Global Economy / Regional Analysis China

China: managing slowdown and risks

Expansión (Spain)

Le Xia

The annual meeting of the National People's Congress (NPC), the parliament that endorses the decisions of the executive power, began in Beijing on 5 March. The economic scenario in which the meeting is taking place is less favourable than last year as a result of the continued slowdown in China and growth being at its lowest for 28 years at 6.6%, which can be attributed to a combination of domestic debt excess adjustment policies and growing trade tensions with the United States.

On the opening day of the NPC, after predictably praising accomplishments in 2018 such as achieving the 6.5% growth target, Premier Li Keqiang hinted at concern and caution in the face of the high level of uncertainty.

The Chinese leader lowered the official 2019 growth target to between 6% and 6.5% (somewhat less than the 6.5% for last year), with growth continuing on a downward trend despite the measures announced to support growth. The fiscal deficit target was set at -2.8% of GDP, a slight increase compared with the -2.6% for the previous year. Li Keqiang also announced tax cuts worth 2 trillion yuan for this year, equivalent to 2.2% of GDP, which is expected to be financed by extrabudgetary funding from the Government.

The tax cuts will be applied to VAT, which currently has three different rates: 16%, 10% and 6%. The 16% and 10% rates will be reduced to 13% and 9%, respectively, while the 6% rate will remain unchanged. This tax cut is expected to be especially beneficial for the manufacturing, transport and construction sectors. Tax cuts will also directly affect employee's salaries, with personal income tax dropping from 20% to 16%.

The stimulus will also affect monetary policy, although relaxation in that regard will be more moderate due to fears of side effects, particularly those side effects that attempts have been made to limit recently with a slower increase in corporate debt in 2017‑2018.

The combination of a slightly lower growth target and stimulus policies is intended to compensate for the adverse effects of U.S. protectionist measures, including two rounds of tariffs on Chinese exports last year. According to our estimates, these tariff measures would reduce China's GDP by 1% if bilateral negotiations with the United States did not lead to an agreement.

Given the current trade tension, there is also an underlying attempt to contain leading Chinese companies in the high-tech sector and thereby maintain a competitive advantage for U.S. tech, which has been shrinking in recent years. The U.S. government could also set in motion a number of measures including: (i) filing selective demands against Chinese high-tech companies (ZTE, Huawei, etc.) on the basis of its broad jurisdiction; (ii) linking progress in trade negotiations to concessions in the broader scheme of Chinese technical advancements , organized around the “Made in China 2025” strategy; (iii) applying pressure to strengthen the protection of intellectual property in China and allowing U.S. companies to open full-ownership subsidiaries in China; (iv) directly prohibiting U.S. companies from exporting essential components to Chinese high-tech companies in certain cases; (v) restricting investments by Chinese companies in the U.S. high-tech sector; and (vi) toughening entry requirements for Chinese students who wish to pursue scientific and technical studies in the U.S.

According to our estimates, in a scenario in which the growth of local high-tech sectors (principally telecommunications and electronics and IT production) is continually reduced by two thirds (from 6% to 2%) as a result of the confrontation with the U.S., China's GDP growth would slow by up to 0.8 pp, which would be in addition to the direct effect of having no trade agreement. This scenario would have severe global effects given the size and strength of China's economic connections with other parts of the world.

BBVA Research

DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA.

ENQUIRIES TO:
BBVA Research: Calle Azul, 4 Edificio La Vela, Floors 4 & 5 28050 Madrid, Spain
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 25
bbvaresearch@bbva.com www.bbvaresearch.com