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On Track to Resist

The Yangtze Delta Region (YDR) in the Global Storm

I. The Negative Impact is Unfolding

For a time, it seemed that Shanghai only heard the **thunder of the financial crisis roar, with little rain falling.** Thanks to its capital control, huge foreign reserves, and strong fiscal surplus, one could think China could be more or less a bystander in this financial tsunami, as it had been during the 1997 Asia financial crisis.

However, the situation China is facing now is much harsher than that of ten years ago. It is now much more linked to the external economies with its export dependence increasing from 15% in 1997 to around 45% in 2008. Furthermore, the internal demand is declining far sharper than it was during last slowdown. As the financial crisis takes its toll on the real economy, **the negative impact on the Yangtze Delta Region is unfolding and intensifying**.

The national economy has been slowing gradually since the second half of last year, due to the government's efforts to cool down the economy and fight inflation. The first three quarter GDP growth reported at **9%, well below last year's 11.9%**. As the dragonhead of the Yangtze Delta Region, **Shanghai's economy expanded 10.1%,** with heavy losses in income of the small and medium size enterprises. The pace at which the economy is cooling accelerated sharply in September and October, prompting a steep drop in confidence among companies and consumers. Pessimists started to worry that no eggs stay intact under an overturned nest of the world economy.

Many economic indicators signaled a sharp slowdown beyond expectation:

Power generation reported negative growth in October, which was the 1st time since May 1998. The Purchase Management Index (PMI) of China's manufacturing sector dropped to historical low to 44.6% in October, down 6.6% from September. Being the economic powerhouse of China, Shanghai' industrial production only grew 3.8% in October to USD 29.2 billion, the slowest expansion this year. It was down from September's 6.4% and August's 9.2%, showing a trend of sharp slowdown.

II. The Stimulus Plan

The worse than expected slowdown forced government to adopt stronger measures to stimulate the economy. Over the past several months, China has taken a series of steps to bolster its weakening economic growth, which included interest rate cuts, lower bank reserve requirement ratios, higher credit quotas, injections of central government funds and increased focus on infrastructure construction. **The Stimulus Plan** announced by the State Council on 10th November started a massive scale package to prevent the economy from slowing too rapidly. That move marked

China's policy turnaround from stepping on the brake for the 1st half of 2008 to tapping the accelerator for the 2nd half.

The plan announced that **China would spend RMB 4,000 billion (USD 586 billion)**, **–** an amount equivalent to 16% of the nation's GDP last year and the total of government spending in 2006 **– on infrastructure and social welfare** over the next two years. The sum is also equivalent to 14 Olympics in two year's time.

The investments will focus on low-income housing, water, electricity, disaster relief and transport, with railways expected to see a big increase. In addition to investing substantial funds in infrastructure, the plan also announced that China will be adopting **"active" fisca**l and **"moderately active" monetary policies**. This is the first time in history China has indicated a policy shift towards "active" currency policies. The stimulus plan also introduced a **long-awaited reform of value added tax** (VAT tax) which would cut industry costs by RMB 120 billion (USD 17.6 billion). The more relaxed monetary policies will potentially further encourage foreign investments in China.

III. Questions Raised by the Stimulus Plan

Much has been discussed and reported about this huge stimulus plan. It is announced that the package should result in China's economic growth remaining above 8.5% for this year, to be above the psychological level of 8%, which is believed to be the lowest China can tolerate to keep the economic engine running and maintain social stability. following the central government's call, local governments started the race on a new round of infrastructure boom.

No doubt the move will boost the declining economy and inspire investor confidence. However, **many questions remained with the massive plan.** Firstly, there was no clear indication where the amount of money would come from. Secondly, among the 4 trillion yuan, how much has already invested on the ongoing projects and how much would be for new projects also remains unclear. Thirdly, the massive government investment might weaken the private investors' purchasing power in raw material and labour force and therefore might deteriorate the business environment for private economy. Furthermore, how to choose the proper projects and monitor the quality will paste challenge for such a huge investment within the short time[1]. The concentration of approval in investment in such a short time might again lead to redundant investment, excess liquidity and overcapacity, which the government has been fighting for several years.

IV. The Move of Shanghai

It is still unclear what will be the share of Shanghai and what will be the approved projects from the central government's package of USD 586 billion.

Echoing central government's call, **Shanghai announced its own 500 billion yuan (US$73.3 billion)** plan to spend through 2010 for urban construction covering the five areas of transformation of old urban areas and affordable housing construction, suburbs infrastructure facility, further construction of international shipping centre, improvement of public transportation, energy-saving and environmental protection.

From January to October this year, nearly 97 billion yuan (USD 14.2 billion) has been put into use for traffic improvements and the construction of new Metro routes, tunnels and transport hubs in

[1] The central government announced to invest RMB 100 billion for the remainder of 2008, which has attracted local officials with new projects applications rush to the National Development and Reform Commission for approvals with relaxed requirements. Anhui Province, the least developed province in the Consular region, has submitted over 440 projects applications and secured its biggest transportation project with total investment of 25.7 billion yuan (USD 3.77 billion).

readiness for the Shanghai **World Expo in 2010**. In addition to this 500-billion-yuan plan, the government will also launch **a 160-billion-yuan (USD 23.4 billion) economic stimulus package** on areas as transportation, industrial upgrading, environmental protection and other projects regarding the 2010 Shanghai World Expo.

The detailed projects of this package have not been unveiled, except for the expanding of **rail and high way connections to other provinces in the Yangtze River Delta region,** which will further the regional integration and co-operation. The city will also continue to promote technology innovation, energy saving and environment protection. It has been announced that 30 billion yuan (USD 4.4 billion), half of the city's entire environment budget will be spent on controlling water pollution over the next three years.

V. Near Future Perspective in YRD

Swiss companies in the region are generally optimistic and still committed to the Chinese market and its future. On the other hand, the impact of the global recession on the region is still unfolding, which turned out varying from sector to sector. **Textile industry, local automobile and components suppliers and are the first to be hit. High-end hotels and restaurants** felt it quickly as well. Some companies are experiencing the decline of orders, or postpone of delivery for the next year. Some hope to recover soon next year. **Construction related industries** will surely benefit from the new round of infrastructure investment. There are also companies enjoying steady growth in the domestic market and trying to **consolidate their presence in YRD**, in an effort to compensate the slowing down in western countries.

It is noteworthy that in the YRD, economy will be dragged by downturn **consumer mode**. As China's economic engine and favourite FDI destination, white-collar workers account for the majority of YRD's workforce[2]. The fear of losing job, together with the economic uncertainty has changed many workers shopping habits and start to cut their expense. Despite big discounts and unusual promotions the city's retailers are facing substantial downside risk[3].

The next two months and the first half of 2009 will be **"tough"** for the region. **But the economy is still in good shape**. For the first nine months, Shanghai has attracted contractual **FDI** with an amount of USD 12.85 billion, which was **an increase of 21.6%**. **Re-investment** accounted for **60%** of the total, showing continuous confidence on the city's sustainable growth.

Certainly the Yangtze Delta Region will not be able to stand by the global recession and it is still too early to judge whether and how soon the stimulus measures will work, but the regional economy and private consumption remain **resilient**, and the state-funded investment could partially cushion the downside risk of the economic development.

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[2] They are part of the country's growing middle class and used to be the big spenders and compulsive buyers.

[3] As a matter of fact, China has enjoyed unbalanced growth, with excessive rates of savings and investment and inadequate consumption for many years. The fruits of the economic reform are not adequately shared by the people to be able to boost a consumption driven growth. Furthermore, the absence of sound social security system force people continue to save.