redressing of the domestic financial balance on a number of different fronts. Given the high levels of dependence on debt, the Chinese government has been trying for months to reduce the extent of shadow banking. To do so, it has been raising interest rates on the interbank market in order to spur companies towards financing themselves on the stock market.
In other words, it is trying to entice or, better still, steer companies towards launching initial public offerings (IPOs).
At the same time, this rebalancing process is also being carried out on the banking front. The more financial support for recapitalization is sought through stocks, the greater the demand for obligations issued by local administrations. The disintermediation, called for in no uncertain terms by the Beijing authorities, is perhaps taking place too fast. According to Nomura analysts, over the course of the last year 60% of Chinese financial companies have preferred to access credit markets other than traditional banking or alternative options such as shadow banking. This means that, even for the banking industry, financial resources are coming from the corporate market, the stock exchange and local administrations. And because these markets are still young and have less efficient watchdogs than advanced economies, the risk of imbalances is even greater.
There are also a few factors that at least in the long term could make matters worse. The first is regulatory actions which have introduced restrictions on margin finance, now standing at 3.4% of GDP, as noted by J.P. Morgan. The more the authorities run scared, the more investors will do the same and feed the wave of sales of the various classes of assets involved in the bubble – from stocks to local administration obligations.
The second factor is related to the fundamentals of the Chinese economy, which are clearly getting worse. "We expect China's annual GDP growth to slip below 7% already during this year", Stanley Morgan warned. At this rate, investors consider the Chinese economy to be in recession. "The risk is a de facto Japanese style stagnation", according to analysts at the US bank.
And then there's the third factor, the most dangerous one. Bubbles by their very nature are unpredictable. We have seen that with the Dutch Tulipmania, hi-tech shares on the US market and sub-prime mortgages.
But the Chinese bubble is different. Firstly, because it has been encouraged partly by the Beijing authorities as a way of redressing the balance of the economy. Secondly, because it involves a wide range of sectors. It's not just the stock market; local administrations, shadow banking and corporate debt are also involved. HSBC views it as "a plethora of bubbles of various

Chinese shadow play

by Manus Flanagan

"The Chinese government is determined to tackle smog and environmental pollution as a whole", Chinese Premier Li Keqiang assured reporters, although he admitted that the pace of progress had not quite lived up to expectations.
In 2014, Beijing's highest legislative body, the National People's Congress, declared war on pollution and stated that among its main goals was the transformation of China into a beautiful country with an ecologically pristine environment.
This commitment led to substantial investments in renewable energies as well as energy and water conservation projects. In addition, more stringent legislation was passed aimed at reducing toxic emissions.
Then at the end of the APEC (Asia-Pacific Economic Cooperation) summit in November, President Xi Jinping finalized an agreement with Barack Obama to strengthen bilateral cooperation between China and the US on the subject of climate change.
Together they signed a document that has paved paved the way for an international agreement that would reflect "the principle of shared but differentiated responsibility".
The Chinese pledged to reach peak emissions of CO_2 by around the year 2030. At the same time, commitments were made to reduce the consumption of fossil fuels and to raise energy production from clean energy sources to 20%.
If viewed in context, however, these efforts still appear rather limited, especially when considering the human suffering caused by toxic emissions in China. The latest official statistics date back to 2004. At that time, the World Health Organization (WHO) estimated that around 300,000 deaths in China

entities, none of which should be taken lightly".

The good thing at least in the medium term is that the Chinese central bank, the People's Bank of China (PBoC), has plenty of arrows in its quiver with which to reduce volatility. From injections of liquidity to the completion of macroprudential regulation, the PBoC still has a means of stopping the rot, both now and in the future. The problem is that it is not clear how deep China's imbalances run, and perhaps it will become apparent only when all of the various bubbles burst. ■

— Michael Gross *is a broadcast journalist who specializes in finance.*



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Investors on the Chinese stock exchange. The Shanghai index has recorded an 80% increase since the beginning of the year.

resulted from smog each year.

More recently, in a study published in *The Lancet* in 2013, the former Chinese minister of health, Chen Zhu, estimated the number to be between 350,000 and 500,000 deaths per year.

Such shocking figures, however, are believed by many to actually underestimate the problem. Consider, for example, the events of 2013. In October of that year, as the coal-powered heating systems were being fired up for the season, a thick cloud of smog lingered for days on end over the regions of the Northwest.

In cities such as Harbin, the particle count reached 1,000 micrograms per m^2, 40 times the maximum level suggested by WHO guidelines.

Less than three months later in some Shanghai neighbourhoods, particle levels exceeded 700 micrograms per m^2 and visibility deteriorated so drastically that the authorities were forced to close down airports and schools.

Similar episodes can be found to have taken place elsewhere during the last century: iIn the US, Black Tuesday in the city of St. Louis in 1939 and the Donora smog in 1948 in Pennsylvania are cited as having led to the emergence of the environmental movement.

The Great Smog in London in 1952 caused 12,000 deaths. In light of that event, the United Kingdom passed the Clean Air Act of 1956 – still viewed as a key milestone in British environmental legislation today.

Thus, such events have the potential to awaken the consciousness of a population. A more recent example is that of *Under the Dome*, a documentary by the journalist Chai Jing that analyzes the problem of pollution in China. Broadcast on the web in February, it was viewed by over 150 million Chinese in the three days prior to its being censored.

Of concern to Beijing, however, is more than the mere cost in terms of public opinion. According to a report by the World Bank, the level of environmental degradation and the exhaustion of resources have an economic impact on China equivalent to 9% of its national GDP. If these figures reflect the actual situation, they represent an $800 billion (€726bn) loss during the last year alone.

The statements of Premier Li Keqiang above should be viewed in this context. They highlight how environmental issues have breached the Communist Party - which is also notably concerned about the flight of human capital. It has become increasingly common for senior Western managers to request far higher salaries to work in China due to the environmental conditions. Even more worrying was a report by the magazine *Hurun* that claimed that in recent years over 60% of the China's super rich have been planning to emigrate or have already done so. ■

— Manus Flanagan *has worked for the newspapers* Il Sole 24 Ore *and* Corriere della Sera. *He specializes in macroeconomics and geopolitics.*