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The temptations of a resilient China

Stephen Roach | Yale University | 27 March 2017

Another growth scare has come and gone for the Chinese economy. This, of course, is very much at odds with Western conventional wisdom which has long expected a hard landing in China. Once again, the Western perspective missed the Chinese context – a resilient system that places a high premium on stability.

Premier Li Keqiang said it all in his final comments at the recent China Development Forum.

I have attended this gathering for 17 consecutive years and have learned to read between the lines of premier-speak. Most of the time, senior Chinese leaders stay on message with rather boring statements about accomplishments, targets, and reforms, toeing the official line of the annual "Work Report" on the economy that is delivered to the National People's Congress two weeks earlier.

This year was different. Initially, Li seemed subdued in his ponderous responses to questions from an audience of global luminaries that focused on weighty issues such as trade frictions, globalisation, digitisation, and automation. But he came alive in his closing remarks – offering an unprompted declaration about the Chinese economy's underlying strength: "There will be no hard landing," he exclaimed.

The all-clear sign from Li was in sync with official data in the first two months of 2017 showing solid strength in retail sales, industrial output, electricity consumption, steel production, fixed investment, and service sector activity (the latter signaled by a new monthly indicator developed by China's National Bureau of Statistics). Meanwhile, foreign-exchange reserves rebounded in February for the first time in eight months, pointing to an easing of capital outflows.

At the same time, the People's Bank of China took its cue from the US Federal Reserve's rate hike this month, boosting Chinese policy rates by about ten basis points. The PBOC would not have taken that step had it been overly concerned about the underlying state of the Chinese economy.

But the icing on the cake came from the trade data – namely, annual export growth of 4% in January and February, following a 5.2% contraction in the fourth quarter of 2016. This underscores a key contrast between the latest and previous Chinese growth scares.

Call it the Trump effect. The revival of the global economy's "animal spirits" in recent months has provided important relief for a Chinese economy that is still heavily dependent on exports. Whereas earlier growth scares were exacerbated by chronic downward pressures from sputtering post-crisis global demand, this time external headwinds have given way to tailwinds.

But while the near-term prognosis for the Chinese economy is far more encouraging than most had expected, an eerie sense of denial, bordering on hubris, appears to be creeping into China's strategic groupthink. With the US looking inward, Chinese decision-makers seem to be pondering the opportunity that might arise from a seismic shift in global leadership.

I was repeatedly asked about the possibility of a China-centric globalisation, reinforced by Chinese leadership in multilateral trade (the 16-nation Regional Comprehensive Economic Partnership, or RCEP), pan-regional investment (China's One Belt, One Road initiative), and a new institutional architecture (the Chinese-dominated Asian Infrastructure Investment Bank and the New Development Bank). It's as if China had been preparing to fill the void being left by Donald Trump's "America first" US.

The Chinese are keen students of history. They know that shifts in global leadership and economic power are glacial, not abrupt. Yet I get the sense that they view the current circumstances in a very different light. Trump, the great disruptor, has changed the rules of engagement for what had long been a US-centric globalisation. Many in China are now wondering whether this may be an opportunity to seize the reins of global power.

Anything is possible - especially in a world where uncertainty is the only certainty. But there is another lesson of history that the Chinese must bear in mind. As Yale historian Paul Kennedy has long maintained, the rise and fall of great powers invariably occurs under conditions of "geostrategic overreach" when a state's global power projection is undermined by weakness in its domestic economic fundamentals. Global leadership starts with strength at home, and China still faces a long road of rebalancing and restructuring before it reaches the Promised Land of what its leadership calls the "new normal".

But here there is another important disconnect between the view inside China and perceptions in the West. The view from outside is that Chinese reforms - the means to rebalancing - have stalled over the past five years under President Xi Jinping. The same view prevailed under the prior 10-year leadership of Hu Jintao. But is this really the correct way to assess what is happening in China?

Results matter more than grand pronouncements. Since 2007, when former Chinese Premier Wen Jiabao laid down the rebalancing gauntlet for a Chinese economy that had become "unstable, unbalanced, uncoordinated, and unsustainable" China's economic structure has, in fact, undergone a dramatic transformation. The GDP share of the so-called secondary sector (manufacturing and construction) fell from 47% in 2007 to 40% in 2016, whereas the share of the tertiary sector (services) increased from 43% to nearly 52%. Structural shifts of this magnitude are a big deal. The key point missed by reform deniers is that China is actually making rapid progress on the road to rebalancing.

All of which brings us back to the questions raised at this year's China Development Forum. The combination of near-term resilience and an inward-looking US appears to offer a tantalising opportunity for China. But China should resist the temptations of global power projection and stay focused on executing its domestic strategy. The challenge now is to realize the "tremendous opportunity" that Li touted in ruling out a hard landing.

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Stephen S. Roach, former Chairman of Morgan Stanley Asia and the firm's chief economist, is a senior fellow at Yale University's Jackson Institute of Global Affairs and a senior lecturer at Yale's School of Management. He is the author of The Next Asia and Unbalanced: The Codependency of America and China.