China lowers economic growth target

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The Chinese government has reduced its growth target for this year to "around" 6.5 percent after the economy expanded by 6.7 percent last year—itself the lowest increase in more than a quarter of a century.

The target was announced in the annual "work report" delivered by Premier Li Keqiang to the opening session of the two-week session of the National People's Congress yesterday. The main reason for the lowered target is concern that increased growth, fuelled by rising debt, could set off a crisis in the financial system, an issue that Li addressed in his remarks.

"At present, overall systematic risks are under control," Li said. "But we must be fully alert to the build-up of risks, including risks related to non-performing assets, bond defaults, shadow banking and Internet finance." He also pointed to government concerns about the "high leverage in non-financial Chinese firms."

The reference to financial problems comes after a warning from the International Monetary Fund in a report on the Chinese economy last August about the high levels of corporate debt.

The IMF's mission chief in China, James Daniel, said the country's medium-term outlook was becoming clouded because of "high and rising corporate debt" and authorities had to "urgently address the problem."

Chinese debt is now estimated by the Bank for International Settlements to be 254 percent of gross domestic product. While that is comparable to the levels of other major indebted countries, the main concern is the speed of the increase. According to one estimate, debt quadrupled between 2007 and 2014.

Another indication of the financial expansion is that the Chinese banking system has now surpassed that of the euro zone to become the largest in world by assets.

In a comment to the *Financial Times* on Li's address, Eswar Prasad, a specialist on the Chinese economy at Cornell University, said the lower growth target was "symbolically important" because it signalled "the government's concerns about rising financial risks and environmental degradation wrought by the earlier emphasis on high growth at all costs and the unbalanced growth model that sustained it."

A Commerzbank economist echoed this assessment, telling the newspaper that "China's policy stance has turned to risk control."

Li said financial supervisors must fix "weak links" in the financial system and action had to be taken to rein in housing prices in major centres, saying "houses are built to be lived in," not for speculation.

Last year, when faced with the problem of unsold real estate and falling construction, the government eased mortgage conditions, setting off renewed buying that led to a slight fall in unsold apartments.

However, according to the report in the *New York Times*, "what looked like a bubble before looks ever more so now." Real estate prices in Beijing and Shanghai are now among the highest in the world in relation to local income, with developers still heavily in debt.

But a lower growth rate brings other problems for the Chinese government. In past years, the official position has been that a growth rate of at least 8 percent was necessary to maintain employment and "social stability." The official target is now well below that level and could go even lower.

Li sought to address those concerns in his report, which called for the creation of 11 million jobs, up from the level of 10 million in 2016. He acknowledged the government's difficulties in developing a "new normal" for the economy, with less dependence on debt. "Like the struggle from chrysalis to butterfly, this process of transformation and upgrading is filled with promise but also accompanied by great pain," he said.

Last year's NPC took place amid protests by hundreds of coal miners in south-eastern China, who marched through the city of Pingxiang as the government announced that some 1.3 million workers would lose their jobs.

The protests saw some officials pressing for government policies to support economic growth. But according to the *Financial Times* "that debate has been settled in favour of officials who feel the government should pay more attention to financial and economic risks even if its results in slower economic growth."

While the issue may be "settled" within ruling circles, it has not gone away. Many regional areas are experiencing far lower levels of growth than the official figures for the economy as a whole, with local authorities covering up the real situation in their regions.

Evidence of this surfaced last month, when Chen Qiufa, the governor of Liaoning, a major industrial region in north-eastern China, revealed that false statistics boosted the province's economic data from 2011 to 2014. According to the official Chinese news agency Xinhua, government officials inflated figures by more than 100 percent. Revenue for one county for 2013 was revised down from 2.4 billion yuan ($350 million) to 1.1 billion yuan ($160 million).

Last year, the province, which has a population of 43 million, larger than the state of California, reported that its economy actually contracted as a result of cuts in major industries.

The government also faces major problems on the financial front. Monetary policy is going to come under pressure because the US Federal Reserve is expected to further raise interest rates, probably as soon as this month, with more rises to follow.

This will tend to increase the outflow of capital from China, putting downward pressure on the yuan under conditions where US President Donald Trump and other members of his administration have denounced China as a "currency manipulator"—allegedly lowering the value of the yuan to gain an advantage in export markets.

In fact, Chinese authorities tried to prop the currency up, spending almost $1 trillion over the past year and imposing restrictions on sending money out of the country. If US interest rates do rise, the government will have to further tighten monetary policy and impose more restrictions, putting it at odds with better-off sections of the middle classes and wealthier layers of society—the main social base of the regime—which have been sending money out of the country.

The government is also under pressure because of the considerable anger in the major urban centres over the increased prevalence of choking smogs. In his report, Li said the government would renew its effort to combat pollution and that "we will make our skies blue again."

But clearing the clouds from the cities is likely to prove as intractable a problem as clearing those which hang over the economy and the financial system.