

# ***MIZUHO CHINA MONTHLY***

## **China's Economy**

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### **China's Economic Policy Direction in 2020**

**- The Central Economic Work Conference Lays the Groundwork for the Transition to a 'New Development Concept'-**

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## - Executive Summary -

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### China's Economic Policy Direction in 2020

The Central Economic Work Conference set out the direction for economic policy in 2020 when it met over December 10–12. It emphasized the importance of the new development concept as it focused on policy management from 2021 onwards. It said deleveraging and other structural reforms had succeeded in dealing with the negative legacy of past economic policy to a certain extent. The priority from here on will be strengthening weak points. While insisting on the importance of maintaining economic stability, the authorities will probably tolerate growth of less than +6% going forward (provided employment stability, etc. is maintained) while fine-tuning the economy through infrastructure investment and monetary policy, for example.

# China's Economic Policy Direction in 2020<sup>1</sup>

## The Central Economic Work Conference Lays the Groundwork for the Transition to a 'New Development Concept'

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### 1. The Central Economic Work Conference formulated economic policy for 2020 with an eye on policy management from 2021

China's Central Economic Work Conference (hereinafter, 'the Work Conference') met over December 10–12, 2019 to set the direction of economic policy for 2020 (Fig. 1).

**Figure 1: Key points of the Central Economic Work Conference**

Heading	Outline
<b>An important consensus formed through past policy management</b>	<ul style="list-style-type: none"> <li>✓ With regards to macro-controls, <b>we must scientifically and steadily control the level of counter-cyclical adjustment</b> while pursuing the basic framework of the <b>supply-side structural reform</b> throughout the whole process.</li> <li>✓ We must optimize the mode of economic governance based on system theory while strengthening the overall concept and <b>pursuing a dynamic balance among multiple objectives</b>.</li> <li>✓ We must proficiently <b>use reform to remove systemic obstacles</b> faced by development while rousing dormant development potential.</li> <li>✓ We must enhance risk awareness and <b>firmly stick to the bottom line of avoiding systemic risk</b>.</li> </ul>
<b>An awareness of the current situation</b>	<ul style="list-style-type: none"> <li>✓ We must recognize that China is going through a difficult period of changing the mode of economic development, optimizing the economic structure, and changing the driving forces of growth.</li> <li>✓ We must recognize that structural, institutional, and cyclical factors are combining to <b>amplify the downside pressure on the economy</b>.</li> <li>✓ We must be aware that the global economy is continuing to slow, <b>with global risk increasing</b>.</li> </ul>
<b>Basic policy</b>	<ul style="list-style-type: none"> <li>✓ We reaffirm our focus on achieving our goals <b>in 2020, the final year of the project to build 'a moderately prosperous society in all respects' and the final year of the 13th Five-Year Plan</b>.</li> <li>✓ We must steadfastly pursue stable development, supply-side structural reforms, the 'three tough battles' (eradicating poverty, tackling pollution, and preventing and eliminating major financial risks), and the <b>'six stabilities'</b> (stabilize employment, finance, foreign trade, foreign investment, investment and expectations).</li> <li>✓ <b>With a priority on stability</b>, we must ensure macroeconomic stability, microeconomic flexibility, and support measures based on social policy. We must ensure a reasonable growth in the size and a steady improvement in the quality of the economy while reinforcing and strengthening weak points.</li> </ul>
<b>Key tasks for 2020</b>	<ul style="list-style-type: none"> <li>(1) We will unwaveringly <b>adhere to the new development concept</b></li> <li>✓ We will ensure action is guided by the development concept, with the concept used as an important evaluation measure for cadres of all levels.</li> <li>(2) <b>We will resolutely win the three tough battles</b></li> <li>✓ We will eradicate poverty, prevent/eliminate pollution, and prevent/eliminate major financial risks (and ensure the basic stability of macro-leverage rates).</li> <li>(3) We will ensure that the basic livelihood of people, especially those in need, is effectively guaranteed and improved</li> <li>✓ We will guarantee a minimum standard of living for the poor while improving the employment structure and increasing housing security for the poor and needy.</li> <li>(4) We will continue to <b>implement active fiscal policies and sound monetary policies</b></li> </ul>

<sup>1</sup> This report was written in January 2020.

Heading	Outline
	<ul style="list-style-type: none"> <li>✓ Fiscal policies: We will <b>improve quality/efficiency</b> and strengthen structural adjustment while reducing general expenditures.</li> <li>✓ Monetary policies: We will <b>keep policy flexible and appropriate</b> and maintain liquidity at a reasonable level while lowering financing costs and deepening structural reforms.</li> <li>(5) We will strive to <b>promote high-quality development</b></li> <li>✓ We will stabilize pork prices, upgrade innovation capacities, build up infrastructure, and develop advanced manufacturing and lifestyle service industries.</li> <li>(6) We will deepen <b>reform of the economic system</b></li> <li>✓ We will accelerate the reform of state-owned enterprises (SOE) and the fiscal, taxation and financial systems while opening up further to the outside world.</li> </ul>

Note: Abridged translation by Mizuho Research Institute

Source: Prepared by Mizuho Research Institute based on Xinhua News Agency materials

As the Work Conference touched on, 2020 marks the final year of the 13th Five-Year Plan (2016–2020). It also marks the last year before the completion the first of the Communist Party’s ‘Two Centenaries’ (a series of national policy goals to be achieved before two centenaries, namely the centenary of the founding of the Communist Party of China in 2021 and the centenary of the founding of the People’s Republic of China in 2049). As such, 2020 will be a transitional year, with the 14th Five-Year Plan (2021–2025) kicking off in 2021 and the second of the Two Centenaries commencing thereafter. Furthermore, 2020 has also been earmarked as the concluding year of a series of major policy challenges set after the launch of the Xi Jinping administration, including the ‘comprehensive deepening of reforms’ (a goal set out in the autumn of 2013 at the Third Plenary Session of the 18th Central Committee of the Communist Party of China) and the ‘three tough battles,’ a three-year strategy that commenced in 2018 (see below for details).

Economic policy measures in 2020 seem to be influenced by this timing, with an eye also on the direction of economic policy management from 2021, when the focus will shift to improving the quality of development. This is hinted in the first key task for 2020, with the Work Conference pledging to ‘unwaveringly adhere to the new development concept.’ In usual years, the key tasks mapped out by the Work Conference are often quite concrete. As mentioned above, though, the first key task of the recent Work Conference emphasized ‘thought’ with a call to ‘ensure action is guided by the development concept.’ The Work Conference also proposed a policy management strategy whereby ministries, agencies and local governments act based on the basic policy of promoting high-quality development, with cadres evaluated on performance.

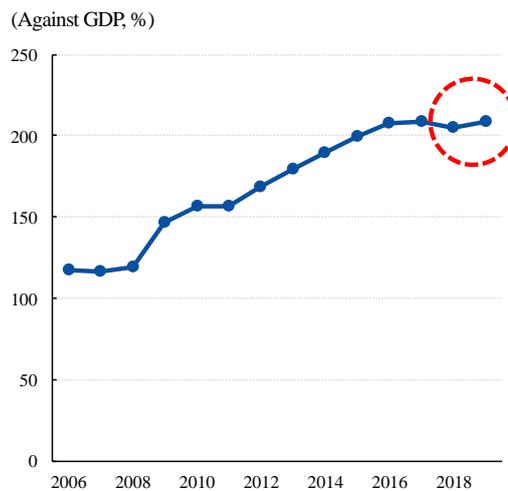
**2. Deleveraging and other supply-side structural reforms are making progress; 2020 will represent a ‘finishing off’ stage.**

For a long time, China moved to eliminate existing risk in order to lay the groundwork for new development. Specifically, under the slogan of ‘supply-side structural reform,’ as propounded at the end of 2015, the authorities pursued five tasks under the collective label of ‘three cancellations, one reduction, and one reinforcement,’ namely, (1) the cancellation of excess capacity, (2) the cancellation of real-estate stock, (3) deleveraging, (4) the reduction of business costs, and (5) the reinforcement of fragile areas. Tasks (1) to (3) could be seen as dealing with the negative legacy left behind by the previous administration as a side effect of its RMB 4 trillion stimulus package, with (4) and (5) regarded as laying the necessary groundwork for future development. The recent Work Conference only mentioned (5), so it seems the authorities recognize that they have succeeded in dealing with the negative legacy to a certain extent.

In fact, pressure for production cuts related to excess capacity and real-estate stock is easing off as a result of cancellations based on numerical targets for steel and coal capacity, for example, and the promotion of real-estate stock disposal though restraints on real-estate development and the redevelopment of rundown urban areas. As for (4), large-scale tax cuts were instituted from 2018 to 2019, so business costs seem to have lessened.

As represented by (3), financial risk is currently positioned as the largest risk facing the Chinese economy, but moves to tackle this risk have been underway since 2016. For example, after announcing deleveraging as a basic policy in 2016, the authorities have steadily pursued policies to promote the soundness of borrowers, fundraising, and supply channels. They rolled out policies in 2017–18 aimed at preventing the unbridled growth of local-government or SOE debt, for example, and they announced restrictions on shadow banking in 2018. They also launched an initiative to strengthen the accreditation system for the non-performing assets of commercial banks over 2018–9, and they started to reorganize regional banks in 2019. The Financial Stability and Development Committee assessed that financial risk was being brought under control when it met in September 2019. In the wake of all this, the recent Work Conference relegated ‘tackling financial risk’ to third place behind ‘eradicating poverty’ and ‘tackling pollution’ when it discussed the ‘three tough battles’ (it had been mentioned first when the issue was raised in 2018). Corporate debt remains at high levels, so the debt-to-GDP ratio is edging higher (Fig. 2). As such, the authorities are unlikely to relax their efforts to tackle financial risk<sup>2</sup>, though the issue has fallen down the pecking order compared to when the initiative was first announced.

**Figure 2: The social financing balance as a proportion of GDP**



Source: Prepared by Mizuho Research Institute based on materials from the National Bureau of Statistics of China, the People’s Bank of China, and CEIC

On the other hand, it seems more policy weight will be placed on (5) as the authorities focus on finishing off supply-side structural reforms and laying the groundwork for future development. When it came to fragile areas, the Work Conference only directly referred to livelihoods and infrastructure, but there are several other areas that will probably need reinforcement from hereon, including: the problems of poverty and pollution (which have risen up the order of priority in the ‘three tough battles’ strategy, as mentioned above); the upgrading of the innovation capacities and the accumulation of the advanced industries needed to realize high-quality growth; and the development of a services

<sup>2</sup> The transitional period for shifting to the current shadow-banking regulations will conclude at the end of 2020, so the authorities will need to be on guard against any problems this could cause. Other ongoing challenges include the development of a bankruptcy system aimed at future moves to strengthen the reorganization of commercial banks.

industry that meets changing consumer needs. It is also likely the authorities will pursue reforms of SOE structures and financial structures/systems, while opening up further to the outside world with an eye on negotiations with the US.

### **3. Despite stressing the importance of stability, the authorities will probably tolerate growth below +6% while tweaking fiscal and monetary policy**

As mentioned above, the Work Conference discussed mid- to long-term issues involved in the transition to a new development phase. It also emphasized how the maintenance of economic stability was a major prerequisite for a steady transition.

For example, it recognized that ‘the economy is facing more headwinds,’ adding that ‘the maintenance of stability must remain a priority in order to achieve the targets for the upcoming year,’ with the authorities tasked with ensuring ‘economic activity remains within a reasonable range.’ After the Work Conference, on December 13, China and the US reached a deal on a phase one agreement, with the US agreeing to relax or suspend some of the tariff hikes on Chinese goods. As a result, exports will probably face less downward pressure. However, some time will be needed before this boosts China’s capacity to undergo a self-sustained recovery through capital investment and consumer spending. Furthermore, reported new coronavirus infections have soared since mid-January and this will probably act a new headwind for the economy going forward, so the economy will continue to require support.

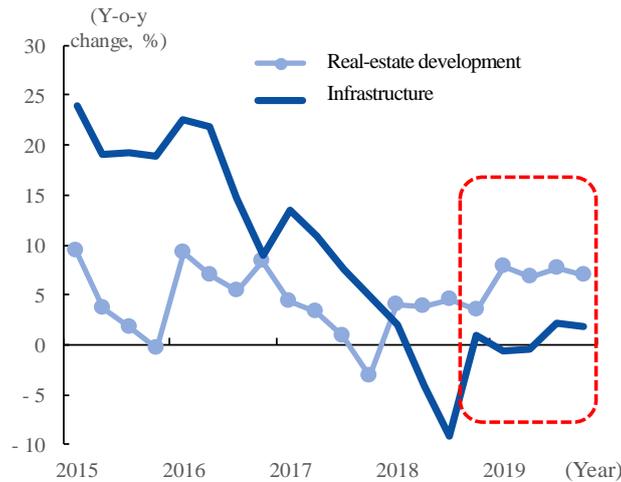
In view of this policy target of ensuring stability, the National People’s Congress is expected to set a growth rate target of ‘around +6%’ when it meets in March, though it will probably tolerate a slight downswing. This is because there are now fewer hurdles in the way of China hitting the target of doubling 2010 GDP by 2020. Before now, it was thought real GDP growth of around +6%–6.1% would be necessary, but the real growth rate for 2014–18 was revised upwards on the results of the fourth economic census, held in 2018. This means it will now be possible to hit the aforementioned target with real GDP growth of around +5.6% in 2020. As such, the authorities will probably tolerate a wider slowdown than before<sup>3</sup>. They will probably steer the economy sensitively based on a comprehensive consideration of several factors, such as: improvements in the external environment; the potential damage caused by the spread of the new coronavirus and the ripple effect on the domestic economy; the burden of stimulus measures; and the goal of doubling GDP.

Policy support will probably be centered around fiscal support, particularly infrastructure investment. With infrastructure investment moving sluggishly in 2019 (Fig. 3), the government has announced a series of measures. As these start to bear fruit from here on, infrastructure investment is expected to bounce back in 2020, though probably at a modest pace. In fact, the Work Conference prioritized the role of fiscal policy in supporting the economy when it said the quality and efficiency of the proactive fiscal policy must be enhanced. There was no mention of the scale of any policies, nor did the conference discuss expanding local government revenue bond issuances by a comparatively large amount, as it had done in 2018. As mentioned before, investment will probably focus on sectors where ‘reinforcing and strengthening weak points’ is required<sup>4</sup>.

<sup>3</sup> Based on the National Bureau of Statistics’ real GDP growth rate, an indicator calculated to one decimal point.

<sup>4</sup> The conference discussed policies to strengthen the construction of strategic and network-based infrastructure. Specifically, it mentioned the Sichuan-Tibet railway, telecommunications networks, natural disaster prevention projects, urban infrastructure (municipal pipelines, car parks, and cold chain logistics), and rural infrastructure (roads, information and water facilities).

Figure 3: Growth of investment in infrastructure and real-estate development



Note: Indexed using the fixed asset investment price index  
 Source: Prepared by Mizuho Research Institute based on materials from the National Bureau of Statistics of China and CEIC

The Work Conference also stated it would implement a ‘steady monetary policy in a flexible and appropriate manner,’ though the ‘tightening’ wording from 2018’s meeting was absent this time<sup>5</sup>, so the authorities might adopt a more accommodative stance. However, the Work Conference stressed that it would ‘adapt the growth of lending and social financing to economic development,’ with the authorities unlikely to boost the total volume of lending by more than necessary as they focus on deleveraging constraints. Rather, they will probably try to improve the fundraising environment based on institutional frameworks, by guiding market lending rates lower through the Loan Prime Rate (LPR) mechanism (which was revised in 2019)<sup>6</sup>, for example, or by optimizing lending structures (increasing the allocation of mid- to long-term lending to the manufacturing sector) through the Macro Prudential Assessment (MPA) system.

With regards to real-estate policy, the Work Conference reiterated that ‘housing is used for living in, not for speculation.’ The authorities will stick to their basic stance of housing-market tightening. However, several cities have recently starting to introduce policies to entice employees (and thus expand housing demand), so rather than tightening further, the authorities will probably maintain the current level of tightening while also tolerating some easing measures depending on the situation in each city. Under the context of improving lifestyles, the authorities have also pursued policies such as ‘urban renewal and the remodeling/upgrading of housing stock,’ ‘rebuilding ageing housing complexes,’ and ‘pursuing the strong development of rental housing.’ These might also create demand for investment in housing development. This investment grew from 2017 onwards (Fig. 3), but it is expected to peak out in 2020, though it may decline at a gentle pace thereafter.

<sup>5</sup> The 2018 Work Conference discussed a ‘steady monetary policy that strikes a balance between easing and tightening.’  
<sup>6</sup> For details, see Yusuke Miura’s ‘China’s interest rate marketization takes a step forward’ (from Mizuho Research Institute’s ‘Mizuho Economic Outlook & Analysis,’ dated August 22, 2019).

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