

Chinese business nervous about steady economic growth

July 28, 2008

CHINA'S leadership had been looking forward to a serene Olympic Games to launch its second term in office, with five golden years ahead.

This was what they had in mind in championing the Olympic slogan "One World, One Dream", which in Chinese characters reads a subtly different "Same World, Same Dream". A stable, prosperous China with us solid guys running the show. Yes, a sweet dream.

But the program has not run according to the script: China has faced snowstorms causing mayhem over Chinese New Year, unrest in Tibet, protests during the international torch relay and the responding nationalist demonstrations by young Chinese, and the earthquake in Sichuan.

And that's just for starters. The economy, which was on a dream course of high growth and low inflation through the leadership's first five-year term, has turned into a much less predictable, more difficult beast.

The West is experiencing a US-led slowdown, cutting the growth of exports (for instance, clothing exports were up just 3.4 per cent in the first half), and food and oil inflation are worrying most of the population. Overall growth remains strong at 10.1 per cent in the quarter that ended on June 30 but below the pace of the Government's first term. The economy grew 11.9 per cent in 2007.

Dragonomics Research managing director Arthur Kroeber says key drivers of the economy (infrastructure, housing and domestic manufacturing) remain unaffected by the global slowdown, but higher labour, energy and pollution-control costs are favouring the consolidation of industry.

Although the consumer price index increase slid to 7.1 per cent in June from 7.7 per cent in May, a degree of that success in the inflation war can be attributed to more stringently imposed price controls, an inefficient and temporary answer.

The producer price index, measuring the cost of production, rose to 8.8 per cent in June, the fastest increase in a decade, and is likely to seep through to consumers sooner rather than later as manufacturers pass their costs on. So the inflation pressure remains considerable.

Add the destabilising issue of "hot money" pouring into China, which is so agitating many of the best commentators on the Chinese economy, and you have a setting for an economic summit you would expect might lead to some action or at least, announcements of fresh policies.

State news agency Xinhua is unambiguous about the extent of the challenge.

"The Chinese economy is still beset with problems, including persistent price rises, uncertainties in demand abroad, squeezed corporate profit margins, difficulty in ensuring energy and power supplies, and undue expansion of foreign exchange reserves," it has reported.

It says Premier Wen Jiabao, Vice-President Xi Jinping and Vice-Premier Wang Qishan have conducted "field inspections" on the economic situation in Jiangsu, Shanghai, Shandong and Guangdong. "The frequency of such high-profile, on-the-spot researches by Chinese leadership in a short period of time has seldom been seen over the past 30 years," Xinhua reports.

But we have not yet seen such concern followed by striking action.

An economic summit on Friday at the top level of the Politburo indicated the strategy would remain relatively unchanged, albeit with a little scope for more flexibility.

And what of hot money?

"Beijing is battling to hold down hot money inflows, which are hard to identify but have been a factor alongside even bigger net export earnings and foreign direct investment inflows that helped push foreign exchange reserves to \$US1.8 trillion in May," says Sydney business analyst IMA Asia.

It remains unclear from where these inflows are really coming. Much is still coming from trade, but it is no longer the trade surplus driving the surge. Some is coming from cunning financial "round-tripping" money being sent out -- perhaps by people who do not want everyone to know how much they've got, or from where -- and brought back into China with a blue-chip pedigree.

"It is increasingly clear that (China's) level of reserve accumulation is not sustainable," Beijing University finance professor Michael Pettis and Stone & McCarthy analyst Logan Wright wrote recently in Financial Times.

"Besides the strains it places on the global balance of payments, the biggest problem it causes is within China itself.

"The People's Bank of China has to purchase these soaring reserves by issuing a combination of local currency and central bank bills. The ensuing monetary creation is fuelling rising inflation, systematic overinvestment and an over-extended banking system."

The yuan rose 6.56 per cent against the greenback in the first six months.

Pettis and Wright insist that China must revalue its currency sharply or "face surging inflation and the threat of financial instability."

Expectation of some decisive government moves has been running hot, especially in global financial companies.

Because hot money is perceived to be betting on continuing rapid appreciation of the yuan as other world currencies slide, some analysts are taking the opposite tack to the more conventional calls for faster and bigger revaluation, and suggesting Beijing will instead devalue.

This would give hot-money speculators a cold shower, and would aid the flagging export sector that provides so many jobs.

Will Beijing move either way?

The 24-member Politburo of the ruling Communist Party met at the end of last week under the leadership of the party general-secretary, President Hu Jintao, and announced on Friday that curbing inflation would be its top economic priority for the rest of 2008.

Meanwhile, the Politburo said it would strive to maintain fast but stable economic growth, and would remain consistent in its macro-economic policies, but with an increased capacity for flexibility in this second half of the year. So, steady as she goes for now.

Although China retains a capacity to surprise people, this Government is demonstrably conservative, having a five-year track record of economic caution.

It continues to reform, but steadily, succeeding in wringing dividends, or taxes, out of often hugely well-off state-owned enterprises, for instance, and recently it raised oil prices by 17 per cent.

The Commerce Ministry is pushing for a slower pace of yuan appreciation and an increase of export-tax rebates in some labour-intensive areas, to soften the blow of the downturn for exporters.

Such fiscal moves are considerably more likely than a bold monetary step, although there may be some easing of China's tight monetary policy.

Chinese leaders tend to avoid taking striking economic measures in periods when the country is coming under other challenges, but the diary shows a huge Asia-Europe summit in China soon after the Paralympics end in September.

And China is organising special celebrations in December of the 30th anniversary of Deng Xiaoping launching China's "kai fang" reform period.

These will be followed by Chinese New Year 2009, and then in March, the National People's Congress annual meeting.

So watch out for April, by which time the economic world may have moved on again.

That China's leaders are not under unsustainable pressure to act, demonstrates the extent to which the country has hit on a broadly successful development strategy, and the comparative room for autonomous decision-making that its growth has created.

Source: Rowan Callick



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