

# Chinese manufacturing contraction points to deeper economic trouble

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The latest purchasing manager index of Chinese manufacturing, released by HSBC last week, was 49.9. Below 50 indicates a contraction rather than expansion. It was the third month in a row of manufacturing contraction. The International Monetary Fund last month also scaled back its forecast for China's gross domestic product growth this year from 9.6 percent to 9.5 percent, and from 9.5 percent to 9 percent for 2012.

These growth figures, while still high by global standards, sent tremors through international financial markets. Amid recessionary trends in Europe and the US, the fear is that China will be unable to stimulate global growth, as it did in the aftermath of the 2008 financial crisis. Moreover, economic analysts understood that China must maintain 8 percent growth just to keep unemployment under control and prevent social unrest.

Private institutions were even less optimistic, with London-based Capital Economics cutting its 2011 outlook for China to 8.5 percent. The firm's chief China economist Mar Williams declared: "China's economy is weaker today than on the eve of the global crisis three years ago and won't be able to shrug off the problems elsewhere or be able to completely offset them."

China analyst Gordon Chang argued that while the data released by the National Bureau of Statistics indicated 9.5 percent growth in the second quarter this year, down from 9.7 percent, the slowdown was likely to be more pronounced. He cited figures for August showing a fall in electricity consumption by 0.1 percent, compared to July, and a decline in industrial value-added output by 0.5 percent.

At this time of year, Chinese factories and shipping lines should be operating at full capacity for the Christmas shopping season in Western countries. "But container lines are not overloaded this month," Chang wrote. "Maersk, the world's largest container-shipping company, reports its

vessels on the Asia-to-Europe and Pacific routes are 90 percent full when they should be almost 100 percent." There are even sharper falls in air cargo volumes, especially among Hong Kong carriers that connect export manufacturers in Guangdong to Europe.

China's manufactured exports are facing enormous pressure from the debt turmoil in Europe, high unemployment in America and recession in Japan. The US-based Apple corporation, for instance, has cut its iPad 2 orders from Foxconn by 25 percent for the fourth quarter (from 17 million units to 13 million). Foxconn is also shifting some orders for the new iPad 3, to be released next year, to its Brazilian plant.

Capital-intensive industries such as ship building, in which China accounts for 40 percent of world output, have seen orders down by 30 percent year-on-year in the first seven months of 2011. Falling cement prices in China, due to slowing construction and real estate activities, have resulted in lower share prices for the big mining companies such as BHP Billiton and Rio Tinto. China's auto industry, the world's largest, saw its sales up a mere 0.5 percent in August from July—a month that saw a plunge of 11.2 percent from June.

Major industries that have overcapacities are bracing for a sharp downturn. Auto is one example. Vehicle sales in China hit 16.6 million last year, compared to 11.6 million in America. Global auto transnationals have rushed to build plants in China, as the *Wall Street Journal* recently noted, because "low labour and production costs have meant juicy profit margins in China." However, research firm KPMG estimated that China would have 20 percent overcapacity in auto within the next five years.

Beijing academic Li Wei recently told Canada's *Globe and Mail*: "Countries [that were] largely pulled by the Chinese demand out of the last recession, with China weakening,

cannot rely on China being the locomotive for growth any longer.” Li was referring particularly to commodity-based economies such as Canada, Australia and Brazil, whose export booms in raw materials have been largely driven by China’s stimulus package in the aftermath of the 2008 financial meltdown.

China is now facing its own debt crisis. The trillions of dollars of cheap credit that were channelled into real estate speculation and poorly planned infrastructure projects has meant that local governments have massive debts. At the same time, due to depressed profitability in manufacturing, industrial companies have used their core productive assets as collateral to borrow and engage in real estate speculation—a scenario similar to that which produced the South East Asian financial crisis of 1997-98.

Given concerns over bad debts held by state commercial banks, rising inflation and, above all, any bursting of the property bubble, the Chinese government cannot fund another large stimulus package. Wu Xiaoling, a former deputy central bank governor, explained last month: “Currently, China’s economy faces inflationary pressure as well as pressures on government debt, which means we cannot go down the road of expanding both credit and fiscal spending.”

Of the \$1.67 trillion debts owed by local governments, 23 percent are dependent on continuing land sales for repayment. However, land sales by real estate developers in collusion with corrupt government officials are generating growing resistance by peasants whose land is being stripped from them. Thousands of residents in the Guangdong province township of Wukan protested late last month against the sale of collectively-owned land to a major developer.

Beijing’s efforts to rein in real estate speculation by tightening credit are threatening to produce a wave of factory closures and industrial unrest. Many small and medium enterprises that operate on slim profit margins are already struggling.

According to US-based Chinese television NTD, hundreds of workers at the Zhejiang Centre Group, one of China’s largest spectacles makers, protested last month after the company’s owner absconded. Workers marched in the city of Wenzhou, bringing traffic to a halt. The owner, Hu Fulin, owed as much as \$313 million, with half the loans coming from private lenders that charge interest rates as high as 100 percent a year.

Hu had turned to these semi-illegal loans because of the tightening of state credit. Economics commentator Chen Zhifei told NTD: “2011, according to many analysts, has been the toughest year for private companies since the economic reform. I’ve read reports on surveys revealing that 90 percent of small and medium enterprises have not gotten a cent from banks this year.”

The crisis of China’s manufacturing is bound up with from growing competition from other cheap labour platforms. UBS economist Jonathan Anderson last month declared that there had been a “pretty convincing turning point” in China’s low-wage export economy over the past 24 months. Its share of low-end light manufacturing exports to the US and Europe “peaked” at around 50 percent and started to decline. Vietnam, Bangladesh, Indonesia and Mexico are all expanding in the US market at China’s expense. In EU markets, China is gradually losing its share to other Asian countries as well as Poland, Czech Republic and Hungary.

Bloomberg’s Global Poll of analysts, investors and traders last week found that 47 percent of respondents feared that Chinese growth would slow to below 5 percent in 2-5 years, with 12 percent predicting such a drop within a year. Such a “hard landing” would be “disastrous,” according to HSBC economist Qu Hongbin. He warned that China would fail to create enough jobs for those entering the workforce, sparking social unrest. “I’d rather bet that it’s the end of the world in five years than to bet on China’s growth falling to 5 percent,” he stated.

China has hundreds of millions of low-skilled labourers from rural areas, for whom a factory job has been a step out of rural poverty. Accelerating job losses, combined with the impact of rising prices on wages, can lead only to a dramatic increase in the resistance of workers to the destruction of their living standards.



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