

China's rapidly growing economy and its pending implosion



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China's rapidly growing economy and its pending implosion Granted the most recent and extreme circumstances of the United States Financial System, there has only been one International player that has received a comparable level of news coverage. Out of what investors refer to as the BRIC countries: Brazil, Russia, India and China; China and its rapidly growing economy has gained full attention by investors, and most importantly US and international federal policy makers. In the following paragraphs I will critique and discuss China's economic progress and how it has the potential to send a ripple effect throughout the world should it drastically slow down or collapse completely.

Taking a broad view at China's booming economy, things have been going really well for this communist state. Even dating back to 1978, the "evolutionary, experimental, and incremental nature of China's reforms" (Sachs 1) have become proven successes that have lead to its stellar economic performance in the past 30 years. More specifically in agriculture their land is not owned by the farmers, the rural communities that own township and village enterprises and state owned enterprises have resulted in a natural competition rather than a push towards privatization. China's development post 1978 has been partly due to Deng Xiapoing in which he took over control from Mao Zedong who established an autocratic socialist system that imposed strict guidelines over everyday life and the expense of over ten million people's lives.

During the last quarter century China's economy has changed from a centrally planned system to a market-oriented one with a rapidly growing private sector. Speaking of reforms, China has sold minority shares in four of <https://assignbuster.com/chinas-rapidly-growing-economy-and-its-pending-implosion/>

their largest state banks to foreign investors and made refinements in foreign exchange and bond markets in 2005. These reforms coupled with large foreign investment have helped China develop into the world's third largest country rivaling with Germany behind the United States and Japan. Now let's get to the numbers. Logan Wright, a China-based economic analyst for Stone & McCarthy Research Associates says " Foreign direct investment in China has surged in the first three months of 2008, totaling \$27. 41 billion, up by 61.

3% year-on-year. Paradoxically, however, the NBS's fixed asset investment data shows a 6. 5% year-on-year decline in the use of foreign-sourced capital as funding got fixed asset investment. " (Pettis, 1) A conclusion can be drawn from this analysis that not only is there a delay that a diverging trend is suggesting speculative capital inflows assuming the appreciation of the Yuan.

Ultimately this demands the central bank's close attention and will inevitably lead them to reduce interest rates. A journalist at South China Morning Post by the name of Shirley Yam has been investigating the widely repeated claim among China's mainland firms that their profits and profit margins have dropped due to increases in raw material and higher fuel costs. What she found among 10 major state owned enterprises was all of the companies " have seen distribution expenses, administrative costs and staff expenses shoot up much faster than revenues - two to eight times as fast. Rather than enjoy economies of scale they seem to be suffering massive diseconomies of scale" (Pettis 1).

This is a concern to most investors in China because in case of an economic slowdown and a decline in revenues it can take management a long time to get rising costs under control. The cash flow, profitability and creditworthiness of companies riding the boom can all be called into question. Some economists ask the question whether China's economy can withstand a U. S. slowdown and there is evidence that suggests this is possible excluding a rapid change in Europe and Asia's markets. A Businessweek article quotes Stephen Roach, Asia Chairman at investment bank Morgan Stanley " with property market showing signs of weakness, American could no longer prolong their seven-year consumption binge by borrowing against the value of their homes.

If the US consumer goes down, Asia will feel it" (Can China 1) One example of a Chinese firm leaning on the US economy is " Samson, which is based in the southern Chinese city of Dongguan, has become one of Asia's most successful residential furniture manufacturers over the last 20 years. It has carved out a strong niche for itself in the US and relies on this market for 95% of its revenue. " (Can China 1) As large as the United States Economy is, junior economies like China's that would certainly be impacted by a U. S. slowdown can stand to collapse with any potential further disruption in the economy.

In fact the derivatives which are essentially worthless pieces of paper that there is no market for will soon to be reported by US firms as they try to prevent future write downs.. We're certainly in uncertain times. There has been increased credit tightening due to the subprime mortgage crisis in the United States and banks have been writing off billions in bonds backed by <https://assignbuster.com/chinas-rapidly-growing-economy-and-its-pending-implosion/>

mortgage securities after mortgage holders defaulted on their mortgage payments in response to higher interest rates - is more of a concern. It's unclear about the US moving towards a recession, but a US Slowdown is quite likely.

According to Dr. Nicolas Lardy, a senior fellow at the Peterson Institute for International Economics (PIIE) in Washington " The total amount of credit outstanding in bank loans and commercial paper has fallen 10% since the subprime problems started - and almost unprecedented decline for such a short period of time". He goes on to add " I would say that a US slowdown is quite likely but whether or not there is a recession is less certain. " (Can China 1) Some problems that exist within China is its rapid growth and federal policy that needs to take action by raising interest rates to absorb some of that cash that's available.

There have been concerns that China's Economy numbers are inflated and a new Asian Development Bank released an article about it. The article basically states that China's GDP on purchasing power parity basis is 40% smaller than previously thought. According to Businessweek " PPP is an attempt to look at the volume of identical goods and services people can buy for the same amount of money across several economies - essentially a study of purchasing power. " (New Report 1) The article goes on to state that " the first problem is establishing what the ' same amount of money' is for all countries being compared. The usual conversion from one currency to another doesn't work, since exchange rates are buffeted by numerous political and international trade issues. The renminbi, for example, is kept

from appreciating against its trading partners through central bank interventions.

Its international value therefore does not reflect its domestic value. " (New Report 1) Economists try and set the exchange rate on domestic prices, so if a can of soda is one dollar in the US, and 3 renminbi in China, that is the exchange rate \$1 to Rmmb3, not the official exchange rate of 8. . After looking at hundreds of prices they aggregate them and come up with a total figure of GDP. This translates into a final GDP which is much larger than in nominal terms, since the exchange rate derived only from domestic prices is much stronger.

Businessweek goes on to say " In nominal terms, the ADB puts China's GDP at \$2. 2 trillion. Because this figure is much easier to calculate, it is no significantly different to other estimates. Chain's national bureau of statistics put nominal GDP at \$2.

7 trillion for 2006. Observers point out that the new findings make poverty in China a more pressing issue than previously realized. China has reaped a huge amount of kudos from the supposed decrease in the number of people living in poverty. But if the purchasing power of the renminbi is 40% less than previously thought, then the number of people living in poverty rockets. " (New Report 2) This makes a lot of sense, since " Many Chinese are cynical about the benefits of rocketing GDP growth, which is bypassing the majority of the population living in the countryside. One joke refers to the letters GDP being a Chinese homonym for ' the arse of a chicken'.

The latest figures are bound to increase the disillusion which many rural residents feel about the country's manufacturing-biased and city-centric growth. " (New Report 2). If the Chinese feel that outsiders' valuation of their currency and spending is incorrect, what will happen to all the large corporations investing in China all the way down to the individual investors fueling its growth when bad news breaks out. What happens if the China Olympics get boycotted due to Human Rights violations as most are already protesting against the Olympic Torches travels around the world.

Investment dollars that are fueling China's economy can be halted and reversed especially when the domestic US economy picks up speed with a Democratic president. Plus investment dollars will soon turn from heavy foreign to a U. S. within the next two years as we focus on rebuilding our own infrastructure.

Some project what China will look like in the next 20 years. An article written in Businessweek reports that " Researchers at the Institute of Quantitative & Technical Economics of the Chinese Academy of Social Sciences, which is the official government think tank housing more than 3, 000 scholars and researchers, have shared some of their insights with us. The institute's English-speaking director, Professor Wang Tongshan, says the forecasts assume a significant slowing of China's growth, but he warns that similar estimates proved wildly wrong in the past. (What Will 1) Here are some of China's own forecasts for China in 2030 to 2035. " The institute sees [population] slowing in the number of Chinese, from approximately 1.

31 billion in 2005 to 1. 47 billion in 2030 and 1. 49 billion in 2035. China's GDP (nominal) is expected to be about \$2. 8 trillion in 2007, is forecast to grow to about \$5.

9 trillion in 2030 and \$6. 7 trillion in 2035. (In comparison, U. S. GDO in 2007 is about \$14 trillion.) By 2030-2035, the economic growth rate is forecast to decrease to about 2% to 5% per year.

Western economists, almost unanimously, forecast a much higher GDP for China. The Chinese researchers are quite aware of foreigners' forecasts, but still stick to their own numbers, which they freely admit are conservative. China's projected GDP per capita shows an even starker gap with the U. S. : \$1, 867 in 2005, increasing to about \$4, 000 in 2030 and \$4, 500 in 2035.

In 2006, the U. S. GDP per capita was about \$44, 000. (A GDP per capita analysis by purchasing power parity would, of course, find a smaller gap). The Service Economy in China's huge trade surplus is driven by its excessively high dependence on export manufacturing. Only when China's service industry increases its percentage of GDP, reflecting a more consumer-oriented economy, will trade imbalances ease.

But while the researchers forecast that service industries will grow from 40% of the economy in 2005 to 48%-49% in 2030-2035, Professor Wang himself thinks service industries will make up 55%-60% in the target years. On Income Inequality, in the 1950s through 1970s, everyone in China was equally poor. Since the beginning of reform, China has followed Deng Xiaoping's dictum, ' Let some people get rich first,' all too well, and the country's Gini co-efficient (an economist's measure of income inequality) has <https://assignbuster.com/chinas-rapidly-growing-economy-and-its-pending-implosion/>

been rising steadily and, to some, alarmingly (from below 0.3 four decades ago to 0.46 today; some say it is nearly 0.

5). Researchers state that income inequality will moderate steadily over the next 30 years. But the institute director, disagreeing with his own team, is not so optimistic. According to Professor Wang with respect to "Energy Efficiency [he] expects progress—energy efficiency is a prime national directive—but expresses doubt about the optimistic projections of his researchers. The researchers respond: 'A fourfold increase [in efficiency] is possible because the majority of China's companies are small with very low energy utilization. With the advancement of technology and the changing mindset of basic consumption, it is possible to enhance the efficiency by a large margin.

" (What Will 2) With regards to Imported Oil, "About 150 million to 160 million tons are imported annually now, forecast to rise to about 350 million tons annually by 2035. Why only this modest increase, considering China's voracious energy appetite? Higher efficiency in energy use, the researchers state, and increasing use of alternative energy." (What Will 2) Speaking about China's economy and efforts put forth to cool its raging economy, Businessweek has a story titled "China Tries to Turn Down the Heat" and it discusses interest rate and reserve rate hikes that are designed to do just that. In the article it says "Ordinary Chinese have yanked some \$9 billion in bank savings this year to join the merriment at the Shanghai Stock Exchange, where the composite index has shot up about 50% so far, following a 130% gain in 2006. The smaller Shenzhen bourse is up roughly 100%." (China Tries 1) What this means is that "It's party time on the <https://assignbuster.com/chinas-rapidly-growing-economy-and-its-pending-implosion/>

mainland as money supply and loan growth rollick along at double-digit rates.

Meanwhile, the country's export sector is smoking, and China is likely to make economic history for a developing economy when it reports a current account surplus this year approaching \$400 billion, a mind-blowing number. China's gross domestic product also blew by market estimates and grew at an 11.1% annual rate during the first quarter. (China Tries 1) With such a rapid rise typically comes a bubble in most markets. The tech boom, Sub-prime mortgages, and now we're looking at China. China has even gone as far to extend a fourth round of credit tightening from the central bank since the late spring of 2006.

The Chinese government has also raised the reserve requirements of cash that mainland lenders must park with the central bank. In Businessweek " Beijing officialdom is genuinely anxious about the social blowback from a stock market meltdown (there are 70 million traders in China) or worse, a boom-then-bust economic scenario. Premier Wen Jiabao and PBOC Governor Zhou Xiaochuan have both expressed public concern about a potential equity market bubble in recent days. " (China Tries 2) Social unrest in China remains as Protests have broken out in the Tibet region. The government has responded with stern response but there hasn't been an event like Tiananmen Square just yet. Inflation pressures reached an 11 year high of 8.7% year on year in February. According to the Economist. com " The increase was mostly the result of higher food prices (in particular pork), which was aggravated by bad weather in February. " (Country Briefing 1)

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These are both issues that can escalate further and cause instability and unrest in a country.

According to our textbook " China may have a huge population, but despite two decades of rapid growth, it is still a poor country where the average income is little more than \$1, 100 per year. (Hill 242) The CIA's World Factbook " China's government faces several economic development challenges: (a) to sustain adequate job growth for tens of millions of workers laid off from state-owned enterprises, migrants, and new entrants to the work force; (b) to reduce corruption and other economic crimes; and (c) to contain environmental damage and social strife related to the economy's rapid transformation" (CIA 7) These challenges have not yet been adequately addressed and with \$75 billion dollars worth of foreign investment over 2007 from upwards of 172 countries, it's likely any of the above might install fear in investors should they become a hindrance on China's short term growth where investors look to take profits. All things considered, China is becoming a major player with respect to its thriving economy. But due to its instability from a political and social aspect these factors can greatly outweigh the economical. A snowballing effect could happen here if things got out of hand.

Foreign direct investment can start to slowdown through vast media coverage about China's corrupt political system. Human rights violations, lead based toys can halt exports, and the toxic chemicals entering their rivers from large corporations that turn a blind eye can all cause disruption to China's overall economic health. Overall, if things continue in China and foreign governments gain influence over those of the Chinese, perhaps their <https://assignbuster.com/chinas-rapidly-growing-economy-and-its-pending-implosion/>

investments will be protected. But I can think of 3 other countries Russia, India and Brazil who are alternatives for FDI. There's less risk associated with these countries and one could be the next hot trend. There's an abundance of natural resources in Russia including oil, natural gas, aluminum, titanium, and timber.

With such scarcity among the ever growing needs of countries like the U. S. we may be forced to interact politically and invest in the country that can help us the most in these uncertain times. It's a major paradigm shift of power from the United States to foreign countries and if China is so closely reliant on our economy, then you'll see further struggle and economic slowdown. Works Cited Hill, Charles W.

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