China cuts growth forecast, warning of “deep-seated” economic problems

Nick Beams
6 March 2015

The Chinese government has lowered its official projection for economic growth this year to “approximately 7 percent” following a year that saw the lowest economic expansion in a quarter of a century.

Chinese Premier Li Keqiang announced the target in his opening address to the annual National People’s Congress which began in Beijing yesterday.

Presenting a gloomy outlook for the world’s second largest economy, he said: “The downward pressure on China’s economy is intensifying. Deep-seated problems in the country’s economic development are becoming more obvious. The difficulties we are facing this year could be bigger than last year. The next year is a crucial year for deepening all-round reforms.”

In a further sign of economic problems, Li said the government planned this year to run its biggest deficit since the global financial crisis. The deficit will rise to 2.3 percent of gross domestic product this year, compared to 2.1 percent last year. Some of the additional money will be spent on railway, water and agricultural projects, but the chairman of the government’s economic planning agency Xu Shaoshi said it should not be seen as a “massive stimulus.”

Li said the new growth target was what was needed and what was possible, adding that China’s growth model was inefficient and that “difficult structural adjustments” were necessary in order to absorb the effects of previous stimulus measures.

As part of “restructuring,” the government is pushing ahead with measures to reduce its control of the giant state-owned enterprises that dominate much of the economy. It also plans to further open the country’s financial system. This is certain to intensify conflicts within the ruling elite. Significant economic and political power brokers, resting on state-owned enterprises, are the target of a corruption purge led by President Xi Jinping.

The new target of just 7 percent growth is considered by many commentators to be inflated, with real growth probably around 2 or 3 percentage points lower. It is politically significant given that the government has stated in the past that growth of at least 8 percent is needed to maintain “social stability.” The government fears that slowing growth and the consequent increase in unemployment will bring about major struggles by the working class.

Li alluded to these fears, at least obliquely, saying that in order to “defuse problems and risks” China relied on development that required an “appropriate growth rate.” However, at the same time, he continued, “China’s economic development has entered a ‘new normal.’”

The new target is also a reflection of major problems in the world economy as a whole. It underscores the fact that the massive quantitative easing programs of the world’s central banks, which will be further extended when the European Central Bank begins a bond-purchasing program next week, have done nothing to boost real growth. They have served only to fuel parasitism, currency wars and speculation.

Furthermore, it shows that far from providing a new platform for economic expansion, the Chinese economy is being afflicted by the same tendencies that have emerged on a global scale, expressed most sharply in deflationary pressures. Li said that the government was lowering its inflation target to around 3 percent from 3.5 percent in 2015.

Last weekend, in announcing a further cut in official interest rates, the second reduction in three months, the People’s Bank of China said that it was responding to a “deflationary risk” as well as to falling property prices.

And in a sign of the growing excess capacity in the economy, factory gate prices of commodities showed a year-on-year decline of 4.3 percent in January.

A product of the deepening global malaise, the Chinese slowdown is, in turn, adding to it. This week iron, which comprise a major component of exports for countries such as Brazil and Australia, fell below $60 per tonne, just one third of the peak it reached four years ago. This fall parallels a similar slide in oil prices.

The Chinese economy is also being severely impacted by the fall in the value of the currencies of its major trading partners. Loosely tied to the rising US dollar, the yuan has risen 60 percent against the Japanese yen and 90 percent against Brazil's real since the middle of 2012. In the past year it has risen 27 percent against the euro.

Any effort by China to push down the value of the yuan will intensify the incipient global currency war as major countries try to lower the value of their currencies to try to improve their competitive position internationally.

In response to the global financial crisis of 2008–2009, the Chinese government initiated a massive expansion of credit—an amount equivalent to the entire US banking system—in order to boost the economy after 23 million jobs were lost in 2009. Since then, Chinese growth has not been fuelled by expanding exports, as it was in the 1990s and in the years leading up to the financial crisis, but by investment in property and infrastructure financed by credit.

However, this road is now closed. Besides creating a potentially dangerous credit bubble, the additional growth generated by each yuan of new loans is estimated to be a ratio of just 0.2 percent, compared to 0.8 percent before 2008. Most of the additional credit is not being used to finance new investment projects, but rather to rollover existing debts owed by banks and local government authorities. They are being hit hard by the fall in inflation, which increases the real value of their debt exposure.

The revenues of both the central government and local authorities are contracting because of the slowdown in real estate developments, with land revenues reported to have fallen by 21 percent in the fourth quarter of 2014.

The ending of the credit-property bubble threatens major economic consequences. The Japanese finance house Nomura has warned investors that relying on the government to always provide a stimulus where needed could prove dangerous.

Nomura financial analyst Rob Subbaraman told the British *Daily Telegraph*: "We assign a one-in-three chance of a hard landing—growth averaging 5 percent or less over four quarters—starting within the next two years."

Such a fall would not only have major consequences in China but would send a shock wave through the global economy and could set off a major financial crisis.