The New York Times

June 7, 2012

China Cuts Lending Rate as Its Economic Growth Slows

By KEITH BRADSHER

HONG KONG — Faced with a sharply slowing economy, weak exports and faltering investment, China's central bank unexpectedly announced Thursday that it would cut interest rates by a quarter of a percentage point.

The action by the People's Bank of China is the strongest measure taken this year by the Chinese government to counteract an economic malaise that has infected Europe and the United States and now seems to be affecting China faster and more extensively than most policy makers or private economists had anticipated.

The interest rate cut is the first by the central bank since December 2008, when policy makers in China were deeply worried they might be behind in responding to an economy slipping downhill faster than expected. Many economists say they believe that China's leaders are behind the curve again this year, after two months of near paralysis on economic policy this spring as the Communist Party wrangled over the fate of one of its own, Bo Xilai.

The National Bureau of Statistics of China is scheduled to release a long list of economic indicators for May on Saturday morning in Beijing, including industrial production and the consumer price index.

Yu Song, an economist in the Beijing office of Goldman Sachs, said that government policy makers were certain to have those figures already.

The decision to cut interest rates suggests that the Chinese economy performed poorly last month, he wrote in a research note, and that Premier Wen Jiabao personally ordered policy makers to take action.

Spreading economic distress in China is readily apparent these days from the street markets of export-dependent coastal provinces, where factories are closing, to the construction sites of investment-hungry inland provinces, where most developers have switched from three shifts a day to a single shift.

In Qingxi, a town in southeastern China, a wave of bankruptcies among exporters of car stereo components has resulted in mass layoffs with a ripple effect of falling sales at local retailers.

In interviews Thursday morning in Qingxi, a range of business people complained that the economy now was worse than in early 2009, when factories closed and millions of migrant workers lost their jobs during the early stages of the global financial crisis.

“Nobody is spending,” said Yu Jia, the owner of a general store selling a variety of goods including tofu and laundry detergent. Her sales have fallen by nearly a third since the Lunar New Year in late January, she complained.

Lowering interest rates makes it easier for companies and individuals to borrow money and start spending again. The People’s Bank of China announced that the regulated one-year corporate lending rate would drop to 6.31 percent, from 6.56 percent, effective Friday.

In a parallel move that will amplify the practical effect of the rate cut, the central bank also said that commercial banks would be allowed to further reduce the lending rate by a fifth for good customers; the previous discount had been a tenth.

Banks will also pay less interest on deposits, however, which could hurt savers. The one-year deposit rate will drop to 3.25 percent from 3.5 percent, the People’s Bank of China said on its Web site.

Less than a month ago, the government took another, smaller step to loosen monetary policy by reducing the percentage of assets that commercial banks are required to hold as reserves at the central bank. That step freed up money for banks to lend but did not help borrowers afford loans.

Liu Li-Gang, the chief economist for greater China in the Hong Kong office of ANZ, a big Australian bank, said that the decision by the People’s Bank of China to reduce interest rates represented a clear shift in direction, showing that it “has formally entered into a stage of policy easing from that of a policy fine-tuning.”

China’s economic indicators for April were dismal. Exports and imports stalled while investment in fixed assets increased more slowly in the first four months of this year than in any year since 2001.

Retail sales grew at a slower annual pace in April than in any month in the last decade, excluding years when January and February were strongly affected by the Lunar New Year holiday.

A statement posted on the Chinese government's Web site on May 24 cited Zhang Liqun, a senior economist advising the cabinet, as saying that "the sharp slowdown in the economy has aroused attention from policy makers."

Cutting interest rates comes as Chinese officials are already speeding up the approval of infrastructure projects and other economic stimulus spending.

The big question now for Chinese policy makers is how much they are willing to ramp up government infrastructure spending and lending by state-owned banks to offset the slowdown. China lent and spent huge amounts in 2009 to limit its downturn to several months and make the fastest recovery of any large economy from the global financial crisis.

But the bill from that binge has since come due. Local governments across the country are straining to maintain payments on heavy debts incurred during the spending spree. Banks are worrying about the extent of the loan write-offs they may need to take.

China's broadly measured money supply grew much faster than that of the United States, leading to steep increases in housing prices through last summer. That led to considerable complaints from the general public that city apartments had become unaffordable, causing the government to pop the housing bubble last summer.

The ensuing housing bust has caused prices to drop as much as 20 percent in some cities, according to real estate brokers. Developers have laid off construction workers in droves across the nation.

Some economists, like Ruchir Sharma, the managing director of emerging-market equities at Morgan Stanley, say that China has reached a level of prosperity at which its pace of growth will inevitably ratchet down from the nearly double-digit annual expansion it has enjoyed for the last three decades.

"Investments and exports will really slow down," as Chinese wages have reached a level that erodes the country's competitive advantage, he said in a speech last week in Hong Kong.

Economic output per person in China is approaching $5,000, prompting the World Bank to reclassify the country last summer as an "upper middle income" nation instead of a "lower middle income" one.

Other economists are more optimistic about China's short-term growth but say that structural changes, like freeing the financial system from bureaucratic controls, are needed for longer-term growth.

Eswar Prasad, a former division chief of the International Monetary Fund, said in an interview in Hong Kong last week that he believed China could still post another year of 8 percent economic growth in 2012, but the question is the composition and long-term sustainability of that growth.

The weaker that China’s exports, retail sales and other indicators become, the more likely that China will have to rely again this year on government spending and lending to reach 8 percent, he said.

One mystery is why Chinese policy makers did not respond sooner to signs this spring that their country’s economy was starting to weaken.

When Morgan Stanley cut its forecast on May 20 for China’s economic growth this year, to 8.5 percent from 9 percent, it mentioned that it had foreseen two months before that the economy needed help and had based its earlier estimate on an expectation of prompt, intensive action by policy makers that did not materialize.

What Morgan Stanley did not mention, and what independent economists tend to be reluctant to discuss, is that the period of inactivity by economic policy makers from mid-March to mid-May roughly matched a time of factional infighting in the Chinese Communist Party. This included the removal of Mr. Bo as the Communist Party secretary of Chongqing and his suspension from the Politburo.