China’s economic travails

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Even as President Xi Jinping strengthens his political grip by way of further asserting the monopoly control of the Communist Party of China (CPC), the country’s economy is refusing to exactly follow political dictates. The middle of last year saw turbulence in China’s stock market raising questions about the health of the economy. The arbitrary measures taken to dampen down such turbulence by directing institutional (state owned/controlled) investors to buy or not to buy stocks might have worked for a while but they failed to address the real problem, which is that Chinese stocks are overvalued with inbuilt bubbles waiting to burst as soon as there is an opportunity. And opportunity arrived early in January when the economic data about weakness in the manufacturing sector was revealed. At about the same time, Chinese authorities depreciated their currency to give them an advantage in the export sector. Whether or not that will translate into more exports is an open question because this can lead to the competitive devaluation of competing economies. However, this tends to frighten investors leading to the flight of capital from China. Subsequently, though, the Chinese authorities sought to support the currency by buying it. All in all, this tends to raise doubts about the health of the Chinese economy, which has not been performing as well as in the past when averaging a growth rate of over 10 percent. At present, its growth rate is around seven percent and there are fears that it might continue to fall. China’s economy is still growing well by comparative standards but there are serious problems and bottlenecks that, unless resolved, could create social and economic issues at home.

After the 2008 global recession, China’s economy continued to perform well with an expansive economic stimulus programme. This was not only good for China at the time but was also good for the world, particularly resource rich countries like Australia, Canada, Brazil and South Africa. Under its stimulus programme, money poured into infrastructure projects, real estate, steel plants, high speed railways and so on. At the same time, the feel good effect of all this investment activity and construction pushed up the value of Chinese stocks, with the government even encouraging small mom and dad investors to invest in the market. Though many people felt rich and invested not only their savings but also borrowed money to play the market, the hype about the stock market was too good to be true.

And, in the middle of last year, the market tumbled with the authorities trying to create stability through diktat forcing large institutional investors to buy more stocks to create a semblance of normalcy. At the same time, the authorities tended to suspend trading when there was too much downward pressure. And when the stock market turbulence kicked in again this month the authorities tried the same old method of imposing order but it did not seem to work. It was clear that what worked in the political domain, which is ruling by diktat, was not working in dealing with market fluctuations.

And there are good reasons for it. First, there is a large overhang of debt that funded the stimulus programme at local, regional and federal levels. All levels of governance vied with each other to spend borrowed money to grow the economy, as it was the guiding principle of all agencies. There was an unstated compact between the party/government that as long as economy was growing with people benefitting from it, people did not care much about the exercise of monopoly power by the CPC. In the process, corruption became rampant with, among other things, the arbitrary acquisition of land as long as it led to the building of more apartments. This led to a glut in the real estate market with rows of expensive unoccupied apartments. In the same way, over capacity built up in the manufacturing sector, like the steel industry, with inadequate demand for construction material.

The upshot of it all was that much of the new infrastructure, real estate construction and the like, did not generate enough income to pay off the debts that kept piling up. At the same time, with very little real information available to the public about the state of the economy, especially the mountain of debt, the stock market continued to operate as if there was no tomorrow to settle the accounts. And that tomorrow appears to be happening sooner than expected. The overhang of debt has to be sorted out and it can no longer be wished away.

This economic necessity of fixing the economy and, at the same time, ensuring a healthy rate of growth to maintain the social compact with the people, has created a complex situation. China is at a transition period when exports that had been the vehicle of its rapid economic growth have slowed down, and to maintain a healthy growth rate of the past or close to it will need a growing internal market based on domestic consumer demand and growth in services' sectors. Both have still to catch up and would need a radical reorientation of the Chinese economy. And with the overhang of the debt and people used to saving (and not spending as much), this is going to be a difficult task, particularly as markets do not respond well to political dictates.

As for the debt overhang, much of it is internal debt and hence not subject as much to external compulsions as foreign debt would be. But it would need to be sorted out sooner, rather than later. Otherwise, as has happened in Japan, burdened with heavy internal debt, the country has been in a deflationary spiral for more than 20 years after its stock market crashed. If that were to happen to China, this might rupture the social compact between the CPC and the Chinese people ensuring them a constant improvement of their economic life while they tolerate the monopoly rule of the ruling communist regime.

A slowing Chinese economy is not only bad for China; it has been causing serious economic ripples in global markets. For instance, international resources and commodity markets have nosedived, as demand from China has shrunk to levels not seen for a long time. And, as things stand, there is not much prospect for any improvement as the global oversupply from investments in these sectors, planned/undertaken when demand for these commodities/resources was high, keeps piling up.

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