

China's Current Economic Situation (May 2009):
A Report from Beijing and Shanghai

The Chinese economy began to recover in February or March, and some Japanese enterprises are preparing an expansion of their local production systems and a push to secure superior human resources in China.

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I made a trip to Beijing and Shanghai in late April just after the publication of the first quarter principal economic indicators, including GDP. I conducted interviews about the Chinese economy with central government officials, think-tank economists, and executives of Japanese enterprises and financial institutions. This is my report of the impressive information that I acquired from them.

1. The Chinese macroeconomic situation

(1) Survey

Most people think that the Chinese economy hit the bottom in February or March and entered the phase of recovery. A few economists believe that the bottom was last November. A high-level Chinese official said, "Although we still have some sources of anxiety, as external demand remains dull and corporate profit and the government revenues have declined, domestic demand is heating up again."

As for the future, some expect a "W-type recovery scenario," that is, the currently recovering economy will enter a downturn after a while due to accumulated inventory, and then enter upon a full-dress recovery phase. Others expect a "U-type recovery scenario," meaning that having reached bottom, the economy will stay there for a while before recovering. But such views are in the minority. Most officials and economists foresee a "V-type recovery scenario."

(2) Exports, fixed asset investment, and consumption

Exports (USD basis / year-on-year change, first quarter -18.8%,) remain much lower than the level of the previous year. But after declining to a -25.7% year-on-year change in February, the breadth of the year-on-year decline shrank to -17.7% in March.

Fixed asset investment (FAI, nominal basis / year-on-year change, first quarter

+28.8%) showed rapid growth. The main factor for this growth was the huge increase in public investment supported by the stimulus policy of 4 trillion RMB. In addition, the enormous increase in bank loans flowing into FAI also had a major effect. But because most of the huge government expenditure and enormous credit flow called for in the stimulus policy have gone into the SOE sectors, the comparatively efficient private business sectors are still continuously plagued by lack of funds.

As for consumption, retail sales of the consumer goods (nominal basis / year-on-year change, 2008 2Q+22.2%, 3Q+23.2%, 4Q+20.6%, 2009 1Q+15.0%) continue to maintain firm growth, but are not as strong a force driving recovery as FAI.

(3) Manufacturing

Thanks to the 4 trillion RMB stimulus policy, demands for construction machinery, agricultural machinery, and automobiles under 1600cc are vigorous. There are shortages of inventory with respect to semiconductors, electronic components, liquid crystals, chemical products, etc. These industries have started to increase production and some Japanese manufacturers have initiated increased investments in plant and equipment at their factories in China.

(4) The real estate market

Although market conditions still vary widely, the trend of recovery is slowly expanding to more and more areas overall. For example, prices and the volume of transactions began to recover from the beginning of this year in Shenzhen and Guangzhou. In Beijing, prices have still not recovered, but the volume of transactions points toward recovery. Transactions clearly increased in March in Shanghai, and probably will follow Beijing into the recovery phase. But it is expected that to see a total market recovery we will have to wait until the second half of this year or next year. The reasons for the above-mentioned recovery are relaxed credit policy, the fiscal stimulus policy, and specific measures to simulate the real estate industry, including the abolition of the rule that obliged people to wait for five years before buying another house, etc.

(5) Policies

With these indicators that the signs of recovery are slowly expanding, the severe criticism of PBC Governor Zhou Xiaochuan so often seen in the newspapers or on TV has recently subsided.

But the officials and economists have started to share strong concern about future problems that may be caused by the excessively relaxed credit policy and the enormous

fiscal expenditures implemented too hastily to permit adequate oversight.

The rapid expansion of bank loans raises the risk of an increase in non-performing loans in the future. Intensive fiscal expenditures mainly related to the inefficient SOEs degrade the total efficiency of the economy. These side effects of the stimulus policies work against the long-term policy targets of which the Chinese government has made much, that is, the improvement of bank loans and fiscal expenditure, the sophistication of the industrial structure, and the improvement of managerial efficiency.

The CBRC and NDRC have already started to monitor these side effects of the stimulus policies and are enforcing examination of the contents of bank loans and fixed asset investment. Although some people are optimistic that the side effects will be well controlled as a result of this scrutiny, others remain pessimistic, so opinion is divided.

(6) The long-term prospect for the GDP growth rate

Because the GDP growth rate dropped sharply during from the fourth quarter last year (year-on-year change, +6.8%) to the first quarter of this year (year-on-year change, +6.1%), more and more people have come to believe it will be difficult for the growth rate to reach 8% this year. But the Chinese government has shown that it could avoid the occurrence of the social unease even with a growth rate of less than 7% during two quarters, so the central government is not as wedded to a policy of 8% growth as before. Rather, the axis of policy seems to be shifting to controlling the side effects caused by the stimulus policy.

So we should focus on the long-term average growth rate after next year. A Chinese economist who has close contacts with the high-level central government officials predicts that the Chinese economy will maintain 9% growth for several years from now. Other economists predict 7% or 8%, so there are different views. Still, most economists agree on prospects for a rapid growth rate between 7% and 9%. This would mean that the Chinese economy would continue to be the only exception to a situation in which the other world economic powers are expected to be unable to avoid continued low growth, at least for several years.

2. Developments among Japanese enterprises in China

(1) Few Japanese enterprises have pulled out of China

Taiwanese, Hong Kongese, and Korean enterprises continue to pull out of China even now. But only a few Japanese enterprises in China are thinking about pulling out. First, most Japanese enterprises have already shifted their focus from exports to foreign markets from China to sales in the domestic market. Many Japanese companies

have already been successful in the Chinese domestic market: the automobile companies, Canon (digital cameras, printers), Ito Yokado (GMS), Shiseido (cosmetics), Kao (shampoo, detergent), Nisshin (cup noodles), Glico (chocolate pretzel sticks) etc. These successes in targeting the Chinese domestic market have led to an increase in the number of the enterprises trying to emulate them. Typical examples are the expansion of production systems in China by Japanese construction machinery manufacturers anticipating increased demand; the rapid expansion of store networks by Family Mart and Seven Eleven in Shanghai; increased sales and the production of plastic wrap etc. Against the unfavorable wind of the world economic depression, the China's demand for Japanese goods and services continues to increase steadily, and Japanese enterprises have worked hard to respond to it.

Second, Japanese export enterprises are facing severe conditions, but fewer of them are pulling out of China than Taiwanese or Korean firms. One reason is that the technological level of the Japanese enterprises is higher and their competitiveness is strong. The other reason is that because the Japanese yen is stronger than the other currencies, products imported to Japan from China are still less costly than Japanese domestic production.

(2) Mitigating of the pressure of rising labor costs and a golden chance for securing human resources

One of the major profit squeeze factors for Japanese enterprises in China for several years has been continuously and rapidly rising labor costs. But the serious decline of the corporate profits in the major coastal cities caused by the world economic depression has invited the deterioration of employment conditions. As the result, the continuous and rapid rise of wages since 2003 has stopped, and a movement to cut wages is expanding among the middle and small-sized businesses. In addition, they now have an opportunity to hire more capable personnel than before. The golden chance for securing valuable human resources has come for the Japanese middle and small-sized businesses targeting the Chinese domestic market.