Signs of serious problems in Chinese and Japanese economies

Nick Beams
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Is it just a blip, or does the sharp contraction in the growth rate of Chinese lending for July signal the start of something much more serious? That is the question being asked in global financial circles following the release of data on Wednesday showing new lending grew at its lowest rate since October 2008, when the global financial crisis erupted.

The fall in the rate of credit expansion in the world's second largest economy has global implications. So does the news, also released on Wednesday, that gross domestic product (GDP) in Japan, the world's third largest economy, contracted at an annual rate of 6.8 percent in the second quarter of 2014.

Chinese aggregate financing, the broadest measure of credit growth, expanded by Rmb273 billion ($US44 billion) in July compared with an expected increase of Rmb1.5 trillion, meaning that credit growth was only 18 percent of that predicted.

The People's Bank of China, the country's central bank, took the unusual step of issuing a statement aimed at reassuring financial markets. It said the slower credit growth in July was still within "a reasonable range" and it would maintain steady credit growth in the coming months. The bank stated that the money supply and credit were expected to maintain stable growth in the future, but added that the economy was facing "downward pressure" and "adjustment in the property market."

The bank's reassurances, however, were not enough to prevent expressions of concern over the implications of the sudden, and unexpected, credit contraction.

Analysts at the Australian-based ANZ bank said the data "should not be viewed lightly." It indicated that "the financial system is engaging in a rapid de-leveraging process, which could have significant repercussions on the real economy." The ANZ added: "Such a sharp drop is in fact a quantitative tightening, which will lead to higher interest rates and endanger China's macroeconomic objectives." ANZ China economist Liu Li-Gang said the figures showed Chinese banks "are becoming risk-averse as they have suddenly stopped lending."

The official policy objective of the Chinese government and financial authorities is to maintain a GDP growth rate of 7.5 percent a year. Growth could fall well short of this target if the fall in the rate of credit expansion signifies that banks and other lenders are pulling back on the supply of new loans for construction and real estate projects, which play a large role in the Chinese economy.

The *Australian Financial Review* reported that Credit Suisse chief China economist Dong Tao described the credit data as "horrible." He said: "Banks are choosing not to lend as the economy is weak and the housing sector is sick."

In its statement, the Chinese central bank said the credit figures were largely driven by seasonal factors: July is traditionally a low month for lending and June was a particularly strong month as banks responded to stimulus measures initiated by the government aimed at keeping growth on target.

That may turn out to be the case, but concerns over the stability of the financial system will continue because of the rapid expansion of credit since the government and financial authorities opened the financial spigots to counter the effects of the global financial crisis. It has been estimated that over the past five years total private and public sector debt has increased by an amount equivalent to 100 percent of GDP and now totals about 250 percent.

The chief China economist at BNP Paribas in Beijing, Chen Xingdong, said the July data were a "warning sign." While it was too early to adopt a pessimistic outlook on growth, he continued, "if the situation continues for another two or three months, there will be serious liquidity problems."

Possible one-off factors are also clouding interpretations of the fall in Japanese GDP in the second quarter. The 3 percent rise in the country's consumption tax, which came into effect in April, meant that spending was frontloaded into the first quarter, producing an annualised growth rate of 6.1 percent. Consequently a contraction in GDP was anticipated for the three months to the end of June.

However, the fall of 6.8 percent was much worse than earlier estimates and outweighed the previous rise, meaning that the Japanese economy contracted in the first six months of the year.

This places a question mark over Prime Minister Shinzo Abe's economic program, dubbed "Abenomics." His government has increased public spending and the Bank of Japan has pumped money into the economy by buying up government debt—the Japanese version of the "quantitative easing" practised by the US Federal Reserve.

While the policy has lifted the rate of inflation to 1.3 percent—the government's target is 2 percent—it has done virtually nothing to boost the economy overall. Exports are not expanding as fast as anticipated in view of the falling value of the yen. Wage rises are not keeping pace with inflation, pointing to a fall in consumer demand, and companies are hoarding cash rather than making new investments.

In an editorial yesterday, the *Financial Times* said "Abenomics" was "mired in difficulty" nearly two years after its introduction in December 2012.

The newspaper called for Abe to give added momentum to the "third arrow" of his economic program—following the fiscal stimulus and expansion of the money supply—by pressing ahead with "structural reform." The editorial insisted: "Mr Abe needs to throw as much of his political weight as he can behind policies that end the rigidities in the labour market."

At the beginning of 2014, Abe pledged to make Japan "one of the most business-friendly places in the world." He promised cuts in corporate tax rates, a further undermining of what remains of "lifetime employment" in Japanese firms and the establishment of special economic zones where corporate regulations in force in the rest of the country would not apply.

In other words, with supposed stimulus measures having little or no effect, the Japanese government, according to the *Financial Times*, must get on with its planned attack on the social position of the working class. That will also be the policy of the Chinese government if the latest financial data are an indication that credit-fuelled economic growth is coming to an end.