

China Policies during Uncertainties: 2016 Outlook

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Understanding the Great Transition



BIG GOV

- Fiscal revenue
- SOEs

Price distortion of FOF

- Land
- Labor
- Capital
- Environment

Mad investment

➤ During 2009-2012, China M2 increased by RMB 50 trillion, exceeding the 47 trillion during 1949-2008

Lawrence Summers (2014) : China Used More Cement In The Last Three Years Than The US Used In The Entire 20th Century



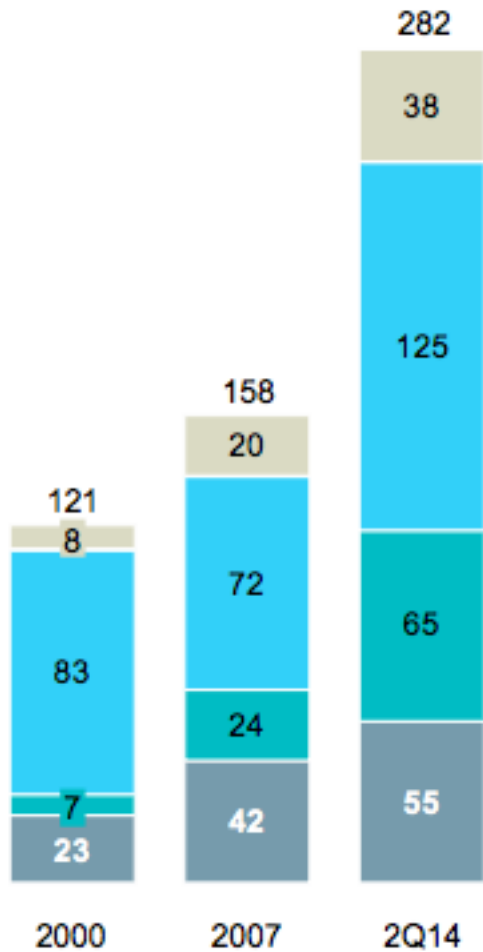
Unsustainable Model

- High leverage
- Overcapacity
- High pollution
- Serious corruption
- High wealth gap



Debt-to-GDP ratio
%

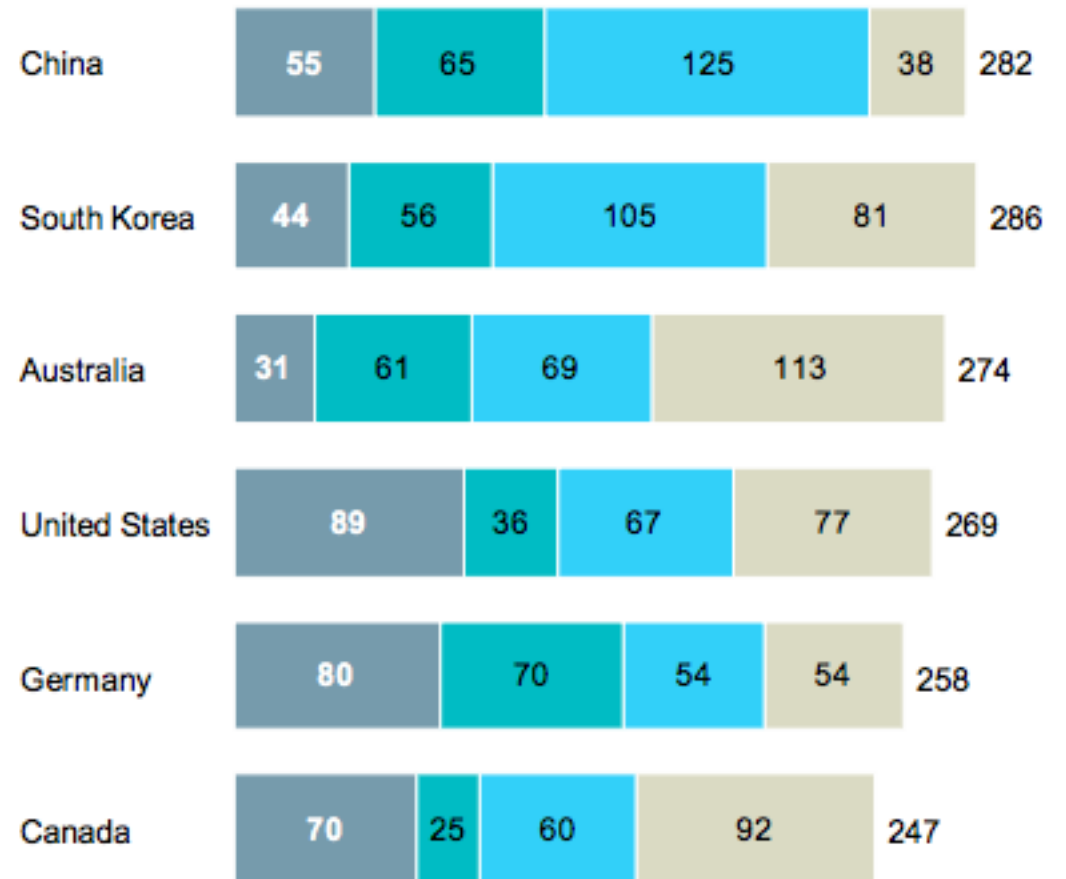
China



Total debt \$ trillion	2000	2007	2Q14
	2.1	7.4	28.2

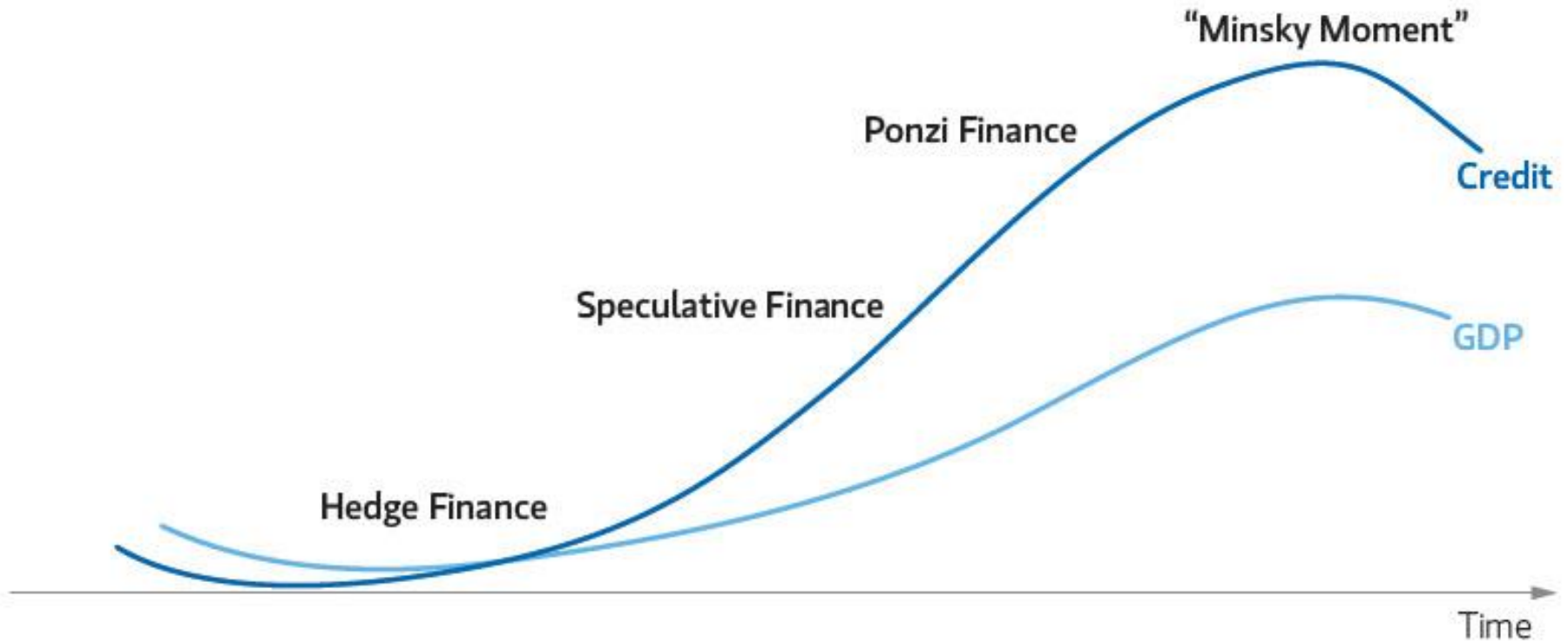


By country, 2Q14



Minsky Moment

Stylized "Minsky Cycle"



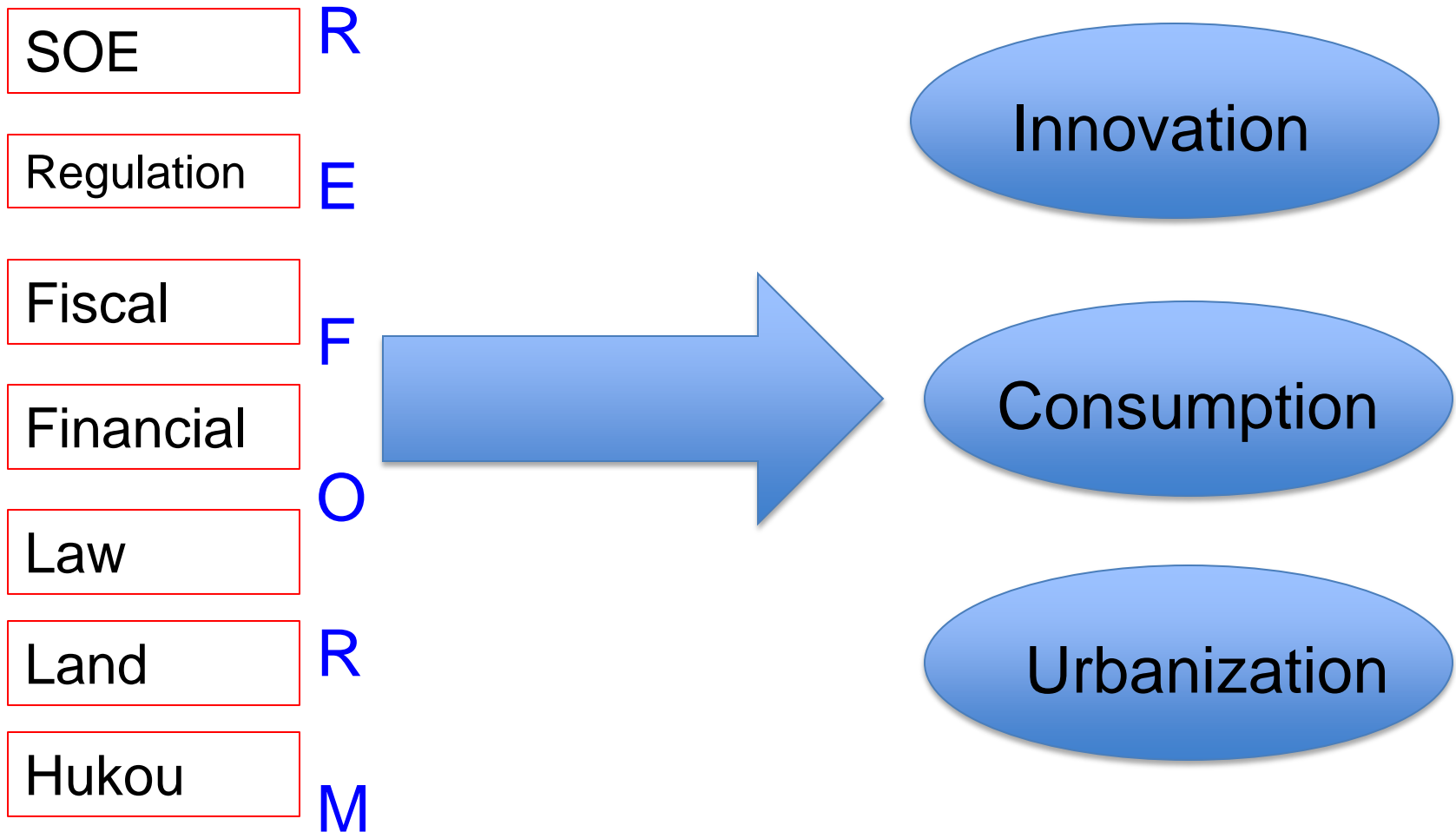
Plan A

LI Keqiang: Reform is the biggest dividend for China

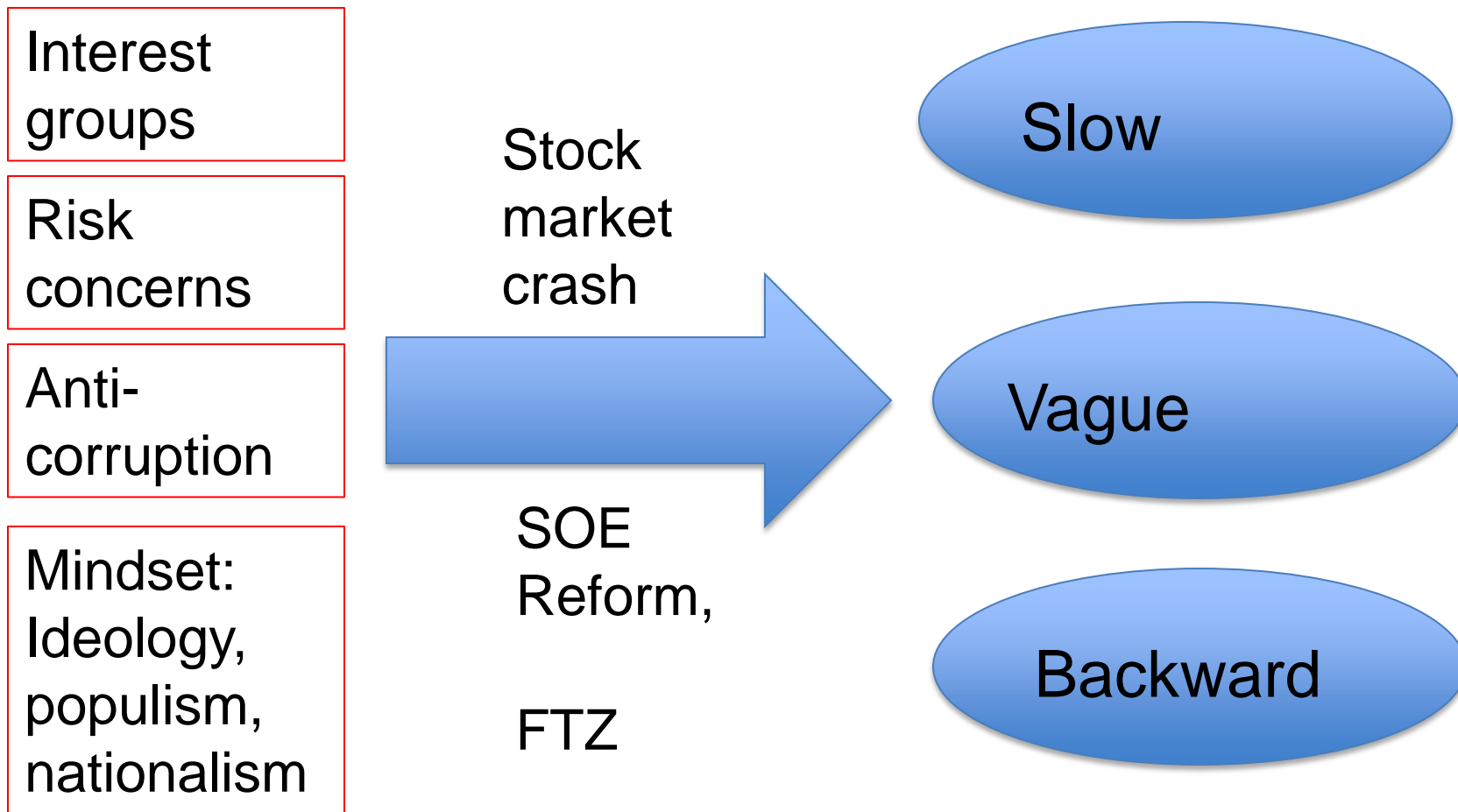
中共中央关于全面深化改革
若干重大问题的决定

CPC Decision on
Deepening
Comprehensive Reform

Reform-driven Transition



Embarrassed reform



Hopes?

- ✧ Call for reformers
- ✧ FANG Xinghai & LI Chao
- ✧ 19th CPC Congress in 2017
- ✧ Conditional amnesty
- ✧ Economic pressures
- ✧ TPP pressure

Li Keqiang's Plan B

Grassroot
entrepreneur
ship and
innovation



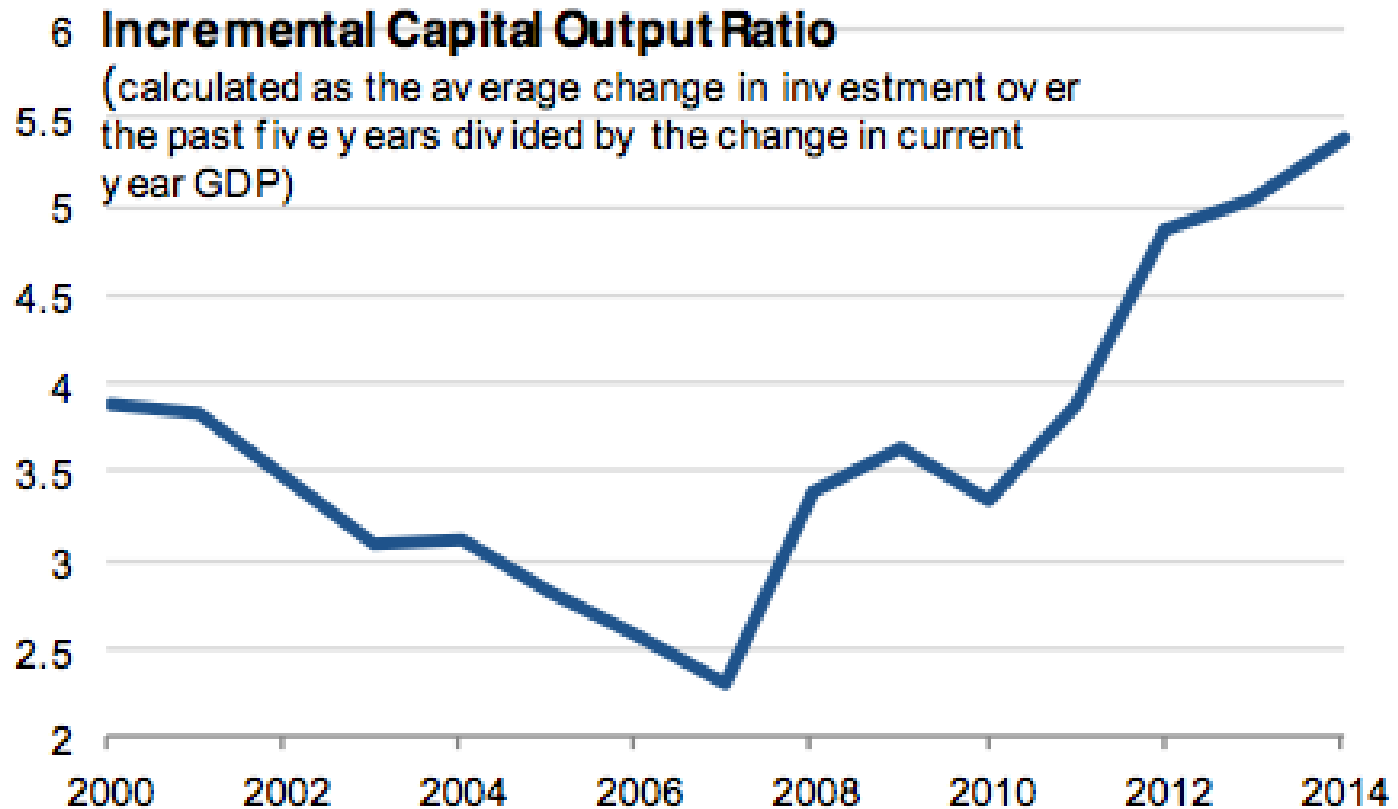
Investment in
public
goods

LI Keqiang: April is a season that the granary is nearly empty but the new crop is not yet ripe.

Li Keqiang's article in *the Economist*

“Yet this transition from ‘bigger is better’ to ‘less is more’ is a good thing. I would otherwise worry whether the reforms were working as intended.”

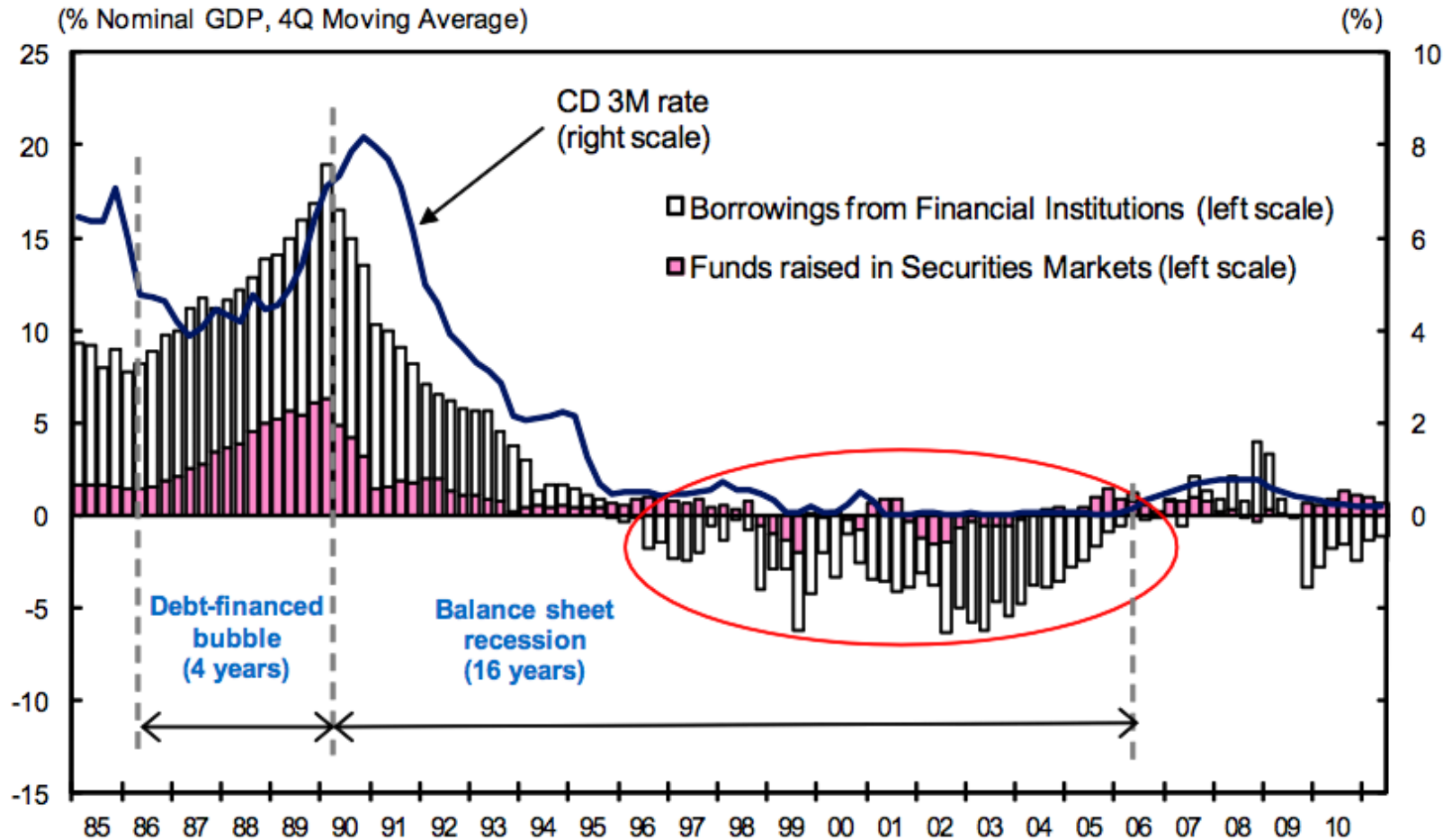
Fail of Keynesian Economics



Ineffective Monetary Policy

- ✧ XI Jinping: only monetary stimulus is not enough.
- ✧ WU Xiaoling: Enterprises are reluctant to make investments, banks are reluctant to lend due to bad loan concerns. There is no shortage of liquidity, but there is shortage of confidence.
- ✧ In Oct 2015, the loan of BIG FOUR decreases compared to September, which is the first decrease since 2009

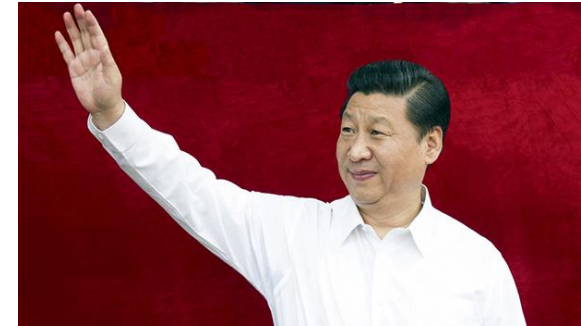
Balanced Sheet Recession



Source: 辜朝明, 2011

New strategies

1. XI Jinping: To especially strengthen Supply-side Reforms
2. LIU HE: To accelerate eliminating dead companies
3. YANG Weimin: To win four wars against: excess capacity, high cost for enterprises, real estate stock, financial risk



Reagan's great experiment with Supply-side economics

- ✓ 1/3 tax cut
- ✓ Small government
- ✓ Less gov expenditures
- ✓ Less monetary stimulus



What will happen?

BAD NEWS:

- ✧ More defaults, layoffs and bankruptcies
- ✧ Further slowdown (5%?)

GOOD NEWS:

- ✧ Tax cut
- ✧ More reforms: IPO registration-based system
- ✧ Real estate: slow recovery
- ✧ Further cuts in interest rate & deposit

Take-away

1. China is facing the New Normal, the growth rate may drop to 5%.
2. Legacy of investment-driven model: high debt, over capacity
3. New engines: innovation, consumption, urbanization
4. Macro policy: from Keynesianism to Supply-side economics
5. Uncertainties: reform

Thank you!