

Weakening currency and economic slowdown in China

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Amid a continuing weakening of the Chinese currency, the People's Bank of China (PoBC) has signalled new moves that could accelerate the slide in the renminbi's value and trigger a currency war among export-dependent countries in Asia and internationally.

Last Friday, as the renminbi hit its weakest level against the US dollar in more than four years, the PoBC announced that it intended to change the way in which the renminbi's value is fixed. In the future, the renminbi will be measured against a basket of currencies, rather than the dollar, opening the door for further devaluation.

China is under pressure from a rising US dollar, compelling the PoBC to intervene to maintain the value of renminbi within its fixed band. This has led to a depletion of foreign currency reserves, which stood at \$3.43 trillion in November, down 14 percent from the peak in June 2014. The renminbi is likely to come under greater pressure if the US Federal Reserve announces an expected rise in US interest rates later this week.

The downward slide in the renminbi's value, which makes Chinese exports cheaper, threatens other Asian exporters, already being hit by the global economic slump, and heightens the danger of competitive devaluations. Societe Generale analyst Jason Daw warned on Thursday that "further renminbi depreciation risks a currency war, either directly by policymaker actions or indirectly by investors shorting Asian currencies."

Commenting last week on the upcoming US Fed decision, UK *Daily Telegraph* business editor Ambrose Evans-Pritchard cautioned: "The greater risk for the world over coming months is that China stops trying to hold the line against devaluation and sends a wave of corrosive deflation through the world economy. Fear

that China may join the world's currency wars is what haunts the elite and funds in London."

Evans-Pritchard warned that a large devaluation in the Chinese currency "would set off currency wars in Asia and beyond, replicating the 1998 crisis on a more dangerous level." In the 1997–98 Asian financial crisis, China was generally praised for maintaining the renminbi's value against the dollar and assisting in stabilising financial markets. Now China threatens to become a major source of instability.

Underlying the weakening currency is the slowdown of the Chinese economy, which was highlighted by figures released last week. Trade statistics showed further falls in US dollar terms, with an 8.7 percent drop in imports in November compared to a year earlier. Exports declined 6.8 percent year-on-year, steeper than the 5 percent fall in October.

China's annual growth rate slowed to 6.9 percent in the September quarter, the weakest result since 2009 in the midst of the global financial crisis and below the 7 percent target set by the government. The Chinese leadership claims to be effecting a transition from an export-driven economy to one based on domestic consumption and services, as if this were a natural progression for all countries.

However, China's rapid economic growth has been completely bound up with its integration into the world economy as the premier cheap labour platform. The regime responded to the 2008 global financial crisis, which led to a contraction in exports and the rapid loss of 20 million jobs, with a huge stimulus package that combined a flood of cheap credit with a massive infrastructure expansion.

The stimulus measures were based on the assumption that the world economy, and thus Chinese exports, would recover. Six years on, that premise has proven

false. Moreover, the cheap credit only fuelled speculative bubbles in property and shares that have heightened economic uncertainty. Property prices are stagnant and shares on the Shanghai and Shenzhen stock markets plunged earlier this year.

The slowdown in the property market, combined with the slump in manufacturing exports, is compounding productive overcapacities in basic industries such as steel. China is the world's largest producer of steel, accounting for about a half the total production of 1.6 billion tonnes. UBS analysts cited in the *Economist* estimate that China this year will produce 441 million tonnes more than it can consume.

In an effort to stave off a wave of bankruptcies, the Chinese government is encouraging steel producers to export and last week cut export tariffs on pig iron and steel billet. For the year to November, China exported over 100 million tonnes—more than the total production of any other country in the world except Japan. However, Chinese steel exports not only fail to soak up overcapacity, but also threaten to provoke demands for protectionist measures from hard-pressed steel industries in other countries.

The Chinese government is fearful that a wave of bankruptcies in manufacturing will send unemployment soaring and result in widespread social unrest. Strike figures reported by the Hong Kong-based *China Labour Bulletin*, based largely on media reports, hit 301 in November, the highest level for the year. Most of the workers' protests were in manufacturing and construction over unpaid wages and factory closures and mergers.

The government's plans to "transition" to a service economy involve a further round of market restructuring and opening up of service sectors to foreign companies by breaking the current dominance of state-owned enterprises. Given the lucrative opportunities that could open up for foreign investors, it is not surprising that major global institutions like the International Monetary Fund and World Bank, along with financial commentators, champion the proposals.

However, the *Financial Times* noted last week that not everyone is convinced that services in China will seamlessly takeover from a stagnant manufacturing industry. John-Paul Smith, from the investment advisory firm Ecstrat, argued that the services sector was heavily interconnected to manufacturing. If

manufacturing "hit the wall, the idea that consumer spending won't take a big hit is absolutely fanciful in the extreme," he said, warning that China had a good chance of experience "a sudden stop"—i.e., zero growth—in the next couple of years.



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