

China lifts interest rates as imbalances grow

John Chan
8 November 2004

Despite comments in the international financial press that China's "overheating" is not a threat to world economic stability, on October 28 the Chinese central People's Bank suddenly lifted the national interest rate from 5.31 percent to 5.58 percent. After nine years of maintaining the previous rate, the increase surprised many international economic commentators.

The *Washington Post* described the decision, which led to a drop in world oil and commodity prices as well as mining and metal company stocks, as "unexpected".

The newspaper commented: "Only a few years ago, the movement of interest rates inside this still nominally communist country was of little consequence to the rest of the world. But China is now by some measures the world's second-largest economy. Its growth has fuelled a surge in demand felt from the iron-ore mines of Brazil and Australia, the cotton and soybean farms of the US Midwest and luxury-good-makers of Europe. China's purchases of materials such as palm oil and rubber are now the single largest source of economic growth in much of Southeast Asia. Its hunger for steel and machinery has played a pivotal role in lifting Japan from years of stagnation. China's thirst for oil—it is the world's second largest importer—is among the key factors driving up the price of that commodity."

The previous interest rate was maintained in order to encourage domestic spending in a largely deflationary environment after the Asian financial crisis in 1997-98. But new problems have arisen with the accelerating foreign investment of the past five years. Last April Premier Wen Jiabao introduced a series of administrative measures to try to slow the feverish growth in real estate, steel, cement and aluminium. But these have been ineffective, necessitating a tightening of monetary policy.

The consumer price index for September rose 5.2 percent compared to the same period last year and retail prices were up 13 percent. In the same period, fixed-asset investment rose 27.7 percent and industrial output rose 17 percent. These official figures indicate that the Chinese government's so-called "macroeconomic-control" have had little impact on the globally integrated economy.

Foreign investment continues to flood into China.

According to Ministry of Commerce, by the end of August, 28,748 new foreign-invested firms or \$45.6 billion have been approved this year, an increase of 20 percent. Total foreign investment in China had reached \$1.04 trillion in committed payment and \$545 billion in paid-in capital or nearly half a million foreign-invested enterprises. The Chinese government has little control over this vast movement of capital.

Beijing's restriction on loans from state-owned banks has forced thousands of medium and small private companies to turn to a rapidly growing "black market" for credit. According to estimates by Credit Suisse First Boston in Hong Kong, up to \$17 billion has been poured into underground financing.

Nor is there any sign that the property market is under control. National Bureau of Statistics figures indicate that the average property price rose 13 percent in the first nine months of 2004 compared with the same period last year. The total investment in real estate is more than \$100 billion, with the largest increase from foreign sources speculating on a revaluation of the yuan.

Up to July, investments in property by Sino-foreign joint ventures, foreign-owned and Sino-foreign cooperatives companies reported a growth of 87.4 percent, 60.3 percent and 60 percent, respectively. At the same time, state-owned joint stock and state-owned enterprises dropped 19.5 and 11 percent.

The property bubble is extremely fragile. In Beijing, for instance, residential housing prices have increased to between 7,000 yuan (\$US843.4) and 8,000 yuan (\$US963.9) per square metre, almost as much as the average annual income of 10,000 yuan or \$US1,204.

Sections of the business elite have argued that it is time for the Chinese government to allow the market to set interest rates, claiming this will "protect" the poor. Chinese financial journal *Caijing*, for example, claimed on October 21 that low interest rates "have hurt the poor and subsidise the rich".

"Given that the Chinese ratio of housing price to average annual income is almost 10 to 1, way higher than the international average, most homebuyers in China come from

a very small group of high-income people. It is this group that are reaping most of the benefits offered by cheap credit. On the other hand, the poor, who deposit most of their life's savings in banks, suffer from the negative real saving rates, as their principals are eroded by inflation and interest taxation. This, economists would argue, constitutes an actual 'interest subsidy' for the rich, with poor picking up the tab."

The newspaper concluded with a call for China to "abandon administrative intervention into the economy and adopt market tools".

Claims that interest rates determined by market forces will benefit the poor are absurd. Higher interest rates will force millions of low-income homebuyers to the wall and push many small businesses into bankruptcy. A collapse of the housing market bubble will not only put China's bad-loan-stricken financial system at risk, but threaten millions of jobs in medium and small companies. High interest rates will also translate into greater financial burdens for millions of farmers who rely on cheap loans provided by rural credit cooperatives.

One of the most vulnerable sections of the population is the urban working class. According to *Radio Free Asia* on October 31, consumer debt in China is now 20 times the level of 1998 with debt now the equivalent of 100 percent of family income in major cities. In Shanghai, it is 155 percent.

US officials have welcomed Beijing's decision to lift interest rates as a step toward a "market-oriented" financial system and a flexible exchange rate between yuan and the dollar.

The relentless pressure on China—the so-called "workshop of the world"—for higher rates of production and profit has produced serious global economic imbalances. Exports from China now account for a quarter of the world's trade deficit or about \$500 billion. The largest imbalance is in the China-US relationship. Anxious to ensure that their exports remain competitive, Chinese and Asian banks have been purchasing US dollar assets to ensure that the value of their currencies does not rise. These purchases in turn finance the US trade deficit and ensure that the American market keeps growing. But if a financial crisis or social unrest were to erupt in China this process could be disrupted with far-reaching implications for the global economy.

The country already faces severe shortages of coal, electricity and transport capacity, as these sectors are unable to keep up the demands generated by the foreign capital inflow. The most serious "shortage" is cheap labour, the biggest attraction for foreign investment, in some coastal manufacturing centres. The Pearl River Delta, China's major export zone in the southern province of Guangdong, for example, is reportedly short of two million workers.

Some of Premier Wen's previous economic measures include subsidies to farmers to overcome consecutive declines in grain output but this policy is colliding with the interests of international capital. The slight increase in rural incomes has drawn millions of low-paid workers in special economic zones and city locations back to the countryside. Higher oil and raw material prices have also forced factory sweatshops to further slash the impoverished wages and conditions.

The *Wall Street Journal* noted on August 16: "The labour shortage has global implications. As the low-price trendsetter for plenty of goods manufactured globally, China's rising labour costs, coupled with recent price increases in oil, electricity and commodities, could put pressure on China's export prices ... This could potentially raise prices of everything from consumer products to mortgages for consumers in Europe and the US."

These economic and social contradictions are the logical outcome of Beijing's "market reforms" over the past two decades. The Stalinist bureaucracy and local capitalists have amassed enormous wealth at the expense of the Chinese masses. Poverty, rampant unemployment, official corruption and other social evils prevalent before the 1949 revolution that brought the Maoist regime to power have returned.

Social unrest has escalated over recent months, the latest incident a bloody clash between 100,000 farmers and 10,000 armed police on October 29 at Pubugou area in Sichuan province. The farmers were protesting over the lack of compensation for their forced relocation to make way for a hydroelectric project.

Business Week chief economist Michael Mandel warned in an article on October 25 that China faces a financial meltdown in the next five years. "[T]he economic and political implications for the rest of the world will be tremendous," he warned. And one of the dangers, he argued, is a political upheaval with "unpredictable" consequences.

"In the 1950s, vicious political arguments raged in the US about who was responsible for allowing China to go Communist. 'Who lost China?' was how it was put in the shorthand of the time. In 2010, will politicians be asking that question again?"

Mandel's warning to the US ruling elite is clear: a financial crisis in China will trigger mass unrest with dire consequences for capitalism in China and elsewhere.



To contact the WWS and the Socialist Equality Party visit:

wsws.org/contact