Uncertainties mount over Chinese economy

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Amid the global uncertainties arising from the economic turmoil in Europe, the World Bank issued a biannual East Asia economic update on May 23. It warned that China's economic growth will slow this year to 8.2 percent—down from 9.2 percent last year and its weakest level since the height of the Asian financial crisis in 1999. As a result, China will drag growth in the rest of the Asia-Pacific to a two-year low of 7.6 percent, down from the previous estimate of 7.8 percent.

The World Bank pointed out that sluggish European and American demand, and a slowing property market growth in China, would weigh on the export- and investment- dependent Chinese economy. "With the European Union accounting for one-third of global import demand, a recession there will inevitably take its toll on East Asia," the World Bank commented.

The report explained that China was at the centre of a transnational network of production, with other Asian economies serving as the suppliers of raw materials, semi-finished parts and capital goods for re-export production in China. As a result, the country accounted for two-thirds of the region's $US592 billion shipments to Europe last year. While China would be the first to suffer from an export slump to Europe, other economies, such as South Korea, South East Asian countries and Australia, would inevitably follow.

Moreover, the World Bank warned that developing Asian countries could face major financial stress because European banks provide a third of the region's trade and project finance. In the event of a full-scale financial crisis in the eurozone, banks will repatriate capital back to Europe. On the same day the World Bank update was issued, Chinese Premier Wen Jiabao warned officials at a cabinet meeting that "downward economic pressure is increasing".

Fears are mounting that China is not prepared to deal with the financial shocks from a Greek withdrawal from the eurozone. Liu Mingli of the China Institute of Contemporary International Relations told *China Daily* last week: "If the European countries are really making plans for Greece's exit, they should do it quietly in private, not through public discussion." He advised Beijing to "lessen its exposure to euro assets in the short term, which are likely to depreciate as there will be capital outflows from the eurozone on a large scale following Greece's exit."

As concern grows over the economy, the Beijing leadership is reportedly considering another round of stimulus measures. The political subtext is the constant fear in Chinese ruling circles that any substantial rise in unemployment or a crash in the country's property market could quickly lead to social unrest.

Premier Wen signalled last week that Beijing would "implement a proactive fiscal policy and a prudent monetary policy" to boost growth. Wen spoke as he was touring the industrial centre of Wuhan, where business leaders warned him that they confront an increasingly dire situation. The chief executive of Hai'er, the world's largest home appliance manufacturer by market share, told Wen that home appliance sales fell 13 percent in the first quarter, compared to the same period last year.

Peng Wensheng, the chief economist for the country's leading investment bank, China International Capital Corp, warned that in the event of a eurozone break-up, China's growth rate could slow to 6.4 percent this year. He called for a one trillion yuan ($US150 billion) stimulus package. Credit Suisse Group AG economist Tao Dong estimated that a new stimulus measures could be as high as two trillion yuan because this quarter's growth could drop to 7 percent or lower. Tao warned that even a new stimulus package would be "probably not enough to stage a 2009-style rebound."

China maintained a growth rate of more than 9 percent during the global financial crisis due to massive stimulus spending that soared from 4 trillion yuan to 14 trillion yuan. The stimulus package was regarded as a short-term solution premised on a quick revival of Western markets. Instead, Europe and the US remain mired in recessionary conditions and China is confronting mounting economic problems. Local governments and major state-owned firms borrowed heavily from the state banking system to finance infrastructure projects and speculative property developments. As a result, the banking system is weighed down by rising levels of bad loans.

Falling export markets in Europe and North America means there is no outlet for much of the China's productive capacity. The domestic market does not provide an alternative. Household consumption accounts for barely a third of the economy—compared to 70 percent in the US—reflecting China's function as a cheap labour platform for global manufacturing.

China confronts a crisis of overproduction that threatens to trigger massive job losses. Export industries are stagnating and contributed nothing to economic growth last year. Debt-fuelled investment on machinery, buildings and infrastructure accounted for over half of growth. New stimulus spending would simply add to the existing overcapacity.

The Chinese Communist Party regime is responding with a new round of free market restructuring, centred on promoting private investment into state-owned enterprises in a bid to attract more international capital.

A guideline issued by the State Assets Supervision and Administration Commission on May 25 significantly expands private investors' ability to participate in the restructuring of state firms, through cash investment, share acquisition, subscriptions to corporate bonds and finance leases. The previous week, private capital was allowed to invest in railways, which had previously been monopolised by the Ministry of Rail and its affiliated companies.

The National Development and Reform Commission also announced last week that drafting is underway for detailed rules governing private investment into heavily state-owned sectors such as electricity, oil and gas. Private firms currently account for only 13.6 percent of the electricity industry and 9.6 percent in finance. The telecommunications, education and health care industries will also be further opened up to private firms.

Far from boosting Beijing's capacity to buffer itself from a global recession, a greater role for private capital, which by its very nature is more closely connected to international financial markets, will only make China more vulnerable to global shocks and turmoil.