Recessionary Spiral and China

by Dr. Sheo Nandan Pandey

Introduction

The People's Republic of China (PRC) has been caught on the wrong foot in its mimic of the free market economy of the west and export led growth model of the East Asian tiger economies of yesteryears. It is in a wind, and has little room to get off the recessionary spiral with *pep talks*, with the Chinese President Hu Jintao, Premier Wen Jiabao, Foreign Minister Yang Jiechi, and Governor of the People's Bank of China (PBOC) Zhou Xiaochuan in the lead role.[1] World Bank (WB) projections seem far off from reality.[2] Worse, for most part, the primary reset and recovery parameters stand frozen, if not immune to active monetary and fiscal policy instruments.[3]

Annual rate of growth of China's gross domestic product (GDP), for example, touched 6.1 per cent year-on-year during the first quarter of 2009.[4] It was 4.5 percentage points lower than the first quarter of 2008 and down 0.7 percentage points from the previous quarter. When calculated quarter-on-quarter basis, the scenario is still more depressing. The decline has been continuous and sharp right since the global down-turn gathered momentum. Earlier, during 2003-2007, the PRC had experienced double-digit growth. It registered 9 per cent growth in 2008. Aggregate demand for goods and services, in particular its external component remains substantially weak. Output glut, massive lay-offs, shutdowns, drop in energy consumption, decline in output, fall in government revenue and increase in budget deficits, cutback in private investments and the like dominate. Among the Chinese think-tank, Fan Jianping, the

[1] China got into *pep talks* mode right when the Chinese President Hu Jintao attended Nov 2008 G-20 Washington summit and visited Costa Rica, Cuba, Peru and Greece. He sought to assure that the Chinese economy had potentials to recover back much early than expected and China would play quintessential role in the recovery of the world economy. Chinese Premier Wen Jiabao, Chinese Foreign Minister Yang Jiechi and the Governor of China's Central Bank, the People's Bank of China (PBOC)Zhou Xiaochuan feverishly spoke about China's potential to lift the world economy and not just the Chinese economy from its down hill journey, caused by global financial crisis and global economic down turn.

[2] In its quarterly updates, released on June 18, 2009, the WB joined Goldman Sach's Group Inc, Morgan Stanley and UBS AG in raising growth forecasts for China for 2009 to 7.2 per cent after its RMB 4 trillion Yuan (US$ 585.5 billion) stimulus package, announced in Nov 2008, triggered record loans and surging investments. In March 2009, the WB had scaled down its projection to 6.5 per cent from its earlier projections of 7.5 per cent in Nov 2008, and 9.2 per cent still earlier. In the first three quarters, China's economic growth had plummeted to 9.9 per cent after five years of double digit growth, the top most being 13 per cent in 2007. China insists on its potential to realize 8 per cent growth, which is the minimum to retain China's employment level at its place.

[3] Recovery connotes a bounce back to the previous peak of growth while reset implies a positive turn.

[4] China's GDP stood at RMB 6574.5 billion Yuan (US$ 939 billion) during the first quarter of 2009, where the primary, secondary and tertiary sectors contributed respectively RMB 470.0 billion Yuan (), RMB 3196.8 Yuan and RMB 2907.7 billion Yuan (). The three sectors respectively recorded growth rate of 3.5 per cent, 5.3 per cent and 7.4 per cent.

Chief Economist of the State Council Information Office, has been the sole exception, pointing out the ground realities of the Chinese capability to early recovery.[5]

In the short run, China's absolute as much as relative capability to ward off recession and/ or early recovers remains dependent on creating an effective demand for the entire range of goods and services in the domestic and foreign markets, both suffering under the impact of global down-turn. The stimulus package, made up of both monetary and fiscal policy instruments, is in place.[6] However, in the best of times, it could be effective only if there was inelastic demand for goods and services. The ground situation in China is just the reverse. Drop in the demand for exportable goods and services relate to totally elastic demand. The demand for capital and wages in respect of low income as much as laid off workers fall in little different category. For long term solutions, China has to make paradigm shift in technology, product mix, direction of product markets, to name only three.

China's rescue potentials to a single and / or group of countries, in the short run, again stand constricted to handful of goods and services. It would largely relate to wages and capital goods with highly inelastic demand. The same would hold good for services as well. The scope is, of course, quite large in the long run. Other things remaining the same, it would pertain to large number of goods offering comparative advantage. It would relate to still larger number of capital goods, needed for improving the competitiveness of Chinese products, in particular environment friendly and energy efficient technology. The upper limits of such rescue potentials are set by an array of variables, the most critical ones being the comparability and compatibility of the GDP and disposable incomes. While considered to be the third largest economy, its share in the global GDP is just 6 per cent.[7] The distribution of income being skewed, the average disposable across the country and social groups suffer handicaps of being representative in character at a macro level. China's foreign exchange reserves of US$1.92 trillion was again not as liquid as people normally think. The *pep talk* could turn to reality only when the rest of the world turned a corner with their stimulus package.

The paper essentially aims at probing into the plausibility of early reset and recovery of the Chinese economy in response to the interventions, essentially composed of monetary and fiscal policy instruments.[8] In the run up, it would focus on: the Onset Factors and Features of

[5] In his paper, published in China Security Journal, and quoted in China Daily in its issue dated 22 April 2009, Fan said: "Possibility for China to have steady and quick recovery is not big due to the current external economic situation and structural problems with the domestic economy. The impact of global crisis is spreading and exerting greater and deeper effects on China. Fan added further: "China still suffered from excess capacity in some undertakings, meaning that some obsolete products capacity should start to be phased out beginning this very quarter. The process could take several years before a logical readjustment could complete". http://www.chinadaily.com.cn/bizchina/2009-04/22/content_7704145.htm

[6] Lack of clarity about the total quantum of the stimulus package continues even as the top Chinese leadership, the Chinese Premier Wen Jiabao included, quite often sought to explain away the doubts. RMB 4 trillion Yuan (US$585.6 billion) package, announced in Nov 2008, has, at best, RMB 1.18 trillion Yuan (US $172.7 billion as the central government component and the rest RMB 2.82 trillion Yuan (US $ 412.9 billion) as local government component. Responding to the doubts about the resource at hand and their viability, the Chinese Premier told media on the concluding day of the second annual session of the 11th National People's congress that the proposed RMB 4 trillion Yuan stimulus package excluded other projects, including the RMB 600 billion Yuan US$ 87.84 billion) tax cuts, old-age pension increase for those who had retired from the enterprises and hitherto lived on quite paltry sum, salary increase to 12 million teachers, subsidies to farmers as well as an RMB 850 billion (US$ 124.45 billion) expenditure in health care. All this amount was then not available for 2009. RMB 4 trillion Yuan was a two year package while other expenditures including those on health care were meant for subsequent three years period.

[7] China displaced Germany with marginal increase in GDP in 2008. Interestingly, there is wide gap in comparison with the top first, the US and top second, Japan. The two respectively hold 28.76 and 09.11 per cent shares in the global economy. Notwithstanding, Germany, France, UK and the rest others in the European Union suffering the bout of recession jointly hold 30.49 per cent share in the global economy.

[8] Monetary and fiscal policies refer to "demand management" techniques. Monetary policy is the process, where the monetary authority of a country controls (i) the supply of money, (ii) availability of money, and (iii) cost of money. It can be expansionary to combat recession or contractionary to address heating of the economy. The economic policy is often referred as accommodative, neutral of tight depending on interest being to add to growth, remain ambivalent or poised to curb inflation. The tool of monetary policies include: increasing interest rates by fiat; reducing the monetary base; and, increasing reserve requirements. Fiscal policy relate to direct intervention of the authority, where the tools available at the disposal of the

the Bust Cycle; the Monetary Policy Instruments and their Liquidity Raising Potentials; the Fiscal Policy Instruments and their Purchasing Power Raising Potentials.

Assumptions of the study include: first, the phenomenon, thus far globally synchronized and essentially part of boom and short cycles, is the inevitable and yet, necessary cost of capitalism; second, the current economic malaise, in global and not just Chinese context, is the outcome of too much reliance on the prescriptions of both the Keynesians, like Paul Krugman and the classical economists, like Milton Friedman. The transmission mechanism for monetary policy, as Hyman Minsky advocates, is through the financial markets and, the financial markets can experience wide swings that lead to boom and bust in the real economy; third, the Chinese monetary and fiscal policy instruments, tailored respectively to prime and/ or pulsate otherwise shutting down export oriented enterprises and dormant domestic demand for their products, stood witness to China's transition to inclusive in place of buoyant exports-led growth and development model; fourth, the streaks of simultaneous down turn and up rush symptoms, currently discernible in the Chinese economy, is but a product of endemic characteristics of the Chinese economy, largely a feature of simultaneous existence of the new and traditional, the high and low tech, the broad based and selective etc. features in structures and functions of different economic sectors; and, the sixth, the most and least affected geographic region, enterprises, urban/ rural residents, high and low income susceptible families are bound to respond differently to the interventions for a host of regions. At long last, at a macro level, the imminent problem before the People's Republic of China (PRC) was to reverse the slide in GDP growth, the minimal level of which is 8 per cent and more lest the wherewithal of expansionary Chinese socio-economic structure should crumble.

Onset Factors and Features of the Bust Cycle

The PRC arrived at the bust cycle after decades of boom. The peak and trough, thus far unveiled, carry some exclusive features. The new and unanticipated aspects would call for a new approach and treatments for recovery. It does not turn history outright obsolete. The situation is essentially borne of calculated risk suffering toll of exuberance. Robert J. Barbera is perhaps right that the society which enjoys the fruits of free market has to be ready for pay up for periodic down-turnl.[9]

Prior to the bust, the GDP of China had peaked at a 13 year best of 11.4 per cent year on year to RMB 24.6619 trillion Yuan (US$3.43 trillion) in 2007. The growth rate was 0.3 percentage points higher than the 2006 level revised at 11.1 percent.[10] Quarter wise, the GDP in the PRC in 2007 had expanded 11.1 percent in the first quarter, 11.9 percent in the second, 11.5 percent in the third and 11.2 percent in the fourth. Now, as the Chinese economy got caught up in the global recessionary spiral, the growth rate has tumbled 5.8 percentage points in comparison with the best fit of the second quarter performance and 5.3 percentage points of the annual average.

The "credit crunch", as a term for financial markets, was first heard in China in the third quarter of 2007 while it came to public attention to the outside world in August 2007.[11] It

government included change in the level of government expenditure or taxation. The two can be used independently or in conjunction with each others, depending on the ideology of the authority.

[9] Barbera, Robert J., The Cost of Capitalism: Understanding Market Mayhem and Stabilizing our Economic Future, March 2009,

[10] http://news.xinhuanet.com/english/2008-01/24/content_7485388.htm

[11] " Credit Crisis- How it Began" In Guardian, Aug 5, 2008.
http://www.guardian.co.uk/business/2008/aug/05/northernrock.banking

happened just as the US economy encounter bust in Dec 2007.[12] US GDP then grew by 0.6 per cent compared with 4.9 per cent in the previous quarter. Ireland, Denmark, Finland, New Zealand, Sweden, Austria, Germany, Italy, Japan, the Netherlands, the United Kingdom, Portugal, Spain, and Switzerland have had recession ranging from two to seven quarters.

Much has happened due to China's export-led developmental paradigm turning unsustainable. When the growth rate of the Chinese economy peaked at 11.4 per cent in 2007, the contribution of export proceeds ran to 40 per cent. According to an estimate, 1 per cent growth in China's exports contributed 0.82 per cent increase in the GDP of the PRC. As the global economy, in particular US, European Union, Japan and other notable export destinations of Chinese goods fell into the whirlpool of recession, the Chinese exports suffered a bloody blow. In the very first punch, as the Chinese Commerce Minister then acknowledged, the slow-down in exports to US and EU in the first quarter of 2008 caused a 12 percentage point drop in China's overall export growth.[13] It is not surprising that the Chinese economy cooled to its slowest pace in 2008, expanding 9 per cent year-on-year, the slowest since 2001. In the first six months of 2008, as many as 67000 small and medium enterprises (SMEs) pulled down their shutters. Industrial output dropped by 5.6 percentage points.[14] 20 million workers were laid off. The trend continues even now. [15]

The Chinese recession, for reasons as such, now stand globally synchronized. As the epicenter happened to be the US, and the aftershock is spread across all continents, the duration and amplitude of recovery of the Chinese economy has to take place together with the rest of the world. While external shock is largely responsible for rocking the Chinese boat, the correctives have but to take care of side effects of an array of other shocks, in particular those which carry bearings on competitiveness of Chinese goods and services.

Monetary Policy Instruments and their Liquidity Raising Potentials

As part of monetary policy maneuvers, the People's Bank of China (PBOC) switched over to "moderately easy" from "tight" monetary policy".[16] Chinese tend to call the moderately easy monetary and fiscal policy options as "prudent" as against tight. There is then "active" monetary and fiscal policy that stands for easy monetary and fiscal policy. As Zhou Xiaochuan, the Governor of PBOC told the 11th National People's Congress (NPC) session in Mar 09, the objective in policy shift was to "check the slip of confidence and spur fast recovery of the economy amid the crisis".

China cut interest rates for the first time in six years on Sept. 15, 2008. This was the time when Chinese economy got to experience the heat of worsening credit turmoil and weakening export demand.[17] The one-year lending and deposit rates were lowered by 0.27 percentage

[12] The classic definition of a recession is two consecutive quarters of negative gross domestic product (GDP). The Business Cycle Dating Committee of the National Bureau of Economic Research (NBER), the US panel recognized as the official arbiter of business cycles, adjudicated onset of recession in the USA right since early December 2007. The NBER, however, did not identify economic activity solely with real GDP growth but used a range of indicators, such as employment, personal income and industrial output, in determining the onset of recession.

[13] http://www.financialexpress.com/news/china-predicts-stable-export-growth-in-2008/283591

[14] Xinhua News Agency, January 22, 2009.

[15] In April 2009, China's exports fell 22.6 per cent from a year earlier in the 6th straight monthly decline. Total Chinese exports in the month ran to US$ 91.94 billion. It was sharper than March 2009 decline of 17. 1 per cent and the median forecasts of 18.4 per cent in Dow Jones Newswire survey of 16 economists. In January 2009 and February 2009, the Chinese exports fell by 17.5 per cent and 25.1 per cent respectively on year on year basis.

[16] PBOC plays pivotal role in monetary policy formulation and implementation after assuming the charge of central bank in 1984. For quite long, it resorted to direct administrative methods to balance the aggregates. After abolition of credit ceiling in Jan 1998 and, the expansion of open market operations, it has come to depend on indirect methods.

[17] The global financial crisis of 2008-2009 raised its head right in July 2007 when the loss of confidence of investors in the value of securitized mortgage in the US resulted in liquidity crisis. In Sep 2008, the crisis deepened, as stock markets world wide

point to 6.93 percent and 3.87 percent. In three months thereafter until Dec. 23, 2008, the PBOC announced as many as five cuts in the interest rates, down from 7.47 per cent to 5.31 per cent. The deposit rate was always cut by the same amount, down from 4.14 per cent to 2.25 percent.[18]

The PBOC simultaneously brought about cuts in the reserve requirement ratio (RRR) of large and small as well as medium sized banks in five subsequent different stages from 17.5 per cent. For small and medium sized banks, it was trimmed to 13.5 per cent. In the case of large banks, it was kept at 15.5 per cent.[19] The mechanism is meant to influence the rate of money supply. A lower RRR as this against a higher RRR obviously gives greater leeway to the commercial banks for lending money to the market.

The credit ceiling of the Chinese commercial banks in respect of priority projects, rural areas, smaller enterprises, technical innovations and industrial rationalization through mergers and acquisitions. It was in tandem with the policy decision to keep credit expansion "rational" and "target specific”. 1% in lending results in a 0.105% increase in money supply.

China followed differential loaning policy to jack up demand for the worst affected industrial products, in particular automobiles, electronics and the like. Lower upfront payments and subsidies of different kinds including coupons constituted major measures.

China’s current account surpluses contribute to add to the liquidity position with a difference. In order to achieve its exchange rate objectives, the Chinese government has to buy hard currency, in particular US dollars or else the RMB would appreciate. In order to buy these dollars, it has been printing RMB, which, in turn, increases the amount of money in circulation. There are estimates that a 1% increase in China’s Foreign exchange reserves would require a 0.111% increase in money supply to sterilize it. The figure could grow with the increase in the volume China’s Foreign exchange reserves as time passes.

Overheating of the economy being a constant feature, the PBOC takes recourse of ‘punishment bonds’, issued to commercial banks at variable maturities and interest rates with obvious goals of putting reins on money supply. In 2008, the PBOC issued Rmb4.3trn of bonds in this way.

Chinese academics held positive and yet, hold differing views on the impact of the monetary policy interventions. Jin Xin, an Everbright Securities analyst, believes it to be good news for the banks, whose profitability has been deteriorating. Jin said the move would widen the gap between the lending and deposit rates, which is where banks make money. As a result, in Jin’s estimated the net profit of banks would expand by 4.2 percentage point in 2009. Quite simultaneously, the reduced reserve requirement would pump more than RMB 640 billion Yuan (US$91.4 billion) into the system.[20] In the estimation of Wu Yongyang, another Securities analyst, the move of the PBOC to cut interest rate and reserve ratio would pump nearly RMB 710 billion Yuan (US$ 103.9 billion) into the system. He said the impact would

crashed and entered a period of high volatility, and a considerable number of banks, mortgage lenders, and insurance companies got into failure spree.

[18] The impact of the cuts in the interest rates in improving the liquidity situation in automatic natural process remains constricted as the lending and deposit rates for commercial banks is set by the Chinese Ministry of Finance in tandem with policy decision of the government and party. The market mechanism have little role. This limits the pass through of changes in the PBOC interest rates.

[19] China had ratcheted up the reserve ratio, from 6 per cent in Aug 2003 TO 14.5 per cent in Dec. 2007 and 17.5 per cent in June 2008. The 1 percentage point cut in the reserve ratio brought to bear upon for the first time in Sep 2008 did not apply for the five large banks e.g. the Industrial and Commercial Bank of China, the Agricultural Bank of China, The Bank of China, the China Construction Bank, and the Banks of Communications. It did not apply for the Postal Savings Banks as well.

[20] http://en.chinagate.cn/top.news/2008-12/07/content_16910501_2.htm

be positive for big banks such as the Industrial and Commercial Bank of China and China Construction Bank, but surely negative for small and medium sized banks. She Minhua, a CITIC Jiantou Security Analyst, said, the latest act of the PBOC has had largely eliminated the rational for further reductions, and as a result, listed banks were likely to see their profits wiped out or might experience a loss in 2009.

Notwithstanding, the Monetary Policy Committee, the key decision making body at the PBPC, said, in its latest meeting on April 12, 2009, that China would maintain a "moderately loose" monetary policy amid the worsening global crisis. The statement said it was essential for "continuity and stability of policy making".[21] PBOC statement later said: "The central bank will continue to ensure ample liquidity in the banking system and reasonably increase loans to fund the economy."

Zhou Xiaochuan, the Governor of PBOC and the Chinese Premier Wen Jiabao had earlier dropped a broad hint to this effect in the course of 11th press briefing at the concluding day of the 10-day session of the Second Session of the 11th National people's Congress (NPC) in March 2009. The two had favoured moderately easy monetary policy for 2009 with perceived objectives of boosting "fast but steady economic growth by expanding domestic demand".[22] The Chinese Premier had then called 2009 a most difficult year ahead and wanted the tight monetary policy currently in vogue to be "relaxed to prevent an economic down slide.

The rationale is not hard to imagine. In the first half of 2008, over 67000 SMEs, each with sales income exceeding 5 million Yuan (US$ 0.7 million), were closed down. It rendered 20 million workers unemployed. The figure did not include service industry and SMEs whose sales were less than 5 million Yuan.[23]

The Chinese banking system responded quite rapidly. New loans in the first quarter of 2009 touched RMB 4.58 trillion Yuan (US$ 670 billion). At the present pace, new loans, averaging just RMB 500 billion Yuan (US $ 72.3 billion) per month for the rest three quarters of 2009 stand to take bank lending to over RMB 9 trillion (US$ 1.32 trillion).

Whilst lucrative, the overdose of medicine holds the specter of incalculable side effects. Growth in M2, the broadest measure of money supply, hit a record 25.5 per cent in March 2009.[24] It pushed up the consumer price index (CPI); eroded real wages; and, put the living of people in jeopardy, in particular the multitude of laid off and migrant workers who suffered the brunt of the downtown. Worse still, where CPI and producer price index (PPI) has shown signs of declines, it is but deflationary in nature and effects.[25] China Banking Regulatory Commission and wide section of Chinese think-tank feared "rise of non-performing assets", encouragement to "fraudulent activities" including "fake mortgages", and last but not least, "seepage of money into stock markets". [26]

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[21] http://www.thearynews.com/english/newsdatail.asp?nid=25003
[22] Xinhua, March 06, 2009.
[23] http://en.cc.cn/business/enterprse/200812/06/t20081206_17599073.shtml
[24] M2, a measure of money supply that includes M1, plus savings and small time deposits, overnight repos at commercial banks, and non-institutional money market accounts.
[25] NBS data released on May 10, 2009 shoed that CPI in China fell by 0.9 per cent year-on-year in the first five months of 2009. In May 2009, it declined by 1.4 per cent. It was nearly constant in comparison to April 2009 when it had dropped by 1.5 per cent. 32 per cent drop in pork price due to governmental initiative for various non-economic reasons contributed in the drop of prices of food items by 0.6 per cent. The prices of non-food items dropped by 1.7 per cent. It was mainly due to fall in the effective demand in the face of scary recession. Producer Price Index (PPI) in May fell by staggering 7.7 per cent year-on year. For the first quarter, the decline in PPI worked out to be 4.6 percent. In the preceding April 2009, it accounted for 6.6 per cent. http://www.chinaeconomicreview.com.cn/dailybriefing/2009_06_10/CPI_PPIfall_in_May.html.
[26] Estimates about non-performing loans (NPL) in China vary. At least 2 per cent of the loans made since 2007 have been reported as non-performing. The proportion was as high as 60 percent for older lending. China had so far RMB 35 trillion Yuan outstanding bank loans. With the present doze of RMB 9 trillion Yuan loan in the market, the total would run to RMB 44 trillion

Notwithstanding, the recent performance of the industrial sector provides grounds for concern due to rapid credit growth. A National Statistics Bureau survey of 22 regions found industrial profits totaled only 323 billion Yuan (US$ 47.29 billion) during the first quarter, down 32 percent from a year earlier. That means annual profits for all industries will amount to only about 1.6 trillion Yuan (US$ 234.2 billion) this year. Outstanding loans currently stand at 35 trillion Yuan (US$ 5.12 trillion) . Assuming companies have kept a moderate debt ratio averaging less than 50 per cent, their capital investments now exceed 35 trillion Yuan (US$ 5.12 trillion). And profits of 1.6 trillion Yuan (US$ 234.2 trillion) versus 35 trillion Yuan (US$ 5.12 trillion) in capital investment means an annual return rate of only 4.57 percent, below the weighted loan interest rate of 4.76 percent we saw in March 09. In this sense, the Chinese companies seem to be in a rather weak position to finance debt with earnings.[27]

Not surprising, Ba Shusong, an economist with Development Research Center and quite a few others have warned the government against the hazard of pushing the panic button too hard. "Monetary policy", told Ba to Economic Information Daily "should revert from being easy to avoid steep ups and downs in credit expansion, which could otherwise affect the economy, and put pressure on the operation of the banks in future. PBOC, too, has taken cognizance of the problem. It called upon major Chinese banks to lend at a steadier, more rational pace.

Fiscal Policy Instruments and their Domestic Demand Raising Potentials

In line with the easy monetary policy as such, the PRC has gone for expansionary fiscal policy.[28] Conceptually, save to the extent of "crowding out" effects, it sounds sensible.[29] It is deemed that the measure would stem out flaccid and/ or dormant aggregate demand, and usher economic objectives of price stability, full employment and economic growth. The crowding out effect, borne of interest push across the market, was a manageable affair.

Sundry elements apart, the RMB 4 trillion Yuan (US$585.5 billion) stimulus package, announced on Nov 09, 2008, hitherto constituted China's fiscal instrument to spur domestic demand.[30] The decision came about two months after the global financial crisis deepened in Sep 2008. It was aimed at creating domestic demand, both in lieu for the down slides in external demand and outright new. However, not until recently, it remained shrouded in controversy on many counts, primarily, the new components. The mystery was not resolved until the Chinese Premier Wen Jiabao gave final tongue to the debate four months later.[31] "Completely new" element in the RMB 4 trillion Yuan (US$585.5 billion) stimulus package, as the Chinese Premier added, constituted of RMB 1.18 trillion Yuan (US$ 172.76 billion),

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Yuan. Experts put the figure to range between 20-40 per cent. Ernst and Young had put the figure at US$ 900 billion as of May 2008, which it later retracted. Fitch Ratings put the figures at US$470 billion.

[27] Lu Lei, No End in Sight for Loose Monetary Policy, Caijing, http://english.caijing.com.cn/2009-06-04/1101

[28] Expansionary stance of fiscal policy involves a net increase in government spending (G>T). The other two stances are neutral and contractionary. A neutral stance of fiscal policy implies a balanced budget (G=T) while a contractionary stance stands for surplus budget (G<T). The deficit in expansionary stance is relative in perspective. It was possible first, when the government spending far exceeded tax revenue or a smaller budget surplus in comparison to what it was earlier, or a deficit if the government previously had a balanced budget.

[29] Crowding out stand for a situation when the government borrowing pushed demand for credit, and the interest rates across the market jump to a limit when aggregate demand slides down in its totality.

[30] RMB 850 billion Yuan expenditure on building health infrastructure, proposal to give reckonable raise in the salary of teachers, etc constitute the sundry elements in the stimulus package.

[31] As the analysts world over doubted the credentials of the Chinese stimulus package, the exasperated Chinese Premier Wen went on record to say on Mar 13, 2009 that RMB 1.18 trillion Yuan in the package was "completely new" investment, slated to be spent on projects concerning people's well being, technology upgrading, environmental protection, and major infrastructure projects. Wen admitted publicly that some projects in the stimulus package, such as roads and railways, were factually already included in China's 11th five year development plan.

funded by the central government. The rest RMB 2.82 trillion Yuan (US$ 412.74) were part of already committed investments.

The expenditure plan of the package has been spread over to two years. While not spelled out in the first go, the best fit of availability of the central fund for 2009 and 2010 could estimably be RMB 590 billion Yuan (US$ 86.3 billion) each. It works out just 3.68 per cent of China's GDP of RMB 15.9878 trillion Yuan (US$ 2.34 trillion). It again works out 3.2 per cent of the estimated RMB 18 trillion investment plan. There yet other components. It included RMB 600 billion Yuan (US$ 87.8 billion) tax cuts and RMB 850 billion Yuan three year investment in health care reform besides proposed increase in the wages of 12 million teachers. The Chinese Premier has, of course, hinted for some more steps in this direction.[32]

Breakdown of the expenditure, unveiled by China's top planning body, the National Development and Reforms Commission (NDRC) in early March 2009, suggested typical Chinese characteristics of making virtue of its otherwise utter necessity to socio-economic survival. Rehabilitation works in May 12, 2008 earthquake hit Wenchuan and other areas in Sichuan province could not have waited any longer. It has claimed 25 per cent (RMB 1000 billion Yuan) of the total stimulus plan. Public infrastructure, involving as much as 38 per cent (1500 billion Yuan) of the total resource bear out rather repackaging maneuvers of the committed planned expenditures. The stated plan to spend RMB 370 billion Yuan on technology advancement is perhaps the long awaited stimulus. Obsolete high energy consuming industrial structure is the bane of the Chinese industrial structure. Social welfare and rural development, constituting respectively RMB 400 billion Yuan and RMB 370 billion Yuan, stand scrutiny to China's efforts to address the dislocations in the life system of vast multitude of rural populace including 120 million migrant workers, forced to return to their villages in interior Chinese provinces. Projects related to so called sustainable development, in particular those catering to environmental protection would cost RMB 210 billion Yuan while education and culture related projects would invite expenditure of 150 billion Yuan. Given the nature of populace, getting due purchasing power, the demand, largely for the wage goods among consumer goods were slated to get major shot in the arm. Theoretically, save the extent of induced consumer expenditure, it held potentials of adding up, and may be even spurring demands for goods and services in existing traditional segments. It carried again little prospect to be a substitute for sagging external demands.

Composition of the stimulus package 8-9 months later now is much different than what it was originally conceived and planned out to be. The stimulus package was supposed to be divided between investment to help companies and social welfare to help stimulate demand. The central government had pledged RMB 1.18 trillion Yuan (us$ 172.6 billion), which accounted for 29.5 per cent of the total RMB 4 trillion Yuan stimulus package. The rest was supposed to come from local governments and lending by state owned banks. The central government has lived up to its commitment. The banks share made up of lending went into overdrive and the local governments only put up about half. RMB 200 billion Yuan (US$29.3 billion) local government bond sale, approved by the Chinese Ministry of Finance (MoF),constituted part of China's RMB 950 billion Yuan (US$139.09 billion) book entry a treasury bond sale plan.[33] The National Development and Reform Commission (NDRC) as well as central State Owned Enterprises have also been issuing corporate bonds.

[32] http://english.people.com.cn/90001/90776/90885/6613552.htm
[33] Of RMB 200 billion Yuan bond, allocated by the MoF to the local governments, Sichuan, the May 12, 2008 earthquake hit province, was to get RMB 18 billion, Guangdong RMB 11 billion Yuan, Yunnan RMB 8.4 billion Yuan, Liaoning RMB 6.6 billion Yuan, Guangxi RMB 6.5 billion Yuan, Guizhou RMB 6.4 billion Yuan, Shaanxi RMB 6.0 billion Yuan, Hebei RMB 6.0 billion Yuan, Anhui RMB 4 billion Yuan, Ningxia RMB 3 billion Yuan, Xinjiang RMB 3 billion Yuan and Beijing, the capital RMB 5.6 billion Yuan. The allocation of bonds for the por other region awaited decision.

Actualization Process and the Simmers

Aware of the enormity of the problem in easy reset and recovery of the economy, the Chinese political and professional leaderships have been constantly revising and reorienting strategic and tactical moves. The malaise, inter alia, owes its genesis to a drastic fall in exports. The glut has created an imponderable situation. As many as 3.18 million small and medium size enterprises had closed or suspended their operation by Dec 2008, and made 40 million jobless. There are host of others, including Chinese logistics to have suffered indirectly. Peng Xingyun, Director, Monetary Policy Decision, Chinese Academy of Social Sciences, Beijing recently expressed his concern about large scale bankruptcies among small and medium size companies in coastal provinces. The Chinese strategy in vogue strives to access new markets while reviving and consolidating old ones. Chinese leadership and trade delegations have been visiting various destinations and clinching every possible deal. As the global economy is slated to contract by 2.9 per cent 2009 and could hardly grow more than 2 per cent in 2010, the Chinese exports may not experience a significant turn around.

Spur in bank lending in the last six months of 2009 in response to the RMB 4 trillion Yuan (US$ 585.5 billion) stimulus package and other investments plans, in particular RMB 800 billion Yuan (US$117 billion) health care network programme is being eulogized as are well thought through short term measures to neutralize the negative impacts of down slides in exports.

In the first quarter of 2009, the Chinese state-owned Industrial & Commercial Bank of China Ltd., China Construction Bank Corporation and Bank of China lent 4.58 trillion Yuan (US$670.5 billion). This cash surge accounted for total bank lending in 2008.[34] An article, captioned "“China's Loan Binge: Stimulus or Insanity?” (*Caijing*, May 6, 2009), says that the Industrial & Commercial Bank of China Ltd., Bank of Agriculture and Bank of China actually accelerated the pace of new loans as the quarter drew to a close. Wen Chunling, a Beijing-based analyst at Fitch Ratings (*Bloomberg*, April 30, 2009), suspects that the banks in question have since compromised their risk management principles under the pressure of the government, and this was every chance in such loans turning non-performing in the next few years.[35] Fearing the bubble, the Chairman of China Banking Regulatory Commission (CBRC) Chairman Liu Mingkang called upon banks to moderate their loaning pace in April 2009.

In announcing the stimulus package of RMB 4 trillion Yuan, the Chinese State Council stipulated that all the funds would be allocated for the 10 priority projects by the end of 2010. After spending 100 billion Yuan in Q4 ’08 and 130 billion Yuan in Q1 ’09, there are only 7

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[34] Industrial & Commercial Bank of China Ltd. advanced 636.4 billion Yuan (US$93.3 billion) of new loans, almost quadruple the amount extended in the same period a year ago and more than the bank’s total lending in 2008. China Construction Bank Corporation offered 521 billion Yuan of new credit in the first three months, compared with 161 billion Yuan a year earlier. Bank of China made 511 billion Yuan of new loans, more than twice the amount a year earlier. All three banks are state-owned and based in Beijing.

[35] The size of China’s bad loan has been a source of constant controversy. Gordon Chang, a China expert and author of "The Coming Collapse of China," told the hearing of the US-China Economic and Security Review Commission that China's banks and instrumentalities were probably sitting on a trillion dollars of doubtful loans. He warned that "a bank failure in the next few years is possible, if not likely" and that China's banks, "almost without exception, are hopelessly insolvent from a balance sheet point of view.” Chinese banks are blowing up their balance sheets at unprecedented rates," he said, adding that banking failure would "almost certainly lead to a collapse of the economy" and cause the political system to be even more fragile. Chang also said that China was burdened by too much debt. Beijing claims that China's debt to gross domestic product (GDP) ratio is only 18 percent but Chang said it was a staggering 81 percent, based on his "conservative" calculations.

quarters left before the deadline to spend 94.25% of the stimulus package. Whether or not the Chinese government will adhere to the plan's deadline remains to be seen, however, it is clear that spending is going to drastically ramp up over the next few quarters.

Points apart, the Chinese leadership and professional pinned their hopes in early reset and recovery of the Chinese economy on specific premise of raising domestic consumption on the strength of new monetary and fiscal policy instruments. Besides adding liquidity to the system, the measures sought to spur the propensity to consume over the propensity to save.

In its stride, the Chinese State Council announced a spate of measures to jack up domestic consumption, which, inter alia, included raising pension and minimum allowance for low income people. The local governments, at their levels, went ahead with issuing concession vouchers during festive occasions. Property buying has been made a lot easier. A recent offering calls for investors to come up with 30 per cent down payment to receive a 4 per cent loan for the remaining 70 per cent. The 3 per cent deed tax and 0.05 per cent stamp duty is now historically very low. The capital gains tax has been reduced to 5 per cent of the gain versus what had been 5 per cent of the entire amount. Simultaneously, China halved the purchase tax on passenger cars to 5 per cent for models with engine displacements of less than 1.6 liters.

NBS data, released on May 20,2009, showed that China's retail sales rose 14.8 per cent in April year on year. It was 0.1 percentage points higher than in March. Rural spending, driven by a Government rebate policy on home-appliance purchases and other commodities, grew by 16.7 per cent in April, which was 2.8 percentage points higher than urban growth. Property sales rose by 17.5 per cent in acreage from a year earlier in the first four months of 2009. Nevertheless, private sector housing sales rose 8.6 per cent year on year in 70 mid-sized and large cities in the first quarter, including Beijing, Shanghai and Guangdong and other metropolises. 2.67 million Vehicles were sold in the first quarter, up 3.88 per cent year on year. In April 2009, more than 1.5 million vehicles were sold. In the first quarter of 2009 as whole, the vehicle sales went up 11.1 per cent. Zhuang Jian, a senior economist with the Asian Development Bank, put a caveat for future sustainability of momentum in sales growth, in particular property and cars until the Chinese government undertook new measures to kindle consumer confidence. "It is difficult for automobile sales to maintain their current momentum, unless new favourable credit policies are released on the purchasing side," said Wu Tujin, an analyst with Great Wall Securities Co Ltd.[36]

It could be a silver lining. Once domestic demand for goods and services moves up, and in particular if it was capable of offsetting the fall in aggregate demand due to fall in external demand, the Chinese economy stands every chance of crossing the threshold for reset and recovery. Accompanying tell tale on-ground developments included unbound resumption of market forces, and rekindling of whole range of economic activities. The NBS report stated that China's industrial output rose 7.3 per cent and 8.9 per cent year on year in April and May 2009 respectively. Hao Daming, a Beijing based economist with Galaxy Securities attributed the phenomenon to "rapid improvements in domestic demand".[37] This can otherwise be true as there is little rationale for production activities to pick up in the face continuous spell of declines in exports and imports.[38] However, the fact is otherwise. The growth as such is

[36] Xinhua, May 14, 2009.
[37] http://www.thestandard.com.hk/breaking_news_detail.asp?id=15012
[38] Chinese exports and imports in fell 26.4 per cent and 25.2 per cent in year on year in May 2009. The fall is consecutive in a row for the last seven months, and at an accelerated pace from April 2009. Notwithstanding, May 2009 trade surplus of US$ 13.4 billion was below forecasts of US$14.8 billion. Expected drop in exports and imports were 23.1 per cent and 22.0 per cent year on year.

investment driven, and could add up the glut as the domestic market is still far less geared to absorb and the prospect for exports are bleak until the major Chinese export destinations in US, EU and such other economies show demand for Chinese goods and services.[39] However, some of economists doubt the figure as the Chinese industrial output growth figure is not matched by energy generation and consumption figures.[40]

Record production is seldom expected to be met with record consumption. According to World Steel Association, the demand for steel in China will fall by 5 per cent in 2009. So too could be the case in other basic industries. Eventually, even state owned industries can not keep on producing unsellable products. In the case of SMEs, a large proportion of target consumers are in the process of de-leveraging, and actually saving. They would not be in buying spree for SME products. The current Chinese monetary and fiscal policy instruments to reset and recovery the economy are thus by no means working.

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Remarks: Opinions expressed in this contribution are those of the author.

Dr. Sheo Nandan Pandey, born Jan 14, 1947, served both institutions of higher learnings and the bureaucratic set up as member of Civil Services in India. He speaks several languages including Chinese mandarine. In area studies, China is his first love.

[39] Investment leaped 40 per cent in May 2009 on the back of government pump priming. As per the NBS data, investment in urban areas in fixed assets rose 32.9 per cent in the first 5 months from a year earlier, compared to 30.5 per cent in the first 4 months.

[40] Statistics released by the Chinese State Grid Corporation of China shows that power generation in April 2009 fell 3.55 per cent from a year earlier, to 274.76 billion kilowatt hours. Since the Chinese industry consumes nearly 70 per cent of Chinese power, it is almost a riddle how drops in power generation and increase in industrial out put could logically go hand in hand. In fact, electricity consumption in all other sectors, say agriculture, tertiary industry, and residential use have had significant rise during the first quarter of 2009. The agriculture, tertiary and household sectors registered respectively increase of 5.12 per cent, 7.41 per cent and 9.88 percent. Drop in energy consumption secondary industry started much before the Chinese government announced stimulus package of RMB 4 trillion Yuan. It started falling with the fall in export orders, in particular in Guangdong, Zhejiang, Shenzhen and other such export bases in China.