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CHINA AND THE EUROZONE CHAOS: STAND BY FOR MORE PAIN !

Herpes Zoster, commonly known as shingles, is an acute viral infection, affecting the skin and nerves of a person. It is characterised by groups of small blisters, appearing along certain nerve segments. This infection is caused by the same virus that causes chicken pox.

Usually, Herpes Zoster vanishes within a fortnight, but the chronic form can attack the nervous system of an inflicted person and it may take more than one year to be eradicated, completely – if at all.

The eurozone is, today, suffering from a form of economic *'shingles'* – and it IS the chronic kind, to be sure.

At this time in the history of this important area of the world, no cure for this form of shingles has been discovered, try as many brilliant economists may put their respective heads together.

Paraphrasing the recent prognostications of Mr Mario Draghi, President of the European Central Bank, the euro is unlikely to emerge from its present crisis until the second half of 2013.

This, in **TARGET**'s opinion, is wishful thinking because, by the looks of things, today, the crisis of the euro is unlikely to be ameliorated to any material degree until 2014 – at the earliest.

Last October, the unemployment rate in eurozone hit 11.70 percent. This was a record level. That figure of 11.70 percent was an increase in the number of people without jobs in this region of the world of about 12.50 percentage points.

In October, another 173,000 eurozone workers were displaced, bringing the total number of people, without meaningful employment, to about 18.70 million.

As the governments of the 17-nations that use the euro as their common currency continue to rein in spending, so the current situation worsens, appreciably, curbing economic growth.

This hits consumers, of course, who are unable to hit the high streets of cities – because they have precious little money to spend.

Two of the biggest economies of Europe are hurting, especially. They are Spain and Italy.

In October, Spain's unemployment level rose to an astounding 26.20 percent while Italy's level rose to 11.10 percent.

At the same time, the October inflation rate in eurozone fell from about 2.50 percent to 2.20 percent.

The Eurozone and China

As is well known, Europe is the largest export market for the People's Republic of China (PRC) and so, as the country's largest single customer wrestles with its problems, the PRC suffers with material contractions in exports as well as adverse effects with regard to its **G**ross **D**omestic **P**roduct (**GDP**).

This situation will, without question, take years to improve and, in the meantime, the PRC economic experts will have to consider what is the best way forward in order that the second-largest economy of the world can continue to record acceptable growth of its GDP.

The PRC has become, and is likely to continue to be for some years, the *'engine'* of growth for most industrialised parts of the world.

For large segments of the Western World, while the PRC continues to be maligned for maintaining the political and economic doctrine of its unique style of communism, having an authoritarian-styled government and shunning Western democratic principles, to a great extent, at the same time, ironically, the Middle Kingdom is the envy of many an economy.

Say what you will of the way in which the government of the PRC operates, but one cannot fart against thunder: The country has never, in its 5,000 or so years of history, been as financially powerful as it is, today; and, the human population of the country, thought to number about 1.30 billion people, has never had it as good as today.

The country still has a long way to go, certainly, but it is making massive strides. Not so, however, for the country's biggest export customers, most of whom are in tsuris.

<u>Looking at the Statistics</u>

On Wednesday, November 21, 2012, Beijing reported that the country's GDP had expanded Year-On-Year, by 7.70 percent, during the first three quarters, ended September 30, 2012.

The PRC's authoritative National Bureau of Statistics announced that the per capita, disposable income in urban areas reached 18,427 renminbi (about $US2,930) for the first nine months of 2012 (adjusted for inflation).

That figure of 18,427 renminbi was an increase of 9.80 percent, Year-On-Year.

Looking only at the country's GDP, it is noted that, in the first quarter of 2011, it hit a peak of about 12 percent. The statistics for the nine-month period, ended September 30, 2012, therefore, indicate that, although there had been an increase of about 4.05 percentile-points, compared with second-quarter's GDP statistic – 7.4 percent, Year-On-Year – 2012's first three quarters' statistic represented a 36 percentile-point drop, compared with the GDP's zenith, reached in respect of first quarter of 2011.

Beijing did not mention the export side of things in the PRC in its November 21, 2012, official release, but it is known, generally, to be declining, day after day after day.

With the man-in-the-street, causing alarm, internationally, by his repeated vocal demonstrations in the streets of Europe over the dire financial situation and his difficult living conditions in many a eurozone city, in Spain, Portugal, Greece and Italy, to name but four sovereign states where there is widespread dissatisfaction over those governments' imposed austerity measures as well as enjoying very high unemployment levels that have risen well into double-digit figures, it is hardly surprising that one of the largest exporters to this area of the world is feeling the pinch.

The eurozone powers-that-be, trying to bring about a financial consensus in the region, are determined to tighten up on excessive spending by member states; and, these austerity measures are hitting the average consumer right where it hurts the most: In his wallet.

In Spain and Greece, especially, one hears, daily, of families, being evicted from their rented premises due to inabilities to pay rent to landlords.

This situation has reached crises proportions and the respective governments have had to step in, in order to try to bring some sanity to the increasing madness.

Externally, whether or not the PRC is willing to own up to the truth, it is well known that, in 2010, exports were growing at the rate of about 30 percent, Year-On-Year.

In 2011, export growth had slowed by about 33.33 percentile points, Year-On-Year, to about 20 percent.

Looking at the first nine months of 2012, the growth in the value of exports had fallen to about 10 percent, a 66.66-percent drop, compared with the situation that existed in full 2010-Year.

One could demonstrate that such a fall in export growth reduces the country's GDP by about 0.50 percent in respect of the first three quarters of 2012.

As export growth continues to fall, so does investment growth, one, following the path of the other.

For the first nine months of 2012, Newly Approved Foreign-invested Enterprises amounted to 18,025, down about 11.67 percent, Year-On-Year, according to an official, PRC-Government announcement.

In terms of the actual usage of foreign investment in the PRC, during the first three quarters of 2012, it amounted to about $US83.42 billion, representing a drop of about 3.76 percent, compared with the like period of 2011.

<u>Investments in Bricks and Mortar</u>

On the PRC property side, in 2010, investment in bricks and mortar by domestic users/investors was about 30 percent. It drifted down only slightly in 2011, but, for the first nine months of 2012, it is down to a little more than 10 percent, compared with 2011.

The drop-off in investment in property, be it residential, commercial or industrial, it is bound to have a cascading effect on other sectors of the PRC's economy.

The PRC produces – or was producing until recently – about 700 million tonnes of steel per annum. Steel is a key ingredient in the construction industry.

In the years, 2009 and 2010, during the times of booming property markets in the PRC, the output of steel was growing at an annual rate of about 15 percent.

In 2011, the growth of steel output had moderated to about 10 percent, compared with 2010.

In the first nine months of 2012, the growth of steel output had fallen to about two percent, at most, Year-On-Year.

This means that steel mills in the PRC are losing money, hand over fist.

The PRC's property market is unlikely to recover quickly. In fact, it could well suffer, adversely, over the next few years, in this medium's opinion.

In the past, property investment had been an important driver for the PRC's economy: Not any more; and, probably, not for some time.

Over the past few years, many PRC households went head first into the property market and, today, household wealth is vested as to about 40 percent in property. This is about twice the amount that it was in the 1990s.

Banks in the country are, obviously, reluctant to fund new, residential property investments for a number of reasons, be they political and/or financial.

Thus, property prices must, inevitably, fall; and, the average householder's appetite for property investment must diminish, and will continue so to do for most of this year.

The PRC's banking system is very fragile when compared with many national banks of the Western World. It has been fragile for some years as a matter of fact.

The Industrial and Commercial Bank of China, The China Construction Bank, The Bank of China and The Agricultural Bank of China, sometimes known as *'The Big Four'*, account for about 45 percent of the total financial assets of the country and about 60 percent of all household deposits.

Put another way, the total equity capital of the entire PRC financial system is held as to about 50 percent by The Big Four.

The People's Bank of China functions as The Central Bank of the PRC and the country's primary commercial bank. It is the lender of last resort and disburses funds to State-owned enterprises when ordered so to do or when it is deemed absolutely necessary.

In 1998, The Big Four received capital injections, amounting to about $US33 billion. The following year, after the establishment of four, asset management companies, about $US169-billion worth of non-performing loans, equal to about 18 percent of GDP, was transferred to The Big Four.

The PRC banking sector, from the start of 2009 until last summer, granted loans in the amount of not less than $US5.40 trillion.

That amount of money was equivalent to about 73 percent of the country's GDP.

Since then, it has been deemed necessary to reclassify about $US438-billion worth of loans.

It is fully expected that there will, once again, have to be a realignment in the PRC's banking industry because not to do so could result in serious financial problems in the coming years.

With close to negative returns, derived from interest on bank deposits, many PRC householders have withdrawn much of their funds from banks in order to find better havens on their money.

This will, sooner than later, cause liquidity problems to banks and, also sooner than later, The Big Four and/or The People's Bank of China will be forced to come to the rescue of the weakened banks because illiquidity of an important State-owned, financial enterprise is not something that the Government of the PRC would want to have visited on the nation.

<u>The Future</u>

The new leadership of the PRC has inherited a number of ticklish and very difficult situations as it teeters on a proverbial knife-edge.

Because of the industriousness of the urbanised Chinese people and of their insatiable appetite for a better lifestyle, plus the established trend, endorsed by the previous leaders of the country, of moving further and further away from the totalitarian, communistic state with emphasis on an economy, driven by consumer consumption, for the next few years, at least, the current devilish situation could rank foremost in the minds of the country's new leaders.

By 2015, the current, hapless eurozone situation should be sorted out and the PRC's exports to its largest single customer are quite likely to be resumed, similar to a great extent of days of yore.

After all, which other nation has the capacity and experience of the PRC?

The one thing that the new PRC leaders would not want is to witness a similar situation as happened in the

US where the market value of homes fell down a bottomless pit, resulting in householders, leaving their homes to banks that, to this day, are left with what is now known as toxic assets.

If such a situation should be permitted to arise in the PRC, it could lead to widespread social unrest and, in a country of this size, being the most populous of the world, such unrest may be difficult to control.

Consumer-spending growth could well soften the slowdown in the country's GDP. It will be emphasised as a stopgap measure. But only, mind you, a stopgap measure; the country must, eventually, export its products in order to maintain growth of its GDP.

Rebalancing the economy of the world's second-largest, financial powerhouse is well expected.

Such a move will be welcomed because there are far too many corporate entities, both domestic and foreign, counting on the new PRC leadership to tackle the situation for everybody's benefit.

To be trite, the economy of the PRC is just too large to fail.

As it is, the PRC is the largest, single creditor of the US – and President Barack Hussein Obama is well aware of that little fact.

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