Beijing Moves To Reform Resources Pricing System

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By Manuela S. Zoninsein and Steve Setzer

Signaling a move out of deflation, China's consumer price index in November climbed 0.6% from a year earlier. This comes in tandem with the decision by China's government, which had held prices for materials at superficially low levels, to allow them to rise and to begin introducing market competition in several key resource sectors.

Peng Sen, vice minister of China's National Development and Reform Commission, said at a recent meeting the country is actively working to reform its resources pricing system. This move is part of a government push to achieve "more efficiency in industry," says Rosealea Yao, research manager for Dragonomics Research & Advisory, Beijing. "It will help bring in excess capacity."

Yao points to a report released last month by the European Chamber of Commerce in China that attributes much of the problem to the Chinese government's overly large stimulus package. It claims the government "has poured credit into increasingly questionable projects and will almost certainly increase direct and indirect subsidies to investment and manufacturing." Yao notes, "It is not that we have excess capacity; it is that we have an extremely loose monetary policy." She contends that it will change as the Chinese government begins considering how to deal with inflation.

Michael Komesaroff, an Australia-based analyst of Asian commodity markets, notes in a recent trade-journal article that China's steel mills, aluminium smelters and other manufacturing plants "still produce far more than the country can absorb. Excess production at home is exported, depressing international prices."

Neville Smith, in-country manager at Gardiner & Theobald, an international construction-cost consultant, says construction cost indexes peaked in 2008 but have stabilized with commodity shortages. China's push to acquire raw goods abroad "has rarely been out of the news, but the Chinese government has addressed the problem of insufficient supply," he says. Smith adds that with the recession reducing demand, shortages seem to be a thing of the past.

According to Smith, clients of his firm experienced cost problems only with steel. However, since most contracts are set for periods of 18 months or longer, steel's nine-month price peak in 2008 was not an issue. In response, China's Tender Management Office, which approves large projects in Beijing, has asked for contract clauses to permit price fluctuations in the future, a sign that the “government is taking away protections for foreign clients in these areas,” he says.

In addition to China’s CPI nudging into the positive column this year, its property price index grew 5.7% in November on top of a 3.5% hike in October. Monetary policy remains unchanged, but Yao says many households and businesses are making banking and investment decisions with expectations of rising inflation.

Total investment in construction projects between January 2009 and August 2009 has increased by 36.2% year-on-year, while total planned investment in new projects in the same period has risen by 81.7%, year-on-year. By mid-2010, the Chinese government will need to limit stimulus spending or increase currency value to counter inflation.

With increased construction activity countrywide, tender prices are expected to increase mildly in the next few months. China’s year-on-year GDP growth was 7.7% in the third quarter of 2009, compared to 7.1% in the second quarter—the fastest growth since the financial crisis hit the market last year, reports Kong Yu, director in Hong Kong for global construction-cost consulting firm Rider Levett Bucknall. Construction activity in most major cities has continued to be strong, resulting in some mild upward cost movement. Tender prices are expected to continue a mild upward trend.

In Hong Kong, bid prices have stabilized after declining for three consecutive quarters since the third quarter of 2008, reports Rider Levett. Bidding levels have increased since midyear, and market outlooks are improved, particularly with large infrastructure projects on the horizon and talk of an imminent resumption of construction on the neighboring island of Macau. Bid tender prices in Hong Kong are reversing a downward trend and will rise mildly in the next few months, with more significant increases by mid-2010, according to Yu.

On the mainland, inflationary pressures might push the Chinese government to revaluate its currency, the renminbi. Since “China’s economy is growing much faster than anyone else’s...its currency ought to be rising, not falling,” says one economic journal in China. Some observers are predicting that, by mid-2010, the government will need to limit stimulus spending or increase the currency value to counter inflation.

As for future cost predictions, some look to Vice Minister Peng’s commitment to enable market-determined prices for such resources as water, electricity and natural gas. One initiative includes plans to open 20% of the power market and allow direct price negotiation with China’s two state power monopolies.

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