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Beijing Hastens To Spur Growth

By BOB DAVIS AND TOM ORLIK

BEIJING—China's leaders started to reach into their economic-stimulus tool kit this weekend to boost flagging growth, but the measures don't pack the wallop they once had.

After China announced a slew of disappointing economic indicators on Friday -- from industrial production to housing to domestic spending -- the People's Bank of China said Saturday evening that it would lower the share of deposits that banks must hold in reserve by 0.5 percentage point, starting May 18.

The cut is aimed at kick-starting lending, but banks already appear to have access to ample funds, with interbank lending rates falling to 3.2% on Friday, down from a high of 5.4% in the second half of February. Song Yu, a Goldman Sachs analyst, said that lowering the reserve-requirement ratio to 20% was simply a "signaling device used by the government to show its willingness to loosen policy," and wouldn't itself have much effect on the economy.

Friday's data showed that the economy was continuing to lose steam in the second quarter and might not rebound as China's leaders and market analysts had expected.

China is widely seen in the West as able to boost growth as easily as a motorist stepping on a gas pedal. As its government is authoritarian, it doesn't need to negotiate with the public or a parliament. With relatively low debt levels, it can afford additional spending. China sailed through the global recession of 2008 and 2009 as a result of a massive lending and spending program.

But Beijing has its own constraints that reduce its ability to maneuver. The immense stimulus program worsened a housing bubble and ratcheted up local-government debt, making leaders wary of undertaking another large-scale stimulus plan. Cutting interest rates, a favorite tool of central banks, is problematic because it could worsen the inflation that China's central bank spent the last year trying to tame.

Further inhibiting action: a once-in-a-decade leadership transition, already marred by the turmoil over the sacking of Politburo member Bo Xilai. Analysts argue that the importance of ensuring a smooth transition raises the chances that China's leaders will act to buoy growth, but it may also make it tougher for rival factions to agree on bold steps.

"Chinese policy makers face a conundrum as a sharp burst of credit expansion is likely to be most effective at boosting growth but would set back financial-system reforms and rebalancing of the economy," said Brookings Institution China specialist Eswar Prasad. "Fiscal stimulus, if carefully targeted, has a better chance of achieving both short-term and long-term goals. But its efficacy may be limited if rising economic uncertainty dampens consumer and business confidence."

China's economy grew at 8.1% in the first quarter from a year earlier, its slowest pace since the spring of 2009, and analysts had widely expected a rebound in the current quarter. But that now looks unlikely, and several downgraded their forecasts. Wang Tao, China economist at UBS, lowered her forecast for second-quarter GDP growth to 8% year-to-year, down from 8.4% before the April data were released.

The data reported before the weekend missed expectations by a considerable margin. Growth in industrial production dipped to 9.3% in April from 11.9% in March, the lowest level since May 2009. That fall in output reflected broad based weakness across investment, consumption, and exports -- the three main drivers of China's growth.

The government's two-year effort to deflate the housing bubble also put the brakes on economic activity. Property-development investment is on a slowing trajectory. Investment grew 18.7% to 1.58 trillion yuan ($250.11 billion) in the January-April period from a year earlier, according to data released Friday. That was slower than the 23.5% of January-March, which in turn was slower than the 27.8% of January-February.

The weakening real-estate sector affected demand across the construction-material and machinery sectors. Sales of earth-moving equipment tanked, down 43% year-to-year in April, said Zhang Wenxian, an analyst at Haitong International Research.

Foreign demand also disappointed, with China reporting Thursday that export growth dipped to 4.9% year-to-year in April from 8.9% in March. Exports to the troubled European economy, down 2.4% year-to-year, were a particular weak spot.

Low public debt means that China's government has scope to ratchet up spending, or cut taxes, to support growth. China's ratio of government debt to gross domestic product in 2011 was 25%, according to the International Monetary Fund, compared to 102% in the U.S. Even accounting for local-government debt, which Premier Wen Jiabao recently put at 10.7 trillion yuan at the end of 2011, or 22% of GDP, China's public finances look relatively healthy. Falling inflation, with the consumer price index edging down 0.1% in April from March, also means there is scope to do more.

Bank of America economist Lu Ting argues that Beijing could "spend more on social welfare and quicken constructions of social housing and infrastructure." But increasing public spending isn't straightforward. A reversal of controls on the housing sector might provide the quickest cure for China's growing pains. But it would be an embarrassing turnaround.

Nicholas Lardy, a China expert at the Peterson Institute for International Economics argues that interest rates -- at least for depositors -- should be increased to pad the wallets of ordinary consumers.