

China is no 1990s Japan - but it could have been

Talk of deflation for China is well wide of the mark, and obsessing over historical growth rates misses the point that 5% growth is sustainable and about the right pace of growth for an economy of China's stage of development



5% growth from China - get used to it

China will probably grow by about 5% this year. And for those for whom GDP growth is the only goal worth pursuing (it really isn't) this sounds nothing short of disastrous. There have even been some media articles questioning whether China is entering a phase of stagnation similar to that experienced by Japan in the 1990s after its bubble burst. This has been spurred by Chinese CPI inflation figures that are hovering at around zero. The D-word (deflation) is being brushed off.

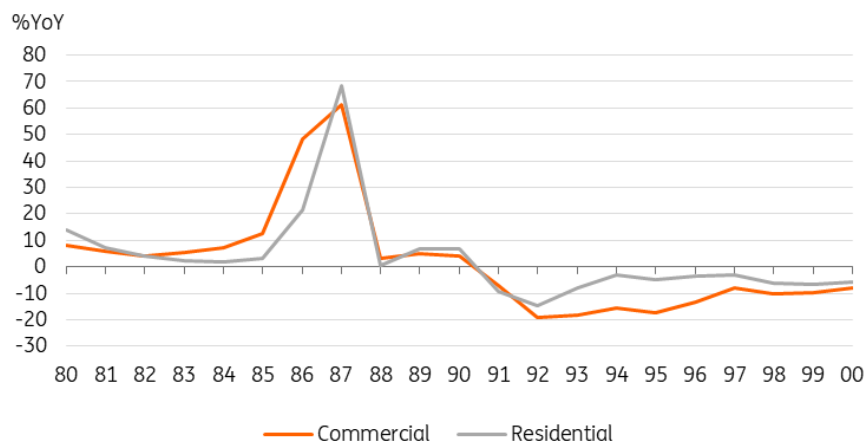
But let us be very clear, China is not on the brink of deflation, and the situation between Japan in 1990 and China today is very different. Indeed, there is a strong argument to support a slower, less debt-fuelled and in all senses more sustainable rate of Chinese economic growth over the coming years, than to provide an artificial jolt of stimulus, after which, will come the inevitable question..."What do we do when that stimulus runs out?"

Japan's answer was to do it again, only larger, and then again, and again. And that is why today, they have a government debt-to-GDP ratio of around 263%. For all the talk of stimulus plans that fills the newswires each week, there is nothing wrong with China sticking to its current path.

Recap of Japan's bubble and subsequent burst

Let's start with a recap of the Japan bubble. The received wisdom today is that this followed a period of over-accommodative monetary policy by the Bank of Japan (BoJ) following the Plaza Accord, after which the yen rallied, prompting the BoJ to keep rates much lower than they would otherwise have done, and which in turn, fed an aggressive property boom and then eventual bust.

Tokyo land prices 1980-2000

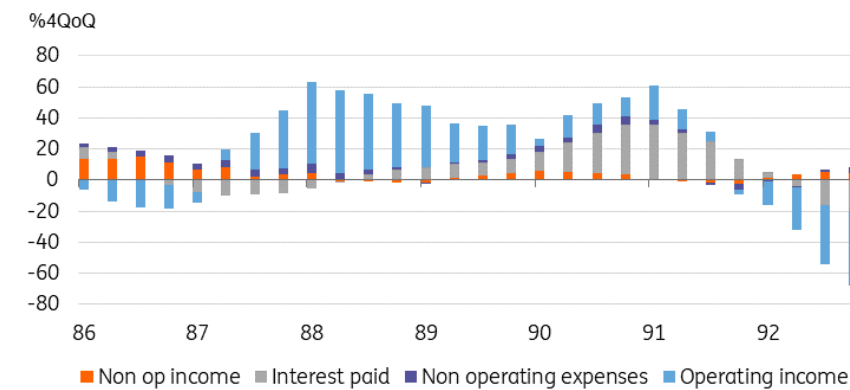


Source: CEIC, ING

Much of the wealth created was illusory

That boom created a lot of paper wealth, in which corporates appeared to be making large profits, often just based on unrealised property gains or stock market investments while their operating profits actually dwindled. Banks got sucked into this, financing projects whose main criteria for success was often just the underlying land price or cross-shareholding exposures. And when eventually, the BoJ started to respond to what it perceived as threatening inflation, it popped what had evidently become a massive financial bubble which encompassed not just the property market (real assets) but financial assets and the banking system too.

Contribution to profits in Japan 1986-1992



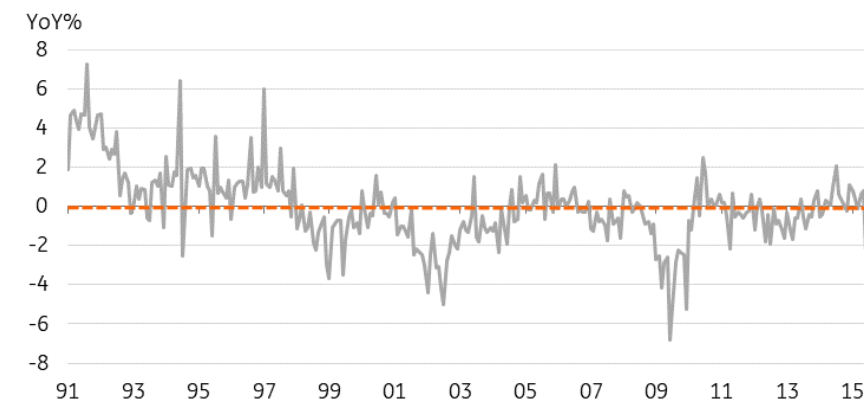
Source: CEIC, ING

A burst bubble is a lot worse than slightly weaker growth

The stock market crashed and stayed low. Firms went bankrupt and insolvent banks were merged with larger more solvent ones under the so-called “convoy system” which meant that even previously healthy institutions were hobbled. The pain was lessened, but it was more widely distributed. Biting the bullet on bad loans and pulling the plug on zombie companies took a very long time which also prolonged the stagnation and delayed the eventual recovery.

The economy of course contracted and remained stagnant for years. Consumer price inflation turned negative and even nominal wages declined. It has taken decades for the economy to pull itself out of the mire that this bubble created, though it appears to be doing so now.

Nominal wages growth 1991-2015



Source: CEIC, ING

Would we spot a bubble forming this time round?

Looking back on it, the causes of the bubble and its subsequent crash are not as obvious as the convenient explanation I have just provided. Policy rates were not all that low relative to inflation, and the appreciation of the JPY following the Plaza Accord should have provided a substantial degree of financial tightening too. Broad money growth also was not so obviously out of control, at least relative to previous decades. It is hard to say we would definitely avoid doing something similar again now, even with the benefit of hindsight.

That said, there is no arguing with the carnage that followed. Japan suffered a textbook case of genuine deflation – a term that is often misused, experiencing widespread and deep declines in the general price level, by which we mean not just consumer prices, but real assets, financial assets, and nominal wages.

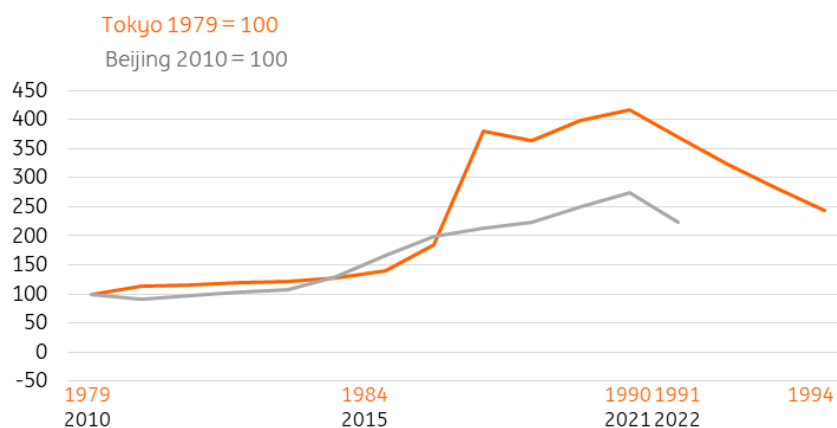
Is there any sign of something similar in China?

So let’s take a look at what is happening in China and pick apart the deflation argument. Firstly, let’s look for evidence of a bubble because if we are going to argue that it is about to burst, it needs to be there in the first place.

In 1984, land prices for commercial property in Tokyo grew at a respectable 7.2% annual pace, The following year, this accelerated to 12.5%, and the year after that, to 48.2%. By 1987, commercial property land prices were rising at a 61.1% YoY pace. It was once suggested that the 1.5 square kilometres of land surrounding the Imperial Palace in Tokyo, were worth more than all the land in California. And whether or not that calculation stacks up (it sounds highly questionable), it shows just how extreme things had become.

Yes, Japan had a bubble. If we use similar land price data for Beijing for both residential and commercial property, then there are certainly periods when prices accelerate sharply. The most recent period where this happened was between 2014 and 2017 when residential property prices accelerated at about a 20% annual pace. But it has slowed since and is showing small declines now.

Tokyo vs Beijing residential property prices



Source: CEIC, ING

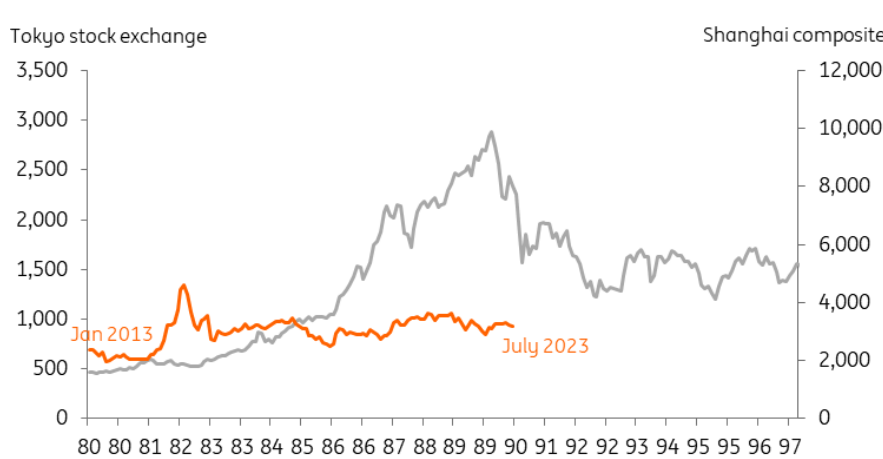
No bubble, no bust

What is missing from the chart above is the sort of exponential growth that typically characterises a bubble, after which there is then a catastrophic drop as participants realise that the “Emperor” has no clothes after all. China has had occasional and short-lived periods of excessive property price growth in the past, that is all. What follows is likely to be a period of much slower property price growth or even some slight declines. From an aggregate point of view, that is neither particularly worrying nor all that undesirable.

Turning now to the equity markets. If we superimpose the recent price developments of the

Shanghai composite index onto the Tokyo stock exchange in the period running up to the bubble, what we see is that China's stock market has for some time been extremely average. There is no sense at all here of an excessive surge that requires a long period of dismal performance to compensate. That's not to suggest a particularly bright future for Chinese stocks, but it beats a Japan-style collapse.

China's stock market performance has been moribund



Source: CEIC, ING

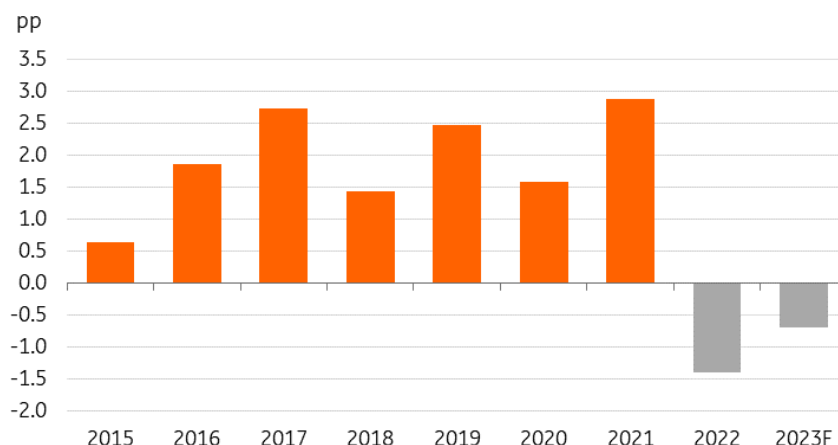
Growth will be slower, but more sustainable without a construction boom

Ruling out a deflationary collapse is clearly a positive standpoint. But we also don't see Chinese growth at much more than 5% over the coming few years. And we have a tough time explaining to people why this is actually a perfectly reasonable growth rate which doesn't require a panicked response. But here goes...

In previous years, China's GDP growth had taken a disproportionate boost from property development. Not only does construction provide a substantial direct boost to activity and labour demand, but it also requires a lot of inputs from industry: cement, steel, copper, aluminium, PVC etc. That also provides a big boost to things like energy demand. And new property sales also require furnishings, and that in turn pushes up this aspect of retail spending.

But the amount of growth that construction was delivering to the economy had grown to totally unsustainable levels. In some years, in nominal terms, construction contributed up to almost three percentage points of total GDP growth, often about a third of the total.

Contribution to Chinese nominal GDP growth from construction



Source: CEIC, ING

Disaster potentially averted...

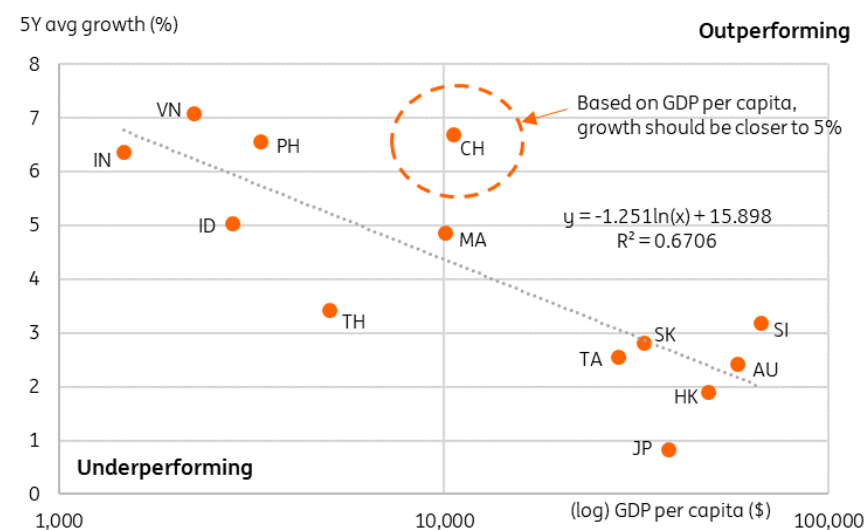
To try to highlight how anomalous this was, if you look at average Asian GDP growth rates pre-Covid relative to GDP per capita, China was a huge outlier, growing several percentage points faster than you would expect for an economy of its state of development. And that deviation can be largely put down to growth generated by excessive construction activity. This was essentially construction-driven GDP “bought” with debt and ultimately, unsustainable.

Maintaining this sector at pre-Covid growth rates could have ended up in disaster. Maybe a Japan-style disaster. What the Chinese authorities have done, quite sensibly, is to nip this in the bud before this happens, though this of course is going to mean reversion to slower (more sustainable) growth rates that are more in line with an economy of China’s stage of economic development.

The property development sector is currently being kept on life support – allowed just enough access to credit to finish the vast stock of unfinished properties which they have sold in advance to a quite understandably nervous household sector. It is unlikely that they will embark on much in the way of new investment until this process is complete. And it is also not clear that Chinese household’s love for property as an investment asset will rapidly, or fully recover after this experience.

So if we can no longer rely on construction to power the economy ahead, then growth will likely average something closer to 5% than the 6-8% China averaged pre-Covid. And in our view, that is surely superior to faster debt-fuelled property-led growth for a few years, followed by a Japan-style collapse. Because while China’s current situation is far from that of Japan in 1990, that is not to say that that future could not have happened if things had run on unchecked as before.

GDP per capita and average GDP growth rates for Asia



Source: CEIC, ING

Author

Olivia Grace

Editor

olivia.grace@ing.com

Julian Geib

Junior Economist, Global Trade

julian.geib@ing.de

Zoltán Homolya

Economic research trainee

zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@ing.com

Michiel Tukker

Senior UK & Eurozone Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Senior Economist, Healthcare & Technology

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Deputy Global Head of Editorial and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporate Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Chief Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801
martin.van.vliet@ing.com

Karol Pogorzelski
Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroeder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com