

Is China Recovering?

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When the worldwide financial crisis began to unfold last year, China immediately announced its first huge 4 trillion yuan (\$586 billion) stimulus package. This was followed quickly by a number of additional policies aimed at speeding recovery while Beijing continued to buy and hold U.S. bonds. Has China's stimulus package worked? What does the current Chinese market and economy look like? Can Beijing engineer another year of 8% GDP growth in 2009?

First, it is important to understand that, unlike the US, the problems in China did not originate with domestic banking and finance. In fact, our Chinese friends often tell us that China has *no financial crisis at all*. They trust the Chinese banks and think they are healthy and strong. It's ironic.

Our business makes us fully aware of the impact on China of the Western financial crisis. For example, during the first five months of 2009, new orders placed with the 1,791 major shipbuilders in China decreased by a massive 96% year-on-year. If Western buyers stop buying exports, then shippers stop sailing, and shipbuilders stop making new ships. Similarly, in the utility market, even though Beijing said it would not slow development of new installations, in fact our equipment bids are down by two-thirds in the first five months of 2009. But we've recently seen a positive sign: China's biggest private shipbuilder, Jiangsu Rongsheng Heavy Industries, just won an order to build four vessels worth US\$ 484 million for Oman Shipping Co. It's not a turn-around, but it's a beginning, and there are similar signs in other industries.

Declining exports is one major problem for China; the other major problem is declining trust in the US Treasury. Everyone knows that China is the largest investor in US treasury bonds, and so steep declines in value have led to monumental risk and loss. China already holds upwards of \$1.3 trillion in US securities, and some 70% of its total \$2 trillion in foreign currency reserves are in dollar assets. This makes China a hostage to US financial and economic policy, a position China very much wants to change. Thus China, with support from Russia and Brazil, is leading an effort to dethrone the dollar as the world's bellwether currency and replace it with a more stable vehicle created by the IMF. The implications of this in terms of both global economics and balance of power are strong stuff for the imagination. (You can already find a number of doomsday scenarios for the US.)

Beijing's strategy to deal with the export headache is to focus on domestic infrastructure investment and consumption. Accordingly, investments in projects such as highways, railways, airports, waste treatment, and so on rose almost 33% in the first five months of 2009. In fact, however, China had begun this effort even before the stimulus package was announced. To take just a few examples:

- *Nuclear Power.* China currently has 11 nuclear plants in operation, with about a dozen now under construction and another dozen or so in the planning stages.
- *Wind power.* China is now building more wind power capacity than any other country and is projected to be number one for many decades.
- *High speed railways.* China plans to spend more than \$1 trillion expanding its railway network from 78,000 km today to 120,000 km by 2020, including 13,000 km of high-speed

rail. So far this year, investment in the railway system is up 164.6% over the same period last year

- *“Big airplane” program.* China has tested and now launched commercial production of its homemade regional jet, the ARJ21, with 30 planes to be delivered to clients by 2012. And the first A320 jet was assembled in Tianjin and is to be delivered to Dragon Aviation Leasing and operated by Sichuan Airlines in southwestern China.

We see no sign that Beijing will stop this big government “stimulus” investment, and we do see signs of recovery.

Moving to the consumer side, there are many indicators of strength. For example, auto sales jumped an incredible 14% in the first five months of the year, thanks largely to government consumer tax cuts on car sales. GM may be in bankruptcy in the US, but GM (China) can't make cars fast enough. GM has doubled its sales projection for 2009 to over 10 million units. Similarly, property transactions have made a strong comeback with sales in the seven largest cities rising 70% in the first five months year-on-year.

GDP grew by just 6.1% in the first quarter, the weakest pace in nearly a decade (but dam good for any other country), but growth in the last two months have pushed up all the numbers. Industrial output, for example, jumped 8.9% in May and retail sales jumped 15.2%. For the first 5 months of 2009, investments in large capital projects (roads, factories) rose 32.9%, according to China's National Bureau of Statistics, while real estate investment grew 6.8%, capital spending in primary industries rose 79.7%, and railway investment grew 110.9%. Based on this, the World Bank has revised its GDP forecast for China for 2009 from 6.5% to 7.2%. And Chinese authorities are saying 8%.

There are many problems we are not mentioning here – unemployment, foreign direct investment, investment imbalances, export replacement, credit overextension, etc. – but we will save these for other episodes. For now, many experts are hoping that the momentum China has gained in a short period of time will hasten not only China's recovery, but global recovery as well.

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