Chinese deflation and economic slowdown brings political clampdown

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The worsening position of the Chinese economy, most graphically revealed in a slowdown in growth, the development of a deflationary environment and lower business and consumer confidence, appears to be having a political impact.

This week the *Financial Times* reported that Chinese authorities were putting pressure on economists and others, including media outlets, to avoid discussion of negative economic developments.

The pressure is coming from the highest levels of the official economic establishment. Data issued last month showed that China's producer price index had declined for eight straight months since last October while annual consumer price inflation hit a two-year low in June.

Economists at the financial conglomerate Citigroup said core goods prices, which strip out food and energy costs, had entered a "deflationary zone" because of weakening consumer demand.

However, authorities are having none of it. According to a statement last month by Fu Linghui, a spokesperson for the National Bureau of Statistics: "Deflation does not and will not exist in China."

This bureaucratic directive is being translated into action, according to the FT.

"Multiple local brokerage analysts and researchers at leading universities," it reported, "as well as at state-run think-tanks said they had been instructed by their regulators, their employers and even domestic media outlets to avoid speaking negatively about topics ranging from fears of capital flight to softening prices."

An adviser to the central bank told the FT there was pressure to present economic news positively. "The regulator doesn't want to hear negative comments about the economy in public. They wanted us to interpret bad news from a positive light."

The bad news is growing. The official view was that after COVID safety measures were scrapped at the end of last year, the economy would rebound quickly. Yet, after a brief uptick at the start of the year, major economic indexes have turned down.

Yesterday official data revealed that exports in July had declined by 14.5 percent in dollar terms year-on-year while imports dropped by 12.4 percent.

Data released last month showed gross domestic product expanded by only 0.8 percent in the June quarter as compared to the previous three months. Last month, the Politburo of the ruling Chinese Communist party declared that the economic recovery was making "tortuous progress."

A recent *Wall Street Journal* report noted three major areas of concern.

Manufacturing is slowing with the Caixin purchasing manufacturers index dropping to 49.2 in July, its lowest level for six months, with 50 the boundary between expansion and contraction.

Home sales, a mainstay of the Chinese economy, continue to be weak with the country's 100 largest developers reporting the lowest sales in July for three years.

Moreover, continuing deflation "could cause serious damage to the economy" if consumers try to save more in the expectation their money will be worth more in the future.

China has long been a producer of cheap consumer goods, but this area of the economy is being hit hard.

A survey of the economy by the FT pointed to the difficulties of the Feng Tait Footwear company, which exemplified "the difficulties faced by low technology manufacturers."

"Prior to the pandemic it sold some 5 million pairs of shoes to clients such as Walmart and Target. This year

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it will do well to sell 3 million. Orders for the second half of the year—typically filled by July—are down at least a third compared with last year."

The chief executive of the company, which has 10 plants across China, described the sector as in "misery" and "basically at a standstill" with workers sometimes not even completing their full-time hours.

One of the chief factors at work in the downturn is the slump in the real estate and property development sector which began in 2021 following government action to try to curb the growth of debt. Last June home sales recorded an 18 percent drop from a year earlier and residential construction was down by 10 percent.

An article in Bloomberg noted: "That's a big drag on growth given the property sector, together with related activities such as the production of steel and home furnishings, accounts for one-fifth of GDP. Sizable declines in Chinese exports to Europe and the US also weighed on the second-quarter number."

The only "bright side," it said was the increase in services spending with spending in bars and restaurants jumping by 20 percent. But this is not going to bring a recovery in the rest of the economy.

"Every China recovery for the past 20 years," the article continued, "has been driven partly by a boom in home building—yet not this time. The anomaly explains why confidence is flagging among both businesses and consumers: it's hard to be convinced that the economy is healthy while the housing market remains in the doldrums, since experience suggests that's a sign of economic malaise."

Parallels are being drawn between China and Japan when the collapse of the Japanese real estate and share market bubble at the beginning of the 1990s led to the deflation and lower growth that has continued to this day.

The eyes of business chiefs, economists, pundits, and analysts have turned to the government looking for a possible response.

In a note to clients last month, economists at the London-based Capital Economics said: "Looking forward, policy support is needed to prevent China's economy from slipping into a recession.

"Unless concrete support is rolled out soon, the recent downturn in demand risks becoming self-reinforcing."

So far, however, there is little movement from Beijing. A 31-point plan issued in July, which sought to boost business sentiment, was regarded as being limited in scope.

In previous times, the government would have intervened with a stimulus package to boost the economy, but this has not eventuated with only hints of more support.

"So far, that has not translated into the sort of sizable fiscal policy stimulus many in the market have become used to expecting," Robert Carnell, an economist at the financial firm ING told the WSJ. "We don't think it is coming."

There are a number of reasons for this. The government is reluctant to provide a boost to the all-important property sector because to do so runs the risk of creating still more debt.

It is also fearful of lowering interest rates and expanding credit—measures that have been used in the past—because that risks sending down the value of the currency, the yuan, leading to the movement of finance out of China.

The clampdown on "negative" economic commentary is an expression of one of the central problems facing the Xi Jinping regime. Having long ago abandoned the goal of social equality, it rules on behalf of a capitalist oligarchy and has only retained political support because of its ability in the past to provide economic growth and improvements in living standards.

That capacity is now being called into question, especially among young people. The unemployment rate for urban youth aged between 16 and 24, many of them college and university graduates, is running at a record 21.3 percent after a steady rise in the past months.

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