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**From:** Sullivan, Jacob J <SullivanJJ@state.gov>  
**Sent:** Thursday, April 26, 2012 1:06 AM  
**To:** H  
**Subject:** FW: NYT - China Slows Down, and Grows Up

**Worth a read.**

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**From:** PA Clips [<mailto:paclips@state.gov>]  
**Sent:** Wednesday, April 25, 2012 07:40 PM  
**To:** PA-Monitoring-Group-DL  
**Subject:** NYT - China Slows Down, and Grows Up

China Slows Down, and Grows Up  
New York Times  
Wednesday, April 25, 2012 7:35 PM EDT  
By RUCHIR SHARMA

MORE than half of Americans think China is already the world's leading economy — an astonishing misperception, given that China's gross domestic product is still less than half of America's. As George Orwell once observed, "Whoever is winning at the moment will always seem to be invincible." China has grown at a breakneck pace for so long that its aura of invincibility has grown to outsize proportions in the Western imagination.

Now, however, there are signs that China's growth is slowing to a rate that is ideal for the interests of the United States: fast enough to remain an important pillar of global economic growth, but not fast enough for China to remain a disruptive threat to American power.

The news of a slowdown in China, which just posted its worst quarter since 2009, has reignited the debate over its future. The consensus remains bullish, and is captured in the latest forecast by the International Monetary Fund, which expects China's G.D.P. to continue growing at an annual rate of around 8 percent for five more years. A bearish minority, however, reads the warning signs — labor unrest, a housing bubble, an unprecedented investment binge — as a sign of impending collapse. Neither side has got it right. In fact, China has reached a stage at which all "miracle economies" have slowed significantly, but not disastrously.

It is well known that developing nations hit a "middle-income trap," and stop catching up to rich nations, when per-capita income reaches about \$5,000 to \$15,000 (in current dollars). The examples (Brazil, Mexico, Malaysia) are numerous. What is less known is that even those rare economies that broke through the middle-class trap started to decelerate — still catching up, but more slowly — after reaching a per capita income of around \$5,000 (in current dollars). Japan in the 1970s, Taiwan in the 1980s and South Korea in the 1990s all slowed from a growth rate of about 9 percent to around 5 percent, simply because the bigger the economy, the harder it becomes to grow fast.

China passed the \$5,000 per capita income level last year, and is now showing the same signs of deceleration that Japan, Taiwan and South Korea exhibited at that level: rising labor demands for higher wages and a decreasing demand for new investments. China's growth model is similar to Japan's in the 1970s, and the most likely scenario is that China will follow the path of Japan in that decade, when its growth rate slowed to 5 percent. China will continue to catch up to the United States, but its growth will slow to a pace of around 6 to 7 percent over the next 5 to 10 years. At that point, China's economy will be even larger, and may decelerate again.

This process is under way, and it signals a basic power shift in the global economy. China became the biggest contributor to global G.D.P. growth in 2007, and it has held the lead ever since. But if the United States continues to grow at its

current pace of about 2.5 percent, and China slows to 6.5 percent, then the United States will regain the lead this year — contributing 23 percent of global growth in 2012, compared to 18 percent for China — and it will hold that lead at least through 2015, according to Morgan Stanley research.

Investors who have bet big on near-double-digit growth in China will be troubled by this slowdown and will start looking for a safer destination. With Europe and Japan both growing at less than 2 percent, the focus of global attention will shift to the improving competitive position of the United States, and capital flows will follow.

China's slowdown is setting the stage for a drop in the price of oil, which has had a crippling effect on growth in the United States. In recent years China has accounted for nearly half of global growth in oil demand, and every 1 percent of G.D.P. growth in China added 10 to 30 percent to the price of oil.

China's slowdown is also opening the door to a revival in American manufacturing. China is suffering many symptoms typical of a maturing miracle economy, from a strengthening currency to rising wages, land prices and transport costs, while the United States has a weak currency, stagnant wages and a moribund property market. The dollar is near record lows (in inflation-adjusted terms) against many of its trading partners, including China. The long-term decline in the United States' share of global manufacturing exports bottomed out in 2008 at 8 percent, but has since been inching higher. The Boston Consulting Group predicts that by 2015, China will have lost most of its cost advantages, accelerating the "reshoring" that is already bringing some factory jobs back home from China.

These shifts will reshape the global balance of economic power, mostly for the better. A collapse in China to zero percent growth would be disastrous for the world economy, but it is unlikely, in large part because Chinese leaders understand that the current slowdown is inevitable. They are lowering growth targets and trying to manage rather than fight the deceleration (which would only make it worse).

At the near double-digit growth rate of the last 15 years, China was the equivalent of a company with disruptive technology — destroying competitors, lifting suppliers, sucking in capital, stealing jobs and moving so fast that rivals couldn't keep up. A smooth downshift to 6 or 7 percent makes China a more normal rival, one the world can do business with and compete head to head against — one that should generate a lot less worry.

Ruchir Sharma, the head of emerging market equities at Morgan Stanley Investment Management, is the author of "Breakout Nations: In Pursuit of the Next Economic Miracles."

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