Inflation in China may limit U.S. trade deficit

By Keith Bradsher
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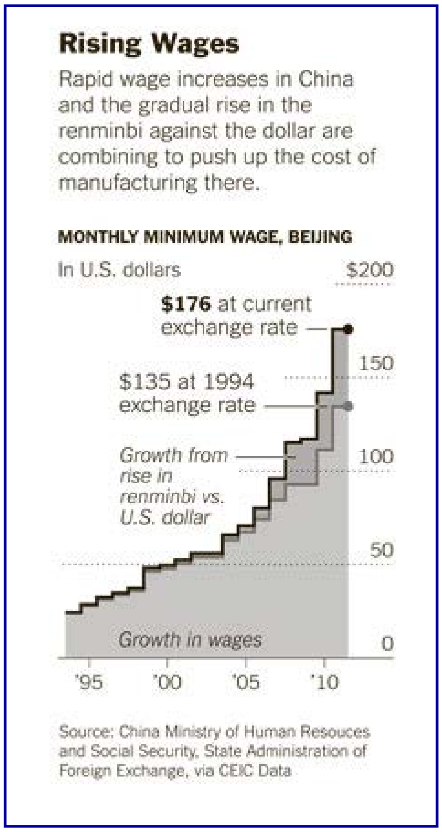
HONG KONG — Inflation is starting to slow China's mighty export machine, as buyers from Western multinational companies balk at higher prices and have cut back their planned spring shipments across the Pacific.

Markups of 20 to 50 percent on products like leather shoes and polo shirts have sent Western buyers scrambling for alternate suppliers. But from Vietnam to India, few low-wage developing countries can match China's manufacturing might — and no country offers refuge from high global commodity prices.

Already, the slowdown in American orders has forced some container shipping lines to cancel up to a quarter of their trips to the United States this spring from Hong Kong and other Chinese ports.

The trend, if continued, could ease tensions by beginning to limit America's huge trade deficit with China. Those tensions were an undercurrent during Chinese President Hu Jintao's recent Washington talks with President Obama.



Manufacturers and distributors across a range of industries say the likely result of the export slowdown is higher prices for American shoppers in the coming months, and possibly brief shortages of some products if Western retailers delay purchases too long while haggling over prices.

China exports more than $4 of goods to the United States for each $1 it imports from America, creating a trade surplus of about $275 billion. The higher Chinese prices will tend to show up mainly in products like inexpensive clothing and other commodity goods in which labor and raw materials represent a bigger part of the final value — rather than in sophisticated electronics like Apple iPads, in which Chinese assembly is only a small fraction of the cost.

Of course, the slowdown in the volume of imports could also prove temporary, if American consumers accept higher prices and Western corporate buyers end up renewing contracts at much higher cost. In the meantime, if the average price for each imported product rises faster than the volume of shipments falls, China's surplus with the United States could continue increasing temporarily.

But whatever the eventual impact on trade, Chinese inflation might also reduce Washington's pressure on Beijing over its currency, the renminbi. For more than a year, the Obama administration has been pushing China to let the renminbi rise in value against the dollar.

China's intervention in the currency market has kept its currency artificially low. But that flood of money has also driven inflation, giving Beijing an incentive to let the renminbi move higher. Indeed, the renminbi has increased 3.6 percent against the dollar since last June.

The Obama administration is starting to suggest that the currency problem could gradually solve itself if Chinese prices rise so fast that American goods become more competitive.

The first signs of a potential slowdown in Chinese exports have shown up in shipping. As factories closed on Friday across much of China in preparation for weeklong Chinese New Year celebrations, ports in Hong Kong and elsewhere along the coast were working long hours to meet last-minute shipments.

But the annual pre-New Year rush has been nothing like that of recent years, causing shipping lines to reverse rate increases and cancel sailings they introduced last summer as the American economy improved. This winter, the scurrying started only two weeks before the holidays, instead of the usual four weeks, according to shipping executives. That is because many Chinese factories simply cut back production this month as their Western customers began resisting steep price increases.

China's inflation is running 5 percent at the consumer level, according to official measures. But Chinese and Western economists describe these measures as based on flawed, outdated techniques and say the real figure may be up to twice as high.

In contrast, the annual inflation rate in the United States is low by historical standards — about 1.5 percent currently.

China imposed price controls on food in mid-November to limit inflation. But Chinese state media began warning the public on Wednesday that those controls might be ineffective, as a drought in northern China has damaged the winter wheat crop and frost has spoiled part of the vegetable harvest in the south.

China's $6 trillion economy used to be heavily dependent on exports for growth. Exports still account for about one-fifth of the economy, after excluding goods that are merely imported to China for final assembly and then re-exported. But China's economy has grown powerfully for the last two years mainly on the strength of investment-led domestic demand. That demand, partly fed by low-interest lending by state-owned banks, is another factor in China's inflation.

Cities and provinces across China have tried to cushion inflation's effect on consumers by sharply raising minimum wages. Guangdong Province, the export heartland of light industry next to Hong Kong, announced two weeks ago that its cities were raising their minimum wages by an average of 18.6 percent, effective March 1.

That follows a similar increase that took effect in Guangdong around eight months ago. Many other provinces and cities have also sharply raised minimum wages recently.

The wage increases are also driven by a growing scarcity of factory workers. The number of Chinese in their 20s and early 30s, the traditional age bracket for factory labor, is slowly shrinking because of the introduction of the "one child system" a generation ago. And a rapidly expanding university system has produced waves of graduates with no interest in factory work.

Some companies have responded by moving factories deeper into China's interior, said Stanley Lau, the deputy chairman of the Federation of Hong Kong Industries, which represents exporters employing 10 million mainland Chinese workers. But inland wages are starting to catch up with coastal pay rates, Mr. Lau said, while higher transportation costs frequently offset the wage savings from moving to the interior.

Coach, the American company that is one of the largest marketers of luxury handbags and other accessories, announced on Tuesday that it planned to reduce its reliance on China to less than half of its products, from more than 80 percent now. It will shift output to Vietnam and India, particularly for smaller, more labor-intensive leather goods.

But Mike Devine, the company's executive vice president and chief financial officer, said that it would take four years to carry out the shift.

Trying to move production elsewhere, some retailers are finding many factories are already fully booked: Vietnam and Thailand each have populations smaller than some Chinese provinces, while Cambodia and Laos have smaller populations than some Chinese cities.

Many manufacturers foresee further labor shortages looming in China that will push wages even higher. They are responding with plans to upgrade their factory equipment and product designs, which could turn them into more direct competitors with high-end manufacturers in Europe and the United States.