CHINA’S ECONOMIC SLOWDOWN, ITS RIPPLE EFFECT

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‘China continues to add a significant number of the working age population as each new batch graduates. That is why unemployment numbers are soaring’ | Photo Credit: AFP

The news about China’s economic slowdown has caused mixed reactions. China, for long, had been worried about fears of a slowdown and a middle-income trap. Now, there are fears of deflation which may bring bad news for China and the rest of the world. Thus, understanding the causes and the magnitude of China’s present-day economic challenges is essential.

Speaking at the National People’s Congress (NPS) in 2007, then Premier Wen Jiabao had cautioned that “the biggest problem with China’s economy is that the growth is unstable, unbalanced, uncoordinated, and unsustainable”. It was expected that some form of course correction would be undertaken in the subsequent period. However, as the world experienced the global financial meltdown in 2008, China chose the strategy of investing in infrastructure that included railways, highways and the energy and construction sectors. It had swept the core problems of a lack of consumption, regional inequality, and lack of social security under the carpet in order to sustain double-digit growth rate. Why it did was simple — the domestic legitimacy of the leadership in China has depended on creating prosperity and making it available to a greater number of citizens, year on year. However, by the time Xi Jinping came to power, the steroids had run their course and the wean-off period was worse off. Chinese financial markets suffered from lack of regulatory oversight since loans to business were distributed on the basis of proximity, or the famous Chinese term Guanxi — the nodal networks based on factions, friendships and relationships.

When Mr. Xi says that China is the world’s second largest economy, he is right. And he is also right when he says that China is the world’s largest developing country. During the 19th party congress of the Chinese Communist Party in 2017, Mr. Xi announced that from here on, the party would focus on quality-of-life issues as part of its growth strategy. Within this announcement there was a recognition that people’s expectations of the state had changed; but there was also an acceptance that the era of growth driven by exports, infrastructure spending and big-ticket investments was over. China termed this an era of “new normal” where the country had to overcome the two-and-half-decade-long habit of enjoying more than 10% growth. The higher growth had translated into more jobs and greater disposable income. Now, with lower than usual rates, new jobs were hard to come by. China continues to add a significant number of the working age population as each new batch graduates. That is why unemployment numbers are soaring. It is also why the government is advising students to delay their graduation and to do extra courses.

During the first term of Mr. Xi (2012-17), exports growth rates had cooled dramatically, a hint that China's labour costs were rising due to wage increase and social security investments. This was the consequence of the Foxconn suicides issue, which was seen as a political embarrassment and a social challenge. On the other hand, bad investments and easy credit availability have meant that sectors such as housing, energy, and construction have got into the bad habit of overproducing far beyond the immediate projected demand. As a consequence, these sectors have been stuck with inventory without any demand. This has happened despite the early success of the supply side reforms which shut down many underperforming companies and regulated the commodities markets.

No other country has as much a political economy as China does. China's ability to overcome its economic challenges today also has to be a political choice. In December 2020, Mr. Xi used the term “Disorderly expansion of capital”; while this term was not elaborated upon much either by Mr. Xi or by others, its timing of having appeared within a few weeks of the withdrawal of the Ant Group IPO was seen to be significant. Most scholars of China have doubted the Chinese economy's ability to be truly innovative while the party wants to control what the capitalists can and cannot do. Having made the promise of allowing the markets play a greater role in the allocation of resources during the third plenum of the 18th Central Committee in 2013, Mr. Xi has rolled back many of the promises made then. It was hoped then that political interventions in loans and investment decisions would reduce; the government did intervene when the stock markets tumbled in 2015, forcing banks to acquire stakes in slow moving stocks. It has tightened the convertibility of the RMB.

The Chinese, who save more than 50% of their income did not like that their money was going to be locked in longer because of speculation by a few others, leading to a few protests. China has initiated several social security measures to counter this tendency of saving a huge proportion of income but progress has been really slow. Also, policies such as “Common Prosperity” (aimed at sharing the fruits of the progress better), and “Dual Circulation” (aimed at increasing domestic consumption and competitiveness of the domestic markets and cutting down inter-provincial red tape) have not succeeded to the level the leadership would have liked.

There is a perception that China's serious slowdown began in 2015 but was held in control by government spending on projects such as urbanisation. The trade war between the United States and China and policies such as de-risking and China plus one (that seeks alternate production destinations for investments) accelerated the process. Finally, China's zero-COVID policy may be considered as the last straw as far as the economy is concerned. Recent data from the second quarter of the year suggest that people and companies have become even more cash conscious and are holding onto their cash. It has been hard to come out of the COVID-19 experience — food supplies ran out even in the urban areas in some parts of the country. For investors, there is a fear of an even bigger slump, thus making them wait for new bottom out levels.

The state-owned enterprises or the SoEs, have been another problem for the political leadership. Their assured contracts and political networks mean that they get away by political bargain and without changing their methods of operation. They also provide social security to several hundred thousand working and retired workers which means that touching them is a politically sensitive issue.

The Evergrande crisis (2020–2023) exposed China's housing bubble. It was also a symptom of misregulation and path-dependency which may be considered as symptomatic of the ills that affect the Chinese economy in general. The fact that path-dependency may cause a crash landing has been feared for nearly a decade, and the leadership is also aware of it. The middle income trap has been another long-term concern as well as China's desire to climb up the value chain — that is, not just making things in China but also designing them — may be a distant dream. It may also affect Mr. Xi's national targets for 2035 and 2049.

Even then, China's economy growing at an estimated rate of 5% would mean adding more value when compared to India's projected growth rate of 6.1% for 2023 given the size difference. For India, it may mean a cooling off of the prices of crude oil and other commodities such as cement and steel for which China has been a gigantic market. Whether economic instability would change China's perception of its rise and its risk appetite on the border is another important issue to watch.

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