PILARSKI SAYS

Hard cold reality of Chinese slowdown: predictable and predicted

Investors have only themselves to blame for not seeing the inevitable, writes Adam Pilarski, senior vice-president at Avitas.

Uncertainties in the world affect aviation profoundly. Some factors are obvious, such as signs of recession, terrorism or wars. Others are less obvious, and even counter intuitive.

One of those was the precipitous drop of oil prices, which I discussed in last month's column. This drop was vilified by many Wall Street analysts as a negative and disruptive force in aviation.

The second most commonly mentioned negative factor was developments in China, which, incidentally, I wrote about in my November 2015 column. To demonstrate that this kind of thinking is not confined to the US, let me quote the UK bank RBS, which in January issued a warning to sell everything, saying "2016 will be a cataclysmic year", citing falling oil prices and volatility in China as the "top two red flags for the year".

The basic reply to the supposedly unexpected volatility and decline in growth rates in China is that these developments have not only been predictable but also have been predicted for some time. Nobody should have been caught by surprise, and anybody who made wrong decisions based on predicting that double-digit growth rates would continue indefinitely cannot complain. The situation is quite different from 30 years ago when I predicted long lasting high growth rates for Chinese aviation.

This time my observations were not out of line with the consensus and were based on facts clearly available to everybody. There are three broad reasons why Chinese growth had to abate. These are related to demographic factors, to structural changes in the economy and to statistical factors.

Starting with the population structure, China had been pursuing a policy of allowing only one child for each family for a number of decades. Such a policy created a very different population pyramid where the proportion of people in the labour force has been declining and the proportion of retired people has been rising rapidly. Many other countries have experienced such developments and its consequences are well known.

Many European countries are facing similar problems as did, closer to China, Japan and Singapore. Fewer people supporting more retirees is a clear prescription for declining economic growth. It is interesting to notice the government reaction in Singapore, where 40 years ago the virtues of having only one child were stressed, but already in the 1980s posters appeared showing a bored looking child with the headline: "The most precious gift you can give your child is a brother or sister."

China now acknowledges the negative consequences of its population. Importantly, though, such developments were clearly in the open for a long time. The number of women in China of child-bearing age, say 20 to 30, has been known for exactly 20 to 30 years. Anyone who did analysis on China should not have missed that point.

The second point is related to the Chinese structure of the economy. China had a national investment policy so high it was unprecedented by world standards: this led to huge manufacturing output. Farmers moved to cities to produce products that were then exported.

This is over. The Chinese leadership realized for a number of years that this could not continue because excess farm labour evaporated and wages were increasing. China decided to shift more towards consumption and away from government investment. This policy even has an official name (the "new normal") and has been promoted by the country's leader Xi Jinping. The result is that growth rates will have to slow down.

The third broad reason for the decline in Chinese growth rates is related to some statistical laws. Larry Summers, maybe the most eminent American economist and a former president of Harvard University, published a paper on the topic in 2013. He pointed out that countries which grow at very high rates can continue that for a few decades but eventually will have to accept lower rates. For example, South Korea, Singapore and Taiwan all grew at more than 8% annually between 1969 and 2000. The average annual growth rates for the period of 2011 to 2015 for those same countries fell to about 3%. Similar developments are under way in China and can reasonably be expected to progress in a most predictable way.

All this does not mean there are no great business opportunities in China. It is still an enormous country with the second largest economy and travelling population in the world – and it will continue growing for a long time. But those who did not anticipate the slowdown we are experiencing now only have themselves to blame. All the signs were there, in plain view.