China Braces As European Crisis Adds To Strains

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HONG KONG (AP) — Europe's festering debt crisis is adding to strains on China just as the country is pricking its property bubble and facing a manufacturing downturn, limiting the ability of the world's No. 2 economy to prop up global growth.

Leaders in Europe are navigating a crucial week as they work to find a breakthrough at a summit Friday to avoid the disintegration of the euro common currency and the global financial panic that could ensue.

Such a scenario would slam China by crimping economic growth through lower demand for its exports. It would also prompt Beijing to slow the rise of its currency to a crawl — exacerbating trade tensions with the U.S. and other nations that say China's yuan is already too cheap.

Even if the euro common currency shared by 17 nations remains mostly intact, China and other Asian countries will still face the daunting prospect of a recession in Europe next year and anemic growth in the U.S. — both crucial markets for the region's cars, electronics, textiles and other exports.

During the 2009 global recession, China's 'shock and awe' style stimulus kept its booming economy on track. For Asia and other parts of the world, it helped soften the impact of the economic upheaval. The stimulus also unleashed high inflation, a torrent of low quality bank lending and uninhibited partying in the property market. Beijing is still trying to contain those distortions, meaning its response to a new downturn will be much more restrained.

The effects of Europe buckling beneath debt, austerity and financial market turmoil, and sloth-like growth in the U.S., are already being felt in China. Factory production shrank in November for the first time in nearly three years, and labor unrest is increasing as employers cut staff.

"Our suppliers here in China are beginning to be a lot more aggressive in trying to get business, which I put down to the fact that they're beginning to feel the pinch," said Christopher Devereux, who runs a company in Guangzhou, southern China sourcing high-quality lightweight parts for the automotive and mining industries.

"We're getting calls from suppliers looking for business — that I've only noticed in last three weeks," he said. Suppliers are now open to negotiating over prices, a sharp change from the past when their attitude was take-it-or-leave-it.

Other Chinese exporters say orders have dropped by 10 to 30 percent from normal times because of slumping demand in Europe and the U.S., according to Stanley Lau, deputy chairman of the Hong Kong Federation of Industries.

Factories that are getting orders say they are smaller than before and customers are placing them at the last possible moment because they want to be as sure as possible a product will sell, he said.

"We will not expect that there will be great improvement until fourth quarter of next year," said Lau, who also owns a watch factory in southern China. "Of course this is only a hope. We never know what will happens in Europe — whether the situation will go further downhill."

In a sign of what might lay ahead, China's exports to troubled Italy tumbled 17 percent in October from a year earlier. Sales to the full 27-nation European Union rose 7 percent, buoyed by strength in Germany and France, according to customs data.

"It's very likely that a recession is going to mean that demand for goods from China is going to sink precipitously," said Doug Guthrie, dean of the George Washington University School of Business.

That could drive down China's economic growth rate from this year's forecast of above 9 percent to as low as 6 percent, he said. The Asian Development Bank trimmed its forecast on Tuesday for Chinese growth next year to 8.8 percent from 9.1 percent. But in a worst-case scenario, with both Europe and the U.S. contracting at levels similar to 2009, it expects Chinese growth to slow to 6.8 percent.

Others think the hit could be much smaller because China's economy is less dependent on exports than it was before the 2008 global financial crisis. Exports now make up about a quarter of China's gross domestic product, down from about 40 percent in 2007 as investment and domestic consumption rose.

But millions of jobs still depend on manufacturing, especially along the southeast coast, where thousands of factories supply Europe and the United States with low-cost shoes, toys, furniture and other goods.

"There will be joblessness, loss of consumption power for a part of the population that has just come out of poverty. There will probably be a fair amount of social unrest that comes along with that," said Guthrie.

On top of interest rate cuts and lower bank reserves to spur lending and backstop growth, it's likely China would slow the appreciation of the tightly controlled yuan to keep its exports competitive on world markets.

That would be even more the case if especially fragile countries that use the euro such as Portugal and Greece ditch it in favor of a weak, export-boosting national currency. That in turn would raise the risk of bigger economies such as Italy doing the same.

A splintering of the euro grouping would send the common currency plummeting while acting as jet fuel for other currencies such as the dollar and the yuan, which is also known as the renminbi.

"We suspect that Chinese policymakers will respond by slowing the renminbi's pace of appreciation to a crawl," said Mark Williams, chief Asia economist for Capital Economics.

Some see the crisis as an opportunity for China's leaders to raise their global clout by stepping in to shore up the world financial system. But over the weekend they sent their clearest signal yet that they intend to stay out of the fray. A senior diplomat rejected the idea that China's $3.2 trillion in foreign currency reserves could be used to help dig Europe out of its mountain of debt.

"The argument that China should rescue Europe does not stand, as reserves are not managed that way," Vice Foreign Minister Fu Ying said in remarks reported on the weekend by Chinese state media.

Fu said China's reserves — some of which are invested in the bonds of European governments — are akin to money in a savings account.

The idea of a possible Chinese role in Europe has caused unease among Europeans. It wouldn't come off well at home either, analysts said.

"It doesn't make sense for China to give money from a relatively poor population, on average, to Europeans who don't want to cut their lifestyle," said Dariusz Kowalczyk, a senior economist at Credit Agricole CIB.

"This kind of logic will be deeply unpopular domestically, and I don't think China will make such moves. They will show some gesture of support because they want to be seen as a player on the global scene."