Chinese Government Takes Foot Off Economic Brakes

[This is a letter I sent to friends on Nov. 30, 2011, together with
an article from the *New York Times* (appended below). —S.H.]

Hi everybody,

For many months the Chinese government has been trying to rein in the overheated property market, and bring the property bubble under some kind of control. They have had substantial success in doing so. However, it was starting to look like the Chinese economy might be weakening to the point where there might even be a "hard landing" (recession).

This was compounded by the weak economy in Europe, the U.S., and even Japan again, and the rapidly falling demand for Chinese export goods.

Given all this, it was highly predictable that the Chinese government would soon take its foot off the brakes, and return to stimulating the economy through lower interest rates, loosening the controls of bank loans, and so forth. Still, it has come as a little surprise just how soon and forcefully this has occurred. (See attached article below.)

There are still many more measures the government can take, including *ordering* banks to issue more loans, *ordering* companies (even private ones) to make more investments, and through expanding government deficit financing (Keynesian debt).

For these reasons, I think that what may have appeared recently as China's economy *sinking* will turn out to be nothing of the sort.

Eventually, some years down the road, the debt and asset bubbles will in fact burst in China too, bringing the country into economic crisis, just as they do at some point in every boom in every capitalist country. But not for quite a long time yet, in my opinion. China still has lots of room to maneuver economically.

Scott

The New York Times

November 30, 2011

China, in Surprising Reversal, Moves to Spur Bank Lending

By KEITH BRADSHER

HONG KONG — Faced with an economy that appears to be slowing faster than economists expected even a month ago, the Chinese government on Wednesday evening unexpectedly reversed its year-long move toward tighter monetary policy and took an important step to encourage banks to resume lending.

The central bank said Wednesday that commercial banks would be allowed to keep a slightly lower percentage of their deposits as reserves at the central bank. The change, which will take effect on Monday, means that commercial banks will have more money available to lend, which could help to rekindle economic growth and a slumping real estate market.

Real estate developers, small businesses and other borrowers have been complaining strenuously in recent weeks of weakening sales and scarce credit. Prices have dropped up to 28 percent for new apartments in some Chinese cities this autumn, real estate brokers have been laying off thousands of agents as transactions have dried up, and export orders have slumped.

The Chinese move was a particular surprise because the central bank usually announces moves on Friday evenings, to allow banks and markets plenty of time to digest the news.

The Chinese announcement came after the Shanghai stock market had slumped 3.3 percent on Wednesday, its worst one-day loss in four months, on worries that the government might not act. Central bank officials in the United States said the action was not made in coordination with the action taken by the Federal Reserve, and central banks in Canada, England, Europe and Japan to lower the cost of borrowing dollars for foreign banks.

The reduction in the so-called reserve requirement ratio came after the central bank had increased the same ratio six times this year, and raised interest rates three times. The monetary policy moves earlier this year had been aimed at curbing inflation, which persists but appears to have been replaced by weakening economic growth as the top worry for policymakers.

Monetary policy changes are made not by the country’s central bank but by the State Council, the country’s cabinet. Shifts in the broad direction of policy are usually made only with the approval of the Standing Committee of the Politburo of the Chinese Communist Party — the nine men who really run China.

Analysts said that the central bank's decision to announce a change in reserve requirements instead of quietly nudging state-controlled banks to make more loans showed an important political decision had been made.

"The public nature of this move _ a move that would have gone through the State Council _ is a clear signal that Beijing has decided that the balance of risks now lies with growth, rather than inflation," wrote Stephen Green, a China economist at Standard Chartered Bank, in a research note. "This is a big move, it signals China is now in loosening mode."

The People's Bank of China, the country's central bank, cut the reserve requirement ratio by 0.5 percentage points as of Monday, to 21 percent for large banks and to 19 percent for smaller banks.

The Chinese move was such a surprise that one of the 15 members of the central bank's monetary policy committee, Xia Bin, had just said at a seminar in Beijing on Wednesday morning that China would only "fine tune" its monetary policy and would maintain an overall stance that he characterized as "prudent."

Those remarks triggered the slump in share prices during Wednesday's trading in Shanghai; the stock market there had been closed for several hours by the time the central bank announced its policy reversal.

The People's Bank of China is considerably more secretive than central banks in the West and particularly wary of foreign governments because of years of international pressure to allow faster appreciation of the renminbi, China's currency.

The Chinese central bank provided no explanation for its move on Thursday evening. The one-sentence statement only said, "The People's Bank of China decided to cut financial institutions' renminbi deposit reserve ratio by 0.5 percentage points."

Easing domestic monetary policy makes it harder to maintain for China to maintain its policy of strictly limiting the appreciation of its currency, the renminbi, against the dollar. The Chinese central bank has been taking most of the money that commercial banks park with it as reserves and then using it to buy dollars in international markets, so as to slow the renminbi's appreciation.

But economists have seen signs in the past month that international investors are losing their appetite for speculative investments in China's currency and have been buying fewer renminbi. That in turn has reduced the pressure from markets for the renminbi to appreciate and has meant that the central bank no longer needs to maintain its reserve requirements at record-high levels to raise the cash for its huge currency market intervention program.

Among the most widely watched economic indicators in China are the various monthly indexes of orders, backlogs and other details, gathered through surveys of companies' purchasing managers. HSBC's preliminary survey for November, released last week, showed an overall index of 48; a reading below 50 suggests a slowing economy, and it was the lowest reading since

March 2009, when the world economy was struggling to recover from the Lehman bankruptcy and ensuing financial shocks.

The monthly release of the government’s survey is scheduled for Thursday morning in Beijing. It is widely expected to show a dip below 50 for the first time in more than two years.

The central bank’s move on reserve requirements comes as inflation in consumer prices has started to slow, from a peak of 6.5 percent in May down to 5.5 percent in October, according to official data. But private economists say that the true rate of consumer inflation is up to twice as fast, as the official data has a series of methodological shortcomings; China’s National Bureau of Statistics has acknowledged some of these shortcomings, although not the extent of their effect on inflation measurements, and is working on solutions.

Inflation in any case remains well above the government’s target of 4 percent. HSBC predicted in a research note on Wednesday evening that the government would not start reducing regulated interest rates for loans of various maturities until the official inflation rate falls below 3 percent.