

Will China be able to weather the storm?

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The international crisis is beginning to have adverse effects on China, whose economy – which, according to the data recently released, became the third largest in 2007, surpassing Germany – has grown until now very rapidly, contributing considerably to global expansion. Let's simply recall that China's GDP growth was 13% in 2007, the highest rate – with difference – in the world. China was responsible of 17% of global growth, measured in purchasing power parity, between 2000 and 2007, a proportion similar to the one of the EU, whose economy is five times greater, and even larger than the percentage of the US, which has a GDP four times greater.

The provisional figures for 2008 suggest that China's GDP increased around 9% in 2008, a still very considerable rate. However, the quarterly rates, which surpassed 10% in the first and second quarters, were 9% in the third and only 7% in the fourth. The forecasts for 2009 vary between the 8% of the official estimate and the 6% of the *Economist Intelligence Unit*, with the 7.5% of the World Bank in between.

Do we really have indications that China might decelerate its growth to half – from 13% to 6% - in only two years, between 2007 and 2009? This would be certainly bad news, partly because China has been, along with the US and the EU, a main engine of the world economy and partly because it is widely acknowledged that, below 8%, growth might not be enough to create the required jobs and, hence, to maintain social and even political stability.

It is true that exports began to fall in November, for the first time in seven years. It is also true that industrial production, whose annual rates surpassed 15% in the first half of 2008, increased only 8.2% in October and 5.4% in November. Besides, inflation, which seemed out of control at the beginning of the year (8.7% in February), decreased to 2.4% in November, a free fall which might suggest an eventual return of deflation, which the country suffered in the late-1990s and also in 2002.

It is also reasonable to expect that recession in the developed world, to which more than half of Chinese exports are directed, might provoke a substantial drop in the growth of China's exports. Overseas shipments increased 30% a year

between 2003 and 2007 and 17% in 2008, but decreased 2.8%, at an annual rate, in December. Some analysts even already predict that they will decrease in 2009, but that seems a pessimistic view, as they increased 7% in 2001, during an important international crisis.

Furthermore, exports are slowing down and dropping in a context in which domestic consumption is not able to replace them, at least in the short term. The stock index has decreased 66% in 2008 and the conditions in the property market, whose prices began to fall by mid-year, are worsening and this is constraining the growth in consumption. Besides, the very high rate of household savings in China is due to structural factors, such as the important costs of education and healthcare and the meager pensions, factors which evidently are impossible to correct in the short term.

We might also expect a slowdown or even a decrease of foreign investment, both direct and portfolio, in 2009, as a result of the difficulties of multinational firms and the greater risk aversion, especially among investors in emerging economies.

Some specialists even anticipate that the drop of private consumption in the US during 2009 would have to be matched by a more or less equivalent reduction in China's production, as it would be impossible to find other consumption sources, inside or outside the US. A hard landing in China would be very bad news for the world economy, which will lost one of its main engines and will substantially aggravate its recession.

However, it should be borne in mind that in China the government and the central bank have powerful instruments to fight a growth crisis. A healthy budgetary situation (the public deficit was 1% of GDP in 2008 and the public debt is about 18% of GDP) has allowed the authorities to launch, last November, a fiscal stimulus plan of 4 trillion yuan (US\$ 585 billion), a figure which surpasses 13% of GDP. This expansive fiscal policy will only duplicate the relative size of the budget deficit, so it might be repeated, should the necessity arise. Besides, the authorities might resort to their foreign exchange reserves, already at US\$ 2 trillion, to finance, for instance, investments in infrastructure.

To help exporters, the government has reduced taxes and increased credit to the sector and, most of all, has slowed down the appreciation of the yuan from mid-2008 onwards. Yuan appreciation, respective to the US dollar, was 7% in the first half of the year, in order to fight inflation, reduce trade frictions and reorient growth towards the domestic market. But it has only been 0.5% in the second half. It is possible that the authorities might allow the yuan to depreciate if exports are really affected or if inflation is reduced to a minimum (or even more if the variation of prices turns negative).

The central bank has substantially reduced interest rates, with five consecutive cuts since September, and the banks' reserve coefficient. It might reduce them further. The banks, in a stark contrast with other cases, have a relatively healthy situation and have responded to the stimulus with a substantial credit expansion, so the liquidity problems so pervasive elsewhere are not present.

So, unless the external environment deteriorates much more than forecasted (for instance, if GDP drops much more than 2% in the US, Japan and the EU), all the indications seem to suggest that China might be able to maintain a 7 or 8% growth rate in 2009 and increase it in 2010. This rate should be enough to maintain social and political stability, although job losses will continue in the export sector. It should be also sufficient to avoid an additional contractive effect on the world economy.

Another story is, of course, if a global growth pattern based, as in the recent past, on US overconsumption and Chinese overproduction is sustainable. The US adjustment would have to be matched, sooner or later, by a rebalancing of China's growth from exports and investment towards consumption. But this rebalancing will take some time.

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