

The Great Fall of China? Insights from a China bull

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If China-economy watchers must be labelled as either bulls or bears, I usually identify as the former. For all the dire headlines, the facts are that the volume of purchasing power being added to China's economy continues to be the same as in the past (in fact, [its increased](#)) and in percentage terms China is still growing at [more than double](#) the pace of the US.

But there is one other fact that concerns even a bull like me. It's the same one that confirms China's economy is revelling in its 'new normal' pattern of growth, for now. China's growth prospects in 2016 hinge on what happens to consumption. The same was true last year when consumption accounted for two-thirds of GDP growth, up from half in 2014.

This reflects a distinct shift away from the old pattern of growth that emphasised investment and exports. It also makes the analogy of China's economy being akin to a single engine aircraft a bit too close for comfort. As long as consumption keeps firing, the economy will be able to keep a steady altitude.

But it also means that the possibility consumption could be dragged down by weaknesses in other parts of the economy needs to be taken seriously. With China now accounting for around [one-third of global growth](#), it's also one of the big risks facing the world economy.

So how significant might these consumption spoilers be?

There's a natural experiment taking place in China today that sheds some light on this question. That's because weaknesses in China's economy are concentrated in particular parts of the country. In 2015, GDP for the country as a whole grew at 6.9 percent. But in the rust belt north-east, where the country's heavy industry and overcapacity problems are at their greatest, the situation is far worse. Liaoning, for example, grew at just three percent.

For other indicators of economic activity the differences are even greater. Industrial output is growing nationally at 6.1 percent. But in Liaoning, it has actually fallen by 4.8 percent. In Shanxi, it's down by 2.8 percent. In Heilongjiang, it's up, but by just 0.4 percent.

The flipside of course is that industrial output is growing faster than the national rate in most other provinces. The obvious question to ask is how are consumption indicators holding up in those provinces that are suffering the most?

The answer provides some reassurance. In Liaoning, where industry accounts for 44 percent of GDP, retail sales are still up 7.7 percent; Shanxi, 5.5 percent; Heilongjiang, 8.9 percent.

To be sure, that means retail sales in all of these provinces are growing at slower than the national rate of 10.7 percent.

Looking at data from all provinces suggests that, on average, a one percentage point fall in the growth of industrial output is associated with a 0.35 percentage point fall in the growth of retail sales. So the concerns about consumption are real but probably not fatal.

The same story is confirmed by household income surveys. Disposable income per capita is growing at nine percent nationally, while in Liaoning, Shanxi and Heilongjiang it is around seven to eight percent.

Then there's the [latest reading](#) of the Westpac-MNI China Consumer Sentiment Index, released on Wednesday. This showed that consumer confidence fell nation-wide in February compared with January. But the optimists still outnumber the pessimists and the current level is roughly the same level as a year ago. And remember, it's been consumption driving growth since then.

The most instructive finding though was that consumers in China's struggling north-east were no less optimistic in their outlook than elsewhere.

Put all that together and China's economic policy-makers will need to keep their eyes open to ensure that the transition to consumption-led growth remains on track. As for me, I'll be renewing my membership to the China bulls club for another year.