21 AUG, 2023

China`s downside is serious but there could be upsides for Asean

The Edge, Malaysia

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There is little doubt that the Chinese economy is in poor shape. It is also becoming evident that the problems go deeper than one-off shocks or the sort of occasional cyclical downturns that all other economies suffer from time to time. With limited prospects for a return to strong growth any time soon, the common assumption is that China is likely to drag the rest of Asia down with it. There are many good reasons why a torpid Chinese economy could hurt its neighbours, as we discuss below. But this is probably only one part of the picture. It is also the case that China's slowdown could bring with it some benefits for the rest of us. After all, it is an ill wind that blows nobody any good, as the saying goes. Overall, our view is that the Asean region will weather a Chinese downturn reasonably well.

Where is the Chinese economy heading?

There was very little that was encouraging in China's economic performance in July. There are three reasons why the immediate outlook is gloomy.

First, virtually every growth engine is faltering. The consumer was in the doldrums in July: Retail sales fell by 0.06% over June. Surveys by the central bank showed that ordinary citizens were saving at a higher rate while repaying debt. These are classic signs of a household sector that has lost confidence. Indeed the government's own surveys show consumer confidence to be well below the levels that prevailed before the pandemic.

Businesses remain in a deep funk as well. That has led to desultory growth in fixed asset investment, which inched up just 3.4% over July 2022. Since investment accounts for more than 40% of the economy, this is potentially quite dangerous. But drilling down into the numbers, it is clear that investment activity was bolstered by growth in investment by state enterprises. The more market-driven private enterprises, which are also the more efficient segment of the economy, actually cut back their investment by 0.5%. A separate set of data showed foreign direct investment collapsing, down 87% in July over the same period last year.

Neither was external demand of much help: The fall in exports accelerated to -14.5% year on year, after falling 12.4% in June. This was the biggest export decline since the disruptions caused by the coronavirus pandemic in February 2020.

Second, the downturn is beginning to have a life of its own, hurting the economy in ways that could accelerate the economy's downward slide.

The unemployment rate in urban areas inched up to 5.3% in July. Observers were puzzled by the government's decision to stop releasing data on youth unemployment, with some analysts wondering whether joblessness among the young had worsened so badly that the authorities wanted to curtail access to that information. A rising number of unemployed young people in urban areas is usually the last thing any government would want since this group is prone to launching protests or engaging in anti-social behaviour when frustrated.

Consumer and producer prices both fell in July, raising concerns over deflation, that is, a period of falling prices. That would be potentially destabilising in an economy with such high levels of debt (more than 300% of gross domestic product) since the real value of debt repayments will become more burdensome for companies as a result.

It is also of great concern that the worsening economy has placed the already weakening real estate sector in more jeopardy. That has led to intensifying financial stresses. Country Garden, one of the largest property development companies in China, has encountered missed coupon payments due in early August, with observers unsure if they can make the payments within the 30-day grace period it has. Then came news that the trust companies that are a large part of China's shadow banking system are also encountering convulsions. In mid-August it was revealed that Zhongrong International Trust Co Ltd had missed payments on dozens of products. Media reports claim that at least 30 products are now overdue and that the company has also halted redemptions on some short-term instruments. These developments must be of grave concern since Zhongrong is a big player in China's US$2.9 trillion (RM13.47 trillion) trust industry.

Third, the Chinese government is facing challenges in devising effective responses that can turn the economy around. China's policymakers have an impressive track record and a reputation for being innovative in finding ways to keep the economy going even in crises. So, there is a good reason why the policy response has been so hesitant. This is because the policymakers face a basic quandary — stimulating the economy in the old ways could undermine other important objectives such as develeraging an economy struggling with high debts. Hence their cautious and narrowly focused policy approach, which has failed to revive confidence.

This is why we have seen only small steps in targeted areas. The central bank is leaning on state-owned banks to lend to cash-constrained sectors such as real estate while cutting rates cautiously. Political leaders have been calling in the top private sector entrepreneurs to provide them assurances so that they will resume investing. The authorities have also announced reforms in major areas such as making it easier for migrant workers to secure permanent residence in the cities. Financial regulators have promised debt swaps, loan extensions and restructuring to tackle the problem of growing non-performing loans.

But these measures have brought little relief. We are probably going to see substantially stronger measures put in place now that China's leaders have completed their annual consultations in Beidaihe. That should help stabilise the economy, but a lot of damage has been done to the psychology of consumers and businesses, which means that any recovery will be slow.

MY Say

BY MANU BHASKARAN

China's slowdown will hurt the rest of Asia

China is the biggest trading partner for most Asian economies. It is a source of direct investment and loans, with Chinese companies becoming more present in many parts of Asia. Some of the capital is channelled through bold initiatives such as the Belt & Road Initiative, which, despite the bad press it gets in some quarters, has done a world of good in most cases. China has also taken the lead to create new financial institutions such as the Asian Infrastructure Investment Bank, which, despite its newcomer status, has emerged as a highly respected multilateral institution that provides high-quality lending to poorer countries in the region. China is also a source of new technology as its advances in electric vehicles, battery technology and solar panels shows.

Consequently, economic stagnation or mediocre growth in China will hurt.

- Chinese imports — which are principally commodities and intermediate goods such as electronic components — will fall or grow only slowly.
- Commodity prices have held up well despite the recent bad news on China, perhaps because production cuts by Saudi Arabia have supported oil prices, while better-than-expected economic performance in the US and Japan helped offset the dampening impact of China. But a sharper downturn in China would certainly damage all commodity prices.
- Cautious Chinese consumers may hesitate to go abroad as tourists and even if they do, they may cut back on how much they spend.
- The gyrations of the renminbi will put downward pressure on Asian currencies.
- Difficulties in the second largest economy in the world will hurt global business confidence generally and could cause investment and hiring decisions to become more cautious.
- Greater investor risk aversion could lead to more capital outflows from emerging market equities, bonds and other financial assets.

So, there is little doubt that if the stepped-up policy measures we expect do not turn around China's economy, the rest of the world will suffer, including Asian economies. The only question is whether there might be some offsets to this dismal outlook.

What are the possible upsides for the rest of Asia?

The saving grace in this is that there are indeed several offsets to the impact that a slower Chinese economy would create.

First, global corporations are recalibrating their assessment of China. The tensions between the US and China, the downwardly revised expectations for Chinese growth as a consequence of worsening demographics, the concerns over Beijing's renewed emphasis on national security over economic growth and its ideological shifts, all combine to persuade more companies to relocate production out of China. China's slowdown and the policymakers' hesitant response will expedite this process. An examination of announcements by companies and data on new foreign investment commitments point to an accelerated pace of such relocation, with Southeast Asia a major winner.

We believe that the re-channelling of foreign direct investment flows away from China to regions like Southeast Asia will continue for a long time, acting as an important driver of the region's growth prospects.

Second, the region's policymakers now realise that a China-inspired commodity price boom is not going to help. In the period when China boomed after it entered the World Trade Organization, commodity prices soared. That provided room for "lazy growth" in emerging Asian economies such as Indonesia. Exports rose effortlessly and royalties from mining companies filled the fiscal coffers, allowing spending that boosted economic growth. There was no need to do the heavy lifting of pushing through unpopular but necessary reforms in labour markets and elsewhere. The result was what economists call "premature deindustrialisation" — the commodity sector grew but manufacturing withered. When commodity prices fell eventually, not much was left behind in terms of drivers of sustainable economic development.

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Now, leaders in developing economies know that tough decisions have to be made and that they have to work hard to mobilise the resources needed for economic success. Leaders in Asean also know that they operate in a very competitive world and that the once-in-a-generation opportunity presented by this relocation of production out of China could be lost to other competitive regions if they do not get their act together. Countries such as India, Mexico and Türkiye are large enough and have developed considerable competitive advantages in recent years. The result is that the political elites in the region are focusing on improving infrastructure, liberalising restrictions on foreign investment, cutting red tape, stepping up human capital development and improving trade connectivity so as to keep Southeast Asia ahead of its competitors.

Third, Chinese manufacturers, faced with a growing oversupply in the domestic market, will tend to flood the global market with their goods at discounted prices. China could thus export its deflation to the rest of the world. This will help to cool the high inflation in the rest of the world. However, this will come at the price of damaged profitability in some sectors.

Conclusion: This could be Asean's moment

So long as the resilience demonstrated by the advanced economies prevails and there are no further shocks, Asean economies should be able to deal with a Chinese economy growing at mediocre rates for a couple of years. But they must continue to improve their fundamentals and avoid policy errors that scare away foreign investors. ■

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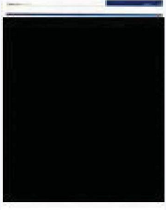

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SUMMARIES

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