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The Rmb4 Trillion Question



The Chinese mainland is on track for solid growth this year, thanks to its Rmb4 trillion (US\$586 billion) economic rescue plan. But better credit allocation is needed to ensure sustainable growth, according to Stefan Kracht, China analyst and Executive Director of Fiducia Management Consultants. Set up in 1982, Fiducia helps international firms implement, expand and optimise their business activities in Hong Kong and on the Chinese mainland. Mr. Kracht has extensive experience in the fields of market and competitor analysis, entry and expansion strategies, mergers and acquisitions, negotiations and commercial due diligence. He joined Fiducia after helping set up and run a components and materials trading company in Shanghai. Mr. Kracht graduated from the London School of Economics with a BSc (Hons) in Management.

Who have been the main beneficiaries of China's stimulus package?

China's stimulus package, which primarily involved making huge amounts of credit available, stabilised the country's economy. According to official figures, the government injection raised GDP and domestic demand to 7.1 per cent and 15 per cent, respectively, in the first half of 2009 compared with the same period last year. But the bulk of the stimulus package – more than 70 per cent – is focused on infrastructure. The main beneficiaries have been large companies and state-owned enterprises. In order to maintain employment levels, structural reforms needed in heavy industry, including steel and automotive, have been pushed back. These firms, which would have been eliminated under market forces, are now being propped up by the stimulus package.

The benefits of the stimulus package have yet to trickle down to the rest of the economy, including small and medium-sized enterprises. In a survey we conducted in July of 2,000 foreign companies based on the mainland, the majority said they have not benefited from China's stimulus package. Those that have benefited include those selling directly to infrastructure projects, such as companies that produce rail components, or those that benefit from reduced purchase tax to domestic consumers – automobiles, for example.

How can the mainland address this imbalance?

In three ways: first, more money should be allocated to other areas. The most important are the health-care and pension systems, followed by sustainable, environmentally friendly development. Second, the government needs to raise and allocate credit more efficiently in the second half of this year to support local government and to avoid bad loans. In this regard, 30 per cent of the stimulus package comes from the Central Government – half of which has already been disbursed – with the rest coming from the provinces and municipalities. But the provinces do not have the money, and so far the Central Government has been conservative in approving bond issuance by provincial authorities. Third, the government should ensure a level playing field. Currently, large state-owned companies receive more benefits than private ones, thereby distorting the market for years to come.

How much of the stimulus package has gone to the Pearl River Delta?

It's a lot in theory, but in practice not enough money is being spent. The mainland government cannot control external demand, and it has left it to the provincial authorities to sort out most of the internal growth financing. For example, Guangdong recently announced that it plans to spend US\$350 billion in the next five years, but so far it has only received approval for 10 per cent of that amount. More can be done to help PRD companies shift away from exports. Switching to selling in the domestic market is financially tough for these businesses because it involves overhauling business models. But the renminbi settlement programme will play a big role in helping to ease the burden, by reducing mainland exporters' and importers' transaction costs and exchange-rate risks.

The Chinese mainland looks on track to meet its eight per cent growth target. Is the recovery, spurred by the stimulus spending, sustainable?

Most of the country's economic indicators show that sectors, except for export, are recovering. But the picture will be clearer in six months' time, and we will see whether the benefits of the stimulus package have trickled down to the rest of the economy. If it shows that the overall economy is stabilising, I hope authorities can then make the tougher decisions, including whether to continue with structural reforms.

With the amount of credit available on the mainland, there's concern about the return of high inflation. Is that a real possibility?

I don't think inflation is the most important issue, at least, not this year. But China's central bank authorities are well aware of the risks of overheating. There will, however, be competing interests between keeping credit flowing to ensure social stability, and maintaining a disciplined fiscal policy. But as long as the mainland's central bank starts slowing down the flow of credit, the mainland should only see minor inflation return next year.

There has been a lot of talk about Shanghai's drive to become an international financial centre. Where does that put Hong Kong?

Having lived and worked in both cities, I get this question often. Hong Kong remains the pre-eminent financial centre and will continue to be for the next decade. As long as the mainland's capital accounts remain closed, Hong Kong will keep its status, because Hong Kong is the only way mainland firms can access international capital markets.

Hong Kong is also the conduit for the liberalisation of the renminbi. It's the perfect test base and is in a unique position, one which Shanghai can't replicate. Finally, as long as the mainland judiciary is not independent, Hong Kong's rule of law and independent judiciary are also hard to replace on the mainland.

I believe that further down the road, Shanghai and Hong Kong will play complementary roles, similar to New York and Chicago. It will take a long time for Shanghai to gain the financial experience that Hong Kong has accumulated over decades.