



# China Policy 2019: Stability over Growth

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In the current environment of slowing economic growth and President Xi's cemented security for longer-term leadership, Chinese policymakers are attempting to initiate a two-pronged internal reconstruction to stabilize its economy: nation-wide deleveraging and supply-side reform.

### Stability over Growth

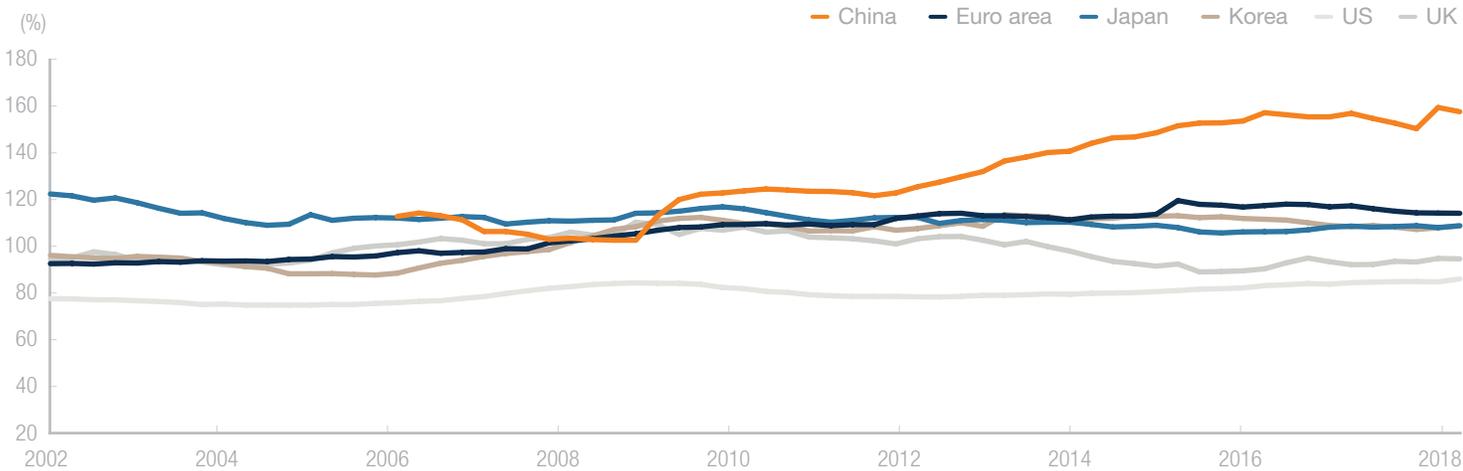
As the trade war starts to weigh on its economy and the US Fed has not completely paused on its rate hike path, China's policy room for

engineering real structural reform, encompassing environmentally-friendly measures, SOE consolidation, and profit-driven business models, is coming into question. For most of 2018, China's policymakers displayed their intent to stabilize the economy in an apparent effort to prop up the fading economy.

China's current level of slowdown remains relatively moderate compared to the conditions in 2015 when the public sentiment was overwhelmed with talks of an imminent banking crisis. Also, unlike

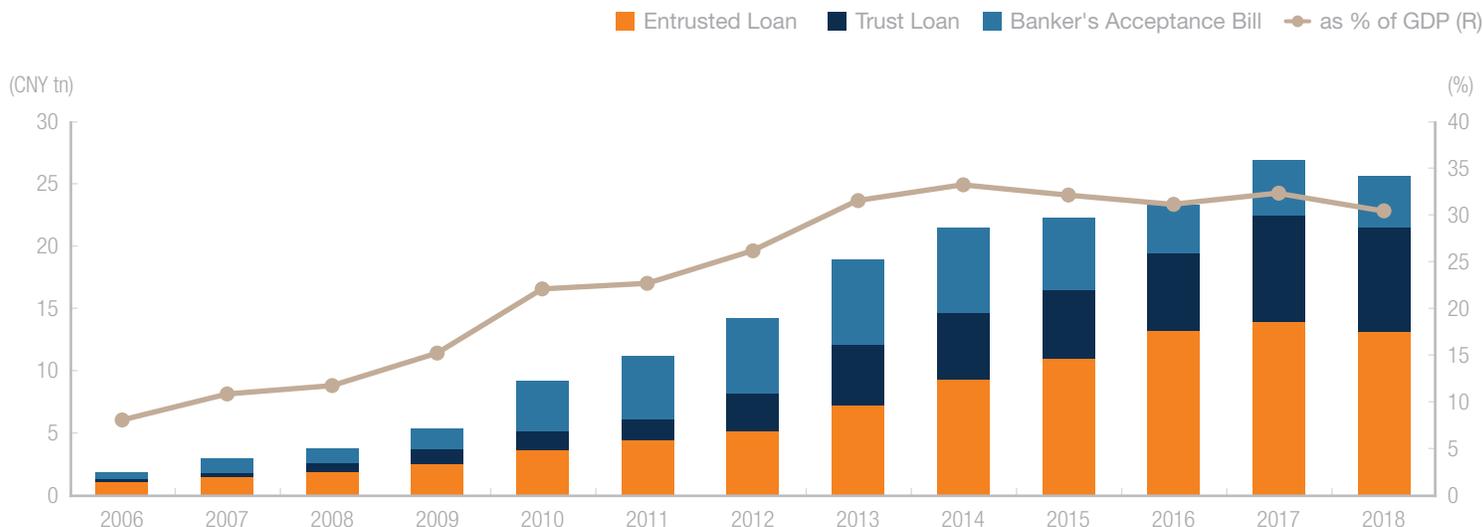
### China's Corporate Debt Stabilizing

Source: Bank of International Settlements (2019)



## Shadow Banking Also Slowing

Source: CEIC (2019)



in 2015, when President Xi was busily consolidating political power, the perch of China's leader is secure for the foreseeable future; equipping him with a rare capability to handle his problems from a long-term perspective. Unlike many democratically-elected officials in the West, Xi will not be "kicking the can down the road" for the next leader to deal with. Therefore, we believe that China will avoid choosing the easy option of monetary stimulus and instead seek to fix the structural problems that have preoccupied global investors for many years.

### China's Supply-Side Reform on Track

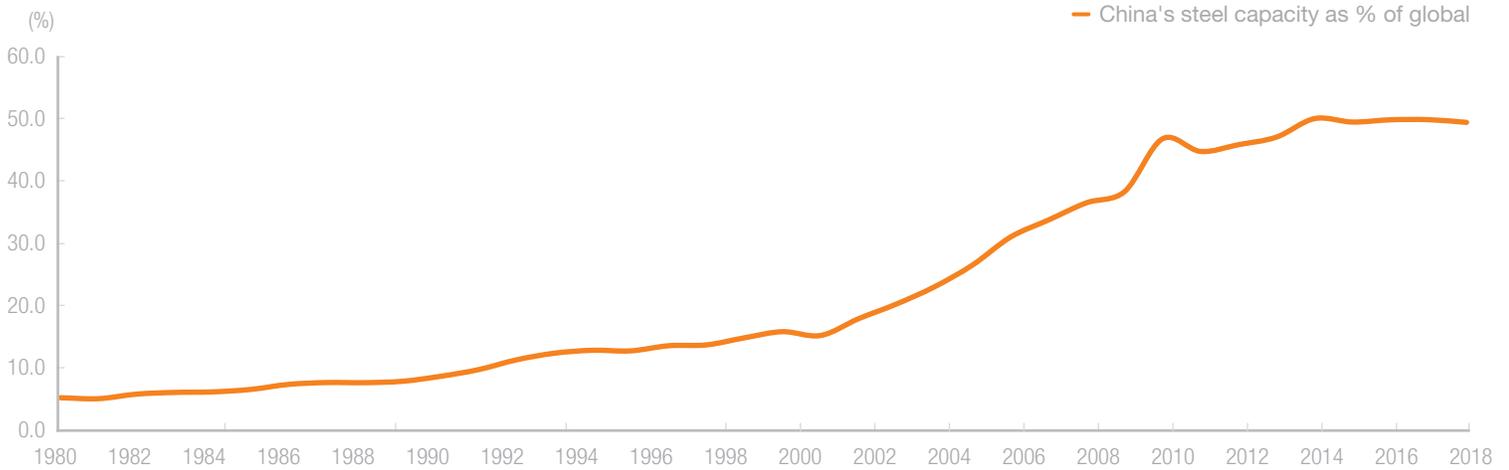
In order for Xi to succeed, reform efforts will require not only consolidation of overall industry capacity, but also a policy focus on companies offering value-added services leveraging cutting-edge technologies. At present, China's looming entry into semiconductors has been marked by investor fears that SOEs will continue to apply the same business strategies implemented for its expansion into steel, shipbuilding and chemicals. However, we conclude that China's policymakers are cognizant of the mistakes of the past ten years and also the mistakes made by Japan and Korea during the past few decades. China's policy on steel since 2015 provides insight into the complexities facing supply-side reform in many other industries.

We note that policymakers are not only seeking to reduce steel capacity, they are also pursuing a measured consolidation process that will have a more adverse impact on non-Chinese producers rather than on local producers. Specifically, China is carefully avoiding price hikes, which would embolden foreign steelmakers, trying instead to find a sweet spot that supports the profitability of efficient domestic companies while forcing the exits of loss-making and/or environmentally-unfriendly firms. Such efforts require intense micromanagement at the provincial level – i.e., a combination of regulated pricing mechanisms and long-term contracts to smooth out short-term volatility and sustain government-dictated price levels.

Current trade pressures from the US have both short-term and long-term consequences for China's industrial policy. For the long-term, China will have to backtrack on its aggressive acquisition of technology transfers and trade practices, especially with US companies. In the short-term, the US trade spat stresses the urgency for China to pursue self-sufficiency, rather than slow it down. Foreign companies and industries who hope to benefit from the stimulative policies of China will find the upside in this current cycle much less apparent as the policy mix is designed to benefit local companies rather than importers.

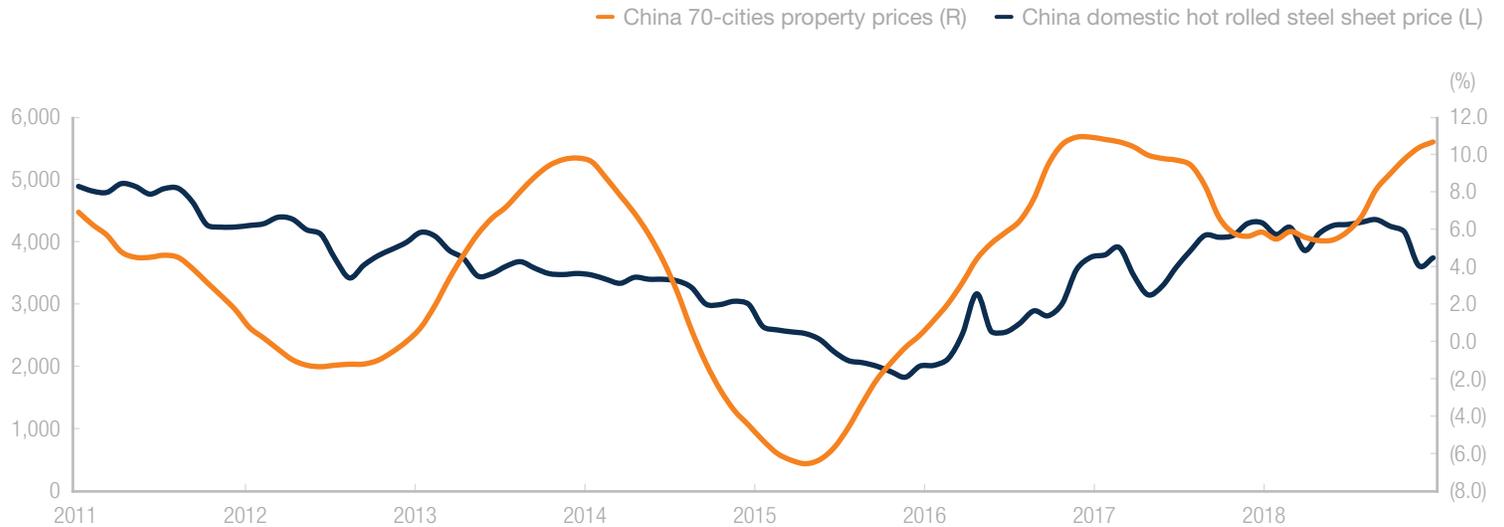
## China's Steel Capacity Slowing

Source: World Street Association (2019)



## Rising Steel Prices Reflect Property Market and Industry Consolidation

Source: Bloomberg (2019)



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