China may need to slow credit growth to stem bubbles, OECD says

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Nov. 20 (Bloomberg) -- China may need to rein in credit growth to tame inflationary pressures and keep asset bubbles from emerging as growth accelerates, the Organization for Economic Cooperation and Development said.

The world's third-largest economy is expected to expand 8.3 percent this year, faster than a June estimate of 7.7 percent, the Paris-based group said in a report yesterday. Gross domestic product growth will climb to 10.2 percent in 2010, it predicted.

China's government has encouraged a $1.3 trillion credit boom this year to complement its monetary and fiscal stimulus, helping propel the economy to its fastest pace of growth in a year last quarter. The credit expansion has pushed house prices to their biggest gains in more than a year and aided an 82 percent climb in the Shanghai Composite Index of stocks.

"The principal upside risk to the projections is that the money and credit expansion in 2009 will give a bigger-than- expected boost to demand, especially in the real-estate sector, the OECD said. "Credit conditions may need to be tightened to prevent the emergence of inflationary pressures and asset bubbles" should that happen.

China is among the emerging markets facing risks of property and commodity market bubbles, central bank adviser Fan Gang said yesterday, joining officials from the region in expressing concern about surging asset prices.

Asian economies from Hong Kong to Singapore are fighting rising property values, which threaten to mimic the U.S. mortgage bubble that roiled the world economy. House prices in 70 major Chinese cities rose 3.9 percent in October from a year earlier, the government said Nov. 10.

‘Abnormal’ Prices

Rising residential prices are “abnormal,” Dong Zuoji, director of land planning at China’s land ministry, said last week. The central bank and banking regulator may “soon” issue measures to limit the use of debt in real-estate purchases to rein in price gains, a Shanghai official said this month.

The surge in credit growth may increase risks in the nation’s banking system, the OECD said yesterday. The China Banking Regulatory Commission on Oct. 16 told the nation’s five largest lenders to increase write-offs against bad loans and make sure their capital ratios don’t weaken.

“Banks have not so far reported significant stress, but the surge in lending in the first half of the year may imply a risk of future bad loans, as has been the case in the wake of earlier lending booms,” according to the report.

Fixed Currency

China’s decision to fix its yuan to the dollar since July 2008 may increase inflationary pressures and boost its external surplus should the U.S. currency continue to depreciate, the OECD said. It has kept its exchange rate at about 6.83 per dollar since July 2008.

The economy grew 8.9 percent in the third quarter from a year earlier, and the median projection of economists surveyed by Bloomberg News is for GDP to jump more than 10 percent in the final three months of 2009.

China may see an expansion of between 8 percent and 9 percent next year, Fan, the academic member of the central bank's monetary policy committee, said in Hong Kong on Nov. 18, adding that a "double-digit" economic growth rate wouldn't be good for the country.

President Hu Jintao last week said the country will take "vigorous" steps to boost domestic demand and reduce its reliance on investment and exports for economic growth.

China's overseas shipments won't regain their pre-crisis growth rates even as the world economy recovers, the OECD said. That may narrow the current account surplus to about 5.4 percent of GDP in 2010, from 6.4 percent this year, it predicts.

The government's 4 trillion yuan ($586 billion) stimulus plan has boosted investment and helped minimize job losses in the world's most populous nation.

China can afford to keep spending at "higher levels" to spur domestic demand as the effects of its stimulus package wanes in 2011, the OECD said. Economic growth may slow to 9.3 percent in 2011, it predicts.

"The composition of public spending ought to be changed to favor outlays on social services, notably education, health and pensions," according to the report.