



Inflation in China: How Big a Concern?

Nicholas R. Lardy says that the latest Chinese steps should be effective in curbing inflation while keeping China on a path of solid growth.

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- Steve Weisman: Inflation in China is in the news. This is Steve Weisman at the Peterson Institute for International Economics with Nicholas Lardy, senior fellow here. Nick, first, how bad is inflation in China?
- Nicholas Lardy: By Western standards inflation in China is fairly modest. The Consumer Price Index went up 5.4 percent in March compared to a year ago but for the quarter as a whole, you take the average of the first three months and prices are up about five percent. That's a little bit on the high side by Chinese standards but not alarmingly so.
- Steve Weisman: Your recent presentation on the world economic outlook at the Peterson Institute suggested that Chinese growth is going to continue to be robust although perhaps not in the double digits in the next few years. What is the relationship between growth and inflation in China?
- Nicholas Lardy: The fear of outside observers is that inflation is picking up to such an extent that the Central Bank will be forced to really slam on the brakes, tighten monetary policy quite substantially, leading to a very dramatic slowdown in economic growth. This is the hypothesized so called "hard landing."
- Steve Weisman: Do you read from recent steps in China, including requiring banks to have more reserves, that the Chinese leadership is worried about that?
- Nicholas Lardy: I don't think they are planning on contracting credit so dramatically that it would lead to a hard landing. They have been gradually tightening over the last year, maybe even a little bit longer. And I think price inflation will moderate. It's very heavily concentrated in food. Food prices are going up about twice as fast as the overall Consumer Price Index. There will be a supply response and I would anticipate by the time we get into the third quarter of this year that price inflation will be moderating.
- Steve Weisman: Is energy a factor?
- Nicholas Lardy: Energy is a factor. China's energy prices do tend to rise roughly speaking in pace with international prices. So the pick-up in international prices of petroleum over the last four to five months have led to price increases in China as well.
- Steve Weisman: What are the global implications of this effort for China to avoid inflation?
- Nicholas Lardy: My view is, as I've already indicated, that there will not be a big slow down, that price inflation thus does not implicitly represent a threat to global recovery. I think China will continue to grow at fairly high rates, something in the neighborhood of nine percent, nine and a half percent, as

they have been doing for several quarters, and that China will make a very substantial contribution to the expansion of the global economy in 2011 just as they did in 2010 and in 2009.

Steve Weisman: What are some of the other steps China is taking on this front?

Nicholas Lardy: They're taking a number of steps to try and hold down food prices, for example. They have eliminated the tolls that trucks have to pay when they are hauling vegetables into major cities. They are trying to make it less expensive to get those kinds of products to market. And they're trying to control some prices. And, of course, they are also allowing the currency to appreciate at a more rapid rate over the last few months. And that tends to moderate the feed-through from higher oil prices.

Steve Weisman: You said the magic word: currency appreciation. What's the latest?

Nicholas Lardy: They've been appreciating at a rate of about one percent a month over the last few weeks.

Steve Weisman: Is that against the dollar or against global currencies?

Nicholas Lardy: That's against the dollar. And of course, when the dollar moves one way or the other, that affects how China moves on a broader basis. But they manage their currency with respect to the dollar, and the pace of appreciation has picked up noticeably in recent weeks.

Steve Weisman: Is the Obama Administration hopeful about that?

Nicholas Lardy: Certainly Treasury Secretary Geithner has pointed to China's appreciation plus their faster rate of price increase as hopeful signs that China's global competitiveness will be reduced somewhat and their external surpluses, which are still quite large, would be further reduced.

Steve Weisman: Since the European and U.S. recoveries are disappointing, is China moving in this direction because it realizes that its export markets may not be as robust as they were?

Nicholas Lardy: Longer term, they're trying to rebalance their economy, and generate more growth through consumption rather than relying so much on exports. But their exports have been doing reasonably well so far this year. Their trade surplus has actually disappeared in the first quarter but their export growth in the first quarter is well into the double digits, something around 35 percent.

Steve Weisman: Any sign of where those exports are going? It's the same pattern as usual?

Nicholas Lardy: There are no dramatic changes. A little bit of slowdown in exports to the United States in February, according to the U.S. data. We won't have the March data from the U.S. side for about another month.

Steve Weisman: Does the rebalancing that China is undertaking--at least gradually over many years-- have anything to do with these inflationary pressures?

Nicholas Lardy: Not directly. There is an indirect connection but it's quite frankly a little bit obscure. I think by and large these things move independently.

Steve Weisman: And just taking the temperature of the U.S./China relationship: What's your assessment?

Nicholas Lardy: I think that President Hu Jintao's state visit to the United States was regarded as quite successful. We're coming up, only three weeks from now, to another major event in the bilateral relationship particularly on the economic and security front referred to as the Economic and Security Dialogue. And I think the signals so far are fairly optimistic. People are expecting that to be a very productive meeting.

Steve Weisman: What's that event?

Nicholas Lardy: It's called the SNED in the vernacular: the Strategic and Economic Dialogue. And it's a once a year event that is co-chaired by very high ranking people on the Chinese side.

Steve Weisman: That will be here or in China?

Nicholas Lardy: It alternates. Next month it will be in Washington.

Steve Weisman: A good time to check in again when that happens. Thanks Nick.

Nicholas Lardy: Thank you.

