
Macroeconomic issues and policies in China

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CURRENT FINANCIAL ISSUES IN CHINA
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Outline

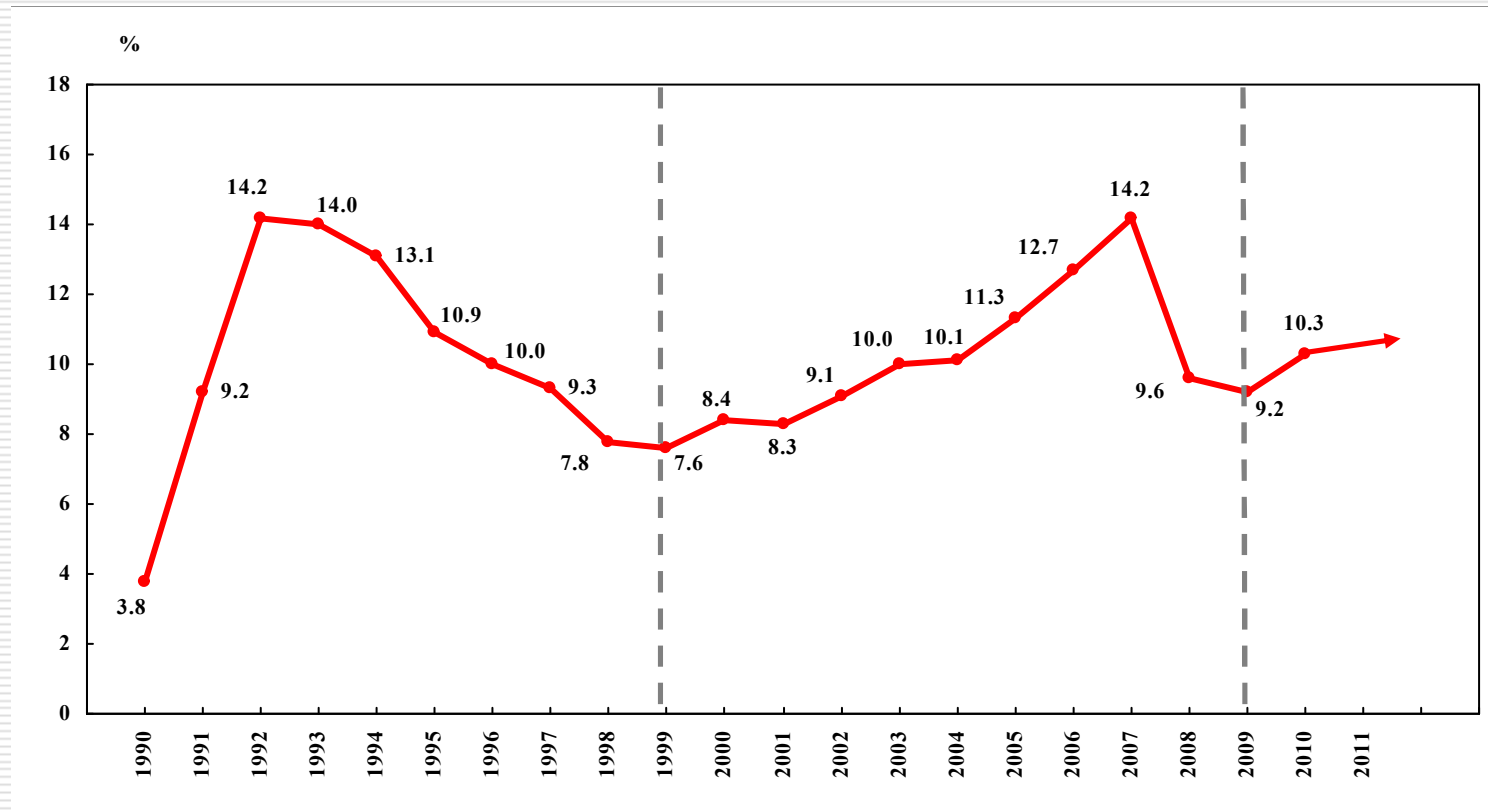
- Macroeconomic issues
 - Hard landing?
 - Inflation out of control?
 - Stagflation?
 - Financial risk?
 - Policy dilemma

 - Policy direction
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Hard landing?

- Growth trend after the 2008-crisis
 - Growth potential
 - 9%-10% in 2011
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Growth trend after the 2008-crisis



China now has much growth potential

- Economic slowdown is mainly caused by intentional macro-control
 - The expansionary incentive of the local government has been contained
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Potential growth will slow down

- Our study shows: In the past three decades, China's potential growth rate is 9.5%, about 1.3 percentage point is the cost of environment, entering the new century, the contribution of environment is 2 percentage point to GDP growth.
 - If we take account of the demographic transition (i.e., the reduction of working age population) and low carbon constraint, the potential growth rate will be below 8% in the next decade.
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Inflation out of control?

- Demand side factors:
 - Liquidity
 - GDP growth
- Supply side factors
 - Supply shock of oil
 - Food price
 - Factor price adjusted: wage rates, land price, resources and energy price, even interest rate liberalization
 - overcapacity
- External factors
 - QE2, QE3?
 - Commodity price

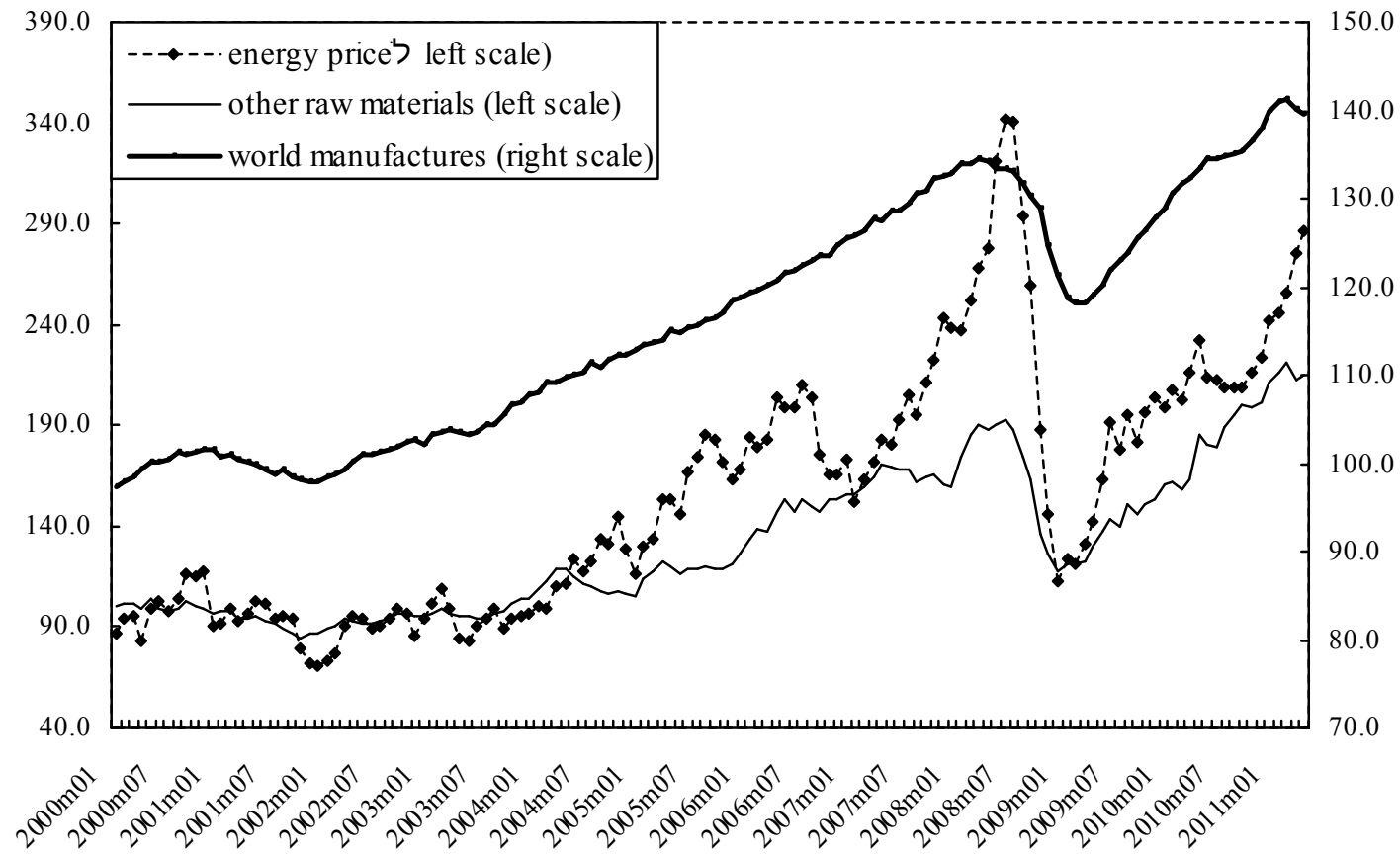


Total social financing

	2009	2010
Bank lending		
Total loans	10523	8360
in which: RMB loans	9590	7950
Bill discounting	691	494
Bank-trust products	400	2000
Stock	390.4	611.6
Treasury bond	818.2	973.5
Corporate bond	1236.7	1171.3
Underground lender	1000	1000
Total financing	15059.3	14610.4

(Billion yuan)

Commodity price and global real demand

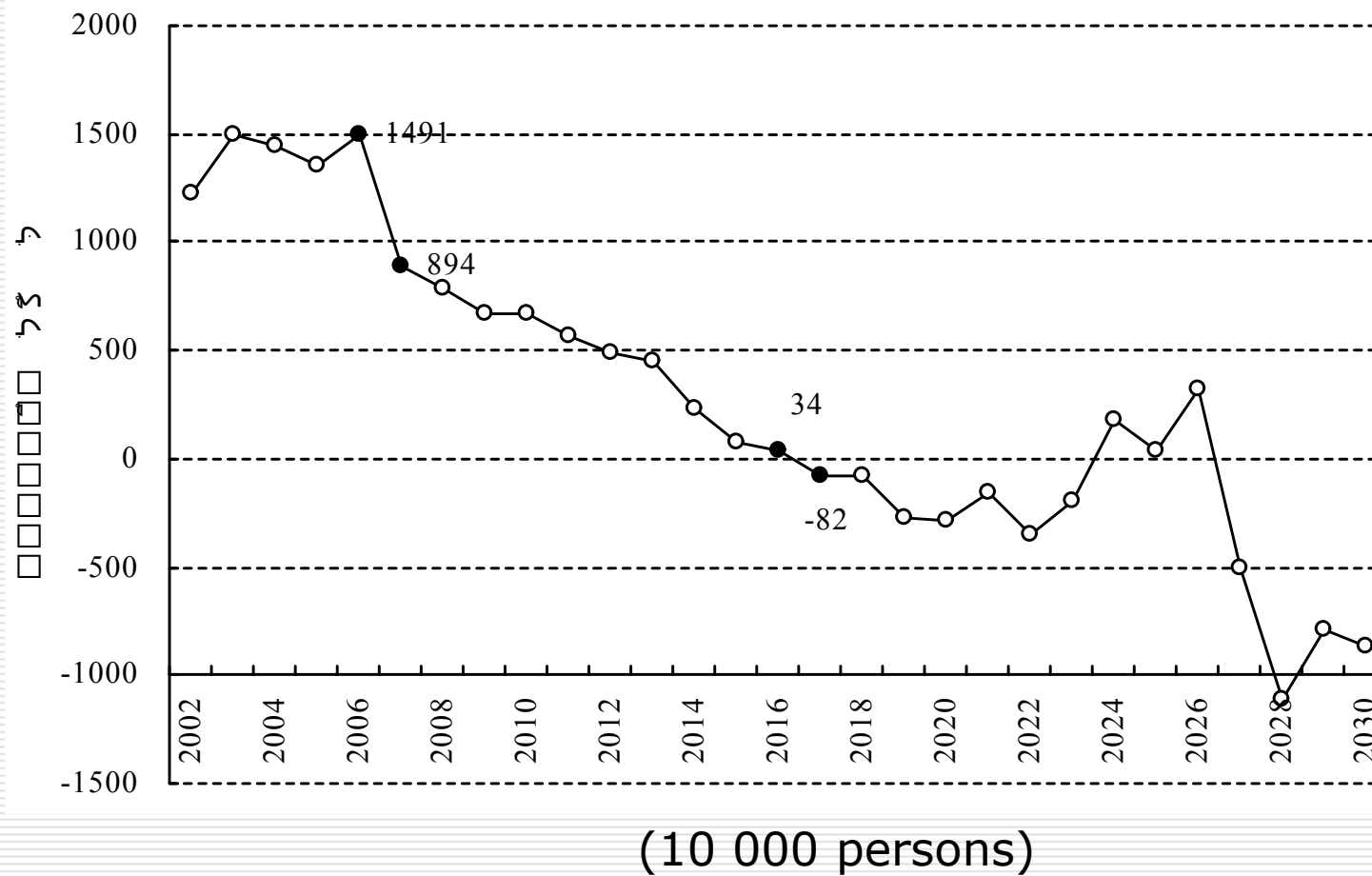


Increasing cost of agricultural goods

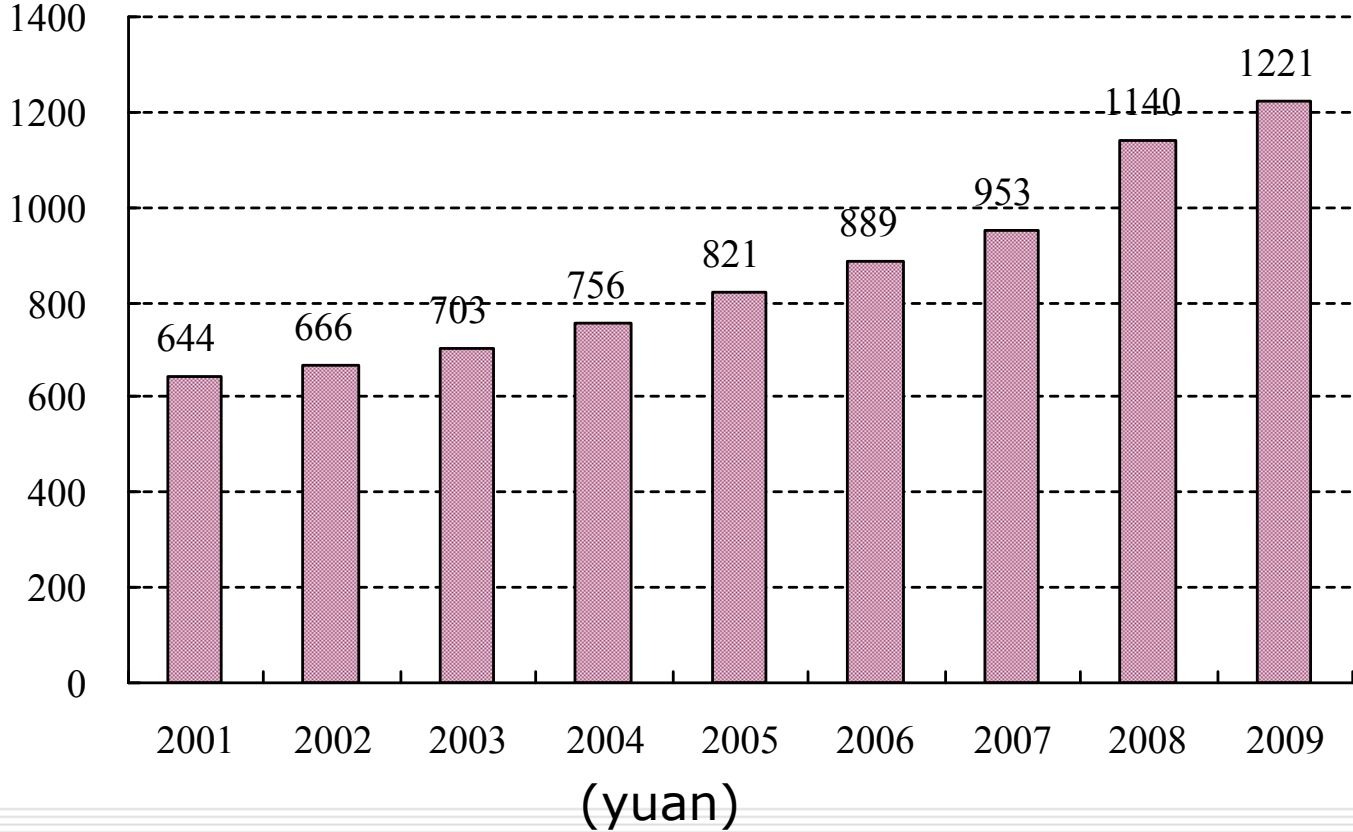
- ❑ **Cost of agricultural input products** like fertilizer, plastic film... is increasing
- ❑ **Cost of land transfer** covers 20% of grain cost
- ❑ **Labor cost** covers 30-55% of some agricultural goods cost, 20 percentage higher than that in the U.S.

	Labor cost share of total production cost (%)
grain	37.1
wheat	28.0
corn	39.9
bean	30.6
cotton	54.8

Annually-added working age population



Real wages of migrant workers



Labor income vs. labor productivity in manufacturing sector(2000-07)

	Labor income ↳ 1000 yuan per head)	Marginal labor productivity ↳ 1000 yuan per head)	Average labor productivity ↳ 1000 yuan per head)
2000	11.48	25.98	42.77
2001	12.25	32.4	52.06
2002	13.09	38.61	60.41
2003	14.08	46.97	77.28
2004	15.35	56.81	95.32
2005	16.96	62.85	115.82
2006	20.74	78.23	148.96
2007	22.01	102	180.46

Note: labor income includes wage, social welfare and insurance.

Reasons for stagflation

- Economic fundamentals
 - Negative supply shock
 - Strong demand factor
 - Labor productivity and rigid real wage rate

 - Policy factors
 - Monetary volatility
 - Price control
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No stagflation in China

- ❑ Strong demand vs. Negative supply shock
 - ❑ Intentionally cool down the economy
 - ❑ Real wage rigidity and labor productivity
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Financial risk

- Housing sector

- Gradual adjustment

- Sovereign debt risk

- LGFP

- Pay attention to the sovereign assets
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Policy dilemma

- Growth vs. inflation
 - Philippe's curve

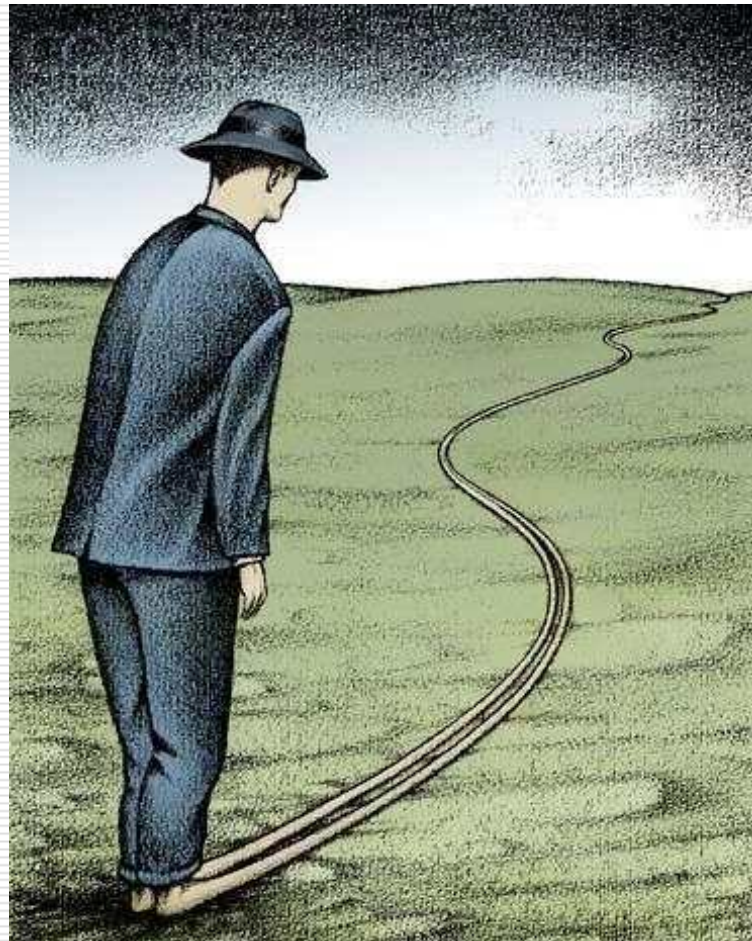
 - Economic growth vs. structural adjustment

 - Tightening policy vs. risk of local government financing platform (LGFP)
 - Macro-control on housing sector
 - Credit control
 - Interest rate hike
 - ...
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Policy direction

- ❑ Maintain tightening policy
 - ❑ Tolerate factor price adjustment
 - ❑ Avoid administrative measures (e.g., price control) to tackle inflation
 - ❑ Focus on supply side
 - Liberalize monopolized industry
 - Structural tax cut
 - Preferential policies for SMEs
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Today's choice shapes our future



THANKS
