GROWTH OR STRUCTURAL REFORMS? CHINA'S CHANGING POLICY PRIORITIES

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Executive Summary

1. Sustaining growth has long been one of the top priorities of the Chinese government and 2017 is no exception. Since late 2016, however, there have been signs of a shifting focus towards structural reforms and risk prevention in the financial sector.

2. A decent economic outcome for 2017 is still important, at least in the lead up to the Chinese Communist Party's 19th Party Congress in November. The current leadership needs to demonstrate its ability to lead the economy through difficult times and to facilitate economic transformation.

3. This is particularly significant for Chinese President Xi Jinping who has been the country's top leader for nearly five years. Xi has assumed a much stronger role and adopted a more hand-on approach in economic affairs. The credentials of his leadership will be tied closely to China's economic performance.

4. Since the early 2010s, China's economic policymakers have worked towards balancing two objectives: to sustain growth and to promote economic restructuring. While structural reforms are essential to ensuring sustainable development and revitalising long-term growth momentum, they incur serious adjustment cost and place downward pressure on short-term growth.

5. The government will modify its priorities, fine-tune its strategies and manage expectations through policy deliberations as circumstances change. The year 2016 served as a good example when strong credit support for growth at the beginning of the year was later overshadowed by stronger push for supply-side structural reforms.

6. Overall, sustaining an above 6.5% growth was a somewhat hard target for 2016 and the government stood guarded to defend it. The economy ended with an annual growth of 6.7% backed by rapid increase in investment, thus making limited progress in structural reforms.

7. There are indications that 2017 will be different. An annual growth of around 6.5% is specified, suggesting tolerance for a figure below that mark. The government is

mindful that strong fiscal stimulus without effective financial institutions could delay economic restructuring and increase financial risks.

8. The government seems more determined to push important reforms and enhance financial regulatory. A new state-owned enterprise programme was announced in May 2017 to shift the governments' role from asset management to capital management. New regulations have also been introduced to reduce financial risks of the financial institutions.

9. Challenges abound. One is to maintain a sufficiently accommodating environment for growth while promoting structural changes such as debt reduction and excess capacity cutting. Another is to continue the anti-corruption campaign without stifling local leaders' aspiration to promote development. Relations between government and businesses also need reconfiguration.