Will China be ‘home’ to the next Black Swan event?

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Renewed China stimulus has been one factor keeping capital markets sanguine so far this year. But what if we told you China’s growth dynamic may not be all it seems?

- China’s progress in rebalancing towards a consumer-led economy is patchy at best
- Statistics still point to the property market as a lynchpin of the Chinese economy
- Investors hoping China will reaccelerate global growth, should be aware of its shaky foundations

As a share of GDP, China’s investment spending reached unprecedented levels in the years leading up to and following the global financial crisis. This was, of course, unsustainable over the longer term and it was widely recognized by China’s policymakers that the economy needed to be ‘rebalanced’, with domestic consumption accounting for a larger share of output while overall investment declined.

This has been commonly depicted as a rebalancing away from the ‘Old Economy’ (secondary industries such as manufacturing and oil refining plus property), to the ‘New Economy’ (service industries such as computer services and tourism). The chart below shows how China’s rapid economic growth prior to the global financial crisis was driven by the ‘Old Economy’.

**Industry contribution to China’s % year-on-year nominal GDP growth**

Source: Bloomberg April 4, 2019
If China’s economy was to be rebalanced then it was inevitable that economic growth would slow, which the chart above clearly shows to be the case, particularly since 2012.

However, what has not been discussed quite so frequently is the fact that whenever policymakers have needed to stimulate the economy, it has tended to be the constituents of the ‘Old Economy’ which are ‘juiced up’. The chart above shows how the acceleration of the Chinese economy between 2009-11 and 2016-17 was mainly driven by the ‘Old Economy’.

Looking deeper still, within the ‘Old Economy’, it is the property sector that drives the big swings in China’s economic growth. Property accounts for 86% of household wealth, while 87% of urban households own their own property and 27% own at least one empty investment property. Around 65% of loans are backed by property collateral and the government funds 60% of its spending through land sales, which depend in turn on rising prices for empty investment properties.¹

So what’s the implication?
Combined, the statistics point to the property market as the lynchpin of the Chinese economy. For all the talk of a consumer-led rebalancing, if Chinese monetary stimulus is going to help drive a reacceleration of global growth this year it won’t be via the Chinese consumer, but instead, through China’s property market. And we all know what happened the last time a superpower’s property market was allowed to dominate to such an extent…

Definitions:
**Gross Domestic Product (GDP)** is a broad measurement of a nation’s overall economic activity. **Primary Industry** – extraction of raw materials – mining, fishing and agriculture. **Secondary Industry** – production of finished goods, e.g. factories making toys, cars, food, and clothes. **Tertiary Industry** – provision of intangible goods and services to consumers, e.g. retail, tourism, banking, entertainment and I.T. services. **Financial Services Industry** – providers of financial services, e.g. banks, investment banks, insurance companies, credit card companies and stock brokerages.

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¹ Newton & Financial Times data, March 31, 2019