

# China Monthly Report



## Highlights February Edition

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## China's prospective leader visits US

China's prospective top leader, Vice President Xi Jinping, begins his first official visit to the United States today, the most senior Chinese leader to do so since President Barack Obama announced last November a new US strategic focus on Asia to counterbalance China's growing assertiveness in the region. As the presumptive successor to President Hu Jintao when China's decennial leadership transition gets underway this fall, Xi will be able to use the visit to enhance his standing at home by reinforcing his foreign-affairs credentials. For US leaders, the meetings should help fill in their limited understanding of Xi's personality and politics. Concluding with planned stops in Iowa and California, the trip will play a part in shaping Sino-US political and commercial relations through the next decade.

Xi may touch on his personal ties to the US once he travels beyond Washington, but almost certainly not to an extent that would risk exposure to criticism by nationalist hardliners in Beijing; Xi's revolutionary-hero father, who visited the US as an emerging reformist leader in 1980, was later sidelined from the Party elite after the Tiananmen crackdown in 1989 for his relatively liberal style of leadership.

**Resetting the bilateral relationship.** Xi and Obama will take initial steps toward building a working relationship during meetings at the White House today. In the process, US leaders will seek to tap into the personal rapport established between Xi and Vice President Joe Biden during the latter's visit to China last year. How-

ever, the circumstances are not propitious: the Obama administration is under pressure in an election year to show toughness toward China, while senior Chinese officials have been warning lately that lack of mutual trust threatens to undermine the bilateral relationship.

Xi will highlight burgeoning bilateral commercial and investment ties as he addresses high-level business groups in Washington and later in Iowa and California. His meetings with US congressional leaders, however, will be a lightning rod for sharp criticism of a range of Chinese practices, especially those involving human rights and treatment of ethnic minorities and dissidents, alleged currency manipulation, and discriminatory trade policies.

**Probing on geopolitical concerns.** There is a less-than-even chance that Xi's meetings at the Pentagon will result in agreement to restart routine military exchanges, given the accumulation of bilateral irritants and still-unresolved suspicions. US arms sales to Taiwan are a hot-button issue within the Chinese political and military leadership, while US leaders are deeply concerned about China's strategic intentions and lack of transparency in modernizing its military.

Festering problems in East Asia -- including North Korea's opaque leadership transition and nuclear weapons ambitions, and China's increasing assertiveness in maritime disputes with regional neighbors bordering the South China Sea -- may be a focus of mutual probing. And while Xi's discussions with the US secretaries of state and defense and other leaders almost certainly

will not result in substantive agreements, Washington will try to size up prospects for better cooperation with Beijing on two global flashpoints that threaten to escalate out of control:

- **Iran.** Chinese leaders have publicly rebuffed American entreaties to curtail imports of Iranian oil because of Tehran's nuclear program, but Premier Wen Jiabao's recent meetings with leaders of Iran's Persian Gulf neighbors probably signal that China's strategic alliance with Iran is under reconsideration in Beijing.
- **Syria.** China's leaders last week angrily brushed aside US criticism of its veto, along with Russia, of a UN resolution seeking to avert civil war in Syria. In discussing the issue, however, US leaders will be looking for signs from Xi that China's new generation of leaders will be inclined to play a more constructive role in global governance. In a possible sign of greater diplomatic engagement, China's foreign ministry disclosed that senior officials met with a Syrian opposition delegation in Beijing last week.

## Glimpsing internal leadership maneuvering

In the runup to China's once-in-a-decade transition to a new generation of leaders, some apparent indications of factional discord are beginning to appear. While the Communist Party's internal leadership maneuvers are almost always played out behind closed doors, the popularity of social media has enabled widespread online speculation about power-plays among prominent personalities and their proteges and allies.

The unexplained events surrounding the dismissal last week and subsequent detention of a well-known crimefighter, former Chongqing police chief Wang Lijun, touched off rumors of infighting and unconfirmed reports that Wang -- a close ally of **Bo Xilai**, the local Communist Party leader who is a contender for a top leadership position in Beijing -- had attempted to seek asylum at the US consulate in Chengdu. Online commentary focused on the possibility that Wang's disappearance was part of an effort by rival factions to sidetrack Bo's ambitions to ascend to the Politburo Standing Committee this fall.

Another contender for membership in the inner leadership circle, **Wang Yang** -- the top Party official in Guangdong province, who is regarded as among the most liberal of potential next-generation leaders -- was

given implicit backing last week by Premier Wen Jiabao in a visit to Guangdong. Wen called for protecting land rights of farmers, which Wang had defended in defusing a confrontation in the southeastern fishing village of Wukan, where residents in December drove out local leaders in a dispute over corrupt land seizures and sales.

Villagers last week held the first of two free elections that will lead to selection of new leaders on March 1. The Wukan situation has been widely debated on social networking sites and is likely to have national political repercussions, given the coverage of the elections by state media.

## Pro-growth economic policies on hold

Chinese economic policy has not yet decisively shifted to supporting growth, although in remarks reported by Chinese state media February 12, Premier Wen Jiabao said that the leadership would start 'fine-tuning' its economic policies during the current quarter.

Leaders are probably waiting to see if a clearer picture of the consumer price inflation trend emerges in February and March after a seasonal upsurge in January. In the meantime, economic sluggishness in Europe -- China's largest foreign market -- will act as a drag on export growth, while the ongoing property-market correction is curbing investment spending and contributing to deflationary pressure, which can be seen in downward-trending producer prices.

**Mixed economic signals.** The economic effects of the week-long Chinese New Year holiday in late January were reflected in sharply higher inflation figures and a widened trade surplus, reversing earlier trends at least temporarily.

Following five consecutive monthly declines, consumer price inflation (CPI) jumped to 4.5% in January, pushed higher by a surge in pre-holiday food shopping. Fighting inflation had been Beijing's top economic priority in 2011, but recently expectations have grown that monetary policy would be eased and fiscal spending stepped up in 2012 to bolster domestic growth. The latest inflation rebound will give policy-makers reason to hold back on aggressive action to prop up growth, however, especially since the overall CPI in recent months has been at levels much higher than in late 2008 -- when China resorted to a debt-fueled stimulus program to rescue the economy from the global financial crisis -- and food price inflation remains stubbornly high.

As temporary production shutdowns during the holiday reduced the need for inventories of imported ma-

terials, imports declined 15.3% year-over-year. Although a drop in imports was anticipated because of the calendar effect, the scale of the falloff probably also reflects weakening domestic demand as investment activity softens. January exports declined 0.5% year-over-year, the first such decline since late 2009. With imports declining much more than exports, the trade surplus widened from \$16.5 billion in December to \$27.3 billion in January.

While a switch to expansionary monetary policy is held in abeyance, Beijing is looking for targeted measures to counteract some of the effects of the downturn:

- **Easing property curbs.** The central bank said on February 7 that it will increase support for building affordable housing and for helping first-time home buyers obtain mortgages, possibly signaling initial moves to ease the two-year-long campaign to rein in the once-overheated property sector. Beijing, however, appears to be clamping down on local government attempts to ease up on property restrictions. The eastern city of Wuhu announced on February 9 a series of subsidies and tax waivers for purchases of smaller-size apartments and homes for self-use, but three days later rescinded the measures after central government officials intervened.
- **Encouraging consumption.** Chinese leaders continue to call for rebalancing the economy away from reliance on exports and toward consumer spending. Massive stimulus spending almost certainly is not in the cards, but various small-bore fiscal measures may be introduced in coming months, according to reports in the Chinese press. These include incentives to buy 'green' products, such as solar

water heaters and alternative-energy cars, and subsidies for purchases of household appliances in rural areas.

## Looking ahead ...

**National People's Congress approaches.** The annual session of China's legislature, the National People's Congress (NPC), will convene March 5. While the proceedings will be tightly scripted, the NPC will offer a partial view of the level of consensus within the Party on key issues in the runup to the upcoming leadership transition. In recent years, the NPC has moved away from its previous role as a purely symbolic, rubber-stamp legislature, and has developed a limited capacity for debating ideas, brokering policy differences, and building consensus among contending groups within the Party and government. Major substantive elements of legislation will, however, have been agreed ahead of the NPC session.

**Citibank to issue own credit cards in China.** Citigroup is set to become the first global bank to issue credit cards on its own to local retail and commercial customers in China, having announced approval for the move by the banking regulator on February 6. Several foreign banks currently have co-branded cards with Chinese banks in which they hold stakes. But, as mainland banks continue to dominate access to Chinese retail customers and large corporate clients, western banks are looking to the burgeoning credit card market as a vehicle for expanding their business in China. According to projections by Mastercard, spending on credit cards in China could reach \$2.5 trillion by 2025.