Falling growth rate sparks concern in China’s ruling circles

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The Chinese Communist Party leadership is showing increased signs of anxiety over the direction of the economy amid indications that growth is starting to slow significantly.

Last month China recorded its lowest quarterly growth figure—6.5 percent—since the impact of the 2008-2009 financial crisis. This week the government’s Purchasing Managers’ Index (PMI) showed that China’s manufacturing output in October had weakened.

The PMI fell to 50.2 in October from 50.8 the previous month. While this is still above the level of 50, indicating expansion, it was the lowest level since July 2016.

A PMI sub-index of new export orders fell from 48.0 to 46.9 in October, its lowest level since January 2016. The index of total new orders, which measures both exports and imports, was also down, dropping to 50.8 from its level of 52 in September.

In a note, reported in the *Financial Times*, Serena Zhou, Asia economist at Mizhou Securities in Hong Kong, wrote: “China’s October manufacturing PMI came [in] much weaker than the market had expected. Softness was seen in both new orders (especially export-related) and factory production, foreshadowing slower manufacturing activity in the fourth quarter amid sluggish domestic sentiment and rising external trade tensions.”

Commenting to the *Wall Street Journal*, Xiaowen Jin, an economist at Citigroup, said: “Companies are definitely feeling the chill from the trade war.”

A statement issued from a meeting on Wednesday of the 25-member Politburo, China’s key policy-making body chaired by President Xi Jinping, reflected the growing concern in Beijing over the economy and the impact of US trade war measures.

According to the state-owned Xinhua news agency, the Politburo said there was “growing downward pressure” on the economy, combined with “profound changes” in the external environment. The latter phrase contrasts with the Politburo statement of three months ago, which pointed to “noticeable” changes in the external environment.

In that time, the trade war initiated by the US has markedly escalated. In addition to 25 percent tariffs on $50 billion worth of industrial goods, a levy of 10 percent was imposed on $200 billion worth of products, set to rise to 25 percent in January, and US President Donald Trump has threatened to place tariffs on the remaining $267 billion worth of Chinese exports to America.

Trade war is not the only problem confronting the Chinese leadership. It is seeking to reduce the level of debt in the economy while balancing the reduction of credit against the need to provide a stimulus for growth. This is a matter of considerable concern to the Beijing leadership because it fears that a significant reduction in growth will lead to struggles by the working class. In the past it maintained that a growth level of 8 percent was necessary for “social stability.” Now growth is down to 6.5 percent and could well go lower in the future.

The Politburo statement said there were “a lot of difficulties with certain enterprises and the emergence of risks accumulated over long periods of time.” The latter appears to be a reference to the accumulation of debt.

S&P Global Ratings issued a report last month saying China could be facing a “debt iceberg with titanic credit risks” because infrastructure projects financed by local government authorities were leading to a debt pile, as high as $5.8 trillion, hidden off their balance sheets.

The Politburo said it had to "enhance reform and opening up to focus on core problems with targeted solutions … We must get our own things done and firmly seek high-quality growth."

The government and the central bank have undertaken a series of measures in recent weeks to try to boost financial liquidity, while providing tax concessions for households as well as giving support to exporters. But these measures appear to have provided little stimulus.

Indicating that further measures are under consideration, the Politburo said the leadership was "paying great attention to the problems" and would be "more preemptive and take action in a timely manner."

Another problem is the decline in the value of the renminbi against the US dollar. The Chinese currency fell to a decade-low this week and is now close to what is regarded as a key benchmark of 7 against the US currency. The Chinese leadership is seeking to sustain its value lest the US brands it a "currency manipulator" and unleashes a further round of punitive measures.

Writing in the *Financial Times* on Tuesday, Diana Choyleva, chief economist at Enodo Economics, a consultancy firm on the Chinese economy, noted that while a major devaluation or a sharp fall in a short period of time would help China's exporters, it would "plunge the world into deflationary disarray" and shred Beijing's claims to be a force for global stability.

Choyleva pointed to the criticism that has begun to surface within Chinese ruling circles that President Xi underestimated the aggressive character of American policies. Despite his strong hold on power, she wrote, he could not "afford to enrage America and risk an overreaction" and that "a second miscalculation would go down badly at home."

This week, the *Financial Times* reported on the criticism voiced by two prominent Chinese economists who have argued the trade war launched by the US is not an attempt to block China's rise—the position of the ruling faction around Xi—but an understandable response to its state-directed economic policies.

According to a recent speech delivered by Zhang Weiying, a professor at Peking University's National School of Development, from the Western perspective, the "China model" makes it "an alarming outlier, and must lead to a conflict between China and the Western world."

Zhang is an advocate of the free market, who was named "economist of the year" by the state broadcaster in 2002 when the emphasis of official policy was market reform. He said the "environment we face today is not unrelated to the mistaken interpretation of China's achievements over the past 40 years by some"—a thinly-veiled criticism of the state-backed "model" of economic growth promoted by Xi.

Zhang's views were echoed by Sheng Hong, the executive director of the Unirule Institute of Economics, a liberal think tank, who warned that China was at risk of abandoning Deng Xiaoping's policy, initiated in 1978, of "reform and opening up," leading to a conflict with the West.

At present, such views are regarded as outliers. They point to cracks opening up within the regime, however. Those cracks could widen if the economy worsens and leads to the emergence of the greatest fear of the ruling regime of ultra-wealthy oligarchs—a movement of the multi-millioned Chinese working class.