China on the Rebound

China's economy is the first to bottom out of the global crisis, which could make it the world's second-largest economy, ahead of Japan, according to *Nicolas Musy*.

AFTER A SHARP SLOWDOWN AT the end of last year, China's economy has picked up significantly in the first quarter of 2009. The government's far-reaching infrastructure investments are spurring innovation, while rural consumption incentives are stoking domestic growth.

Lower production costs and higher availability of skilled labour make China a more attractive production base. Amidst the economic downturn, the need for world-class technology to complete huge infrastructure projects provides rare market opportunities for international companies.

Considering that China clocked growth as low as 2.6 per cent in the last quarter of 2008, growth of 6.1 per cent in the first three months of 2009 marks a significant rebound. This figure could touch 14 per cent next quarter and economists predict seven to eight per cent economic growth this year.

Just what makes China the only top economy to grow so astonishingly, when the rest of the world is experiencing its worst performance in 50 years?

Firstly, retail sales have grown strongly despite lower consumption after 23 million migrant workers lost their jobs in coastal export industries. The government offered China's 800 million farmers VAT exemptions on big ticket electrical appliances, ingeniously replacing lost exports with better domestic consumption without loss to the state (VAT is refunded on exported goods). Retails sales climbed almost 15 per cent this April compared to a year ago.

China announced its stimulus investment program last October. Two months later, 93 projects, totalling an investment of USD58bn, were approved in just three days!

The Chinese banking system remained unscathed by the credit crisis. In terms of market capitalisation, the nation now houses the world's top three banks, reflecting the confidence of investors in Chinese banks. Lending is growing, with new loans in the first quarter of 2009 alone surpassing total new loans in all of 2008.

Infrastructure investment is helping China move out of the economic crisis.

Exports tumbled 25 per cent to USD65bn in February from an all-time monthly high of USD136bn in September 2008, but rebounded to USD92bn in April.

Rare Market Opportunities

Imports have been recovering with equipment goods companies seeing an increase in enquiries from China. Attendance at the China International Machine Tools fair in April remained high with 200,000 visitors.

While developed economies are almost stagnating, China's size and growth make it a rare opportunity in 2009. Over the next two years, the USD600bn stimulus investment will go into high-speed trains, metros, power plants, telecommunications systems, hospitals and water treatment plants, while business processes outsourcing (BPO), and advanced technologies will get investments on the coast.

To boost the systematic export of labour-intensive services, local and foreign companies setting up BPO operations are offered a mix of tax incentives, free office space for five years and USD1,500 in cash per hired employee.

Local R&D and innovation are also strongly encouraged, generating the need to import instruments and hi-tech components for new products to be made in China.

The Chinese cabinet announced heavy incentives for the purchase of electric public vehicles in 13 cities. In the next three years, production of electric vehicles is expected to jump to 500,000 annually, not only reducing environmental costs, but also boosting export of new technologies. Instead of becoming a major exporter of traditional cars like Japan and Korea, China intends to leapfrog competitors and become a top exporter of electric cars.

Competitive Labour

Weak international demand has pushed down labour costs. Migrant workers, who found jobs back on the coast after the Chinese New Year, have reportedly taken 30-50 per cent reductions in salaries or benefits.

Hong-Kong-based manufacturers in China estimate that business activity is stabilising 20-30 per cent lower than before the crisis. In an over-supplied environment, Chinese producers are increasingly competitive.

Consequently, production costs have fallen. After five consecutive months of decline, the producer price index tumbled 6.6 per cent in April. Consumer prices followed suit, resulting in an actual deflation of -1.6 per cent starting in February and confirmed by the -1.5 percent just reported for April.

China's quick reaction to the economic crisis has put the country in strong contention for the number two slot amongst world economies, pushing it further up the value chain. China has to continue its efforts to make itself more attractive both as a market and a production base. SBR

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