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CHINA'S ECONOMIC FUTURE IS NOT AS BRIGHT AS IT WAS TILL RECENTLY

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Chinese military might on display can't hide the fact that its economy is past its best growth years

The Chinese Communist Party celebrated the 70th anniversary of the founding of the People's Republic of China on 1 October with a military parade that did not hide its prowess. It was raw power projection. The US has been warned, though I very much doubt that it played a role in the mini trade deal that China and the US appear to have struck last week. If China's economy matched its military strength, the world might have more reasons to be worried. That is not the case. Far from it.

Many writers, including yours truly, have written premature obituaries on China's economy many times in the last few years. It is easier to explain forecasting failures than to get them right. One explanation is that unlike the former Soviet Union, China is too embedded in the global economy for its economic collapse not to affect others. Second, just as is the case with sovereign states and their leaders, corporate and many personal fortunes too, are tied to access to China's markets and much else. The same can be said for think-tanks, research scholars, former government officials, and scores of others. Sample this: *An Open Letter To Donald Trump From The Australian People*, 17 September 2019. Third, China's strong and coercive state apparatus ensures that even if foreign money left, domestic money is not allowed to leave in prodigious quantities and threaten economic and financial stability. That threat loomed on the horizon in 2015-16 when China responded with draconian capital controls that remain to this day. Without domestic capital fleeing, its "house of cards" economy would not unravel. Fourth, with authoritarian regimes, it is always the case that they look in control until they don't.

In August, the International Monetary Fund (IMF) published its annual *Article IV Consultation Report* on China. In the report, IMF publishes "Selected Economic Indicators" which shows its estimates of China's government debt and deficit. These are different from official estimates.

As of 2018, IMF estimates that China's government debt as a proportion of gross domestic product (GDP) was 72.7% and its government fiscal deficit was 11.2% of GDP. In the *Article IV Consultation Report* published in July 2018, the projection for 2018 was 72.4% and 10.7% of GDP, respectively, for these. Further, the July 2018 report forecast that the government's budget deficit ratio would slowly drop to 10.3% by 2023 and that its debt ratio would rise to 91.6% by 2023. Let us now look at what the report of August 2019 projects for the future.

The IMF sees the budget deficit ratio rising to 12.7% in 2019, dropping to 12.2% in 2020 and further to 11.4% by 2024. Consequently, the government debt ratio keeps rising and, according to the IMF's projections, it crests at 100% in 2024. The estimate for 2024 is 101.5% of GDP. Let us see where they stand for India, for comparison.

For one, India's *Article IV Consultation Report* for 2019 has not been released yet. That is interesting because the previous report was released in August 2018. Second, in the report released in August 2018, India's fiscal deficit, according to IMF's projection, was 3.5% for 2019-20 while the government's new budget deficit estimate for 2019-20 is 3.3%. IMF treats divestment and licence auction proceeds as "below-the-line" financing. Interestingly, IMF projects the cyclically adjusted fiscal deficit for India at 6.5% of GDP for 2019-20. A few private sector analysts think that the true general government budget deficit is somewhere around 9% of GDP, if one includes the off-budget borrowing by government-owned entities and statutory corporations.

There is much hand-wringing in informed circles about India's fiscal situation. However, in most countries, not just in China, if one includes many off-budget items, the true fiscal deficit would be much larger than official estimates. It is partly because governments have a natural proclivity and reason to spend more than they earn and, two, economic growth rates are lower than desired which, in turn, is because too much borrowing has brought much of it forward. However, bond markets are not pricing in the risk of many governments inflating away the debt or simply writing them off, thanks to their central banks having become the dominant part of the bond market. China is rated A+ and its 10-year government bond yields 3.2%. India's 10-year government bond is rated BBB- and yields 6.71%. The pricing of European sovereign bonds is much more egregious. The 10-year Greek government bond is rated B+ and it yields 1.49%. There is discrimination in the bond market without much reason, and reason is not the same as an explanation.

Monday morning headlines scream that China's imports and exports are in deep contraction and a private research group estimates China's real GDP growth at 4.4% versus the official estimate of 6.2% (*China's Weak Growth Is Not A Consequence Of Rebalancing* by Fathom Consulting, 9 September 2019). China's military may barely succeed in hiding its brittle economy and the fact that it is largely a friendless nation with its best growth years behind it. That is perhaps the reality for the next 70 years.

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These are the author's personal views

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