China's Paper Inflation Stimulus To End Badly

Problem loans at China's banks are significantly worse than initially thought, according to Moody's Investors Service's news release on July 4th. This raises concerns already expressed about China's continued ability to grow its economy at annual rates approaching double-digits. The weakness is so pervasive that Moody's "views the credit outlook for the Chinese banking system as potentially turning to negative. " It added: We assume that the majority of loans [by the banks] to local governments are of good quality, but based on our assessment of the loan classifications and risk characteristics, as provided by the NAO [China's National Audit Office] and other Chinese agencies, we conclude that the banks' exposure to local government borrowers is greater than we anticipated…

> Since these loans to local governments are not covered by the NAO report, this means they are not considered…as real claims on local governments. This indicates that these loans are most likely poorly documented and may pose the greatest risk of delinquency.

In reviewing the numbers provided by the Chinese agencies, Moody's never questioned the validity of those numbers, but did discover that about $500 billion worth of loans were simply "unaccounted for", further raising the specter of substantial defaults in the near future.

When the Chinese government decided to build cities for its massive urbanization plans to move 350 million people from rural areas, it set up 10,000 investment companies to build the necessary infrastructure, such as subways, electric power plants and telecommunications grids. Those investment companies turned to the banks for loans, a significant number of which now appear to Moody's to be substantially at risk.

20 new cities are being built every year and best estimates are that there are now 64 million homes that are empty and waiting to be occupied. Remarkable satellite images available here show cities such as Zhengzhou New District, China's biggest ghost city, with entire blocks of residences completely empty of inhabitants.

Moody's is just the latest to express warnings about the impending implosion of the Chinese economy. David Barboza, writing in *The New York Times*, noted that several economists in China "have recently lowered their growth forecasts for this year and next year…while warning about the possibility of a sharp rise in nonperforming loans at the nation's big state-owned banks. "

Credit Suisse said that credit in China has expanded "at alarming levels", and consequently downgraded its profit forecasts for Chinese companies and state-owned banks. Credit Suisse also discovered huge amounts of "off-balance-sheet lending" which has exacerbated the explosion of credit in the economy. And the chief economist for China at UBS, Wang Tao, warned that nonperforming loans could reach $460 billion “over the next few years. ” Standard and Poor’s just lowered its outlook on Chinese property developers as well, predicting that property sales could drop significantly as banks tighten credit and raise interest rates.

Even the head of China’s national audit office, Liu Jiayi, admits the potential for bad loans to impact the economy negatively: “The management of some local government financing platforms is irregular, and their profitability and ability to pay their debts is quite weak. ”

This isn’t surprising as so many of the projects such as new roads, bridges, tunnels, subways and “showpiece projects” have little or no traffic to generate any revenues. And that is the fundamental problem: China is still a command economy, with statist economists attempting to make decisions for more than 1.3 billion people. Forcing millions from their homes — “urbanizing” is the politically correct expression being used — into cities is an expression of the excessive hubris of the ruling elites in China. Anthony Wile, writing in *The Daily Bell*, noted that there is:

> Nothing wrong in building cities, of course. People tend to clump in cities because it makes providing and finding goods and services easier. Cities are a marketplace phenomenon. Most cities seem to have begun for purposes of trading. But what China’s old Marxist leaders are doing is something that goes well beyond reconfiguring already established cities.

One is reminded of the cataclysmic disaster that China imposed on its people under Mao Zedong: the “Great Leap Forward. ” In the four-year period from 1958 to 1962, the Chinese government attempted to transform the country from an agrarian economy suddenly, by force, into a highly industrialized one. The effort failed miserably at the cost of millions of lives. As historian Frank Dikotter, author of Mao’s Great Famine, said, “Coercion, terror, and systematic violence were the very foundation of the Great Leap Forward” and it “motivated one of the most deadly mass killings in human history. ”

Although it is hoped that the “urbanization” of 350 million people from country to city will be much more benign than China’s previous attempt in its Great Leap Forward, it still reflects the commitment to economic and political statism that plagues countries around the globe, including the United States. China’s leaders have bought into the philosophy that they know best, rather than leaving the myriad intimate daily decisions to each individual as he or she sees fit. China’s economic bubble is bursting for the same reason that it did in the United States: paper money being printed to “stimulate” the economy and to achieve economic and political goals. Sound money and individual freedom of choice are the only engines that can create the wealth and improving standards of living that citizens seek. Government’s proper role, as ever, is to stay out of the way and let it happen.

Photo: Bank of China Headquarters, Beijing, China.