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Chinese Numbers Reopen Stimulus Debate

After Inflation Downtick, Economists See Room for Measures to Lift Growth; Officials Playing Defense as Party Realigns

By BOB DAVIS and WILLIAM KAZER

BEIJING—A modest downtick in Chinese inflation could give policy makers more room to boost the world's second-largest economy, as growth continues to decelerate in China's biggest swoon since the global financial crisis.

On Thursday, China is expected to report that its GDP growth in the third quarter slid below the 7.6% it reported for the second quarter, with little evidence in sight of a quick turnaround. While China over the weekend reported a surprising boost in September exports, imports continued to grow at sluggish 2.4% pace, reflecting persistent weak domestic demand.

One of the mysteries about the Chinese economy is why policy makers haven't done more to boost growth. The central bank cut interest rates once in June and again in July, leading to a slew of forecasts that considerable monetary easing was in the works. But since then, the People's Bank of China hasn't touched either the interest rate or its requirement that banks hold 20% of their deposits in reserve—among the highest reserve-requirement ratios in the world. Lowering that ratio would free up more money for loans.

International Monetary Fund chief economist Olivier Blanchard said he assumed Chinese authorities would stimulate the economy on a vast scale, as they did in response to the global recession that began in 2008. "The surprise comes from the fact that they haven't done it, at least on the scale that we assumed," he said.

Continued low inflation—the consumer price index has been at 3% or below since May—gives Chinese officials room to move without fear of igniting big price increases. September's index was up 1.9% from a year earlier, slowing from August's 2% pace, data from the National Bureau of Statistics showed Monday. It matched the median 1.9% forecast of 12 economists surveyed by The Wall Street Journal.

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Governor of the People's Bank of China Zhou Xiaochuan

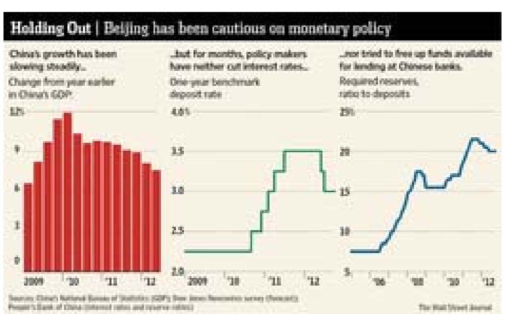
While some economists warned of a possible rebound in prices in the months ahead, others insisted any rebound wouldn't threaten the economy and there's a need for additional stimulus.

Joseph Yam, a former chief executive of the Hong Kong Monetary Authority who is close to China's economic leaders, said that central bank Gov. Zhou Xiaochuan may have skipped a meeting of the International Monetary Fund this past weekend in part to discuss at high-level meetings in Beijing "whether or not there is a need for monetary and fiscal stimulus."

Cornell University economist Eswar Prasad, a former senior IMF official specializing in China, expects a reserve-requirement cut shortly. "They need to send a signal to markets that they are ready to act and get things under control," he said. "It will set the stage for policy action."

His views are probably in the minority among China economists, with more thinking that Beijing will try to muddle through at least until after the once-a-decade leadership transition, which begins Nov. 8 with the selection of top Communist Party officials.

With the world's biggest advanced economies either in recession or growing tepidly, the global outlook depends ever more on Beijing. China is a major destination for products as diverse as commodities, construction equipment and machine tools, as well as the services needed to build and operate complex projects.



One explanation for the policy inaction thus far is political. With Chinese officials angling for promotion, they may be wary of making high-profile policy decisions. Today the 2009 stimulus is blamed for a housing bubble, inflation, bad loans and an entrenching of state-owned firms, which received much of the ramped up lending from banks. That has put Premier Wen Jiabao, who championed the program, on the defensive and sent a signal to others to act cautiously, say analysts.

Another possible reason for inaction is concern that a cut in the reserve ratio would do little to ramp up growth, because the problem is a lack of demand rather than an availability of funds to lend.

Policy making in China "is constrained in subtle ways," said Lu Feng, deputy director of Peking University's National School of Development. He argues that the slowdown, however, is putting pressure on China's new leaders to make fundamental changes.

In contrast with countries that are burdened with high fiscal deficits or have already cut interest rates close to zero, China has policy room, People's Bank of China Vice Gov. Yi Gang said in an interview with the Financial News, a publication backed by the PBOC. Beijing, he said, is well positioned to use both fiscal and monetary policies to support economic growth.

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