# Growing signs of a financial crisis in China

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The Politburo of the Chinese Communist Party (CCP) held a special session on April 25 to discuss the economy, amid mounting concern about the stability of the country's financial system and the latest GDP figures showing an unexpected slowdown to 7.7 percent in the first quarter.

A Politburo statement expressed particular concern about "potential risks in financial sectors". A promise to establish a standardised local government financing mechanism underscores fears that local governments have accumulated huge levels of bad debt as a result of speculative activity, especially in real estate ventures.

The Politburo special session followed the April announcement by global crediting rating agency, Fitch, that it was downgrading China's sovereign credit rating from AA minus to A plus. The rating cut was China's first since 1999, when the Asian financial crisis forced Beijing to vastly accelerate the privatisation of state enterprises. Tens of millions of workers were made redundant.

Fitch warned that "risks over China's financial stability have grown" as the domestic credit supply has ballooned from 125 percent of GDP in 2008 to 198 percent at the end of 2012, as a result of the government's huge stimulus package following the 2008 global financial meltdown. Both corporate and local government debt in China have grown exponentially, much of it in the loosely-regulated underground banking markets.

According to Fitch, local Chinese governments from the village to the provincial level now owe as much as 13 trillion yuan ($US1.12 trillion). Other analysts put the figure as high as 20 trillion yuan.

Leading Chinese auditor Zhang Ke told the *Financial Times* on April 16 that China's local government debt was "out of control" and could trigger a bigger financial breakdown than the US subprime crisis in 2007-08. He explained that his accounting firm, Shing Wing, audited some local Chinese government bond issues "and found them very dangerous, so we pulled out." He said: "Most don't have strong debt servicing abilities. Things could become very serious."

Zhang pointed out that many local governments have been taking new loans to repay the old, "but there will be some day down the line when this can't go on." In the first quarter this year, investment companies owned by local governments sold bonds worth 283 billion yuan—more than double the amount for the same period last year.

Zhang said that it was "frightening" that much of the increase came from small town and county governments that used their investment companies to issue bonds as an easy way to raise finance. With more than 2,800 counties in China, he said, "if every county issued debt, it could lead to a crisis. It could be even bigger than the US housing crisis."

A report by the Australian investment bank Macquarie pointed to problems in China's corporate sector with non-financial corporate debt at 108 percent of GDP at the end of 2011—the same level as for crisis-stricken British and French companies. Macquarie analyst Chen Shao warned that this level of corporate indebtedness was "not sustainable" and that "the potential emergence of a corporate debt crisis" would threaten China's economic stability.

The root of the emerging financial turmoil in China lies in the economic breakdown of global capitalism that erupted in 2008. As the world's largest cheap labour platform, China has grown over the past two decades by depressing workers' wages and squeezing domestic consumption. Its economic expansion, led by a vast buildup of physical capital in factories and infrastructure, was driven primarily by the expanding consumption in the West, especially in the 2000s.

The onslaught on the living standards of the working class in America and Europe in the aftermath of the

2008 crash has hit China's exports. The government's stimulus measures have led to speculation, particularly in real estate, massive infrastructure projects and subsidies to industry that have worsened the crisis of overcapacity.

The latest figure of 7.7 percent annualized GDP expansion in the first quarter, down from 7.9 percent in the last quarter of 2012, underscored the fact that the injection of credit has not gone into the real economy.

China's industrial output growth decelerated to 8.9 percent year-on-year in March, down from 9.9 percent in February. By contrast, Chinese banks made new loans of 1.06 trillion yuan ($US171 billion) in March—much higher than the 620 billion yuan in February. JP Morgan economist Zhu Haibin told the *Wall Street Journal* last month that this credit did not enter productive channels. "We see fast credit growth but the money stays out of the real economy. That will trigger concerns on financial stability," he said.

According to the British-based *Telegraph* on May 6, China's leading business journal *Caixin*, recently reported that there was a growing "sense of crisis" within the Chinese ruling circles, not felt since the depths of the global financial meltdown in 2008-09. At the time, more than 20 million workers lost their jobs.

There are divisions within the CCP bureaucracy over the economy. The *Telegraph* reported that the state-owned Assets Supervision and Administration Commission (SASAC), which runs the 115 largest state-owned groups with assets of $6 trillion, has assembled a team to "protect economic growth". This has "cut across efforts" by Premier Li Keqiang, who, guided by a report worked out with the World Bank last year, is seeking to vastly reduce the economic role of the state and to drive up productivity at the expense of the working class. However, this means, according to Li's instruction to the State Council, reducing the growth rate to just 7 percent next year.

The CCP regime is caught in a dilemma. International finance capital demands an intensification of the exploitation of workers through a new wave of pro-market restructuring. However, Li's factional rivals, aware a slowdown would lead to huge job losses and social unrest, are calling for a boost to the state sector through another round of stimulus measures that will only worsen the debt crisis.