Opinion **Chinese economy**

China needs a new growth model

This matters for Beijing's sake and for the rest of the world economy

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Apartment buildings in Huizhou. China must resolve an unravelling property sector and find substitutes to generate output and wealth © Gilles Sabrie/FT

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China's economy is on the mend. And it is in serious trouble. Recent data supports both narratives, but the calm on the surface belies deep-rooted problems that are hurting not just China's but the world's growth prospects.

Perhaps there is reason for concern but not panic. The economy is supposedly chugging along, registering GDP growth of about 4.3 per cent on an annual basis. CPI inflation has turned positive and producer prices are also rising, after a long period of deflation. Industrial profits seem to be rebounding.

Even official statistics cannot hide the underlying fragilities, though. Feeble growth in household consumption means that domestic demand is not keeping pace with the goods churned out by China's industrial machine, leaving exports to fill the gap. Private-sector investment is falling, suggesting a poor business environment and lack of confidence in the government. Inflation is being driven by the rise in energy prices rather than stronger demand.

For its own sake and that of the rest of the world, China needs a new growth model. This requires some key shifts. First, it needs to reduce reliance on public investment and exports to drive growth. Second, it must resolve an unravelling property sector and find substitutes to generate output and wealth. Third, China has to move away from low-wage, low-productivity manufacturing to higher-productivity industries and the services sector. Fourth, it should lessen the role of the state in the economy.

Such moves are essential to deal with a shrinking population, reduce wasteful investment and boost employment and household income growth. Each is challenging, but the government needs to take concrete action to fix both cyclical and structural problems.

The upcoming mid-year meeting of China's Politburo, the country's main decision-making body, thus takes on special significance. Either the government will decisively start tackling the economy's weaknesses or, as has happened in the past, it will punt these problems into the future, heightening the dangers for China and the world. The deeper the imbalances get ingrained, the harder it becomes to pull the economy out.

The government has good raw material to work with. President Xi Jinping's desire to promote a high-tech, high-value-added economy and put China in a dominant position in the race for AI supremacy is delivering results. China has achieved remarkable success in high-tech manufacturing. Cheap, high-quality products — from solar panels to electric vehicles — are a boon to consumers worldwide and are helping with the much-needed energy transition away from carbon. These shifts are not doing much for household income or employment growth, though, particularly since an unravelling property market has destroyed a great deal of household wealth.

To its credit, the government has not shied away from reform. The household registration system, *hukou*, has been revamped, giving migrants better access to public services and allowing freer mobility of labour across provinces. The central bank is modernising its monetary policy instruments. Such measures are welcome but fall short of what the moment calls for.

More open competition would help. While the private sector faces intense competition, partly on account of subsidised overcapacity, state enterprises remain protected in many industries. The private sector needs a more predictable regulatory environment rather than being subject to capricious crackdowns. Reform of the financial system is needed to ensure that more credit flows to small and medium-sized enterprises, especially in the services sector. Local governments, which carry enormous spending burdens, need more stable revenue sources.

Monetary and fiscal stimulus have a role to play but only in tandem with a broader reform plan. The quick and easy solution of making credit cheaper and more plentiful is unlikely to get traction at a time when households are loath to spend and businesses to invest. Budget deficits and public debt are worse than official figures indicate, so caution is warranted. But judicious stimulus will inevitably be needed to smooth the transition to a different growth model.

China's vision of providing international leadership while defending globalisation and free trade rings hollow if it fails to tackle its homegrown problems, and continues to count on the rest of the world to keep its own economy afloat. China's future and its international standing depend on its leaders acting decisively. And soon.

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