



中國人民大學  
RENMIN UNIVERSITY OF CHINA

# China's Current Macroeconomic Situation: **Opportunities and Challenges**

YU Tongshen

School of Economics

Renmin University of China

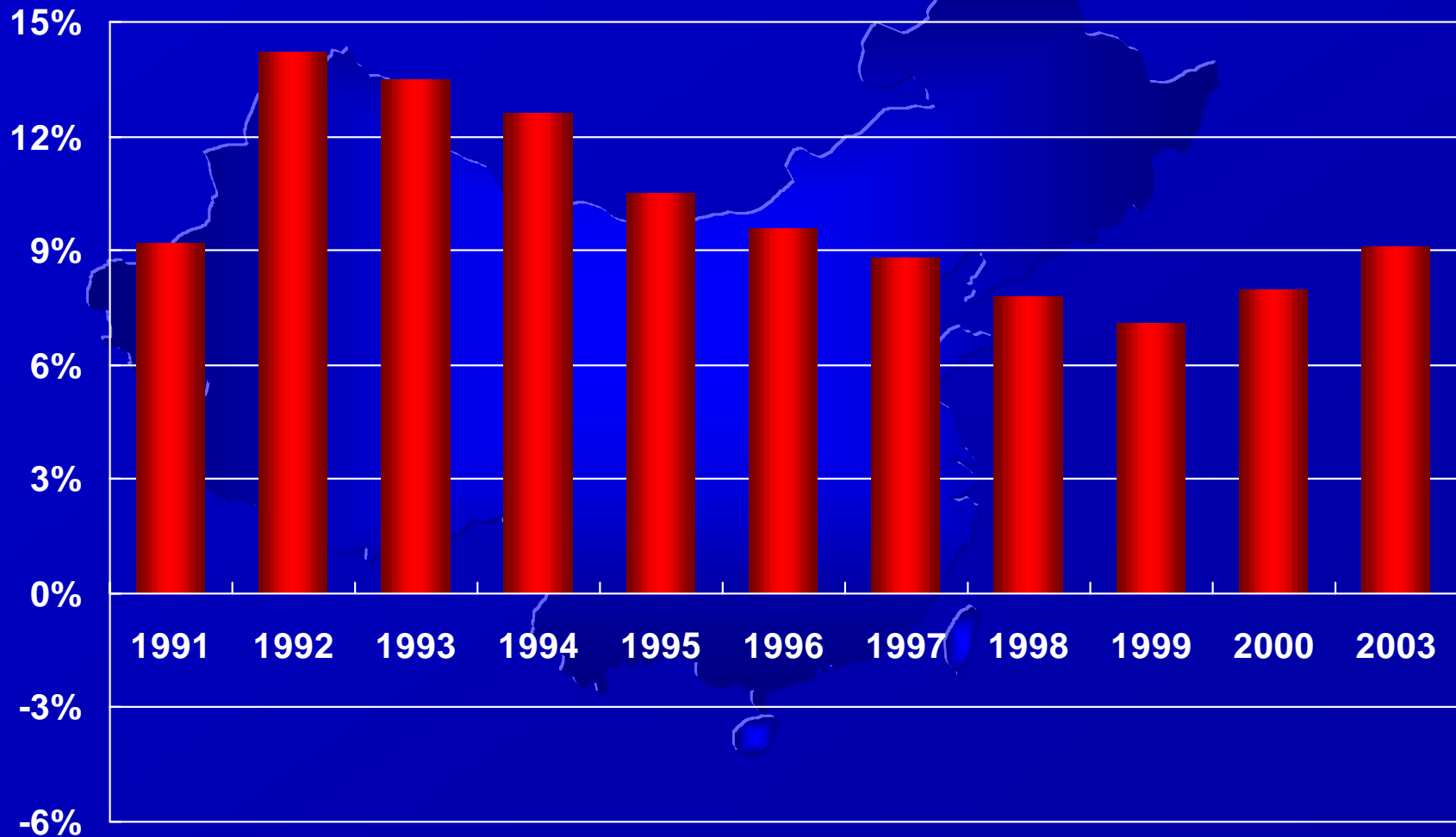
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# Outline of the Speech

- The Economic achievements of China since the setup of the reform and opening up.
- The New Challenge facing China's economy
- Different point of views on the current economic situation

# Sustained Economic Growth...

Real GDP Growth




# The dual transformation of China's economy

The process is essentially a dual transformation:

- From a centrally-planned economy to a market economy
- From subsistence agricultural economy to an industrialized economy

# The Nature of the Economic Reform

**A continuous reform towards a more market-oriented socialist market economy system with Chinese characteristics.**



# Strong Reform Track Record

**2001** The more balanced strategy

**1999 & 2000-** Banking & SOE reforms accelerated

**1998** Government restructuring, continued reforms in banking, SOE & social security

**1997** SOE reform accelerated

**1996** Current account convertibility

**1994 & 1995** Banking, foreign exchange system and tax reform, enactment of Corporate Law

**1993** Tightened monetary and fiscal policies to contain inflation, Chinese corporations accessed International equity markets

**1991** First stock exchange established

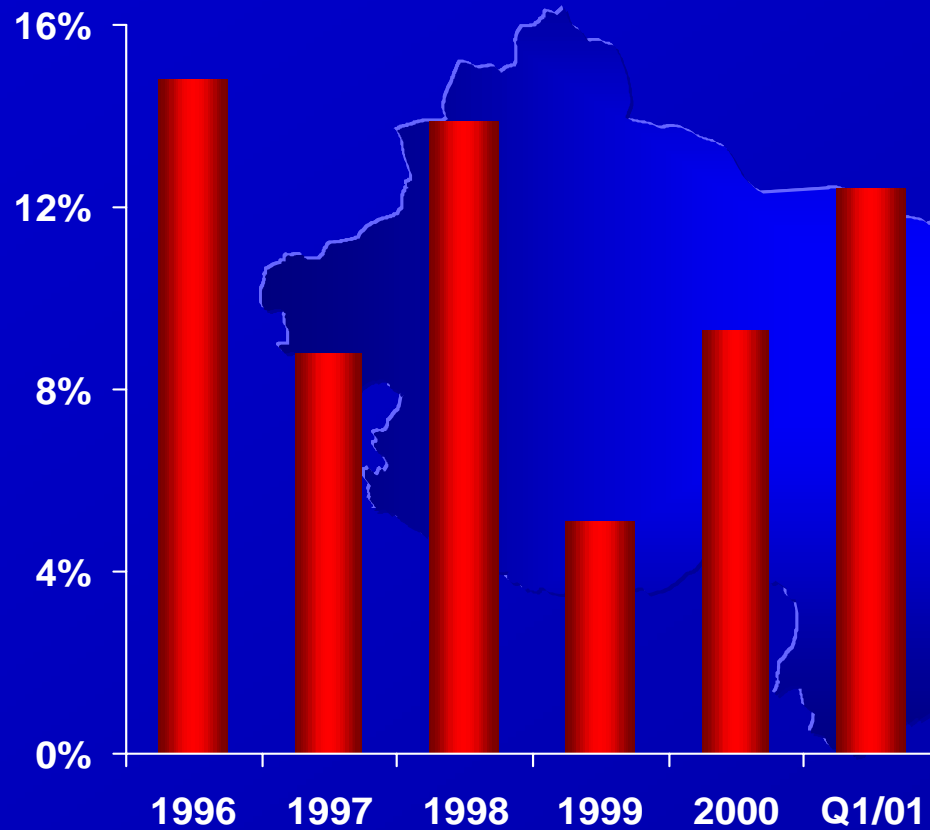
**Mid 1980's** Price reform

**1980** First Special Economic Zones established

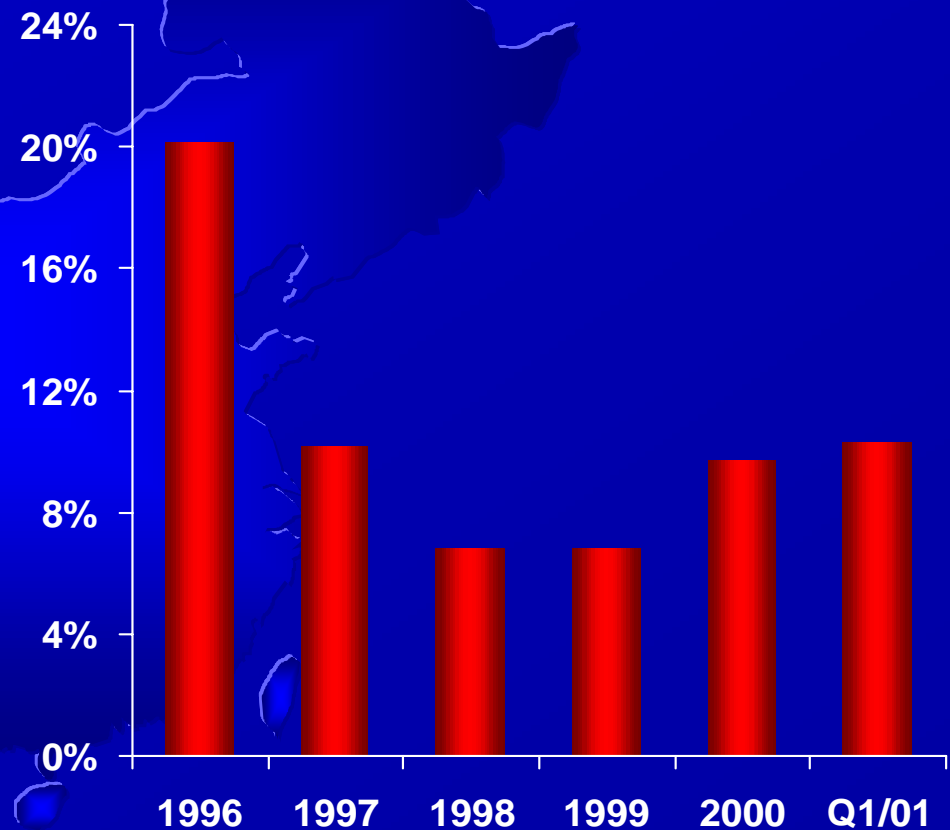
**1978 & 1979** Agricultural reform, beginning of "Open Door Policy"

# Driven by Strong Domestic Demand...

Fixed Asset Investment Growth

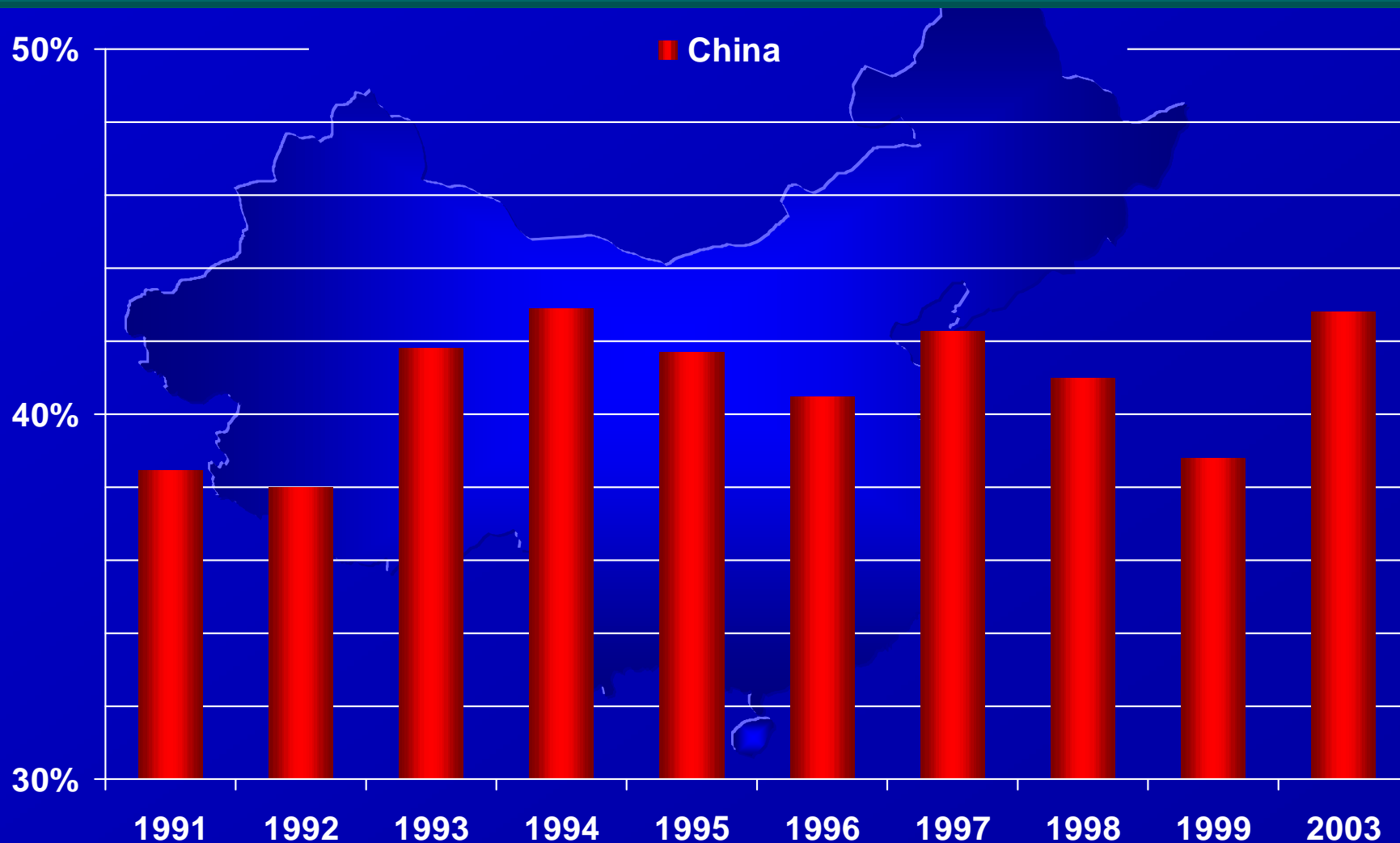


Retail Sales Growth



# Supported by Large Savings Pool...

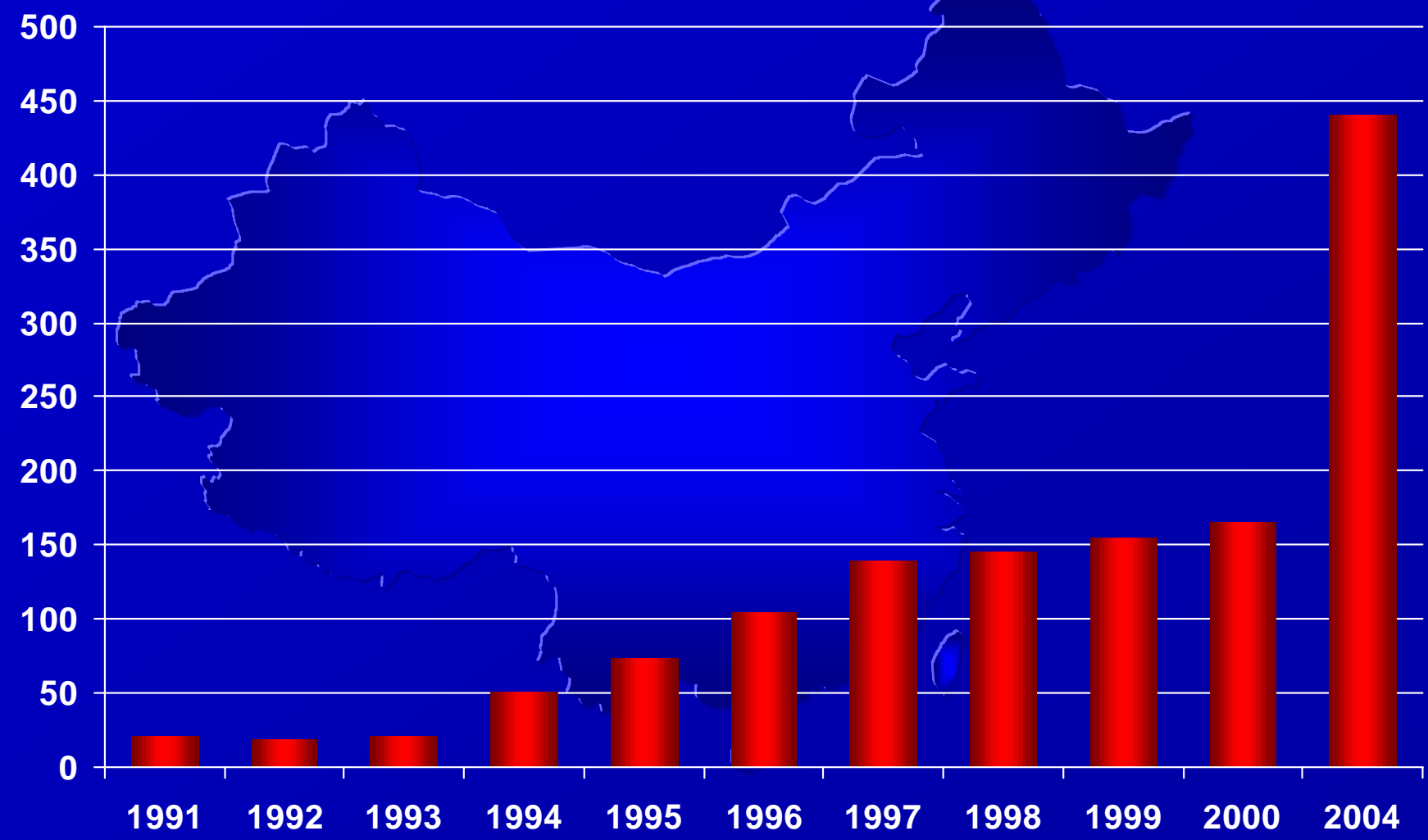
National Savings / GDP





# Leading to Strong Buildup of FX Reserves

US\$ Billions



# And Rapidly Growing Domestic Capital Markets

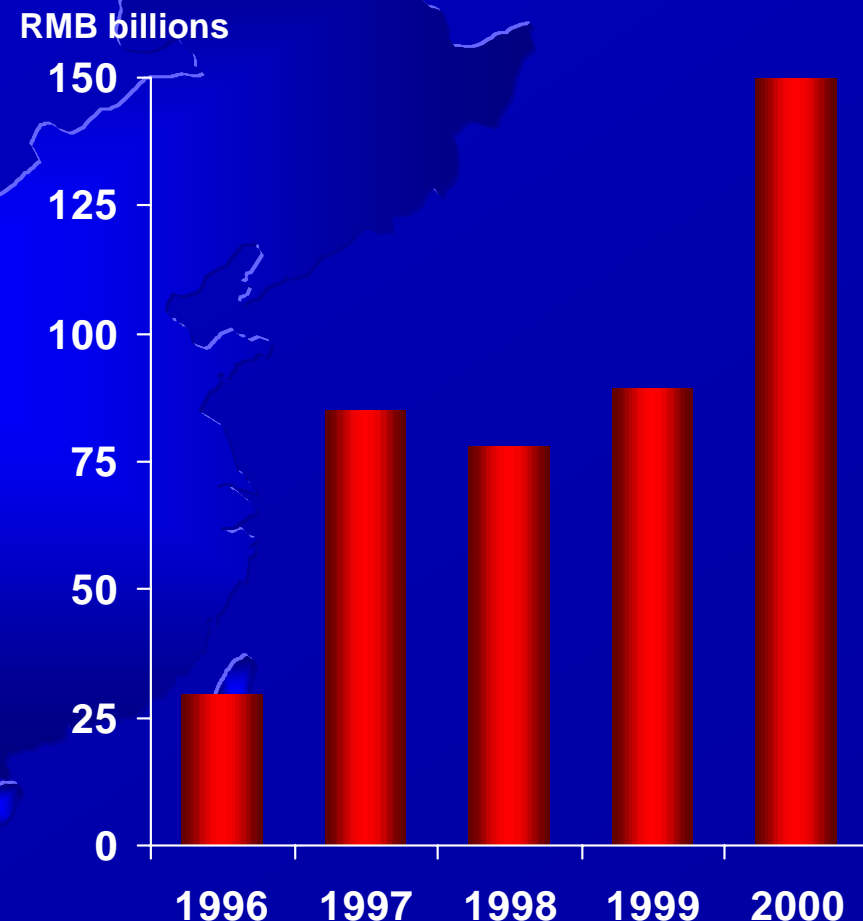
## Bond Markets

- Total amount of government bonds issued from 1981-2000: RMB 2,182 billion (US\$263 billion)
- Total amount of financial bonds issued at the end of 1999: RMB 669 billion (US\$81 billion)
- Total amount of corporate bonds issued at the end of 1999: RMB 291 billion (US\$35 billion)

## Equity Markets

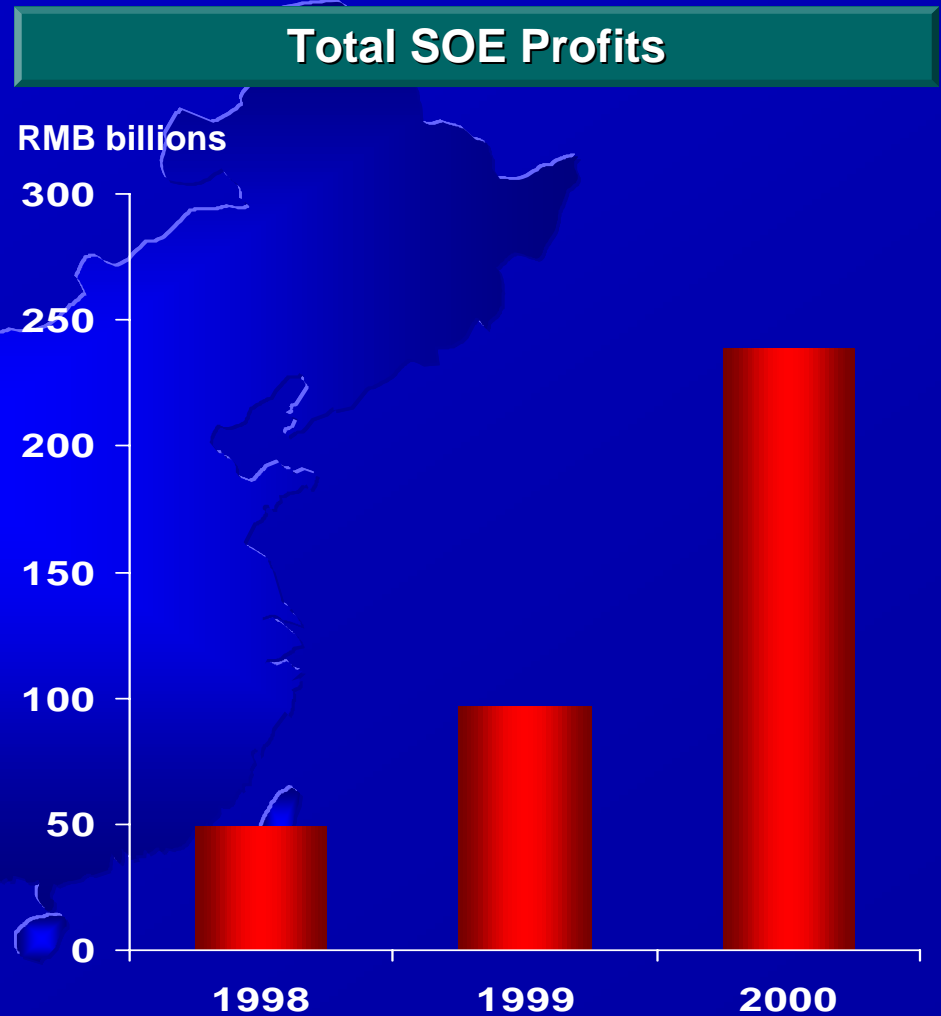
- Number of listed companies by the end of 2003: 1,300 or so.
- Total capital raised through “A” shares offering from 1991-2000: RMB 483 billion (US\$58 billion)

## Capital Raised in the “A” Share Market



# Enhance SOE Competitiveness

- Increase management autonomy and accountability
- Rationalize industry structure
- Enhance efficiency and productivity
- Consolidate SOE's through orderly bankruptcy
- Accelerate SOE reform through domestic and international offerings



# Financial Regulatory Framework

**Banking**

**People's Bank of China  
("PBOC")**

**Securities**

**China Securities  
Regulatory Commission  
("CSRC")**

**Insurance**

**China Insurance  
Regulatory Commission  
("CIRC")**

# Establish Sound and Efficient Banking System

## Supervisor

- Establish a new central bank structure in 2003
- Strengthen supervision over financial institutions with accountability and strict enforcement
- Reclassify banking assets

## Commercial Banks

- Separate policy and commercial lending in 1994
- Re-capitalize four state-owned banks since 1998
- Establish AMC to manage bad loans since 1999
- Public listing of selected commercial banks in domestic markets

# Develop Social Security System

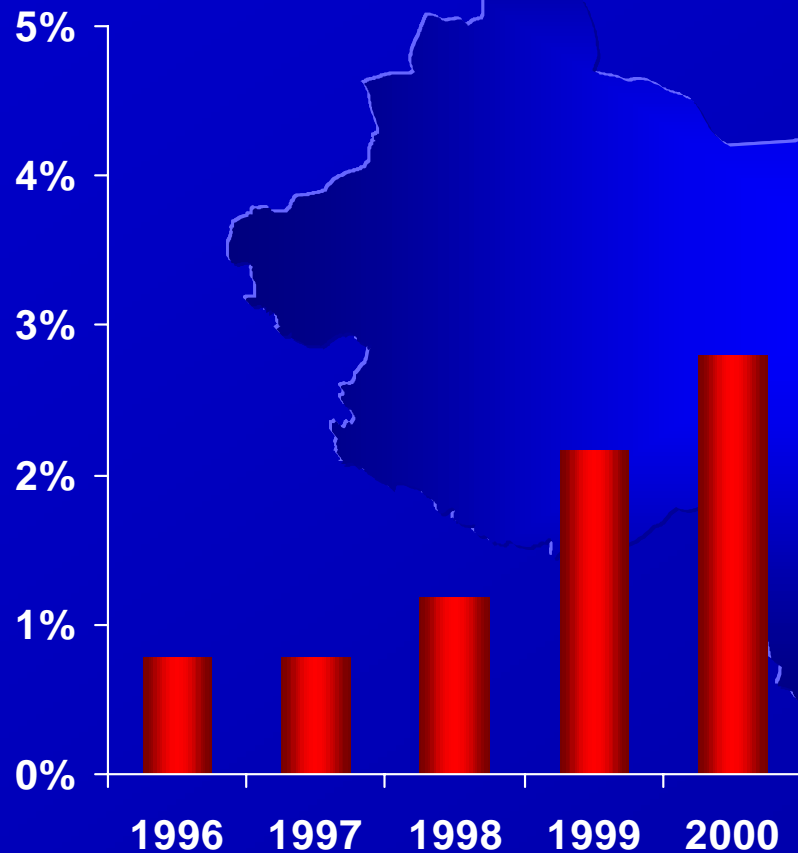
- **Extend the coverage of nation-wide pension system to all urban employees**
- **Improve unemployment insurance system and implement a minimum living standard program for urban residents**
- **Establish a basic medical insurance system**



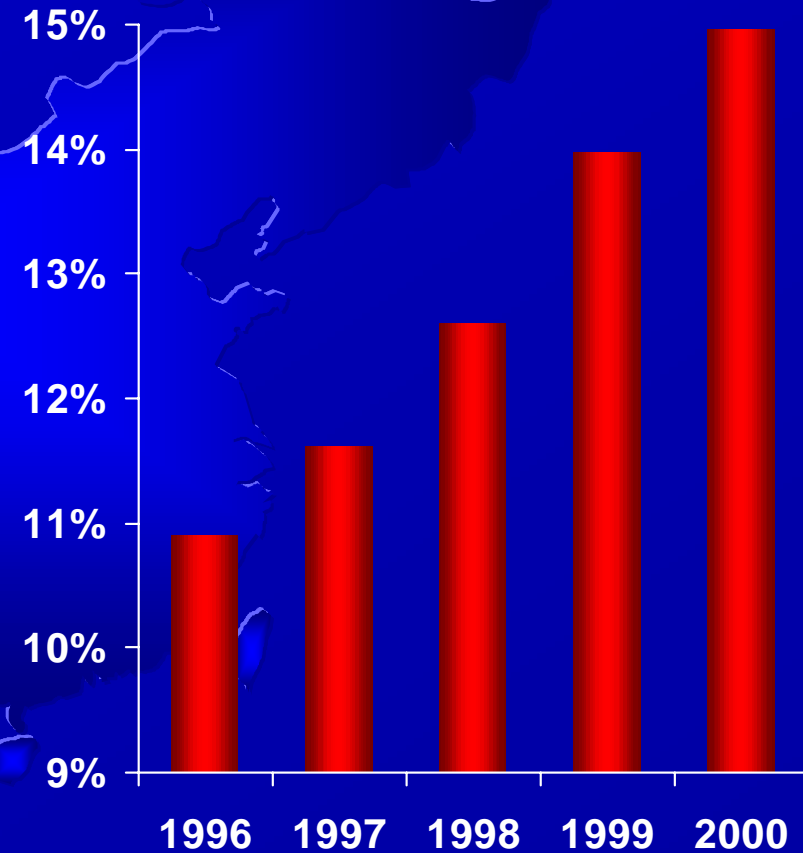
**A social security system with joint contributions from the government, employers and employees**

# Fiscal Flexibility and Sustainability

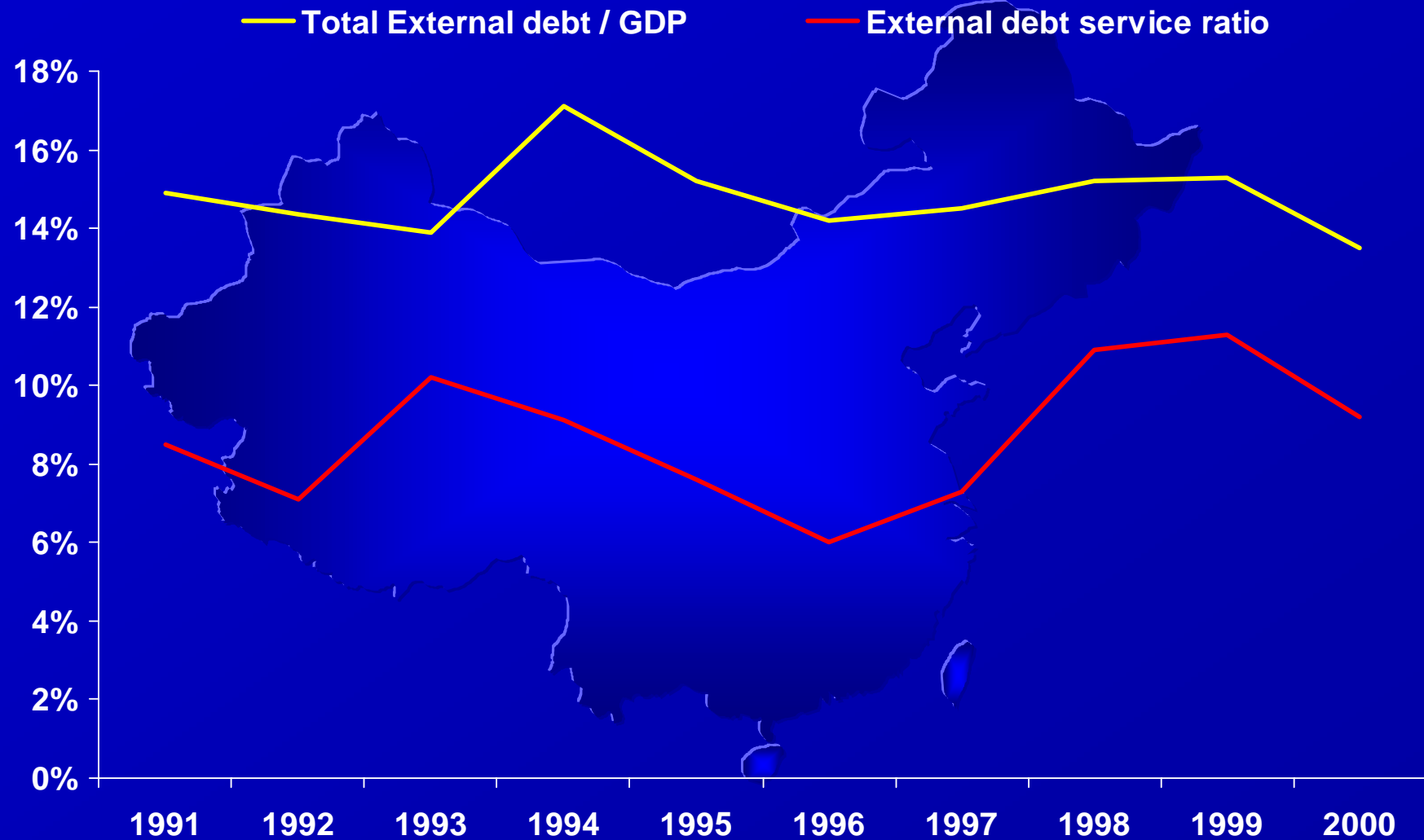
Deficit / GDP



Government revenue / GDP



# Strong Debt Servicing Capability





# New Challenges Facing China's Economy



# Challenges to Growth

- **1. Rationalize the industry structure.** While the economy grew rapidly, the deficiency of the demand, especially the deficiency of the domestic demand remains a problem. It is necessary to build up some new leading sectors to generate more demand. For the moment, housing and automobiles are two priorities, among the others, for the further development.

# Challenges to Growth

- **2. Balance the regional development.** While China's economy maintains strong growth momentum, there emerged the widening of the economic disparity in the economy. The development gap between the Eastern seaboard areas and Western remote areas has become widened.

- **3. Reduce the income gap.** The income growth rate for the rural residents is much lower than that of the urban. The widening of the income gap and the slowdown of the income growth of the peasants have become the main constraints on the expansion of the consumption and the challenge to the economic growth in the future.

- **4. Further restructuring of financial sectors & SOEs.** The health of the financial sector and the SOEs are significant for the China's future economic development. However the financial sectors, mainly the commercial banks, have too high rate of non-performing loans, mainly due to the bad loans to the SOEs. Building up a sound and efficient financial system is another main challenge facing China's economy.

- **5. Reorientation of the status of China in the international trade system in the 21st century.** The volume of export/ and import reached US \$850 billion in 2003. China now is the 3rd largest importer in world economy and accounts for 6% of the world export. However China's export mainly consists of labor-intensive commodity. It seems that this int'l trade structure can no longer persist. On the other hand, the export of high-tech and capital-intensive goods and services seems has encountered many obstacles and difficulties.

# Looking Forward

## Tenth Five-Year Plan (2002-2005)

- **GDP growth: 7% annually**
- **Rationalize economic structure and balance regional development**
- **Protect the environment**
- **Establish a comprehensive social safety network**
- **Maintain registered urban unemployment rate below 5%**
- **Further integration with the world economy**

# Different point of views on the current economic situation of China's economy

**In the outset of the 21st century, there emerged many new challenges for China's economy. The new challenges mainly fall into 4 fields:**

- **Foreign Trade**
- **Inflation and unemployment**
- **Security of national finance**
- **The appreciation pressure on RMB**



# Foreign Trade

- In the first 4 months of 2004, the volume of export and import reached to US\$336.2 billion, at a growth rate of 38% compared with the same period of last year.
- However, the trade deficit for the first 4 months were \$10.7 billion, of which the deficit for February hit \$7.9 billion, at a historical record.

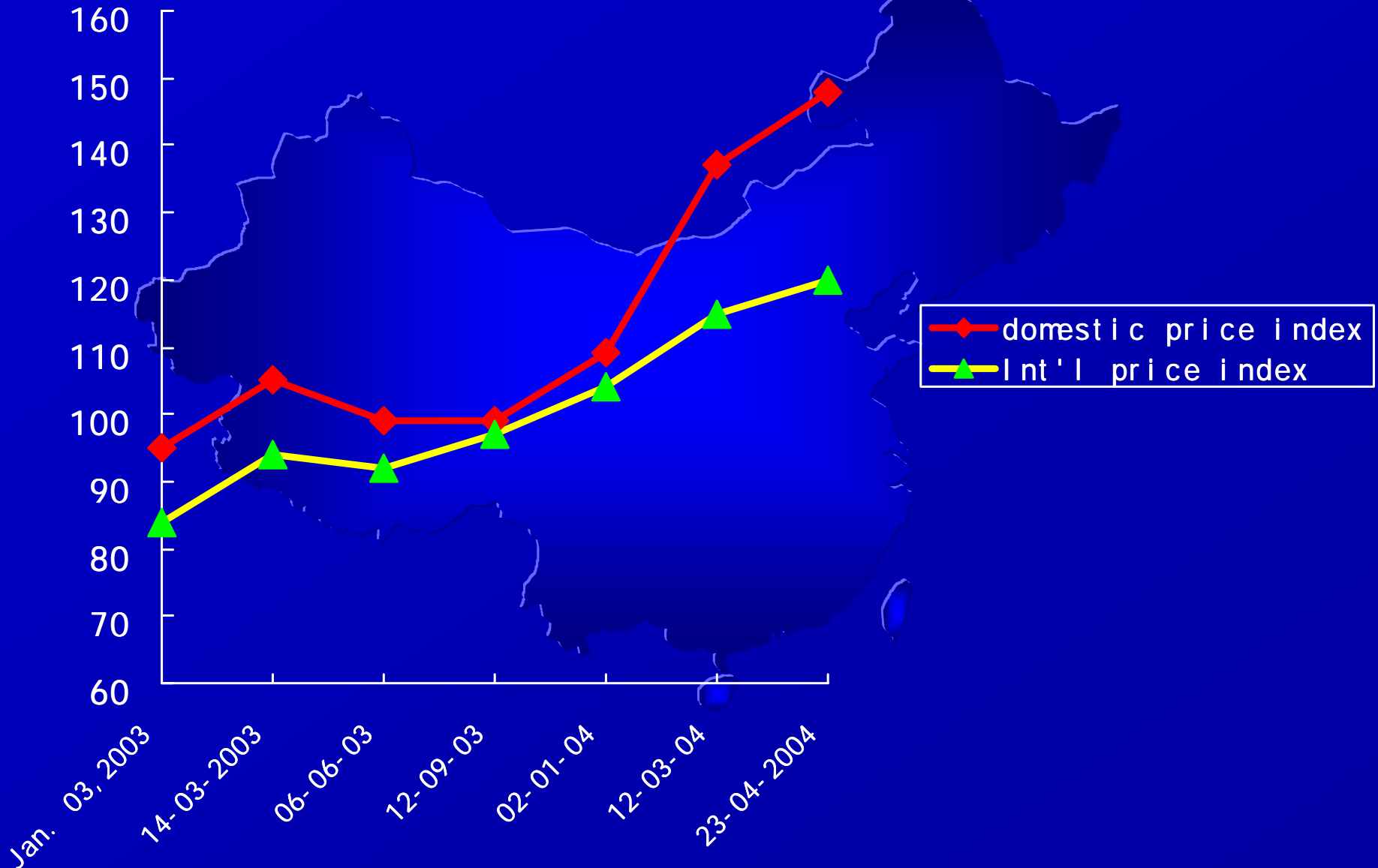
# Foreign Trade

- **With the prices for raw materials and energy rose substantially, the export cost of the enterprises increased rapidly. On the other hand, the prices for manufacturing goods keep declining.**
- **With the interim period of China's accessing to WTO comes to an end, there are more and more anti-dumping law suits against China.**

# Unemployment and Inflation

- The issue of inflation has not been heard for many years in China. However, while the shadow of deflation has not disappeared, when the inflation appeared unexpectedly.
- In the January of 2004, the CPI increased at a rate of 3.2%, arising the worries of the threat of inflation.

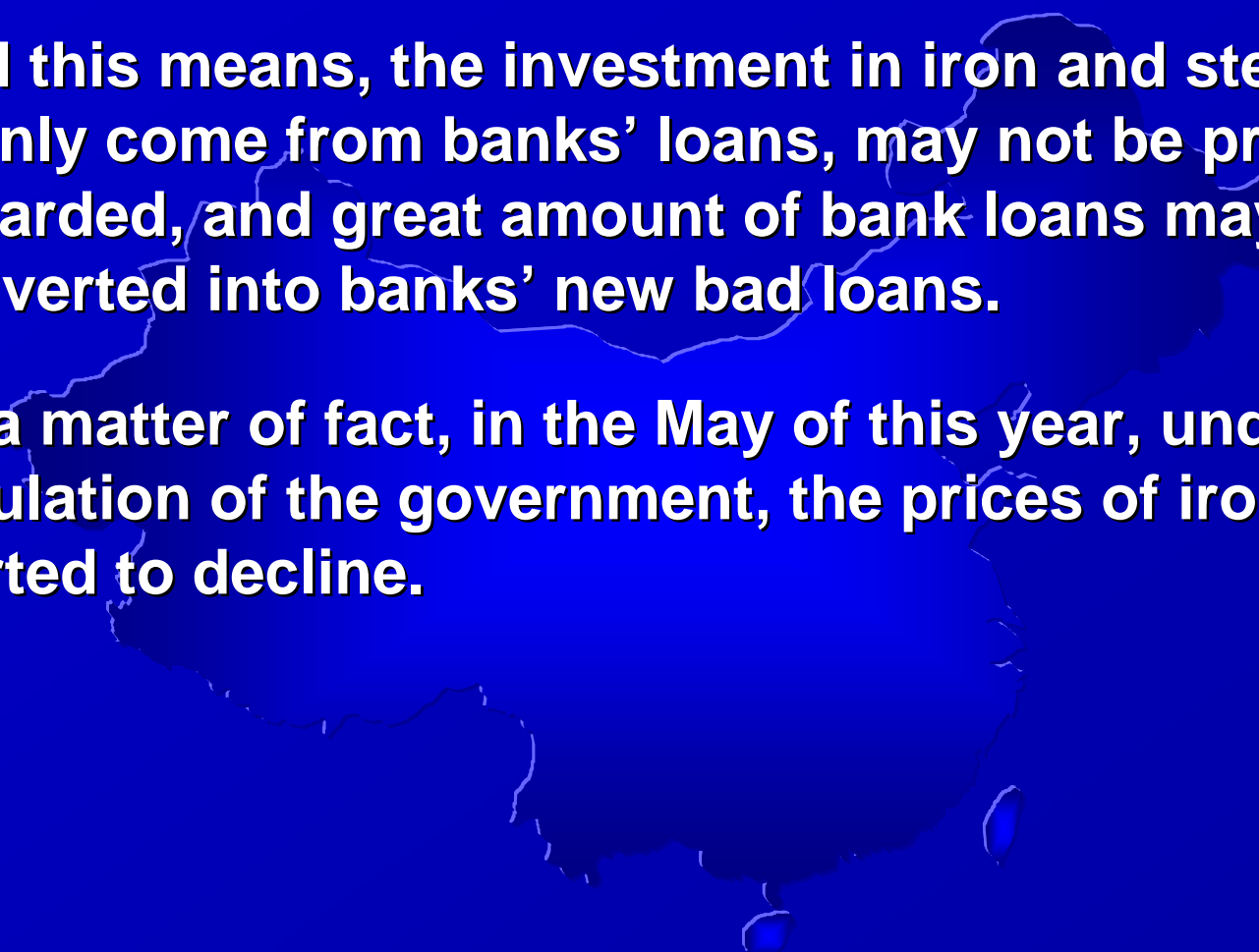
# Case study: the price rises of steel and iron products and the hidden risks in iron and steel sector



# The hidden risk in the steel and iron industry

- The high price of the steel and iron is not an isolated phenomenon, but the reflection of the overheated macro economy.
- The hot spot in consumption on real estates and automobiles, the large investments in infrastructure generated large demand for steel and iron products, leading to the rise of the prices. As a result, the domestic price index for iron and steel rose rapidly, with the price in September 2003 as a turning point, and the divergence of int'l and domestic price index.
- The high price directly stimulated the over-investment in the steel and iron sector.


- **A report issued by the National Statistical Bureau showed that the fixed asset investment in the iron and steel sector in the first season of this year has reached 33.5 billion yuan, increased 107.2% compared with same period of last year. It was estimated that the growth rate for the second season will remain this high level.**
- **The problem is, by the end of 2005 the potential productive capacity of steel and iron sector will reach to at least 330 million tons, however the demand for the iron and steel products will not reach to this level until the year of 2010.**

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- **And this means, the investment in iron and steel, which mainly come from banks' loans, may not be properly rewarded, and great amount of bank loans may ultimately converted into banks' new bad loans.**
  - **As a matter of fact, in the May of this year, under the regulation of the government, the prices of iron and steel started to decline.**

# High unemployment pressure

- On the other hand, China's economy is under high unemployment pressure. Every year, there will be 13 million new labor force entering into the labor market. It's a very serious challenge to any government in the world. At same time, it was estimate that China has more than 140 million rural surplus labor waiting in the countryside to be transferred to the urban areas. In the urban area, due to the structural industrial adjustment, great number of ( millions of ) SOEs workers have been laid off.
- The situation arises the worry of the possibility that China could enter into a period there coexistence of inflation and unemployment?



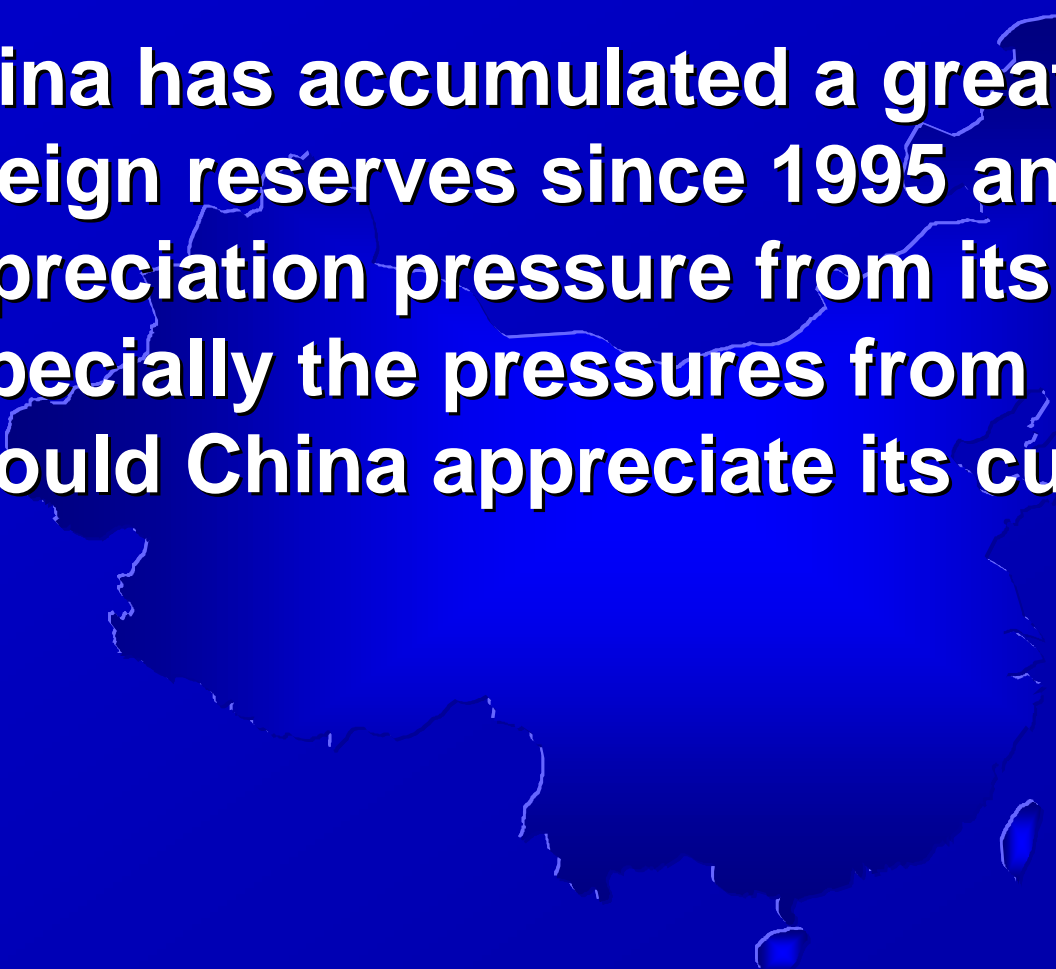


*The unemployment, inflation and sustainable growth, can China reach the three macro-economic targets simultaneously?*

# The Appreciation Pressures on RMB

- Many Eastern Asian Countries have great amount of trade surplus, that is, the increase of foreign assets. This may either lead to the expectation of the appreciation of domestic currency and thus increase the holding of domestic currency, and eventually lead to the realization of the appreciation; or bring about the retaliation from the trade partners with deficits, since they would attribute their deficits to the under-valued currency of their trade partner, thus increase the appreciation pressure.

- **The dilemma facing these counties is that, if they allow their currency appreciated, the continuous appreciation may probably lead to the serious deflation, and eventually lead the economy to the liquidity trap characterized by zero interest rate; On the other hand, if they do not allow their currency appreciated, they may bring about the retaliation from their trade partners.**

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- **China has accumulated a great deal of foreign reserves since 1995 and felt great appreciation pressure from its trade partner, especially the pressures from United States. Should China appreciate its currency?**

- **If China did allow its currency appreciated, it's possible that the appreciation of RMB becomes a self re-enforcement process. As a result, the RMB may further and repeatedly appreciate itself, and eventually lead China's economy to serious deflation and falling into the zero interest rate liquidity trap.**

# Economic Growth and the Security of National Finance

- Although China's economic growth continue its momentum, it is obvious that the fiscal measures played great role in stimulating the economy, especially during and after the period of Asian financial crisis.
- As a result, the central government has accumulated a great deal of public debts, and many local governments are in the very difficult condition.
- What impacts these difficult situations have on China's long run economic growth? Can this kind of economic growth sustainable?

# The important outcome of PRC's accession to WTO

## Two roles in the region with unusual prominence

1. Reinforce regional export competition
2. PRC's long-term growth will make it a prominent importer in East Asia

# The important outcome of PRC's accession to WTO

- 1. PRC will probably enhance its trade capacity in the world economy.**
- 2. China will develop a structural trade surplus with the western OECD countries, and get a deficit of about the same scale with East Asian countries.**
- 3. The growth of PRC's internal market will probably accelerate other East Asian countries export and income growth**



# The important outcome of PRC's accession to WTO

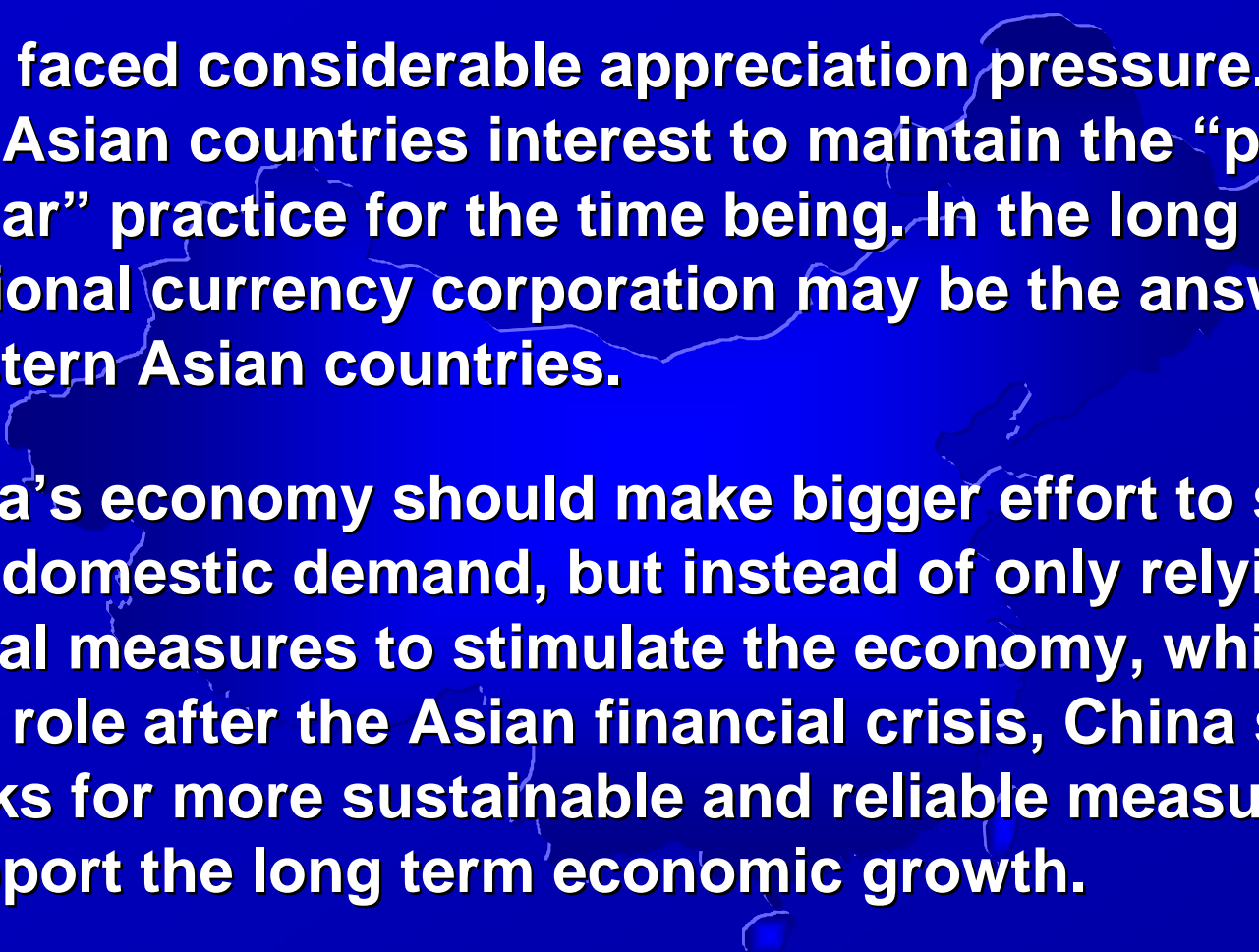


**4. Response to PRC's WTO initiative is neither protectionism nor passivity**

# Conclusions

- 1. The macro performance of China's economy has been satisfactory since the setup of reform and open door policy. When entering into the new century, China's economy maintained the growth momentum**
- 2. From the middle of the 2003, domestic price level rose slightly due to the int'l price rise in raw material and energy. However, some overheated industries in China partly responsible to the general price rise.**
- 3. These overheated industries (including iron and steel, alumina and aluminous products, real estates, car making, etc.) would bring about the bubbles in the economy, jeopardize the safety of the financial sector, and destabilize the economy.**

- 4. The government has taken some mild measures to stabilize the economy, realizing the goal of “soft landing” and get rid of the threat of hidden risk. As a matter of fact, the fine tune policy worked effectively.**
- 5. In the first 4 months, China recorded trade deficit in current account, which is rarely be seen for a long time. The trade balance problem reflects the new status of China’s economy in the world market. It is noticed that China’s accession to WTO produces a new win-win framework in foreign trade in Asia. On the other hand, China can no longer to simply play the role of “world factory”, it must elevate the level of its products, to diversify its products from labor-intensive to high-tech and more capital-intensive products.**

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- 6. RMB faced considerable appreciation pressure. But it is in the Asian countries interest to maintain the “pegging to dollar” practice for the time being. In the long run, the regional currency corporation may be the answer for Eastern Asian countries.**
  - 7. China’s economy should make bigger effort to stimulate the domestic demand, but instead of only relying on the fiscal measures to stimulate the economy, which play a key role after the Asian financial crisis, China should looks for more sustainable and reliable measures to support the long term economic growth.**

