Chinese conference underlines mounting economic problems

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The Chinese government's concerns about mounting financial instabilities dominated its annual Central Economic Work Conference in Beijing from December 5 to 7, which set the country's economic policy for 2010.

Over the coming year, Chinese economic growth will continue to be heavily dependent on government stimulus measures. At the same time, excessive and wasteful fixed-asset investment and rampant speculative activities are forcing the regime to tighten monetary policy.

The meeting's key decision was to set a lending target of 7-8 trillion yuan ($US1-1.17 trillion), down from the estimated new loans of 10 trillion yuan for 2009, but still much higher than the 4 trillion yuan in 2008. This flood of cheap credit, which is part of the original 4 trillion yuan two-year stimulus package announced in November 2008, has not only expanded infrastructure and steel production, but also led to rampant stock market and real estate speculation.

A Lex column in the *Financial Times* on December 6 pointed to the unsustainable character of China's performance, by noting that fixed-asset investment accounted for 95 percent of GDP growth in the first nine months of 2009. "China will be the only one of the world's top 10 economies with a higher real gross domestic product number this year… But in 2010 and beyond, the costs of that achievement should become more obvious."

The column cited the International Monetary Fund's estimate that China's incremental capital output ratio—a measure of investment spending efficiency—will be less than half China's average in the 1980s and 90s. During those decades, Chinese state banks accumulated hundreds of billions of dollars of bad debts, which were only "cleaned up" in this decade, largely by transferring the debts to state asset management companies. The current lending spree will create a higher mountain of bad debt.

In a bid to rein in speculation, the state council reintroduced a real estate tax last week. Residential housing prices in China's 70 largest cities rose 5.7 percent in November from a year earlier, up from October's 3.9 percent rise. The new 5.5 percent tax applies to anyone who sells an apartment or house within five years of its original purchase. This represents a U-turn from a year ago, when the regime was desperate to stimulate the flagging real estate market amid the global financial turmoil.

There are still concerns, however, about sending the property market into a tailspin. Ha Jiming, chief economist for China International Capital Corp, an investment bank, told the *Financial Times* last week: "We estimate that if policies are too harsh [and] sharply reduce real estate transactions to the levels we saw at the end of last year, then China's GDP growth could drop to as low as 6 percent, and that is clearly something the government does not want to see."

The property tax is in line with warnings from the United Nations Development Program (UNDP) that the tide of easy credit created by low US interest rates, the weak US dollar and the stimulus packages was inflating equity and property market prices in Asia. UNDP Asia-Pacific director Ajay Chhibber told the *Financial Times* on Sunday that the asset speculation in Asia was "very dangerous”. He called for regulatory reform to strengthen capital control, added that it might be too late. “The bubbles are already there. The time for serious financial reform has about passed. It may take another [financial hit] to do it,” he said.

The conference also discussed growing overcapacity in a number of industries, which was causing falling profits, plant closures and job losses. In order to provide new markets, the Chinese leadership sought to bolster demand in rural areas by raising agricultural subsidies, increasing the state purchasing prices of grains and investing more in infrastructure and social services. No concrete measures have been announced so far, however. China has already adopted stimulus measures for rural residents to buy vehicles and home appliances, providing a one-off boost to manufacturers.

The *New York Times* noted on December 10 that in volume terms, China has overtaken the US as the largest market for major manufactured goods. Auto sales in China jumped 42 percent in the first 11 months compared with the same period last year. China is on track to sell 12.8 million cars and light trucks this year, compared to 10.3 million in US. White goods like washing machines and refrigerators are expected to sell 185 million units in China in 2009, compared with 137 million in the US. Desktop computers sold 7.2 million units in China in the third quarter, compared with 6.6 million in US.

The huge sales growth depends heavily on consumer subsidies. With Chinese consumer spending only one-sixth of America’s, and an annual average income of just $2,775 in the cities and $840 in the rural areas, it is impossible to maintain the present expansion of the domestic market that has averted a collapse of industry in China.

A European Chamber of Commerce in China study published in November showed that the country’s industry is facing severe overcapacity. The report cited low capacity utilisation rates for 2009 in six basic industries: aluminum 67 percent, wind power equipment 70 percent, steel 72 percent, cement 78 percent, chemicals 80 percent and oil refining 85 percent. Yet capacity is continuing to expand.

China’s emergence as a low-cost export platform for foreign corporations depended on debt-driven consumption in North America and Europe, which was undermined by last year’s financial turmoil. “The crisis has throttled demand for exports from China at a time when even more investment, in the form of the Chinese government’s massive stimulus package, is being pumped into building new plants and adding unnecessary capacity. As a result, the problem is actually getting worse in many industries,” the study explained.

Beijing’s attempts to resolve the overcapacity crisis by exporting more to the shrinking world market is fuelling trade tensions. In order to maintain exports, Beijing has ignored demands by the US and Europe and refused to let the yuan float and thus appreciate against the weakening US dollar. China has effectively re-pegged the yuan to the dollar at a rate around 6.83 since August 2008.

The global financial media cheered China’s new data last week showing that exports fell just 1.2 percent in November from a year ago, compared to a 13.7 percent drop in October. November 2008, however, recorded one of the lowest points of Chinese exports. Far from revaluing the yuan, central bank deputy head Zhu Min told reporters that as China’s total exports may fall 16 percent in 2009, there was “good reason for China to depreciate” the yuan.

International financial commentators are hailing China as an engine of global recovery. In reality, as the discussions at Beijing’s annual economic conference indicated, its economy is resting on shaky foundations. The cheap credit and the government stimulus package, far from representing a new path of growth, has generated destabilising asset bubbles and industrial overcapacity.