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ECONOMIC WATCH

China | A preview of the NPC and CPPC sessions

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On March 5th, 3,000 newly elected Chinese lawmakers will convene at Beijing for about 10 days of parliamentary pageantry, the National People's Congress (NPC). As the highest institution through which Chinese people exercise their state power, the NPC generally has a term of five years and meets at an annual session. The NPC runs alongside a meeting of China's top political advisory body, the Chinese People's Political Consultative Conference (CPPCC) which will be held on March 3th. Together they're known as "two sessions".

This is the first annual session of the 13th NPC during which a new national leadership including both President and Premier will be selected to lead the country. However, there is no doubt that incumbent President Xi Jinping and Premier Li Keqiang will retain their positions for the next five years. Comparatively, some other items on the NPC agenda could have attracted more attention such as the proposed amendment of the Constitution and the potential restructure of the government agencies. On these issues, we don't expect the full details to be disclosed until several weeks after the NPC meeting.

Amongst other things, Premier Li Keqiang will present his annual "government working report", in which a working plan of national economic and social development for 2018 is to be provided. Moreover, the Premier will announce a number of key targets for 2018, including growth, CPI, M2 and fiscal budget etc. Importantly, this NPC session will also be the first one after the 19th Party's Congress concluded last November. That being said, the annual working plan at the NPC should give some tips about how China authorities will push forward the reform agenda and achieve the ambitious long-term targets set in the Party's Congress.

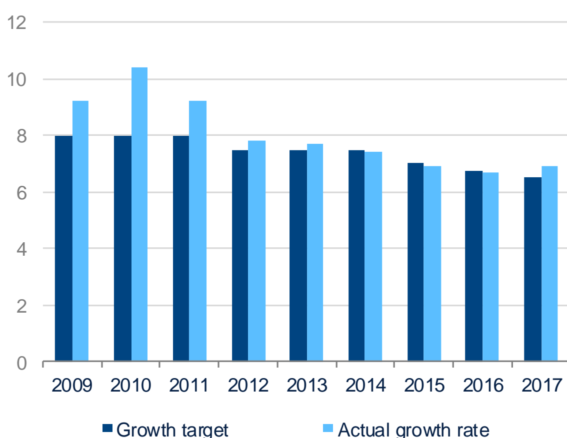
2018 economic targets: growth, CPI and M2

In the past NPC sessions, a number of targets are usually provided, including growth, CPI and M2 etc. However, in the 19th Party's Congress, President Xi attempted to downplay the importance of economic growth. Instead, he said that Chinese socialism has entered a new era that requires the authorities to pivot from pursuing high growth rate to improving the quality of growth. President Xi's remarks have been interpreted by some analysts as the signal of dropping annual growth target.

Nevertheless, we believe that the authorities will continue to provide an annual growth target this year. Indeed, President Xi's speech at 19th Party's Congress also promised to meet the previously set target of build a "moderately prosperous society" by 2020. According to our estimation, meeting this target means an average growth rate of around 5% between 2018 and 2020. Moreover, the authorities need to give some transition period to local governments so that they can better adapt to the new mode with emphasis on growth quality rather than growth rate. An abrupt scrap of growth target could make local governments anchorless and as a consequence amplify the volatility of economic output unnecessarily.

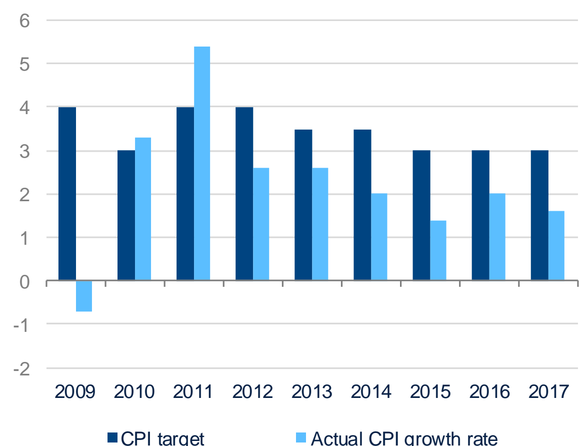
We therefore anticipate the authorities to set a range growth target at 6%-6.5%. (Figure 1) Such a flexible growth target to make sure that growth maintains a decent level while leave some room for the authorities to push forward necessary reforms as well as contain financial risks. In addition, we expect the authorities to fix an inflation target (ceiling) at 3%. (Figure 2) Finally, in order to boost economic growth and meet targets, we envision that China will set its money supply (M2) growth at 12% (compared to last year's target of 13%) to reflect their prudent monetary policy stance. It is also noted that the target of M2 is not binding, in particular under the condition of persistently financial regulatory tightening. To a certain extent, the target of M2 can also be interpreted as a cap for this year. (Figure 3)

Figure 1 Growth target and actual growth rate comparison



Source: BBVA Research, HAVER and website information

Figure 2 Inflation target and actual inflation rate



Source: BBVA Research, HAVER and website information

Figure 3 M2 target and actual M2 growth rate

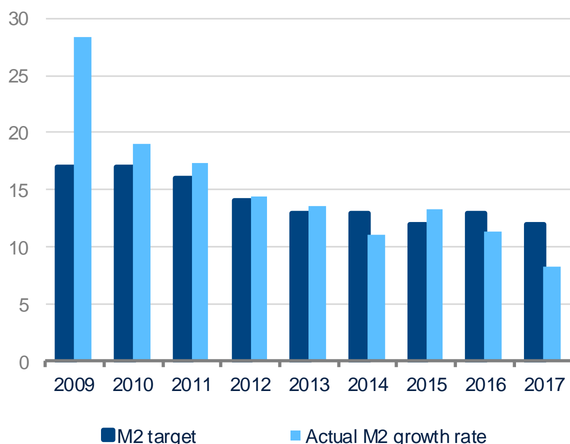


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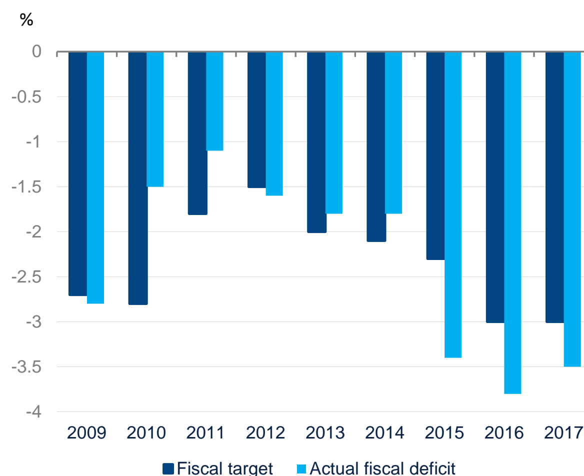
Figure 4 Fiscal deficit target and actual fiscal deficit to GDP ratio



Source: BBVA Research, HAVER and website information

The next central bank governor and what's on the top of his agenda

Zhou Xiaochuan, the long-serving governor of the People's Bank of China (PBoC), wasn't included on a new list of the nation's top political advisory body, sending a strong signal that he is about to step down soon. Moreover, with the prospective restructuring of the financial regulatory framework, the central bank will play a much more important role in financial regulation than now. Accordingly, the next helmsman of the PBoC will shoulder more responsibilities.

A number of candidates are in the lead vying for this important position. Liu He, who is a member of the Party's Politburo and is believed to become one of vice premier and head the Financial Stability Development committee, could take the position of the central bank governor as well. Moreover, the current Chairman of China's Banking Regulatory Commission (CBRC), Guo Shuqing, and Hubei provincial Party chief Jiang Chaoliang could also have their chance.

On balance, we believe the personnel change won't sway the policy direction determined at the 19th Party's Congress last November. In particular, the PBoC, with the newly equipped regulatory power, will maintain its prudent monetary policy stance as well as endeavor to facilitate the deleveraging of both the financial system and corporate sector. In the meantime, the central bank needs to ensure that there will be no hard-landing in growth through the process of financial regulatory tightening.

The fiscal policy in 2018

A combination of a prudent monetary policy and financial regulatory tightening is expected to weigh on growth in 2018. Therefore, the fiscal policy needs to be pro-growth so as to offset the downward pressure on growth emanating from the monetary front. In the meantime, China's government is subject to a greater pressure to maintain its financial soundness after two international rating agencies downgraded its sovereign rating last year. We therefore envision that the authorities are likely to keep the 2018 fiscal deficit at around -3.0%, broadly flat with last year's target. (Figure 4) That being said, the fiscal impulse in 2018 is not expansionary, which could add investors' concern over growth slowdown.

In addition, the market is also speculating on whether the NPC session will provide any timetable for the long-awaited property tax. In December, the Finance Minister Xiao Jie indicated that property tax will be imposed based on the valuation of housing. He also mentioned that the authorities could accomplish property tax's legislative procedure by 2019 and will start imposing it as early as 2020. His remarks were in line with President Xi Jinping's warning at the 19th Party's Congress that houses are for living but not for capital speculation.

However, a property tax is seen by some analysts as a risky choice to cool the housing market since it could have strong knock-on impact on housing market. Given the complex legislation procedures to introduce a new tax, we don't expect the property tax to be nationwide implemented in a short period of time. Instead, a property tax experiment in several pilot provinces is more likely.

Finally, as the US has just passed a bill of large-scale tax cut for the corporate sector, the Chinese authorities are also facing the ever-increasing call of lowering the general tax level of Chinese enterprises. This type of suggestion is well founded. Although China's headline corporate income tax is as low as 25%, the employers' real burden will increase substantially if including their mandatory contribution to pension funds, medical insurance, unemployment insurance, job-related handicap insurance, birth insurance and a housing provident fund etc.

According to the statistics of the World Bank, China's total tax level for corporate account for 67.3% of firms' profit, way above the US level of 43.8% and the global average of 40.5%. Too high tax level could trigger capital outflows from China and hurt its competitiveness in the long run. The authorities are seemingly well aware of this point. Therefore, they could provide some positive surprises for Chinese enterprises in this respect, in particular on various types of mandatory contribution to pension funds and insurances.

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