FT Alphaville **Chinese economy**

The implications of China’s mid-income trap

The IMF has chainsawed longer-term growth forecasts

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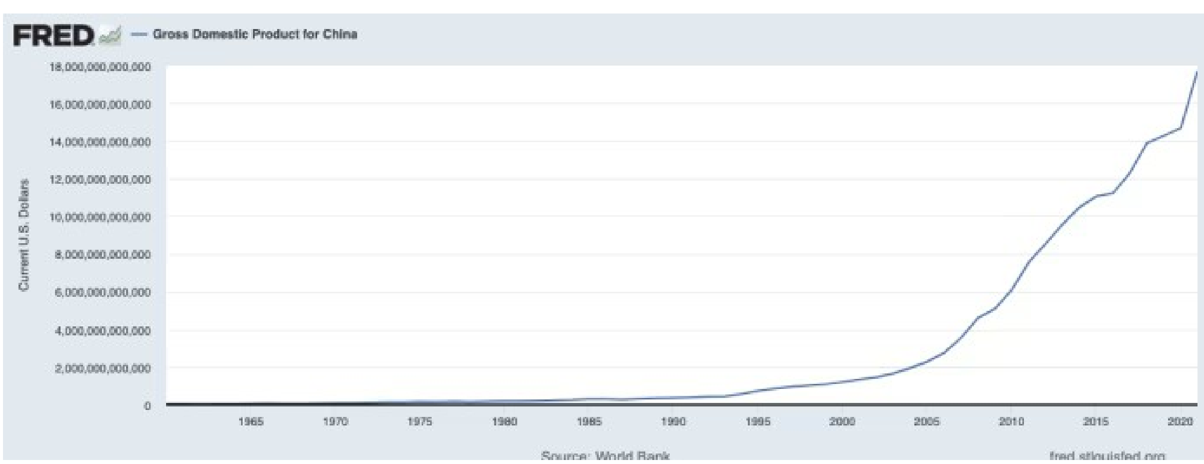
Three decades ago, China's annual economic output was about $433bn in current dollar terms, making its economy roughly the size of an Austria or South Africa today.

It is now comfortably the world's second biggest economy — with current-dollar gross domestic product of $17.7tn — and in the post-financial crisis era it has easily been the single biggest contributor to global GDP growth.

Between the beginning of 2010 and the end of 2020, China's economy grew by about $11.6tn in current-dollar terms. That's the equivalent to adding about six and a half Russias, almost four UKs or Indias, nearly three Germanys, more than two Japans, or more than 50 Greeces. It's like adding an Indonesia every year for a decade.



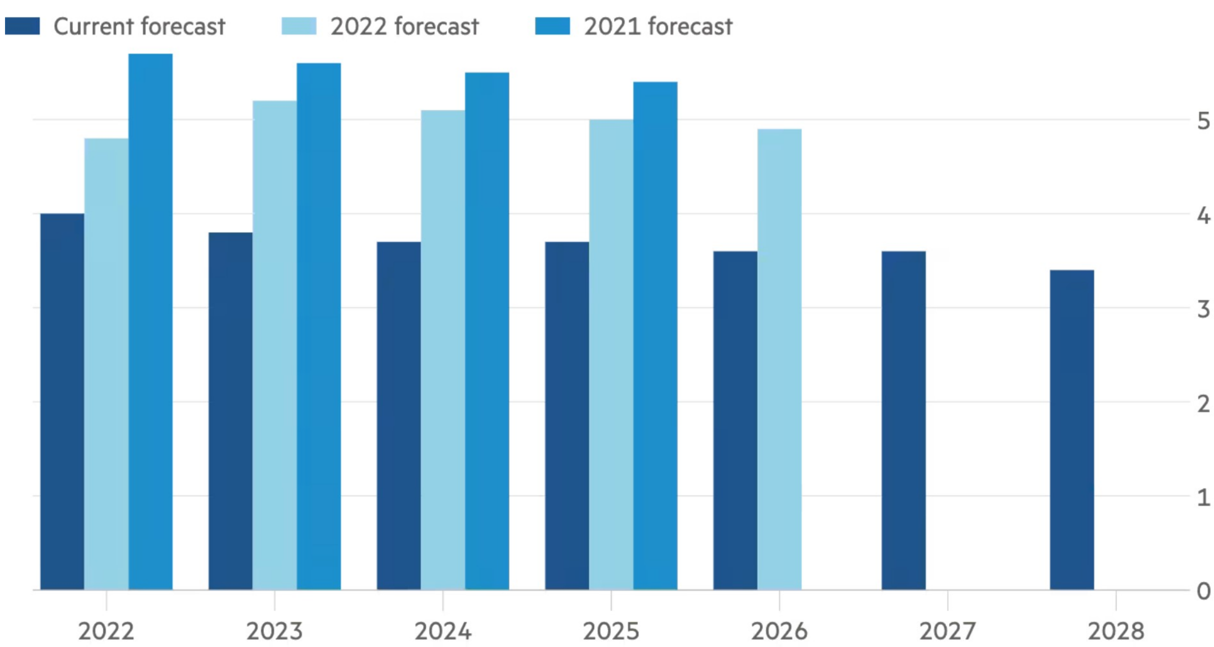
Let's set aside quibbles about the accuracy of Chinese economic data using current dollars etc. The point of this numberwang is to show that China has clearly been THE essential engine of global economic growth for the past decade plus.

Why are we going over this again? Well, a few weeks ago we wrote about the IMF's Article IV report on China. FT Alphaville subsequently had a chat with Sonali Jain-Chandra, the IMF's mission chief for China, to dig a bit deeper into some of the issues (such as the ongoing property-market shenanigans) and find out what we should be thinking about that doesn't necessarily hit the headlines.

Our biggest takeaway was that the IMF has become much gloomier on the longer-term growth potential of China, having marked down forecasts for 2024-28 by **more than a percentage point**, decelerating to just 3.4 per cent by 2028. Here's a chart showing the most recent forecasts versus those the IMF made in the last Article IV report a mere year ago, and the one from 2021.

Mid-income trap ahoi

The IMF has chainsawed its longer-term Chinese economic forecasts (%)



Source: IMF
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As Jain-Chandra pointed out, some of this was inevitable. But it is also a consequence of policy choices — and with the right policies the slowdown can be ameliorated. Here's her view:

> “As the Chinese economy reaches closer to the frontier it is natural that growth would slow down from the 8-10 per cent growth seen in the past few decades. A slowdown was therefore inevitable, but that does not mean that higher than expected growth is not within reach. In fact our analysis shows that China has the potential to grow faster than our current medium-term projection if it adopts a comprehensive set of reforms aimed at boosting productivity and counteracting a declining labor force.”

A separate “selected issues” report published after the Article IV puts more flesh on the bone. The main issues are well known. A rapidly ageing population means much slower labour-force growth in coming years, and productivity growth has already fallen sharply as the easy gains from investment in technology and skills have mostly been made.

But there are some idiosyncratic issues that is increasingly weighing down China’s economic potential, according to the IMF:

> What is unique in the case of China is the additional pressure from diminishing returns of investment-led growth, as excessive investment — driven by record-high domestic savings — has been channeled towards relatively less productive SOEs, activities such as real estate, which are less growth-enhancing over the longer term, and to further increase China’s already comparatively very large public capital stock. This pattern of investment in China has sped up the decline in aggregate productivity, and hence, potential growth.

Basically, it looks like China has now found itself in a classic middle-income trap, a term the World Bank invented back in 2006 to describe the phenomenon of emerging economies that never, well, actually emerge.

On one hand, almost all the countries that have managed to spring themselves free from the mid-income trap are in Asia: South Korea, Taiwan, Hong Kong and

Singapore, for instance. On the other, the current global economic environment is radically different today. Globalisation, for example, is sputtering.

If China's economy keeps downshifting then the implications are . . . not great.

Going by World Bank data — via the St Louis Fed's FRED database — China accounted for more than one in three dollars of economic growth in the 2010-2020 period. It can probably claim indirect credit for a lot more, thanks to the knock-on impact in countries like Brazil and Australia. What could possibly replace it? Let's just say we're still sceptical India will prove the answer.

The IMF is not the only institution worried about the global implications of a secular downshift to China's growth. Last October FTAV highlighted how the BlackRock Investment Institute was also low-key freaking out about the longer-term outlook for China and what it might mean for the rest of the world.

While the relaxation of Covid-caused lockdowns has improved China's near-term economic outlook, BlackRock's Alex Brazier and Serena Jiang reckon that China's potential growth rate could fall to just **3 per cent** by the end of the decade.

> In the past, when countries faced a slowdown, they could still rely on Chinese consumers and companies to buy up their cars, chemicals, machinery, fuel — even as consumers at home tightened their belts. And they could rely on China to continue supplying an abundance of cheap products as China's rapidly growing working population enabled it to keep production costs low. Not so anymore. Recession is looming now for the US, UK and Europe. But this time, China won't be coming to its own, or anyone else's, rescue.

It now looks like the US and Europe might escape recessions (fingers x'd). But the longer-term fallout from stalling Chinese growth could still be stupendous.