China's Moderate Growth Slowdown

Nicholas R. Lardy says China is taking sensible steps to counter the moderate slowdown in growth, rejecting the route of expanding credit aggressively as it did in 2009.

Steve Weisman: In China, news report suggests that the economy is slowing down and the leadership is considering new economic stimulus programs. Nicholas Lardy, senior fellow at the Peterson Institute for International Economics is here with me, Steve Weisman, to assess those reports. Nick, how bad is the slowdown in China? What steps is the government taking to counter the slowdown?

Nicholas Lardy: There are a lot of indirect indicators. We don't get very good data on economic growth in China in the first couple of months of the year and it'll be a little while longer before we get a first quarter GDP number, but it's likely to reflect some slowdown from the pace of growth at the end of last year. And at one level, that's not surprising because the first quarter does tend to be weak in China, the fourth quarter tends to be on average stronger.

Steve Weisman: Why?

Nicholas Lardy: It's not clear. But the data simply show that almost a third of GDP is produced in the fourth quarter of the year and part of it is this long New Year holiday that slows things down in the first quarter. So, many people anticipate the government will launch a bigger stimulus program and they took a couple of little steps yesterday announcing some new measures. But these don't really amount to a stimulus program yet in my view. A lot of the things that they are doing still are focusing on structural reform as a way of holding up the growth rather than throwing out more credit.

Steve Weisman: Just to be clear. When you say a slowdown, from what to what?

Nicholas Lardy: It depends on how you measure it. It's a little bit complicated. But I think the growth is likely to be something in the 7 to 7.5 percent range, perhaps closer to 7 percent than to 7.5 percent, which would be a significant slowdown from the overall pace of last year.

Steve Weisman: But the pace of recent years is unlikely to have been sustainable.

Nicholas Lardy: Right. They've been growing last year at 7.5 percent, so the official goal for this year is 7.5 percent. They have slowed down quite a bit from three or four years ago. But this level of growth is still very, very strong and is generating a lot of jobs. And more importantly, the leadership has put consistent emphasis on the quality of growth and sustainability of growth rather than just emphasizing the need to grow faster.

Steve Weisman: On the issue of structural reform, what is happening?

Nicholas Lardy: A number of initiatives have been announced in the last few weeks. For example, the authorities are licensing five new private banks. This is the first time in many, many years that China has allowed the creation of new banks. These will be completely private. The basic idea that they have in mind of course is that private banks will be better able to assess smaller borrowers which will be mostly private companies. So, this is basically a signal that they need to shift further to providing more financial support for smaller companies and most of whom are private. And that will be very good for economic growth because the returns of these private firms, particularly in manufacturing, are more than twice those of the big state companies. So, one way of maintaining growth even as investment slows down is to allocate credit more efficiently to firms that have a higher return on assets. Certainly private firms fill the bill.

So, that's a very important structure form that is sending a signal to the market. They're opening up some sectors to investment by private parties that they have not allowed before and that again is another structure reform that's positive for growth in the long run.

Steve Weisman: You see these as welcome.

Nicholas Lardy: I think they reflect that the leadership is taking a medium term view on how to sustain growth rather than kind of just cranking up the credit machine as they did starting in 2009 in response to the global financial crisis. That led to a huge increase in debt outstanding. That's not something they want to continue. They want to bring the growth or credit down gradually so the financial risks are reduced.

Steve Weisman: Are the markets reading this correctly?

Nicholas Lardy: I think that markets in this case, as perhaps in other cases, are overreacting. The stocks of some resource companies in Hong Kong are going up quite a bit on the assumption that there will be a big stimulus program to offset the slower growth. Whether or not that actually materializes, I'm skeptical.

Steve Weisman: Finally, you see these latest steps as fairly consistent with some of the earlier pronouncements this year.

Nicholas Lardy: Yes. They're consistent with the Third Plenum which was in November of last year and some of the announcements that were made at the time of their national legislative meeting, the so-called National People's Congress in March of this year.

Steve Weisman: Thank you, Nick.