

China's Economic Growth Cools to Slowest Since 2005

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July 17 (Bloomberg) -- China's economy grew at the slowest pace since 2005, handing more ammunition to Chinese officials calling for reduced gains by the yuan as the export outlook dims.

Gross domestic product rose 10.1 percent in the second quarter from a year earlier, down from 10.6 percent in the first, the statistics bureau said today in Beijing. Consumer prices rose 7.1 percent in June, slowing from 7.7 percent in May.

The yuan had the biggest drop in seven weeks on speculation China's leaders will slow its advance to protect jobs at exporters after a 7 percent increase against the dollar this year. The Ministry of Commerce has urged China's cabinet to rein in currency gains and raise some export rebates, a ministry official said July 14, speaking on condition of anonymity.

"The performance of the export sector could influence the government's approach to pacing the appreciation of the yuan," said Jing Ulrich, JPMorgan's chairwoman of China equities. "A slower pace of appreciation would mean breathing room for the export sector, but at the cost of containing imported inflation from higher commodity prices."

The yuan fell to 6.8276 versus the dollar as of 11:51 a.m. in Shanghai from 6.8113 yesterday, the biggest decline since May 27.

GDP growth cooled for the fourth straight quarter. The median estimate of 18 economists surveyed by Bloomberg News was for a 10.3 percent expansion. The U.S. economy grew 2.5 percent in the first quarter.

Free-Market Reforms

China's economy has grown an average 9.9 percent a year since leader Deng Xiaoping ditched hard-line Communist policies in favor of free-market reforms in 1978.

Economic problems include rising prices, constraints on agricultural production, lagging rural incomes and global financial market turmoil, the bureau said in a statement.

China's growth is the fastest of the world's 20 biggest economies and is helping to sustain the global expansion this year as a housing slump and credit-market turmoil threaten to send the U.S. into a recession.

"This is an orderly slowdown, not a dramatic one," said Kevin Lai, a Hong Kong-based economist with Daiwa Institute of Research.

China's export growth slowed to 21.9 percent in the first half from 25.7 percent in all of 2007, as U.S. demand weakened, and prospects for the rest of the year have deteriorated. The U.S. faces "significant downside risks to the outlook for growth," Federal Reserve Chairman Ben S. Bernanke said July 15.

Factory Closures

Rising costs and the yuan's appreciation may prompt Hong Kong companies to close or relocate 20,000 of their 70,000 factories in Guangdong province this year, Danny Lau, chairman of the Hong Kong Small and Medium Enterprises Association, said last month.

The economy "is slowing down more quickly in the wrong places where job creation is concerned," William Hess, director of Global Insight Inc. in Beijing, said on Bloomberg Television. "In the second half the employment question could be one that is put near the top of the list for policy makers."

Inflation has eased from February's 12-year high of 8.7 percent on smaller gains in food prices. It remains above the central bank's 4.8 percent annual target and rising commodity costs may keep prices elevated.

Producer prices climbed 8.8 percent in June from a year earlier, the statistics bureau said today, after rising 8.2 percent in May. That is the fastest pace since Bloomberg data began in 1999.

Inflation Risk

"The high producer prices number points to the potential risk of inflation in the coming months," said Huang Yiping, chief Asia economist at Citigroup Inc. in Hong Kong. "Inflation is still way above the official target so a tight policy will continue."

The yuan is the best-performing Asian currency versus the dollar this year, gaining 4.2 percent in the first quarter and 2.3 percent in the second. It's still undervalued, according to officials and manufacturers in the U.S. and Europe.

"The Chinese currency issue is a ticking time bomb," said Nicholas Lardy, a senior fellow at the Washington-based Peter G. Peterson Institute for International Economics, citing the potential for U.S. legislation targeting the Asian nation.

Besides using the currency to cool inflation, China has imposed lending quotas and ordered banks to set aside a record 17.5 percent of deposits as reserves to soak up cash flooding the economy from trade, foreign direct investment and investors betting on gains by the yuan. The central bank hasn't raised interest rates this year to avoid attracting more money.

Consumer Spending

Government efforts to boost consumption at home may be paying off. Retail sales rose 23 percent in June from a year earlier, the fastest pace since at least 1999. Urban disposable incomes rose 14.4 percent to 8065 yuan for the first half from a year earlier. Rural cash incomes climbed 19.8 percent to 2528 yuan.

“The surprising thing is the strength of the domestic economy,” said Paul Cavey, an economist with Macquarie Securities Ltd. in Hong Kong. “Consumers still have a lot of cash and in that sense it's difficult to be too pessimistic about the domestic economy.”

Investment jumped amid rebuilding after the Sichuan earthquake in May. Urban fixed-asset investment surged 26.8 percent in the first half from a year earlier, the statistics bureau said, after climbing 25.6 percent in the first five months.

“They can keep the economy growing at 10 percent even if there is a sharp slowdown elsewhere in the world,” said Julian Jessop, an economist with Capital Economics Ltd. in London, citing the government's ability to boost spending.

Source: Bloomberg