



VIDEO: What is the Chance of a Hard Landing in China?

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William Blair Economist Olga Bitel discusses China's rapid GDP growth, how government efforts have helped to avoid an economic crisis, and which concerns may still be on the horizon. Watch the video or read the recap below.

The outlook for China is key to the global growth outlook, and the potential risks associated with China's transition from an investment-led economy to a consumer-driven one continue to raise concerns among investors. What is the chance of a hard landing in China? And how likely is a financial crisis given the acceleration in the accumulation of debt in the financial system?

Bitel: In less than five years, China's growth rate slowed by two-thirds. Perhaps China's economy has landed already. From here, China's growth trajectory depends on how the government addresses broad-based industrial overcapacity created during phenomenal growth over the last 15 years and the associated buildup of debt. So far, government efforts to buy time with growth and inflation have avoided a crisis.

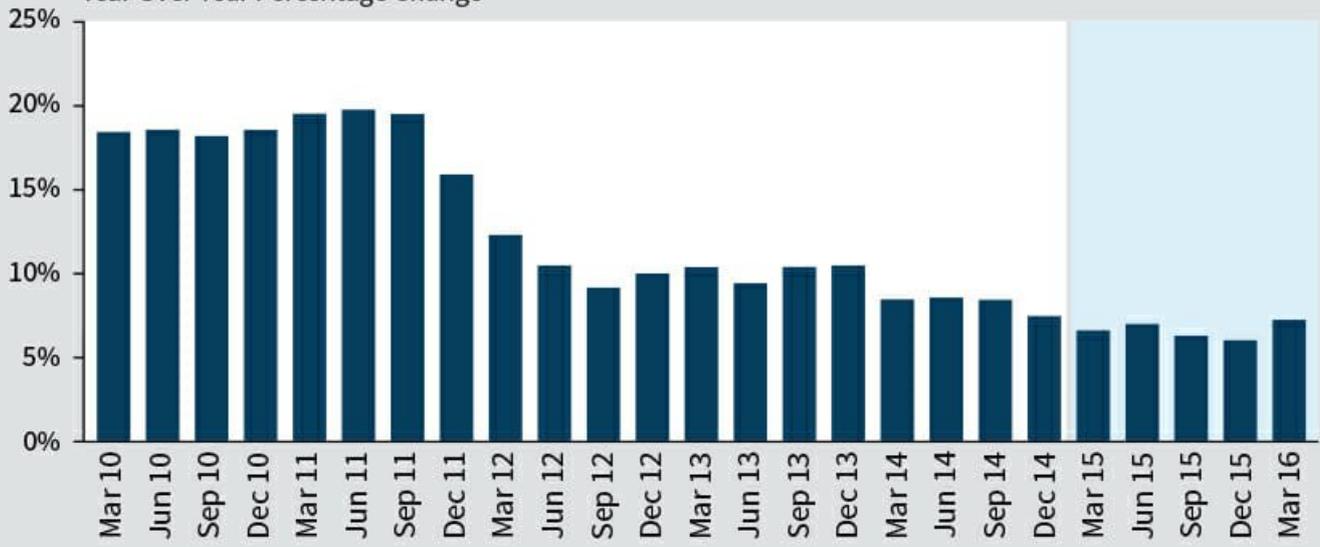
At the same time, this approach reinforces a negative feedback loop between continued misallocation of capital to service unproductive capacity today and the level of growth that can be achieved in the future.

An alternative approach is closure and disposal of assets for a significant number of state-owned enterprises,

together with orderly disposal of nonperforming bank loans.

As long as China retains a relatively insulated financial system with low levels of foreign debt, a financial crisis seems unlikely. The bigger concern is that by not pursuing a system clean-up, Beijing is locking itself into an unfavorable policy bargain that ensures limited economic pain today at the expense of years of declining real growth. (See the chart below).

Nominal GDP Growth in China Year Over Year Percentage Change



Source: William Blair, Datastream, as of 5/31/2016

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