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Chinese Economy 2018: Transforming Economic Structures and Stabilising Growth

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QIAN Jiwei*

Abstract: China’s economy ended 2018 with 6.6% growth. Its recent supply-side structural reforms to manage the transition of its economy from an investment-driven to an innovation-driven growth model may have some achievements, but the China-US trade war and high debt level of corporations and local governments are among the major uncertainties for the Chinese economy. Since mid-2018, the government has modified its policy priorities, from a strong emphasis on structural reforms to measures that safeguard growth.

The Chinese economy entered a “New Normal” of growth in 2014 and has since registered a downward growth trend (Figure 1). Gross domestic product (GDP) in 2018 grew by 6.6% from that of 2017, in line with the target set by the Chinese government in early 2018. Total GDP in 2018 reached RMB90 trillion.

Figure 1: China’s Quarterly Economic Growth, 2009-2018 (%)

Source: National Bureau of Statistics

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The surveyed unemployment rate in urban areas, which also takes into account the unemployment rate of migrant workers, also showed that unemployment had stabilised at about five per cent in 2018 (Figure 2), a similar level as that in 2017.

**Figure 2** China’s Urban Surveyed unemployment rate in 2017 and 2018 (%)

![Graph showing the unemployment rate from 2017 to 2018](image)

Source: CEIC.

Other measures also indicate the relative stability of the economy, though growth continues to decelerate. Fiscal revenue amounted to RMB18.3 trillion in 2018, up by 6.2% from 2017. Year-to-year Consumer Price Index and Producer Price Index were up by a modest 2.1% and 3.5% in 2018, respectively.

From the demand side, growth of total retail sales of consumer goods and fixed capital formation reached a respective 9.0% and 5.9% in 2018, compared to those of 2017. Final consumption and gross fixed capital formation contributed 76.2% and 32.4% respectively to GDP growth in 2018. Net exports in 2018 amounted to US$351.8 billion, down from $419.6 billion in 2017, a drag to overall growth.

GDP growth rate in 2019 is likely to be about 6.2%, according to predictions by IMF, OECD and the World Bank. At that rate, China is still on course to fulfil its target of becoming a moderately well-off *xiaokang* society according to President Xi Jinping’s report at the 19th Party Congress in October 2017.
Growth deceleration in recent years is in part the outcome of structural reforms to modify the country’s growth mode, from one that is driven by investment to a more efficient growth model that is also innovation-based. These structural reforms include cutting over-capacity and reducing overproduction as well as vigorous debt deleveraging.

However, risks and uncertainties for the Chinese economy have emerged as indicated by some recent economic indexes. In November 2018, total profit of above-scale industrial firms in China had decreased for the first time since December 2015. The purchasing managers’ index for China’s manufacturing sector dipped to 49.4 in December 2018, the lowest since February 2016. In the first three quarters of 2018, 446 plots of land went unsold at auctions (with construction area of 56 million sq m), 80% higher than that for the whole year of 2017 in terms of construction area.

Domestically, high debt level (the “Minsky Moment”) has been highlighted by many media outlets as the major risk of the Chinese economy. Local government and corporate debts are still at a high level. Externally, China is facing growing hostilities and uncertainties due in part to increasing tensions between China and the United States in a trade war that began in early 2018. The two countries have significantly raised tariffs on goods from the other country and warned of further increases. Both have refrained from taking actions to increase tariffs or impose new tariffs, based on the agreement reached in December 2018 to give a 90-day (until 1 March 2019) grace period. It is uncertain whether a more comprehensive trade deal could be reached by 1 March 2019.

In mid-2018, the government modified its policy priorities, from a strong emphasis on structural reforms to measures that safeguard growth. Expansionary fiscal policy has been implemented to promote investment. Employment policies have been initiated to stabilise the labour market, along with a number of government initiatives to support private sector financing from the equity and bond market.

The government has also taken steps to improve the country’s business environment. Some major sectors such as automobile and financial service sectors are to be deregulated further for foreign investors. The competition policy, which ensures a level playing field in the Chinese economy, has been highlighted by the Chinese government as “foundations” of China’s economic policies.
**Policy Changes after the “New Normal”**

While growth stabilisation is important in the short run, the major issue for the Chinese economy in the long run is whether China can escape the “middle-income trap”. Many economies fail to catch up with the leading country after reaching middle-income level.

Before the Chinese economy entered the “new normal”, labour migration from rural to urban areas as well as high investment rate were driving forces behind economic growth. This growth model brought forth two major macroeconomic imbalances: excess domestic savings (i.e. imbalance between high-investment and low-consumption) and external payment surpluses (i.e. the difference between domestic productive capacity and domestic expenditure). One important reason for these macroeconomic imbalances is decentralised governance in China. Local officials were incentivised to promote economic growth and coverage of local social programmes is shallow, leading to high household savings and low consumption.

The high-investment, high-saving and low-consumption model is unsustainable as productivity growth is slowing down, undermined by the misallocation of resources at the micro level with overcapacity in heavy industries, high leverage ratio, excess investment in the real estate sector and so on. A fiscal stimulus package could make the imbalances and misallocation in the Chinese economy even more serious. For example, the stimulus package in 2008 had diverted a lot of resources to the real estate sector and drove up land prices.

Policymakers in China in recent years have shown their preference for structural reforms than for stimulus packages to avoid the “middle-income trap”. Premier Li Keqiang stated in the 2016 National People’s Congress that structural reforms rather than stimulus package will be adopted for the next step of reform. Many structural reforms are designed at “the top level”. Compared to the decentralised economic and social governance model, reforms with “top-level design” are expected to have better coordination with other reforms. Policymakers can also set appropriate timing across reform initiatives.
Since December 2015, the Chinese government has initiated “Supply-Side Structural Reforms” (SSSR), an unconventional policy package. SSSR policies address the inefficiency in resource allocation at the micro level via administrative measures. Unlike western economies where players on the supply side are households and firms, players on the supply-side in China also include local governments and SOEs (state-owned enterprises). SSSR policies include eliminating excess capacity in heavy industries, cutting excess stocks in the real estate sector, lowering the leverage ratio for firms and local government, reducing costs for firms and strengthening weak links of the economy. Another important reform on industrial policy is related to the “Made in China 2025” blueprint first released by the State Council in 2015. In this plan, industrial development of automotive, aviation, machinery, robotics, high-tech maritime and railway equipment, energy-saving vehicles, medical devices and information technology is highlighted.

By initiating large-scale poverty alleviation programmes, consumption of low-income households is likely to be increased. Some government initiatives have been released recently to promote consumption as stated in a government guideline released in October 2018. In the report of the central economic working conference in December 2015, structural reforms, industrial policy, macroeconomic policies and social policy are considered as complementary.

Achievements of these reforms include a significant reduction in leverage ratio and number of vacant apartments and an increase in the industry utilisation rate. The value-added output of new industries, new types of business and new business models accounted for 15.7% of China’s GDP in 2017, up 0.4 % from 2016. The implementation of these structural reforms however did cause certain tensions. To a large extent, SSSR relies on government intervention rather than the market. Further, while structural reforms were designed at “the top level”, it was implemented by the local government. In many cases, the newly initiated structural reform changed the local government’s incentive structure. Economic growth is no longer as important for local officials’ performance as before. As a result, investment growth decreased. Further, under SSSR policies, local governments have the incentive to reduce the leverage ratio and capacity of local enterprises. Privately owned enterprises are more likely to be in a disadvantageous position for credit access, expanding capacity and debt restructuring.
Recently, challenges to the Chinese economy have emerged. Fixed asset investment growth rate decreased from 9.8% in 2015 to 7.0% in 2017. The rate was even lower at 5.3% for the first eight months of 2018. Over RMB115 billion corporate bonds had defaulted in 2018, a record high. The impact of shocks to the private sector is considerable, taking into account that private companies currently account for 60% of GDP and 80% of urban employment in China. Most of the 11,000 firms that bankrupted between 2016 and the first half of 2018 were privately owned.¹

The magnitude of these adverse outcomes could become even more significant vis-a-vis uncertainties in external economic relations. Indeed, the China-US trade war has caused negative shocks to ripple through the labour market, investment as well as other aspects of the economy. The number of jobs in above-scale enterprises in the manufacturing sector went down by about 760,000 in Guangdong to 15.1 million in September 2018 from more than 15.8 million in September 2017.

Anticipating possible negative shocks, since mid-2018, policymakers in China have once again prioritised stabilising economic growth to structural reforms. At the political bureau meetings in July and October 2018, “six stabilisation” initiatives were highlighted: employment, the financial sector, foreign trade, investment, foreign direct investment and economic expectation. The main policy priorities for 2019 were further spelled out at the annual Central Economic Work Conference in December 2018. Stabilising economic growth topped the agenda for 2019 while SSSR remains as major economic policies.

To address the difficulties faced by the private sector, the People’s Bank of China had announced “three arrows”, namely, increasing lending, supporting bond issuance and promoting equity financing for privately owned enterprises in October 2018. Many local governments have set up funds to support private sector financing since October 2018. To further improve the business environment for privately owned businesses, in October 2018, an official source reported that the principle of “competitive neutrality” will be applied as part of the competition policy, giving privately owned enterprises a level playing field with SOEs and enterprises in other ownership types.

¹ The Economist, 8 December 2018.
Externally, the United States has complained of its high trade deficit with China, China’s practice of subsidising firms to achieve the targets set in the “Made in China 2025” and the infringement of the intellectual property right (i.e. in US section 301 investigation). Initiative to deregulate the entry of the market was announced by President Xi Jinping at the Boao Forum for Asia in April 2018. Foreign investors can expect further opening up of industries including financial services, automobile industry and so on.

Although policies to stabilise growth can be helpful to address the risks of the high debt ratio as the state can coordinate creditors including state banks and debtors such as enterprises/local government to restructure debt, the China-US trade war can have a persistent effect on structural reforms of the competition policy and industrial policy.

The Imperative of Restructuring and Reform

Before 2014, the growth model of the Chinese economy was largely factor-driven. First is labour reallocation from sectors with lower productivity (rural areas) to sectors with higher productivity (urban areas). Second is high investment as a major factor for high growth. Investment rate reached as high as 45% of GDP between 2009 and 2014. With this growth model, one major imbalance in the Chinese economy is excessive savings (i.e. high investment and low consumption). For instance, household final consumption as a share of GDP was about 38% in China in 2014, which was much lower than that of developed countries as well as some countries with similar development level such as India and Russia (Table 1).

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<td>64.2</td>
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<td>56.4</td>
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</tbody>
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Source: *International Statistical Yearbook*, various years.
External payment surpluses (i.e. the difference between domestic productive capacity and domestic expenditure) are another imbalance. For example, in 2007, external balance as a share of GDP in China reached 8.7%. Export growth registered a very high growth (over 15%) in all but one year between 2002 and 2011 (Figure 3). Exports of goods and services as a percentage of GDP in China hit more than 35% in 2007, much higher than that of Japan and the United States (Figure 4).

Decentralisation of economic governance is one of the major reasons behind this growth model. Since the 1980s, some local governments have the discretion to coordinate and implement pilot reforms for local economic and social development.

Figure 3: China's Foreign Trade, 2001-2018

Source: CEIC and China General Administration of Custom
Recent studies show that local officials in China are more likely to be promoted if they have achieved better economic performance, such as higher GDP or fiscal revenue growth. Local officials hence have incentives to allocate fiscal resources to infrastructure rather than public service provision to residents.

At the household level, as the benefit level of pension, health insurance and other social programmes is shallow and social protection limited, household saving rate tends to be very high to prepare for possible adverse shocks; correspondingly, the share of consumption in total expenditure has been low. The high-investment, high-saving and low-consumption model is not sustainable. The number of rural workers has started to decline since 2012. The scale of reallocation of labour force from rural to urban areas is likely to decrease.

More importantly, aggregate total factor productivity (TFP) has registered lower growth in recent years in China, which indicates resource misallocation at the micro level. TFP in China could be increased by as much as 25% if misallocation within sectors could be lowered to the levels as observed in the USA. In a recent study, TFP growth rate in China was even estimated to be negative between 2007 and 2012.2

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Many of these misallocations are associated with overcapacity in heavy industries, overinvestment in the real estate sector and high leverage ratio for local governments and corporations, in particular SOEs. High leverage ratio for SOEs is related to the resource allocation pattern between SOEs and privately owned enterprises, with formal financial institutions giving priority to SOEs. The debt ratios (liability-asset ratio) for the centrally controlled and local SOEs are much higher than that for private enterprises (Figure 5).

Figure 5  Liability-Asset Ratio in SOEs and Private Enterprises (%)

Source CEIC.

The high leverage ratio of local government is related to local infrastructure building and real estate development. Local governments set up Local Government Financing Vehicles (LGFVs), an indirect channel for local governments to borrow from commercial banks or other avenues, to finance infrastructure building as well as commercial real estate projects. Total debt incurred by these LGFVs was estimated to be around RMB45 trillion by the end of 2015, much higher than the official local government debt.3

Land sales and real estate development can contribute significantly to local government fiscal revenue. In this context, inventory in the real estate market is high particularly in lower tier cities as a lot of investment has been made in the real estate sector under the

support of the local government. Table 2 shows the significant increase in inventory volume particularly in lower tier cities in recent years.

**TABLE 2 DEVELOPER INVENTORY (BILLION SQ FEET)**

<table>
<thead>
<tr>
<th>Tier of city</th>
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<th>2014</th>
<th>2015</th>
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<td>0.4</td>
<td>0.4</td>
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</tr>
<tr>
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<tr>
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<td>0.9</td>
<td>1.8</td>
<td>2.2</td>
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<td>3.5</td>
</tr>
<tr>
<td>4</td>
<td>1</td>
<td>2</td>
<td>2.5</td>
<td>3.4</td>
<td>3.9</td>
</tr>
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<td>Total</td>
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<td>11.3</td>
</tr>
</tbody>
</table>


Overcapacity, another form of resource misallocation, is a byproduct of local industrial policy. Firms are likely to be small in size as the market is local and fragmented. Many local governments are incentivised to exercise local market protection to generate more tax revenue and GDP growth. In many cases, it is the local governments that create entry barriers which will segmentalise the market. For some industries with economies of scale, it is not efficient to have many small firms in the market. For example, in a government plan for the steel industry to improve industry efficiency, the policy target of the market share of the 10 largest companies in the industry was 50% in 2010 and 70% in 2020. However, in 2015, the actual share was only 34.29%, much lower than the target set for the industry.

**Deepening Reforms: Rebalancing and Reallocating**

To avoid the “middle-income trap”, economic policies to facilitate the transition to “high quality” growth which requires more efficient use of resources and an innovation-driven economy are necessary. However, a fiscal stimulus package could worsen the imbalances and misallocation in the Chinese economy. For example, then Premier Wen Jiabao’s introduction of a huge stimulus package to pump prime the Chinese economy during the global financial crisis in 2009 had diverted a lot of resources to the real estate sector and drive up land price. Local government debt has surged after the fiscal stimulus. Total debt of LGFVs was believed to have increased by over RMB14 trillion in two years between 2014 and 2015.
Fiscal stimulus has also been associated with shadow banking activities. Local government non-bank debt was estimated to account for 48% of total shadow banking activities including trust loans and Wealth Management Products in 2016. For these reasons, policymakers consider structural reforms as necessary for addressing the imbalances and misallocations in the Chinese economy. Premier Li Keqiang highlighted this point at the National People’s Congress meeting in 2016: “Rather than adopting strong stimulus policies that would have an economy-wide impact, we continued to move forward with structural reform”.

The Central Leading Group for Finance and Economy (CLGFE) was the coordinating body for economic policymaking before 2018. Since March 2018, the Central Financial and Economic Affairs Commission has replaced the CLGFE in the coordination of major reforms.

According to Liu He, current deputy premier and chief of General Office of Central Financial and Economic Affairs Commission, structural reforms under the “top-level design” was expected to have facilitated better coordination. Policymakers can also set appropriate timing across reform initiatives, compared to the decentralised and pilot-based reforms.

Since 2015, several major government initiatives to transform the economic structure and shift the economic growth model have been introduced. The SSSR initiated in December 2015 is an unconventional policy package that addresses the inefficiency of resource allocation at the micro level. In China, players on the supply side also include local governments and SOEs. It is different from the case of a western economy where the main players on the supply side are households and firms while the government can only play indirectly by changing behaviours of households and firms with tax reductions, infrastructure building, R&D policies and other institutional reforms. These policies include eliminating excess capacity, cutting excess stocks in the real estate sector, reducing the leverage ratio for firms and local government, lowering costs for firms and strengthening weak links of the economy. To achieve the policy target of eliminating excess capacity,

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local governments have signed “target responsibility documents” to reduce capacity in selective industries such as the steel and coal industry.

To cut excess stocks in the real estate sector, local governments encourage migrant workers in cities to buy apartments. The monetisation in shanty towns rebuilding is also another important policy initiative. Residents in shanty towns were provided funds (i.e. monetisation) to buy apartments in the market when the government plans to rebuild shanty towns. Monetisation accounted for over 53% of shanty town rebuilding in China in 2017.

The government is expected to use the debt-for-equity swap in some cases and close zombie companies to lower the leverage ratio of SOEs. Local municipal bond has been issued to reduce the leverage ratio for local governments. In 2015, the Ministry of Finance announced the issuance of low-yield local municipal bonds to pay for local government/LGFVs’ debts maturing in the short term. To reduce the leverage further, the State Council released No. 50 document in April 2017, forbidding local governments from endorsing the repayment of LGFVs’ loans.

In the first meeting of Central Financial and Economic Affairs Commission in April 2018, “structural deleveraging” was highlighted to reduce the leverage ratios in major sectors for SOEs and local governments. In April 2018, to undermine shadow banking activities, PBOC announced overarching guidelines aimed at tightening supervision of the country's $15 trillion asset management products issued by banks, trust firms, insurance asset management companies, securities firms, funds and other entities.

There are also efforts to cut costs for firms with the reduction of social security contribution rate for employers (e.g. employers’ contribution rate to pension and unemployment rate have been reduced since 2016) as well as tax cut (e.g. tax cut under the replacement of business tax with VAT reform). The government is considering more efficient use of energy and infrastructure upgrading to strengthen weak links.

Large scale poverty alleviation programmes have been implemented which are also considered very useful for promoting domestic consumption. Consumption per capita for poor households in China is estimated to increase significantly after they have been lifted out of poverty (i.e. $1.25 per capita in 2005 price per day).
Achievements and Problems of Structural Reforms

The bright spot in the Chinese economy in recent years is the progress made in structural reforms. Consumption has since 2015 accounted for more than 50% of economic growth, higher than investment (Figure 6). In 2018, consumption expenditure contributed to 76.2% of economic growth.

The growth rate of the leverage ratio (i.e. Debt-GDP ratio) has also been significantly reduced since 2017 (Figure 7). Between 2012 and 2016, the leverage ratio had registered annual double-digit growth. The growth rate has since 2017 slowed down. Figure 8 shows the decrease in the liability-asset ratio in medium and large state holding enterprises since 2015.

Figure 6  Source of China’s Economic Growth 2008-2018

Local governments’ debt situation has improved as most local government debt now is in the form of long-term government bond. By the end of December 2018, outstanding local government debt was about RMB18.4 trillion, among which local municipal bonds accounted for RMB18.1 trillion. These local government bonds have an average maturity of 4.4 years.
Shadow banking activities also showed marked decline. According to the rating agency Moody, China’s shadow banking assets accounted for about 70% of GDP in the third quarter of 2018, compared to 87% of GDP in 2016. There is also improvement in the industrial capacity utilisation rate in recent years (Figure 9). So has market concentration ratio. The top 10 steelmakers accounted for about 36.9% of market share in 2017 compared to 34.3% in 2015. There have also been fewer vacant apartments reported since 2016 (Figure 10).

**Figure 9: Industrial Capacity Utilisation Rate**

![Industrial Capacity Utilisation Rate](image)

Source: CEIC.

**Figure 10   Floor Space Waiting for Sale (Vacant, million sq m)**

![Floor Space Waiting for Sale](image)

Source: CEIC.
Some industrial policies are evidently taking effect as the size of the “new economy” has enlarged. The value-added output of new industries, new types of business and new business models accounted for 15.7% of China’s GDP in 2017, up 0.4% from 2016.

However, the implementation of structural reforms is not without its setbacks. Investment growth has decelerated and privately owned enterprises are more likely to be in a disadvantageous position for credit access, retaining production capacity and issuing bonds. To a large extent, SSSR relies on government intervention rather than the market. Further, while structural reforms were designed at “the top level”, it was implemented by the local government.

In this context, the incentive structure of local government is critical to implementing structural reforms. The weightage given to GDP growth rate in the evaluation of local officials’ performance has been lowered and other indicators such as local government debt, environment protection and other policy targets have been included. With this new incentive structure, it is not surprising that there was a dive in the growth rate for infrastructure investment from local government/LGFVs. Fixed asset investment growth rate decreased from 9.8% in 2015 to 7.0% in 2017, and even further to 5.3% for the first eight months of 2018.

Under policies of SSSR, local governments have the incentive to reduce the leverage ratio of local enterprises to fulfil policy targets. To meet the target for air/water quality, some local officials closed down all factories regardless of whether the factories meet environmental standards before the inspection teams arrive to monitor pollution levels. Small and privately owned enterprises are hence at a disadvantage.

**Economic Risks and Uncertainties in 2018**

The biggest blow to the Chinese economy in 2018 was undeniably the China-US trade war. In April 2018, the Office of US Trade Representative listed $50 billion of Chinese goods for 25% tariff. China hit back with the same tariff on $50 billion of American goods. In September, a 10% tariff on another $200 billion Chinese products was imposed. In response, China announced a 5% to 10% tariff increase on $60 billion of American goods in the same month. In December, the United States and China put a temporary halt to the trade war,
setting a 90-day deadline to arrive at an agreement. The two countries agree to a temporary truce to de-escalate trade tensions, following a working dinner at the G20 Summit in Buenos Aires on 1 December 2018. According to the agreement, the two will refrain from increasing tariffs or imposing new tariffs for 90 days (until 1 March 2019), while the two sides work out a larger trade deal.

The United States’ complaint was on China’s high trade surplus, China’s practice of subsidising firms to achieve the targets set in the “Made in China 2025” and the infringement of intellectual property right (i.e. US section 301 investigation). Some of the recent studies even point out that China’s industrial policy may result in the misallocation of resources in other countries.5

Exports to the United States accounted for about 19.2% of China’s exports in 2018, with the United States remaining as the largest source of trade surpluses for China. Evidently, the trade-war with the United States certainly has a significant impact on the Chinese economy. The impact was first felt in the local labour market, particularly in the export sector. In Guangdong, the number of jobs in the above-scale enterprises in the manufacturing sector was slashed by about 760,000 in September 2018 to 15.1 million, compared to more than 15.8 million in September 2017. Sichuan province reported a job loss of 6,000 in 2,416 enterprises monitored by the government in the first nine months of 2018. Firm level performance has not been very optimistic after the outbreak of the trade war for export-related companies. In November 2018, the profit of above-scale industrial firms reported a dip for the first time since December 2015.

Besides economic shocks related to the trade war, the high debt level, particularly for privately owned companies, is still a serious concern. Privately owned companies currently account for 50% of tax revenue, 60% of GDP, 80% of urban employment and 90% of incremental jobs in the Chinese economy. In 2015, the private sector was estimated to account for 78% of investment in the manufacturing sector in China.

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Banks do not have strong incentive to grant loans to privately owned companies especially when the leverage ratio is still high in the Chinese economy. Figure 11 shows that state-controlled enterprises enjoyed an even bigger share of bank loans for all groups of enterprises by size since 2014. The strengthened regulation of the shadow banking sector has further cut off private sector’s access to credit.

Figure 11: Bank loans to state-controlled enterprises as a share of total loan, group by size (%)

Source CEIC

According to a report by China International Capital Corporation Limited (CICC), 49 public listed companies had changed ownership type in 2018 (until September), 26 of which had changed from private to state-controlled ownership. Many of these companies have difficulties repaying their debt. Most of the 11,000 bankrupted firms between 2016 and the first half of 2018 were privately owned. Many public listed companies in Shanghai and Shenzhen stock exchanges pledged their shares as collateral for loans. In the first half of 2018, the pledged shares of non-state-controlled listed companies amounted to RMB4.56 trillion.

Local government debt is still a critical issue for some localities. For example, financial risks are higher in lower level governments (e.g. city/county government) than in provincial level governments. According to the Ministry of Finance, by the end of 2015, over 90 cities and 300 counties were on the risk-warning list for local government debt.
**Initiatives to Stabilise Economic Growth**

Anticipating possible negative shocks to the Chinese economy, policymakers in China have since mid-2018 prioritised stabilising economic growth to structural reforms. In the political bureau meetings in July and October 2018, “six stabilisation” initiatives on employment, the financial sector, foreign trade, investment, foreign direct investment and economic expectation have been highlighted. Main policy priorities for 2019 were further spelled out at the annual Central Economic Work Conference in December 2018. Stabilising economic growth topped the agenda for 2019 while SSSR was still highlighted as major economic policies. Competition policy remains as the “foundation” of economic policies.

To stabilise growth, new expansionary fiscal policies had been introduced. Local governments can borrow more, as a significant lift to the upper limit of local government bond issuance is expected in 2019. Tax cut, which amounted to RMB1.3 trillion in 2018, is another important policy direction. Tax rate for value added tax has been reduced by one per cent since 1 May 2018 (from 17% to 16% for manufacturing and from 11% to 10% for transportation and construction sectors).

From October 2018, the threshold for personal income tax exemption was raised from RMB3,500 to RMB5,000 a month. Additional deductions from taxable income will be implemented from January 2019. Further tax cuts for small and micro-sized companies by RMB200 billion were announced in January 2019. Tax deduction policies imply lower tax revenue growth rate; in October and November 2018, tax revenue growth rate was negative (Figure 12). Fiscal deficit-to-GDP ratio target for 2019 is expected be further raised to three per cent.
Another booster for economic growth was the cut in reserve requirement ratio (RRR) by 100 basis points, effective 15 October 2018, to inject liquidity to the banking sector. This is the fourth decrease of RRR in 2018. In January 2019, PBOC announced another cut in RRR for all banks.

To stabilise the labour market, the State Council issued a policy in December 2018 to give employers a 50% rebate of employer’s contribution to the unemployment insurance if a firm does not lay off its employees. To address the difficulties faced by the private sector, in October 2018, PBOC announced “three arrows”, namely, increasing lending, supporting bond issuance and promoting equity financing for privately owned enterprises. More credit, more bonds will be issued to ease the financial difficulties of privately owned enterprises. PBOC will also have supportive policies for public listed companies which plan to pledge their shares as collateral for loans. Many local governments have set up funds to support the financing of the private sector since October 2018. For example, Shenzhen municipal government set up funds of over RMB17 billion in November 2018 to support private enterprises.

To address the concern of the United States in the China-US trade war, China has increased its import from the United States, leading to a significant dip in current account balance as a share of GDP in recent years (Figure 13).
Figure 13 Current account balance as a share of GDP (%)

Source: State Administration of Foreign Exchange

China has also made efforts to deregulate the entry of the market, an initiative announced by President Xi Jinping at the Boao Forum for Asia in April 2018. A further opening up to foreign investors has been indicated in industries including financial services, automobile industry and so on. Foreign investors will have majority ownership in securities, fund management, future companies and life insurance. In April 2018, China addressed foreign investors’ concern on “market for technology” by lifting the limit on foreign ownership of automotive ventures by 2022. In December 2018, a draft of the Foreign Investment Law had been reviewed, prohibiting local governments from forcing foreign businesses to transfer technology or illegally restrict their market access. Protection of intellectual property right will also be enhanced.

For the year 2019, despite the risk of a high leverage ratio, the possibility of a debt crisis is low as the state can coordinate creditors including state banks and debtors such as enterprises/local government to restructure debt. One interesting case is the restructuring of Chongqing Iron and Steel which had a debt of over RMB41 billion and a liability asset ratio of over 114% in mid-2017. However, the restructuring of the firm took about only half a year under the coordination of the Chongqing municipal government using mostly a debt/equity swap. The liability asset ratio of the firm was reduced to 30% in 2018.
However, major uncertainties for the Chinese economy are how the China-US trade war will unfold in 2019, which can have a persistent effect on structural reforms of the competition policy and industrial policy. China has downplayed the visibility of “Made in China 2025”. Local officials are no longer required to work on “Made in China 2025”.

In October 2018, OECD announced and promoted the principle of “Competitive Neutrality”, which will be applied as part of the competition policy in China. Foreign and privately owned enterprises are expected to enjoy the same terms as the SOEs.