Is China ready to occupy the 'centre stage'?

While 18 October was the day of Diwali in some parts of India, the day was important for a few other things too. In China, the 19th congress of the Communist Party opened with President Xi Jinping delivering a three-and-a-half-hour address. On the same day, Rex Tillerson, the US secretary of state, delivered a speech at the Centre for International and Strategic Studies on the Indo-Pacific and came down hard on China while holding up India as a potential long-term partner. On the same day, I finished reading Y.V. Reddy's *Advice And Dissent: My Life In Public Service.*

According to Reddy, Chinese policymakers do their homework, come well prepared for meetings, are very punctual, share information only to the extent necessary and do not answer questions if the questions have not been given to them in advance. They made it clear that they wanted to beat the US by 2020 in every aspect of the economy. He had observed these traits in the early 1990s. He thought they had the work ethics of the developed world and would grow rapidly. This was his experience in 1993-95. They have proven him right, for the most part.

Xi's address informed the world that China was prepared to take centre stage and offer guidance to the rest of the world on development. He had laid down markers along the way—a moderately prosperous society by 2020; one of the most innovative countries by 2035; and a first-class military by 2050. Commentators also made much of the fact that the target of doubling gross domestic product (GDP) by 2020 had been omitted and this was taken to mean that there would be focus on the quality rather than quantity of economic growth going forward. But we have seen this movie before. Indeed, on the day, the Chinese stock market managed to close with gains due to some last-minute buying in stocks of big companies. This has happened before. It is not hard to guess how.

The People's Bank of China (PBoC) releases China's annual financial stability report in June or July, with the English version following a month later. In July, when the Mandarin version for 2017 came out, Ambrose Evans-Pritchard wrote (for *The Telegraph*, London) about the fact that the size of the Chinese banking system's off-balance sheet assets had been quietly bumped up to 109% of the on-balance sheet assets. The new estimate of off-balance sheet assets of the banking system is 253.52 trillion renminbi, as of 2016.

The English version for 2017 is not yet available on the PBoC's English language website in the usual place, "Financial Stability". But in the "ZeroHedge" blog, I found a link to the English version of the 2017 Financial Stability Report. It confirmed the figure that Evans-Pritchard wrote about. So, now China's off-balance sheet assets in the banking system are about 340% of GDP! In fact, between on- and off-balance sheet assets, based on PBoC calculations, the banking system's assets are about 6.5 times the nominal GDP of 74.4 trillion renminbi for 2016.

Prof. Victor Shih at the University of California at San Diego thinks that the PBoC estimates of banking system assets are overstated because there could be double-counting. He has come up with his own calculations in a new brief for the Mercator Institute for China Studies in Germany (Merics' *China Monitor*: "Financial Instability In China: Possible Pathways And Their Likelihood", 20 October). According to him, overall credit to the non-financial sector (including households, Central and local governments) from banking and non-banking channels (including shadow-banking channels) was around 328% of GDP in May. For comparison, the Bank for International Settlements puts this number at 257.8% as of March. Given this huge debt burden, China's interest payments are rising much faster than its nominal GDP. He notes tersely, "China as a whole is a Ponzi unit." That does not leave much room for doubt.

The massive amount of credit that is being created has become incrementally inefficient.

According to a JP Morgan research note from June, China now needs more credit units per unit of economic growth than it did before the crisis of 2008. The Conference Board, a business lobby and research group in the US, publishes global productivity tables twice a year. Its figures for China are now based on two estimates of economic growth—official and alternative (theirs). According to the "alternative" estimates, China's GDP growth in 2015 and 2016 was 3.6% (7.5%), 3.9% (7.2%). For 2017, the estimate is 4.1% (6.9%). The official figures are in brackets. These figures are adjusted for purchasing power parity. Similarly, the International Monetary Fund has its own estimate of China's general government debt and deficit ratios. The estimates are 62.2% (36.6%) and 10.4% (3.7%), respectively, for 2016, with the official figures in brackets. By 2022, it sees these rising to 91.5% and 10.7%, respectively.

China's leadership might well be aware of these issues. But they have concluded that Western nations are far worse off than them—politically in disarray and economically vulnerable too—and that their relative decline presents them with a "strategic opportunity". Therefore, they are betting that they would be better off solving their economic problems through a dash for the centre stage now. But heavier reliance on debt in recent years to sustain economic activity has made the case for "hiding and biding" only stronger.

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