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Date: 26 September 2012

Publication: The Business Times (Executive Money, Page 26)

Circulation: 34,368

How S'pore PM got America right

Most Americans believe China is the world's leading economy, but reality is that US' bounce-back is already underway

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PRIME Minister Lee Hsien Loong's recent speech at the Central Party School in Beijing made headlines globally for highlighting to China that the country should not write off the United States as a nation in decline, because the US has the flexibility and dynamism to bounce back from its current economic difficulties. His point: Asean's key ally is still a major player in the region and Chinese academics and writers may be focusing too much on its recent problems.

So is Mr Lee right about America's resilience? The irony is that most Americans already believe China is the world's "leading" economy, and many nations that once looked to US free market capitalism as a model are doing some rethinking in the light of the debt crisis. But the reality is that the bounce-back Mr Lee envisages is already underway, particularly relative to China.

China has grown so fast for so long that this has taken on an aura of invincibility in the Western imagination, but the Asian giant has hit the stage in development when all "miracle economies" slow down. Japan in the 1970s, Taiwan in the 1980s and South Korea in the 1990s – all saw economic growth slow by about four percentage points when they attained a level of economic development similar to where China is today.

The basic law of economic gravity is that the bigger the economy, the harder it becomes to grow fast. China recently passed the US$5,000 GDP per capita mark to become a truly middle-income country. That's the main reason it is slowing now, and growth is likely to decelerate to a pace of 6 to 7 per cent now with possibly a deeper slowdown in store as the economy continues to mature.

This signals a basic power shift. China overtook the US as the biggest contributor to global GDP growth in 2007, but if the US grows at about 2.5 per cent and China slows to 6.5 per cent, then the US will regain the lead this year – contributing 23 per cent of global growth in 2012, compared with 18 per cent for China – and it will hold that lead at least through 2015.

China's slowdown is setting the stage for an American revival. In the long term, slower growth in China will undercut the high price of oil, which has had a crippling effect on US growth. In recent years, China has accounted for nearly half of the incremental demand in oil worldwide.

China's slowdown is also creating a new opening for American manufacturing. China is suffering many symptoms of a maturing economy, from a strengthening currency to rising wages, land prices and transport costs, while the US has a weak currency, a moribund property market, and has seen unit labour costs fall 14 per cent over the past decade.

The dollar is near record lows (in inflation-adjusted terms) against many trading partners, including China. The long-term decline in the US share of global exports bottomed out in 2008 at 8 per cent but is now inching higher, helped by the fact that the US accounts for more than a third of global R&D spending that makes it the premier knowledge economy.

With China's slowdown spreading to all the emerging markets, the average global growth rate is slowing, and the US economy is now on track to grow faster than the global average for the first time since 2003.

The difficulties Mr Lee mentioned are real, namely the debt problem. But if the shadow banking sector is included, China's total debt (household, corporate and government) is 200 per cent of GDP, arguably a tougher challenge than total US debt at 350 per cent of GDP, because China has a much lower per capita income, and wealth and debt levels are often two sides of the same coin.

The McKinsey Global Institute has shown that the US is ahead of most developed nations in reducing its private-sector debt burden. Households and corporations in the US have been working down debt faster than its European counterparts. The question is whether Washington can reach a deal to cut the government debt as well.

These shifts could reshape the balance of economic power for the better. China has been like a company with disruptive technology, destroying competitors and sucking in capital. A smooth downshift to 6 or 7 per cent makes China a more normal competitor, one that generates less tension, worldwide and regionally. A collapse in China, which some forecasters predict, would be disastrous for the world but is unlikely, largely because Chinese leaders get it.

They understand that a maturing economy will decelerate and are trying to manage rather than fight the process by launching another major stimulus plan (which would make collapse more likely). It is not clear, however, that everyone appreciates the resilience of the US economy quite as well as Mr Lee does.

The writer is head of Emerging Markets and Global Macro at Morgan Stanley Investment Management and the author of 'Breakout Nations: In Pursuit of the Next Economic Miracles' (Allen Lane, 2012)

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Making things move: *China's slowdown is setting the stage for an American revival and also creating a new opening for American manufacturing*