China’s economic slowdown

Description

Theme:

- Only a couple of years ago, China was on the path of overtaking the United States and becoming the world’s largest economy. But recently, China finds itself surrounded by a lot of issues, both economic and political, which are so big that they are threatening the very power structures of the country. In this article, we will try to analyze these issues and find out how China’s economic slowdown can affect India and the rest of the world.

The Beginning:

- In 1979, China underwent economic reform that resulted in the opening of its market to the rest of the world, which led to the economy and housing market in China experiencing their greatest expansion. People begin to move in large numbers from rural areas to cities as they seek to enhance their quality of life. As a result, two-thirds of the country’s population now resides in big cities in China.
- In China, owning a house is seen as a sign of financial stability as well as a good investment option. Furthermore, the country’s gender imbalance as a result of the one-child policy has created intense competition for brides, with men frequently having to prove their material worth. All this led to the man and his family pooling money to contribute to the purchase of a house. Prices of apartments rose sharply, and in no time, China became one of the worst countries in the world in terms of housing affordability. Taking into account the living expenses, it takes an average earner in China 50 years to buy an apartment.
- To solve this problem, issuing of loans at a cheap rate to property development companies was increased and credit lending standards to individuals were eased by the Chinese government. At present, in China, the general population has about 70% of their total wealth stored in the real estate market. The real estate-related activity represents 30% of total China’s GDP.

Housing Crisis:

- Developers started to take large amounts of foreign debt to finance their expansion. Also, they created pre-sale options for buyers where the buyers would give money to the developers for a house that is yet to be built, which quickly became the norm in the country. Due to the easy availability of finance, the developers were able to start new projects without finishing the old ones.
- However, the scheme started to fall apart when the influx of people to major cities started to slow down in 2020 due to a lot of issues such as the COVID pandemic, loss to local businesses due to the trade war, increasing inflation and major foreign companies shifting their factories to other countries to reduce dependence on China.
- With the slowdown in pre-sales, developers started to rely more and more on banks and foreign debt to keep expanding. In many cases, the debt payment was too large to pay with an operating income, so they used further debt to finance their existing ones. Soon enough, companies like Evergrande, Kaisa, Yuzhou group and Shimao group started to run into liquidity problems. They failed to pay the investors.
- Now, these Chinese companies have stopped the construction of apartments. This resulted in a large loss of confidence in the Chinese housing and bond markets, both inside China and internationally. A large number of mortgage strikes has been seen by the buyers of apartments who were paying monthly bills without seeing any progress on their purchased property.

Internal Debt Struggle:

- China is infamous for building projects in china which do not bring any profits. The goal of the Chinese government in building these projects was to generate a large number of employment opportunities, but they turned out to be temporary as these projects generated little to no return on investment for the investors. As of 2022, the total liabilities on funding these projects have crossed $900 Billion dollars, which is 5% of China's total GDP.
- Due to massive amounts of debt expansion, profit motives and poor planning, there are numerous ghost cities in China. These are areas of vast amounts of infrastructure and property that virtually remains unoccupied. These infrastructures were built in suburbs and villages to attract people there when the migration to major city hubs slowed down, but this plan turned out to be a complete disaster. People refuse to live there because of no jobs and logistics available in these ghost cities.

Debt Trap Backfires:

- The grand Belt and Road initiative (BRI) of China is threatened to turn out as one of the most unprofitable global projects of all time.
- The BRI is an initiative to invest in other countries as China's ambitious attempt at growing its global influence and its export to the global market. As of 2022, China is investing in nearly 150 countries under BRI. For this, China started to provide loans to countries. Many of these countries are struggling to repay the loans. This turned out to be very unprofitable for China.

- In 2021, China had to renegotiate the $52 Billion dollars of debt it provided to other countries because the countries were not willing or unable to repay their debt. This is largely due to the infrastructure developments not providing the benefits as expected, either because it was poorly planned, poorly constructed or never finished.
- The BRI project became so large that China became the largest source of development credit, overtaking the world bank as well as the IMF. Due to the project being political in nature, no matter how unprofitable it is, it is likely that China will keep financing it.

Zero-COVID policy:

- The world has gone back to normal by lifting lockdowns and other covid restrictions. But China is still following the 'zero COVID policy', under which a complete lockdown of areas that are virus hotspots was being followed and people are forced to stay inside their homes until there are no new COVID cases. This aimed at eliminating the spread of the virus and to make the government be seen as competent and able to deal with big challenges.
- This not only hurt their economy very badly but also made the common citizens feel oppressed by the government.

Unemployment Issue:

- China's youth unemployment rate hit a record high of 20% in July, with roughly one in five young people unemployed.
- Foreign companies who depend on China for imports and exports have less confidence as a result of the zero COVID policy. Large multinational corporations like Apple are reportedly shifting their manufacturing from China to nations like Vietnam and India.
- Furthermore, to make the employment situation worse, the Chinese government is cracking down on their tech companies, tightening regulations for them and banning private school tutoring, which is squeezing out some of the remaining opportunities that Chinese citizens had.

Impact on the World:

- The inter-connected global markets have been the engine of growth and the key to the economic prosperity of this century. A recession in one major economy means a global slowdown for the rest of the world. As the world is already struggling with the Russia-Ukraine war, energy crisis, inflation and as a result global economic slowdown, China's economic slowdown is adding fuel to the fire.
- China's economic slowdown is hurting the rest of the economies of the world, especially those that heavily rely on the import-export market of China. This is increasing the probability of global recession.

Impact on India:

- Data released by the commerce ministry reveals that China overtook the US to return as India's largest trade partner with $11.49 billion worth of goods traded in July 2022. A lot of Indian firms still rely on China for the imports of important components and raw materials as well as for their manufacturing plants.

It means that India will not be immune to the economic setbacks that China's fall will create. We can expect a lot of Indian companies to face manufacturing challenges and look for more expensive alternatives.

- Also, if there is a global recession, India will see a massive jump in its inflation rates as well as a slowdown in exports and a further weakening of the Indian rupee.

Conclusion:

China's economy is in trouble due to several factors such as the zero-covid policy, the unprofitable Belt and Road initiative, the property crisis etc. The rest of the world is feeling the ripple effect as China's economic slowdown is affecting manufacturing, technology and energy sectors globally.

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