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Comment/ Opinion

A booming US economy and a Chinese crash? Think again

China is using its downturn to deflate bubbles and raise productivity while the US is doing the opposite – feeding the Bernanke bubble and hoping for an AI cure for falling productivity

Andy Xie

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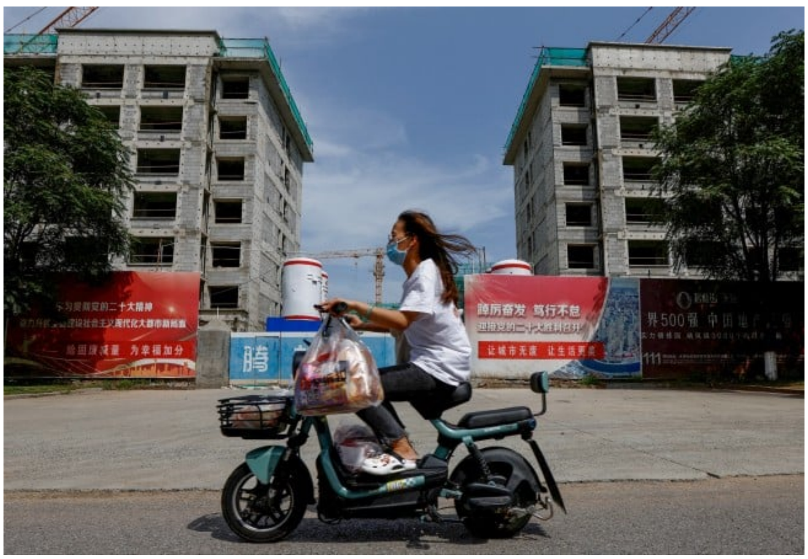

A woman rides a scooter past a construction site in Tianjin on August 18. China is busy dealing with its "twin cancers": a property bubble and shadow banking system rife with Ponzi schemes. Photo: Reuters

China's economy is more sustainable precisely because it is deflating its bubbles, while a US economy that continues to rely on an expanding debt bubble can only be headed for a cliff.

For the first three quarters of this year, China's growth of 5.2 per cent came from improving efficiency on the supply side; in the US, growth came on the back of its fiscal deficit increasing sharply as a proportion of its gross domestic product.

Yet there is manufactured consensus in the West that China's economy is crashing and the US economy is booming. For China, its deflating property bubble and high youth unemployment rate are cited as evidence. As I have said before, when an economy enters a downturn for the right reasons, it is an opportunity for renewal. And China appears to be making all the right decisions.

China's economy has been plagued by "twin cancers": a property bubble and shadow banking system rife with Ponzi schemes. A bunch of very destructive people screamed "GDP!" and "jobs!" to get the government to print money. China was marching to the cliff. But the government stopped feeding the beasts two years ago.

Chinese workers are among the world's most competitive. As long as China's economic system is not too obstructive and the global market remains open, China will boom. Prosperity happens naturally in peacetime China. Only endemic government corruption and a mass speculative frenzy can bring China down. These destructive forces are in check for now, so China's immediate future looks good.

Dealing with the twin cancers will take a long time and the economic pain is just beginning. The losses embedded in the shadow banking system, for instance, are estimated to be in the trillions of yuan – and the psychological blow from these losses has yet to sink in fully.

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But as the bubbles deflate, Chinese businesses are focusing more on productive, but less glamorous, activities such as becoming better at making things. The breakout success of China's electric vehicle sector is probably the most important one. The automobile sector is a major chunk of global manufacturing and much bigger than the smartphone market. China's transition towards electric vehicles was inevitable.

Chinese companies are not just leading, they are also innovating faster than their competitors and can dominate the global auto sector in the coming decade. Countries competitive in automotive-making have traditionally become high-income economies. China may well go down that path.

But while there are bright spots in the Chinese economy, they cannot completely offset the drag from its property sector. The surge in domestic tourism made up for some of the downward pressure – but it won't be able to do the same next year.

As China holds the line against reviving its bubbles, productivity growth will eventually boost the economy again. In particular, the virtuous economic circle linking China and the rest of the Global South will provide a powerful lift.

China is supplying renewable technology and infrastructure across the Global South at affordable prices. This will increase productivity across the region and lift the purchasing power of billions of people.

06:32

China's Belt and Road, 10 years on

China's Belt and Road, 10 years on

The United States, on the other hand, is stuck with the legacy of the bubble engineered by former Federal Reserve chairman Ben Bernanke in 2008, in response to the subprime mortgage crisis that triggered a global financial crisis. When the market is trying to flush out destructive people, the government should not step in to save them.

When it does, they come back to haunt you. In the US, there are those who were bailed out who went on to help create a bigger bubble, which now hangs around the neck of the US economy. This is why the Federal Reserve cannot shrink its balance sheet in a timely manner. This is why the government must run ever bigger deficits to keep the economy afloat.

Meanwhile, despite a boom in demand, US labour productivity has been going nowhere for the last three years. It fell to 1.6 per cent the decade before, down from 2.7 per cent in the previous decade.

The US seems to be pinning its hopes on artificial intelligence and its promise of revolutionising productivity. But I wouldn't bet the farm on that. Rounds of AI hype have come and gone: the latest caught the mass imagination only because ChatGPT appears to be able to talk to people.

05:03

How does China's AI stack up against ChatGPT?

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But it is too early to say if it is just a version of a more sophisticated deepfake or real intelligence. The latest developments in generative AI are based on massive data and computing power. But how confident are we that intelligence boils down to data and computing power?

Remember self-driving cars? For at least a decade, we were promised that the miracle of autonomous driving was very nearly here – but it will probably be another decade before it is ready. And this is task-specific AI.

There is talk in the market of a recession coming to the US once the Federal Reserve starts cutting interest rates again soon. Don’t hold your breath. The US government is spending borrowed money like a drunken sailor chasing alcohol. Lower interest rates just means cheaper alcohol.

How can an economy go into recession when more money is available to be spent? This story will stop only when the US bond market crashes. But that is another story.

Andy Xie is an independent economist