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China's Economic Reform in 2016 – Will it be a Tough Year?

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These past few years the Japanese media, weekly economic magazines for example, have been continuing to give warning about risks of the Chinese economy. Now as it has become the Chinese New Year of 2016, indeed the current Chinese economy is in a very tough situation. It seems as if it is standing at the entrance of a tunnel with no exit insight, or it has already entered the tunnel. On January 26th the head of the State Statistics Bureau who transferred from the Ministry of Finance in less than a year ago was suddenly dismissed due to “serious infraction of rules”. It might be due to corruption in the tenure of former ministry but no specific details were given. This lack of clarity might be reflecting the real picture of the “New Normal” of China in the early part of 2016.

Has the Chinese Economy fell into Deflation

China's 2015 real GDP growth rate was 6.9%. The number itself has been discussed in many ways but the problem is the fact that GDP deflator has become clearly minus. Mr. Yu Yongding, a renowned economist and a member of the committee at the Chinese Academy of Social Sciences, says it is wrong to conclude that it is not deflation simply because although the PPI is continuously dropping the CPI is at a plus, and maintains that the Chinese economy is already in a malignant deflation spiral¹. The cause of the deflation is simply due to lack of effective demand, therefore stimulating the economy by large scale government spending is the most needed macro-economy policy, stresses Mr. Yu. He may have intended to give warning that by paying attention only to restructuring enterprises in regional areas, which is push about by the popular growing phrase of “Supply Side Reforms”, might raise further strong downward force on macro-economics and lead to a hard landing.

The Core of “Supply Side Reform”

The Chinese authorities in 2016 will continue to pursue both stable growth (“稳增长” in Chinese) and structural reform (“调结构” in Chinese). From the first half of 2015 they have continuously been threatened by the downward pressures against the economy, but they managed to realize stable growth using the government funds into targeting specific areas to stimulate the

¹ News article titled “The reasons why I stress the implementation of economic stimulus plan”. Mr. Yu is an expert on macro-economics and clarifies the “Supply Side Reform” with micro-economic policies on which he does not give many comments. <http://economy.caixin.com/2016-02-09/100908349.html>

economy. Probably they would basically continue to do so in 2016. But for structural reforms in 2016 the key word will be “Supply Side Reform”. This phrase suddenly became popular since President Xi mentioned this at the Central Finance and Economy Leading Small Group in November 2015. The aim of this reform includes promoting innovative activities to make more consumer welcoming products, but the main theme is reformation of the state owned enterprises, which till now have been put off for later. The Party and State Council finally decided to coup with this problem from 2016.

Reformation of State Owned Enterprises is Adjusting the Interests of the Regional Areas

The groups of enterprises which are the target of reformation are not necessary the ones under the central government controls, but rather many are under controls of regional governments. Provinces, cities, counties, they are under different ranks of government. Enterprises under the protection of the local government, with over capacity facilities, etc., will be listed up and not by market principles “the unseen hand of god”, but will be restructured according to the governments’ plans, the hand of man. The points of reformation expressed by the authorities are the following five; 1) the elimination of over capacity facilities of enterprises, 2) the disposal of inventory assets and real estate, 3) the restructure of excess debts on the balance sheet, 4) the reduction of unnecessary management cost, 5) re-employment assistance and financial support for those that had to be laid off. It is really an all-out restructuring in people, assets and money. Can the regional governments take leadership in this by themselves under deflation pressure? Of course the real GDP growth rate target is also expected as high as 6.5%, and anyone can see that this is not going to be easy. The regional government officials should face with the workers, and will they push through restructuring against resistance from them? If one were to raise questions and worries it would be endless.

2016 will be a Year of Difficult Reform

The Chinese economy in 2016 will likely be more difficult than last year. At the press conference of February 3rd by the top members of the National Development and Reform Commission, their responses were very calm and it seems they had confidence in all the government’s management of macro-economics². At least it makes us feel a kind of safe that the governmental authorities are aware of the difficulties of reform. But it of course would not be a guarantee that it will with stands the downward pressures of the economy. In 2016 while the central government will raise the cohesive power of the Communist Party of all of society, each regional government will seriously take up the difficult reformation issues.

² Explanation and Q&A responses of Mr. Xu Shaoshi, Head of the National Development and Reform Commission at the 2015 Economic Situation and Social Development press conference arranged by State Council Information Office on February 3rd.
<http://www.scio.gov.cn/xwfbh/xwfbh/wqfbh/33978/34138/wz34140/Document/1467212/1467212.htm>