Deepening problems for Chinese economy

Nick Beams
6 October 2021

The major economic and financial problems in the Chinese property development sector continue to mount with the announcement by Fantasia Holdings this week that it had failed to make a payment on a bond.

Just a few weeks ago, Fantasia issued an assurance that it had "no liquidity issue" but on Monday announced "that it did not make the payment" on a $206 million bond.

Last month Evergrande, the most indebted property development company, missed a payment on a dollar-denominated bond, triggering a 30-day grace period before a default is declared.

The question being asked in Asian markets is how far the financial crisis will spread to other property developers, which account for a large portion of the high-yield or so-called junk bond market.

Dickie Wong, the head of research at the Hong-based Kingston Securities, told the *Financial Times*: "There's nothing investors can do… the worst is yet to come."

The rating agency Fitch said Fantasia has $1.9 billion due on offshore bond payments by the end of next year as well as 6.4 billion renminbi ($US992 million) of onshore bond payments due in the same period.

The crisis goes far beyond real estate, given the crucial role it has played in the 13 years since the global financial crisis in 2008 when the Chinese government turned increasingly towards property development as a central driver of economic growth.

Financial Times columnist Martin Wolf wrote yesterday that the most serious issue to arise from the crisis was that the economy's dependence on demand from investment in real estate had to end. "That will impose a huge adjustment and create a big headache for authorities: what can replace property investment in creating demand?" he wrote.

Wolf cited statistics pointing to the fact that well before the Evergrande crisis, the Chinese growth model, based on high levels of investment, was running out of steam. Total fixed investment averaged around 43 percent of gross domestic product (GDP) between 2010 and 2019, five percentage points higher than between 2000 and 2019. But in the latter period GDP growth had started to fall, indicating a drop in investment returns so far as the overall economy is concerned.

At the same time, debt has been rising. Household debt jumped from 29 percent of GDP in 2010 to 61 percent in 2021, while non-financial corporate sector debt rose from 118 to 159 percent of GDP in the same period.

Wolf cited the finding from a 2020 paper by economists Kenneth Rogoff and Yuanchen Yang that when its flow-on effects are considered the Chinese property sector accounted for 29 percent of GDP in 2016.

He claimed that because the government controlled the Chinese financial system, a financial crisis could be averted—a position advanced by many others. But this supposition has yet to be tested by the events now unfolding.

The major impact, he said, was that property investment would collapse and this would have a "large negative effect on local government finances." The taxing powers of local governments are restricted, and they depend on the flow of revenue from land sales to finance infrastructure projects.

According to the research by Rogoff and Yang, cited in the article, "a 20 percent fall in real estate activity could lead to a 5–10 percent fall in GDP, even without amplification from a banking crisis, or accounting for the importance of real estate as collateral." And, according to Wolf, "it could be worse."

He held out the prospect that growth could continue if there was a shift away from wasteful investment and increased consumption spending flowing from a redistribution of income towards poorer households. This would require “big reforms” combined with a shift away from property and a transition from high carbon emissions, also requiring “big policy changes.”

The model based on wasteful investment had reached its end and had to be replaced, he concluded.

But this fact has long been recognised by the Chinese regime and was the basis for the launching in 2015 of the Made in China 2025 plan that set out the need to develop hi-tech industries.

However, it has run into a major barrier—the domination of US imperialism over the world economy, exercised through its design of vital computer chips and the pre-eminent position of the dollar in the international financial system.

The US is determined to crush Chinese high-tech development by all means necessary because it is seen as a threat both economically and militarily.

This policy, initiated under Trump, continued and deepened by the Biden administration, is exemplified most clearly in US actions against the Chinese high-tech telecommunications company, Huawei, regarded by the Xi Jinping regime as a vital component of the next stage of economic development.

Three years ago, Huawei, which had poured major investment into the development of communications technology, was on the edge of becoming the world’s leading developer of the global 5G phone infrastructure.

Last month, Huawei chairman Eric Xu said the company’s revenue from the sale of smartphones will drop by $30 to $40 billion this year from the $136.7 billion of sales in 2020, with no prospect for recovering that money in the next few years. Earlier Xu had said the company’s goal was simply to survive.

The destruction of its smartphone business is seen in the fact that despite having made significant advances in the development of 5G infrastructure—many of the patents are held by Huawei—its latest smartphone will be only 4G.

The actions of US imperialism with regard to Huawei are emblematic of its position with regard to the Chinese economic development as whole—its reduction to what amounts to status of an economic semi-colony.

In the period when Chinese growth was dependent on the export of cheap consumer goods and low-tech industrial components, it was regarded by the US as a “strategic partner,” summed up in the invention of the term Chimerica by the economic historian and media commentator Niall Ferguson.

Now China is a “strategic competitor.” The methods employed by the US against Huawei are a 21st century form of imperialist gangsterism. The phone company has been excluded from the development of telecommunications networks on the spurious grounds that it is a “security” threat.

US firms that supplied it with computer chips have now been banned from doing so. The ban has been extended to companies from other countries by threatening them with a cut-off of their own supplies from US firms if they continue to sell components to Huawei. And there is the ever-present threat that firms which defy US directives will be excluded from the global financial system because of the dollar’s pre-eminence.

With US firms banned from dealings with Huawei, Google stopped offering services such as Gmail, and YouTube to its phones. From a position where it was once the leading smartphone supplier in the world, Huawei has now dropped out of the top five.

The collapse of the old model of Chinese economic advance, based to a major extent on property development, and the barriers being erected by US imperialism to a model based on high-tech development contain the potential for a major economic crisis.

The perspective of the regime of so-called “socialism with Chinese characteristics,” based on capitalism, has proven to be a chimera and the mounting economic problems will lead to the eruption of social and political struggles by the multi-million Chinese working class.