

### **Emerging Three “China Risks” Attract Attention**

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China has become the world's second largest economy, while expanding its global presence in political, diplomatic, military and technological areas as well. While Japan, the United States and other industrial countries and many developing nations have struggled to achieve economic recovery since the September 2008 Lehman Shock, China has implemented a 4 trillion yuan economic stimulus package to get back on a recovery path ahead of other countries and has driven the global economy. By sustaining very high economic growth and expanding energy and resources demand and imports substantially over the past decade, China has become one of the most important players in the international energy market. But China has intensified its tensions with neighboring countries regarding such problems as its territorial dispute with Japan over the Senkaku Islands and is now faced with various uncertainties and destabilizing factors involving domestic politics, diplomacy, and the economic and social situation. Among them, I would like to discuss three risk factors that are expected to exert grave impacts on international politics, the global economy and the energy situation.

The first risk factor involves China's intensifying tensions and dispute with Japan over the Senkaku Islands, the emergence of China's very harsh domestic reaction to the dispute, and their future implications. Since the Japanese government's "nationalization" of the China-claimed Senkaku Islands, bilateral tensions or frictions have remained very serious and are unlikely to calm down. In a general debate speech at the U.N. General Assembly on September 26, Japanese Prime Minister Yoshihiko Noda emphasized the importance of peaceful resolution of disputes under international law and the significance of the rule of law for the peaceful resolution of disputes, without naming any specific country. China made a strong reaction to the Noda speech. Bilateral diplomatic tensions have remained fierce.

In an attention-attracting phenomenon, the rising Japan-China diplomatic tensions have been spilling over to bilateral social, economic and cultural relations. Between September 15 and 18, particularly, large-scale anti-Japan demonstrations broke out in various Chinese locations including Beijing and Shanghai. Some demonstrators grew violent, destabilizing the situation rapidly and exerting serious effects on bilateral relations. Violent demonstrators surrounded such Japanese facilities as the embassy and threw stones at them. They attacked plants, stores or other facilities of Japanese companies including Panasonic Corp., Toyota Motor Corp., Ito-Yokado Co. and Aeon Co., causing huge economic losses. After Chinese authorities stepped-up their crackdown on such

demonstrations later, however, we now see no major demonstrations. But the fact that Japanese private companies and their business operations became an attack target has had a great impact on bilateral relations. The situation is complicated as some analysts point out that the factors behind the violent anti-Japan demonstrations include not only anti-Japan sentiment and nationalism over the Senkaku problem but also social discontent and anxieties accumulated in Chinese society. These developments in China have reduced bilateral economic and cultural exchanges and tourist traffic and led Japanese companies (or foreign companies in general) to sense business risks in China anew. Widespread political and economic tensions between China and Japan, as the world's second and third largest economies, are a grave risk factor for international politics and the world economy. Given the close reciprocal economic relations, the tensions are expected to exert serious impacts on the two countries.

The second risk factor is a slowdown in China's economic growth, which is separate from problems regarding the abovementioned Japan-China relations. Though achieving a high economic growth rate of 10.4% in 2010 after its prompt recovery from the Lehman Shock, China saw its economic growth decelerating to 9.2% in 2011 and detected a clearer slowdown in 2012. Economic growth in the April-June 2012 quarter fell to 7.6%, slowing for the sixth consecutive quarter. Growth for the whole of 2012 is increasingly expected to slip below 8%. A direct cause of the slowdown is a slump in exports that account for a key part of the Chinese economy. The slump is attributable to such factors as Europe's stagnation. Meanwhile, some analysts point to a more structural factor behind the economic slowdown. They say that China's export competitiveness has declined on the yuan's appreciation as well as a rapid personnel cost hike that has accompanied the past high economic growth. These changes have reportedly affected direct investment in China that had realized the China's Status as "factories for the world" and driven economic growth. The first China risk mentioned above is also expected to affect direct investment in China, making the future course of such investment even more uncertain. The Chinese government is seeking to switch to domestic demand-led growth from the past economic expansion dependent on exports and foreign direct investment and has announced a 1 trillion yuan economic stimulus package to help sustain growth that could stabilize society. Future developments in China, including the effects of these efforts, are attracting global attention.

Chinese economic trends are a matter of great concern to energy market players in the world. With the United States taking advantage of unconventional energy resources development to move in the direction of energy independence, China's moves in the energy market could become even more significant. Under this situation, a slowdown in demand for energy and resources has grown clearer in line with the economic growth deceleration in China. Electricity consumption in August totaled 449.5 billion kilowatt-hours, limiting year-on-year growth to 3.6%. Particularly, industrial electricity consumption slipped below 2%, reflecting slowing economic activities. Crude oil imports in the month declined 12.5% from a year earlier to 18.4 million tons, indicating a slowdown in oil demand and imports. The International Energy Agency in September projected China's oil demand in 2012 at 9.48 million barrels per day, a sharp downward revision from 9.91 million bpd as estimated in January. Future economic developments in China may be one of the

biggest factors for anticipating the global economy and the world energy situation.

The third risk is how China's society and politics would stabilize and develop. This year, China faces a leadership change where Xi Jinping is widely expected to become the next top Chinese leader. But the country has various uncertain factors including how the new leadership would address and resolve problems regarding the abovementioned future Chinese economic developments, social discontent and anxieties accumulated in Chinese society, and how a domestic power struggle accompanying the power transition would affect the Chinese economy and society. How the next Chinese leader would develop his stable domestic power base and deal with the international community, including Japan and other Asian countries, and the United States and Europe, is a matter of great concern that we cannot miss in anticipating the future international situation.

As China grows even more important for the world, the interpretation of China factors or China risks will be the most important challenge not only for Japan but also for the entire world.

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