



## SOCIAL AND ECONOMIC TRENDS IN CHINA

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Summary

Chen Gong et al.

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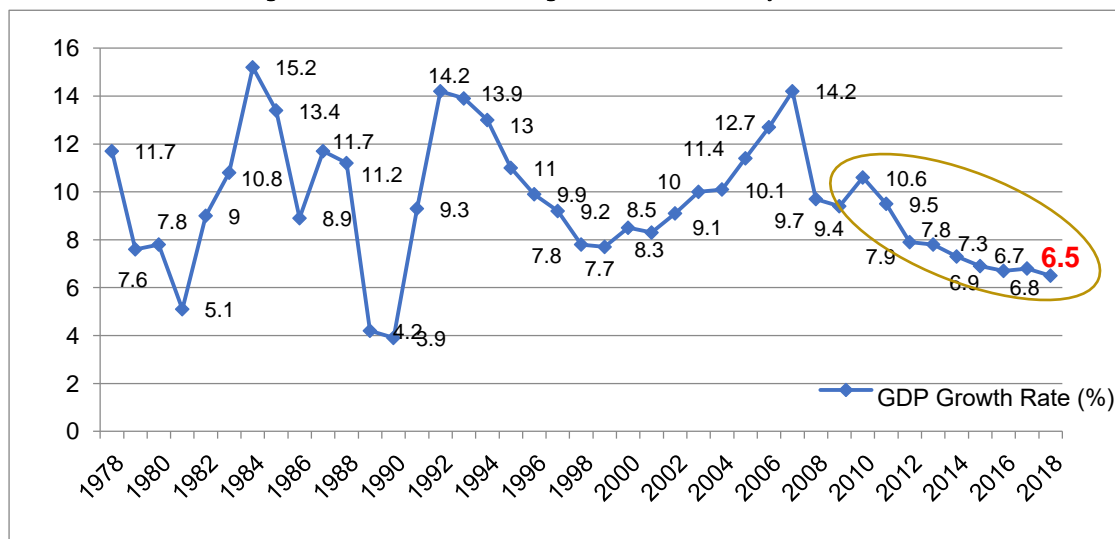
## China's Economic Growth Rate in 2018

To predict what China's economic growth will be like in 2018, one might simply extrapolate from the downward linear progression of China's macroeconomy in recent years. It is apparent that China's economic growth has been decreasing for the most part in the last decade or so, and only a fraction of the statistical data indicates an increase in economic growth (Figure 1). Even from the perspective of the global market, things do not look very bright for China's economic growth in 2018. For one, China's goods and services are facing increasing challenges in the global market thanks primarily to the wave of conservatism sweeping across the world. This in turn is affecting the Chinese economy like never before. Moreover, China is also facing growing ecological and environmental pressures which, compounded by the challenges of past economic uncertainties such as an

GDP and the reduction of growth at the expense of the environment, will result in a decrease in the country's economic growth in 2018.

The current forecast of Anbound Think Tank remains consistent (no amendments have been made) with that which has been widely published at the end of 2017—China's economic growth in 2018 is estimated to be 6.5%. It is worth noting, however, that this forecast is based on a linear extrapolation from the current data; any government would make adjustments and policy changes in line with the demands of the concomitant economic situation and consequently revise the corresponding data on economic growth rates, at least to a certain extent. Therefore, 2018 still holds a few uncertainties for China's economic growth.

Figure 1: China's economic growth rate over the years (%)<sup>1</sup>



Source: National Bureau of Statistics.

<sup>1</sup> The economic growth rate in 2017 was 6.8%; the economic growth rate in 2018 as estimated by Anbound is 6.5%.

Table 1: Forecast of China's economic growth in 2017 and 2018 by major domestic and foreign institutions.<sup>2</sup>

Name of Institution	2017	2018
IMF	6.8%	6.6%
World Bank	6.7%	6.4%
Asian Development Bank	6.5%	6.2%
OECD	6.8%	6.6%
Goldman Sachs	6.8%	6.5%
Bank of America Merrill Lynch (BofAML)	6.8%	6.6%
Moody's	6.8%	around 6.6%
UBS	6.8%	6.4%
Nomura Securities	6.8%	6.4%
Morgan Stanley	6.8%	6.5%
Bank of China	6.7%	6.8%
CICC	6.5~7%	6.9%
Haitong Securities	6.8%	around 6.6%
Guotai Junan Securities	--	6.9%
Minsheng Securities	6.8%	around 6.6%

Source: Research reports of the respective institutions. Compiled by Anbound Think Tank.

### Keynesianism and China

It is difficult to comprehensively realise and implement Keynesian thought in Western governments because these governments do not have full control over their own economies; rather, they function more like “stewards” of their country’s finances. The Chinese government, on the other hand, plays a more active role in the country’s economy and functions more like the head of the household rather than a mere steward, to use the previous analogy. This is why it is possible for Keynesian thought, including its socialist aspects, to be fully implemented in China.

It is for this reason that the role of the Chinese government in the future will not be limited to the regulation of the market and the macroeconomy. Rather, the government will also play a more active and dominant role in areas such as industry, fiscal, monetary policy and foreign exchange rates.

China is a populous country that is rapidly modernizing. It is thus also necessary that overinflated and distorted (economic) ambitions are kept in check. This check and balance could serve as the ideological basis of governance in China, as suppressing such ambitions would probably require the leadership of the government as well.

The actualization of Keynesian thought has never been comprehensively achieved in Western governments. Only in a socialist society like that of China’s can such an ideology be truly realised. This is why Keynes would most likely have been an admirer of the Chinese economy if he were still alive today.

<sup>2</sup> Data used in this table was taken from the newest forecasts of the respective institutions.

### Debt issuance required to maintain steady economic growth

We estimate that the debt issuance scale will be RMB 30 trillion at the minimum, and RMB 50 trillion at the maximum over a period of 5 years.

Anbound is convinced that in the face of current and future domestic and international circumstances, China must take a holistic approach in evaluating the structural defects and problems of its economy if it wishes to maintain a steady economic growth and achieve its developmental goals. It cannot afford to take a linear approach to these issues, but must rather consider them within the context of the global economic situation. In this regard, the future is not optimistic. In order for China to resolve these looming challenges and problems, it needs to ensure that its economy maintains a certain momentum. To do so, China will need to significantly expand its debt issuance in order that it may stay on track to achieve its diverse goals of economic growth and structural reform.

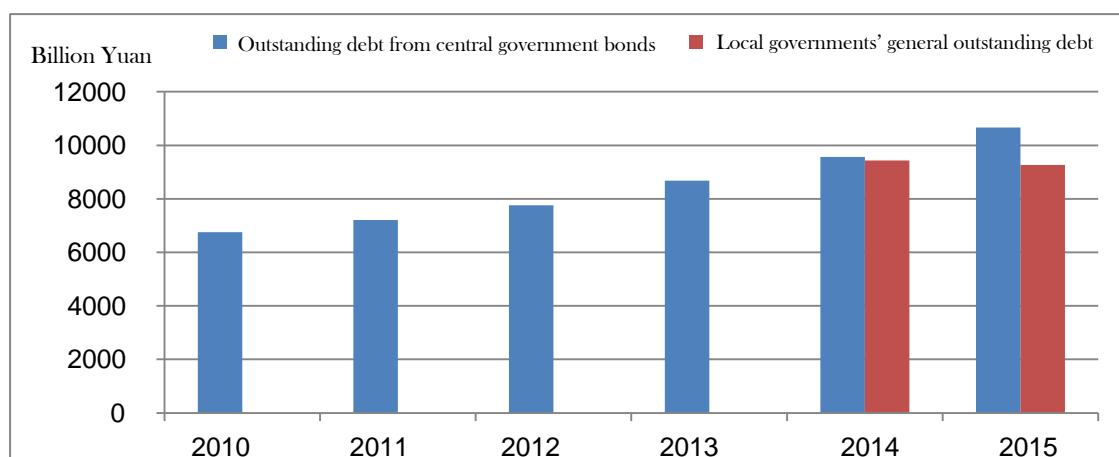
The main reasons for implementing a proactive debt issuance policy include: (1) China needs to cope with the impact of the United States' vigorous tax reform policy in order to maintain China's fiscal stability. (2) China needs to revitalize its real economy; it needs to create a domestic market with a more vigorous demand, and this requires an injection of new capital into the economy. (3) There is still room for the Chinese government to increase its debt now, and China's current capital surplus will be able to provide sufficient funding. (4) China needs to buy itself more time to undergo structural reform and economic restructuring. (5) China needs to prevent its economic growth rate from decreasing too quickly. (6) At the 19th National Congress of

the Communist Party of China, many political and social goals as well as international strategies were declared, the realization of which will require significant financing. An increase in debt issuance might just be the most effective solution to the above problems.

Although increasing debt issuance entails many restrictions, it is obvious that there are still many reasons that justify this move. Consequently, we are convinced that it is necessary for China to start thinking about formulating a large-scale stimulus package that exceeds the four-trillion-yuan one unveiled by the Chinese central government in the wake of the breakout of the 2008 global financial crisis. In rough estimations, China may need to increase its debt issuance by more than 30 trillion to RMB 50 trillion in the next three to five years in order for it to be effective.

As for the investment of capital, investment in infrastructure should not be increased further as there are many problems with doing so, be it in terms of efficiency, or contingent debt in the future. A more ideal approach would be to invest in the real economy by cutting costs and increasing capacities through measures such as setting up funds. Other than that, there are also opportunities for investment in civil and military integration, emerging industries with strategic importance, local industries, environmental protection industries, as well as the consumer electronics industry that is driven primarily by demand from the youth of China, not to mention the 'Silver Hair Industry', the construction of Xiong'an New District and so on. This may not necessarily be the best solution, but it is the most viable and forceful move to safeguard China from potential economic difficulties.

Figure 2: Chinese government's outstanding debt in recent years



Source: Annual accounting reports of previous years from the Ministry of Finance. Compiled by Anbound

### Hong Kong Is Important; Taiwan Is Not

Here, the word “important” is relative.

The social, capital, and geographic bonds between Hong Kong and China make it clear that the social stability of the former has a significant influence on the latter. This is why Hong Kong's stability should be maintained under China's dominance. Such a statement may lead to changes in policies that concern Hong Kong, along with changes in the Chinese mainland's position and attitude toward Hong Kong-related affairs.

Taiwan, on the other hand, will not have a significant impact on China's development in the near future due to a couple of historical ‘restrictions’. The first is the relationship between its President and its Premier, while the second is the relationship between Democratic Progressive Party and the Kuomintang. These two factors limit Taiwan's ability, especially that of its authorities, to pursue significant progress.

Therefore, in light of the recent developments in the Cross-Strait relations, Hong Kong is of great significance to China. Consequently, policies on Hong Kong aimed at maintaining China's influence within the former will proliferate. As for Taiwan, its political arena might be in disarray, but this is only because they are making too much of a fuss over what they imagine to be China's threatening presence. In truth, all of this is merely a brouhaha stirred up by both politicians and the media on both sides of the Straits.

### China's competitiveness exhibits overall downward trend

It has been observed that most, if not all, countries undergo a cyclical developmental process. A rising curve is followed by a falling curve, and vice versa; this essentially makes up the trajectory of a cycle. In this regard, it would not be incorrect to say that a new cycle will follow after the current cycle, for each cycle is linked to yet another. Nonetheless, at least for the time being, China's economic development appears to be embarking on a falling curve instead of a rising one.

However, the perspective of information analysis differs from that of classical economics'; the Chinese economy is not a perfect market economy, and thus it is not productive to analyse or understand it in cyclical terms. The cyclical theory may be said to be inapplicable in the Chinese context because of the Chinese government's influence over the country's economy. In short, the government plays a dominant and leading role in the economy, and even has the power to manipulate economic trends at any time. This will in turn disrupt the rhythm and course of any naturally progressing cycle and consequently render the cyclical theory meaningless.

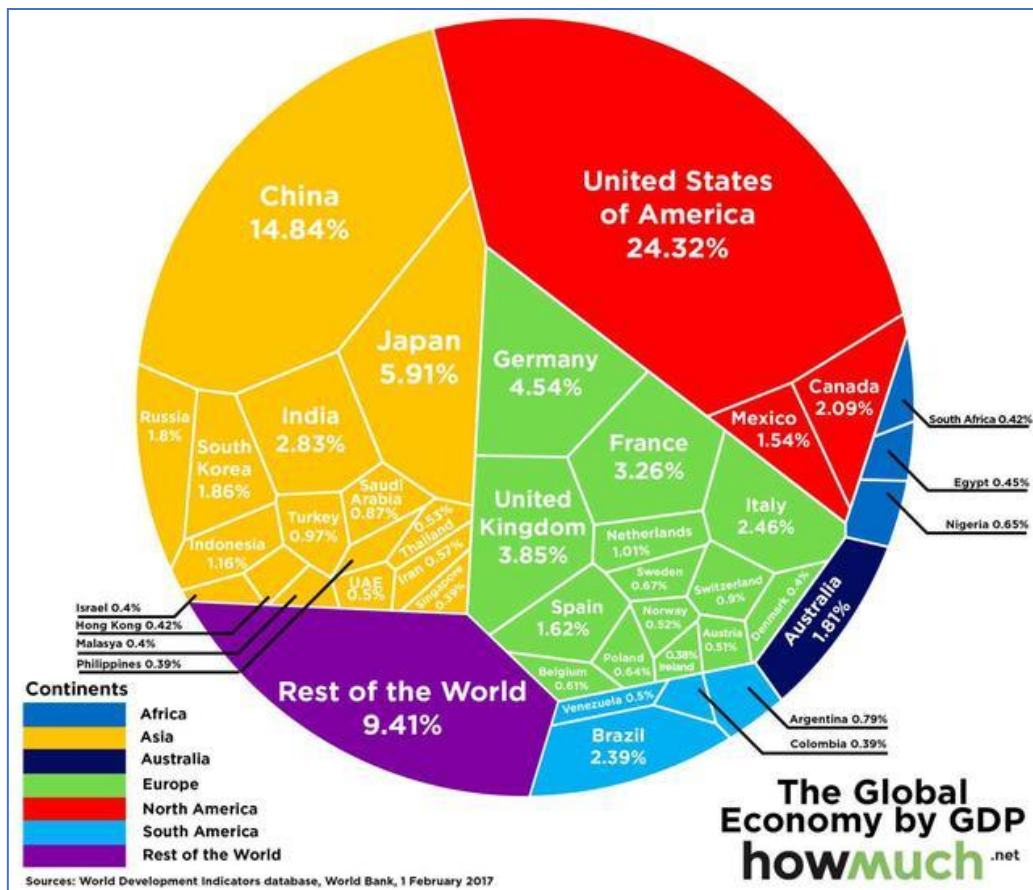
Notwithstanding this, an analysis of the trends in the data regrettably reveals that China's economic growth is currently following a downward trajectory, indicating that the country is presently at the peak of its economic growth. China will thus be going through a phase of

economic correction in the future, where growth factors like an ineffective GDP will be corrected and gradually eliminated from the its framework of economic growth. This will undoubtedly be a costly process, the cost of which cannot yet be fully assessed. Nonetheless, it is certain that the growth of China's effective GDP in the past has never been as much as what people perceived it to be.

In this regard, two phenomena are worth noting. The first is the fear that the rest of the world has

of China—this fear is completely unwarranted, for in reality, China is not the threat that it is perceived to be. Secondly is China’s own overly optimistic assessment of its own strength. As a country with a population of 1.3 billion, China undoubtedly has a certain leverage in the global arena. However, its competitiveness is currently on a downward trajectory, not an upward one. It is important to shed light on this, lest differing speculations and judgments lead to self-contradictory policies.

Figure 3: The global economy by GDP



Source: Data from the World Bank February 2017. Image from howmuch.net



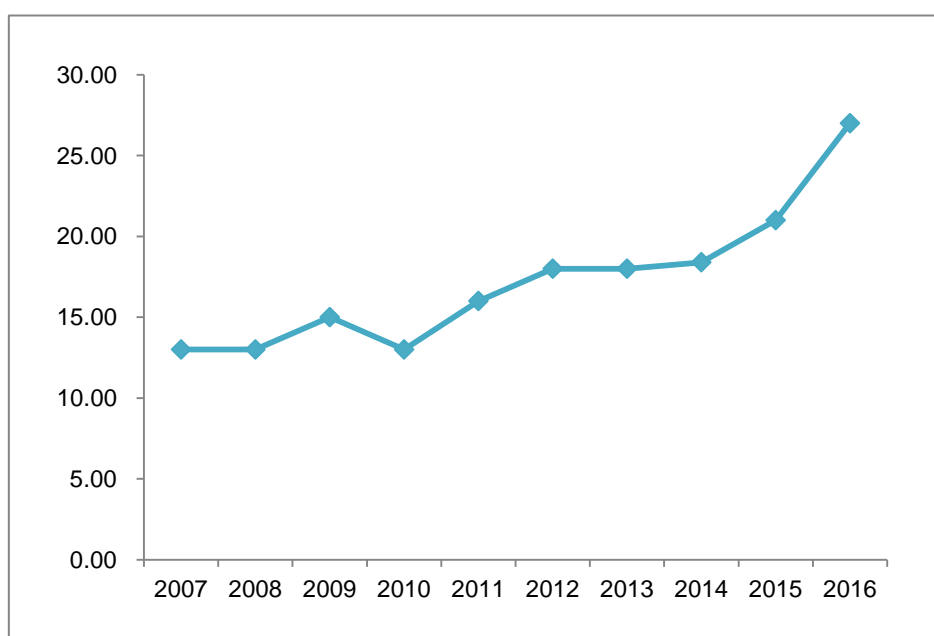
### Differences between compression of production capacity and deleveraging

We estimate that in 2018, China will continue to reduce its production capacity and realign the structure of its industry in order to solve its problem of surplus. In a sense, a reduction in production capacity can be considered as a kind of deleveraging, but differences between the two do exist. Thus far, the Chinese government has remained cautious on the issue of deleveraging because it wants to ensure the stability and momentum of the economy; it is utilizing leveraging as a means of regulation and control. Reducing production capacity can reduce the

country's dependence on the international market and prevent an increase in imports. This is significant as an increase in imports might affect the strength of the RMB. Moreover, China will also be able to weaken the influence that the West currently has over it by reducing its production capacity.

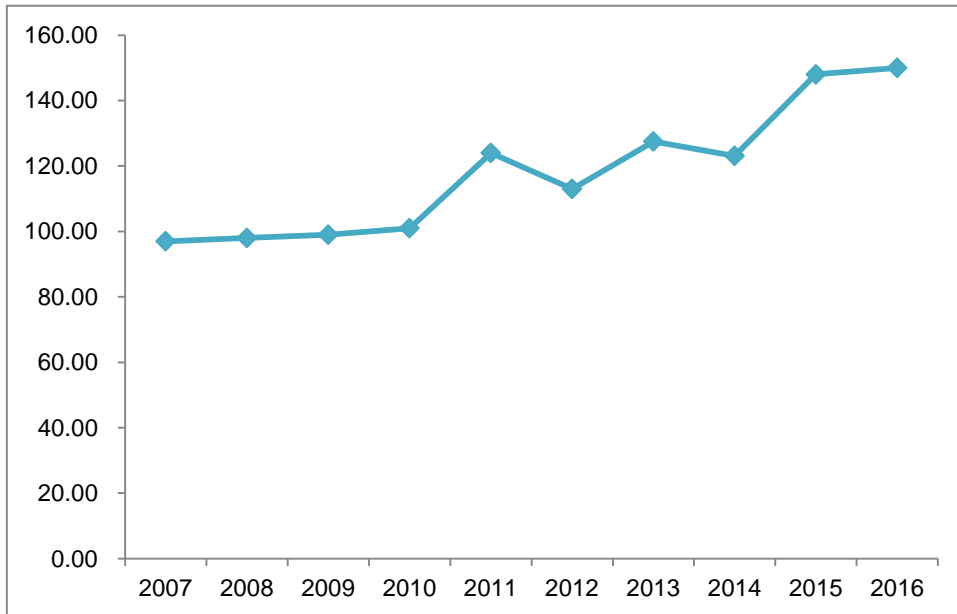
Yet another issue that merits attention is the fact that China's economic policy has undergone a drastic change; its focus is now internal rather than external. This means that China's economic policy will mainly be focused on its domestic market in the future.

Figure 4: Leverage of financial institutions from 2007 to 2016 (%)



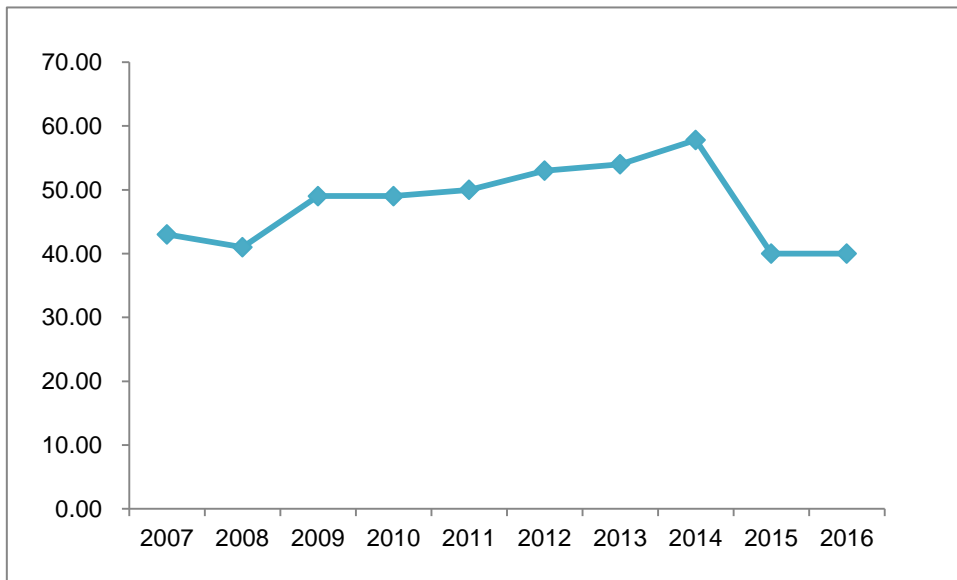
Source: Wind info, Bank for International Settlements. Chart by Anbound Think Tank.

Figure 5: Leverage of enterprises from 2007 to 2016 (%)



Source: Wind info, Bank for International Settlements. Chart by Anbound Think Tank.

Figure 6: Leverage of the government from 2007 to 2016 (%)



Source: Wind info.

## Reorganizing the system of social organization

China is currently at a crucial point in its history. In our opinion, it is now in the early stages of this historical period, characterized by the growing push back against corruption. As things progress, China will likewise transition into a phase where its society, which is currently in a relatively unordered and ununified state, will undergo a complete reorganisation and restructuring.

As far as commercial activities are concerned, it is possible that various kinds of associations will be materialised through the realisation of important organisational resources such as appointment, approval, and resource allocation rights. In our opinion, such a reorganisation of the system is actually an important development that will help the government counteract the influence of the Internet. Inevitably, the Chinese government will pay more attention to the construction of various social organizations.

## Establishment of consortiums and mixed-ownership reform

The possibility of the adoption and promotion of a consortium economy has long been a source of confusion. This is because of the conflation of the conventional understanding of the consortium and the consortium's economy. In reality, the consortium has always been a tool used by the government to control the market indirectly. Consortiums can play a very effective role especially in strategically important industries. Having said that, the problem for China in the future lies in the realization of the consortium.

Policy documents on mixed ownership reform have pointed out that it is necessary to differentiate between commercial and public welfare state-owned enterprises by strengthening the strategic positioning and developmental goals of state-owned capital, consolidating the roles and needs of state-owned enterprises in terms of their contribution to economic and social development, and in accordance with the scope of core business entities.

The main focus of commercial state-owned enterprises is on enhancing the vitality of the state-owned economy, expanding the capacities of state-owned capital, and maintaining and increasing the value of state-owned assets. On the other hand, public welfare state-owned enterprises mainly focus on protecting the livelihood of the people, social services, and providing public goods and services. While the prices of essential goods and services can be left to the government to be regulated, market mechanisms need to be actively introduced to continuously improve the efficiency and capacity of public services.

The current mixed-ownership reform thus provides a way to realise the consortium economy. Commercial state-owned enterprises will be able to spread their wings overseas, while public welfare state-owned enterprises will be able to more easily introduce new market mechanisms. All in all, this will lead to a new system of mixed ownership made up of "state-owned +" or "private +" enterprises that will keep the Chinese economy vital and robust.

Based on the policies that have been enacted and implemented since China's reform, Anbound is convinced that a good policy cannot be drawn up based on theoretical and administrative orders alone. Rather, meaningful outcomes can only be achieved based on considerations of efficiency, in addition to the ability to navigate market forces strategically.

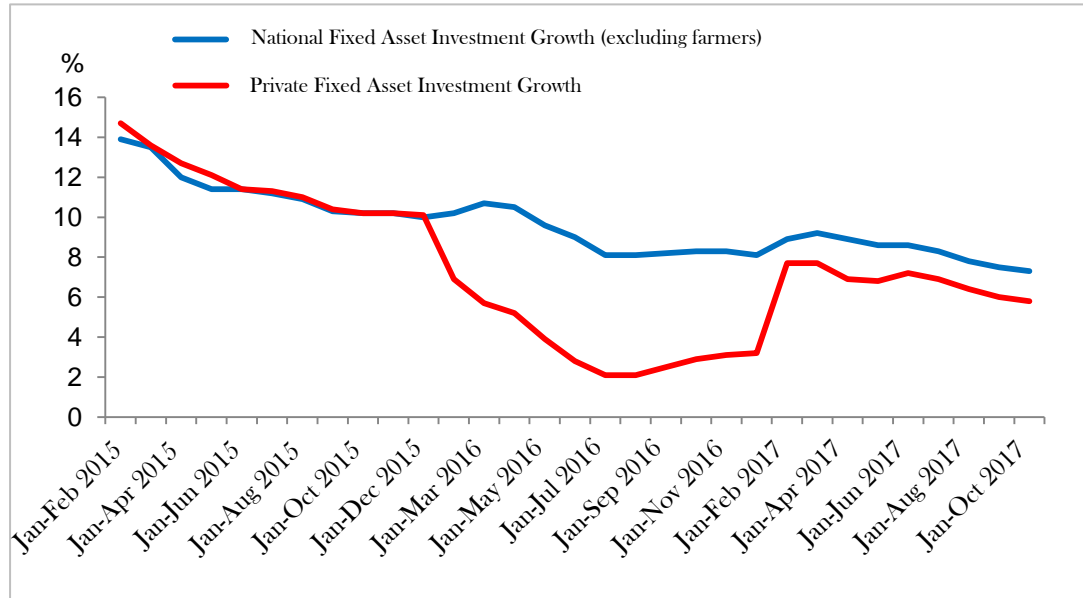
## Private enterprises face considerable challenges

Private enterprises in China will be facing many challenges in the future not only because of their own shortcomings but also as a result of external factors such as the challenges arising from social development. Some of the problems private entrepreneurs will need to face in the future are: (1) limited financial resources; (2) changes and transitions in politics; (3) labour shortages; (4) the inadequacy of the law to meet developmental needs; (5) restricted permission to utilise resources; (6) tighter regulations on resource allocation; and (7) mixed-ownership reform. Furthermore, private entrepreneurs will have to face both domestic and foreign competition. Some private-owned

enterprises may also undergo a process of "retailisation" and "individualization". It is thus evident that real industries are influencing and

transforming the behaviour of individual investors.

Figure 7: National and Private Fixed Asset Investment Growth in China



Source: Data from National Bureau of Statistics. Chart by Anbound Think Tank.

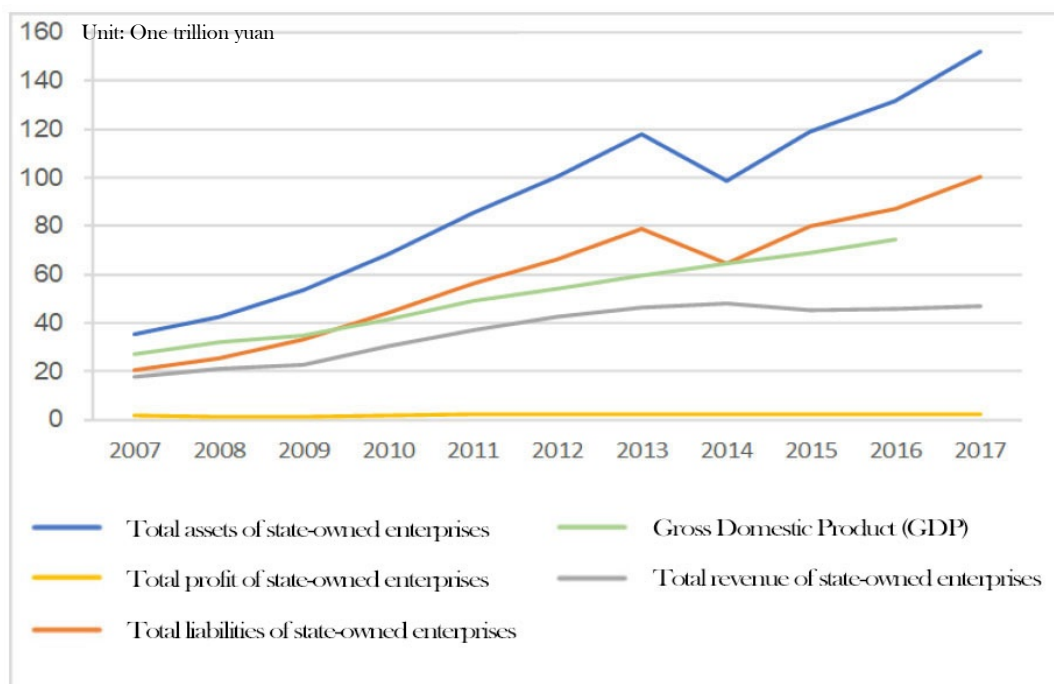
**On re-privatization and re-nationalization**

The two-track approach of re-privatization and re-nationalization is currently an important and emerging trend in China. On one hand, state-owned enterprises, which are overwhelmingly numerous, have expanded through privatization. On the other hand, private-owned enterprises, which require a lot of policy-based support, have achieved a certain degree of nationalization through the assistance of state-owned capital.

The current problem for state-owned enterprises, which thrive on competition and enthusiasm, is re-privatization, while the problem weighing down on the non-profitable but systematically important private enterprises, is re-nationalization.

All in all, a foreseeable trend in China's future reforms is the handing over of the industry to the capitalists and subsequently, the handing over the capitalists to the Party.

Figure 8: Inefficient state-owned enterprises are huge consumers of social funds<sup>3</sup>



Note: Data is from the SASAC, the Ministry of Finance, and the National Bureau of Statistics.

### Large amount of debt issuance unavoidable

China undoubtedly has a debt problem. In general, debt is used as a measure to assess the health of a country’s economy. Based on this standard, other countries are under the impression that China’s economy is developing at “worrying” rates. While the Chinese economy does indeed have a lot of debt, what’s more important to note is that this debt is also increasing rapidly. The liabilities of local governments, state-owned enterprises, as well as that of Chinese residents have become the three major problems for China’s debt issue.

This increasing amount of debt is partly due to the lack of financial resources required for the government to realise China’s major social developmental goals. The duty to realise these goals inevitably falls on the government’s shoulders as only under its leadership will

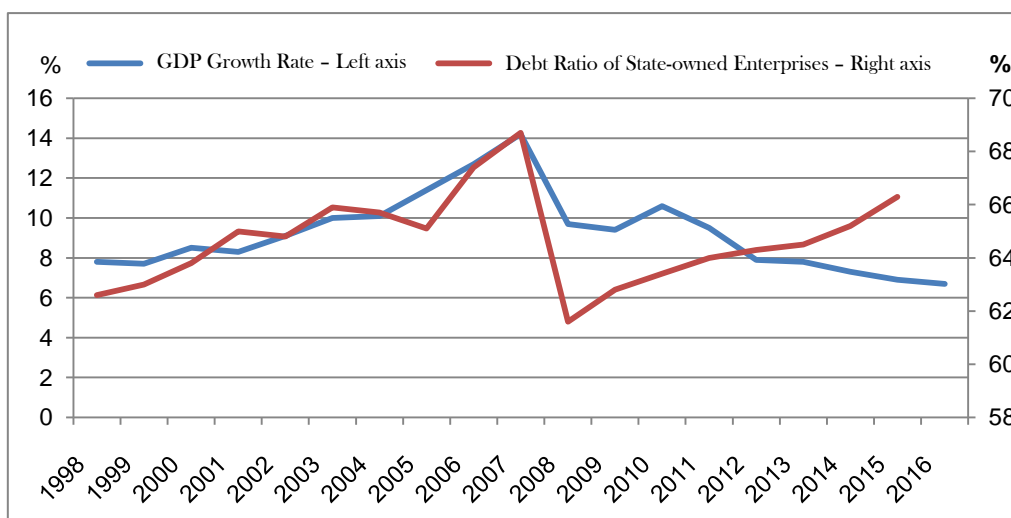
stability be maintained. Therefore, in order to compensate for the lack of funds, the government must raise funds by increasing its debt issuance.

Another important reason for China’s increasing debt is its efforts to recover the liquidity of its currency. Since its residents seem reluctant to spend their money, the government has to step in and do the spending for them. It is thus evident that debt is a big problem for China, but since it is both the only option and the last resort available, China might as well make the most out of it.

Such a way of thinking is of course a traditional Keynesian mentality, but it is nonetheless incredibly effective when the interest rate is low. Moreover, a socialist country like China has the ability to exploit many of the advantages from such a situation, while Western governments, on the contrary, will have a lot of difficulty doing so due to the constraints and limitations of their social conditions.

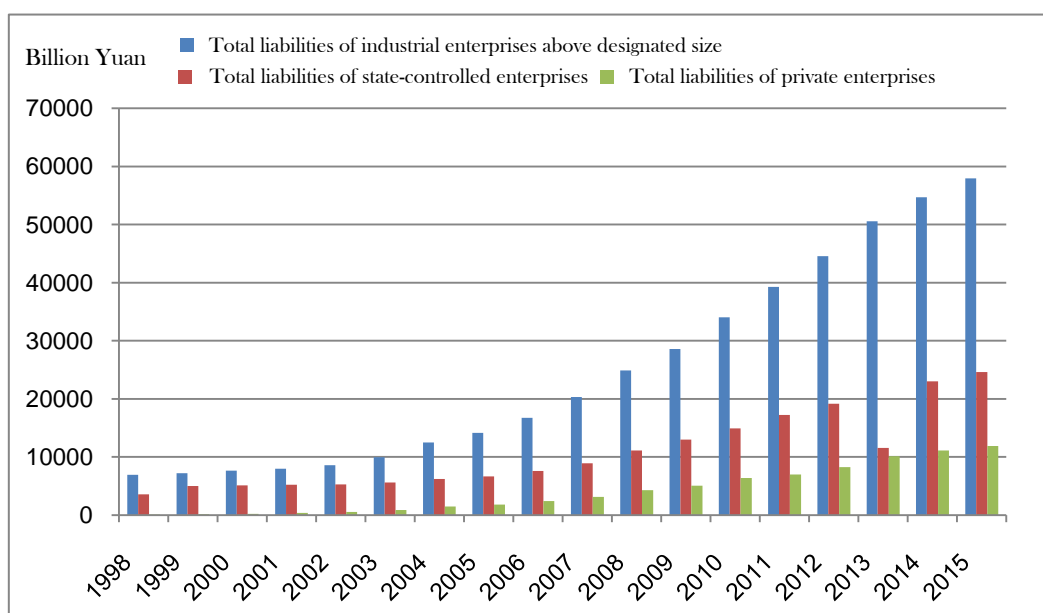
<sup>3</sup>Data on state-owned enterprises in 2017 was only recorded up till November.

Figure 9: GDP Growth Rate and the Debt Ratio of State-owned Enterprises<sup>4</sup>



Source: National Bureau of Statistics

Figure 10: Debt Scales of Various Types of Industrial Enterprises



Source: National Bureau of Statistics. Compiled by Anbound Think Tank.

### Differentiations of foreign investments in China

There have been some subtle changes in the Chinese government’s attitude towards foreign investment over the course of the social and economic development within the country. During the first stage of this attitudinal shift towards foreign investment in China, which was during the time of China’s reform and opening

up, foreign investors were treated like royalty—China wooed them with the most attractive deals and conditions. At that time, China was happy as long as foreign investment was flowing in. In the second stage, China began to value foreign investment in terms of its utility, or whether or not China could “make good use” of these investments. The third stage, on the other hand,

<sup>4</sup>Development Research Center of the State Council. Zhang, Wenkui, The Problem of Corporate Debt: Acute Epidemic or Chronic Plague?

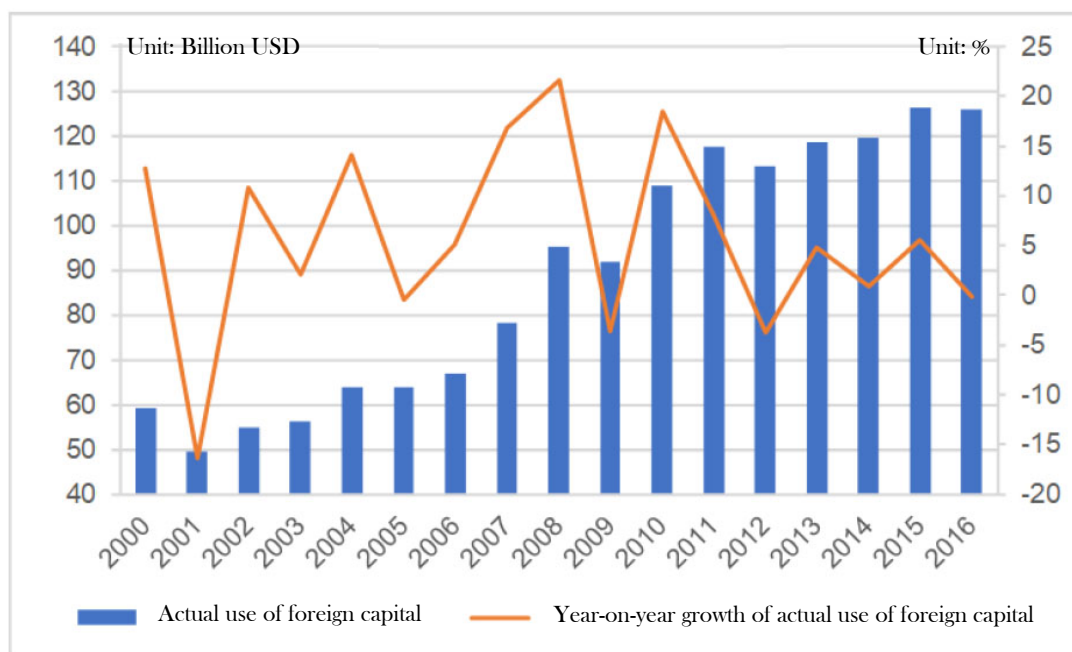
was characterised by China’s confidence (if not overconfidence) in the size of its own market, and at this stage, the tables had turned—China was now being wooed by the investors.

It is currently anticipated that a differentiation in the types of foreign investments in China will soon occur, and that this differentiation will be manifested in both the industrial sector and beyond. To a certain extent, global financial capital will also begin to look favourably upon the Chinese market; after China’s social transformation and industrial restructuring, its market is now extremely attractive to the service industry. Other systemically important industries

and enterprises around the world will also realise that there will be increasing privileges that come with investing in the Chinese market. Consequently, they will increase their active involvement in the Chinese market, and their investments will be of a somewhat different nature from that of what is common today.

Thus, it is without a doubt that a differentiation will occur between the various types of foreign investments in China. Likewise, there will be those who will be strongly opposed to this, while others will sing its praises.

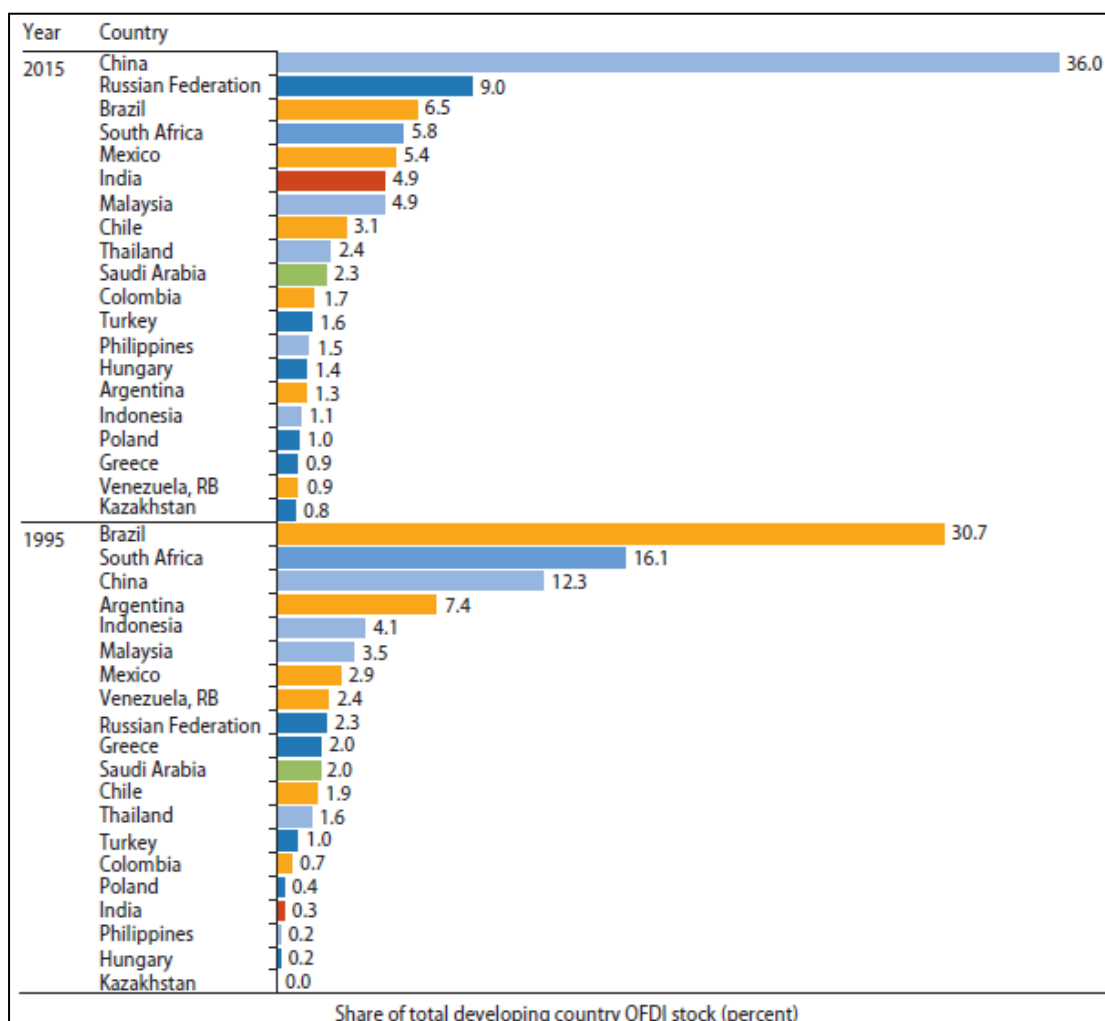
Figure 11: China's actual use of foreign investment between 2000 and 2016<sup>5</sup>



Source: Official statistics. Chart by Anbound Think Tank.

<sup>5</sup> All data was obtained from the National Bureau of Statistics except for data on the year 2016, which was obtained from the Foreign Investment Department of the Ministry of Commerce.

Figure 12: Share of Major Developing Countries' Outward Foreign Direct Investment



Source: World Bank, *Global Investment Competitiveness Report 2017/2018*.

### The nature of the administrative economy

The spectrum on which lies the market economy on one end and the planned economy on the other does not progress linearly. To put things simplistically, at the market economy extreme, we have a completely free and competitive economy, whereas at the other extreme, that of the planned economy, all production and living is planned out. However, nestled between these two extremes is actually a more “balanced” type of economy that allows the government to play a dominant role; this is the administrative economy.

Those who think that China will inevitably become a planned economy are thus going to be labelled as retrogressive. However, it is also a fact that the administrative economy has been widely implemented with intensifying intervention.

Regardless of whether it is in the resource, labour, capital, or market sectors, there is an administrative trend that is being implemented through administrative policies. To a certain extent then, administrative policy has replaced market regulation.

### China’s wavering tax policy

The increase of debt is evidence that the government’s financial resources are already strained, and this will be exacerbated by the pursuit of China’s social developmental goals. There is thus a looming risk of the deterioration of revenue and expenditure.

Typically, there are two ways to deal with this kind of systemic risk. The first is by increasing taxes to boost tax revenue, while the other is by



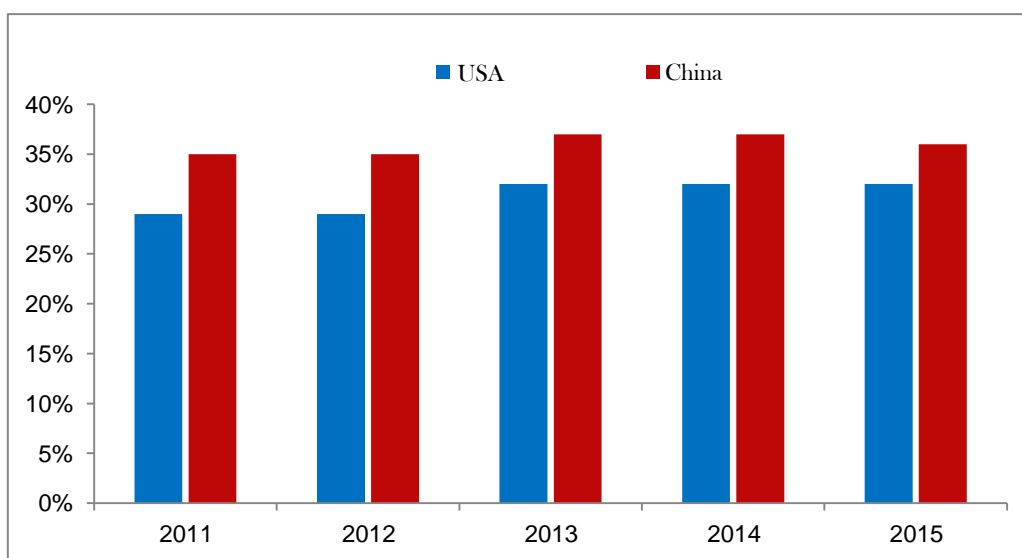
invigorating the economy to indirectly increase tax revenues.

At this point of time, the Chinese government will not be able to increase taxes, at least not with the desired effect, primarily because the competitive dynamics of the global economy have already taken shape. For one, various countries are already implementing tax cuts in light of the tax reform in the United States. Invigorating the economy, on the other hand, calls for an increase in free market competition alongside an increase in the level of marketization, both of which are inconsistent

with the China's social goals. This is why there is currently a lot of fluctuation in China's tax policy.

Regardless of whether it is a reform of real estate tax, or any other type of institutional tax reform, or even an adjustment of the tax-sharing system, the key issue here is the instability caused by the fluctuation in the tax policy. In can thus be said that China's current tax system and tax policy are guided by naïve optimism; once things get worse and the risk of a deterioration in revenue and expenditure becomes more pronounced, there will be fewer fluctuations in the tax policy.

Figure 13: Comparison of the tax burden between China and the USA



Source: China International Capital Corporation Research Division. Compiled by Anbound Think Tank.

### Anti-consumerism

China is now caught in a Catch-22 situation; it needs consumerism for its economic growth, yet it also needs anti-consumerism to realise one of its grand social goals, that of closing the gap between the rich and the poor. However, it is obvious that consumerism targeted at luxurious products will not only not contribute to a more economically egalitarian society but also increase the gap between the rich and the poor. This is why China's policy on (anti)consumerism, especially with regard to the consumption of

luxury products, is bound to become part of the mainstream discourse.

Furthermore, consumer goods, especially luxury products, need to be imported in large quantities, which in turn entails a large amount of exchange in currencies. Because of this, in addition to the depreciation of the RMB, it is exceedingly difficult to get policy makers to support such consumerism. It is thus likely that the rejection of a decadent lifestyle will become part of the anti-consumerism movement in the future.

**Individual efficiency is not equivalent to overall efficiency**

Does China have individual industries and enterprises that are thriving? But of course. Many take this as powerful proof of China's economic prosperity, without understanding that individual efficiency cannot be used as a measure of overall efficiency. On the contrary, the thriving of these

individual entities is more telling of a defect than it is of an achievement.

Any successful economy, especially one that is as large as China's, must be able to maintain high levels of effectiveness across various sectors in order to achieve overall efficiency; the flourishing of individual and separate industries and enterprises do not form the backbone of an economy that is the size of China's.

**Table 2: Top 20 Internet companies in China by revenue in 2016**

No.	Typical Enterprise	Industry	Revenue (billion yuan)
1	Jingdong	New Retail	260.20
2	Tencent	Culture and Entertainment	151.94
3	Alibaba	New Retail	143.88
4	Baidu	Search Engine	70.55
5	Vipshop	New Retail	56.59
6	Suning Online Market	New Retail	52.88
7	Ant Financial	New Finance	40.00
8	Mi Store	New Retail	39.85
9	NetEase	Culture and Entertainment	38.18
10	Ctrip	Online Travel	19.79
11	Meituan.com	Domestic Services	19.50
12	LinkedIn	New Retail	18.21
13	Lufax	New Finance	13.50
14	Vmall	New Retail	11.93
15	Dangdang	New Retail	11.70
16	Sohu	Culture and Entertainment	11.45
17	IQIYI	Culture and Entertainment	11.28
18	Tuniu	Online Travel	10.55
19	Qihoo 360	Search Engine	9.90
20	Cainiao	New Retail	9.35

Source: iResearch Consulting Group. Compiled by Anbound.

**Issuance of new currency does not necessarily lead to inflation**

Since the implementation of QE in various Western countries, the People's Bank of China has also invested a large amount of money. Nonetheless, this move has not resulted in an

inflation. Likewise, most of the Western countries that have implemented QE also did not experience any inflation. What's the explanation for this?

According to Anbound's senior researcher, Chen Gong, this is because the money has been

converted into an increase in production capacity, which in turn lowers the prices of goods and services; this is how inflation is circumvented. The question then is whether or not inflation will occur as China moves towards its larger goal of social development, for this will entail an increase in debt and bonds.

Likewise, that need not be the case. This is not necessarily because the Central Bank will manipulate financial tools to stabilise the economy and prevent inflation—in fact, there is no conclusive evidence that such measures taken by the Central Bank will achieve the desired result. Rather, strengthening the bond between the Chinese market and the global market will be more effective in this case.

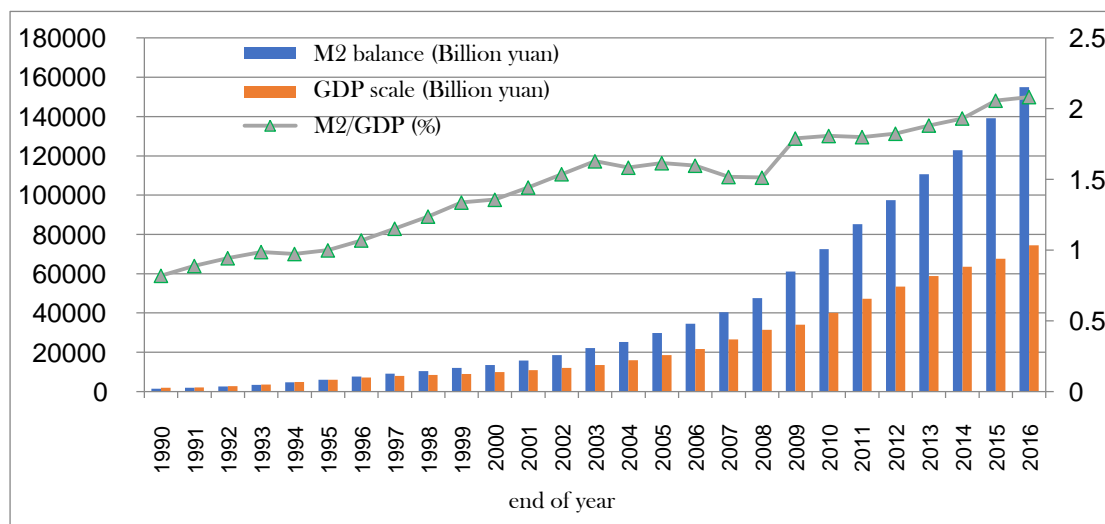
If the Chinese market gradually changes its focus from “outward” to “inward” and trains its focus on the domestic market, it will be able to transform from an outward-focused “factory of the world” into a super-sized inward-focused consumer market. The possibility of inflation will thereby be reduced drastically. This is not

wishful thinking; it is possible for China to achieve this degree of isolation as it is currently an administrative economy.

The reason why reservations about inflation still exist is because of the externally-driven transformation of the Chinese economy. In short, inflation in China is caused by external factors. If there is an issuance of new currency without a corresponding increase in the control of imported goods, the value lost in the exchange rate will be reflected in the commodities. In this sense then, one can say that inflation is one of the (undesirable) “commodities” being imported. Therefore, we can expect that future policies will be anticipating such a situation should China continue to increase its issuance of currency.

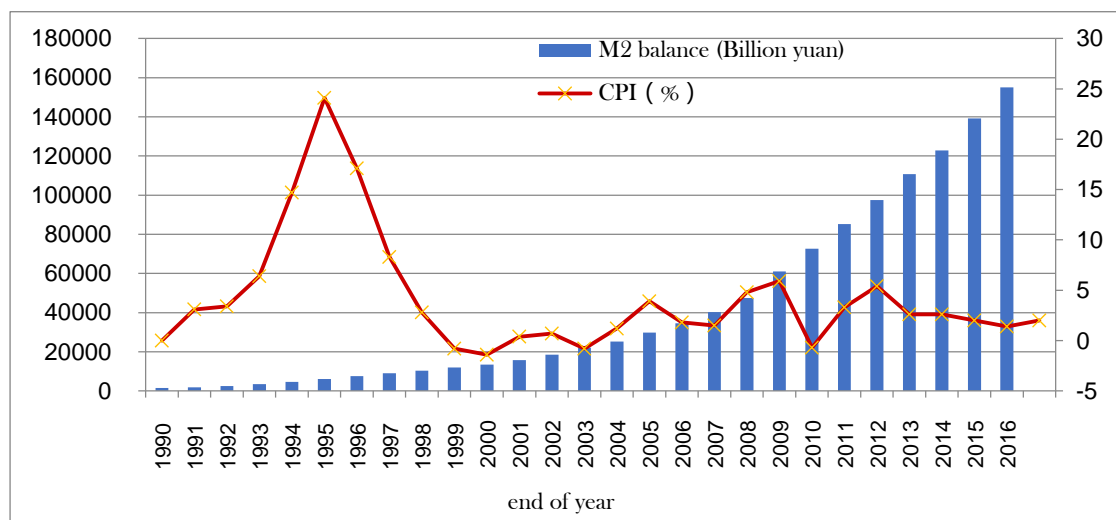
All in all, an increase in currency does not necessarily result in inflation. Rather, inflation is caused by external factors. Understanding this is crucial, because in order to prevent inflation, there needs to be tighter regulations on imports.

Figure 14: China’s M2 balance, GDP scale, and GDP ratio from 1990 to 2016



Source: People's Bank of China, the National Bureau of Statistics. Compiled by Anbound.

Figure 15: China's issuance of new currency has not brought on high inflation rates



Source: People's Bank of China, the National Bureau of Statistics. Compiled by Anbound.

### The epidemic of trade protectionism

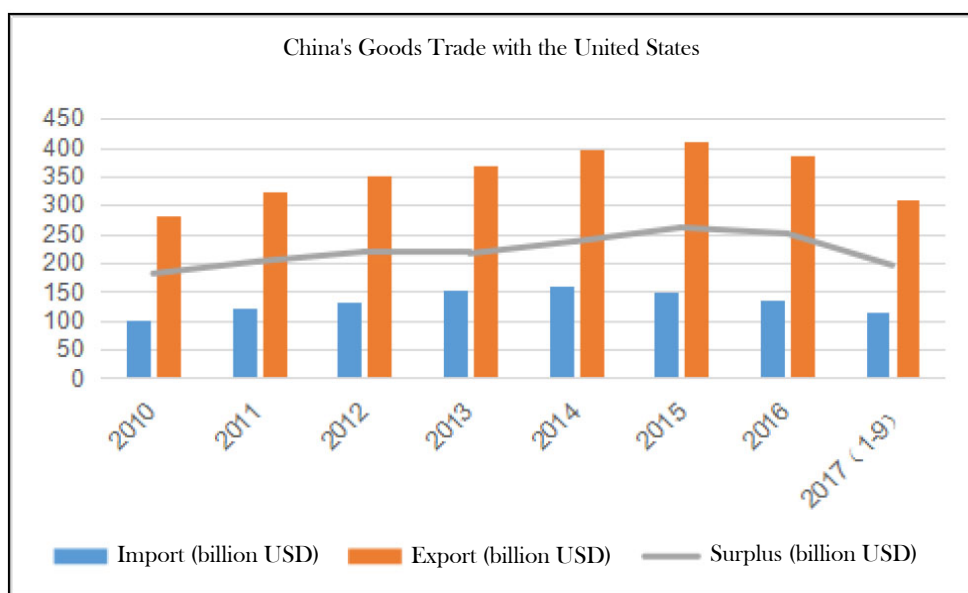
The level of trade protectionism in the United States is significantly lower than that of the European Union's. Trade protectionism is actually on the rise in the EU, even though its member states are currently still divided on the issue. However, should they be able to reach some sort of consensus, it will be obvious that trade protectionism in the EU is higher than that of the USA's. The difference between trade protectionism in the EU and the USA lies in the fact that in the latter, it is out in the open and clearly stated and reflected in the country's laws and regulations. On the contrary, trade protection in the EU is often masked as "culture and tradition". It is worth noting that after Donald Trump took office as president of the USA, policies based on his campaign slogans "America First" and "Make America Great Again" have been implemented, especially in tax reform. This has been highly effective in encouraging the return of US manufacturing capital. Additionally, amendments in the immigration policy, as well as the USA's drastic

cut in funding to the United Nations, is leading the world into a new era of trade protectionism.

What is worrying is the fact that trade protectionism spreads like an epidemic; if no countermeasures are put in place, trade protectionism will flourish globally. Furthermore, this is a growing wave that has the potential to become an economic tsunami, by the time of which it will be too late to turn things around. It is thus anticipated that currently free and open markets all around the world will begin to become more conservative. The rise of such a trend is also partly caused by the indiscriminate overproduction of goods that is driven by globalization. We cannot turn a blind eye to the rise in trade protectionism that is driven by overproduction.

It would be a wishful thinking for any country to think that it can achieve the same level of development as that of China's. Likewise, China would be delusional to think that it can continue to pursue development without changing its ways.

Figure 16: China's Goods Trade with the United States (2010-2017 Jan-Sep)



Source: Ministry of Commerce, the National Bureau of Statistics. Compiled by Anbound.

**Macro liabilities determine devaluation of RMB**

Since China’s reform and opening up, the exchange rate of the RMB has been an important economic indicator. For one, many policies have been drawn up based on the exchange rate of the RMB. When we talk about the devaluation of the RMB exchange rate here, we are talking in terms of the long run; we are not discussing the short-term or current devaluation of the RMB.

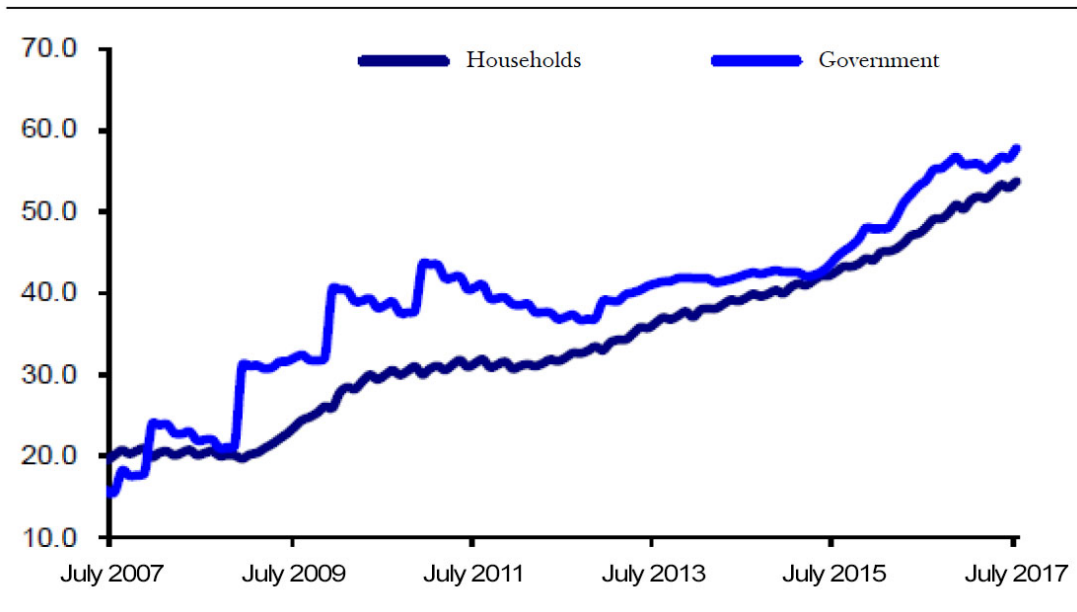
There are many ways to manipulate the exchange rate through the market, at least in the short-term. These interventions would be used by the central banks of any country in the world. Likewise, China’s central bank is also bound to use the offshore Hibor tool to manipulate, or rather, regulate, interest rate costs. Since the short selling of the RMB requires the use of RMB itself, it would be self-defeating to not keep the cost of RMB low. Should an increase in the cost of the RMB be compounded by the tightening of the scale of RMB outside the country, the central bank will still have recourse to some ways to control the exchange rate of the RMB.

Therefore, the current problem is dealing with the exchange rate of the RMB in the long-term.

The current trend in information analysis is to focus on the visible trends that emerge with time; such an approach is known as a cross-sectional analysis. This approach can likewise be applied to the issue of the exchange rate of the RMB; should the timeline be extrapolated, we will be able to see how the liabilities of the Chinese macroeconomy influence the devaluation of the RMB, much more so than other factors like the amount of net exports is able to.

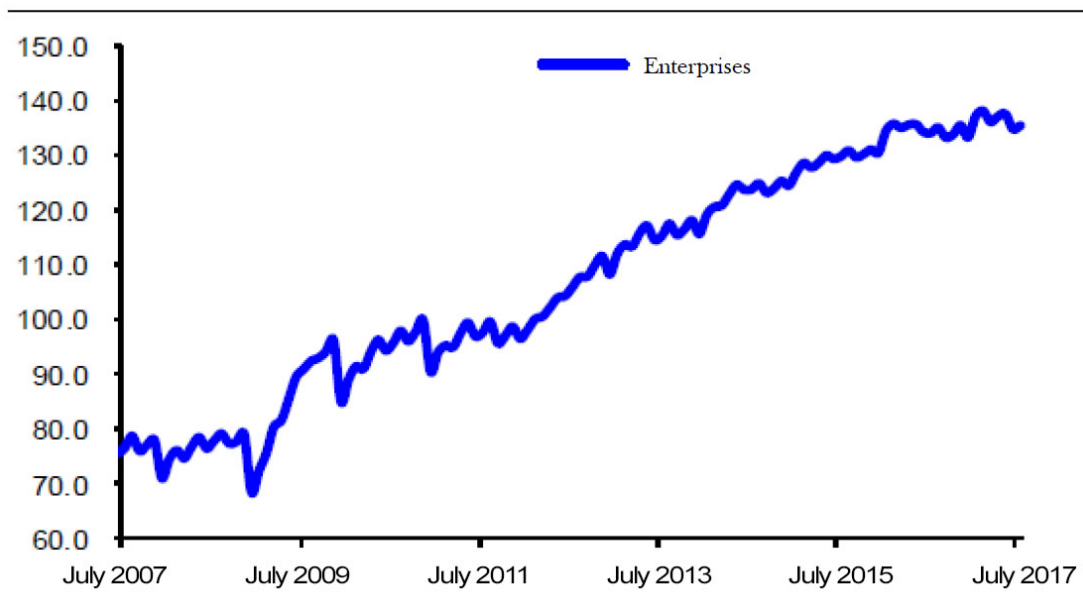
An increase in net exports may well be achieved through regulations. Doing so, however, would not mean that the exchange rate of the RMB is strong, for many internal factors still play a decisive role in determining such trends. Nonetheless, it is still undeniable that there is a rise in debt that might continue to increase in coming years. It is thus that the issue of the rise and fall of the exchange rate of the RMB, though multifaceted and complicated, is primarily contingent on the country’s debt.

Figure 17: Debt of Chinese residents and government to GDP ratio (%)



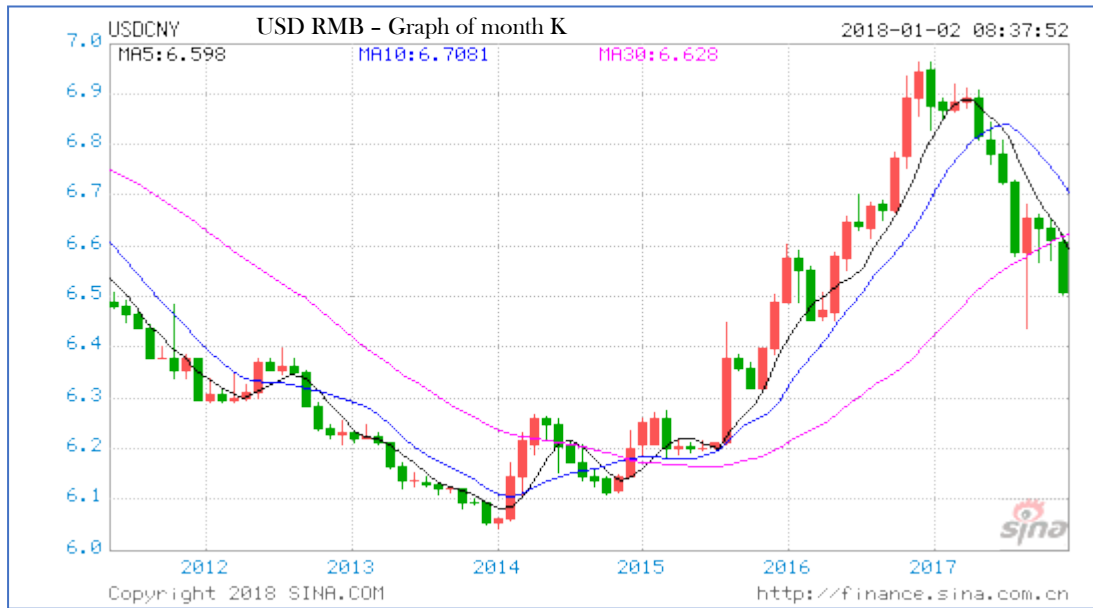
Source: Wind, Haitong Securities.

Figure 18: Debt of Chinese Enterprises to GDP ratio (%)



Source: Wind, Haitong Securities.

Figure 19: USD against RMB exchange rate



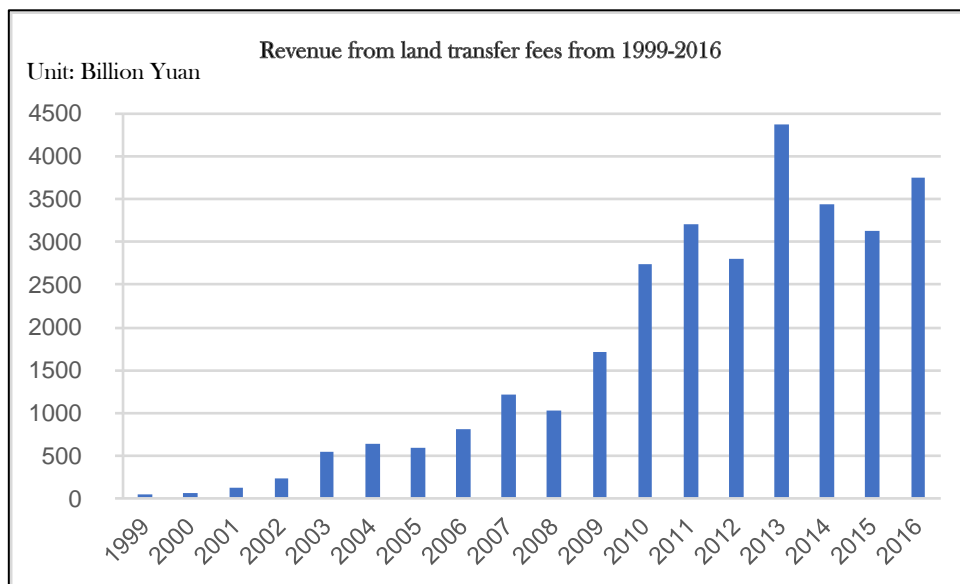
Source: Sina.

**Fiscal stimulus package should replace land economy**

Financial backing is required for us to realise the main goal of housing, which is to create living spaces for people rather than for investment purposes, without causing too much disruption to the market. Anbound has thus proposed a RMB 30 trillion to 50 trillion fiscal stimulus package that will partly serve to replace the land economy with a fiscal programme. Without sufficient financial backing, there will inevitably be a shock to the market which will especially be felt by the banks, local governments, as well as asset prices.

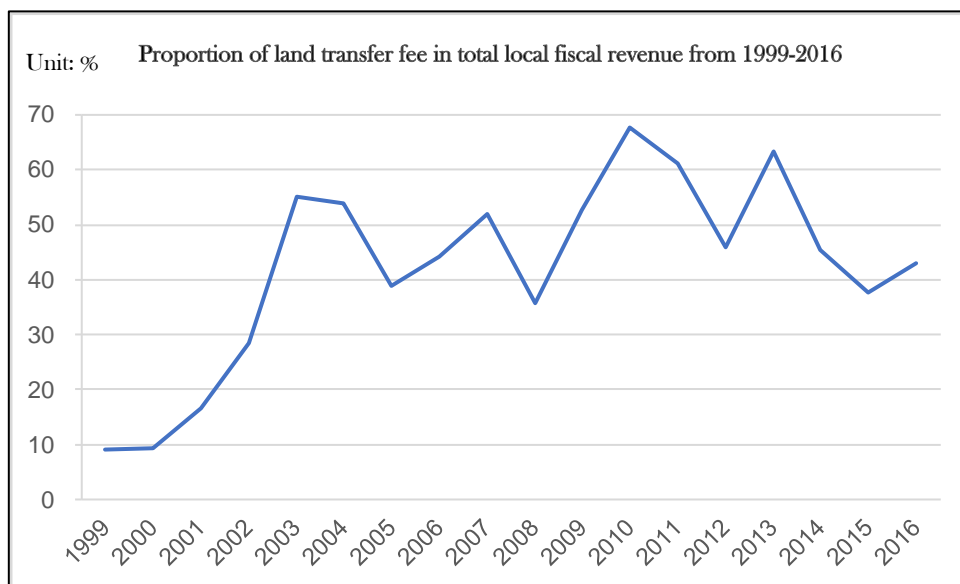
One important lesson that can be drawn from the past successes and failures of China's policies is that policies that focus on demand achieve the best results while creating the least impact. An illuminating example can be found in the real estate industry: suppressing the market would require a significant amount of national resources, but this will not bring about the desired effect as it will be difficult to get the cooperation of the market, the people, and the developers on such a policy. On the contrary, focusing on affecting demand by providing more housing leases will reduce rental prices and thereby reduce the need for people to purchase houses. Here, it is evident that money is needed to implement such a policy.

Figure 20: Scale of China’s revenue from land transfer fees in past years



Note: Data from China Statistical Yearbook for Land and Resources and the Ministry of Finance.

Figure 21: Proportion of land transfer fee in total local fiscal revenue



Source: China Statistical Yearbook for Land and Resources, Financial Yearbook of China, Ministry of Finance.

**Technological innovation beneficial to the market**

From a historical perspective, while innovation and technology do not necessarily benefit a country, they certainly bring a lot of benefit to entire generations.

There are two reasons why an increase in

innovation and technology will be beneficial to China's economy in the near future. The first reason is the size of its market; even technology that is not the most advanced or attractive of its time may be able to bring about significant technological benefits should the size of a market be large enough. Innovation and technology will undoubtedly stimulate China's



"idea culture" and consequently encourage more technological innovations in the market. Therefore, the second reason is that such developments will also encourage more technological innovations in the market in the future. While money is not an issue here, it is crucial that it is channelled to the right avenues.

Technological innovations in the market have always been focused on increasing consumption. These innovations are simply new and fun ways that have been created for consumers to spend their money more conveniently. This is no different from the advent of the credit card in the market, an innovation used by the financial sector to encourage more consumption. Such innovations, while conducive for consumption, are also accompanied by many risks.

What China lacks most is technological innovation in production activities and production efficiency, especially in terms of original innovations. At present, most of the innovations are for the purposes of consumption, while there is hardly any innovation happening in the production sector. Therefore, in the future, although technological innovation in China might be able to capture a huge market, it will not be able to capture an era.

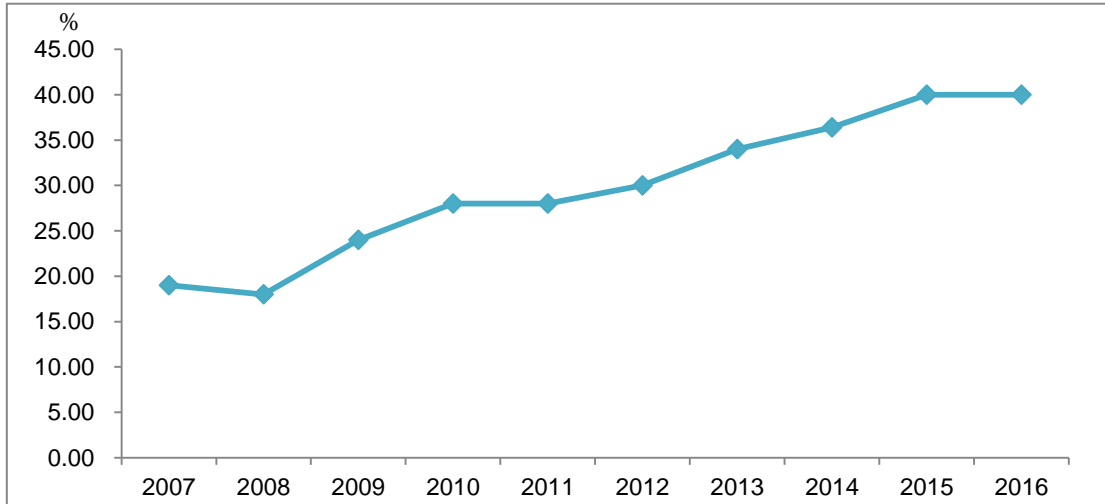
#### **Middle class in China has ceased to exist**

The concept of the middle class, which was our focus in the last century, has already become a

common term today. However, it is a pity that China will cease to have a real middle class in the future. This is because of two reasons: firstly, living costs are soaring, and this swallows up wealth and assets rapidly. In this sense, the middle class is an insubstantial concept and its assets are at risk. The second is that the middle class is causing rifts among technical aristocrats in China, which is in fact a kind of differentiation of the middle class. Another characteristic of the middle class is their higher-than-average income, which is a result of their unique technological and innovative abilities. On the contrary, the "ordinary" middle class has all but ceased to exist because of the rate at which the cost of living has increased, a rate that far surpasses the rate of increase in their income.

The impoverishment of the middle class is not just a problem for the United States; this is evidenced by the large amount of liabilities accumulated by the general household. It is important to pay attention to the disappearance of the middle class as it is a "social stabilizer" and this will become a major problem for China in the future. It is no coincidence that society is increasingly being driven by the internet, this has profound social and economic implications, as evidenced by the discussion above.

Figure 22: Rapid increase of Chinese residents' leverage ratio affects stability



Source: Wind info, Bank for International Settlements, compiled by Anbound Think Tank.

**The world is entering an era of major crisis**

A proclamation that the world is entering an era of major crisis certainly differs from the optimistic discourse that proliferates today; but by no means is it meant to be sensational.

The logic behind such a proclamation is that the global trend of conservatism will bring about rising costs. As costs rise, so will that of capital, as it is highly cost-sensitive. This will in turn result in a major crisis. Whether such a rationale befits our predictions and judgments is of course still to be seen. Nonetheless, history tells us that conservatism does not bode well for an era.

**Overproduction will cause a global crisis**

For a long time, overproduction has been regarded as progress, even though its name itself suggests that overproduction is production that is excessive. Although production has not surpassed the recommended margins by much, it

is still able to accumulate a large amount of capital and assert a certain influence over the market due to its large scale. It is this influence over the market that tends to be conflated with influence in the global market.

Nothing, however, could be further from the truth. A representative case of overproduction can be found in China's previous economic model, which resulted in serious environmental problems, increased economic inequality, social instability, and excessively high costs of living. While China will be able to overcome the domestic problems that come with overproduction, the same cannot be said for the global market, for overproduction also has an impact on global market relations.

Many countries in the world consider China a model of prosperity. Many countries that want to compete with China, including India, certain Southeast Asian countries, and even some Eastern European countries, do so in the name

of emulating China. This in turn exacerbates the problem of overproduction in the global arena. Essentially, these countries are competing in the production and sales of their goods. This has resulted in a disruption of global economic dynamics, which in turn causes a lot of confusion among political elites. The poor have become rich and the rich seem to have become poorer. At the same time, the natural environment has been destroyed. These countries, which are already financially challenged, are likely to face even more financial challenges as they abandon conservatism and general prudence. As a result, conservatism will prevail in various countries around the world with the rise in antiglobalization and debts accumulation.

The world is currently facing the problem of overproduction as a result of an excess of capital. At present, we do not know how this problem can be resolved. However, things are not bleak; in the future, economic research will inevitably create another system and form a new economic understanding.

### **The problems plaguing China's Southeastern Coast**

As declared at the 19th National Congress of the Communist Party of China, the country's major social development goal is shifting its focus from

"letting some people get rich first" to achieving social balance. Economic growth is no longer being prioritised, rather, more emphasis is being put on protecting the environment, reducing income inequality, maintaining diplomatic relations, as well as increasing efficiency and fairness.

In light of these developments, it appears that the era of mercantilism is coming to an end. As a result of this shift in policy, the provinces of Fujian, Zhejiang, Jiangsu, Shanghai, Guangdong and other developed eastern coastal areas have been affected, and this is in turn creating more challenges for China. Because the disparity between current social development goals and those of the past are rather significant, these provinces are having a lot of difficulty in adapting to the steep costs of social transformation.

The 19th National Congress merely established a framework for development; whether or not this can be realised through the current economic capabilities of the country is a critical matter. From the point of view of regional economics, the decisive factor is the social and economic development of China's south eastern coast. If the provinces and municipalities along the south eastern coast are able to achieve social and economic stability, it would signify the successful implementation of the 19th National Congress's grand social developmental goals.

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