

MIZUHO CHINA MONTHLY

China's Economy _____ 1

General Secretary Xi Jinping's Vision on the Path toward Building China into a "Strong Country"

- The direction of China's "New Era," seen in Xi Jinping's report at the 19th National Congress of the Communist Party of China -

Industrial and Regional Policies _____ 8

Economic Growth Prospects and Future Outlook for the Two Major Midwestern Urban Centers in Yangtze River Economic Belt Part 1: Wuhan

- Towards Wuhan's reinstatement as a megalopolis and an emporium -

News from the China Advisory Division _____ 24

Examination of the Open-market Policy toward the Internationalization of the Chinese Yuan

- After the National Congress of the Communist Party of China -

December 2017 Edition

- Executive Summary -

China's Economy	General Secretary Xi Jinping's Vision on the Path toward Building China into a "Strong Country"
<p>At the 19th National Congress of the Communist Party of China (referred to below and in the main text as the "19th National Congress") in October 2017, General Secretary Xi Jinping was re-elected at the first plenary session of the 19th Central Committee of the Communist Party of China. In addition, a doctrine including Xi Jinping's own name was incorporated into the Communist Party of China's constitution, and it was confirmed that he will continue to exercise strong leadership going forward. At the opening session of the 19th National Congress, Xi Jinping declared that "socialism with Chinese characteristics" has entered a "new era" through past development and presented a policy to aim to turn China into a "strong country," especially regarding its economy, by the middle of the century. On the other hand, as Xi Jinping admits, the needs of the people have become broad and qualitative, and the scope of challenges has been expanding. Under such circumstances, it has become more difficult to manage national politics. We need to pay close attention to how Xi Jinping will carry out reforms, which will be unveiled in the future.</p>	
Industrial and Regional Policies	Economic Growth Prospects and Future Outlook for the Two Major Midwestern Urban Centers in Yangtze River Economic Belt – Part 1: Wuhan
<p>This report examines the economy, trade and industry, investment climate, and market trends in the two major urban centers that are located in the middle and upper reaches of the Yangtze River Economic Belt (Wuhan and Chongqing) on the basis of a field survey. These two cities have developed rapidly in recent years and are identified as a priority in the central government's regional development policy. It demonstrates the importance of these two major cities to the integrated development of the Yangtze River Economic Belt and to furthering the development of China's central and western regions, sheds light on the challenges these two cities face and looks at the prospects for future development. This first report deals with Wuhan, a city that is seeking to reinstate itself as both a megalopolis (a very large, heavily populated city) and an emporium (center of commerce).</p>	
News from the China Advisory Division	Examination of the Open-market Policy toward the Internationalization of the Chinese Yuan
<p>While it has been more than a year since the Chinese yuan was adopted as an SDR basket currency, one question remains: has the internationalization of the Chinese yuan been advancing? Under the President Xi Jinping government, China has introduced various measures to control marketization, which the market reacted to more dramatically than anticipated. Even though there were some events that opposed internationalization in 2017, such as strengthened regulations, President Xi Jinping has announced the opening up of the Chinese yuan market at the National Congress of the Communist Party of China. It is thus important to observe how the Chinese monetary authorities will continue opening up the market in the times ahead.</p>	

General Secretary Xi Jinping's Vision on the Path toward Building China into a "Strong Country"

- The direction of China's "New Era," seen in Xi Jinping's report at the 19th National Congress of the Communist Party of China -

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1. Xi Jinping's administration entered its second term after the 19th National Congress of the Communist Party of China.

At the 19th National Congress of the Communist Party of China (hereinafter referred to as the "19th National Congress"), which was held over October 18–24, 2017, 204 members of the Central Committee of the Communist Party of China (hereinafter referred to as the "Central Committee") and 172 candidate Central Committee members were elected. On the following October 25, the first plenary session of the 19th Central Committee was held, and members of the Standing Committee of the Central Politburo of the Communist Party of China (hereinafter referred to as the "Politburo Standing Committee" [PSC]) and others were selected. The PSC members will serve as the top leadership over the next five years (Fig. 1). Xi Jinping was ranked first as the member of the PSC and was re-elected as the general secretary of the Communist Party of China (hereinafter referred to as the "CPC"). Likewise, Premier of the State Council Li Keqiang was ranked second as the member of the PSC, the same as the 18th National Congress of the CPC. (See Fig. 2 on the next page.) The remaining five members are those that were promoted from the members of the Central Politburo of the CPC, and they are listed in descending order according to rank: Li Zhanshu, Wang Yang, Wang Huning, Zhao Leji, and Han Zheng. With Xi Jinping at the top, the seven members will be responsible for policy management as top Chinese leadership until 2022.

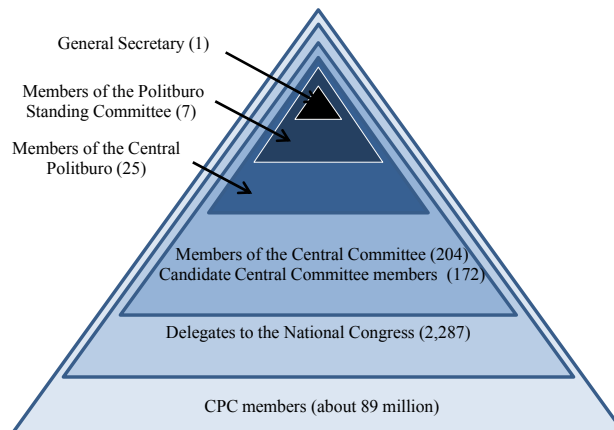
In Xi Jinping's 3.5-hour report at the opening session of the 19th National Congress, he listed the achievements made during his first term. Among them are: maintaining a medium-high growth rate; maintaining the position as the world's second-largest economy; comprehensively "deepening reform," which is one of the goals laid out at the third plenary session of the 18th Central Committee in 2013; pursuing "supply-side structural reform,"¹ which has been given priority since 2016; improving living standards; and protecting the environment. On top of these, Xi Jinping said, "We have solved many tough problems that were long on the agenda but never resolved, and accomplished many things that were wanted but never got done." Furthermore, he added, "The achievements of the past five years are the result of the strong leadership of the Party Central Committee." Through these statements, Xi Jinping indicated that these remarkable results could be achieved only by him.

At the 19th National Congress, the doctrine, including Xi Jinping's own name in the title, "Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era," was incorporated into the CPC's

¹ "Supply-side structural reform" is the pillar of economic policy for 2016 and after, presented at the Central Economic Work Conference in December 2015. "Supply-side structural reform" consists of: (1) cutting overcapacity; (2) lowering the costs of companies; (3) reducing real estate stock; and (4) expanding effective supply (which means developing the ability to supply goods and services for which needs are not satisfied due to insufficient supply ability); and (5) preventing and eliminating financial risks. The main focus of the "supply-side structural reform" is placed on addressing declining in growth caused by overinvestment and excessive debt, along with addressing financial risk.

constitution as action guidelines for the future. Xi Jinping is the third Chinese leader whose self-titled doctrine was incorporated into the CPC's constitution, following Mao Zedong and Deng Xiaoping. This probably means that it was confirmed as the will of the CPC that Xi Jinping will exercise strong leadership in policy management from here on. Then, with what ideas will Xi Jinping manage policy in the future? This article will look into Xi Jinping's report at the 19th National Congress and will relay: Xi Jinping's understanding of the current situation; his vision for the future direction of China; his policy plan to lead China in that direction; and his recognition of the challenges facing China.

Fig. 1: Structure of the CPC



Source: Prepared by Mizuho Research Institute based on various materials

2. The report emphasizes a socialism with Chinese characteristics that has entered a “new era.”

The most-notable point in Xi Jinping's report at the 19th National Congress is that he declared that “with decades of hard work, socialism with Chinese characteristics² has crossed the threshold into a new era.”

Behind this statement is Xi Jinping's understanding of the current situation; namely, “the Chinese nation, which since modern times began had endured so much for so long, has achieved tremendous transformation—it has stood up, grown rich, and is becoming strong.” Looking back at the history of the People's Republic of China since its establishment in 1949, China has achieved remarkable economic development through reform and opening up, and has increased its presence in the global economy. For example, as mentioned previously, China's GDP became the second largest in the world after the United States, and China is in the top three in the world in terms of total trade and inward FDI stock.³ Furthermore, in recent years, China is more active in reaching out to the international economy and community, as seen in the overseas expansion of Chinese companies, the internationalization of the Chinese yuan, the taking of initiative in the establishment of the Asia Infrastructure Investment Bank, and the promotion of the “Belt and Road” initiative. Xi Jinping said in the report that the CPC propelled “China into a leading position in terms of economic and technological strength, defense capabilities, and composite national strength” and

² “Socialism with Chinese Characteristics” is a concept outlined at the 12th National Congress in 1982. It means that China should not mechanically copy the experiences and models of other countries, but its modernization should start with reflecting China's actual conditions. By making “socialism with Chinese characteristics” a basic policy, the CPC intended to change its policy direction from the conventional “class struggle-oriented” to “modernization-oriented” policy, centering on economic construction.

³ For more information, please refer to みずほ総合研究所調査本部アジア調査部中国室「第19回中国共産党大会と2期目に向けた習政権の課題」（『緊急リポート』 October 11, 2017).

that “China’s international standing has risen as never before.” The phrase “new era” represents Xi Jinping’s confidence and pride in the fact that China has seen the fruits of the above efforts and has reached a point of entering a new era.

Such confidence and pride are also represented in Xi Jinping’s statement that the Chinese development model offers a new path for other developing countries to achieve modernization. More specifically, he said, “The path, the theory, the system, and the culture of socialism with Chinese characteristics have kept developing, blazing a new trail for other developing countries to achieve modernization. It offers a new option for other countries and nations who want to speed up their development while preserving their independence.” This statement could indicate his recognition that socialism with Chinese characteristics, which has entered into a transition phase toward a “new era,” should not be held close only by China but should be expanded to other developing countries.

Fig. 2: Members of the PSC (honorifics omitted)

Name	Positions within the CPC and other organizations at the 18th National Congress	Positions in the CPC at the 19th National Congress
Xi Jinping (64)	General secretary of the Central Committee, chairman of the CPC Central Military Commission, president	General secretary of the Central Committee, chairman of the CPC Central Military Commission
Li Keqiang (62)	Premier of the State Council	—
Li Zhanshu (67)	Director of the General Office of the Central Committee, secretary of the Secretariat of the Central Committee	—
Wang Yang (62)	Vice Premier of the State Council	—
Wang Huning (62)	Director of the Central Policy Research Office	Secretary of the Secretariat of the Central Committee
Zhao Leji (60)	Director of the Organization Department of the Central Committee, secretary of the Secretariat of the Central Committee	Secretary of the Central Commission for Discipline Inspection
Hang Zheng (63)	Secretary of the CPC Shanghai Committee	—

Note: The figures in parentheses indicate age as of October 25, 2017. Positions within the government, the National People's Congress, etc., such as the premier of the State Council and the chairman of the Standing Committee of the National People's Congress, will be decided later.

Source: Prepared by Mizuho Research Institute based on the communique of the first plenary session of the 19th Central Committee (Xinhua, October 25, 2017), etc.

3. The direction of development is to become a “strong country.”

Another notable point in the report is that it emphasized that growing into a “strong country” is the future direction that should be taken by China, which has entered a “new era.”

In his report at the 19th National Congress, Xi Jinping outlined “the Thought on Socialism with Chinese Characteristics for a New Era” as the action guidelines to support this “new era.” As described above, this

thought was incorporated into the CPC's constitution with his own name. In the doctrine, Xi Jinping sets the goals of achieving the missions of the socialist modernization and major rejuvenation of the Chinese nation through promoting the strategies he had laid out during his first term, such as the “five-sphere integrated plan”⁴ and the “four-pronged comprehensive strategy,”⁵ as well as building China into a “great modern socialist country that is prosperous, strong, democratic, culturally advanced, harmonious, and beautiful” by the middle of the century, when China celebrates its centenary. So far, China had aimed to turn itself into a “modern socialist country that is prosperous, strong, democratic, culturally advanced and harmonious” by its centenary. In other words, at the 19th National Congress, the wording of “modern socialist country” was revised to “great modern socialist country.” By doing this, China intended to relay its will toward becoming a “great China.” (Another additional word, “beautiful,” will be touched on later.)

On top of this, the path toward building China into a “great country” was divided into two steps, and the visions for each step's completion were presented (Fig. 3). China now has the prospect of finishing “building a moderately prosperous society in all respects” by 2021,⁶ when China celebrates the centenary of the CPC, which is represented by numerical targets such as doubling the GDP and per capita income by 2020 from 2010. Ahead of the full-fledged start of measures for achieving the goal of becoming a “strong country” at the 20th National Congress to be held in 2022, the CPC appears to be ready for policy management, also eyeing the middle of the 21st century.

The first step is to ensure that “socialist modernization is basically realized” over the 15 years from 2020 to 2035. More specifically, China assumes that the following things will be achieved by 2035: significantly increasing China's economic and technological strength; basically achieving the modernization of China's system and capacity for governance; significantly strengthening cultural soft power; significantly reducing disparities in urban-rural areas, etc.; having a modern social governance system basically take shape; and basically attaining the goal of building a “Beautiful China.” For the second step, China, as described previously, set the goal of becoming a “great modern socialist country that is prosperous, strong, democratic, culturally advanced, harmonious, and beautiful” over the 15 years from 2035 to the middle of the 21st century. According to the vision of Xi Jinping, China will achieve the following in the mid-21st century: “new heights reached in every dimension of material, political, cultural and ethical, social, and ecological advancement”; “modernization of China's system and capacity for governance achieved”; “China becoming a global leader in terms of composite national strength and international influence”; “common prosperity for everyone basically achieved”; “Chinese people enjoying happier, safer, and healthier lives”; and the “Chinese nation becoming a proud and active member of the community of nations.”

As the goal of becoming a global leader in “composite national strength” indicates, the details of a “strong country” as aimed for by Xi Jinping cover a wide range of areas, such as the economy, culture, public welfare, and the military. Among them, especially notable is an abundance of references to the “strength” and “quality” in the part of the economic policy. More specifically, the report aims to turn China into a

⁴ The “five-sphere integrated plan” involves the full promotion of economic, political, cultural, social, and ecological advancement.

⁵ The “four-pronged comprehensive strategy” consists of comprehensive moves to finish building a moderately prosperous society in all respects, deepen reforms, advance law-based governance, and strengthen CPC self-governance

⁶ For more information, please refer to みずほ総合研究所調査本部アジア調査部中国室「第19回中国共産党大会と2期目に向けた習政権の課題」(『緊急レポート』 issued on October 11, 2017).

“manufacturer of quality,” “strong maritime country,” and “trader of quality”; and to build China’s strength in “science and technology,” “product quality,” “aerospace,” “cyberspace,” and “transportation.” This indicates that China places further emphasis on strengthening economic power, as it serves as a material foundation for becoming a strong country in other areas. Regarding culture, the report sets goals of developing a “great socialist culture” and building China into a “country strong on sports,” while aiming for “strengthening education” in the area of people’s wellbeing, and building the people’s armed forces into a “world-class force” in the area of military.

On the other hand, in diplomacy, China is expected to maintain “great-power diplomacy,” which began in earnest after the inauguration of Xi Jinping’s administration in 2012. As for “Chinese characteristics,” the report cited such ideas as: “forging a new form of international relations featuring mutual respect, fairness, justice, and win-win cooperation,” and building “a community with a shared future for mankind.” It also suggested that China aims to become a global leader in terms of “international influence” through the One Belt, One Road initiative and others, while contributing to global issues such as infrastructure development and climate change measures. The report again clearly states that “China will never pursue development at the expense of others’ interests, but nor will China ever give up its legitimate rights and interests.” This statement is believed to be made with territorial disputes and other issues in mind.

Fig. 3: Roadmap for development from 2020 to the mid-21st century

The First Step (2020–2035)
Goal: Basically, achieving socialist modernization
<ul style="list-style-type: none"> • China’s economic and technological strength has increased significantly. China has become a global leader in innovation. • The rights of the people to participate and to develop as equals are adequately protected. The rule of law for the country, the government, and society is basically in place. Institutions in all fields are further improved; the modernization of China’s system and capacity for governance is basically achieved. • Social etiquette and civility are significantly enhanced. China’s cultural soft power has grown much stronger; Chinese culture has greater appeal. • People are leading more comfortable lives, and the size of the middle-income group has grown considerably. Disparities in urban-rural development, in development between regions, and in living standards are significantly reduced; equitable access to basic public services is basically ensured; and solid progress has been made toward prosperity for everyone. • A modern social governance system has basically taken shape, and society is full of vitality, harmonious, and orderly. • There is a fundamental improvement in the environment; the goal of building a Beautiful China is basically attained.
The Second Step (2035 to the mid-21st century)
Goal: Turning China into a great modern socialist country that is prosperous, strong, democratic, culturally advanced, harmonious, and beautiful
<ul style="list-style-type: none"> • New heights are reached in every dimension of material, political, cultural and ethical, social, and ecological advancement • Modernization of China’s system and capacity for governance is achieved • China has become a global leader in terms of composite national strength and international influence. • Common prosperity for everyone is basically achieved • The Chinese people enjoy happier, safer, and healthier lives • The Chinese nation will become a proud and active member of the community of nations.

Source: Prepared by Mizuho Research Institute based on “Xi Jinping’s report at 19th CPC National

4. Xi Jinping strongly recognizes increased difficulty in managing national politics.

As described above, Xi Jinping expressed confidence and enthusiasm for China's future development. However, at the same time, it should be noted that he also expressed his recognition that it would become more difficult to manage national politics toward building China into a “strong country,” and he gave strong caution against arrogance and carelessness. Such a recognition is clearly indicated by the reference to the principal contradiction facing Chinese society.

Since 1981, just after the reform and opening-up policy, the CPC had seen “the ever-growing material and cultural needs of the people with backward social production” as the principal contradiction facing China, which means that the CPC continued to believe that their basic challenges were to meet relatively basic and quantitative needs, such as ensuring income to enable better clothing, food, and housing, and to make people's lives affluent, as well as to expand abilities to supply the products and services necessary for that. In the latest report, however, the recognition of the principal contradiction was changed to that “between unbalanced and inadequate development and the people's ever-growing needs for a better life.” More specifically, the report points out that “The needs to be met for the people to live better lives are increasingly broad. Not only have their material and cultural needs grown; their demands for democracy, rule of law, fairness and justice, security, and a better environment are increasing.” Further, at the same time, it explains that “the more prominent problem is that our development is unbalanced and inadequate.” In other words, the report admits that the needs of the people have become more diverse and qualitative, and that various challenges accompanied by unbalanced development are no longer resolved only by economic expansion, as seen in the typical example of economic growth accompanying environmental pollutions. This understanding of the current situation was clearly demonstrated at the 19th National Congress.

In the report, Xi Jinping said that the above shift “creates many new demands for the work of the Party and the country,” suggesting that managing national politics is becoming increasingly difficult. By saying, “The last leg of a journey marks the halfway point... Every one of us in the Party must be prepared to work even harder,” Xi Jinping gave caution that the CPC should not be overly optimistic about the largely robust achievements that have been made during his first term, but should engage in policy management with a sense of urgency.

In fact, many issues remain unsolved. For example, regarding its economy, China is still halfway to eliminate overcapacity and excess debt, etc. In addition, when it comes to institutional reforms for fiscal, tax, and financial systems, important reforms remain to be undertaken, such as personal income tax reforms, the introduction of real estate tax, and the liberalization of exchange rates and capital transactions.⁷ Moreover, as indicated by the fact that the word “beautiful” was added to the “ideal state” that China aims to achieve by the middle of the century, environmental measures such as improving resource/energy usage efficiency and strengthening measures against air/water/soil pollution will also be an important challenge

⁷ For more information, please refer to みずほ総合研究所調査本部アジア調査部中国室「第19回中国共産党大会と2期目に向けた習政権の課題」(『緊急リポート』October 11, 2017).

for China. Moreover, China is facing a wide variety of challenges such as: “comprehensively advancing law-based governance”; nationally unifying social security systems; responding to an aging population; and eliminating corruption, which is positioned as “the greatest threat that the CPC faces.” The Chinese leadership believes it is necessary to take further measures to address each of these.⁸

The theme of the 19th National Congress was: “Remain true to our original aspiration and keep our mission firmly in mind.” In addition, it was reaffirmed that the original aspiration and the mission of the CPC is to “seek happiness for the Chinese people and rejuvenation for the Chinese nation.” Against that backdrop, a long-term policy eyeing the mid-21st century, which is more than 30 years from now, was presented. In order to build a firm foundation for long-term development, as Xi Jinping gave caution regarding, China needs to steadily solve many challenges. When dealing with individual challenges, it will be necessary to coordinate complex interests, while China also needs to continue careful discussions on procedures and methods for implementing institutional reforms so as to enable compatibility between the development and the stability of the economy and society.

The report at the 19th National Congress lists 14 points that should be firmly maintained in “the Thought on Socialism with Chinese Characteristics for a New Era.” On top of these comes “Ensuring CPC leadership covering all tasks,” which indicates a policy to further strengthen the party’s leadership. Xi Jinping is expected to exercise strong leadership in managing the CPC in the future, and we should pay close attention to the reforms he intends to undertake and the basis for the procedures and methods thereon, along with the value judgement, from here onward.

⁸ The latest report presented a plan to create four organizations: “a central leading group for advancing law-based governance,” “regulatory agencies to manage state-owned natural-resource assets and to monitor natural ecosystems,” “administration for veterans,” and “supervisory commissions at the national, provincial, prefectural, and county levels.” This suggests China’s seriousness about tackling these challenges.

Economic Growth Prospects and Future Outlook for the Two Major Midwestern Urban Centers in Yangtze River Economic Belt

Part 1: Wuhan

–Towards Wuhan’s reinstatement as a megalopolis and an emporium–

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1. Introduction: The importance of the Yangtze River Economic Belt to China’s regional development policy

China has upgraded the focus of its regional economic development and spatial policies from its traditional growth pole-centered approach such that it now converges on areas along the Yangtze River – a key national axis, and is promoting the construction of a Yangtze River Economic Belt in a move that represents a major shift in policy. One reason for this is the robust economic growth of the middle reaches of the Yangtze River (the interior reaches of central and western China). Moreover, given that China’s One Belt, One Road Initiative is targeting the development of a global economic belt, the strategy for regional development that is to be implemented within the timeframe of the 13th Five-Year Plan for National Economic and Social Development (2016–2020; 13th FYP), based on documents relating to the 13th FYP released following the recent Communist Party convention, will likely focus on flying the banner for the formation of Xiong’an New Area and promoting the development of the Jingjinji Metropolitan Area (Beijing, Tianjin and Hebei, or the national capital region), with these two giant economic belt strategies serving as the principal axis for development.

In light of the above, the author enlisted the cooperation of the Mizuho Wuhan Branch and undertook a field survey of the two major urban centers (Wuhan and Chongqing) in the middle and upper reaches of the Yangtze River at the end of October this year. This two-part report examines the current state of development in these two major cities and looks at their prospects for the future. This issue gives a status report on Wuhan and Hubei, the province to which it belongs, and examines Wuhan’s potential to serve as a driver of economic growth in central China and the potential economic ripple effects for neighboring regions.

Central government measures to promote the economy, trade and industry in the Yangtze River Economic Belt began gathering momentum between 2014, when the 12th FYP was in its final stages, and the beginning of the 13th FYP (**Table 1**). Among the various measures being implemented, the *Plan for the Development of City Clusters in the Middle Reaches of the Yangtze River (2014–2020)* (item 3 in **Table 1**) and the *Chengdu-Chongqing City Cluster Development Plan (Approval Reply)* (item 7 in **Table 1**), both of which were issued in 2015, and the *Plan for the Development of Markets in the Middle Reaches of the Yangtze River (2017–2020)*, which was released by the Ministry of Commerce in October this year, are serving to reinforce policy targeting urban agglomeration and economic promotion in the middle and upper reaches of the Yangtze River Economic Belt (central and western China). The *Yangtze River Economic Belt Innovation-driven Industrial Transformation and Enhancement Plan*, which was released by the National Development and Reform Commission (NDRC), Ministry of Science and Technology, and Ministry of Industry and Information Technology (MIIT), clearly establishes the transformation and upgrading of the

industrial structure in the Yangtze River Economic Belt as goals for the plan (**Table 2**). Economic growth in the provinces and cities in the middle and upper reaches of the Yangtze River Economic Belt has gathered pace in recent years (**Figure 1**) and it is growing a presence in the national economy and industry (**Figure 2**). Specifically, the growth in the share of China's import trade accounted for by the Yangtze River Economic Belt that has come with moves to accelerate urbanization and industrialization in the eleven regions it encompasses (specifically, industrial production and the construction industry), can be seen as an important political rationale for promoting the supply side reforms that are needed to adjust to China's "economic new normal."

Table 1: Key Policies on Promoting the Development of the Yangtze River Economic Belt

No.	Title of Policy/Plan	Issuing organ	Date
1	Yangtze River Economic Belt Comprehensive Three-Dimensional Transport Corridor Plan (2014–2020)	State Council	2014
2	Guiding Opinions on Promoting the Development of the Yangtze River Economic Belt building on the Golden Waterway	State Council	2014
3	Plan for the Development of City Clusters in the Middle Reaches of the Yangtze River (2014–2020)	NDRC	2015
4	Guiding Opinions on the Construction of State-level Model Development Zones in the Yangtze River Economic Belt	NDRC	2015
5	Yangtze River Economic Belt Innovation-driven Industrial Transformation and Enhancement Plan	NDRC, et al.	2016
6	13 th Five-Year Plan for National Economic and Social Development (Chapter 39, etc.)	National People's Congress	2016
7	Chengdu-Chongqing City Cluster Development Plan	NDRC	2016
8	13 th FYP for Promotion of Central China (2016–2020)	NDRC	2016
9	13 th FYP on Developing the Western Regions (2016–2020)	NDRC	2017
10	Guiding Opinions on Strengthening Green Manufacturing in the Yangtze River Economic Belt	MIIT, et al.	2017
11	Plan for the Development of Markets in the Middle Reaches of the Yangtze River (2017–2020)	Ministry of Commerce	2017
12	Guiding Opinions on Supporting the Construction of National Hub Cities in Wuhan	NDRC	2017

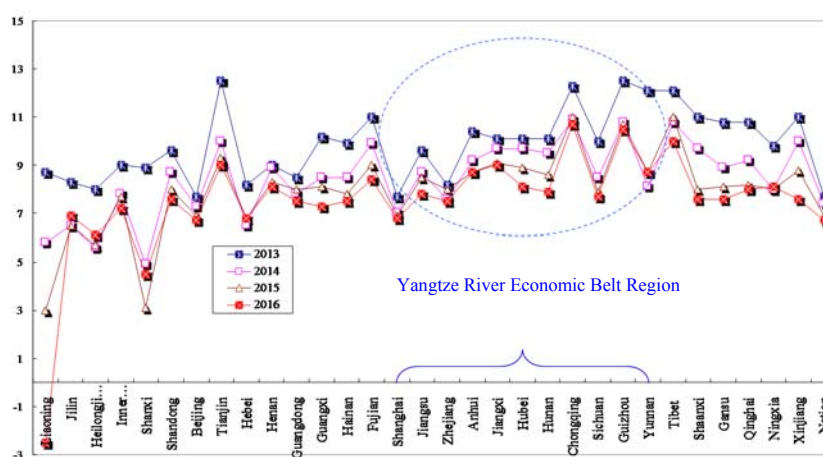
Source: Compiled from Chinese government websites and related press releases

Table 2: Goals for the Industrial Transformation and Upgrading of the Yangtze River Economic Belt

Related indicator		2014	2017	2020
Innovation capacity	Share of patented inventions of industrial enterprises above designated size (%)	44.8	49	53
	Share of new product sales in total sales (%)	51	54	59
	Research and development expenditure as a percentage of regional GDP (%)	1.47	2.1	2.5
Industrial structure	Strategic emerging industries as a percentage of regional GDP (%)	7	12	17
	Value added by the service industry as a percentage of GDP (%)	44	51	54
Economic development	Yangtze River Economic Belt as a percentage of national GDP (%)	41.6	42	43
	Yangtze River Economic Belt exports (US\$100 billion)	10.7	12	15
	Average consumption expenditure (RMB10,000)	1.85	2.2	2.7

Source: Compiled from the *Yangtze River Economic Belt Innovation-driven Industrial Transformation and Enhancement Plan* (NDRC, Ministry of Science and Technology and MIIT, March 2, 2016)

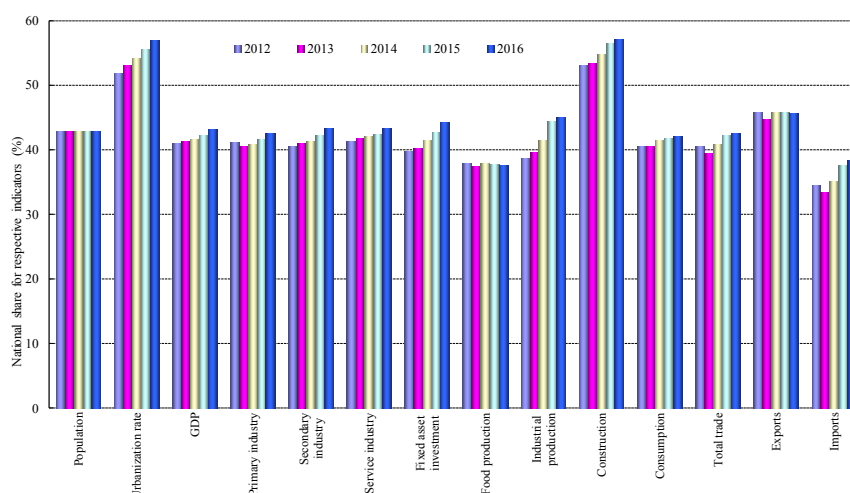
Figure 1: China's Regional GDP Growth Rates in Recent Years



Source: Compiled from National Bureau of Statistics data and data released by the various regional governments.

Note: The Yangtze River Economic Belt comprises eleven provinces and cities: Shanghai, Jiangsu, Zhejiang, Anhui, Jiangxi, Hubei, Hunan, Chongqing, Sichuan, Guizhou, and Yunnan.

Figure 2: The Yangtze River Economic Belt as a percentage of Major Social and Economic Indicators



Source: Compiled from the *Hubei Statistical Yearbook* (2017)

Given these policy developments and the economic growth of the region, the spatial distribution of city clusters given in the 13th FYP (**Figure 3**) and the direction of regional development strategy on promoting urban and industrial agglomeration are likely to become more firmly established in the coming years. In fact, the growth in the share in national industrial production accounted for by the central and western regions is becoming increasingly conspicuous (**Figure 4** and **Figure 5**). Urbanization and industrialization is the most basic driver of a country's economic and regional development and creates the dynamism necessary to achieve these ends, this report thus examines economic growth and industrial development in Wuhan (Hubei province included) and Chongqing from this perspective, and looks at the regional factors and challenges these two cities face and the prospects for their future development.

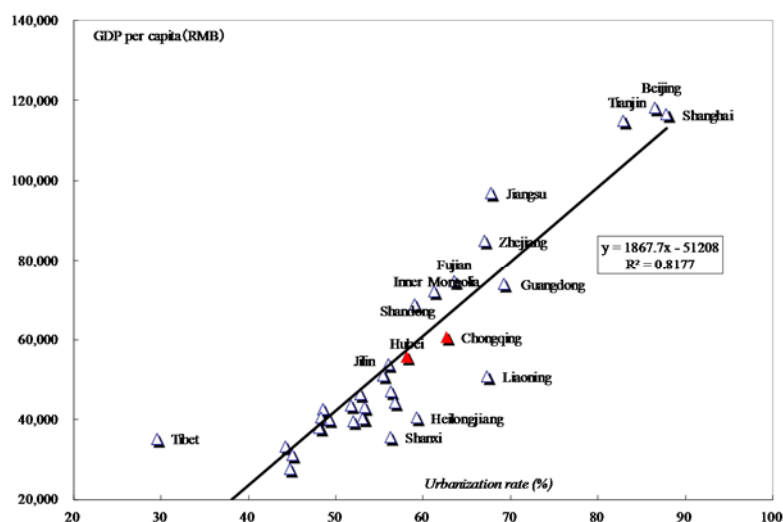
Figure 3: The Blueprint for the Spatial Distribution of City Clusters in the 13th FYP



Source: Excerpted and adapted from the Outline of the 13th FYP

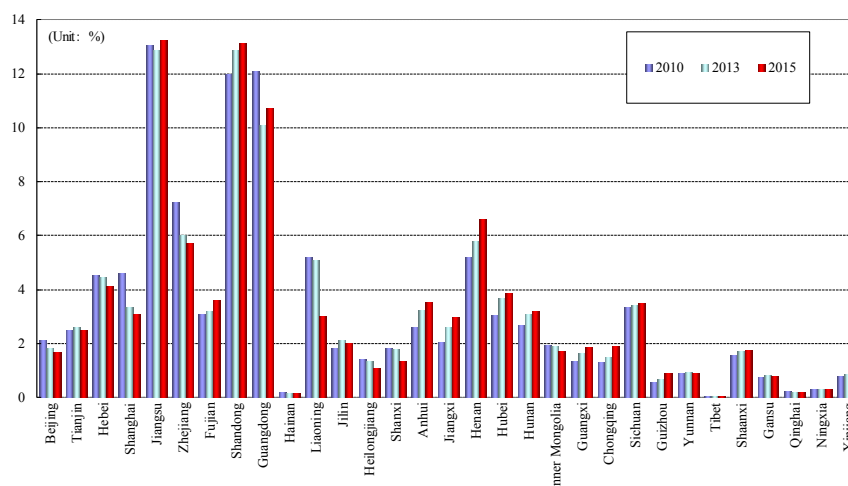
Note: This distribution map is based on China's new "two horizontal, three vertical" urbanization strategy, with the Yangtze and Yellow Rivers providing the two horizontals, and the coastal route from the northeast, the route from the capital region through the middle reaches of the Yellow and Yangtze Rivers, and the route linking Shaanxi province to the upper reaches of the Yangtze River as the three verticals. Spread across a vast area, the Yangtze River Economic Belt is home to the largest number of city clusters.

Figure 4: Regional Per Capita GDP and Urbanization Rates (2016)



Source: Compiled from the *National Statistical Yearbook 2017*

Figure 5: Trends in the Regional Weighting of National Industrial Output



Source: Compiled from *China's Industrial Development Report* (2016), Institute of Industrial Economics, Chinese Academy of Social Sciences

2. Economic and industrial development trends in Wuhan, Hubei province in the midst of urbanization and industrialization

The province of Hubei is an important administrative district in central China and its capital city, Wuhan, has had a tremendous presence from ancient times until the present. Wuhan is essentially a microcosm of the province to which it belongs and its prosperity and decline is closely linked to that of Hubei. Its location in the middle of the Yangtze River basin meant that Wuhan began its growth as a city before Shanghai, and in the Qing Dynasty of the nineteenth century it was one of four megalopolises alongside Beijing, Suzhou and Guangzhou, when it flourished as a major trading hub (emporium) in China's central and western interior. Wuhan was not simply a center for trade, however, it served as a hub for numerous people from neighboring regions, and was a sophisticated metropolis¹. Wuhan continued to evolve as an important center for industry and commerce in China's interior following the founding of the People's Republic of China, but then languished for long periods under the central government's policy of giving priority to the development of heavy industries where the main players were state-owned enterprises, and its growth in the immediate aftermath of Chinese economic reform (literally "reform and opening up") lagged far behind that of the country's eastern coastal region. Wuhan has been undergoing a major transformation following the 2005 implementation of the central region development policy and is on its way to recovering its status as the megalopolis of the interior². As **Figure 4** and **Figure 5** illustrate, both Hubei and Wuhan are in the process of urbanization, meaning that there is considerable potential for further economic growth and industrial development.

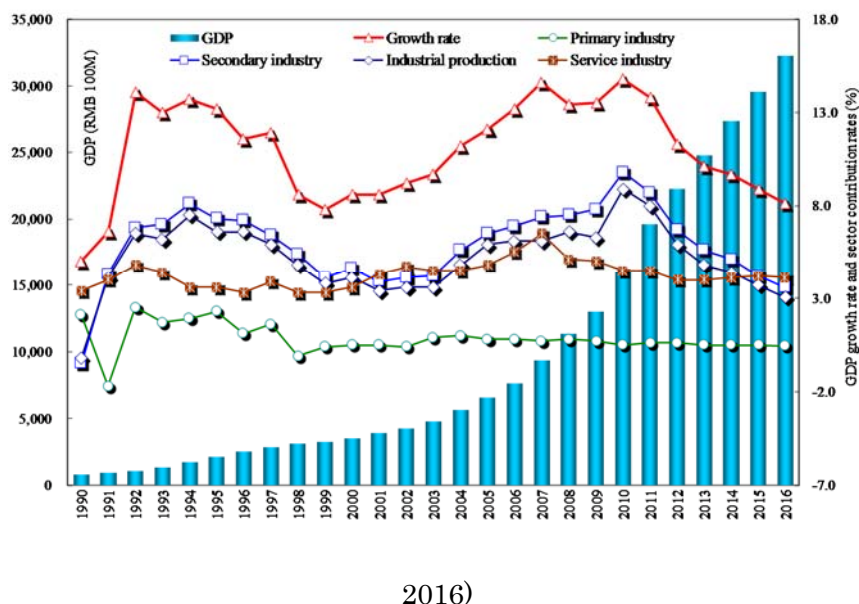
The following paragraphs use chronological data to give a concrete picture of economic growth trends in Hubei and Wuhan.

¹ Shiba Yoshinobu, "A History of Chinese Cities" (in Japanese), University of Tokyo Press, 2002. Yongyu Shao, "Research on Urbanization and Industrialization in China: Historical and Spatial Developments against a Backdrop of Resource and Environmental Constraints" (in Japanese), Taga Shuppan, 2012.

² For example, Wuhan ranked fortieth in "The Global Urban Competitiveness Report 2017–2018", which was released by the Chinese Academy of Social Sciences in association with the United Nations in October 2017. Twenty-one of the top 100 cities in economic competitiveness are from China.

As **Figure 6** shows, Hubei province continued to post double-digit GDP growth following the global financial crisis, and in 2016 was still maintaining a growth rate above 8 percent, which was significantly higher than China's economic growth rate. In terms of sector composition, the secondary sector is the main contributor to Hubei GDP, though the service sector began contributing at a similar level in 2015.

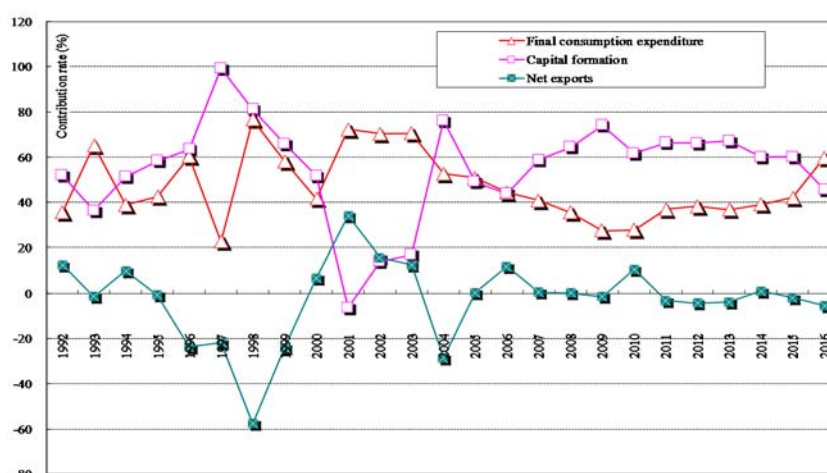
Fig. 6: Economic Growth Rates for Hubei Province and GDP Sector Composition (1990–



Source: Compiled from the *Hubei Statistical Yearbook 2017*

Looking at demand-side GDP contributors as a factor in economic growth, in 2016 final consumption expenditure and investment were major contributors to Hubei GDP growth, whilst export returns were negative (**Figure 7**). The cross-sectional data on China's 31 administrative districts given in **Figure 8** gives an overview of GDP totals and GDP sector composition for the nation. Hubei and Sichuan are the largest economies in both the central and western region and the middle and upper reaches of the Yangtze River, whilst its service sector share in GDP is around 45 percent and rivals that of Shandong province and Inner Mongolia, etcetera.

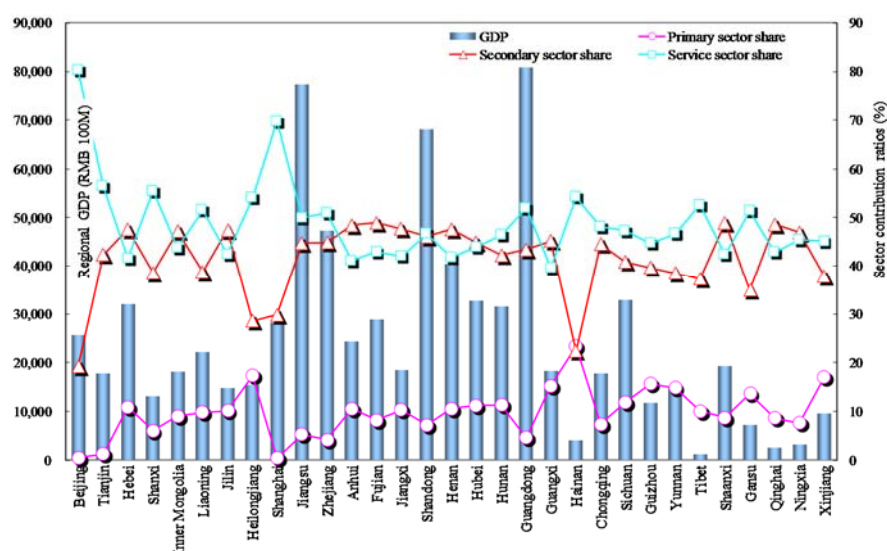
Figure 7: Hubei Economic Growth Trends in terms of the Three Big Demand-side



Contributors (1990–2016)

Source: As for Figure 6

Figure 8: Total GDP and GDP Sector Composition for China's Regions (2016)



Source: Compiled from the *China Statistical Yearbook 2017*

The next section looks at GDP trends in Wuhan (**Figure 9**). Wuhan's economy is essentially growing with the same vigor as that of Hubei, but in terms of sector composition, the secondary sector has been on a downtrend since 2014 whilst the service sector is on an uptrend, which suggests that the city's industry is becoming more sophisticated.

Wuhan's per capita GDP (**Figure 10**) continued to show double-digit growth up until 2014, and whilst it slowed in 2015 it remains well in excess of RMB 100,000, providing evidence of the city's significant development.

Figure 9: GDP Growth and GDP Sector Composition Trends for Wuhan (1990–2016)

Source: Compiled from the *Wuhan Statistical Yearbook 2016* and the *Wuhan Statistical Bulletin*

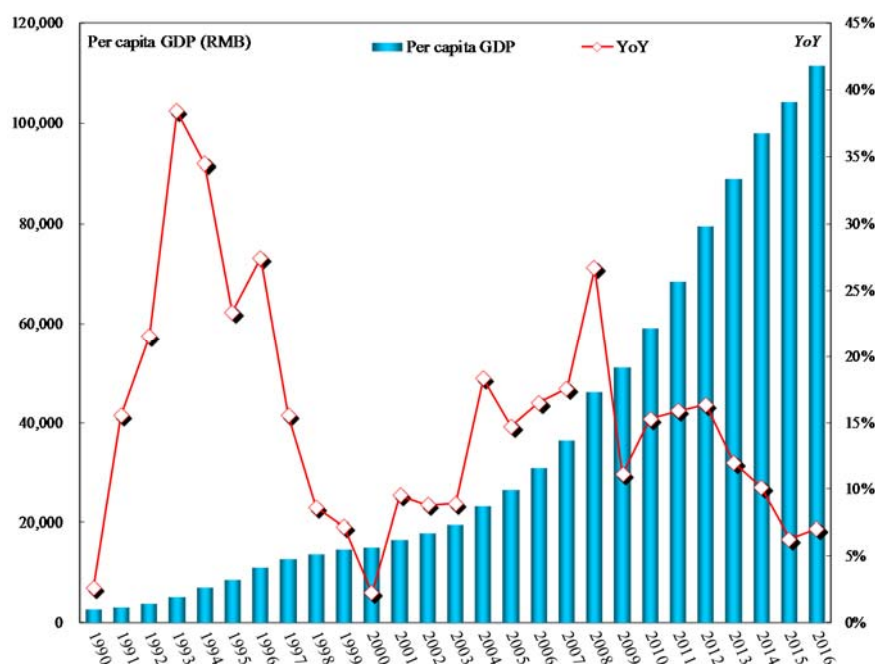
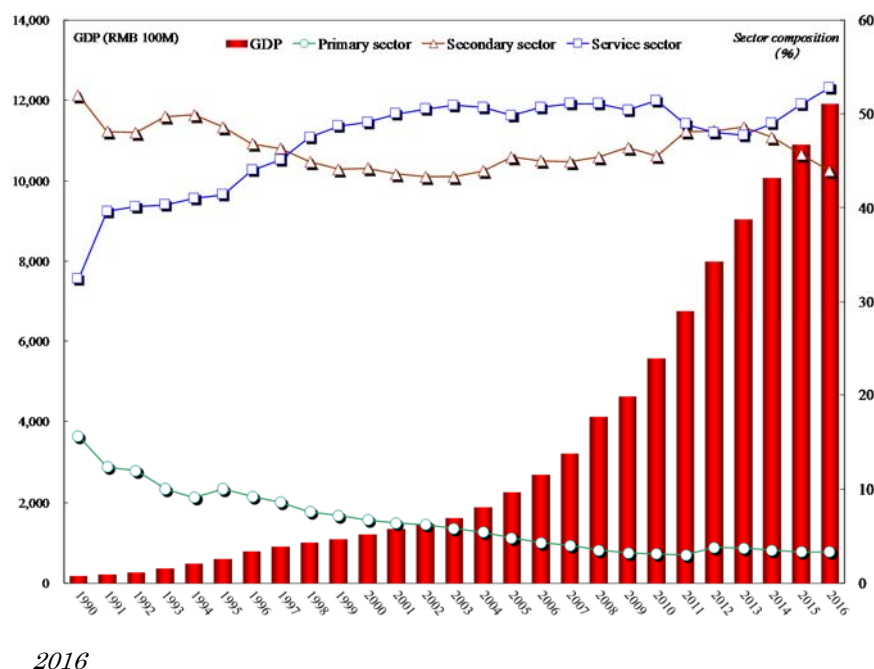


Figure 10: Per Capita GDP Growth in Wuhan (1990–2016)

Source: As for Figure 9

This next paragraph offers an overview of Wuhan's external economy. As **Figure 11** shows, the global financial crisis marked a massive scaling up in the city's external economy (including its trade surplus), and foreign direct investment continues to expand at a healthy pace (**Figure 12**). More than 200 Japanese companies have set up operations in Hubei, 170 of which are located in Wuhan (approximately 40 companies on the Fortune 500 list have established operations in Hubei. JETRO Wuhan Office).

Figure 11: Wuhan's Foreign Export and Import Trade (1990–2015)

Source: Compiled from the *Wuhan Statistical Yearbook 2016*

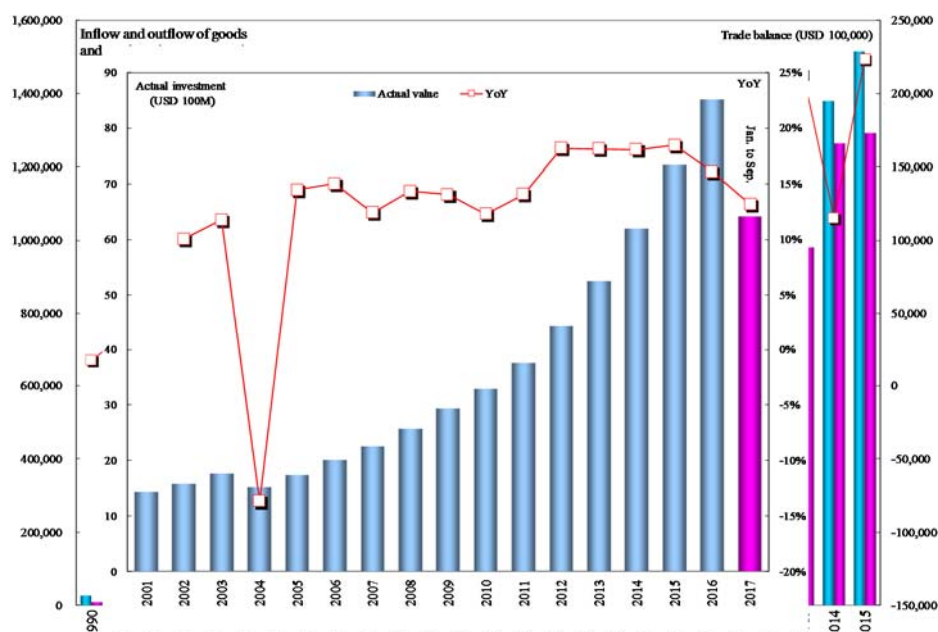


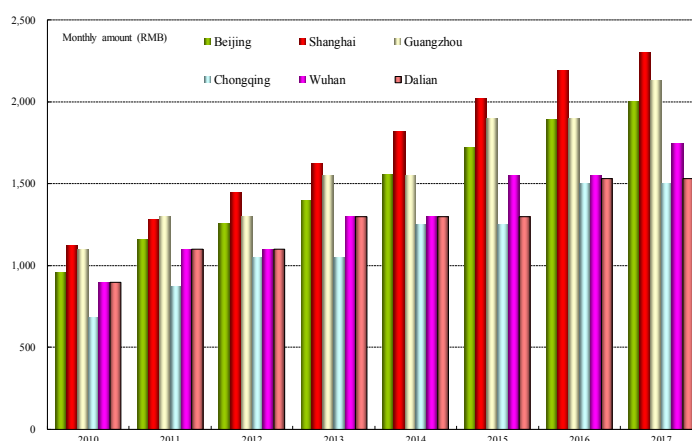
Figure 12: Foreign Direct Investment in Wuhan following China's WTO Entry

Source: As for Figure 11

The increase in foreign direct investment is closely linked to the growth of Wuhan's economy, though the fact that wage levels are comparatively low is likely a contributor to the favorable for investment. As **Figure 13** shows, wage levels in Wuhan are higher than those in Chongqing and Dalian but are lower than those in China's eastern cities and fell short of RMB 2,000 again this year.

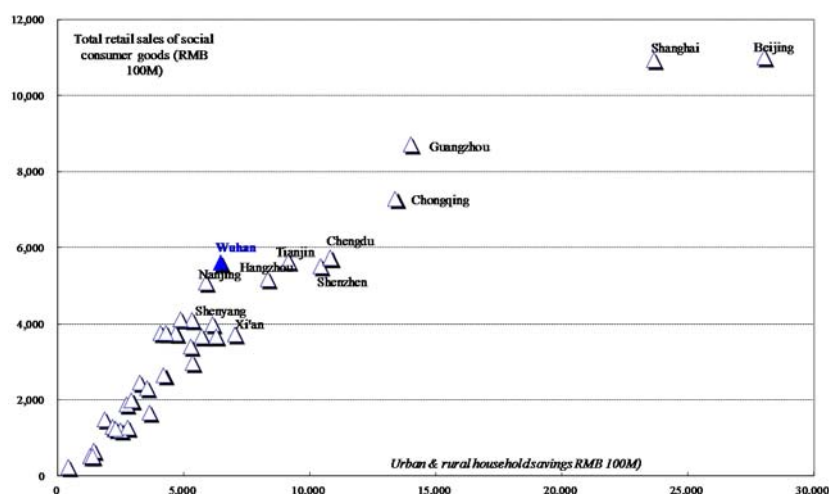
By contrast, Wuhan's market – another factor that is closely related to foreign direct investment – ranks relatively highly in national statistics (**Figure 14**). Whilst urban and rural household saving rates in Wuhan (**Figure 14**, horizontal axis) are lower than those in Chengdu, Shenzhen, Tianjin and Hangzhou, retail sales of social consumer goods (vertical axis) are now on a par with those in these cities, suggesting that Wuhan's residents have a strong propensity to consume, a factor that is favorable to foreign corporate investment. The development of local industries, growth of the local market and huge improvements in transport infrastructure are making this region increasingly attractive to foreign corporate investors.

Figure 13: Minimum Wage Rates in Major Cities in China's Eastern, Central and Western Regions (2010–2017)



Source: Compiled from respective regional government press releases

Figure 14: A Comparison of Market Size in Major Chinese Cities (Household Savings and Retail Consumption)



Source: Compiled from the *China Statistical Yearbook 2017*

Note: Data are actual figures for 2016.

3. The Path to Becoming an Innovation-driven Region/Municipality

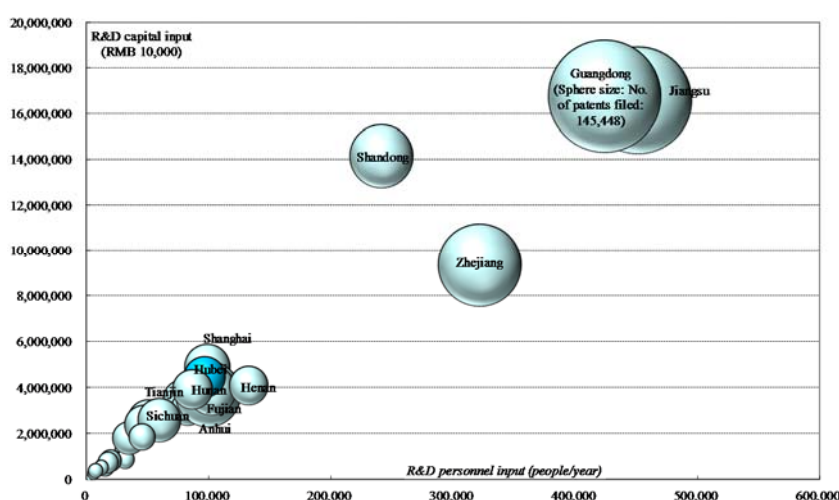
Both Hubei and Wuhan are conspicuous in their efforts to promote innovation driven development. Innovation has served as the engine for growth to date and it continues to offer considerable potential for future development.

Hubei is home to numerous universities and research institutes. Wuhan, meanwhile, has the world's largest population of university students (with 1.2 million undergraduates and 110,000 graduate students enrolled in Wuhan universities), and ranks third behind Beijing and Shanghai in terms of overall scientific, technological and educational capabilities in China. In recent years, data on both patent application and approval numbers in Hubei province have shown a marked increase due to those by universities. In general terms, R&D activity is increasing at universities and research institutes and through corporate tie-ups with industry and academia, and there is evidence of an increase in the number of innovation projects being undertaken through industry-academia-research institute collaborations in the province. According to a November 27 report in the *People's Daily*, Guangdong province emerged at the top of a national ranking of regional innovation capability in the

“China Regional Innovation Capability Evaluation Report 2017”, which was published by the China Entrepreneurship and Innovation Management Research Center of the University of Chinese Academy of Sciences on November 25, but Hubei also improved its ranking by a wide margin, advancing into the top ten for the first time.

The data on the R&D input and output performance of industrial enterprises above designated size given in **Figure 15**, puts Hubei essentially on a par with Shanghai and slightly ahead of Tianjin. **Figure 16**, meanwhile, evidences the growth of Wuhan’s high-tech industries (high-tech sector output increased from around 15% to 20.5% of municipal GDP in 2015), which is undoubtedly a reflection of the city’s scientific and technological capabilities.

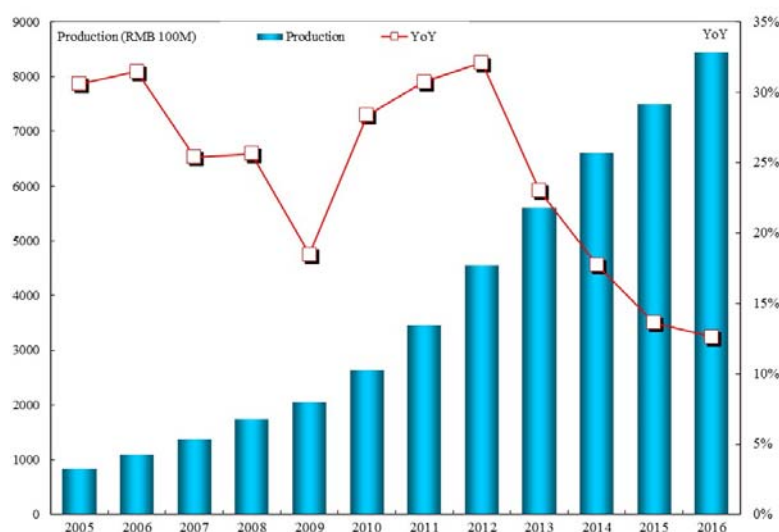
Figure 15: R&D Input and Output Performance of Industrial Enterprises Above Designated Scale in Hubei versus other Provinces



Source: Compiled from the *China Statistical Yearbook 2017*

Note: Data are actual figures for 2016.

Figure 16: The Growth of Wuhan’s High-Tech Industries (2005–2016)



Source: Compiled from the *Wuhan Statistical Yearbook 2016* and the *Wuhan Statistical Bulletin 2016*, Wuhan Municipal Bureau of Statistics

Numerous economic and technological development zones have been built in Wuhan. Among these, the

Wuhan Economic and Technological Development Zone and the Wuhan East Lake High-Tech Development Zone, both of which were approved as state-level development zones in 1991, are particularly large and are developing rapidly. The author visited both zones and conducted hearings with administrative staff.

Industry location maps are given for both industry parks (development zones) in **Figure 17**. Wuhan Economic and Technological Development Zone has all the hallmarks of a traditional economic and technological development zone and to date has served as a receptacle for numerous companies looking to set up operations in the Wuhan area (investment density is RMB 4,500 per cubic meter on a total investment basis. Mizuho Wuhan Branch). Many auto manufacturers as well as auto parts manufacturers and raw materials suppliers are located in the zone and it draws a number of global companies. As its name suggests, Wuhan East Lake High-Tech Development Zone is an industry park for the high-tech industry, and many companies from the so-called strategic emerging industries have set up shop within its bounds (investment density is between RMB 4,500 and RMB 7,500 per cubic meter). Wuhan East Lake High-Tech Development Zone includes both a bonded area and the Wuhan portion of the Hubei Free Trade Zone, which received government approval last year, which, officials explain, means that companies stand to benefit from the multiple incentives that are granted to the various industrial zones. The development zone has undergone a complete transformation since the author visited at the end of 2011 and now resembles a huge boomtown. Among the top twenty state-level high-tech and new technology zones, which includes Zhongguancun –the technology hub in the Haidian district of Beijing, Wuhan East Lake High-Tech Development Zone ranks fifth in terms of tenant company numbers (it had more than 3,200 corporate tenants as of 2016), and it continues to advance up the rankings in both sales and exports terms (**Table 4**). Some 50 important new drug development projects have already received government approval in the Wuhan National Bioindustry Base, which is located inside the development zone, and there are 300 new drug development projects currently in progress, suggesting that this agglomeration of high-tech industries is serving as a driver of innovation in Wuhan.

Table 3: Trends in Patent Application and Approval Numbers in Hubei Province

	No. of patents filed				No. of patents approved			
	2005	2010	2015	2016	2005	2010	2015	2016
Total number of patents	11,534	31,311	74,240	95,157	3,860	17,362	38,781	41,822
Inventions	2,038	7,410	30,204	43,789	733	2,025	7,766	8,517
Utility model	4,835	12,792	35,676	42,181	2,238	10,431	25,298	27,209
Design registration	4,661	11,109	8,360	9,187	889	4,906	5,717	6,096
Individuals	7,400	10,844	18,512	24,182	2,189	4,990	8,874	9,136
Universities	1,365	3,265	11,380	15,487	574	1,972	6,468	7,382
Research institutes	182	1,112	1,756	2,453	101	532	799	922
Industrial enterprises	2,305	15,856	36,702	48,420	901	9,744	22,193	23,864
Institutions/organizations	283	234	5,889	4,615	98	124	447	518

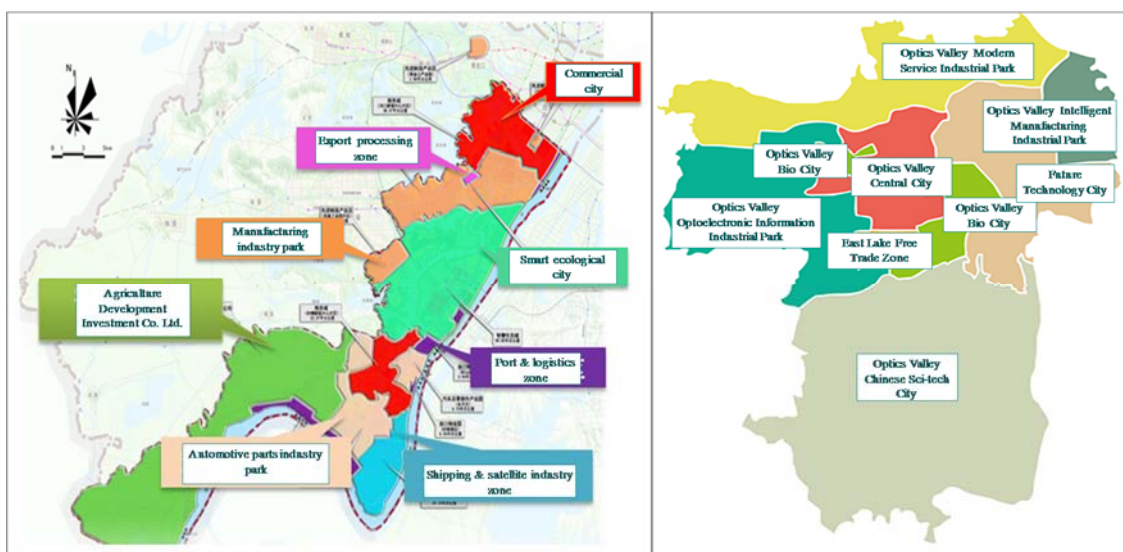
Source: Compiled from the *Hubei Statistical Yearbook 2017*

Table 4: Wuhan East Lake High-Tech Development Zone's Standing
in the Top 20 State-level High-tech and New Technology Zone Rankings

No.	Development Zone	No. of companies	Employees	Sales (RMB 10,000)	Exports (RMB 10,000)
1	Zhongguancun National Innovation Model Park	19,869	2,482,615	460,476,182	17,470,400
2	Shanghai Zhangjiang New Technology Development Zone	4,244	913,156	154,550,926	19,831,941
3	Tianjin Binhai New Technology Development Zone	4,005	372,824	71,777,542	4,897,597
4	Xian New Technology Development Zone	3,882	415,344	100,316,466	8,505,938
5	Wuhan East Lake High-Tech Development Zone	3,215	548,668	113,688,036	9,815,702
6	Guangzhou New Technology Development Zone	2,868	469,592	60,242,204	7,512,727
7	Hangzhou New Technology Development Zone	1,950	291,863	43,998,869	3,826,371
8	Shenzhen New Technology Development Zone	1,874	485,461	62,085,347	12,947,430
9	Chengdu New Technology Development Zone	1,762	379,478	57,439,028	10,539,551
10	Suzhou National New Technology Development Zone	1,176	225,468	28,125,028	14,714,063
11	Wuxi National New Technology Development Zone	1,163	247,778	33,599,408	9,329,216
12	Taiyuan New Technology Development Zone	1,110	119,348	19,307,595	151,620
13	Changzhou New Technology Development Zone	1,108	164,026	21,825,147	4,081,467
14	Changsha New Technology Development Zone	1,106	300,129	48,373,741	4,117,568
15	Hefei New Technology Development Zone	1,074	219,528	41,105,081	4,917,938
16	Chongqing New Technology Development Zone	1,055	200,392	22,033,038	2,186,452
17	Nanjing New Technology Development Zone	1,037	249,453	43,954,487	4,620,485
18	Foshan New Technology Development Zone	995	287,748	38,666,081	5,072,997
19	Dalian New Technology Development Zone	881	180,671	18,449,378	2,138,750
20	Jinan New Technology Development Zone	807	258,606	34,993,309	3,854,589

Source: Compiled from the *China Statistical Yearbook 2017*, National Bureau of Statistics

Figure 17: Industry Locator Maps for the Wuhan Economic and Technological Development Zone (left) and



the Wuhan East Lake High-Tech Development Zone (right)

Source: Excerpted from the respective development zone websites

There are 131 economic and technological development zones in Hubei province (Table 5), fifteen of which are located in Wuhan. Whilst this number is not particularly high, Wuhan ranks highest in the province in terms of both the number of companies it draws and the scale of its industries, and Wuhan's industrial clusters are visibly expanding. Looking ahead, should the ongoing industrial migration from China's eastern coastal region and the increasing number of foreign companies advancing into China result in even higher investment densities for Hubei's industry parks, there will undoubtedly be economic ripple effects for neighboring regions and municipalities. Wuhan, which was the birthplace of modern Chinese industry at the time of the Self-Strengthening Movement, and has served as the base for major developments in numerous cutting-edge industries, including autos, precision equipment, optoelectronics and pharmaceuticals, is metamorphosing into a metropolis with a population in excess of 10 million people.

Table 5: Key Indicators for the 15 Wuhan Economic (& Technological) Development Zones

Source: Compiled from the *Hubei Statistical Yearbook 2017*, Bureau of Statistics of Hubei Province

Development Zone	Developed area (sq. km)		Tenant companies		Industrial enterprises above designated size		High-tech companies		Employees (10,000)	
	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016
Hubei (131)	2320.12	2552.67	127636	167696	10182	10921	3241	4029	419.46	465.66
Wuhan (15)	482.75	531.6	71023	97043	1581	1660	1401	1718	106.28	118.56
Wuhan Economic & Technological Development Zone	39.7		216	230	216	230	89		11.70	11.90
Wuhan East Lake High-Tech Development Zone	68.32	77.54	35982	48596	683	745	1063	1391	45.28	47.34
Wuhan Linkonggang Economic & Technological Development Zone	125.49	139.26	29629	37712	273	271	62	102	29.04	31.15
Wuhan Hanyang Economic Development Zone	12	12	921	921	68	68	25	25	3.89	3.89
Wuhan Wuchang Economic Development Zone	2.34	2.34	216	164	16	14	11	10	1.85	1.74
Wuhan Qingshan Economic Development Zone	10	10	323	341	99	91	15	15	3.68	2.38
Wuhan Hongshan Economic Development Zone	0.27	0.27	157	158	13	14	18	19	0.87	0.92
Wuhan Qiao Kou Economic Development Zone	1.14	1.14	408	445	27	24	9	10	4.00	4.20
Wuhan Hannan Economic Development Zone	15.13	16.74	493	487	136	139	13	13	3.70	3.84
Wuhan Caidian Economic Development Zone	44.5	53.3	479	1495	85	128	18	39	3.30	3.90
Wuhan Jiangxia Economic Development Zone	108	110	738	738	168	168	53	53	6.20	6.30
Wuhan Panlongchen Economic Development Zone	20	20	673	691	41	40	0	11	5.04	5.10
Wuhan Yangluoyang Economic Development Zone	31.85	33	147	175	85	90	15	18	2.90	2.45
Wuhan Jiangnan Economic Development Zone	3.31	3.31	242	242	15	14	7	7	0.90	0.90
Wuhan Jiangnan Economic Development Zone	0.7	0.7	399	401	11	11	3	3	2.36	1.89
Huangshi (8)	154.67	158.36	8281	8835	487	561	145	159	27.16	27.86
Shiyan (7)	88.46	88.61	5347	5969	617	642	130	150	19.78	21.88
Yichang (15)	181.35	190.58	7397	9421	1030	1092	320	363	30.61	32.53
Xiangyang (15)	211.6	255.2	12554	16482	1268	1349	347	457	53.44	67.69
Ezhou (3)	65.4	70.2	3449	3923	418	437	68	85	11.86	12.25
Jingmen (8)	120.7	167.5	1578	1867	781	857	150	232	22.09	22.98
Xiaogan (8)	210.0	214.3	3971	5908	936	973	150	201	28.01	29.51
Jingzhou (10)	249.8	258.5	3627	6591	865	948	105	129	38.06	46.19
Huanggang (14)	242.5	285.8	3043	3668	693	775	167	218	26.37	28.36
Xianning (8)	104.0	117.3	1066	1140	564	608	84	113	12.29	13.24
Suizhou (4)	60.4	61.0	1852	2176	220	232	65	74	9.60	9.96
Enshi Tujia and Miao Autonomous Prefecture (9)	53.5	54.9	940	1012	281	324	22	27	11.57	11.70
Xiantao (2)	30.8	31.2	1210	1308	265	286	48	63	8.41	8.72
Qianjiang (3)	26.4	26.4	1914	1933	52	48	21	20	5.55	5.61
Tianmen (2)	35.8	39.1	356	392	119	124	16	18	8.26	8.47

4. Challenges to and prospects for Wuhan's reinstatement as a megalopolis and emporium

As the central city in both China's central region and the Yangtze River Economic Belt, Wuhan has leveraged its geographical location, industrial infrastructure, scientific and technological capabilities, and other resources to develop its economy under central government policies including the *Rise of Central China Plan* and the *Yangtze River Economic Belt Development Strategy*. Accordingly, regional economic development and industry agglomeration are expected to continue down the line.

Wuhan must overcome two major challenges if it is to realize sustainable economic development in the coming years, however. The first will be its ability to realize the sustainable new-type urbanization called for in building a resource-saving and environmentally friendly society³. The second will be to find ways, as the capital of Hubei province and the core city in central China, to increase its influence within the region and over neighboring municipalities and generate greater economic ripple effects so that it can serve as the engine for the development of Hubei province, Wuhan Metropolitan Area (left side of **Figure 18**), and central China as a whole. This is, perhaps, the overarching mission that has been assigned to Wuhan.

Despite being one of the largest economies in Hubei province (accounting for 35% of its

³ In 2014, the Wuhan Metropolitan Area and urban clusters in Hunan Province were named as pilot zones for the development of a resource-saving and environmentally friendly society, but the fruits of these efforts are proving somewhat elusive.

GDP), Wuhan does not have particularly strong ties with neighboring cities, and it is hoped that the city's ability to attract people will increase (it is currently home to less than 20 percent of the province's population). A larger population will enable Wuhan to exert greater influence and will have benefits in terms of increasing the size of the Wuhan Metropolitan Area and the balanced development of Hubei province as a whole. Hubei province lies at the midpoint between eastern and western China (right side of Figure 18) and it is expected to serve as both a bridge and an intermediary for industry migration to the Yangtze River Economic Belt and in efforts to promote regional economic development. The future development of Wuhan and Hubei province and their roles as models for other regions and municipalities are thus expected to have extremely important implications down the line. The framework for China's new-type urbanization strategy establishes the Yangtze River Economic Belt as a key national axis, and both Wuhan and Chongqing have been assigned critical positions in the middle reaches of the Yangtze River Basin. More than ever before, both cities must thus acknowledge their role in the cooperative development and joint growth of metropolitan areas in the region and central and western China as a whole.

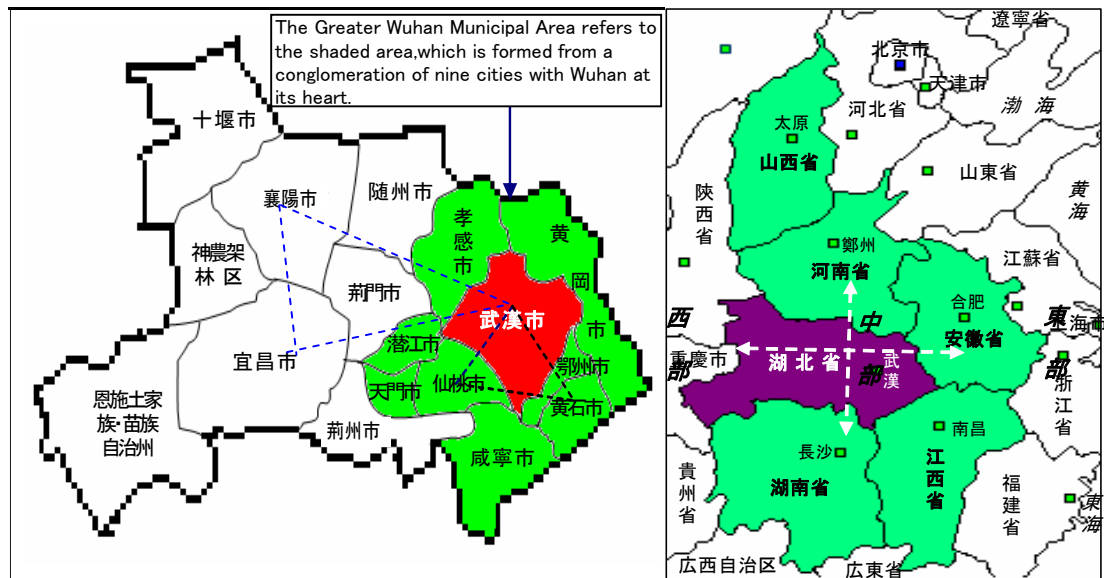


Figure: 18: Hubei Province as the Central China Transit Point
and the Location of Wuhan Metropolitan Area in Hubei Province

Source: Reprinted from the February 2012 edition of MIZUHO CHINA MONTHLY: "Development Trends in Wuhan Metropolitan Area and its Prospects for the Future"

The central government passed a plan to boost development in the country's central regions during the 13th FYP period at the end of 2016, and the governments of both Hubei province and Wuhan have released plans to promote its implementation. Building on recent momentum for the fourth industrial revolution, efforts are also being made to cultivate new industries⁴. Both the *Plan for the Development of City Clusters in the Middle Reaches of the*

⁴ Six months after the release of "Made in China 2025" - China's version of Germany's Industry 4.0 (which was issued in May 2015), the government of Hubei province issued plan of action that was consistent with this strategy and Wuhan is spearheading the promotion of various specific initiatives. According to recent news reports, Wuhan has followed Shanghai

Yangtze River (item 3 in **Table 1**) and the *National Development and Reform Commission Guiding Opinions on Supporting the Construction of Wuhan as a National Core City* cite goals for the population and economy of Wuhan (to give it the third largest population and the fourth highest GDP among China's coastal cities) and anticipate it serving a major bridging role for industrial development and the Yangtze River Economic Belt.

During this recent survey, the author was made keenly aware of Wuhan's strong enthusiasm for its attempts to evolve into a large, modern and global city that plays a central municipal function in central China and the middle reaches of the Yangtze River Economic Belt. Specific measures are being taken towards this end and as these efforts intensify, it cannot be long before Wuhan achieves its goal of reinstating itself as a Chinese megalopolis and emporium.

in announcing measures to support the development of the artificial intelligence industry inside the Wuhan East Lake High-Tech Development Zone, and is working to attract human resources and businesses and to promote collaboration between companies and educational organizations and research institutes in a bid to make the development zone a leading base for the AI industry in China. A sum of at least RMB 200 million (approximately 3.389 billion yen) has been earmarked for these measures in this year's budget and various incentives, including subsidies are being offered to companies that succeed in attracting high-end manufacturing personnel, for both the companies and the personnel they bring in.

Examination of the Open-market Policy toward the Internationalization of the Chinese Yuan - After the National Congress of the Communist Party of China -

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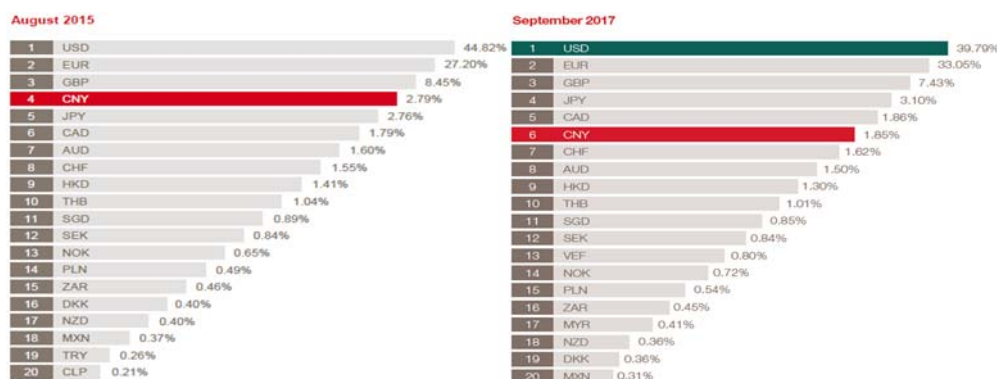
1. Introduction

This year was a turning point for Mizuho Bank (China) Ltd., celebrating its 10th anniversary. For the author of this article, personally as well, this year was a “year of challenges,” working abroad for the first time in Shanghai. In China, the quinquennial National Congress of the Communist Party of China was held this year, and the second term of the government under President Xi Jinping began. The Chinese monetary authorities have made every effort for an open market through trial & error so far. This article will re-examine the measures taken so far by the Xi Jinping government so as to discuss the future direction based on the outcome of the National Congress of the Communist Party of China held this year. It should be underlined that this article is largely based on the personal opinions of the author, and readers are thus asked to keep this in mind when reading this article.

2. Status quo of the internationalization of the Chinese yuan

In October 2016, the Chinese yuan was adopted as a basket currency for the special drawing rights (SDR) for the International Monetary Fund (IMF), raising expectations for the advancement of reforms for the Chinese yuan as an international currency. It has been more than a year since this event, and Sheng Songcheng, advisor to the People’s Bank of China (PBOC), emphasized on September 15 that Chinese yuan reforms have been advancing smoothly after adoption in the SDR currency basket. However, it seems that, in reality, the internationalization of the Chinese yuan has not advanced as expected. According to the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the ratio of the Chinese yuan used for account settlement worldwide rose temporarily to 2.79% in 2015, exceeding the Japanese yen (2.76%) and ranking fourth after the U.S. dollar, the euro, and the British pound. However, the latest ratio has been 1.85%, falling below 2% and ranking only sixth in the world (Fig. 1). In terms of importance as a settlement currency, therefore, it gives the impression that the internationalization of the Chinese yuan has been going backward.

Fig. 1: Share of the Chinese yuan in global account settlement



Source: Extracted from RMB Tracker, SWIFT

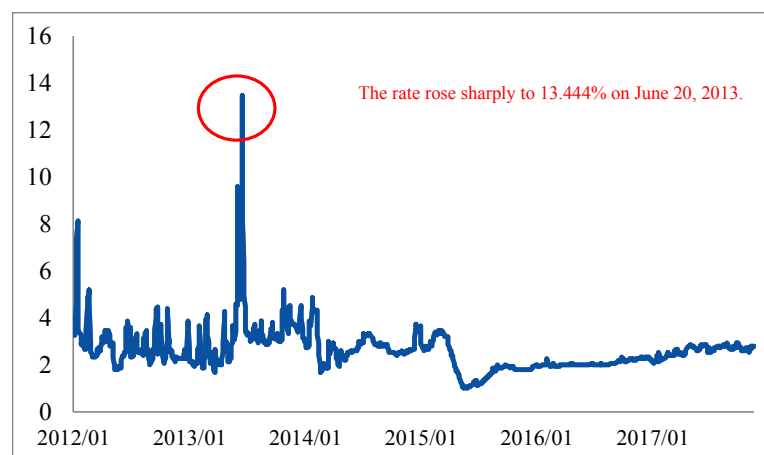
3. Market control: A cause of confusion

The Chinese monetary authorities have taken various measures so far. However, they failed to hold efficient dialogue with the market and sometimes caused violent fluctuations in the market. The below are some examples of such situations as seen in the past under the Xi Jinping government.

(1) SHIBOR⁹ spike: June 2013

While the Chinese monetary authorities were strengthening regulations against shadow banking, the liquidity level fell sharply at the end of June in 2013 before the large-scale maturity of a wealth management product worth approximately 7 trillion yen, leading to a sharp rise in interest rates—those for short terms, in particular (Fig. 2). The market was temporarily in confusion, fueling concerns among medium- to small-sized banks about not succeeding in fund procurement. This was also caused by the fact that seasonal capital demand was on the rise for the payment of deposit reserves and taxes, while a series of measures were being introduced in order to strengthen supervision and administration. In order to control shadow banking, the Chinese monetary authorities did not supply funds at the beginning. However, they had to gradually soften their tough stance and started unofficially supplying funds to settle the situation. Thereafter, deleveraging advanced temporarily, but the capital flow became more complex after several years. As a result, shadow banking increased again, and financial risks persist today.

Fig. 2: SHIBOR (overnight) trends



Source: Compiled based on data from Bloomberg

(2) Collapse of the Chinese stock bubble

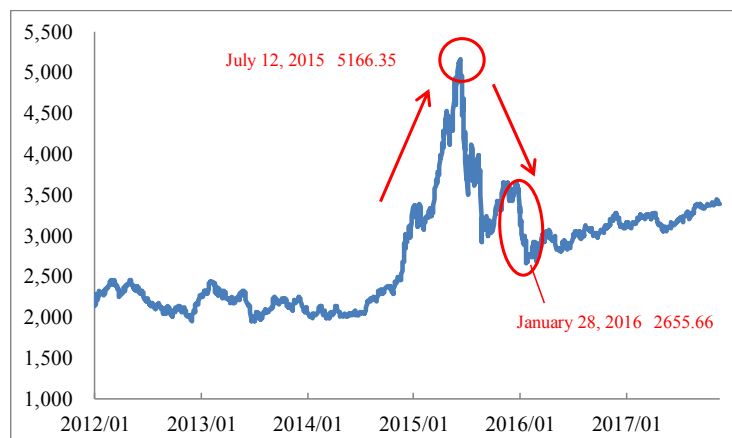
From June 2015 to January 2016, Chinese stock prices fell sharply. This was a result of the fact that, despite the slowdown in the economy, there was a stock bubble with growing expectations for stock market reforms and economic stimulus measures. The collapse of the bubble was triggered by increasing concerns over the deteriorating supply & demand balance, which resulted from an increase in IPOs, the announcement of a plan for strengthening regulations against credit transactions, and the anticipation of financial deregulation. On January 4, 2016, the Chinese monetary authorities introduced a “circuit breaker”¹⁰ as a safety measure, while cancelling regulations on stock sales for major stockholders. However, these measures only

⁹ SHIBOR: Shanghai Interbank Offered Rate. This is a base rate for interbank capital transactions.

¹⁰ Circuit breaker: An instrument to forcefully halt trading when the price fluctuation exceeds a certain level in the stock market or in futures transactions.

encouraged market participants to hurry and sell more stocks, leading to the further depreciation of stock prices (Fig. 3).

Fig. 3: Trends in the Shanghai Stock Exchange Composite Index

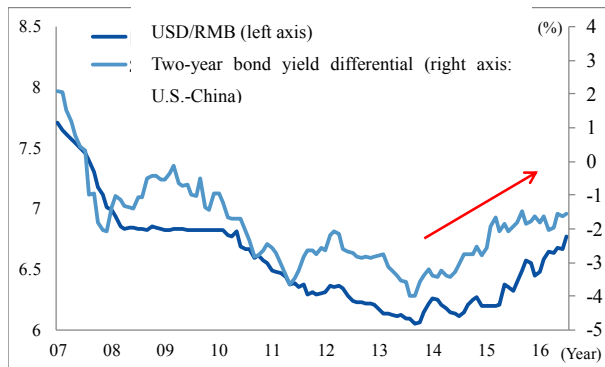


Source: Compiled based on data from Bloomberg

(3) Growing pressure for the depreciation of the Chinese yuan and capital outflow, along with the tightening of control

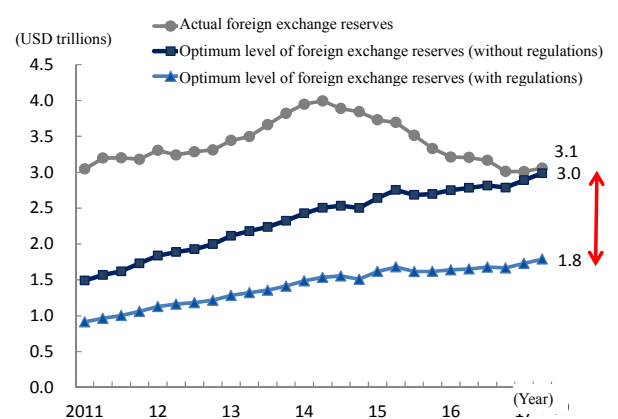
Since 2014, pressure has strengthened for the depreciation of the Chinese yuan and for capital outflow, due to concerns over the economic outlook and decreasing interest rate differentials between the U.S. dollar and the Chinese yuan. As a result, the Chinese monetary authorities once again took measures of monetary easing by strengthening regulations on capital transactions. On the other hand, in the U.S., measures of quantitative monetary easing were downsized. Following the narrowing of interest rate differentials between the U.S. dollar and the Chinese yuan, the Chinese yuan depreciated against the U.S. dollar (Fig. 4). Thereafter, the capital outflow continued to increase, accelerating the depreciation of the Chinese yuan. In response to this, the Chinese monetary authorities intervened in the market by buying the Chinese yuan while strengthening capital regulations through window guidance. As a result of the market intervention through Chinese yuan-buying (U.S. dollar-selling), the amount of foreign exchange reserves declined significantly from its peak at 4 trillion dollars, temporarily falling below 3 trillion dollars, and this attracted substantial attention from foreign media. Thanks to the measures above, the pressure for capital outflow has currently been mitigated and the market interventions were reduced, leading the foreign exchange reserves to stabilize at the level of approximately 3.1 trillion dollars. However, this is still around the same level as the optimum level of foreign exchange reserves (without capital regulations) calculated by the IMF. It is thus more likely for the Chinese monetary authorities to maintain the capital regulations for a while (Fig. 5).

Fig. 4: U.S.-China interest rate differentials and the U.S. dollar/Chinese yuan exchange rate



Source: Compiled based on data from Bloomberg

Fig. 5: Trends in the optimum level of foreign exchange reserves



Source: Compiled based on data from the IMF and Mizuho

Research Institute

(4) Confusion related to the foreign exchange reforms

Even though the foreign exchange system reforms have been positively evaluated to some extent, leading to the entry of the Chinese yuan into the SDR currency basket, the changes in the system have also caused some confusion. In August 2015, a new method was introduced to calculate the Chinese yuan central parity rate using the closing rate of the previous day as a reference, in order to increase the importance of the market. Furthermore, at the end of 2015, the CFETS currency basket was publicly announced in order to enhance communication with the market. Such decisions of the Chinese monetary authorities were seen as the acceptance of the depreciation of the Chinese yuan by market participants, further strengthening the pressure to sell the Chinese yuan. Thereafter, the Chinese yuan continued depreciating, following the depreciation of the offshore Chinese yuan, until around February 2016 (Fig. 6).

Fig. 6: Growing expectations for the depreciation of the Chinese yuan based on changes in the foreign exchange system



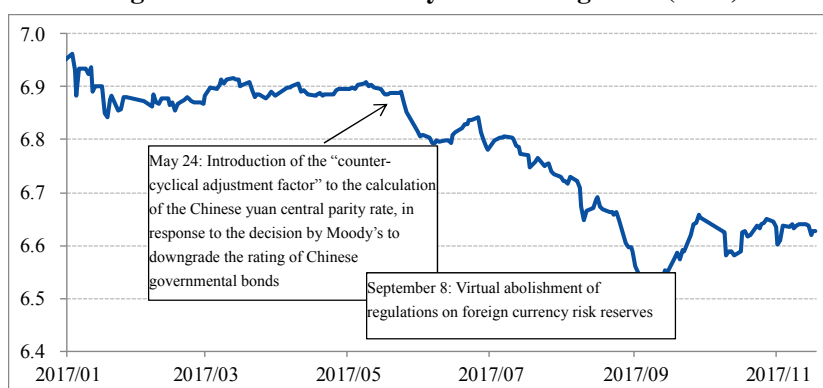
Source: Compiled based on data from Bloomberg

4. Internationalization of the Chinese yuan emphasized once again at the National Congress of the Communist Party of China, despite the Chinese yuan appreciating against market expectations this year

In the second half of 2017, Donald Trump declared during his presidential campaign that he would name China as a “currency manipulator,” fueling concerns over a possible trade war between the U.S. and China. Furthermore, interest rate differentials between the U.S. and China narrowed as a result of the interest rate hike in the U.S., leading the U.S. dollar/Chinese yuan exchange rate to approach the CNY 7.0 level. Even though the U.S. dollar/Chinese yuan exchange rate remained flat for a while since the beginning of the new fiscal year, a ratings company in the U.S., Moody’s Investors Service, announced its decision to downgrade the rating of Chinese government bonds in late-May 2017. This fueled concerns regarding sales of Chinese government bonds and an increase of capital outflow. In reaction to this, the Chinese monetary authorities introduced the “counter-cyclical adjustment factor”¹¹ in the calculation of the Chinese yuan central parity rate, while also continuing to intervene in the market by buying the Chinese yuan. As a result, contrary to expectations, the Chinese yuan appreciated against the U.S. dollar and the U.S. dollar/Chinese yuan exchange rate reached the CNY 6.4 level. Once the Chinese yuan appreciated to some extent, the Chinese monetary authorities virtually abolished regulations on foreign currency risk reserves, thereby reversing the trend, and the Chinese yuan depreciated significantly against the U.S. dollar. Thereafter, the U.S. dollar/Chinese yuan exchange market remained stable, waiting for the National Congress of the Communist Party of China, scheduled for October 18 (Fig. 7).

As shown above, the Chinese monetary authorities have introduced various regulations and system reforms while efficiently using market interventions by both buying and selling the Chinese yuan in order to control excessive fluctuations in the Chinese yuan exchange market, stabilizing the monetary market and economic conditions. It thus seems that the Chinese monetary authorities have recently been successful in controlling the market.

Fig. 7: U.S. dollar/Chinese yuan exchange rate (2017)



Source: Compiled based on data from Bloomberg

It is thus certain that, after having a difficult time, the government under President Xi Jinping has made certain progress in its first term at the structural level toward monetary system reforms. We should thus at

¹¹ Counter-cyclical adjustment factor: The Chinese monetary authorities can add adjustment to the Chinese yuan central parity rate when it is considered to be out of the optimal range based on economic conditions.

least positively evaluate the fact that systems and the structures were organized for the marketization of interest rates, the promotion of the development of monetary services, and the supervision and administration of the monetary system (Fig. 8).

Fig. 8: Monetary system reform plans and achievements in the first term of the government under President Xi Jinping

Main policies in the reform	Main achievement	Evaluation of progress
(1) Marketization of interest rates etc. – Marketization of the Chinese yuan rate formation mechanism – Acceleration of the promotion of the marketization of interest rates – Preparation of government bond yield curves that reflect the supply & demand in the market – Opening of capital transactions	– The fluctuation range of the Chinese yuan was widened, and the calculation mechanism for the central parity rate was revised. – A deposit insurance system was introduced and the interest rate restriction was abolished, and preparations were started for the introduction of the interest rate corridor system. – The types of government bonds available were increased, and the Ministry of Finance started transactions. – Capital outflow was deregulated, while administration was strengthened for outflow.	There has been steady progress in terms of system improvement, while some criticize that it goes against the open-market economy to strengthen regulations on the foreign exchange system and on capital transactions.
(2) Promotion of the development of various financial services – Approval of the establishment of banks and other financial institutions based on private capital – Establishment of a multi-layered capital market system – Establishment of an economic security system based on insurance – Reforms of monetary policy institutions – Development of inclusive finance – Encouragement of financial innovation	– The establishment of banks based on private capital was approved (14 banks at the end of 2016). – An over-the-counter stock market was established, and the opening of the bond market to foreign investors was promoted. – The “Plan for Implementing a Catastrophe Insurance System for Households” was announced. – Reforms plans were approved and executed at various monetary policy institutions. – “The Plan for Promoting the Development of Financial Inclusion (2016–2020)” was announced. – Financial technology (Fintech) was drastically developed.	There was steady progress in terms of the establishment of basic principles and system improvement, while some other objectives were also advanced, such as the establishment of privately financed banks.
(3) Improvement of the financial supervision and administration system – Establishment of a cooperative mechanism for supervision and administration – Definition of the professional and risk-handling responsibilities for the central and local bodies	– A committee for financial stability & development was established. – Related measures by the State Council were released.	Revision of the supervision and administration system

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On October 17, President Xi Jinping announced China’s further efforts to open up its market to the world, making it easier for foreign investors to access the domestic market. As part of such efforts, on November 10, the last day of the visit of U.S. President Donald Trump in Asia, China introduced a plan to abolish its

restrictions on foreign investment in domestic financial institutions so as to make it easier for foreign financial institutions to access the domestic market of China (Fig. 9). In the times ahead, foreign financial institutions will be approved to be able to own more than half of all shares of domestic financial institutions in China.

Fig. 9: Plan to abolish restrictions on foreign investment in domestic financial institutions

Financial institutions	Plan to abolish investment restrictions
Securities companies	1) To raise the upper limit on foreign investment from the existing 49% to 51%
Investment trust management companies	2) In three years after the execution of 1), to accept overall foreign investment
Futures commodity transaction dealers	
Commercial banks	To abolish the existing restrictions on sole capital contribution (20%) and joint capital contribution (25%) from foreign investors
Asset management companies	
Insurance companies	1) To raise the upper limit on foreign investment to 51% in three years
	2) To entirely abolish restrictions on foreign investment in five years

Source: Compiled based on materials from Xinhua News Agency and Mizuho Securities Asia

This series of actions shows how strong the will of the Chinese monetary authorities is in regard to opening up the Chinese market and internationalizing the Chinese yuan. It is thus expected that in 2018 and after, China will continue making efforts to open up its market and enhance the efficiency of the monetary system for the internationalization of the Chinese yuan. Since the beginning of this year, the Chinese yuan has appreciated against the U.S. dollar by approximately 6.8%, while the foreign exchange reserves have been stable, recording a slight increase for the ninth consecutive month. Based on the trends seen in the past, it seems that the market has been increasingly well controlled. However, market participants should still keep an eye out for the movement of Chinese monetary authorities regarding future policy measures, looking also at past examples.

5. Conclusion

It has been approximately half a year since I arrived in China, and I have had opportunities to visit different places in the country. There are many ethnic groups, languages, and cultures in China, which confirms once again the vastness of the country. It is astonishing that the country is several times larger than Japan both in terms of population and land area, and its economy is the second largest in the world, while still on the rise. It was Singles' Day on November 11, and online sales on Alibaba were extremely active. The scale of the sales remains outstanding, reaching single-day sales of approximately 3 trillion yen, and demand from consumers has not seen a slowdown. It is therefore an important task for President Xi Jinping and other executives of the Communist Party to lead the future of the country. The year of 2017 marked a turning point, with the start of the second term for the government under President Xi Jinping. It will be interesting to continue observing how the past dialogues with the market will be used for the future and what measures will be taken in which direction.

On November 17, 2017, five monetary and administrative organizations, including the PBOC and the China Banking Regulatory Commission (CBRC), released "Guiding Opinions on Regulating the Asset Management Business of Financial Institutions (Draft for Comment)." These opinions are meant to break

the habit of “guaranteed returns” through which the principal and the expected revenues of wealth management products are guaranteed, while also controlling the leverage rate (debt ratio) by June 30, 2019, when the transition period ends. This is based on the statement by Guo Shuqing, chairman of the CBRC, made during the financial representatives’ meeting at the National Congress of the Communist Party of China, such that the “CBRC would more rigorously execute laws, regulations, and orders in the time ahead.” It is thus expected that additional regulatory measures will be introduced in 2018 in order to prevent financial risks.

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