IS SLOWDOWN FOR REAL?

China has been achieving a relatively high GDP growth rate over the last few decades. However, faced with a multitude of headwinds, both domestic and external, its growth engine appears to be fast losing steam.

Questions are increasingly being asked whether China's socioeconomic, if not political, fault lines are now being exposed, thanks to the burden of fighting the most-challenging pandemic not seen in a century, 360-degree mortal combat with the US' robust trade and technology sanctions, rapidly greying demographics, a national crackdown on its most successful tech giants, a simmering real estate crisis, a Damocles Sword of persistent debt overhang, and a younger generation of workers no longer prepared to accept the hard grind.

A Bloomberg Research report of July 6, 2021, warns that, depending on various imponderables, China may never be able to overtake the US as the world's largest economy. The report acknowledges that as China's population is four times the US while its productivity is about a fifth, China would only have to increase its productivity by more than 25% over a period to claim the top slot. However, "...another path is possible. Stalled reforms, fraying global ties, a shrinking workforce, and financial crisis could keep China indefinitely in second place."

China's GDP grew at a "below-par" 8.1% in the whole of 2021, which is way less than the eye-popping growth of 18.3% recorded in the first quarter of the year. Is the growth engine choking now?

No longer a blind worshipper of sheer growth

First, I need to repeat what I said in these columns in April and June last year. 10% growth on a 10-dollar economy is nothing. But for massive economies like the US and China, anything over 5% would be respectable, if not enviable.

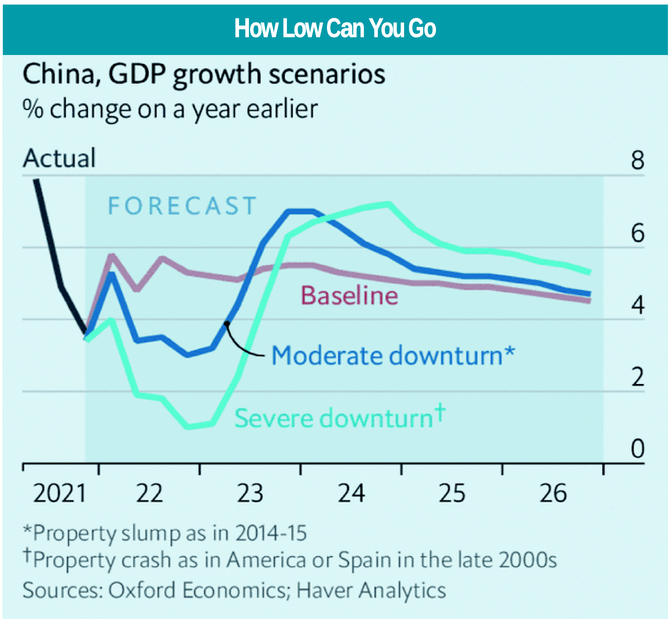
Besides, quoting the growth rate of 18.3% serves only to confuse. This exceptional rate only happens compared with the previous year's quarter when almost the whole country was in economic lockdown from the first wave of Covid-19.

Then, what has derailed China's growth after growing at a break-neck pace for nearly two decades or so? Is China finally losing its mojo?

In answering this question, one has to understand what Beijing is trying to achieve.

In early 2007, former Premier Wen Jiabao lamented that the country's economic growth had become "unstable, unbalanced, uncoordinated and unsustainable".

In pursuit of the second centenary goal of becoming a "strong, democratic, civilized, harmonious, and modern socialist country" by 2049, the centenary of the founding of the People's Republic of China, the nation can no longer afford to worship GDP growth for its own sake. A high rate of GDP growth, while remaining important in generating sufficient jobs, is no



The Economist

longer the be-all-and-end-all. It's now the quality of growth that matters.

Common prosperity: Striving for more equitable growth but maintaining an even keel

Realizing the China Dream requires Beijing to grasp the nettle of "overinvestment, reckless lending, excessive liquidity, unbalanced foreign trade, inequality between cities and the countryside, inefficient energy use, wasteful allocation of resources and environmental ruin" as pointed out by Tom Holland in the *South China Morning Post* (*SCMP*) of April 10, 2017.

Beijing has been cracking down on speculative or monopolistic investments by real estate developers, commodity traders, crypto miners, tech giants, and tutoring firms, as well as unscrupulous lending by various financial entities. While the similar crackdown on speculators occurred in the past, this time, emphasis is laid on the national imperative of "Common Prosperity". As heightened in my October 2021 article in these columns, China has 626 dollar-billionaires, the second-highest number in the world, while 600 million people have an average monthly income of only $160. This is unsustainable and politically explosive. According to a report in the Atlantic Council of November 22, 2021 by senior fellow Hun Tran, China's non-financial-sector debt—incurred by the government, corporate, and household sectors—grew to 272% of GDP in 2020. This has been reduced to 265% of GDP by the third quarter last year, thanks to stringent property regulatory measures such as the so-called "Three Red Lines"—a property company cannot borrow new debt unless its debt-to-asset ratio is less than 70%, its net debt-to-equity ratio less than 100%, and its cash-to-short-term-debt ratio more than 100%.

My November 2021 *The Global ANALYST* feature article "China: The Evergrande Crisis" shows how Beijing has been managing the giant developer's debt implosion. Armageddon so far seems to have been averted. However, due to the importance of the housing property sector to social stability, Evergrande, Kaisa and other giant indebted developers are getting a break from the government's rate cuts to relieve their cash crunch and mounting debt conundrum, as reported by the *SCMP* of January 20, 2022.

Economic rebalancing

Instead of over-reliance on exports, China's economy is rebalancing towards services and domestic consumption.

According to the *SCMP*, China's services sector accounted for 54% of Gross Domestic Product (GDP) in 2019, including transport, information and investment services, health care, arts, entertainment, and recreation. McKinsey Global Institute's July 2019 report 'China and the world: Inside the dynamics of a changing relationship' shows that exports now only account for 17% of China's GDP, with net exports (fewer import components) representing much less than 1% of GDP growth. Leaving aside pandemics distortions, in 11 of the 16 quarters since 2015, consumption contributed more than 60% of total GDP growth.

While middle-class consumption seems robust, there is still a great deal of room for China's consumption growth. In 2020, final consumption accounts for about 54 % of GDP, compared with 68.7% for the US and 58% for the UK.

As outlined in my earlier piece here dated June 2021, "China: No Longer the Global Growth Engine?" , China is doubling its high-speed rail network to 70,000 km, linking up all cities over half a million people, while an additional 200,000 km of the modern railway would connect all towns of 200,000 people and above. As a result, China's urbanization rate would increase from 60.6% in 2019 to 65%, doubling China's consumer middle class to 800 million by 2035.

According to a *SCMP* report of January 20, 2022, partly by way of economic stimulus, Beijing is frontloading its high-speed rail further expansion, increasing the network to 50,000 km by 2025, adding 12,000 km, more than the total length (11,945 km) of high-speed rail networks in Spain, Japan, France, Germany, and Finland combined.

Greying demographics is not necessarily a death knell

An oft-quoted insurmountable bottleneck to China's further growth is its worsening demographics. A popular mantra is that China will grow old before getting rich.

As reported in *Business Insider* on December 4, 2021, China's birth rate hit a record low last year, with just 8.5 births per 1,000 people, a relaxed "Two-Child Policy" notwithstanding. That is likely the lowest since the 1940s, thanks to prohibitive costs of child-raising including education, lack of childcare facilities, and a changing lifestyle.

As reported in the *SCMP* of January 1, 2022, Beijing is grappling with the challenge with new measures such as a "Three Child Policy" more days off for childbirth parents, and financial incentives, including housing subsidies.

Raising the universal retirement age from 60 to 65 and loosening the household registration (hukou) system of internal migration could add at least 150 million to the urban workforce by 2035.

Nevertheless, as China is rapidly moving towards higher-value-added productive activities, worsening demographics are no longer China's economic death knell.

Productive digitization and robotics

As reported by *Bloomberg*, China is betting on productivity instead of the population to drive economic growth.

China is witnessing nine million university graduates a year, up from only a million in 2000. As outlined in my earlier article "China: No Longer the Global Growth Engine" of June 2021 in these columns, more than 40% of these graduates are in Science, Technology, Engineering, and Mathematics (STEM). China ranks second only to the US in scientific publications. Its universities are climbing up global ratings. While still struggling to catch up on high-end semiconductor chips, China is leapfrogging in 5G, Artificial Intelligence (AI), Big Data, Internet of Things (IoT), quantum computing, biotechnology, and space exploration.

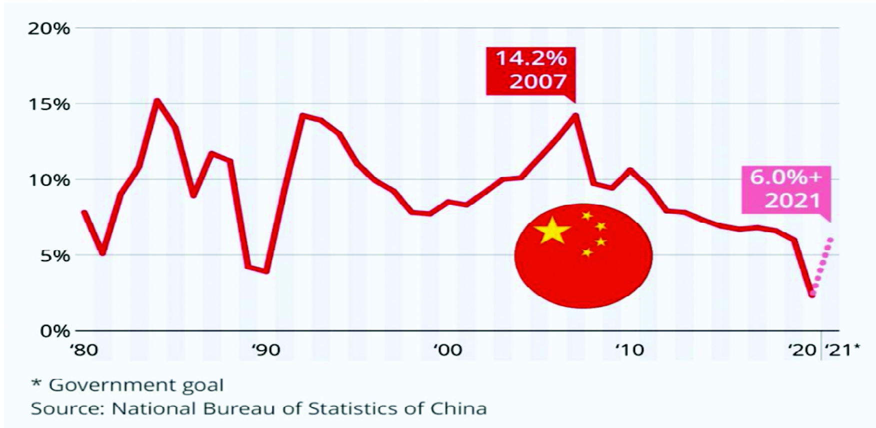
China has successfully landed a robotic probe on Mars, the second country to do so, and is single-handedly completing its own Space Station, as reported in my other feature article of July 2021 "China's Space Odessey: World's Envy?"

China's economy is now being driven by digitization and robotics. Appearing on the scene are "people-less" stores, shops, hotels, and waiter-less restaurants with digitally-ordered menus perfectly prepared by robotics.

On December 28 last year, China unveiled a 5-year plan for robotics amid a global race in smart manufacturing. By 2025, more than 70% of large-scale Chinese enterprises should be digitalized, and more than 500 demonstration manufacturing facilities will be built nationwide.

China Announces GDP Growth Goal of More Than 6%

China's real GDP growth since 1980



As reported on January 18, 2022, by Natixis, a French bank, pandemics disruptions notwithstanding, China's resilient manufacturing sector registered value-added growth increasing to 13.9% year-on-year in Q4 2021, way up from only 2.7% in Q4 2019. Exports surged more than 20% year-on-year in dollar terms in November and December 2021. In December 2021, the manufacturing fixed asset investment grew by more than 10% year-on-year.

The above suggests that China's overall productivity could rise significantly, supported by the latest five-year plan emphasizing better vocational education and more investment in scientific research, automation, and digital infrastructure.

A greener China in the making

As emphasized above, China is no longer seeking growth for growth's sake. A greener China is in the making. Witness the recent forced closure of many subpar coal mines across the country, even at the risk of energy shortages, in a turbo-charged effort to meet China's Paris Agreement pledges of reaching carbon peak by 2030 and carbo neutrality by 2060.

Continuing reliance on coal notwithstanding, China's carbon intensity, the quantity of energy input to achieve a unit of economic growth, dropped 48.1% in 2019 from the 2005 level, exceeding the reduction target of 40% to 45% ahead of schedule. Also exceeding 2020-set targets are China's photovoltaic installed capacity reaching 204 million kilowatts; its installed wind power capacity reaching 210 million kilowatts; the ratio of non-fossil energy to primary energy; and the ratio of green buildings in new urban areas.

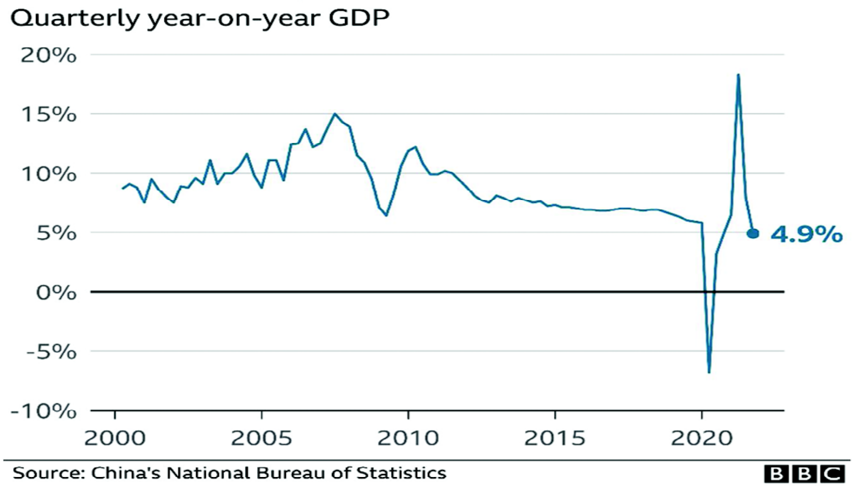
China already leads the world in solar, wind, and hydroelectric power capacities. In partnership with America's clean energy car giant Tesla, China's 2021 electric car sales soared, putting the world's largest Electric Vehicle (EV) market on track to reach its 20% penetration target ahead of schedule, reported the *SCMP* of January 11, 2022.

A seldom acknowledged imperative of China's green credentials is that in addition to pressing calls for blue skies and clear air from a rising middle class, national security dictates greater self-reliance on home-grown renewable energies, thereby minimizing oil and gas shipments through transit "choke points" such as the Persian Gulf and the Malacca Strait which are liable to interdiction by hostile forces.

Deep-rooted and ubiquitous global connectivity

Decades of opening-up and export-led growth to embrace the world has entrenched China's position at scale as the center of a global supply and value chain par excellence. Seven of the top ten container ports are in China, includ-

China's Economy Slows Down



ing Hong Kong. Out of 190 countries, 128 have China as the largest trading partner. Numerous products and components, even not marked "Made in China", have China's inputs of materials and parts embedded, including logistics. Indeed, one would struggle to find many items completely free of any input from China.

This reality is further cemented by the commencement of the Regional Comprehensive Economic Partnership (RCEP), comprising all ASEAN member states and their regional partners including Japan, South Korea, Australia, and New Zealand. This is the world's largest free-trade block accounting for a third of the world's GDP and a third of the world's population. China remains very much at its center, supported by infrastructural, maritime, trade, investment, and digital links of its epochal Belt and Road Initiative (BRI). Headwinds and accusations of "debt traps" notwithstanding, the BRI is history's largest global infrastructural and economic linkage program. It has now been embraced by 146 countries and 32 international organizations. As reported by Nikkei Asia, Richard Branson of the Virgin Group, which has infrastructure investment projects in India and other countries, said in 2017: "The Belt and Road Initiative is the only winning infrastructure strategy that can spur growth globally."

The BRI has largely been welcomed by developing economies, which are expected to account for 70% of global growth and half of global GDP by 2030, according to Jonathan E Hillman, a senior fellow at the Washington DC—based Center for Strategic and International Studies (CSIS).

In an eye-opener *The Digital Silk Road: China's Quest to Wire the World and Win the Future* (Profile Books, London, 2021), Hillman outlines how China has deeply embedded itself digitally with the world, including an ultra-high-precision global GPS satellite communication network (Beidou), ubiquitous 5G and other telecommunication infrastructure, extensive undersea cables, e-commerce, and Internet-of-Things smart mobile devices. US-led decoupling, therefore, is unlikely to suffocate China's long-term growth.

Prospects for 2022 and beyond

According to a CNBC report of January 2, 2022, Morgan Stanley considers China's GDP growth better than expected, accelerating to 5.5% growth for 2022. The nation's exports are likely to remain strong, it's economic tightening likely to ease, with the expectation of more relief for the real estate sector, and less onerous energy targets.

Looking further afield, the Chinese Communist Party (CCP)'s 19th Central Committee Plenum to be held from 8-11 November looms large. At CSIS's YouTube webcast seminar on October 28, last year, Freeman Chair Jude Blanchette and Andrew Polk, co-founder and head of economic research at Trivium China, dissected President Xi's new policy framework for turning China into a "modern socialist nation" by 2035, building a PRC.3.0.

PRC.1.0 was when Chairman Mao enabled China to stand up from a century of foreign humiliation and decades of civil war and Japanese occupation. PRC.2.0 was when Deng Xiaoping made China richer by allowing some people to get rich first. President Xi's PRC.3.0 means that after decades of unbridled breakneck growth, the country needs to become socially, ecologically, economically, and technologically more equitable, sustainable, innovative, and stronger, along with a state-of-the-art military, to propel the realization of the China Dream of national renaissance. The vision is being supported by fresh thinking like the "New Development Concept", the "Dual Circulation Strategy", "Common Prosperity", and the 14th Five Year Plan.

The CCP's track record of creating China's economic miracle and its people-based strategies and governance have won widespread support of the Chinese people. According to a July 2020 Harvard Kenney School Ash Center report, the CCP is amongst governments most supported by the people, multiple ranks above the United States.

As forecast by British consultancy Centre for Economics and Business Research (CEBR) on January 5, 2022, China's GDP should grow 5.7% annually through 2025 and then 4.7% annually until 2030, overtaking the No.1-ranked US economy by 2030, two years later than recently forecast, taking into account latest developments including the pandemics and US-China standoff. Credit insurance firm Euler Hermes made a similar projection.

Nevertheless, nothing is pre-ordained. The exact timing of China becoming the world's largest economy is less important than the real prospects for the nation's developmental trajectory. Many obstacles and imponderables remain, both domestically and internationally. Black swans cannot be ruled out. Watch this space. ■

Reference # 20M-2022-02-13-01