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Topics There are three highlights in China's next Five-Year Plan

A draft of China's next Five-Year Plan will be announced around October. Attention will focus on three points: whether the government will set a growth rate target, whether industrial policies such as industrial subsidies will be reviewed, and what kind of new development model will be proposed.

■ What was the impact of the previous Five-Year Plan?

The fifth plenary session of the Central Committee of the Communist Party of China (CPC), an important meeting that sets the direction of China's medium- and long-term policies, will be held in October. The main agenda items are the 14th Five-Year Plan (2021-2025), which is the pillar of economic and social policies, and long-term targets through 2035. It will be interesting to see what kind of policy the Xi Jinping administration will come up with as the environment surrounding China changes drastically.

In the 13th Five-Year Plan announced in the fall of 2015, the following were positioned as priority policies: sustained economic growth at an annual average of 6.5% or higher; advancement of industry; realization of environmental improvement; promotion of the Belt and Road Initiative (BRI); and abolition of the one-child policy. Despite the controversy over the credibility of China's GDP statistics, there is no doubt that over the past five years, many Chinese companies have emerged that boast high international competitiveness in the high-tech sector. Air pollution has declined and trade and investment in China and the BRI corridors has increased significantly. Although the declining birth rate still continues, all married couples are now allowed to have up to two children, which is considered to be move in the right direction.

On the other hand, the confrontation between the United States and China has intensified, particularly in the high-tech field, and countries have become increasingly wary of the BRI. While the National Security Law has strengthened China's security, the expansion of Chinese companies overseas has come under various restrictions. The establishment of Communist Party organizations within companies has led to a qualitative change in corporate management. Over the period of the 13th Five-Year Plan, the national average income level rose remarkably, but the income gap began to widen again.

■ What will growth targets, industrial policies, and new development models look like for the next Five-Year Plan?

With regard to the next Five-Year Plan, attention will be focused on the following three points. The first is whether a new growth rate target will be set, and if so, what will its percentage be. Current projections indicate that the new growth target is likely to be set ranging from a low of 5.0% to a high of 5.5%. The aim is to indicate a shift from a "doubling of income" to "moderate growth."

In the past in China, after the government set growth targets, local governments in 31 provinces, cities and autonomous regions set their own growth targets and planned and promoted investment in infrastructure and real estate development. Capital investment by state-owned enterprises depends on growth targets set by state and local governments.

The Chinese government has promised to double its national income between 2010 and 2020 to achieve a "moderately prosperous society." In order to achieve this goal, five years prior, a target was set for economic growth to reach at least 6.5% per annum. Considering the fact that real per capita disposable income in 2019 increased by 96.6% compared to 2010, it can be said that the double income target will soon be achieved.

In recent years, however, there have been growing calls for the government to refrain from setting growth targets, and the Chinese government is also wary of "excessive growth." This is because local governments and companies have placed too much emphasis on achieving numerical targets, resulting in inefficient investment in infrastructure, plants and equipment, as well as housing. As a result, China's investment efficiency has declined significantly. Against this backdrop, the Chinese government has reduced the weight placed on achieving growth rate targets and boosted the importance of other evaluation items such as environment improvement in personnel evaluation of local leaders.

On the other hand, if the pace of economic growth is curtailed too much, the problem of excessive debt and nonperforming loans (NPLs) may arise. The ratio of corporate debt to China's GDP is already higher than that in Japan during the bubble economy period, but the potential NPL ratio is believed to be much higher than that announced by the government, indicating that the problem has reached a level that needs to be addressed immediately. From around 2017, the Chinese government began to reduce its debt (deleveraging), curbing shadow banking and strengthening supervision and management of the debts of local governments and state-owned enterprises, while at the same time allowing the growth rate to decline. However, as the economy stalled amid strong pressure to repay debts, local governments and some companies faced serious financial difficulties. In response, the governor of the People's Bank of China apologized, saying that he regretted the bank's hasty deleveraging policy. The lesson learned was that it is important to maintain a certain pace of economic growth in order to promote the smooth repayment of debt.

Against this backdrop, the Chinese government is expected to aim for "moderate growth." They will endeavor to manage the economy in order to avoid a sharp decline or rise in the ratio of debt to GDP by keeping it relatively flat. It is expected that the government will continue to request local governments and state-owned enterprises to reorganize their debts. At the same time, the government will actively support projects that contribute to the advancement of industry and focus on construction of the Chinese economic zone, including BRI corridors.

The second point is whether industrial policies such as industrial subsidies will be reviewed. Based on "Made in China 2025," the Chinese government has launched a series of measures to support priority areas such as semiconductors, 5G and AI, including the provision of industrial subsidies. Strong support for these priority areas continues, even as the U.S. Government urges the Chinese Government to drastically review its industrial subsidies. The Xi Jinping administration will continue to regard the development of high-tech fields as an important national policy that will determine the nation's future.

In the next Five-Year Plan, "Chinese Services" may become a new keyword in industrial policy. On August 12, the Ministry of Commerce announced 122 measures to strengthen service exports, including trial introduction of the digital yuan in Hong Kong and Macau, and clearly stated that it would enhance the position of "Chinese Services" in the global value chain.

The third point is what kind of new development model should be proposed. Since May of this year, "dual circulation" has been attracting attention as a keyword indicating the new development model of the Xi Jinping administration. Although the government said, "Aiming to create a new development model that promotes both domestic and international cycles with a focus on the domestic general cycle," it has yet to explain a clear concept of the domestic general cycle and dual circulation.

Against this background, intellectuals at home and abroad have begun to express various interpretations of the dual circulation concept. For example, given the increasing uncertainty of the external environment caused by the intensifying acrimony between the United States and China and the spread of the novel coronavirus infection, some believe that the Chinese government will aim to develop a model that will enhance self-reliance of the domestic economy without depending on overseas demand. On the other hand, as foreign companies are reviewing the global supply chain, some say that it is a development model to accelerate the attraction of foreign capital by promoting the high potential of the Chinese market, and to aggressively advance overseas.

It is true that with a population of 1.4 billion, China has a large potential market, and it is conceivable that China will aim for the former type of development that would place greater emphasis on the domestic economy. Since the policy management method known as national capitalism has a high affinity with digitization, there is a possibility that the pace of industrial advancement will accelerate in the next five years.

However, in order to achieve economic growth over a longer period of time, it is necessary to exchange people, trade and investment with the world, rather than focusing purely on the domestic situation. In addition, if China aims to achieve sustainable development, it is important to become a country that attracts the world's best and brightest human resources. Therefore, it is reasonable to think that the Xi Jinping administration's "dual circulation" is a concept that emphasizes the active attraction of foreign capital, acquisition of human resources, and incorporation of overseas markets. It will be interesting to see whether the draft of China's next Five-Year Plan will be based on the recognition of this "dual circulation."

(Shinichi Seki)

Topics Spread of the novel coronavirus infection continues in India

It appears that the Indian economy has passed its worst period thanks to the easing of the lockdown. However, economic and social conditions are expected to remain unstable for the time being.

■ India' s economy has picked up as the lockdown eases

In late March 2020, India implemented stricter lockdown measures than any other country amid the global outbreak of the novel coronavirus. However, when the number of those unemployed increased rapidly due to the suspension of economic activities, social problems became serious, including the deterioration of people's nutritional state and an increase in suicides among people living in poverty. Therefore, since mid-April, the government changed its policy to gradually ease the lockdown measures.

However, the resumption of interstate travel has accelerated the rate of spread of the pandemic, with the cumulative number of confirmed cases exceeding 2 million in early August. Although the cumulative number of confirmed cases and deaths relative to the population is low among countries with the largest number of cases, due to its enormous population, India now has the third largest total number of cases in the world following the United States and Brazil.

On the other hand, the economy is now emerging from its worst period due to easing of the lockdown measures. The Purchasing Managers' Index (PMI) bottomed out in April and is on an improvement trend. The unemployment rate, which had exceeded 20% in April and May, has now fallen to single-digits.

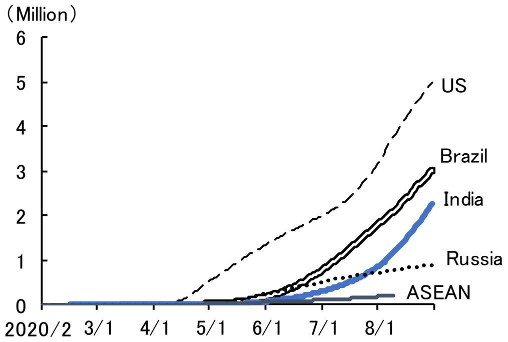
However, the pace of economic recovery has been slow, partly due to the fact that certain restrictions remain in place, mainly in "Containment Zones" where the spread of the novel coronavirus is yet to be contained. According to Google's mobility report, which quantifies the movement of people based on location information, the number of people, particularly in entertainment and commercial facilities, is still much lower than the previous year, and the number of people out and about once again started to decline from the beginning of July as local governments implemented stricter lockdown measures for their own states.

■ What are the current risks for economic and social instability?

Although the economy has emerged from its worst period, economic and social conditions are likely to remain unstable for the time being in a situation where the following risks persist.

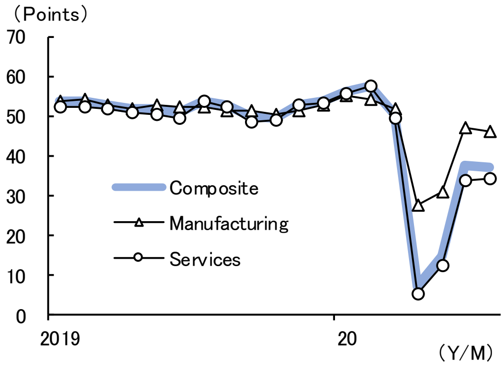
The first concern is the risk of a tight medical system. India has the lowest number of beds and doctors per capita in the world, so there is always a risk concerning health care. If it becomes difficult to provide appropriate treatment to people who have

<Cumlative Confirmed Cases of COVID-19 >



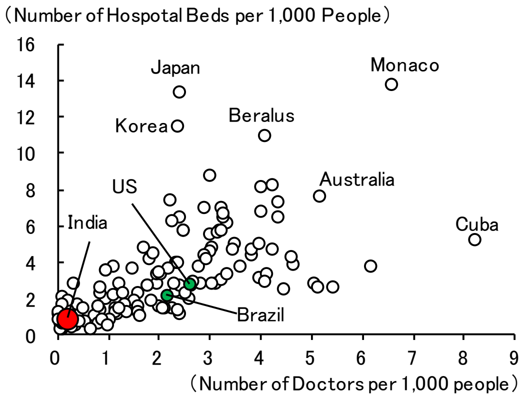
Source: World Health Organization

<PMI>



Source: IHS Markit

<Medical Infrastructure>



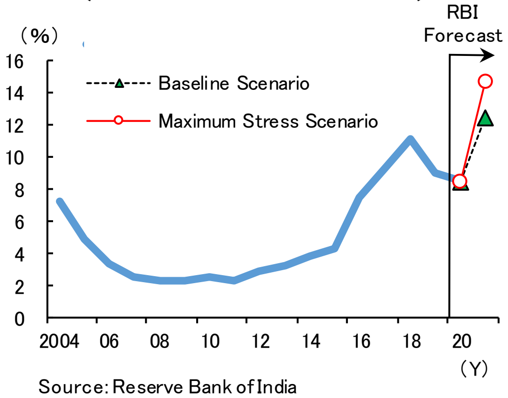
Source: World Bank
Note: Most Recent Data.

contracted the virus, particularly in areas where the medical system is weak, the rate of critical cases and deaths could increase, leading to a so-called "medical breakdown." On the other hand, if the government places priority on preventing a collapse in medical services and tightens lockdown measures again, the unemployment problem caused by the economic downturn will reappear. As a result, the government is faced with the difficult task of both avoiding the collapse of medical services and rebuilding economic activities.

The risk of instability in the financial system is also continuing. Deterioration of financial institutions' business condition is inevitable due to the economic downturn and the moratorium on the repayment of debts for individuals and companies. The Reserve Bank of India said in its July report on financial stability that it expects the non-performing asset ratio for commercial banks to rise through 2021, leading to capital shortages for some banks. In addition, the financing environment for non-banks will become more severe, given that borrowing from financial institutions and financing through corporate bonds and CP account for nearly 50% of total liabilities. As a result, financial institutions that have difficulty in procuring funds may face financial challenges, which could lead to a credit crunch and restrict economic growth from a financial perspective.

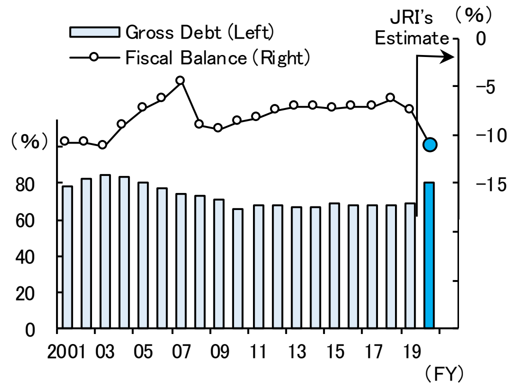
Fiscal deterioration is also a risk. The general government’s fiscal deficit in fiscal 2020 (April 2020 to March 2021) is expected to exceed 10% of nominal GDP, and outstanding debt is likely to exceed 80%, mainly due to a significant decrease in tax revenues resulting from the economic downturn. If medical costs increase due to the spread of the novel coronavirus and the need arises to inject public capital into state-run banks to stabilize the financial system, the fiscal situation will inevitably deteriorate further.

<Commercial Banks’ NPA Ratio>



Source: Reserve Bank of India
Note: As of March. Forecasts of Real GDP Growth for FY2020-2021 are -4.4%(Baseline Scenario) and -8.9%(Maximum Stress Scenario).

<General Government’s Fiscal Situation>
(% of GDP)



Source: JRI’s Estimate Based on Data of IMF and Ministry of Finance

■ Presence of other accumulated risks

Under these circumstances, the Reserve Bank of India is expected to expand its unconventional monetary policy, including long-term repo operations, to reduce the fiscal burden and stabilize the financial system. If the situation becomes more serious, the bank may carry out what is considered to be a prohibited practice but that is advocated by some economists—for example, directly underwriting government bonds. However, if such fiscal finance policies are implemented, a lack of fiscal discipline will lead to a sharp fall in the rupee, and the risk of inflation will increase. In such a case, the government will be forced to tighten monetary policy despite being in the midst of an economic slump, which will place a heavy burden on the economy.

In addition, risks may arise such as the deterioration of agricultural production due to locust plagues (caused by swarms of desert locusts), and instability of intermediate goods procurement as a result of worsening economic relations with China triggered by the border problem. Given this situation, India's economy is unlikely to pick up significantly if nothing is done.

(Shotaro Kumagai)