Mounting concerns about China's slowing growth

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There are signs that the Chinese economy is slowing down, a development that has rattled economic commentators and share markets globally in recent weeks.

The Organisation for Economic Cooperation and Development last month revised its growth forecast for China's gross domestic product (GDP) to 9 percent in 2011, down from a 9.7 percent projection made last November. China's GDP officially expanded by 10.3 percent in 2010.

At the same time, the international credit ratings agency Standard & Poor's warned of possible fallout from the Chinese government's anti-inflationary measures, especially those tightening the supply of credit. Its report noted: "Inflation and a possible economic slowdown stemming from tightening measures could lead to a spike in credit losses over the next two to three years. Chinese banks' profitability could slip in the remainder of 2011 and drop further in the next two years."

Following the 2008 global financial crash, which quickly destroyed some 20 million jobs in China, mainly in export industries, the Chinese regime opened the floodgates of state bank credit to stimulate the economy. The lending of 17.5 trillion yuan ($US2.7 trillion) in 2009 and 2010 was equal to a quarter of the Chinese GDP during that period. The result has been overcapacity in industry, soaring property prices and a mountain of debt.

Two-thirds of the country's banking assets are in the hands of major state-owned commercial banks and joint-stock banks, but there are more than 3,500 small banking institutions, such as credit cooperatives, most of which financed infrastructure projects for local governments. The S&P report estimated that some 30 percent of such loans could become bad debts. The level of bad loans in China's banking system is expected to rise to 5-10 percent over the next three years, sharply up from 1.14 percent at the end of 2010.

Beijing's tightening credit policy, which includes sharply increasing the reserve requirement ratio to more than 20 percent of a bank's total assets, is also causing small banking institutions to struggle to find new funds to lend. Chinese newspapers have pointed to a wave of closures and cutbacks among small- and medium-sized export firms due to the constriction of lending, in addition to workers' demands for higher wages and the contraction of markets in Europe and US.

In Wenzhou, an export city in eastern Zhejiang province, a survey showed that export companies making glasses, lighters, pens and locks saw their sales decline by 7 percent, and profits by 30 percent, in the first quarter of 2011. More than a quarter suffered losses, and the average profit margin was only 3.1 percent. It was "a harder time than 2008", a local official in charge of medium and small enterprises told *China Business Times*.

Globally, fears have grown that China's property prices are grossly over-inflated, and headed for a crash. The *Financial Times* commented on June 1: "Whether China's real estate market is a bubble that could pop, knocking out Chinese growth and shaking the world's economy, is a question that is being asked by everyone from Brazilian iron ore traders to hedge fund managers in the City of London."

Construction directly accounts for an estimated 40 percent of Chinese steel usage. If one includes property-related industries, such as home appliances and construction equipment, the property market broadly consumes about two-thirds of the country's steel output. Chinese mills produced 626 million tonnes of steel last year, 44 percent of the world's total.

American economist Nouriel Roubini recently warned in the British *Economist* magazine that Beijing's post-2008 stimulus programs lifted the fixed investment share of the

GDP from 42 percent to 47 percent in 2009. That proportion further increased to almost 50 percent in 2010.

"The problem, of course, is that no country can be productive enough to reinvest 50 percent of GDP in new capital stock without eventually facing immense overcapacity and a staggering non-performing loan problem. China is rife with overinvestment in physical capital, infrastructure, and property," Roubini wrote.

Roubini noted that China now featured "highways to nowhere, thousands of colossal new central and provincial government buildings, ghost towns, and brand-new aluminium smelters kept closed to prevent global prices from plunging." He predicted that a crash was likely in 2013, followed by a protracted period of slow growth, similar to the aftermath of the 1997-98 Asian financial crisis.

Any sudden outflow of international funds from China could seriously destabilise the country's financial system, as happened across South East Asia in 1997-98. Last month, the Hong Kong Monetary Authority carried out stress tests to gauge the ability of local banks to survive the withdrawal of some $90 billion in deposits that flooded into Hong Kong, as a gateway to China's real estate sector, following the 2008 global crash.

According to a recent study by the Institute of International Finance, China has become since 2008 the largest destination for international private investment, attracting a net inflow projected to reach about $250 billion between 2010 and 2012. Much of this capital is thought to be "hot money" seeking quick, high returns from Chinese real estate.

To keep the economy growing while placating public anger over high housing costs, Beijing has announced a plan to build 36 million state-subsidised flats for low-income families over the next five years. The aim is to accommodate one-fifth of the 218 million urban households.

The *Financial Times* noted that despite a target of building 10 million subsidised flats at a cost of 1.3 trillion yuan this year, the government had allocated only 103 billion yuan. Some 400-500 billion yuan are to come from local governments and 800-900 billion yuan from private developers.

In other words, these projects will depend primarily on the same layers that have profited from the speculative housing bubble. According to the latest *Forbes China* list of 213 Chinese-origin dollar billionaires, 30 percent built their fortunes, wholly or partly, in real estate, mostly in China. At the same time, local governments have become heavily reliant on property and land sales as revenue sources, giving them an incentive to drive up prices.

Widespread discontent over soaring housing prices has led to public differences over who is to blame. Last month former Premier Zhu Rongji defended himself from allegations in Chinese newspapers that his pro-market tax reforms in the 1990s, which centralised government revenue in Beijing and left no funds for local governments, were responsible.

Zhu criticised the current leadership's "mistake" of allowing local governments to retain real estate revenues and thus "extract people's fat" by pushing up prices. He said he was defending the "third generation of leadership" headed by former President Jiang Zemin, which has become notorious for introducing the private housing market in 1998.

Zhu also attacked the current leadership's policy for subsidising the auto industry. At Shanghai auto shows, he explained, some luxury cars cost more than 100 million yuan ($15 million) each, while some business owners had started to buy private jets. "But what about rural areas, where some are still struggling to feed their stomach?" he asked.

This hypocritical blame game at the top of the Stalinist regime underscores the fears in the ruling elite that China's increasingly unstable economy has generated social tensions that at some point must trigger an explosive movement by the multi-million working class.