

Economic Analysis

China | NPC Reaction: Targets point towards new focus on growth and financial stability

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The annual session of the National People's Congress (NPC), started on March 5 and will conclude on March 16. Most targets are consistent with our projections. In line with our [pre-NPC note from last week](#), measures to boost short-term growth were put ahead of structural reforms. Most importantly, the authorities seem adamant about maintaining high growth rates, and set the target for 2016 at 6.5-7.0%. Consequently, stimulus measures will be revved up via fiscal and monetary policy channels. For instance, M2 expansion was increased to 13%, up from 12% in 2015 and the inflation target was kept untouched at 3%. The official budget deficit will be expanded to -3% of GDP in 2016, below our projection of -4%. This makes us think that the authorities have a preference to increase fiscal spending off-budget, rather than through an aggressive expansion of the central budget deficit. In addition to the targets, the rhetoric around some of China's long-term strategic goals – capital account liberalization and RMB internationalization – seemed muted compared to last year. This suggests that the emphasis of reforms has shifted to the domestic realm, following from two episodes of financial turmoil since August last year. The bottom line is that the authorities have become more prudent and have pivoted their focus to short-term growth and financial stability.

- **Ambitious growth targets...** First of all, the GDP growth target was set at a lofty 6.5%-7.0%. This is the first time that authorities set a range as opposed to a fixed-point target. A flexible target does give policymakers some room to maneuver; however we reiterate our stance that even 6.5% is ambitious given the circumstances. Traditionally, GDP targets have served as the cornerstone of Chinese economic planning. Leaders are usually appraised in terms of their ability to deliver growth; which could explain why President Xi Jinping is so reluctant to deviate from his pledge to double 2010 nominal GDP levels by 2020, requiring annual average growth rates of 6.5%.
- **...will require revved up stimulus measures.** Premier Li Keqiang's working report outlined an expansion of M2 growth from 12% in 2015 to 13% in 2016. Moreover, the authorities left the inflation target unchanged at 3%, despite lower CPI levels. Disinflationary pressures have both domestic and foreign components. On the domestic front, protracted PPIs (Figure 1) point towards serious overcapacity concerns in China's manufacturing sector, while weak global demand in combination with falling commodity prices have played a role in reducing the price of inputs. Most likely, the foreign component of this deflationary trend will be played up as a means to justify an even more accommodative monetary policy stance in 2016. This will most likely be achieved via RRR cuts (200 bps), direct liquidity injections and asymmetric interest rates. On the fiscal policy front, the Ministry of Finance (MOF) highlighted that it would increase the official budget deficit from -2.3% in 2015 to -3% in 2016, although the figure ought to be higher if you include expenditures via the central budget stabilizing fund. The thrust behind fiscal loosening will be more tax cuts for households and firms, estimated to reach approximately RMB 500 billion this year.
- **Policy focus pivots to domestic side.** Unlike last year, Premier Li Keqiang didn't stress capital account convertibility and RMB internalization in his working report. The authorities have seemingly realized the seriousness of the sequencing issue in pushing for their grand project of financial liberalization and so the emphasis will now fall on financial stability amidst increasing growth headwinds and external uncertainty. Generally we think that it's a welcome step as priority should be given to increasing the efficiency of the domestic financial market and upgrade the country's financial regulatory framework, including [the new monetary policy framework](#).

- No pain no gain: too much attention on short-term growth could delay necessary structural reforms.** Stimulus measures will help to boost growth and facilitate a cyclical recovery in the short term. A hard-landing is an unlikely scenario any time soon. However, the authorities haven't come up with actionable measures to address one of the most pressing issues – [overcapacity in the industrial sector](#). Admittedly, Premier Li Keqiang's working report did mention the need to "eliminate overcapacity in a planned way (and) address the issue of 'zombie enterprises' proactively yet prudently by using measures such as mergers, reorganizations, debt restructurings, and bankruptcy liquidations". This is a positive development. The MOF also earmarked a RMB 100 bn fund that will be deployed to facilitate the elimination of overcapacity in the steel and coal industries. However, in light of the 6.5%-7.0% growth target, any form of painful "supply-side" reform will have to be put on the back burner for the time being. In the absence of reforms, accommodative monetary and fiscal policy stances will continue to aggravate China's looming overcapacity concerns and further push up corporate leverage (Figure 2).

Figure 1
The PPI has been in negative territory since 2012



Source: CEIC and BBVA Research

Figure 2
Debt/EBITDA on the rise



Source: Wind and BBVA Research

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