



Concerns of Over Deflation in China

For Prelims: Concerns of Over Deflation in China, [Consumer Price Index](#), [Deflation](#), [Inflation](#), [Gross Domestic Product](#), [Debts](#), [Wholesale Price Index](#).

For Mains: Concerns of Over Deflation in China, Implications of Deflation in China on India.

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Why in News?

Recently, China's National Bureau of Statistics reported that the [Consumer Price Index \(CPI\)](#) had declined in July 2023 by 0.3% compared to a year earlier, causing [Deflation](#) in the Country.

What is Deflation?

▪ About:

- Deflation is the **opposite of Inflation**. It refers to a **sustained and general decrease** in the **overall price levels** of goods and services in the economy.
- In a deflationary environment, **consumers can buy more goods** and services for the same amount of money over time.
- However, **deflation can occur for various reasons**, such as reduced consumer demand, oversupply of goods, technological advancements that lower production costs, or tight monetary policies by central banks.
 - In China's case, reduced consumer demand and economic slowdown are the reasons.

▪ Impact:

◦ Positive:

- **Lower Interest Rates:** In a deflationary environment, central banks may lower interest rates to **encourage borrowing and spending**. Lower interest rates can lead to **reduced borrowing costs for businesses and consumers**, potentially stimulating investment, consumption, and economic activity.
- **Improved Savings Incentives:** Deflation can encourage saving because the value of money increases over time. Savers are more **likely to see the value of their money grow**, which can incentivize them to save more for the future, contributing to long-term financial stability.
- **Economic Efficiency:** Deflation can prompt businesses to become more **efficient and streamline** their operations. Falling prices can encourage companies to **reduce costs, innovate, and become more competitive** in order to maintain profitability. This focus on efficiency can lead to productivity gains and long-term economic growth.
- **Favorable for Fixed-Income Beneficiaries:** People who rely on fixed-income investments, such as retirees with pension plans or fixed annuities, may benefit from deflation. Since the value of money increases, **their fixed income becomes relatively more valuable**, providing them with a stable and reliable source of

income.

- **Negative:**
 - **Downward Spiral of Economic Contraction:** When consumers expect **prices to fall further, they delay purchases**, leading to decreased demand for goods and services. This reduction in demand can **lead to lower production, reduced business** revenues, and even layoffs, which in turn further **reduce consumer spending**.
 - This cycle can create a **downward spiral of economic contraction**, job losses, and financial instability.
 - **Drive Down Business Revenue:** Lower prices **drive down business revenues**, leading to lower profits, less investment, and potentially higher unemployment as companies pare back on production in the face of decreased demand.
 - **Expensive Service Debt:** Deflation can increase the **real burden of debt**. As prices fall, the value of debt remains constant or **even increases in real terms**. This can make it more difficult for individuals, businesses, and governments to **manage their debt obligations**.
 - In times of deflation, the relative **purchasing power of every dollar spent on debt repayment is higher** than it was before prices began falling.
- However, economic situations can be complex, and **the actual effects of deflation can vary depending on the specific circumstances of an economy**.

What Caused Deflation in China?

- **Zero-Covid Policy:**
 - The Chinese economy has been **struggling for more than a year**. The most prominent was a **heavy-handed Zero-Covid** policy that saw entire cities shut down, **sometimes for weeks at a time**, in an effort to prevent the spread of the coronavirus.
- **Slowdown in Property and Banking Sector:**
 - The property sector, which in recent years **accounted for between 20% and 30% of GDP (Gross Domestic Product)**, has suffered a **severe slowdown**, with a number of major developers **unable to service their Debts**, and many projects left incomplete.
 - The banking sector is also **burdened by bad loans**, many of which were made to local government agencies that have experienced sharp declines in revenue.
- **Unemployment:**
 - Increasing unemployment among **younger workers is also a problem**, with the official jobless rate for **people ages 16 to 24 at 21%**, and some experts expressing concern that the **real number is significantly higher**.

How can China's Deflation Impact India and the World?

- **India:**
 - **Positive Effect:** If investment in the Chinese economy is lowered owing to the increasing **slowing rate of their economy**, and now deflation, India could potentially **emerge and take over as the manufacturing hub** for the developed economies.
 - For India, if economic reforms are accelerated, India can **become the next manufacturing hub**.
 - **Negative Effect:** China remains one of the biggest **importers of iron ore from India**. The east Asian country imports **almost 70% of Iron-ore from India**.
 - Therefore, a slower economy for China would mean the amount of import into **China could fall, spelling somewhat doom from India's economy**.
- **World:**
 - **Global Supply Chains:**
 - Many global supply chains **are intricately linked with China**. If China's export **engine is sputtering due to deflation and weak demand**, disruptions in supply chains could affect industries worldwide, including those in India that rely on intermediate goods from China.
 - **Global Growth:**
 - China is the **world's second-largest economy**, and its economic health has a

significant **impact on global growth**.

- A sharp decline in China's economic activity due to deflation could lead to **reduced demand for goods and services worldwide**, contributing to a slowdown in global economic growth.
- **Central Banks and Monetary Policy:**
 - Central banks in various countries might face challenges in managing monetary policy in response to deflation in China.
 - Lower global demand could lead to reduced inflationary pressures and impact the effectiveness of interest rate policies.

Way Forward

- Policymakers around the world, including in India, would need to closely monitor these developments and formulate strategies to mitigate potential negative impacts.
- The implications of deflation can include increased debt burdens, altered consumer behavior, reduced business investment, and challenges for monetary policy.
- Addressing deflation will require **a combination of fiscal stimulus** and monetary policy measures to **boost demand and reignite economic growth**.

Q. Which one of the following statements is an appropriate description of deflation? (2010)

- (a)** It is a sudden fall in the value of a currency against other currencies
- (b)** It is persistent recession in both the financial and real sectors of economy
- (c)** It is persistent fall in the general price level of goods and services
- (d)** It is a fall in the rate of inflation over a period of time

Ans: (c)

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