A SYMPOSIUM OF VIEWS

Can China Achieve a *Soft Landing?*

China's official policy community seems desperate to curtail runaway investment even as it seeks to encourage the middle class to consume. Interest rate increases have been difficult to implement. Currency appreciation, occurring at only a modest pace, appears to offer little help in slowing the economy. Some have suggested that as an alternative, the official community is starting to encourage hikes in exports prices as a kind of backdoor means of slowing things. Of course, no one can completely predict the future state of the global economy, but what are the chances China successfully achieves a soft landing over the next year or two?

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A hard landing is inevitable.

TADASHI NAKAMAE
President, Nakamae International Economic Research

Having followed the Asian model of over-investment and under-consumption established by Japan in the 1960s, the Chinese economy inevitably faces a hard landing.

Investment in steel factories, for example, increases demand for steel, leading to further investment in steel factories. As a result of such self-perpetuating investment-led growth, fixed capital formation is 38 percent of China's GDP compared with household consumption at 35 percent. The rapid expansion of supply capacity relative to the domestic market has made China overly dependent on exports. The Chinese economy now looks particularly vulnerable to any fall in external demand stemming from weakness in the U.S. housing market.

Even without such an external shock, the profitability of Chinese industries is already declining fast, for two reasons. First, oversupply has undermined capital efficiency. Second, wage inflation has begun to emerge, especially due to the short supply of skilled Chinese workers. This cost pressure is causing multinational producers to switch new investment from China to cheaper destinations, and causing both multinational and domestic producers to raise the prices of the goods they produce in China.

The renminbi is thus being revalued, in real terms: even with the exchange rate remaining more or less unchanged, cheap imports from China are becoming a thing of the past. From the global perspective, the inflationary impact on commodity prices of China's growth has hitherto been balanced against the dual benefits of supply of cheap goods and downward pressure on wages. But now these benefits to developed economies are fast disappearing—a shift that will stimulate protectionist argument.

As wage inflation eats further into already deteriorating return on capital, China's capital investment bubble must sooner or later burst. Capital investment and economic growth will then both go into reverse, chasing each other downwards in a vicious spiral.

As a basis for judging when China has reached this point, the usual indicators of economic downturn—GDP and unemployment statistics, and so forth—will not be reliable.

The figures to watch are changes in China's foreign exchange reserves. In the five years to 2005, these grew by $653 billion from $166 billion to $819 billion. During the same period China's accumulated current account surplus was $328 billion. Foreign direct investment into China accounted for most of the remaining $325 billion increase in reserves. According to official statistics, about half of this direct investment flowed in from Hong Kong, the Bahamas, and other tax havens. If the inference is valid that the nature of such investment is largely speculative, then China appears to be very vulnerable to capital flight. The beginning of the hard landing—regardless of what rosy picture official statistics are still painting at that time—is likely to coincide with the beginning of capital flight.

In sum, after years of over-investment and under-consumption, China is bound to suffer a fate similar to that of Japan: a hard landing followed by years of structural adjustment. Nobody can predict exactly when the hard landing will come, and what hardships it will bring. But the chances of China establishing in the next year or two the conditions for sustainable economic growth, and thereby averting an eventual hard landing, are non-existent. If China enjoys another couple of soft years, it will simply mean that the economy has yet to land.

My rating of the chance of China achieving a soft landing, on the scale of one to ten, is one.

Let me lay down the odds…

JEFFREY A. FRANKEL
James W. Harpel Professor, Kennedy School of Government, Harvard University

Let's look at the odds.

Odds that if China revalued the currency within the next year or two it would substantially resolve global imbalances (e.g., halve the U.S. current account deficit): 0 percent.

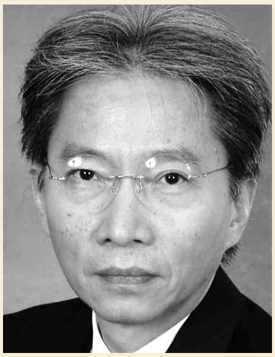
Odds that China will undergo a nominal appreciation of the yuan sufficient to make a modest contribution to equilibrate excess demand domestically, by shifting production from traded to non-traded goods: 30 percent.

Odds that China will undergo a real appreciation of the yuan sufficient to make a modest contribution to equilibrate excess demand domestically: 45 percent.

Odds that China's growth will continue strong for the time being, with a small increase in flexibility in the currency having little effect and with questions of sustainability remaining: 60 percent.

Odds that we will continue to debate whether China will have a soft landing: 75 percent.

Odds that there will eventually be some serious bumps along the way before the Chinese miracle is complete, such as a banking crisis or real estate crash: 90 percent.



It's too early to tell, but Beijing really has its hands full.

FRIEDRICH WU

Adjunct Associate Professor of International Political Economy, Institute of Defense & Strategic Studies, Nanyang Technological University, and former Director of Economics at Singapore's Ministry of Trade and Industry

Even though there was a deceleration in the expansion of industrial output and fixed asset investment in the latest month of July, one month's figures do not make a trend. We will have to wait for a few more months' numbers on fixed asset investment, industrial output, bank loans, money supply, and construction activity, as well as property transactions and prices, before we can draw any meaningful conclusion on whether the administrative and market-based measures implemented by Beijing earlier are taking effect. To look for excess capacity, one has to see inventory and sales figures, and company profits, which all have a time lag.

The key question is whether the leaders in Beijing would have the political resolve to rein in provincial and municipal government officials who are enamored with extravagant construction projects that help drive the investment frenzy. The recent humiliating penalty (to write a public self-criticism paper) for the governor of Inner Mongolia and his deputies for embarking on an unauthorized investment binge in coal-fired power plants sets a good example. But there are still many more defying regional "economic tsars" that Beijing has to subdue. Some of us still have the misconception that the Chinese Communist Party is a powerful monolith. But actually its rule is rather fragmented, especially after three decades of opening to the outside world and increasing economic decentralization.

The central government's rope-tightening act would also pit the People's Bank of China against powerful state-owned commercial banks which hitherto have provided almost free-flowing credits for many investment projects of dubious value. In particular, credit managers of the local branches of these banks either are under a lot of pressure from local officials and businessmen to lend, or are lending to the latter willingly in exchange for unspecified benefits. Graft is still rife at the sub-national levels.

While the outcome cannot yet be known, failure to avert an economic "hard landing" this round would have widespread ramifications not only within China but also beyond its borders, as China's economic linkages with the rest of the world have multiplied and deepened since the last "near hard landing" episode in the 1990s. Not only would its Asian neighbors have to sustain various degrees of collateral economic damages, but commodity-exporting countries such as Argentina, Australia, Brazil, Chile, Peru, and Russia would also feel the fallout quickly. In other words, should Beijing's economic mandarins fail to re-balance the Chinese economy, the world could possibly witness the first "Made-in-China" global growth deceleration.

There's real concern because levels of investment are out of control.

DAVID D. HALE

Chairman, Hale Advisors LLC

There is widespread concern that China could have a hard landing because its investment share of GDP has risen to levels as high as 48 percent. At the top of the East Asian economic boom of the mid-1990s, countries such as Thailand and Malaysia got as high as 41 percent but no country reached the level of China today. There can be little doubt that China will soon slow down.

The growth rate of the U.S. economy is now decelerating from 4–5 percent to 2.0–2.5 percent. As the United States takes about one-third of China's exports, its slowdown will reduce export growth from 30 percent in early 2006 to about 15 percent.

The government has also announced numerous administrative measures to curtail investment in real estate and selected industries. These measures will probably reduce the growth rate of capital spending to 18 percent from 28 percent during recent months. The central bank is also raising interest rates in order to slow investment and dampen the boom. The major offset to weakness in imports and investment could be consumer spending.

China's newly privatized banks plan to significantly expand household lending for property, autos, and other durable goods. These new lending policies should help to bolster consumption even as other sectors cool.

The fact is China's government wants to dampen the boom in the economy, not create a recession. As a result of the huge pent-up demand in China for both consumer goods and capital goods, it should not be difficult for the government to sustain a high growth rate indefinitely. The coming slowdown will be an experiment in fine-tuning as China attempts to prevent excessive capital investment from producing a new upsurge of non-performing loans.

No need for a soft or hard landing.

GENE HSIN CHANG

Professor of Economics, University of Toledo and Shanghai University of Finance and Economics

China's economy grew at 11.3 percent in the second quarter of 2006. The number looks like red-hot, but the economy is not as overheated as in 1994 or in 2004. Supplies of commodities are plentiful, the inflation rate is moderate at 2 percent, the shortages in coal and electricity disappeared this year, and even housing prices in Shanghai are falling after the government adopted a series of measures to cool down the real estate market. While the current economy is not overheating and thus not really in need of a soft landing, a danger of runaway investment or a real estate bubble does exist. Hence China's government needs to take precautions.

The recent surge in fixed asset investment and housing price was mainly caused by the huge capital inflow from overseas, estimated at more than $200 billion a year. So long as the yuan is undervalued, speculative foreign capital continues to pour in, betting on an appreciation, then money supply grows rapidly anyway. The cheap and plentiful credits will encourage housing developers and local government to continue to expand their investment. Then the central government's measures to rein the investment, such as raising the required reserve ratio, can only be temporally effective.

The government needs to do a couple of things. First, it needs to accelerate yuan appreciation, which serves to correct the market distortion and finally stop undesired foreign capital inflow. Second, it should further curtail the speculation on real estate in order to avoid bubbles. Third, the government should utilize the plentiful capital to invest in infrastructure, in particular in the poor and rural areas. By doing so, the government can reduce the excessive money supply and increase the productive use of the money for the long term economic growth.

There'll be no landing.

CHRIS LEUNG

Senior Economist, DBS Bank

We believe China will not be able to achieve any kind of landing (neither soft nor hard) in the next year or two for three reasons: the absence of swift policy responses to rising economic problems; the heightening investment incentive ahead of major political events; and the inconvertibility of the capital account lengthens the duration of the bubble.

The transformation of two of the biggest state banks into shareholding companies offers them much more lobbying power against rate hikes to maintain profitability. Since their fee incomes are still underdeveloped, they need to extend new loans to generate revenue. The absence of inflation at the consumer level also offers justifications to the monetary policy committee to hike rates slowly. The authority is unlikely to tighten too much ahead of the Olympics in 2008 as well.

Investment will probably not decelerate too much in the next year. 2006 was only the very first year of the eleventh Five-Year Plan and investment incentives are often heightened during the first two years. Besides, the elections in the seventeenth Communist Party Congress in 2007 will tempt provincial governments to create an impressive "report card" by cranking up their respective GDP figures. As of 2005, the fixed asset investment-to-GDP ratio has gone up to an astonishing 45 percent.

It was the inconvertibility of capital account that prevented China from being dragged into the Asian financial crisis in 1998. Viewed from another perspective today, it is a system that serves well to lock incoming liquidity up in the domestic economy. Although China has taken steps to relax capital outflow restrictions (portfolio investment/direct investment) under the capital account in the past few years, the progress has not been able to cope with the rapid speed of foreign reserves accumulation.

Unless stronger measures are implemented promptly in China, under the inconvertibility of the capital account and heightened political investment incentives, the economic bubble could be unprecedented in size and duration. Based on our analysis, we would put a score of three.

A modest reduction in growth might be welcomed.

RICHARD COOPER
Maurits C. Boas Professor of International Economics, Harvard University

The term "soft landing"—and its presumed opposite, a hard landing—is not well defined for any country; it is especially problematic when applied to China. Six percent annual growth would make many countries proud. A rapid drop in growth from over 10 to 6 percent would be a severe jolt to China, which needs high growth to re-employ redundant workers still being shed from state-owned enterprises, and to draw additional people out of agriculture into more productive non-agricultural activities. Growth in employment of non-agricultural, non-state owned enterprise workers was 54 million, 15 percent of the non-agricultural labor force, over the period 2001–2004. There are about 22 million new young adults every year.

Increases in general prices have been modest since 2004, 1 percent on the official consumer price index, although real estate prices continue to grow in some areas. The external trade surplus has continued to grow over the past year, despite an increase in prices of oil, of which China is now a substantial importer. These three factors—ample unskilled labor, price stability, and a large trade surplus—suggest that high growth will continue in the near future unless the world economy turns sharply down or strong protectionist restrictions are imposed on China's exports, neither of which seems likely. A modest reduction in growth to say 9 percent would be welcome by Chinese authorities, but to achieve that would require tighter credit restraint, tighter fiscal policy, or an appreciation of the currency greater than the 10 percent market participants seem to expect over the coming year.

A good possibility of a soft landing.

TADAO CHINO
Senior Advisor, Nomura Research Institute, Ltd., and Former President of Asian Development Bank and Former Vice Minister of Finance, Japan

The Chinese economy sprinted ahead in the first half of 2006 with its fixed asset investment growth near 30 percent and GDP growth at 10.9 percent. Recent statements by Government officials hint at more tightening to come. However, there are several challenges.

First, provincial officials tend to attach higher priority to fast growth than they do to less tangible macroeconomic stabilization objectives. Second, private investors as well as state enterprises play a more important role in investment. Enterprises' retained earnings become an increasingly important source of investment funding which is largely out of government control. Third, increasing foreign reserves could offset the efficiency of monetary tightening policies. These are sources of concern.

However, given the good track record of the Chinese government in bringing down the overheated economy in late 1980s and middle 1990s, I believe that if appropriate policies are pursued, there is a possibility of achieving a soft landing over the next year or two.

By my definition, a soft landing means economic growth in the range of 8–9 percent, fixed assets investment growth rate of about 20 percent, and inflation below 4 percent. In order to achieve such a soft landing, several policy changes are necessary. First, the flexibility of exchange rates must increase. Second, financial market reforms are needed to enable market mechanisms to function better. Third, further monetary tightening is necessary. And last, the criteria for performance evaluation of provincial officials needs to change. The criteria should not be limited to GDP growth and the amount of foreign investment received, but should include factors such as investment efficiency, macroeconomic stability, environmental protection, and income distribution.

At the same time, longer-term structural reforms toward more emphasis on consumption rather than saving need be started and pursued effectively.

Beijing doesn't mean what it says.

NORBERT WALTER
Chief Economist, Deutsche Bank Group

Beijing's leadership talks about slowing down the economy, but does not mean it. They are of course interested in curtailing excessive investment in certain sectors and companies. Producing more nonperforming loans and thereby increasing the need for a government bailout later certainly is on nobody's wish list. But the leadership's overwhelming target is to provide a dynamic economy so that more rural workers can be absorbed in vibrant private manufacturing and services companies, preferably in central and western China. Similarly, the redundant workers in state-owned enterprises need to be employed. Thus, Beijing is interested in keeping up the pace of growth, particularly if inflation remains south of 4 percent annually. The rhetoric of foreign exchange liberalization is meant to appease the international community, especially the U.S. Congress. However, how anybody in his right mind could perceive a 2–3 percent annual appreciation of the yuan *vs*. the U.S. dollar as a means to dampen China's price competitiveness forever will remain a mystery to me. China's real effective exchange rate is not rising. Instead the yuan is depreciating in real effective terms—notoriously and by a considerable margin. And it shows: in terms of current account developments—despite a huge appetite for ever more expensive commodities—China achieves an increasing surplus, and foreign currency reserves are skyrocketing, approaching one trillion U.S. dollars.

China's growth in the second half of 2006 and the first half of 2007 will be slightly below 10 percent because of a drought in China's northeast. The interest rate increases and the exchange rate adjustments are too incremental to be effective as a changing factor. Increased reserve requirements will limit bank loans, but not the availability of finance—which will come, if necessary from non-banks and from abroad. In 2007 China will see some reduction of foreign demand, especially from the United States (through the Wal-Mart channel). To assume China would face a serious downturn in the year before the Beijing Olympic Games reflects little understanding of political economics in China!

An 80 percent chance.

BERNARD CONNOLLY
Global Strategist, Banque AIG

I'd give the chance for a soft landing an eight. Two years takes us to the end of the Olympics. A hard landing before then, with rising unemployment and social unrest, is close to politically unthinkable—hence the recent beefing-up of efforts to slow investment now and reduce the risk of a crash one or two years out. But traditional macro measures—sharply higher interest rates and a yuan appreciation—could, in the unbalanced Chinese economy—produce, rather than avoid, a hard landing.

The best prophylactic against a hard landing if and when investment crashed would be to end the one-child policy now, but this is very unlikely. True, there is a lot of potential consumption demand in China. But the structural factors producing high precautionary saving will persist, and a determined macropolicy squeeze would hit consumption—or at least consumption of Chinese production—as well as investment. So it seems that administrative measures will have to continue and be intensified, with the aim of keeping private-sector investment demand, economically justified or not, unsatisfied and thus psychologically not ripe for a crash. If that doesn't work—and the extent of overinvestment and inefficient investment means it cannot be guaranteed to work—then either or both of increased government investment and of even bigger net exports will be necessary for a soft landing. That can probably be done, but it will leave China's economy structurally and dynamically inefficient.

To repeat, the distortion of intertemporal choices involved in the one-child policy has been one factor—though obviously not the only one—making excessively low real interest rates and a weak yuan necessary to maintain sufficient employment growth. China will probably avoid a hard landing over the next two years, but a landing on an equilibrium path looks close to impossible.

An 8-in-10 chance.

STEPHEN GILMORE
New Markets Strategist, Banque AIG

Yes, China can achieve a soft landing over the next year or two and I would assign an eight-in-ten chance of it doing so. For several years analysts have fretted about the risks of a hard landing—however that may be defined. Rather than a hard landing, China's economic growth has hardly missed a beat.

Growth in China has been driven primarily by very strong investment. Investment growth can be expected to moderate as administrative controls bite, profit margins get squeezed as capacity is added, and as credit growth slows on the back of modest monetary tightening measures. More recently, net exports have provided an additional albeit much smaller boost to growth. Export growth can also be expected to moderate as global economic growth slows.

However, even with an expected slowdown in investment and net export growth, overall growth in the next year or two is unlikely to slow markedly to levels that could be considered consistent with a hard landing.

First, with continued plentiful liquidity and China's prodigious savings rate, the slowdown in investment growth should be modest—especially as the authorities tend to be more concerned about potential overheating and overcapacity in specific sectors rather than overall levels of investment. The authorities' policy of taking small iterative tightening steps also reduces the chance that they will tighten too much.

Second, while net export growth has lifted overall growth its total contribution is relatively small. Third, household consumption has remained very steady and looks likely to remain so given robust increases in household earnings. Fourth, the government has plenty of scope to boost its own consumption should it choose to do so. Finally, China has effectively self-insured itself against most conceivable externally driven negative liquidity shocks through its very large foreign exchange reserve holdings.

The question is inappropriate because China has no boom-bust cycles.

CHI LO
***Author of* Phantom of the China Economic Threat**
(Palgrave Macmillan, 2006)

Talking about a hard or soft economic landing for China is inappropriate. Technically, China has no boom-bust cycles. China's volatile growth fluctuates between very high growth and high growth rates. The real problem that China is facing is economic imbalance (over-reliance on investment and exports for growth) but not overheating (there is no inflation, but overcapacity, profit squeezing, and weak pricing power).

So Beijing is in a policy dilemma. The flip side of over-investment is over-saving or under-consumption. China has a current account surplus of 7 percent of GDP. Together with its 43 percent investment share in GDP, that means a national saving of 50 percent! Beijing cannot use the same policy to address these two sides of the coin. It now wants to shift growth drivers to consumption from investment and exports. But the loose policy bias it needs to stimulate consumption clashes with the tightening policy it needs for curbing investment. A potential U.S. economic shock would add to China's near-term growth risk.

Given the current pro-consumption policy bias, any macro tightening measures to curb investment will likely be modest and selective. They will likely be used to facilitate the structural shift towards more consumption without jeopardizing overall growth. This means investment growth will slow, but nevertheless over-investment will not reverse until consumption starts to take over as a solid growth driver.

Changes are taking place that show Beijing's resolve to improve China's future growth dynamics. It is experimenting with scrapping population control, financial repression, and public asset ownership. When implemented nationally, these moves are extremely positive for consumption and economic growth. If Beijing is showing a will to break up the communist policy icons, odds are high that it would be successful in managing this structural shift.

No hard landing.

DIANA CHOYLEVA
Director and Head of the UK Service, Lombard Street Research Ltd.

China is unlikely to escape a hard landing—a cyclical weakening of growth to well below trend. A consumer-led U.S. downswing is set to knock the last support from beneath China's expansion in 2007. Faltering external demand should reveal the destruction of profitability in China. In the state side of the economy profits do not matter, but they affect the private sector. Overinvestment and overheating have trashed profit margins. Net return on assets was at most 1–2 percent by the end of 2005. As long as China's savings are excessively high they cannot be invested profitably because they negate the possibility of a mass consumer market. Consumer spending is unlikely to take up the baton in the face of an investment and export meltdown. Moreover, the authorities are serious about tightening at present, which will inadvertently coincide with waning external demand to hit the already weakened domestic economy.

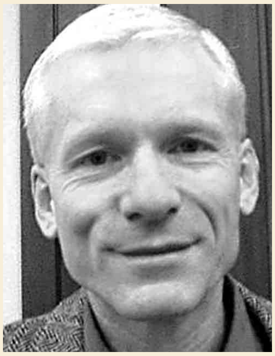
When the going gets tough, public investment is likely to be ramped up again, probably just in time for China to save face before the Olympics in 2008. A return to muscle-bound development will be bad news. The leadership seems prepared to push market reforms only as long as they do not endanger the Party's hold on power. But the clash between rigid politics and liberal economics has begun. State protectionism is on the rise and the private economy is losing out. Beijing is failing to cross the threshold of reforming the economy to become a real market-price economy rather than the current outsourced manufacturing hub of the world. It has the money to bankroll a few more years of fast expansion after the cyclical hard landing as long as people's confidence in the banking system persists. But time is running out fast for the authorities to make the final transition to a market economy.

The question is whether any landing occurs.

DANIEL ROSEN
Principal, China Strategic Advisory

Yes, China can report to the world that it has achieved a soft landing over the coming year: the question is whether any sort of landing is intended. Seen through G7 eyes, China's current economic conditions beg for cooling off. But through Beijing's lens the situation appears different. Eleven percent growth feels sustainable; it is some pockets of 20 percent or 50 percent growth within the whole that raise alarm, and those are better addressed through administrative measures rather than general tightening. Reserve requirements are still lower than those in the United States; interest rate tools staunch borrowing by responsible firms but don't affect reckless ones. Open market operations struggle to keep up with hot money inflows, with little left over for taming indigenous growth, and yet this is not seen as too troubling by senior leaders (other than People's Bank of China head Zhou Xiaochuan and a few like-minded technocrats).

With ten million citizens switching to urban residence per year, much of China's massive investment spending is reasonable. To the extent the remaining share is frothy and must be pulled back, the Statistical Bureau has such a murky set of numbers to work with that it can credibly report a mild investment driven-slowdown and no one will be able to prove otherwise. Therefore, China gets a nine out of ten chance of reporting a soft landing if it has any landing at all—and only fails to get a ten because global political risks could yet cause a hard landing for everybody, but that is a different matter.



A very soft landing.

ANDREW DEWIT

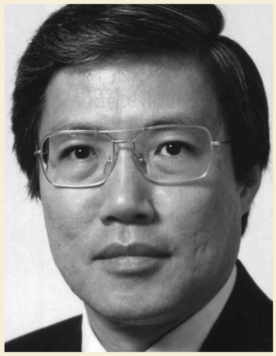
Professor of the Politics of Public Finance, Department of Economics, Rikkyo University, Tokyo

I'll go out on a limb and opt for ten, a very soft landing. There certainly are grounds to worry about China's economy. Among the hair-raising scenarios is a cascade of bad debt in the property sector. The white-hot economy adds vertiginous height to the potential drop. The 2006 GDP growth target of 8 percent was blown away by second-quarter growth of 11.3 percent, the highest in a decade. And a hard landing of the American property bubble would be a tough challenge for export-dependent China.

But China's durability is too often underrated. During twenty-seven years of economic reform and high growth, we have heard repeated warnings that—for example—a 9 percent rate of growth was unsustainable. But in fact, China's average growth over the same period has been just about 9 percent.

China has ample resources and incentives to sustain high growth, particularly as it shifts towards more domestic, regionally balanced consumption as well as exports within Asia and to other developing areas such as Africa. China's financial and human resources are legendary, including perhaps US$1 trillion in foreign exchange holdings and tens of millions waiting to join the urban workforce. The incentives to work, invest, and produce efficiently are extraordinary. And as even the once complacent Japanese now realize, China is attaining the critical mass for world-class innovation.

But just as critical, the political incentives to adapt the overall regime are also robust. The state managers know, for example, that they have to create at least twenty million jobs every year to maintain governability. At the risk of seeming crass, it appears that having over 80,000 demonstrations per year substitutes for democratic elections. And never underestimate the ruling elites' commitment to creative destruction to avoid global embarrassment, especially in the run-up to the 2008 Beijing Olympics.



A 70 percent chance.

RICHARD C. KOO

Chief Economist, Nomura Research Institute

Seven. There is no question that some areas of the Chinese economy are in the state of bubble, and what goes up must come down. However, we must also put them in perspective. When Japan was growing rapidly from 1955 to 1970 under the fixed exchange rate of Bretton Woods, its average GDP growth rate over that period was 9.8 percent per year in real terms and 15.6 percent in nominal terms. During the same period, commercial land prices increased on average 17 percent per year and residential land prices by 21.4 percent per year. These numbers are not all that different from those found in China today. Other Asian countries also had similar numbers during their so-called take-off period.

The Japanese growth during that period was driven, but also limited by, domestic capital and technology, with very few foreigners taking part in the process. The Chinese growth, on the other hand, has been getting a huge boost from the inflow of foreign capital, both human and financial. The Taiwanese population in China alone is said to be over half a million, and the amount of money European and American financial institutions are pouring into Chinese banks is simply mind-boggling.

Local Chinese who are seeing this massive and continuous inflow of foreign financial and industrial capital are invariably made to feel that the future must be very bright for their economy. And that confidence translates into speculative activities in the real estate market. Officials in Beijing, on the other hand, are fully aware of the dangers involved, and are implementing measures both at macro and micro levels to cool things down. And these measures are beginning to have impact in cities like Shanghai where condominium prices have already fallen by 6 percent.

Unless foreigners suddenly decide to stay away from China, or China does something stupid like attacking Taiwan, the fundamental growth momentum of the economy is likely to remain. The impact of any correction in the real estate market therefore, is likely to be limited to a deceleration of that momentum, instead of dislodging the momentum completely.

The time hasn't come.

JEFFREY E. GARTEN
Juan Trippe Professor of International Trade and Finance, Yale School of Management

I am inclined to give China the benefit of the doubt when it comes to avoiding a hard landing. The reason is that for a quarter of a century China has surprised every skeptic with its ability to manage its economy so effectively. One of these days, an increasingly market-oriented and globally connected Chinese economy, too complex for any government to direct as tightly as Beijing has to date, will have to experience a dramatic setback, as every other major country has. But I don't believe that time has come. In fact, the odds favor neither a hard nor soft landing for 2006–07, just continued growth of 8–10 percent.

The key is the United States.

MICHAEL KURTZ
Asian Economist and Equity Strategist, Bear Stearns

Because of mispriced credit and indiscriminate lending practices, China's economy is certainly characterized by excess capacity, and consequent low rates of return on capital sustain the danger of a new financial system bad-debt eruption. But the question as to how much overcapacity China suffers must, of course, also be a function of demand as well as available supply.

In that regard, one wild card we can't afford to ignore is the United States. If China's export market of first resort slows appreciably in 2007—for example, if an inflation breakout were to force the Fed to significantly overshoot 'neutral'—much of China's growing capacity would find itself without external outlet, causing a deflationary buildup at home. The adverse impact on domestic private consumption (witness Japan in the 1990s) could more than outweigh recent marginal attempts to support household spending, and cause any "landing" to feel much harder. I rate the probability of a "soft landing" at seven, but falling with every month that fails to produce a lasting slowdown in China's indiscriminate fixed asset investment.

The relative effectiveness and impact of Chinese interest rate moves, quantitative credit controls, and other investment constraints have been well explored. Yet dividend reform may hold the key. Encouraging enterprises to remit a materially greater proportion of their earnings to shareholders (including, of course, to the State majority-shareholder itself) would help to drain the large pool of corporate cash that has fueled so much of China's careless investment. It would also raise the disposable incomes of households that own stock, and boost Beijing's fiscal revenues—the latter enabling more aggressive pro-consumption tax cuts and/or a more robust social safety-net buildout that would reduce households' perceived need for high precautionary savings rates. This would dramatically reduce the risk of a hard landing.

No landing!

L. WILLIAM SEIDMAN
Chief Commentator, CNBC Business News

It is my guess that China will not have any landing during the next couple of years. In my view, their fast-growing economy will continue at or around the present pace with perhaps a small gain or loss around their present gain in GDP of 8 to 9 percent. Some day they will have a hard landing when they misallocate investment—which they do not seem to be doing in any large way now. They have the labor and capital to continue to grow at the present rate for many months.

Of course, if the U.S. economy takes a real dive, China and the rest of the world will have a hard landing. Finally, China will have a real recession/depression when their environment is sufficiently polluted. This event is also some years off, but given their present government, the chances are ten out of ten it will get to the point of no return. ◆