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Topics China switches its development model and focuses on social stability

The Chinese communist party and government have become increasingly concerned about balancing international trade payments, switching the economic development model and maintaining social stability. However, even as the sense of crisis increases, they do not appear to be able to come up with an effective set of countermeasures.

■ International payments balance added as major task

In December, the Communist party's Central Committee and the State Council held the Central Economic Work Conference, for the purpose of determining China's economic management policy in 2010. At the Conference, it was revealed that the proactive fiscal policy and moderately easy monetary policy would be continued, and that measures would be implemented so that the high economic growth rate can be maintained. An economic growth rate target of around 8% looks likely, the same as for the previous year. The details of the 'major tasks' were basically the same as those provided for by the Eleventh Five Year Plan (2006 to 2010), but a comparison with the previous year reveals slight changes.

At the Central Economic Work Conference, the number of major tasks was increased from five to six. The newly added task focused on the promotion of exports and the balancing of China's international payments. The attempt to achieve balance in international payments has come about as a result of US and European pressure to raise the value of the Renminbi. As concrete measures aimed at achieving this balance of payments, export restrictions will be placed on goods that consume a large amount of natural resources in terms of energy consumption and have high pollution output (the so-called 'energy-intensive, highly polluting' exports' - lianggao yizi), and efforts will also be made to encourage direct investment in neighboring countries (a policy known as 'going out' - zouchuqu).

As regards the export of lianggao yizi exports, export controls on rare metals and rare earth will be tightened, and the question remains as to whether these restrictions will be more widely deployed throughout the manufacturing industry as a whole, in terms of targets on energy consumption and pollution. The manufacturing industry provides a supporting framework for the economy as a whole and, given the likely serious impact on employment, it will not be easy to restrict exports in actuality.

However, in response to the outcome of the Central Economic Work Conference, China's Ministry of Industry and Information Technology made it clear that it would not permit small and medium sized steel makers to stay in business. The iron and steel industry has much room for improvement in terms of energy efficiency and CO2 emissions, and iron and steel products are classic examples of lianggao yizi materials. Rather than simply a series of export restrictions, these moves are being seen as evidence of the government's unusual determination to address the structural problems of the iron and steel industry, wherein local governments take the lead and production capacity is ramped up regardless of demand and businesses can continue to exist with no regard for energy efficiency or their environmental impact.

Direct investment overseas has flourished in recent years, with the aims of securing resources, acquiring technology and developing overseas markets. In the balance of payments table for 2008, direct investment overseas was worth \$53.5 billion, roughly five times that of 2005. As this trend strengthens, China's presence, not only as a recipient of direct investment but also as an investor, will surely become stronger as well.

Nevertheless, it is thought unlikely that the measures described above will be effective in balancing China's international payments by themselves. Inter-industry relationships in the manufacturing industry are strong, and if restrictions pertaining to energy consumption and pollutant emissions are toughened and then strictly applied, economic growth could be blunted. Also, China's domestic direct investment is about three times the size of outward direct investment, at \$147.8 billion, so no matter how strongly the government pushes its zouchuqu outward investment policy, the balance of capital account will not go into the red.

■ Little progress yet in development model switch and social stabilization

B The other major tasks worked out by the Central Economic Work Conference are practically the same as those of the previous year, and may be summarized in the following four points: 1) to upgrade the quality and effect of economic growth by stimulating domestic demand and developing high added value industries, by promoting energy saving and by the implementation of measures designed to redress

intra-regional economic disparity, 2) to increase economic growth potential by the reform of government, finance and ownership structures, 3) strengthen measures to tackle the 'three rural problems', the impoverishment of agriculture, rural communities and farmers, and to expand domestic demand, and 4) improve living conditions for the general public and strengthen social stability.

However, the content of the Central Economic Work Conference over the last two years has been characterized by features not seen till the inauguration of Hu Jintao's administration.

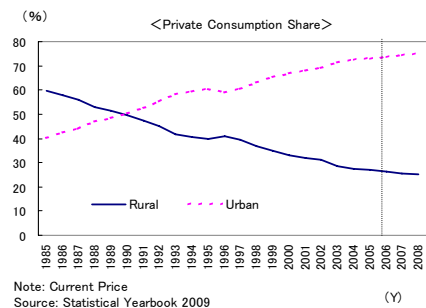
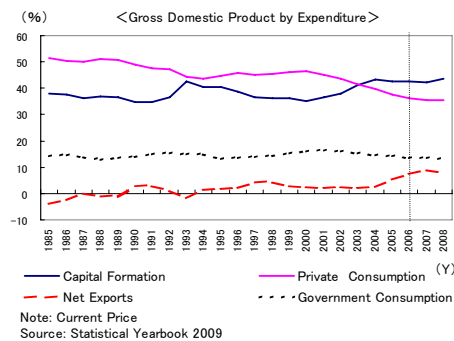
One is the frequent appearance of the phrase 'economic development model shift', and another is the inclusion of 'maintain social stability' as one of the major tasks. In particular, while reference to a development model shift appeared six times in the previous year, this year it was repeated 13 times, while reference to efforts to maintain social stability was upgraded from the previous year's 'appropriately' to 'exert every effort'.

A development model shift and the maintenance of social stability are, in fact, inseparably related. In other words, the development model shift and the promotion of social stability can only begin once rural communities and other low income earners perceive an improvement in their standards of living. However, examination of the situation since 2005, when the Eleventh Five Year Plan began, shows that private consumption's share of GDP has been declining steadily, and the development model switch and social stability cannot be said to have advanced much.

One reason that private consumption has fared relatively poorly is the failure of consumption growth in rural communities. A breakdown of private consumption shows that the portion accounted for by rural communities has fallen drastically, managing only 25.1% in 2008. The advancement of urbanization is of course a contributory factor, but the rural population in 2008 accounted for 54.3% of the total. The failure of consumption to grow in rural communities must surely be considered a reflection of the growing economic disparity between urban and rural communities.

Since 2005, the government has been reinforcing its efforts to improve conditions in rural communities. Specifically, it has 1) expanded subsidies for farmers, 2) abolished agricultural taxes and the collection of fees by local governments, 3) waived education fees, 4) used increased subsidies to spread medical insurance uptake, and 5) introduced a minimum standard of living social security system. In addition, farmers themselves have been able to diversify and stabilize their income sources by coming into the cities to find work. Agricultural day laborers (nongmin gong) numbered 200 million as of the end of 2008, and sent several billion yuan in earnings home to their families in rural areas. The fact that consumption in rural communities has failed to grow in spite of this is evidence that the realization of a development model switch and social stabilization will not be easy. In 2010, the government plans to continue to pay subsidies to assist in the purchase of electrical household appliances, automobiles and agricultural equipment but, given the relatively low social position of rural communities, as can be seen from the figure above, it is difficult to imagine that these subsidies will really bring about a significant change in the situation.

If H1N1 influenza develops into a serious illness in a person, treatment can cost between 70 and 80 thousand yuan. This is well above the upper limit payable from medical insurance in rural communities, and is far beyond the means of farmers who earn on average 4,716 yuan annually. Government policies are on the right track in trying to increase the real incomes of low income groups through subsidies, and in trying to spread medical insurance uptake. However, the challenge facing the government is what to do about the different social security systems in urban and rural communities, as well as the difference in the quality of public services, and whether it can do anything about the family registration system, land registration system and taxation system, which are at the root of the problem. **(Yuji Miura)**



Korea Economy is on recovery track, but little room for optimism

■ 3.2% quarter to quarter growth in July to September, 2009

Korea's real GDP growth rate (compared to the previous period) was 3.2% in Q3, July to September, up from 2.6% in Q2, April to June. Private consumption was up 1.5%, facilities investment 10.4%, and exports 4.8%, with both domestic and external demand driving growth. Compared to the same period in the previous year also, growth switched to a 0.9% increase (private consumption up 0.8%, exports up 1.2%, facilities investment down 7.4%), and it is expected that growth for 2009 will turn out to have been positive.

Recent trends show that domestic and external demand are on a recovery track. Though the impact of the sudden drop from the autumn of 2008 was indeed large, export worth (flash report figures) in November was up 18.8%, compared to the same month in the previous year, boosted by exports to China.

October's real retail sales figures were up 10.7%, beating September's performance and encouraged by the healthy sales of automobiles. Due to a surge in purchases in an attempt to beat the deadline (end of 2009) for the end of the tax reduction on replacement automobile purchases, automobile sales in November were the highest in 2009, and November's growth figures are expected to be high.

The manufacturers' production index fell from 11.4% in September to 0.3% in October, but this was partly due to the effects of the Chuseok holiday (falling in September in 2008 and in October in 2009) and, when adjusted according to the number of working days, September's figure was 5.5% up, and October's 4.4% up, showing relatively stable growth over the two months.

■ Household budgets continue to face hard times

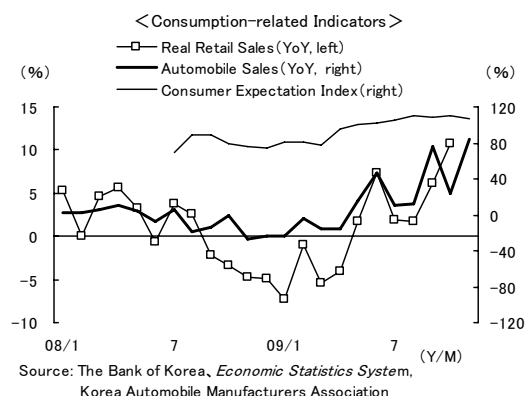
The economy is recovering steadily, but attention must be paid to the difficult circumstances facing household budgets. According to a household income and expenditure survey conducted by the Statistics Bureau, the real incomes of households (excluding single person households) in the period July to September, 2009, were down 3.3%, compared to the same period in the previous year, while real consumption expenditure was up by 1.5%. Judging from the fact that tax reductions meant that 'non-consumption expenditure' was actually minus 5.5% and that credit card usage (particularly automobile related) was up, it would appear that tax reductions and consumption credit have been successful in encouraging consumption. For this reason, it is highly possible that there will be evidence of a recoil some time in 2010.

In recent years, however, housing loans have increased against a backdrop of lower interest rates, with the result that the ratio of debt to incomes is increasing. Fear of economic downside risk will likely mean that the comparatively easy monetary policy will continue for the time being, but there is a possibility that interest rates could go up soon, depending on how commodity prices and real estate prices behave. An increase in interest rates will put further pressure on household budgets and also brings with it the risk of increasing financial institutions' non-performing loans.

The unemployment rate (seasonally adjusted) fell from 4.0% in June to 3.4% in October and the number of those with jobs in September and October was higher than in the same month in the previous year for two consecutive months, so the employment situation appears to be starting to improve, but the increase in the numbers of those employed is largely in social direct capital and other service sectors, where much of the employment is of a temporary nature. Also, given the fact that work sharing has been implemented in some companies in order to avoid layoffs and that living assistance payments for low income earners are time limited, the probability is high that any recovery in incomes is going to be a slow and mild one.

In addition to making sure of economic recovery, the government will need to work hard to create employment opportunities by vitalizing investments.

(Hidehiko Mukoyama)



Hong Kong Economy trending towards recovery, but lacking strength

■ Domestic demand leading economic recovery

Hong Kong's economy suffered significantly, but with domestic demand making a comeback, the economy is continuing to trend towards recovery.

External demand is struggling, mainly due to the economic slowdown in Europe and the US. Exports, 97% of which are transit trade, also recovered in September to around 90% of 2008's monthly average levels. In terms of export destination countries, some 50% of total exports are China-bound and these have been slow to show signs of recovery, due to stagnation in China's process trade, which is in turn affected by the economic slowdown in Europe and the US. The 20% accounted for by exports to Europe and the US have also been at a low level. Alongside this difficult set of circumstances, there has been an improvement in the number of travelers visiting Hong Kong, mostly from mainland China, and this has provided some brighter news.

In addition, domestic demand is recovering. Total retail sales for October came back strongly with an 8.1% increase on the same month in the previous year in volume. The volume of sales of automobiles also switched to 9.4% growth, similarly. Improved consumer sentiment due to the rise in asset prices is one of the main contributory factors here. Both the Hang Seng Index and house prices rose sharply by 45.6% and 22.8%, respectively, from the end of 2008 through September, 2009. One additional factor in the recovery in consumption has been the improvement in employment conditions in some industries, such as the relatively highly paid finance industry.

Deterioration in the employment situation has been slowed by economic improvement and the implementation of government measures. The unemployment rate for the period August to October (seasonally adjusted) was 5.2%, down 0.1 point from July to September. By sector, finance and construction have shown signs of improvement.

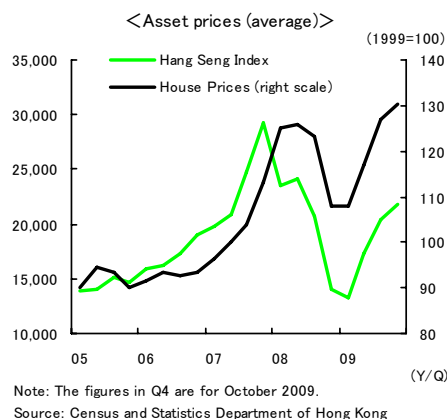
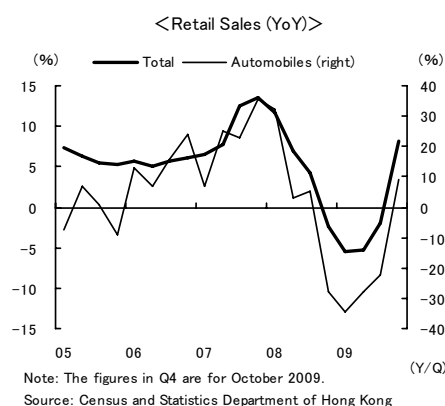
■ Economic recovery appears to be weak

The outlook as regards Hong Kong's external environment is that the economic slowdown in Europe and the US looks like it will be a protracted one. Meanwhile, though China is expected to continue to report a solid rate of growth, fixed asset investments are the economic growth driver and a recovery in process trade is expected to be late in arriving. Given the fact that Hong Kong's core industries are service industries closely linked to China's process trade, it would be unwise to place too much hope in China.

There is a high probability that consumption will decelerate due to the weakening of the asset effect, since there is little prospect of a major improvement in employment and wage levels. The rate of increase of both the Hang Seng Index and house prices slowed in October. The rise in asset prices will gradually slow, because 1) there is a high possibility that capital inflow will continue to be sluggish due to the settling down of China's bank lending, 2) stock investments and real estate investments are being treated more cautiously in the wake of rising fears of a bubble economy, both within Hong Kong and externally, and 3) the Hong Kong government implemented measures aimed at curbing overheating, such as raising the deposit on housing loans.

Viewed generally, due to the sluggishness of external demand and the failure of domestic demand to grow, it seems likely that Hong Kong's economic recovery overall will be lacking in real strength.

(Shinichi Seki)



Malaysia Economic growth in Q3 minus 1.2%

■ Economic growth rate minus 1.2% in Q3

Malaysia's real GDP growth rate in Q3, July to September, was minus 1.2%, compared to the same period in the previous year. Though this was the third consecutive quarter of negative growth, the pace of deceleration is contracting, with the growth rate having already improved from minus 6.2% in Q1, January to March, to minus 3.9% in Q2, April to June.

In terms of demand, private consumption bolstered the economy, although at a low level of 1.5% growth over the same period.

While public investment increased, stemming from economic stimulus measures, the sudden drop in exports meant that private sector plant and equipment investment was restrained, and fixed capital formation grew minus 7.9% in the same period.

On the supply side, the expansion in public investment caused the construction industry to grow 7.9% in the same period, and communications, real estate, finance and other services were up 3.4%, similarly. Meanwhile, manufacturing, which accounts for 30% of GDP, has been slow to recover, and posted negative growth of minus 8.6% in Q3. However, this figure represents a contraction in the rate of deceleration compared to minus 14.5% in Q2, and some improvements are being seen in crude oil and petrochemical products, rubber, plastics and other raw materials.

■ Economy picking up, but Dubai shock poses downside risk

Towards the end of the year, both domestic and external demand began to pick up the pace of recovery and the economic growth rate for 4Q appears likely to have become into positive.

October's exports were up 6.2%, worth \$12.563 billion, showing to positive growth for the first time in 2009. Among them, major export items, electronic and electrical goods, brought good news with a massive 14.1% increase. This caused the manufacturers' production index to rise steeply by a full 1.0%, similarly.

From early in 2009, in order to avoid further deterioration in the domestic employment situation, the government implemented a series of restrictions, such as freezing new hires of foreign workers and bringing in compulsory employment charges.

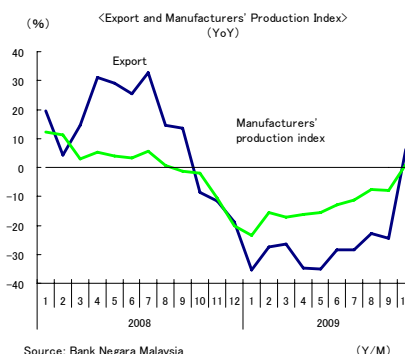
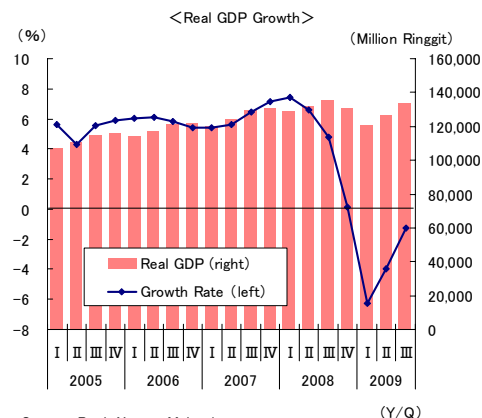
However, the improvement in exports caused the labor shortage to become more pronounced and the government announced that it was temporarily relaxing employment restrictions for exporters handling electronic and electrical goods, textiles, plastics, rubber gloves and furniture.

Hopes of a full economic recovery are growing, but there is little room for optimism as yet.

In addition to lingering economic depression in Malaysia's main export destinations, Japan, the US and Europe, the Dubai shock has given rise to a new downside risk. The second round of economic stimulus measures contains infrastructure construction projects that, in many cases, planned on receiving funding from middle eastern countries. Those plans are now at risk. Furthermore, exports to middle eastern countries, which have been increasing in recent years, will likely be affected, as will the number of tourists from those countries.

The Najib administration has adopted a stance of wishing to restrict public investment and consumption, relying instead upon a private sector driven recovery as a foundation for economic growth. However, as the economic situation in the developed nations and the middle east changes, it appears that the time has come to begin thinking about a third round of economic stimulus measures.

(Keiichiro Oizumi)



China 2010 basic economic management was set

■ Easy monetary policy to continue in 2010

The Central Economic Work Conference was held over three days in Beijing, from December 5 to 7. The conference is held once a year (usually in early December), and determines the basic economic management and major items of economic policy for the following year. The conference this time was characterized by the following three points.

First, a decision was made to continue with the relatively easy monetary policy. While there have occasionally been calls for a switch to tighter monetary policy with a view to preventing increased inflation risk and sharply rising asset prices, the Central Economic Work Conference announced that a 'moderately easy monetary policy' would be continued, albeit with the conditions that inflation expectations be managed and loans to the overproducing industries be restricted. In

addition, a clear stance was taken with regard to responding to funding needs in major projects and efforts to expand lending to industries where growth is expected, and for regional transfer of industries, and so on.

Second, emphasis was placed on the importance of pushing ahead with structural adjustments or reform. Among of the priority items for 2010, the government promised to transform its economic growth pattern. Mention was also made of the orderly progression of industrial transfer, the relaxation of restrictions in order to encourage movement from rural areas into small and medium sized cities, and the implementation of urban development. In any case, while these steps will not be easy to realize, they are issues that need to be addressed in the interests of sustaining economic growth over the long term.

Third, the government revealed its desire to equilibrate China's balance of payments. Exports have continued to fell below the same month of the previous year's levels since November, 2008, and the policies worked out by the Hu Jintao administration of expanding export growth in a sustainable fashion by developing new markets and improving quality would seem to be the natural response. At the same time, the government appears determined to balance China's international payments, not only by applying export restraints on some (energy and resource intensive and highly polluting) products, but also by increasing imports. In this, the government may be said to have given some consideration to foreign demands that China's swollen trade imbalance be corrected.

■ Consumption stimulus measures to be extended and enhanced

Going forward, it is thought that the focus will be on the implementation of concrete steps aimed at encouraging consumption, considered to be of vital importance in both sustaining economic growth and making structural adjustment.

Once the Central Economic Work Conference was completed, the Central government decided to 1) extend the vehicle purchase tax reduction measures for small automobiles by one year (until the end of 2010, tax reduction range contracted by 2.5% points), and 2) to raise the new car subsidiary payable upon purchase of a replacement vehicle. These measures will likely bolster healthy automobile sales in 2010 and beyond also.

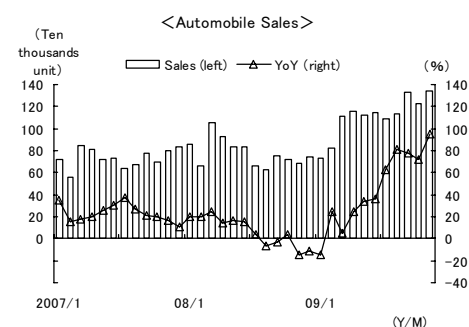
However, with regard to the appliances in rural homes project, though a decision was made in early December to enhance the system by raising the level of subsidies and increasing the number of applicable items (one extra item to be added at the discretion of local government), a certain amount of ambiguity remains, with the amount of the subsidy increase still left unclear. The prompt formulation and implementation of specific additional items within a range of consumption stimulus measures is surely an item of priority for the government.

(Junya Sano)

<Main Points of The Central Economic Work Conference>

Decisions	Contents
Basic Economic Management of 2010	<ul style="list-style-type: none"> Acceleration transform of economic growth Integrated promotion of the "Maintaining stable and relatively fast economic growth"
Six Major Items	<ul style="list-style-type: none"> Improvement of the level of macro-economic control Vigorous promotion of economic structural adjustment Expansion of domestic demand mainly to rural areas Deep reformation of the economic system Promote of stable export growth and equilibrate balance of payments Stabilize society through improvement of public welfare

Source: Chinese Government's official site



Source: China Association of Automobile Manufacturers and CEIC data