World Economy

Challenges of Restarting Growth All Over Again

A paradigm shift is in the offing in how we do business and conduct ourselves as citizens and countries in an increasingly globalized, interconnected and interdependent world. Doing more of the same may well lead to extinction.

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The world's continuing lackluster economic performance since the 2007-08, global financial crisis seems to contradict the wisdom that post-crisis recovery takes about eight years on average, the median being 6.5 years (*This Time Is Different: Eight Centuries of Financial Folly*, Reinhart and Rogoff, 2011).

The apparent malaise is largely due to a number of strong headwinds. To wit, China's struggle to re-balance growth and to deleverage, weakened demand in advanced countries due to worsening demographics, decreasing marginal utility of stimulus measures like quantitative easing, and more recently, Brexit.

China's re-balancing conundrums

As the world's second largest economy and largest trader, China has been a leading driver of global growth in recent years, particularly in the aftermath of the global financial crisis. However, a 'new normal' of much slower and bumpy Chinese growth is setting in. This is dampening global growth.

Far too many analysts still think that China needs to boost GDP growth by artificial means like fiscal stimulus. To China's leadership, however, quality of growth rather than quantity now matters far more as low-margin, resource-intensive growth is facing a dead-end.

Wages have been allowed to rise to put more purchasing power in the hands of the masses. The renminbi's long-term trajectory should be up rather than down, although short-term downward adjustments remain necessary in response to changing socioeconomic pressures. The overall aim is to grow a majority of middle-class consumers to substantially re-balance the economy, away from overdependence on exports and capital investment in favor of higher-technology-intensive manufacturing, and a greater proportion devoted to domestic consumption and services.

Digital automation and aeronautics are promoted as part of a new "*Made in China 2025*" strategy. Environmental and labor laws are becoming more stringent and regional and city environmental targets are set, holding party-secretaries to account.

All these are embodied into China's *13th Five-Year Plan* (2016-2020), which focuses on innovation, re-balancing, the environment, further opening-up, and more inclusive growth.

Meanwhile, the nationwide anti-corruption drive shows no sign of abatement. It has been a wake-up call to the party politic that the entire system is corrupt to the core. Absent a comprehensive surgery and massive generational cleansing, the very legitimacy of the Communist Party is at stake. To achieve this against entrenched vested interests, concentration of power is perceived to be necessary.

There is still too much debt in China's economy. According an article in the *Financial Times* (October 10), Chinese companies have accumulated about $18 tn in debt, an amount equivalent to 170% of gross domestic product. The State Council said it would encourage mergers, bankruptcies and debt securitization to help reduce leverage across the corporate sector. Deleveraging is not going to be smooth, as a massive number of workers will be involved. A similar concern applies to the much-vaulted reform of China's mammoth state-owned-enterprises, which is the foundation of a single-party state. It's little wonder that reform efforts seem to have stalled.

So, when will the Chinese economy rise up again? My reading is that cylinders are unlikely to be fired until a new leadership team under President Xi is in shape towards the end of 2017. Much of the power re-shuffle and jostling for positions will become clearer at the Sixth Central Committee Plenum scheduled for late October this year. Politics notwithstanding, however, China's overall economic direction, forged over a succession of five-year plans, is unlikely to change. Growth, if more moderate, is likely to be sustained.

Brexit

Regardless of the rationality of the Brexit referendum, Theresa May's government is putting up a brave face to turn lemon into lemonade. The unbundling and unraveling of thousands of EU laws and regulations, many inter-related and affecting various EU members, promise to be a complete negotiation nightmare.

As May vows to trigger Article 50 to start formal negotiations by March next year, a two-year delay-action guillotine will hang over the UK like the sword of Damocles. The UK will be cut off from the EU even if there is no agreement after two years. There is no going-back. The time limitation can only be extended with complete unanimity of all other 27 EU members. These mechanisms are designed in the first place to discourage any exit from the EU.

Other EU members are unlikely to let the UK eat her cake and have it at the same time, not least *pour encourager les autres*. Moreover, contrary to some claims, exports to the EU accounts for 12% of UK's GDP while exports to the UK represents only 3% of the EU's GDP, according to *The Economist* (October 8).

In the circumstances, the UK Parliament is fully entitled to demand being consulted on what kind of deal the UK can expect before negotiations begin rather than being presented with a fait accompli at the end. However, this seems impossible as no other EU member is in a position to promise anything before formal negotiations start. Likewise, no negotiation with non-EU countries within or outside the Word Trade Organization (WTO) framework is possible, absent UK's formal status outside the EU's Common Commercial Policy.

In this chicken-and-egg dilemma, therefore, it is difficult to see how the UK would be able to secure a very good deal. Meanwhile, market uncertainties continue to overhang. The British pound has been dropping like a lead balloon.

Western *Demographic Cliff*

Harry S Dent, Jr, a demographer, points out that baby-boomers born after the Second World War up to the early 1960s are a disproportionately large cohort compared to what came before and after (*The Demographic Cliff*, 2014). The highest peak was the late boomers now in their early 50s who should start cutting back consumption to prepare for retirement. Since relatively fewer people are coming behind, consumption in the economy will reduce, dampening economic growth. Moreover, the last 20 years has seen an orgy of debt-fueled consumption. After the bubble burst in the last financial crisis, consumption in the next decade will become even more cautious. Dent predicts a Great Deflation spanning 2014-19.

Mountains of debt

The whole world seems now drowned in mountains of debt. According to McKinsey Global Institute, at 217%, China's Debt-to-GDP ratio in 2Q 2014 ranks 22nd out of 47 countries, compared with Japan (400%), Ireland (390%), Singapore (382%), Portugal (358%), Belgium (327%), Netherlands (325%), Greece (317%), Spain (313%), Denmark (302%), and Sweden (290%). Many countries are now deleveraging, impacting on growth.

Decreasing marginal utility of stimulus

Few countries seem capable of generating sustainable growth through continual productivity increases. For want of better palliatives, many resort to quantitative easing or whatever the latest money-printing measures are termed. However, like a patient on steroids, such temporary boosts are becoming less and less effective.

For example, the Fed's balance sheet has skyrocketed from $900 bn prior to the recession in 2008 to $4.5 tn currently. Japan's Abenomics' 'first arrow' has more than doubled the size of the Bank of Japan's balance sheet since 2013. According to *The Economist* (June 30, 2016), this has failed to stimulate domestic demand or overall growth. Japan's nominal GDP was roughly the same in 2015 as it was 20 years earlier. The European Central Bank doesn't have an enviable record either.

The other side of the coin

Nevertheless, amidst gathering dark clouds, there are a number of bright spots. A more balanced view is in order.

While China and some other emerging markets are braving themselves against various headwinds, the Asian Development Bank has recently come up with a more upbeat assessment. According to a *Times of India* report (September 27), the ADB thinks that the Chinese and Indian economies combined will grow at 5.7% in 2016 and 2017. Moreover, both India and China will gain as exports to developed economies increase after two years of contraction with flows picking by 4% in 2016 and 7% in 2017.

The holy grail of emerging markets' middle-classes

A *McKinsey Quarterly* report in August 2012, *"Winning the $30 trillion Decathlon: Going for Gold in Emerging Markets"* highlights a looming seismic change in the global consumption landscape over the coming decades with an economic force "perhaps 1,000 times bigger than the 18th-century Industrial Revolution". According to the report, *"By 2025, annual consumption in emerging markets will reach $30 trillion—the biggest growth opportunity in the history of capitalism. To compete for the prize, companies must master ten key disciplines"*—to hone country-and-region-specific insights, strategic focus, flexibility and talents—necessary to get on top of the scale, diversity, rapidity, and complexity presented by this coming transformation.

According to McKinsey Global Institute's report *"Urban World: Cities and the Rise of the Consuming Class"* (June 2012), from 2010-2025, the GDP of the world's top 600 cities will account for 65% of global growth, or $30 tn, of which the emerging 400 cities will account for $23 tn, or 47%. This will create one billion new consumers by 2025. 60% of those will be in the emerging 400 whose annual consumption is expected to rise by $10 tn by 2025.

Additionally, a presentation of *Brookings Institution* (June 20, 2011) shows that, by 2030, the size of the middle-class in the Asia Pacific is expected to grow from 525 million (28% of global total) to 3.2 billion (66% of total) or from 23% of global consumption to 59% (2005 PPP$ terms). The key two drivers are China and India. The global consumption share of the top 10 countries by 2020 would change to a redistribution—China (13%), US (12%), India (11%), Japan (6%), Germany (4%), Russia (3%), France (3%), Indonesia (3%), Mexico (3%) and the UK (3%). By 2030, the share will be dominated by India and China—India (23%), China (18%), US (7%), Indonesia (4%), Japan (4%), Russia (3%), Germany (3%), Mexico (3%), Brazil (3%) and France (3%).

Green shoots set to define economies in the 21st century

Strong economic headwinds notwithstanding, brand-new transaction models driven by block chain and mobile payment technologies, Internet-of-things, social media and e-commerce are beginning to challenge many traditional businesses.

For example, the future role, size, coverage and design of bank branches will be up for a revamp. A New York City company R3 is leading a consortium on block chain R&D, consisting of 60 financial companies from developing countries including Barclays Africa, the financial services firm Ping An and China Merchants Bank.

Internet-of-things are revolutionizing how smart cities are designed and built. Quantum dot technology is ushering in a new SUHD television experience. It is also beginning to revolutionize the harnessing of solar energy. A new generation of hack-proof quantum super computers is on the cards.

Meanwhile, climate change is opening up many new and exciting business frontiers, including regional and transnational smart grids to harvest inexhaustible renewal energies, and the development of driverless cars.

Additionally, a new 'sharing economy' is taking shape, led by the likes of *Uber* and *Airbnb*.

Takeaways

We are in an Age of Disruptions. With mounting problems swept under the carpet for decades, we are facing an inflexion point. A paradigm shift is in the offing in how we do business and conduct ourselves as citizens and countries in an increasingly globalized, interconnected and interdependent world. Doing more of the same may well lead to extinction. There are bound to be winners and losers. The key seems to lie in thinking outside-the-box, through a continuous application of technology, innovation, and adaptability. ■

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