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China GDP Expands 9.8% Despite Tightening Measures

By AARON BACK And JASON DEAN

BEIJING—China's economy unexpectedly accelerated in the fourth quarter of 2010 despite a series of tightening measures, spotlighting Beijing's difficulties managing growth and fueling market concerns about further government moves to combat inflation.

The fourth quarter's 9.8% expansion in China's gross domestic product makes it all but certain that China became the world's second largest economy in 2010, ending Japan's 42-year reign in that position—although Japan doesn't report its year-end economic data until next month. Acknowledging the milestone and the anxiety its impending arrival has caused some Japanese, Japan's minister of economic and fiscal policy, Kaoru Yosano, said it appears likely that China has surpassed Japan and that "the Japanese people should welcome our neighbor China's growth."



WSJ's Jake Lee speaks to Heard on the Street Asia Editor Mohammed Hadi about the implications of China's strong growth numbers, and the implication for its efforts to control inflation.

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China's economy surpassed Japan's based on quarterly data for the two countries in the March-June period, but global rankings are generally based on full-year output. China's economy remains much smaller than that of the U.S.: For the full year, China's GDP grew 10.3%—up from 9.2% growth in 2009—to about \$5.88 trillion. The International Monetary Fund forecast in October that U.S. GDP would top \$14.62 trillion.

Still, China's latest growth data, released as Chinese President Hu Jintao visited the White House, point up the stark contrast with the U.S. and other major world economies, which are still struggling to maintain growth and revive employment.

As Washington has announced tax cuts and other stimulus measures in recent months, and the U.S. Federal Reserve has continued pumping cash into the economy through its quantitative easing program, China has raised interest rates twice, ordered banks several times to increase deposits held in reserve to curb lending, and imposed price controls on some staple goods. China's inflation slowed somewhat in December, but analysts expect it to pick up again.

Other major emerging markets have also been battling inflation, which some officials and analysts have blamed partly on the loose monetary policies of the U.S.

China's strong performance is in some ways good news for the global economy, in that it reflects improving demand for Chinese

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goods in the U.S. and elsewhere. China reported last week that exports in 2010 rose 31%. Imports rose an even faster 38%, as China purchased more raw materials, machinery and consumer goods from the rest of the world.

But the new data also add to expectations that Beijing will feel the need to yank the reins back harder to fight inflation. That has worried global investors, who fear that Beijing might overcorrect

and sap the strength of an economy that has accounted for a huge share of global growth in recent years.

Stock markets across Asia fell on the news Thursday. China's benchmark Shanghai Composite stock index fell 2.9%, while Hong Kong's main index fell 1.7%, and Japan's and Australia's both dipped 1.1%. Stocks in Europe were down early Thursday, with basic resources shares leading the decline as investors worried that Beijing would tighten monetary policy further.

Thursday's data "shows that the tightening done so far hasn't had a major impact on growth," said Citigroup China economist Ken Peng, adding that the numbers also reinforce "signs of strengthening in the U.S. and Europe, which may have helped."

It's unclear whether the latest reading will affect China's exchange-rate policy—a subject of major contention during Mr. Hu's U.S. visit. American officials have argued that Beijing's suppression of the yuan hurts U.S. exports but also feeds inflation in China, and have urged faster appreciation. But Mr. Hu ahead of his trip played down inflation as a factor in exchange-rate policy. The yuan slipped slightly against the dollar in Shanghai trading Thursday, after hitting records earlier in the week.



John Bussey discusses Chinese President Hu's scheduled address to Congress today, as well as China's GDP growth. Plus, Dave Kansas reports on Spain's bailout of its savings banks. Also, Janet Adams on Republican efforts to derail the healthcare bill.

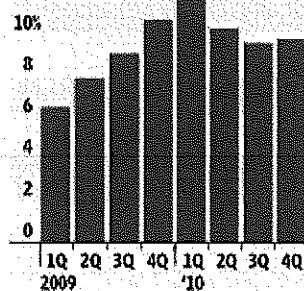
China's consumer price index rose 4.6% from a year earlier in December, down from the 5.1% pace in November, which was the fastest clip in more than two years.

But economists said that was largely a result of softer prices for food, which had been a prime driver of inflation, and warned of other signs that inflation could rebound. The increase in nonfood prices accelerated in December, and analysts said prices are likely to pick up in the first quarter of 2011 due to an unusually cold winter—which boosts energy demand and hurts crop yields—and to elevated demand during the Lunar New Year holiday, which starts in early February.

"I expect inflation to rebound in January," said Wang Tao, China economist for UBS. "We have already seen food prices rebound after their initial fall in late November and early December."

China's GDP

Change from a year earlier in quarterly GDP



Source: China's National Bureau of Statistics

For all of 2010, the consumer price index rose by 3.3%, more than Beijing's official target of around 3%, and reversing a small decline in consumer prices in 2009. The government has raised its target to 4% for 2011, implicitly acknowledging the limits of its ability to constrain prices.

Still, economists widely expect Beijing to keep trying. Economists polled last week by Dow Jones Newswires expected on average that the People's Bank of China will raise interest rates three times in 2011, by a total of 0.75 percentage point, following the two separate rises of 0.25 percentage point each in October and December.

One of the biggest problems Beijing has had is constraining its state-run banks from pumping too much credit into the economy. Banks got around

regulatory curbs last year in part by shifting loans off their books and onto those of lightly regulated trust companies.

On Thursday, China's banking regulator unveiled new restrictions on trusts. The China Banking Regulatory Commission instructed banks to move at least 25% of loans issued through trust companies back onto their balance sheets at the end of each quarter. Trust companies were also instructed to set aside capital worth 10.5% of their outstanding loans to guard against risks.

Bank lending has helped drive the investment that has underpinned China's rapid growth. Urban fixed-asset investment, a closely watched indicator of investment activity, rose by 24.5% in 2010, according to Thursday's data, showing that spending on plants, equipment, and infrastructure remains powerful.

—Victoria Ruan contributed to this article.

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