

China Factory Closures Shatter 'Decoupling' Myth

The 'China boom' appears headed for a hard landing, primarily due to soaring transportation costs and the economic downturn underway in China's largest export markets.

The OECD predicts the end of China's competitive advantage as rising transportation costs cause relocation of industries away from China and closer to U.S. and European consumer markets, and wage and price inflation erodes China's export competitiveness. As China's export-driven economy contracts, the limited purchasing power of China's domestic consumers is insufficient to replace the loss of demand for exports. China's dependency on low margin-high volume manufacturing makes the country especially vulnerable to the global economic slowdown already underway in the US and Europe.

Commerce Minister Bo Xilai recently stated that it takes over 800 million pairs of shoes and t-shirts to purchase a single Boeing aircraft. But even China's shoe industry is feeling pain: Xinhua reports 2,331 shoe factories in China's Guangdong Province, half the total, closed in the first five months of 2008.

"We expect a lag of 2-3 quarters before the real impact appears," commented Kevin O'Brien at risk analytics firm Sovereign Advisers. O'Brien cited the drop in trans-pacific container traffic and the miles of idled railroad container freight cars placed into storage by Burlington Northern as early signs of the reversal of China's past economic boom. O'Brien added, "the accelerating global slowdown will have a pronounced adverse effect on China's economy. As a producer nation and net importer of oil, China is particularly vulnerable to commodity price inflation, and its economic and political stability is dependent upon hard currency earnings derived from export manufacturing. China's vast income disparity precludes a seamless transition to a domestic consumer economy."

Diane Swonk, chief economist at Mesirov Financial, stated "We are seeing weakness in the U.S., and the whole idea of a "decoupling" of the U.S. and external economies is being debunked."

Factory owner Tim Hsu, whose lighting fixtures plant is operating at 60% of capacity, predicts half of China's lighting factories will close their doors this year. "Shoe factories, clothing, toys, furniture, everyone is shutting down," he says. Philip Cheng, chairman of Strategic Sports and producer of half the global supply of motorcycle, bicycle, and snowboarding helmets from 17 plants, says "now we are dying."

"The Asian outsourcing game is over," says CIBC World Markets chief economist Jeff Rubin. China's heyday may be in the past.

China Economic Outlook:

www.globalsecuritieswatch.org/PRC_Sovereign_Risk_Review.pdf

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