

3. Current status and problem of China's economy

(1) The current status of China's economy to pull the world economy

(A) Importance of the presence of China in the world economy

After the world economic crisis, the China's economy rapidly got rid of its influence, while most of the developed economies fell into serious recession, and accomplished rapid recovery and played the role of an engine for the world economic recovery. In 2010, Chinese nominal GDP reached US\$5,900 billion, and exceeded Japan (US\$5,500 billion), coming at the second place in the world next to United States (Figure 1-1-3-1). The Chinese nominal GDP was only 364.5 billion yuan in 1978 when the reformation and opening policy began, but after the high growth for 30 years, it became “the world's factory” and afterward, transformed the figure to “the world market” with high growth rate. In 2010, the nominal GDP reached 39,800 billion Yuan (or US\$5,900 billion), 110 times larger than the amount in 1978, and accounted for 9.5% of the whole world. In the trade side, The total amount of the trade was only approximately US\$20 billion in 1978, but it expanded to approximately US\$3,000 billion in 2010 or approximately 150 times larger than the amount in 1978 and the export was the world largest and the import was the world second largest (Table 1-1-3-2). China has been rapidly gaining importance with its presence in the world economy.

Figure 1-1-3-1 Changes in nominal GDP in the world top 3 countries

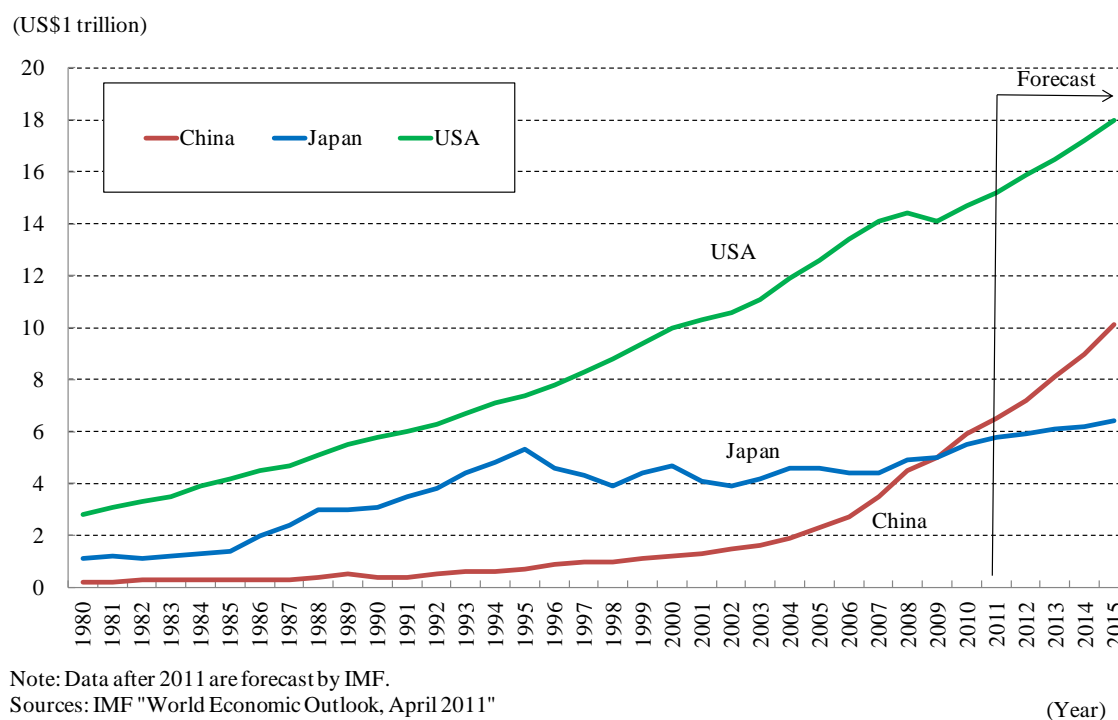


Table 1-1-3-2 Ranking of the major world exporters and importers in 2010

Ranking	Exporter	Amount (US\$100 million)	Share (%)	Ranking	Importer	Amount (US\$100 million)	Share (%)
	World total	148,533	100.0%		World total	153,847	100.0%
1	China	15,804	10.6%	1	USA	19,681	12.8%
2	USA	12,776	8.6%	2	China	13,939	9.1%
3	Germany	12,061	8.1%	3	Germany	10,543	6.9%
4	Japan	7,717	5.2%	4	Japan	6,940	4.5%
5	Netherlands	5,671	3.8%	5	France	5,947	3.9%
6	France	5,104	3.4%	6	UK	5,367	3.5%
7	Korea	4,422	3.0%	7	Netherlands	5,130	3.3%
8	Italy	4,412	3.0%	8	Italy	4,759	3.1%
9	Russia	4,038	2.7%	9	Hong Kong	4,335	2.8%
10	Belgium	4,027	2.7%	10	Korea	4,303	2.8%

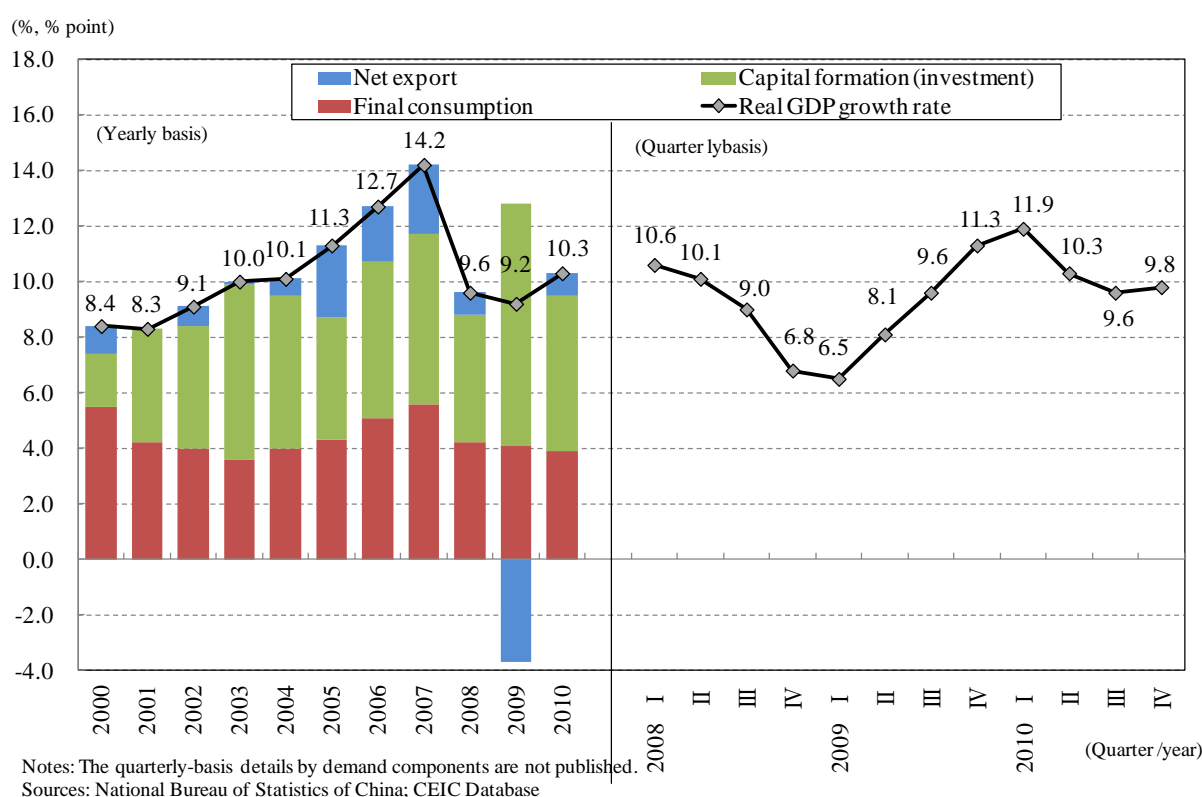
Sources: IMF "DOT"

(B) China's economy in 2010

(a) Movement of GDP and indices related to each demand components

From the end of 2008 through early 2009, China's economy that slowed under the influence of the world economic crisis, strengthened the recovery tendency after the bottom in the first-quarter in 2009, and, as for the real growth rate in 2010, it was 10.3% increase over the previous year. It achieved a double digit growth after 3 years since 2007 (Figure 1-1-3-3). The contribution of degrees according to demand components was 3.9% points for "final consumption", 5.6% points for "capital formation" (investment) and 0.8% points for "net export. It continued to be the type of growth led by "capital formation" (investment).

Figure 1-1-3-3 Changes in nominal GDP growth and contribution by demand components



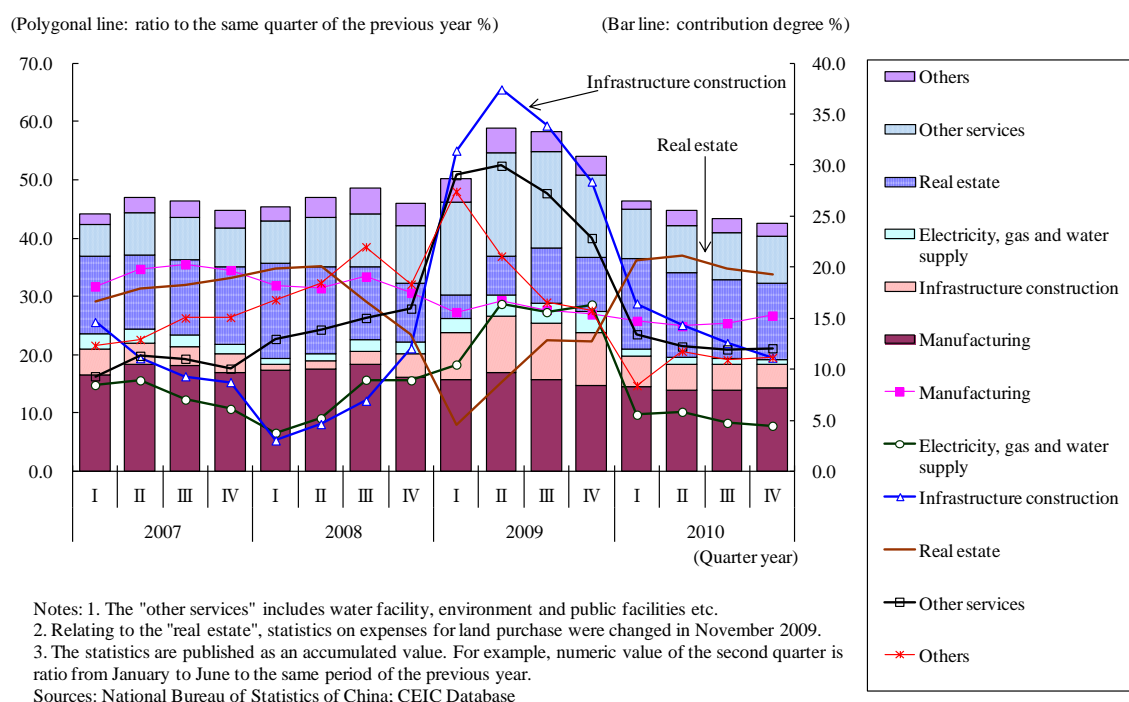
Examining the movement of each demand component from a related index, and as of investment, fixed assets investment in urban area which occupied approximately 90% of all society fixed assets investment increased by 24.5% compared with the previous year⁶². Although the growth was less than the growth in 2009 (30.4% increase over the previous year) which greatly increased by implementation of the "4 trillion Yuan" domestic demand stimulus policy⁶³, it still maintained a high level. Examining according to each industry, the "infrastructure construction" which was closely

⁶² This based on data from National Bureau of Statistics of China. The urban area fixed assets investment is implemented by government offices at the prefectural level or higher and enterprises and it account for 86.8% (in 2010) of the fixed assets investment in whole China.

⁶³ This is an economic stimulus measure focusing on the infrastructure investment taken by the government of China after the world economic crisis.

related to the public investment was slowing down after 1 years from starting the of “4 trillion Yuan” domestic demand stimulus policy. Contrarily, “real estate” continued high growth (Figure 1-1-3-4).

Figure 1-1-3-4 Changes in growth rate of fixed-assets investment in urban area and contribution of individual sector



About the consumption, the total amount of retail sales of consumer goods increased 18.4% over the previous year⁶⁴. Examining by items, under the influence of the consumption stimulus policy⁶⁵, growth of “automobile” which accounted for approximately 30% of the total amount of retail sale⁶⁶ raised the overall growth (Figure 1-1-3-5). In addition, like automobile, the “household electrical appliances” which was the object of the consumption stimulus measure showed high growth⁶⁷. 2010 was a year during which the effect of the consumption stimulus measures appeared extremely great. As discussed

⁶⁴ This based on data from National Bureau of Statistics of China.

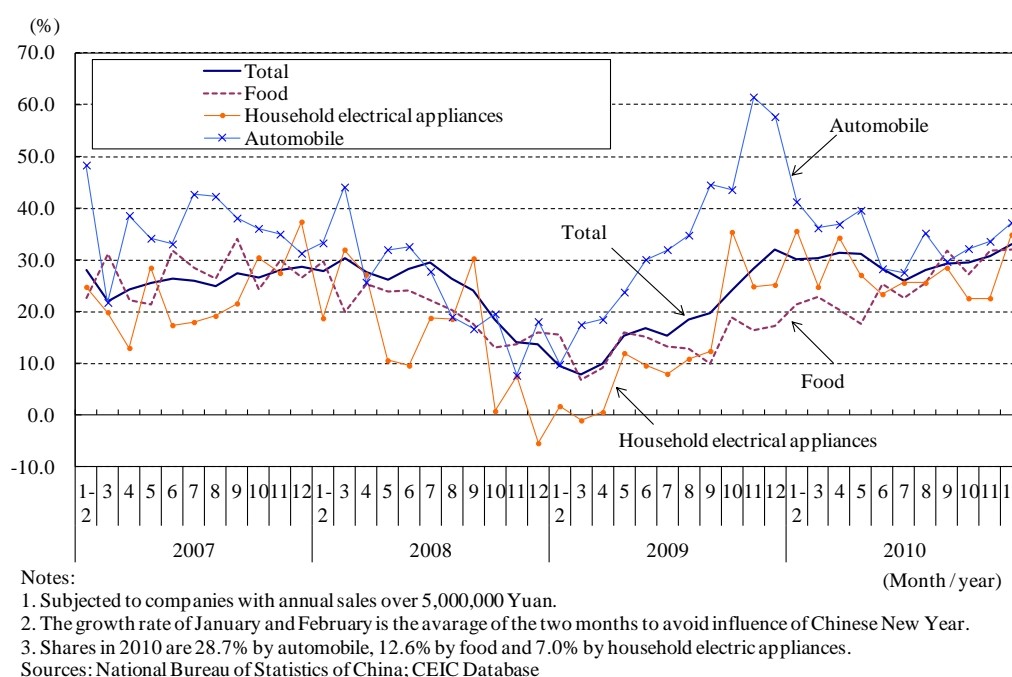
⁶⁵ Apart from the “4 trillion Yuan” domestic demand stimulus policy, the government implemented consumption stimulus measures such as “household appliance to rural areas”, a nationwide campaign to issue 13% subsidy to rural consumers when they purchase household appliance (from February 2009 to January 2013), “old replaced by new”, issuing subsidy when new household appliance are purchased to replace old one (from June 2009 to the end of 2011), “trucks to rural areas”, issuing subsidy when people living in rural areas purchase light trucks or micro trucks to replace three-wheeled trucks or old type trucks (for commercial vehicles from March 2009 to the end of 2010; for motorcycles from March 2009 to January 2013), and policy to issue subsidy for purchasing downsized vehicles (from June 2010). As the reduction of taxes of the carts acquisition tax on cars less than 1.6 liters cubic centimeter displacement (usual 10% tax rate was discounted to 5% within 2009 and to 7.5% within 2010), and the “old replaced by new” cars measure were terminated by the end of 2010, it can be thought that there was rush purchase before the expiration.

⁶⁶ The amount of retail sales of companies with annual sale over 5,000,000 Yuan.

⁶⁷ Sales amount of “household appliance” accounted for 7.0% of the total retail sales in 2010.

in Section 1.1, the auto sales number rose 32.5% compared with the previous year by reaching 18,040,000 and became the first place of the world for consecutive 2 years. Furthermore, sales of products targeted for “household appliance to rural areas” campaign (the subsidy for purchase of household appliance in the rural areas), achieved 77,180,000 units, or 2.3 times increase over the previous year and the sales amount was 173.23 billion Yuan, or 2.7 times increase over the previous year⁶⁸. It is thought that the consumption was propped up by the improvement of employment and the increase of income. On the employment, the registered unemployment rate in urban areas was 4.1% and this is improved 0.2% point over the previous year⁶⁹. On the income, both the disposable income per capita in urban areas and the net income per capita in rural areas were increased, but the growth rate of the income in rural areas exceeded that of the urban areas due to large increase of wage income and net income of agriculture for the first time after 1997⁷⁰ (Figure 1-1-3-6).

Figure 1-1-3-5 Changes in growth rate of retail sales (by commodities) in China

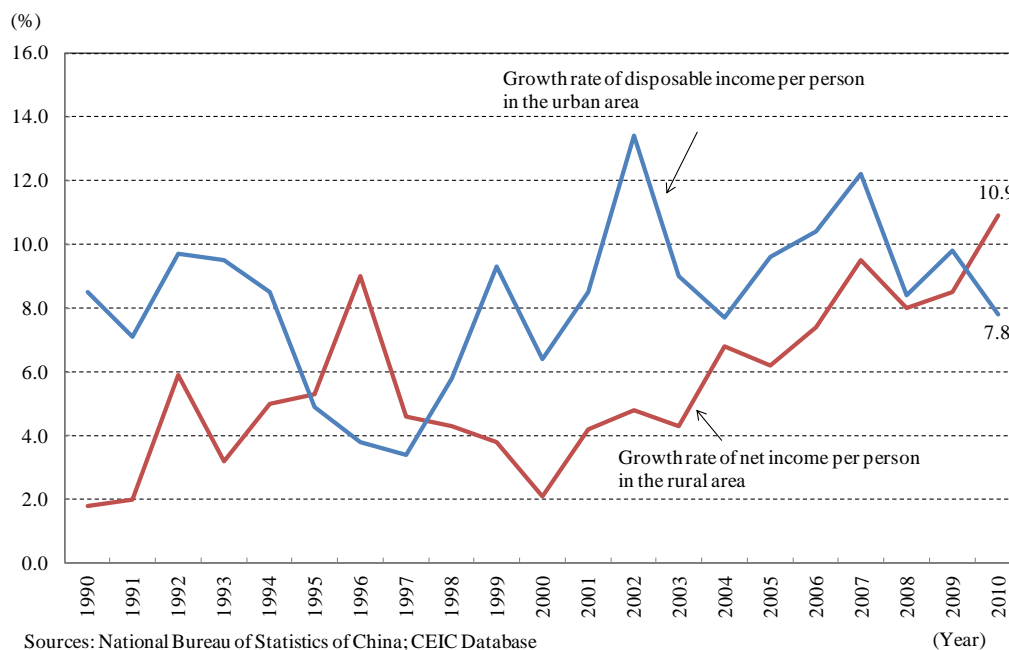


⁶⁸ This is data from Ministry of Commerce of China. Examining the sales amount by items, the first place was the refrigerator and the second, color television, and these high ranked 2 items accounted for 61% of the sales amount of whole items.

⁶⁹ This is data from Ministry of Human Resources and Social Security of China. Number of registered unemployment in urban areas was 9,080,000 in 2010 decreased from 9,210,000 in 2009.

⁷⁰ According to National Bureau of Statistics of China, the wage income of the rural areas in 2010 increased 17.9% and enlarged increase width 6.7 points, and the contribution rate to increased income reached 48.3%. The agriculture net income per farmer rose 15.1% in response to the sudden rise of the main agricultural price including cereals, vegetables and raw cotton, and the increase width enlarged 10.1 points from the previous year. The farmer's net income per capita rose 20.7%, 16.4%, 16.0%, 15.0% and 14.0% in low income group, middle low income group, middle income group, middle high income group and high income group respectively. The ratio of high income group and the low income group reduced to 1:7.5 from 1:8.0 of the previous year. The disposable income of urban dweller per capita increased in all the groups by 13.1%, 13.0%, 11.8%, 10.3% and 9.9% respectively, and the ratio of high income group to low income group was reduced from the previous year's 1:5.6 to 1:5.4 (SHIN KAMOU News, dated February 9, 2011).

Figure 1-1-3-6 Change in income growth rates of urban and rural areas in China



On the foreign demand, the amount of both export and import became record-high due to increase of “machine/ electricity” which account for approximately 60% of the total export and 50% of total import, and “crude oil” which account for approximately 10% of import amount⁷¹ (Figure 1-1-3-7). As the growth of the import exceeded the growth of the export, the amount of trade surplus decreased. Watching the trend of trade according to the countries/ regions, China had large surplus in trade with EU and United States, and large deficits in trade with Japan, Korea and Taiwan. It seemed that China continued to be a processing trade base, procuring parts and intermediate goods from East Asia, exporting finished products to advanced economies (Figure 1-1-3-8). In 2010, China’s trade was characterized by the increase in trade amount with Asian countries and the emerging economies. Amount of trade with Japan, United States and Europe increased more or less 30% over the previous years. Contrarily, total amount of trade with ASEAN, Taiwan, India, Australia and Brazil increased 40 to 50% over the previous years (Figure 1-1-3-9). The background for this development was the FTA concluded with ASEAN became fully effective in January 2010, and “Economic Cooperation Framework Agreement” (ECFA) with Taiwan enabled both China and Taiwan to lower their customs duty from January 2011. China is seemed to plan the relation reinforcement with the Asian countries and the emerging economies, which have much potential for growth (Figure 1-1-3-10).

⁷¹ According to General Administration of customs of China, the export of “machine/electricity” in 2010 increased 30.9% over the previous year, and, the import of “crude oil” increased 51.4% over the previous year.

Figure 1-1-3-7 Changes in China's trade balance

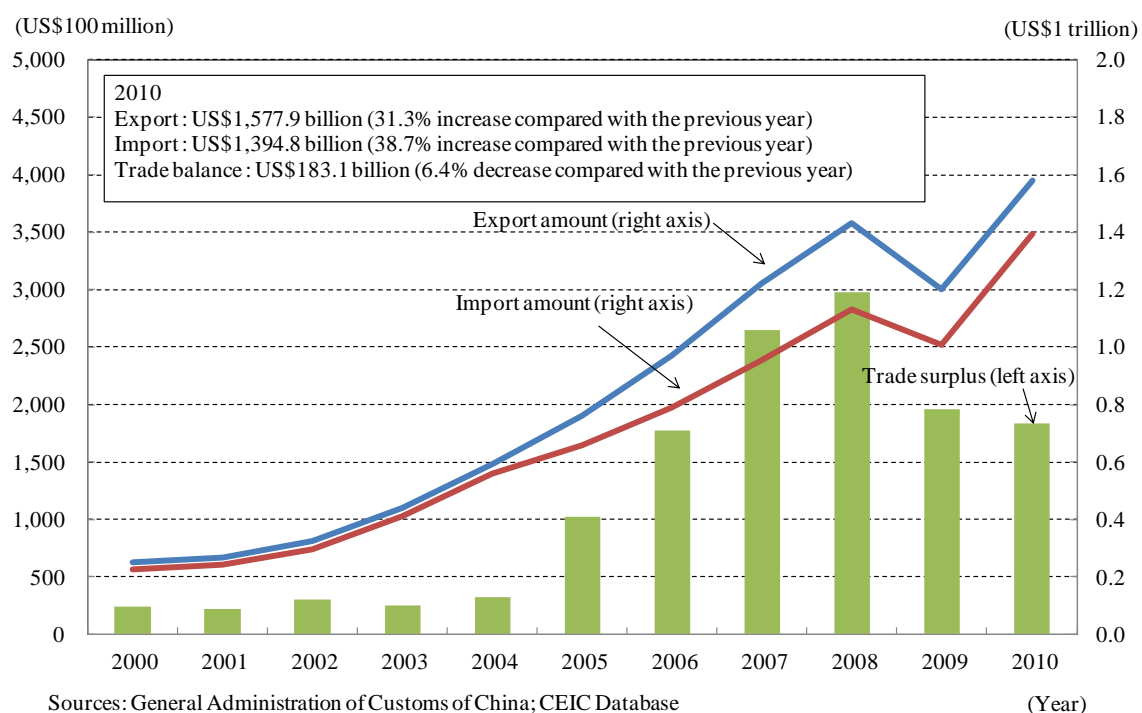


Figure 1-1-3-8 Changes in trade balance by China's trade partners

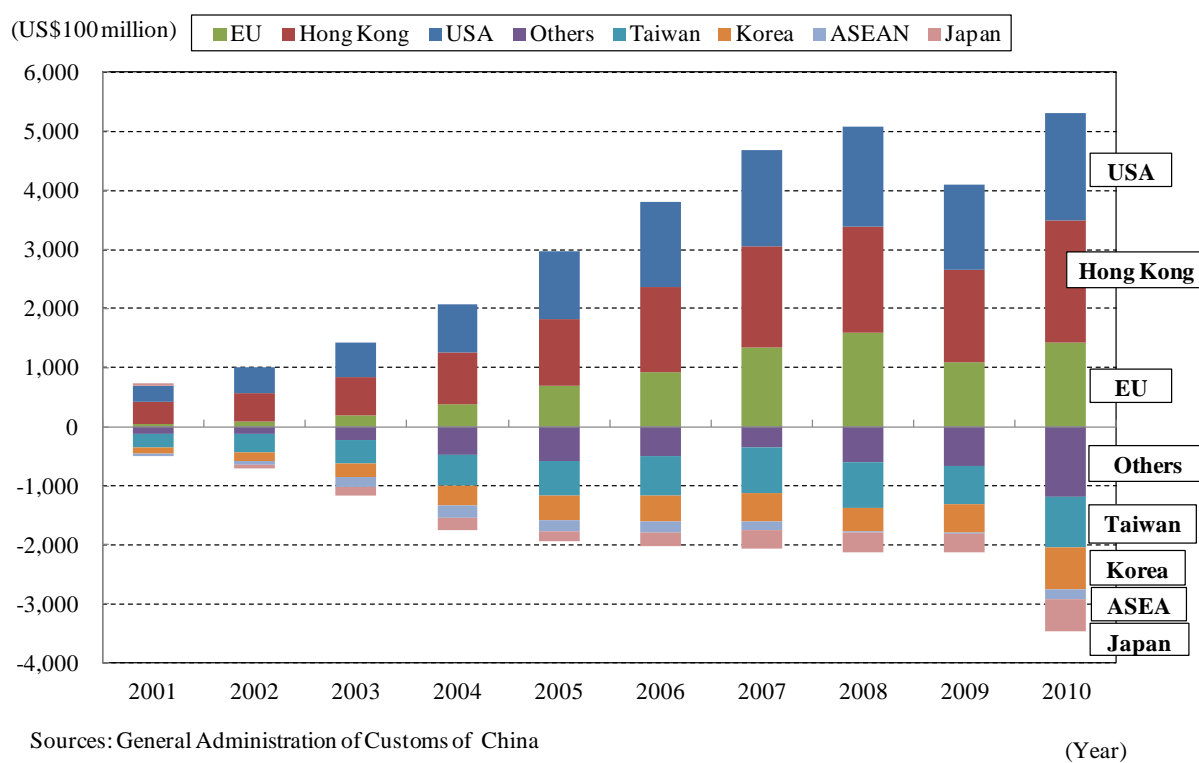


Figure 1-1-3-9 Changes in trade amount by China's trade partners (top 10 countries/ regions)

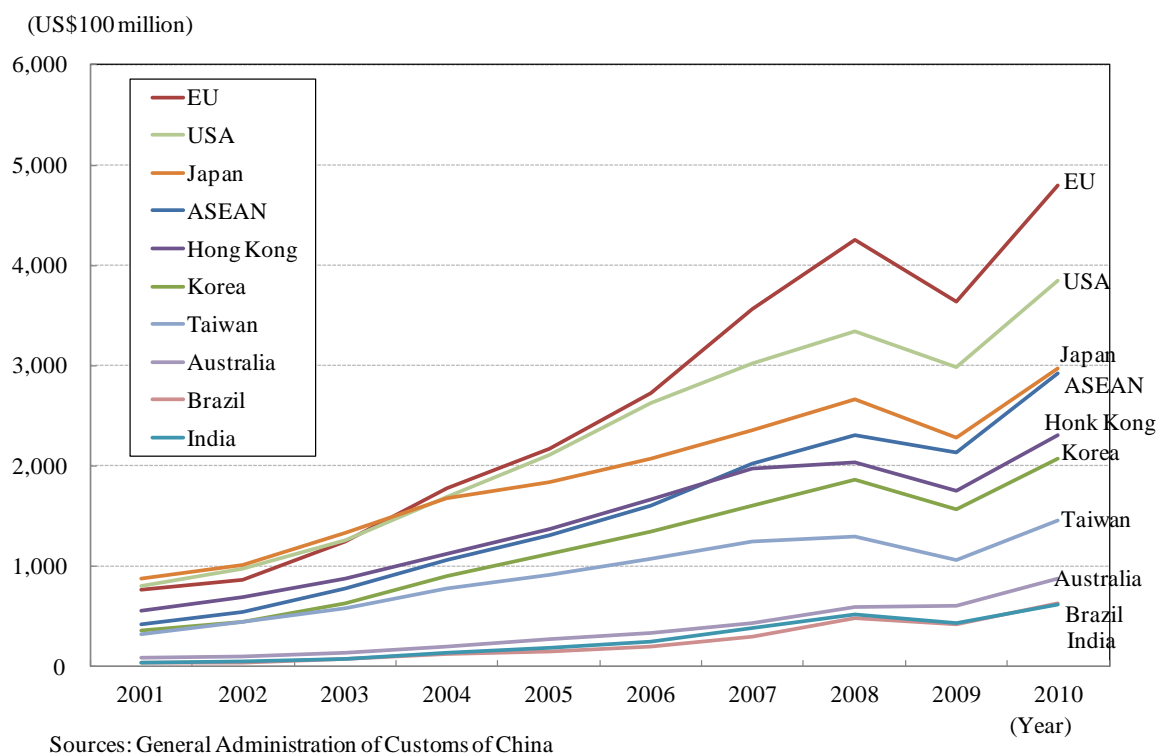
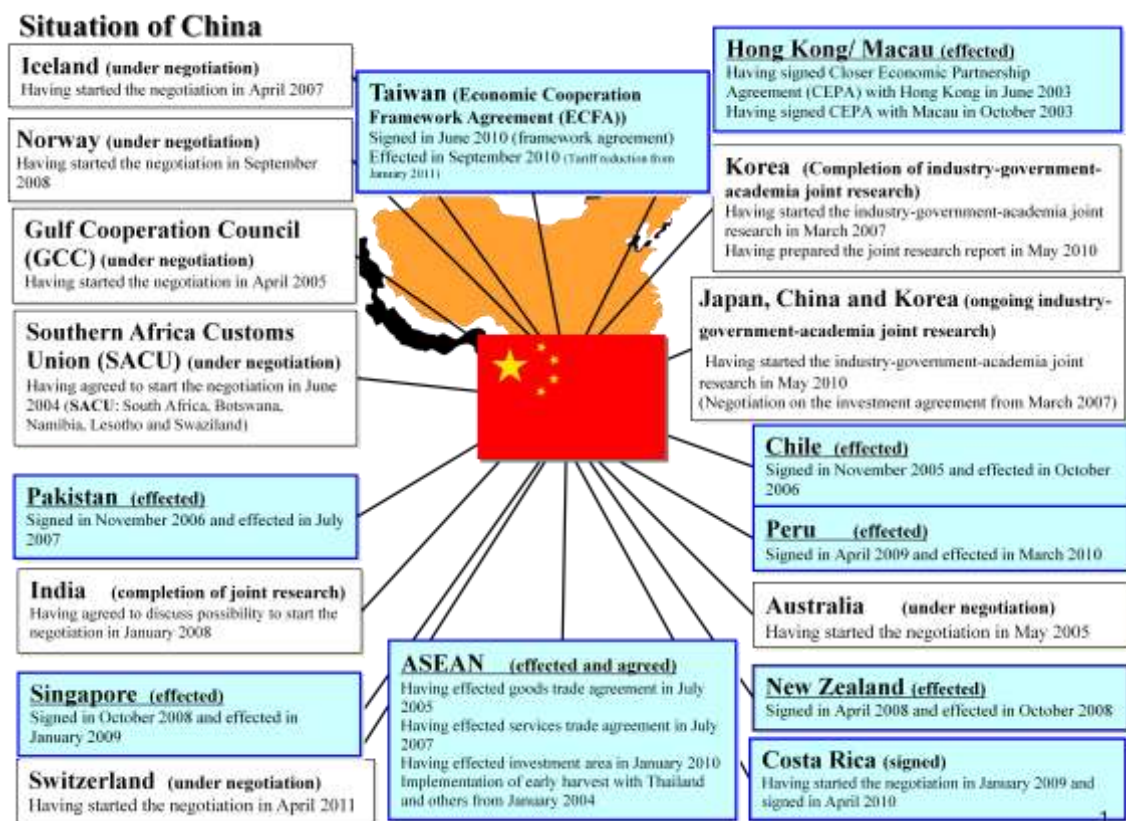


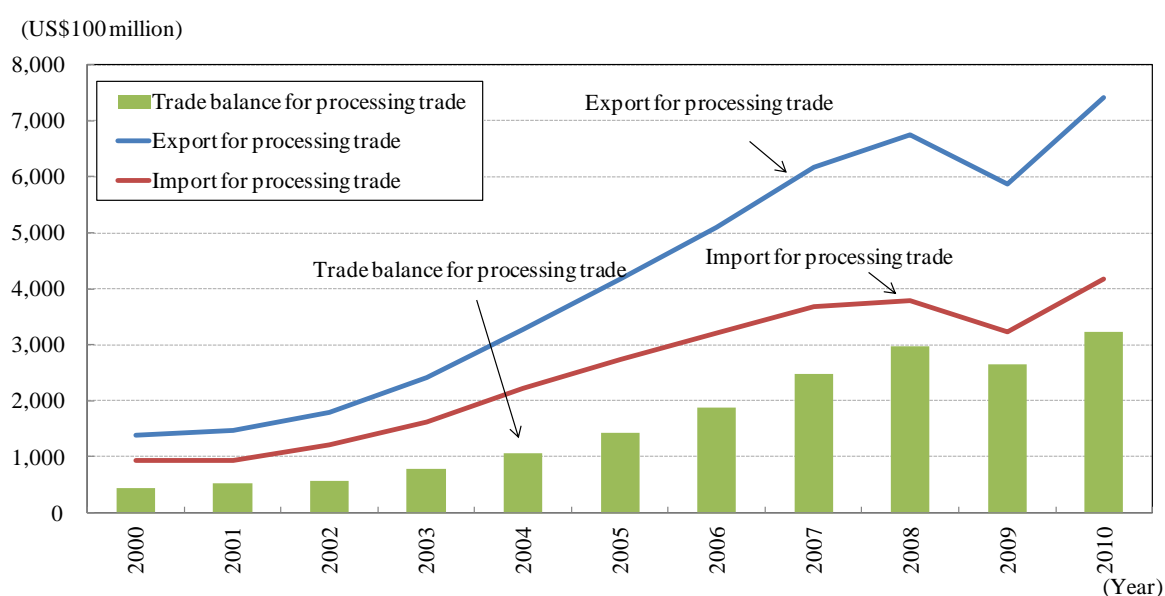
Figure 1-1-3-10 Situation of China's approach for economic partnership



Sources: Ministry of Economy, Trade and Industry of Japan

Examining the trade trend by classifying it into the “processing trade⁷²” and “ordinary trade”, in 2010, the surplus in the “processing trade” increased, but deficit in the “ordinary trade” increased (Figure 1-1-3-11 and Figure 1-1-3-12). Hike in such prices as resources caused the increase of import in the “ordinary trade”, but it was considered that expansion of the domestic demand also became its background. Examining the ratio of the processing trade in China’s export and import value, in 2010, both ratios of export and import of the processing trade decreased compared to the previous year (Figure 1-1-3-13). And the ratio of the export and import amount of the foreign companies, being a main leading figure of the processing trade of China in total trade amount, had a decline tendency after its peak in 2006⁷³ (Figure 1-1-3-14).

Figure 1-1-3-11 Changes in China’s processing trade balance



Notes:

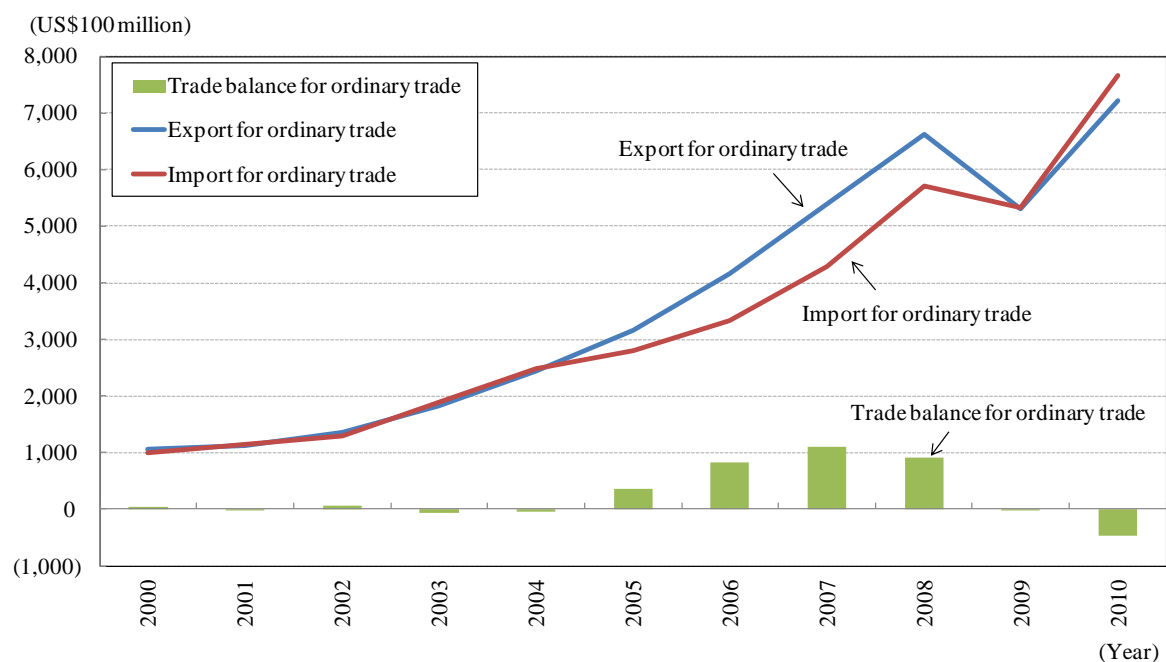
1. The amount for processing trade is a total of 2 categories of custom regime: "processing and assembling" and "processing with imported materials".
2. The processing trade accounted for 46.9% and 29.9% of the total export and import, respectively, in 2010.

Sources: General Administration of Customs of China; CEIC Database

⁷² The processing trade value is a total value of 2 categories of custom regime: “processing and assembling” and “processing with imported materials”. The “processing trade”, using parts/ intermediate goods procured from foreign countries, processing and assembling them in domestic plants and shipping the finished products abroad, forms a key of China's trade structure. The export of the processing trade accounts for approximately 50% of the total export, and the import of the processing trade accounts for approximately 30% of the total import (the year 2000 basis).

⁷³ The China government has been controlling over the processing trade since September, 2006 to restrict the export of products with large energy consumption and the products which have low technical standards. After a world economic crisis, the government took a measure to stop processing trade regulation temporarily in consideration of the influence, but, in November 2010, the government newly added 44 items including the hot rolling steel sheet to the processing trade prohibition goods based on demand of energy saving and the pollution gas discharge reduction (number of the processing trade prohibition goods was a total of 1,803 as of November 2010). The State Council government activities report of March 2010 stated that “it is encouraged to work on optimization of the utilization structure of the foreign capital and the foreign capital is input to advanced manufacturing industry, high-tech industry, modern service industry, new energy, energy saving and eco business”.

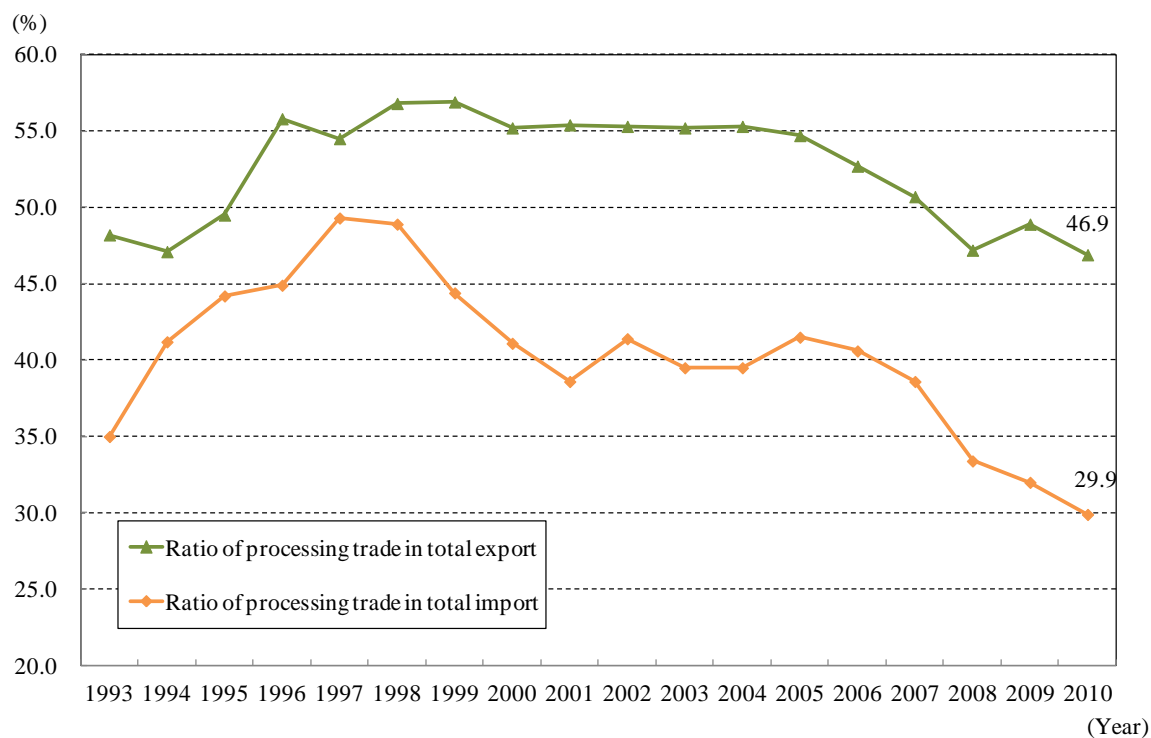
Figure 1-1-3-12 Changes in China's ordinary trade balance



Notes: The ordinary trade accounted for 45.7% and 54.9% of the total export and import, respectively, in 2010.

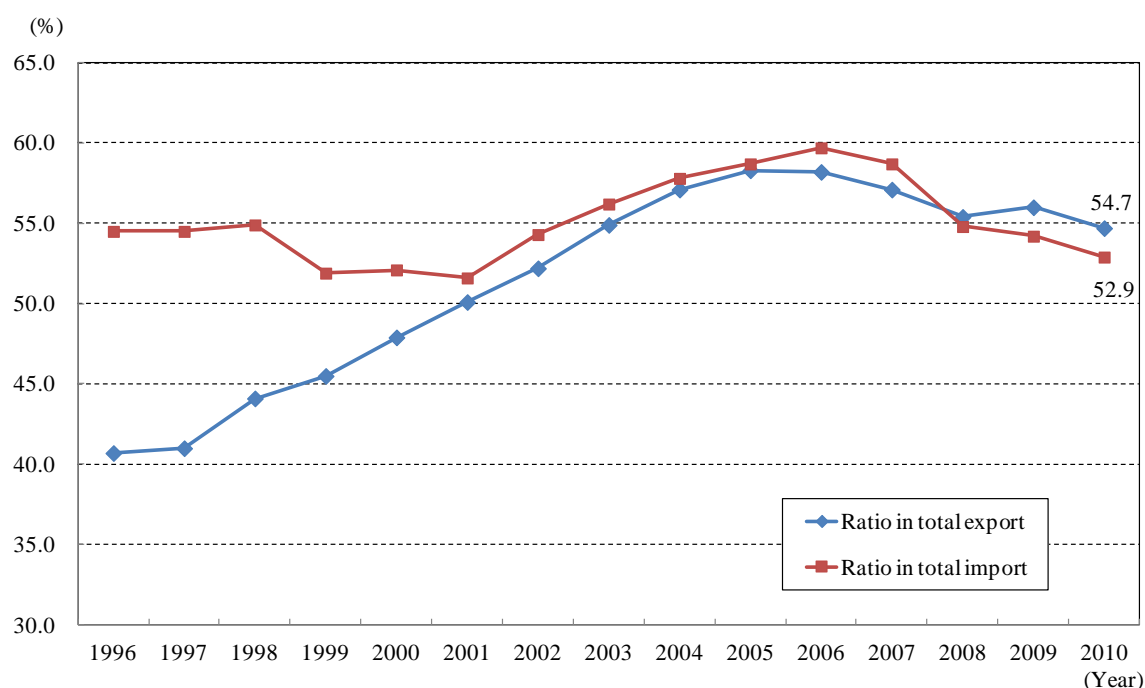
Sources: General Administration of Customs of China; CEIC Database

Figure 1-1-3-13 Changes in ratio of processing trade in China's total trade



Sources: General Administration of Customs of China; CEIC Database

Figure 1-1-3-14 Changes in ratio of foreign companies in China's total trade amount



Sources: General Administration of Customs of China; CEIC Database

(b) Changes in the labor market

In 2010, strike to demand wage increase and treatment improvement occurred in various places in China especially at factories of foreign companies in the coastal areas. In its background, there may be some factors such as labor shortage, the pay gap between the managerial class and farmer mechanics⁷⁴, the improvement of sense of rights for labors with the work contract law enforced in 2008, changes in the consciousness by the appearance of “the new generation of farmer mechanic” and rises in living costs as housing expense. “The new generation of farmer mechanics” mainly refers to farmer mechanics born after 1980. Presently, the number of farmer mechanics going away from home to work at the other places in China is 150 million, and that of the new generation farmer mechanics is 100 million which account for approximately 70% of the whole farmer mechanics population. The new generation of farmer mechanics have much higher education than farmer mechanics of the past⁷⁵. The purposes to be farmer mechanics are changed from “to earn money” to “to train oneself” and “to gain skills and technique”. The importance shifts from the economic factor to non-economic factors⁷⁶.

In China, there are large social and economic gaps between urban and rural areas which have been

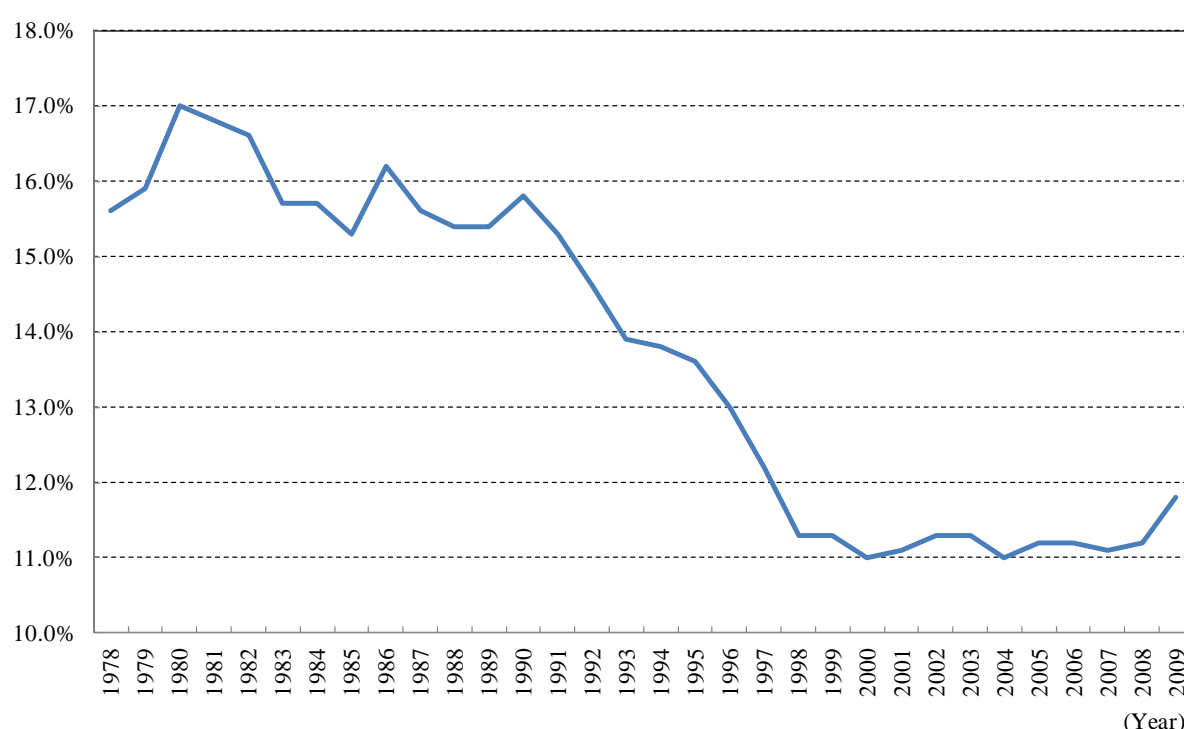
⁷⁴ This means labors with rural districts family register, working in fields of non-agricultural industry such as manufacturing, construction or service industry. A total number of the farmer mechanics was 230 million in 2009 (approximately 30% of the employed workers) and the migrant workers were 150 million.

⁷⁵ Among farmer mechanics going for work away from home, the ratio of a person having educational background higher than high-school graduate level is 23.5% altogether, but among farmer mechanics younger than 30 years old, it is more than 26%, and those of age 21 to 25-year-old age group is 31.1%. The lower the age becomes the higher the ratio rise (China National Statistics Administration 2010 [Monitoring survey on famer mechanics in 2009]).

⁷⁶ Suzuki, T. (2010), “CHUGOKU DE TSUYOMARU KOUJOU ROUDOUSHA NO CHINAGE ATSURYOKU”, (Mizuho Asia Oceania Insight, August 6, 2010, Mizuho Research Institute

divided by its family registration system and agrarian system. Although wages of farmer mechanics are rather low in a standard of urban areas, but it becomes higher wages when they use it in rural areas because prices in rural areas are very low. This condition is sufficient incentive for farmer mechanics to work in the urban areas. The existence of divided urban rural system unique to China has created the China-specific numerous “farmer mechanics” with very low wages. China’s low wage labor intensive export industry and initial growth of China’s economy has been supported by these workers. However, this kind of structure has been getting difficult to continue. Percentage of total wage in China’s nominal GDP has been largely reduced since the reform and liberalization, but it has recently turned to a rising tendency. Now, the labor structure may come to a turning point (Figure 1-1-3-15).

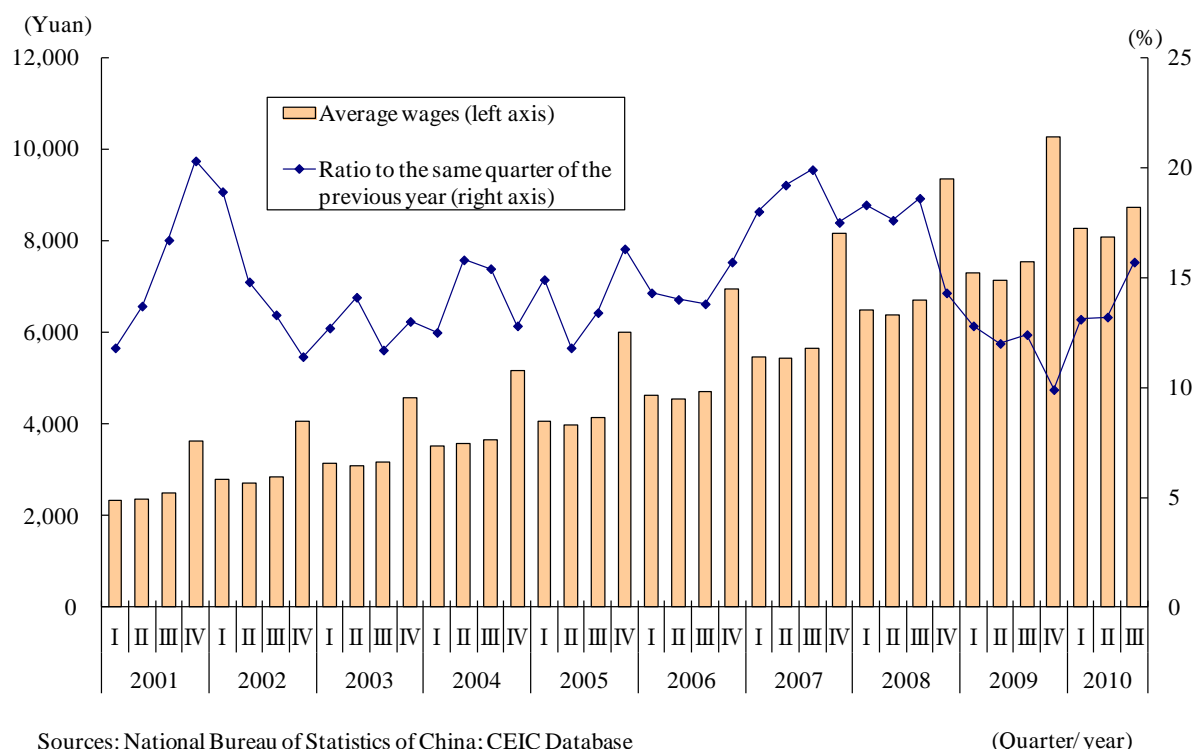
Figure 1-1-3-15 Changes in ratio of total wage against China’s nominal GDP



Sources : National Bureau of Statistics of China; Ministry of Human Resources and Social Securities of China; CEIC Database

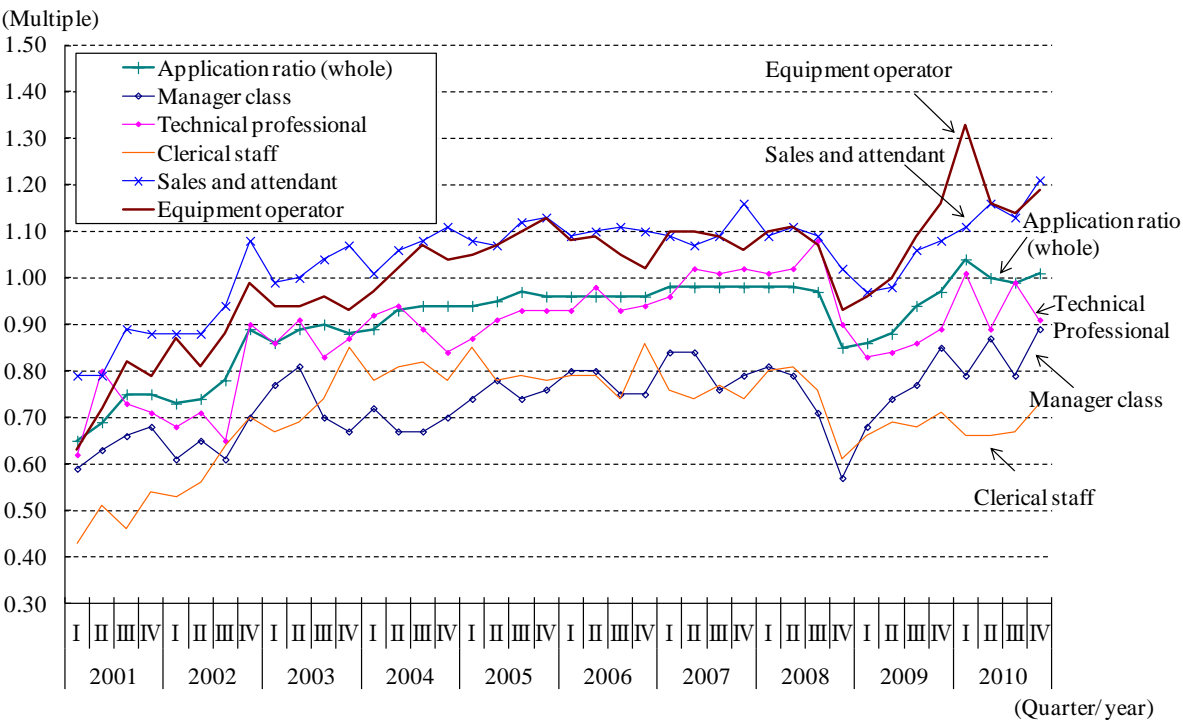
Actually, in 2010, both average wages and minimum wages rose greatly. The climb rate of average wages increased from the 9.9% increase over the same period of the previous year in the fourth quarter of 2009 to 15.7% in third quarter of 2010 (Figure 1-1-3-16). As for the minimum wages, 30 among 31 regions (provinces, directly governed cities, and autonomous districts) in mainland China raised the legal minimum wages. The average increase rate of 2010 was approximately 24%. The 12th Five-Year Plan (from 2011 to 2015) raised the annual average growth rate of the income expansion from 5% of the previous 5-year plan to 7% (Refer to “ (2) (B) “The 12th Five-Year Plan”; aiming at enhancement more qualitative than quantitative expansion”). It also aimed to raise the minimum wages to an average of 13% a year. The trend of the pay rise in China is more likely to be continued.

Figure 1-1-3-16 Changes in average wages in China



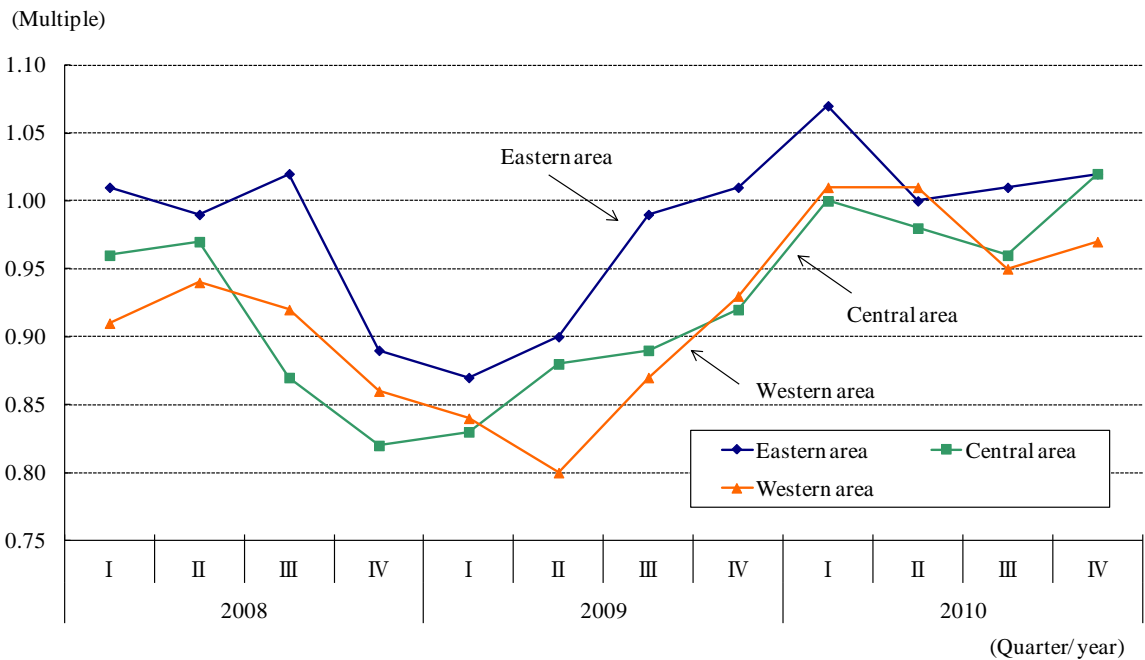
The labor supply-and-demand situation is also tight. As for the job opening-to-application ratio of the first-quarter of 2010 was 1.04, and the number of the job opening exceeded the number of the jobseekers for the first time since 2001 (Figure 1-1-3-17). Examining trend of the job opening-to-application ratio according to the types of job, the labor supply-and-demand was remarkably tight particularly in “equipment operators” which involved large number of the industrial workers. Background of this situation is considered to be increase of demand for the factory workers not only in coastal areas but also in local areas derived from the government’s re-development projects and the “4 trillion Yuan” domestic demand stimulus policy. Examining changes in the job opening-to-application ratio according to regions, in 2010, it increased not only in the eastern area (coastal areas), but also the central and western areas (inland area) (Figure 1-1-3-18).

Figure 1-1-3-17 Changes in application ratio (by jobs) in China



Sources: Ministry of Human Resources and Social Security; CEIC Database

Figure 1-1-3-18 Changes in application ratio (by areas) in China

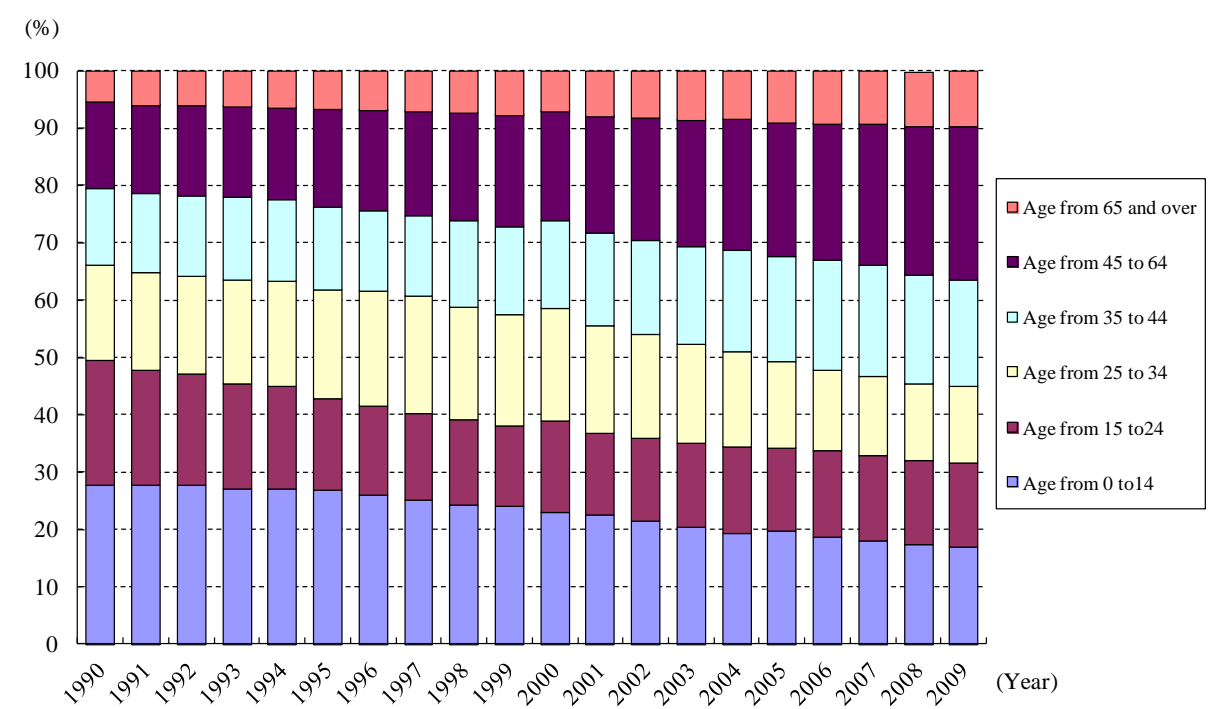


Sources: Ministry of Human Resources and Social Security of China; CEIC Database

While percentages of “age 15 to 24” and “age 25 to 34” groups of population to total population

were decreasing, percentages of “age 45 to 64” and “age 65 and older” groups were increasing by the influence of one-child policy conducted in China from 1979 (Figure 1-1-3-19). The labor supply-and-demand may be affected by trend of the economy, however, considering development of such a low birthrate and aging, the tight labor supply-and-demand seems to continue in the future.

Figure 1-1-3-19 Changes in shares of age groups in the total population of China



Sources: National Bureau of Statistics of China; CEIC Database

In such a situation, China is considered to accelerate industrial advancement by shifting its resources from labor-intensive industry to high value-added industry and technology intensive industry.

(c) The top priority in 2011 is inflation control

The China’s economy was rapidly restored after the world economic crisis by implementation of the large-scale economic measures and the monetary easing policy by the government. However, such a measure and policy could not be continued for a long term, and it caused various problems such as the surge of the overheat feeling of the economy, concern for real property bubble (Figure 1-1-3-20), the debt increase in enterprises related to local government⁷⁷, excessive production capacity. Therefore, in

⁷⁷ The government of China published “4 trillion Yuan” domestic demand expansion policy and encouraged the local government to expand the infrastructure investment. The local government piled up investment projects competitively each other, but the financial assurance from the central government to the local government was poor. The local governments, which suffered from a chronic financial difficulty, covered the lack of financial resources with the land disposal income (the advantage which occurs when land acquired from farmers was sold to real property developers in higher prices) after the introduction of the tax separate system in 1994. Local governments increasingly depended on the “local government financing platform” (a fund procurement platform established by local government to implement the infrastructure projects). The local government input the land disposal income to the “local government financing platform”

2010, the government was pressed to control the economy overheat and to take measures responding to these problems. People's Bank of China tightened the money market after 2010 (Figure 1-1-3-21). The government proposed real estate transactions control measure⁷⁸, planed the administrative reinforcement of enterprises related to local government⁷⁹, and strengthened guidance for the excessive production capacity in some types of industry⁸⁰. By effect of such policies, the extended tempo of the economy in China showed a slow downswing from mid-2010. However, a fear for the economy overheat rose again as the inflation rate increased from the autumn of 2010, and property prices rose again.

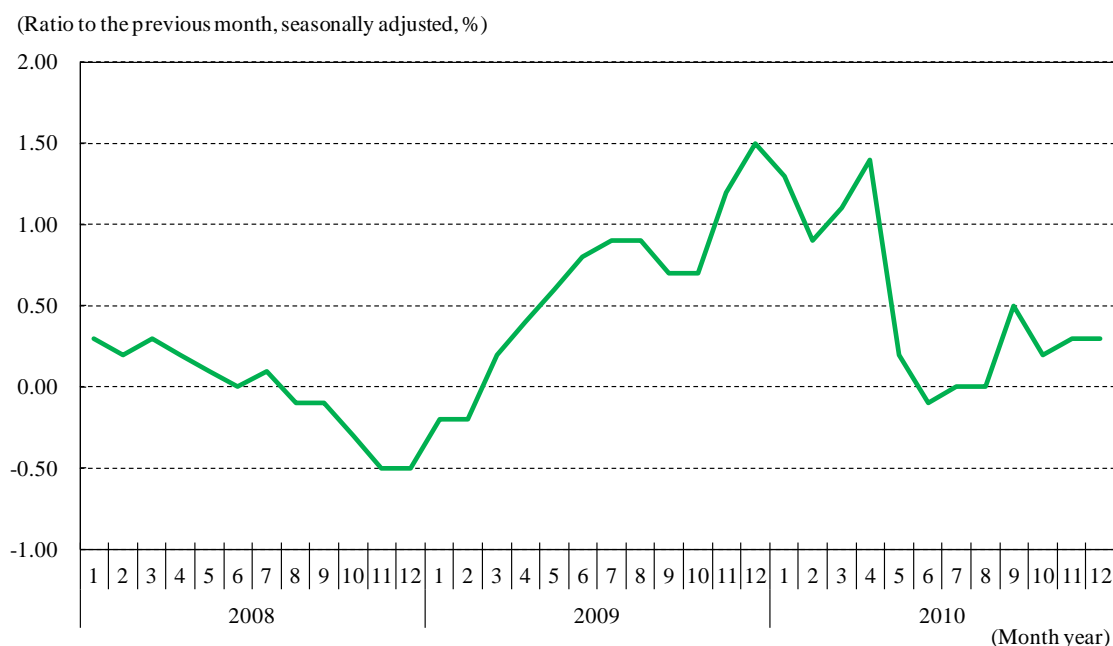
as capital, and the “local government financing platform” escalated projects to several times by debt issuance and borrowing from the banks and carried out the urban projects. “The banking supervision and management executive committee” stated that return of the 1,760 billion yuan, equal to 23% of 7,660 billion Yuan that was the bank lending balance to the “local government financing platform” (as of the end of June, 2010).

⁷⁸ The Chinese government proposed the real estate transactions control measures including the raises in down payment ratio of the home loan and bank loan interest rate in April and September 2010. However, as the property prices increased again afterward, the government proposed measures to make clear the responsibility of the local government for the property price control in January, 2011. In addition, in cities of Shanghai and Chongqing, real estate tax (equivalent to the property tax of Japan) was introduced experimentally from January 28. In this way, real estate transactions control was proposed in succession.

⁷⁹ Ministry of Finance, National Development and Reform Commission, People's Bank of China and Banking Regulatory Commission required the local governments to make their platform enterprises to totally arrange their debt consolidation in August, 2010. Provincial governments (including autonomous districts and directly governed cities) reported data of the debt consolidation by December 10, 2010, and the Ministry of Finance and other organizations were discussing the establishment of a debt statistics reporting system on the financing platform enterprises, and a debt scale control and risk alarm system for the local governments, while they were confirming the reported relating data. (“People's Daily”, (Japanese edition), March 1, 2011).

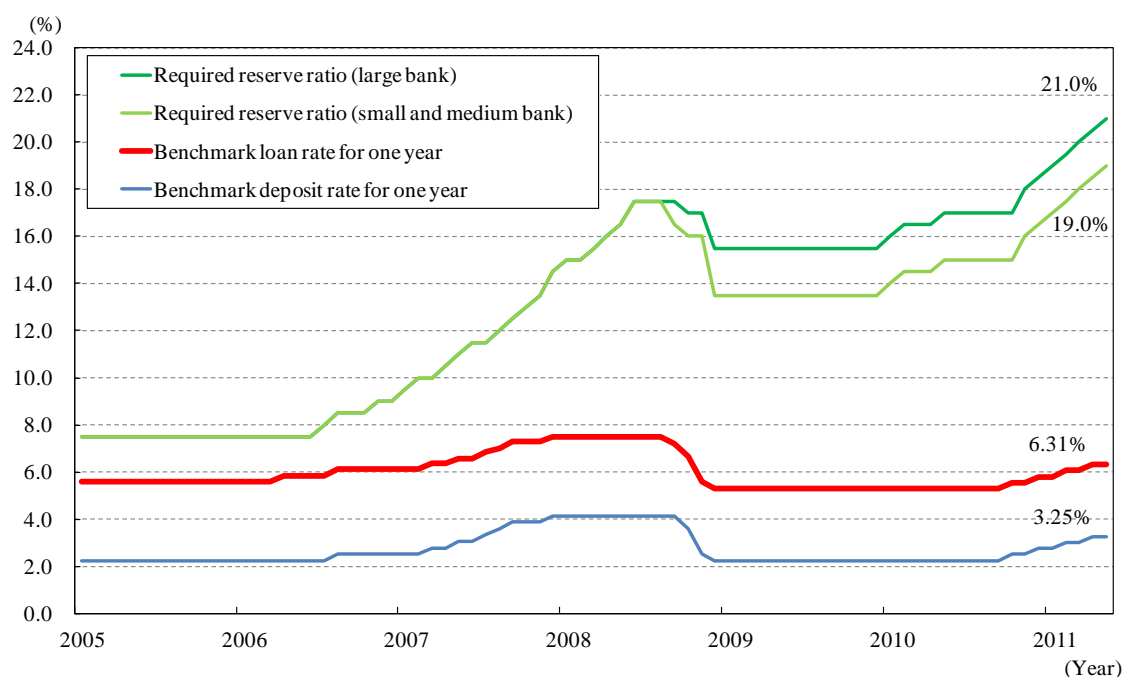
⁸⁰ Adjustment for the excessive capacity of some industries to which need of restructuring was always recognized, became the urgent task by the activation of monetary easing and the public works project after the world economic crisis. Therefore, the Chinese government issued notification to industry such as steel, cement, coal and electricity in April, 2010 to integrate and abolish small and inefficient facilities and to address improvement of the industry-wide production efficiency. Additionally, in May, the industrial information department showed the curtailment target of 18 types of industry including steel, cement, glass and paper manufacturing to curtail their production facilities, and in August, they published a list of 2,087 companies to abolish their timeworn excessive production facilities.

Figure 1-1-3-20 Change in growth rate of real estate price index in major 70 cities of China



Notes: The government of China has not published the real estate price index in major 70 cities since January 2011.
Sources: National Bureau of Statistics of China; CEIC Database

Figure 1-1-3-21 Changes in China's monetary policies

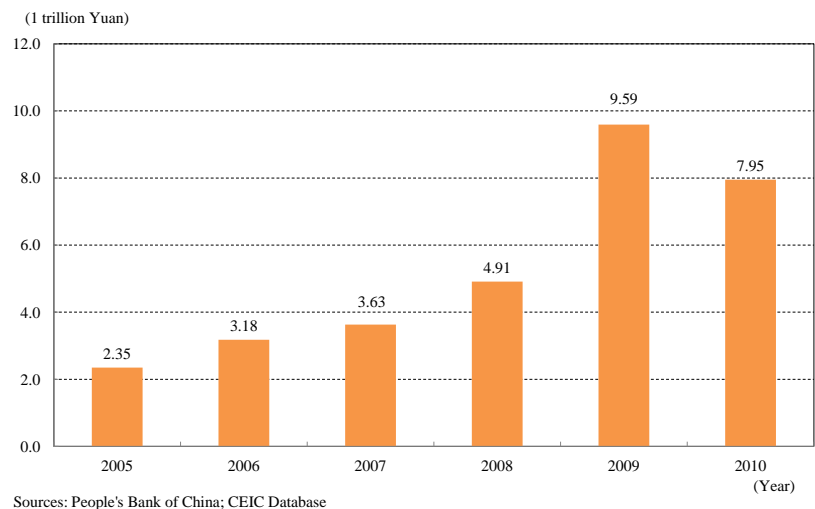


Sources: People's Bank of China; CEIC Database

There was excessive liquidity in the background of such overheating of the economy. The net increase of new loans in 2010 was 7,950 billion Yuan. The amount decreased from the amount in the previous year (9,590 billion Yuan), but exceeded the government target of 7,500 billion Yuan in 2010 (Figure 1-1-3-22). The money supply (M2) also increased to 72,600 billion Yuan or 19.7% increase over the end of the previous year. Marshall's K ($M2 / \text{nominal GDP}$) was changing at a level

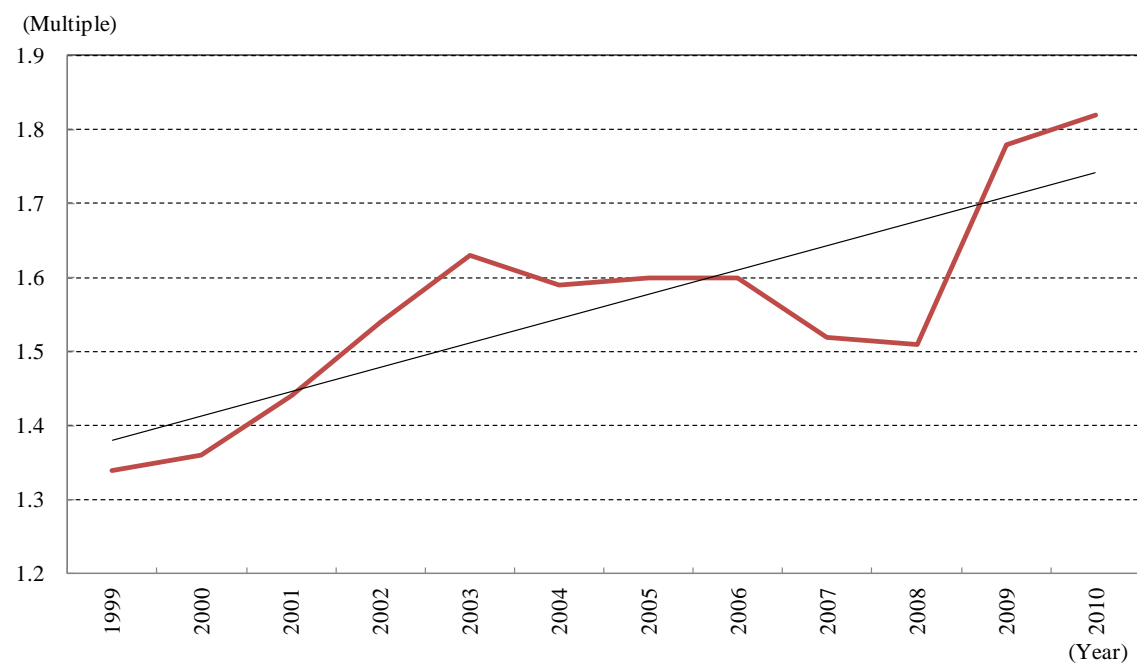
exceeding the trend line, and this suggested that the funds supply was excessive in comparison with the economic scale (Figure 1-1-3-23). In addition, by expansion of the surplus in the current account and expansion of net inflow in capital and financial account, the foreign currency reserves at the end of 2010 reached the world’s largest US\$2,850 billion (Figure 1-1-3-24)⁸¹. The foreign currency reserves continued to increase afterwards and, at the end of March 2011, exceed US\$3,000 billion. While the foreign currency inflow largely increased in this way, People’s Bank of China implemented foreign exchange intervention to control the level of Yuan market price, and large quantity of liquidity was supplied to the money market.

Figure 1-1-3-22 Changes in net increase of new loans



⁸¹ About foreign funds inflow, State Administration of Foreign Exchange of China published on February 17, 2011, that the preliminary calculation amount of the short-term speculative net funds inflow, which flowed into China from the foreign countries in 2010, was US\$35.5 billion. State Administration of Foreign Exchange announced that the percentage of the short term speculative funds among the increased amount of the foreign currency reserves in 2010 remained at 7.6% (“Nippon Keizai Shinbun” (electronic edition) February 17, 2011).

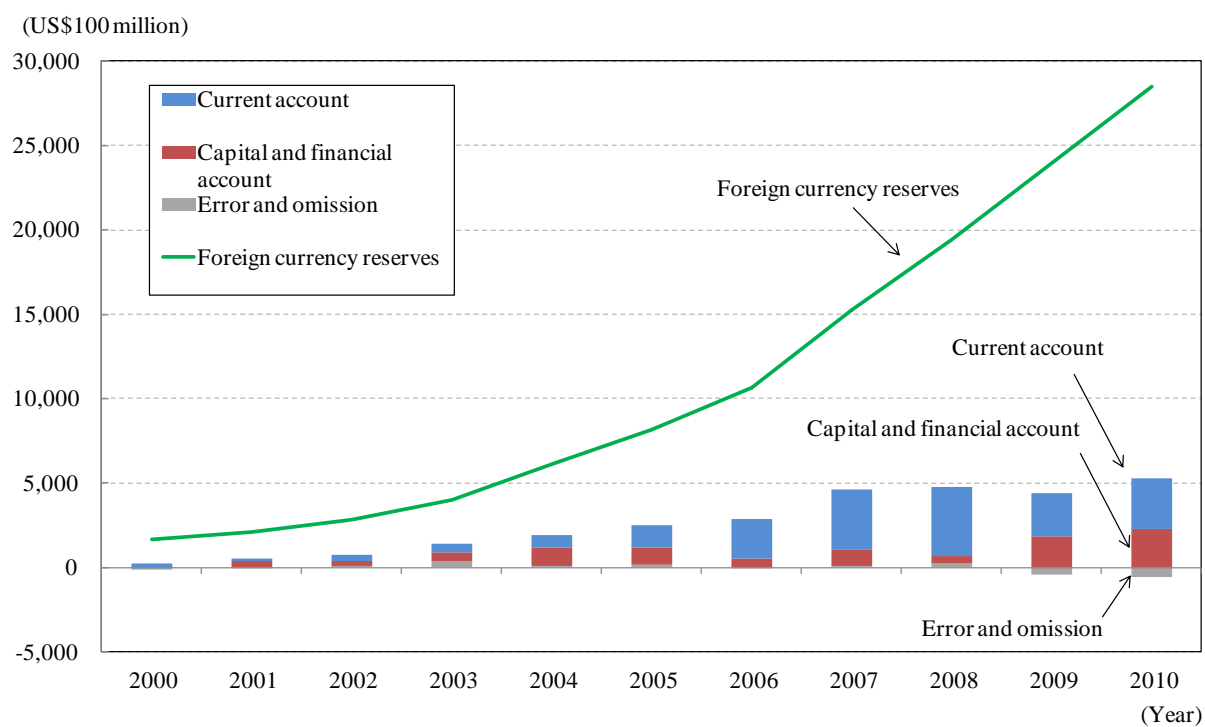
Figure 1-1-3-23 Changes in Marshall's K in China



Notes: Marshall's K = Money supply (M2) / Nominal GDP

Sources: National Bureau of Statistics of China; People's Bank of China; CEIC Database

Figure 1-1-3-24 Changes in China's international balance of payments

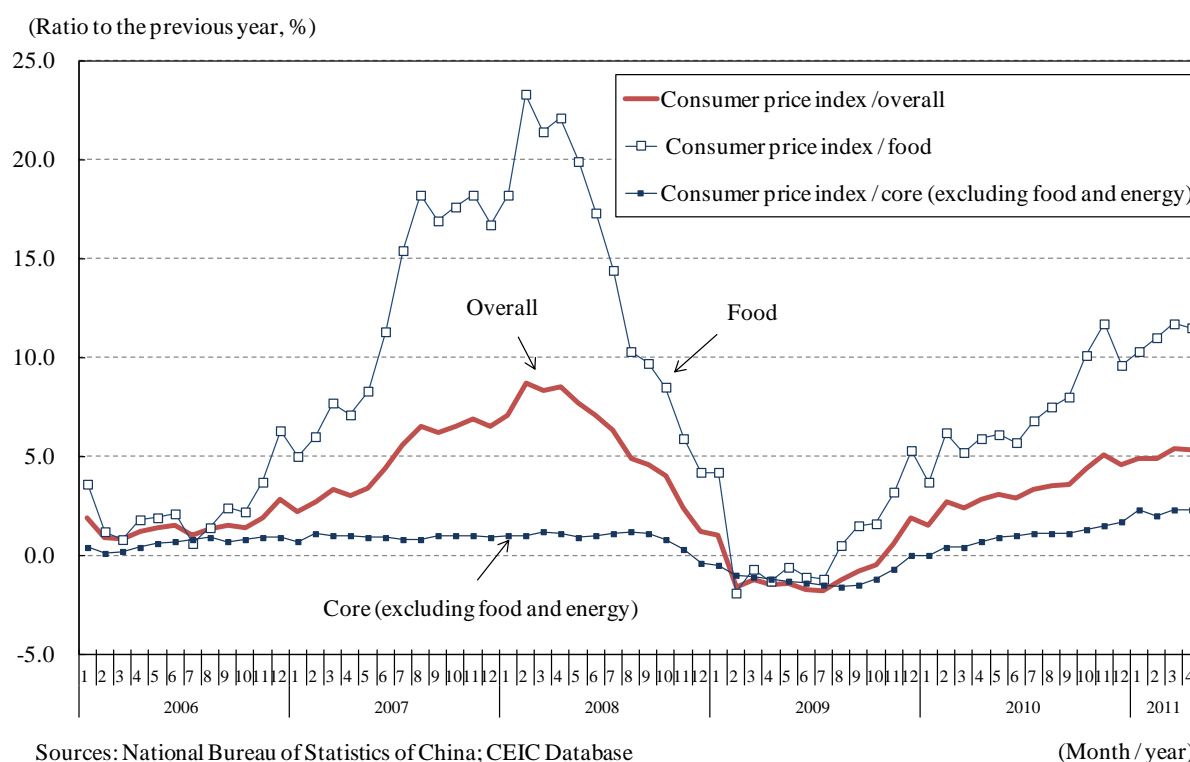


Sources: State Administration of Foreign Exchange of China; CEIC Database

On the inflation rate, the growth rate of consumer price index (compared with same month of the

previous year) exceeded the government target (3%) in late 2010; particularly, climb rate of “food” exceeded 10% (Figure 1-1-3-25). The causes of the rise in food price were pointed out to be unreasonable weather as well as the funds inflow from the money market being accompanied by abundance of the capital infusion. “Notification of the State Council on stabilizing the general level of consumer prices, and guaranteeing basic lives of the people” consisted of 16 items including increase of agricultural production, cutting in the cost of distribution, as well as future price control was issued on November 20, 2010. In addition, after the end of 2010, imported inflation pressure strongly rose due to remarkable rises in international commodities prices such as crude oil.

Figure 1-1-3-25 Changes in consumer price index in China

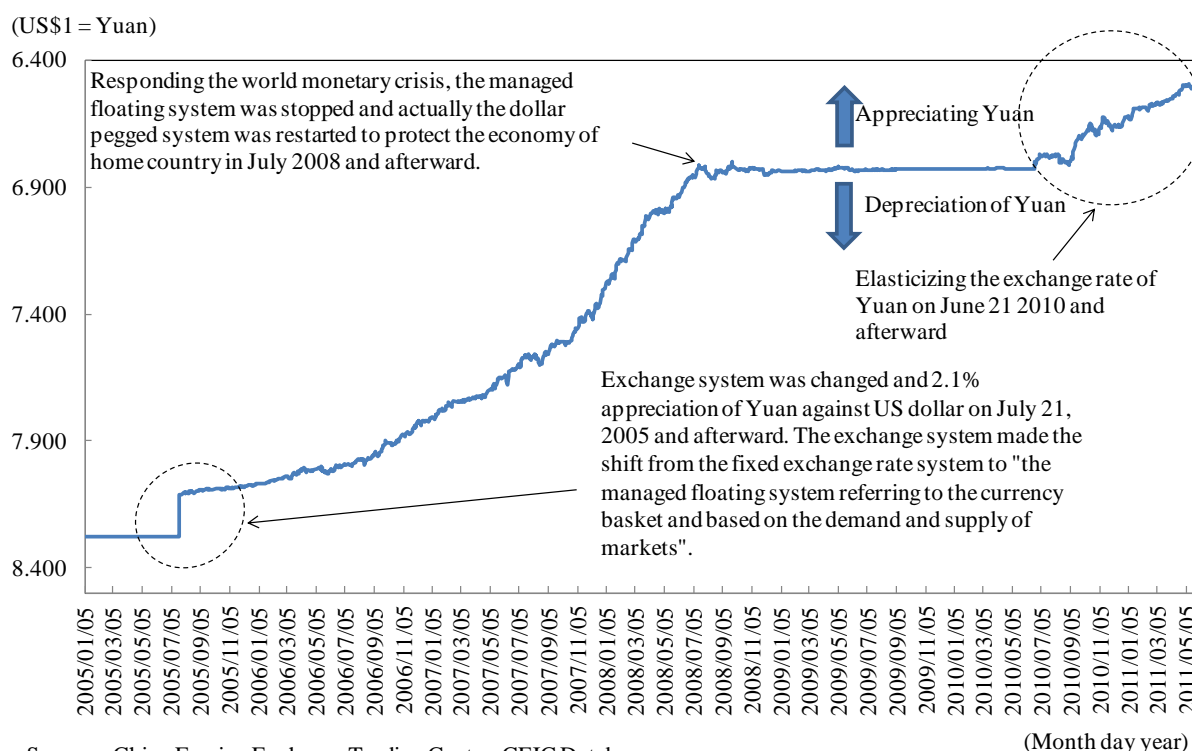


In such a situation, the Central Economic Work Conference held in December 2010 announced to switch the monetary policy posture from conventional “adequate monetary easing” to “moderateness (neutral)” and confirmed to switch the policy in direction of the monetary tightening. In addition, in the 4th Meeting of the 11th National People’s Congress held in March, 2011, Premier Wen Jiabao emphasized in “the Government Activities Report” that inflation control was a top priority problem for this year. The current task of the China’s economy is to be in tune with the stable growth railroad track while gradually decelerating economic growth to cruising speed. Attention is drawn that how the government and People’s Bank of China implement the “Operation to Exit” from the heating economy. In addition, after the Yuan exchange rate elasticity⁸² in June, 2010, the Yuan market prices continued to

⁸² People's Bank of China announced a statement in June 2010 that the Bank further implemented reformation of the Yuan exchange rate formation mechanism and to raise the elasticity of the exchange rate of Yuan. People's Bank of China expressed that elasticity of Yuan should follow the reformation of Yuan in

rise gradually⁸³. However, while the import inflation pressure caused by remarkable rises in international commodities prices such as crude oil continues, attention is drawn that how the raise in Yuan exchange rate is started to be accelerated (Figure 1-1-3-26).

Figure 1-1-3-26 Changes in exchange rate of Chinese Yuan against US dollar



(2) The challenge for China's economy, "Transfer to consumption-led economic growth"

(A) Transfer from investment/export-led economic growth to consumption-led one is necessary

Recently, China achieved high economic growth by "investment" as a main engine (previously shown Figure 1-1-3-3). In addition, it continued double-digit growth from 2003 through 2007 with adding "export" as another engine. As discussed in the Section 1.1, China's high growth depending on the "investment" and "export" before the world economic crisis was backed by United States's over-consumption which played a leading role in the world economy.

However, due to the world economic crisis, the composition changed greatly, and the world economy has been still in an unstable state. For the sustainable development of China, the change of the economic structure is necessary towards the domestic demand-driven economic growth, in other words, the consumption-led economic growth, while pressure to raise Yuan becomes higher, and labor

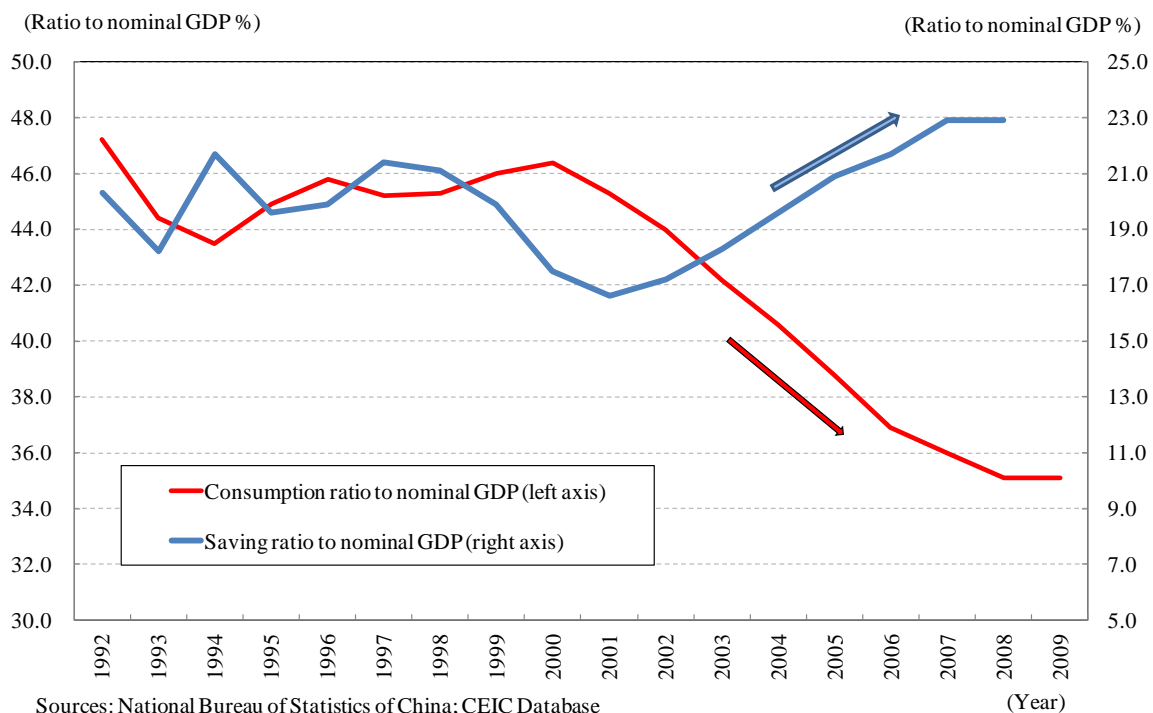
2005, and the Yuan should be adjusted within a fluctuation range per day of plus or minus 0.5% of the standard value (middle value), referring to the currency basket. It also stated that currently there was no basis to up-value the Yuan largely. Yuan reformation in 2006 implemented initial up-value of 2.1% and in 3 years afterward Yuan value increased approximately by 20% against US dollar. But the initial fixed up-value of Yuan was not implemented in this time's reformation.

⁸³ The climb rate of the Yuan against dollar in 2010 was 3.5%, and the record high of the climb rate per year was 6.6% in 2008.

cost continues increasing.

While China's dependence on "investment" and "export" for the economic growth becomes higher, the dependence on "consumption" decreases. The ratio of saving of households to nominal GDP increases, with uneasiness to social security⁸⁴, while the ratio of consumption of households to nominal GDP decreases (Figure 1-1-3-27). The urbanization rate of China was 17.9% in 1978 when the reformation and opening began, but increased to 49.7% in 2010 (Figure 1-1-3-28). Gaps between regions (Figure 1-1-3-29) and gaps between urban and rural areas (Figure 1-1-3-30) were widening while the urbanization progressed. Recently in China, social structures and systems are unable to catch up the economic development speed, and various social contradictions such as widening economic gaps between urban and rural areas, un-developed welfare program systems e.g. social security, medical and residential environment, and the escalation of environmental issues are beginning to emerge around people's lives.

Figure 1-1-3-27 Changes in consumption tendency of household in China



⁸⁴ As the base of former social security system of China collapsed by state-owned enterprise reformation, the government in 1997 established a nationwide social security system. But the percentage of the social insurance member is low, and it is yet in a transitional phase.

Figure 1-1-3-28 Changes in urbanization rate in China

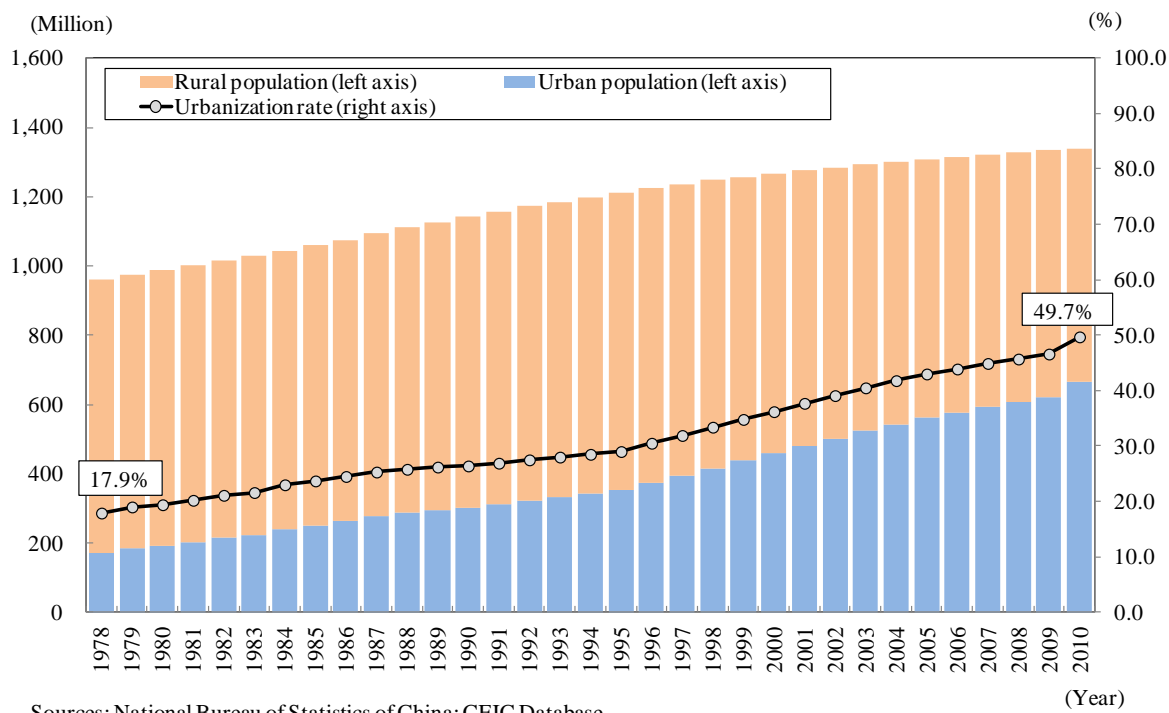


Figure 1-1-3-29 Nominal GDP per capita by areas in China (2009)

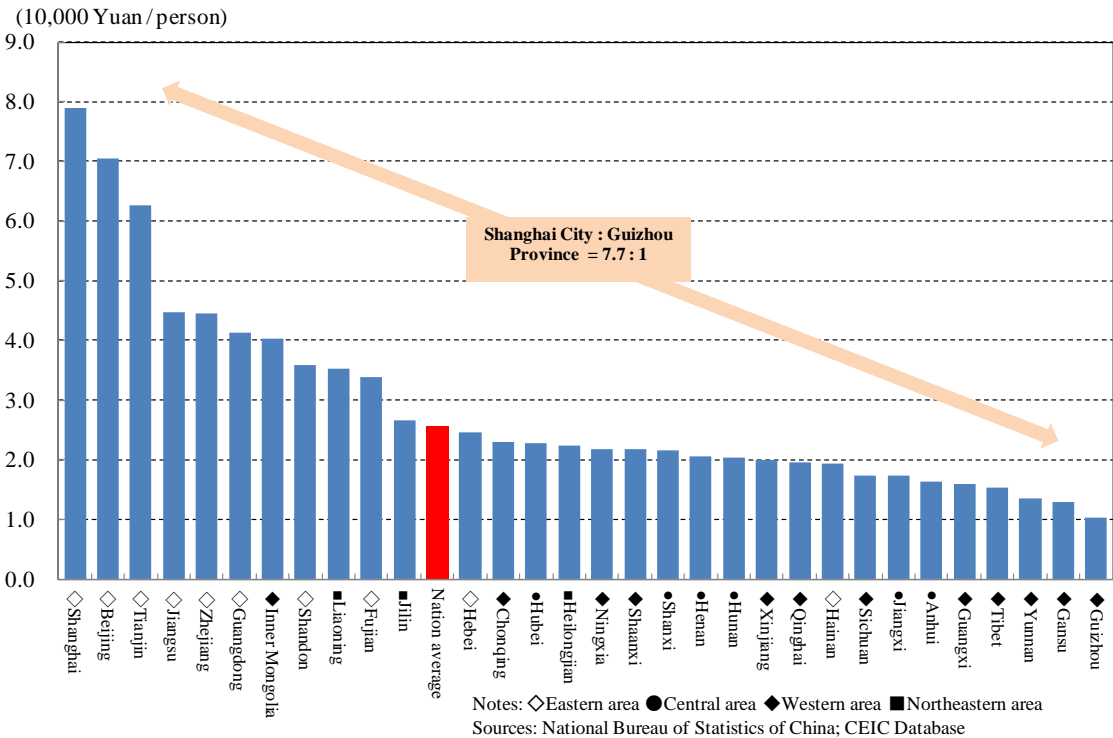
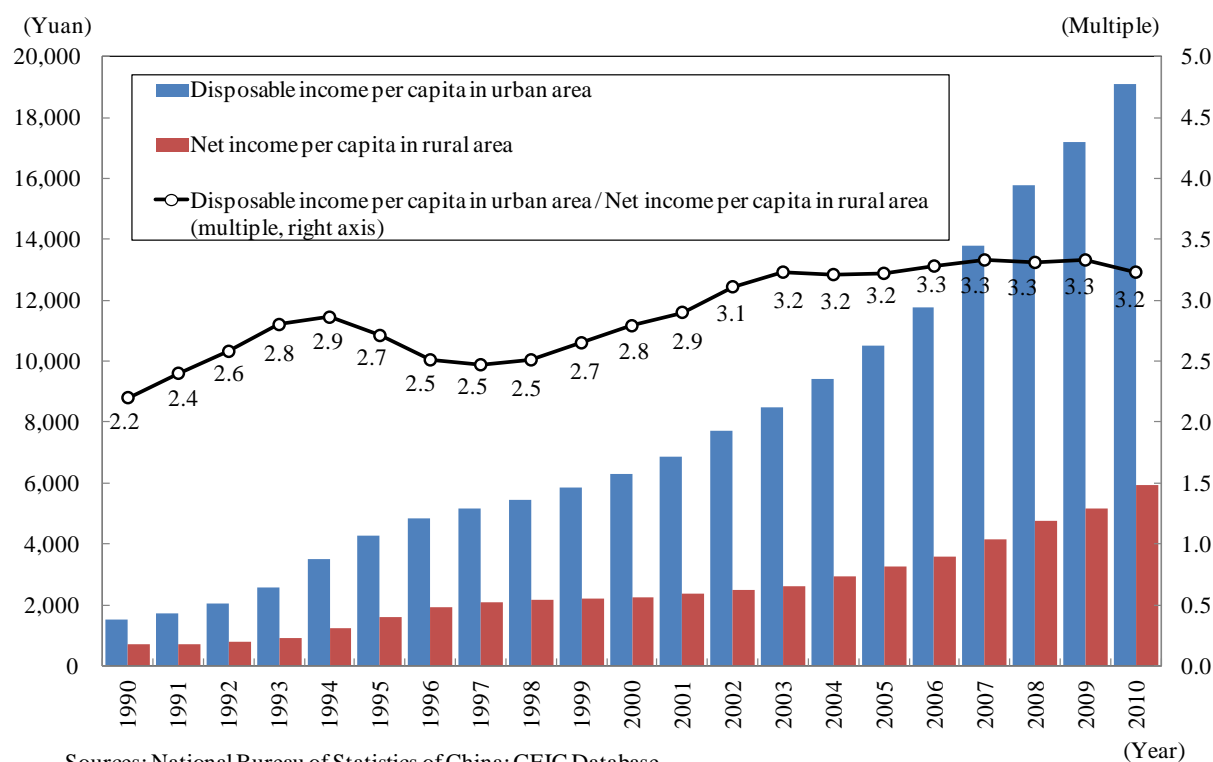


Figure 1-1-3-30 Changes in income gaps between urban and rural areas in China

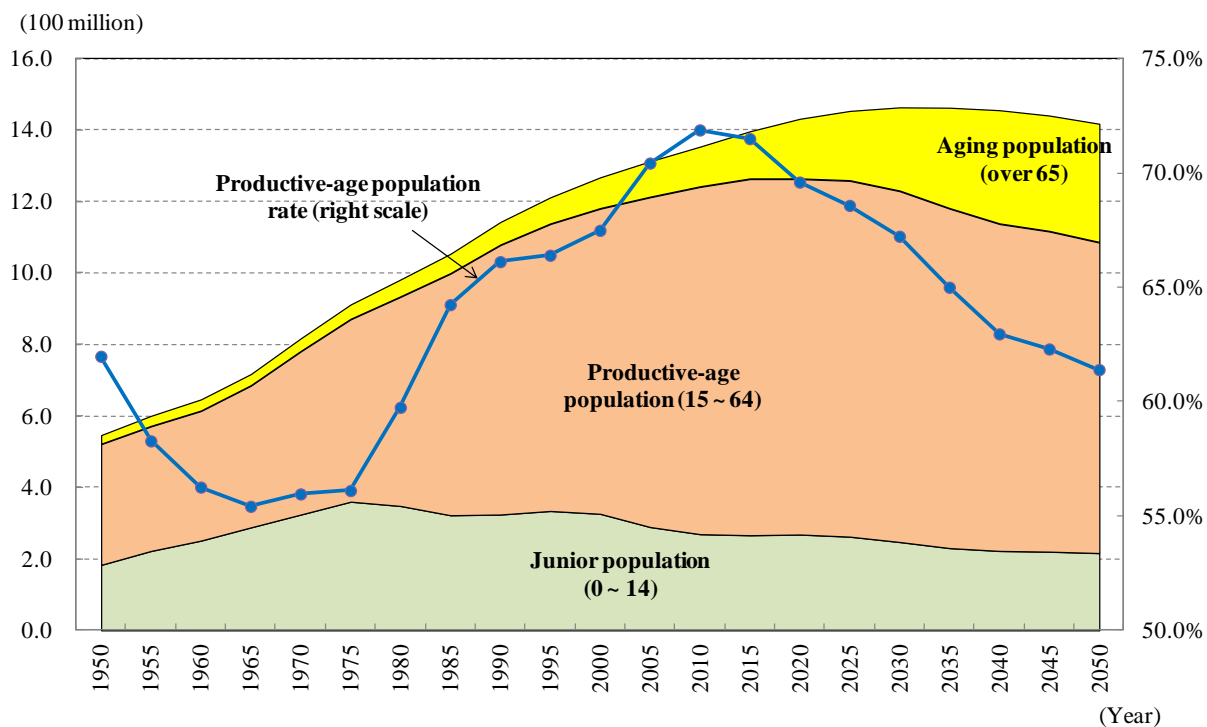


The Hu Jintao/ Wen Jiabao government raised a basic economic policy called realization of “the harmonious society” by transferring the economic development mode, and aimed at the transfer to a) balanced growth of investment, export and consumption; b) balanced growth of 1st, 2nd and 3rd industry; and c) from the “extensive type” economy depending on quantitative expansion to “intensive type” economy depending on the improvement of productivity, and at the same time, planned reduction of farmer’s burden and betterment of the social welfare (Table 1-1-3-31). However, such action is still left incomplete, and from the viewpoint of sustainable growth of China in the future, it is urgently required to accelerate the transfer of the economic development mode, to reduce the domestic economic gaps and to develop the domestic demand-driven growth, as the rapid development of low birthrate and aging is predicted in the future (Figure 1-1-3-32).

Table 1-1-3-31 Basic policy of China’s economic measures

(1) Converting the demand structure
Converting the type of growth from one that mainly driven by investment and export to growth that driven also by consumption
(2) Converting the industrial structure
Converting the type of growth from one that mainly driven by secondary industry (industry) to growth that well balanced among primary (agriculture), secondary (industry) and tertiary (services) industries
(3) Converting the production types
Converting the production types from “extensive” which mainly depends on “quantitative increase of input” such as labor, capital, resources to “intensive” which depends on “enhancement of productivity” such as scientific technology improvement, workers’ skills and capability building and innovation of management

Figure 1-1-3-32 Changes in population composition in China



Sources: UN "World Population Prospects"

(B) “The 12th Five-Year Plan”; aiming at qualitative enhancement rather than quantitative expansion

The 4th Meeting of the 11th National People’s Congress (NPC) held on March 5 to 14, 2011 adopted the 12th Five-Year Plan (from 2011 through 2015). The 12th Five-Year Plan, along with the above-discussed basic economic policy (Table 1-1-3-31), focused on a) making the acceleration of transfer in the economic growth mode as a top priority; b) promoting the reformation in every field; and c) improving people’s livelihood. The target of the real GDP growth rate for the next 5 years was decided at an average of 7% per year, but this was a lower level than 7.5% and 11.2% which were initial target of the 11th Five-Year Plan and the actual performance carried out respectively. It made clear that the Chinese government aimed at the qualitative enhancement rather than the quantitative expansion of the economic growth (Table 1-1-3-33).

Table 1-1-3-33 Main targets of China's 12th Five-Year Plan

Classification	Indicator	Results in 2010	Targets in 2015	Average annual growth rate (the blue portions are accumulated values in 5 years)
Economic growth	Domestic gross production (GDP) (1 trillion Yuan)	39.8	55.8	7.0%
Economic structure	Ratio of added value by service industry to GDP (%)	43.0	47.0	4% points
	Ratio of R&D expenditure to GDP (%)	1.8	2.2	0.4% points
	Ratio of urbanization (%)	47.5	51.5	4% points
Population, resources and environment	National total population (10,000)	134,100	Less than 139,000	Less than 7.2‰
	Ratio of non-fossil fuel to primary energy consumption (%)	8.3	11.4	3.1%
	Energy consumption per unit of GDP (%)			▲16%
	Emission volume of CO ₂ per unit of GDP (%)			▲17%
	Total emission volume of main pollutants (%)			▲8~10%
	Ratio of forest area (%)	20.36	21.66	1.3% points
People's lives	Disposable income per capita of household in urban area (Yuan)	19,109	Over 26,800	Over 7%
	Net income per capita of household in rural area (Yuan)	5,919	Over 8,300	Over 7%
	Registered unemployment ratio in urban area (%)	4.1	Less than 5.0	
	Number of newly employed workers in urban area (10,000)	5,771(Accumulated for 5 years)	4,500(Accumulated for 5 years)	45 million
	Number of persons covered by basic endowment insurance in urban area (100 million)	2.57	3.57	100 million
	Participation rate of basic medical insurance (3 items) in urban and rural areas (%)			3.0%
	Construction of safeguard housing in urban area (10,000 cases)			36 million

Notes:

1. Gross domestic product (GDP) and disposable income per capita of household in urban area are nominal values and average annual growth rate is real value.

2. Participation rate of the urban and rural basic medical insurance (3items) is population rate of participant of urban workers basic medical insurance, urban household basic medical insurance and new type rural collaboration medical insurance to the total national population at the end of the years.

Sources: Data from various websites

In the 12th Five-Year Plan, growth rates of “income per person of urban resident” and “net income per person in rural area” were decided both at “average 7% per year or more” and a target was adopted

to increase them more than the growth rate of the real GDP of average 7% per year. The line of policy was made clear to increase income, which was necessary to expand consumption. Additionally, targets were set to increase the weight of the resident income in the distribution of the national income and to further enhance the social security.

Meanwhile, the energy saving and resources/ environmental protection were also considered to be an important issue as a part of the transfer of the economic development method. Policy was declared to strengthen important mineral resources conservation and mining management and targets were shown to reduce 16% of the energy consumption per unit GDP and 17% of CO₂ emission in 5 years from 2011 through 2015.

In addition, as strategic industry intending to achieve industrial advancement, seven industrial areas namely a) energy saving and environmental protection, b) next generation information technology, c) biotechnology, d) high-end production facility, e) new energy, f) new material, and g) new energy (automobile) were shown to make percentage of these industries in GDP to raise up to 8% by 2015 from 3% in 2010.

(C) Industrial advancement; towards the consumption-led economic growth

In the 12th Five-Year Plan, placing importance on the security and improvement of people's livelihood to increase the individual consumption, acceleration of the rational income distribution was proposed and also balances of the first, second, and third industry, promotion of scientific technology and industrial advancement were targeted to accomplish. But taking the history of China's economic development into consideration, some difficulties may be predicted to realize these policies. The reformation of social security is undergoing, but various problems lie ahead. Prospect cannot be found at the present stage to solve the dual economy of urban and rural areas, as a fundamental problem of China's economy. The 12th Five-Year Plan states to promote the reformation in the every field, but there are many problems to overcome such as monopoly and advantage protection of the state-owned enterprises, weakness of fundamental researches.

Attention is drawn to whether or not China, overcoming the above-mentioned difficulties, can accomplish such objects as to improve the people's livelihood, to promote energy saving and environmental protection, to advance the industry and to transfer the development mode from investment/export-dependent economic growth to consumption-led one.