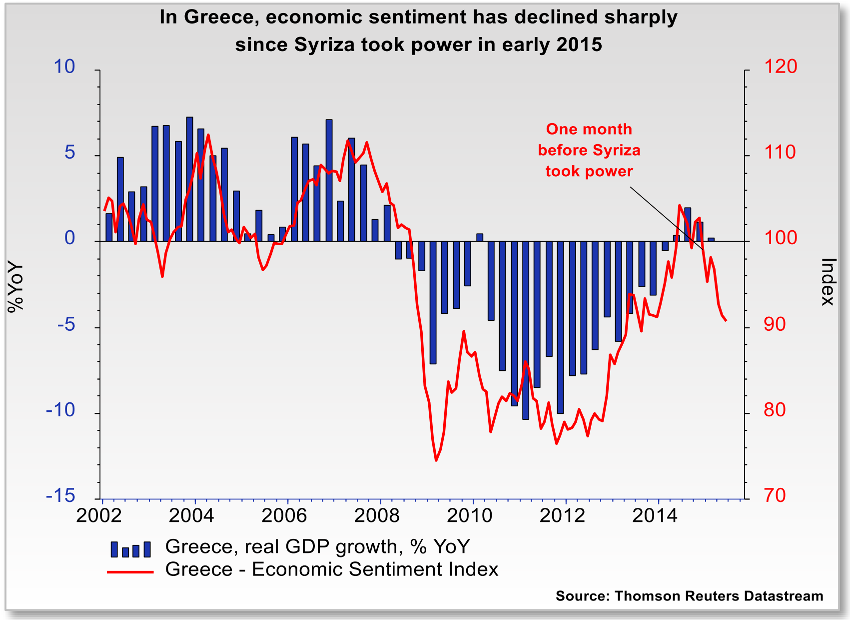
**The case against the EMU without a political union**

Today, the Euro-zone is exactly in a situation predicted by both the Bundesbank and the US economist Martin Feldstein in the early 1990s (read the article, The case against EMU). The "obvious" missing link remains the political union. In the last few years, what is "obvious" has, however, not prevented Brussels from allowing more countries to enter the monetary union based on only a "photo finish" (rather than long-term fundamentals).

This is also why Greece will not be the last crisis in the Euro-zone. Every upcoming national election is a potential crisis for the entire monetary union. Perversely, this also means that the strongest country in the EMU will be no stronger than the weakest links, which is a decisive difference compared to the monetary union in the United States. The failure of for instance California will not trigger expectations of a "Calexit".




Today, the problem is that the failure of the EMU is becoming too obvious to ordinary Europeans. Last week, this was highly visible in a German television debate, where a leading members of the CDU, Mr. Peter Altmaier, admitted that he could no longer be sure that Greece would not need more capital in the future. This is surely not reassuring for German voters who are now exposed to the risk of yet another solidarity tax ("soli") - read the Frankfurter Allgemeine article, Soli wegen Griechenland auf 8 Prozent erhöhen.




Unfortunately, the failure of today's European policymakers to take a loss before it becomes too big risks making leeway for European disintegration rather than integration. This bodes ill for long-term political stability and makes Europe vulnerable in a period when the European Union is more important than ever before - read the China Daily article, Greece is up for sale and Chinese firms are in pole position.


Granted, it seems more European policymakers slowly realise that the answer is deeper integration, not less integration. Last week, France's President Hollande proposed a Euro-zone parliament to deepen political integration. But this approach ignores an important factor namely that deeper integration has to come from the people rather than the political establishment. In France, deeper integration appears, unfortunately, to be not what the voters want, at least not as long as Marine Le Pen still sees solid support in opinion polls.

**Euro-zone turmoil and the financial market - more euro weakness**

Insightperspectives believes that last week's Greek compromise was the worst possible outcome. It may have saved Greece in the short run, but at the expense of European unity. Indeed, this is more kicking the can down the road. It is true that Brussels has finally drawn a line in the sand; but this was far too late. The outcome will therefore add further downward pressure on the euro.

In the second half of 2015, a weaker euro may not necessarily be bad for the European stock market. This may, however, change if the Euro-skeptics gain more momentum in upcoming national elections. Indeed, Europe is facing significant political turmoil and less integration, although more integration is the solution to the EMU's current problems!

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China

# Stock market sell-off will intensify the reform process; but Beijing is walking a tightrope

China's reform process will not be a walk in the park, which was also underscored in this newsletter after President Xi Jinping launched his economic plan at the Third Plenary Session of the 18th Central Committee of the Communist Party in November 2013. This is neither the case if Beijing were to launch "big bang" reforms nor if policymakers continue on the current path of small reform steps. The latter was clearly visible during the latest turmoil in the mainland stock market as policymakers in Beijing lost their nerves to some extent.

On the other hand, the sharp decline in Chinese equity prices will not derail the reform process, as policymakers are well aware that volatility in the stock market was caused by too few rather than too many reforms. Indeed, China has reached a point of no return. Beijing has started an irreversible reform process which will leave more decision-making to market forces. Indeed, the current political leadership recognises that free market forces (supply and demand) will more efficiently allocate capital, goods and services.

Conversely, Beijing will still ensure that it remains "in control" of the economy. Policymakers know all too well that more reforms may put a question mark on the very existence of the Communist Party further down the road – read the article in the previous edition of Insightperspectives, China leaves nothing to chance as Beijing pursues multidimensional strategy with significant global ramifications.


The latest dramatic sell-off in the stock market was surely not part of Beijing's plan and is a political humiliation of President Xi Jinping. The stock market rally was after all "approved" and promoted by the Chinese government. Indeed, many government-sponsored newspapers encouraged ordinary households to enter the market just before equity prices collapsed. Beijing has, however, wasted no time wiping the slate clean by finding a convenient scapegoat, which, not surprisingly, appears to be "foreign speculators".

## Low transparency due to shortage of accountants

In Beijing, the policy direction remains clear; but it is also obvious that the road ahead will be bumpy and an uphill struggle, not least due to one of China's more long-term problems – a low degree of transparency in the stock market. This is caused by the fact that the mainland is exposed to a significant shortage of accountants, which has been a well-known fact for a very long time - read the Shanghai Daily article, Shortage of accountants in China.

In fact, the problem does not only apply to corporate accounting. The quality of public sector accounting needs a significant boost as well. This is not necessarily an issue about cheating, which may have been the case five to ten years ago. Chinese investors want as much as foreign investors to see the truth and nothingbut the truth. The same is the case when it comes to the political leadership. But only few people are able to provide high quality information.

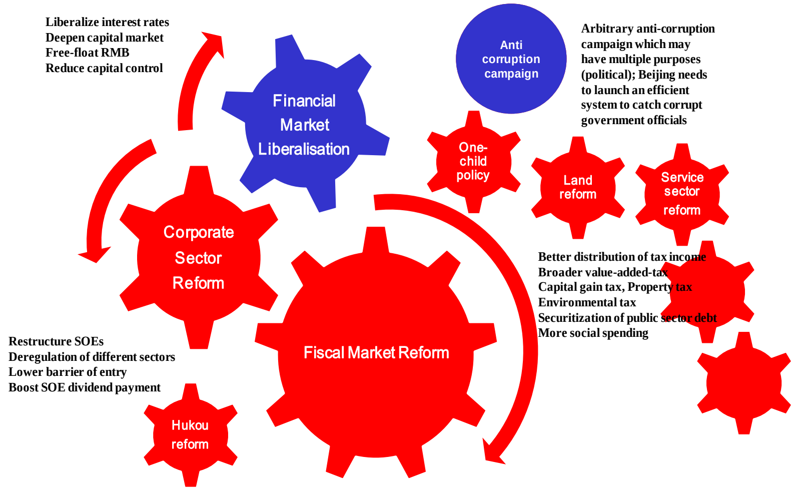
On the other hand, more transparency will provide support to the stock market. First of all, this will reduce uncertainty thereby minimising market volatility. Higher visibility will also boost P/E multiples. Futhermore, a higher degree of transparency should make leeway for mainland A-shares to be included in the MSCI benchmark indices. The same applies to the possibility that the yuan will be included in the International Monetary Fund's SDR basket. Such an outcome would create a wave of foreign institutional investors into the mainland stock market.

Nonetheless, the problem will not be solved in the near future although Beijing has now cleared the way for Hong Kong accountants to audit Chine firms. This is also why investors and the Chinese government need to get used to high stock market volatility and the fact that the Chinese stock market needs to trade cheaper compared to other more transparent stock markets.

## The risk of recession is becoming part of the future outcome range

In China, the size of the stock market is still too small to have a major impact on the broader mainland economy. The property market is still far more important to Chinese households. Interestingly, the stock market turmoil has so far been to the benefit of home prices. It has reinforced the monetary easing process although the jury is still out when it comes to the final impact – read more in the China section on page 5 or the Mingtiandi article, Chinese Move Out of Stocks into Real Estate in Q2.

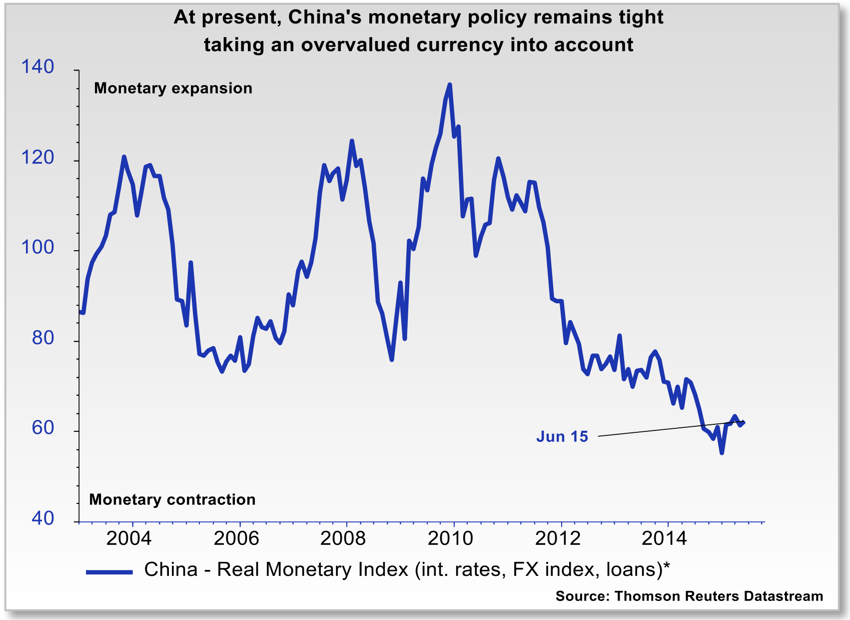
**China's overwhelming reform plan**




This is also why there are no signs yet that the latest stock market collapse will cause growth to collapse, at least not in 2015. Beijing has launched quite significant monetary and fiscal stimulus measures in the last few quarters, which are slowly feeding into the economy. This was also why, in April, Insightviewrevised its growth forecast for 2016 to 6% from 5%, although Insightperspectives' forecast is still lower than market consensus (read the article, China "travel notes" -

Beijing intensifies easing measures; growth forecast for 2016 is raised).

On the other hand, as Beijing moves further down the reform path, China cannot escape being exposed to what this newsletter sees as part of being a market economy, i.e. the risk of “recession”. This is the case as the economic reform process will not only expose excesses in the Chinese economy (disequilibrium), but also trigger a macroeconomic adjustment process.




This will make the reform process a delicate balancing act, as the risk of recession could also endanger social stability. The latter is not in the interest of Beijing, which means that sometimes Beijing will be “forced” to slow the reform process or even move one step backwards, although this will later be followed by two steps forward.

The leadership in Beijing may soon be tested more seriously, even though the official economic data shows that the economy is still growing by 7% - see more in the China section on page 5. This is, however, in sharp contrast to the fact that the mainland’s power consumption in the first half of 2015 rose at the slowest rate in 30 years. Indeed, there is no doubt that the Chinese economy is under more pressure than is currently reflected in official growth data. The economy is exposed to more headwind, not least from a beggar-thy-neighbor policy in Japan and the Euro-zone in particular. In 2015, the real value of the yuan hit an all-time high (read more in the Insightview article, Germany and Japan are "currency-manipulators" – not China!) No other countries in a similar situation have survived similar excess capacity in the economy without devaluation.

So far, Beijing has resorted to aggressive fiscal and monetary easing. But China’s policymakers may soon have to resort to a strategy of a weaker yuan to support the “lower 50%” of the manufacturing sector that is suffering significantly from weaker domestic investment and an overvalued currency! In fact, such a policy move would make sense in an environment of economic reforms, although yuan depreciation, admittedly, somewhat contradicts Beijing's efforts to join the International Monetary Fund's SDR basket!

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China

# China's Development of Wind and Solar Power in and beyond the 13th Five Year Plan

**By Invitation**

China has commenced its long but steady transition towards a less coal based power system, where the recent years' massive investments in renewables with a very high degree of certainty will continue and even accelerate. However, the real uncertainties for renewables in China lie in the leadership's ability to move ahead with difficult reforms in and outside the power sector. In this context, **Christian van Maarschalkerweerd** and **Kaare Sandholt** are invited to make their assessment of China's Development of Wind and Solar Power in and beyond the 13th Five Year Plan.

**Christian van Maarschalkerweerd** has worked since 2013 as Energy Counsellor at the Danish Embassy in Beijing, where he has been working on several projects involving the Danish Ministry for Energy, Utilities and Climate and China's central government in the fields of capacity building and experience sharing within renewable energy, energy systems and energy efficiency.

**Kaare Sandholt** has worked since 2009 with renewable energy development in China. From 2011 to 2014 he was the international advisor for the Sino-Danish Renewable Energy Development Program, and from 2012 he is the Chief Expert at China National Renewable Energy Centre, CNREC, which is part of the Energy Research Institute under NDRC. Among other things, he is coordinating a new five-year cooperation program for boosting renewables involving CNREC, the Danish Energy Agency and the US National Renewable Energy Laboratory.

On the 30th of June 2015 China publicly announced its intended contribution to the international climate agreement, which is expected to be reached at the COP21 meeting in Paris late this year. While this recent announcement (see the text box on the right) does not represent any fundamental changes in Chinese level of ambition, it is nevertheless still an important signal for renewable energy development in China. The announcement thus confirms China's long term commitment to increase energy efficiency and continue the rapid installation of nuclear and renewable energy capacity, especially solar and wind power.

China was in 2014 by far the worlds' biggest investor in renewable energy with a comfortable lead to both Europe and US, and it seems that this clear lead is only going to expand in the future. In 2010-2014 grid connected wind power capacity grew from less than 30 GW to almost 100 GW, corresponding to an average annual added capacity of more than 17 GW. In the same period solar PV grew from less than 1 GW to 28 GW.

The upcoming 13th Five year plan period from 2016-2020 will most likely see even further accelerated development of both wind and solar power. Existing targets of 200 GW wind capacity and 100 GW solar PV capacity are in itself an indication of this, but according to Chinese experts involved in the preparation of the 13th Five Year Plan, 250 GW wind and 150 GW solar are more likely 2020 targets.

**Intended Nationally Determined Contributions**

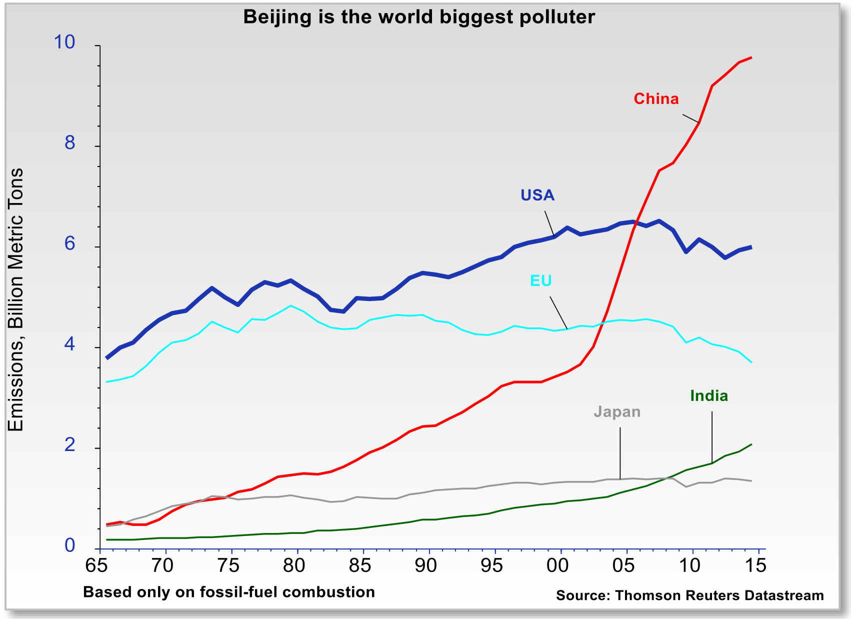
The so-called Intended Nationally Determined Contributions announces the following energy related targets:

- Chinese carbon emissions will peak around 2030 and China will make best efforts to peak early
- Non-fossil energy will amount to 20 % of primary energy consumption in 2030
- China carbon intensity (carbon emissions/GDP) will be 60-65 % lower in 2030 than in 2005

The two first targets are repetitions from the joint US-China Announcement on Climate Change made during Obama's visit to China in November 2014 and the third target also does not represent a significant new course for China as it lies in a continuum with historic developments and previously announced targets for 2020.

If this proves to be true China will in only five years install two times the *total* US wind capacity and more than five times the *total* US solar PV capacity. And it does not end here: According to a recent report published by China National Center for Climate Change Strategy and International Cooperation, de-carbonization of the Chinese power sector will further pick-up after 2030 with annual capacity growth of 31-35 GW wind and 33-40,8 GW solar PV in the period 2030-2050. Another report from China National Renewable Energy Centre has even more ambitious development goal and estimates that it will be possible to cover around 85% of the power consumption in China with renewable energy in 2050.

This unprecedented growth outlook will no doubt play a major role for the development of the Chinese solar and wind industry and it will bring down costs and further increase the competitiveness of these renewable technologies. There are however also barriers and challenges ahead for the Chinese development of renewables. The first and foremost challenge is that the integration of these renewables so far has not been very smooth. According to Bloomberg New Energy Finance, as much as 8 % of Chinese wind power production was lost last year because it couldn't be accommodated by the grid and in some provinces this figure was as high as 15 %. The main reasons for this being a regulation that does not incentivise the coal fired power plants to lower their production in situations with surplus supply and a transmission grid that is not planned and built to optimise renewable energy utilization.




While other countries have managed to solve the integration of renewables successfully, *e.g.* by market liberalisation and the use of price signals to incentivise flexible production from power plants, China has so far not made fundamental progress on this regulatory challenge. In fact all recent attempts to move ahead with Chinese power sector reform have stalled and little progress has been made since 2002 where generation and transmission was divided in the split up of the State Power Corporation into eleven different state enterprises.

This might however change after the Chinese State Council in March this year issued the so-called State Council Document #9 on Chinese power sector reform. The document mentions a broad range of measures, like grid company revenue reform and improved electricity dispatch. In this document increased use of market mechanisms and increased use of renewables are both mentioned among the guiding principles of the reform.

While the Document 9# neither offers details on measures nor a road map for the implementation, it has clearly induced momentum and started a process where the Chinese administration is now also collecting international experience and analyzing its applicability in a Chinese context. So while no quick-fix should be expected, it seems that the reform process has been restarted and that there is reason for optimism with regard to better integration of renewables in the future.

Besides integration problems, quality problems and poor maintenance also constitute a challenge, especially for Chinese wind turbines. The speed with which capacity has been installed has not been paired with a similar development of quality equipment and build-up of maintenance/service systems among the owners. One reason is that it takes time to build up such competences and organizations. But another and maybe more prominent reason might be that the vast majority of generation capacity, including renewables, is owned by State Owned Enterprises which are not necessarily so focused on maximizing their return on investment but more so on other factors such as increasing their market size and creating local jobs. The result is that the performance of Chinese wind farms is comparably low and therefore the National Energy Administration of China is now also signaling that focus must shift from just installing capacity to also ensuring high output. This also means that foreign turbine manufacturers and sub-suppliers might see better opportunities in a market that has otherwise been dominated almost entirely by Chinese companies.

In the beginning of 2015 the Chinese State Council presented its work report in which it was emphasized that the reform is given the highest priority. Since then the powerful ministry, National Development and Reform Commission (NDRC) has announced that reform of the State Owned Enterprises will be a focus area in

2015. So while the long term targets are already firmly set, the Chinese reforms of the power sector and the State Owned Enterprises will be decisive for the real integration of renewables in China and thereby the success or failure for long-term ambitious sustainable energy and climate goals in the future.

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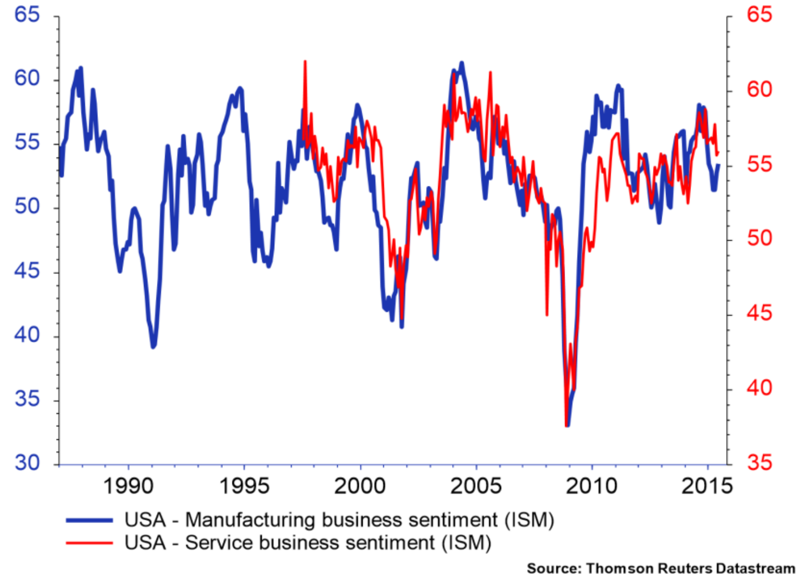
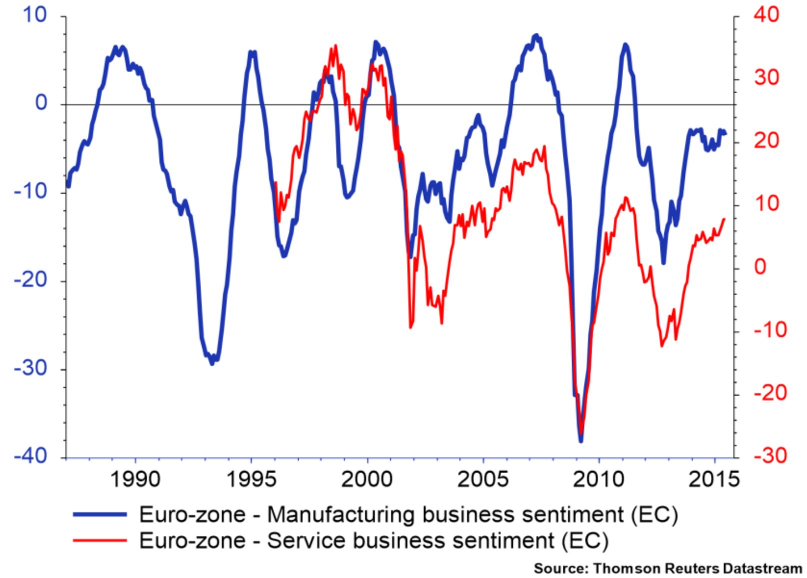
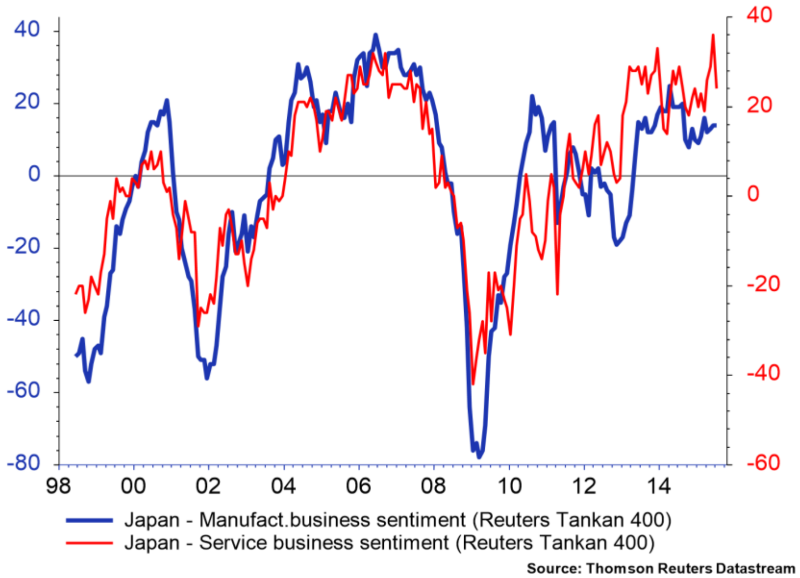
# Charts

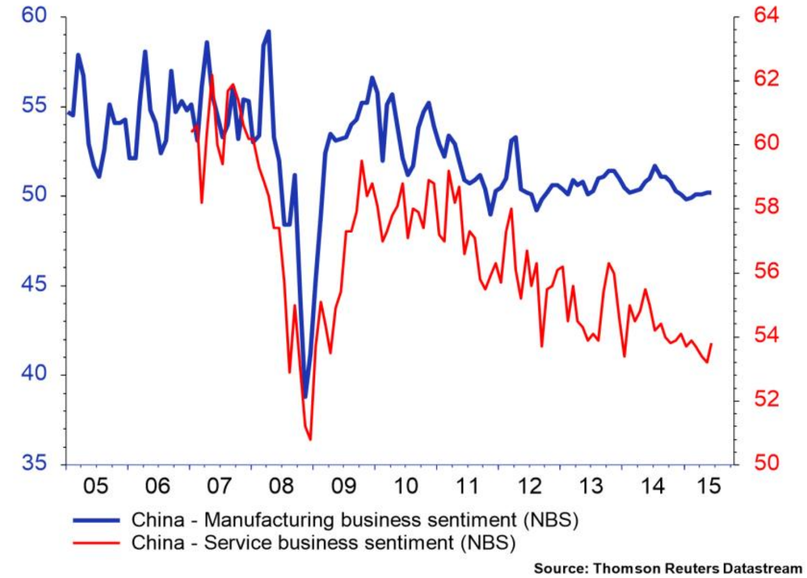
*All charts are updated on July 24, 2015*

**Business Sentiment**

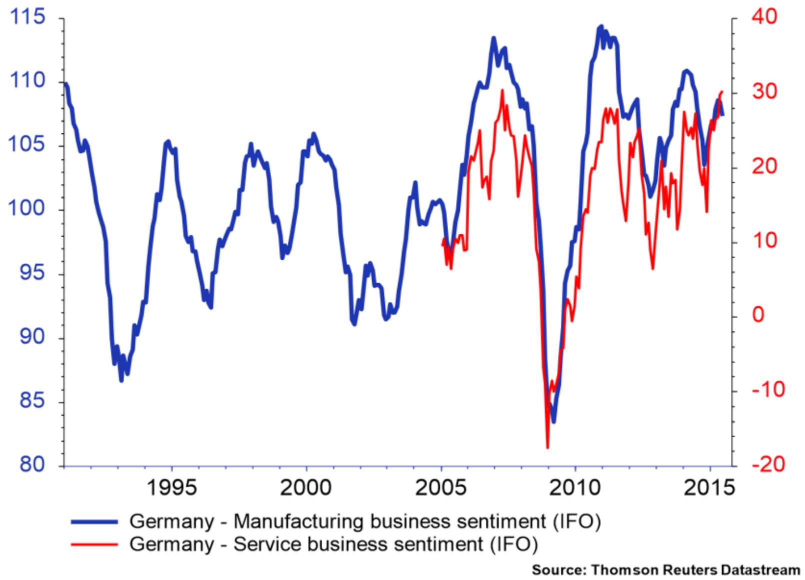


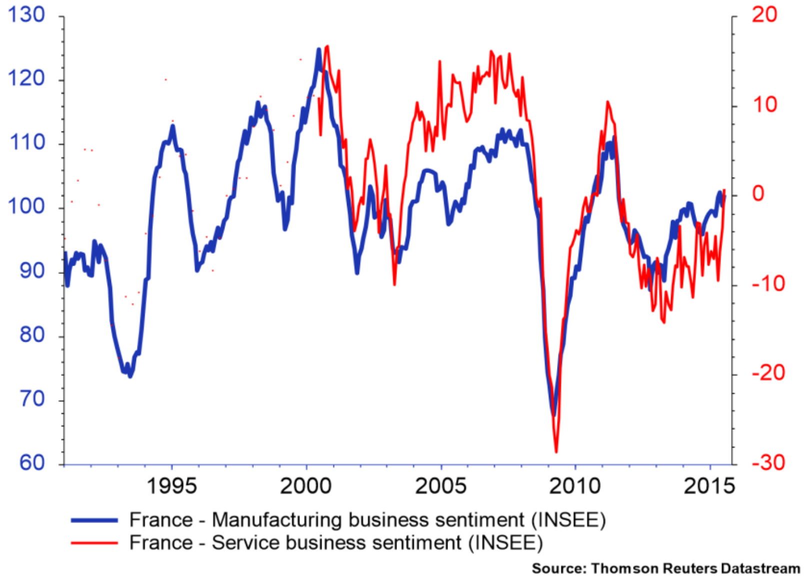



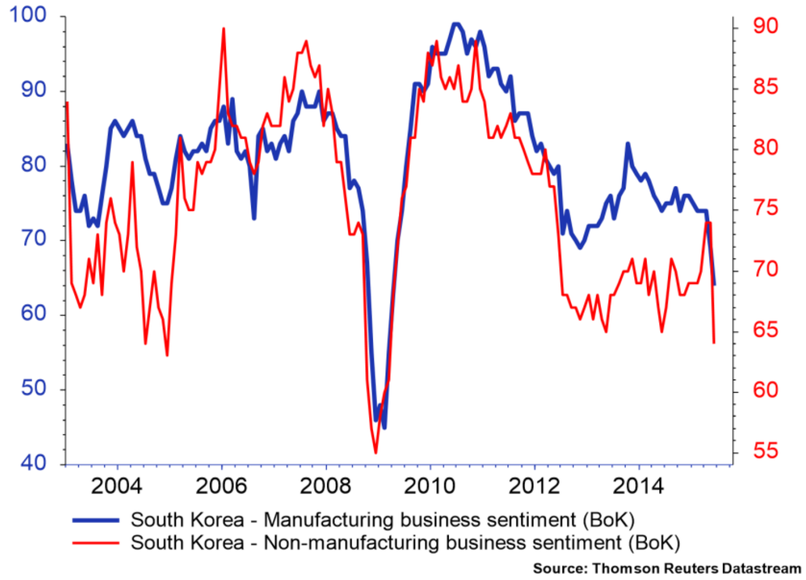



## Business Sentiment (continued)

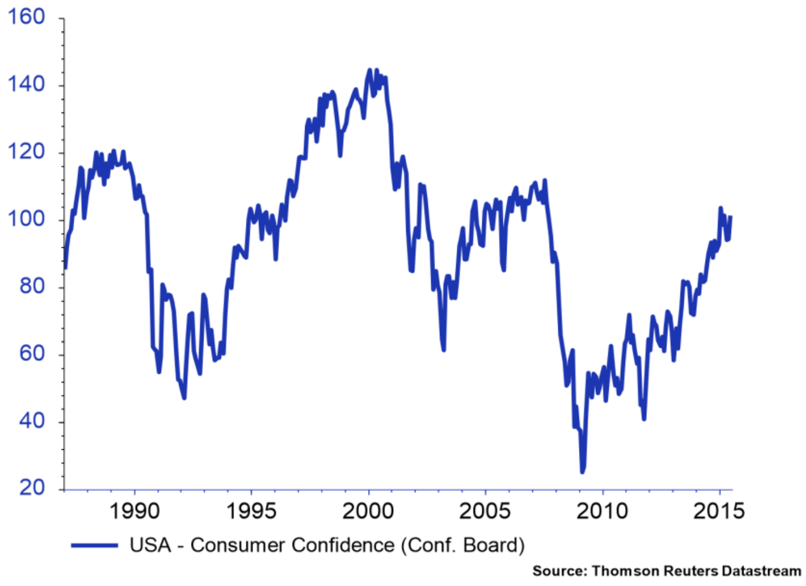


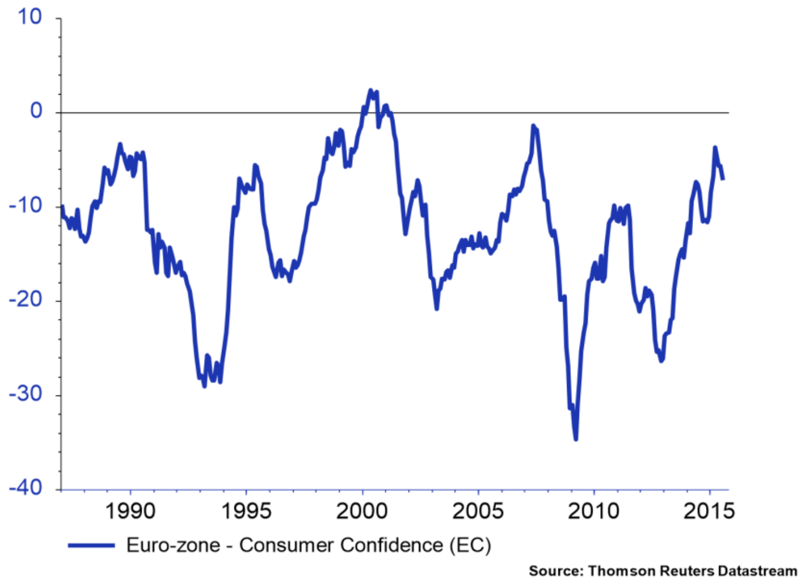


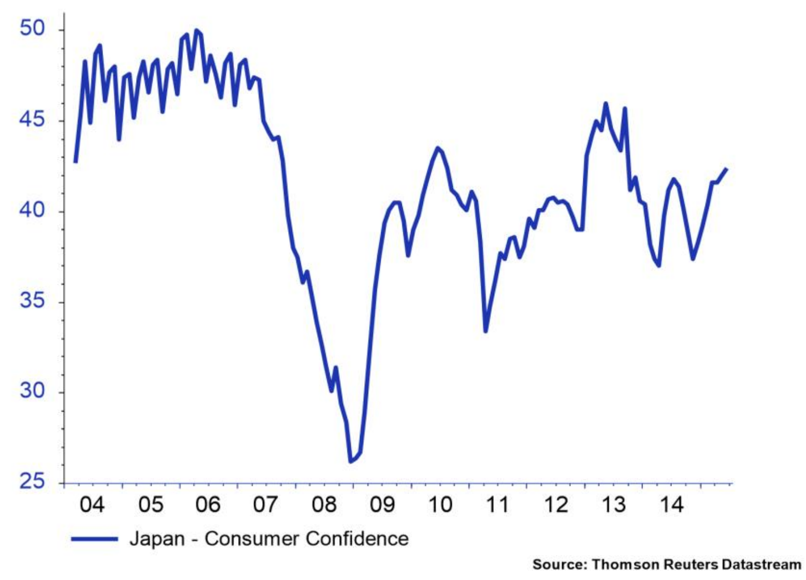


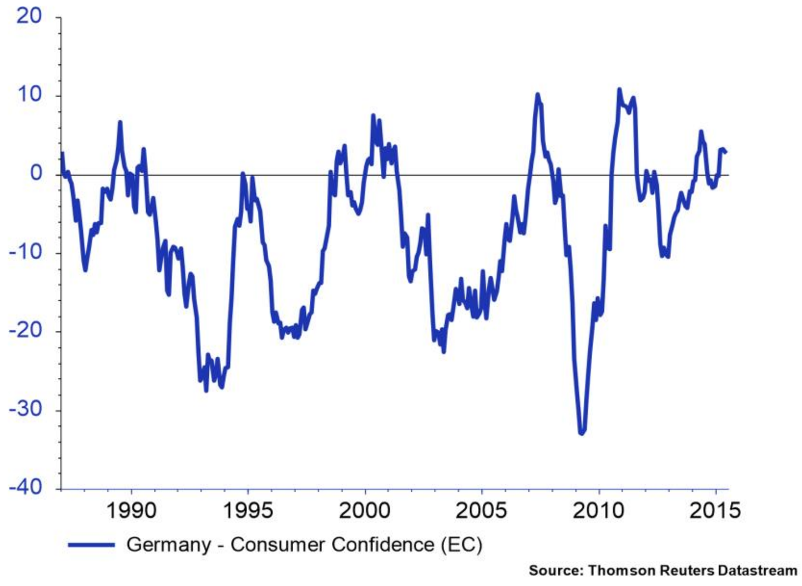



**Consumer Confidence**

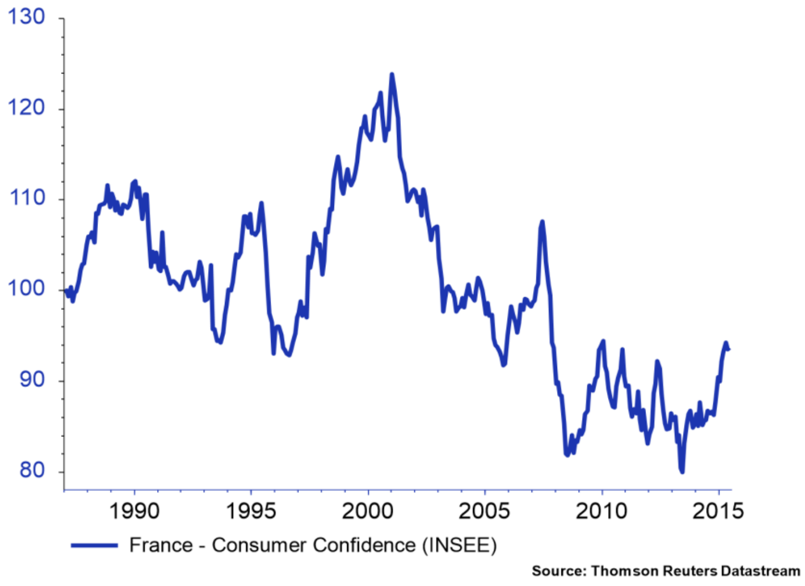


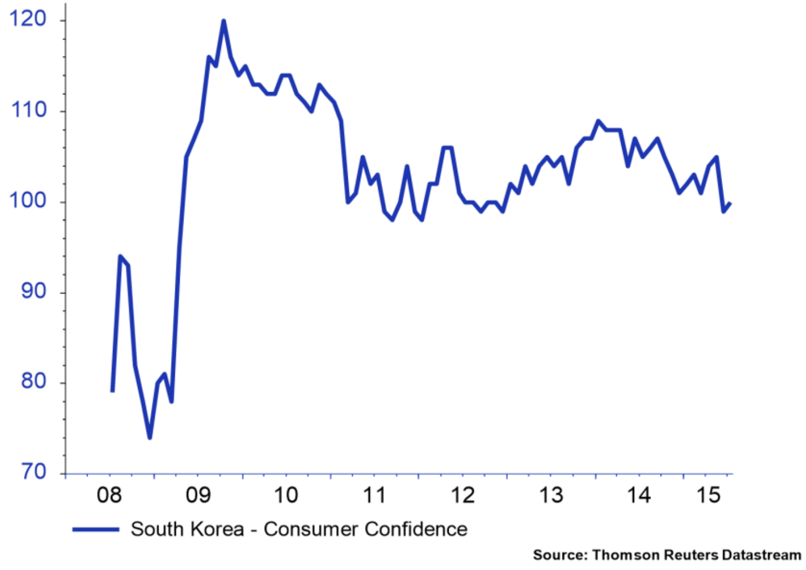



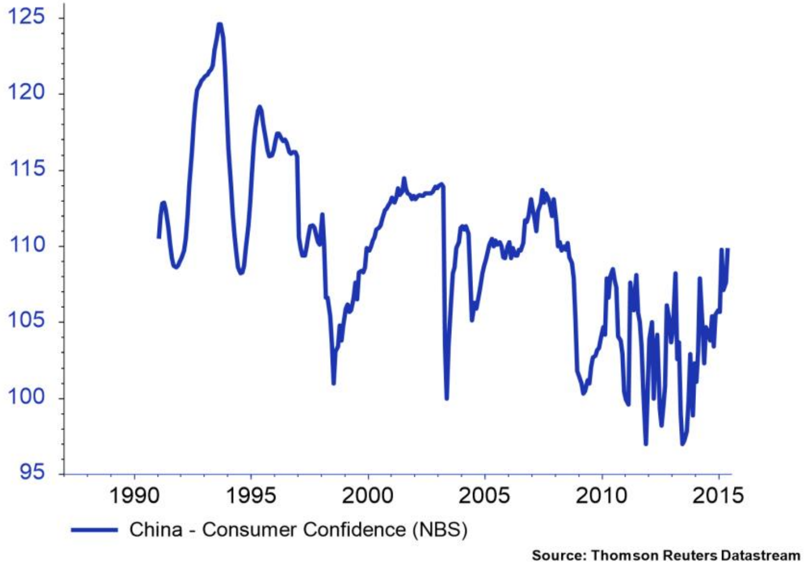



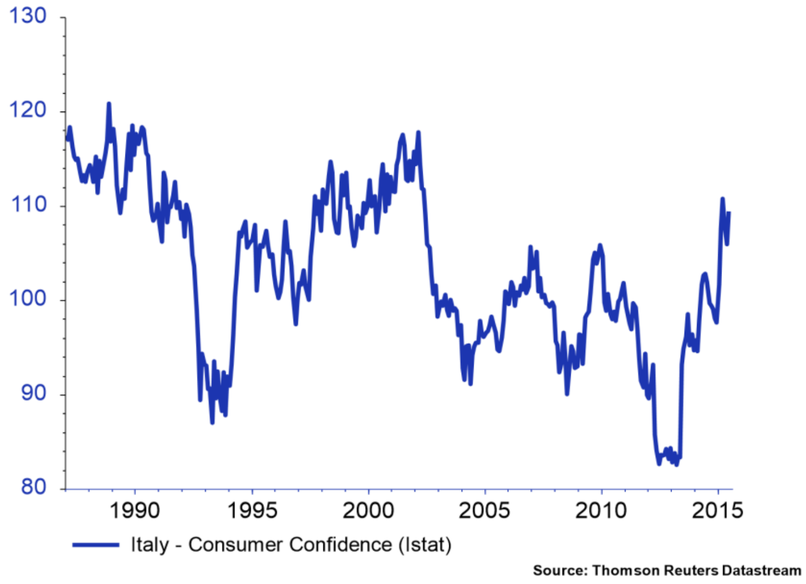



## Consumer Confidence (continued)



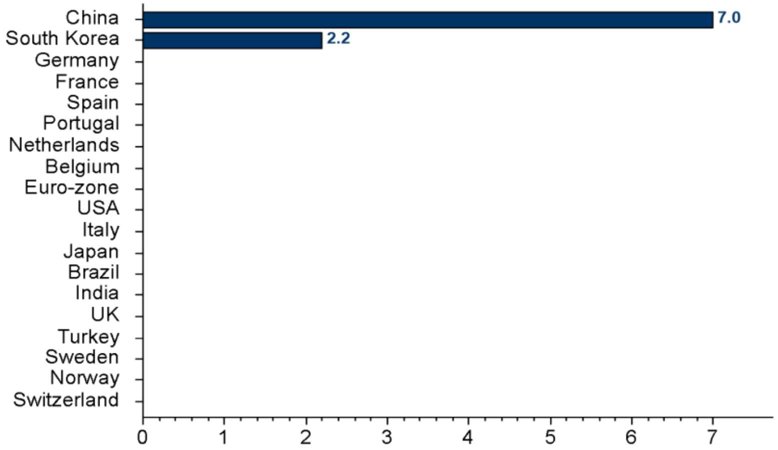



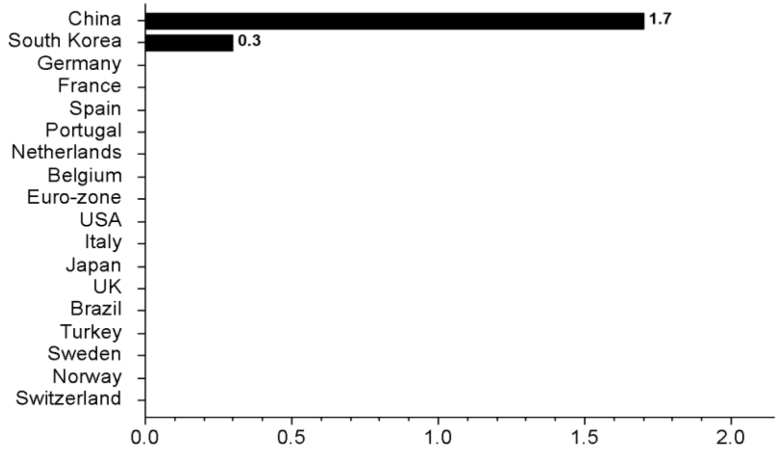
## Real GDP growth

%YoY- Q2 2015



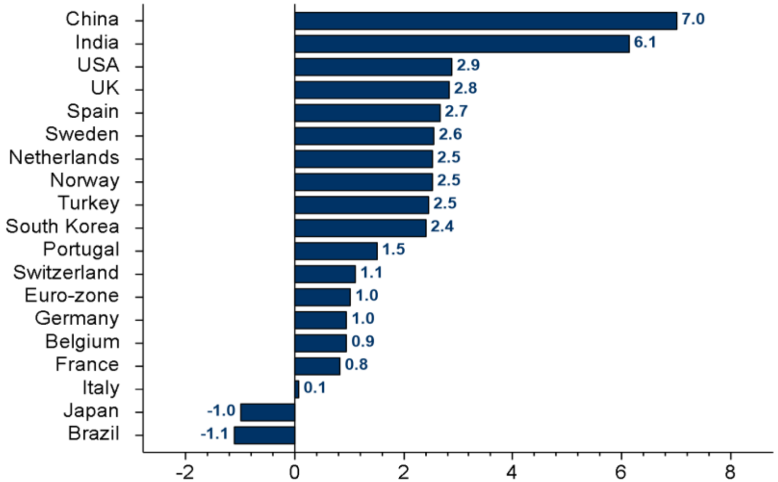

Source: Thomson Reuters Datastream

%QoQ - Q2 2015
(India is not included)




Source: Thomson Reuters Datastream

% YoY - Q1 2015

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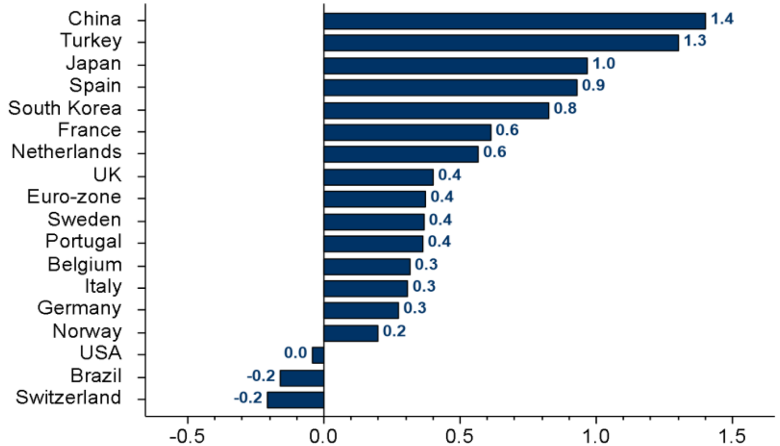
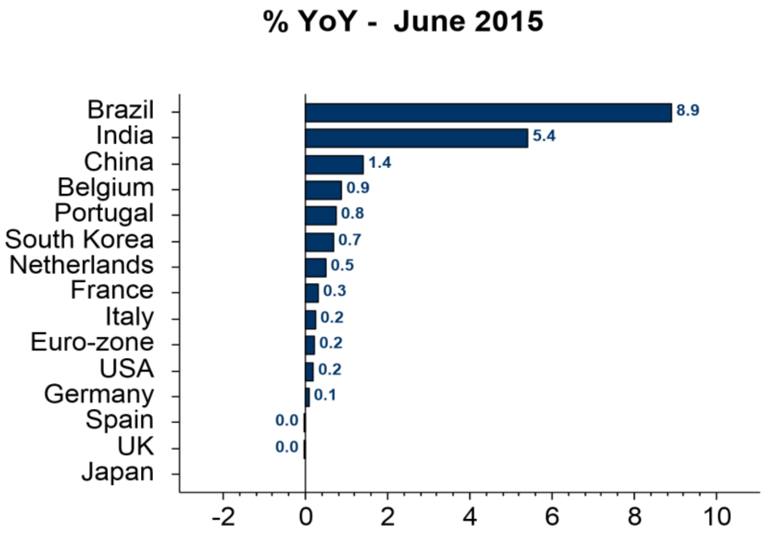
% QoQ - Q1 2015
(India is not included)




Source: Thomson Reuters Datastream

## Consumer price inflation

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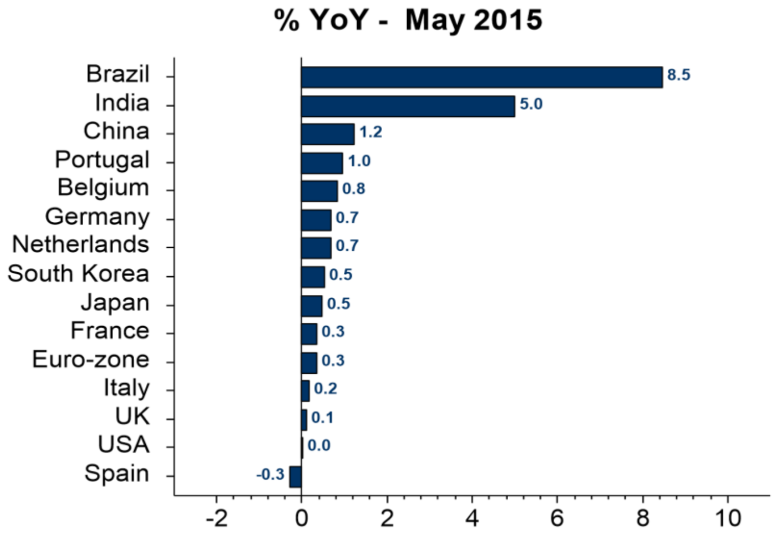
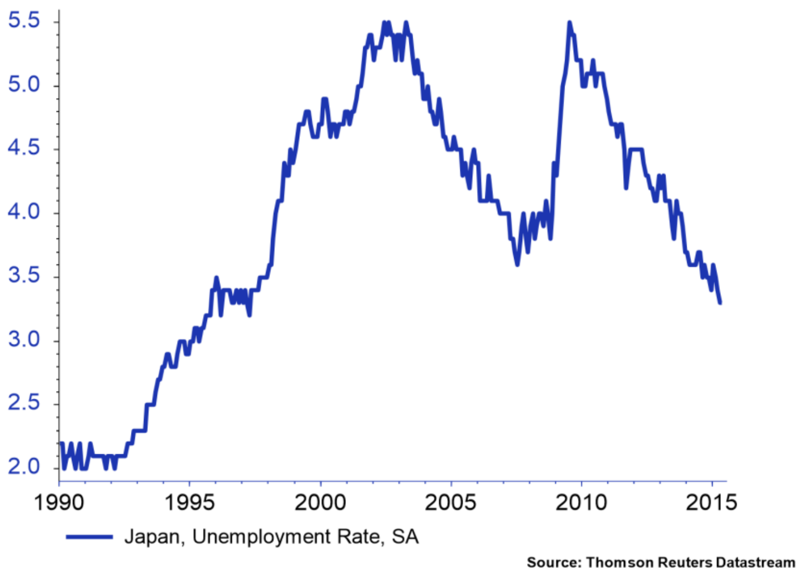
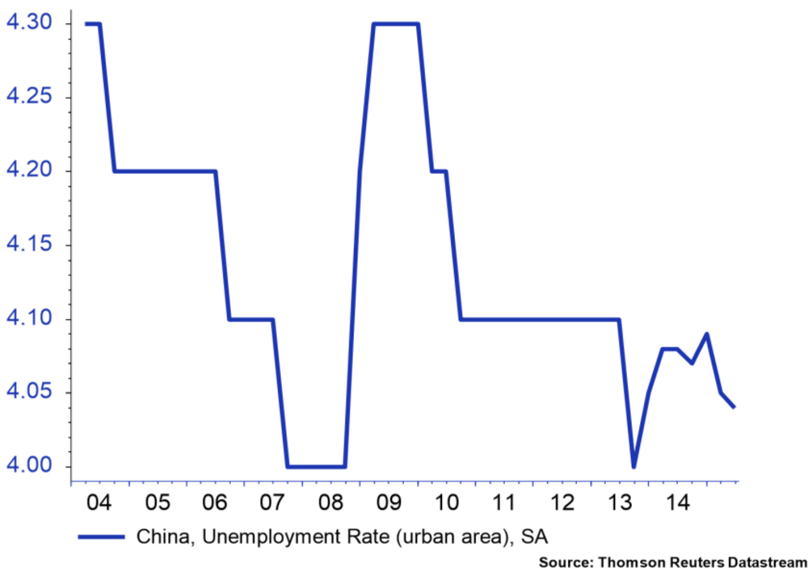



Source: Thomson Reuters Datastream

## Unemployment





## Unemployment (continued)


Source: Thomson Reuters Datastream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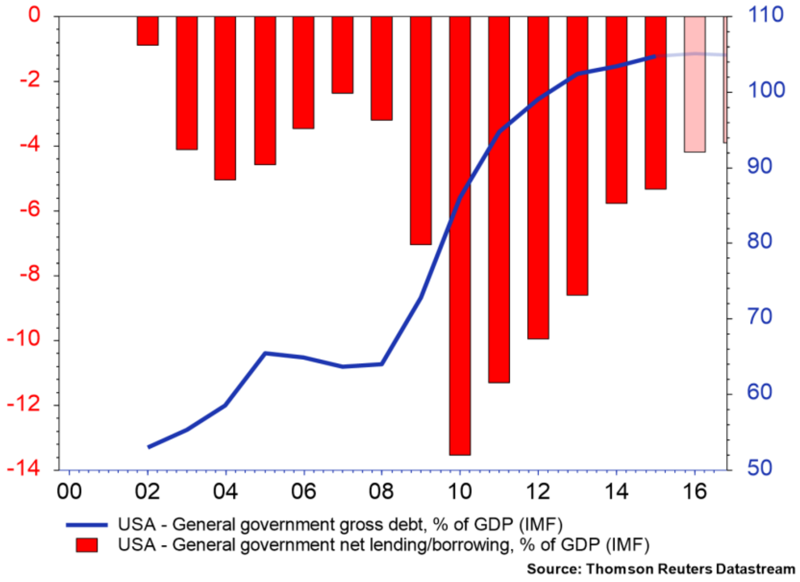
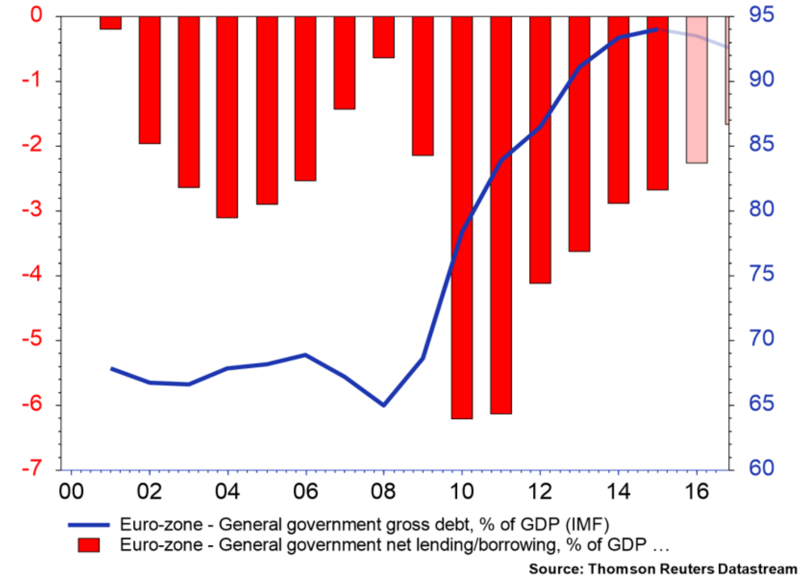
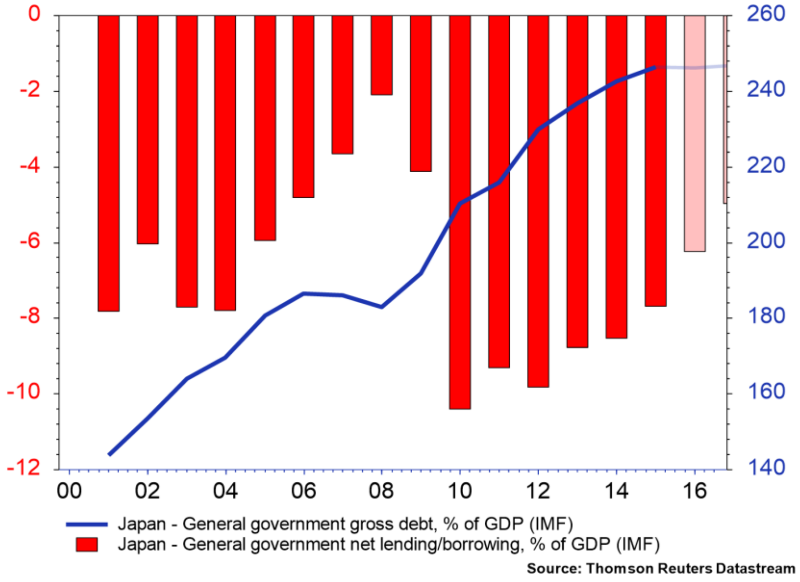
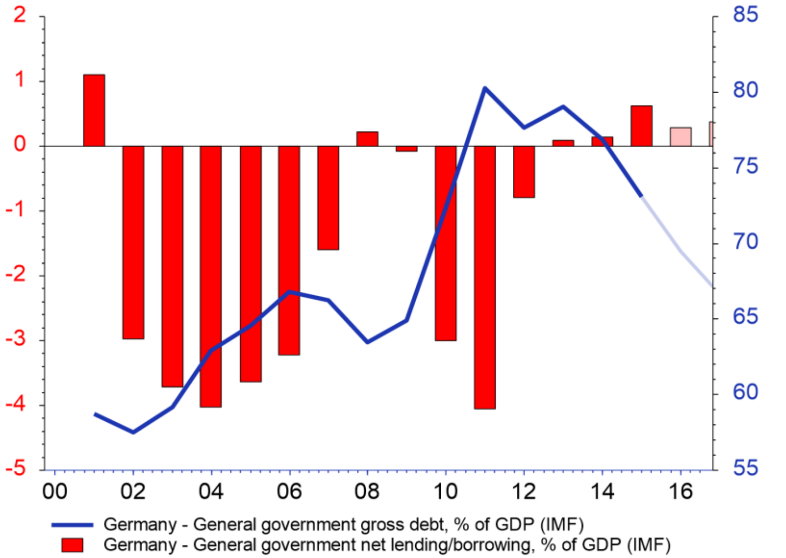
**Public Sector Balances**




## Public Sector Balances (continued)

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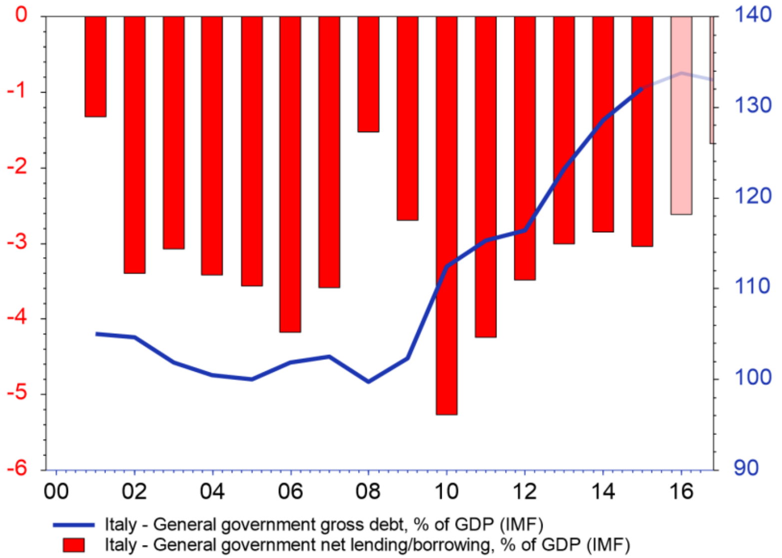


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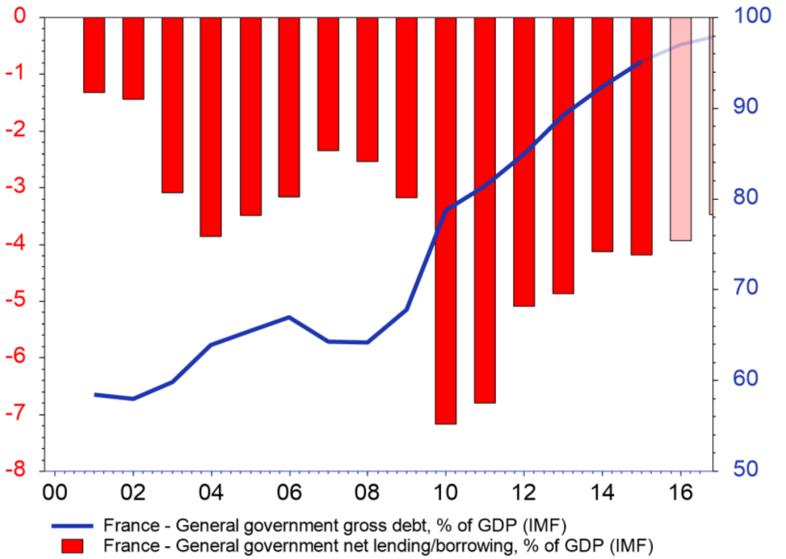


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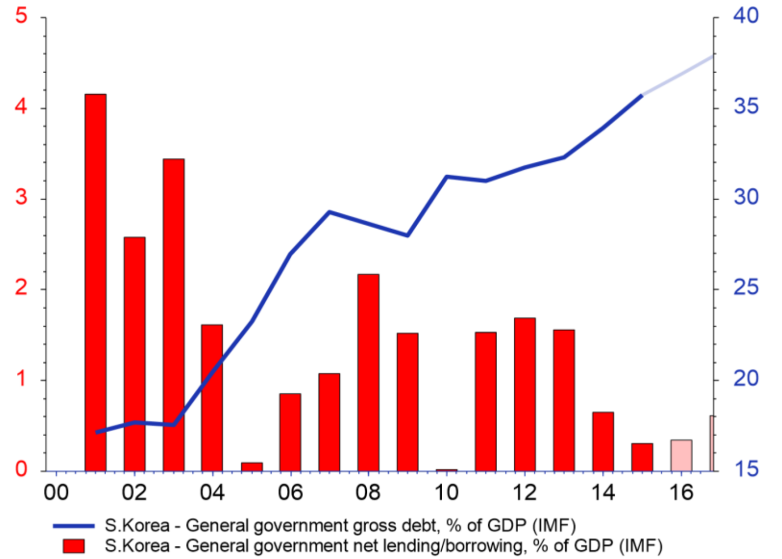


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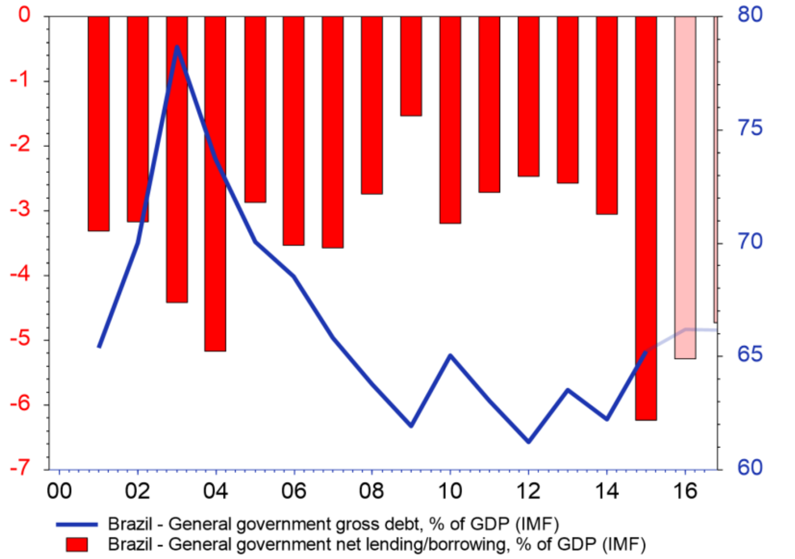
# Public Sector Balances (continued)

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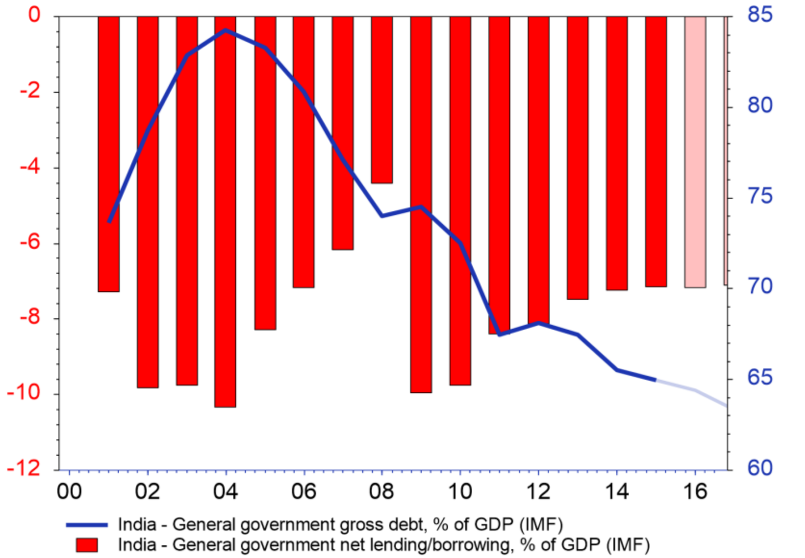


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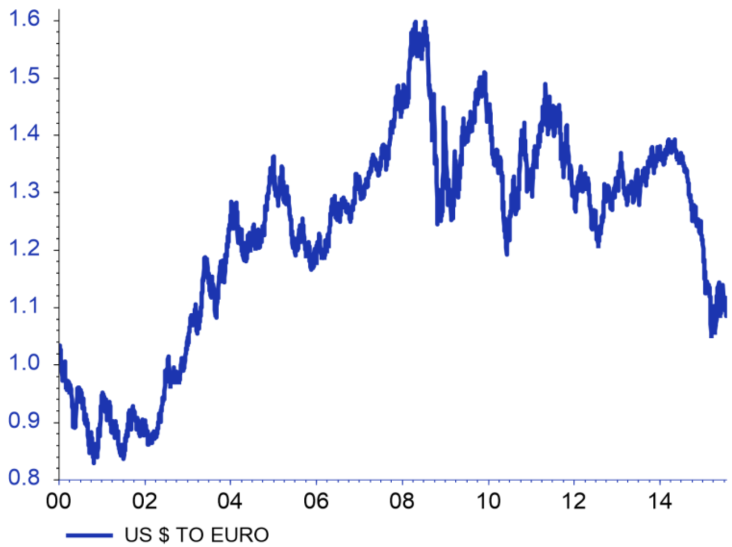
## Foreign Exchange Market

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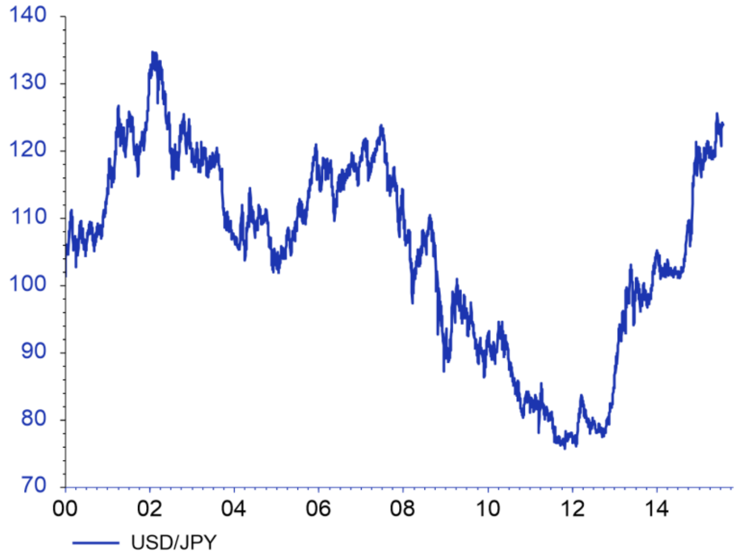


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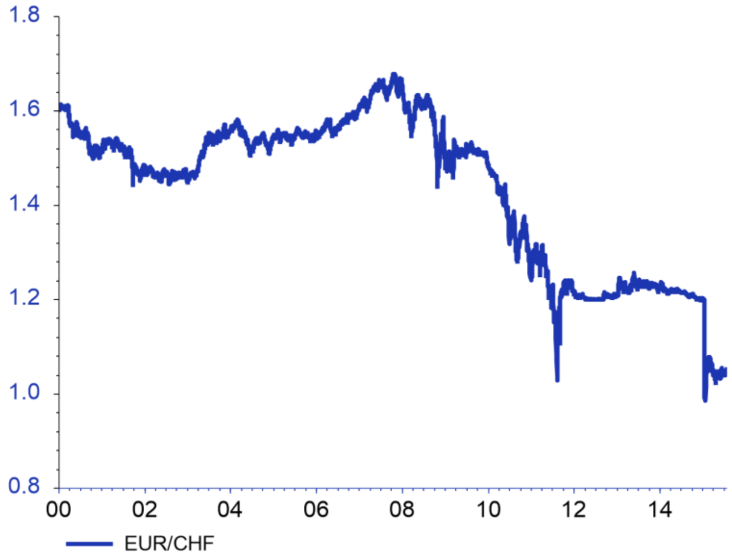


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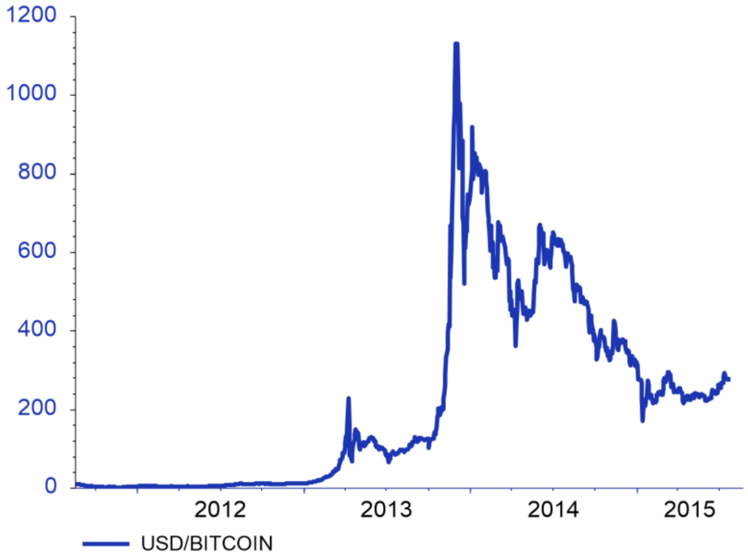


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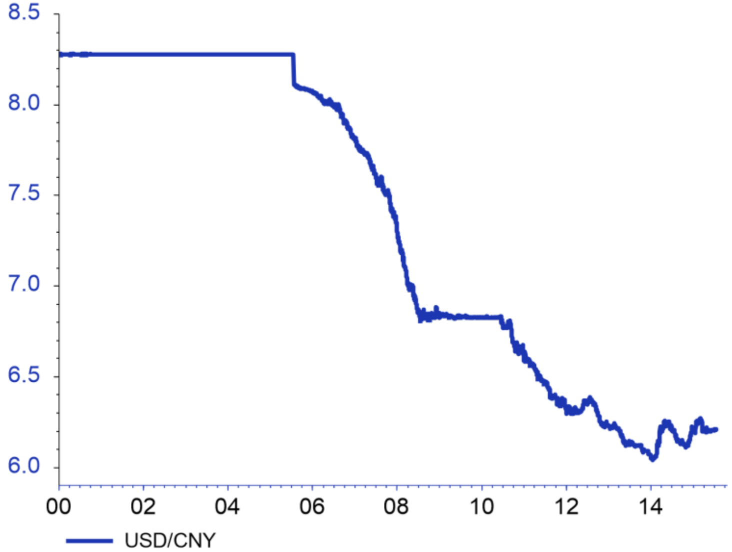
## Foreign Exchange Market (continued)

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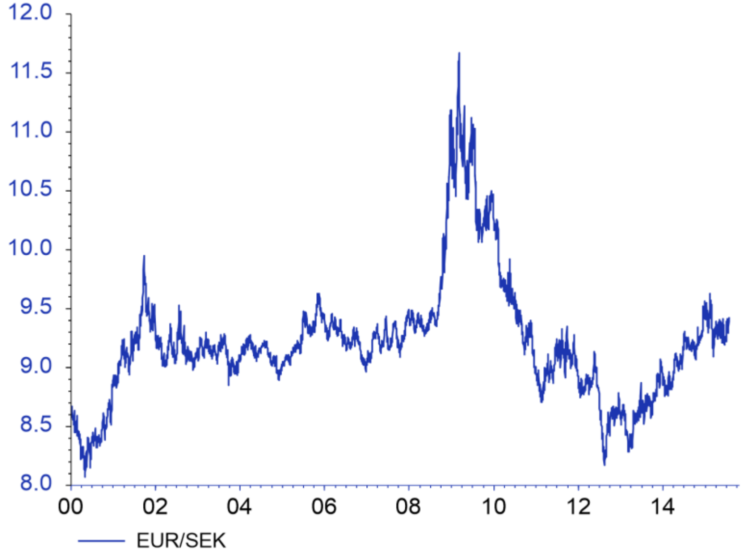


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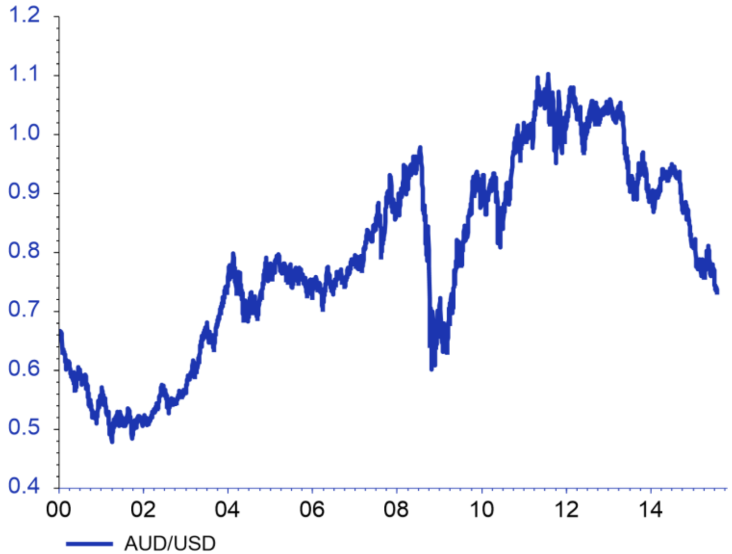


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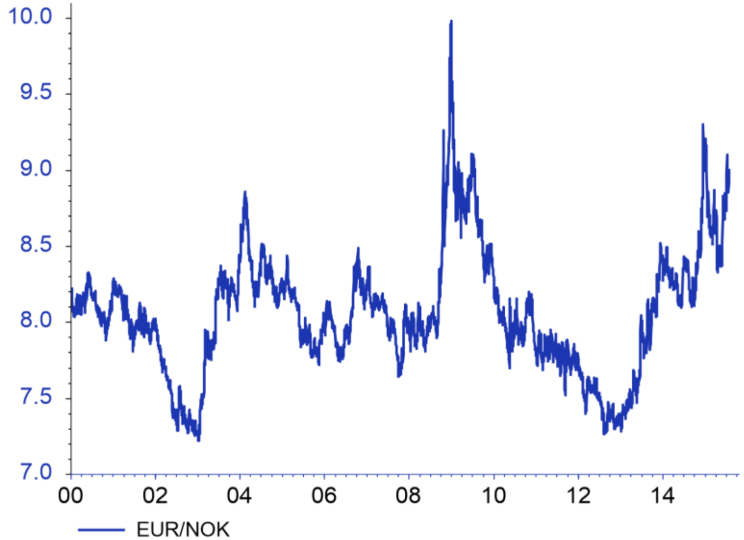


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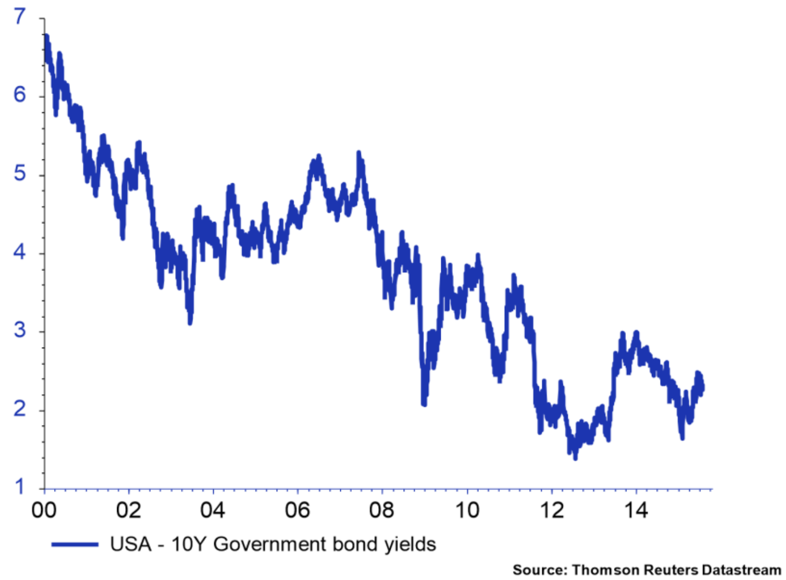
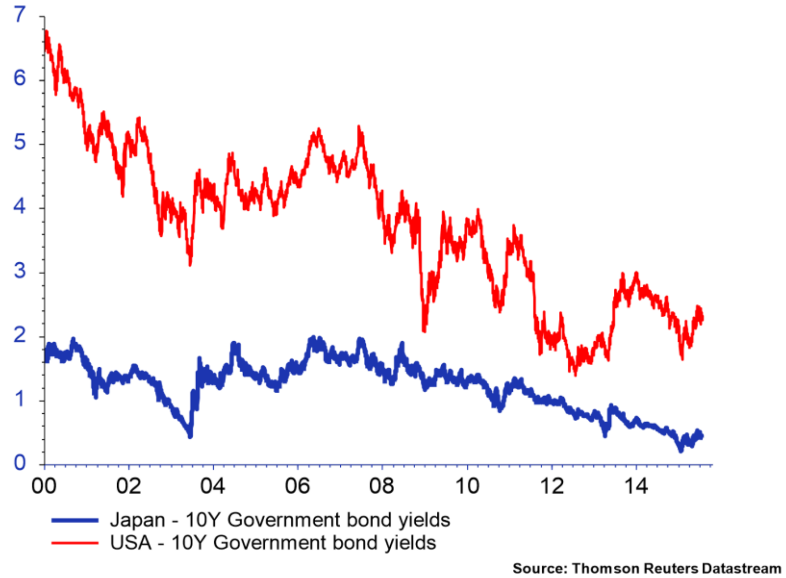
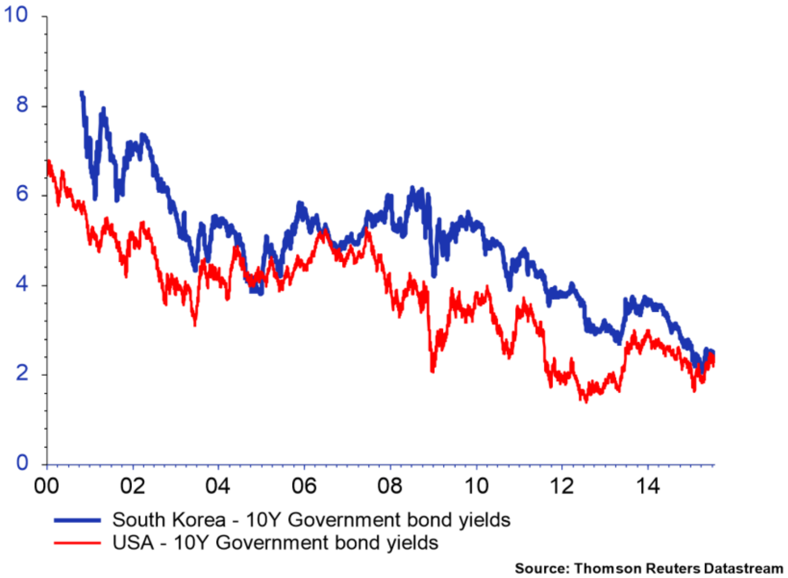
## Government Bond Yields

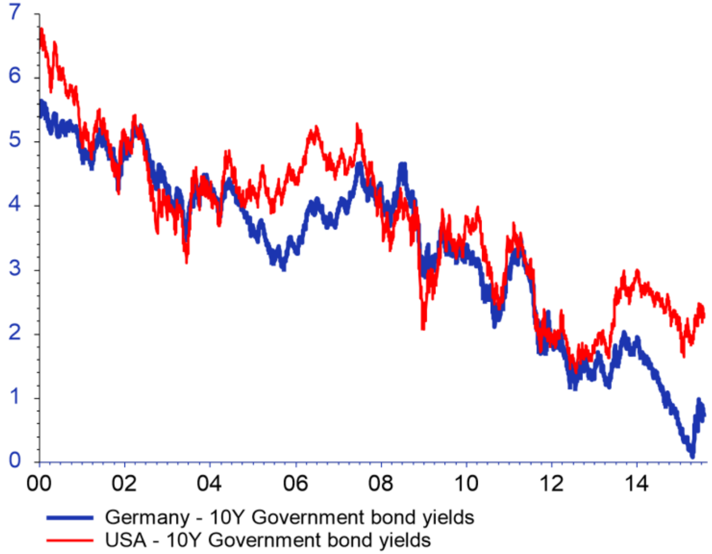




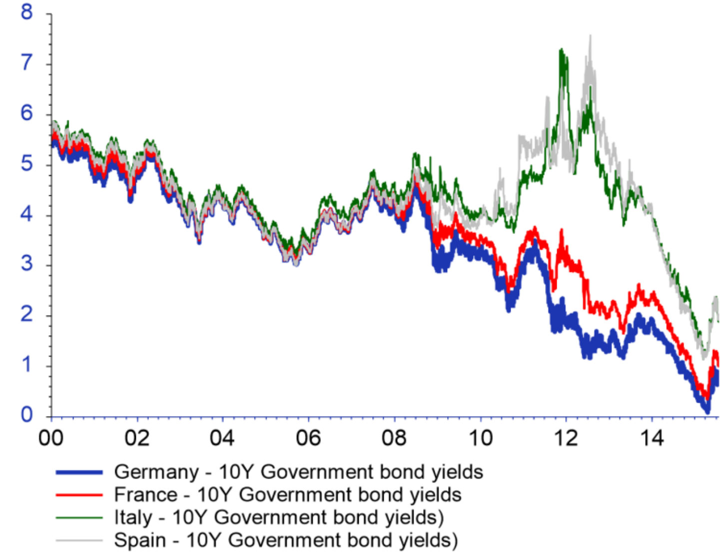


## Government Bond Yields (continued)




Source: Thomson Reuters Datastream

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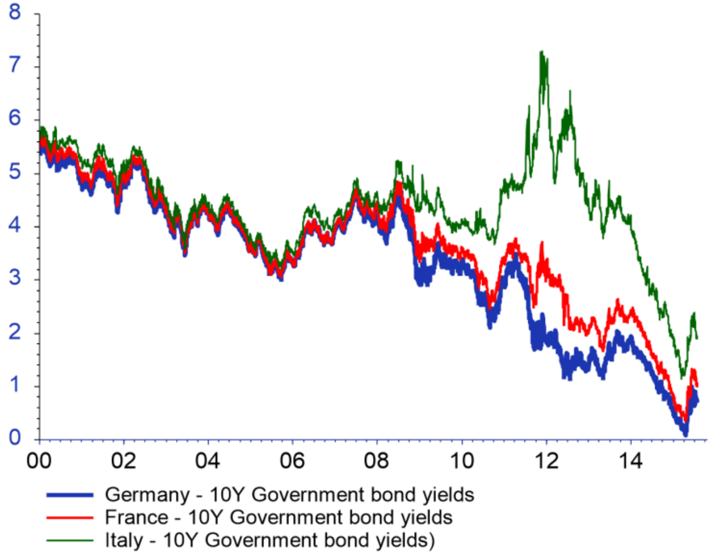


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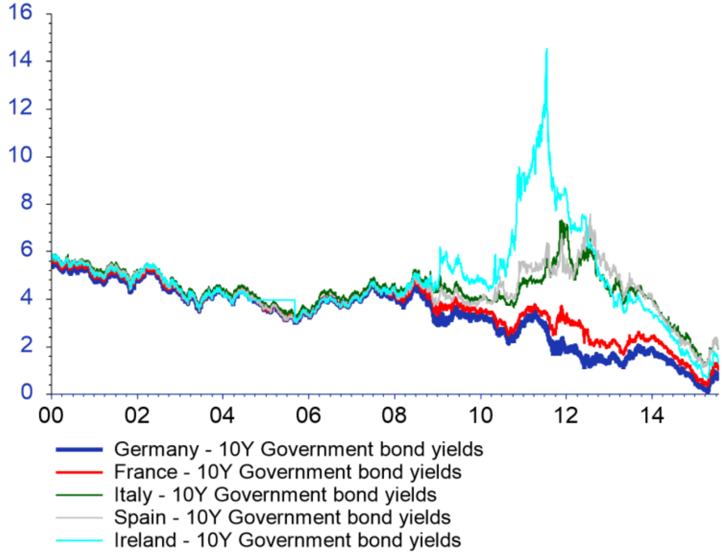
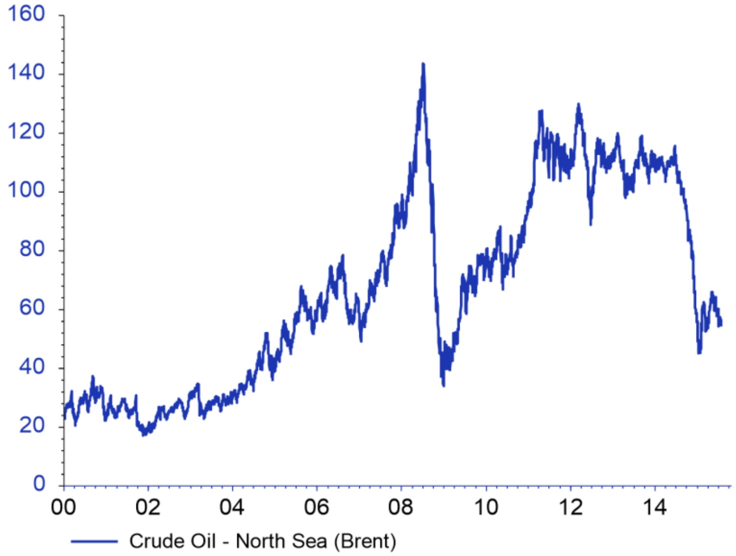



Source: Thomson Reuters Datastream

## Commodity Markets

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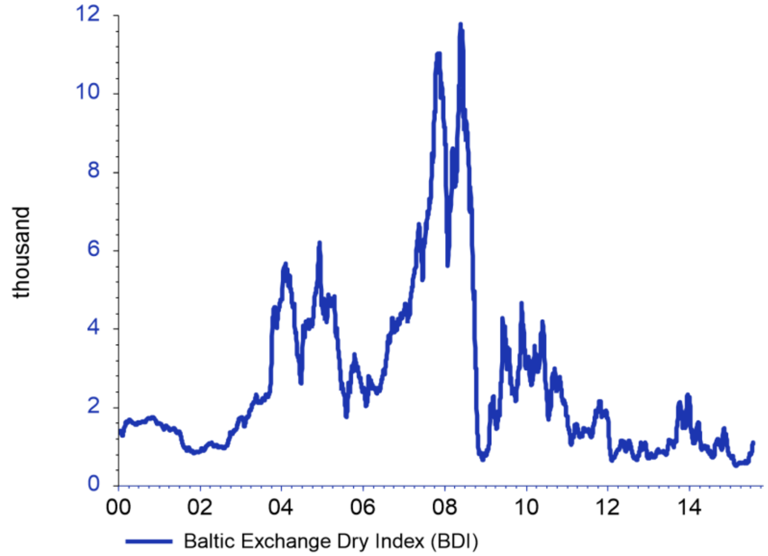
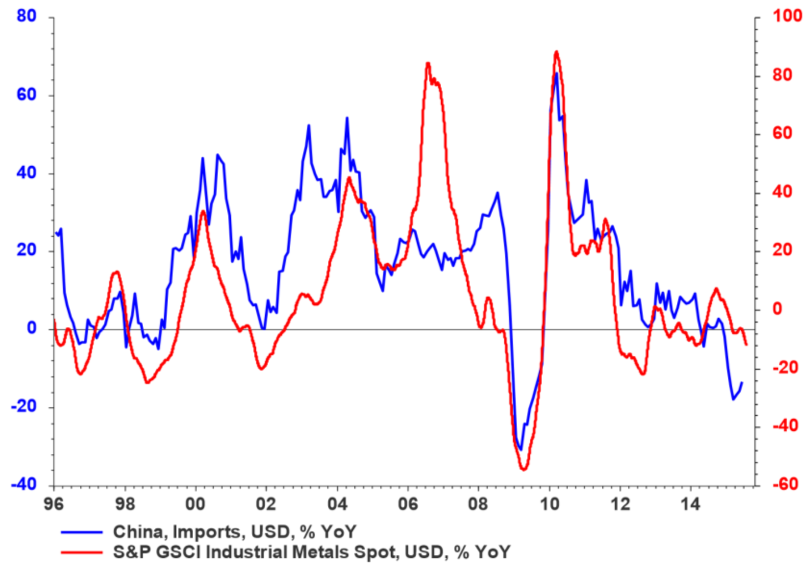


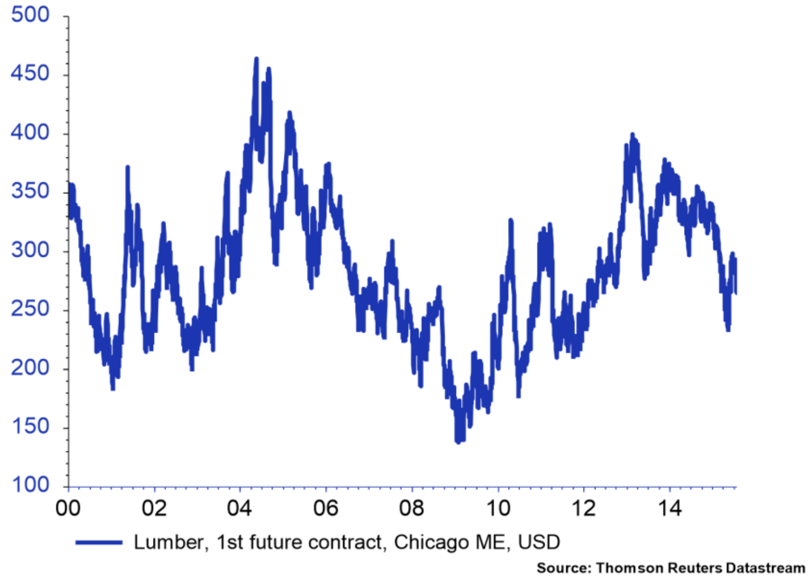

Source: Thomson Reuters Datastream


Source: Thomson Reuters Datastream

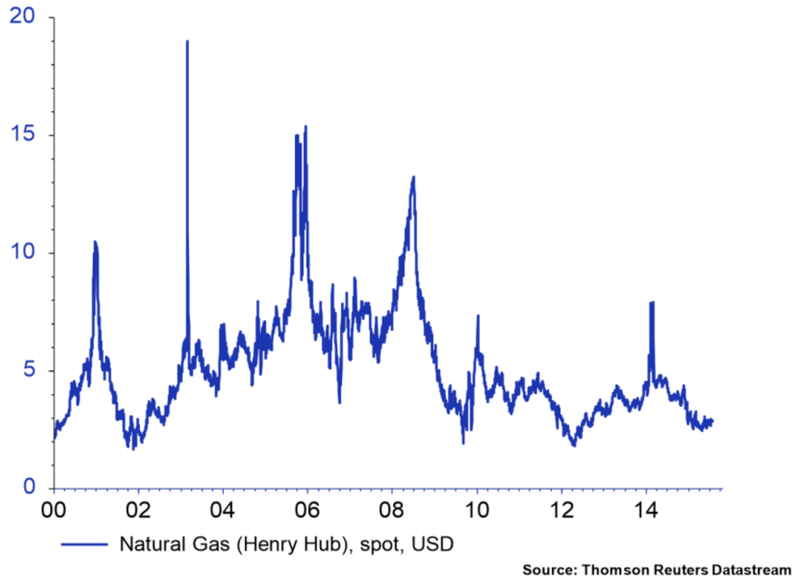


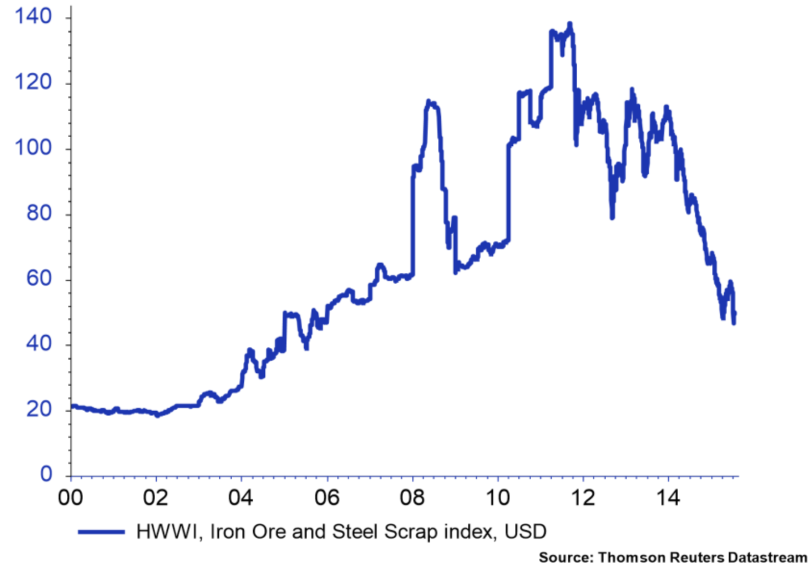

Source: Thomson Reuters Datastream

## Commodity Markets (continued)





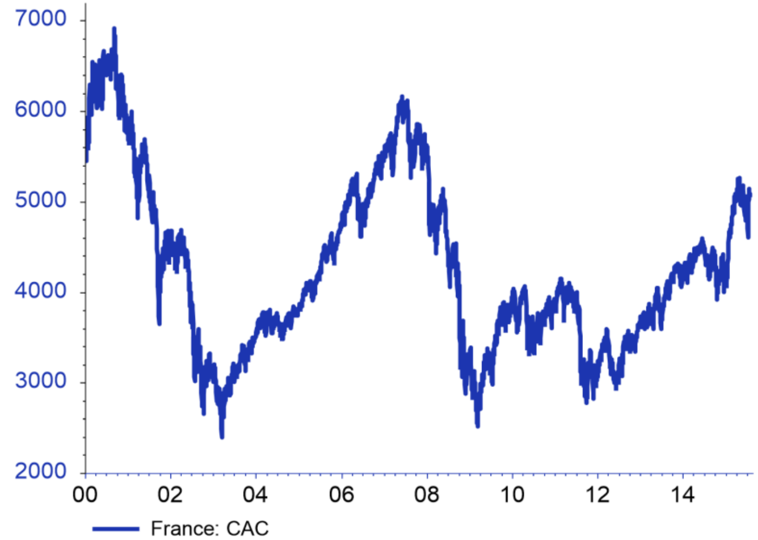


## Commodity Markets (continued)

## Equity Markets


Source: Thomson Reuters Datastream

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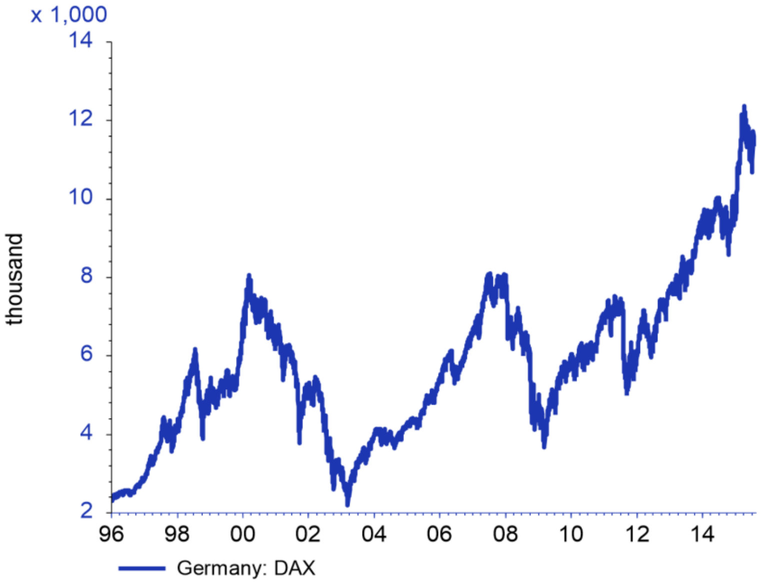


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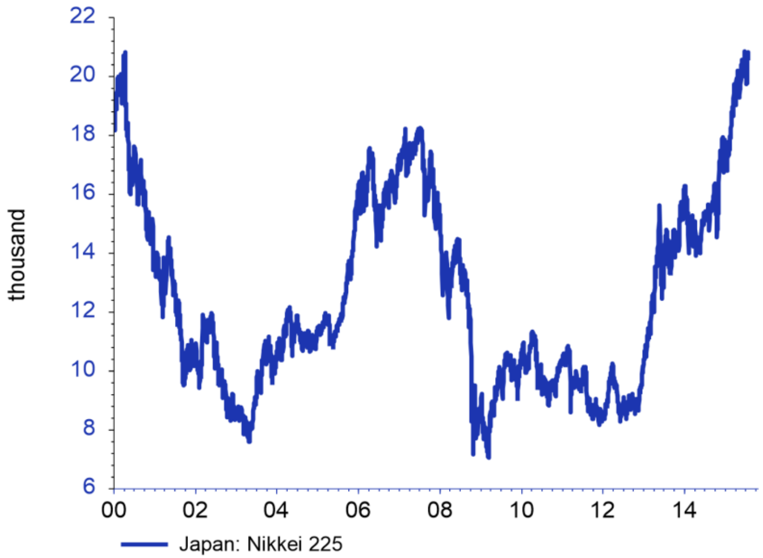
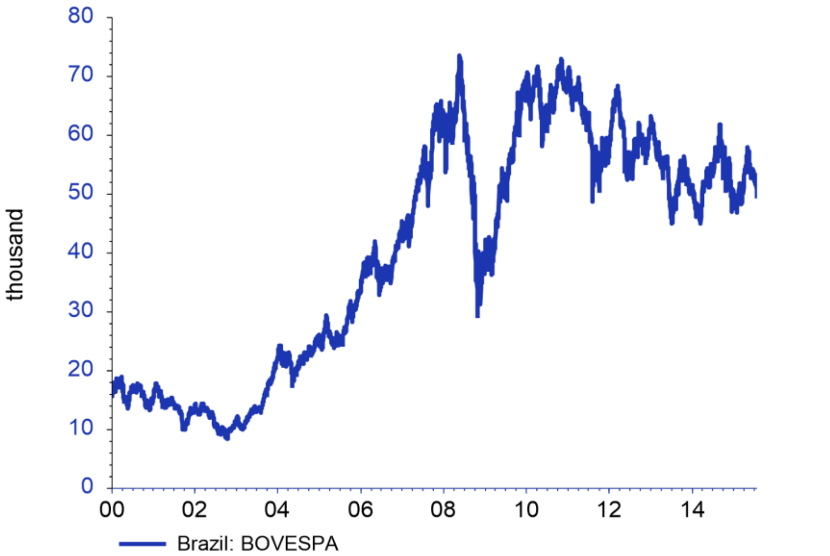



Source: Thomson Reuters Datastream

## Equity Markets (continued)


Source: Thomson Reuters Datastream


Source: Thomson Reuters Datastream

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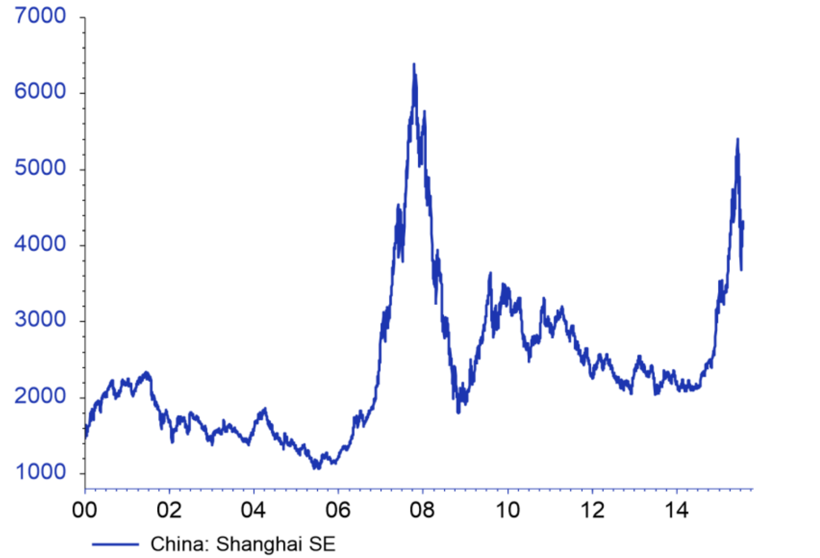
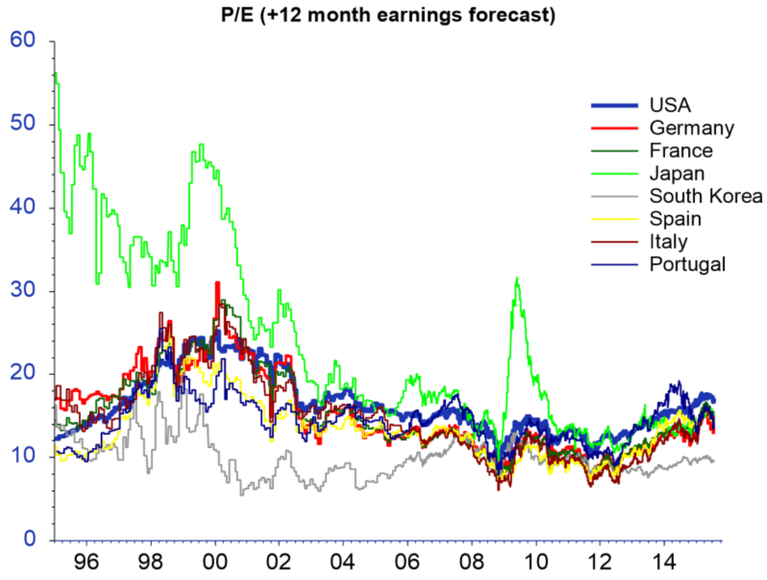



Source: Thomson Reuters Datastream

## Equity Markets (continued)



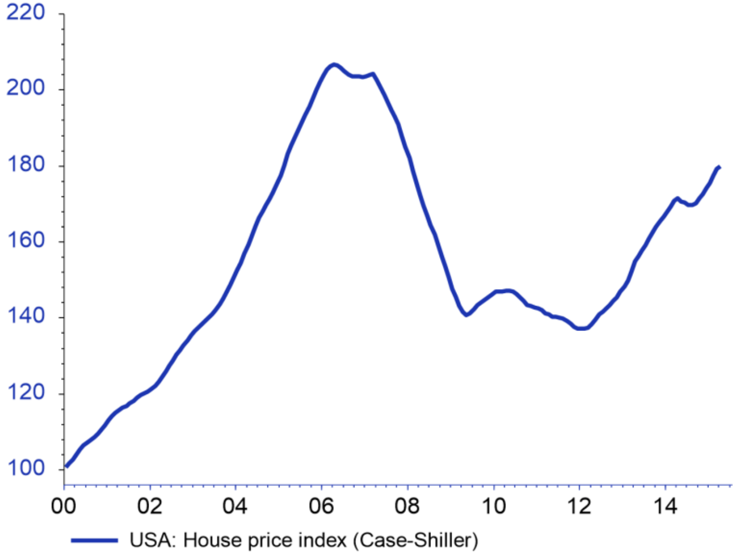

## Equity Markets - Valuation




Source: Thomson Reuters Datastream


Source: Thomson Reuters Datastream

## Home Prices

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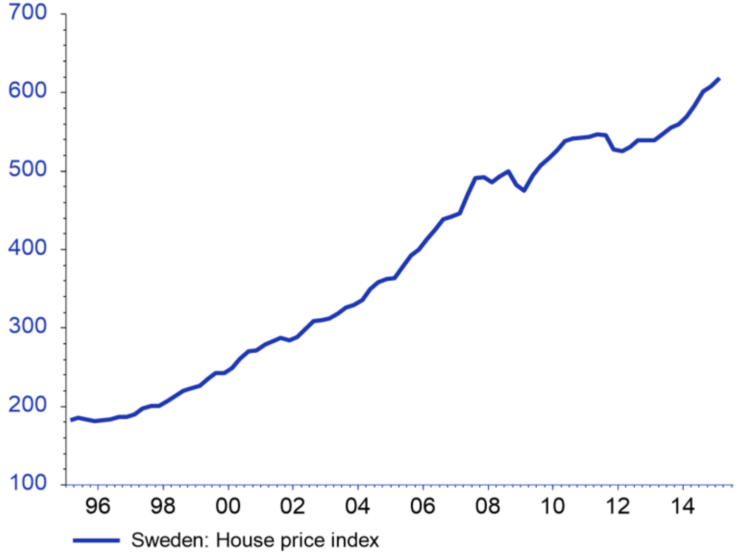


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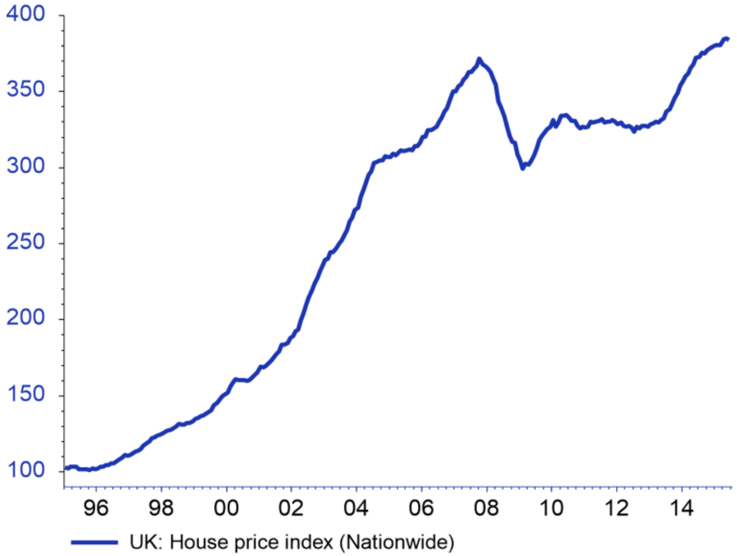


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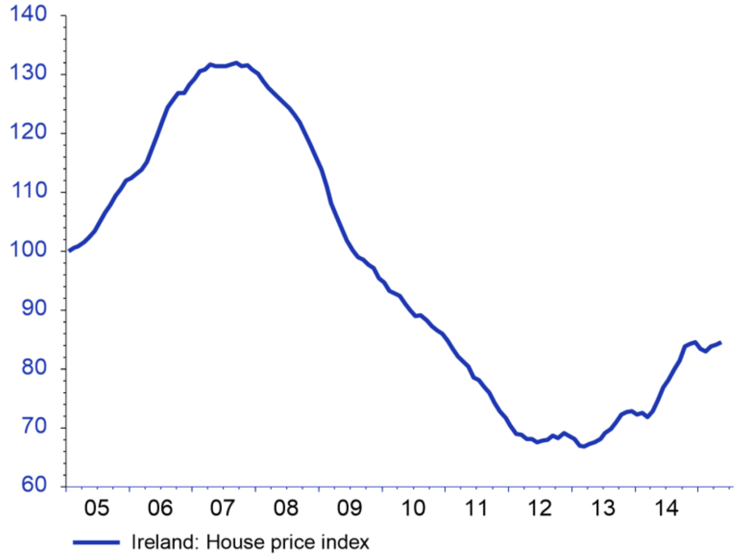
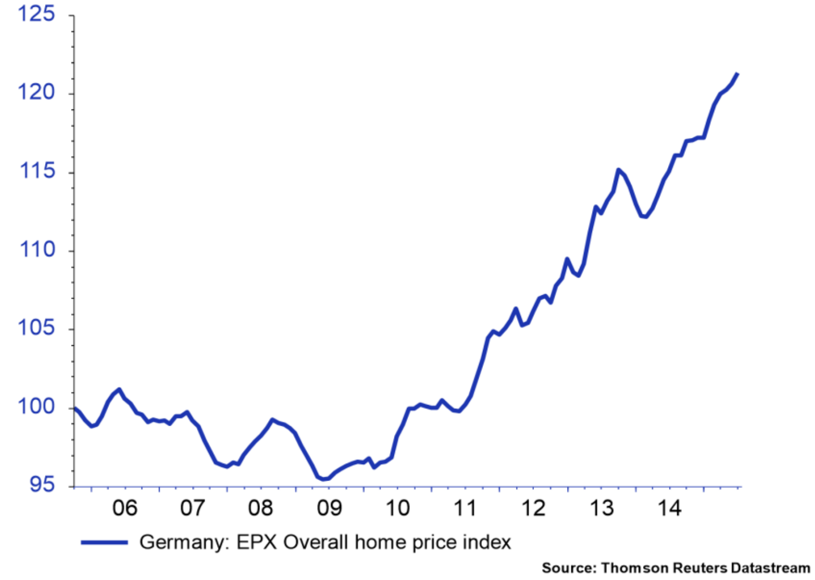
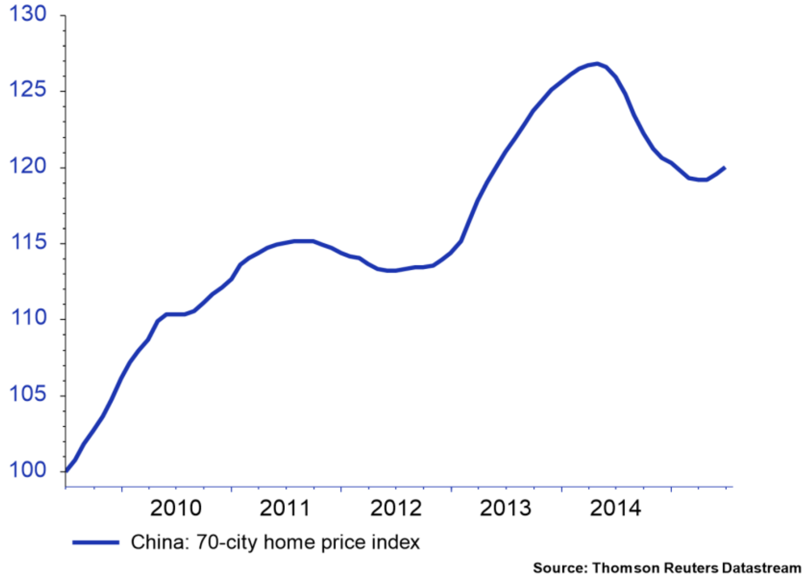
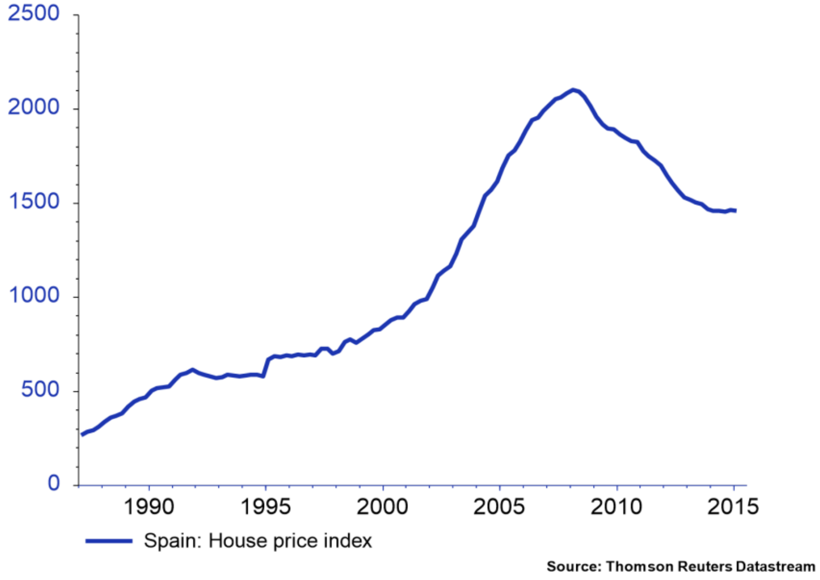



Source: Thomson Reuters Datastream

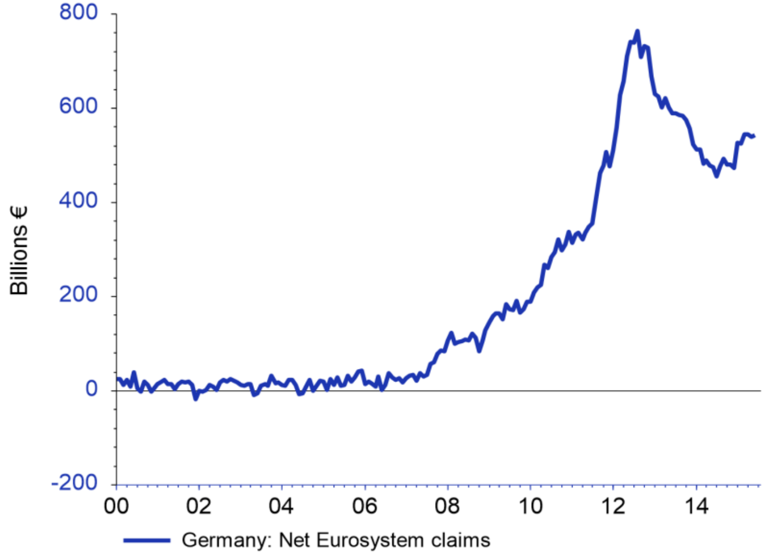
## Home Prices (continued)



## Euro-zone Crisis

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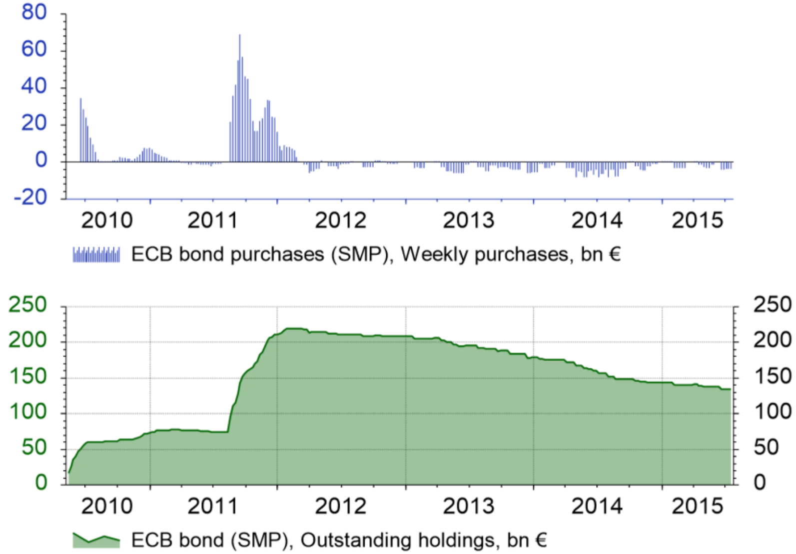


Source: Thomson Reuters Datastream


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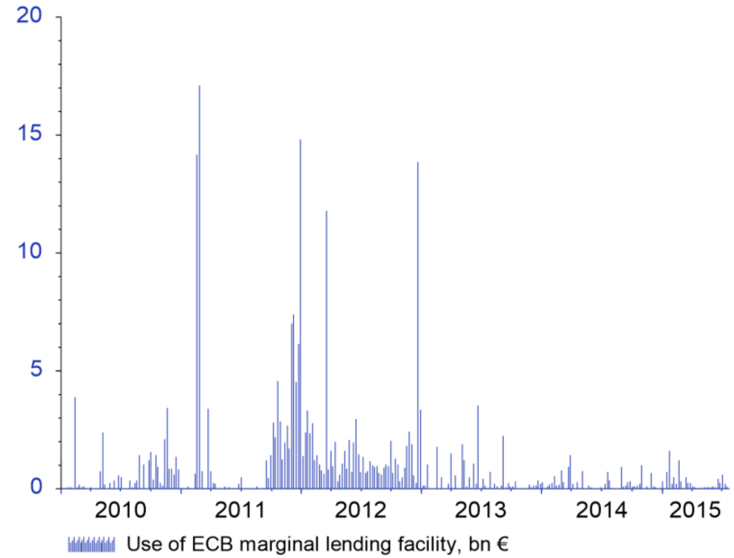
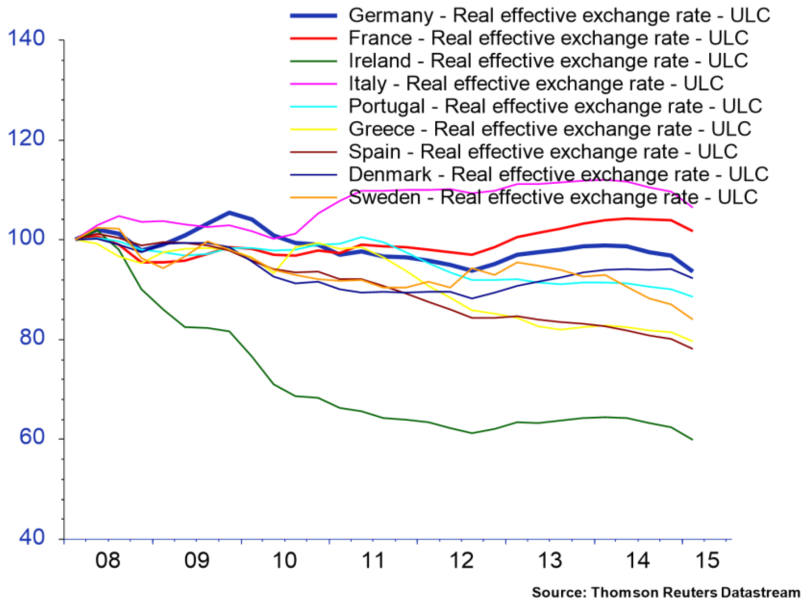


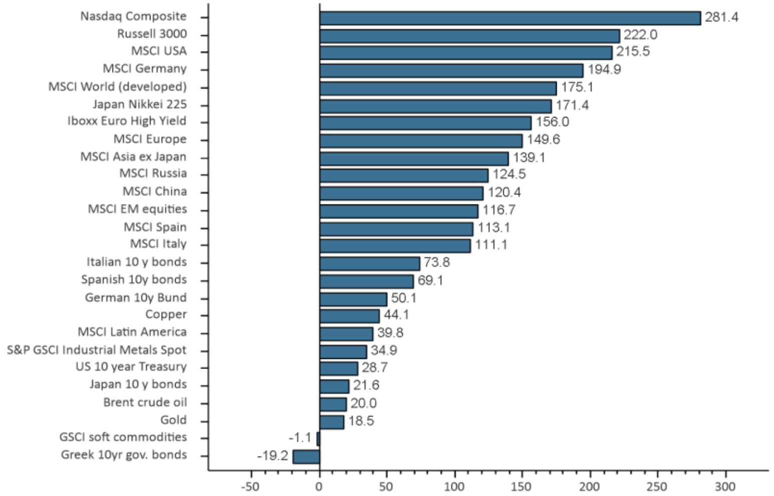

Source: Thomson Reuters Datastream

## Labour costs



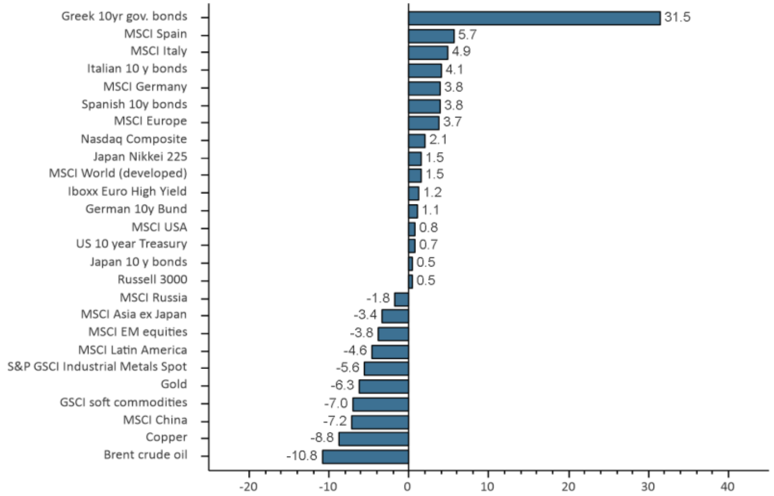
# Performance of Asset types (local currency) – last update: July 24, 2015

% Return Index from 15/3/2009 to 24/07/2015



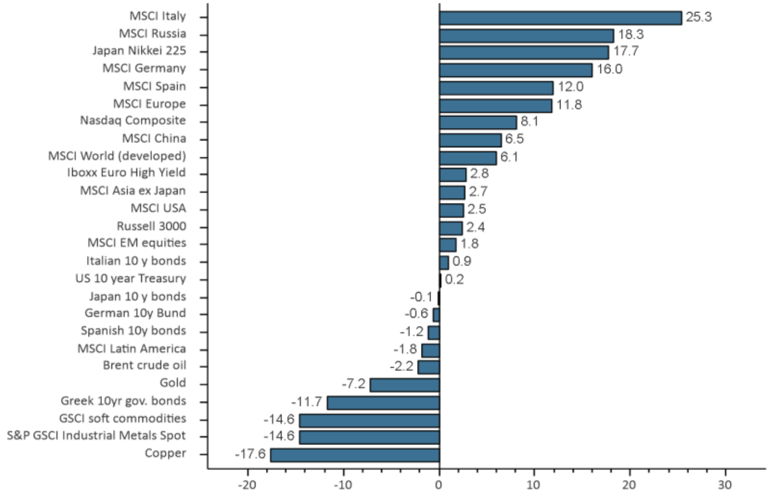

Source: Thomson Reuters Datastream

% Return Index from 30/6/2015 to 24/07/2015



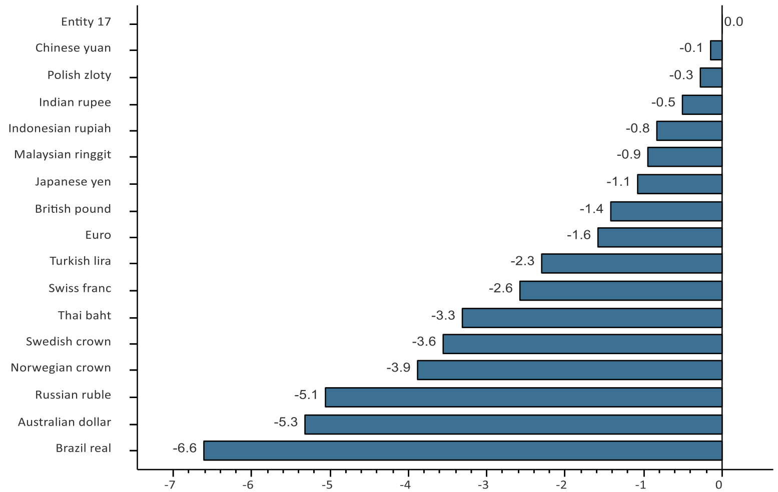

Source: Thomson Reuters Datastream

% Return Index from 31/12/2014 to 24/07/2015




Source: Thomson Reuters Datastream

% Return Index vs USD from 30/6/2015 to 24/07/2015




Source: Thomson Reuters Datastream

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