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A Perspective on the Chinese Bubble

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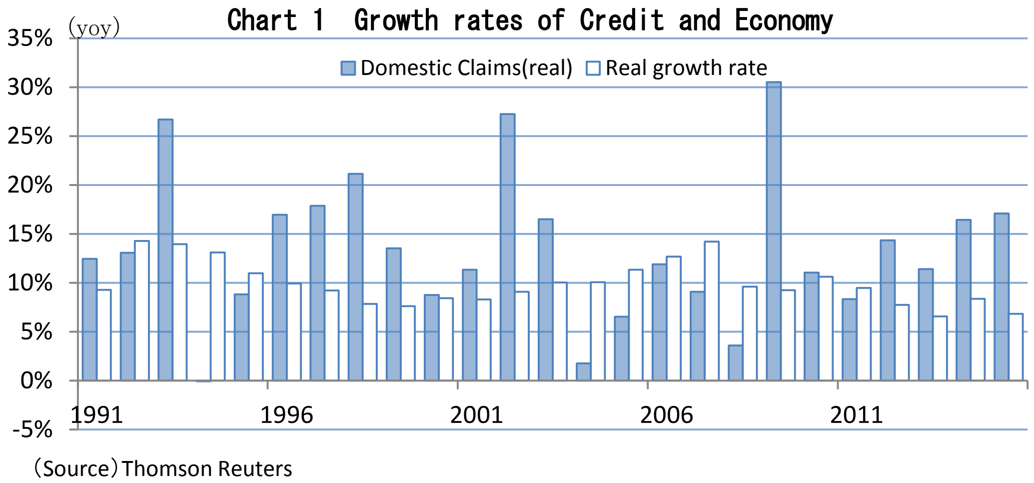
At a glance, China seems to have had a robust real GDP growth rate at 6.8% in 2015 over a year earlier but many of the news from China indicate a contrary situation to such robustness. For example, the Institute for International Finance (IFF) published the data that the capital outflow from China amounted to $676 billion last year, exceeding the trade surplus of $594.5 billion for that year. There are reports that the foreign companies located in the coastal China are shifting their factories one after another to Vietnam ad Myanmar. It is also reported that in the manufacturing sector there are an increasing number of delayed delivery of wages and sudden closes of factories. Pictures of the apartment buildings that became a ghost town are not rare any longer. Overseas analysts and economists voice a concern over the burst of the bubble or rapidly increasing non-performing loans. And these concerns are not just an unfounded fear.

Chart 1 compares the growth rates of domestic credit (adjusted by GDP deflator) with the real GDP growth rates since 1991. With some fluctuations, the growth rate of credit generally exceeded the GDP growth rate in the 1990s. It can be said that in this period China achieved high economic growth while depending on credit. As a result, however, non-performing assets had accumulated especially in the state owned enterprises in the first half of 2000s. The ratio of non-performing assets of the government banks amounted to 15.4% in 2002 for China Construction Bank, 25.2% for Industrial and Commercial Bank of China Limited, 22.4% for the Bank of China, and 36.6% for Agricultural Bank of China. It was only in 2004 that the bad assets were mostly disposed through restriction of loans.



Since the middle of 2000s, the Chinese economy continued to grow at double digit rates, especially by 14.2% in 2007, exceeding the increase of domestic credit.

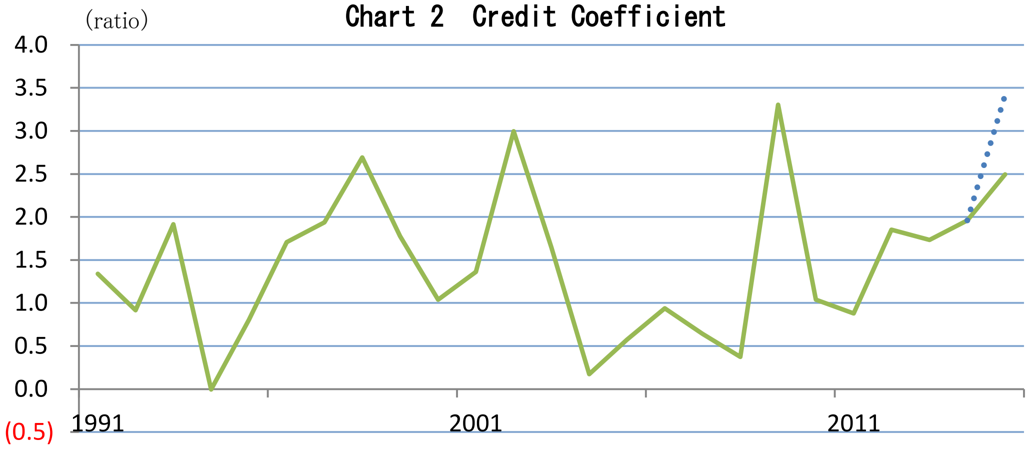
The growth rates of both economy and credit slowed down after the Lehman crisis that took place in the autumn of 2008, and the Chinese government took economic stimulus measures of 4 trillion yuan in the spring of 2009, which contributed to the recovery of the world economy. The provision of credit increased by 30.5% in 2009 in real terms, with the growth rate of more than 9% continuing to 2011.

In 2012, however, China had another turning point where the growth rate started to gradually slow down. As if to compensate the decline, the credit provision rather accelerated with the gap gradually expanding between the credit growth and economic growth. This meant that the effectiveness of credit for generating additional values was decreasing.

Taking an example of capital coefficient, let's try to compute a "credit coefficient". This coefficient measures how much credit should be increased to raise the growth rate of the real GDP by 1%. The credit coefficient has been on a rising trend since 2012, suggesting that the amounts of would-be non-performing assets are increasing.

There are other concerns. Many economists doubt that the actual growth rates may be lower than the published data. If the actual growth rate happens to have come down to 5%, the credit coefficient for 2015 would be estimated at as much as 3.4 times of the GDP, exceeding the past peak of 3.3 times recorded in 2009 (dotted line in Chart 2). The hypothesis that mountains of non-performing loans have accumulated in the Chinese economy is not likely to remain a mere assumption any more.

Chart 2 Credit Coefficient



(Source) Thomson Reuters