Economic Analysis

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

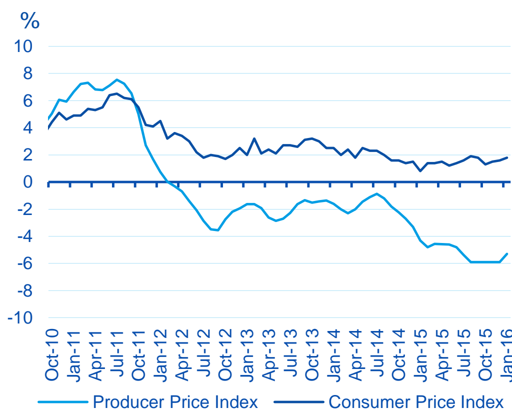
Carlos Casanova / Le Xia

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 internationalization 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.

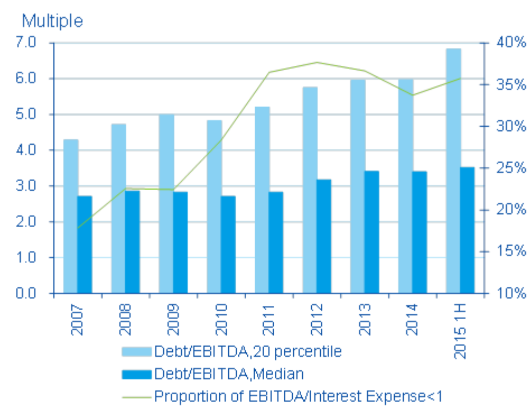
- **No pain no gain: too much attention on short-term growth could delay necessary structural reforms.** Stimulus measures will help to boost growth and facilitate a cyclical recovery in the short term. A hard-landing is an unlikely scenario any time soon. However, the authorities haven't come up with 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

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.

All images and texts are the property of BBVA and may not be downloaded from the Internet, copied, distributed, stored, re-used, re-transmitted, modified or used in any way, except as specified in this document, without the express written consent of BBVA. BBVA reserves all intellectual property rights to the fullest extent of the law.