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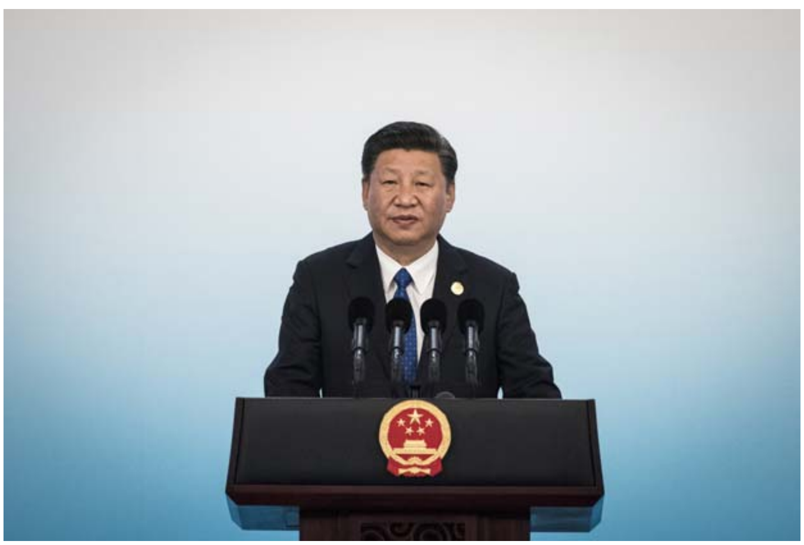
MARKETS | HEARD ON THE STREET

Strongman Xi Jinping Now a Big Risk for China's Economy

China's most powerful leader in decades has shown he can tackle economic issues that have plagued weaker predecessors. But that much power in one pair of hands creates its own problems.



Chinese President Xi Jinping speaks during the BRICS Summit in Xiamen, China, in 2017. PHOTO: FRED DUFOUR/ASSOCIATED PRESS

By Nathaniel Taplin

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Why did sentiment on China improve so much in 2017? Progress in taming longrunning structural problems, such as the country's excess manufacturing capacity and mushrooming off-balance sheet debt, deservedly caught investors' attention. The driving force behind that progress was the same factor that should now give investors pause: The primacy of Xi Jinping.

Mr. Xi's five-year campaign to consolidate power has left him in firm control of China's fractious bureaucracy. He has started to do what his predecessors couldn't, bringing slippery local officials and state-owned banks and firms to heel.

But his success entails a sea-change in how to view China: The biggest risk may no longer be a weak Beijing, but a strong Xi administration which local officials are terrified to defy. That brings up ghosts of a darker time. Back in the late 1950s, millions of Chinese died of starvation because no one was brave enough to tell Chairman Mao his economic program had caused a disastrous famine.

Such tragedies are far less likely in the age of cellphones and surveillance. But recent problems suggest that the economic—and political—risks of so much concentrated power are still significant.

Many Chinese found themselves without heat this winter as local governments scrambled to meet pollution targets by shutting down coal power plants. Mr. Xi has made a cleaner environment a centerpiece of his agenda.

But the idea that coal-dependent northern China could suddenly convert wholesale to gas for power and heat generation smacks of Maoist magical thinking. Chinese gas demand was still a paltry 6.4% of total energy consumption at the end of 2016. Coal comprised 62%.

China's national planning agency bowed to reality in mid-December, urging officials to "act based on the facts" and use coal if needed. But officials' willingness to leave residents to freeze for so long rather than disobey orders is a worrying sign.

A similar dynamic unfolded last spring when Beijing's campaign against debt stopped bond issuance in its tracks. A drumbeat of new directives resulted, as different regulators competed to show Mr. Xi they were on board with the campaign to crimp leverage. Money and bond market yields rocketed higher, only easing after massive cash injections by the central bank.

Because the campaign came at a time when companies were flush with profits, wider damage to the economy and markets was averted. The next time Beijing tightens the screws so hard, it may not be as lucky.

Mr. Xi has correctly identified Beijing's weakness relative to China's unruly local governments and banks as the source of many of the nation's greatest problems. The risk now is that a more muscular Beijing squeezes too hard with unforeseen circumstances—and doesn't reverse course quickly enough.

Companies often encounter so-called "big-man risk," when a successful CEO or chairman becomes too dominant. The same can happen to countries —even one as large as China.