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ANBOUND is an independent think tank for strategic analysis and risk research in finance and public policy. *China Observation* is an information product prepared by ANBOUND researchers based on the tracking research and analysis of public information. The report covers both developmental and public policies concerning China's macro-economy, industry, finance, environmental protection, urban development, population and aging. Through independent observation and analysis, *China Observation* provides an independent window into the Chinese market and allow the world to understand changes faced by the country.

The heads of both China and the United States have decided to meet at the G20 summit in late June, bringing hope to the easing of the U.S.-China trade war. Officials from both countries indicated that they have commenced preparations for the meet. At present, the downward pressure on China's economy is more serious than expected, and the long-standing structural problems might become more obvious. Under real and tangible economic pressures, China's macroeconomic policies will be further relaxed.

U.S, China negotiators prepare for trade talks

Chinese President Xi Jinping and U.S. President Donald Trump confirmed on June 18 that they will arrange a meet to discuss bilateral trade issues at the G20 summit. Stimulated by this news, the U.S. and China stock indexes have risen sharply. The expectations that the two countries would reach a trade agreement are also rising.

U.S. Trade Representative Robert Lighthizer said that before President Trump and President Xi had met at the G20 summit, Washington was “ready to engage” with Beijing and added that it is a common goal of the two countries to “resolve” the trade dispute. Lighthizer and Treasury Secretary Steven Mnuchin would be meeting with Chinese officials in Japan to set the stage for the summit.

The Chinese side has also stated its position. On June 20, China's spokesperson for the Ministry of Commerce Gao Feng said that chief trade negotiators of China and the United States will communicate in line with the instructions given by the two heads of state to prepare for the meeting during the summit in Osaka. The statements of both Lighthizer and Gao Feng are closely related to the tone given by the two heads of state, which is an important basis for further talks between the two sides.

On June 26, Mnuchin told CNBC that the U.S. and China were “about 90% of the way there (with a deal)” and he thinks “there's a path to complete this”. He said that he is confident that President Xi Jinping and President Trump can make progress in the trade talks at the G20 summit.

China's economic downturn is more worrying than trade war

The trade war has brought negative impact on the Chinese economy, but what is even more worrying is the downward trend of China's domestic economy. The new and internal driven factors are still weak, and the conventional that support economic growth are also stalling. In terms of investment, from January to May, the growth rate of China's domestic fixed asset investment fell by 0.5 percentage points from The first four months. Industry wise, investment in the primary industry decreased by 2.3% year-on-year. Investment in the secondary industry increased by 3.2%, of which manufacturing investment increased by 2.7%, 0.2 percentage points faster than that in January-April, although it still represents a low level. Investment in high-tech manufacturing and service industry grew rapidly, up 10.2% and 15.6% respectively, but the base remained relatively small and was still insufficient to support the economic growth. Real estate development investment slowed down under the policy pressure, and comparing the growth rate in January-May with that of January-April, a fall of 0.7 percentage points was recorded. These data show that there is a lack of momentum in the Chinese economic growth.

China's manufacturing loan ratio has continued to decline. In 2006-2016, the proportion of loans to China's manufacturing industry fell from 25% to 16.2%. At the same time, the non-performing rate for manufacturing loan remained high. According to data from the China Banking and Insurance Regulatory Commission (CBIRC), at the end of the first quarter of 2019, the non-performing manufacturing loan rate was as high as 9%. Moreover, the proportion of value added by manufacturing to GDP has fallen below the security line. Xiao Gang, a member of the National Committee of Chinese People's Political Consultative Conference (CPPCC), said that the proportion of China's manufacturing value added to GDP continued to fall from 31.5% in 2010 to 29% in May 2019. In China, there is an economic security policy of no less than 30% for such proportion. In other words, China urgently needs to introduce supportive policies to increase the proportion of value added by manufacturing.

When it concerns consumption, the performance of bulk consumption is less than satisfactory. Automobile sales underwent a cliff-like fall. From January to April, the cumulative production and sales of automobiles nationwide fell by 11% and 12.1% respectively, which were 1.2 and 0.8 percentage points more than the first quarter. From January to May, the sales area of commercial housing nationwide fell by 1.6% year-on-year, 1.3 percentage points higher than the first four months. The growth rate of commercial housing sales fell by 2 percentage points from January to April.

Employment pressure in China is also increasing. Officials from the National Development and Reform Commission (NDRC) acknowledged that the recruitment needs of university graduates in the internet, finance and other industries are also tightening due to the continuous increase in the Sino-

US economic and trade frictions and other uncertainties.

Currently, the internal and external situations faced by China remain complicated. In addition to that, both external and domestic demands are sluggish, and the momentum of internal economic growth still remains insufficient. The efficiency of consumption and investment in economic growth is changing. Some structural problems that have long existed in the Chinese economy may be further revealed.

Monetary policy continues to be loosened with increasing targeted efforts

The efforts of the People's Bank of China to stimulate the economy have been effective. According to the latest statistics, the currency multiplier rose from 5.52 in December 2018 to 6.31 in April 2019, reaching an all-time high. On one hand, this is because of the People's Bank of China carrying out the operation of lowering the RRR. On the other hand, the banks have also channeled the loose money from the RRR cuts into entities, and bank credit has been increased as well. In the face of the current situation, China will continue its loose monetary policy. Some Chinese economists believe that it is difficult for China's economy to see a sharp rise in inflation. Monetary easing will be maintained to cope with downward pressures on the economy. The government's leverage will be an important measure in counter-cyclical adjustments. There are also economic analysts who believe that China's monetary policy will continue to play down the "capacity function" while strengthening the "structural function" provided there are no external extreme geopolitical risks. The monetary policy of many countries in the world has also turned to easing, which has created some space for China's monetary policy adjustment. In the steps to come, China's monetary policy will be focusing on stability in order to ensure the rationality of liquidity in the Chinese market, and highlight its structural features and orientation. As such, the possibility of targeted easing is more likely to be implemented than comprehensive easing.

The funds released by easing policies should be directed at urban renewal

ANBOUND advocates for the Chinese government implementing a large-scale easing policies, which is known as “flood-like” stimulus policies. However, concerns on how to allocate the abundant funds from the massive easing is an important policy and economic issue. If the easing policy leads to another rise in the real estate market, it not only violates the policy orientation on China's regulation of real estate, but also implies economic failure and intensified financial risks.

ANBOUND’s research team believes that in the context of the gradual acceptance of comprehensive easing policies, the Chinese government should devote more funds released to urban renewal projects to guide the transformation from "real estate development" to "real estate construction". Differing from "real estate development", under urban renewal, "real estate construction" focuses on improving the value of urban space, including the reconstruction of the old city, reconstruction of public spaces, design and promotion of dynamic central areas, enrichment of spatial content, adjustment of urban spatial structure, and upgrading of consumption.

China needs systemic easing to tackle its current economic problems

Since the second half of 2018, China has launched a series of stimuli-based policies to stabilize its economic growth. China's economy has seen a correction in the first quarter of 2019, but recent data suggests that it still lacks momentum in economic growth. From the perspective of industry data, the biggest problem that enterprises are facing is overcapacity. According to the survey, 66% of Chinese enterprises' products were oversupplied in China's domestic market in the first quarter of 2019, consistent with ANBOUND researchers' judgment that "overcapacity" is the main problem at present. The pace of industrial transformation and upgrading in real estate industry and traditional manufacturing industries including steel and automobiles is slow, which is the main reason for the Chinese economy facing internal and external pressures. Meanwhile, the high-risk in financing for SMEs was transmitted to small and medium-sized banks and subsequently spread to the financial system, which began to affect the stability of the entire Chinese financial system. Therefore, to ease the complex problems of China's economy, the government will be required to implement systemic easing policies. On the whole, however, through the policy of loose currency and loose credit, an outbreak of financial risk may be prevented, the overall economic confidence could be improved, and the domestic market space may experience an expansion. For structural problems such as overcapacity, precise industrial policies and flexible credit policies is needed to guide the capital flow after the implementation of loose policies.

Premier Li retained multinational companies with industrial chain environment and Chinese market

Premier Li Keqiang on June 20 met with a group of multinational corporate leaders attending the seventh Global CEO Council roundtable summit in Beijing. Among the industry leaders attending the meeting were from Schneider Electric, Swire, ArcelorMittal group, Pfizer, Daimler-Benz, UPS group, Nokia, Hyatt group, ABB group, BHP Billiton and others, collectively representing nearly 20 Fortune 500 companies. During the meeting, Premier Li Keqiang stressed that China will stick to its long-term commitment of reform and opening up, as well as continue to further open up China’s market and welcome more foreign investment into China. It will also ease access restrictions in more sectors to create a market-oriented and law-based international business environment.

It is worth noting that Premier Li Keqiang highlighted two key points for multinational companies to stay in China: Firstly, the current international economic and trade situation is becoming more uncertain, which requires multinational companies to reconsider issues from the perspective of the global industrial chain. Secondly, in terms of investment, China remains a huge market for investment and will work to promote global business and economic stability. In previous instances of cooperation, foreign investors have brought capital, technology and new ideas to China, and have gained business interests in the mainland market. Foreign companies and Chinese partners have achieved win-win results from this arrangement, and hopes to achieve more of similar results in the future.

It can be regarded that Premier Li emphasized on the global industrial chain and the Chinese market because both are the elements of China's comparative advantage. For multinational enterprises currently investing in China, the industrial chain and the Chinese market both holds an important value, in which they can also be regarded as important chips for the Chinese government to "retains" foreign investment.

Fundamental views

- Consumption is an internal driving force for urban economic growth, and it is also sustainable. ANBOUND believes that under both internal and external economic pressures, China needs to increase the overall easing policy, and channel funds brought by such policy into urban renewal projects to promote the transformation of urban public space and the construction of urban vitality centers, in order to boost urban business and consumption. This is so as to achieve sustainable economic growth, and guide the transformation of "real estate development" to "real estate construction". It is the only viable, effective development path that China can tread on. Fundamentally, infrastructure construction is actually a debt that only materializes in the long-term, and will only increase the intensity of the “debt explosion”.

- In February this year, the National Development and Reform Commission (NDRC) stated that it will actively implement policies to stabilize investments and explore the growth space of future investments. The effective areas for concentrated efforts encompasses four major aspects, which are: high-end manufacturing, new infrastructure, production factors, and Social weak links improvement.
- Chinese Minister of Finance Liu Kun said in March that in order to cope with the downward pressure on the economy, the authorities will continue to increase the scale of infrastructure, support new-energy vehicles, and tap the potential of rural consumption.
- The Chinese Academy of Social Sciences believes that the current focus of supply-side structural reforms has shifted from “de-capacity and destocking” to “improving weak links” and increasing the strength of the infrastructure-related areas. Infrastructure referred to here is not solely limited to construction projects, but also includes construction in support of national urban agglomeration and the economic belt, improvement of urban and rural public facilities services, pollution prevention and control, as well as more precise efforts on poverty alleviation. The Chinese monetary policy may also consider increasing loan support and capital guidance for investment in infrastructure-related areas through targeted easing.
- Jiang Chao, chief economist of Haitong Securities, pointed out in October 2018 that if China ushered in a new round of loose monetary policy cycle, China should not foray into real estate investment. However, in the

context of overcapacity, there is also not much room for equipment investment. Therefore, in the short-term, infrastructure investment can serve as the underpinning foundation, while the hope for the long-term should be on launching the technological innovation cycle.

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