Fears of a Chinese economic slowdown

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Growing uncertainty over the Chinese economy has contributed to sharp falls in global share markets. There are mounting concerns over frenzied property speculation and the sustainability of the government's stimulus measures, compounded by a series of strikes focussed in the country's burgeoning auto industry.

The immediate trigger was the release of the Leading Economic Index for China produced by the New York-based Conference Board in the US on Monday. The rise in the index for April, originally reported as 1.7 percent, was revised sharply downward to 0.3 percent, sparking fears of a slowdown in China in the second half of the year. The Conference Board forecast an annual growth rate of 9 percent, down from nearly 12 percent in the first quarter.

Bill Adams, a resident economist for the Conference Board China Centre in Beijing, told the media: "The rising trend of the [index] has been moderating since the middle of last year, suggesting there is no strong basis for assuming accelerating growth. The majority of the [index] components have been increasing, but consumer expectations fell in April, and new export orders have been weakening for most of the previous six months."

News of the growth revision came on top of concerns about the European banking system and weaker US consumer and job figures, sending global shares down. Any slowdown in Europe and the US will impact on demand for Chinese goods, adding to fears of a decline in growth in China. The World Bank is also estimating a slowdown in China, predicting a growth rate of 9.5 percent this year and 8.5 percent in 2011.

The Shanghai Composite Index fell by 108.23 points or 4.3 percent on Tuesday, the largest drop since May 17 and the lowest close in 14 months. The Shanghai Composite has plunged by 22 percent this quarter.

The high growth rates in China over the past two years have been sustained by the government's massive stimulus program, which included a huge expansion in bank lending from late 2008. During 2009, the banks lent a 9.6 trillion yuan ($US1.4 trillion) and, although the government has moved to restrict lending this year, the target is still 7.5 trillion yuan. Given the downturn in export markets and the lack of opportunities to invest in productive capacity, much of the easy credit was used by real estate speculators to push up housing prices.

There are fears that the property bubble in China could collapse, with dangerous ramifications for the country's financial system. Sun Mingchun, an economist at Nomura Holdings, warned on Bloomberg Television on June 16 that China's property prices could fall as much as 20 percent in the next 12-18 months, after rising 22 percent last year.

A collapse in property prices threatens a major debt crisis. A National Audit Office report published last week showed that many local governments have run up debts to the extent of 100 to 365 percent of their total revenue. The debts of 18 audited provinces, 16 cities and 36 counties total 2.79 trillion yuan or $410 billion, of which 40 percent is the product of the 2009 lending spree. Overall local government debt is estimated to be between 6 and 11 trillion yuan.

According to China Confidential research published in the *Financial Times*, as much as $294 billion in outstanding loans to local government investment companies could turn bad. The risk of a major financial crisis is aggravated by the country's chaotic

underground banking system, which is apparently booming as investors seek higher rates of return, under conditions where the official benchmark rate is just 2.25 percent. According to the *Financial Times*, this murky financial market is estimated at $647-$1,290 billion, or 10-20 percent of the formal outstanding loans at the end of May.

At the same time, cheap credit and rising housing prices are fueling inflation, which is a major factor in the strikes that have erupted, starting in the Honda auto parts plants in May. A consumer survey released by China's central bank last week found that 58.9 percent of respondents thought that current prices were too high—the highest result in the past 10 years and up 7.9 percentage points from the previous quarter. A record 72.5 percent of respondents said housing prices were "unacceptable".

A debate is underway in ruling circles in China and internationally over how to respond to the demands for higher pay. In most cases, the strikes have led to significant wage rises. Many local governments have announced increases in the official minimum wage. While some commentators argue for limited pay rises to boost domestic consumption, others express fears that any concessions will undermine China as a cheap labour platform. All insist that the regime must contain social unrest and any challenge to the capitalist order.

Last Sunday Premier Wen Jiabao called for local governments and firms to build "harmonious employment relations" by increasing pay for workers. At the same time, he insisted that wage rises should only occur "in accordance with increases in productivity". In other words, workers must produce more before they get limited wage rises.

Higher wages are already encouraging companies to move away from the southern and eastern coastal regions to lower wage areas in the interior. Foxconn announced plans this week to relocate 300,000 jobs from Shenzhen to a new plant in Henan province. The company was compelled to raise wages at Shenzhen after media attention on a spate of suicides in its giant complex. Several major Western corporations, including Apple, have been reluctant to allow Foxconn to pass on the wage increases through higher prices.

Speaking at a forum in Shanghai last weekend, Goldman Sachs executive Fred Hu declared that higher wages were a far greater threat to China's export industry than an appreciation of the yuan. He warned that transnational corporations were considering moving production to cheaper countries like India or Vietnam.

Hu called on Beijing to put an end to strikes and higher social expectations. He underscored his argument by contemptuously referring to Greek workers: "The Greek debt crisis is ultimately due to the bad social psychology of hoping that the government will spend more, enjoying great social welfare, consuming rather than saving, and not wanting to work hard, which led the country to the crisis of debt default."

Hu's comments provoked angry online comments to *Caijin*, which reported his talk. One denounced Hu as a "comprador" for Western capitalists. Another compared him to a stupid Chinese emperor who told starving peasants to eat meat soup—in other words, a man completely out of touch with everyday life. A third wrote that recent strikes reflected "extreme inequality in social distribution" and warned that "political turmoil historically follows waves of strikes, leading to collapse of the governments". The blogger urged the government to mediate rather than suppress the strikes and to readjust wealth distribution.

Hu's remarks are a thinly-veiled appeal to the Chinese government to crack down on strikes. While Beijing has so far been reluctant to resort to large-scale police measures against strikers—fearing such action could trigger wider unrest—it has put police on alert and would not hesitate to use them if a wider political movement of the working class developed.