Fears in China about the impact of global economic crisis

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Beijing is increasingly worried about the impact of the global financial storm and looming international recession on the Chinese economy. While joining other major economies to try to stabilise American and world capitalism, the Chinese regime is also concerned at the economic, social and political stresses being generated by a sharp slowdown at home.

Yesterday the People's Bank of China joined other major central banks around the world in an effort to steady international financial markets via coordinated interest rate cuts. More fundamentally, China continues to hold massive amounts of US debt--already more than $1 trillion--which, as well as maintaining currency exchange rates, helps to shore up the US economy.

During a trip to the UN, Chinese Premier Wen Jiabao met leading American financial figures on September 24 to express his grave concerns at the unfolding financial meltdown. Those present included Timothy Geithner, president of the New York Federal Reserve Bank; Robert Rubin, Citigroup chairman and former US Treasury Secretary and Andrew Liveris, chairman of the US-China Business Council and of Dow Chemicals.

Wen declared that the most important commodity had become "confidence" in the American economy, saying it was "more important than gold and currency". Dismissing comparisons with the 1930s Depression, Wen insisted that the situation was different because the US was now based on high-tech industries and therefore "sound". He declared that Beijing was willing to cooperate to maintain US financial stability because that would be "beneficial to China".

Just how anxious China is about the US economy was revealed in the Hong Kong-based *Ming Bao Daily* last weekend. It reported that the Chinese central bank was going to buy another $200 billion in US Treasury bonds in order to help finance the Bush administration's $700 billion bailout of Wall Street. The People's Bank of China denied the report, but welcomed the US package and declared that China and the US "share common interests" in global financial stability.

Several analysts have commented on the dilemma facing Beijing: whether to pour more money into buying up US debt to support the American financial system or use the country's huge currency reserves to boost the slowing domestic economy. While the regime is facing pressures at home to maintain growth, any withdrawal of Chinese funds or even a slowing down of cash injections into the US could encourage others to follow suit, with devastating consequences for the American and global economic system.

An editorial in Hong Kong's *Ta Kung Pao* newspaper on October 8 warned Beijing not to fall into the trap of bailing out the US economy. Its reasons included: firstly, the US was seeking to strategically contain China and was selling arms to Taiwan; secondly, the US measures would weaken the dollar, causing further huge losses to China's existing dollar assets; and thirdly, without coordination with other Asian countries, China could end up paying the bill, while others dumped dollars. Beijing should reduce its dollar holdings, the newspaper argued.

Former Morgan Stanley Asia chief economist Andy Xie, on the other hand, is one of the "save America" advocates. He called for China and other Asian countries to use their vast foreign currency reserves to prop up the US economy simply because so much was at stake. Writing in the financial journal *Caijing* on September 23, Xie argued that the US was so indebted that any domestic solution, including the $700 billion bailout, would only replace one form of debt with another. "When the shell game runs out of options, printing money is the only way out. That will eventually lead to the US dollar collapsing and hyperinflation in the US economy," he warned. The outcome would be a global depression of "unimaginable proportions" that would consume not only the US but China as well.

To avoid "such a tragic ending," Xie called on China, Japan, Kuwait, Saudi Arabia and the United Arab Emirates to negotiate a deal with Washington to swap their huge dollar assets for equity assets like shares. Xie admitted, however, that the ruling US financial elite was extremely unlikely to accept new Asian and Middle Eastern bosses on

Wall Street. "Even though the US is the largest debtor in the world, it behaves like the largest creditor. America may need much more hardship to change their attitude," Xie wrote.

The *Financial Times* explained on October 1 that China and Asia had become intimately intertwined with the American economy and thus its financial crisis. Cheap goods from China and their deflationary pressure over the past decade underwrote the cheap credit policy of the US Federal Reserve, which, in turn, encouraged the formation of highly speculative financial derivatives. The Asian banks' huge reserves of $4.3 trillion also provided US financial markets with endless liquidity, helping to suppress interest rates, inflating the housing market and debt-driven consumption. In turn, the US provided a huge consumer market for the explosive growth of industry in China.

When the US housing bubble began in 2002, China's exports to the US skyrocketed at double-digit annual growth rates-until the first seven months of this year, when they fell by 8.1 percent, leaving China with massive overcapacity. Several of China's largest steel makers agreed to cut output by one fifth this month in order to prop up falling prices. Demand for steel is weakening in all three major areas-construction, home appliances and auto industries-which will also impact on global commodities prices.

China's export sector is struggling, according to the *Australian Financial Review* on September 28. C.K. Yeung, vice-president of the Toys Manufacturers Association of Hong Kong, which mainly operates in Guangdong's Pearl River Delta, said this was the toughest year since investment in China began in the early 1980s. He estimated that 10 percent of the 4,000 large toy factories in the region had shut down. Andrew Yeh, the head of the Dongguan Taiwanese Business Association, told the newspaper that in the first half of the year, 1,500 Taiwanese firms closed in Dongguan, a major manufacturing city in Guangdong.

China's other major export hub, the Yangtze River Delta near Shanghai, is suffering similar problems. The two regions are the main motors of China's economic growth, generating 70 percent of exports and 40 percent of property sales. Many inland provinces depend on supplying these two regions with labour and raw materials. Economic troubles in the two deltas--a falling real estate market, declining car sales and increased closures of small and medium firms--are expected to create a far wider downturn throughout China.

Most economists are no longer optimistic about China's "decoupling" from the global economic crisis. A Morgan Stanley report in late September pointed out that as prices fall, "the likelihood of a property sector meltdown is high," leading to insolvency among developers and impacting on Chinese banks. Credit Suisse's Vincent Chan warned: "Suddenly you have a situation where external demand is weakened, manufacturing costs are rising and you have a property market bubble bursting. So you have a perfect-storm situation."

Another economist, Stephen Green from Standard Chartered, wrote to his clients, asking: "China-Time to Panic?" Although he did not think so, he predicted a sharp decline of China's growth rate by 4 percent next year, to just 7.9 percent. Other analysts are predicting even lower rates of 5-6 percent.

At the World Economic Forum in Tianjin on September 26-28, Chinese officials joined others at the international gathering of CEOs, academics and political figures in calling for "international cooperation" to avert a US financial meltdown. But behind the calls for joint action, all the major powers are jostling to shore up their own economies and strengthen their own positions internationally.

Ding Yifan, a researcher for the State Council, China's cabinet, commented in the *China Daily* on September 26: "The unfolding financial crisis in the United States leads us to wonder whether this signals the end of that country's long-established financial hegemony in the world." While Ding pointed to opportunities for China to buy "cheap financial assets" in the US, he also expressed the fear that government bailouts of the financial markets in the US and Europe represented a turn towards protectionism, shutting the door to Chinese exports.

For all the talk of global economic cooperation, governments in the US, Europe and Asia are increasingly taking a beggar-thy-neighbour approach amid the greatest economic crisis since the 1930s. China, which is heavily dependent on huge inflows of foreign investment and exports to the major capitalist economies, may well turn out to be among the hardest hit by the current turmoil.