How serious is China’s economic slowdown?

Losing this engine, which has been shoring up global growth, may be more disruptive than we imagine

The outcome of the ongoing US-China trade war is closely linked to the assumptions regarding China’s economic growth trajectory. A China capable of sustaining a 6-6.5 per cent gross domestic product (GDP) growth rate over the next decade is unlikely to make significant policy changes to resolve the trade war. Its effort would be to offer tactical concessions in the form of enhanced purchases of US goods, improved access to the Chinese market and providing assurances of an even playing field to foreign investors and companies we in the US or Chinese entities. Structural changes demanded by US negotiators would likely be resisted. The latest round of US-China trade talks ending in January 9, 2019, from the American and Chinese sides suggest that while China has conveyed its readiness to increase its purchases of agricultural products and energy from the US, they were still far apart on structural issues relating to intellectual property, industrial policy and cybersecurity issues. A Reuters report, quoting US sources, said that the “two sides were far apart on Chinese structural reforms.”

There was also aин announcement that these talks were not about the detention of US nationals or the spreading of hacking across borders in Washington which would have been expected if progress had been warranted. We may have to wait until President Trump’s next tweet to know what happens next.

China’s economic growth has steadied declined from 10.6 per cent in 2010 to 6.5 per cent in 2015 and 6.5 per cent in 2018. This deceleration is reflective of a complex transition which the economy is going through. One, China’s demographic dividend, which drew upon a huge and growing working-age population to drive up the dependent population, peaked around 2012 and has been declining since. This is in line with Lewis’ “人口红利 curve.” Two, exports which have been a major driver of growth, are now flat. Having become the world’s largest exporter, China will find it harder to expand its global market share, currently 17 per cent, particularly when its major markets are putting up protectionist walls. Three, total factor productivity (TFP), which was fairly high in the catch-up phase of development, has now declined from an estimated 3 per cent in the 2006-12 period to only 0.4 per cent in 2018. This deceleration in TFP is the slowdown in China’s economy is not due to cyclical factors but the result of the structural transformation taking place. Unless these new drivers, GDP growth is likely to decline to progressively lower rates converging with other advanced economies. “China will not be exempt from the iron law of diminishing the mean in the long run.”

This means is said to be 2-2.5 per cent per annum. But how long will this long run be? It is only through significant technological advancement that decent long run means can be pushed further into the future. The third challenge relates to the outcome of whether China makes the grade as a generator of intellectual property rather than its user. The Made in China 2025 initiative, which is aimed at making China a leader in advanced technologies, is critical to sustaining Chinese growth momentum and, therefore, unlikely to be modified to as pragmatist American and Western concerns.

Despite the commitment to reshoring a high-tech future, China seems unable to undertake a relatively speedy transition to higher value-added economic processes. This is apparent, for example, in the continuing overcapacity in steel, cement and coal industries. China’s debt overhang is estimated to reach 275 per cent of GDP this year. It has now become clear that there is a significant foreign exposure to these debts. Total foreign debt currently stands at $1 trillion of which the short-term component is $252 billion. Of this $62 billion will need to be refinanced over the next year. Interestingly, a substantial part of this debt is owed by state-owned firms primarily engaged in financing for projects under the Belt and Road Initiative, some of which have questionable viability. The commitment to alleviating this mounting risk to economic stability has been repeatedly compromised in order to show up flagging growth, which, in turn, may have political and social consequences. In 2018 alone the Chinese Central Bank cut banks’ reserve requirements on four occasions and recently local governments have been permitted to launch a new tranches of bonds to move investment in infrastructure projects. Growth in consumption has declined from 12 per cent per annum in the recent past to about 6 per cent at present despite a steady increase in per capita incomes. The efficiency of investment is likely to be lower as capital is increasingly directed toward non-productive non-productive purposes.

Although China has entered a new phase of development, it is only adding another layer of risk to an already vulnerable domestic situation. Will the Chinese leadership be able to manage both these risks simultaneously and successfully? These risks then we will confront a different kind of challenge but no less serious. The world has become more disruptive than we imagine. But how long will this long run be? It is only through significant technological advancement that decent long run means can be pushed further into the future. The third challenge relates to the outcome of whether China makes the grade as a generator of intellectual property rather than its user. The Made in China 2025 initiative, which is aimed at making China a leader in advanced technologies, is critical to sustaining Chinese growth momentum and, therefore, unlikely to be modified to as pragmatist American and Western concerns.

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