World economy needs China to slow growth gradually

By PAUL WISEMAN, AP Economics Writer – 17 hours ago 0

WASHINGTON (AP) — China's high-flying economy is starting to lose altitude. The big question is whether the world's economic superstar will descend gradually — or so fast that it harms a fragile global economy.

China's comedown is being engineered by its policymakers. They want to slow its growth rate just enough to cool inflation without sapping job growth.

It's a delicate task.

"Nobody can say with any confidence" if they'll succeed, says Barry Eichengreen, an economics professor at the University of California, Berkeley.

China's explosive growth remains the envy of developed nations like the United States. It grew faster than any other major economy in the April-June quarter, according to The Associated Press' latest quarterly Global Economy Tracker. Only Argentina's much smaller economy matched China's 9.5 percent annual growth rate.

By contrast, the U.S. economy grew at a 1.3 percent rate in the April-June quarter, before expanding 2.5 percent in the July-September period.

The AP's Global Economy Tracker monitors economic and financial data in 30 countries representing more than 80 percent of global output.

Economists worry that China's economy could suffer what they call a "hard landing." A sudden plunge in China's growth would harm the economies of the United States, Europe and small countries that need China to buy their coal, copper and other raw materials.

On Tuesday, a Chinese government group said manufacturing grew in October at the slowest pace in nearly three years, partly due to weak export orders. It forecast that the economy would slow further the rest of the year.

The threat from a slower-growing Chinese economy comes as the United States is still struggling to recover from the Great Recession of 2007-2009. And an agreement last week to ease Europe's debt crisis might not prevent the continent from sliding back into a recession that would ripple through the United States and other countries.

When surveyed this year by the Society of Actuaries, corporate risk managers in the United States, Canada and elsewhere said a slowdown in China posed the greatest threat to their business.

A hard landing wouldn't just squeeze U.S. and European exporters. It could also destabilize Chinese society. And it could escalate global trade tensions.

Hampered by inflation above 6 percent and slowing exports, China's growth is expected to decelerate from 10.3 percent last year to 9.5 percent in 2011 and 9 percent in 2012, according to the International Monetary Fund. The IMF expects the global economy to grow 4 percent this year.

Developing countries emerged faster than other nations from the Great Recession. They're now growing much faster than rich countries. According to the AP's global tracker:

—The three fastest in the April-June quarter were China (a 9.5 percent annual growth rate), Argentina (9.5 percent) and Indonesia (6.5 percent).

—The laggards are from the industrialized world — Japan (down 1.1 percent), Norway (up 0.3 percent) and Britain (up 0.6 percent).

—Growth is slowing worldwide. It weakened from a year earlier in 19 of 26 countries that reported April-June data.

China's gaudy growth doesn't mean much to Xie Jun, who runs a factory in the southern Chinese boomtown of Dongguan. He's enduring a tough year.

His company makes and exports headphones, cell phones and computer accessories. It's paying 30 percent to 50 percent more this year for chemicals, fuel and other raw materials. Labor costs have nearly doubled.

Xie's customers are reducing orders, forcing him to lay off more than 10 percent of his staff at Dongguan Jincai Real Co. and leaving him with about 100 workers.

"I just feel hopeless," Xie, 45, says. "It's hard to say if it will get any better next year."

China will likely account for nearly a third of global growth this year.

Exporting countries depend on China's demand for raw materials and consumer goods. Mines in Australia and Chile supply coal, copper and iron ore. General Motors sells more vehicles in China than anywhere else, including the United States. China was the No. 3 destination for U.S. merchandise exports last year, behind Canada and Mexico.

China's trading partners are watching warily to see whether it can avoid a hard landing. Economist Nouriel Roubini has defined a hard landing as a drop in annual growth to 5 percent or less. He says China must expand 8 percent a year just to keep enough people employed to "maintain its social and political stability."

Eswar Prasad, professor of global trade at Cornell University, puts the odds of a hard landing in China at 50-50.

Other analysts say they're confident China's policymakers will manage to reduce inflation gently without stifling growth too much.

The authorities "are well-aware of the risks," says Bob Mark, who runs Black Diamond Risk Enterprises and has advised Chinese banks. "It's not like they're going to be blindsided."

China's central bank has raised interest rates five times since mid-2010 to try to shrink inflation. Even so, consumer prices jumped 6.2 percent from August 2010 to August 2011. That was fifth-fastest among the 30 countries in the AP's global tracker. In the United States, by contrast, prices rose 3.8 percent in the 12 months ending in August.

News that China's growth dipped to 9.1 percent in the July-September quarter from 9.5 in the April-June period was met with relief by some economists. Rajat Nag, managing director of the Asian Development Bank, says it suggests a soft landing ahead.

Eichengreen notes that Beijing's communist authorities "have lots of levers they can pull, unlike U.S. authorities."

Senior bureaucrats in effect run the economy. The government owns most of the biggest companies and banks. It controls the currency.

Officials can, for example, suppress the value of China's currency, the yuan. A lower yuan makes Chinese goods cheaper overseas. The United States has long accused China of keeping its currency artificially low to give its exporters an unfair edge.

Chinese policymakers can also order state-owned banks to lend if the economy slows much. They can command local governments to keep workers busy building roads and bridges.

Roubini, a New York University economist who runs a research firm, thinks China's authorities will use all those tools to keep the economy growing briskly through 2012. They'll want to ensure a smooth transition next year, when a new president and premier will come to power.

But Roubini and others worry that the outlook after that is bleaker. He thinks China's growth could sink to 5 percent or less in 2013 or 2014.

At the heart of the problem is how China has stoked its expansion. It hasn't encouraged its consumers to drive the economy with their spending, as Americans do. Instead, it's juiced growth by pushing exports and investing in factories, roads, railways and real estate.

Such investments account for about half of China's gross domestic product, a broad gauge of economic activity. That is a wildly lopsided share that suggests China is investing in far more construction than it needs.

In most major countries, consumer spending, not investment, drives the economy. Last year, for example, consumers accounted for more than 70 percent of GDP in the United States, 63 percent in Britain, 58 percent in Germany and 57 percent in Japan. In China, consumer spending represented just 39 percent of GDP.

Behind China's investment boom are bank loans that might never be repaid, because the projects aren't expected to throw off enough revenue.

Roubini's research firm estimates that China has wasted $1.4 trillion since 2008 on investments that will likely end up as bad debts.

Optimists say China is merely planning for the future. A growing middle class will eventually occupy the new houses, ride the new trains, fly from the new airports and drive new cars on the new highways. The new factories will make goods to meet rising demand at home and abroad.

But demographics pose another problem. China is aging fast. Largely, that's because of population control policies that limit most families to one child. This year, 8.9 percent of Chinese were 65 or older. By 2021, 12.9 percent will be.

"A significant slowdown is coming because their labor force is aging," Eichengreen says. By 2015 or 2016, he says, China's growth could slow to 5 percent or 6 percent.

Economists have urged China to rely more on its consumers and less on exports and dubious investments. In Dongguan, factory owner Xie would agree.

"I am thinking about focusing more on the domestic market next year," he says. "At least we have 1.3 billion people. It is a big market."

AP Business Writer Joe McDonald in Beijing and AP researcher Fu Ting in Shanghai contributed to this report.

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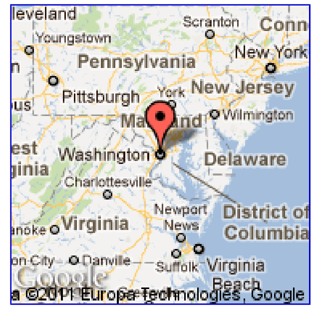
Map



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