

# Asia's asset bubbles fuel global financial instability

**John Chan****30 November 2009**

China's huge stimulus bank lending, combined with the US Federal Reserve Board's loose monetary policy and US pressure on China to revalue the yuan to the US dollar, has generated a flood of credit that is fuelling property prices across a number of countries in East Asia. The resulting speculative spirals are creating new global financial instabilities.

During the recent Asia-Pacific Economic Cooperation (APEC) meeting in Singapore, World Bank president Robert Zoellick warned that central banks, by responding to the global financial crisis by opening the "tap of liquidity", would produce asset bubbles and inflation, which "could undermine confidence in 2010".

Zoellick specifically warned of the dire situation in Asia in a *Financial Times* article on November 24, entitled, "Heed the danger of asset bubbles". "House prices in China jumped in October by the biggest amount in 14 months, with a recent auction in Shanghai attracting record bids to a commercial property that drew none last year," he wrote.

"Elsewhere in Asia, equity markets have surged and property prices are on the rise, notably in Hong Kong and Singapore. Gold is rising and the prices of commodities are likely to rise too. The combination of loose money, volatile commodity markets and poor harvests—such as occurred recently in India—could make 2010 another dangerous year for food prices in poor countries. Asset bubbles could be the next fragility as the world recovers, threatening again to destroy livelihoods and trap millions more in poverty."

What is happening in Asia is part of a global phenomenon. Various banks, hedge funds and financial institutions that were bailed out by major capitalist governments, particularly Washington, are borrowing cheap US dollars to invest in other high-yielding currencies, thus reviving feverish financial speculation internationally.

In Asia, the main problem is China, where a flood of cheap bank credit ordered by Beijing to counter the huge downturn in export-dependent industries, has been channelled into real

estate and share market speculation. At the same time, speculators are taking advantage of the Obama administration's pressure on Beijing to end its de facto peg with the dollar in order to reduce the huge US trade deficit with China and open up more export opportunities for American companies. Speculative funds are moving into China, on the expectation that the yuan will be forced up.

According to the *Wall Street Journal* last Wednesday, "hot money" could contribute almost half the \$US62 billion increase in Chinese foreign currency reserves in September, mainly in anticipation of a revaluation of yuan-denominated assets. Despite China's nominally tight controls on capital movements, such flows can prove destabilising. In late 2008 and early 2009, amid the global financial turmoil, a rapid outflow of speculative capital contributed to a sharp downturn in the construction industry, China's second economic pillar after the export sector.

Zhang Xin, chief executive of Soho China, one of the largest Chinese private real estate developers, told the *Financial Times* on November 18 that rampant wasteful investment in the property market was resulting in "more and more empty buildings across the whole country and in every real estate segment". She pointed out that in New York's Manhattan, if the vacancy rates reached 10-15 percent, "they feel like the sky is falling," but in Shanghai's Pudong district, vacancy rates were as high as 50 percent and new skyscrapers were still being built. "If you look at GDP growth, then China looks like a new engine driving the global economy, but if you look at how growth is being created here by so much wasteful investment you won't be so optimistic," Zhang warned.

Urban property prices in 70 large and medium Chinese cities rose 3.9 percent in October from a year earlier, accelerating from 2.8 percent in September. Investment in real estate development rose even more sharply—up 18.9 percent in the first 10 months of the year from the same period of 2008.

In order to prop up China's economy, which has battered hard by the global financial crisis, Chinese banks issued

unprecedented loans of 8.92 trillion yuan (\$1.3 trillion) in the first 10 months of this year, up by 5.26 trillion from the same period last year. This has also caused a sharp fall in the core capital of the banks.

Reflecting fears of huge non-performing loans resulting from risky investment, the Shanghai share market tumbled 3.5 percent last Tuesday—the deepest one-day fall in nearly three months. The plunge sent shock waves to other Asian markets. Investors are concerned that the Chinese banking regulatory authorities are asking the 11 largest listed banks to raise at least 300 billion yuan (\$43 billion) to meet a more stringent capital adequacy requirement.

The financial dangers have already spread beyond China. A *Wall Street Journal* commentary on November 18 noted that other Asian economies with relatively more flexible exchange rates did not “import” the impact of US monetary policy as directly as China. “But these countries are also vulnerable to cheap-money-fuelled speculative inflows from China. Their economies ... are benefiting from the trade boom with China, from which they also receive the same capital leakages now flowing into Hong Kong.”

At the APEC meeting in Singapore, a number of Asian leaders openly expressed their concern over the expanding bubbles. Hong Kong chief executive Donald Tsang declared that he was “scared” by the US ultra-low interest rate policy. The city is facing a flood of speculative capital (\$HK567.5 billion or more than \$US73 billion from October 2008 to this November) both from abroad and within China, driving up property prices by 30 percent this year, and the Hang Seng share index has doubled from a low in March.

Singapore prime minister Lee Hsien Loong said: “We have to live with it for now and manage the difficulties, but if it becomes a significant and broad, widespread bubble ... this will become a serious problem.” Singapore’s property prices rose 15.8 percent in the third quarter of 2009, compared to the second quarter.

Hong Kong monetary authorities have increased the required downpayment on homes costing more than \$HK20 million by a third to 40 percent to curb speculation, mainly by wealthy mainland Chinese investors. Singapore government has shut down lending schemes that allowed buyers to defer mortgage payments on unfinished developments, and plans to release more land for sale to curb the rising prices.

In South Korea, the central bank is also considering measures to tighten mortgage lending, amid fears of rising housing prices and growing household debt. “Given ample liquidity and expectations for further gains in housing prices, upward

pressure on home prices appears to linger,” a semi-annual financial stability statement by the Bank of Korea warned. The bank said that as a result of high unemployment, the ratio of household debt to disposable income rose to 1.43 in the first half of this year, compared with 1.4 at the end of 2008 and 1.13 in 2004. Total household debt rose to \$US708.4 billion in June, up 2 percent from March.

The rising share and property prices in Asia are bound up with a worsening of the underlying economic base. Japan, the second largest economy in the world, has just entered deflation for the first time since 2006, triggering deep divisions in Japanese ruling circles over interest rates. Citing concern about inflation and higher commodity prices, the Bank of Japan (BoJ) declared on November 20 that it would hold the official rate at 0.1 percent. The new Democrat government wants the BoJ to implement more aggressive measures such as lower the already rock-bottom rate in order to counter the slump. Deflation plagued Japan’s prolonged stagnation during the 1990s, despite a zero interest rate.

Japan reported a so-called “rebound” in exports in October, but this was only because exports were 23.2 percent down from the same period last year, rather than the 30.6 percent decline recorded in September. Japanese exports to China fell 14.3 percent year-on-year, smaller than the 28.4 percent decrease to North America and the 26.9 decline to Western Europe. Thus, the slight improvement is heavily dependent on China.

Other Asian economies are basically in the same shape. Despite being the largest trade partner of most Asian countries, China offers no viable way out for them. Over the past decade, transnational corporations, including those based in Asia, have transformed the East Asian countries from individual cheap labour platforms into a giant network of suppliers of semi-finished parts, capital goods and raw materials for Chinese assembly operations that re-export to the US and other developed markets. These final destinations account for 60 percent of the demand for the Asian goods, and China’s relatively small domestic market is too small to provide a substitute.

Far from creating a new, sustainable upswing, China’s huge stimulus package and bank lending, together with the US policy of weakening the dollar to spread its astronomical debt burden to major rivals, is helping to seed a new global financial disaster.



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