World Starts To Worry As Chinese Economy Hiccups

by SCOTT NEUMAN

Enlarge Andy Wong/AP

Chinese women walk past a billboard showing a box full of gold coins and jewelry, outside a shopping mall in Beijing on Thursday. Chinese leaders are scrambling to shore up flagging economic growth as exports weaken, abruptly reversing course after they spent two years struggling to cool an overheated expansion and surging inflation.

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Not long ago, economists and others expressed concerns that China's economy was expanding too quickly. Now, the latest data are raising concerns about a slowdown — and the woes it could trigger.

With a sluggish U.S. economy and troubles in the eurozone, Chinese exports are taking a hit, causing a slowdown on shop floors in Shanghai and Shenzhen. Earlier this week, the Chinese Purchasing Managers' Index, or PMI, fell to its lowest level in nearly three years.

At the same time, it looks like China's commercial real estate bubble may be bursting, with property values in some cities already declining.

China's officials are concerned. Vice Finance Minister Zhu Guangyao earlier this week called the current crisis in Europe "more serious and challenging" than the one triggered by the collapse of Lehman Brothers in 2008. With an eye toward propping up Chinese export markets, he called on global policymakers to stimulate demand.

Global Impact

It's not just a problem for China. In an interconnected global economy, what's bad for China is likely to be bad for everyone else.

In recent years, China has emerged as the biggest player in commodities. It consumes half of the world's cement, iron ore and coal and a significant share of a long list of other raw materials. As a result, commodities producers such as Australia, Brazil and Canada as well as the oil-exporting nations of Africa are likely to feel the biggest and most immediate pinch, says Alistair Thornton, a Beijing-based China analyst for IHS Global Insight.

"Although China doesn't buy much directly from the EU or the U.S., the indirect impact for a slowing China is fairly significant," Thornton said. "Australia, for example, buys quite a lot from the EU and U.S. So, there's a significant indirect link."

There's also likely to be an effect for countries such as Vietnam and Thailand, said Eswar Prasad, who studies international trade and economics at the Brookings Institution.

"It could also affect a lot of Asian economies that are supplying goods to China partly for final demand and partly for onward export to Europe and the United States," he said. A slowdown in China "hurts the commodities exporters and it hurts those who are providing inputs to China for eventual export to the West."

China is Australia's No. 1 trading partner, and that dependence has caused considerable hand-wringing among politicians in Canberra. In the past year, China has also supplanted the U.S. as Thailand's largest market, including for such exports as computers and electronic parts, rubber and chemicals.

Household Income

But a cooling off in Chinese exports is just part of the problem.

Prasad explains that Chinese officials acted starting in the last half of 2010 to tamp down inflation by putting the brakes on lending and bringing the property market under control.

"Instead, what seems to be happening is that because of tighter credit conditions as well as weak external demand, we have seen a slowdown in manufacturing, which is not ideal from their point of view," he said.

Policymakers in Beijing sought to reverse course this week, announcing Wednesday that they would lower the amount that banks needed to keep in reserve, thus freeing up cash for new loans.

Meanwhile, China, Prasad said, has been trying to boost domestic household demand — partly as a hedge against cooling export demand and partly as a way to get the country's growing wealth to trickle down.

"Those who own the capital are the ones who are doing better. So, this is also feeding into more income inequality," he said.

The share of nongovernment gross domestic product in China has been declining year after year, and now it stands at about 35 to 40 percent — far lower than that of the United States and most other advanced countries, and even lower than that of a number of less advanced economies, Prasad said.

Boosting that household consumption is proving an uphill battle, said Todd Lee, managing director for the Greater China Division at IHS.

"This issue of stimulating demand isn't a short-term thing, because there are structural issues," Lee said. "They can't turn on a dime, so that's a challenge for them."

Not-So-Good Loans

But Lee and others think China still has plenty of room to increase government investment and that if the government doesn't overreact, it can still steer the economy to a soft landing.

"It depends on what happens," Lee said. "If it's more of a controlled downturn, meaning it's not a hard landing, and the domestic situation doesn't get out of control, it won't be so bad," he said.

"The government still controls the major banks, so even if the banks get in trouble, it's relatively easy for authorities to flush those institutions with a lot of cash to control the situation," Lee said.

"But the downside is that lending practices are not always market-based, so the source for producing a lot of not-so-good loans is always there."