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# It is now China's turn

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Three interest rate cuts by China's central bank in the last six months, including the latest one early this week to 5.1 percent, show all is not well with its economy.

It is slowing down.

After growing at an average annual rate of 10 percent for three decades, China's slowdown is of concern to the world.

Its insatiable hunger for oil and other minerals kept the natural resource rich countries booming all these years. Decrease in the rate of China's growth would now spell disaster for all nations, which have been dependent on their mineral exports to China.

In 2014, China grew at 7.4 percent. Growth rates are predicted to fall to 6.8 percent in 2015 and 6.3 percent in 2016. The slowdown is attributed to fall in investment including energy projects.

**Export driven growth**

China's economic growth was driven by exports of cheap manufactured consumer goods to rest of the world, having attracted foreign direct investment to locate their plants, with various incentives including the supply of low-wage factory labour. With a fixed exchange rate regime and the Chinese currency, renminbi kept undervalued, it built huge foreign reserves through regular annual export surplus.

According to BBC's estimates, around US$4 trillion of foreign reserves is kept by China in various sovereign wealth funds in major countries. Further, Chinese investment overseas has grown eightfold over the past 10 years to reach more than US$140 billion in recent years.

The US was the number one destination all along. Australia beat America in 2012.

Growing interest in Africa's natural resources has led Chinese investment to spread to the African continent as well. It now covers 34 African countries, which include Nigeria (US$21billion), Ethiopia and Algeria (US$15billion) with Angola and South Africa (US$10 billion). Chinese oil and mineral resource needs are estimated to triple by 2050 and energy needs are immense to satisfy the demand of 1.4 billion population.

According to Heritage Foundation/American Enterprise Institute, China's investment in not only energy companies such as Canada's Nexen and Switzerland's Adaz Petroleum but also in metal companies such as Australia's Rio Tinto and financial institutions including Standard Bank have also been substantial. They run into multibillions as equity.

Any slowdown would mean drying up of investment flows of China to rest of the world. The concerns are real.

**Why this slowdown**?

High investment rate, 48 percent of gross domestic investment is not sustainable. Three decades ago, China's stocks of labour and capital as well labour productivity were low.

After rapid growth, law of averages strikes and slowness sets in. Both working-age population and investment peaked. With technological skills in China catching up with the advanced countries, productivity gains will be smaller in future.

Higher incomes created in the formal sector, mostly in urban areas have led to huge demand for housing. The boom in housing sector to satisfy the demand of the emerging rich urban middle class fuelled by a credit-binge has presented grim prospects of property bubble. It is reported by the Economist of London, that inventory of unsold homes is rising. The housing sector will face contraction.

Total debt (including government, household and corporate) is at 250 percent of GDP. This debt increased by 100 percentage points since 2008 global crisis. It helped the country to come out unscathed. The aftermath will be felt soon, as it has left all debtors with greater repayment burden. The slowing down is cyclical than structural. Overheated economic growth is always followed by a correction.

Both the structural and cyclical factors are slowing down the economy. While cyclical factors can be dealt with appropriate fiscal and monetary policies, which presently include changes in interest rates, structural factors can be dealt with reforms. They include movement of vast rural farm and unskilled labour to manufacturing towns and change in population policies (it is claimed one –child policy has created labour shortages) and training. Above all, China needs rebalancing the economy. The IMF says domestic consumption should drive the demand, not overseas demand through an "undervalued" currency.

Well, as economists gather, we have always different views: Ruchir Sharma, of Morgan Stanley, told Global Private Equity Conference in Washington, D.C., on Tuesday that the Chinese credit boom would cause problems: "Whenever a country increases its debt to GDP, sharply over five years, in the next five years there's a 70 percent chance of a financial crisis and 100 percent chance of a major economic slowdown".

On the other hand, there was a less grim view expressed by another speaker, former U.S. Gen. Wesley Clark. He had two reasons:

“The renminbi is not fully convertible to other currencies, and the Chinese economy still has elements of central control.”