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ASIA | ECONOMIC OUTLOOK

China reports fast growth, but rings inflation alarm

China's rapid growth is prompting fears of inflation, raising expectations that Beijing might hike interest rates and possibly the value of its currency.

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Associated Press

BEIJING - China's blistering economic growth may accomplish what all the cajoling by the United States and its allies could not: boost the value of the yuan.

On Tuesday, China reported its fastest economic growth in a decade and warned that booming construction and bank loans could fuel inflation, raising expectations that Beijing might nudge up interest rates and possibly the value of its currency.

That would be welcome news for U.S. and European businesses, which have complained that China's yuan is undervalued, that its exports are too inexpensive and that it has been siphoning jobs from the developed world by dumping cheap goods in their markets.

Of course, the appetite in America for those cheaper goods is huge, leading to China's multibillion dollar trade surplus. In May, the U.S. deficit with China rose by 4 percent to $17.7 billion, reflecting big gains in imports of cellphones, clothing, textiles and art supplies.

China reported on Tuesday that exports surged, adding that consumer inflation stayed low at just 1.3 percent.

The 11.3 percent growth in the second quarter compared with a year ago exceeded forecasts. It came despite China's efforts to cool off the sizzling economy by increasing borrowing costs and curbing investments after first-quarter growth hit an already strong 10.3 percent.

Economists said they expected Beijing to respond by raising interest rates for a second time this year and possibly allowing the currency, the yuan, to rise against the U.S. dollar, which could slow growth by making exports less competitive.

"There is an even stronger case for tighter monetary policy and yuan appreciation," said Masahiro Kawai, an Asian Development Bank economist, speaking at a briefing in Hong Kong.

PRESSURE REJECTED

China ended its decade-old policy of tying the yuan directly to the dollar last July but has let it rise just 1.4 percent against the U.S. currency since then. And officials have publicly rejected pressure for sharp increases.

The government gave no forecast for full-year growth, but the ADB said it should be 10.1 percent. The official target is 8 percent, but Beijing often sets a low goal and revises it upward later in the year.

Chinese leaders want fast growth to reduce poverty, pay for reforms of state industry and create jobs for millions of laid-off workers, migrant laborers and new university graduates.

But they worry that a wave of construction of factories, shopping malls and luxury apartments is creating a glut of unneeded properties and could leave banks buried under unpaid loans.

"Investment in assets is excessive, and there is an oversupply of loans. In the long run, those will cause inflation," a statistics bureau spokesman, Zheng Jingping, said at a news conference. "So we need to pay close attention to price changes."

Beijing raised interest rates in April by 27 basis points to 5.85 percent and tightened lending standards. Regulators imposed curbs on new construction and reportedly are considering limiting foreign investment in real estate.

Zheng said measures meant to avert financial problems are beginning to take effect, pointing to slower growth in bank lending and China's foreign currency reserves.

But he acknowledged that construction was racing ahead, with the number of new projects begun in the first six months of the year up 22.2 percent from the same period of 2005. The 11.3 percent growth rate is the highest for a quarter since the start of 1995, according to Lehman Brothers in Hong Kong.

REDUCING LENDING

Goldman Sachs economist Hong Liang, in a report to clients, said Beijing was expected to raise interest rates by another 27 basis points and reduce the amount of money available for bank lending.

Hong said she also expected China to widen the narrow band in which the yuan is allowed to fluctuate against the dollar, which could lead over time to a stronger currency.

But planners also face conflicting demands, because Chinese leaders want high growth, said Stephen Green, an economist for Standard Chartered Bank in Shanghai. "So long as inflation stays low, China can continue growing at this general pace," he said.

In trade, exports surged 25.2 percent to $428.6 billion in the first six months of the year compared with the same period of 2005, though that growth rate was down 7.5 percentage points from last year, the statistics bureau said.

First-half imports rose to $367.1 billion, up 21.3 percent from the same period of 2005, with the growth rate up 7.3 percentage points, the bureau said.

Prices of oil, electric power and industrial raw materials rose 6.1 percent in the first six months of the year, which squeezed profits for Chinese companies and retailers.

With a surplus of goods holding down prices, producers aren't likely to be able to pass on higher costs to consumers, Zheng said.