

ECONOMICS

## Forecasting China?

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Nobel Prize-winning economist Paul Krugman does not mince his words:

the signs are now unmistakable: China is in big trouble. We're not talking about some minor setback along the way, but something more fundamental. The country's whole way of doing business, the economic system that has driven three decades of incredible growth, has reached its limits. You could say that the Chinese model is about to hit its Great Wall, and the only question now is just how bad the crash will be.

That was in the summer of [2013](#). China's GDP grew by 7.8 per cent that year. In the decade since, its economy has expanded by 70 per cent in real terms, [compared](#) to 21 per cent for the United States. China has not had a recession this century – by convention, two consecutive quarters of negative growth – let alone a 'crash'. Yet every few years, the Anglophone financial media and its trail of investors, analysts and think-tankers are gripped by the belief that the Chinese economy is about to crater.

The conviction reared its head in the early 2000s, when runaway investment was thought to be 'overheating' the economy; in the late 2000s, when exports contracted in the wake of the global financial crisis; and in the mid-2010s, when it was feared that a buildup of local government debt, under-regulated shadow banking and capital outflows threatened China's entire economic edifice. Today, dire predictions are out in force again, this time triggered by underwhelming growth figures for the second quarter of 2023. Exports have declined from the heights they reached during the pandemic while consumer spending has softened. Corporate troubles in the property sector and high youth unemployment appear to add to China's woes. Against this backdrop, Western commentators are casting doubt on the PRC's ability to continue to churn out GDP units, or fretting in grander terms about the country's economic future ('whither China?', asks [Adam Tooze](#) by way of [Yang Xiguang](#)). [Adam Posen](#), president of the Washington-based Peterson Institute, has diagnosed a case of 'economic long Covid'. Gloom about China's economic prospects has once again taken hold.

That there are structural weaknesses in the Chinese economy is not in dispute. After two waves of dramatic institutional reform in the 1980s and 1990s respectively, China's economic landscape has settled into a durable pattern of high savings and low consumption. With household spending subdued, GDP growth, slowing over the past decade, is sustained by driving up investment, enabled in turn by growing corporate indebtedness. But despite this slowdown, the current bout of doomsaying in the English-language business press, half investor *Angst*, half pro-Western *Schadenfreude*, is not an accurate reflection of the fortunes of China's economy – plodding, but still expanding, with 3 points of GDP added over the first six months of 2023. It is rather an expression of an intellectual impasse, and of the flawed conditions in which knowledge about the Chinese economy is produced and circulated within the Western public sphere.

The essential thing to bear in mind about Western coverage of the Chinese economy is that the bulk

of it responds to the needs of the 'investor community'. For every intervention by a public-minded academic like [Ho-fung Hung](#), there are dozens of specialist briefings, reports, news articles and social media posts whose target audience is individuals and firms with varying degrees of exposure to China's market, as well as, increasingly, the foreign policy and security establishments of Western states. Most analysis of China strives to be of a directly useful and even 'actionable' kind. The stream of profit- and policy-oriented interventions, aimed at a small section of the population, shapes the 'conversation' on the Chinese economy more than anything else.

Two further features follow from this. First, the most salient preoccupations of Western commentators reflect the skewed distribution of foreign-owned capital within the Chinese economy. China's economy is highly globalized in terms of trade in goods but not in terms of finance: Beijing's capital controls to a large degree insulate the domestic financial sector from global financial markets. Overseas financial capital has only a handful of access points to China's markets, meaning international exposure is uneven. China-based companies with foreign investors, offshore debt or listings on stock markets outside of the mainland (that is, free of China's capital controls) generate attention precisely in proportion to their overseas entanglements. Thus countless news articles over the past two years have been devoted to the defaulting saga of real estate giant Evergrande - a Hong Kong-listed firm that has relied on dollar-denominated debt. Journalists and commentators may be gearing up to give the same high-visibility treatment to Country Garden, another troubled property developer with a Hong Kong listing and offshore debt. By contrast, the *Wall Street Journal* or *New York Times* subscriber will be forgiven for not remembering the last time they read an article about State Grid (the world's largest electricity provider) or China State Construction Engineering (the world's largest construction firm) - two companies less dependent on global finance and over which international investors are unlikely to lose any sleep.

The second feature relates to the financial industry's reliance on the art of political-economic storytelling to sell investment options. Clients with money to invest want more than an analyst's projection about the likely rate of return on a given investment product; they want a sense of how that product fits into the 'bigger picture' - into an overarching tale of opportunity, innovation or transition in one part of the market, in contrast to vulnerability, decline or closure elsewhere. Discussion of the Chinese economy is regularly inflected by narrative arcs of this marketable variety, whether 'bullish' or 'bearish'. These have included, for instance: the theory of Xi Jinping ushering in a third wave of institutional reform - 'Reform 3.0' - at the Central Committee's third plenum in November 2013 (nothing of the sort happened); fears of a 'hard landing' if not a 'Lehman moment' during China's financial volatility of 2015 and 2016 (GDP growth remained close to 7 per cent); and belief in the inevitability of China 'rebalancing' from investment to consumption through the 2010s (the investment share of GDP has remained above 40 per cent since 2003). Such narratives, which seem to be crafted in response to the storytelling needs of Western investors and financial intermediaries, become magnets for public debate. The 'rebalancing' story, for example, served as a compelling inducement to invest in consumer-facing sectors of the Chinese economy - until it gradually lost credibility. Some money was made along the way, and some lost, and in that sense the story was partly successful on the industry's own terms even though it was a poor reflection of economic fact.

That so much of the discourse on China's economy takes shape in response to investor interests may also explain its susceptibility to short-term reversals of sentiment. As a rule, the performance of financial markets is more volatile than that of the real economy, and in China's case it is mostly the former - to which overseas investors are most exposed, if unevenly - that drives perceptions of the latter. Hence the sharp mood swings from bullish to bearish and back, from one financial cycle to the next. In part fluctuating with the vagaries of market sentiment, Anglophone commentary also lacks consistent, credible criteria with which to assess China's economic performance. How much

growth is enough? What kind of economic expansion would it take for China not to be in a 'crisis'? In 2009, as the Chinese government was unleashing a spectacular wave of bank lending to stimulate activity in the aftermath of the global financial crisis, it was widely believed that growing the economy by 8 per cent was necessary to avert mass unemployment and social instability. That benchmark has now conveniently vanished from view; nobody in the West today would dream of saying China should aim to grow by 8 per cent per year. And is GDP growth itself an adequate metric of economic strength? The significance that Chinese authorities attribute to GDP performance has declined. The official target for 2023 is an approximate one - 'around 5 per cent' - affording a measure of leeway, meanwhile the Fourteenth Five-Year Plan (2021-2025) dispenses with an overall GDP target altogether.

In addition to protean standards for evaluating performance, there is also a degree of confusion about how to interpret major developments within the Chinese economy, especially in relation to the intentions of policymakers. The travails of the real estate sector are a case in point. The slow-motion collapse of over-indebted Evergrande has repeatedly been portrayed in the Western media as a calamity in waiting for the entire Chinese economy, in yet another iteration of the 'Lehman moment' trope. This elides the fact that the Chinese government deliberately prevented highly indebted property developers, including Evergrande, from accessing easy credit in the summer of 2020 - a measure since referred to as the ['three red lines' policy](#). Of course, no large-scale corporate default and restructuring is desirable *per se*. But it appears that failures like Evergrande's have been treated by Chinese authorities as the price of disciplining the property sector as a whole and reducing its weight in the broader economy. Although the real estate downturn, with investment declining sharply in 2022, has weighed negatively on China's overall growth performance, this seems to be the consequence of a concerted attempt to 'rectify' the sector - whose shrinking share of total economic output, even at the cost of GDP growth, might well be described as a positive development.

A starting-point for a more level-headed approach to the Chinese economy is to put the current moment in a longer-term perspective. China's economy was comprehensively transformed in the 1980s and 1990s. As a result of the waves of reform that defined those decades, agricultural production passed from the collective to the household; state industries were converted into for-profit enterprises; the allocation of goods, services and labour was thoroughly marketized; and a powerful private sector was born, expanded rapidly and was consolidated. Since this era of intense institutional restructuring ended in the early 2000s, China's GDP has more than quadrupled in real terms but the country's fundamental economic structure has remained stable, in terms of both the balance between state-owned enterprises and private capital, and the precedence of investment over consumption. In this context, instances of significant change - technological upgrading, the expansion of capital markets - have been slow-moving. The decline of GDP growth is itself a protracted affair, and the essentials of the present configuration are likely to endure for some time. China's economy is neither a 'ticking time bomb', as Joe Biden [daringly opined](#) last month, nor - an overused expression - 'at a crossroads'. The China bulls of the West may well continue to morph into China bears and vice versa in the coming years, while the Chinese economy indifferently trudges on.

**NATHAN SPERBER**

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