

Two of the most characteristic features of China's economy

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Two of the most characteristic features of China's economy today are its heavy reliance on export driven growth and its addiction to collecting US dollars. The former has provided a massive current-account surplus, while the latter an artificially undervalued currency. Together, they have largely effectuated the current Chinese liquidity problem. This has, of course, exacerbated international trade tensions and forced the central bank to worry about and fend off inflation and speculative excess. China's \$3bn investment in Blackstone stock and its future plans to more aggressively deploy their foreign reserves should serve to somewhat balance current and financial-accounts and even, depending on the nature of investment, curry overseas good will. Low interest rates, working in concert with additional facets of PRC monetary policy to keep the Yuan inexpensive and skirt inflows of "hot money", have swelled the money supply, ignited the equity markets and excessively fueled export-sectors of the economy. Recent, nearly concurrent moves to raise interest rates, widen the band on which the Yuan floats and increase bank reserve ratio requirements all underscore the urgency with which Beijing desires not only to provide relief, but also nudge the economy (with increasing force) toward a healthier, more sustainable model. Some problems are more intractable than others and no one adjustment or area of adjustment will bring a panacea-like paradigm shift. That said, one of the more stubborn issues contributing to Chinese liquidity concerns is a persistent inclination toward investment over consumption. The central government sets the trend placing their continuously ballooning \$1,200bn reserves of foreign exchange in overseas markets—mainly ultra-safe, low-growth US treasuries. While it is necessary and a supremely good idea to wisely reinvest such sizable reserves, China remains (especially on a per-capita basis) a relatively poor country whose needy, underprivileged and disenfranchised masses far outnumber her more fortunate peers. Party leadership has rightly made addressing domestic wealth and opportunity disparities a priority and diverting cash away from overseas investment to more robustly fund social reconstruction projects is smart and affordable policy; it will also simultaneously foster growth through what is traditionally the most significant component of GDP, domestic spending—an area of frustratingly sluggish growth in the Chinese economy. Lack of domestic consumption, especially during a period of such unprecedented growth, stems in no small part from PRC financial realities. The economy is entirely without deep/stable capital markets and the population's wealth is confined to the limited (government sanctioned) financial alternatives—most prominently, saving in banks. Until the most recent series of banking-sector reforms and today's stock market surge, depositing in banks at rates outstripped by inflation was, for the vast majority of Chinese, the only viable financial instrument. While today China enjoys bullish, super-active equity markets, most all observers agree that a central, stabilizing, value-informed dynamic—the foundation of any healthy market—is altogether absent. Were capital markets of a healthier, more substantive nature created, providing competitive financial instruments of greater value and potential, not only would a massive—currently nonexistent—component of the

Chinese service sector find life, but also both create new wealth and unlock existing capital tucked away in precautionary savings. Consumption, both of and resulting from increased financial performance and confidence should grow considerably. Today, understandably, the Chinese service-sector is small. As the economy continues to develop and mature, however, and as wealth continues to grow over larger areas of the population, this component of the economy will become increasingly important. The lack of domestic consumption and inadequate service-sector further pressurize an economy that is already off balance. Erik Britton and Vanessa Rossi note, “Historically, in all economies, the period of rapid industrialization generally is just the first phase of economic development. The next phase involves the shift out of manufacturing industries toward service industries.” To this end, economic diversification, especially areas targeting domestic consumption, should be encouraged. Constraints on service-sector imports need to be relaxed and centrally directed incentives should be shifted away from heavy industry and manufacturing and toward cultivating the nascent service-sector.