

China: Two Sessions – what to expect on reforms

We recently wrote [a note](#) on what to expect from this year's Two Session meetings. That note focused on the economic aspects of the Two Sessions. This note focuses more on the three main reform targets



Great Hall of the People in Beijing, capital of China where Two Sessions will be held.

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1 Social reform

The Two Sessions will likely focus on how to reform the household registration system at a faster pace. The current system separates urban and rural social systems so that rural workers cannot enjoy social benefits if they move to work and live in a city. There are already some experimental policies to include rural residents in the urban social security system. But the speed of adjustment is slow, and the number of people that can be “removed” from the household registration system is small compared to the whole population. More [pilot projects](#) have been started recently but this does not cover the biggest cities in China, which means many workers cannot enjoy social benefits. The ultimate solution is to replace the current household registration system with a unified national social security system. The main difficulty with this is fiscal redistribution between the central and local governments. Consequently, we only expect experimental steps until there is further progress in the fiscal structure.

2 Anti-corruption

There has been one story after another about corrupt officials being arrested in China over the past month. This has not been unusual in the period prior to the Two Sessions whilst Chairman Xi has been in office. Anti-corruption reforms were put on hold during 2020. But now that the government has more room to look at agendas other than Covid, one of the top priorities will be to clean up government. Some of these top officials are C-suites of SOEs (state-owned enterprises). If the same happens to POEs (Privately-owned enterprises), investors may lose confidence in the company, but this is not relevant for SOEs. Investors understand that the C-suites of SOEs rotate every few years, and the decision maker behind those decisions is the central government.

3 Exchange rate and interest rate reform

The People's Bank of China, China's central bank, has already started reforming the exchange rate system by fading out the counter-cyclical factors used in the daily exchange rate fixing mechanism. The goal of this is to increase transparency in yuan movements. We also expect interest rate reform to speed up this year to match these exchange rate reforms. Short-term interest rates should better reflect daily open market operations and be linked to financial products. This will help the PBoC in the future (maybe not for a decade) to shift gradually from the current myriad policy rates ranging from 7D to 5Y to a single policy rate.

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