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Singapore Management University

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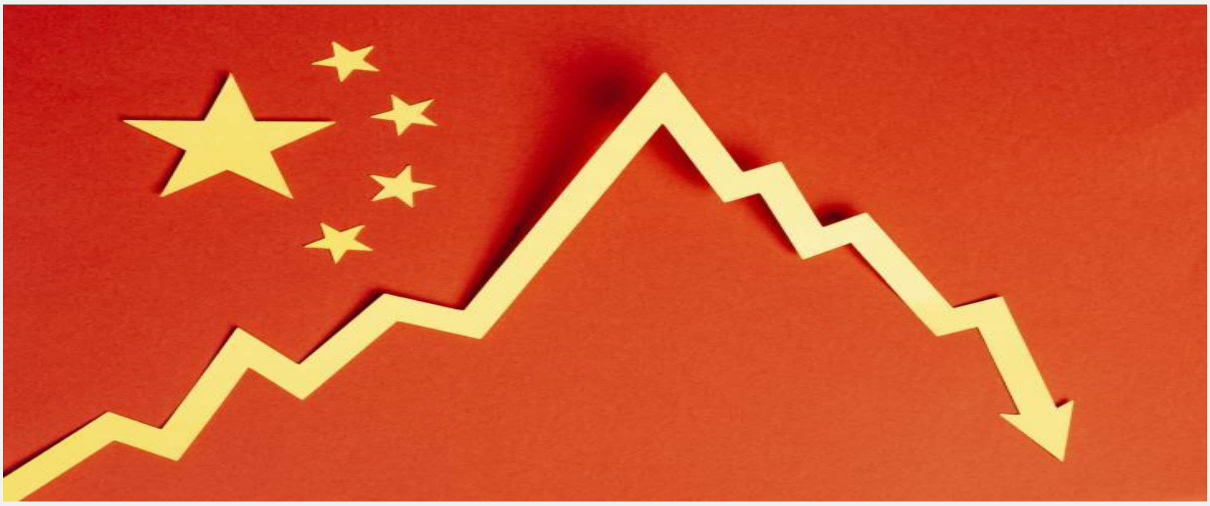

It is still a developing economy with room to grow out of trouble

When China announced in April that its economy grew 6.7 percent in the first quarter of 2016, hitting the top end of Beijing's 6.5 to 6.7 percent target growth rate for the year, fears of a much-talked about "hard landing" were allayed if not completely removed. Economists credited rate cuts by China's central bank, the People's Bank of China (PBOC), for stabilising the macroeconomic situation but also pointed to the mountain of corporate debt state-owned enterprises (SOE's) have racked up to fuel overinvestment and created unproductive excess capacity.

"What you are going to see in China now is a second massive wave of layoffs which would be similar to that in the early 1990's," explains **Henry Gao**, Associate Professor at the Singapore Management University (SMU) School of Law. "But it will be different this time because in the 90's there was a lot of hope amongst the population. People's earnings were rising, career prospects were good.

"These days, wage growth has slowed and even stagnated, and there are problems in the economy, the environment and the housing market. The expectations have changed and people no longer have a rosy picture for the future."

CHINA: ROOM TO GROW OUT OF TROUBLE

Gao made those observations at the recent recording of a discussion panel for Singapore-based station Channel NewsAsia's Perspectives programme, "The Impact of China's Economic Slowdown". While over 40 million SOE jobs were lost during the 90's along with another 30 million in sectors such as manufacturing and mining, growth in service industries helped absorb the workforce.

China's economy, currently undergoing painful structural reforms, would be hard pressed to accommodate a fraction of that number. With current debt-to-GDP ratio of 250 percent – most of that debt tied to SOEs – the panel was asked if the current situation is akin to that of Japan's in the mid- to late-1990's.

"I think there is no parallel at all," asserts **Ho Kwon Ping**, Chairman of the SMU Board of Trustees. "When Japan went into recession it was already a very developed economy.

"China is still growing at 6.5 percent, Japan was at zero growth. If China goes to zero growth, there will be riots on the streets. But because it's a developing economy, it has a lot of headroom."

Making a comparison between Singapore and China, fellow panel member and economist **Song Seng Wun** of CIMB Private Banking points out: "Singapore is 20 square kilometres. When it slows down, go atop the Monetary Authority of Singapore building and you will see if things are slowing down. In China, you go to the top of the Shanghai tower and you just see Shanghai.

"You're talking about a population in excess of 1.3 billion people in the whole of China, so the coastal areas may be slowing down but China can push growth inland. They can push consumption to raise disposable income and drive the economy."

He adds: "Is 6.5 percent doable over the next 10 years? Yes, if we don't see another big external shock that leads to a recession. The potential for China to maintain at least five percent growth is quite easy mainly because of that huge development gap between provinces and cities."

Making inroads inland and into China

Gao believes that China's appetite for infrastructure development in the vast rural hinterland offers plenty of growth opportunities.

"One of the reasons for the [creation of] AIIB (Asian Infrastructure Investment Bank) and the One-belt One-road initiative is to get rid of the surplus capacity within China," he explains. "You see the excess capacity within China along the coastal areas, so the leadership is looking to export the capacity to the countryside along the one-belt one-road initiative where there is a lot of need to build infrastructure.

"One unfortunate fact about the one-belt one-road initiative is that it's driven by the state-owned enterprises, who ultimately take their orders from the government. The private firms, on the other hand, are rather hesitant in investing in the countries along the one-belt one-road initiative."

While China's private sector sit on their hands amidst economic uncertainty, Ho urges companies to seize the opportunity to enter the Chinese market.

"If you talk to South East Asian companies that are regional or international, they see the slowdown as a good opportunity for them," says Ho, who is also the Executive Chairman of resort operator Banyan Tree Holdings. "China's consumption economy, or to the extent that it exists, was largely an upper class economy. That's why the Chanel and Louis Vuitton phenomenon was so big, but that's slowed down.

"On the other hand, you see in places in China that consumption is growing, the middle class is growing. These consumers aren't buying Chanel bags but they could be buying Charles & Keith shoes, which is a Singaporean brand. The middle class is continuing to grow, they are continuing to consume."

He advises: "You do not go into a market when it is at its peak. You go into a market when it's beginning to develop some problems, and there is some sightline that the cycle could change in two years' time."

A Xi change?

By 2018, Xi Jinping will still be the man in charge although the makeup of the Politburo will likely be rather different. Current power struggles within the Chinese Communist Party suggest that the Chinese president may not be as powerful as he has been made out to be. It raises the question: What will happen to the slate of economic reforms that Xi had embarked on?

“There are more observers who now say given the size of the Chinese economy and the relative sophistication of policy makers, there are things that will happen regardless of Xi Jinping,” says Ho. “The central bank is quite capable of handling the NPL’s (non-performing loans) coming up regardless of what happens to Xi Jinping. The restraint on the SOEs and the restructuring of the SOEs are going ahead irrespective of what happens to him. There’s not much worries on the macroeconomic side.

“But there is growing concern about the political machinations around Xi Jinping himself whether his own fate might not derail the whole process. The question is: how will his political fate in any way affect what is an inevitable reform process in China?”

Ho Kwon Ping, Henry Gao and Song Seng Wun were part of a discussion panel, “The Impact of China’s Economic Slowdown” for the SMU-Channel NewsAsia programme Perspectives that was recorded at SMU Labs at Singapore Management University.