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China's Economy Strengthens

By TOM ORLIK And BOB DAVIS

BEIJING—China's economy strengthened in November, as leaders turned to their old infrastructure-spending playbook to boost growth.

Industrial output, the key monthly measure of China's growth, rose 10.1% year-to-year in November, up from 9.6% in October and the strongest since March. Electricity production, a widely watched proxy for China's economic activity, accelerated to 7.9% growth from 6.4%.

Stronger-than-expected growth provides further evidence China's economy has recovered from its midyear slump, and raises prospects for an acceleration in gross domestic product growth in the fourth quarter, up from a three-year low of 7.4% in the third. The median forecast of 12 economists polled by The Wall Street Journal is for 8% GDP growth in 2013.

The improved prospects come as China's new leaders give hints that they may be open to big changes in a formula for growth that has relied for a decade on exports and investment. A number of economists inside and outside of China have argued that model won't sustain growth in the longer term, and that China must rely more on domestic consumption.

Over the weekend, China's new Communist Party Chief Xi Jinping toured the city of Shenzhen across from Hong Kong in an echo of Deng Xiaoping's famed "Southern Tour" of 1992, when China's paramount leader signaled he would make a renewed push for economic reform, which had stalled after the Tiananmen Square crackdown of 1989. China's incoming premier, Li Keqiang, talks regularly about making it easier for migrants to become permanent residents of China's cities, where they can earn more—and spend more.

"Li's statements about the need for reform are encouraging, but the lack of specifics suggests that he intends to pick his battles carefully," said Cornell University China scholar Eswar Prasad.

China's improving economy puts the new leaders in a quandary. The old model continues to deliver growth but may not be sustainable. Change could undermine growth in the short term, by reducing investment spending, in the hope of creating a stronger foundation for the future.

The risks of relying on the old model were evident on Monday as China reported that exports rose just 2.9% in November from a year earlier, much lower much lower than October's 11.6% rise and far below economists' median forecast of a 9.6% expansion. Imports were flat from a year ago level. Overall the trade surplus fell in November to $19.6 billion from $32.0 billion in October.

The export slowdown shows the riskiness of relying on a global economy that continues to sputter along, with Europe continuing to deal with its financial crisis and the U.S. politicians wrestling with how to cut the long-term deficit before a deadline for draconian spending cuts comes into effect—the so-called fiscal cliff. Failure in Europe or U.S.—China's largest trading partners—could push the world into recession and batter China.

For now, the main catalyst for growth is an increase in investment in infrastructure, especially public-transport projects. In the first 11 months of 2012, the National Development and Reform Commission—China's powerful government planner—has given the green light for 837 billion yuan ($134 billion) investment in 32 subway systems. That includes six entirely new systems in cities ranging from Urumqi in remote Xinjiang province to Lanzhou in impoverished northwestern Gansu.

Overall, China is starting work on, or extending, more than twice the 15 subway systems that exist in the U.S.

Other state transportation spending also is increasing. Investment in roads grew 36.8% year-to-year in November, from zero growth at the end of 2011, and railway spending also has accelerated.

In contrast, investment in the manufacturing sector dipped to 19.4% growth in November from 24.4% at the beginning of the year. That reflects caution by entrepreneurs faced with an uncertain outlook, rising costs, idle capacity, and high debts to repay from past investment. Andy Hwang, chairman of Jaw Lien Enterprise Co., in the southern coastal city of Xiamen, which makes buckles for handbags, said his business is down 10% from last year. "Our major cost is our labor cost which is increasing tremendously," he said.

The return to state-sponsored investment in 2012 is more moderate than in 2009, when the government responded to the slowdown in growth with a surge in bank lending for infrastructure and real-estate projects. While that stimulus spending helped China ride out the global financial crisis, it is blamed now for creating a real-estate bubble and the risk of rising bad debts.

Many Chinese car-clogged cities want to improve public transit. "I'd say we have been moving slowly in developing the urban rail system, and we should strengthen such investment to resolve the city congestion problem," said Guo Xiaopei, director of the Institute of Comprehensive Transportation in the NDRC. "Cities that get approvals have millions of people; some cities abroad which establish subways don't even have that many."

But the problem with relying so heavily on government investment for growth is that it risks misallocation of capital and starves the private sector of financing. "There are only about 20 cities in China that satisfy the standard of establishing subways but many cities are preparing for it or have submitted applications to NDRC, and NDRC is irresponsible if they approve that," said Zhao Jian, a professor of transport at Beijing Jiaotong University.

Shifting away from investment spending to domestic consumption, however, would require large changes in China's economy, so that more wealth winds up in the pockets of lower-income households. Shaking up the system is bound to produce a political backlash from those who benefit, especially state-owned enterprises, local governments and the bureaucrats that service both. Over the past two decades, the growth in household income hasn't kept up with the overall growth of the Chinese economy.

In November, retail sales growth rose to 14.9% year-to-year from 14.5% in October, a healthy pace, but less than the increase in investment, which held steady at 20.7% in the first 11 months of the year, unchanged from the level in the first 10 months.

New floor area under construction in the real-estate sector showed signs of recovery, as residential sales rose 31.6% year-to-year. China's leaders say they remain committed to keeping real-estate prices from rising too sharply as a way to make housing more affordable for the mass of Chinese buyers.

—Liyan Qi and Yajun Zhang contributed to this article.