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Impact of Continuing China crisis

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The stock market debacle in China last week which shocked world, was followed this week by another string of gloomy GDP growth figures from China.

They certainly affected the rest of the world's stock markets, business confidence and future prospects. Share prices fell to their lowest levels in UK, France, and Japan since 2009. The fall was more than 20% from their 2009 highs. In New York, the Dow Jones index also fell.

The last week fall in stock prices was due to the growing Chinese fears of another round of devaluation of their currency following the August 2015 devaluation. Already ever since then, there has been a steady capital outflow.

That resulted in steady, offshore depreciation of its currency. Domestic downward adjustments of onshore value of renminbi gave rise to suspicions about another impending devaluation of the currency to domestic users.

That crashed domestic confidence and led to the heavy sell-off.

Only less than 2% of Chinese stocks are held by foreigners. So, Chinese stock market gyrations do not materially affect the rest of the world. Only the Chinese holders of stocks are affected. But what is happening inside China in the modern, globalized world gets transmitted too fast.

It is the crash of domestic business confidence and weak investment and consumption climate that affects the growth prospects of those economies, which are highly dependent on China's appetite for raw materials, especially minerals.

Not so good news again this week

The latest news is that China recorded the slowest growth in the latest quarter since 2009. It grew by 6.9% as against 7.3% in 2014. China has been an engine of growth during the last seven years, ever since the world entered the period of recession. China saved the world from the recession by lending a helping hand to major economies, which are heavily dependent on mineral exports. It remained only a Great Recession. Otherwise it would have become another Great Depression.

New fears

Fears may be true or unfounded.

Are the Chinese statistics really reliable?

Official reports say growth is only 6.9% in 2015, just below 2014's growth rate of 7.3%.

In any country, a rate higher than 5% is truly remarkable. All along China has been said to be growing at around 10%. Any rate less than 10% seems embarrassing to the authorities!
So they put it as 6.9%, just close to 7%.

Chinese pessimists say the downturn is much more serious. The energy consumption has fallen. There has been failure of many establishments with steep rise in wages. Their closures have led to loss of business confidence.

Statistics generated by communist governments, and often by one party ruled governments are usually more of propaganda material. China's regional governments are also known to report data inflated, with one province reporting revenue some time ago at 127% higher than the actual number.

The BBC quotes Tom Rafferty of Economist Intelligence Unit saying that growth data is never accurate: "There is a risk of smoothing it because of the political rationale. But it's as much technical constraints in terms of data management and collection as outright political manipulation."

China's Premier Li Keqiang once called regional GDP data as "man-made" and unreliable. He suggested determining growth from electricity consumption, volume of rail cargo and amount of loans disbursed.

So, with the latest news from China, International Monetary Fund has lowered the forecasts.
No more insulation of countries in these days of the globalized world.

Fears of domino effect

The revisions are: global growth would be 3.4% per cent in 2016 (down from 3.6% in October) and 3.6% in 2017 (down from 3.8% in October); US economy growth would be 2.6% in 2016 and 2017 (down from 2.8%); and the eurozone growth would be 1.7% (down from 1.8%).

International banks have lent a lot to Chinese companies. The US dollar debt of China is estimated to be above one trillion!

If the debt becomes bad, there will be a currency crisis. If China allows renminbi to fall instead of supporting the currency, it is feared that there would be a devaluation.

It would be as high as 20%.

One more Thai baht kind of crisis of 1997 will ensue, spreading across several continents. Competitive devaluations and sanctions against cheap Chinese exports will be the result.

With asset prices crashing, stock market prices down and the commodity price boom over, the only solution is investment. That is for every country.

Rebalancing the economies by encouraging greater consumption is only a short run remedy. Investment would eventually raise consumption and services.