Growing signs of China’s economic slowdown

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Statistics for May indicate that growth in key sectors of the productive economy in China, including manufacturing, continues to slow, while capital is increasingly moving into speculative investments in the share market, creating an unstable financial bubble.

Official indices showed a 2.8 percent decline in exports in May, compared to the same month in 2014. The figure was a small improvement on results for March and April, which witnessed year-on-year declines of 14.6 percent and 6.2 percent, respectively.

Import figures painted a starker picture, with a year-on-year slump of 18.1 percent for May, following a decline of 16.2 percent in April. The result bucked expectations of a slight improvement based on the stabilisation of commodity prices.

The continuing decline in imports is bound up with an ongoing slowdown in the manufacturing sector. Imports of raw materials, including coal, refined oil and iron ore, all fell, with the latter dropping by 1.1 percent compared to last year.

According to the preliminary HSBC/Markit purchasing managers’ index, May marked the third month of contraction in the Chinese factory sector, and saw the fastest decline in output in over a year. The index was 49.1 in May, below the 50-point benchmark indicating growth. At the same time, the figures showed a 23-month low in new export orders, along with the worst contraction in real output in 13 months.

Foreign trade volume was down 7.8 percent over the January to May period. China’s trade with the European Union declined by 7.1 percent, and 11.2 percent for Japan.

The figures prompted HSBC to lower its forecast for export growth this year from 7.1 percent, to 4.2 percent, while the research arm of the Chinese Central Bank revised overall growth forecasts for the year from 7.1 percent, to 7 percent. That would be the lowest growth rate in 25 years.

A European Chamber of Commerce survey this month pointed to declining confidence among European companies that have invested in China. Just 28 percent of the 541 European firms polled with operations in China said they were optimistic regarding profitability in the country. Only 52 percent indicated that they would expand their operations in China, down from around 90 percent two years ago. Almost 40 percent were planning on cutting costs, with two-thirds considering job cuts, and 25 percent were already planning to sack workers.

The economic slowdown comes amid continuing concerns over the implications of China’s slowing property market. A speculative property bubble has led to a massive accumulation of debt. Now, with signs that the bubble is bursting, the quality of those debts is increasingly being called into question. Prices for new homes have fallen for eight consecutive months, up to and including May.

“The increase in China’s debt over the past five years ... is the largest that any major developing country has seen in post-WWII history,” Ruchir Sharma, head of emerging markets at Morgan Stanley Investment Management, commented. “Corporate sector debt (including that of financials) now stands at close to 200 percent as a share of GDP, the largest of any developing nation that I know. And more worryingly, this has doubled from the level where it was before the global financial crisis.”

The vast expansion of debt centred in the housing sector was encouraged by the activities of “shadow banks” that have operated as intermediaries between state-owned institutions and highly-leveraged private operations since the massive stimulus operations undertaken by the Chinese government. Given the opaque character of these banks’ operations, it is unclear how many corporate and state entities might be exposed to bad debts.

According to the McKinsey Global Institute, almost half of China's non-financial sector debt is tied to property—some $9 trillion—while about 15 percent of outstanding loans are to property developers.

At the same time, Chinese borrowing from abroad has escalated. JPMorgan figures indicate that Chinese issuance in the US dollar bond market this year stands at $42 billion to the end of May, the highest on record. According to the report, seven of the top borrowers are property developers with low credit ratings.

In a process similar to developments in the US and Europe, symptoms of slowdown in the productive economy in China, have been accompanied by a turn to feverish speculation on the stock markets.

According to figures cited by *Time*, the Shanghai Stock Exchange Composite has risen by 149 percent over the past year, while the Shenzen Stock Exchange Composite is up 190 percent. As an expression of the "outright madness" of the bubble, the article points to the fortunes of Beijing Baofeng, which went public late last March, and has since risen by over 2,900 percent.

The rally has been fuelled by three interest rate cuts in the space of six months, and the continuing availability of cheap credit.

Peter Chovanec, managing director and chief strategist at Silvercrest Asset Management, told CNBC late last month: "It's clearly in bubble territory and this a replay of what happened in 2007, where the Shanghai index more than doubled, actually tripled, and then came down just as abruptly the next year."

Chovanec noted that the stock market rally was bound up with the slump in real estate. "You've got Chinese investors who have always been pouring their cash into the property market [who] are now disengaged from the property market because it's been down for over a year," he said. "They need somewhere else to put their cash."

The Chinese economy's deepening malaise has been reflected in record capital outflows, estimated at around $159 billion in the first quarter of 2015. Some commentators have noted that the figure could be far higher, if secret and illicit outflows were included.

The mounting contradictions of the economy confront the Chinese regime with an intractable dilemma. Any serious attempt to rein in the massive growth of debt, and the speculative bubble on the stock market could result in a liquidity crisis, and hasten capital outflows. However, recent trends have demonstrated that in the absence of any action, the tendency toward financial bubbles will continue.

The deepening economic crisis also threatens to provoke major social struggles. According to the Hong Kong-based *China Labour Bulletin*, strikes tripled in the first five months of 2015, compared to the same period last year.