PROF XU BIN:

Future of the Chinese Economy

To make a judgment about what China's economy will look like in 2016 and the years to come, one should first remember the goal for 2020 as outlined in the Report to the Eighteenth National Congress of the Communist Party of China. It says, "We should double 2010 GDP and per capita income for both urban and rural residents." This goal requires average annual growth of 7.18%.

The average annual growth rate from 2010 to 2015 was about 7.78%, therefore the growth rate needs to stay at 6.58% from 2015 to 2020; 6.5% is the target that must be achieved and the government will make every effort to achieve this in order to keep its commitment to the people. Keeping this goal of 6.5% in mind makes it clear what policies the government will use. To meet this goal, further monetary and fiscal policy stimulus will be introduced over the next five years on the demand side. It will not be less than the stimuli seen in 2015; otherwise the target growth rate will be difficult to reach.

The government will also pay attention to long-term supply-side reform. Instead of giving up its dominant position in a state-owned economy, the Chinese government hopes to create a mixed-ownership economy through which the private and state-owned economies can supplement each other, with the former lending vitality to the latter. Reform of state-owned enterprises is a way to allow the government to adopt a partly market-oriented policy while the old system still remains in place. There are two reasons for this compromise. First, state-owned enterprises are too important to the government for it to allow them to go bankrupt. Second, there are many vested interests that benefit from the state-owned enterprises' current manner of operations. However, if the demand-side stimuli cause a delay or lessening of supply-side reforms, it will cause problems for the development of the Chinese economy.

> *The government is trying to make the market play a more positive role in capital allocation.*

A landmark event will occur on October 1 of this year when the RMB will officially become the fifth currency in the International Monetary Fund's (IMF) basket of Special Drawing Rights (SDR). The inclusion of the RMB in the SDR will force China to implement financial reform. The effect will be as significant as China's joining the World Trade Organisation (WTO) in 2001. Over the next few years, China's financial market will become more market-oriented, while the capital market's pace of reform and opening up will be accelerated. The deepening of financial reform is a new challenge for the Chinese government's risk management and control capabilities, and there may be some financial turmoil in the coming years as a result.

The Chinese stock market experienced a sharp decline in early 2016, but we don't have to be too pessimistic about the outlook for the market. Let's take a look at the liquidity available. If the economic growth rate is to reach 6.5% or higher, monetary stimulus is inevitable and liquidity will increase, most likely going to real estate and the stock market. On a deeper level, the government is trying to make the market play a more positive role in capital allocation. Once the RMB joins the SDR, the Chinese government will create conditions to encourage more foreign capital to buy Chinese stocks and other financial products. The government will actively strengthen the development of RMB financial products and promote them to the international market.

Just as it was inevitable that the RMB should be included in the SDR basket, it is only a matter of time before China's A shares index is included in the MSCI emerging market index. This will boost demand for A shares. That said, stock prices cannot deviate from economic fundamentals for too long; the prosperity of China's capital market can only be guaranteed by supply-side reforms.