Written by Bruce Walker on July 10, 2012

Chinese Economy Continues to Weaken

If Americans are looking at the Chinese economy to lift the United States out of recession, it would be prudent to look somewhere else. The second quarter GDP statistics for China are expected to reveal a relatively slow growth rate of 7.5 percent, weaker than growth in the same quarter of last year. If so, those numbers would mean that China's economy is growing at the slowest rate in four years. The news pulled down stock prices around the world.

The actual situation in the massive Asian country is undoubtedly not that rosy. Communist Chinese government data is widely known to understate economic problems, which is consistent with how communist regimes typically handle economic statistics and related data. This problem is compounded by the fact that local government officials tend to pad their economic reports to make conditions seem better than they are. A key to promotion for these officials is reaching government goals; therefore, the incentive to come up with the best possible figures is strong. Other economic data, which are harder to conceal, suggest that is exactly what is happening.

Record amounts of iron ore and coal remain at depots, indicating that construction and electric power production are weak sectors of the economy. Large construction equipment, such as excavators, are sitting idle or are being sold very cheaply; furthermore, the diesel fuel required to power these machines has been flat for six months. Shipyards have laid off dockworkers and half-built freighters have been left with their hulls rusting.

Zhu He, a real estate sales manager in Beijing, reports that the owners of an 800-unit apartment complex in central Beijing have pulled dozens of apartments off the market. The property values in some real estate markets of the country have declined by half. Zhu notes: "Real estate is too important to the Chinese economy." The value of homes in China has also dropped and builders have large numbers of unsold homes on the market. Part of the reason for the sharp drop in real estate prices is that the Chinese government in 2010 mandated restrictions on sales which were intended to reduce the big profits of speculators.

American companies such as Kentucky Fried Chicken, McDonald's, Nike, and Pizza Hut, which have set up operations in China targeting the average consumer, are taking a hit on their earnings because of weak sales. New McDonald's CEO Don Thompson noted that his company was facing contracting markets there, and was "seeing challenging economic conditions, with slow growth in China."

Alan Wang, the managing director of Charmy Shoes in Shenzhen, reported that sales have declined by one third from last year and in addition some of his customers, notably from Spain and France, have been taking a long time to pay for the shoes they ordered. As a consequence, at least one of his local suppliers has closed and another is on the verge of bankruptcy. "This year is really bad compared with last year," he observed. "I think China needs another big stimulus. Factories are closing down because they can't get paid."

The weak Chinese economy has had an impact upon Europe, where several nations face virtual bankruptcy because of the dramatic reduction in the credit rating of their sovereign debt instruments. Countries in other parts of the world have been hurt by the slowdown as well. Chinese demand for Brazilian oil and iron has dropped. Neighboring Macao and Hong Kong, both of which are dependent upon demand from China for their goods and services, are also facing a serious crisis. Macquarie Group senior analyst Gary Pinge comments: “Growth expectations in Macao are going to undergo an uncomfortable adjustment phase.” Trade data released on July 10 showed that Chinese imports had grown at half the rate of the previous month and that export growth had also declined. Oil imports plunged by 35.4 percent, while the drop in steel imports was 8.3 percent, and copper imports 11.9 percent.

On Sunday Chinese Prime Minister Wen Jiabao spoke of “huge downward pressure” on the economy, which was widely viewed as an admission that the government is concerned about the slowdown. China’s central bank cut lending rates last week, a move which surprised analysts and which also reaffirmed the perception that the massive economy was faltering.

The month before, China’s trade minister warned that the country might not meet its targets for the year, admitting that the global trade environment was “grim.” Shanghai economist Andy Xie says that the economic problems are affecting the revenues of government: “Local governments are in dire shape. Some can’t make payroll. They want to sell more land but they can’t.” The collapse of the real estate market in China has also hit local governments particularly hard, which have raised revenue by the sale or lease of land.

Barclays economist Yiping Huang stated,

> Recent economic data, including steel production and corporate profits, have continued to weaken visibly. There is a renewed perception that the real economy is much weaker than is suggested by official statistics.

New York University professor Nouriel Roubini warned Bloomberg that the weakening of the Chinese economy could have dire consequences for the global economy:

> The landing of China is becoming harder rather than softer. It’s the perfect storm. You could have a collapse of the Eurozone, a U.S. double dip, hard landing of China, hard landing of emerging markets and a war in the Middle East. Next year could be a global perfect storm.

Christine Short, senior manager at Standard & Poor’s Global Markets Intelligence, sees the same compounding of bad news: “China is still slowing. Manufacturing numbers in the United States are weak. You can only have so many things working against you.”

Almost everywhere, the economic news is grim, and all the indicators suggest that nothing is going to get better anytime soon.

Despite the weaknesses in the Chinese economy, however, the Asian behemoth continues to hold more than one trillion dollars of U.S. government debt.

Photo: An investor gestures as she looks at the stock price monitor at a private securities company, June 18, 2012 in Shanghai, China: AP Images