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China's Chances of Overtaking US Economy 'Declining'

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The possibility that China will overtake the United States as the world's biggest economy is declining, according to Cornell professor and former International Monetary Fund (IMF) official Eswar Prasad.

In a recent interview with *Nikkei*, Prasad said that the economies of the two countries—currently the largest and second-largest economies in the world—have taken opposite trajectories, with the U.S. likely to maintain its growth while China continues to face structural problems like high public debt and a low birth rate.

"China faces a variety of fragilities, including undesirable demographics, a collapsing real estate market, deteriorating investor sentiment at home and abroad, and the lack of clarity over a new growth model," Prasad said.

"Even a 4 to 5 percent growth rate will be difficult to sustain over the next few years. The likelihood of the prediction that China's GDP will one day overtake that of the U.S. is declining."

While inflation soared immediately after the COVID-19 pandemic in the U.S., raising the cost of living and fueling fears of an incoming recession, the economy proved resilient to the challenges of the past few years. In the last quarter of 2023, the U.S. grew at a 3.3 percent rate, surpassing expectations, and added more than 350,000 jobs.

"The U.S. has cemented its position as the main driver of global growth as the Chinese economy sputters and most other major economies [with the exception of India] continue to struggle," Prasad said. "It is striking that the U.S. economy has managed to remain an island of stability despite numerous headwinds and amidst a turbulent global landscape."

China, on the other hand, had a very bumpy post-pandemic recovery because of a combination of factors that originated beyond the pandemic, including its aging workforce, slower internal demand, and an ongoing crisis in the real estate sector, which had been driving the country's explosive growth in the past few decades.

"China's economic growth is gradually slowing, weighed down by a combination of unfavorable demographics, an inefficient financial system, a huge overhang of debt, and a lack of institutional reforms," Prasad said. "These factors are likely to limit productivity growth. So China will keep growing but at a slower pace than over the last three decades."

For Prasad, the downturn in China's property sector represents a particular risk for the government, as it accounts for significant shares of the economy's GDP and household wealth, "in addition to creating ancillary risks for the financial system," he said. "With the property sector unlikely to provide much of a contribution to growth in the coming years, overall growth could be significantly hampered.

"Weak institutions including the absence of the rule of law, lack of central bank independence, and a creaky financial system will limit the currency's long-term appreciation against the dollar, making it harder for the country's nominal GDP to catch up to that of the United States at market exchange rates."

George Magnus, once chief economist of UBS and now an associate at the China Centre at the University of Oxford in the U.K., previously told *Newsweek* that "this idea of China becoming the world's biggest economy may not happen, actually."

"The housing market crisis is not the only factor, there are a lot of things that are contributing to a much more pedestrian growth rate in the next 10 to 20 years. I call them the seven Ds," he added.

"The debt, in which the housing market obviously is included. Demographics, with the Chinese population rapidly aging. Dynamism, with which I mean that productivity isn't really firing anymore because reform in this direction hasn't happened. Decoupling and de-risking, which is a constraint on China's ability to develop the new economy and technology. Directive, the government has become more controlling. And shortage of demand."

The U.S. is faring much better.

"While most major economies are struggling, the U.S. is consolidating its position as the driving force of the global economy," Prasad said. "The U.S. labor market is very flexible and strong. The government's fiscal policy and financial system have enabled small and midsize businesses to weather very difficult times.

"That said, I am a little concerned by the impact of the global economic slowdown. While U.S. GDP growth is not heavily dependent on exports, the sluggishness of other countries might be some drag. The increasing U.S. public debt and the increasing share of interest payments as a percentage of revenue are also significant concerns."

President Joe Biden, who's campaigning for reelection in November, recently took credit for the resilience of the U.S. economy, which he said is due to the success of his administration's economic policies, dubbed Bidenomics.

"But our work is not done," he said last month after the Bureau of Economic Analysis released its latest data on GDP growth. "I will continue to fight to lower costs—from implementing historic legislation to lower prescription drugs costs, health insurance premiums, and clean energy costs, to taking on hidden junk fees that companies use to rip off consumers, to calling on large corporations to pass on to consumers the savings they have been seeing for months now."

Update 2/6/24, 10:20 a.m. ET: This article was updated to include comment from Eswar Prasad.