

# MIZUHO CHINA MONTHLY

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*April 2017 Edition*

## - Executive Summary -

### China's Economy

#### Key Areas of the 2017 National People's Congress: Before the Communist Party Congress, Priority Placed on Stability

As the Communist Party Congress is scheduled for the second half of the year, the policy indicated at the National People's Congress this year emphasized priority on stability. This has been reflected in various target figures, including that for employment creation, which has been raised. While the target figure for the fiscal deficit as a percentage of GDP was maintained at 3%, as was the case in the budget proposal last year, the intention to support the economy can be seen in the revision to the budget allocation, along with the increase in investment in local infrastructure under a special account. Particular focus was also placed on the management of monetary risk. While the National People's Congress reconfirmed the importance and urgency of reforms, it is possible that tough reforms will be delayed, such as those related to state-run companies, due to the excessive focus on stability. The key challenge for the government under President Xi Jinping is thus to prevent such delays from causing economic instability as a result.

### Industrial and Regional Policies

#### Enhancements in Policy on Comprehensive Resource Utilization and the Issues China Faces in its Bid to Achieve this Goal

This article provides an overview of current resource demand and supply conditions in China as the major factor underpinning the government's focus on the development of a recycling-based or circular economy, draws on government reports and official statistics to examine recent trends in comprehensive resource utilization (primarily through recycling), clarifies China's achievements in comprehensive resource utilization and the issues it now confronts, looks at the focus of technical measures aimed at cultivating "venous" industries and future directions for China in its bid to create a circular economy.

### News from the China Advisory Division

#### The Direction of Chinese Monetary Policy

A statement issued after last December's Central Economic Work Conference said that China will make a gradual shift towards neutral monetary policy from its "moderate" path of recent years. This report examines the future direction of Chinese monetary policy against a backdrop of current conditions of the Chinese economy.

## **Key Areas of the 2017 National People's Congress: Before the Communist Party Congress, Priority Placed on Stability**

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### **1. Strong stance of priority on stability: National People's Congress held with the Communist Party Congress approaching**

The National People's Congress (hereinafter referred to as the "NPC") of the People's Republic of China was held from March 5 to 15, 2017. This time, the NPC was held before the Communist Party Congress (the 19th National Congress of the Communist Party of China) to discuss the new leadership of China for the next five years, scheduled for the second half of this year. The NPC thus gathered substantial public attention, as the outcome of the NPC this time may indicate to what extent the power base of President Xi Jinping has been established.

During the NPC, a number of Chinese leaders, including Prime Minister of China Li Keqiang, referred to President Xi Jinping as the core of the central committee of the Communist Party. Given this situation, it is certain that the power base of President Xi Jinping has been growing. However, it should also be mentioned that the contents of the government activity report suggest that the government prioritizes stability over the execution of reforms, which involve great risk, as least with regard to economic policy.

#### **(1) Principle of "seeking progress while maintaining stability": Once again confirmed**

At the Central Economic Work Conference held in December 2016, economic policy in 2017 was identified as "seeking progress while maintaining stability,"<sup>1</sup> and the NPC confirmed once again this principle of prioritizing stability.

In the government activity report released this time, "five key areas" were identified as areas of focus in order to carry out this year's government activities in an efficient manner. These five areas also confirm the preference of the stability of the government under President Xi Jinping. For the first of the five areas, emphasis is placed on "making progress while maintaining stable performance and keeping our strategic focus." Also insisted on is that "stability is of overriding importance," as well as stability as a condition for progress in deepening reforms and accelerating structural adjustments." Thus, the order of priority between stability and reform has been clearly defined. As a result, the key area regarding reform, "to focus on supply-side structural reform," was placed as second out of the five key areas. Subsequently, "to expand aggregate demand as appropriate and improve its efficacy" was put in third place, "to rely on innovation to replace old growth drivers with new ones and speed up structural improvement and upgrading" was put in fourth place, and "to solve prominent problems of public concerns" was put in fifth place.

<sup>1</sup> 玉井芳野「2017年の中国の経済政策方針～中央経済工作会議で示された「安定の中での前進」～」(みずほ総合研究所『みずほインサイト』 issued on December 22, 2016.

## (2) Target figures set to achieve the principle of “seeking progress while maintaining stability”

The stance of priority on stability has been reflected in the various target figures made clear in the government activity report. The most revealing examples include those for the real GDP growth rate and the number of new employees in urban areas.

The target real GDP growth rate for 2017 has been set out at “around +6.5%” (Fig. 1). Even though this target rate is lower than the target growth rate set out for 2016 at “+6.5–7.0%,” this time there was the newly added remark of “higher if possible in practice.” It seems that this target rate indicates that priority has been placed on stability, by maintaining the growth rate at the slightly higher end of “around 6.5%” in order to make sure that the growth rate for this year will not significantly fall below the result of 2016 (6.7%).<sup>2</sup>

The target figure for the number of new urban jobs was raised from “10 million or above,” which was kept as the goal for the past three years, to “11 million or above.” It is clear that employment is important for economic and social stability. From this point of view, the government under President Xi Jinping has been further prioritizing stability.

Fig. 1: Target figures for economic indices in 2017

Index	2017	2016	
	Target	Target	Result
Real GDP growth rate (YOY)	Around 6.5%	6.5–7.0%	6.7%
Consumer Price Index (YOY)	Around 3.0%	Around 3.0%	2.0%
Total investment in fixed assets (YOY)	Around 9%	Around 10.5%	7.9%
Total retail sales of consumer goods (YOY)	Around 10%	Around 11.0%	10.4%
Total value of external trades (YOY)	Stable, recovery	Stable, recovery	- 0.9 %
M2 growth rate (YOY)	Around 12.0%	Around 13.0%	11.3%
Aggregate financing to the real economy (stock, YOY)	Around 12.0%	Around 13.0%	12.8%
Registered unemployment rate in urban areas	4.5% or less	4.5% or less	4.02%
Number of new urban jobs	11 million or above	10 million or above	13.14 million
Deficit of national finance	CNY 2.38 trillion	CNY 2.18 trillion	CNY 2.18 trillion
As a percentage of GDP	3.0%	3.0%	2.9%

Note: The year-on-year growth rates for total investment in fixed assets and total retail sales of consumer goods are based on nominal figures. The year-on-year growth rate for the total value of external trades is based on the nominal figure denominated in CNY.

Source: Compiled by Mizuho Research Institute Ltd. based on “Report on the Work of the Government” by Prime Minister Li Keqiang issued on March 16, 2017, “Report on the implementation of the 2016 plan for the national economy and social development and on the 2017 draft plan for the national economy and social development” issued by the National Development and Reform Commission on March 5, 2017, and on figures released by the National Bureau of Statistics of the People’s Republic of China and CEIC

<sup>2</sup> Some may say that if that is the case, the target figure should have been maintained at the “+6.5–7.0%” level. However, that would emphasize priority on stability too much, and the momentum for reforms would have been weakened too far. The government under President Xi Jinping had been emphasizing that economic development in China had entered “New Normal,” shifting from growth at a high pace to growth at a medium-to-high pace, and therefore reforms were necessary in order to adapt to the new situation. If the target rate is maintained at the same level, market participants may have taken it as a message that the momentum of reforms, i.e., the concept of “progress,” can be weakened.

## 2. What are the contents of a “more proactive and effective” fiscal policy and a “prudent and neutral” monetary policy?

As has been made clear in the fact that the above “five key areas” included “to expand aggregate demand as appropriate and improve its efficacy,” the Chinese government believes that economic stability requires economic stimulus measures. As a means to achieve the goal, the basic principles for fiscal and monetary policy were established at the Central Economic Work Conference held in December 2016. According to this decision, the fiscal policy is to be “more proactive and effective,” while the monetary policy is to be “prudent and neutral,” and this was also confirmed at the NPC. Thus, there has been nothing new in terms of the basic principles regarding fiscal and monetary policy. However, a detailed nuance was added through the budget bill and the target figures.

### (1) How can the budget bill render the already proactive fiscal policy “more proactive and effective”?

Before the NPC, many expected that the fiscal deficit as a percentage of GDP would be raised from the 3% included in the budget for the FY2016, given that the expression used at the Central Economic Work Conference in regard to rendering the proactive fiscal policy was “more proactive.” However, the figure was maintained at 3% in the budget for FY2017 (see Fig. 1 above). However, it should be mentioned that the budget bill released this time emphasizes the plan to make the allocation of budgets more efficient through the expansion of transfer expenses from the central government to local governments, while cutting budgets for inefficient projects in order to follow the principles to render the proactive fiscal policy “more effective.” Even though this is not the most evident means of promoting proactive fiscal policy, such as in an upward revision on the fiscal deficit as a percentage of GDP, such changes show the intent to expand the scale of actual expenses toward economic stability and the improvement of public welfare.

According to the explanation given by the Ministry of Finance,<sup>3</sup> the main causes for the fiscal deficit continue to be tax cuts and the exemption of administrative fees, as was the case last year. In total, the funds used for such measures amount to approximately CNY 550 billion (approximately 0.7% as a percentage of GDP) in terms of the reduced contribution. The tax cuts include the continued tax reduction as part of the “shift from a business tax to a value-added tax” that was also executed in 2016, as well as the expansion of areas to cover the preferable corporate income tax treatment for small and medium-sized enterprises, along with the upward revision on the tax deduction ratio for the purpose of research & development at small and medium-sized enterprises, among others. Furthermore, with regard to administrative fees, the 35 items involving the administrative fees that the central government was collecting from enterprises will be abolished or discontinued, while the payment of contributions will be reduced for “five insurance policies and one fund (pension, medical, unemployment, work-related injury, and maternity insurance, as well as a housing reserve fund).”

On the other hand, with regard to fiscal expenditures, expenses will be increased for priority areas such as measures for poverty, agriculture, education, social welfare, healthcare, and environmental concerns, in

<sup>3</sup> 财政部「财政部长肖捷等就“财政工作和财税改革”答记者问」 issued on March 7, 2017 and 财政部「财政部解读2017年预算报告」 issued on March 8, 2017.

order to follow the principle of “increasing such expenses in an appropriate manner.” Furthermore, the issuance of local government special bonds to be used for public projects and which are included in the governmental funds was doubled in the budget from FY2016 (CNY 400 billion) to CNY 800 billion. This shows the intention of the Chinese government to support the economy through investment in infrastructure. In addition, it seems that the government plans to make up for fiscal expenses by increasing loans by policy monetary institutions and PPP (Public and Private Partnerships) as the sub-section of finance. Through PPP, the project funds that have been used after the approval of the government amounted to CNY 2.23 trillion yen by the end of 2016, which is about four times the amount recorded in January 2016.

## **(2) “Prudent and neutral” monetary police: Controlling the increase in the balance of aggregate financing to the real economy**

The basic principle for monetary policy was shifted at the Central Economic Work Conference held in December 2016 from the previous year’s policy of “rendering the prudent monetary policy more flexible and appropriate” to “rendering the monetary policy more prudent and neutral.”<sup>4</sup> At the People’s National Congress, the target growth rate for the M2 money supply and the balance of aggregate financing to the real economy were announced, which made clear the degree of “prudent and neutral.” While both target rates were “around +12%” year-on-year for this year,” the balance of aggregate financing in particular clearly shows the intentions of the Chinese government.

The Chinese government is growing more and more cautious about the possibility that not only traditional bank loans but also fund procurement through shadow banking will spread further, intensifying asset bubbles as a result. Indeed, the balance of aggregate financing that include funds procured through shadow banking is growing at a high rate. As of the end of 2016, the growth rate was +12.8% year-on-year, significantly exceeding the nominal GDP growth rate of the same year (+8.0% year-on-year). The target growth rate of the balance of aggregate financing set out this year at “around +12%” is slightly lower than the target rate set out last year (“around +13%”), along with the actual figure. This shows the intention of the government to shift to a “prudent and neutral” monetary policy. In other words, the government seems to be aiming to steadily control excessive credit expansion including that of shadow banking by weakening the momentum of monetary easing without rapid measures of monetary tightening.<sup>5</sup> Therefore, it will be difficult to expect the monetary policy to support the economy this year, making the fiscal policy a central part of economic support.

### **3. What are the main points for the “priority activities for 2017”?**

The government under President Xi Jinping has made clear its intention to maintain economic and social stability through economic support based on the fiscal policy. While placing focus on stability, the

<sup>4</sup> With regard to the principles regarding Chinese monetary policy for 2017, see 三浦祐介「中国人民銀行の政策運営の展望～「緩和」から「中立」に移行しつつ安定維持に腐心～」(みずほ総合研究所『アジアインサイト』issued on December 22, 2016.

<sup>5</sup> It should also be mentioned that the growth rate of the M2 money supply as of the end of 2016 was +11.3% year-on-year, lower than the target rate for 2017 (“around +12%” year-on-year). However, it would be too early to conclude that the Chinese government is strengthening its intention toward monetary easing. It is more reasonable to understand that the government decided to keep the growth rate of the M2 money supply at a minimal increase, despite the fact that the growth rate of the Consumer Price Index is most likely higher in 2017 than in 2016.

government does also recognize the importance and urgent need for reforms, as can be seen in the principle of “seeking progress while maintaining stability”. What would then be the details of the reforms planned for 2017? Figure 2 below summarizes the main points for the priority activities for 2017.<sup>6</sup>

**(1) As was the case in the previous year, highest priority placed on “three cancellations, one reduction, and one reinforcement”**

The first part of the main points in the “priority activities for 2017” involves the deepening of the principle of “three cancellations, one reduction, and one reinforcement” through reforms (in Chinese, this is written as “三去一降一补”). “three cancellations, one reduction, and one reinforcement” refers to the core of the supply-side structural reforms that include the cancellation of excess capacity (去产能), the cancellation of real estate stocks (去库存), and the cancellation of excess debt (去杠杆), as well as the reduction of business costs (降成本) and the reinforcement of the fragile areas of the economy and of society (补短板). Since 2016, the government under President Xi Jinping has been promoting this “three cancellations, one reduction, and one reinforcement” principle, and the measures are to be deepened.

For example, under the slogan of “taking solid and effective steps to cut overcapacity,” the excess capacity of steel and coal will be reduced,<sup>7</sup> while for coal the decision was taken to abolish, discontinue, or postpone the construction of no less than 50 million kW of coal-fired power plants equivalent. With regard to the cancellation of real estate stocks, the government emphasizes that measures will be taken according to the actual situation in each city. Under this framework, it was re-confirmed that support will be given to residential demand by the habitants of small and medium-sized cities, known as “third-tier cities” and “fourth-tier cities,” as well as to housing purchase demand from those who are moving from agricultural villages to urban areas, while also establishing a long-term framework that is efficient in promoting the stable and healthy development of the real estate market. With regard to the cancellation of excess debt, the highest priority is to be placed on companies, state-run companies in particular, with the principle to work on the debt level in a “active and prudent” manner. With regard to the reduction of business costs, various measures are to be taken including tax reduction as well as the reduction of administrative fees, as discussed in the section on fiscal policy.

With regard to the reinforcement of fragile areas, on the other hand, the new target is to reduce the population in poverty in agricultural villages further by 10 million or more, after having achieved reducing the figure by 12.4 million in 2016, under the principle of making further effort toward reducing the regions and population in poverty. As a means to achieve this goal, 3.4 million people will be transferred to other regions. In order to achieve such goals in a concrete manner, the central government decided to increase its special fund for poverty alleviation by more than 30% year-on-year.

<sup>6</sup> It is difficult to describe “priority activities for 2017” in detail, because of a space constraint. However, the full text of the government activity report can be read in “ENGLISH.GOV.CN” ([http://english.gov.cn/premier/news/2017/03/16/content\\_281475597911192.htm](http://english.gov.cn/premier/news/2017/03/16/content_281475597911192.htm)).

<sup>7</sup> The reduction target for productivity in 2016 was 45 million tons for steel and 250 million tons or more for coal, while the result was above 65 million tons and 290 million tons, respectively. On the other hand, for this year, the reduction target has been set at around 50 million tons for steel and 150 million tons or above for coal. While the target figures for this year are smaller than the results from the previous year for both steel and coal, it does not necessarily mean that reforms have become less difficult. This is because the large part of the productivity cut last year had long been in idle mode, while for this year, it would be necessary to cut what is currently working.

Fig. 2: Summary of “priority activities for 2017”

1. To deepen “three cancellations, one reduction, and one reinforcement” through reforms	<ul style="list-style-type: none"> <li>(1) To take solid and effective steps to cut overcapacity</li> <li>(2) To take targeted policies to cut excess urban real estate inventory</li> <li>(3) To carry out deleveraging in an active and prudent way</li> <li>(4) To take multiple measures to cut costs</li> <li>(5) To take targeted and powerful measures to strengthen areas of weakness</li> </ul>
2. To deepen reforms in major sectors and key links	<ul style="list-style-type: none"> <li>(1) To continue to transform government functions</li> <li>(2) To continue to reform fiscal and tax systems</li> <li>(3) To advance reforms in the financial sector</li> <li>(4) To deepen the reform of SOEs and state capital</li> <li>(5) To do more to energize the nonpublic sector</li> <li>(6) To improve the property rights protection system</li> <li>(7) To make a big push for progress in the reform of the social system</li> <li>(8) To deepen institutional reform to build a sound ecological environment</li> </ul>
3. To do more to unleash the potential of domestic demand	<ul style="list-style-type: none"> <li>(1) To promote a steady increase in consumer spending</li> <li>(2) To work proactively to expand effective investment</li> <li>(3) To improve planning for regional development</li> <li>(4) To take solid steps to pursue a new type of urbanization</li> </ul>
4. To transform and upgrade the real economy through innovation	<ul style="list-style-type: none"> <li>(1) To strengthen our capability for making technological innovations</li> <li>(2) To accelerate the development of emerging industries</li> <li>(3) To endeavor to transform and upgrade traditional industries</li> <li>(4) To continue to encourage people to start businesses and make innovations</li> <li>(5) To take comprehensive steps to improve product quality</li> </ul>
5. To promote steady development of agriculture and continued increases in rural incomes	<ul style="list-style-type: none"> <li>(1) To push forward with structural adjustment in agriculture</li> <li>(2) To boost the development of modern agriculture</li> <li>(3) To deepen rural reforms</li> <li>(4) To step up the development of public facilities in rural areas</li> </ul>
6. To actively expand China’s opening up to the world	<ul style="list-style-type: none"> <li>(1) To make solid efforts to pursue the Belt and Road Initiative</li> <li>(2) To ensure that foreign trade continues to pick up and register steady growth</li> <li>(3) To make big moves to improve the environment for foreign investors</li> <li>(4) To promote the liberalization and facilitation of international trade and investment</li> </ul>
7. To effectively strengthen environmental protection	<ul style="list-style-type: none"> <li>(1) To make our skies blue again</li> <li>(2) To strengthen the prevention and control of water and soil pollution</li> <li>(3) To move forward with ecological conservation and improvement</li> </ul>
8. To promote social development to ensure and improve the well-being of our people	<ul style="list-style-type: none"> <li>(1) To strive to boost employment and business startups</li> <li>(2) To work to ensure that our people have access to equitable and quality education</li> <li>(3) To make continued progress in building a Healthy China</li> <li>(4) To weave a strong safety net to ensure people’s well-being</li> <li>(5) To develop cultural programs and industries</li> <li>(6) To explore new forms of social governance</li> <li>(7) To ensure workplace safety and protect people’s lives</li> </ul>
9. To strengthen the all-around improvement of government	<ul style="list-style-type: none"> <li>(1) To continue to work to see that government functions are fully carried out in accordance with law</li> <li>(2) To maintain ethical conduct and moral integrity at all times</li> <li>(3) To perform with a strong work ethic, sense of responsibility, and enterprising spirit</li> </ul>

Source: Compiled by Mizuho Research Institute Ltd. based on the “Report on the Work of the Government” released by Prime Minister Li Keqiang on March 16, 2017

**(2) Focus on the control of financial systemic risks: Basic principle being the steady progress of reforms at state-run companies**

After “three cancellations, one reduction, and one reinforcement”, the second “priority activity for 2017” is “to deepen reforms in major sectors and key links” that cover eight sectors. In particular, the reforms in the financial sector gathered substantial attention. This is because of the fact that the Central Economic Work Conference held in December 2016 had established the principle of “further enhancing the importance of financial risk control.” In the government activity report issued this time, Prime Minister Li

Keqiang relayed his view that “at present, overall, systemic risks are under control,” while also exhibiting his cautious attitude by emphasizing that “we must be fully alert to the buildup of risks, including risks related to nonperforming assets, bond defaults, shadow banking, and Internet finance.” Based on such views, he declared that systemic risks would be thoroughly avoided by establishing firewalls for financial risks through reforms of the system for financial surveillance, the organized cancellation and treatment of eminent individual risks, and the organization and standardization of the financial structure.

The reform of state-run companies and state-owned assets was also included in the eight sectors for which reforms are to be promoted. The priority areas in the reforms of state-run companies and state-owned assets this year include (1) to finish transforming central companies into stock-listed companies and limited companies, in principle, by the end of the year, (2) to practically carry out mixed-ownership system reform (investment in state-run companies by other ownership companies) in areas such as electricity, petroleum oil, natural gas, railway, commercial flights, munitions, and telecommunications, etc., (3) to transfer the function to provide public services from state-run companies to the government, and (4) to further reduce the number of companies and management posts at the group companies of state-run companies.<sup>8</sup> It can be said that these goals have been set out in order to continue with existing reforms rather than starting new ones.

### **(3) Announcement of anti-protectionism and proactive/autonomous openness to the international community: Strong awareness of the trade policy of the U.S. government under U.S. President Donald Trump**

It is also worth mentioning that the “priority activities for 2017” included to open the market to the international community at a more profound and higher level by proactively and autonomously expanding openness to the international community.

In the government activity report issued this time, there were many references to caution against growing protectionism as well as the support for economic globalization. It can be easily explained that such an attitude was based on the fact that the United Kingdom has decided to leave the EU along with the fact that a cautious feeling has been fueled by U.S. President Donald Trump, who repeatedly called for a reduction of the trade deficit, emphasizing that the trade deficit has been a reason for problems in employment. Furthermore, the government activity report also shows the intention of the Chinese government to strengthen the soft power of China by emphasizing that China is the “guardian of the existing international order.”

As a concrete measure to proactively and autonomously expand openness to the international community, the government activity report listed (1) to make solid efforts to pursue the Belt and Road Initiative, (2), to ensure that foreign trade continues to pick up and register steady growth, (3), to make big moves to improve the environment for foreign investors, and (4) to promote liberalization and the facilitation of trade and investment. Among these, for (3), the proposed measures included further deregulation on the participation of foreign companies in the service, manufacturing, and industrial sectors through the revision in the

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<sup>8</sup> 「国资委主任肖亚庆等就“国企改革”答记者问」 (『新华网』 issued on March 9, 2017.

*Catalogue for the Guidance of Foreign Investment Industries*, the approval of the participation of foreign companies in national scientific technology projects, and to give equal opportunities to domestic and foreign companies in license applications, standard-setting, and government procurement, as well as in applying the various measures included in “Made in China 2025,” a measure to help develop the manufacturing industry of China. As all the above measures would influence the business environment surrounding Japanese companies, it is necessary to watch out for future progress regarding them.

#### **4. Challenges for the government under President Xi Jinping: How far can the government advance reforms while maintaining stability?**

As has been discussed above, the government under President Xi Jinping sustains the principle of “seeking progress while maintaining stability.” The challenge for the government would then be how far it can advance reforms while maintaining stability.

Immature reforms can harm stability. For example, if a tacit governmental guarantee for state-run companies is suddenly removed, there will be many state-run companies collapsing due to difficulty in financing, possibly increasing financial systemic risks and rapidly increasing unemployment. However, it is unlikely for the government under President Xi Jinping to carry out such radical reforms because of its basic principle of “seeking progress while maintaining stability.”

It is more likely for the government to delay reforms by focusing too much on stability, which may also increase instability in the economy. For example, due to the excessive fear of the bad influence of tightened shadow banking on the economy, the expansion of shadow banking may not be slowed down as much as necessary, which may cause asset bubbles, resulting in increasing systemic risks that can weaken the economy. Such risks would be measured by the growth rate in the balance of aggregate financing as well as the degree of the increase of wealth management products. Furthermore, as the ratio of bonds in wealth management products is increasing, it is necessary to watch out carefully for bond prices, even more than before. In addition, medium-sized banks are increasingly dependent on interbank loans rather than deposits, using such liabilities for investment in wealth management products.<sup>9</sup> Therefore, it is also important to continue monitoring the liquidity level and interest rates in the interbank market.

Even if stability is sustained for a short period, it is possible for economic growth to slow down for the long term due to the delayed progress that results from the fear of the negative impact of the “three cancellations, one reduction, and one reinforcement” project, the reforms of state-run companies and state-owned assets, and the more profound and higher level of openness to the international community, which would lower productivity. For example, based on the overall principle of “seeking progress while maintaining stability,” focus is being placed on the “strengthened control of risks” in reforming state-run companies and state-owned assets in 2017. While this is expected to “increase mergers and reorganization” and “reduce cases of bankruptcy,”<sup>10</sup> excessive adherence to such principles may result in the sacrifice of economic efficiency,

<sup>9</sup> 三浦祐介「中国人民銀行の政策運営の展望～「緩和」から「中立」に移行しつつ安定維持に腐心～」(みずほ総合研究所『アジアインサイト』issued on December 22, 2016.

<sup>10</sup> 「国资委主任肖亚庆等就“国企改革”答记者问」(『新华网』issued on March 9, 2017.

regarding which we need to remain cautious.

It is the core of the central party that decides on the pace of “progress,” and this depends on the strength of the power base of President Xi Jinping, who is also the leader of the Central Leading Group for Financial and Economic Affairs—the management organization for economic policy. In other words, it is also possible to see the strength of President Xi Jinping by examining the pace of “progress.” If reforms do not accelerate after the Communist Party Congress and the 3rd Plenary Session of the Central Committee of the Communist Party of China in 2018 that agrees on the overall picture of the reforms under the new personnel, it would be proof that the power base of President Xi Jinping has not yet been fixed sufficiently after the Community Party Congress. Furthermore, if measures of economic stimulus continue through a further increase in fiscal deficit or monetary policy without any significant external shock, it would indicate that the Chinese economy and the government under President Xi Jinping are both under difficult situations. As President Xi Jinping repeatedly emphasized that “the effect of overall economic stimulus is clearly falling,”<sup>11</sup> continued economic stimulus would mean that the policy is going against the intentions of the government. In such cases, we need to be more cautious about risks related to China.

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<sup>11</sup> 「中央经济工作会议在京举行」 (『新华网』 issued on December 11, 2014)

**The Benefits to China of Implementing its “Plan for the Development of a Modernized Comprehensive Transport System (2016-2020)” and its Expected Outcomes (Part 1)**

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**Expectations for both more cost-effective**

**passenger and freight transport and economic growth and structural change in the national economy, and the challenges to achieving them**

**1. Introduction: China’s redoubling of its efforts to step up transport infrastructure development and the significance of these policies**

Since 2000, the evolution of new spatial economics by Krugman and others<sup>12</sup> has served to reinforce policy aimed at promoting the development of China’s western interior and that aimed at promoting the agglomeration of regional industries and cities. During this time, the central government has continued to promote both the development of and investment in transport infrastructure; numerous plans for the development of inland waterway transportation that center around the Yangtze River Delta and the Yangtze River basin as the main lateral axis in China’s T-shaped economic development strategy (**Table 1** (1), (2), (3), (5), (7), (9), and (10), etc. ) have been implemented; and in 2004, the “Medium- and Long-Term Railway Network Plan”, which is intended to help address the nation’s transportation needs to the year 2030, was formulated, with two amendments made to the original blueprint in the intervening years (**Table 1** (4), (8), and (13)). China has also invested heavily in road and port construction both at the national and the regional level ((6) and (12), etc.). Moreover, the development and upgrading of road infrastructure is being front-loaded now that with the start of the 13<sup>th</sup> Five-Year Plan (FYP) last year, the government has formulated a succession of related plans, including blueprints for rail transport, improvements to urban transport systems and commercial (civilian) airports ( (13) to (17)).

The “13<sup>th</sup> FYP for the Development of a Modernized Comprehensive Transport System” (hereinafter abbreviated as the “Development Plan”): a new five-year plan ((18)) aimed at promoting the development of an integrated transport system was officially announced at the end of February this year, and is garnering considerable attention. Much of this attention is focusing on the promised impact of increased investment on economic growth during the course of the plan’s implementation, but the content of the plan and the policy briefings that have taken place since its publication suggest that (in formulating this plan) the central government has set its sights on significantly higher goals.

<sup>12</sup> The new spatial economic model developed by Krugman et al. places particular emphasis on the economies of scale involved in urban agglomeration and industry clusters and on the transport costs that accompany freight transportation and factory mobility, specifically labor. This new economic geography is having a major impact on contemporary economic research and regional policy formation elsewhere in the world, and China is no exception. (Ryohei Nakamura, et al., “Urban and Regional Economics”, Yuhinkaku, 1996 [in Japanese]. Yongyu Shao, Ph.D., “Research on Urbanization and Industrialization in China: Historical and Spatial Developments under Resource and Environmental Constraints” , Taiga Shuppan, 2012, [in Japanese])

**Table 1: Trends in the Evolution of Transport Infrastructure Development Policy in China**

No.	Name of relevant policy / plan	Issuing organ	Date of issue
(1)	Outline of Plans for the Development of Inland River Shipping in Western China	Ministry of Transport	2000
(2)	Plan for the Development of Yangtze River Shipping Artery	Ministry of Transport	2003
(3)	Plan for a High Grade Shipping Network in the Yangtze River Delta	Ministry of Transport	2004
(4)	Medium- and Long-Term Railway Network Plan (1 <sup>st</sup> edition)	Ministry of Transport	2004
(5)	Outline of Plans for a Modern Network of Roads and Waterways in the Yangtze River Delta	Ministry of Transport	2005
(6)	Nationwide Coastal Port Location Plan	Ministry of Transport	2006
(7)	Guidance for the Overall Promotion of Yangtze River Golden Waterway Construction in the Period of 11 <sup>th</sup> Five-Year Plan	Ministry of Transport	2007
(8)	Medium- and Long-Term Railway Network Plan (2 <sup>nd</sup> edition)	Ministry of Transport	2008
(9)	Outline of General Plans for a Yangtze River Shipping Artery	Ministry of Transport	2009
(10)	Several Opinions on the Cooperative Promoting the Construction of Yangtze River Golden Waterway	Ministry of Transport	2009
(11)	12 <sup>th</sup> FYP for Development of a Comprehensive Transport System	National Development and Reform Commission	2012
(12)	National Road Network Plan (2013-2030)	Ministry of Transport	2014
(13)	Medium- and Long-Term Railway Network Plan (2016-2030) (3 <sup>rd</sup> edition)	Ministry of Transport	2016
(14)	13 <sup>th</sup> FYP for Development of an Intelligent Transport System	Ministry of Transport	2016
(15)	Three-Year Action Plan for Construction of Major Transport Infrastructure (2016-2018)	National Development and Reform Commission and Ministry of Transport	2016
(16)	13 <sup>th</sup> Five Year Outline Plan for Urban Public Transport Development	Ministry of Transport	2016
(17)	Nationwide Commercial Airport Location Plan	National Development and Reform Commission, Civil Aviation Administration	2017
(18)	13 <sup>th</sup> FYP for the Development of a Modernized Comprehensive Transport System	State Council	2017
(19)	Several Opinions on the Integrated Promotion of Transportation and Tourism	Ministry of Transport, China National Tourism Administration, etc.	2017

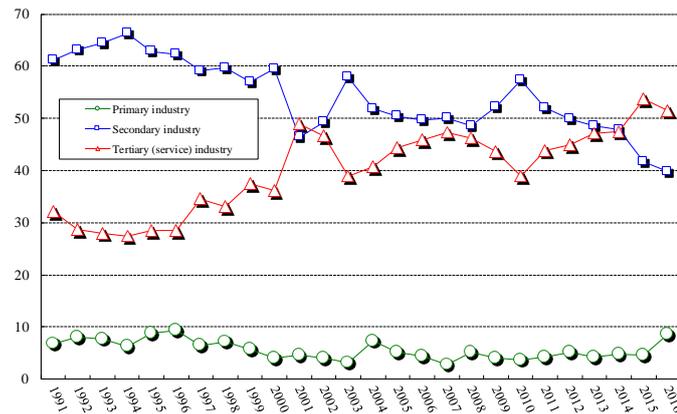
Source: Compiled from the relevant Chinese government websites.

Note: This table lists the major documents that have been formulated and released by the central government, but is not all-inclusive.

Whilst there can be little debating the importance of transport infrastructure to regional development and industrial and economic growth, the development of the transport industry has significant spillover effects on other industries, while transport system construction has far-reaching significance in that it has the potential to reduce logistics costs and stimulate tourism, promote interregional relocation of industry, resolve the segmentation of domestic markets, reduce regional inequality, ensure sustainable economic growth, and move China closer to its goal of realizing a moderately prosperous society. Moreover, the government is hoping that it will prove useful in promoting the construction of fourth industrial revolution technologies, including the Internet of things and smart cities, and is clearly pursuing a combination of outcomes with this Development Plan. The data on the tertiary (service) industry's contribution to the growth of the nation's economy (**Figure 1**) in recent years also testify to the importance of consolidated

transport industry growth to facilitating structural changes in China’s economy (including the relocation of industry), the transport industry being, primarily a tertiary (service) industry and having significant spillover effects on the growth of other services. A government notice regarding the integrated promotion of transportation and tourism was released immediately after the official publication of the Development Plan (**Table 1** (19)), suggesting that the government is focused on the synergies between transport industry development and the growth of other service industries.

**Fig. 1: Trends in the Tertiary (Service) Industry’s Contribution to GDP Growth in China**



Source: *China Statistical Yearbook 2016* and the *2016 Statistical Bulletin*, National Bureau of Statistics of China.

At the same time, the government’s expectations for increased investment in infrastructure during the period covered by the 13<sup>th</sup> FYP on the back of the Development Plan are incontrovertible. The info-graphic shown in **Figure 2** appears on the Chinese government’s website as part of its briefing on the economic effects of the Development Plan; it puts investment in transport infrastructure between 2016 and 2020 (i.e. the five years covered by the 13<sup>th</sup> FYP) at 15 trillion yuan. Most of this is to be spent on roads (RMB 7.8 trillion) and railways (RMB 3.5 trillion), with investment in these two sectors topping 11 trillion yuan. In fact, the special three-year action plan (2016-2018) for transport infrastructure investment unveiled in 2016 as an economic growth driver (**Table 1** (14)) lists investments in major infrastructure construction by year, and includes a total 303 projects and aggregate investment of 4.7 trillion yuan. According to a news report, the Shanghai Railway Bureau expects rail investment in the Yangtze River delta to reach approximately 22.62 billion yuan this year alone (*Jiji News Bulletin*, March 17, 2017). Several projects are underway, but the high-speed rail link between Shanghai, Suzhou and Huzhou (total length: 164 km; design speed: 350 km/hour; total investment: approximately RMB 41.8 billion) is attracting significant attention, and there are plans for work to begin on high-speed rail links for Nantong-Yancheng in Jiangsu Province, as well as Anqing (Anhui Province – Jiujiang (Jiangxi Province)) and Huangshan (Anhui Province – Chizhou (ditto)) in the central region, suggesting that the Development Plan will result in a rush of high-speed rail construction.

This two-part report examines the significance, characteristics and key elements of the Development Plan and offers an overview of the major transport projects in the pipeline, before discussing the expected outcomes of the various policies and the challenges China will need to overcome if its plans for its transport

system are to succeed.

**Fig. 2: Breakdown of China’s RMB 15 trillion investment in transport during the period of 13<sup>th</sup> FYP**



Source: Excerpted from the State Council’s website ([http://www.gov.cn/xinwen/2017-02/28/content\\_5171576.htm](http://www.gov.cn/xinwen/2017-02/28/content_5171576.htm))

**2. An overview of the major characteristics, policy goals and missions of the Development Plan**

China formulated and implemented a five-year plan for a comprehensive transport system during the period covered by its 12<sup>th</sup> FYP (Table 1 (11)). Table 2 lists its achievements in transport infrastructure construction during that five-year period (2011-2015), and shows that China has basically either met or exceeded its targets thereby laying the foundations for the formulation and implementation of the latest five-year plan. The government has added the words “modernized” and “development” to title of the Development Plan for the 13<sup>th</sup> FYP period, suggesting that it is seeking to adapt to the times and achieve ongoing development. The composition and number of indicators (24 in total) given in the latest plan, too, point to a dramatic attempt to raise the level of achievements. Three items have been added: “transport services”, “intelligent transport” and “green safety”, and numerical targets assigned to each, marking a noteworthy shift in governmental thinking on transport (Table 3).

**Table 2: Transport infrastructure developed during the period of 12<sup>th</sup> FYP**

Indicator	2010	2015	2015 target
Rail lines (total route-km)	91,000 km	121,000 km	120,000 km
Of which, high-speed rail links	5,100 km	19,000 km	-
Percentage of double-track railways	41%	53%	50%
Percentage of electric railways	47%	61%	60%
Total road length	4,008,000 km	4,580,000 km	4,500,000 km
Of which, national expressways	58,000 km	80,000	83,000
Percentage of Class II or higher public highways	60%	69.4%	70%
Percentage of township/community roads with asphalt (or cement concrete) surfaces	96.6%	98.6%	98%
Percentage of village roads with asphalt (or cement concrete) surfaces	81.7%	94.5%	90%
Total length of high-grade inland waterways	10,200 km	13,600	13,000 km
Total length of oil and natural gas pipelines	79,000 km	112,000 km	150,000 km
Light rail transit lines (total route-km)	1,400 km	3,300 km	3,000 km
Number of berths with a capacity of 10,000	1,774	2,207	2,214

tons or more in coastal ports			
Number of commercial airports	175	207	230

Source: 13<sup>th</sup> FYP for the Development of a Modernized Comprehensive Transport System, State Council (February 3, 2017)

Note: The statistical standard used for total national expressway length is based on the Chinese system of national-level expressways that is officially known as the National Highway Trunk System/7918 Network.

**Table 3: Major Indicators for China's 13<sup>th</sup> FYP for Comprehensive Transport System Development**

	Indicator	2015	2020	Quality
Basic infrastructure	Rail lines (total route-km)	121,000 km	150,000 km	Provisional
	High-speed rail links	19,000 km	30,000 km	Provisional
	Percentage of double-track railways	53%	60%	Provisional
	Percentage of electric railways	61%	70%	Provisional
	Total road length	4,580,000 km	5,000,000 km	Provisional
	Completed expressways	124,000 km	150,000 km	Provisional
	High-grade inland waterways	13,600 km	17,100 km	Provisional
	Number of berths with a capacity of 10,000 tons or more in coastal ports	2,207	2,527	Provisional
	Number of commercial airports	207	260	Provisional
	Number of General Aviation Aerodromes <sup>*2</sup>	300	500	Provisional
	Percentage of hard-surface village roads <sup>*1</sup>	94.5%	99%	Provisional
	Light transit rail lines (total route-km)	3,300	6,000	Provisional
	Oil and natural gas pipelines (total length)	112,000 km	165,000 km	Provisional
Transport services	Percentage of rail passengers traveling in high-speed electric multiple unit (EMU) trains	46%	60%	Provisional
	Percentage of regular commercial flights	67%	80%	Provisional
	Percentage of village bus routes	94%	99%	Binding
	Percentage of standardized road cargo tracking	50%	80%	Provisional
	Average annual growth rate of combined rail-inland waterway freighting	10%		
	Bus stop coverage in completed urban areas with a permanent population of 1 million or more (located 500m apart)	90%	100%	Provisional
Intelligent transport	Percentage of digitized traffic information (basic)	90%	100%	Provisional
	Percentage of online train ticket sales	60%	70%	Provisional
	Percentage of ETC use on bus routes	30%	50%	Provisional
Green safety	Percentage reduction of traffic CO <sub>2</sub> emission intensity <sup>*3</sup>	7% <sup>*4</sup>	7% <sup>*4</sup>	Provisional
	Percentage decrease in fatalities from comparatively serious traffic accidents on roads	20% <sup>*4</sup>	20% <sup>*4</sup>	Binding

Source: As for Table 2

Notes:

\*1 “Hard-surface roads” generally refers to roads covered with asphalt (or cement concrete), but since conditions for construction are particularly rigorous in western China, the term is applied to areas of high altitude and/or extreme cold that have little use for transportation.

\*2 The statistics for General Aviation Aerodromes include landing areas.

\*3 Emission intensity refers to the average emission rate of CO<sub>2</sub> relative to distance traveled.

\*4 The asterisk indicates the percentage compared to that at the end of the 12<sup>th</sup> FYP (i.e. in 2015).

According to a Chinese government official<sup>13</sup>, the Development Plan has been designated one of twenty-two major state-level initiatives that are to be undertaken as part of the 13<sup>th</sup> FYP for National Economic and Social Development. The primary objective of the Development Plan is to build a safe, convenient, efficient and eco-friendly modernized comprehensive transport system by 2020, with certain regions and sectors to take the lead in achieving the modernization of China’s transport network.

The Development Plan calls for the construction of an additional approximately 420,000 kilometers of railroads (of which 11,000 km are to be high-speed rail links) and approximately 320,000 kilometers of roads (of which approximately 30,000 km are to be expressways) during the 13<sup>th</sup> FYP period, upwards of 300 berths with the capacity to accommodate vessels of 10,000 tons deadweight minimum, plus at least fifty additional commercial airports.

Exceeding 26,000 characters, the Development Plan comprises three parts, the Part 1 (“Overall Requirements”) provides details of the aforementioned development goals and the overall requirements of the Plan; the Part 2, meanwhile, specifies key missions and the major projects to be implemented, whilst the Part 3 comprises a brief outline on “strengthening the policy support measures” in respect of five points (1. Better management of plan execution; 2. Reinforced policy support; 3. Completion of the system governing regulations and standards; 4. Stronger innovation in traffic technology; and 5. Development of multifaceted personnel teams), “Arrangements for the allocation of key missions” as an appendix, and seven planning maps. Broadly speaking, the Part 2 deals with the essentials of the Development Plan, and it is the contents of this part that are addressed below. The Plan lists eight key missions: (1) Improving transport facilities and network infrastructure; (2) Strengthening strategic support; (3) Optimizing transport services; (4) Improving smart management levels; (5) Promoting green (or eco-friendly) development; (6) Enhancing safety and security; (7) Cultivating new sectors and businesses; and (8) Stronger innovation, where items (4), (5) and (7) look to have been added in in response to emerging needs. Having identified these eight key missions, the Development Plan goes on to provide a ten-column table, and maps out 32 priority projects and five major special action plans.

Of particular note are the plans to construct twenty major (country-spanning) transport corridors that will interconnect east to west and north to south China, respectively. In specific terms, the Plan maps out a transport network that encompasses the whole of China from its southernmost point to its northernmost and from its easternmost point to its westernmost. Details of the cities at the start and end points of each transport corridor and the cities the respective routes will pass through are given in **Table 4**, but a central

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<sup>13</sup> A high-ranking Ministry of Transport official speaking at the press conference that was given following the official announcement of the Development Plan.

feature of the plan is the inclusion of numerous cities in central and western China and the autonomous regions that are home to its ethnic minorities, cities that had a tendency to be passed over in earlier blueprints. Moreover, consideration is also given to links to international (transport) routes and the route of a prospective transport corridor running along China's western border is included (**Fig. 3**), suggesting that the plans for the development of transport network infrastructure were devised with an eye to future economic globalization and China's "One Belt, One Road" initiative (i.e. the land-based Silk Road Economic Belt and the oceangoing Maritime Silk Road).

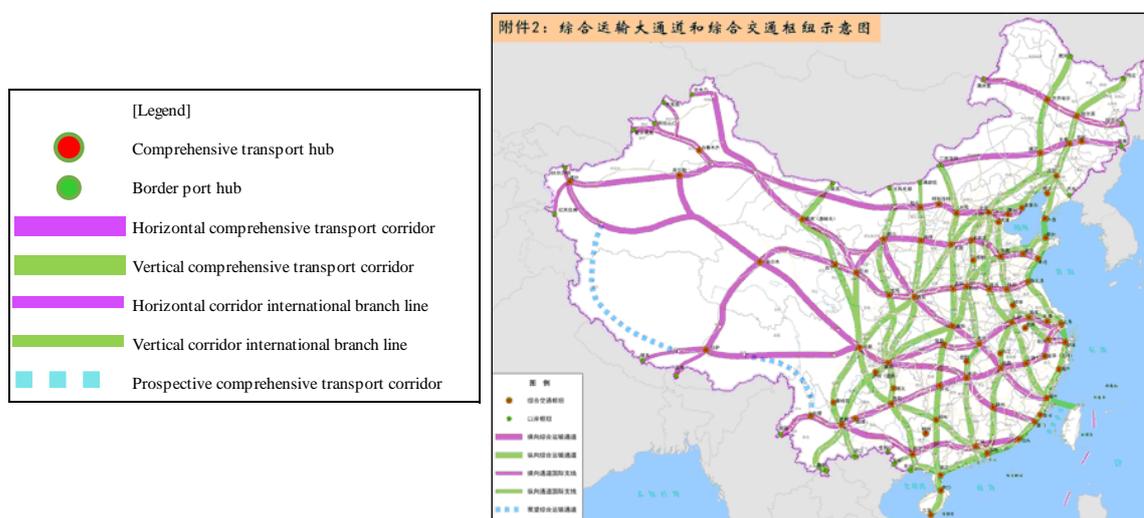
**Table 4: Location of the Comprehensive Transport Corridors in the Plan for the Development of a Modernized Comprehensive Transport System**

[10 Horizontal Comprehensive Transport Corridors]		
1	Coastal Transport Corridor	From Tongjiang to Sanya via Harbin, Changchun, Shenyang, Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Fuzhou, Xiamen, Shantou, Guangzhou, Zhanjiang, Haikou.
2	Beijing-Shanghai Transport Corridor	From Beijing to Shanghai/Hangzhou via Tianjin, Jinan, Bengbu, Nanjing
3	Beijing-Hong Kong, Macao and Taiwan Transport Corridor	From Beijing to Hong Kong (Macao) via Hengshui, Heze, Shangqiu, Jiujiang, Nanchang, Ganzhou, Shenzhen. A branch line via Hefei, Huangshan, and Fuzhou to Taipei.
4	Heihe-Hong Kong, Macao and Taiwan Transport Corridor	From Heihe to Hong Kong (Macao) via Qiqihar, Tongliao, Shenyang, Beijing, Shijiazhuang, Zhengzhou, Wuhan, Changsha, Guangzhou.
5	Erenhot –Zhanjiang Transport Corridor	From Erenhot to Zhanjiang via Jining, Datong, Taiyuan, Luoyang, Xiangyang, Yichang, Huaihua
6	Baotou-Fangchenggang Transport Corridor	From Baotou (Mandula) to Fangchenggang via Yanan, Xi'an, Chongqing, Guiyang, Nanning
7	Linhe- Mohan Transport Corridor	From Linhe (Ganqimaodu) to Mohan/Hekou via Yinchuan, PingLiang, Baoji, Chongqing, Kunming
8	Beijing-Kunming Transport Corridor	From Beijing to Kunming via Taiyuan, Xi'an, Chengdu (Chongqing)
9	Ejina-Guangzhou Transport Corridor	From Ejina (Ceke) to Guangzhou via Jiuquan (Jiayuguan), Xining (Lanzhou), Chengdu, Luzhou (Yibin), Guiyang, Guilin
10	Yantai-Chongqing Transport Corridor	For the north, Yantai to Chongqing via Weifang, Jinan, Zhengzhou, Nanyang, Xiangyang
[10 Vertical Comprehensive Transport Corridors]		
1	Suifenhē –Manzhouli Transport Corridor	From Suifenhē to Manzhouli via Mudanjiang, Harbin, Qiqihar
2	Hunchun-Erenhot Transport Corridor	From Hunchun to Erenhot via Changchun, Tongliao, Xilin hot
3	Northern Section of the Northwest Transport Corridor	From Tianjin (Tangshan, Qinhuangdao) to Turgart, <a href="#">IrkeshTam</a> , Khunjerab via Beijing, Hohhot, Linhe, Hami, Turpan, Korla, Kashgar A branch line from Hami to Altay (Jeminay) via Jiangjunmiao
4	Qingdao-Lhasa Transport Corridor	From Qingdao to Lhasa via Jinan, Dezhou, Shijiazhuang, Taiyuan, Yinchuan, Lanzhou, Xining, Golmud
5	Landbridge Transport Corridor	From Lianyungang to Alashankou, Khorgos via Xuzhou, Zhengzhou, Xi'an, Lanzhou, Urumqi, Jinghe
6	Coastal Transport Corridor	From Shanghai to Yadong, Zhangmu via Nanjing, Wuhu, Jiujiang, Wuhan, Yueyang, Chongqing, Chengdu, Linzhi, Lhasa, Shigatse
7	Shanghai-Ruili Transport Corridor	From Shanghai (Ningbo) to Ruili via Hangzhou, Nanchang, Changsha, Guiyang, Kunming
8	Shantou-Kunming Transport Corridor	From Shantou to Kunming via Guangzhou, Wuzhou, Nanning, Baise
9	Fuzhou-Yinchuan Transport Corridor	From Fuzhou to Yinchuan via Nanchang, Jiujiang, Wuhan, Xiangyang, Xi'an, Qingyang
10	Xiamen-Kashgar	From Xiamen to Kashgar via Ganzhou, Changsha, Chongqing, Chengdu, Golmud,

	Transport Corridor	Ruoqiang
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Source: As for Table 2, this table is compiled from the State Council’s “13<sup>th</sup> FYP for the Development of a Modernized Comprehensive Transport System.

Fig. 3: Blueprint for China’s Comprehensive Transport Corridors and Comprehensive Transport Hubs



Source: Reprinted from the State Council’s 13<sup>th</sup> FYP for the Development of a Modernized Comprehensive Transport System.

### 3. Positioning of high-speed rail links, roads, airports and transport hub cities in the Development Plan and the relevant projects

Another key area of note are the priority projects planned in connection to the “Fast-Transit Grid (Network)”, which will include the construction of high-speed rail links, expressways and commercial airports within the timeframe of the Development Plan (Table 5).

Table 5: Priority Projects for the Fast-Transit Grid in the Plan for the Development of a Modernized Comprehensive Transport System

[High-speed Rail Links]	
➤	Complete construction of the following high-speed rail links: Beijing to Shenyang, Beijing to Zhangjiakou/Hohhot, Datong to Zhangjiakou, Harbin to Mudanjiang, Shijiazhuang to Jinan, Jinan to Qingdao, Xuzhou to Lianyungang, Baoji to Lanzhou, Xi’an to Chengdu, Chengdu to Guiyang, Shangqiu to Hefei/Hangzhou, Wuhan to Shiyan, Nanchang to Ganzhou.
➤	Construct the following high-speed rail links: Yinchuan to Xi’an, Guiyang to Nanning, Chongqing to Kunming, Beijing to Shangqiu, Jinan to Zhengzhou, Fuzhou to Xiamen, West to Chengdu, Chengdu to Zigong, Lanzhou to Zhongwei, Huanggang to Huangmei, Shiyan to Xi’an, Xi’an to Yanan, Yinchuan to Baotou, Yancheng to Nantong, Hangzhou to Shaoxing/Taizhou, Xiangyang to Yichang, Ganzhou to Shenzhen, Changsha to Ganzhou, Nanchang to Jingdezhen/Huangshan, Chizhou to Huangshan, Anqing to Jiujiang, Shanghai to Huzhou, Hangzhou to Wenzhou, Guangzhou to Shanwei, Shenyang to Dunhua, Mudanjiang to Jiamusi, Zhengzhou to Wanzhou, Zhangjiajie to Huaihua, Hefei to Xinyi.
[Expressways]	
➤	Construct the following six expressways passing through international and/or provincial borders: Beijing–Ürümqi Expressway (G7), Hohhot-Beihai Expressway (G59), Yinchuan-Baise Expressway (G69), Yinchuan-Kunming Expressway (G85), Shantou-Kunming Expressway (G78), Metropolitan Loop Line (G95). Promote the extension of the following eight major corridors: Beijing-Haerbin Expressway (G1), Beijing-Shanghai Expressway (G2), Beijing-Taibei Expressway (G3), Peking-Hong Kong-Macao Expressway (G4), Shenyang-Haikou Expressway (G15), Shanghai-Chengdu Expressway (G42), Lianyungang-Khorgas Expressway (G30), Lanzhou-Haikou Expressway (G75).
➤	Construct a corridor crossing the Yangtze River between Shenzhen and Zhongshan. Construct a new expressway linking the following ports: Jinghe to Alashankou, Erenhot to Enkhsaikhan Tara, Jingxi to Longbang.

[Commercial Airports]	
➤	Complete construction of the following airports: New Beijing airport, New Chengdu airport, Chengde, Hologola, Songyuan, Baicheng, Bei da huang jian san jiang, Wudalianchi, Shangrao, Xinyang, Wugang, Yueyang, Wushan, Bazhong, Renhuai, Lancang, Longnan, Qilian, Shache, Ruoqiang, Tumu Shuker, Suifenhe, Wuhu/ Xuancheng, Ruijin, Shangqiu, Jingzhou, Ezhou/Huangguang, Chenzhou, Xiangxi, Yulin, Wulong, Ganzi, Qianbei, Honghe.
➤	Build new airports at: Qingdao, Xiamen, New Hohhot Airport, Xingtai, Zhenglanqi, Lishui, Anyang, Leshan, Yuanyang. Build new airports at Zhengzhou, etc. to provide cargo services. Study the construction of airports at New Dalian, Liaocheng, etc. Conduct preliminary research into the construction of airports at: Guangzhou, Sanya, and Lhasa (new-build).
➤	Expand the following airports: Shanghai Pudong, Guangzhou, Shenzhen, Kunming, Chongqing, Xi'an, Urumqi, Harbin, Changsha, Wuhan, Zhengzhou, Haikou, Shenyang, Guiyang, Nanning, Fuzhou, Lanzhou, Xining.
➤	Promote construction of major circular, one-way aerial transport corridors between Beijing-Shanghai, Beijing-Guangzhou, China-South Korea, Shanghai-Haerbin, Shanghai-Kunming, Shanghai-Guangzhou, Shanghai-Lanzhou, Qingdao-Kunming, so as to create the framework for a commercial airspace network that primarily operates in one direction.

Source: As for Table 2, this table is compiled from the State Council’s 13<sup>th</sup> FYP for the Development of a Modernized Comprehensive Transport System.

Since China has been constructing expressways for longer than it has been building high-speed rail links, most of the new expressways planned are either east-west links or located in western China. In contrast, the plans for new and extended/expanded high-speed rail links and commercial airports cover the whole nation. This is clearly evidenced by the maps given in **Figures 4, 5, and 6**. The routes and/or points (the airport construction map given in **Figure 6**) marked in blue and green were principally completed during the 12<sup>th</sup> FYP period, whilst those marked in red are to be constructed during the 13<sup>th</sup> FYP period. The plans for high-speed rail link and commercial airport construction outnumber those for new expressways.

China’s longstanding regional development strategy and increased public investment have resulted in dramatic improvements in its transport infrastructure, meaning that it has dealt with its transport bottlenecks and must now upgrade and optimize its transport system. Transport network infrastructure in the eastern coastal region is complete, and its task now is to build and expand traffic network infrastructure in central and western China.

The Development Plan also has a clear policy direction in that it focuses on the construction of hub city functions and the effects created by the economics of agglomeration that arise from the development of transport networks, and its formulation is unquestionably a response to the “One Belt, One Road” initiative that was unveiled in 2013 as China’s strategy for the development of intercontinental regional economic cooperation. The positioning of the comprehensive transport hubs and the infrastructure projects given in **Table 6** testify to this. The plans then specify the regional cities and relevant construction plans under three broad categories: international comprehensive transport hubs, national comprehensive transport hubs, and regional comprehensive transport hubs and border port hubs. Again, the selection of Chengdu-Chongqing in western China as one of four international comprehensive transport hubs is noteworthy. That Chengdu-Chongqing is being given the same weight as the other three regional hubs (Beijing-Tianjin, Shanghai, Guangzhou-Shenzhen) is significant in that construction of railways, high-speed rail links and public highways linking the various cities can be expected to gather pace in the coming years, waterway infrastructure and a network airports will be built, China will get a multidimensional, high density transport network comprising railways, roads, waterways and airports, which will hopefully result in travel time savings for intercity travel, and allow the synergies created by city clusters to reach central China. Moreover,

in making transport networks in central and western China functional and enhancing the region’s transport infrastructure, the hope is that it will encourage the mature industries and excess capacity of the eastern coastal region to relocate to central and western China, that the fast-growing industries of central and western inland area will serve to stabilize economic growth and help to reduce the regional inequalities that continue to plague China.

**Table 6: Comprehensive Transport Hubs planned in the Plan for the Development of a Modernized Comprehensive Transport System**

[International Comprehensive Transport Hubs]	
➤	Build international comprehensive transport hubs focusing on Beijing to Tianjin, Shanghai, Guangzhou to Shenzhen, and Chengdu to Chongqing; build international comprehensive transport hubs at Kunming, Urumqi, Harbin, Xi’an, Zhengzhou, Wuhan, Dalian, and Xiamen, etc.; broadly enhance service functions, including international passenger traffic, freight distribution and relay services; set up fully functional transport hubs offering highly efficient links to link China to the rest of the world.
[National Comprehensive Transport Hubs]	
➤	Enhance the overall function of comprehensive transport hubs at Changchun, Shenyang, Shijiazhuang, Qingdao, Jinan, Nanjing, Hefei, Hangzhou, Ningbo, Fuzhou, Haikou, Taiyuan, Changsha, Nanchang to Jiujiang, Guiyang, Nanning, Lanzhou, Hohhot, Yinchuan, Xining, Lhasa, Qinhuangdao to Tangshan, Lianyungang, Xuzhou, Zhanjiang, and Datong, etc.; enhance the international service functions of certain major transport hubs.
➤	Promote construction of transport hubs at Yantai, Weifang, Qiqihar, Jilin, Yingkou, Handan, Baotou, Tongliao, Yulin, Baoji, Quanzhou, Kashgar, Korla, Ganzhou, Shangrao, Bengbu, Wuhu, Luoyang, Shangqiu, Wuxi, Wenzhou, Jinhua—Yiwu, Yichang, Xiangyang, Yueyang, Huaihua, Luzhou—Yibin, Panzhihua, Jiuquan—Jiayuguan, Golmud, Dali, Qujing, Zunyi, Guilin, Liuzhou, Shantou, Sanya, etc.; promote harmonization and efficiency across all methods of transport and expand coverage so as to optimize transfer facilities and distribution networks.
[Regional Comprehensive Transport Hubs and Border Port Hubs]	
➤	Promote construction of a cluster of regional comprehensive transport hubs, enhance coverage and spillover capacity in respect of surrounding areas, strengthen the level of support provided to major comprehensive transport corridors and national transport hubs.
➤	Promote construction of major hubs along China’s border at Dandong, Hunchun, Suifenhe, Heihe, Manzhouli, Erenhot, Ganqimaodu, Ceke, Baketu, Jimunai, Alashankou, Khorgos, Turgart, Hongqilafu, Zhangmu, Yadong, Ruili, Mohan, Hekou, Longbang, Pingxiang, Dongxing, etc.

Source: As for Table 2, this table is compiled from the State Council’s 13<sup>th</sup> FYP Plan for the Development of a Modernized Comprehensive Transport System.

The unveiling of the Development Plan more than a year after the 13<sup>th</sup> FYP went into action was partly a response to the major parliamentary session that is the National People’s Congress, but can also be seen as a statement of policy intent reflecting the need to achieve an annual economic growth target of 6.5 percent in the current fiscal year. The addition of the words “modernized” and “development” to the title of the Development Plan can also be taken as a response to the initiation of a new five-year plan and to the dawning of a new era in economic and industrial development. Unusually, the latest Development Plan includes, in the form of attachments, detailed planning maps for the construction of high-speed rail links, expressways and commercial airports that pertain to future transport system needs (**Figures 3 through 7**), and this makes the Plan distinctive. These detailed maps argue that this is a far-reaching five-year plan for China’s transport that will facilitate the development of a modern, comprehensive transport system, and that it constitutes a strategy for regional development that factors in the constraints on national development, resources and the environment, as well as energy security. These issues will be addressed in more detail in Part 2 of this report.

**Fig. 4: China’s 13<sup>th</sup> FYP Railway Construction Map**



Fig. 5: China’s 13<sup>th</sup> FYP Expressway Construction Map

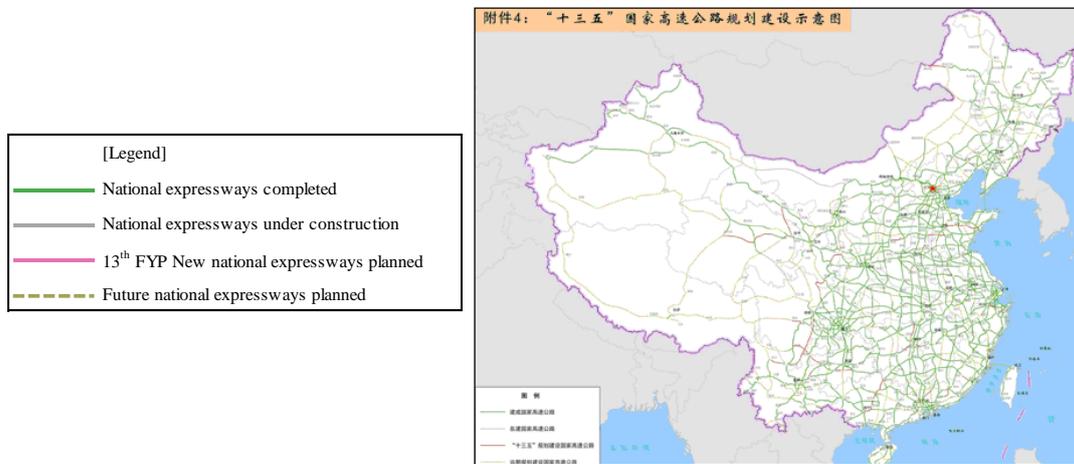


Fig. 6: China’s 13<sup>th</sup> FYP Commercial Airport Construction Map



Source (Figures 4, 5 and 6): Reprinted from the State Council’s 13<sup>th</sup> FYP for the Development of a Modernized Comprehensive Transport System.

# The Direction of Chinese Monetary Policy

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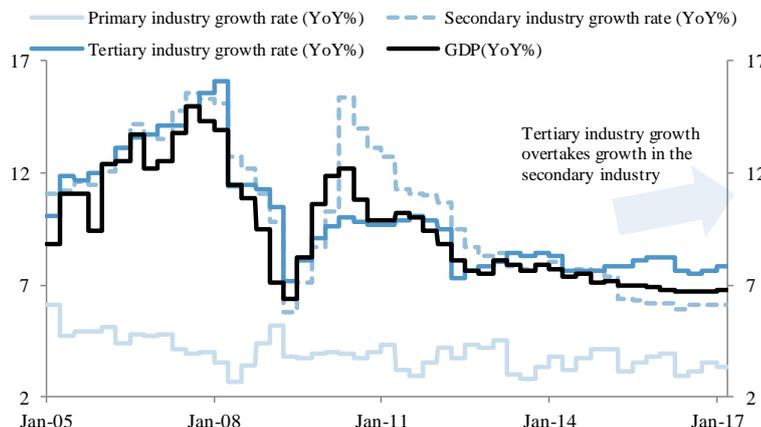
## 1. Introduction

In January 2016, a mysterious figure called “authoritative person” appeared in the *People’s Daily*, the official paper of the Communist Party, stating that “China’s growth over the next few years is likely to be L-shaped (i.e. that economic recovery will be slow)” with regard to the Chinese economic conditions. The phrase has since become common parlance in Chinese economy talk, but China’s economy has in fact continued to follow an L-shaped growth curve. Positive changes in China’s latest economic data offer evidence that its economy is recovering, however. This report provides an overview of the current state of the Chinese economy and considers the direction its policymakers are likely to pursue in monetary policy going forward.

## 2. An overview of the Chinese Economy

China’s economy is showing signs of recovery, albeit gradual. The Caixin manufacturing Purchasing Managers’ Index (PMI), which monitors sentiment about business conditions among factory managers, has been reading above the critical 50-mark for eight consecutive months (indicating expansion), while China’s Producer Price Index (PPI) rose for the first time in nearly four and a half years in September 2016, increasing 7.8 percent year-on-year in March this year and marking the highest growth rate since 2011. Figure 1 shows the trends in Gross Domestic Product (GDP) and the growth rates by industrial structure. The media tends towards pessimistic views on the Chinese economy, but there is evidence that China is **“upgrading its industrial structure”**, with the proportion of value-added from the tertiary industry in GDP in fact exceeding the contribution of the secondary industry. Moreover, nominal GDP growth averaged an annualized 5.7 trillion yuan between 2010 and 2015 (approximately 1 trillion USD: equivalent to Indonesia’s nominal GDP growth in 2015), and its market is continuing to expand in terms of both scale and presence.

Fig. 1: GDP Growth Rate and the Growth Rate by Industrial Structure

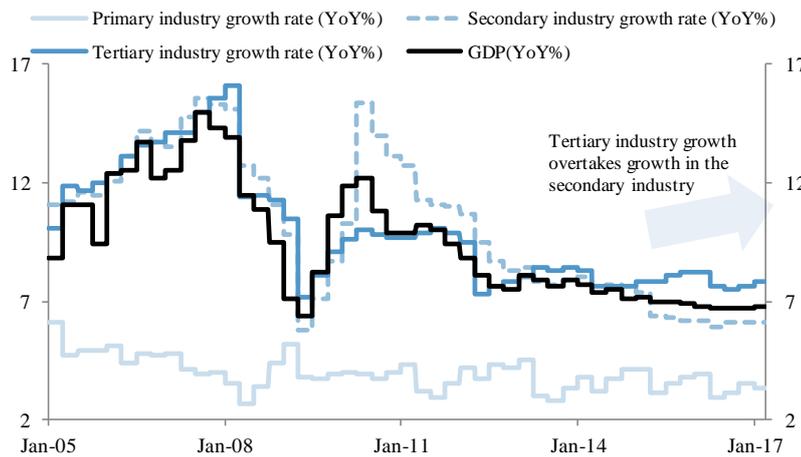


Source: Bloomberg

At the same time, some of China’s economic indicators are showing signs not of “recovery” but of “overheating”. One is the **price trends in newly-built houses**.

Prices of newly-built houses in first-tier cities<sup>14</sup> announced in February 2017 increased by a breathtaking 22.68 percent year-on-year, with the soaring price growth suggestive of a real estate bubble in China’s newly-built housing market akin to that seen in Japan at one time (see Figure 2).

Fig. 2: Trends in Base Rates and Prices of Newly-built Houses



Source: Bloomberg

The People’s Bank of China (PBOC), Ministry of Housing and Urban-Rural Development, and the China Banking Regulatory Commission began announcing measures aimed at stimulating housing demand on March 31, 2015, including cuts to the minimum mortgage down payment required of first-time buyers and looser restrictions on the number of housing purchases, in support of which the Ministry of Finance has cut taxes on housing transactions in a desperate effort to stimulate demand for housing. At the Central Economic Work Conference in December 2015, China’s monetary authorities declared their commitment to moderately expanding overall demand and “strengthening supply-side structural reform”, part of which would include the resolution of its housing inventory problem. Since then, there has been some gradual improvement in the housing market in third-tier cities, but amid signs of property overheating that could generate a record-breaking housing bubble in China’s first-tier and other larger cities, China faces the unexpected prospect of a real estate bubble.

China has since moved to tighten its housing policy, with Shanghai and Shenzhen raising the down payment requirements on housing purchases in March 2016 in an effort to ease housing bubble fears, but house prices in first-tier cities have continued to grow at an annualized rate of around 20 percent.

To address this problem and prevent both a real estate bubble and systemic financial risk, at the Central Economic Work Conference of December 2016, China’s monetary authorities tightened the restrictions on housing purchases and affected a shift in the nation’s monetary policy.

<sup>14</sup> First-tier cities: Beijing, Shanghai, Guangzhou and Shenzhen  
 Second tier cities: Tianjin, Chongqing, Hangzhou, Nanjing, Wuhan, etc.  
 Third tier cities: Shaoxing, Hefei, Changchun, etc.

### 3. Central Economic Work Conference Offers Evidence of a Shift in Monetary Policy

China's central leadership convened at the Central Economic Work Conference, a three-day meeting that took place on December 14-16, 2016, to discuss economic policy and growth targets for 2017. The Work Conference positioned 2017 as a year in which **“China’s economic work will focus on deepening supply-side structural reform since it is a key year in the 13<sup>th</sup> Five-Year Plan”**, and highlighted the basic tone of **“seeking progress while maintaining stability”** as a main theme of next year's economic planning. In addition, China has turned from its moderate monetary policy to a neutral stance, signaling a gradual tightening in the central bank's operations over the coming months, and, in respect of the property market, has reiterated the principle that “houses are built to be inhabited, not for speculation”.

The PBOC has taken the Central Economic Work Conference's statement regarding the “shift in monetary policy” at face value and has been engaged in a **“moderate tightening of monetary policy”**, draining liquidity (capital) from the financial system by raising the lending rates on its Medium-Term Lending Facility (MLF) and Standing Lending Facility (SLF)<sup>15</sup> at the beginning of the year, and since February, refraining from open-market operations, which it usually conducts on every working day, for six consecutive trading days .

As the tightening stance of the PBOC becomes more obvious, the three-month Shanghai Interbank Offered Rate (SHIBOR)<sup>16</sup> – the benchmark interest rate used in lending activities between banks – has been inching up, rising by about 1.5 percent since early November 2016 and climbing to the level of the one-year benchmark lending rate (4.35%) (see Figure 3).

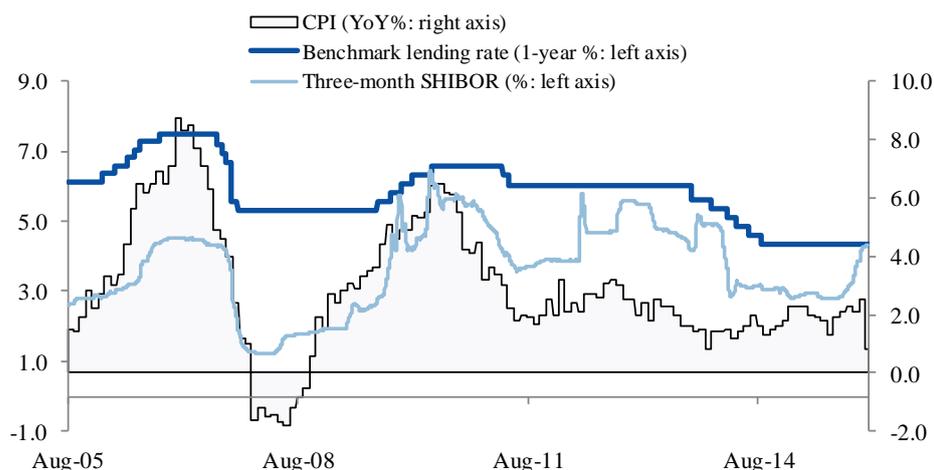
The three-month SHIBOR has risen to the level of the one-year lending rate twice before, but on both occasions the PBOC had raised the benchmark interest rates. The previous interest rate hike (in 2008) was in response to a different set of economic circumstances, however, and came during a phase of surging consumer prices when China's CPI inflation had accelerated to 6.5 percent. Given that price trends are an important factor in the decision to raise benchmark interest rates, the central bank is unlikely to make this move any time soon since China's consumer price index announced in March increased 0.8 percent (in February) from a year earlier, which is a long way off its official consumer inflation target of 3 percent for this year.

At the same time, the widening interest rate gap between China and the US is causing some apprehension over the exchange rate of the yuan, meaning that the PBOC will be watching the US closely for interest rate hikes and trends in US bond yields and could yet elect to raise Chinese interest rates. Daily open-market operations (repo rate) and an increase in the rate on MLF loans are a strong possibility given rising commodity prices worldwide and the need to address inflation concerns.

<sup>15</sup> The MLF offers collateralized loans primarily to financially sound banks with the aim of guiding medium-term liquidity.

<sup>16</sup> The SLF is a short-term lending facility that is mainly used in response to specific factors.

Fig. 3: Trends in Benchmark Interest Rates the SHIBOR/CPI



Source: Bloomberg

#### 4. National People’s Congress on the Renminbi Exchange Rate

The 12<sup>th</sup> National People’s Congress (NPC) convened on March 5-15. Chinese Premier Li Keqiang delivered the government work report at the opening ceremony, which included the growth target for 2017 and other economic goals. The report is a blueprint for the country’s economic policy in 2017.

The stance on economic policy presented at the NPC was consistent with that of the Central Economic Work Conference, with the work report setting “**ensuring steady growth**” and “**preventing systemic financial risks**” as priorities for the year ahead and stating China’s shift from “**monetary policy tightening**” to an “**expansionary monetary policy**” in bid to achieve these ends. China has set a realistic growth target for 2017 that is consistent with the basic tone of the latest work report on the necessity of maintaining steady economic growth as the overriding policy goal for top leaders.

Table: Economic Policy Goals in the NPC Government Work Report

GDP growth rate (year-on-year)	6.5%	6.7%	6.5-7.0%
Consumer price index (year-on-year)	3.0%	2.0%	3.00%
Retail sales (year-on-year)	10.0%	10.4%	11%
M2 growth rate (year-on-year)	12.0%	13.0%	13.0%
Budget deficit (trillion yuan)	2.38	2.19	2.18
Budget deficit in relation to GDP (year-on-year)	3.0%	3.0%	3.0%
Fixed asset investment (excluding rural households) (year-on-year)	9.0%	8.1%	10.5%

Source: Compiled by the author from various news reports

Speaking on the subject of China’s exchange control policy at the conclusion of the NPC, Premier Li Keqiang said: “China has not intention of devaluing its currency to boost exports and will continue to push forward reform of its exchange rate formation mechanism. China’s foreign exchange reserves are way above the international standard and officials will guarantee the normal use of foreign currency by

individuals and companies.” Movements in the yuan exchange rate, however, argue that, in the face of considerable capital outflow pressure, the climate in markets will continue to favor a depreciation bias as expectations that the yuan will weaken against the US dollar increase. But with Chinese authorities expressing alarm over excessive depreciation in the yuan and capital flight, the expectation is that China will continue to tighten its capital controls in a bid to achieve “currency stability”.

China has switched from easing to a neutral monetary policy in a bid to deflate the country’s growing asset bubble epitomized by overheated housing market and curb systemic financial risks. With its overheated property market showing no signs of cooling, the climate favors a new round of tightening by China’s central bank, but it will have to steer carefully, including making use of expansionary fiscal policy, if it is to avoid such moves having an impact on the real economy. Likewise, with capital outflow pressure and a bias for depreciation on the yuan now deeply rooted, Chinese authorities who take full advantage of the nation’s foreign exchange reserves and capital controls, are expected to beef up their management of the yuan exchange rate, and markets will be monitoring their policy maneuvers closely.

## 5. Conclusion

Whilst China’s vast economy keeps its market in the global spotlight, it comes under fire for its lack of communication in comparison with other developed nations. It is hoped that this report will give readers a better understanding of the Chinese economy.

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