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# China's Move Shifts Growth to Top of Agenda

*Beijing Loosens Bank Reserve Requirements as Fears Over Global Crisis Eclipse Inflation Concerns*

By BOB DAVIS And TOM ORLIK

BEIJING—China moved decisively to stimulate its economy by cutting its bank reserve requirements for the first time in nearly three years, in what analysts said could be the start of a campaign of monetary easing aimed at bolstering China at a time when its trade and real-estate sectors are sagging.

The move signals that China has put economic growth at the top of its agenda, rather than concerns about inflation, even at the risk of reigniting a property bubble that it has spent months struggling to deflate. "This is a big move," said Stephen Green, China economist at Standard Chartered. "It signals China is now in a loosening mood."

Beijing has said that it will reverse some of its recent increases in bank reserve requirements. While not a surprise, it does suggest that China is now worried about global growth too.

The People's Bank of China said it would cut the reserve requirement ratio by 0.5 percentage point, taking the level to 21% for major banks, effective from Dec. 5, the first such cut since December 2008. The move would free up around 390 billion yuan, (about $61 billion) in funds for the banks to lend. Standard Chartered said that it expected China would reduce the reserve ratio again in January due to a potential liquidity crunch coming up before Chinese New Year. HSBC also forecast additional reserve ratio cuts and an increase in the amount of total lending Chinese authorities would approve.

China is much more likely to use changes to the reserve requirement ratio than interest-rate cuts to stimulate the economy because its leaders believe they can better target the results they want by manipulating bank requirements than by easing monetary conditions across the economy.

Agence France-Presse/Getty Images

Authorities in China moved Wednesday to stimulate growth as gains in the trade and real-estate sectors

The move came several hours ahead of an announcement that six major central banks in wealthy nations jointly agreed to provide cheaper dollar loans to any banks that need them. Those banks are the U.S. Federal Reserve, the European Central Bank, the Bank of Canada, the Swiss National Bank, Bank of England and Bank of Japan. A central bank official said that the Chinese acted on their own.

In the past, the PBOC hasn't coordinated its actions with the other major central banks. The Chinese central bank doesn't have the authority to make key decisions on monetary policy by itself and must win approval by China's most powerful have slowed. Pictured, workers at a construction site in Beijing this week.

government body, the State Council. PBOC officials didn't respond to emails requesting comment.

The PBOC's actions reflect a growing pessimism among the country's top leaders about the direction of the global economy. In late November, Vice Premier Wang Qishan said that "global conditions remain grim and that ensuring economic recovery is the overriding priority." Earlier in the month, Premier Wen Jiabao said that the European debt crisis posed "severe challenges to world economic recovery."

With Europe perhaps headed into recession, the U.S. struggling with a fragile recovery, and Japan battered, China's export growth has been flagging, with expectations of worse to come. China's official purchasing-managers' index fell to 49.0 in November compared with 50.4 in October. A reading below 50 signals contraction in the manufacturing sector. It was the first contractionary reading for the index since February 2009.


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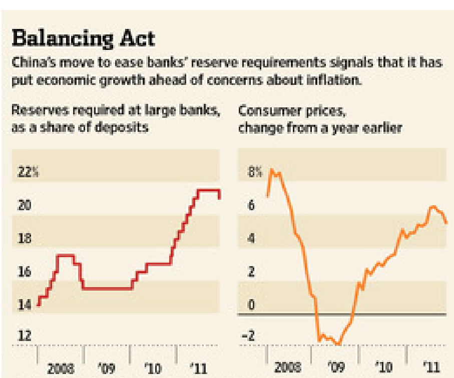
Add to that woes in China's residential property market, where the government has sharply increased requirements for down payments and limited financing for developers in an effort to bring down sky-high property prices. The policy actions have worked but at the cost of reducing economic growth.

"The data for the last few weeks has been bad," said Mark Williams, China economist at Capital Economics. "There's zero growth in property starts, electricity output growth has slowed, the export numbers for November will be awful and [the government] may have had a sneak preview of that. All of these things could have triggered a shift in policy."

Although the government continues to say that it will press to keep property prices under control, its job will be much tougher as it eases liquidity. The challenge then will be to direct the extra lending into the hands of small and medium-size enterprises and out of the hands of developers of luxury apartment buildings. Before Wednesday's reserve rate move, some economists had expected prices of residential property to fall somewhere between 10% and 20% in the months ahead. Real-estate investment equals about 15% of China's gross domestic product and is the main domestic driver of economic growth.

The impact of the policy move was heightened by its surprise. Few analysts were expecting an outright cut in the reserve requirement before the first quarter of next year, if then.




Until now, China's policy makers had used so-called targeted easing to prop up small manufacturers under stress, without loosening overall monetary policy. For instance, the State Council unveiled a set of measures in October aimed at making more funds available to small businesses in the wake of a slew of bankruptcies among factory owners in the coastal city of Wenzhou, a Chinese entrepreneurial center. More recently, the government reduced reserve requirements for some rural cooperatives in east China's Zhejiang province.

How much further China eases monetary policy is bound to reflect the leaders' views of how deeply the Chinese and global economy may slow. "This move signals that the authorities are preparing to move aggressively to stoke domestic demand if the external environment remains weak," said Brookings Institution China expert Eswar Prasad.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The scope for a stimulus on the same scale as that launched in response to the 2008 financial crisis is limited. But few expect the Chinese to include fiscal stimulus anytime soon. After the 2008 global downturn, China stimulated its economy mainly by a surge in lending by state-owned banks to state-owned firms and the real-estate market. China is likely to move much more cautiously this time both because the global economy isn't as weak as it was in 2008 and because the last loan spree inflated a property bubble and a produced an unknown number of bad loans.

Still, says Mr. Prasad, "if there are shock waves from a massive shock such as a euro breakup, they would go full bore on both fiscal and monetary stimulus."

—Lingling Wei contributed to this article.

**Write to** Bob Davis at bob.davis@wsj.com and Tom Orlik at Thomas.orlik@wsj.com