Deepening problems in the global economy

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21 August 2023

The four largest economies in the world—the US, China, Japan and Germany—are expressing, in their different ways, the deepening problems developing in the global capitalist economy.

At present, attention is mainly focused on China where deflation, lower growth, a growing slump in the property market, a weakening currency, and problems in the shadow banking system have led to increased pressure on the Xi Jinping government to provide some kind of stimulus package.

However, moves by the People's Bank of China (PBoC) over the past few days to ease financial conditions and provide a boost to the real economy have been generally dismissed as falling far short of what is needed.

Yesterday, the PBoC lowered the one-year prime loan rate by 10 basis points to 3.45 percent. However, in a surprise move, the equivalent five-year rate was kept at 4.2 percent, after projections that both would be cut in a bid to stimulate the housing market.

The chief China economist at Goldman Sachs described the limited move as "quite surprising and frankly it's a bit puzzling."

More was expected because of the latest data on the economy which showed that growth in the June quarter was only 0.8 percent compared to the previous three months, under conditions where a deflationary environment seems to be setting in.

Julian Evans-Pritchard chief China economist at Capital Economics, told the *Financial Times* (FT) the "underwhelming" move by the PBoC meant it was "unlikely to embrace the much larger rate cuts that would be required to revive credit demand."

Immediately after the decision, Citigroup cut its forecast for Chinese growth this year to 4.7 percent, compared to the official government target of 5 percent. Two other major banks have also cut their growth projections to below 5 percent.

The present marked downturn in the Chinese economy is increasingly being characterised as signifying the end of an era. As the *Wall Street Journal* (WSJ) put in a recent headline "China's 40-year Boom is Over. What Comes Next?"

"Economists now believe China is entering an era of much slower growth, made worse by unfavourable demographics and a widening divide with the US and its allies which is jeopardizing foreign investment and trade. Rather than just a period of economic weakness, this could the dimming of a long era," it said.

Summing up present conditions, it noted: "The outlook has darkened considerably in recent months. Manufacturing activity has contracted, exports have declined, and youth unemployment has reached record highs."

Over the past decade and more, particularly since the financial crisis of 2008, the Chinese economy has become increasingly reliant on the housing and property market which, when flow-on effects are taken into consideration, accounts for between 25 and 30 percent of GDP.

This growth has been fuelled by cheap credit for the property development giants as well as to local government authorities for the development of infrastructure projects. But in mid-2020, fearing debt creation was getting out of control, the government tightened regulations.

This led to a crisis at the property giant Evergrande, now undergoing a restructuring process, as well as the subsequent failure of many other developers. According to the Standard and Poor's rating agency, more than 50 property developers have either defaulted or failed to make debt payments over the past three years.

Even if credit is eased it will not have the effect it did in the past. It has been estimated that it now takes around $9 of investment to produce a $1 increase in

GDP compared to $5 less than a decade ago and $3 in the 1990s.

The worsening Chinese economy raises profound questions for global growth. Even with a lowered rate of expansion, the International Monetary Fund estimated China would account for around 35 percent of global growth this year. That is now called into question under conditions where there is no alternative source.

Certainly it will not come from Europe, where Germany, the world's fourth largest economy, is expected to be the worst performing leading economy in the world this year. The German economy stagnated in the June quarter after contracting in the previous two.

One of the main reasons for the worsening performance is the downturn in manufacturing which has been hit by rising energy prices because of the US-NATO war in Ukraine. However, its problems go back further.

As the chief economist at the Commerzbank, Jörg Krämer told the FT: "If you take the coronavirus out, the underperformances started in 2017, so the structural issues have been there for quite a while now."

These include the lack of competitiveness, higher labour costs and losses of market share in the all-important car industry.

A recent survey conducted by Consensus Economics predicted that German GDP would contact by 0.35 percent this year, compared to the growth forecast three months ago.

The world's third largest economy, Japan, appears to be something of a bright spot. GDP increased by 1.5 percent in the June quarter compared to 0.9 percent over the previous three months. Much of this was due to a rise in exports which have benefited from a fall in the value of the yen in currency market.

But exports may start to decline because of weakness in the US and China. Credit Agricole economist Takuji Aida told the WSJ that the Japanese economic upturn was supported mainly by government stimulus measures.

He warned that "Japan may be swallowed into the darkness of deflation again" if the government spending stopped and the Bank of Japan started to lift interest rates. The latter is in prospect because of the increase in Japanese inflation, now running at 3 percent, and the fall in the value of the yen because of the country's lower interest rate regime.

In any case, the relatively higher growth rate of the second quarter is not expected to last. According to SMBC Nikko Securities, the economy may contract at an annualised rate of 3 percent in the third quarter because a global economic slowdown will cut exports.

Last week it was reported 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.

The US economy is also not going to provide a path forward with predictions of a slow down or even a recession next year. Even limited growth in the US means the Federal Reserve will maintain its high-interest rate regime, as it seeks to drive down real wages. This threatens further financial instability following three of the four largest banking failures in US history in March.