The Impact of European Debt Crisis on Chinese Economy and Potential Countermeasures

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Abstract: European debt crisis can never be neglected since it brings important influence to not only Chinese domestic economy but also its import and export trades. This paper deeply explores the cause of European debt crisis based on the analysis of the past and present of European economy, discusses the harmful impact of European debt crisis on Chinese economy, and then put forward some countermeasures for reference.

Keywords: European debt crisis, Financial crisis, Industrial structure, China-EU trade

1 Introduction

The European sovereign debt crisis began in the late of 2009. On the 8th, December 2009 Fitch ratings cut Greece’s credit rating from A- to BBB+, so the European sovereign debt crisis on the European summit in December 2011, common concerns arising from society as a whole. China and European trade and investment have important issue. As Chinese largest trading partner, the first biggest export markets, the first largest source of technology import and the second largest import market, which is becoming the most important overseas market of China recently. The European debt crisis will lead to the loss of confidence for investor, risk aversion is aggravating, and money will began to withdraw from Europe to all over the world to looking for the new investment. Therefore, Europe’s debt problems can never be neglected.

2 The Financial Crisis and the Sovereign Debt Crisis

Financial crisis mainly include currency crisis and banking crisis. Kaminsky and Reinhart (1999) took the loss of foreign exchange reserves and the real exchange rate depreciation as a measure of a currency crisis. Reinhart and Rogoff (2008) defined the bank crisis specifically as bank runs or major financial institutions collapse, merger, takeover, or by the government’s aid.

The sovereign debt crisis occurs as a cyclical phenomenon and which has a same essence in previous crisis. Generally, the sovereign states take their own sovereign for guarantee, to borrow from the international community by issuing bonds and on other ways. As most of sovereign debt values weigh by foreign currency, to take international agencies, foreign governments or international financial institution for loans, therefore, once the debt countries appear sovereign default phenomenon, its credit rating was lowered, the result will happen on a sovereign debt crisis.

Banking crises often preceded or accompanied earlier by the sovereign debt crisis. There outbreak of a severe financial crisis in Latin American countries in the 1980s. So Aliejandr (1985) argued that after the financial liberalization in Latin America, as the imperfect financial market, the government relying on borrowing from the private bank weakened its ability to repay, in the end, the sovereign debt crisis happens when the bank crisis tend to be accompanied.

Before the banking crisis, the surge of private debt is usually found. Rodrik and Ve1asco (2000) via an external borrowing time limit and cost of simultaneous model, pointed out that short-term debt and the proportion of foreign exchange reserves can effectively predict the banking crisis.
3 The Reason Analysis of Why Europe Erupt Debt Crisis

3.1 External reason

3.1.1 The financial crisis made extra debt burdens on the governments in 2008
After the financial crisis, in order to maximum extent to stimulate the economy, most of the crisis countries adopt expansionary fiscal and monetary policy. In America, for example, the United States proposed $700 billion rescue plan, the actual money supply increase, government purchases increase, after the financial crisis. In the floating exchange rate under the condition of small open economy country, according to the Mendel-Fleming model, real money supply increases, the LM curve shifts to the right. Therefore, we can improve the income and reduce the exchange rate and its currency devaluation relative to foreign currency, thus we can suppress import and increasing exports. In Greece, generous welfare, low surplus, while it is not a high fiscal surpluses to boost domestic demand, through the crisis.

3.1.2 Rating agencies led to the crisis quickly spread
In December 2009 the world’s three major ratings firms (S&P, Moody’s and Fitch) down graded Greece’s sovereign rating, Greece’s debt crisis intensified. On July 5, 2011, the standard & poor’s cut Greece’s sovereign rating levels from 2009 A to C (junk), Italy’s outlook also adjust to negative, then in September and early October 2011, standard & poor’s and moody’s downgraded Italy’s sovereign debt rating again. Meanwhile, sovereign debt ratings downgrade in Spain and Portugal. Rating agencies downgrade of European debt credit rating of the country caused a panic in the market, the lack of confidence in the market, which can be looked at as the direct cause of crisis to the depth development.

3.2 Internal reasons

3.2.1 The imbalance of industrial structure and real economy
Among the European Union countries, Greece with a relatively low level of economic development, and resource allocation is unreasonable, and tourism industry is difficult to resist the impact of the crisis. Coupled with the increase of $9.1 billion of debt held by Olympic Games in 2004, debt in Greece by 2010 is already up to 328.6 billion Euros in total. Due to the impact of financial crisis, the tourism industry into the trough since 2008, the Greek economy transition is seriously rely on the external demand, under the impact of the financial crisis, which is extremely fragile. At the same time, Italy, Spain, Ireland and Portugal and many of other countries included: under the financial crisis hit by the severe, the European economy as a whole surface deterioration, at last the crisis break out.

3.2.2 Demographic imbalance and aging is serious
With the accelerating of industrialization and urbanization, the cost of living increase, while the fertility rate fell, the number of elderly people increases rapidly, and the scale is more and more huge, and the developed countries began to enter into the aging time. At the same time with the rapid aging of the arrival of wave, which brought to the economic growth and social development a lot, mainly reflected the labor population burden, a shortage of labor force, rising labor costs, heavier burden on society, and many other aspects.

3.2.3 The rigid social welfare system is not match to domestic GDP growth
In recent years, many countries in southern Europe social welfare as a share of GDP raised rapidly, which included Greece and Ireland, the most prominent, welfare as a share of GDP rose from less than 20% to 20% above. In 2010 Greece welfare took as a proportion of GDP of 20.6%, and 41.6% in total government expenditure. The welfare state in the case of economic running is not a problem, but due to the impact of the financial crisis in 2008, Greece, Ireland and Spain were different degrees of stagnation and negative growth appeared. Economic stagnation, high unemployment and resulting in a large number of laid-off workers, increase social welfare spending, GDP fell again, double pressures lead to fiscal deficit soared, Greece’s fiscal deficit in 2010 accounted for the proportion of 10.4% in GDP, Ireland even as high as 32.4%.

3.2.4 The Euro area has only unified monetary policy and lack of unified fiscal policy
European debt crisis was derived from its system structure existed the defects of “congenital deficient”. Some members could not according to its own unique situation at the appropriate time for a proper monetary policy. At the same time, the “stability and growth pact” in Europe about the budget deficit must not exceed 3% of GDP, public debt should not exceed 60% of the GDP the provisions of the basic decoration, to analyze the causes of European debt crisis, this is why they had no Euro zone countries abide by and perform.

4 The Impact of European Debt Crisis on China

4.1 The impact on China-EU trade at the macro level
The China’s macroeconomic influence mainly displays in the import and export trade. According to customs statistics, between January and June, in 2011, China to the European export growth was 16.9%, the national overall export growth low 7.1% over the same period, and after the financial crisis the Export growth is longer than the period in stark contrast to the European export growth is higher than the national average. As to the country, between January and June, Chinese is in the first six largest export market of the European Union, which includes Germany, the Netherlands, Britain, France, Italy and Spain, combined exports accounted for 74.1% of the total amount of exports to the European during this period, down 0.6% compared with the same period in 2010. Since China’s accession to the WTO ten years, the volume of trade between China and the European Union, the trade surplus has maintained a stable rise, and the proportion of trade in all of China’s foreign trade has been rising steadily. Tools to the European debt crisis mainly through exchange rate on China’s export enterprises, which form a larger impact. According to the incomplete Reinhart alternative model, Exchange rate is an important parameter of import and export functions. If the Euro remains weak, relatively appreciation of RMB exchange rate, European importers would feel China is getting expensive, the loss of price competitiveness on the domestic export can cause adverse effects. In the Euro against the RMB exchange rate from December 2009 to ask price of 10.25 to 8.4127 recently, depreciation is close to 20%. This number means that China a lot of the profits of the foreign trade enterprise exports to Europe have been wiped clean.

4.2 The impact on economy at the micro level
Microeconomic impact is mainly manifested on individual companies. Most Chinese companies do not have a mature market in the European Union to carry out large-scale investment management, just enter, could eventually bite the dust. Concentrated a large number of Chinese enterprises in Europe, especially in individual companies regardless of the cost of acquisition of the European Union behavior of high-end technology, which led to the vigilance of the EU, the European Union politicians and public opinion in China investment of protectionist rhetoric sometimes appear. European debt caused by Euro depreciation, individuals, small and medium enterprises in our country is almost from unprofitable. According to the export enterprises in view of the eastern coastal areas of pressure test, according to the RMB has appreciated 3% against the Euro in the short term, the related enterprise profit is reduced up to 50% at most. For China’s export-oriented manufacturing enterprises, especially to the average profit, which is only 3%-5% of the traditional textile products export enterprises, long-term low profit or zero profit run will undoubtedly increase survival crisis.

4.3 The impact on the real economy
The European debt crisis on the real economic performance is the most obvious impact on commodity prices since the European debt crisis, the global commodity market developed. Followed the European debt crisis expected only symptoms. And it filled column is becoming increasingly obvious. Based on crude oil futures fell, international oil prices in the 8 May 2011 the European central bank after weaker-than-expected measures and comments too fell by about 3%. Given the current public opinion agree that no quick solution to the European debt crisis, crude oil, accountability and industrial metals
such as metal prices in the future will still maintain a high level of sensitivity to Europe. Europe’s debt crisis was able to dominate the commodities market, largely because it can have a decisive impact on global economic fundamentals. And on this question, in the field of commodity market research analysis holds the authority standard bank issued periodically view: low inventory, more commodities for strategic reserves. The weak demand growth and overall silver to be faster recovery.

5 Potential Countermeasures

5.1 Change the traditional pattern of economy growth, upgrading industry and expanding domestic demand

From the economic aspect, our country still has a lot of hot money into the stock market or real estate and other virtual economy at present, and dominated by the government investment-led economic development remains unchanged. Economic structure must be adjusted to prevent such as Greece, Dubai, such as the economic crisis caused by the real estate bubble burst. At the same time, with the demographic dividend in China since reform and opening up, this phenomenon has gradually disappeared, “labor shortage” problem gradually revealed. To analysis of this, we must speed up the transformation of manufacturing industry, changing the consumption structure upgrade, development of strategic emerging industries, and encourage and protect intellectual property rights, industry and improve the international competitiveness.

5.2 Speed up the implementation of free trade area strategy

From the aspects of trade, the European Union is Chinese largest export market, if it break-up, this would bring huge negative effects to our country with foreign trade. In the current Doha round negotiations are deadlocked situation, countries are looking for a long-term strategic partner mechanism construction, through the construction of free trade area or closer economic strategic cooperative arrangements, to win a greater profit space. Strategy to speed up the implementation of free trade zone, which is also the major strategic deployment of China’s opening to the outside world, it is also an important strategic task of “twelfth five-year” period. Continue to use and maintain the good existing Free Trade Area, actively promote the new Free Trade Area negotiations, in particular to vigorously promote the construction of China, Japan and South Korea free trade, and carefully in engaging in the trans-pacific partnership talks, actively explore alternative markets.

5.3 Suggest the Euro zone to issue Euro zone debts and promise to buy

From the aspects of financial, in some Euro zone countries under the background of treasury bonds that have higher risks of restructuring, debt should not be rushed to buy in Euro zone countries. We can regard to promote global European bond markets in Europe as one of China strategy to support the Euro area. The Euro zone bonds can be form of global European bond markets, or good for the Euro zone to walk out of crisis. Europe’s government bond markets will also be the most powerful rivals of the US Treasury market, which can provide more channels for reserve diversification in our country. So we can consider through commitment to large purchases of Euro zone debt in our country to support the Euro zone through the debt crisis.

5.4 Innovate investment ways to directly invest in Europe

From the aspects of investment, at present, our country in the European Union’s 27 countries of the direct investment only $15 billion, accounting for 0.2% in the Euro to absorb foreign direct investment. Speed up to the direct investment, not only can expand our country economy development space, but also solve the Euro zone debt crisis in Europe and led to solve contraction in credit and liquidity shortage problem. We can support its economic development, indirectly helps to solve its debt problems. In addition, we can consider forming a corresponding investment platform, innovation investment approach to invest in Europe. So as to negotiate with the present price bid or to invest in funds difficult
5.5 Carefully set up the East Asian monetary union
From system level, a numerous, economic development level of countries are separated by great loose monetary body need to, so the system design can not only think of the good side, but also fully estimated to potential threats. East Asian monetary cooperation will further expand the scale of mutual funds, and establishing economic and financial conditions in the territory and rescue mechanism, supervision and management system to guard against the financial and fiscal risk.

5.6 Scan domestic debt problems combined with domestic actual situation
On the aspects knowledge level aspect, at present, our government achievements obtained in the fiscal deficit problem in control is relatively outstanding. Such as fiscal deficits as a share of GDP in 2009 to less than 3%, and total debt is controlled within 20% in that category, and achieve the early warning index, compared to 60% in the control result is obtained in China. But we should also worth pointing out that Chinese debt problems still exist uncertainty factors, especially in the part of local government debt measure as high as 300%, the China banking regulatory commission statistics there are 11 trillion on local government debt, international authoritative institutions think that China’s local government debt is close to 25 trillion or more. Therefore, debt ratio problem exists in a very great degree is a wake-up call to the local government, the global financial crisis and debt crisis can also help the central and local governments to have a clear understanding of the internal and external debt problem, and then to regulate the government financing platform, strengthen financial regulation to increase the dynamic.

6 Conclusion

The harsh facts have proved that the financial crisis company around us, all countries should be vigilant, be ware of the emergence of a new round of financial crisis, according to the different national conditions, to implement fiscal austerity, regress to reduce the budget deficit, grope for flee out of the crisis of the different paths and mode. For China, though the influence of financial crisis is not very big, we also make the Chinese authorities and economists recognize that the economic crisis on China’s influence can not be ignored, the authorities should take measures to cope with heavy multiple crisis have occurred, to avoid another crisis. Only through this way, can we make the national economy healthy and stable development.

References