Economic Analysis

China | NPC starts tomorrow, what are the main takeaways?

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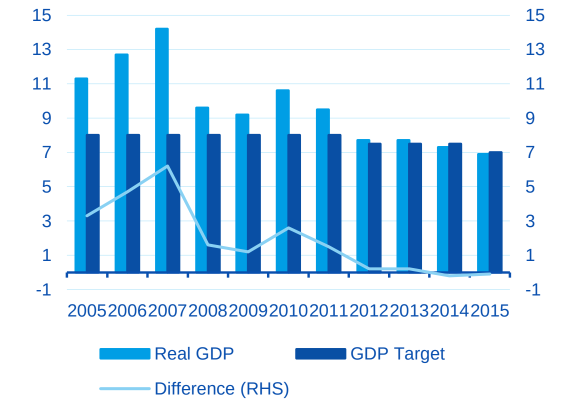
The annual plenary session of the National People's Congress (NPC) starts this Saturday and will come to an end on March 16. The meeting is one of the most important events on China's political calendar. Amongst other things, Premier Li Keqiang will announce the results of his "working report", which will include key targets for 2016. The main themes that will dominate the economic discourse in the coming year will also be highlighted during the meetings. Finally, the NPC will also serve as a platform to put the finishing touches on China's upcoming 13th Five Year Plan (2015-2020). While we don't expect the full details to be disclosed until several weeks after the NPC, the tone of the meetings will give us an idea of how China's top leaders envision the economic landscape will look like in the coming years.

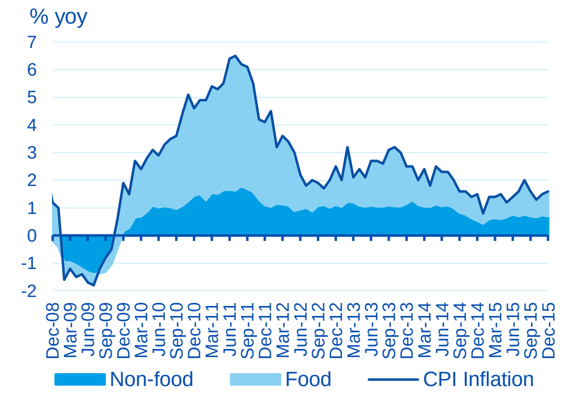
- **2016 targets: 6.5%-7.0% growth, 3% CPI, 13% M2 expansion.** Premier Li Keqiang will present the outcomes of the study in an opening address to the NPC, during which we expect the targets for 2016 to be announced. Amongst other things, and in keeping with the recent easing stance, we anticipate that the GDP growth target for 2016 will come out at 6.5-7.0%. A flexible target gives the authorities room to maneuver, however this range appears ambitious given the circumstances (Figure 1). Presumably, President Xi Jinping wants to deliver on his pledge to double 2010 nominal GDP levels by 2020, which requires an annual average growth rate of 6.5% over the next five years. We would honestly prefer it if the discourse focused on qualitative as well as quantitative aspects of growth. In addition, we expect the authorities to fix the inflation target at 3% (Figure 2). Unlike other central banks implementing inflation targeting, the People's Bank of China (PBoC) treats the CPI target as a cap, meaning that the tolerance for inflation outturns below this target is quite high. Finally, in order to boost economic growth and meet targets, we envision that China will have to expand its money supply (M2) growth to 13% versus last year's target of 12% (Figure 3).
- **Revved up expectations of further monetary as well as fiscal stimulus.** Chinese Finance Minister Lou Jiwei reiterated earlier this week that accommodative monetary as well as fiscal policy would be deployed in order to boost growth. In addition to expanding M2 growth, the authorities still have ample room to cut reserve requirement ratios (RRR), which are amongst the highest in the world (Figure 4). We expect more cuts equivalent to 200 bps in total this year. On the other hand, any further interest rate cuts ought to be asymmetrical (i.e. only on deposits) in order to avoid worsening capital outflows. We thus envision monetary policy to be increasingly data dependent and to take place gradually via an array of tools, including a new interest rate corridor. On the fiscal policy front, more spending at the central level is likely in order to compensate for tighter conditions in the provinces, stemming from last year's tightening on the use of local government financing vehicles (LGFV). An increase in the budget deficit from 3% to 4% is in order, to benefit investments in water, environmental services, transportation infrastructure and high-tech.
- **The 13th Five Year Plan (FYP).** The NPC concludes with a press conference hosted by Premier Li Keqiang, during which details on China's 13th FYP will be unveiled. The main themes should be in line with those circulated in a communiqué following from October's Fifth Plenum. Most importantly, we are watching out for actionable "supply-side" measures, or reforms to the state-owned enterprises (SOEs). Implicit guarantees to SOEs have led to misallocation of capital and mispricing of risks. In the absence of structural reforms, accommodative monetary and fiscal policy stances will aggravate China's looming overcapacity concerns, exacerbating risks in the corporate bond market down the line. In sum, don't get too excited about pro-growth measures. The NPC should be all about striking a balance between growth and reforms, which will translate into more mini-bouts of volatility in the future.

Figure 1
Pressure to meet growth targets is mounting…



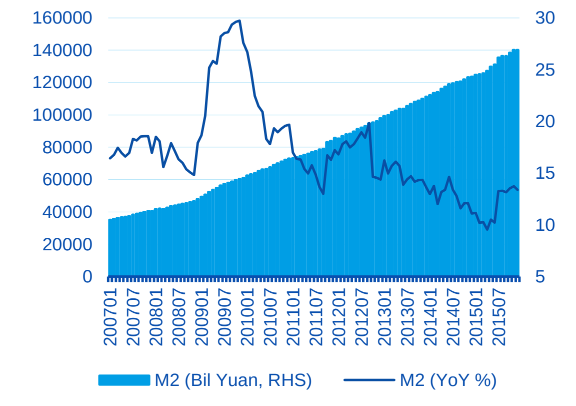
Source: Bloomberg and BBVA Research

Figure 2
…amid disinflationary concerns



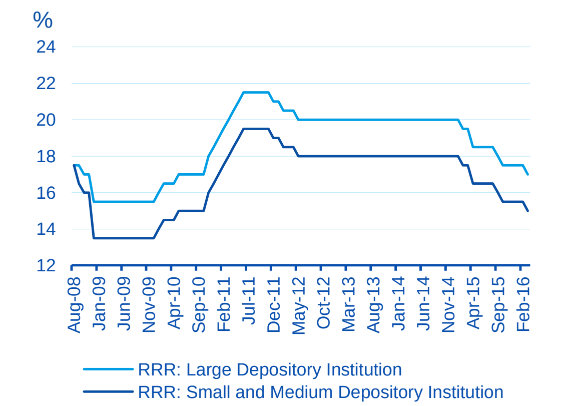
Source: CEIC and BBVA Research

Figure 3
M2 growth to edge up marginally to 13%...



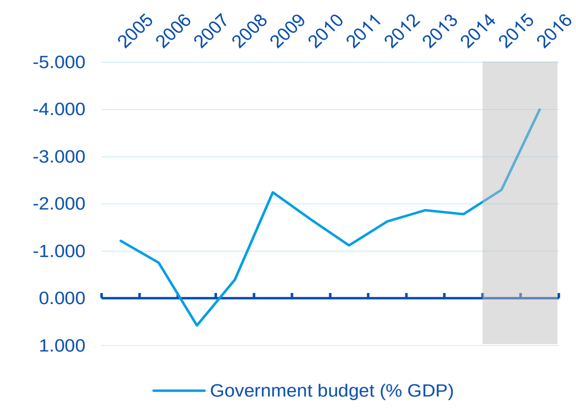
Source: Haver and BBVA Research

Figure 4
… and there is still room to implement RRR cuts



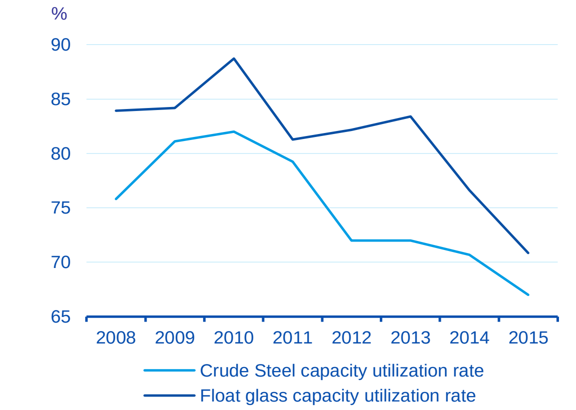
Source: CEIC and BBVA Research

Figure 5
Budget deficit will be increased to -4%...



Source: CEIC and BBVA Research

Figure 6
… which could worsen overcapacity concerns



Source: Wind and BBVA Research

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