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—The macroeconomy—

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Summary

December's economic indicators generally slowed on the previous month. A glance at the GDP data for 2017 shows consumption moving firmly, exports recovering, and the service sector playing a more prominent role. Total trade rose on a y-o-y basis for the first time in three years, with the PPI data moving in positive territories for the first time in five years. The authorities are extremely concerned about financial risk. Business activity could be impacted by moves to strengthen regulations in order to prevent/eliminate financial risk, so caution will be needed.

1. December's economic indicators generally slowed on the previous month

- **GDP growth was up on the previous year for the first time since 2010**
- **Production picked up slightly; investment and consumption slowed**
- **The sales prices of residential buildings grew at a faster pace again**
- **Total trade in 2017 rose on a y-o-y basis for the first time in three years**
- **The PPI data moved in positive territories for the first time in five years in 2017**
- **New bank loans and total social financing both grew at a slower pace**

2. Policy responses: Measures to prevent financial risk based on the policy of 'high-quality development'

- **"Structural adjustment, optimization and upgrading are being carried out at an accelerated pace and quality improvements will become more obvious" (NBS)**
- **"The establishment of an indexing and a statistical system to promote high-quality development" (NBS)**
- **The Chairman of the CBRC's thinking regarding financial risk and measures to prevent financial risk**

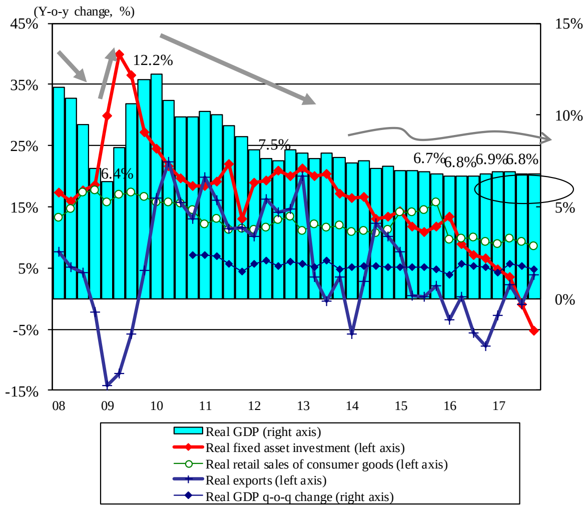
1. December's economic indicators generally slowed on the previous month

・GDP growth was up on the previous year for the first time since 2010

On January 18, the National Bureau of Statistics (NBS) announced that China's real GDP growth rate had hit +6.9% y-o-y in 2017, up on 2016's figure of +6.7% y-o-y, with the economy growing by +6.8% over October–December (from here on, all figures refer to 'same-period previous-year' growth unless otherwise specified)[1]. Growth was up 1.6% on the previous quarter (Fig. 1).

A glance at contribution levels by demand item shows the contribution of gross capital formation hitting +2.2%Pt over 2017, down slightly on the figure for January–September (+2.3%Pt), with the contribution of final consumption expenditure also shrinking from +4.5%Pt over January–September to +4.1%Pt for 2017 as a whole. However, the contribution of net exports rose from +0.2%Pt over January–September to +0.6%Pt for 2017 (Fig. 2).

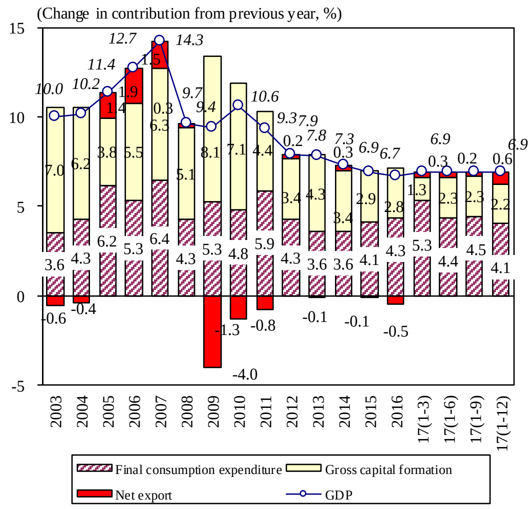
Fig. 1: GDP and major economic indicators (quarterly)



Note: The real RMB value of exports is indexed using the production price index (PPI); the real value of fixed asset investments is indexed using the price index of investment in fixed assets; and the real value of retail sales of consumer goods is indexed using the retail price index (RPI).

Source: National Bureau of Statistics of China, CEIC

Fig. 2: Breakdown of GDP by demand item



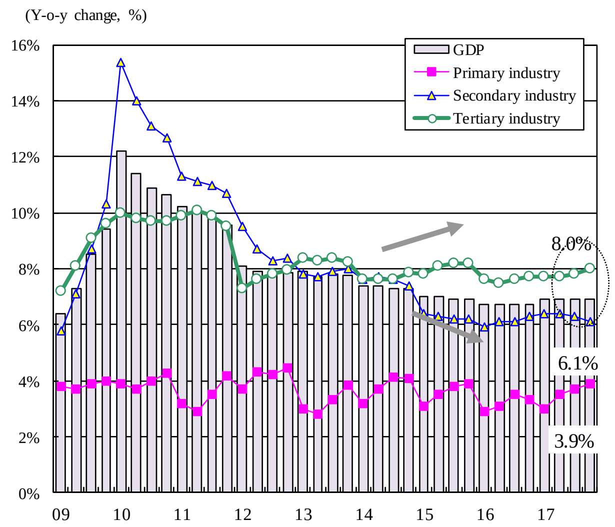
Source: National Bureau of Statistics of China, CEIC

A breakdown by sector shows the tertiary industry growing by +8.0% in 2017. This once again compensated for a slowdown in the secondary industry, which slowed from +6.3% in 2016 to +6.1% in 2017 (Fig. 3).

A glance at the composition of nominal GDP shows the tertiary industry's share rising slightly from 51.56% in 2016 to 51.63% in 2017, with the secondary industry's share also rising slightly from 39.9% in 2016 to 40.5% in 2017 (Fig. 4).

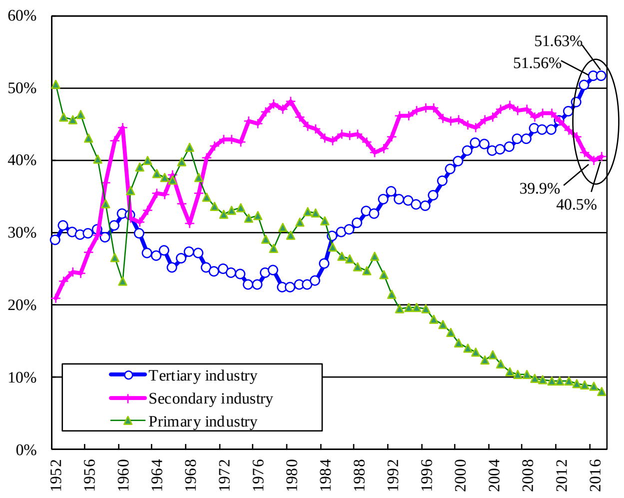
[1] National Bureau of Statistics of China, January 18, "*2017 年经济运行稳中向好、好于预期 (The National Economy Maintained the Momentum of Stable and Sound Development and Exceeded Expectations)*"
http://www.stats.gov.cn/tjsj/zxfb/201801/t20180118_1574917.html

Fig. 3: GDP by sector



Note: The figures denote the most recent period
Source: National Bureau of Statistics of China, CEIC

Fig. 4: GDP composition ratio by sector



Note: The figures within the graph show the composition ratio of the secondary industry and the tertiary industry in 2015 and 2016.
Source: National Bureau of Statistics of China, CEIC

・Production picked up slightly; investment and consumption slowed

December's economic indicators generally slowed on the previous month. At +6.2%, December's value-added industrial production figure was up on November's +6.1% (the m-o-m figure was +0.5%) (Fig. 5). At +6.6%, the figure for 2017 was up on the figure for 2016 (+6.0%).

NBS pointed to three particular production trends in 2017: (1) moves to improve the industrial structure began to bear fruit, with production rising by 11.3% in the equipment manufacturing industry (up 4.7%Pt on 2016) and by 13.4% in the hi-tech sector (up 6.8% on 2016); (2) growth in energy-intensive industries slowed to +3.0%; and (3) the manufacture of emerging-industry products grew at a faster pace[2].

Nominal fixed asset investment contracted by -2.3%[3] in December (January–December: +7.2%), with the data slipping into negative territories following the +5.8% result recorded in November (the m-o-m figure was +0.5%). Investment in real-estate development accelerated by a cumulative +7.0% until December, an improvement on 2016's figure of +6.9%. At +13.9%, though, investment in infrastructure construction slowed slightly on 2016's figure of +15.8%. Manufacturing investment growth also slowed from +4.1% in 2016 to +3.1% (Fig. 6). Talking about fixed asset investment in the manufacturing sector, Zhao Peiya, an inspector with the Department of Investment of the NBS, said investment had bottomed out, with the industrial structure continuing to improve. As evidence of this, he pointed out that: (1) investment in the hi-tech sector had grown by +17% in 2017; (2) investment in technological innovation had grown by +16%; (3) the equipment manufacturing industry had grown by +8.6%; and (4) energy-intensive industries had shrunk by -1.8%[4].

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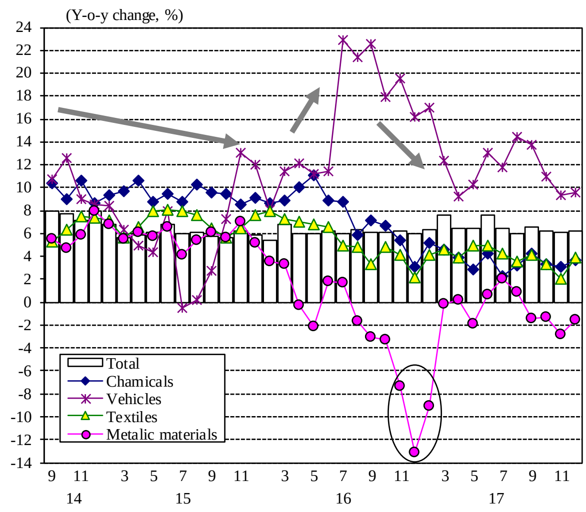
[2] National Bureau of Statistics of China, January 19, "*文兼武：工业经济稳中向好 为高质量发展夯实基础* (*Wen Jianwu: The industrial economy is undergoing a stable recovery; China is shoring up the foundations for high-quality development*)." Production of new industrial products: Industrial robots (+68.1%); private drones (+67.0%); new-energy vehicles (+51.1%); urban rail vehicles (+40.1%); lithium ion batteries (+31.3%); photovoltaic cells (+30.6%) (y-o-y rate of change). Wen Jianwu is the Director-General of the NBS's Department of Industry Statistics. http://www.stats.gov.cn/tjsj/sjjd/201801/t20180119_1575462.html

[3] Calculated by the author from the cumulative data.

[4] National Bureau of Statistics of China, January 19, "*赵培亚：有效投资持续发力 结构调整深化优化* (*Zhao Peiya: Utilizing the power of effective*

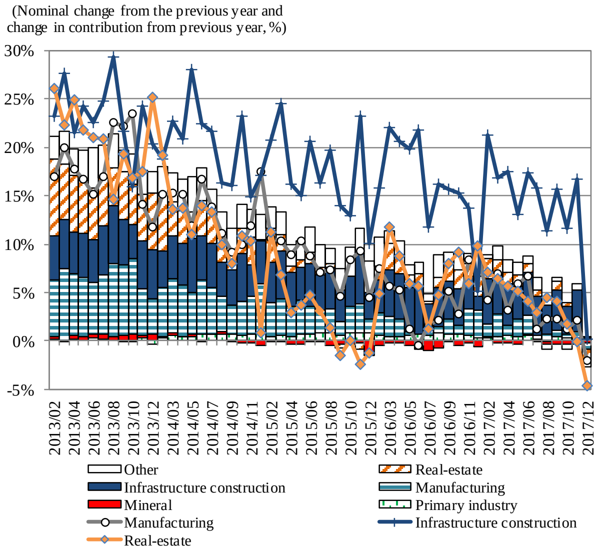
Fig. 5: Value-added industrial production



Note: The value-added industrial production amount. The figure for January shows the aggregate year-on-year change for the period January–February.

Source: CEIC

Fig. 6 Fixed asset investment by sector



Source: National Bureau of Statistics of China, CEIC

Nominal retail sales of consumer goods grew by +9.4% in December. This was down on the +10.2% recorded in November. At +10.2%, the figure for 2017 was down slightly on 2016's figure of +10.4%, though growth remained in double digits[5] (Fig. 7).

Internet retail sales of goods and services grew by +32.2% to hit RMB 7,175.1 billion in 2017 (goods: RMB 5,480.6 billion; services: RMB 1,694.5 billion), with net shopping accounting for 19.6% of total retail sales of consumer goods (RMB 36,626.2 billion), up from 15.5% in 2016. Goods related to 'consumption upgrading' continued to grow at a fast clip, with sales of household appliances growing by 9.3% (up 0.6%Pt on 2016) and sales of cosmetics growing by 13.5% (up 5.2%Pt on 2016). Sales of new-energy vehicles grew by +53.3% to hit 777,000. Meng Qingxin, Director-General of the Department of Trade and External Economic Relations Statistics of NBS, explained that the consumption gap between urban and rural areas continued to shrink as rural incomes rose and consumption became more convenient in rural areas thanks to improved transportation routes[6].

3.06 million new vehicles were sold in December, up on November's figure of 2.958 million, though y-o-y growth fell from +0.6% in November to +0.1% in December (Fig. 8). 28.941 million vehicles were sold in 2017 as a whole. This represented growth of +3.6%, down on 2016's figure of +13.7% (27.939 million). Sales had been boosted by a tax break on purchases of small vehicles, instituted in October 2015. This slowdown seems to be a reaction to the flurry of buying that occurred before the government announced it would be extending the program on December

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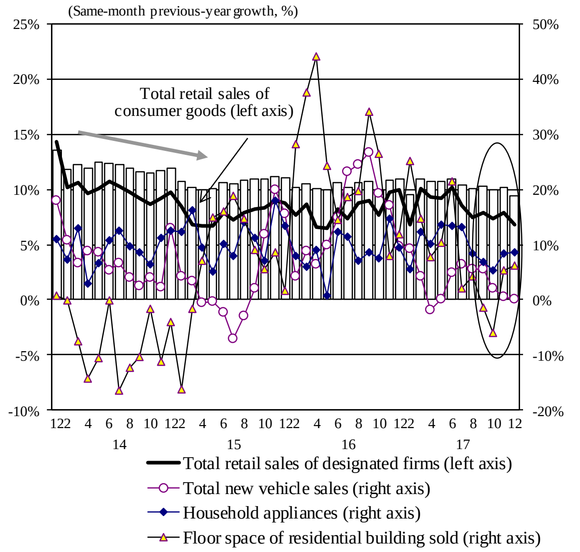
investment; pursuing optimization through deeper industrial adjustment)." Zhao Peiya is an inspector with Department of Investment of the NBS.
http://www.stats.gov.cn/tjsj/sjjd/201801/t20180119_1575473.html

[5] National Bureau of Statistics of China, January 19, "*孟慶欣：消费市场平稳增长 消费结构持续优化* (*Meng Qingxin: Consumer markets are growing stably and the consumption structure continues to improve*)." According to this report, the rate of change of total retail sales of consumer goods in 2017 was up 0.3%Pt on 2016 once automobile-related products were removed from the equation. Meng Qingxin is the Director-General of the Department of Trade and External Economic Relations Statistics of NBS.
http://www.stats.gov.cn/tjsj/sjjd/201801/t20180119_1575470.html

[6] Same as No.5

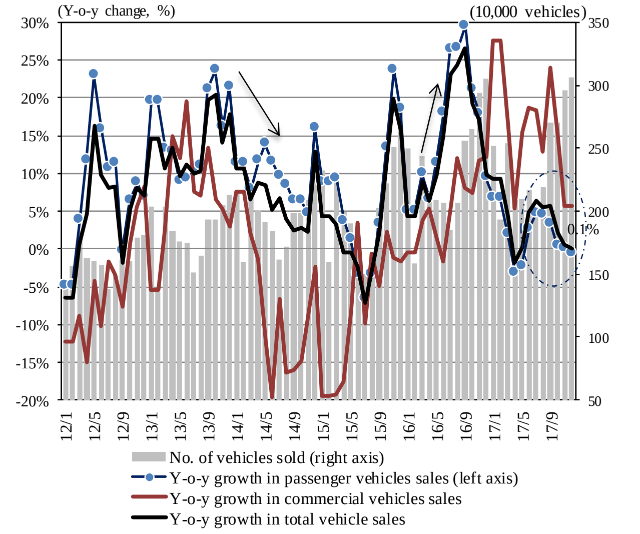
15, 2016[7].

Fig .7: Retail sales of consumer goods; retail sales by item; floor space of residential building sold



Note: Designated firms: firms with an annual turnover of RMB 5 million or over; the household appliance data also refers to sales by these designated companies; February = the cumulative results for January–February.
Source: CEIC

Fig. 8: Number of vehicles sold (by passenger vehicles and commercial vehicles)



Note: The figure for January and February shows cumulative y-o-y growth for the period January–February.
Source: China Association of Automobile Manufacturers, CEIC

･The sales prices of residential buildings grew at a faster pace again

The floor space of residential buildings sold grew by +7.7% (1,694.08 million m^2) in 2017, down from +22.5% in 2016 and +7.9% in January–November. At +6.1%, the data rose on a monthly basis in December, up from +5.3% in November, when the data had returned to positive growth for the first time in three months (the figure had contracted in September (-1.5%) and October (-6.0%) for the first time since March 2015[8]). Housing sales bottomed out and began recovering in April 2015 following measures by the authorities to prop up the real-estate market. The People's Bank of China (PBOC) lowered deposit and lending rates six times from November 2014, for instance, while the (lowest) down payment rate for second homebuyers was cut from 60% to 40% (March 30, 2015) and the down payment rate for first-time homebuyers was also lowered to 25% (September 30, 2015). Thereafter, buying restrictions pioneering in Shanghai and Shenzhen in March 2016[9] subsequently spread to other cities with surging

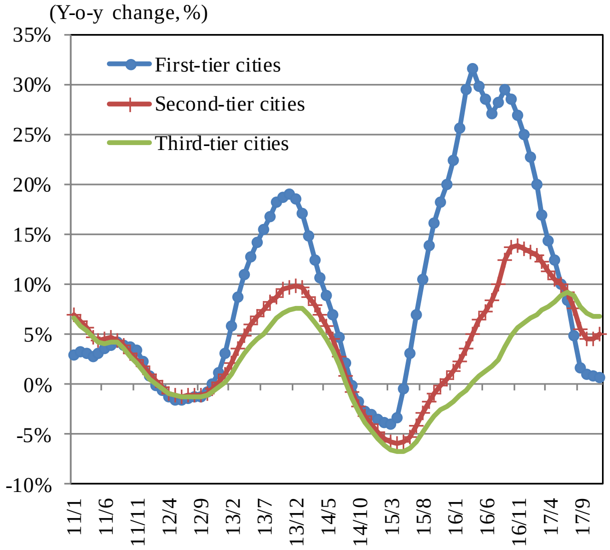
[7] On December 15, the Finance Ministry and the State Administration of Taxation announced that the tax cut on purchases of new vehicles with low emissions would be extended one year to the end of 2017. However, the tax rate will rise from 5% to 7.5%, so the size of the cut (compared to the normal tax rate of 10%) will be halved in 2017 (2.5%).
Finance Ministry: "*关于减征 1.6 升及以下排量乘用车车辆购置税的通知 (Circular on the Lowering of the Purchase Tax on Passenger Vehicles with Emissions of 1,600cc or Less)*"
http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201612/t20161215_2483048.html
On September 29, 2015, the State Administration of Taxation issued Notice No. 104 [2015]. This announced that the purchase tax on passenger vehicles with emissions of 1,600cc or less would be lowered from 10% to 5% from October 1, 2015 to the end of 2016.
http://www.chinatax.gov.cn/n810341/n810755/c1827947/content.html
[8] The floor space of residential buildings decreased at a slower y-o-y pace for 13 successive months from February 2014 to March 2015 before the impact of measures to stimulate homebuying were introduced.
[9] On March 25, 2016, the down payment rate for second homebuyers was lifted from 40% to 50–70% in Shanghai. Shenzhen has lifted the down payment rate for second homebuyers from 30% to 40%. Both moves represent a tightening of restrictions on purchases by non-resident buyers.

house prices[10], with the restrictions being tightened further thereafter[11].

In December, 61 cities saw the price of new homes rising on the previous year, up from 59 cities in November. However, price growth in Shanghai and Shenzhen had slowed after peaking at +28.0% and +62.4% respectively in April 2016. This reflected a policy shift in these cities away from stimulus measures to tightening measures. In December, prices in Shenzhen contracted by -2.9%, but prices in Shanghai grew by +0.2% to record positive y-o-y growth for the first time since August. Prices in Beijing fell by -0.2% in October, November and December. However, the growth rate hit +5.0% in second-tier cities and +6.8% in third-tier cities in December. This represented a slight improvement on the figures for November (+4.5% and +6.7%, respectively) (Fig. 9)[12].

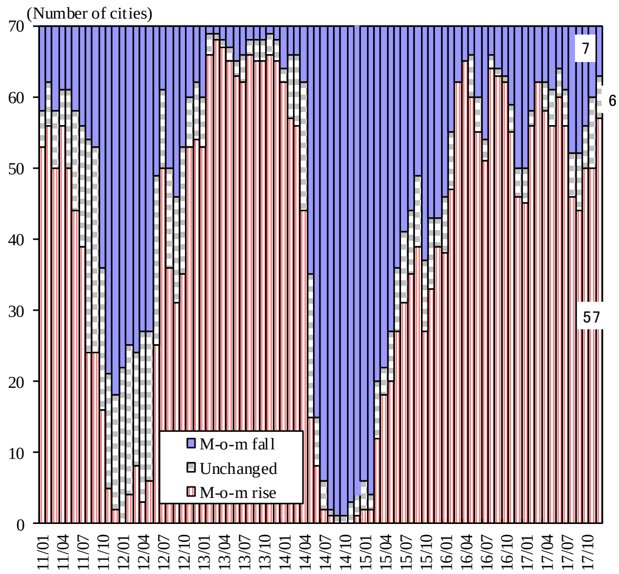
On a monthly basis, 57 of the 70 cities surveyed saw the price of new homes rising, up from 50 in November. Six cities saw prices moving flatly on the previous month, down from ten cities in November, while seven cities saw prices falling on the previous month, down from ten cities in November (Fig 10)[13].

Fig .9: New-homes prices (Y-o-y)



Note: First-tier cities: Beijing, Shanghai, Guangzhou and Shenzhen

Fig. 10: Number of cities recording m-o-m changes in sales prices of residential buildings



Source: National Bureau of Statistics of China, CEIC

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[10] Similar tightening measures have also spread to cities with conspicuous house price inflation, with Xiamen, Nanjing and Hefei introducing similar regulations from the end of April to mid-July 2016, for example. Source: Economic Information Daily, July 14, 2016"*房地产现严重分化 因城施策将是下半年楼市政策主线*（'China's acute property price bifurcation problem: Metropolitan real-estate measures in 2H influenced by the regional policies')"
http://www.china.com.cn/shehui/2016-07/14/content_38877726.htm
According to an article in the People's Daily on October 11, 2016 entitled"*限购、限贷，近期已有 20 城市推出新举措 楼市调控 因城施策*
('Restrictions on housing purchases and loans recently introduced in 20 cities: Restrictions geared to meet the circumstances of each city') ", restrictions on housing purchases were introduced in 20 cities at the time the article was written.
http://www.fangchan.com/news/6/2016-10-11/6191397283909931925.html

[11] According to an article in the 21st Century Business Herald on March 20, 2017, entitled "*北京最严楼市调控"认房又认贷" 下半年全国楼市降温可期 ('Checks on housing and loan records': Beijing's strictest real estate controls set to chill housing markets nationwide in 2H)",* Beijing has introduced 'the toughest controls in history'. It lifted the down payment rate for second home purchases to at least 60 percent on March 17, for instance, with the rate lifted to at least 80% for buyers who will not be living at the property.
Furthermore, the city has also suspended issuances of mortgage loans for individuals with maturities of 25 years or more, while homes bought by companies cannot be resold for at least three years.
http://epaper.21jingji.com/html/2017-03/20/content_58356.htm

[12] Of the 70 cities surveyed, the following three cities saw the fastest home price growth: Beihai +13.1%, Shenyang +11.5% and Xian +11.2% (December)

[13] National Bureau of Statistics of China, January 18, "*2017 年 12 月份 70 个大中城市住宅销售价格变动情况 (Sales Prices of Residential Buildings in 70 Medium and Large-sized Cities in December 2017)*"
http://www.stats.gov.cn/tjsj/zxfb/201801/t20180118_1574781.html

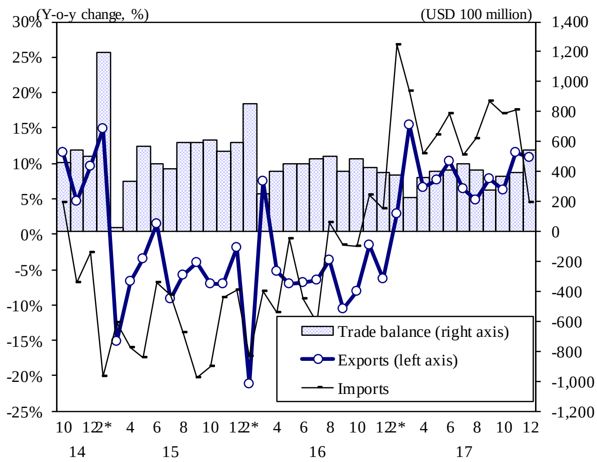
Second-tier cities: Capitals other than first-tier cities (municipality), capitals of autonomous regions, Dalian, Qingdao, Ningbo, and Xiamen.
Third-tier cities: Cities other than first-tier and second-tier cities (35 of the 70 cities surveyed)
Source: CEIC

・Total trade in 2017 rose on a y-o-y basis for the first time in three years

Exports were up +10.9% in December ($231.79 billion), while imports rose by +4.5% ($177.10 billion), with the trade surplus hitting $54.69 billion (Figs. 11, 13 and 14). Exports rose by +7.9% and imports by +15.9% over 2017 as a whole (trade surplus: $422.51 billion). The total amount of trade rose by +11.4% to hit $4,104.47 billion. This was the first y-o-y increase in three years, since 2014.

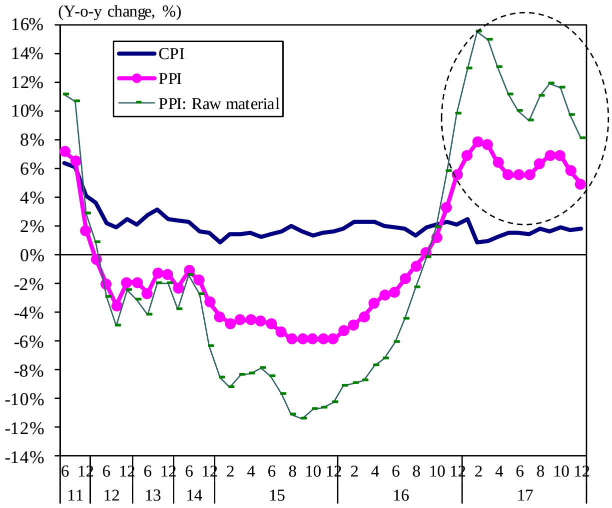
According to the Ministry of Commerce, this rapid growth was because: (1) the international market (export destinations) had picked up; (2) the stable and strong domestic economy had driven the continuous growth of the imports, with ten major commodities (crude oil, iron ore and natural gas, etc.) boosting the total import figure by 7.2%Pt; and (3) the base number was low, with imports and exports in 2016 reaching their lowest levels since 2012[14].

Fig. 11: Imports/exports; trade balance



Note: * Same-period previous-year growth and cumulative figures for January–February.
Source: China Customs Statistics

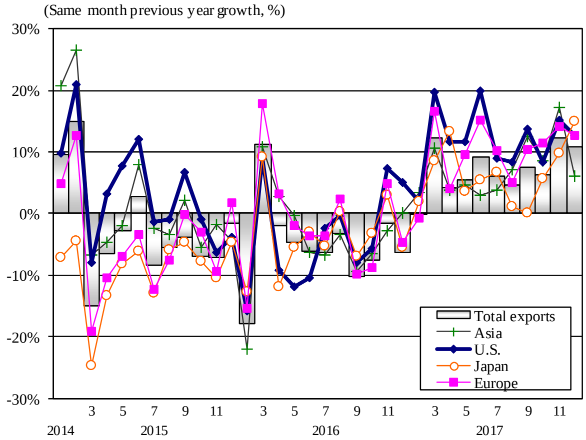
Fig. 12: CPI, PPI



Note: The data from June 2011 to 2014 only shows the quarterly (March, June, September and December) figures. The data from 2015 onwards shows the monthly figures.
Source: National Bureau of Statistics of China, CEIC

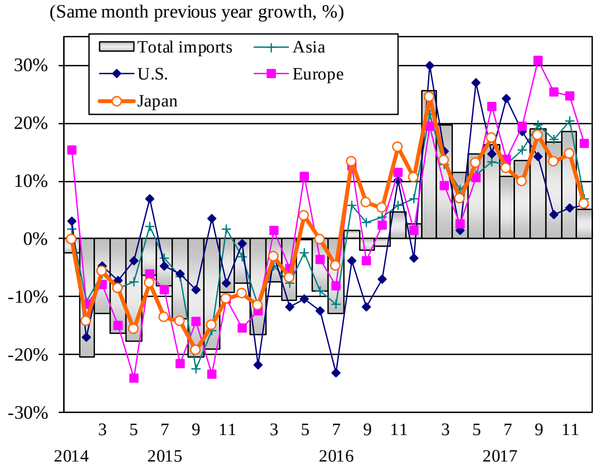
[14] Website of the Ministry of Commerce, January 15, "*商务部外贸司负责人谈2017年1-12月我国对外贸易情况 (Official from the Department of Foreign Trade Comments on the Foreign Trade Situation of China in January-December, 2017)*"
http://www.mofcom.gov.cn/article/ae/ag/201801/20180102698781.shtml

Fig. 13: Exports by major region



Note: The figure for February shows a same-period previous-year comparison of the cumulative results for January–February.
Source: China Customs Statistics, CEIC

Fig. 14: Imports by major region



Note: The figure for February shows a same-period previous-year comparison of the cumulative results for January–February.
Source: China Customs Statistics, CEIC

・The PPI data moved in positive territories for the first time in five years in 2017

In December, CPI (Consumer Price Index) growth stood at +1.8%, up on November's figure of +1.7% (Fig. 12). At +0.3%, CPI growth was up on a monthly basis (November: +0.0%). The figure for 2017 as a whole was +1.6%, significantly below the government's target of +3.0%.

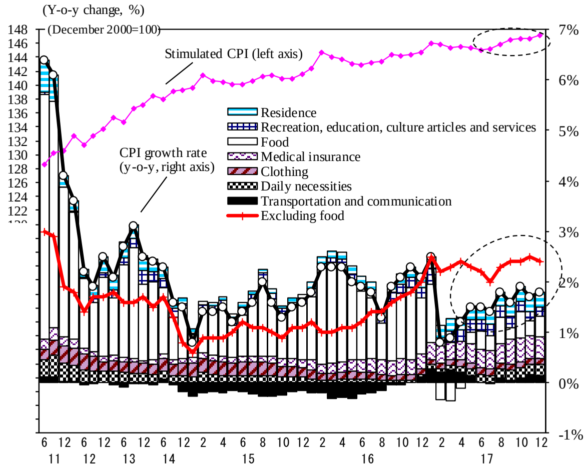
A breakdown of the CPI data for December shows food price inflation contracting at a slower pace, from -1.1% in November to -0.4%, with pork price inflation also shifting from -9.0% in November to -8.3% in December (Figs.15 and 16). At 53.40 million tons, pork output rose by +0.8% in 2017, with production growing after two consecutive years of negative growth in 2015 and 2016. The impact of the pork cycle[15] waned since a peak in May 2016, though it bounced back after bottoming out in June 2017. Vegetable prices also contracted at a slower pace, from -9.5% in November to -8.6%. At +2.4%, non-food price rises slowed slightly on November (+2.5%).

In December, PPI (Producer Price Index) growth slowed to +4.9% (November: +5.8%) (Fig. 12). According to the NBS[16], prices rose at a slower y-o-y pace in five sectors in December: The Extraction of Petroleum and Natural Gas sector (+20.1%), the Manufacture and Processing of Ferrous Metals sector (+18.5%), the Processing of Petroleum sector (+12.3%), the Manufacture and Processing of Non-Ferrous Metals sector (+10.1%), and the Mining and Washing of Coal sector (+4.7%). These five sectors pushed the PPI growth rate down by 0.6%Pt. NBS data also showed prices rising at a faster pace in two sectors: The Nonmetallic Mineral Products sector (+12.4%) and the Production and Distribution of Gas sector (+6.4%). The contribution of these two sectors to PPI growth hit 2.9%Pt.

At +6.3%, PPI growth moved in positive territories in 2017 for the first time in five years, dating back to 2012.

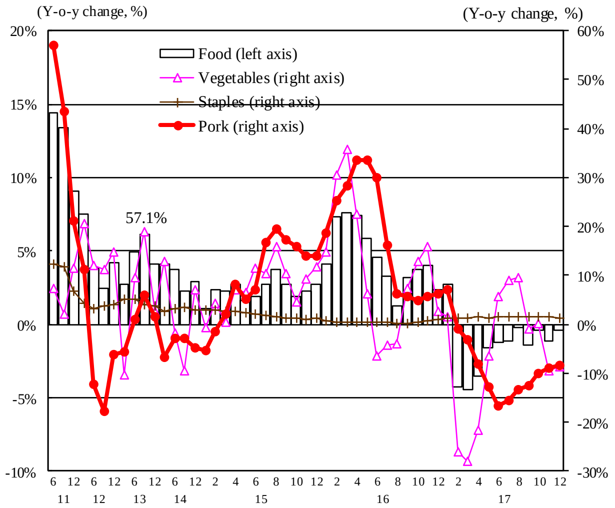
[15] This is a cycle whereby: farmers respond to lower pork prices by raising fewer pigs→supply falls and prices rise→farmers increase output→supply increases and prices stabilize→farmers raise fewer pigs.
[16] National Bureau of Statistics of China, January 10, "*国家统计局城市司高级统计师绳国庆解读 2017 年 12 月份 CPI、PPI 数据 (NBS senior statistician Sheng Guoqing deciphers the December 2017 CPI and PPI data)*" http://www.stats.gov.cn/tjsj/sjjd/201801/t20180110_1571520.html

Fig. 15: CPI; Growth contribution by item



Note: The contribution rate by item is calculated by Mizuho Bank (China) based on the y-o-y growth rate and consumption expenditure statistics for each item. The simulated CPI data is calculated by Mizuho Bank (China) based on the m-o-m growth rate for each month, with December 2000 as the base month. The data from June 2011 to 2014 only shows the quarterly (March, June, September and December) figures. The data from 2014 onwards shows the monthly figures.
Source: National Bureau of Statistics of China, CEIC

Fig. 16: Food prices



Note: The data from July 2011 to 2014 only shows the quarterly (March, June, September and December) figures. The data from 2014 onwards shows the monthly figures.
Source: National Bureau of Statistics of China, CEIC

・New bank loans and total social financing both grew at a slower pace

According to the PBOC, M2 money supply growth in December hit +8.2%. This was down on November's figure of +9.1% and it was also below the government's target (2017: +12.0%). Ruan Jianhong, head of the Survey and Statistics Department at the People's Bank of China said that "amid the deleveraging process and tougher financial regulations, the slower growth indicated that capital uses by commercial banks have become better regulated, with less funds circulating inside the financial sector and less derivative deposits.[17]" She went on explain that the slowdown in M2 growth was also due to an increase in financial deposits due to the healthy fiscal revenue climate. Ruan also stated that "in the future, slower M2 growth than before will become the 'new normal' as the country's deleveraging process deepens and the financial sector gets back to the function of serving the economy." She added that factors impacting the money supply had grown more complex due to the deepening of markets and financial innovation, with the M2 figure becoming less predictable, less controllable and of less relevance to the economy. As such, Ruan said there was "no need to get overly concerned about or over-interpret the changed pace."

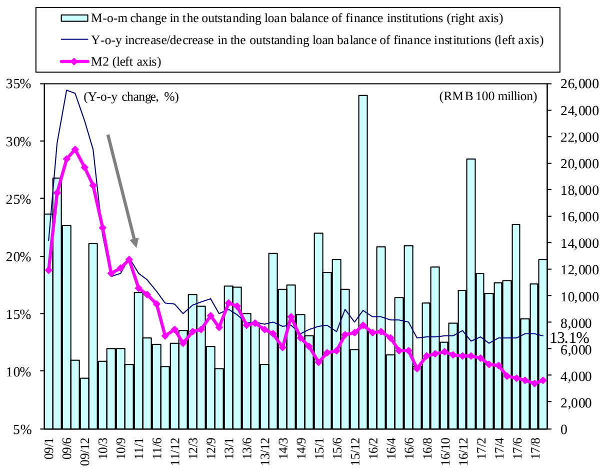
New bank loans increased by a net RMB 584.4 billion in December, down on November's figure of RMB 1,120 billion. Total social financing, which includes funds procured from non-bank sources, increased by a net RMB 1,139.8 billion, down on November's figure of RMB 1,619.6 billion. A glance at the details reveals that: entrusted loans, trust loans and banker's acceptances grew at a faster pace; and RMB loans, foreign currency loans, corporate

[17] Financial News, January 13, "*M2 增速低位运行 金融部门内部资金循环嵌套减少 (M2 is growing at a slow pace, with less opaque funds circulating inside the financial sector)*"
http://www.financialnews.com.cn/jg/dt/201801/t20180113_131439.html

bonds and non-financial-institution equity issuances grew at a slower pace (Fig. 18).

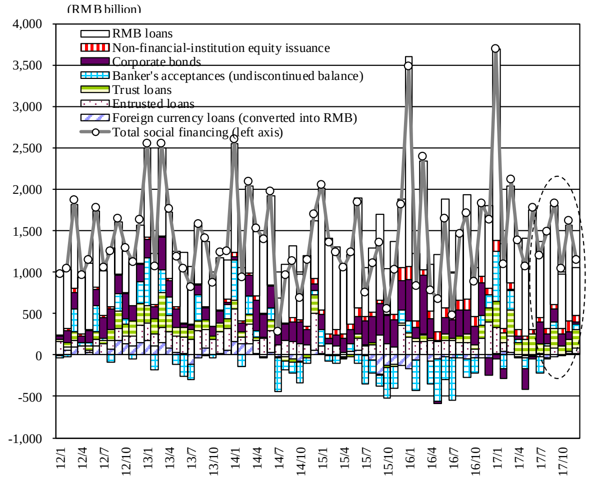
Foreign exchange reserves stood at $3,139.9 billion at the end of December, up $20.67 billion on November, with the figure rising on the previous month for the 11th successive month (Fig. 19).

Fig. 17: Financial institution lending; the money supply



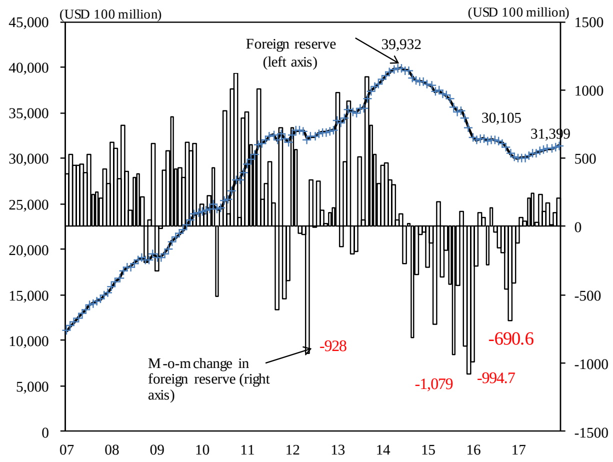
Note: The graph shows January and end-of-quarter figures up until 2015. The figure in the graph shows the y-o-y change in the outstanding loan balance for the most recent month.
Source: PBOC, CEIC

Fig. 18: Total social financing
(net increase and decrease)



Source: PBOC, CEIC

Fig. 19: Foreign exchange reserves



Note: The foreign reserve data shows the June 2014 at peak, end of 2016, and the latest monthly figure.
Source: People's Bank of China, CEIC

2. Policy responses: Measures to prevent financial risk based on the policy of 'high-quality development'

・"Structural adjustment, optimization and upgrading are being carried out at an accelerated pace and quality improvements will become more obvious" (NBS)

With China's economy growing faster than expected in 2017, a debate has ignited about whether this marks "the beginning of a new cycle for China's economy" or whether this is "a crucial period for China's economic restructuring and the economy may face some downward pressure.[18]"

In response, NBS head Ning Jizhe admitted at a press conference on January 18 that the issue "has caused heated discussion among Chinese economists in the second half of last year." He said that China's economy had undergone phased development (from a period of rapid growth to a period of high-quality development) and structural adjustment (through changes to the industrial structure and demand structure as well as supply-side structural reforms), adding that cyclical factors should also be observed in this context. He continued that "structural adjustment, optimization and upgrading are being carried out at an accelerated pace. The phased changes brought by quality and efficiency improvements will become more obvious." As such, he seemed to suggest that more positive factors would emerge from the process of structural adjustment and phased development.

・"The establishment of an indexing and a statistical system to promote high-quality development" (NBS)

At the press conference on January 18, Ning Jizhe was asked on reports that the Tianjin Binhai New Area had submitted inaccurate GDP data and that Inner Mongolia had provided inaccurate figures in its industry report. Mr. Jizhe replied that "unified accounting [of local and national statistics] will be implemented by 2019.[19]" He also outlined the tasks the authorities would fulfil in the coming years to promote high-quality development. He spoke about "the establishment of an indexing and a statistical system to promote high-quality development" and he said the authorities would: "establish and improve an index system endorsed by new development philosophy," "establish an index system…to enhance quality and efficiency and promote transformation and upgrading," "further improve the statistical monitoring system to collect data reflecting the progress of supply-side structural reform," "provide more data on economic changes in national economic accounting," and "improve the unified monitoring index system according to the requirements of securing a decisive victory in building a moderately prosperous society in all respects."

・The Chairman of the CBRC's thinking regarding financial risk and measures to prevent financial risk

In January, the PBOC and the China Banking Regulatory Commission (CBRC) usually hold work conferences to discuss monetary policy and financial supervision and regulatory policy for the current year based on the measures set by the Central Economic Work Conference at the end of the previous year. At the time of writing, though, there

[18] China Net, January 18, "*新闻办就 2017 年国民经济运行情况举行新闻发布会 (The State Council Information Office Briefing on China's Economic Performance in 2017)*."
http://english.scio.gov.cn/pressroom/2018-01/20/content_50267860.htm

[19] People's Daily, January 20, "*三问天津如何闯关 (Three Questions for Tianjin: How can the Problem be Solved?)*." According to this article, the Tianjin Binhai New Area 2016 GDP was revised down to RMB 665.4 billion from an initial figure of RMB 1.2 trillion, with the GDP forecast for 2017 set at RMB 700 billion. The revision was due to double accounting, with the data including the activities of firms registered in the district, even if the activities of these firms actually took place outside the district. Furthermore, on January 19 it was announced that Tianjin's total GDP growth had only hit +3.6% in 2017. In his press conference on January 18, Ning Jizhe stated that "total local GDP in 2016 was 3.6 trillion yuan higher than the national figure."
http://www.xinhuanet.com/politics/2018-01/20/c_1122286935.htm

has been no announcement about the convening of conferences this year. However, in an interview with the People's Daily on January 17, CBRC Chairman Guo Shuqing talked about preventing and eliminating major financial risks (Fig. 20)[20].

In 2017, he explained, measures to prevent and control financial risk had yielded results when it came to interbank businesses, wealth management products, and off-balance sheet activity.

Mr. Guo said risks were generally being controlled at present, but he also explained that there was considerable pressure for a rebound in bank non-performing loans (NPL), while a large number of financial institutions had unsound internal control mechanisms, so with shadow banking stock (balances) still at high levels, financial irregularities were occurring. He warned that the financial system could be hit by unhealthy economic/social phenomena or international uncertainties, adding that the resulting dangers of 'grey rhinos' and 'black swans' threatened China's financial stability[21]. He voiced particularly strong concerns about financial risk, saying that financial risks could be very sudden, contagious and harmful. If the financial system suffered such a shock, he added, this would seriously impact economic and social development and could impede the goal of building a moderately prosperous society in all respects.

Asked about the focus of future moves to prevent and eliminate financial risk, Mr. Guo mentioned five goals: controlling the macro-leverage rate; improving the flexibility of financial institutions; strengthening the ability of the financial sector to serve the real economy; strengthening the construction of a system of hard constraints[22]; and effectively preventing and controlling systemic risk. To achieve these goals, he said the authorities needed to: lower corporate debt ratios; constrain household sector leverage; set strict standards for products that cross multiple financial sectors; continue to eliminate the shadow banking sector; clean up and regulate financial conglomerates; dispose of high-risk banks in an orderly fashion; crack down on illegal financial acts and illegal fund-raising activities; continue to keep the propensity for real-estate bubbles under control; and actively help local governments to deal with implicit debt.

As for banking reform priorities, Mr. Guo mentioned (1) the problem of minority shareholders interfering in normal banking operations and (2) the need to improve corporate governance.

Business activity could be impacted by these moves to strengthen regulations to prevent/eliminate financial risk, so caution will be needed.

Fig. 20: Preventing and eliminating major financial risks (Guo Shuqing, Chairman of the CBRC)

1. The results of measures to prevent and control financial risk in 2017; the location and awareness of financial risks
    - The shift of banking sector funds 'from the real economy to the fictitious economy' has been initially reined in. Financial leverage rates have fallen. More than 100 banks have shrunk their balance sheets.
    - Though new loans increased by +12.6%, total banking industry assets only increased by +8.7%.
    - Interbank assets and liabilities shrank for the first time since 2010, with interbank wealth management products falling by a net RMB 3.4 trillion compared to the start of the year.

[20] People's Daily, January 17, "打好防范化解重大金融风险攻坚战（权威访谈）(*Interview with Guo Shuqing: Firmly dealing with the difficult tasks of preventing and eliminating major financial risks*)."
http://politics.people.com.cn/n1/2018/0117/c1001-29768826.html
[21] Grey rhinos = Major threats that are likely to occur but which are nevertheless not taken seriously. Black swans = Very rare and unlikely events that would pose huge risks to the markets if they occurred.
[22] This is an antonym to the phrase 'Soft Budget Constraint,' which was coined by the Hungarian economist János Kornai to refer to the tendency of the authorities in socialist planned economies to offer support (investments, loans or tax breaks, etc.) to firms or projects that were in the red.

- Bank wealth management products only increased by just over RMB 5 trillion.
- Bank investments via special-purpose vehicles (SPV) only grew by less than RMB 10 trillion.

○ The risks to China's financial system are manageable on the whole, but there are still many periods when risks are likely to occur, with the situation still complex and grave.

- There is considerable pressure for a rebound in bank non-performing loans (NPL), while a large number of financial institutions have unsound internal control mechanisms; shadow banking stock (balances) is still at high levels and financial irregularities are occurring.
- The financial system could be hit by unhealthy economic/social phenomena or international uncertainties. This could see China's financial stability threatened by 'grey rhinos' and 'black swans*.'
- Financial risks could be very sudden, contagious and harmful. If the financial system suffered such a shock, this would seriously impact economic and social development and could impede the goal of building a moderately prosperous society in all respects.

2. The focus of future moves to prevent and eliminate financial risk

○ Goals: Control the macro-leverage rate; improve the flexibility of financial institutions; strengthen the ability of the financial sector to serve the real economy; strengthen the construction of a system of hard constraints**; effectively prevent and control systemic risk.

- The banking sector needs to strengthen the prevention and elimination of various risks while striving to construct a virtuous cycle involving (1) finance and the real economy, (2) finance and real-estate, and (3) the financial system.

○ Focuses: Lower corporate debt ratios; constrain household sector leverage; set strict standards for products that cross multiple financial sectors; continue to eliminate the shadow banking sector; clean up and regulate financial conglomerates; dispose of high-risk banks in an orderly fashion; crack down on illegal financial acts and illegal fund-raising activities; continue to keep the propensity for real-estate bubbles under control; and actively help local governments to deal with implicit debt.

- The authorities are deterring financial risk through supervision, control and penalties. 3,452 administrative penalty decisions were made in 2017. Banking sector awareness of compliance management has clearly improved.

3. Strengthening the ability of the financial sector to serve the real economy

- New loans increased by RMB 13.98 trillion in 2017.This was up by RMB 1.2 trillion on the same period the previous year.

—Loans for small and micro enterprises increased by +15.1%, for low-income housing projects by +42.3%, for agriculture by +9.6%, and for infrastructure by +15.7%.

- Lending policy for 2018: Focus on supply side structural reform by strengthening cooperation and coordination with local authorities and enterprises while promoting structural adjustment, M&As and restructuring.

– Support the marketization/legalization of debt-equity swaps (DES).
– Continue to utilize the role of credit committees; focus on zombie enterprises; accelerate the disposal of NPL using various methods; and reduce corporate leverage.
– Improve differentiated service capabilities and provide strong support for the implementation of major strategies like rural rejuvenation, regional coordination and the promotion of innovation.
– Further promote financial inclusion***; improve financial services for small/micro enterprises and the agriculture sector, rural areas and farmers; accurately support the fight against poverty.
– Actively promote green (environmentally-friendly) lending; actively explore financial service models for science and innovation enterprises.
– Clamp down on the illegal collection of fees and reduce financing costs.

4. The direction of banking sector reforms

(1) The problem of minority shareholders interfering in the normal banking operations

- Some shareholders treat banks like their personal ATMs and they engage in improper transactions or profit transfers.
- Some shareholders create huge, illegal financial groupings using complex structures, fictitious investments and circular capital injections. These seriously disrupt moves to deepen financial reforms and safeguard the banking system. As such, they must be dealt with severely in accordance with the law.

(2) Improve corporate governance	・ Manage shareholder rights and promote forming the board of directors; strengthen the vigorous supervision and control of shareholders. ・ Strengthen the performance evaluation, appraisal and accountability of directors; enhance the independence and professional capacities of independent directors. ・ Further utilize the role of supervisory boards. ・ Actively explore modern banking systems with Chinese characteristics; incorporate party leadership in corporate governance structures. ・ Further improve banking frameworks and structures. Promote the sound development of the financial market system. Unify the supervisory and control standards for wealth management products by revamping interbank operations. Guide more funds to standardized multi-tiered equity and bond markets.

Note: *Grey rhinos = Major threats that are likely to occur but which are nevertheless not taken seriously. Black swans = Very rare and unlikely events that would pose huge risks to the markets if they occurred.

**This is an antonym to the phrase 'Soft Budget Constraint,' which was coined by the Hungarian economist János Kornai to refer to the tendency of the authorities in socialist planned economies to offer support (investments, loans or tax breaks, etc.) to firms or projects that were in the red.

***Inclusive finance = A financial system that provides services in a comprehensive manner to all social classes and groups.

Source: Prepared by the author of this report based on "打好防范化解重大金融风险攻坚战 (权威访谈)" (People's Daily, January 17, 2018)
http://politics.people.com.cn/n1/2018/0117/c1001-29768826.html

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