China deflation worsens as economic problems mount

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The announcement over the weekend that China is experiencing significant deflation highlights the growing problems confronting the government as it seeks ways to boost the economy.

Consumer prices fell by 0.5 percent year on year in November, the steepest decline in three years. Producer prices, which measure the cost of goods at the factory gate, dropped by 3 percent continuing a trend which has been evident over the past year.

In another indication of the expectations of a worsening economy, the rating agency Moody's last week cut its outlook for Chinese sovereign debt to negative.

It cited the risk of lower growth in the medium term and the likely need for the government to provide support for economically weaker regions of the country.

It said there was a risk of persistently lower growth amid the effects of the ongoing crisis in the real estate sector which has been the mainstay of Chinese growth over the past decade. The need to provide support for weaker regions posed "broad downside risks to China's fiscal and institutional strength."

Moody's downgrade sparked an immediate and sharp reaction from the finance ministry which said it was "disappointed about the decision."

"China's macroeconomy continues to recover and high-quality development is steadily advancing," it said. "It is unnecessary for Moody's to worry about China's economic growth prospects and fiscal sustainability."

The impact of the problems in the property sector on local and central government was "controllable," it said. That may be the case, at least for the present. But the situation is not showing signs of improvement and the response by the ministry indicates the sensitivity of authorities to economic issues.

Economists and economic institutions have been warned not to make adverse comments on the state of the economy. Also the publication of youth unemployment data was halted earlier this year after it consistently showed the jobless rate for young people aged between 16 and 24 in urban areas above 20 percent.

Data released at the end of November showed that manufacturing activity had fallen for the second month in a row. The official purchasing managers index (PMI) came in at 49.4, below the level of 50 that marks the border between expansion and contraction.

The non-manufacturing PMI was 50.2. While positive, this was the lowest reading since the COVID surge in December last year after the government abandoned public health measures.

On Friday, on the eve of the release of the deflation figures, the Politburo, comprising the 24 top officials of the ruling Communist party, met under the chairmanship of president Xi Jinping to consider the economic outlook in preparation for issuing the official growth target for 2024.

It did not announce any specific measures but said that fiscal policy would be stepped up "appropriately," according to a report in the official Xinhua News Agency.

The Politburo unveiled a new slogan—"use progress to promote stability"—another indication of sensitivity of the Xi regime to economic slowdown given its political legitimacy is largely derived from the claim that it promotes Chinese advancement.

The new slogan has been interpreted as meaning that the growth target for 2024 will be 5 percent, the same as this year. But that will be harder to achieve because growth in 2023 was coming off a lower base because of the COVID restrictions in force in 2022.

The situation facing the government is also being compounded by the general slowdown in the world economy and the effects of the intensifying economic warfare measures being employed against China by the US, particularly in the areas of high-tech, which have led to a contraction of investment.

On monetary policy, the Politburo declared that it should be flexible, appropriate, targeted and effective. But the word “forceful” was dropped from the statement. This is an indication that while there may be some easing of credit at the margins there is not going to be a general expansion as has occurred in the past.

According to an assessment by Citigroup economists, reported by Bloomberg, the language of the Politburo suggested a shift of focus “more toward economic progress” and that there would be a target of “around” 5 percent for next year. But there is “no indication for mega stimulus from the meeting.”

The call from the meeting for the government to “act within its capabilities” also suggested there were not going to be moves to transfer incomes to households.

One indication of the worsening economic position of households was provided in a *Financial Times* (FT) report published yesterday.

“China’s state health system,” it said, “has lost tens of millions of subscribers, as higher costs have put one of the world’s largest healthcare schemes out of reach for many people struggling in a post-pandemic downturn.”

It said membership in the scheme, which is state subsidised and covers more than a billion policyholders, fell by “an unprecedented 19 million people” in 2002, according to official data, with warnings that the decline could have continued this year.

The cancellations, following years of growth, have been attributed to a decline in incomes, putting the cost of insurance beyond the reach of large sections of the population, particularly farmers and migrant workers.

The minimum premium for the main health insurance policy has more than doubled since 2018 while the wages of migrant workers have increased by only 24 percent in the same period.

Moreover, like their counterparts in many countries, workers are being hit with onerous co-payments even if they are insured.

The income decline has a significant impact on the government’s economic recovery plan, as explained by Dan Wang, chief economist at Hang Seng Bank in comments to the FT.

“A lack of social safety net, led by strong health insurance coverage, has forced Chinese people to save a significant portion in their income to prepare for external shocks like serious diseases. That has undermined government effects to boost consumption, which holds the key to China’s recovery from the post-COVID economic downturn,” he said.

Xi has stepped forward to play a somewhat more public role on the economy, delivering a speech to a political gathering earlier this month. As reported by Xinhua, he said “our country’s economic recovery is still at a critical stage “and the “development situation” it faces was “complex.”

No doubt the reporting of the remarks was intended to give reassurance to the population that the top leadership was concerned with the issues and intervening. But that tactic is very much a two-edged sword because the more the president associates himself directly with economic policy, the more he will be blamed for any failure to turn the situation around.