

## **Is the Chinese economy spiralling out of control?**

*(A short note written for the Asymmetric Threats Contingency Alliance (ATCA) dated 23 July, 2006)*

My heart is heavy with what is happening in the Middle East as my mind is being seized with the most interesting and illuminating analyses on the subject from distinguished contributors on the ATCA forum. But this also prompts me to throw in my two pence worth on the questions posed by Prof Jean-Pierre Lehmann on ‘China: Querying the Dynamics’ as both these overarching stories, though not immediately related, beg the question of long-term global implications.

First, is the Chinese economy spiralling out of control?

As I have commented earlier, the Chinese leadership is very much alive to the risks to stability of a breathless fixed-asset investment and export-driven economy. This awareness is very much behind the about-turn in the latest Five-Year Plan putting sustainability and balanced development ahead of sheer GDP growth.

This also explains the People’s Bank of China’s decision in June following its last quarterly meeting to raise the reserve ratio for banks by half a percentage point, in addition to its lending rate rise in April.

But China’s M2 grew at a year-on-year rate of 19.1 % at the end of May, well past the central bank’s projected 16% for this year. The latest figures reported in this debate also sharpen the mind.

So Dr Walker's warning is legitimate. He is right to say that much of the heat comes from unbridled property development and there is an urgent need to further contain the excess liquidity. Mr Yu Yongding, a leading economist who sits on the central bank's monetary policy committee, has recently commented that 'Fixed-asset investment is growing well above that of GDP and this is not sustainable'. He is also reported to have said, 'It is highly likely that the Yuan will appreciate at a greater speed'.

Indeed, a greater Yuan flexibility goes beyond monetary considerations. It is a much needed safety valve for a 'growth oriented' economy, however fine-tuned. Linking to a basket of currencies instead of just the US Dollar helps to avoid too much hostage to fortune with geopolitical advantages. Building up more practical experience in managing a more flexible currency would pave the way to future full convertibility. A stronger Yuan would help China's quest for outward, international investments. Above all, it would help to address both China's internal and the global economic imbalance by fostering China's consumerism as a counterweight to its export-led growth.

However, Premier Wen Jiabao was spot-on in emphasising recently that there was no chance of another one-off revaluation. Any such action could only add fuel to increasing currency speculation and serve to destabilise international markets. He is also more than mindful of the risks of derailing China's export locomotive, already facing squeezed profit margins and increasing protectionist pressures, let alone the impact on impoverished farmers grappling with loosened foreign-

subsidised food imports. Last but not least, the heightened risks of unauthorised outflow of capital. Before China can successfully complete her much needed financial services reform, she has to ‘feel the pebbles on the riverbed’ before venturing to cross it.

So perhaps in a measured way, we can expect more efforts to improve on the Yuan’s continuing liberalisation, moderating the size of China’s massive foreign exchange reserve fast approaching USD 1 trillion, tightening credit further, and better managing the inflow and outflow of investments.

The second question is what would be the implications for the world economy.

Having tried to put the first question in some context, I can do no better than providing some food for thought by sharing a recent think-piece I wrote, in which I have tried to encapsulate some of the main global dynamics of a Rising China. The piece was delivered as a Keynote Speech to the China-Britain Technology and Trade Association at Reading University and was also circulated to ATCA members on 11th June 2006 under a slightly modified title. For newer members of ATCA, who may not have read it before, it is re-produced below. *(The think-piece now features separately with the title ‘How Technology and Trade are driving China in the 21<sup>st</sup> Century’ in the list of Publications on my website.)*

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