Slowdown in China: Did Chinese Leadership Drop the Ball?

Nicholas R. Lardy assesses the latest evidence of decelerating economic growth in China, saying that the leadership in Beijing may have been distracted by the recent political turmoil.

Steve Weisman: Reports of an economic slowdown in China are causing some concern around the world. Nicholas Lardy, senior fellow at the Peterson Institute for International Economics is here with me, Steve Weisman, to assess the signs of a slowdown and their impact. Nick, first, how much of a slowdown is China experiencing?

Nicholas Lardy: I think the background is that their economy has been slowing now for four or five quarters, and the question is how much more has it slowed in the second quarter of this year. A lot of the indicators are suggesting that growth has decelerated further. Electric power generation is down, imports are stagnant suggesting very little growth of domestic demand. Some purchasers of commodities on international markets have either cancelled contracts or tried to get the deliveries postponed because the demand for steel and so forth is down dramatically, so they don't need the iron ore that they import in such large quantities. So there are a lot of indicators to suggest that growth has decelerated as we have moved through the second quarter, but we won't know for sure for several more weeks exactly how big the deceleration has been.

Steve Weisman: In previous conversations, I have asked you about inflation in China. Is that still a concern or less of a concern given the slowdown?

Nicholas Lardy: It is the classic tradeoff. I think inflation concern does still constrain the government in terms of the size of a stimulus program they might want to undertake. They're trying to deal with the aftermath of their massive stimulus of 2009–2010. They've been tightening credit now for a couple of years. So inflation is down quite a bit from the peak of last summer, but still above the level they'd like to see in the long run.

Steve Weisman: Watching the Chinese try and control the machinery of their economy by using stimulus or interest rates or controls of other kinds, how do you think they are doing in the way they are managing this gigantic economy?

Nicholas Lardy: I think there is a risk that they've fallen a bit behind the curve. They are now gradually beginning to approve more investment projects, but perhaps that might have been done a few months ago. They're cutting the reserve requirements for banks which frees up more money for lending, again a plus, but might have been started sooner than they did. So I think there are some questions about whether or not the leadership has been distracted by other events and taken their eye off the economic ball for a while that is now causing them to play catch up.

Steve Weisman: This is not a crash landing though, which some worried about.

Nicholas Lardy: Certainly the evidence now suggests they are still going to have growth in the 7–8 percent range. But virtually every investment bank has downgraded their forecast for China's growth now, but they're still hovering and in the high 7s low 8s. So certainly, if that growth can be achieved it will still put China near the top of the global heap.

Steve Weisman: What evidence do you see that the economic issues are affecting the leadership struggles in China? You mentioned earlier that they took their eye off the ball.

Nicholas Lardy: I think the distraction's in the political spheres. The Bo Xilai affair quite frankly is still ongoing. They are still investigating his various activities. I certainly think they probably want to wrap this up well in advance of their big party meeting in the early fall. One can't help but wonder how much time this has absorbed, how much attention it has absorbed and detracted perhaps a bit from their adeptness at formulating economic policy.

Steve Weisman: Finally, is this slowdown posing a threat in the rest of the world economy?

Nicholas Lardy: Certainly the rest of the global economy has benefited from very high Chinese growth in recent years, particularly China's strong performance at the height of the global financial and economic crisis. China is slowing down more now than it did back then and so those that have looked to India and China and other emerging markets to keep the global economy growing, I think, now are really having second thoughts. India has slowed down quite a bit. China is slowing down, perhaps will slow down more going forward. So I do think it means emerging markets are not going to be the rescuer of global growth.

Steve Weisman: Thank you, Nick.