China's economic malaise deepens as economic warfare intensifies

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The New Year has opened with deepening concerns that the present malaise in the Chinese economy, the world's second largest, could be the lead-in to a long-term deflationary spiral which is set to be compounded by the tariff measures threatened by incoming US President Trump.

The clearest evidence of mounting long-term problems is the situation in the $11 trillion government bond market where yields have fallen sharply. A move by investors into bonds, which sends their price up and their yields down (the two have an inverse relationship), is a sign they expect low growth in the future and deflationary conditions.

The yield on the 10-year government bond, which was just below 5 percent in 2013, fell to below 1.6 percent when trading began this week. There is now a gap of 300 basis points (3 percentage points) between Chinese and US ten-year bonds.

The extent of the deflationary trend was underscored by monthly price data released yesterday. Consumer price growth was up by only 0.1 percent in December as against a year earlier and down from the 0.2 increase recorded in November. Producer prices, taken at the factory gate, were down 2.3 percent with this measure in deflationary territory for the past 28 months.

In a report on the bond market published on Wednesday, Bloomberg commented: "The plunge, which has dragged Chinese yields far below levels reached during the 2008 global financial crisis and the COVID pandemic, underscores the concern that policymakers will fail to stop China from sliding into an economic malaise that could last decades."

Comparisons are being drawn with what took place in Japan at the start of the 1990s when the collapse of a property and real estate bubble led to decades of stagnation from which the country has never really recovered.

The Bloomberg report noted it was significant that China's ten largest brokerage firms had all produced research on Japan's "lost decades."

The situation in China is potentially even more serious. This is because of its greater size and its role in the global economy as the chief engine of growth over the last decade and a half.

Its problems have been exacerbated by the economic warfare which now prevails, sparked by the anti-China measures implemented by the US. These will be intensified by the incoming Trump administration which has threatened to impose a 60 percent tariff hike on all Chinese goods.

The Bloomberg report noted that Chinese markets had entered 2025 "on a knife edge."

This is expressed not only in the fall in bond yields but also in the continuing decline in the stock market. The CSI 300 index is down by around 4 percent since the start of the year, having lost more than 30 percent from its high in 2021. The offshore value of the renminbi has fallen to a near record low.

The fall in the value of the currency, which the central bank is pushing to halt, is the direct result of the tariff measures foreshadowed by Trump. The view in the markets is that financial authorities will have to lower the official value of the renminbi to counter the effect of the Trump measures by making exports cheaper.

However, the central bank is seeking to hold the line because it fears any devaluation of the currency will spark a capital outflow from China.

In a statement issued on Monday, the central bank, which sets a daily official exchange rate, said it would "resolutely guard against the risk of exchange overshooting and maintain the basic stability" of the renminbi.

It said the experience of "multiple rounds of appreciation and depreciation" showed it had "sufficient" tools to do this.

Apart from concerns about capital outflow, the central bank is fearful that if the value of the renminbi falls, thereby making Chinese goods cheaper in world markets, this will only bring further attacks from the US and also from Europe.

But the pressure from the financial markets for a devaluation is continuing notwithstanding the statements of the central bank.

The *Financial Times* reported that leading officials at the two main stock markets in Shanghai and Shenzhen have also

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intervened. They held meetings last weekend to reassure investors that China's economy was supported by "solid fundamentals and resilience."

But such assurances are not likely to cut much ice. The prevailing view in the world of finance capital is that the government must undertake far more radical measures than it has so far to boost the domestic economy via increased consumption spending.

Some measures have been initiated in the past few months including a loosening of monetary policy, limited easing of the debt burden on local governments and some action to lift consumer spending.

The government this week announced the expansion of a subsidy program it introduced last year providing money for customers who traded in old appliances such as air conditioners and washing machines for new ones. The subsidy program has been extended to include such items as microwaves, rice cookers and dishwashers, as well as smartphones and tablets costing less than 6000 renminbi.

According to the finance ministry, the program will cost 81 billion renminbi ($US11 billion) in 2025.

The scheme has already had some impact in boosting consumption. The commerce ministry has said 36 million people used the scheme last year to buy new appliances. But this is a small portion of the market in a country of 1.4 billion and the effects are only short term.

And as the *Financial Times* (FT) reported "overall sales rose just 3 percent in November, missing expectations and reigniting concerns about the pace of consumption growth, while real estate data showed the largest year-on-year fall in new home prices since 2015 and a deepening decline in property investment."

Finance capital is looking for what has been termed a "big bazooka" aimed at the domestic economy. "In term of key things to look for in 2025… we think investors need to see more regarding consumption," Winnie Wu, chief China equity strategist at Bank of America, told the FT.

But while it has been willing to introduce some marginal measures and President Xi Jinjing has pointed to the need to lift consumption in recent speeches and remarks, the government is not prepared to introduce the kind of large-scale stimulus measures it did in the past, fearing this will only compound debt problems.

Moreover, it is operating in a highly uncertain economic environment given the Trump tariff threats and the intensification of economic warfare measures from the US in the dying days of the Biden administration.

In the latest decision from Washington this week, the Pentagon placed more companies on a list deemed to have links to the Chinese military. These included the social media and gaming giant, Tencent, CATL, the world's largest maker of electric vehicle batteries, and COSCO, China's largest shipping firm and one of the biggest in the world, among others. There are now 134 companies on the list.

The Pentagon listing does not bring any sanctions with it but is a sure sign that the named firms are being targeted for further action.

All three companies denied connections with the military, with Tencent insisting it was "clearly a mistake" and it would work with the defence department to "address any misunderstanding." CATL said it had never engaged in military related business. COSCO said none of its companies were involved with the military and it would seek to "clarify this matter" with US authorities.

But the actions of the Pentagon are not the result of mistakes or a misunderstanding. The US miliary apparatus is one of the most vociferous proponents of the position that economic and technological advance by China, irrespective of whether there is a direct connection to the military, is in and of itself a threat to the US.

The listing of CATL indicates some of the contradictions which will arise as the economic war intensifies. As a result of its expanding sales—CATL is a supplier to Tesla—the company was drawing up plans for a secondary stock market listing in Hong Kong, with an initial public offering (IPO) intended to give it access to offshore funds as it expanded its international operations.

The US firms Goldman Sachs, Bank of America, JPMorgan and Morgan Stanley have been reported as expressing interest in supporting the IPO. In the past US banks made considerable profits from such deals. But if they were to do so after the Pentagon listing, they could be accused of underwriting shares for a company with ties to the Chinese military that is supposedly thereby a threat to US national security.

Back in 2021, the Chinese consumer electronics firm Xiaomi was able to undertake court action to have itself removed from the Pentagon list. It successfully argued that its investment in 5G and artificial intelligence, the reason for its inclusion, was what every other company was doing.

No doubt the latest named firms will try to take the same path. But four years on, the economic war against China has been qualitatively stepped up and is about to become even more intense under Trump.

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