



China's Economic Restructuring-New Challenges and Opportunities

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Economic Risks and Policy Options

With the implementation of a series of measures to sustain growth, the Chinese economy has successfully met the challenges posed by the global financial crisis in 2009. Economic growth began to reaccelerate in the second quarter and reached a high level of 10.7% in the fourth quarter. Nevertheless, economic complexities and risks seem to have remained. Concerning the economic environment, risks in two areas have been mounting this year. Firstly, some overheating pressures have grown, as reflected in over-investment, excess capacity, and heightened risks for property market bubble and inflation. Owing to the extraordinary stimulating measures launched in the face of the financial crisis, in particular the extremely loose monetary policy and unprecedented expansion of credit, risks at the current stage would even be larger in comparison to previous overheating periods.

Secondly, while economic growth in 2009 was mainly underpinned by policy measures, domestic momentum did not catch up. Should global economic recovery fail to meet expectations, coupled with the waning of policy effects or unavoidable tightening as well as possible slowdown in the property market that dampens related investment and consumption, economic growth may recede. By the end of 2009, CPI increase has accelerated alarmingly to 1.9% in December, after resuming positive (0.6%) in November. This has rendered policy decision more difficult. The worst possible outcome can be soaring inflation (or asset bubble) that far exceeds the improvement in domestic economic growth momentum. Under such circumstances, the government would have no choice but to tighten, impeding economic growth.

Facing such situation, China's macroeconomic policy issue is not simply a matter of "withdrawal of stimulus" or not, since either would incur substantial risks, dampening growth or encouraging overheating. Besides, the current difficulties concerning either excessive or lack of momentum are actually long-term structural problems of the Chinese economies, particularly the strong investment but weak consumption, powerful government bodies but timid non-government organisations. To tackle the above risks, structural problems should be targeted, particularly to boost private consumption. In other words, restructuring is not an independent policy choice other than sustaining growth, but the most effective means to eliminate different kinds of risks while maintaining growth.

Long-term Pressures

In the long-term, China's economic performance depends much on its growth model and economic structure. Therefore, after the economy has stabilised, it is deemed necessary to investigate into the impacts of the external shock and extraordinary measures on the economic structure. Below are some observations on the macro aspect.

1. Relationship between domestic and external demand. In contrast to previous years, China's economic growth in 2009 was driven solely by domestic demand instead of exports. In the first three quarters, the contribution to GDP growth by investment and consumption reached 94.8% and 51.9%. Exports contributed a -46.7%, with its share in GDP falling from 32.4% in 2008 to 24.5%. Apparently, this fits the change of growth reliance from exports to domestic demand and reflects the strong adaptability and

potential of the Chinese economy, including the substantial demand for infrastructures and the huge room for growth arisen from divergences in development stages among different regions and sectors. The stimulating measures have boosted the development of these areas, filling the gap created by the sudden shrinkage of external demand. Nevertheless, whether this development trend can persist is far from certain, as it only takes place passively due to the deterioration of exports. Specifically, relying on stimulating measures to boost domestic demand would probably be unsustainable and the inner drive for over-reliance on exports may still remain. At least, the 26.8% high growth of fixed investment in manufacturing during the first 11 months of 2009 still signifies the persisting reliance on foreign demand should domestic consumption fail to bolster.

2. Investment and Consumption. Both investment and consumption contributed to the economic rebound in 2009. However, there are both positive and negative implications. On the one hand, consumption has performed well. Annual retail sales grew by 17% in real terms, just slightly below the high level of the previous year, while growth only ranged within 10-15% during the 2003-07 boom years. Various measures have played a part, including those that boost car and electrical appliances sales in the rural areas. Consumer confidence should be lifted by improvement in social benefits. These are valuable experiences for stimulating consumption and can reflect the huge potential consumption demand of the population, which can be realised once certain conditions are met. On the other hand, it should be noted that investment growth remains much higher than consumption, under the same expansionary policies. Investment growth reached around 35% in Q2 and Q3, much higher than the 25% level in the so-called overheating years in 2004-07. Growth divergence compared with consumption has widened to nearly 20 percentage points from around 10, signifying the worsening imbalance between consumption and investment. Moreover, in view of the lack of change in economic system, it does not appear that the long-term pattern of strong investment but weak consumption would change. Specifically, concerning the remaining impacts of the 2009 measures, investment growth is customary, but some consumption growth may be once and for all. For example, total investment growth of new projects reached 67.2% last year, signifying the larger possibility for growth to maintain, but subsidies for purchase of electrical appliances and car are granted once only. These still cannot make us optimistic about the correction of structural imbalance.

3. Industrial Structure. In 2009, the shares of the secondary and tertiary sector in the Chinese economy were 46.7% and 42.6% respectively, indicating the persisting dominance by the former and lagging behind of the latter. Although industrial production suffered much during the financial crisis, its annual growth still reached 9.5%, higher than the 8.9% of the tertiary sector, reversing the situation last year when the latter grew slightly higher than the former. Such has important implications for China. First, the original structure among the three sectors seems to be strengthening. Second, this implies little relaxation on pressures on resources and the environment. Third, growth of employment prospects remain dim, as the services sector in general can absorb more labour. Take the period 1991-2007 as example, while average nominal growth of the secondary and tertiary sectors were 18% and 18.3% respectively, average employment growth for the latter reached 4.4%, higher than the former's 2.4%. If employment growth fails to match with the economy and inflation rises, improvement in people's livelihood and consumption would be much limited. As for the manufacturing sector, some major measures for specific industries were implemented in the past year, but most are long-term nature. Currently, improvement to the low development level and excess capacity conditions has been limited. According to official statistics, duplications in some industries have become more serious. Particularly during the first 10 months, the construction materials industry grew by 47.4%, in which the cement industry grew by 64%. Capacity utilisation for steel and cement industries reached 75.8% and 75.3% respectively, with substantial work-in-progress capacity. At the same time, excess capacity is largely out-dated, with dated capacity in the cement industry up to 27% and deep-processing rate for flat glass industry less than 30%.

Prospects for Restructuring and Areas of Concern

With the direct and indirect impacts of the global financial crisis, the Chinese economy faces new obstacles and pressures in its restructuring, posing challenges for both short and long-term economic development. No doubt, pressure can generate momentum. Although China's economic growth rebounded in the later half of 2009 and is widely hailed for its future prospects, the Chinese government has remained cautious. In the Central Economic Conference during the end of last year, it stated that the global financial crisis has made the change of growth model a more urgent issue, expressing a strong desire and conviction to foster economic restructuring.

In addition to official motivation, market forces favouring restructuring are also gaining momentum. For example, amid sudden shrinkage of external demand and possible prolonged slow recovery of the U.S. and European markets, export demand may be hard to recover fully. This would push enterprises to enhance core competitiveness and product quality, or develop the domestic market. As urbanisation is progressing in China, some basic consumption demand would increase and urban services would develop. Similar to the past, technological progress can be made after the recent crisis, e.g. various countries have been working to make energy-saving and environmental protection their new growth spots. In this respect, China has been in line with the world and can make high attainments with its huge domestic market. Therefore, as restructuring may become a main theme in the Chinese economy in 2010, it would be the major direction of development in the coming years.

For China, policy and reform are the means of economic restructuring. In particular, the following are areas of attention amid China's economic restructuring in the coming years.

The first is the change of economic and social environment centred on the consumption issue. Behind China's persistently low consumption is a series of structural issues related to income distribution, social security, employment and rural-urban social structure. Therefore, to boost consumption is actually to launch a series of reform to improve people's livelihood. This has far-reaching impacts. In fact, some major changes have taken place since 2009. For example, among the nationwide infrastructure investment items, services directly related to people's livelihood grew by 61.8%, health-care, social security and social welfare services grew by 58.5%, both higher than average. Considering urban and rural disposal income, annual real growth reached 9.8% and 8.5% respectively, of which transfer income grew by 14.9% and 23.1%, reflecting strong policy support, particularly in the rural area. While China's continual effort to boost consumption would bring about business opportunities, it also represents a major socio-economic transformation.

The second concerns industrial policy divergence. In addition to the need to upgrade traditional industries, new industries like new energy, environmental protection and pharmacy would gain more government assistance and attention. In contrast, industries characterised by energy-consuming, highly polluting and involving excess capacity would face more pressure, e.g. in market access, taxation and credit. It has already been stated in last year's Central Economic Conference that lending to these industries has to be tightly controlled.

The third is about the diverging roles between fiscal and monetary policies. Both fiscal and monetary policies have played their parts in the V-shape upturn of the Chinese economy in 2009. Both areas would emphasise continuation and stability in 2010, while also attending to restructuring. Their implementation, yet, would show differences. In view of the previous extraordinary credit expansion and the current economic and inflation situation, monetary policy should mainly focus on the steady normalisation of the monetary condition. Economic restructuring should be left to fiscal policy, supporting consumption and new industries through taxation and subsidies. In other words, fiscal policy would play the crucial role in national macroeconomic policy in 2010.

The fourth concerns reform in sensitive areas. In order to foster economic restructuring and transformation, reform in some areas would certainly accelerate, e.g. transformation of the government's role, particularly the executive system and fiscal investment mechanism. Breakthrough in these areas would have positive implications for government behaviour or even the operation of the economy. Besides, price reform in resources like water and electricity may also speed up as their actual cost and policy preference have to be reflected in order to realise energy-saving, environment protection and industrial upgrade. This may have far-reaching implications. Its impacts on economic growth, inflation and the asset markets deserve close attention.

Summing up, the global financial crisis has posed challenges for China and also added pressure and momentum to change and reform. China may have stood by a new starting line, ready to accelerate economic transformation and restructuring. From Hong Kong's perspective, China's policy reversals undoubtedly deserve attention, but more worthy of concern should be China's economic restructuring direction and its effectiveness, and identification of Hong Kong's advantages and the roles we can play.

主要經濟指標 (Key Economic Indicators)

一. 本地生產總值 GDP	2007	2008	2009/Q2	2009/Q3
總量(億元) GDP (\$100 Million)	16,154	16,536	3,834	4,125
升幅(%) Change (%)	6.4	2.4	-3.6	-2.4
二. 對外貿易 External Trade	2008	2009	2009/12	2009/1-12
外貿總值(億元) Total trade (\$100 Million)	908	577	52	577
港產品出口 Domestic exports	27,334	24,113	2,197	24,113
轉口 Re-exports	28,242	24,691	2,248	24,691
總出口 Total exports	30,253	26,924	2,583	26,924
進口 Total Imports	-2,011	-2,233	-334	-2,233
貿易差額 Trade balance				
年增長率(%) YOY Growth (%)				
港產品出口 Domestic exports	-16.8	-36.4	-7	-36.4
轉口 Re-exports	6	-11.8	9.7	-11.8
總出口 Total exports	5.1	-12.6	9.2	-12.6
進口 Imports	5.5	-11	18.7	-11
三. 消費物價 Consumer Price				
綜合消費物價升幅(%) Change in Composite CPI (%)	4.3	0.5	1.3	0.5
四. 樓宇買賣 Sale & Purchase of Building Units				
合約宗數(宗) No. of agreements	113,298	133,962	11,112	133,962
年升幅(%) Change (%)	-22.2	18.2	104.4	18.2
五. 勞動就業 Employment	2008	2009	2009/9-11	2009/10-12
失業人數(萬人) Unemployed (ten thousands)	13	19.7	18.1	17.3
失業率(%) Unemployment rate (%)	3.6	5.3	5.1	4.9
就業不足率(%) Underemployment rate (%)	1.9	2.3	2.5	2.3
六. 零售市場 Retail Market	2008	2009	2009/12	2009/1-12
零售額升幅(%) Change in value of total sales (%)	10.5	0.6	16	0.6
零售量升幅(%) Change in volume of total sales (%)	5	-0.8	11.3	-0.8
七. 訪港遊客 Visitors				
總人數(萬人次) arrivals (ten thousands)	2,951	2,959	306	2,959
年升幅(%) Change (%)	4.7	0.3	10	0.3
八. 金融市場 Financial Market	2007	2008	2009/10	2009/11
港幣匯價 (US\$100 = HK\$)	780.15	775.05	774.85	775.05
H.K. Dollar Exchange Rate (US\$100 = HK\$)				
貨幣供應量升幅(%) change in Money Supply (%)				
M1	25.4	4.7	49.5	53.7
M2	20.6	2.7	11.3	10.1
M3	20.4	2.7	11	9.8
存款升幅(%) Change in deposits (%)				
總存款 Total deposits	23.1	3.3	11.5	10.3
港元存款 In HK\$	19.7	-1.3	15.3	15.1
外幣存款 In foreign currency	27.1	8.3	7.6	5.4
放款升幅(%) Change in loans & advances (%)				
總放款 Total loans & advances	20.0	10.9	-4.9	-1.8
當地放款 use in HK	15.7	10.2	-5	-2.8
海外放款 use outside HK	46.9	14.2	-4.5	2.8
貿易有關放款 Trade financing	20.4	1.8	-19.8	-12.5
最優惠貸款利率(%) Best lending rate (%)	6.7500	5.0000	5.0000	5.0000
恆生指數 Hang Seng index	27,813	14,387	21,753	21,822