China slumps as global recession deepens

Mike Head
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In the latest shock to the global economy, China's industrial production is declining sharply, indicating that the entire national output is contracting. The official statistics for November are a staggering measure of how quickly the world slump is worsening, cutting off demand for Chinese exports.

Only months ago, China was still reporting double-digit economic growth and commentators were speculating that China's boom would help global capitalism avoid a depression on the scale of the 1930s. Now, Western analysts estimate that the Chinese economy is probably shrinking this quarter and will contract again in the first quarter of next year—meaning that China will join Europe, Japan and the US in recession.

China's overall industrial output grew just 5.4 percent over the year to November, implying a sudden contraction since mid-year, when the annual rate was running at 17 percent. Heavy industry saw the biggest fall, with steel production down more than 12 percent since November 2007, to 35.2 million tonnes.

Electricity production was down by 9.6 percent over the year, which analysts said was the largest fall since the Beijing leadership adopted its open pro-market policy three decades ago. Gross domestic product this quarter "must be contracting; everything is pretty bad," Macquarie Bank's China economist, Paul Cavey, told the Melbourne *Age*. "And we're not at the worst point yet."

As well as being hit by plunging sales, Chinese steel manufacturers have faced a 40 percent fall in global steel prices since July. In an unusually frank statement, Industry Minister Li Yizhong also warned that worse was yet to come. "Many factors are combining to produce a striking impact on industry. Our forecast is that we have not yet bottomed out, and the impact will continue to widen in December," Li said.

Li said it would take steel companies until March to run down the stockpiles of raw materials bought at high prices earlier this year. In the meantime, it was almost impossible for most producers to make money. "It's not just small companies that are losing money, it's also the big ones, so the situation is really rather serious," Li said.

China's reversal has enormous implications for the world economy. Most immediately, because China is the world's largest producer and consumer of steel, the industry's decline is battering companies that have relied on the country's steel boom for growth, from Chinese electricity producers to big iron ore miners such as BHP Billiton and Rio Tinto.

Hopes that Beijing's trillion dollar stimulus measures could offset the impact of the global collapse by boosting domestic consumption have been dashed by a precipitous 20-30 percent year-on-year fall in real estate construction, which has been a prime force in the economy. Sales of passenger vehicles also fell 10 percent in the year to November, while truck sales plunged 25 percent in the year to October.

There is visible anxiety in world financial circles that China's downturn could not only intensify the global slump but lead to mass unemployment and an explosion of social unrest within China, whose cheap labour regime has been central to corporate profits internationally for the past 20 years.

Under the headline, "China's economy hits the wall," *Financial Times* commentator Gideon Rachman wrote: [T]he economic crisis of 2009 could pose the toughest tests that the Chinese government has faced since the student uprisings of 1989, whose 20th anniversary will fall next year. For it is now clear that, far from being immune to the global financial crisis, China is very vulnerable... It would be a historic irony if the Chinese Communist party was thrown into crisis, not by the collapse of communism in 1989—but by the convulsions of capitalism in 2009."

The pessimistic outlook for China comes amid further signs of deepening global recession, including the release of the Bank of Japan's closely watched Tankan index of business. In the survey for the December quarter, the diffusion index for confidence among large manufacturers dropped to minus 24, down by 21 points from the previous survey taken in September. Looking ahead, predictions by the big firms indicated a further 12 points decline in the index over the next three months to minus 36.

The result was the second-steepest quarterly decline since August 1974, during the first global oil shock, and the lowest reading for big manufacturers since March 2002, at the tail of Japan's last severe recession.

With Japan now certain to record its third quarter of official recession at the end of this month, after shrinking by an annualised 1.8 percent in the September quarter, there was no signal that any class of business in the survey of 210,000 companies could see a bottom to the slump. Manufacturing and service companies at all levels forecast a sharp worsening in conditions between now and March.

Confronted by an unprecedented collapse in their export markets, companies from Sony to Toyota have started slashing jobs. Auto manufacturers have cut planned output for the next six months by 20 percent. "The economy is worsening very quickly," Hiroshi Watanabe, an economist at the Daiwa Institute of Research told AFP. "The wave of job cuts will spread to the service industries such as auto dealers, retailers and restaurants."

There were also further signs of deepening problems in Europe, where the number of people with jobs across the euro zone fell in the third quarter compared to the previous three months. The European Union's statistics office said the number of employed fell by 0.1 percent of the workforce, or 80,000 people, in the July-September period against the second quarter to 146.1 million. It was the first quarterly drop since the Eurostat records began in 1995.

Already in its first official recession, the 15-member euro zone economy will almost certainly sink deeper in the fourth quarter. A widely-used gauge of activity in the manufacturing and services sectors fell to a record low. The preliminary Markit composite purchasing managers index fell to 38.3 in December, down from 38.9 in November. A figure of less than 50 indicates a decline in output.

Economists said the results suggested that gross domestic product contracted by 0.6 percent in the October-through-December period—worse than the 0.2 percent declines in both the second and third quarters. Marco Valli, economist at UniCredit MIB in Milan, told London-based *MarketWatch* the data offered no sign that activity was set to bottom out.

European banks have been hit by the fallout from US investment adviser Bernard Madoff's alleged $US50 billion fraud. British-based HSBC confirmed that it could lose up to $1 billion and the bailed-out Dutch arm of Belgian bank Fortis admitted losses could reach $1.4 billion. Royal Bank of Scotland joined BNP Paribas and Banco Santander among the casualties, saying it might lose up to $612 million.

One of the most telling indicators of the worsening of the year-long world meltdown came in the US, where the US Federal Reserve cut its target for overnight interest rates to zero to 0.25 percent—its lowest level on records dating to July 1954—and said it would likely keep it at "exceptionally low levels for some time".

The latest 75-basis point cut leaves no more room for trying to stimulate the world's largest economy by lowering interest rates. US authorities have been unable to prevent the recession from intensifying despite a range of unprecedented multi-billion dollar initiatives designed to encourage lending by loss-ravaged banks and financial institutions.

Economists polled by Reuters last week expected the US economy to contract at an annualised 4.3 percent in the last three months of the year, and to continue to decline through the first six months of 2009. The grim data since then, including from China, has led many economists to predict an even deeper contraction, with some forecasting that output would fall at more than a 6 percent pace in the fourth quarter.