China Faces Hidden Concerns about Stagflation

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China's economic growth has slowed down for the fifth consecutive quarter and its consumer price index (CPI) increased by as high as 6.4% year-on-year in June. Although the People's Bank of China (PBC) has raised interest rates twice this year and lifted the required reserve ratio six times to 21.5%, inflation pressure remains heavy even if money supply growth rates have slowed down. In addition, the Chinese housing market bubble and the large scale of local government debt, both affected by monetary tightening, are on the brink of popping or collapsing. China's economy faces risks of stagflation and a hard landing. While confidence concerns about the Chinese economy have mounted, the Taiwanese government still pursues headlong a direction for economic development that depends entirely on China. Now that both sides' economies are highly linked, whether Taiwan can bear the consequences of the least upheavals in the Chinese economy has to be carefully observed.

Growth slowdown and the risk of a hard landing

The Chinese government announced that the country's economy grew by 9.6% year-on-year in the first half of 2011 and that its economic growth had slowed for the fifth consecutive quarter. Soaring commodity prices affect consumer demand; therefore, how to control commodity prices has become the government's primary task. Facing complicated domestic and foreign environments where uncertain factors remain high, China has implemented "macroeconomic control" and has seen its central bank, the PBC, raise interest rates twice this year, lift banks' required reserve ratio six times to 21.5%, increase the interest rate for one-year loan up to 6.56%, and plan to adopt tight monetary policy that involves raising interest rates by the end of the year. However, except for giving pressure to companies that operate normally and try to raise funds, hikes in interest rates can only exert limited influence on stabilizing commodity prices and on reining in real estate speculation. The risk of "a hard landing" that the Chinese economy faces has not been completely removed.

Rocketing commodity prices: food prices in CPI calculation jumped as high as 14.4% year-on-year

China's CPI in June, which was just published, increased by as high as 6.4% year-on-year. Soaring commodity prices have gravely threatened the economy. Food prices went up by 14.4% year-on-year, pushing the overall price level up by 4.26%. Apart from driving up the overall commodity prices, high food prices have created severe pressure on people's commodity needs. China's producer price index (PPI) also rose to 7.1% year-on-year in June. Analyses revealed that major factors contributing to China's inflation include increases in minimum wages for domestic workers and in raw materials as well as rising prices of imported goods revved up by international oil prices and bulk materials.

Moreover, 13 provinces in China have widely raised their minimum wage standards by an average 20.6% this year. In addition, according to the Chinese Ministry of Human Resources and Social Security's Outline of the 12th Five-Year Plan, China's minimum wage will be increased by an average of more than 13% for each of the next five years. This shows that it is hard to reverse this cost-push inflation caused by continually rising wages. Whether this inflation will bring about a double spiral effect that sees wage and commodity price increases is worth follow-up observations.

China's economy faces the crisis of becoming a bubble

Although China's money supply growth has slowed down, the total loan scale remains huge and inflation pressure still exists. Besides, the Chinese housing market bubble and the large scale of local government debt have both been affected by monetary tightening policies and are on the brink of popping or collapsing. According to China's official audit, the country's local government debt reached 10.7 trillion RMB at the end of 2010, which was 27% of gross domestic product (GDP). Among the debt, money raised by local financing platforms such as local government-owned city investment companies accounted for 4.96 trillion RMB, of which 4 trillion will intensively become due this and next years. It is estimated that 2.5 trillion may become non-performing loans. These loans are viewed as a "time bomb" that threatens China's economy.

According to a PBC statement, these local governments' hidden debt was created mainly through the borrowing from financial institutions by the more than 8,000 companies set up by local governments that circumvented the Beijing central government's ban on them from direct financing. These businesses set up by local governments are having increasingly high shortfall risks and are likely to damage the financial system as well as dealing a blow to the economy.

Taiwan's economy at high risk due to heavy reliance on China

Under the Ma administration, total dependence on China has become Taiwan's economic development strategy. Council for Economic Planning and Development (CEPD) Minister Christina Liu repeatedly emphasized that Taiwan's industries should move toward the objective of "a twin-engine economy that had been driven by both exports and domestic demand" and proposed a policy watchword that named this year as Taiwan's "Year of Consumption." However, observations of the government's strategy to develop domestic demand discover that the government only has wishful policies in this area, such as "the Individual Travel Program for Chinese Tourists," which has entirely depended on China. No wonder that, in the Directorate-General of Budget, Accounting and Statistics' GDP growth forecast, government spending and fixed capital formation both saw negative growth, and the real growth rate of private consumption was only at the same level as that of last year. Other leading domestic and overseas research institutions are also of the opinion that the growth of Taiwan's domestic demand will be limited. Obviously the CEPD's catchphrase of "a twin-engine economy" lacks the backing of substantial policies.

Taiwan's employment situation has improved, plus the appreciation of the New Taiwan Dollar has brought some effects. If private consumption, which accounts for up to 60% of Taiwan's GDP, can grow, it will certainly contribute to the overall expansion of the economy. But the government has to be reminded that Taiwan's economy faces problems such as overdependence on exports as its growth momentum as well as weak, languid domestic demand. The government should proactively work out responsive measures to deal with these problems.

That the government has been hoping the Individual Travel Program for Chinese Tourists may make contributions to Taiwan's domestic economy is an obvious sign that the administration lacks clear awareness of problems as well as positive policies and proposals. What's more, the administration relies on China as the way out for Taiwan's economy, yet ignores the high risks that the unevenly developed Chinese economy contains, thus further sacrificing Taiwan's economic autonomy. As both sides' economies are linked, whether Taiwan can bear the consequences of the least upheavals in the Chinese economy has to be carefully observed.

China’s GDP Annual Growth Rate

Source: National Bureau of Statistics of China
GDP 年增率 =GDP annual growth rate

China’s CPI Annual Growth Rate

CPI 年增率 =CPI annual growth rate
PPI 年增率 =PPI annual growth rate

Source: National Bureau of Statistics of China

Trend of China’s Monetary Policy

存款準備金率 =deposit reserve ratio
貸款基準利率 =benchmark lending rate
存款基準利率 =benchmark deposit rate

Source: The People's Bank of China