China and the global

by Andrew Leung

CHINA has long been facing a host of problems including acute inequalities, regional imbalance, rampant corruption, choking pollution, bursting stock and real estate bubbles, and bankruptcies of labour-intensive exporters no longer competitive. Last year the country launched a 'circular economy' law to promote sustainable development and a new reform initiative to address rural inequalities. But these have nothing to do with the world's current economic crisis of historic proportions. Otherwise, China has so far been coping with it comparatively well.

This is, however, not very surprising. China's finances are much more isolated from external influences by tight exchange and macro-economic controls. They are also backed by the world's largest foreign currency reserve by far, standing at over US$1.9 trillion, growing at the rate of about US$1.7 billion a day.

Although it is impossible to de-couple in a world of globalization, there are major dynamics that set China's economy apart. While the West's economies are mostly consumer-debt driven, China's is not. Household debt accounts for only 14% of China's GDP, compared with up to 180% in the West, which is much more vulnerable to fluctuations in consumer interest rates and bank credits. With government costs and contingent liabilities skyrocketing from various banking bailouts, public debt in Western countries is expected to mount with public finances under increasing pressure. For example, UK's public debt is now exceeding 50% of GDP, while China's public debt stands only at 18%.

In addition, infrastructural investment has long been steaming ahead in China's second and third-tier cities in the largest and fastest urbanization program in the history of mankind. This is set to provide a vast consumer market driven by China's rising 'middle class' (McKinsey Global Institute, *Preparing for China Urban Billion*, March, 2008). This would also serve to re-balance China's over-dependence on exports. With inflation coming down from 8.7% in February to 4.9% in August 2008, the prognosis of China's economy should not be too dire.

The world is aware that there is a great deal of money locked inside China. However, China's recent efforts to export some of this money by encouraging enterprises to join the world's 'capitalist club' by taking equity stakes in overseas businesses have not always been welcome. CNOOC's thwarted attempt to acquire UNOCAL, a US oil enterprise, is a case in point. Moreover, China's equity stakes ranging from Blackstone and Barclays to Fortis Asset Management have so far resulted in huge book losses, which are facing increasing criticisms back home. Still, it is much better for these funds to go abroad than to be locked inside China where they are prone to stoking domestic inflation and inefficient or illegitimate allocation.

A win-win situation

The funds are vast: sovereign wealth initially entrusted with the state investment agency China Investment Corporation alone amounts to US$200 billion. Separately, the State Administration for Foreign Exchange, responsible for managing China's gigantic foreign currency reserve, has even deeper pockets. These funds should be as eager to find more profitable investment opportunities abroad as China's home-grown corporate champions are going out in search of global markets and expertise. Nevertheless, with fingers already burnt and a host of economic problems to grapple with at home, these sovereign funds are now binding their time. Over time, subject to greater transparency, they should be proactively engaged in the West to create a win-win situation for all.

Meanwhile, China has invested around US$600 billion of the country's vast foreign currency reserve in US treasuries. This, along with a similar investment by Japan and oil-exporting countries in the Middle East, accounts for the total of 1.803 trillion worth of foreign-owned US treasuries, according to a Congressional Research Service report of March 2008. On the one hand, while the world's financial tempest is raging, these investments are now even more crucial than before as a counterweight against the threat posed to the long-term confidence in the US Dollar with the Fed's balance sheet being stretched by those mother-of-all banking bailouts (George Soros, *The New Paradigm for Financial Markets: The Credit Crisis of 2008 and What It Means*, Public Affairs, 2008). On the other hand, this one-sided investment is a product of the global economic imbalance with surplus countries saving too much and debtor countries saving too little.

China's financial system is thus so far relatively insulated from the world's leveraged quagmire by exchange and banking controls, non-convertibility of the renminbi (the Chinese yuan), traditional aversion to excessive personal debt, and a gigantic foreign currency reserve. Notwithstanding such insulation, however, the threat to jobs presents an even bigger challenge.

China continues to need some 20 million jobs a year mainly to absorb excess labour from the countryside. More than 75% of such employment is provided by labour-intensive SMEs. In addition to excess labour, six million graduates are entering the work force each year. The global economic downturn with withering export markets is compounding China's employment pressures which have already been coming from industrial upgrading and rising productivity. These daunting challenges are highlighted in a recent paper by Professor Zhou Tianyong, a leading academic of the China Communist Party Central Committee Party School (*Need for a major re-adjustment in China's macro-economic objectives and policies*, China Economic Times, 5 December, 2008).

Social unrest

As much as one third of export-dependent SMEs especially in the Pearl River Delta have been facing the prospects of closure in 2008 or 2009. The service sector supplies only 32.4% of China's jobs, compared with the average 50-60% in developing and 70-85% in advanced countries. While consumption has been rising, it still accounts for less than 50% of China's GDP compared with over 70% in advanced economies. In any case, it depends heavily on the security of jobs and household incomes. Professor Zhou is worried that excess unemployed labour could lead to more social unrest, which may threaten stability. Even President Hu Jintao has warned that the hard times ahead are poised to test the Communist Party leadership.

Hence it was no surprise that China was

The Pudong skyline in Shanghai

economic crisis

amongst the first to come out with a massive stimulus package of US$586 billion (4 trillion yuan). Further details have since emerged on the spending allocations: 44% on rural infrastructure and welfare housing, 25% on other infrastructure projects like railways and airports, 13% for healthcare, education and social welfare, 12% for energy and environmental protection, and 6% on technology upgrades. Nearly 70%, therefore, is devoted to job-creating infrastructural projects, while improving healthcare, education and social welfare is designed to release some of the pent-up consumer demand hidden in rainy-day household savings. What is more, with a clear signal from Beijing, the provinces are dusting off many other delayed or deferred local job-creating infrastructural projects, which may boost China's total package to the tune of a further 10 trillion yuan.

It would take some time for any stimulus package to work. But bank lending surged in December 2008 largely as a result of stimulus items while excess capacity is beginning to diminish. Premier Wen Jiabao is reported as saying that the economy is performing 'better than expected' (South China Morning Post, 12 January, 2009). While still expecting some grim economic figures in H1 2009, contrary to many other opinions, Nomura International has maintained an overall 8% growth forecast for China (13 January, 2009). Even this level of growth is no guarantee for China getting out of the woods, but it would represent a more comfortable distance towards safety.

China has now overtaken Germany to become the world's third largest economy, though still amongst Africa's poorest countries in per capita terms. A world reeling from the brink of economic meltdown will no doubt be increasingly watching China's performance with abated breath, if not always with great expectations.

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China Log

by Peter Bishop

PRESIDENT Hu Jintao was on an extensive foreign tour when I visited China late last year. The local press proudly reported his contribution to the G20 meeting in Washington DC ("Hu urges revamp of finance system") and ran front page stories of the Chinese Premier with his counterparts in Peru, Costa Rica, Greece, and Cuba, where he met a surprisingly robust-looking Fidel Castro.

Along with Hu's calls for reforms of the currency system and financial institutions, and increased international cooperation was a plea for international efforts to help developing countries with the global financial crisis. At first glance it didn't seem that China had too much to worry about. Like India, it is of a size that it is comparatively independent of external markets, and it has less exposure in financial services as agriculture and manufacturing dominate the economy. However Andrew Leung's deeper insights (see opposite page) demonstrate that this is only part of the story.

I took with me Yintong Betser's *China Active Business Guide* which gave me invaluable and accessible information on business and culture in the country and more than lived up to its glowing review in the April 2008 edition of London Business Matters.

I went first to Beijing where I chaired the biannual meeting of the World ATA Carnet Council. China acceded to the international temporary import convention in 1998 and they were keen to host the meeting to celebrate the tenth anniversary of their participation. The Chinese were attentive and charming hosts, efficient organisation balanced by generous entertaining. The Beijing Games had provided the opportunity to extend the use of the ATA Carnet (basically a 'passport for goods') and the meeting provided a good excuse for a tour of the Olympic sites.

These were at least as stunning as I remembered from the television pictures in the summer and were obviously continuing to pull in tourists despite the wintery conditions. The summer's security measures remained in force too, with frequent bag checks and x-ray machines at every subway station. However I didn't encounter any of the multi-lingual taxi drivers we had all heard about, and attempts to get a ride without a Mandarin speaker or being armed with the address in Chinese characters invariably ended with shrugs and frustration.

I moved on to Shanghai to see at first hand one of the identified threats to London's competitiveness in last year's LCCI report. I had read in the report of the decade of double digit economic growth it had enjoyed and saw it evidenced in the Pudong skyline, the transport developments and the pedestrianisation of the Bund. Not a bad place for a GLA office to look after London's interests especially now as the city is gearing up to host EXPO 2010, the 'Olympics' of the trade world.

The GLA office, which the Chamber urged last year should remain open, is run by Zhao Bingbing, a delightful Shanghai-ite who knew more about the workings of business support in London than I did. Appointed in 2006 her job is to promote London – Shanghai business relationships in key areas such as tourism, financial services, education, and creative industries. She is as passionate about the two cities as she is about art and gave me a whistle stop tour of the galleries culminating with the opening of Yoko Ono's exhibition at a new venue on the fringes of the French concession area.

Zhao Bingbing

Homeward bound, I travelled the 30 km to Pudong International Airport by the Shanghai Maglev (short for magnetic levitation) train. It didn't take long – 7 minutes 30 seconds to be precise – but at a top speed of 301 km/h most journeys don't. I was back in the UK in good time for the Year of the Ox, and news that there was a Shanghai delegation in town to recruit the cream of the redundant financial workers in the City. Somehow I think Shanghai will survive the downturn.