China slowdown worsens

Nick Beams
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The latest data from China show the slowdown in the world's second largest economy, reflected in significant deflationary trends, is not abating. Moreover, it is in danger of missing the already low official target of 5.5 percent growth this year.

According to official figures released on Monday, the economy grew by 6.3 percent in the second quarter compared to a year ago. However, that figure was below expectations and conceals, rather than reveals, the actual situation because a year ago Shanghai and other cities were in a COVID lockdown.

A more accurate assessment is provided by the quarterly data. These show that growth was only 0.8 percent in the second quarter compared to 3.2 percent in the first three months of the year.

The downward pressures go across the board: weakening spending after the initial boost following the lifting of anti-COVID measures; deflationary pressures throughout the economy; continuing problems in the housing and real estate markets; and falling export revenues.

Retail sales rose by only 3.1 percent in June compared to a year earlier, down from 12.7 percent increase for May.

Louis Kuijs, chief Asia Pacific economist with S&P Global Ratings told Bloomberg: "What we all expected was a consumption and service-led recovery. If that is sputtering, then there's no engine left for the recovery."

The extent of deflation was highlighted by a report in the *Economist* magazine. It noted that China's "nominal" growth, that is growth before adjusting for inflation, was weaker than the inflation adjusted figure. Generally, it is the other way around.

"It suggests that the price of Chinese goods and services is falling. Indeed, it implies they fell by 1.4 percent in the year to the second quarter, which would be the sharpest drop since the global financial crisis."

Consumer prices did not rise at all in the year to June and producer prices, those charged by factories, fell by 5.4 percent.

The Chinese economy is also being hit on the international front. The rise in interest rates by the major central banks is bringing a slowdown in demand for its exports. In June they fell by 12.4 percent in dollar terms, the largest year-on-year decline since the start of the pandemic.

The situation is not likely to improve as the global economy weakens with the International Monetary Fund forecasting world economic growth of only 2.8 percent this year, amid predictions that it could be even lower.

A comment by David Lubin, the head of emerging markets at the global financial firm, Citi, published in the *Financial Times*, detailed some significant trends in world trade.

He noted that, according to Citi data, the annual growth of import volumes turned negative last year and has continued negative so far this year and there were "few reasons to think things will improve."

According to Lubin, global economic growth will come in at about 2.3 percent this year. Next year "will almost certainly be weaker than this, not least because big central banks are, in effect, aiming to induce slowdowns to regain control over inflation."

This would create a more hostile environment for trade, he wrote, noting that "the last time the world saw two consecutive years of sub-2.5 percent growth was in the wake of the financial crisis."

China is facing added pressure because of the trade and tech wars being waged against it by the US. Washington claims its bans on high-tech exports to China are only aimed at a narrow range of technologies that have military applications and are not directed at the broader economy. It says it wants to lessen tensions, but its actions speak louder than words.

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In comments delivered during the Group of 20 finance ministers meeting in India earlier this week, US Treasury Secretary Janet Yellen said that her recent visit to Beijing had been aimed at putting the relationship with China on a "surer footing."

But at a later press conference she ruled out removing or even relaxing the tariffs imposed on Chinese goods by the Trump administration.

"The tariffs were put in place because we had concern with unfair trade practices on China's side and our concerns with those practices remain," she said.

Faced with a worsening international environment, the Xi Jinping regime is seeking to lift domestic demand. However, the kind of stimulus measures it employed in the past, in response to the global finance crisis, are no longer available because of the growth of debt.

After it removed all measures against the spread of COVID, Beijing expected there would be an uplift in the economy. But after the economy grew faster than expected in the first three months of the year there was a sharp slowdown as retail sales, investment and property sales dropped.

According to a recent note by Citi analysts: "China is on the brink of a self-fulfilling 'confidence trap' as the initial reopening impulse starts to fade."

The all-important property market is showing the same trend as the rest of the economy. Earlier this year it appeared to be recovering from the swathe of defaults by real estate companies and uncompleted housing projects as home buyers came back into the market.

The revival appears to be short-lived. The price of new homes fell in May. According to the China-focused consultancy firm Gavekal Dragonomics, property sales are now 70 percent of where they were in 2019 and housing starts have fallen to 40 percent of that level.

A survey conducted by the Japanese financial firm Nomura told the same story. It found that property transaction volume as measured by floor space fell by 19.2 percent year-on-year in June following a 3.5 percent decline in May.

Last November the government took measures to try to boost the property sector, which it continued earlier this month by easing rules for the extension of debts.

However, according to a report in the *Financial Times,* "its efforts have so far failed to revive market activity."

Asia property analyst Andrew Lawrence, at the financial firm TS Lombard, told the FT: "What we're seeing is a complete lack of trust emerging in the Chinese property sector."

The report said so far government measures of support had only been directed to so-called "high quality" developers, leaving those that have defaulted and are caught up in restructuring operations to fend for themselves.

"The funding model for Chinese developers is broken," Lawrence said, "and there isn't anything to replace it. Ultimately they're going to get to the point where they've got nothing to sell and they've got no revenue."

In the face of the worsening economic situation, the official line is that China is not facing deflation. In a press conference held in the wake of data showing consumer prices were flat, the deputy governor of the People's Bank of China Liu Guoqiang said China was not in deflation and "won't show signs of deflation in the second half of this year."

Amid the slowdown, one issue that will be causing concern in ruling circles is the increase in youth unemployment that is hitting highly educated graduates from universities and colleges who cannot obtain decent-paying jobs in their chosen field.

The jobless rate for those aged 16 to 24 in the urban areas hit a new record high of 21.3 percent in the June quarter. The official response is that they should "work hard" and take those jobs that are available. This response does not sit well with young graduates whose families have spent considerable amounts of money to secure their education and who have studied hard but who find there is nothing for them when they seek employment.

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