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Impact of China's slowdown on world economic growth

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China is in the news again.

For the sixth time in a year, its central bank, the People's Bank of China cut its one year benchmark interest rate by 0.25 percentage points to 4.35%, for encouraging greater bank credit. One-year benchmark deposit rate was lowered by 25 basis points to 1.50%, enabling banks to have more reserves for lending.

The reserve requirement ratio (RRR) was also cut by 50 basis points for all banks: 17.5% for the biggest lenders. Further, banks lending to agricultural firms and small companies received a 50-basis-point reduction in their RRR.

These monetary policy actions were a surprise as the official news released earlier indicated a more encouraging, moderate weakening. Is there anything seriously wrong?

Enviable or credible growth rate?

Economic growth rate was at a stunning 10% per year for the past three decades. The economy started to decline during last few years and the growth rate fell to 7.4% in 2014. By any standards, the growth rate above 5% is an enviable one.

However, there has always been a credibility problem surrounding China's statistics. The central bank action only adds to lingering worries about the economy. The sixth rate cut in the year has created fears whether China is heading for an abrupt weakening rather than for an officially declared moderate weakening.

The *Economis*t of London has developed an unofficial "Keqiang index", based on Prime Minister Premier Li Keqiang's way of assessing economic health based on some key indicators. These indicators include electricity consumption and rail freight volumes, besides export volumes. *The Guardian* of UK reports that based on similar indicators, the London-based consultancy Fathom has estimated China is growing only at 3.1% a year, and not at 7%.

Anyway, the undeniable fact remains. The debt level of Chinese companies is around 150% percent of country's GDP. Central banks know from past experiences one of the ways to reduce possibilities of a financial disaster is to cut interest rates. That would put a stop to the rise of bad loans. That will enable rolling over the loans cheaper.

As it happens with all interest rate cuts, it is the savers who will be discouraged by a fall in real interest rate. If the reported interest rate on one year-term deposit is 1.5% and inflation is 1.6%, the savers are clearly the losers.

The negative real interest rates act as a disincentive to savings.

Impact on the rest of the world

In these circumstances, China will experience more capital outflows. Holders of the renminbi have been shifting their funds from China, seeking higher returns in the last two months. It is estimated US$138 billion has been transferred out of China fearing further decreases in the value of the currency.

Hot money flows to Fiji are ruled out: Fiji does not offer any attractive financial assets. The only assets Chinese would immediately seek are urban built up properties and lands in rural areas and coastal parts. If they increase in prices, they offer excellent opportunities for capital gains.

Major capital outflows are more likely to industrialized countries including Australia and New Zealand. If they materialize, the currencies of industrialized countries will appreciate. With export earnings already affected by China's weak economic outlook, further depreciation of Aussie and New Zealand dollars would be halted.

Central banks are aware of the risks in depending much on hot moneys. They are the most fickle of all capital flows, as the flows are quickly reversible.

Until the rebalancing efforts not only in China but also in mineral exporting countries are taken up in all seriousness, things will not improve.

OECD forecast

The European think tank, the Organization for Economic Cooperation and Development (OECD) says a two-percentage-point decrease in the growth of Chinese domestic demand for two years would reduce world GDP by 0.3 percentage points a year and countries with stronger links to China, including Australia and New Zealand would be adversely affected.

In their Press Release on October 28 at the end of their two week consultation, the IMF Mission to Fiji reminds the decision makers: "Fiji is subject to potential risks from lower growth in trading partners, particularly Australia and New Zealand".

Presently, Australian tourists find Fiji a cheaper tourist destination, as their currency depreciated much less against Fiji dollar than the US dollar. Fiji's foreign exchange earnings are limited by a

narrow range of commodity exports. So the major component, the tourism earnings depend on domestic policies.

Any slip from fiscal discipline and failure to control non-essential expenditures would make Fiji's real exchange rate appreciate and adversely affect tourism earnings.

The 2016 budget presentation is around the corner.

The IMF advice on "recalibration of monetary conditions and fiscal consolidation in the medium term" is timely.

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