
Chinese Economy under Global Financial Turmoil --Recent Development, Policy Responses, and Rebalancing Strategy

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Main Contents

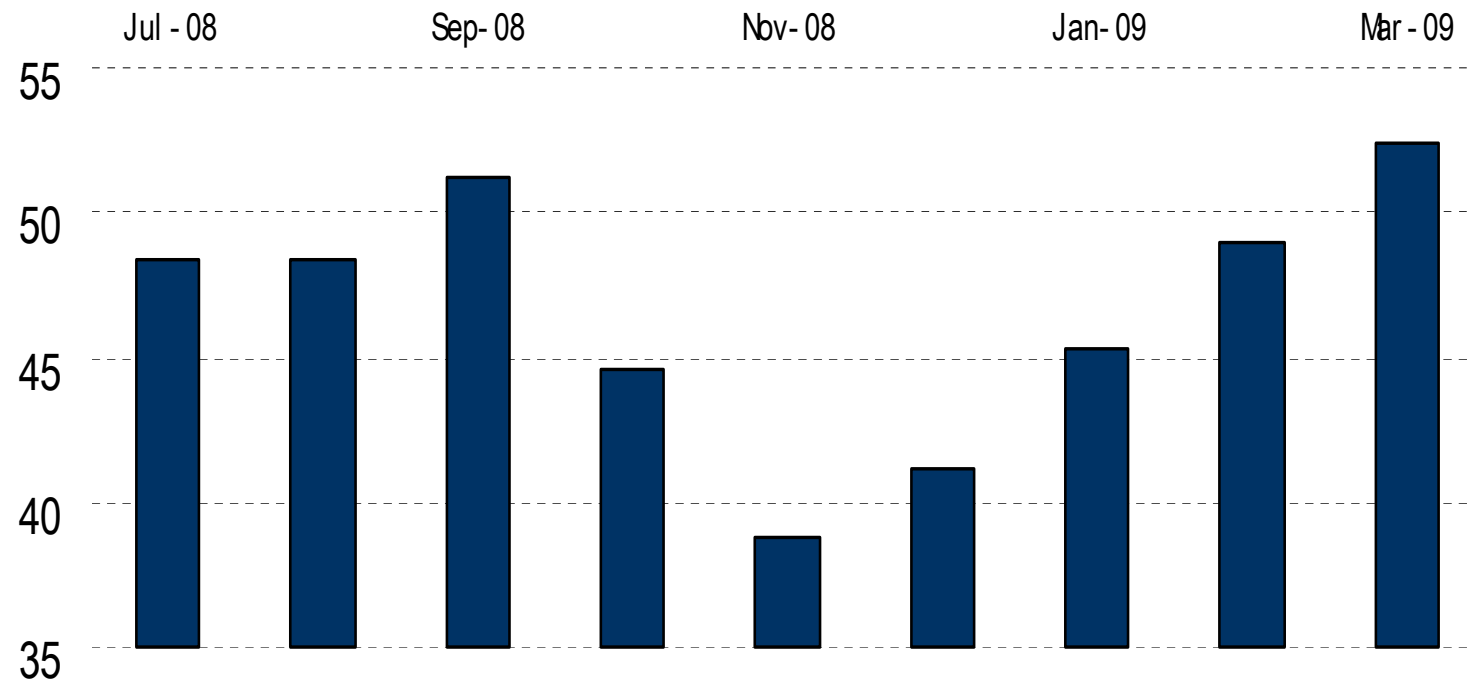
- Recent development of Chinese economy
 - China's stimulus package and its effectiveness
 - China's rebalancing strategy
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Recent development of Chinese economy

- In q4 of 2008, China's industrial sector saw extreme inventory and production reduction .
 - In q1 of 2009, industrial sector saw better-than-expected recovery.
 - Many real and nominal economic indicators exhibited “V” shape recovery.
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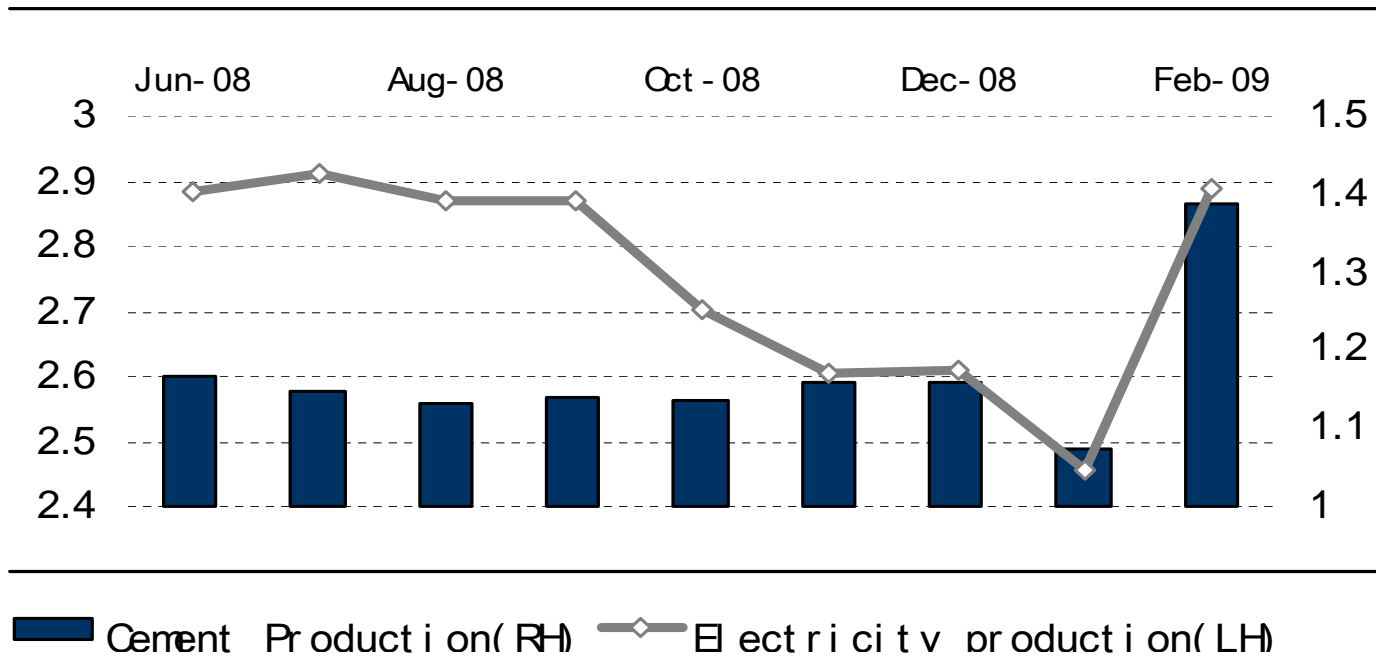
Recent development of Chinese economy

Manufacture PM



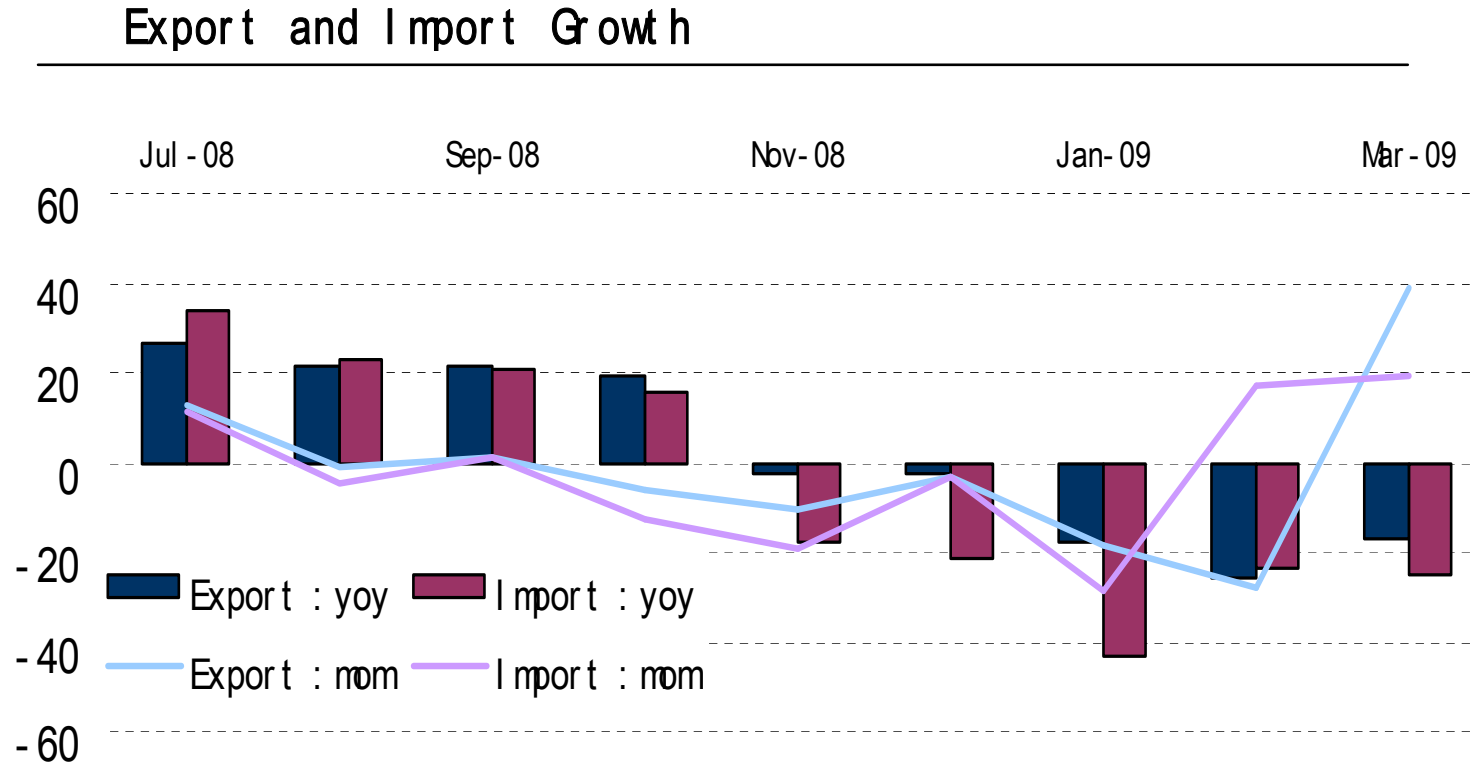
Recent development of Chinese economy

Electricity and Cement Production (s. a)



Recent development of Chinese economy

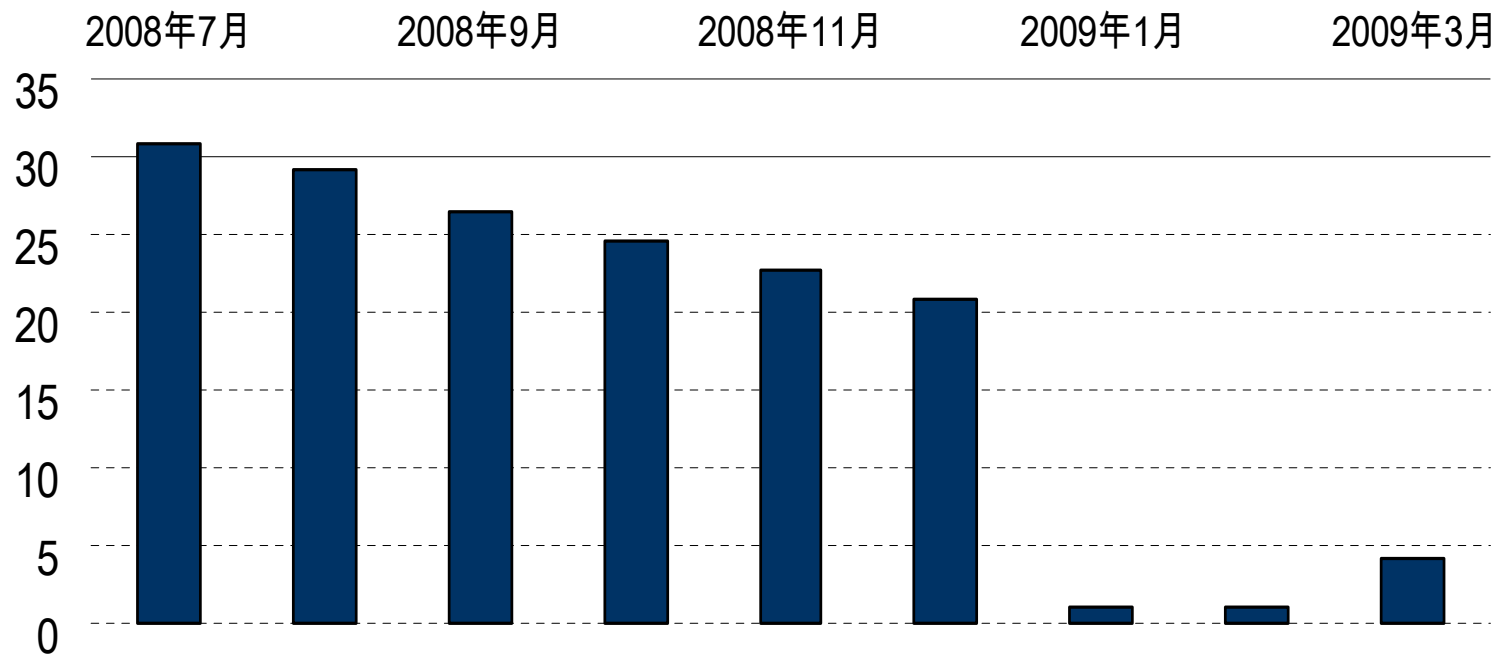
■ Export and Import



Recent development of Chinese economy

■ Real Estate Sector

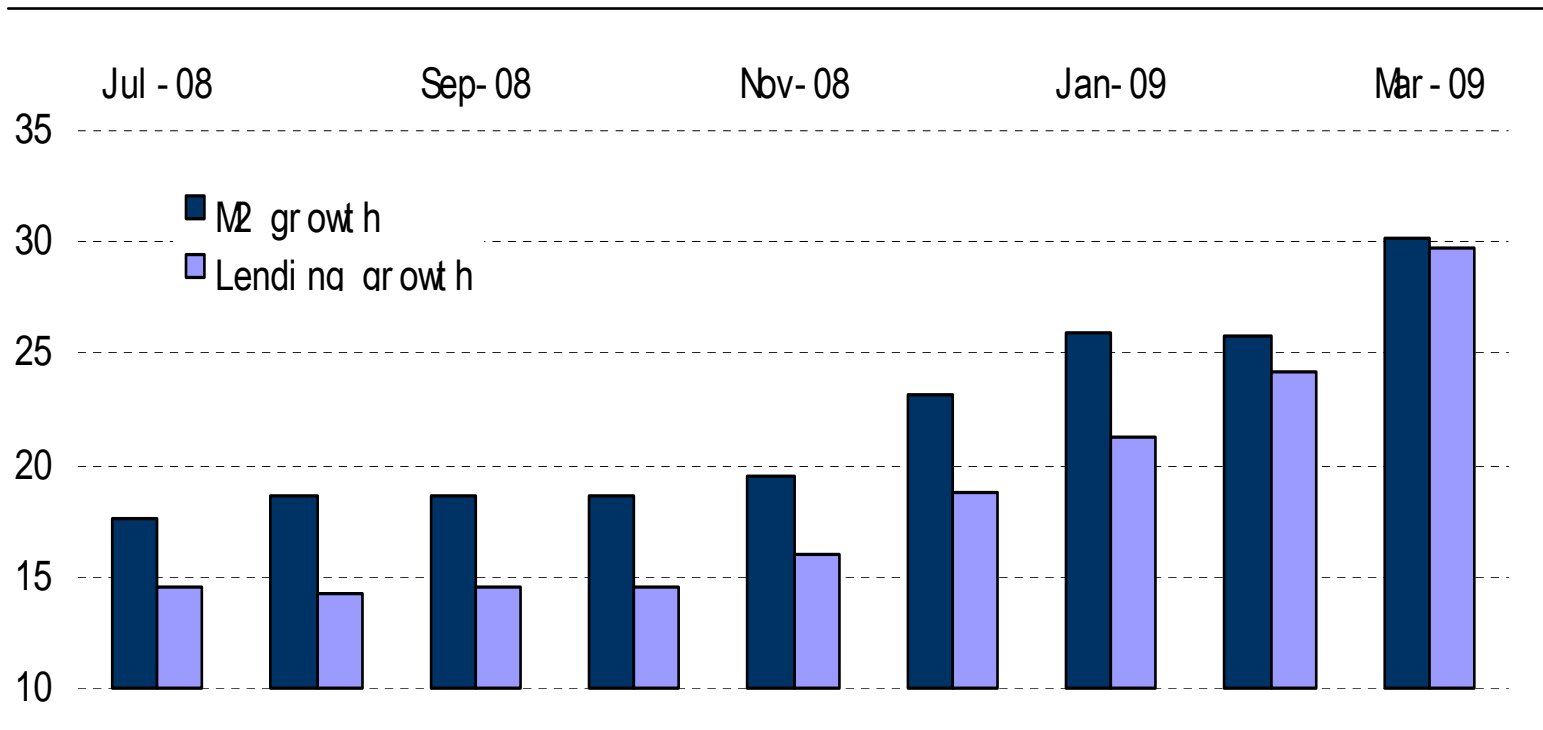
Real Estate Total Investment Growth Rate(yoy)



Recent development of Chinese economy

■ Monetary condition

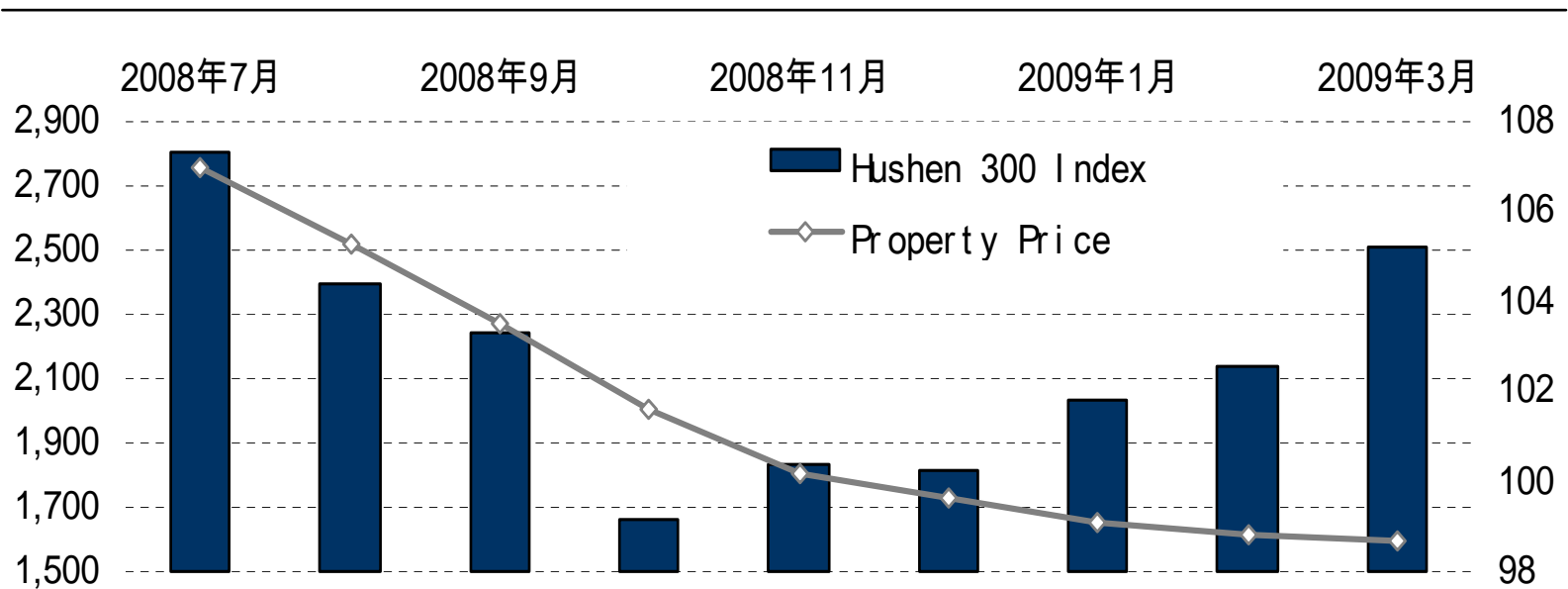
Lending and M2 growth



Recent development of Chinese economy

■ Asset price

图6 Stock Share and Real Estate Price



Recent development of Chinese economy

How to explain the “V” shape change?

- China's economic growth are so dependent on tradable sector and will suffer more in the short term, in the way of reducing inventory and production, from sudden loss of external demand
 - Large stimulus package replace external demand (will see details below)
 - Improvement in term of trade reduce real income loss
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Middle-long term impacts of global financial crisis on Chinese economy

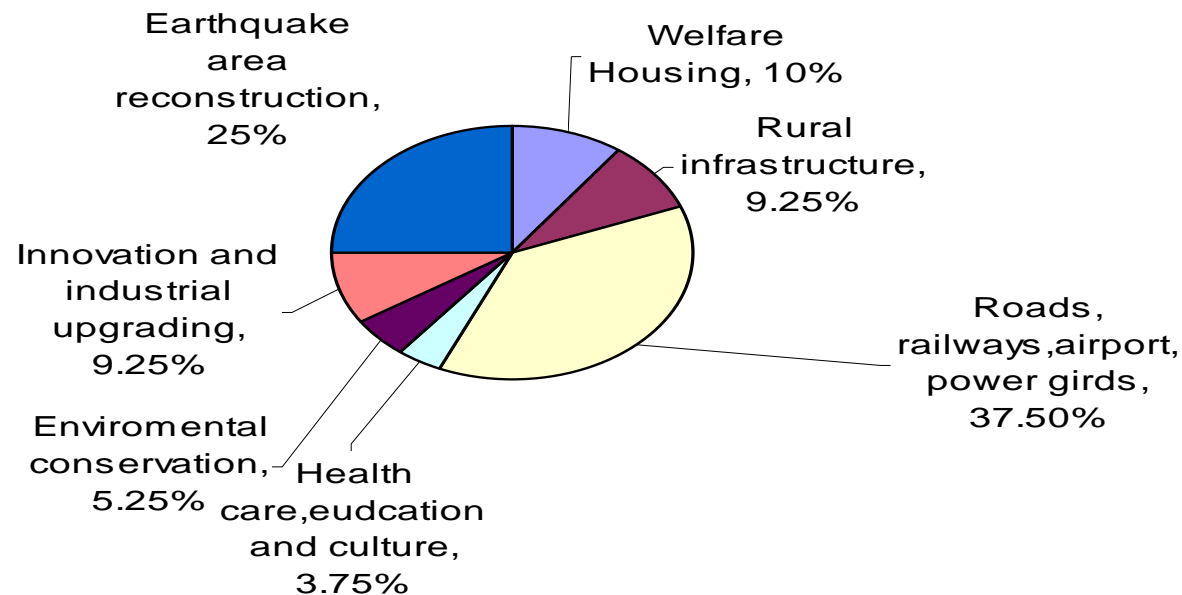
- Financial turmoil released a strong and clear signal that consumption and trade deficit growth in US could not catch up with export growth of East Asia, especially that of China. Chinese economy is standing at crossroad. Policy makers are forced to make changes.
 - Good scenario: with proper rebalancing strategy that solve the mismatch between domestic supply and domestic demand, Chinese economy may not recover so fast, but will keep sustainable growth and contribute to global growth in the long run (will see details about our views on rebalancing strategy below).
 - Bad scenario: with addiction to old growth model and failure of solving mismatch between domestic supply and domestic demand , Chinese economy will see temporarily rebound followed by double dip and shrinking growth potential in the future.
 - Now, we see both positive and worrying news from existing stimulus package.
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China's stimulus package

---fiscal policy

■ Fiscal stimulus package-----4 trillion plan

Chart 3-1 4 trillion fiscal stimulus package structure



China's stimulus package

---fiscal policy

Who pay for the 4 trillion package?

- Central government is responsible for $\frac{1}{4}$ of total expenditure
 - Local governments are responsible for $\frac{3}{4}$ of total expenditure. They collect money through tax revenue, land sales , borrowing money from commercial banks, raising local government debts, and so on
 - Commercial banks are major financing sources for local governments. They exhibits great interests in lending money to those projects backed by central government or approved by National Development and Reform Committee (NDRC).
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China's stimulus package

---fiscal policy

How effective of the 4 trillion package?

- According to Dong, Zhiwei and Wenlan (2009) , announced fiscal spending of RMB2 trillion yuan in 2009 could lead to a direct increase of output of RMB1.7 trillion yuan, implying a fiscal multiplier of around 0.84 in the short-run, and could potentially generate 18 million to 20 million new jobs in non-farming sectors.
 - Total intermediate imports amount to RMB317 billion Yuan (approximately 46 billion US dollars), around 16% of the fiscal package.
 - This result is based on I-O table analysis.
 - The long run effects could be different. I will evaluate it later, together with other stimulus policies.
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China's stimulus package

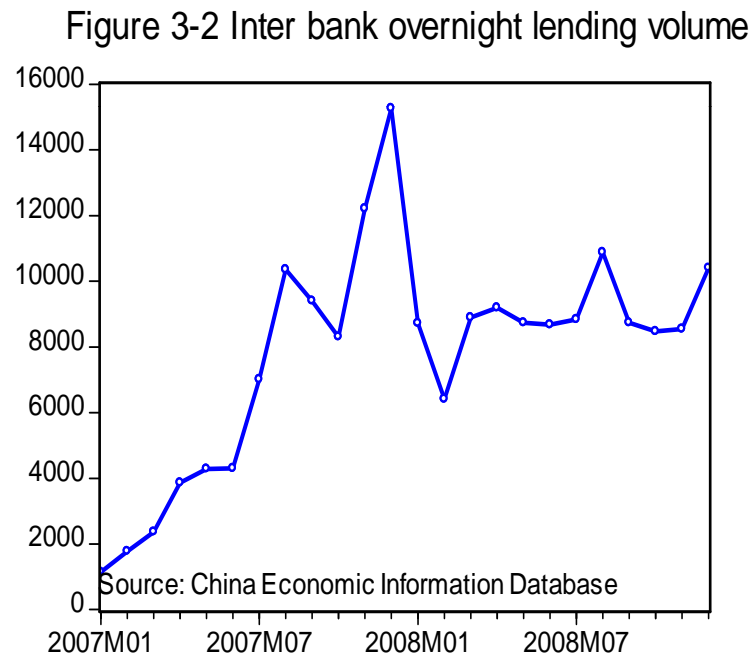
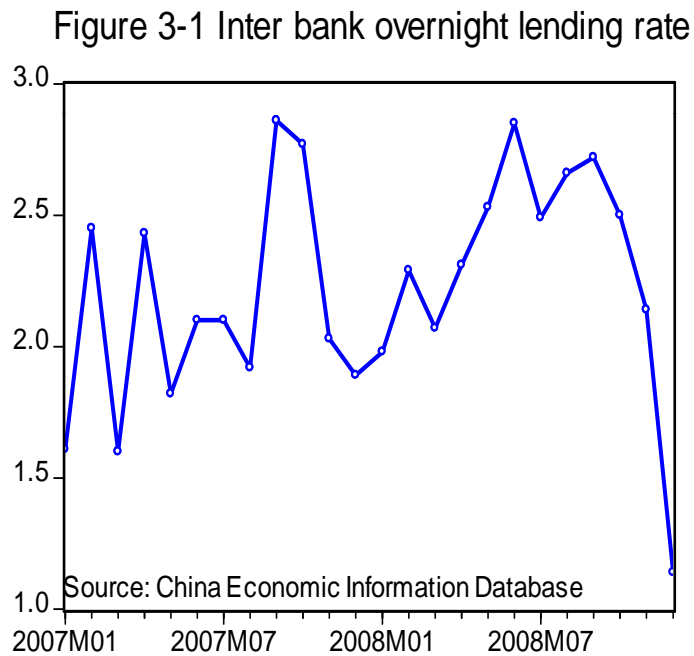
---monetary policy

- Quantity measures:
 - (1) People's banks of China (PBC) lowered required reserve ratio four times in the fourth quarter of 2008. Accumulated reserve ratio cut amounted to 2% for large scale commercial banks, and 4% for middle-small scale commercial banks
 - (2) PBC lowered issuance of central bank bills significantly in the fourth quarter in 2008 by 371 billion Yuan, which amounted 8% of total insurance of central bank bills in 2008
 - (3) Quota management on commercial bank's lending growth was abolished
 - Interest rate: five interest rate cuts in the fourth quarter in 2008
 - Exchange rate: gradual appreciation of RMB/USD from middle of 2005-middle of 2008 was replaced by stable RMB/USD rate and appreciation of trade weighted exchange rate
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China's stimulus package

---monetary policy

- Sharp decline of lending rate and stable lending volume



China's stimulus package

---monetary policy

- Gradual RMB/USD appreciation replaced by stable RMB/USD rate and NEER increase.

Figure 3-3 RMB/USD

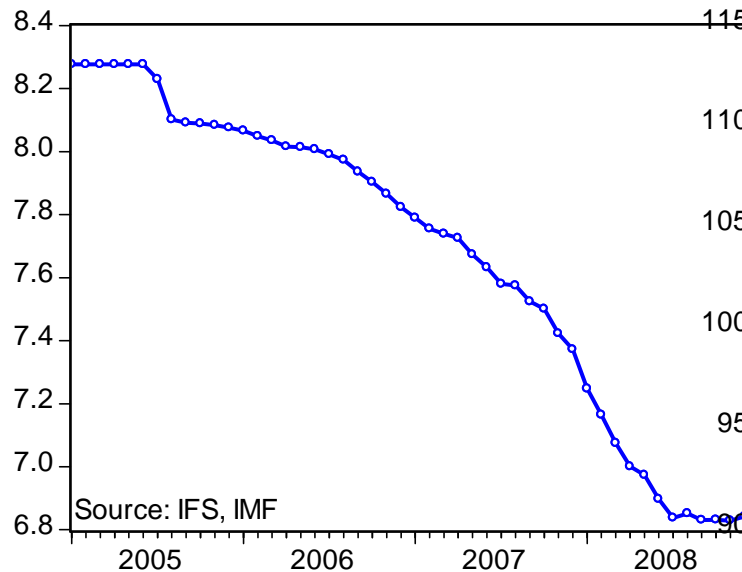
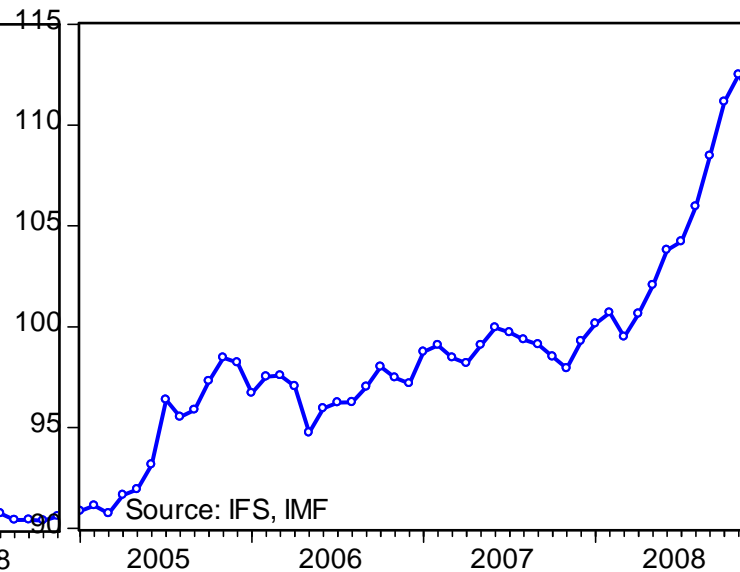


Figure 3-4 NEER



China's stimulus package

---other policies

- Ten Industrial 'Reinvigoration' Plans: Auto, Steel, Textile Industry, Machinery, Ship Building, Electronics and information, Light Industry, Petrochemical, Non-ferrous, Logistics
 - Reforms in medical and health care sectors
 - Reforms in pricing on rural land, energy and natural resources
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China's stimulus package

-----are they effective?

- In term of boosting investment demand, they are very effective. This has been proved by “V” shape recovery.
 - In term of paving way for sustainable growth, further reforms need to be done.
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China's stimulus package

-----are they effective?

Major worries on China's stimulus plan

- Efficiency of such a big amount of infrastructure investment is not promised. NPL in banking sector and corruptions will increase rapidly in the future
 - It leave less room for necessary adjustment of real sector, such as washing out outdated production capacity in industrial sector and transferring resources from over-developed (in term of quantity rather than quality) industrial sector to under-developed service sector
 - Government's too much involvement in industrial sector will impair market competition and squeeze out private investment.
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China's stimulus package -----are they effective?

■	With stimulus plan	Without stimulus plan
For those well measured and eye-catching indicators, such as GDP, investment, export and employment in the short run	+++	
For those bad measured and less eye-catching growth potential indicators, such as efficiency improvement of labor and capital		+
For those bad measured and less eye-catching household welfare indicators, such as real income growth, real income distribution, term of trade	+ or - ?	+

China's rebalancing strategy

As for many Chinese government officials and scholars, solving structural problems (or imbalance problems) are thought to be paving way for sustainable economic growth. But structural problems have different meanings or focus by different people, they may refer to:

- low consumption/GDP ratio or high investment/GDP ratio
- Increasing trade surplus
- Worsening of income distribution
- Increasing regional growth gap
- high foreign trade/GDP ratio
- Disproportional share of service in GDP by international standard
- Low value added in China's industrial sector
- Environmental problems and so on...

Obviously, most of those issues are closely related, if not the same thing.

China's rebalancing strategy

Based on our tradable/nontradable model, we connect most of those imbalances together and look for the same cause behind those imbalances.

Introduction of the model: Balassa-Samuelson model with three revisions

- We allow marginal return on capital flexible. Justification on this revision is China's capital control.
 - We don't allow relative price of tradable to nontradable respond to exogenous shocks, such as TFP shocks. Justification on this revision is (1) Chinese monetary authority are stabilizing both aggregate price and nominal exchange rate, leaving less room for relative price adjustment; (2) we want to know what will happen to other endogenous variables if relative price of tradable to nontradable fail to work.
 - We add demand side in this model.
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China's rebalancing strategy

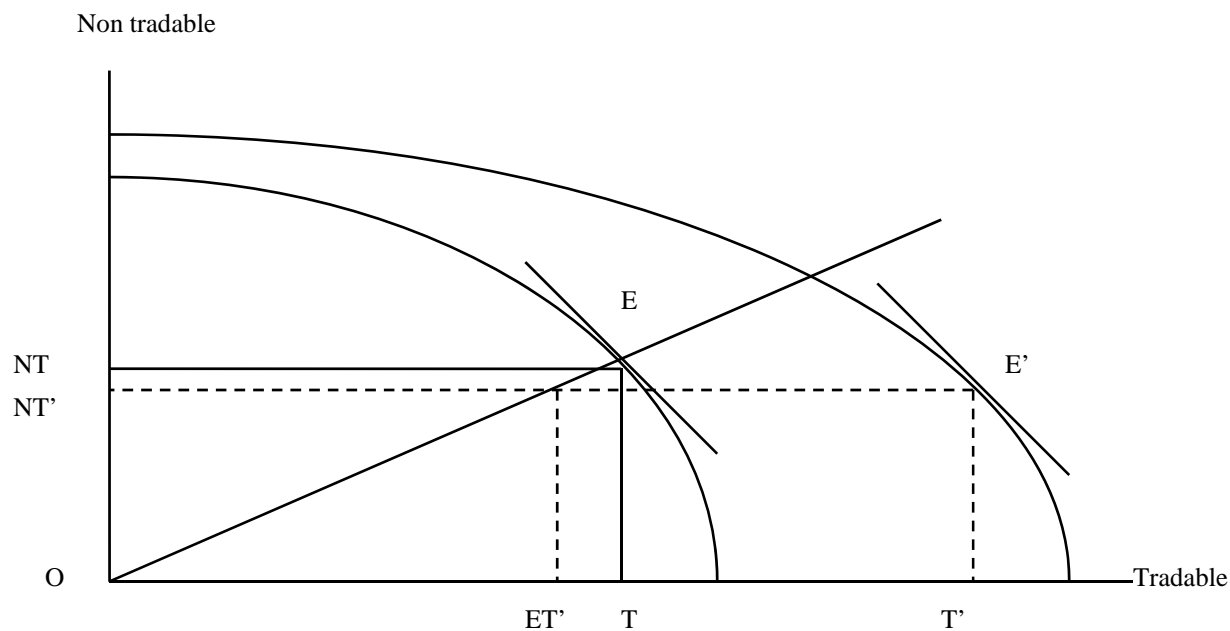
Without correspondent adjustment in relative price of tradable to nontradable, faster TFP growth in tradable sector than that of nontradable sector result in:

- (1) Decrease of capital-labor ratio in both tradable and nontradable sector
- (2) Increase of marginal return on capital and decrease of marginal return to labor
- (3) Lower domestic consumption on tradable and nontradable, higher trade surplus, and higher saving rate comparing with flexible relative price of tradable to nontradable

Adding (1)+(2)+(3) together, we have low consumption/GDP ratio; Increasing trade surplus; Worsening of income distribution; high foreign trade/GDP ratio; disproportional share of service in GDP

China's rebalancing strategy

- Original production of tradable and nontradable: OT and ONT, tradable production=tradable consumption, no trade surplus
- New production of tradable and nontradable: OT' and ONT', new tradable and nontradable consumption are lower than original tradable and nontradable consumption, tradable production>>>tradable consumption, large trade surplus



China's rebalancing strategy

- Firstly, deregulations should be introduced in key service sectors, such as railway, medical care, education, finance, telecommunication, energy, express delivery, and so on.
 - In the short run, deregulation measures will be the best confidence promise for domestic demand. They open up a massive market, which has been depressed for long time and confronted with large unsatisfied demands, for private sector investment and release millions of job opportunities.
 - In the long run, deregulation measures, by improving TFP growth in above sectors, will (1) increase ratio of marginal return on labor to marginal return to capital, and therefore improve income distribution and enhance domestic consumption; (2) direct more resources to nontradable sector, rather than tradable sector
 - We regard deregulation policies as the first priority in lowering China's saving rate and trade surplus, and therefore rebalance Chinese economy.
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China's rebalancing strategy

- Secondly, government intervention in RMB exchange rate, interest rate, energy price, and service price in many other sectors should be reduced.
 - Favorable policy toward tradable sector, such as more tax rebate and lower land price to manufacture firms, should be replaced by fair policies toward both tradable and nontradable enterprises.
 - Above measures are promise of efficient resource allocation and indispensable part of China's rebalancing strategy.
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China's rebalancing strategy

- Thirdly, more government resources should be used in providing public health care, basic education for the poor, welfare housing, and other poverty reduction areas. Government should be careful in expanding further infrastructures, such as high way and power grid, for their uncertainty of effectiveness in the future. In addition to tax revenue and government debt financing, SOE profits should be submitted for public benefits.
 - An exit strategy of exceptional fiscal stimulus should be put in place.
 - Above measures are aiming at increasing welfare as well as purchasing power of the poor and could be important in boosting domestic demand and rebalancing the economy.
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China's rebalancing strategy

- Fourthly, closer financial cooperation within East Asia region and reform in international financial architecture is needed.
 - Loose monetary policies in US and over dependency on US dollar in East Asia (by increase holdings of US treasury bills and other US dollar assets in their foreign exchange reserve assets) are underlying factors that increase global imbalance and fragility of East Asia economies.
 - It is time not only to redress internal structural distortions, but also to alleviate over dependence on US dollar and US monetary policy. To achieve this end, East Asia economies should improve regional cooperation in term of developing regional financial markets and enhancing policy coordination.
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- Thanks for your attention
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