THE WALL STREET JOURNAL.
ASIA

Beijing feels heat as economy cools --- Exporters seek boost despite 10.1% growth but inflation lurks

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813 字
2008 年 7 月 18 日
The Wall Street Journal Asia
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英文

BEIJING -- China's rapid growth continued to slow in the second quarter as exports eased, but the nation's expansion still appears strong enough -- and inflation high enough -- for the government to refrain from employing new stimulus measures.

Gross domestic product expanded 10.1% from the same period last year, the National Bureau of Statistics said Thursday, slowing from the first quarter's 10.6% increase and the 11.9% gain for all of last year. The second-quarter slowdown was widely expected, given the combination of a weakening global economy, curbs on domestic bank lending, and the disruption caused by May's massive earthquake in Sichuan province.

But the still-strong pace of growth shows that China remains one of the few bright spots in an increasingly gloomy outlook for the world economy. "If you believe their numbers, China is still booming," says David Cohen of Action Economics in Singapore. "They should be more than satisfied that they came through all the travails and were able to continue growing at near their long-term average" of 9.9%.

Though a 10% expansion is extraordinary, it has become something of a challenge for a country that has become accustomed to even faster growth. With U.S. financial-market turmoil raising the prospect of an extended period of global weakness, there is rising political pressure for China's authorities to move to boost the economy. Exporters are lobbying the government to slow or stop the appreciation of the Chinese yuan, while real-estate developers are begging for a relaxation of the limits on credit.

Li Xiaochao, spokesman for the National Bureau of Statistics, said the slowdown in the second quarter was "smooth" and within official expectations. The government's policies have successfully reduced the risk of economic overheating without leading to "big ups and downs" in growth, he told reporters.

The increasingly vocal complaints from the export sector seem to have succeeded in shifting the terms of the debate, however: from whether authorities should move more forcefully to combat inflation, to whether they should do more to support growth. That is worrisome to the numerous economists who think that China hasn't contained inflation, which has averaged 7.9% so far this year. "Beijing must keep credit tight for the rest of the year to check inflation," says Qu Hongbin, China economist for HSBC.

While consumer inflation in June moderated to 7.1%, from a high of 8.7% in February, inflation at the producer level surged to 8.8% in June, the highest since China's last inflation scare, in the mid-1990s. "The rise in producer prices is continuing to accelerate, and this creates pressure that is transmitted to the consumer-price index," said Mr. Li. He also warns of consumer expectations of high inflation. "In the current situation, particularly with prices overseas rising fairly quickly, it is easy for the public to form expectations of continued price rises," he says.

Along with continued high inflation, renewed signs of strength in the domestic economy argue against an immediate stimulus. Inflation-adjusted growth in retail sales accelerated in June, as did growth in fixed-asset investment. So the most likely course for the next few months seems to be small adjustments to the details of policy, rather than a wholesale change of direction.

The finance and economics committee of the national legislature, which met Wednesday, said the current "stable fiscal policy and tight monetary policy" should continue, though authorities should adjust "the force and timing of policy implementation in accordance with changes in the domestic and international economic environment."

While few analysts project any interest-rate increases this year, the Chinese yuan is expected to continue appreciating. Some economists suggest allowing exporters of some products to claim a larger rebate of China's 17% value-added tax. "They can do more on exchange-rate flexibility and at the same time they could rescind some of the reductions in VAT rebates, which could help to offset some of the negative effects coming from exchange-rate appreciation," says Shang-Jin Wei, a professor of finance and economics at Columbia University's Business School in New York.

This year's slowdown has also made long-discussed structural reforms to the economy seem more urgent. With China's growth driven largely by exports and corporate investment, many economists advise doing more to encourage consumer spending. "This would put China's economic development on a more sustainable path," says Mei Jianping, a professor at the Cheung Kong Graduate School of Business in Beijing. Such changes, if they arrive quickly enough, could help China endure a more severe slowdown in the U.S. and European economies.

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