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Bubble Risk Bulletin
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The Society of Actuaries (SOA) has brought together several leading enterprise risk management (ERM) actuaries to identify the top 11 concentrated areas of risk in 2011 and provide insight on how ERM programs can be used to hedge against those systemic risks. With rigorous training in identifying, managing and mitigating risk, actuaries are well-equipped to discuss the areas of risk that need attentions as we work to rebuild the financial system post-crisis.

China's Runaway Inflation – Hard Landing Ahead?

Risk managers have a new, very real concern to add to their list of items to watch: pork. China's inflationary pressures have been an ongoing point of concern for risk managers for several months, but recently, governments and businesses alike have been taking notice, as escalating food prices, led by a 57% year-on-year increase in the price of pork, have sparked panic and pushed Chinese inflationary pressures to the center of the international stage.

As risk managers, actuaries consider China's inflation a serious emerging risk. Underscoring this concern, the 2010 Emerging Risks Survey by the Society of Actuaries (SOA) found that 41 percent of respondents predicted a Chinese economic hard landing as the emerging risk that will have the greatest impact over the next few years.

New data points to these inflationary risks coming true, with the potential to greatly impact the Chinese economy, and reverberate through businesses around the world. China's inflation jumped to a three year high in June, with the year-over-year consumer price index at 6.4 percent. While the price of pork, a core staple of the Chinese diet, surged, food prices overall, making up 30 percent of the CPI basket, climbed 14.4 percent from a year earlier. June saw China's slowest import growth in 20 months, and as Chinese banks continue to tighten lending, businesses are struggling.

While the Chinese government has been increasing interest rates and raising bank reserve requirements in an effort to counteract inflation, China's Premier Wen Jiabao announced in July that taming inflation is the government's top priority. Despite current efforts to curb inflationary pressures, and the fact that second-quarter GDP slightly exceeded expectations, risk managers warn global companies to prepare for the worst – a hard landing for the Chinese economy, an echoing effect on the global economy, and potential social and political unrest in the world's second-largest economy.

China's increasing importance to the global economy makes the ramifications of spiking inflation all the more important to global risk managers. Actuarial experts in risk management point to what companies can and should consider given emerging inflationary risks in China. Some of these include:

- If China continues to lose its ability to produce goods at a significant cost advantage to western economies, global companies will scramble to find other producers of cheap goods typically supplied by China
- Cooling of China's economy and continued slowdown in import growth could put pressure on companies dependent on demand from the world's most populous country
- As Chinese consumers and businesses continue to feel the squeeze, rioting and social unrest could threaten business both in and outside of China. Actuary Max Rudolph estimates that China must maintain a growth rate of 8 percent or more in order to maintain social stability, and warns that big problems lie ahead if inflation dampens the Chinese economy

Soaring prices are a warning sign of what might lay ahead. The systemic risks associated with prolonged inflation threaten China's domestic economic and social welfare but also its partners internationally. A realistic outlook on the clear and present danger of China's inflation surge is critical for businesses, as is thoughtful preparation for potential global repercussions.

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The Society of Actuaries is an educational, research and professional organization dedicated to serving the public, its members and its candidates. The SOA's mission is to advance actuarial knowledge and to enhance the ability of actuaries to provide expert advice and relevant solutions for financial, business and societal problems. The SOA's vision is for actuaries to be the leading professionals in the measurement and management of risk. To learn more, visit www.soa.org.