Signs of twin troubles in China

The adverse geopolitical developments are making China’s economic slowdown more worrisome

The world has become so used to China as a driver of global economic growth that the possibility of it finally stopping strains credibility among economists, businesses and scholars alike. China’s weight in the global economy has been increasing steadily. Its nominal gross domestic product (GDP) of $19.9 trillion is around 15 per cent of global GDP, making it the second largest economy in the world. It has a similar share of global trade, being the world’s largest exporter and the second largest importer of goods. About 50 per cent of the consumption of all metals in the world is accounted for by China, which is also the world’s largest importer of oil. It is estimated that China accounts for over 30 per cent of global economic growth. China is a highly globalised economy, densely interconnected to all major markets of the world. The state of its economy and its economic and commercial inter-linkages with the rest of the world have major implications for the global economy.

The Chinese economy has been slowing for some time but, even after the global financial and economic crisis of 2007-08, it is the only major economy to register a consistent 6 per cent GDP growth. Now, however, against a target of 5.5 per cent growth for 2022, it is likely to achieve only 3.5 per cent growth, the lowest in several years. More importantly, the longstanding structural imbalances in the Chinese economy are coming to a head. Over the past four decades, it is the property sector that has been the main driver of Chinese economic growth, constituting about 30 per cent of GDP. The financing model for the property sector has been inherently unsustainable. Typically, property developers obtain the full sale price of an apartment before starting construction. The funds thus collected may be used to buy land and to invest in other activities. The sales proceeds collected on another project may then be used to finance construction of the first project and so on in a continuous cycle. This is like a game of musical chairs until the music suddenly stops. Which is what has happened. The Chinese government’s efforts to start deleveraging the property sector and to limit speculation have led to a downward spiral in property prices, bankrupting major property firms and leaving a large number of buyers with expensive mortgages but no housing. In the 12 months since June 2021, property sales have declined by 22 per cent. According to another report, Chinese developers had started work on over 6.6 million square metres of property construction in the past three years but have been able to complete less than 50 per cent of the promised space.

In China, property is also used as a means of saving since very few investment outlets are available and deposit rates are low. It is estimated that as much as 59 per cent of Chinese household wealth is locked up in real estate. With property prices falling for the first time in recent years, there is a significant impact on consumption expenditure. It is reported that retail sales fell by 11.1 per cent year-on-year in April this year and by 6.7 per cent in May, but recovered to 3.1 per cent positive growth in June. China is facing weak demand, which is why its inflation rate is low compared to other major economies, remaining in the range of 2-2.5 per cent.

Another sign of a slowing economy may be seen from rising unemployment figures particularly among younger age groups. In the 15-24 age category, the unemployment rate is as high as 20 per cent.

China’s economy is also being disrupted by President Xi Jinping’s persistence with Zero-Covid policy, which is leading to frequent lockdowns and reducing China’s engagement with the rest of the world.

What is making these economic headwinds more worrisome are their interplay with adverse geopolitical developments. The confrontation with the US is sharpening. The level of mistrust and the potential for miscalculation are rising in the wake of the ongoing Ukraine war and the more recent crisis in the Taiwan Strait. The latter crisis is more consequential for several reasons. The Taiwan Strait is now a key channel for trade and energy flows to the major economies of Japan and South Korea. If there are repeated military drills and the blockade of Taiwanese ports then both shipping and air services may be forced to reroute, increasing costs and complicating supply chain flows. Taiwan is a key supplier of advanced semiconductors to several countries, including China, and a range of high-tech industries world-wide would be affected by supply disruptions.

China and Taiwan have an extensive investment and trade relationship. This cannot remain unaffected by continuing tensions between them.

An important event later this year will be the convening of the 20th Congress of the Chinese Communist Party where Mr Xi is likely to seek a further five-year term as China’s top party and state leader. Chinese reactions to the Ukraine war and the Taiwan crisis would no doubt play into the political dynamics leading to the meeting. Mr Xi cannot afford to be seen as bending to US pressure on Taiwan, which is a particularly emotive issue for Chinese people.

China is also facing challenges relating to the implementation of its ambitious Belt and Road Initiative. Thanks to the disruptions caused by the pandemic, the economic mismanagement manifest in several partner countries and the limitation of resources, there is trouble on this front as well. Cases like Sri Lanka have earned China a bad reputation of leading partner countries into a debt trap. This reputation may not be well-deserved but it has led to a wariness across the developing world about Chinese development assistance. China appears to be winding down the initiative and focusing more on projects with a geopolitical payoff rather than presenting them as an expansive harbinger of infrastructure development across Asia, Africa and Latin America.

What are the implications for India?

One, as US-China confrontation escalates, China will become more allergic to any further increase in India-US security partnership and may increase pressure on India’s borders.

Two, Chinese profile in our neighbourhood may diminish somewhat creating opportunities for India to regain lost influence in the sub-continent.

And three, a continuing decline in Chinese GDP growth, will accentuate the slowing down of the global economy and this will mean a less benign external economic environment for India’s economic prospects. Balancing these contradictory developments will pose a complex challenge for India’s foreign policy.