



Leverhulme Centre
for Research on Globalisation and Economic Policy

February 2011 www.gep.org.uk

Wolf predicts China crisis

China is almost certain to experience a financial crisis in the coming years, one of the most influential voices in economics has told an audience at GEP.

Financial Times Chief Economics Commentator Martin Wolf said he could not see the country achieving the unprecedented feat of a half-century of rapid economic growth.

He predicted it would survive any difficulties but only if it first confronts a series of "significant vulnerabilities" that threaten its continued development.

Often described as the world's pre-eminent financial journalist, Wolf is a frequent and popular contributor to GEP's *Leverhulme Globalisation Lecture Series*.

Delivering his latest address, *Challenges to Sustaining China's Growth*, he described China's growth model in the decade leading up to the global financial crisis as "fundamentally unsustainable".

The Chinese government's next five-year plan would have to be built around the recognition that the model has "clearly reached its end", he said.

Wolf told a packed audience: "My view is that, however remarkable the success China has had in the last three decades, the next two decades will be ineluctably more difficult.

"I don't know any significant country that has gone through development and opened up its financial sector to the world which has not had at least one world-class financial crisis."

Wolf said China would need to avoid falling into a "middle-income trap" that might leave it unable to compete globally in terms of low wages and technological capability.

"The aim over the next two or three decades is going to have to be very, very rapid increases in fundamental productivity and innovation," he said.

He added that managing the consequences of the country's "simply staggering" investment ratio would represent another huge challenge.

"Quite uniquely in history, China has emerged as both the largest investor relative to gross domestic product in the

world and the largest exporter of capital in absolute terms," he said.

Suggesting this growth pattern created a "significant vulnerability", Wolf predicted a "certain" decline in growth rate from 10 to five per cent during the next two decades.

He explained: "This would reduce the investment rate that China needs by 20 percentage points of GDP, from 45 per cent to 25 per cent of GDP.

"If this happens abruptly, like it did to Japan, there will be a collapse in demand. This is not an imminent risk, but a sharp adjustment is likely to happen at some point in the next 25 years.

"When that happens China will have to shrink its savings dramatically or increase its current account surplus to something like 20 or 25 per cent of GDP if it is to balance its economy."

Japan failed to rise to the challenge and has never fully recovered, he said, adding: "China is going to have to manage a



The University of
Nottingham

decline in investment rate without losing its dynamism.”

Wolf also warned large losses in China’s banking sector are “quite plausible” as marginal returns on capital fall and bubbles become more frequent.

He said: “Higher interest rates – necessary to support household incomes and improve efficiency in the use of capital – would further squeeze the margins of the banking sector.

“Any move to open up the capital account, which is again quite possible, will make the financial sector extremely vulnerable to crisis. This transition is going to be extremely difficult.”

Wolf’s address opened 2011’s *Leverhulme Globalisation Lecture Series*, which is also set to feature Next CEO Lord Wolfson and former Bank of England MPC member Kate Barker.

He concluded: “In some ways China is the most capitalist society ever – in the sense that the profit share of GDP is at a level I have never seen before.

“The current model... has to be changed in quite fundamental ways towards a domestic, demand-led model. A fundamental strategic shift will be required.”

Martin Wolf

Martin Wolf was joint winner of the Wincott Foundation Senior Prize for Excellence in Financial Journalism in 1989 and 1997. He won the RTZ David Watt Memorial Prize in 1994, the Accenture Decade of Excellence award in 2003 and a Newspaper Feature of the Year award in 2003. In December 2005 he was given *First Magazine’s* Special Advocacy Award, and in January 2008 he won the AMEC Lifetime Achievement Award at the Workworld Media Awards.

Wolf was named Commentator of the Year at the 2008 Business Journalist of the Year Awards and was also placed among the world’s 100 leading public policy intellectuals by the British magazine *Prospect* and the US magazine *Foreign Policy* in May 2008.

GEP lectures

GEP hosts a number of public lecture series.

The *Nottingham Lectures in International Economics* represent a ‘masterclass’ series and attract leading academics from around the world.

The World Economy Annual Lecture, *The World Economy Annual Asia Lecture* and *The World Economy Annual China Lecture* are all sponsored by Wiley-Blackwell, publisher of *The World Economy*.

The Leverhulme Globalisation Lecture Series attracts speakers from the policymaking, business and media communities.



Leverhulme Centre
for Research on Globalisation and Economic Policy

www.gep.org.uk

About the Globalisation and Economic Policy Centre (GEP)

Based at the University of Nottingham in the UK and substantially funded by grants from the Leverhulme Trust, GEP is the major centre in Europe studying the impacts of globalisation and economic policy.

In January 2008 it opened GEP in Malaysia at the University of Nottingham’s purpose-built Semenyih campus, 30km from Kuala Lumpur. In November 2008 it launched GEP in China at the University of Nottingham, Ningbo, China.

GEP is keen to promote its research work and is committed to communicating its expertise. Its academics have advised the Treasury, the OECD, the World Bank and the WTO.