The Angst over China's Slowdown*

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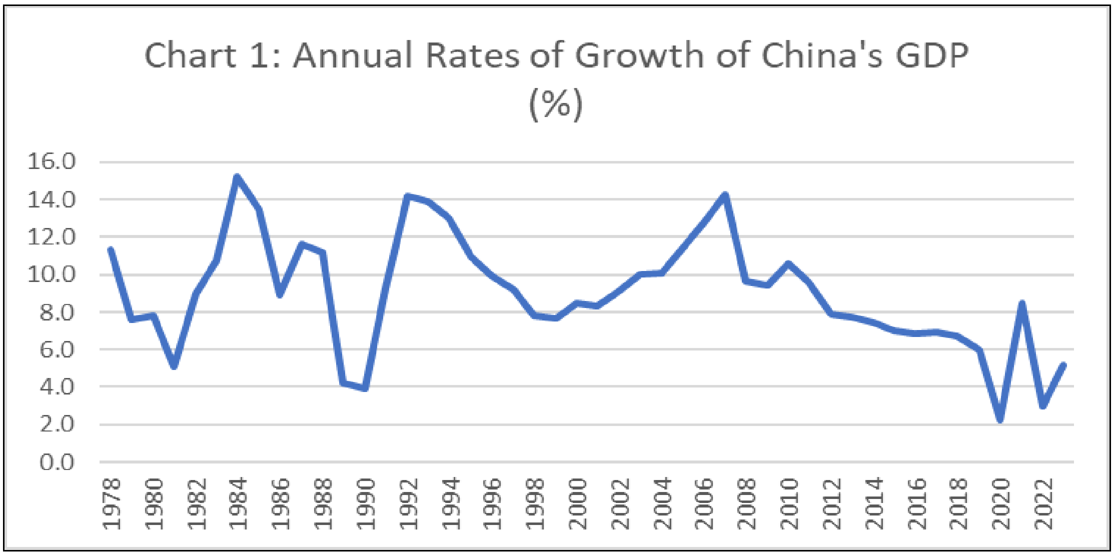
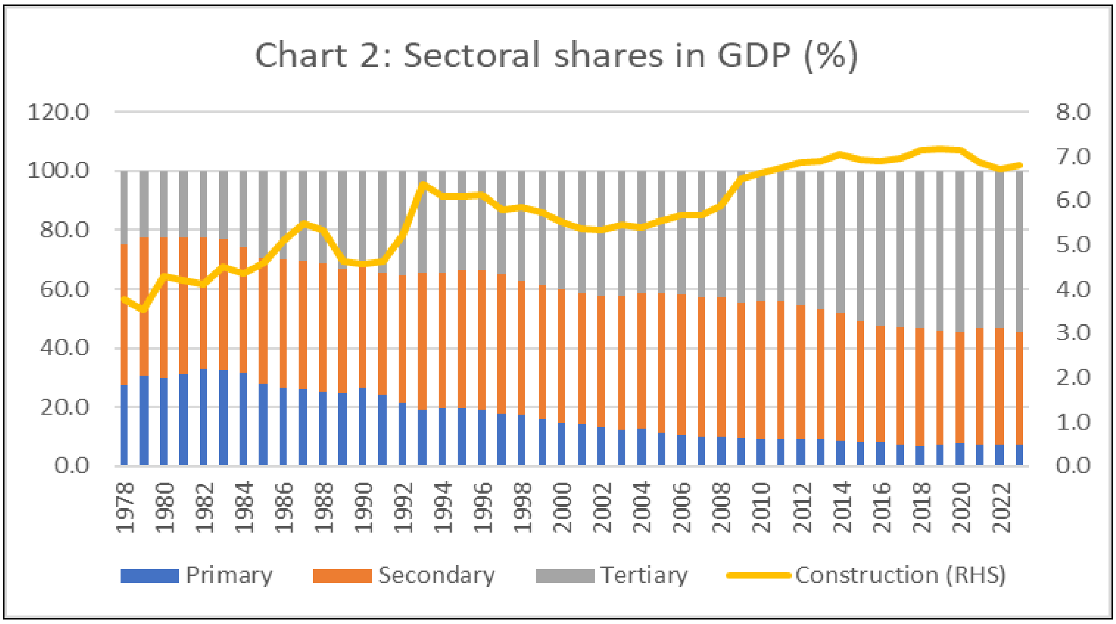
For some time now, global economic news reporting has been dominated by the growth slowdown in China. The tone of that reporting is conflicted. On the one hand, there is a barely suppressed sense of satisfaction or "schadenfreude" (pleasure derived from another's misfortune). The myth of a 'rising China' capable of sustaining high growth for decades is seen to be busted. On the other hand, there is a sense of fear about the consequences for the rest of the world. This is not restricted to the less developed countries exporting primary commodities to China and receiving large investments from it. Fear rules among the transnational firms which benefit from China as both a market and a cheap production site, and the financial wealth holders who profited from the opening up of Chinese financial markets. They pretend that China needs them more they need China but recognise their dependence.

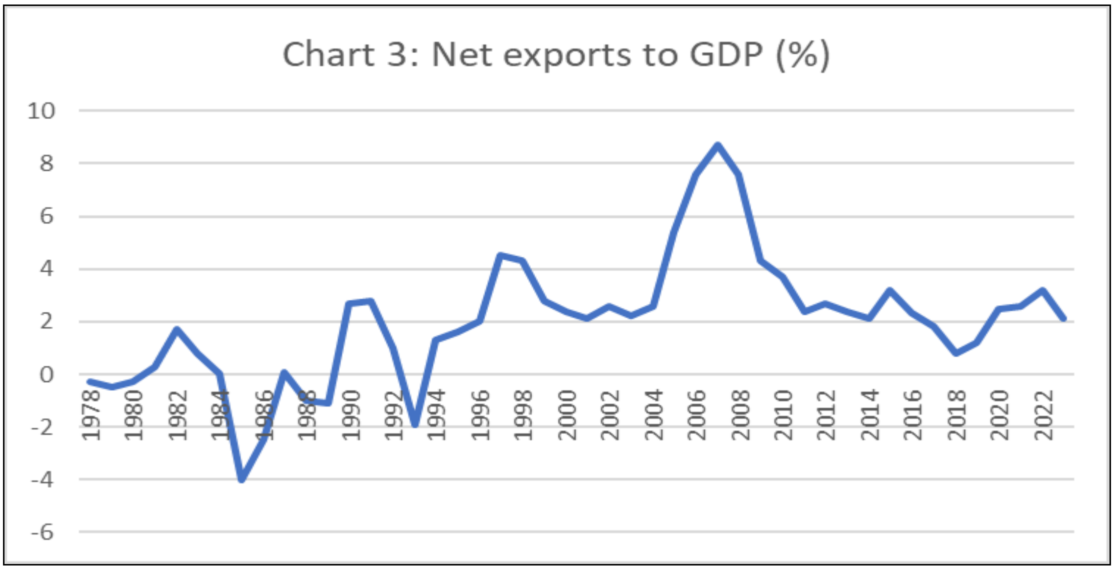
A caveat is needed at this point. Although slowing down, Chinese growth (at near 5 per cent per annum) is by no means low for an economy of Chinese dimensions. It is only relative to its own past record that China is doing badly. But this too should not be exaggerated. As Chart 1 shows, in the years since 'reform', began in the later 1970s, annual GDP growth rates have fluctuated quite sharply in different sub-periods. In fact, though the slowdown can be traced back to the advanced economy financial crisis year 2008, if we exclude the pandemic year, it is only in 2020 that growth at 3 per cent was below the previous 1991 low of 3.9 per cent. GDP bounced back to 5.2 per cent in 2023 and is expected to remain close to the official target of 5 per cent in 2024. This near 5 per cent rate of growth is well above that in any of the advanced economies oi North America and Europe and in Japan. Since 1978 the growth rate has been above 10 per cent in 16 years, between 8 and 10 per cent in 12, between 5 and 8 in 14, and below 5 in four years. The current "low" level of growth is not even "unprecedented".



Structurally too China seems to have done well. Even before the launch of reforms, the share of the secondary sector had touch closed to 50 per cent. Despite the restructuring of ageing state-owned enterprises, involving the closure of many, that share stood at between 40 and 47 per cent till early 2000s, after which the previously gradual transition to services accelerated (Chart 2). That is the classic pattern of structural change in the transition from less developed to developed country status.

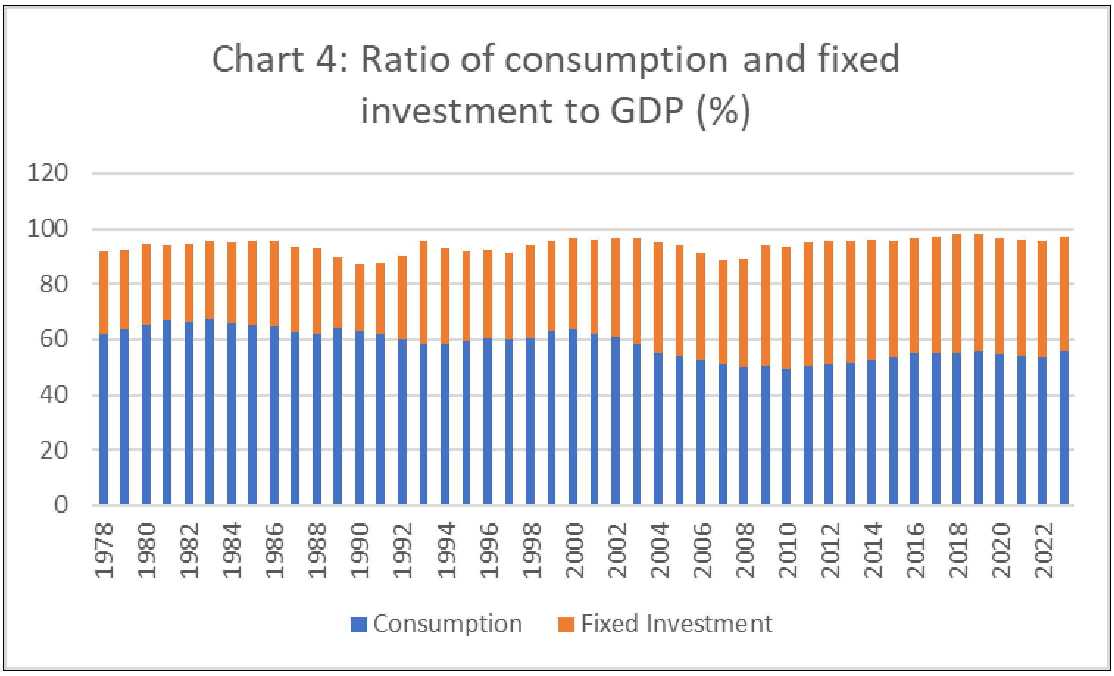


This is not to say, there are no weaknesses in China's economy and its structure as it evolved in the years since reforms began. One important weakness is, ironically, what was a crucial driver of China's earlier high growth: exports. As Chart 3 shows, high exports have meant that, China's recent hunger for imported food and raw materials notwithstanding, the ratio of net exports to GDP has been positive and often relatively high, providing China both a stimulus for growth as well as the flexibility that foreign exchange surpluses provides. But with the global economy slowing after 2008, rising concern about the growing presence of imports from China in the markets of the advanced economies, and a backlash against China's rapid technological advance in frontline areas, this 'dependence' on exports has proved a liability. The export stimulus has been dampened, with attendant implications for growth.



But as has been noted by many analysts, this was not the only consequence for growth. A parallel tendency was for wages and incomes to rise slowly and remain relatively low as a means of ensuring competitiveness. In the years immediately following China's entry into the WTO, the share of labour compensation in China's GDP fell from 60.3 per cent to 54.8 per cent, before that trend was reversed. But even in 2019 it was at 58.6 per cent below its 1999 peak of 60.6 per cent.

A concomitant was that consumption has failed to rise significantly as a share of GDP despite many years of high growth (Chart 2). As a result, the ratio of fixed investment to GDP has remained at very high levels, exceeding 40 per cent in all years since 2009 (Chart). While this was all positive initially, helping to drive growth, diversification in production and exports, along with productivity increases, in time the benefits derived from investment have been falling with the ratio of investment to output rising. Meanwhile, restrained consumption has meant that domestic demand has been slow to take the place of exports as a driver of growth.



A rising share of this investment has been in real estate, financed with borrowing from an increasingly liberalised financial sector. This fuelled speculation in real estate, contributing to oversupply, partly reflect in a high and rising share of construction in GDP. This has led to both oversupply and unsustainable debt, both of which underlie the unravelling of the housing boom in recent times.

A growth strategy of this kind has had collateral damage in the form of rapidly rising inequality in what was a significantly egalitarian system before the reform. Such inequality has also meant that income increases outside of government have also had lower effect on output growth.

Chinese policy makers have been conscious of these inadequacies of the growth trajectory for some time now, making "rebalancing", away from exports and investment to domestic markets and consumption, and "common prosperity", or a reduction of economic and social inequality, policy priorities. Those efforts, though underway, have clearly not gone far enough to reverse the slowdown. But the recognition of these challenges in government and the still reasonable rate of growth of a relatively large economy suggest that the excessive celebration of or concern about China’s worsening economic performance are both exaggerated.

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