China's central bank cuts rate amid further signs of slowdown

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China's central bank has cut interest rates for the third time in six months in a bid to counter an economic slowdown and ease debt pressures on local government authorities and corporations.

The move, which was made on Sunday night, gave an immediate boost to share markets, with stocks in China rising by 3 percent on Monday, ending their worst week in five years. Other Asian markets also rose after suffering losses the previous week as a result of the bond sell-off in Europe.

However, while the financial markets welcomed the news, the decision expressed mounting concerns over the slowing Chinese economy and growing debt problems arising from lower inflation.

In its official statement, the People's Bank of China (PBOC) said the country's economy was "still facing relatively big downward pressure."

"At the same time, the overall level of domestic prices remains low, and real interest rates are still higher than the historical average."

In one of its starkest warnings about the pile up of debt resulting from measures to counter the effects of the 2008–2009 financial crisis, the PBOC said "rising debt size is forcing China to use a lot of resources in repaying and rolling over debt."

In the five years following the global financial crisis, Chinese credit expanded by an amount equal to the size of the entire American financial system. But now the need to reduce this debt mountain is restricting the capacity of the central government to use fiscal measures to boost the economy.

At the same time, the Chinese economy is being hit by the general slowdown in the major capitalist countries.

Chinese economic data for April showed a marked decline in trade as well as a lower than expected inflation rate. Exports dropped 6.4 percent for the month, following a 15 percent fall in March. Predictions had been for a rebound in April, so the continued fall has raised concerns over whether the predicted growth rate of 7 percent—the lowest in more than two decades—is going to be met.

Imports, a large component of which comprise semi-finished goods entering their final stage of manufacture in China, plummeted by 16.2 percent for the month, pointing to a slowdown in factory output.

The interest rate cuts and the easing of the reserve requirement ration (RRR) five times in the past six months have prompted concerns among some financial analysts that the slowdown in the Chinese economy is proceeding faster than government and financial authorities have anticipated.

Nizam Idris, an analyst with the Macquarie financial group expressed this view in comments to the American CNBC business channel.

"The cut announced over the weekend justifies my view that China falls behind the curve in terms of controlling the slowdown," he said. "Everyone calls it an engineered slowdown, but when you see how the duration of the interest rate has been compressed and how the RRR rate has been made at a more aggressive pace, it seems to me that China is catching up with the curve rather than being in full control."

Further cuts are expected in the not-too-distant future, with predictions that the bank rate could drop from its present level of 5.1 percent to 4.6 percent.

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According to Barclays, "the persistent deflation risk and the still-elevated lending rates point to the need for further monetary easing. As such we look for further benchmark rate cuts of at least 50bp [50 basis points or

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0.5 percent] and two more reserve ratio requirement cuts by the third quarter."

In another sign of growing financial problems, the central bank is reportedly considering measures that would allow local governments to restructure their debts. Local government authorities have been at the centre of the land and property bubble which has formed a significant component of Chinese economic growth over the past five years.

The real estate market, together with construction and related industries, accounts for a quarter of China's gross domestic product and is described as "sluggish." Bad debts are also on the rise. Non-performing loans rose from 140 billion yuan at the beginning of the year to almost 983 billion yuan ($200 billion) at the end of March. It was the biggest quarterly rise in more than a decade.

As has taken place everywhere else in the world, the rate cuts by the central banks have failed to provide any impetus for investment in the real economy. Rather, the central bank's actions in providing cheaper money have helped fuel a rapid rise in Chinese stock markets over recent months.

In a statement last week, the Chinese Communist Party Politburo, the country's top decision-making body, emphasised the need to "more efficiently channel monetary policy to support the real economy."

But the government is discovering the capital and the flow of money is not determined by "Chinese characteristics," but operates according to its own laws.

According to estimates by the Royal Bank of Scotland, more than $300 billion has left China in the last six months, attracted by the rise of the US dollar and repelled by fears of mounting financial problems within China. These outflows could well increase in coming months, leading to a drying up of funds available for lending within China, and exacerbating its growing economic and financial difficulties.

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