Economic Analysis

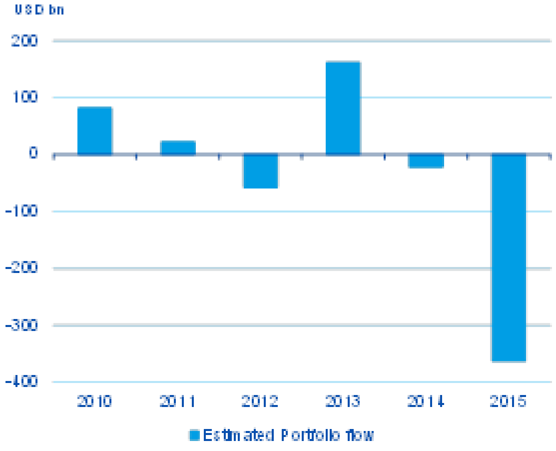
China | Strategic misalignment could hinder the outcoms of the G20 Finance Ministers Meeting in Shanghai

Carlos Casanova / Le Xia

Finance Ministers of the G20 will meet in Shanghai on February 26-27 to discuss global growth woes and financial stability. The objective is to reach a pact that fuels global growth through a combination of coordinated monetary, fiscal and structural reforms. However, disparate economic realities and a dysfunctional international financial system will limit the scope of commitments that can be achieved in Shanghai. Most importantly, the meeting could serve as a platform to calm anxieties regarding the health of China's economy and its ability to implement reforms that move the country towards more sustainable, market-driven and consumption-based growth.

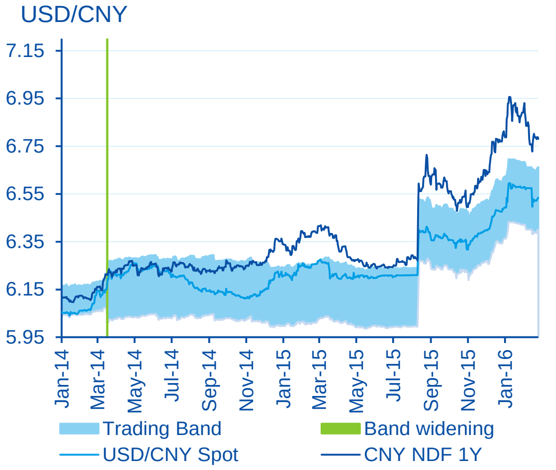
- **G20 Finance Ministers to look towards fiscal as well as monetary policy for growth.** Finance Ministers of the G20 will meet in Shanghai on February 26-27 to discuss global growth headwinds and financial stability. One of the main outcomes of the meeting in Shanghai is expected to be greater policy coordination in the fiscal as well as monetary policy fronts. The US Treasury Jack Lew will most likely push for further fiscal expansion, a proposal which we expect will be backed by China, as evidenced by Vice Finance Minister Zhu Guangyao's statement that "countries with room to make fiscal expansion should do so" at a conference hosted by IIF one day before the G20 event. Depreciatory pressures on the RMB have forced the PBOC to tap into its FX reserves in order to defend the currency, leading to capital outflows (Figure 1). Further interest rate cuts could exacerbate these concerns, leaving China with more room to maneuver in the fiscal policy front. We therefore expect that Beijing will expand its fiscal deficit to around 4% of GDP in 2016, which it was most likely going to do anyways in order to prop up its domestic economy.
- **But good intentions may not translate into actionable policies unless domestic priorities are aligned**. While some unity on the US-China front would be nice, following from recent squabbles over the South China Sea, it is unlikely that other major economies will subscribe to more fiscal stimulus. For example Japan's huge debt, equivalent to 450% of its GDP, makes reducing taxes or fiscal expansion beyond the additional 2% of GDP target unfeasible. Having said that, "Abenomics", the economic policies advocated by Japan's Prime Minister's Shinzō Abe, have so far proven effective in the correction of excessive Yen appreciation, but have done little to achieve the 2% inflation target and concerns have emerged regarding the sustainability of BoJ's QQE program. We don't exclude the possibility of more fiscal stimulus in Japan, particularly if Japanese Finance Minister Tarō Asō finds support from its G20 peers.
- **Beyond just monetary and fiscal policy.** The IMF has declared that a mix of structural reforms, in addition to fiscal support, is required in order to boost global growth. Nowhere is this necessity more apparent than in China. Increasingly, it seems like the G20 Finance Ministers Meeting could become a platform for China to calm anxieties surrounding the health of its economy. In fact, the government may have already started to implement steps in this direction. Just last night, the PBoC announced that it was lifting restrictions to the onshore Interbank bond (IBB) market – a gesture that China is committed to CA liberalization ahead of the G20? The move should trigger substantial portfolio inflows from global investors, curbing capital outflows. Furthermore, Politburo releases statement on Tuesday pledging stable marco policies and setting the stage for a firmer line on SOE reforms ahead of the NPC meeting in March. Finally, RMB strengthening (Figure 2) calls for cautious optimism ahead of the meeting. We expect that the RMB to remain stable against the basket of currencies.

Figure 1
Capital outflows have intensified, limiting the scope of monetary easing in China



Source: CEIC and BBVA Research

Figure 2
Yuan Strengthening ahead of G20 Finance Ministers Meeting in Shanghai



Source: CEIC and BBVA Research

Disclaimer

This document and the information, opinions, estimates, forecasts and recommendations expressed herein have been prepared to provide BBVA Group's customers with general information and are current as of the date hereof and subject to changes without prior notice. Neither BBVA nor any of its affiliates is responsible for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, to undertake or divest investments, or to participate in any trading strategy. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. Other than the disclosures relating to BBVA Group, the contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA or any of its affiliates and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. To the extent permitted by law, **BBVA and its affiliates accept no liability of any type for any direct or indirect losses or damages arising from the use of this document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.**

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, derivatives, options on securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such

circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying securities. Investors should also be aware that secondary markets for the said instruments may not exist. Before entering into transactions in futures, derivatives, or options, investors should review all documents on disclosures for risks of investing in options and/or futures at the following websites:

Options - http://www.finra.org/Industry/Regulation/Notices/2013/P197741

Futures - http://www.finra.org/Investors/InvestmentChoices/P005912

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. More specifically, this document is in no way intended for, or to be distributed or used by an entity or person resident or located in a jurisdiction in which the said distribution, publication, use of or access to the document contravenes the law which requires BBVA or any of its affiliates to obtain a licence or be registered. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

The remuneration system concerning the analysts responsible for the preparation of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons.

BBVA Hong Kong Branch (CE number AFR194) is regulated by the Hong Kong Monetary Authority and the Securities and Futures Commission of Hong Kong. In Hong Kong this report is for distribution only to professional investors within the meaning of Schedule 1 to the Securities and Futures Ordinance (Cap 571) of Hong Kong.

This document is distributed in Singapore by BBVA's office in this country for general information purposes and it is generally accessible. In this respect, this document does not take into account the specific investment goals, the financial situation or the need of any particular person and it is exempted from Regulation 34 of the Financial Advisors Regulation ("FAR") (as required in Section 27 of the Financial Advisors Act (Chapter 110) of Singapore ("FAA")).

Garanti Securities headquarters is in Istanbul, Turkey and is regulated by Capital Markets Board (Sermaye Piyasası Kurulu - SPK, www.spk.gov.tr)

BBVA, BBVA Bancomer, BBVA Chile S.A., BBVA Colombia S.A., BBVA Continental, BBVA Securities and Garanti Securities are not authorised deposit institutions in accordance with the definition of the Australian Banking Act of 1959 nor are they regulated by the Australian Prudential Regulatory Authority (APRA).

General Disclaimer for Readers Accessing the Report through the Internet

Internet Access

In the event that this document has been accessed via the internet or via any other electronic means which allows its contents to be viewed, the following information should be read carefully:

The information contained in this document should be taken only as a general guide on matters that may be of interest. The application and impact of laws may vary substantially depending on specific circumstances. BBVA does not guarantee that this report and/or its contents published on the Internet are appropriate for use in all geographic areas, or that the financial instruments, securities, products or services referred to in it are available or appropriate for sale or use in all jurisdictions or for all investors or counterparties. Recipients of this report who access it through the Internet do so on their own initiative and are responsible for compliance with local regulations applicable to them.

Changes in regulations and the risks inherent in electronic communications may cause delays, omissions, or inaccuracy in the information contained in this site. Accordingly, the information contained in the site is supplied on the understanding that the authors and editors do not hereby intend to supply any form of consulting, legal, accounting or other advice.