China's 2009 Economic Outlook

By KE Long

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The year 2008 was a special and important year for China, not only because of the Beijing Olympic Games but also because of difficulties in economic performance and policymaking. At the beginning of the year, Premier Wen Jiabao reported to the National People's Congress that 2008 would be a very difficult year and, unfortunately, his view was right. China experienced a terrible earthquake in Sichuan and Yunnan provinces in May 2008. The global financial crisis also inflicted more damage on the economy than expected.

The Chinese economy has begun slowing down as macroeconomic data show that the GDP growth rate dropped from 13.0% in 2007 to 9.0% in the third quarter of 2008. The world, however, still expects the Chinese economy could be the next engine to drive the world economy instead of the United States. Few people believe the US economy will be hopeful in coming years. Although the new US administration of President Barack Obama could be cause for more hope than the administration of George W. Bush, Obama is not superhuman. Americans need to pay the cost for their actions over the past years, not only in terms of the financial crisis but also for prolonged overconsumption. Now the issue is whether China can play the role of an engine instead of the United States for the world economy. China has decided to enforce a 4 trillion yuan (about $590 billion) stimulus package to boost economic growth.

The Chinese government is campaigning to make it known that the goal for economic policy in 2009 is to maintain 8% growth and try to realize 9% growth. Actually, from the economic potentiality (capital + labor + total-factor productivity or TFP) on the supply side, it is not a problem for China to realize 8%-9% growth. China also has a 48% savings rate, and potential demand is very strong. Here the problem is how to encourage households to consume and improve economic efficiency.

1. Why 8% Economic Growth?

China realized 9.8% economic growth (in real terms of GDP growth) annually over the past three decades, even though the government announced 8% growth as the goal for policymaking. So the performance of government policymaking could be considered very effective and successful. However, it seems to me that policymakers hardly feel this success because they usually feel very strong pressure in terms of inflation and excessive investment in the policymaking process not only from the domestic market but also from abroad.

Basically there are three goals for policymaking in China.

The first is to maintain high economic growth, which is a symbol of China catching up with the industrial world in economic development and which can contribute to rebuilding self-confidence in Chinese society.

The second is to create more employment opportunities. China is a country with the largest population in the world. It is easy to understand how important it is for China to create jobs.

The third goal is to change an economic development model. China cannot sustain growth by depending on external investment. It needs to improve the efficiency of domestic investment, and meanwhile strengthen effective demand.

The first goal was the most important in policymaking three decades ago at the beginning of the "open door policy." But now creating employment opportunities and changing the economic structure are the main tasks for China. The problem of unemployment could damage society, and it is hard to consider that China could sustain economic growth under the current extensive model.

As a result, the government has to maintain growth at a level of 8%-9% and meanwhile try to change the economic structure and

CHART 1
Chinese economic figures (2002–2008)

	2002	2003	2004	2005	2006	2007	2008
Real GDP growth (%)	**9.1**	**10.0**	**10.1**	**10.4**	**11.1**	**13.0**	**9.5**
Fixed asset investment (%)	16.1	26.7	27.7	25.7	25.9	24.8	25.0
Housing investment (%)	21.9	29.7	30.3	19.8	25.4	30.2	25.0
Retail sales (%)	8.8	9.1	13.3	12.9	13.7	16.8	22.0
Trade balance ($1 billion)	**30.4**	**25.6**	**32.0**	**101.9**	**177.5**	**262.2**	**250.0**
FDI (%)	12.5	1.4	13.3	-0.5	2.1	13.6	50.0
Foreign reserves ($1 billion)	**286**	**403**	**610**	**819**	**1,660**	**1,330**	**2,000**
CPI (%)	**-0.8**	**1.2**	**3.9**	**1.8**	**1.9**	**4.8**	**5.5**
M2 (%)	16.8	19.6	14.6	17.9	16.0	16.7	18.0

Source : Chinese National Statistic Bureau; the data for 2008 are estimates.

shift labor from agricultural and manufacturing industries to the service sector. We cannot hope that China could stop the "train" (economic growth), repair it and then restart it to catch up. China has to maintain the "train" running at a certain speed, and still repair it. It is a very hard business, but there are no other options for the government in its policymaking.

2. 8% Growth Not Enough for China

A conclusion of this paper is that the economic recession in 2008 was not because of the global financial crisis, but rather it was the result of a mistake in policymaking since the second half of 2007. Until 2007, the Chinese economy had maintained double-digit growth for five years. It was believed the economy would be adjusted for the economic cycle. That means the economy would begin to slow down. For the policymakers, they need to enforce some policies to rule out unstable development. The most reasonable policy is to relax the economic cool-down policy, for example, to stop controlling commercial bank lending by the central bank. But Governor Zhou Xiaochuan of China's central bank repeatedly announced that the monetary policy was to lower the inflation rate by October 2008. On October 30th, 2008, the State Council finally decided to stop the control of commercial bank lending. It is clear that the policy change has been too late.

Since the impact of the financial crisis could hurt the Chinese economy, Premier Wen urged all considerable policies to be enforced to maintain the growth rate above 8%, and try to realize 9% growth. But I have to point out that 8% growth is not enough for China today. And here the problem is how to realize the goal. Wen and his team seem to want to bolster GDP growth by an active fiscal policy, something like what Japan has pursued since 1990. Active fiscal policy could be effective to buoy GDP growth while real demand is weak. But the main task for China today is not to strengthen investment, but to encourage consumption by households.

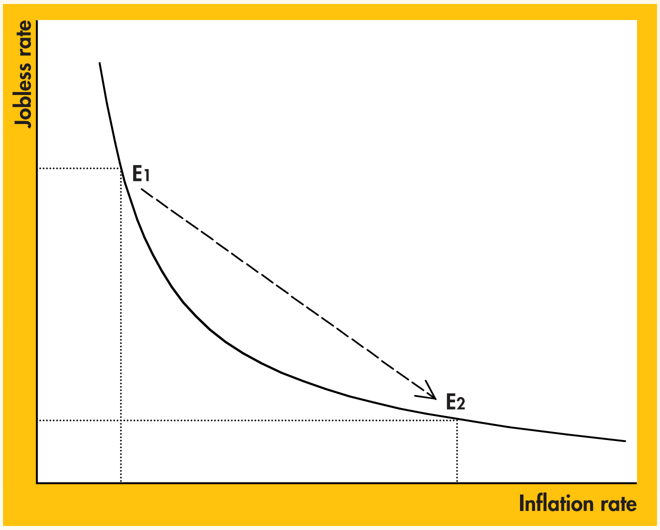
Here let's turn back to take a look at the Chinese economy in 2008 *(Chart 1)*. We find that the Chinese economy is still continuing high growth above 9%. What about 2009? American investment banks seem very negative about the Chinese economy in 2009. They predict that Chinese economic growth will slow to 5%-6%. If true, Chinese society is going to be highly unstable. From some comprehensive studies on the Chinese economy, the growth rate could be considered to have peaked at 13.0% in 2007, but it is possible to maintain growth at 8.5%-9.0% in 2009.

3. Pro-inflation Policy Could Help China

China is facing the most difficult situation during the past three decades, but there are still some effective solutions for China to overcome the current recession, a product of the global financial crisis. Theoretically, it is considered that the unemployment rate and inflation rate won't rise together *(Chart 2)*. If China wants to lower the unemployment rate, it can enforce policy targeting a rise in inflation. It would be simple for China to raise food prices about 5%.

CHART 2

Pro-inflation policy could help China create employment opportunities



Source : author

That means income would be transferred from urban to rural areas. That would contribute to closing the income gap between rural and urban areas, so it is also an effective policy to stabilize society.

Pro-inflation policy would change the minds of households and investors. Under the current situation, households and investors are expecting the CPI to drop tomorrow. As a result, currently no one wants to consume, only save. But if households and investors recognize prices are going up, they will choose to consume today, not tomorrow. The main point here is that Chinese households have enough savings, and potential demand is very strong. The key is how to encourage them to consume by targeting inflation.

Finally, Japanese firms don't need to be concerned about economic development in China. The only thing they need to focus on is how to rebuild their investment strategy to strengthen their competitiveness in China with other foreign companies as well as local companies. Japanese firms are very strong in terms of technology and product quality. But marketing and brand strategy seem a little weak. In addition, personnel strategy has not succeeded. Many Chinese elite students graduating from Beijing University, for example, enter Japanese firms but only remain for a few years. After mastering the business, most of them are headhunted by US or European multinational enterprises. It is strange to me that Japanese firms are just like a training center for their competitors.

Now is a big chance for Japanese firms to rebuild their investment strategy, because most US and European enterprises have been damaged by the crisis. So, here is a message to Japanese firms: rebuild the strategy to access the Chinese market – this is a last chance for you. JS

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Note: This concludes a series of *Asian View* articles by Ke Long. A new author will take it over from the next issue.