Gerard Lyons

An uncertain summer

Viewpoint

Last week I visited Tianjin in China for the "Summer Davos". Each year, in January, the great and the good of civil society and of the business, financial and political worlds gather in Davos for the annual World Economic Forum meeting.

Because of the timing of their new year, the Chinese tend not to travel to Switzerland in big numbers. Hence, each September over the past six years a similar event has been held in China — "Summer Davos."

The mood of the business people in Tianjin was one of uncertainty, not pessimism. China's economy is slowing but there is not yet a sense of panic. In a keynote speech, China's Premier Wen Jiabao gave a reassuring message. The past decade has seen phenomenal growth. Incomes per head have risen fivefold. Yet the old growth model is dead. A new one is needed.

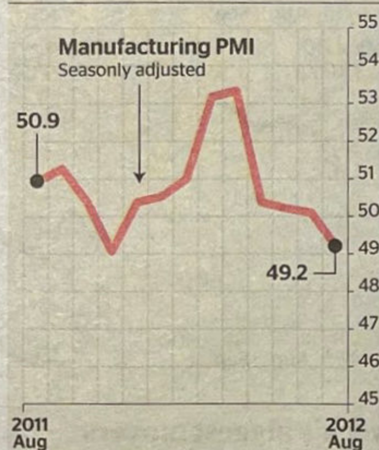
China is moving from an investment and export-led economy to one driven more by consumer spending. It wants to become more like America and Britain — although it never says it like that — while avoiding too much debt and an unaffordable welfare system.

One message from Tianjin was that China and Asia want a welfare system that provides a safety net and incentivises people to work. As one policymaker put it, Asia does not want Europe's unaffordable system "where people are paid not to work and then the Government borrows money to be able to pay them".

One implication of changing the model for China's economy is the need to focus less on quantity and more on the quality of growth. That means worrying less about the decimal point in China's GDP number and instead seeing where growth is coming from.

China was hit hard by the global recession as exports slowed. Then it unveiled a huge fiscal stimulus. Although the economy rebounded strongly, it is reluctant to repeat the scale of that boost now. There is a feeling that pumping so much money into the economy created problems, leading to local governments getting into financial difficulty and to many things being rushed, with poor-quality roads being built.

Mr Wen talked of a prudent fiscal policy and proactive monetary policy. The message was not to worry about this slowdown getting out of hand, as the authorities will ease policy to prevent growth weakening too much.



Since May the authorities have, indeed, eased policy. The question is how much of a slowdown has there been? Until two months ago, there was a clear divide: exporters were complaining, hit by weak global demand; in contrast, firms selling into China's domestic market were in good shape. More recently, particularly as the euro crisis escalated, the weakness from exporters spread, affecting manufacturing and weighing on domestic spending, as well. People in China have become less confident. Yet this is not like the end of 2008, when 30 million migrant workers lost their jobs — or, at least not yet. About 11 million new jobs have been created this year.

As the world's second-biggest economy, China now has a huge global impact. After the global recession, the world economy grew strongly by 4.4 per cent in 2010, helped by policy stimulus in the West and by a rebound in China and other emerging economies. Then, in 2011, global growth slowed to 3.1 per cent as policy stimulus in the West wore off and China raised interest rates to curb inflation. Last December, I forecast world growth of only 2.2 per cent for this year because of recession in Europe and the UK, only steady growth in the US and a slowdown in China. Despite likely weakness in coming months, global growth should pick up next year to around 3.1 per cent and China will play a key role if it does.

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While the pace and scale of change in China is huge, so, too, is its catch-up potential. For instance, China's income per head is only 18 per cent of that in the United States.

China's growth, however, comes with a cost. Its environmental situation is poor. The authorities made this a centrepiece of their Five-Year Plan last year but they have some way to go. I didn't see the sky on half the days I was there last week.

China's biggest challenge is its institutional set-up. It is still run from Beijing in much the same way as when it was a smaller economy. Also, its financial system is repressed, with big constraints in place. This means that unlike Britain, the transmission mechanism of monetary policy is not always smooth. There are other areas, too, as the inability to communicate last week over the whereabouts of Xi Jinping, the Vice-Premier, shows.

When one puts this alongside the imbalanced nature of China's economy, the implication is clear: do not be surprised if there are slowdowns like now. But a setback in China's economy does not mean that its economic boom is over. Far from it. The trend is up.

China is not the first country to enter a new phase of growth. It is called the middle-income trap. Moving from being a low-income country to middle-income one, as China has, is much easier than making the next step up to become a high-income economy. Usually, one in three countries succeed in making that next step. I think China will be one of them, but it is not going to be easy.

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