There's No Crash in China's Future, Just Years of Stagnation

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For about the past 18 months, many people have worried about a Chinese economic crash. While they have the right country, they have the wrong time frame and wrong risk.

China has serious problems, but they've been visible for years. They add up to long-term stagnation, not a crash. That stagnation matters to the U.S., but in very different ways than a crash would.

The Organization for Economic Cooperation and Development (OECD) rekindled some China fears by pointing out several of its problems. Topping the OECD's list, with good reason, was debt. The OECD puts total Chinese debt at 250 percent of gross domestic product at the end of 2016, about the same as the U.S.

The level might not sound too alarming but the trend is. Most of the China's debt is corporate, and roughly half of corporate debt has been accumulated in just the past 10 years. It isn't just the OECD crying wolf — Chinese officials have publicly admitted to a problem, even while downplaying it.

The ditch China has been digging for itself is actually deeper than it appears, not shallower. Credit Suisse reports American mid-2016 private wealth as $61 trillion larger than that of the Chinese. Yet at the end of 2016, the money supply, which reflects uses of this wealth, was $9 trillion larger in China than in the U.S.

Another fun fact — the money supply gap was $4 trillion in 2011. China has, in this sense, become $5 trillion more leveraged compared to the U.S. in just five years. It's not as if the U.S. is facing tight monetary conditions. China may be the most over-leveraged economy in history.

This sounds like a disaster in the making and it is. But it's a slow-moving, confined disaster. Having far too much money floating around makes for exactly what we've seen in China the past four years — asset bubbles. Property, stocks, bonds, commodities — funds slosh their way from one asset to the other. If you're not faster than the "moneyball," it can be personally disastrous.

Otherwise, too much money stock helps depress yields. Chinese policymakers worry about the financial sector, not supporting the real economy, and they're right to do so. Most money-holders aren't interested in supporting a long-term commercial project, they're flipping from asset to asset every few months to squeeze out another 1 percent annually.

This kills the contribution of capital to long-term growth in the economy as a whole. Combined with an aging population and a polluted, inadequate (for all those people) resource base, and you get looming stagnation.

What you don't get is a crash. A property market bubble in the U.S. caused a crash in 2008, but China is definitely not the U.S. Their government directly controls most of their financial system. Companies and banks go out of business only when the Communist Party wants them to. Money is being massively wasted in the bubbles but Beijing has the ability to limit their impact.

The differences between China and everyone else also matters to corporate debt. The OECD assigns two-thirds of corporate debt to state-owned enterprises. No matter how much Beijing protests to the contrary, when push comes to shove, Chinese state-owned enterprises are not real companies. They are arms of the government.

The state-owned banks that lend to them are also arms of the government. They don't go bankrupt, they don't fire workers, they don't stop lending to bad companies — they do nothing unless the Party tells them to. It's very easy to make extremely costly mistakes in this kind of system, but it's hard to have a financial crisis.

What does it all mean for the U.S.? On the security side, the news is mixed — China will not pass the U.S. as an economic power anytime in the foreseeable future. Of course, that may make it more nervous and dangerous.

On the economic side, a global crisis caused by a financial crisis in China is not on the table. The odd downside there is that the threat of a crisis might be the only thing that pushes the Communist Party to make pro-market reforms. Without those reforms, China will not spur growth in other countries, as many seem to be counting on.

There are very prominent American companies with fortunes tied to China, from Apple to Boeing to Caterpillar. Because China's not collapsing, some companies will continue to do well. Those expecting long-term growth, however, are going to struggle and their workers and stockholders with them.

For the U.S. as a whole, China's economic problems simply reinforce that we have to generate our own growth, with no help from the rest of the world. Our own decisions about how to treat labor and capital, along with how to encourage innovation, will continue to be what determines whether our economy surges forward or struggles. Same as it ever was.

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