Eurozone crisis brings worsening outlook in China and Asia

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Far from providing a stimulus to the crisis-ridden world economy, China, Asia and other so-called "emerging markets" could well be a further source of global instability in the coming period. This is clear from the latest economic statistics and from indices of market and business confidence.

Asian markets suffered their biggest decline in two months yesterday, hit by the shock waves from the European financial crisis, signs of weakening economic growth and warnings that the expansion of bank credit, which has played a key role in Asian growth, could slow. Europe is not only a crucial destination for Asian exports, European banks are also a key source of funding for companies throughout the region.

Last Tuesday HSBC chief executive Stuart Gulliver warned that Asia faced the prospect of a credit slowdown and that the strong increase in "credit availability in Asia that has supported demand growth cannot continue indefinitely." According to the Bank for International Settlements, continental European banks were responsible for 21 percent of the $2.5 trillion in loans outstanding in Asia, excluding Japan.

The *Financial Times* has reported that business confidence in the global economy has "evaporated" in the past three months since the deepening of the eurozone crisis. More than half of the 1,600 executives surveyed for the FT/Economist Global Business Barometer in October expected global conditions to worsen in the next six months, with one of the most significant shifts coming in Asia. There the proportion of executives who thought global conditions would worsen rose from 36 percent in July to 54 percent.

Earlier this week, speaking in Beijing, International Monetary Fund managing director Christine Lagarde warned that the world runs "the risk of a downward spiral of uncertainty [and] financial instability" that would impact on Asia.

"We are all in it together and our fortune will rise or fall together," she said. "Asia is not immune. Whether it is the trade channel or whether it is the financial sector which can operate as a crisis accelerator, Asia needs to be prepared."

The impact of the eurozone crisis was reflected in Chinese export figures, which experienced a slowdown in October. Exports were up by 15.9 percent for the year, down from the 17.1 percent year-on-year increase for the previous month. Exports to the European Union were up 7.5 percent year-on-year, compared to 9.8 percent in September.

Imports are continuing to rise but this could be short-lived. Economists are warning that Chinese domestic demand might start to fall as China's policy of monetary tightening over the past year starts to make an impact, especially on the real estate and building boom.

An article in the FT noted: "A sharp fall in real estate transactions could pave the way for a slackening in China's voracious appetite for commodities, which has been the main driver of its import growth."

China's monetary tightening has eased the threat of inflation, at least for now, with the annual rate dropping to 5.5 percent last month compared to 6.1 percent for September. But tighter credit might bring what has been described as "serious trouble" in the banking system and in property markets.

"We have already seen that the Chinese property market has a very high risk of entering into a slump," Liu Li-Gang, head of China economics at the ANZ bank told the FT. "Given that the external environment has deteriorated sharply, the People's Bank of China needs to take out an insurance policy and ease monetary policy immediately."

While nowhere near as significant as China, India has also been touted as a new source of growth. But there are signs of growing problems, with car sales in October experiencing their biggest fall in over a decade. Domestic sales dropped by 23.8 percent amid warnings that India's economic momentum was slowing because of high inflation, a tight monetary policy and rising interest rates.

Last Wednesday, the Moody's rating agency downgraded the outlook for India's banking system to negative. It cited concerns over global instability and a domestic slowdown that could increase defaults and lower profitability.

The worsening European crisis has prompted a sharp response from Indian and Chinese banking authorities in the wake of the failure of the G20 summit to come up with anything even resembling a solution. A statement from the fifth India-China Financial Dialogue held in New Delhi on Tuesday contained an explicit call for Europe to get its financial house in order.

The statement declared: "The two sides recognised that the global economy is in a critical phase." While growth was "relatively stronger" in emerging markets, "there are clear signs of a slowing as developments in advanced economies begin to weigh on these countries."

The statement went on to urge "developed economies to adopt responsible macroeconomic policies to handle the issues of debt and financial stability properly, promote investment and create demand."

It seems that there was some disagreement from Indian authorities over the bluntness of the tone, with the finance ministry initially denying that a statement had been issued. However, a top foreign ministry official did later confirm that a meeting had been held and a statement issued.

China, India and the BRICs group as a whole are viewed as a possible source of funding for Europe. But there is opposition to this within the Chinese regime and doubts over whether India could play a meaningful role.

The sharpness of the statement indicates that both India and China fear they are going to be dragged into the vortex created by the ongoing European financial collapse—with enormous social and political consequences for both states. The dispute over its content also points to the fact that the crisis is not going to produce a unified response from the "emerging powers" whose interests coincide at some points but can also conflict.