Chinese growth decelerates further

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Against the background of the annual Chinese Communist Party meetings, the latest batch of indicators released this week show that economic activity softened further in the last quarter. Given the still healthy situation in the labor market, however, Chinese leaders are still comfortable with the gradual slowdown witnessed since the very sharp recovery from the global 2008-2009 financial crisis. Therefore, despite the ongoing correction in the housing market, there is no need for a broad-based stimulus program to spur growth. The other reason is that credit growth, while decelerating, remains too high.

Economic growth in the third quarter slowed down to 7.3% from 7.5% in the second. Although this was the slowest pace seen in the last five years and slightly below the government’s own target of 7.5%, it was still better than what many had expected and absolutely no reason to panic. The main reason is that overall confidence as well as the labor market situation remains healthy. The Chinese leadership that came into power in 2012 has stated numerous times before that as long as that remains the case, the gradual slowdown in economic activity is no major concern even if growth dips somewhat below the flexible target set for the year. The current slowdown is concentrated in investment spending, especially in the residential real estate market. Surveys suggest that income growth and household consumption, on the other hand, remain strong. In fact this is a welcome evolution. Indeed, although still early days and much more is needed in this respect, it’s perfectly in line with the government’s plan to rebalance the economy away from investment to consumption. Therefore, a large scale stimulus program should not be expected. More targeted efforts, instead, like the occasional central bank liquidity injections or relaxation of restrictions for second-home buyers seen in recent months, will remain part of the government’s toolbox.

In addition, there is another and probably more important reason why authorities will refrain from significant stimulus. Clearly, although decelerating, credit growth is on a very unstainable trajectory. Over the last five years, China has seen a true debt explosion. It is widely agreed that credit growth in countries like Brazil, Turkey or Thailand has been fast in recent years. Yet, credit growth comes nowhere close Chinese levels. The new leadership is very much aware of the risks associated with this kind of credit boom. Aggressively loosening monetary policy or increasing budgetary spending would only add to the underlying instability of the system. It will surely prove extremely difficult to successfully guide this necessary debt deleveraging process. That said, with external debt very low, high domestic savings, a current account surplus, a state-owned financial system and capital controls in place, the probability of an imminent crash is still very low.

Looking forward, there’s no doubt that growth will come down further. It would only be logical given the rapid economic progress seen in recent decades, China’s rapidly ageing population and further implementation of rebalancing measures (including slower credit growth). For now at least, given the current strength in the labor market and decent household and business confidence levels, authorities should be pretty comfortable with the way the gradual slowdown takes place.