

中国：永远不破的“泡沫”？
China: Bubble that will never pop?

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Summary

*The article by LIU Qiudi 刘袭蒂 is the first in Chinese language discussing Thomas Orlik's most recent book **China: The Bubble That Never Pops**, Oxford University Press (June 2020). Thomas Orlik is the Chief Economist with Bloomberg Economics. Orlik's book has already been discussed by major think tanks the world over. The article in Chinese is based on an online seminar held by the US think tank CSIS, on June 26, 2020. The FTChinese.com article discusses a wide range of issues related to the Chinese economy today, especially in the context of Covid-19. The article also adds geopolitical and security dimensions to China's rise in the post-pandemic world.*

Source: <http://www.ftchinese.com/story/001088424?adchannelID=&full=y>

Author of the Original Article: LIU Qiudi

Orlik's *China: The Bubble that never pops* explores the hidden strength and endurance of the Chinese economy. Orlik offers a new perspective to the West to work with China.

Many consider Bloomberg chief economist Thomas Orlik's latest book *China: The Bubble that never pops*, yet another piece of writing making a big fuss about "China collapse theory." The fact is, at a webinar held on June 26, the director of the China Research programme of the US think tank CSIS, called Orlik "over optimistic."



Image: Tom Orlik

For long, China watchers have been presenting to us two extreme scenarios of China: on one hand, some paint a rosy picture of China and believe China has unlimited potential, because no one can compete with 1.4 billion people, China trains a large number of engineering graduates each year, and China's GDP continues to enjoy room for substantial growth...

Then there are pessimists, who think China's economy is doomed to fail, financial bubbles are always frothy, the housing market is destined to failure, the banking sector is going to be burdened with bad loans, everywhere there are excessive empty buildings and zombie companies and trade tariffs have all-around set off anti-globalization waves, etc...

However, Thomas Orlik reckons despite these precipitous expectations, China will continue to grow and expand its international influence. The so-called "China collapse" seems to be imminent, but it has never arrived. Even under coronavirus pandemic conditions, the China model appears to have gained an advantage again.

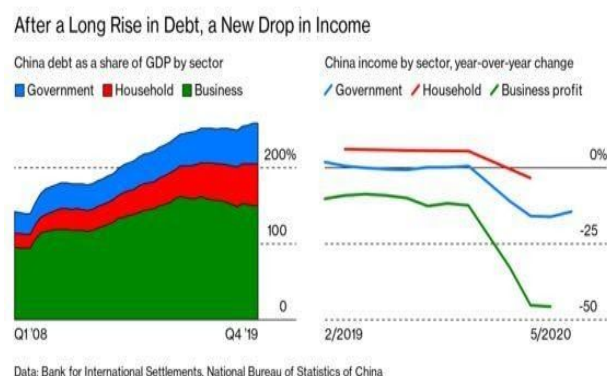
Chinese Economy: Four Misjudgements

Orlik, who spent 11 years in China as a journalist for *The Wall Street Journal*, from 2007 to 2018, brings a journalist's nose for observations and an economist's eye for an analysis to unwrap the mystery of China's growth that has defied doomsayers and challenged conventional perceptions of the failure of the Chinese model: behind the glamorous 10% growth rate, these China watchers saw too many bad debts in the banking sector, threatening the financial

system; due to obstructions from the vested interests lobby, policymakers may not be able to continue to push reforms; state-owned enterprises too big to sustain efficiency; and last but not least, the middle-income trap and a fast-aging population...

Come 2020, the so-called “China bubble” has not at all popped, and this explains why Orlik has chosen to use his book to discuss the hidden strengths and endurance of the Chinese economy. At the same time, Orlik spells out the reasons why China has defied its collapse as predicted by many and hopes to provide a fresh perspective for the West to interact with China. Orlik believes, at least in the four arenas – debt, reform, SOEs and future growth, although the Western observers may not have completely misunderstood China, they have certainly reversed them in their order of priority, in terms of their importance.

The overseas economists generally agree the biggest threat facing the Chinese economy is debt, and they cite the following data from the period 2000-2019, to prove their point:



Data: Bank for International Settlements, National Bureau of Statistics of China

In 2008, China’s debt stood at the GDP’s 140%; in 2015 the total debt increased to 250%. The total debt for the economy rose precipitately – reaching to 260% in 2019. There is no other precedent in history and no other nation, to beat the debt China has accumulated and with such unparallel speed. But although no other country has set such a high debt volume before, there are examples of countries getting caught into a financial crisis. South Korea in 1997 and the US in 2007 respectively, are good examples.

Moreover, China has zombie companies borrowing loans and real estate developers constructing ghost towns in the desert. Local governments are hand-in-hand with shady realtors and there has been an explosive growth of shadow banking. On one hand, Orlik notes that the risk of a financial crisis in China’s debt-ridden economy is real. But at the same time, Orlik also claims that a crisis is not the most likely scenario. He suggests the doomsayers have all along overlooked several

institutional factors that allowed China to pass through challenges and continue to bless the country's development down the road.

Orlik emphasises, a typical financial crisis is not the one caused due to excessively high non-performing loans, but the one caused by banks not having sufficient funds. In the middle of the Asian financial crisis in 1997, the South Korean banks did not meltdown because they provided too much loan to the crony capitalist *chaebol*. They melted down because the money markets that financed it dried up. Similarly, in 2008, Lehman Brothers did not fail due to excessive investment in subprime mortgage securities, but because the money markets that financed its activity decided to cut it off.

Looking back at China, a combination of high savings rate and stricter control of capital outflows means that funds are unlikely to be a problem. Orlik points out China's central bank can overcome the so-called impossible trinity, where an economy cannot have free-flowing capital, a fixed exchange rate and an independent monetary policy – all at the same time. True, the surge in borrowing is a problem. The bank's balance sheet may not adequately reflect the actual scale of bad debts. But as long as the bank's funds are sufficient, it will not trigger a crisis, Orlik counters.

Besides, at the government level, its capability to implement reform policy should not be underestimated. Even during the Hu Jintao days, the Western observers had always doubted the extent to which China would open up. But Orlik believes, when we look at the currency exchange rate and interest rates (these are two important factors impacting the economic activity and financial system), they both showed low or minimal human intervention. Likewise, in 2020 too, the RMB exchange rate is a true reflection of its market value. Moreover, the interest rate today as compared with 5 or 10 or 15 years ago respectively, is more a reflection of the impact of the market.

Since China watchers in the West tend to view the Chinese leadership in a certain manner, they have often ignored the real progress happening in China. Speaking of China's policy of deleveraging, Vice Premier Liu He had outlined deleveraging measures at a select core group meeting of the central finance leadership four years ago. The figures below reveal a rapid slowdown in "grey loans" following the measures announced by Liu He. The same slowdown trend has been noticed in the recent two years. This proves the Western observers underestimated the ability of the Chinese leadership to act.

The third error of judgement the overseas observers have towards China has much to do

with the SOEs. The contrast between the US free market system and the Chinese mixed market mechanism centring on the central government makes an interesting comparison, especially as reflected in the relationship between the government and enterprise. In the US, laissez-faire is a key driver of economic vitality; whereas in China the largest bank, telecom companies, airlines and other large industrial enterprises are all state-owned, even there is a (Communist Party of China) CPC unit in all privately-owned companies – unthinkable in America.

If we look at China's SOEs as a large, independent economic entity, they actually will be ranked as the world's fourth-largest economy – larger than economies of Germany, United Kingdom, France and India, and many other developed as well as developing economies.

In the West, there is a completely negative image of state-owned enterprises, and SOEs are believed to be inefficient as well as “hotbed” of corruption. Indeed China's SOEs have come with many costs, including the dilemma of inefficiency as their return on assets is very small as compared with that of private enterprises.

But according to Orlik, China's leaders have learnt their lessons from the mistakes committed by Mikhail Gorbachev, the leader of

the erstwhile Soviet Union. The lesson learnt is: Gorbachev did not have control over the nation's lifeline industries. This not only caused chaos in the regime but also undermined the country's reform process.

The book was written before the world was disrupted by the coronavirus outbreak, but its arguments about the pros and cons of China's state-led growth model remain relevant. China's direct control over the SOEs, along with penetration in the private sector enterprises provides policymakers with powerful tools to manage the ups and downs of the economic cycle. There is very little evidence to show there is any disruption caused by the impact of the pandemic: the SOEs insisting on continuing to hire employees has prevented the unemployment from rising; on the other hand, major technological companies, including state-owned dinosaurs to gleaming new tech titans have swung into action, and have come forward to support public health and provided cut-price loans to smaller businesses and street vendors, helping them keep afloat during the lockdown. In the middle of a crisis, joint actions on the part of the central government and giant enterprises act as great strength to deal with the situation. Behind all this lies the advantage of the competitive edge that comes from its enormous size.

The fourth aspect of China which is grossly overlooked by the observers in the West is the

medium-term prospects of the economy. As Orlik sees it, overseas China watchers are obsessed with the communist country's declining working-age population, the middle-income trap and ongoing trade war as factors that may hinder China's entry into the global market. He admits these are the headwinds of China's economy, but at the same time, he also emphasises China has indelible advantages.

Behind all these advantages are the benefits of China's enormous size. He refers to the wisdom of Adam Smith, the father of modern economics, who realized in 1776: that the "vast multitude" of China's population gave it a built-in advantage in the global economic race. If, Smith wrote, China could "learn for themselves the art of constructing all the different machines made use of in other countries," they would be able to leapfrog ahead of smaller rivals. China's domestic market is so large it can support a very large labour force segment and it can support a strong manufacturing industry.

In 1978, Deng Xiaoping opened China's doors to the outside world, and following China's entry in the WTO in the year 2001, China made full use of every opportunity that came its way "to learn." By planning the country's resources to acquire new technology and then by expanding it to the huge domestic market, Chinese companies first used the technology in

the textiles and metals, and soon extended the use of the technology in high-speed railways, solar panels and nuclear power etc.

Is Chinese economy losing its engine of growth? Orlik does not think so. He compares China with Japan. In 1989 when Japan's economic bubble busted, its GDP had already reached the level of advanced European nations, Orlik writes. The Japanese economy's ability to use technology to promote productivity had reached its peak. In contrast, China's per capita GDP today is far behind the US, and it is this process of catching up which will continue to act as China's engine of growth for years to come. Orlik is confident of China continuing to maintain an average annual GDP growth rate of 5% up to 2025, and a growth rate between 3% - 4% until the year 2030.

COVID-19 and "Chinese Model"

To say there are various factors which can make a variety of "bubbles" within the Chinese economy to pop, or that there exist moments of "total liquidation," for example under the current pandemic crisis, Orlik does not seem impressed. The contrasting results shown by China and the US in containing the COVID-19 crisis indicate a reversal of the situation as compared with the situation prevailing before the global pandemic crisis outbreak. Just when

the epidemic had hit Wuhan, the US Commerce Secretary Wilbur Ross had said, the outbreak of coronavirus in China “will help to accelerate the return of jobs to North America.” A few months later, China’s economy has recovered, while in the US there is a danger of the pandemic getting out of control.

A close look at the past six-months (January – June 2020) economic situation in China and some other economies shows, China had been the first country to be hit by COVID-19, however, the decline was not as great as in other major economies, and the rebound was faster. How come China is not reeling under economic crisis? Why has China recovered faster than the other economies? According to Orlik, answer to all above questions lies hidden in China’s unrecognized strength.

The outbreak of epidemic in Wuhan and during the economic lockdown that followed, the PBoC, China’s banking industry, China Insurance Regulatory Commission and State Administration of Foreign Exchange all issued a joint statement, promising to keep money flowing through the system. Besides, these giant state-owned institutions also announced several measures including easy and more money in loans to MSMEs. The PBoC pumped in 1.7 trillion RMB into the market; reduced interest rate; and helped eased the tight market conditions by creating a record high cash reserves. By introduced new regulatory

restrictions making it difficult for the bearish short-sellers, sent a clear signal to the cash-rich insurance funds to immediately start buying stocks.

Under the full support of the central authorities, the market in China quickly recovered its lost ground. RMB is a key indicator of investor confidence, and the exchange rate against the US dollar returned to a strong 7 level. China’s 7-day repo rate is at the centre of the financial system’s fluctuations and has all along remained low and stable, indicating banks have no funds shortage.

Under stable financial system conditions, the policy focus is on bridging the gap between businesses and households and thereby preventing the lockdown measures brought in due to the pandemic from triggering bankruptcy and rise in unemployment. With banks fully aware that they have to release loans. All across the country, small businesses and firms have been given loan holiday facilities. Changes in fiscal policies have helped reduce the burden on businesses, measures such as the release of cash flow, tax relief and social security payments have helped businesses to keep their operations going during the pandemic lockdown conditions.

State-owned majors know from their long experience that during a crisis they need not stop hiring workers and they need not shut

down the flow of funds. Tencent Holdings Ltd. and Alibaba Group Holdings Ltd., tech giants whose payment and messaging apps are the digital arteries of China's economy, created add-ons that enabled the government to judge who could leave the house safely. Leveraging its payment network, Alibaba provided cut-price loans to small businesses and street vendors, helping keep them afloat through the lockdown.

The pandemic has revealed a systemic advantage that China has been hiding from the public view, i.e., intervention from the state machinery during a crisis is much more efficient. The state's intervention provides solid financial support to banks reflecting a huge competitive edge. Orlik admits, this is precisely why the so-called Chinese bubble has never popped up.

“Rosy Scenario” Perspective

At the CSIS online seminar, various experts engaged themselves with Orlik, raising all kinds of doubts and questions. Joyce Chang of J P Morgan said, the Chinese government's gradualist approach is proving out to be beneficial under a crisis situation, mainly because China did draw its lessons from the Asian financial crisis. China's situation today is different from what Japan was faced with when its bubble busted. The Chinese situation

is also different from the South Korean economy which was heavily dependent on foreign funds, whereas China's current approach is to gradually welcome foreign investment.

J P Morgan estimates China's GDP this year to be around 2%, and it has placed the global GDP growth rate at minus 4%, while it is hoping China to grow at 8% next year. This V-shape rapid re-bounce is impossible to be achieved by any other economy. Chinese system could provide a fixed supply of funds which was able to pull together all its resources. Chinese economic stimulus exceeded its GDP by 15%, which will further accelerate its economic recovery. Suppose a few “bubbles” in the Chinese economy were to perish, that will tantamount to striking a huge blow to not only China but also to the global economy. This does not augur well even for those in the West who view China's rise as a geopolitical challenge.

In J P Morgan's calculation, each drop by 1% in China's GDP would mean the rest of the world will see a fall of 0.4%, while economies that rely on export bulk commodities, such as Brazil, will see their GDP fall by 1%. J P Morgan also reckons, by 2030, if China maintains a growth rate of at least 4% - 4.5%, the global economic growth rate too will continue to reel under the impact of the Covid-19 pandemic. To get relief from the

pandemic, global government's public debt will have to be maintained between 15% and 20%. So if China will continue to face debt issues, other economies too will not be able to remain immune.

Joyce Chang underlined China's ability to be "self-sufficient," which is evident in the arena of sci. & tech consumption where China leads the world. China has put a lot of emphasis on building a sound science and technological base. It has already constructed a high level of sci. & tech supply chain. Although China did not achieve this easily, yet in fields such as telecommunications, consumption, science and technology, artificial intelligence and Internet of Things (IoT) etc, China aims to achieve full self-sufficiency by 2030. These concrete aims and goals will enable China to put off the so-called bubble popping up scenario.

Speaking of geopolitics and national security, China is clear about certain bottom lines that cannot be crossed. These are, namely the Taiwan issue, territorial disputes in SCS and the continuing activities in the Korean Peninsula. Besides, China also considers its fight against coronavirus pandemic has been better than any other country.

Helge Berger, IMF Director, China and Assistant Director, Asia Pacific pointed out, the Chinese government need to learn about an important development, that is the top-bottom

overall control strategy definitely has its advantages but it can also lead to extremes. Cited the example of the 2008-2009 global financial crisis, Hegle said, China's excessive stimulus package eventually resulted in partial impact only. China's one-child policy too had been violent at times, he noted.

On the high tech front, though it is true China is in frontline position in several areas, but it is also true, there are key high tech areas in which China is still not a global leader. This will impact both China's productivity and growth rate. While it is true China enjoys high national savings, but 45% savings of the GDP is far from ideal way of utilizing funds. China's overall debt continues to be extremely high, corporate debt too is between 130% - 170% of the GDP (this remains to be seen whether this includes the local governments backed corporate debt), which is far above the world ratio of 90%.

Ann Rutledge, Founding Principle – CreditSpectrum thought there were bubbles in the observer's eyes. Elaborating it further, Ann said, bubbles exist or not depends on how one looks at them. What is a bubble for me can simply be a malfunction to someone else. People in the West often misjudge the Chinese model due to the difference between the capital market and the Chinese economic model. Economists in both China and the US often

interpret the Chinese system from their own respective social and cultural perspectives.

China has the largest securitization market in the world. This has in the past caused the US financial crisis. But is there a bubble in China's securitization market? Both China and the US haven't done much to understand this problem. However, Rutledge believes it is important to realize that a large component of Chinese financial activities belongs to shadow banking. She said she completely disagrees with Orlik's view of the source of China's financial bubbles. For she thinks the real bubble in China's financial system is not in debt. Although banks are short of funds, assets cannot their tangible value because they cannot be fully monetized. The generation of intangible funds depends on the transparency and quality of information, she concluded.

Rhodium Group Director, Logan Wright began his argument by saying the Chinese government's policy move to reduce debt is not without cost. China has not been exempt from the cost of leveraging, and now banks are more exposed to credit risks. 52% of China's financing comes from unconventional sources. Deleveraging in the year 2018 had an extremely negative impact on economic growth, causing a two-thirds contraction in corporate credit. 70 of the 103 industrial value indices fell, and the weighted average fell between 6%-7%. Since then, we have seen

banks continuing to generate new credit risks. In 2019, the Baoshang Bank Co., a city lender in Inner Mongolia, became the first bank in twenty years to fail. The bank was taken over and reorganized. More recently, two local banks were in trouble, all this shows that shadow banking remains excessively vigorous.

Wright further pointed out, of course, national savings are important, but during the pandemic, it became challenging to redirect savings. The central bank can always inject more circulation funds into the market, but if it does not acknowledge that China is currently facing a crisis, it (China's central bank) will find it difficult to sustain take big measures. And once the central bank recognizes there are problems within the system, it may then lead to a real financial crisis. Wright also talked of between 30% - 50% possible fall in the Chinese real estate market.

Scott Kennedy asked: Isn't China's overall system too fragile? Elaborating further, he wondered if the current Chinese regime was too flexible. What standards should be used to measure China's economic performance? Isn't Orlik being too illusionary about Chinese economy? What impact will Sino-US ties have on China? Were the United States to block China's ability to use the world financial system, what would be the consequences?

Orlik responded by saying, faced with some really difficult choices, the Chinese government chose to confront the problem head-on. Therefore, he does not think the Chinese government will overlook its hidden value, and we cannot underestimate the advantages the government enjoys. In the past, to maintain stability, China tried its best to maintain the GDP target even if high growth brought the imbalance that came with it. The first six months of this year is a stress test for China, the economy has contracted by 6.8%, individual incomes have declined, the unemployed population has increased, but we have not seen social unrest. Therefore, the claims about the vulnerability of the Chinese system are a bit exaggerated. China and America are in a new cold war? If the US had refused to establish diplomatic relations with China in 1978, refused to provide financial and technological assistance to enable China to implement reform and opening up, we would be living in an altogether different world today. But now, even if Europe and the US are increasingly wary of a rising China, it is difficult to imagine a world completely decoupled.

Hegle Berger cautioned, it is too early to speak of the impact of the pandemic on the Chinese financial system. The fact is the government guarantees enterprises and credit under the pandemic situation, so it is difficult to see the chinks. But once the society returns to normal

and the guarantees are gone, we shall begin to know the risks of bad debt and shadow banking.

Berger further pointed out, although the government's deleveraging policy has been somewhat successful, let us not forget China has 1.7 trillion in securitization credit which is not counted in the accumulated debt. Instead, shadow borrowings get consumed through securitization and the actual debt may be as high as two to four times the book. Berger's real concern was not fragility of the Chinese financial system but a weak global system. The bias of the data reflects contempt for science, she remarked.

Joyce Chang noted China's share in the international financial market is still very limited. In the foreign investor's investment portfolio, China-related securities or products account for only 2.3%. Though China has begun various mainstream stock and bond indexes, it is the development of its financial market which will determine China's future growth. Two-thirds of China's savings are still in a traditional bank savings account, with securities and fund investments accounting for only 16.4%. In post Covid-19 world, the RMB internationalization will be extremely slow-paced. At present, foreign investment in China has declined, and the global industrial chain is also facing reorganization. Therefore,

China is still facing human-made financial dangers.

Future of a Rising China

Nevertheless, the story of China's rise is far from over. According to Orlik, China's GDP is still one-third of the US, meaning there is a lot of room for catching up and growth. As China focuses its attention on future technologies such as electric vehicles, robots and AI etc, it will maintain a 5% growth rate up to 2025 and will be able to stay afloat around 5% growth rate until 2030. As global businesses continue to invest in building relations with China, President Trump's trade war is unlikely to change this trajectory.

Although many banks and shadow borrowings are having problems, these activities will continue to take place as long as the market believes that the government will guarantee their businesses. As long as China continues to develop, the government's ability to provide such support will not be questioned.

Of course, if the "bubble" does not perish during a once-in-a-century pandemic, then what? Just like Scott Kennedy said, the story of China's rise reflects the typical "half glass water" phenomena; some people see the glass half full, while others see it half empty.

Following "GDP 6%" debate among China's economist at the end of 2019, the government work report during this year's "Two Sessions" chose not to set GDP growth target for the year 2020, the first time since the reforms unfolded. I reckon this to be a wise move. To not set a GDP growth target under specific circumstances will give the government flexibility in flattening the pandemic and in resuming production. On the other hand, the government will continue to strive hard to avoid excessive investment or in giving out bad loans due to the pursuit of growth figures.

The views expressed here are those of the translator and not necessarily of the Institute of Chinese Studies

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