

WebMemo



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China's Economy: Something Is Not Right in Beijing

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Consider two countries. The first country reported:

- Annual GDP growth of 9.6 percent, then 8.7 percent;
- Consumption expanding at better than a 16 percent inflation-adjusted rate over those two years; and
- Unemployment stable at a very low level.

The second country reported:

- Job losses of at least 20 million over just a few months;
- A stimulus equivalent to 13 percent of GDP, led by local governments despite severe local debt problems; and
- Deflation comparable to the worst of Japanese deflation.

Both of these countries, of course, are China in 2009.

Consider two more countries, where this time their identities are trickier to discern: The first country reported strong real GDP growth of 9.6 percent yet responded the following year by expanding lending in a state-directed banking system by a wild 32 percent. The second reported solid real GDP growth of 7.6 percent and responded the following year by expanding lending in a state-directed banking system by a subdued 6 percent.

The first country is China in 2008–2009; the second is China in 1999–2000.

China's State Statistical Bureau (SSB) claims that everything from GDP to consumption to employ-

ment is humming along. If its economic statistics are accurate, Chinese policy is then incomprehensible—even by the PRC's own standards of less than a decade ago. Because there are so many flaws in the numbers, it is certainly plausible that they have been falsified while Beijing's policy choices have been largely correct.

The other possibility, though, is that the economy really has been doing fairly well. In this case, however, hyper-stimulative policy is a travesty. The State Council has demanded frantic bank lending that has generated far too much liquidity, a stunning increase in commercial property sales, and an even more unbalanced economy. The American version of this policy ended badly and the Chinese version will as well, whatever official data say.

Is It Bad Data? Much published Chinese data is unusable, unemployment being an obvious example. Because most of the workforce is excluded, China's official unemployment rate invariably stays under 5 percent. This is acknowledged even by government think tanks to understate urban unemployment by at least a factor of 2 and total unemployment by perhaps a factor of 3,¹ but it will remain the official word because in China, politics trump accuracy.

This paper, in its entirety, can be found at:
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In prices, sales volume and sales value (volume multiplied by inflation) often clash sharply with announced inflation. Last year, the property price increase implied by official sales data was three times faster than official property inflation.² This has also been the case at various times in autos and other major consumer markets. The broadest definitions of prices are the consumer price index and the deflator used to turn the simple arithmetic change in GDP into official real GDP growth. It has become very difficult to find a consistent relationship between these two, suggesting that either official GDP or consumer inflation is inaccurate.

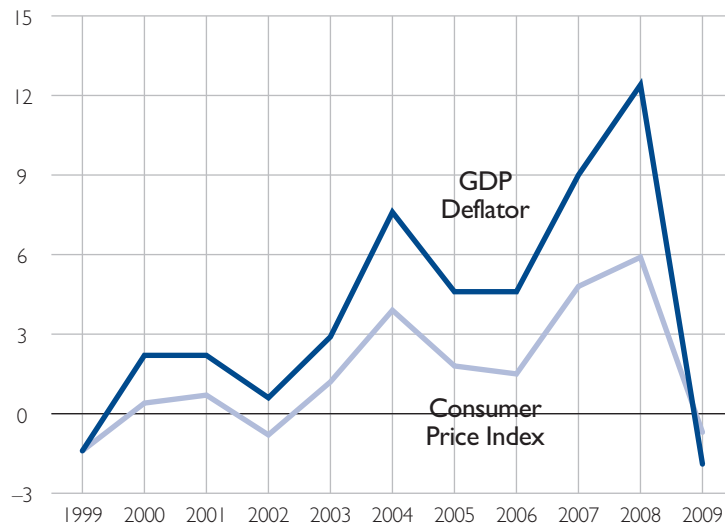
There is a theme to these results: severe problems measuring anything related to consumers. Chinese consumption is vital to global economic health, but the official indicator for consumption is fatally flawed. The indicator—retail sales—can as much as double true consumption growth by counting shipments to vendors that are never sold and purchases by state firms from other state firms, which are sometimes made to merely bulk up sales figures.³

This mis-measurement has outlandish results. From 2001 to 2009, both retail sales and personal savings rose far faster than household income. In other words, over a nine-year period, Chinese households appeared to be able to both spend much faster and save much faster than they earned,

a nice trick. This is chiefly because retail sales do not measure genuine consumer spending.

It is also routinely the case that the components of GDP—retail sales, fixed investment, the trade surplus, and the government budget—add to more than GDP and that real growth of GDP is somehow far slower than real growth of all components. When pressed, the SSB argues retail sales and fixed investment are not the correct measures of consumption and investment. It then continues to publish only the incorrect measures.⁴ Finally, Chinese

Price Measurements in China



Sources: National Bureau of Statistics, *China Monthly Statistics*, Beijing, Vol. 10, 1999 to Vol. 11, 2009; National Bureau of Statistics of China, "Announcement of the Revised Result about Historical Data of China's Gross Domestic Products," January, 10, 2006, at http://www.stats.gov.cn/was40/gtjij_en_detail.jsp?channelid=1175&record=520 (January 21, 2010); Carsten A. Holz, "China's 2004 Economic Census and 2006 Benchmark Revision of GDP Statistics: More Questions than Answers," *The China Quarterly*, No. 193, March 2008, pp. 150–163, at <http://ihome.ust.hk/~socholz/CQ-Holz-EconomicCensus04-13July07.pdf> (January 21, 2010).

Chart 1 • WM 2775  heritage.org

1. Li Li, "Unemployment Blues," *Beijing Review*, January 18, 2009, at http://www.bjreview.com.cn/print/txt/2009-01/18/content_175396.htm (January 21, 2010).
2. Chia-Peck Wong, "China Property Sales Rise 75.5% to 4.4 Trillion Yuan (Update2)," *Bloomberg Business Week*, January 18, 2010, at <http://www.businessweek.com/news/2010-01-18/china-s-2009-property-sales-rise-75-5-to-4-4-trillion-yuan.html> (January 21, 2010).
3. Andrew Batson, "China Downplays Retail Sales Data," *China Real Time Report*, May 19, 2009, at <http://blogs.wsj.com/chinarealtime/2009/05/14/china-downplays-retail-sales-data/tab/article> (January 21, 2010).
4. *China Daily*, "NBS Official Refutes Charges of Unreliable GDP Figure," July 23, 2009, at http://www.chinadaily.com.cn/bizchina/2009-07/23/content_8463840.htm (January 21, 2010).

data emerge far more quickly than for any developed economy.⁵

Or Is It Bad Policy? So when the PRC says that 2009 real GDP grew 8.7 percent, real retail sales grew 16.9 percent, and consumer inflation was -0.7 percent, some of the results may be fraudulent. Indeed, it seems that even China's government might believe so.⁶

The PRC announced a growth rate of 9 percent for 2008, revised to 9.6 percent. Growth in the fourth quarter of 2008 dipped only slightly below 7 percent and stayed above 6 percent in the first quarter of 2009 before again spiking higher.

Beijing reacted with absolute panic. In addition to the touted 4 trillion yuan fiscal package, bank lending rose an astonishing 32 percent last year. State banks pushed out \$1.4 trillion in new loans, the equivalent of nearly 30 percent of GDP. In recent weeks, government officials pledged to continue roughly the same fiscal and monetary policy.⁷

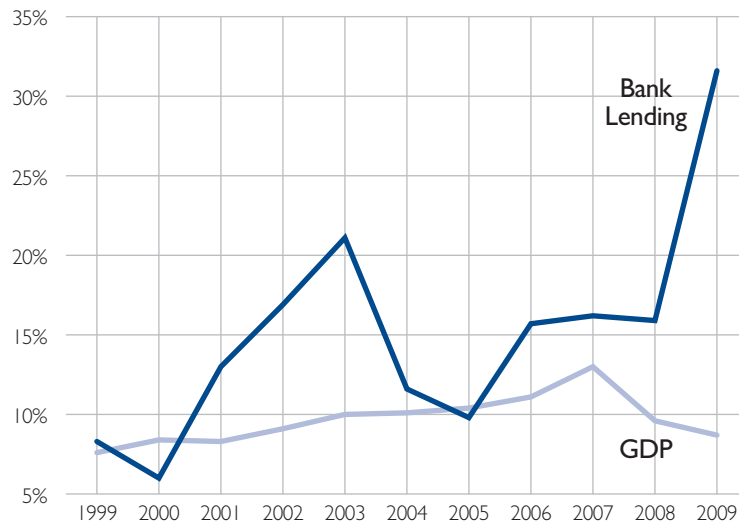
This is a very odd reaction. The central government chose an emergency response to an emergency that never materialized in official data. Further, it has committed to largely continuing that emergency response, even though official growth has averaged almost 10 percent over the previous six months.

It may be that hyper-stimulus has become the normal state of affairs. The willingness in the early part of this decade to genuinely target 8 percent GDP growth and accept 7 percent when necessary looks to have been replaced by a growth target closer to 10 percent, where 7 percent is considered a disaster.

Such a change would be driven by jobs. Early in 2009, Chinese media reported 20 million lost jobs

Chinese Lending Leaves GDP Behind

Figures Are Percentage Changes



Sources: The People's Bank of China, Statistics Database, 1999–2009, at <http://www.pbc.gov/english/diaohatongji/tongjishujul/> (January 20, 2010); Carsten A. Holz, "China's 2004 Economic Census and 2006 Benchmark Revision of GDP Statistics: More Questions than Answers," *The China Quarterly*, No. 193 (March 2008) pp. 150–163, at <http://ihome.ust.hk/~socholz/CQ-Holz-EconomicCensus04-13July07.pdf> (January 20, 2010); GDP news reports from *People's Daily Online*, *China Daily*, and *Xinhua*.

Chart 2 • WM 2775  heritage.org

- This is enabled by "extrapolation" parameters, which extend previous results to the present. Sectors such as transport are measured via extrapolation, not a lengthy survey. Lihua Dong, "Quarterly GDP Estimation in China," paper from a conference organized by the International Association for Income and Wealth and National Bureau of Statistics, September 20, 2007, at <http://www.iariw.org/papers/2007/dong.pdf> (January 21, 2010). Data revisions could address this issue, but Chinese revisions are extremely limited. They consist solely of revising annual GDP higher. Revised (and always higher) GDP is then not comparable to anything else. The revisions thus reduce transparency and probably accuracy as well.
- Jiantang Ma, "National Economy: Recovery and Posing in the Good Direction in 2009," National Bureau of Statistics of China, January 21, 2010, at http://www.stats.gov.cn/english/newsandcomingevents/t20100121_402615502.htm (January 21, 2010). The SSB politicizes its reports from the outset that "the Central Party Committee and the State Council sized up the situation, made scientific decision and headed the whole nation united as one to surmount the difficulties of our time."
- Xinhua*, "Macro-Economic Policies to Continue: Premier," December 27, 2009, at http://news.xinhuanet.com/english/2009-12/27/content_12711436.htm (January 21, 2010).

among migrant workers alone, in addition to any job losses among resident urban workers and rural workers.⁸ This occurred in the context of GDP growth of about 6.5 percent over a six-month period. If GDP growth dipping below 7 percent entails massive job losses, then the emergency response was justified.

Unfortunately, this would also mean China's economic strategy is failing. It is one thing for Chinese officials to suggest—as they have for over a decade—that 7 percent growth is needed to absorb new labor market entrants, though even this number seems strangely high. It is quite another for near-7 percent growth to be associated with potentially catastrophic job losses. At that point, the only conclusion is that China's growth model has become astonishingly bad for employment.

If so, that explains the trend toward hyper-stimulus. The job market has become less and less responsive to lending and other government policy, forcing the government to ramp up spending that much faster. The evidence for this is overwhelming. In 1999, fixed investment was equivalent to 36 percent of GDP. Just 10 years later, it was equivalent to a staggering 67 percent.

This cannot continue, either in terms of the basic figures or the economic reality behind them. If Chinese data are accurate, policy is therefore headed straight off a cliff—constantly pushing real GDP growth near 10 percent but in an increasingly futile and clearly unsustainable effort to create jobs.

The Inevitable Bust. There is a debate over whether major sectors of the economy are expanding unsustainably, a bubble with Chinese characteristics. One point to note is that the data may be faulty. A second is that bubbles in a mixed economy like the PRC's are not the same as bubbles in a market

economy. When China's bubble bursts, it will not look like the financial crisis in the U.S.

The last point is that the Chinese economy does have fundamental weaknesses. The State Council began calling for rebalanced consumption and investment in 2003, yet the imbalance is much worse. Investment is far beyond any precedent for a market economy—either the investment share of GDP must eventually plunge or China will revert to a planned system.

In the near term, there are problems in banking and real estate. In 2005, bank lending was actually slower than real GDP. Since then, GDP has stayed fast but has required more and more lending to do so, typical for the latter half of a boom and always a severe strain on any banking system.

Real estate may be worse. The increment to commercial property sales in 2009 was equivalent to almost 90 percent of the increment to GDP. Without property, the Chinese economy would be in the terrible shape the government feared. In this light, the outpouring of liquidity is understandable, but it is still dangerous. The surge in property prices must eventually halt. This will expose investors, from individuals to the biggest state banks, to heavy losses that will then be compounded by ensuing stock market weakness.

It is certainly true that China's experience will not be the same as Japan's 20 years ago or America's last year, especially since official data are altered for political reasons. Nonetheless, a bust always follows a liquidity-driven boom. The SSB's reports will remain happy, but the Chinese economy is headed for a rough patch, this time domestic in origin.

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8. Yingzi Tan and Dingding Xin, "20 Million Migrants Lost Jobs: Survey," *China Daily*, February 3, 2009, at http://www.chinadaily.com.cn/china/2009-02/03/content_7440106.htm (January 21, 2010).