

*From the Desk of...*

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Issue No.27 - June 2008



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## China's Inflationary Earthquake

The great earthquake of May 12th is likely to have both positive and negative impacts on the Chinese economy. Besides the tragedy of a death toll, which could rise as high as 100,000 and some 12 million people needing to rebuild their homes or relocate, the major negative effect is likely to be a shove to already-problematic inflation, as shrinking supply and reconstruction spending connect with food and fuel price rises.

But rebuilding will also, on the positive side, increase aggregate demand.

April's CPI inflation rose to 8.5%, once again higher than many pundits predicted – and it's set to rise even higher. The good news is that agricultural markets are stabilizing; the bad is that fuel price pressures are mounting.

But industrial growth has been relatively steady. It rose 15.3% in April, slightly lower than in March, but was probably basically flat, if we factor in the introduction of a new April holiday this year.

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Investment growth trends look unclear. Recent data suggest a considerable slowdown in real terms – but we can't rule out the possibility of a rapid rebound.

A quick analytical exercise demonstrates that RMB appreciation since 2006 has not been sufficient to mitigate the impacts of a weakening dollar, or of rising inflation abroad, on rising prices for imported products in China. This implies that, if China wants to avoid importing inflation, RMB appreciation vis-à-vis the dollar should be greater. However, the concerns over financial speculation on RMB revaluation may prevent the authorities from firmly pursuing such a strategy.

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### About Prof. Fan Gang and The Insight Bureau

Dr. Fan Gang is one of China's most influential economists, based in Beijing. Trained at the Chinese Academy of Social Science (CASS) and Harvard University, he is the Director of the National Economic Research Institute (NERI) and Chairman of the China Reform Foundation, China's first independent economic think-tank. He is also a professor at several top universities in China, notably Peking University. He is an advisory to numerous Chinese government ministries and is therefore highly sought-after for his insights, focusing on the direction of China's economic policy and its implications for Chinese and international businesses investing in China. Fan Gang is part of The Insight Bureau's resource network that provides confidential, in-house briefings to senior executives, a service that helps to achieve a better understanding of the world in which businesses operate around the world and therefore ultimately to enable companies to make better business decisions.

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