Chinese economic growth slows

By Nick Beams
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China recorded a 7.7 percent annual growth rate for the fourth quarter of 2013 amid predictions that the decline from rates of close to 10 percent—recorded as recently as two years ago—could be the start of a long-term trend.

While the growth rate beat the prediction of 7.6 percent, it was below the 7.8 percent for the third quarter. Total growth for 2013 was 7.7 percent, the same as 2012. However the growth rate for 2014 is expected to fall to 7.4 percent, the lowest level for 20 years.

In other signs of a slowdown, surveys of both the manufacturing and services industries showed a weakening in market conditions. All four purchasing managers' indexes—two conducted by the government and two by the HSBC bank—showed a decline last month, the first time that has happened since last April.

The predictions of a trend of falling growth are based on the assessment that the provision of increased credit, which has fuelled a domestic investment and construction boom since the global financial crisis of 2008, cannot continue indefinitely. In fact, official government policy is to rein in the expansion of credit.

State authorities, however, have to tread a fine line. On the one hand, they want to bring down the levels of debt, while on the other they fear that too rapid a withdrawal of credit could set off a major economic and financial crisis.

Total debt in China rose from 130 percent of gross domestic product in 2008 to more than 200 percent at the end of last year. Translated into dollar terms, credit increased from $9 trillion to $24 trillion. The increase of $15 trillion is equivalent to the size of the entire US commercial banking sector. In other countries such a rapid increase has been the prelude to a financial crisis.

Earlier this month, the global financial speculator George Soros issued a warning about the state of the Chinese financial system. "There are some eerie resemblances with the financial conditions that prevailed in the years preceding the crash of 2008," he wrote. There was, however, a difference. In China, the government owned the banks. The outcome of the problems in the financial sector would have "profound consequences for China and the world."

The contradiction facing the government is that it is committed to "reform" the financial sector, and reduce debt, while at the same time it is pledged to sustain economic growth, above 7 percent. The two goals are incompatible. Since the financial meltdown of 2008, the driver of Chinese economic growth has tended to be debt-financed investment and construction, rather than an increase in exports.

Previous efforts by the central bank to rein in debt by lifting interest rates, such as occurred last June, have raised the spectre of deepening financial turbulence, causing financial authorities to increase the credit flow.

The government lives in fear that a rapid fall in growth will provoke a reaction in the working class, threatening the stability of the regime itself. Having long ago abandoned any claim to represent "socialism" or "equality," the ruling apparatus fears that it will only retain any semblance of "legitimacy" if it keeps economic growth above the 7 percent level considered necessary to expand jobs and maintain social stability.

However, economic analysts are pointing out that history suggests this will not be possible.

Frederic Neumann, the co-head of Asian economic research at HSBC, told the *Financial Times*: "We've seen this movie before—in South Korea, Taiwan, Hong Kong, Japan. We're just seeing a bigger and more colourful version in China. Japan in the 1960s grew at 10 percent and was considered the miracle economy at the time."

To believe that China was immune to the same forces that impacted on other economies was to put "misplaced faith in Chinese exceptionalism," he said.

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Michael Pettis, professor of international finance at Peking University, who has consistently maintained that the debt-fuelled growth model is not sustainable, says expectations of a growth rate of 7 percent and more are too optimistic.

Pettis claims that if the "reform" process starts to work, and the authorities do reduce debt levels, the Chinese growth rate could fall to as low as 3 or 4 percent. Debt levels, he insists, cannot continue to grow at two or three times the rate of growth in the economy.

According to Steven Barnett, an economist covering China at the International Monetary Fund: "Borrow and spend, or in China's case, borrow and invest, works great to prop up growth for a while but eventually debt rises, investment becomes less productive and the risks rise.

"The economy is becoming more vulnerable on several fronts: surging credit, strains on local government finances and weakening balance sheets in parts of the corporate sector."

Any significant slowdown in the Chinese economy will have a major impact, not only in countries, such as Australia and Brazil, for which it is major export market, but the economies of the south-eastern Asian region, which have become increasingly dependent on China.

There are major implications for the world economy as a whole. Over the past five years, it is estimated that around three quarters of world economic growth has been provided by China and other "emerging markets."

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