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# CHINA ECONOMIC OUTLOOK 2016

## 2016年中国经济展望

By Former Chairman of CBRC Liu Mingkang | 特邀：前银监会主席刘明康

MARCH 30, 2016



HARVARD CLUB OF NEW YORK



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An aerial photograph of the Great Wall of China, showing the stone wall snaking across a series of rolling hills and valleys. The landscape is covered in trees with vibrant autumn colors, including shades of orange, red, and yellow. The sky is a clear, pale blue. The wall's structure is clearly visible, with battlements and watchtowers. The overall scene is a mix of natural beauty and historical architecture.

**Challenges and Opportunities  
for a Sustainable Chinese Economic Growth**

**Prof. Liu Mingkang**

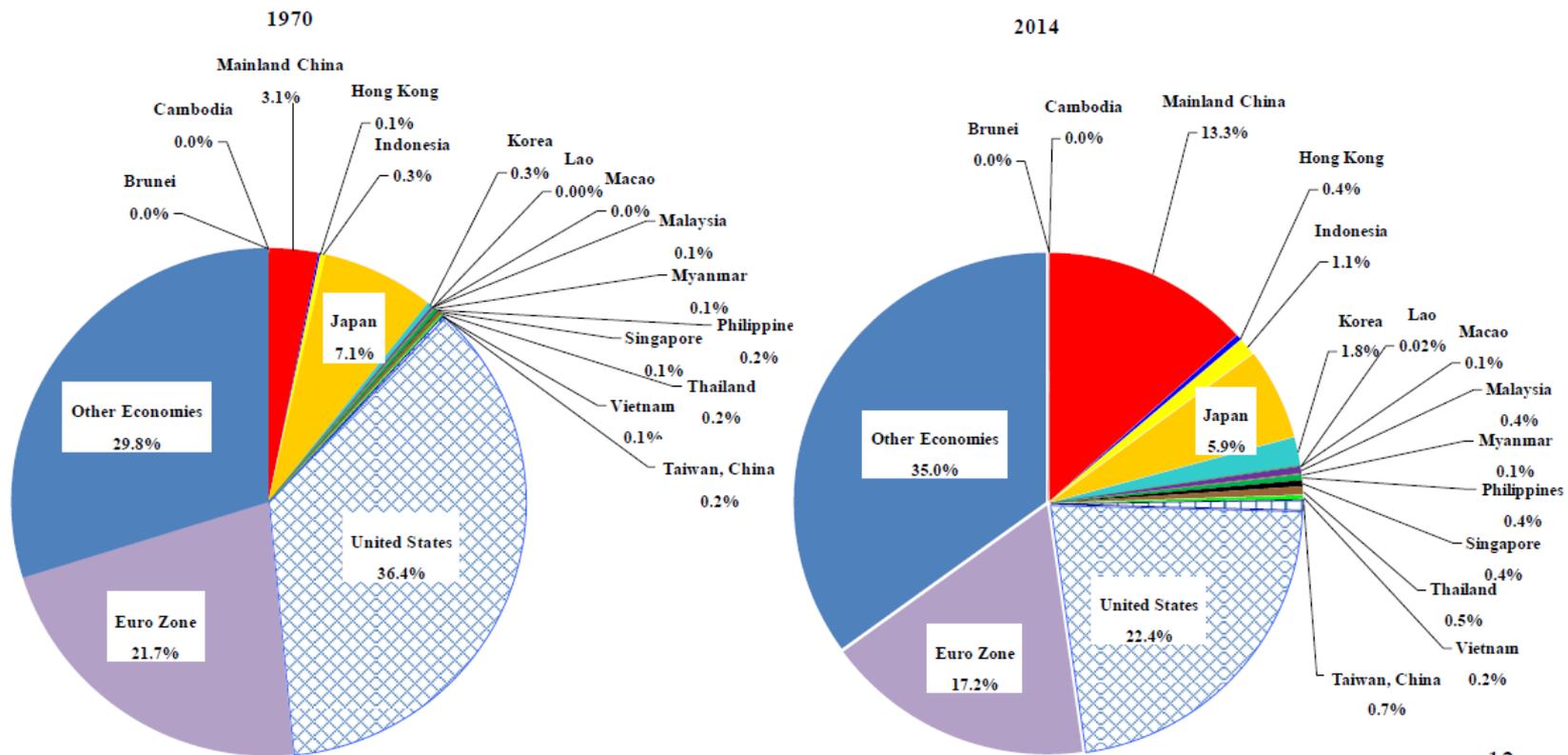
# 1. Introduction

- China has made tremendous progress in its economic development since it began its economic reform and opened to the World in 1978. It is currently the fastest growing economy in the World—averaging 9% per annum over the past 37 years. It is historically unprecedented for an economy to grow at such a high rate over such a long period of time. However, the Chinese economy has begun to slow down, to an average annual rate of growth of around 6.5%, in a process of transition to a “New Normal”.

# 1. Introduction

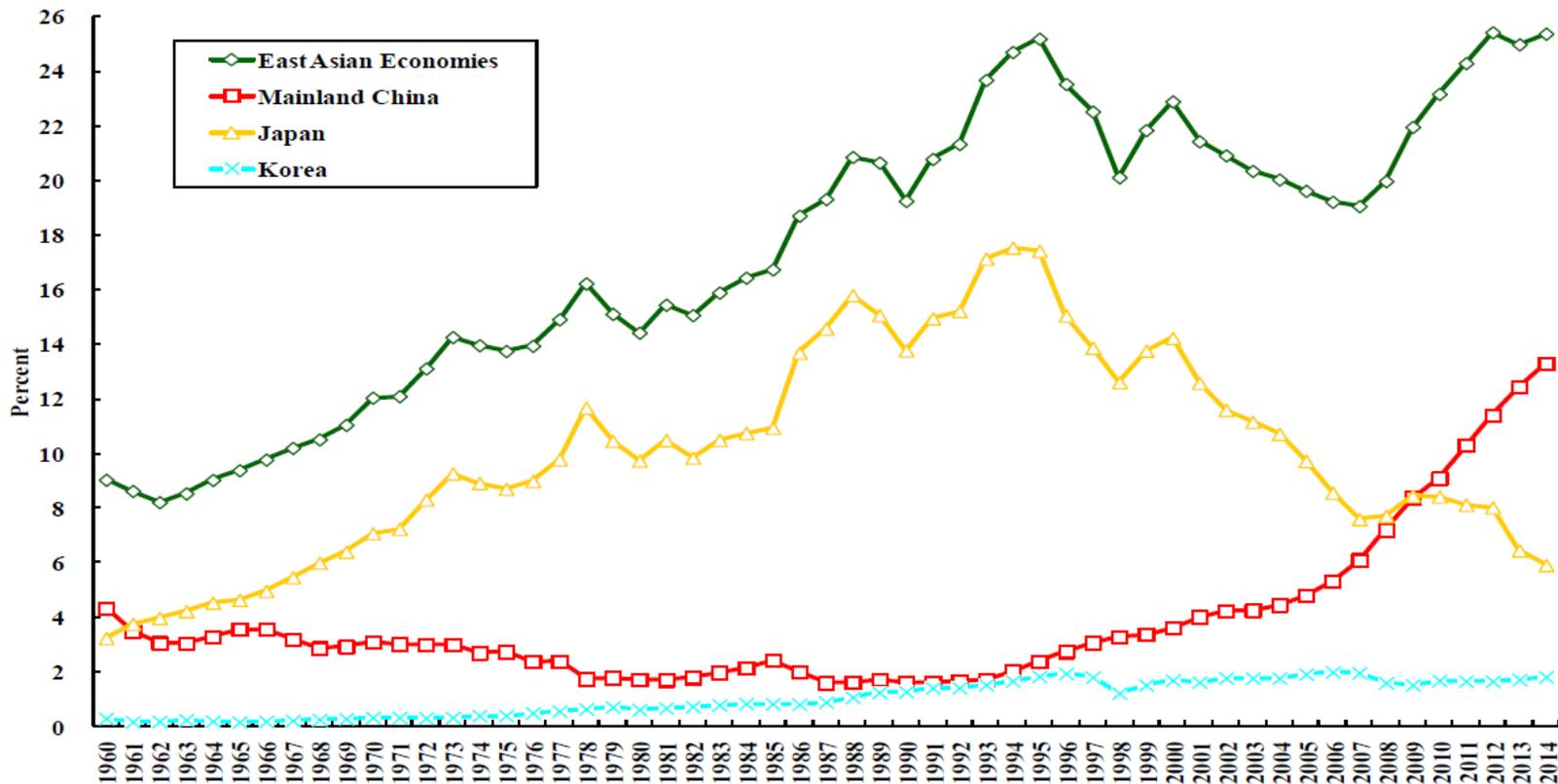
- The most important development in the global economy since 1980 is the reform and opening of the Chinese economy and its participation in the World (2001,12, China's accession of WTO).
- Chinese international trade in goods and services has also grown very rapidly since the beginning of its economic reform. It's rate of growth accelerated after Chinese accession to the WTO.

# The distribution of world GDP, 1970 vs 2014, US\$



# The Shares of East Asia, China, Japan and South Korea in World GDP, 1960-present

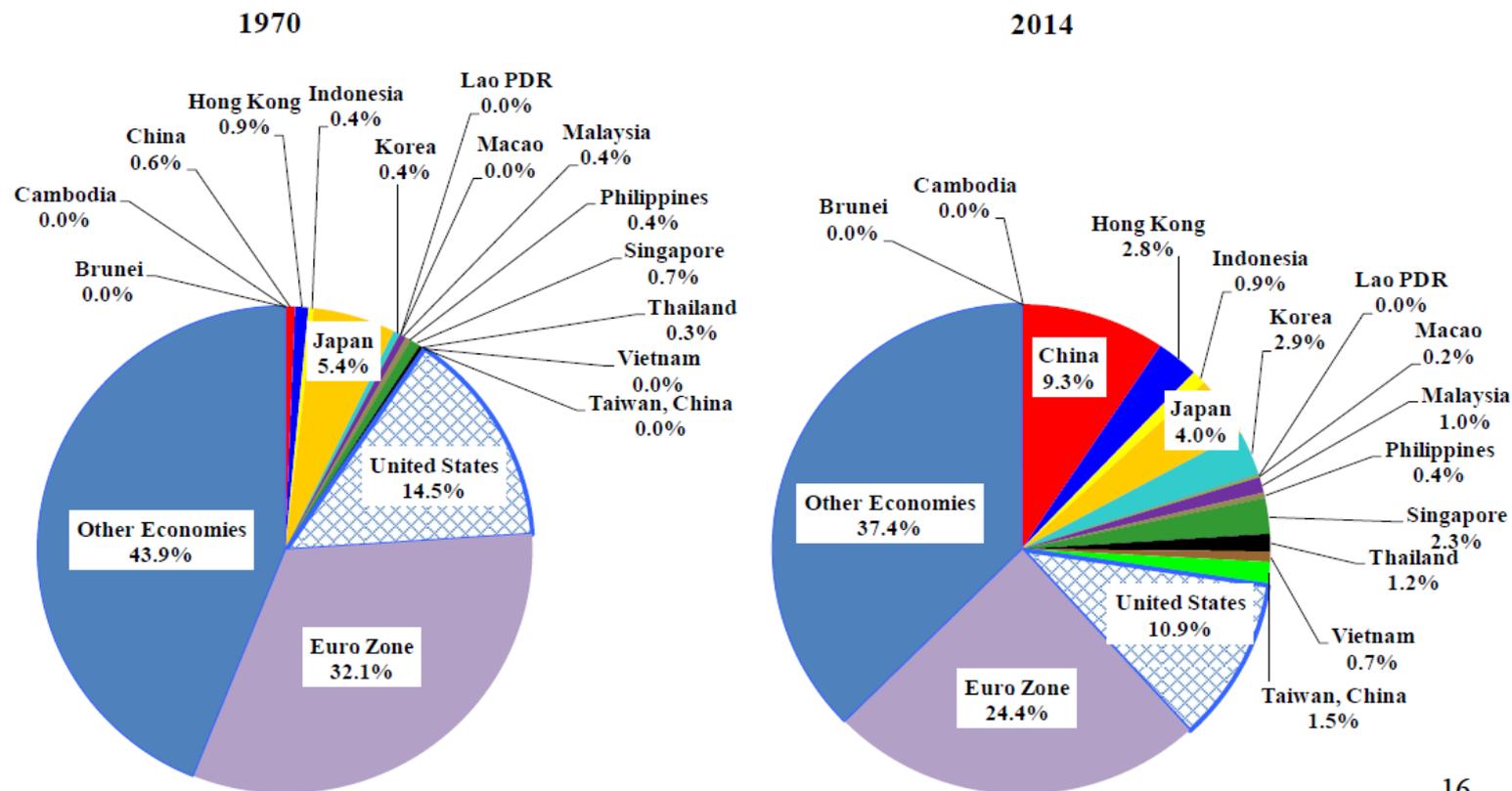
The Shares of East Asia, China, Japan and South Korea in World GDP, 1960-present



# 1. Introduction

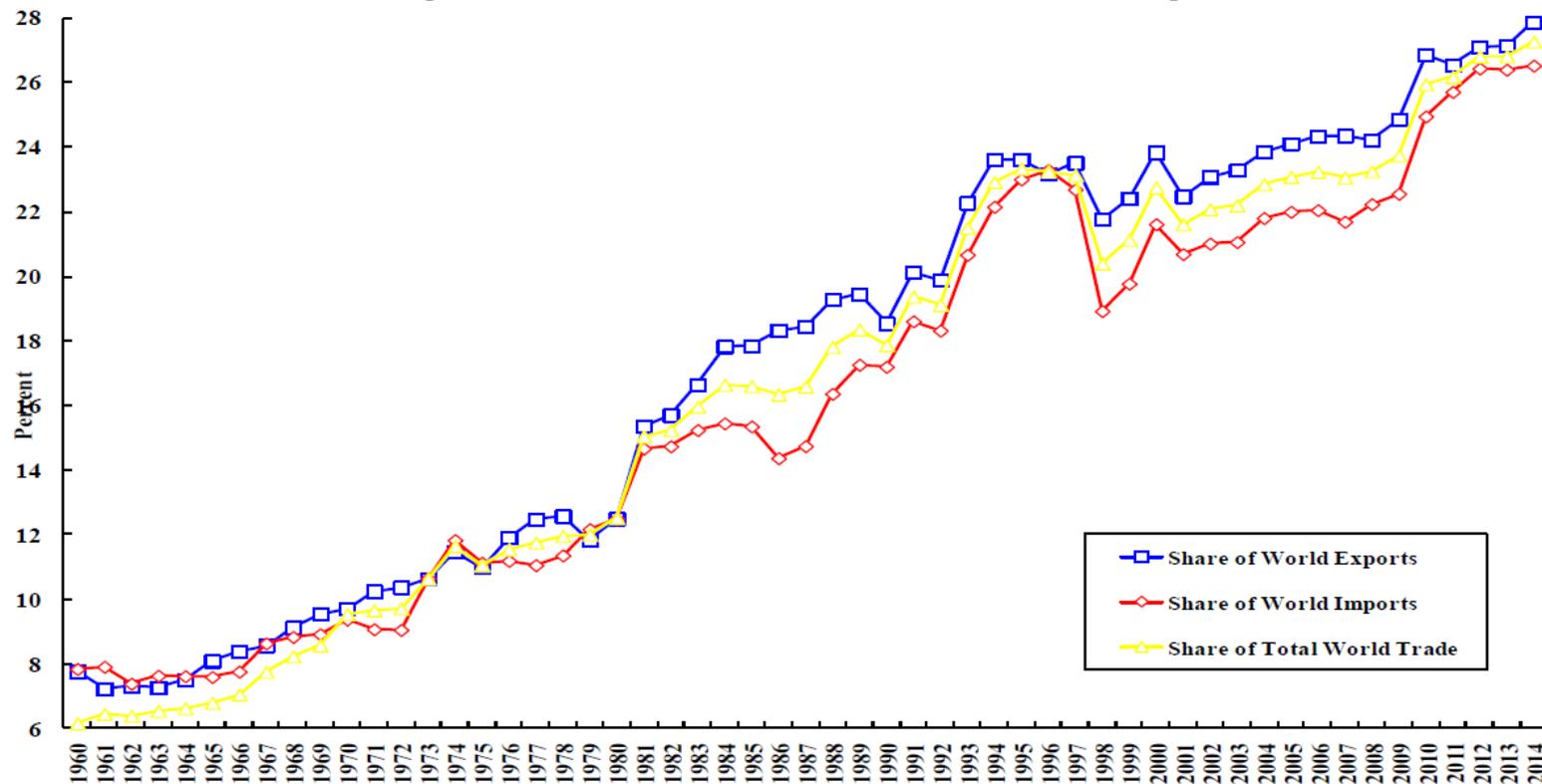
- While China is the largest exporting nation in terms of goods and services (US\$2.362 trillion in 2015), followed by the U.S. (US\$2.242 trillion), the U.S. is the largest importing nation in terms of goods and services (US\$2.779 trillion), followed by China (US\$1.999 trillion). China is also the largest exporting nation in terms of goods alone, followed by the U.S. The U.S. is the largest exporting as well as importing nation in terms of services, followed by respectively the United Kingdom and Germany.

# The Distribution of Total International Trade in Goods and Services, 1970 and 2014



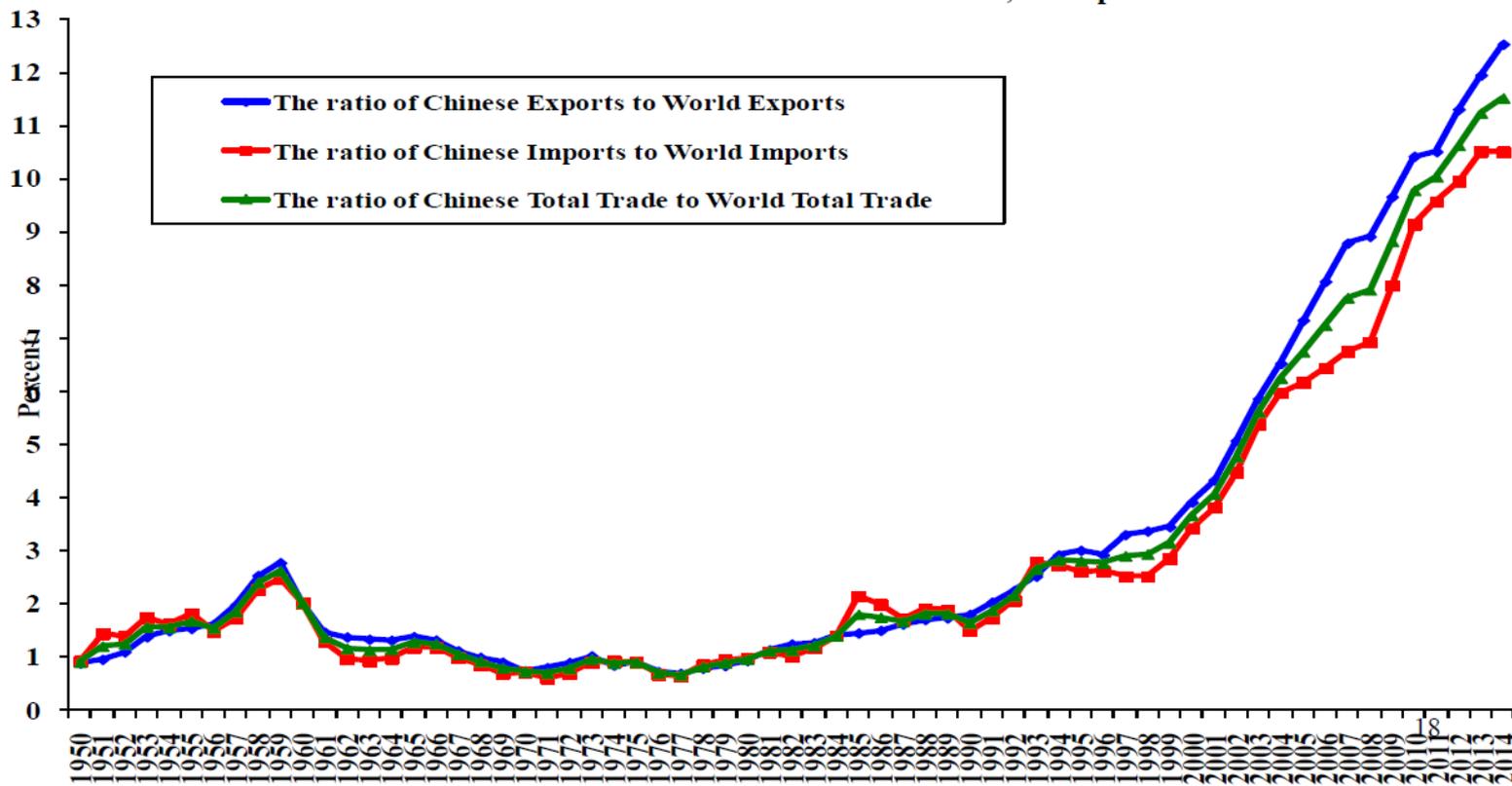
# The Rising Share of East Asian Trade in Total World Trade, 1960-present

The Rising Share of East Asian Trade in Total World Trade, 1960-present



# The Chinese Share of Total World Trade, 1950-present (in Goods only)

The Share of Chinese Trade in Total World Trade, 1950-present



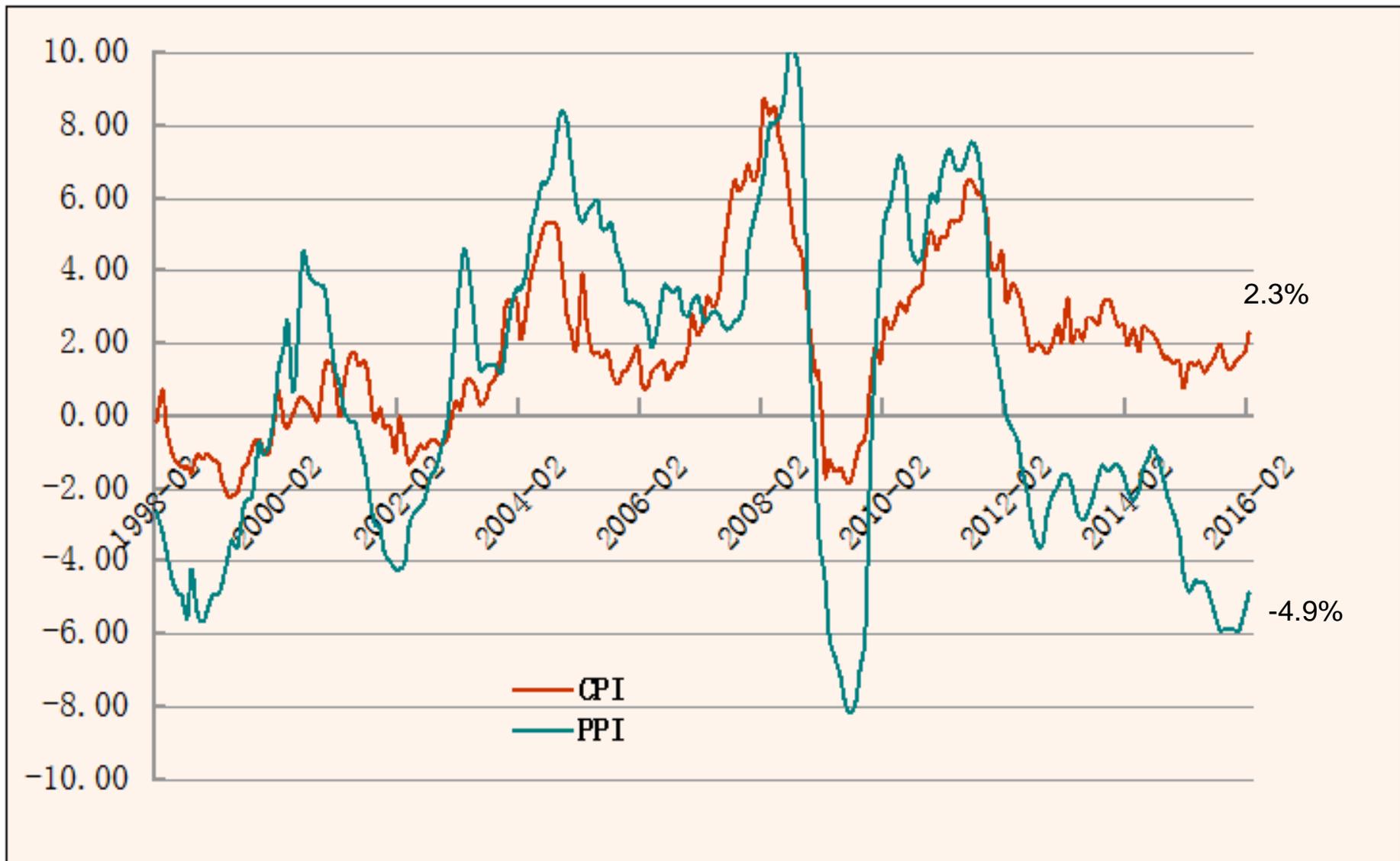
# The Chinese Economic Fundamentals

- Long-term economic growth of a country depends on the rates of growth of its primary inputs—capital (tangible or physical) and labor—and on technical progress (equivalently, the growth of total factor productivity)—that is, the ability to increase output without increasing inputs.
- The rate of growth of tangible or physical capital depends on the rate of investment on structure, equipment and basic infrastructure, which in turn depends on the availability of national savings and foreign investment and loans.
- The rate of technical progress depends on the cumulative past investment in intangible capital (including human capital and Research and Development (R&D) capital).

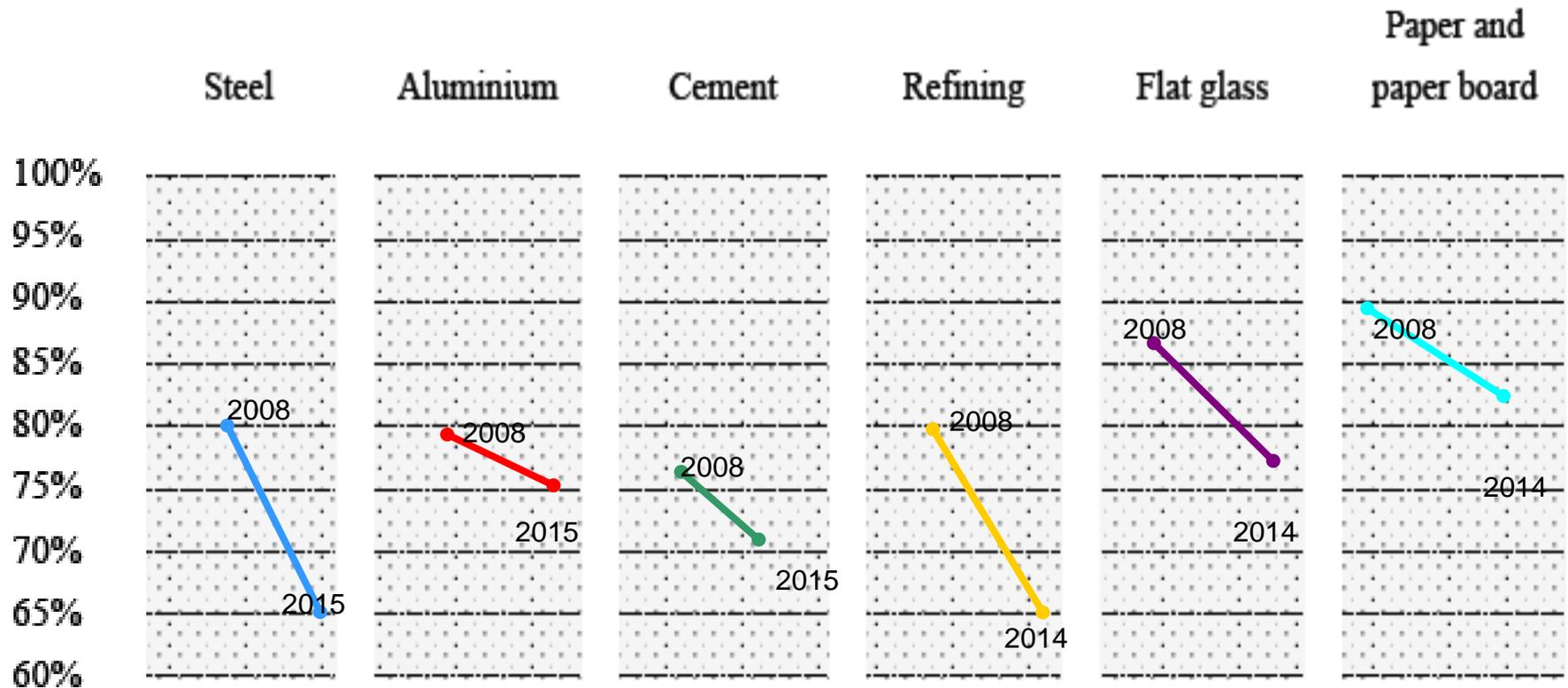
## Investment driven by tangible capital and labor inputs

- However, the heavy reliance on investment driven by capital and labour have reached its end. Overcapacity is affecting dozens of industries and causing far-reaching damage on the environment balance in general. The scale of overcapacity in steel, coal, aluminum, cement, glass making and ship building industries highlights the severity of the problem.
- Due to the effect of over capacity in industry profits and in line with weak commodity and fuel prices elsewhere, during almost 50 months up to now, China saw its PPI (Producer Price Index) continually declined. This trend has deterred seriously the producers and investors and dragged down CPI and brought deflation pressure.

# CPI & PPI



# Utilisation rates for six industries



As the chemical industry covers an extremely wide range of products and quantifying capacity in the shipbuilding industry is highly complex, for the sake of clarity these two sectors have not been included in this chart.

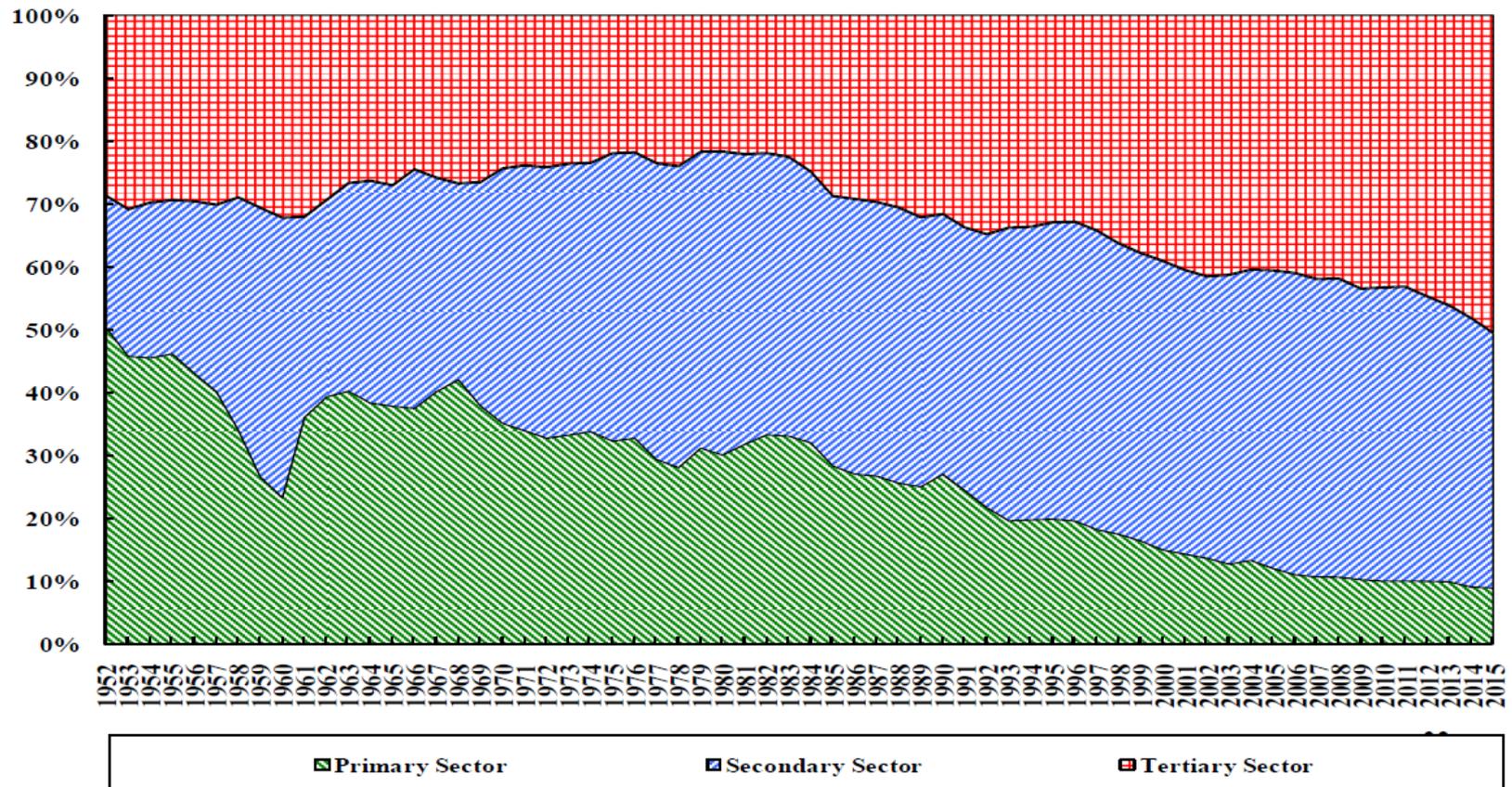
Source: European Chamber in China

## Crude steel and refining

	Crude Steel		Refining	
	2008	2014	2008	2014
<b>Capacity</b>	644m tonnes	1.14bn tonnes	391m tonnes	686m tonnes
<b>Production</b>	512m tonnes	813m tonnes	314m tonnes	456m tonnes
<b>Utilisation rate</b>	80%	71%	80%	66%
<b>Overcapacity</b>	132m tonnes	327m tonnes	77m tonnes	230m tonnes

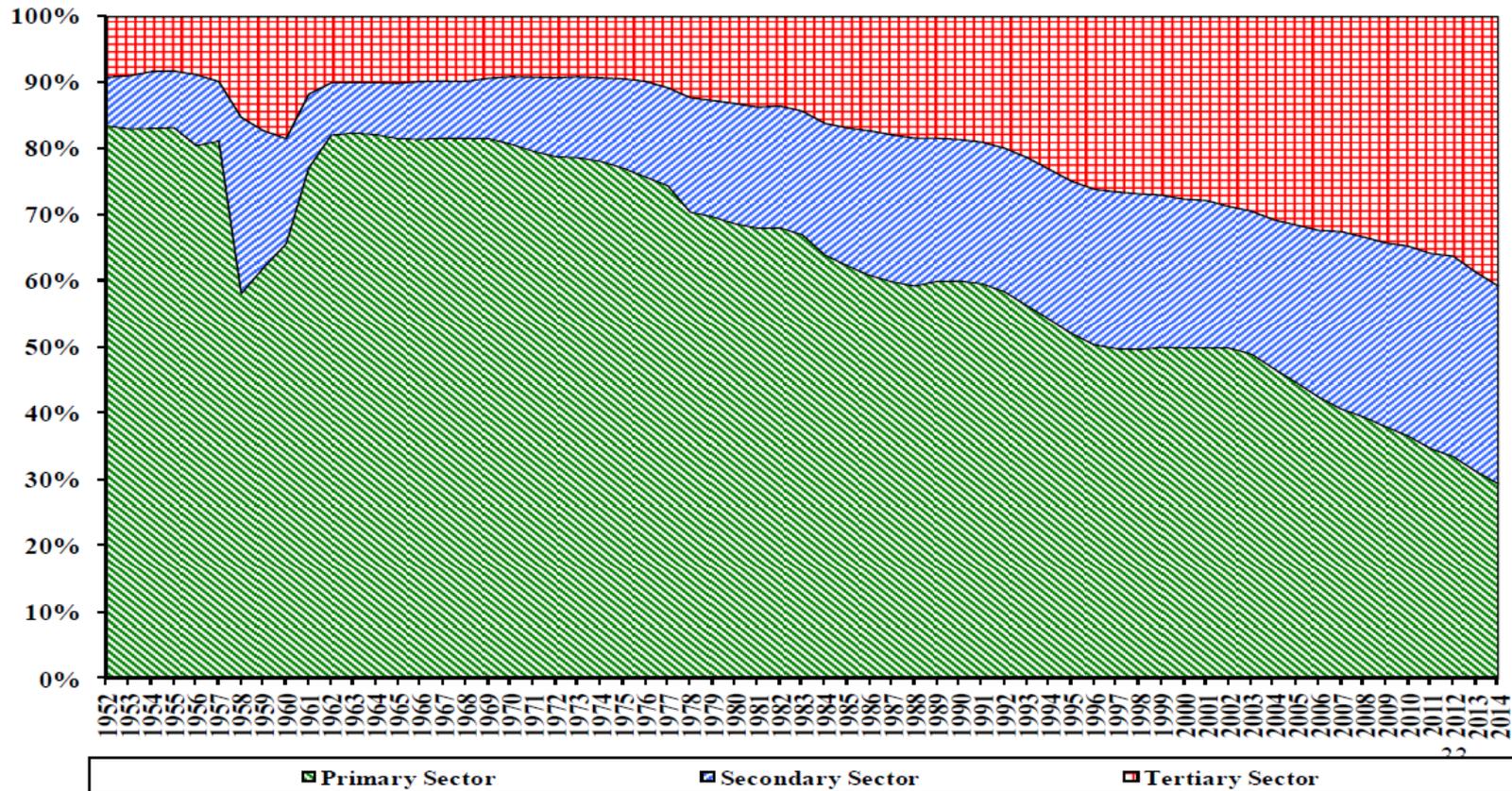
# The Distribution of Chinese GDP by Sector Since 1952

The Distribution of GDP by Sector



# The Distribution of Chinese Employment by Sector Since 1952

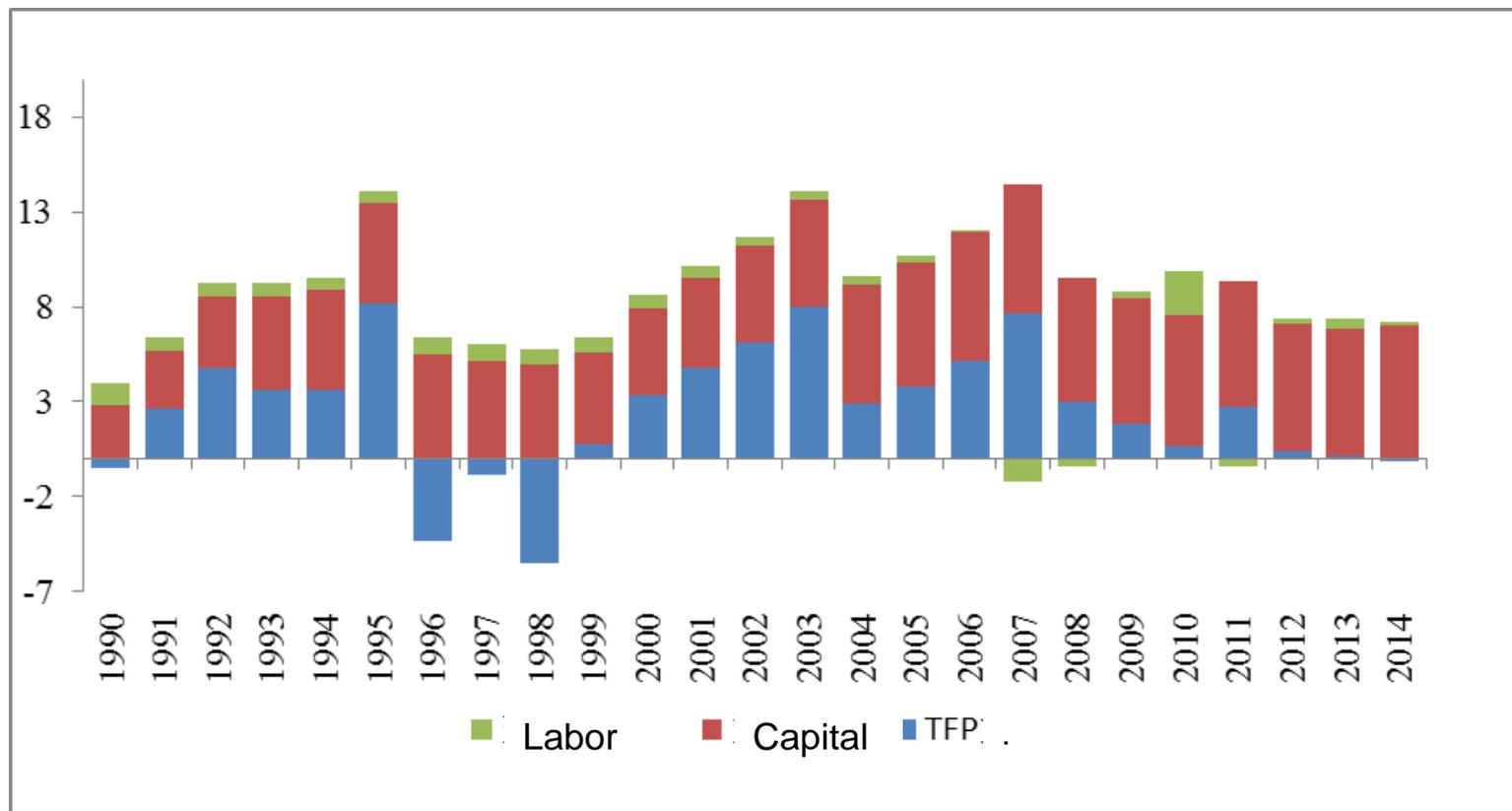
The Distribution of Employment by Sector since 1952



# Chinese Economic Fundamentals: Intangible Capital

- China has a long tradition of emphasis on education and learning (human capital) and will continue to increase its investment in human capital. The number of school years per working-age person in China was probably around 10 years in 2015.
- The enrollment rate of tertiary education has been rising rapidly and stands at over 30 percent today. It is expected to rise further over the next decades as private tertiary educational institutions become more numerous in response to demand and facilitated by government policy.
- China has also begun to increase its expenditure on Research and Development (R&D), with the target of 2.2 percent of GDP by 2015.
- However, relative to many other economies, China lags behind on investment in both human capital and R&D capital, especially on a per capita basis.

# Contribution of labor, capital and TFP to GDP growth



Data source: developed with data from TED.

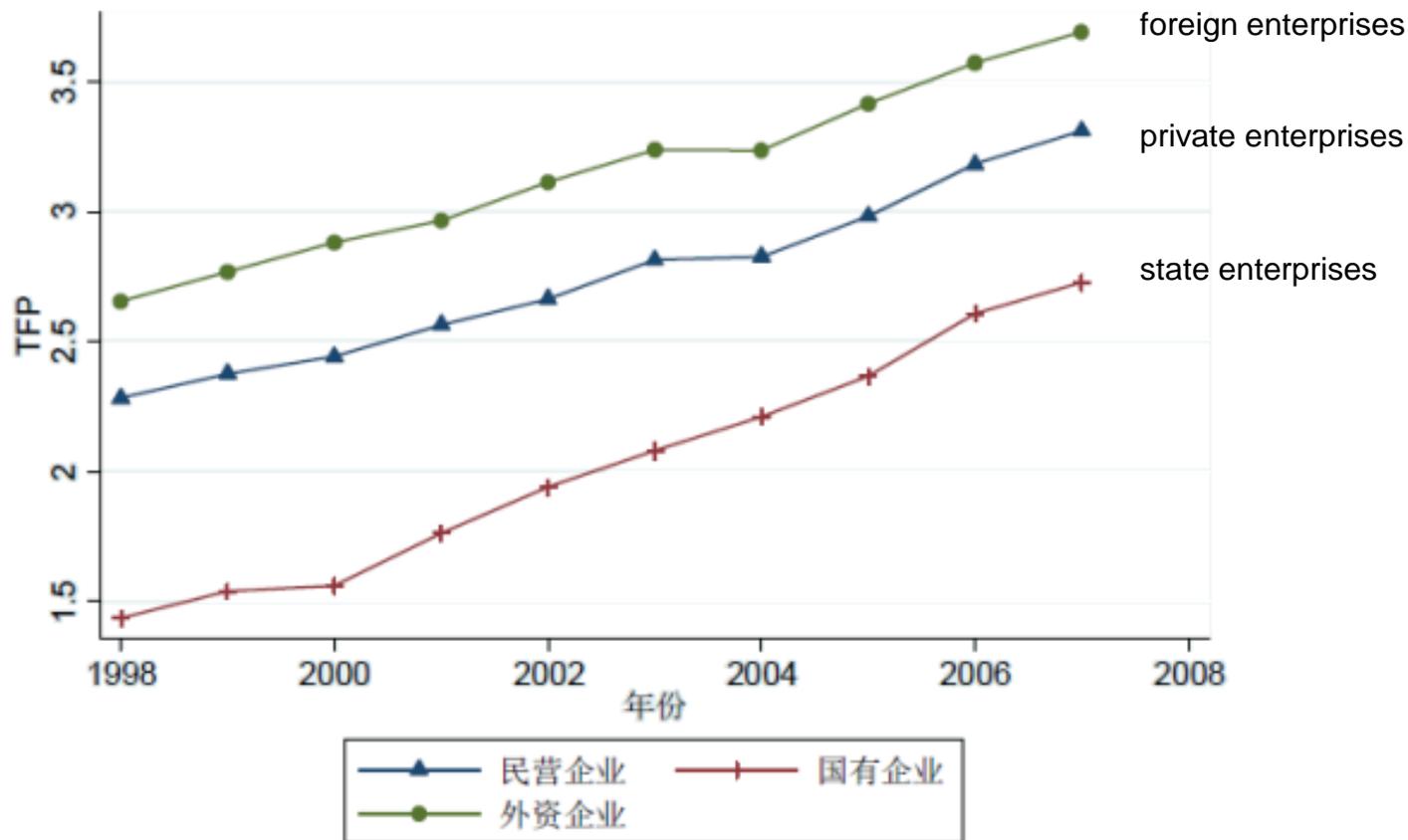
# Total Factor Productivity in China: 1990-2014

Total Factor Productivity growth in 2014 turned out to be negative, at -0.1%.



Data source: The Conference Board

# The TFP changes of the corporates of different ownership



## Major tasks of the year 2016

- The goal of GDP growth rate in 2016: 6.5%-7%;
- From 2016, focuses de-stocking, reducing overcapacity, de-leveraging, reducing funding cost, making up weaknesses and poverty relief.

## 2. GDP Growth 6.5%, Can we make it?

### Scenarios of Chinese Economic Growth in 2016

Scenario I, The secondary industry grows at -5% (6% in 2015),

<b>Primary Industry</b>	9% x 3.7%	= 0.33%
<b>Secondary Industry</b>	37.7% x 1% (6% - 5%)	= 0.347%
<b>Tertiary Industry</b>	53.3% x 10.7%	= 5.70%
<b>Sum</b>		≈ 6.4%

- The tertiary industry grew at 8.3% in 2015, and has to grow at 10.7%, which will increase 29% in 2016.

## 2. GDP Growth 6.5%, Can we make it?

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### Senarios of Chinese Economic Growth in 2016

Senario II, The Secondary industry grows -10% ( 6% in 2015 )

<b>Primary Industry</b>	9% x 3.7%	= 0.33%
<b>Secondary Industry</b>	37.7% x -4%	= -1.51%
<b>Tertiary Industry</b>	53.3% x 14.2%	= 7.58%
<b>Sum</b>		≈ 6.4%

- The tertiary industry grew at 8.3% in 2015, and has to grow at 14.2%, which will increase 71% in 2016.

## 2. GDP Growth 6.5%, Can we make it?

### Scenarios of Chinese Economic Growth in 2016

Scenario III, The secondary industry grows -14% (6% in 2015)  
 proxy by the real output/demand of steel & coal, the total over supply  
 squeezed to minimal in 3 years.

<b>Primary Industry</b>	9% x 3.7%	= 0.33%
<b>Secondary Industry</b>	37.7% x -8%	= -3.02%
<b>Tertiary Industry</b>	53.3% x 17%	= 9.08%
<b>Sum</b>		≈ 6.4%

- The tertiary industry grew at 8.3% in 2015, and has to grow at 17%, which will increase 105.8%.

## Assumptions for the above scenarios

- 1) The ratio of GDP created by the secondary industry decreases about 2.3%, which is the decreasing rate during 2015/2014.
- 2) The ratio of GDP created by the primary industry decreases at 0.2%, which is the decreasing rate during the past 5 years.
- 3) total overcapacity is proxied by the over supply of steel and coal in 2015.

$$(800m (1-X)^3 \approx 500m, \text{ unit tonnage}), x \approx -14.5\%.$$

### 3. Where are the growth engines from?

- Chinese economy is standing at a crux, facing the challenges from both inside and outside.
- More reform, less waste.
- It is time to focus on the improvement of the Total Factor Productivity (TFP).
- Getting system right would benefit everyone. How to make it happen?

### 3. Where are the growth engines from?

- The tertiary industry need to grow faster enough to make room for reducing capacity of the second industry to rebalance the demand and supply of steel, coal, shipping vehicles, glasses, chemicals, automobiles, technical equipments, etc. and to create a competitive environment. But where are the growth engines from, and how to make it happen?

## Where are the gaps-the gap between China the World

Contribution to innovation engine	China	World	Gap
Non State Enterprises	50%	64 – 66%	33%
Universities/ Labs	9%	16 – 17%	80 – 90%
Government agencies	1%	2%	100%

## Three major gaps

1. Support non-state enterprises to effectively invest and conduct innovation both inside China and at overseas (where we still have at least 33% of improvement potential ).
  - $6.4\% * 0.7 = 4.48\%$ ;
  - $4.48 * (1 + 33\%) = 5.96\%$
  - $5.96\% - 4.48\% = 1.48\% \approx 1.5\%$
  - This can offsets the negative effects of slow down of the sencodary industry to GDP growth in the second senario.
2. Through reform and openning up to make the universities and labs work better in innovation (where we still have at least 80-90% of improvement potential).

## Three major gaps

3. The government should create a more favorable environment (where we have 100% of improvement potential for innovation).

- 1) Institutional environment
- 2) Infrastructure
- 3) Taxation and financial reform

### 3. Where are the growth engines from?

- 1) innovation of growth model
- 2) break through of technology
- 3) improvement of the institutional environment
- 4) education and retain talents

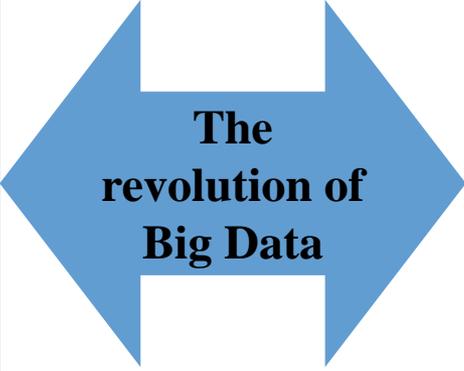
### 3. Where are the growth engines from?

#### 5) The potential demand vs. the great innovations

A) Quality of Health

B) Quality of living  
Environment

C) Individual security and  
sprital home needs.



**The  
revolution of  
Big Data**

virtual reality, new  
material, augment  
reality, great use of  
visualization, biological  
medicine, life sciences,  
intelligent  
manufacturing,  
intelligent  
service, privacy  
protection, internet  
security, etc.

## 4. The 13th Five year plan in the age of 'New Normal'

- In March this year, China's congress formally endorsed the 13th Five-year plan that would keep the overall reform and development with 5 principles ( innovation, coordination, green development, opening-up and inclusiveness.) on track for 2020 completion. This plan enhance the potential for more substantial market reforms in the medium-term and clear statement of tasks and clear deadlines signify significant high-level environment and support the view that China's reforms and development are moving ahead despite the downward pressure and institutional resistance.

## 4. The 13th Five year plan in the age of 'New Normal'

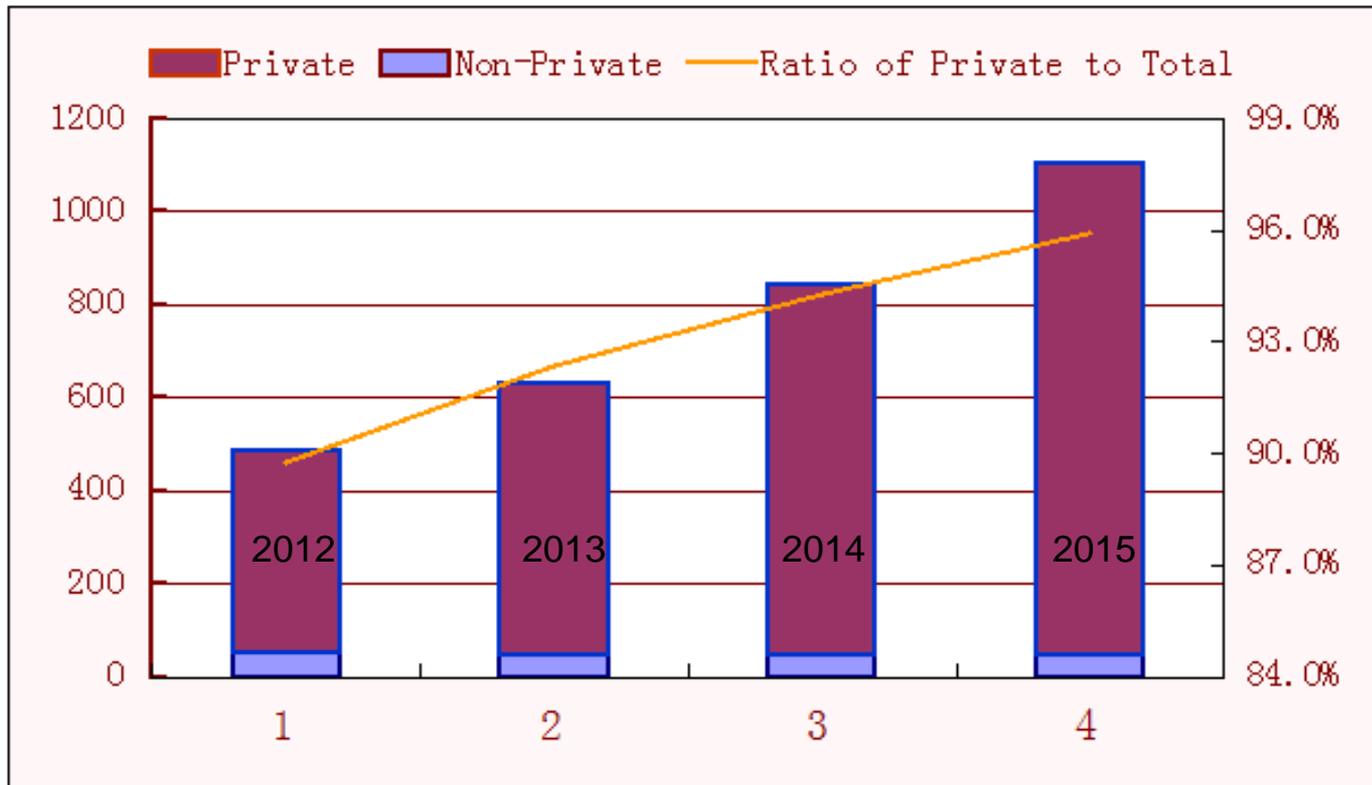
- Though the plan span a broad range of issues, the main objective is further improvement in
  - 4.1 rule of law (including transparency and enforcement, IPR protection and standards),;
  - 4.2 innovation;
  - 4.3 supply side reform- de-stocking, reducing over-capacity, de-leveraging, lowering financing cost, making up for the weaknesses, at the same time, raising up quality standards of products and services;
  - 4.4 poverty relief;
  - 4.5 green development;
  - 4.6 open economy: equal rights, equal opportunities, and equal rules.

## 4.1 Rule of law --stay the course with bettering the system, transparency and enforcement

- On March 12, 2016, The Supreme People's Procuratorate promulgated the 18 rules on protecting the rights of and promoting the healthy development of non-state enterprises. These rules reassures
  - the importance of the equal rights and equal treatments of non-state enterprises if they are involved in a legal procedures with state enterprises (“Hear both small & great alike” and “ Follow justice and justice alone”-Deuteronomy).
  - private enterprises have the lawful right to refuse unfair, unreasonable requirements (if any) by procuratorate officers (“Hear the disputes between your people and judge fairly”-Deuteronomy).
  - protection of IPR so as to encourage innovation of non-state enterprises.
- The judicial reform has bear fruits. The Intellectual Property Right proection courts have been set up in Beijing, Shanghai and Guanghzou and running in an independent and professional way.

## 4.2 Innovation

- The innovation activities are mainly driven by non-state enterprises.
- the number of private enterprises account for over 95% of the total enterprises in Shenzhen in 2015.



# Tencent



# DJI Technology

- Its flying and camera stabilization systems redefines camera placement and motion.
- It has grown from a single small office in 2006 to a global workforce of over 3,000. Its has offices in the United States, Germany, the Netherlands, Japan, Beijing and Hong Kong.



# Kuang-Chi Technology Co. Ltd

Martin Jetpack

Meta-RF Satellite Communication Products



first created by New Zeland Martin Jetpack

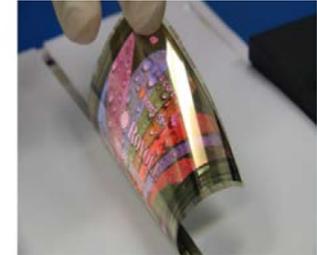
# BGI Group

- BGI, a world leading biotechnology group, offers a wide portfolio of transformative genetic testing products across major diseases, enabling medical providers and patients worldwide to realize the promise of genomics-based diagnostics and personalized healthcare.
- BGI's distinguished achievements have made a significant contribution to the development of genomics throughout the world.
- BGI's services and solutions are available in more than 50 countries around the world.



# Royole

- Royole creates and manufactures the most advanced flexible displays, flexible sensors and wearable consumer electronics. In 2014, Royole introduced the world's thinnest full-color flexible displays with a thickness of 0.01 mm and a bending radius of 1 mm. In 2015, Royole began mass production of its proprietary flexible electronics at its production facility in Shenzhen China. In September 2015, Royole announced the world's first foldable smart mobile theater.



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柔宇科技发布  
全球最薄彩色柔性显示屏



## 4.3 Supply side reform

- De-stocking, reducing over-capacity, de-leveraging, lowering financing cost, making up for the weaknesses, at the same time, raising up quality standards of products and services.
- Examples:
  - Steel making industry will reduce over-capacity of at least 150 million tons in the next 3-5 years.
  - More than 1000 coal mines, which is equivalent to 60 million tons of production capacity, will be closed in 2016.
  - Coal mining industry will reduce over-capacity of 500 million tons in the next 3-5 years.
  - The government has budgeted RMB 100 billion for the training of the unemployed to help them find new jobs.

## 4.4 Poverty relief

- 70 million poverty population
- By 2020, that population shall be cared with basic living conditions, such as food, primary and middle education, health care and housing. Disposal income growth rate in poor rural areas shall exceeds the average level of growth rate of the whole nation.
- Poverty standards:
  - In October, 2015, the World Bank raised the poverty line from US \$ 1.25 per day expense to US\$ 1.9.
  - China 's poverty lines: personal annual income RMB 2300 ( on unchangable price basis of 2010), above US\$1 per day. It is RMB 2800 in 2015 (adjusted to the PPP), which is equivalent to US\$ 2.2.

## 4.5 Green development

- Fuel consumption per unit GDP shall decrease 15% during the 13th Five-year plan.
- By 2030 or even earlier, the CO<sub>2</sub> emission will be reaching the peak point. By 2025, the CO<sub>2</sub> emission per unit of GDP shall decrease 45-49% compared with 2005.
- By 2030, non-fossil fuel will be accounting for more than 20% of the first fuel consumption.
- By 2020, PM2.5 decreases 18% in county-level-above cities.
- Number of days of heavily polluted air conditions decrease significantly in all cities.
  - API: 0-50, I air quality is good.;
  - API: 51-100, II airquality acceptable;
  - API: 101-150, III(1), minor pollution, and harmful to weak population;
  - API: 151-200, III(2) , mildly polluted, harmful;
  - API: 201-300, IV, very polluted, very harmful;
  - API: over 300, V, heavily polluted and extremely harmful.
- Promoting carbon emission trading market and system.
- Incentivize capital to flow into environmental protection.
- COP21-- China and US worked hand in hand in Paris

## 4.6 Open economy

- Follow the WTO convention and promote regional and bilateral agreements
- Set up fair and transparent market rules,
  - Anti-monopoly and anti unfair competition
  - government procurment
  - consumer financing and non bank financial institutions, banking, securities firms, insurance, law firms
- Negative list and enlarged national treatment towards FIEs.

## 5. More work need to be done

- In addition to political will and courage, we need more broader and deeper changes to China's economy:
  - Continue to reform the fiscal and financial system
  - Promote a vibrant service sector
  - Promote innovation
  - Rigorous implementation
  - Provide verified and high-quality information to facilitate decision-making and enhance the independence and capacity of industrial trade association

Thank you!



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