

Growing pressure on Xi as China's economic woes mount

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Pressure is mounting on the Xi Jinping regime to take emergency action as China's economic and financial problems daily go from bad to worse.

China is being hit by two interconnected developments: a worsening property market, and an accelerating liquidity crisis in the shadow banking system that has the potential to spread more broadly.

In addition, there are the growing sanctions by the US impacting the Chinese high-tech sector, which is crucial for future economic growth, and the restrictions on US investment in China due to come into effect at the start of next year.

The latest stage in the property and finance turmoil has been set off by the marked slowdown of the Chinese economy in recent months, following a brief uptick at the start of the year following the lifting of COVID safety measures, reflected in the emergence of a deflationary environment.

The Chinese government has pledged to take action to support the economy. This week the People's Bank of China lowered its interest rate by 15 basis points, the most significant cut in three years. But these measures are seen as inadequate.

The *Financial Times* (FT) reported earlier this week that foreign investors dumped Chinese stocks and bonds in the Hong Kong market. This almost completely reverses the \$7.4 billion in net purchases made after a July 24 statement by the Chinese Communist Party Politburo to increase support for the economy.

The attitude of the market was summed up by Mohammed Apabhai, head of Asia strategy at Citigroup.

“The measures taken so far appear to have disappointed the market. There is increasing frustration and concern from investors about the lack of any solid

policy action,” he told the FT.

Growth estimates for the Chinese economy are being downgraded. The official target for this year is 5 percent, the lowest level in three decades, but there are growing doubts it will be achieved. JP Morgan has lowered its growth estimate for this year to 4.8 per cent, after predicting 6.4 percent growth as recently as May. Barclays has cut its projection to 4.5 percent.

JP Morgan cited the worsening property market as a key factor in its downgrade. “The deterioration in housing market outlook, especially another year of big decline in land purchase and new home starts” tended to increase the drag on the economy, it said.

The woes of the real estate sector came into view this week with the news that Country Garden, one of the China's largest developers, had missed two international bond payments. It was something of a shock because amid the failure of many Chinese property firms over the past two years, Country Garden had been promoted by authorities as being soundly managed.

Worse news was to come with the revelation that Zhongrong International Trust, an offshoot of the Zhongzhi Enterprise Group, a major private wealth manager, had missed payments on two of its investment products.

It then emerged that in late July Zhongzhi had hired the global accounting and financial advisory firm KPMG to assess its balance sheet and advise on how to deal with what has been described as a worsening liquidity crunch.

Financial authorities are also concerned about the possibility of contagion—problems at Zhongzhi flowing to other parts of the shadow banking system—and have set up a task force to carry out a risk assessment.

As new problems emerged in the property sector,

older ones continued to play out. The Evergrande group filed for Chapter 15 bankruptcy in the US aimed protecting its American assets from creditors while it works out a restructuring deal.

When Evergrande defaulted on a bond in December 2021, it might have been hoped that the problems of the Chinese real estate sector it revealed could be contained. However, in the period since, they have continued to grow, steadily reaching into the shadow banking system because of its critical role in financing property development.

The sensitivity of the government to the problems at Zhongzhi is highlighted by a Bloomberg report that investors who put money into the shadow banks had been visited by police at their homes advising them not to join public protests.

Earlier this week, about two dozen people in Beijing gathered outside the company's offices demanding to know why they had not been paid the money they were owed.

According to the Bloomberg report, "dozens of people" who had invested in Zhongzhi received "what they described as cordial visits from police in recent weeks." The visits covered a large area including Beijing, the southwest province of Sichuan and the coastal area of Jiangsu and Shandong.

There are two motivations for the action by authorities. The investors in wealth management firms such as Zhongzhi are wealthy members of an upper-middle class stratum that forms a vital prop for the Xi regime.

Another, more significant reason, for the police action is the fear that protests by these more privileged layers could set off a much more dangerous movement from below, especially from urban youth, many of them well educated, who face a record unemployment rate of 21.3 percent.

The regime's nervousness over such a development and its effect on the broader working class is indicated by the clampdown on media comments about the problems of the Chinese economy and the decision by the National Statistics Bureau to no longer release youth unemployment data.

Another indication of the growing financial and debt problems is the decision by China's state council to send teams of officials to ten of the country's financially weakest provinces to examine their books.

According to an article in the FT, the working groups involved in the debt resolution effort will report to Premier Li Qiang.

"The enormous debts accumulated by China's provinces had become an urgent problem for policymakers as they try to end the country's long reliance on a debt-fuelled infrastructure binge to drive economic growth," it said.

Goldman Sachs has estimated that total local government debt, held directly and off balance sheet by local government funding vehicles, comes in at \$13 trillion.

The worsening economic and financial travails of China, the world's second largest economy, are starting to have significant international consequences.

In the decade and a half since the global financial crisis of 2008, China has been far and away the biggest single contributor to global growth, adding the equivalent of almost three Germanys, the world fourth largest economy, in that time.

Now it has entered a period of stagnation, the global effects of which are starting to show up.

It was reported this week that Japanese exports in July fell for the first time since February 2021, largely as a result of falling Chinese demand, with shipments to that destination down by 13.4 percent.

This week the Commonwealth Bank of Australia warned that the Australian currency could drop to below 60 US cents, after falling from around 67 cents to 63, because of the weakening Chinese economy on which Australia is dependent.

The problems are extending. US Treasury Secretary Janet Yellen said this week that the Chinese problems were a "risk factor" for the US. In an expression of the ever-more strident America first and the devil take the hindmost line of the administration, she said while there would be "spillovers" for the US, "China's slowdown will have the largest impact on its Asian neighbours."



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