

CITI: China is about to pull everyone into a 2-year 'global recession'

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Economists at Citi put out a scary research note this week laying out their views on the Chinese economy and how it'll affect the world.

Chief economist **Willem Buiter** now thinks the most likely scenario is one in which China tugs the world into a "global recession."

Buiter and Citi are not defining a global recession as an actual drop in world output — they mean "an extended period of excess capacity: the level of potential output exceeds the level of actual output."

More simply, it means more people are out of work than needed. Global GDP would grow at about 2% or less per year for a couple of years.

To put that in perspective, GDP has grown by less than 2% only one year during the 21st century — 2009, when the full effect of the global financial crisis came crashing down and total global output actually fell.

For starters, Citi thinks China's true real GDP growth rate is more like 4%, or even lower, not the 7% or so that the Chinese government reports. ***Their "global recession" call suggests that growth will dip to just about 2.5% by the middle of 2016. China's growth hasn't been lower than that since 1976, when Chairman Mao was still alive.***

That's a big problem for Beijing. The country's investment levels have gone through the roof since 2008 as the country tried to stimulate its economy, but there's been a lot of waste along the way. They weren't good investments, but they still need paying off, so debt levels have surged too.

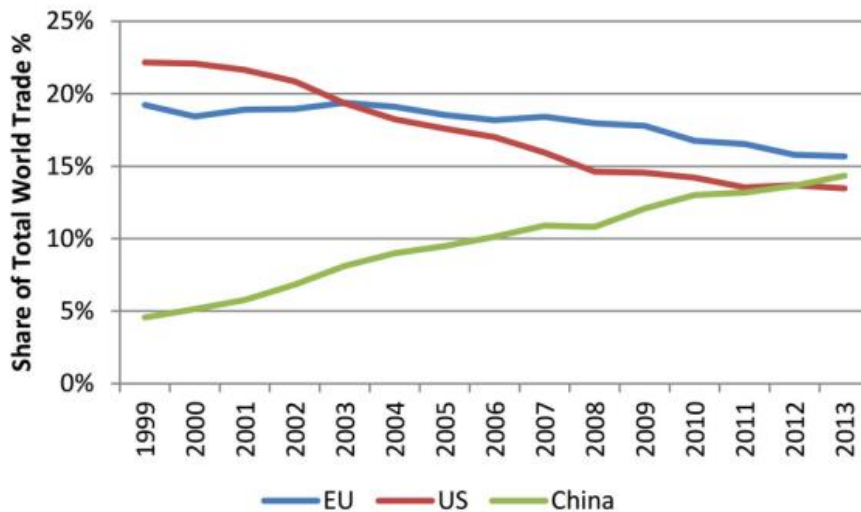
China is going through a painful rebalancing phase, attempting to shift from being a low-income mega-exporter that turned its massive trade surpluses into investment, to an increasingly services-driven middle-income economy that saves less and consumes more. But that's hard. Here's Citi:

Can such a necessary structural rebalancing of aggregate demand (and a corresponding change in the structure of production from physical goods production to services and from capital goods to consumer goods and services) be achieved in China without passing through a recession? In principle, certainly. In practice, we consider this unlikely.

It's worth stressing just how incredibly low 2.5% growth is for China. In the early 1990s, the rate fell below 5%, but never that low. The average growth rate for the subsequent 20 years was about 10%. The relatively sudden slowdown is an incredibly jarring experience, even though it's not actually a contraction.

And here's why it matters to the world, in one chart:

Figure 16. China's share in world trade



(Citi)

The country's share in world trade is now higher than that of the US — based on the existing trend, it will soon be larger than that of the EU. It has practically tripled in about 15 years.

In 2011, the International Monetary Fund confirmed that [China is the biggest source of real economic spillovers in the world](#).

That means that while it's not as financially interlinked as the advanced economies, big changes to China's economy ripple through trade channels and the rest of the world feels the effect.

Citi's analysts also explain that those figures don't even account for a lot of the trade that China does with the world: "A country could, however export nothing to China directly (and import nothing from China directly) yet export raw materials or intermediate goods and services to third countries that, directly or indirectly, depend on demand from (exports to) China."

It's a worrying prospect. Weak growth in the developed economies was being propped up by a handful of emerging markets, China most of all. But the tables are turning and emerging markets are going sour.

Worst of all, as the researchers note, in the event of an even worse scenario, mainstream acceptable monetary policy is already exhausted, and political constraints make fiscal stimulus unlikely.

As HSBC chief economist Stephen King warned previously, "[the world economy is like an ocean liner without lifeboats.](#)"