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CHINA’S ECONOMIC MIRACLE IS TURNING INTO A LONG SLOG

As consumer prices fall and other signs of weakness emerge, fears are growing that the world’s second-largest economy could be heading toward an extended slump.

By John Cassidy

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A nationwide real-estate bust has has left many banks burdened with bad debts and many homeowners facing a decrease in their net worths. Source photograph by Qilai Shen / Bloomberg / Getty

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As prices rise in the United States, they are falling in China. In the twelve months leading up to July, China's Consumer Price Index fell by 0.3 per cent, the National Bureau of Statistics announced this week. (During the same period, consumer prices rose by 3.2 per cent in the United States.) On the face of things, lower prices are a boon for Chinese consumers. But this deflation has been accompanied by other signs of economic weakness, including a sharp slowdown in G.D.P. growth, sluggish retail sales, a fall in exports, and a renewed downturn in real-estate prices. These developments have raised fears that the world's second-largest economy, which for many years looked like a miracle, could be descending into an extended slump. "It is a perilous moment," Eswar Prasad, an economist and China expert at Cornell University, told me, "because of the possibility that you could have declining growth, faltering confidence, and price deflation all leading to a downward spiral and reinforcing each other."

After growing strongly at the beginning of the year, triggered by Beijing's abandonment of strict COVID restrictions, China's G.D.P. expanded by just 0.8 per cent in the three months from April to June. That's well below the Chinese government's growth target of around five per cent for all of 2023, and it's far, far below the double-digit rates that the economy produced in its miracle days. And yet the Chinese government has resisted calls for a big fiscal stimulus of the sort that the Biden Administration introduced at the start of its term, leaving little hope for an immediate rebound.

Many analysts attribute some of the current weakness to public concerns about Chinese authorities' economic stewardship. Last year, Xi Jinping's Communist Party regime did an abrupt about-face on COVID lockdowns and launched an aggressive campaign to rein in some of China's most successful businesses, including the country's big Internet companies. Prasad, who returned recently from a trip to China, said that some of the business leaders and academics whom he met there expressed worries about whether the government could turn the economy around.

But the larger issue is the nationwide real-estate bust, which has left many Chinese banks burdened with bad debts, and many homeowners facing decreases in their net worth. To relieve the pressures on the property market and the financial system, the government has eased some borrowing restrictions for developments, reduced some reserve requirements for banks, and cut interest rates slightly. Earlier this year, these measures appeared to be stabilizing the property market, but home prices are now falling again, and that is putting more pressure on the highly indebted developers. Earlier this week, the biggest privately owned developer in the nation, Country Garden, missed interest payments on two of its dollar-denominated bonds, raising fears of a broader meltdown.

Rising debts are nothing new in China, to be sure. Between 2007 and 2014, total private debt went from about a hundred per cent of the G.D.P. to about a hundred and eighty per cent. This rapid jump generated fears that the country might eventually experience a debt crisis in which borrowers would renege on their debts en masse, asset prices would collapse, and the economy would tank—a phenomenon sometimes referred to as a Minsky moment, in memory of the American economist who wrote extensively about financial instability and debt crises. Using a combination of policy tools, including fiscal stimulus packages, low interest rates, and currency devaluation, the Chinese authorities managed to avoid a catastrophe after 2014. But, during the past few years, real-estate and household debt, in particular, have continued to climb sharply, prompting renewed fears of a financial crash.

Prasad, who was once the head of the China division at the International Monetary

Fund, said that there would almost certainly be more cases of individual property developers going bust and banks getting into trouble. But he didn't think that a systemic financial collapse was likely. "It's a risk," he said. "But, after having studied China for twenty-plus years, I've been constantly surprised by how they've managed to squirm out of very difficult situations." He added, however, that both China and the rest of the world will have to get used to a reality in which the Chinese economy grows a lot more slowly than it once did.

Although the Chinese economy still has many strengths, including a strong scientific base, plentiful savings, and a large internal market, it is now too large—according to the I.M.F., China's G.D.P. is approaching nineteen trillion dollars—to simply expand by relying on cheap labor and ever-rising exports. Knowing this, the government is trying to engineer a shift to consumer-led growth, while simultaneously trying to reduce inequality and foster what Xi has termed "common prosperity"—all at a moment when China's vital trading relationships with the West are threatened by rising political tensions. (Earlier this week, President Biden issued an executive order that placed new limits on American investments in Chinese high-tech companies.)

Since the Chinese economy now accounts for almost a fifth of global economic output, how it fares has important implications for other countries, including the United States. A strong China generally leads to higher prices for commodities such as oil and copper and for many other goods that the nation imports in large quantities, such as factory machinery, electrical equipment, and medical devices. A weak China could help bring down the price of gasoline and other items, but it could also depress demand and output in many other countries, with consequences that are difficult to predict.

For the past three decades, the world has been coming to terms with China's rapid economic rise, which has enabled hundreds of millions of people to escape extreme poverty, transformed global supply chains, and upended the global strategic balance. Going forward, the world may well have to adapt to something very different: a China slowly digging itself out of an economic hole. As Steve Cochrane, the chief Asia-Pacific economist at Moody's Analytics, told the *Wall Street Journal*, the former miracle economy is facing "a long slog." ♦

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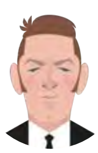

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