

China: Growth And Policy Targets Set For 2016

Growth Range Of 6.5-7.0% For 2016

At the opening of the annual National People's Congress (NPC) session on Sat, 5 Mar, Chinese Premier Li Keqiang laid out the work report for 2015 and targets for 2016, as well as for the 13th five-year plan (2016 to 2020).

As has been flagged months earlier, growth projection for 2016 is set at 6.5-7.0%, from the "about 7%" set for last year (which came in at 6.9% for full year 2015), while aiming GDP growth rate of at least 6.5% through the 2016-2020 period. This is the first time in two decades that a target range, rather than specific forecast, has been used.

Fiscal deficit for 2016 is projected at 3% of GDP, from 2.3% in 2015 as revenue is likely to slow as the government lowers taxes to reduce business costs. Other targets for 2016 are shown in the table.

China: Economic Targets At A Glance			
Indicator	2016 Target	2015 Actual	2015 Target
GDP growth rate	6.5-7.0%	6.9%	"About 7%"
CPI inflation	3.0%	1.4%	3.0%
M2 money supply growth	13.0	13.3%	12.0
Total Social Financing (% change)	13.0	12.4	("Steady Growth", 平稳增长)
Fiscal deficit (% of GDP)	3.0%	3.5%	2.3%
Job creation (millions)	10.0	13.12	10.0
Source: Bloomberg, UOB Global Economics & Markets Research Estimate			

According to data from Ministry of Finance earlier, fiscal expenditure in 2015 rose sharply by 15.8%/y/y compared to 8.3% increase in 2014, while fiscal revenue growth slowed from 8.6%/y/y in 2014 to 8.4% (the slowest pace since 1988), leaving a deficit of RMB2.355 trillion, compared to a fiscal shortfall of RMB1.131 trillion in 2014. With 2015 GDP at RMB67.7 trillion, headline fiscal deficit works out to be 3.5% of China's GDP for the year, up from 2.1% of GDP in 2014. Fiscal deficit is projected at RMB2.18 trillion in 2016.

In the work report, Premier Li also emphasizing the need for economic reform, with the word appearing 76 times, vs 86 times in 2015, suggesting that economic restructuring and reform will remain the key theme for 2016 and beyond.

For the 13th five-year plan target period of 2016-2020, the government aims to maintain average growth rate of 6.5%, employment creation of at least 50 million, urbanization rate of 60% by 2020, and 30,000km of high speed rail, among other things.

Comments

This is the first time in two decades that a target growth range, rather than specific forecast, has been set. This suggests that: 1) the government wants to deemphasize the obsession with economic growth alone and focus on other more crucial policy indicators, such as economic reform, efficiency, productivity, value-add, and performance of the labour market, and 2) uncertainty of economic forecasts given a backdrop of weak global environment and demand – which is outside the control of China – and domestically, the challenges of balancing economic growth and the ongoing market/industries reform.

However it is clear that the government has a baseline growth target of 6.5% to ensure that the objectives for the 13th five-year plan will be achieved to maintain the momentum of job creation. As every 1% of GDP growth is estimated to generate about 1.2 to 1.5 million new jobs, it is crucial to maintain a baseline growth to meet the demand of roughly 15 million of new job seekers (graduates from universities and other tertiary institutions) entering China's labour market each year.

Among other things, the 13th 5-year plan aims to double the size of China's GDP and per capita GDP from 2010 to 2020. In 2010, China's GDP was RMB40 trillion and per capita income at USD4,400, and achieving RMB90 trillion of GDP by 2020.

We think the growth range is reasonable and the risks of a “hard landing” remain low, especially with more than sufficient room from fiscal and monetary policy measures, if needed. We maintain our growth forecast for China at 6.8% for 2016, and expect the pace to slow gradually through the 2016-2020 planning period, as the size of the economy increases. China continues to transition to a service-led and domestic-demand driven economy. At the same time, the manufacturing sector is undergoing transformation with excess capacity continues to be rationalized in old and inefficient sectors such as steel, cement, and coal which the government is setting aside a budget of RMB100 billion to help in the restructuring efforts.

The task of reforming and restructuring, especially within the state-owned enterprises (SOE) sector, is challenging, given the extent of excess capacity (see table below). Utilization rates are estimated in the 50-70% range for a wide range of industries in China, after the stimulus-induced sharp increases in investment since the global financial crisis in 2009. This is down from utilization rate of as much as 80-90% prior to 2008, according to IMF data.

Premier Li vouched again at the 2016 Work Report that there would not be any massive government stimulus anytime soon and we expect the pace of reform and restructuring to gather speed as the 13th 5-year plan gets underway this year.

China: Industrial Production Capacity		
	Current Capacity (estimated)	Capacity Closed in Last 3 Years
Steel (million tons)	1,200	More than 90
Cement (million tons)	2,350	230
Flat glass (million weight boxes)	793.0	76.0
Aluminum smelting (million tons)	42.0	More than 1.0
Coal (million tons)	5,700	560 (between 2010-2015); a further 700 to be eliminated by 2019

Source: 2016 Work Report for NPC; Media Reports, UOB Global Economics & Markets Research Estimate

In terms of monetary policy, the reserve requirement ratio (RRR) cut announced on 29 Feb, just days prior to the NPC session, has set the tone of a “prudent but with slight easing bias” for now. Premier Li noted that the policy stance would be flexible to maintain sufficient liquidity in the system through the coordinated use of policy tools including open market operations, interest rate, RRR, relending, and others, to lower financing costs and provide sufficient support to the real economy, especially for smaller enterprises and agricultural sectors.

As such, we think there is room for further monetary policy easing in 2016, although the burden is likely to fall on RRR, as PBoC works to fine tune the interest rate corridor. PBoC last changed interest rate policy on 23 Oct 2015, the sixth interest-rate cut in a year (depo rate 1.50%; lending 4.35%). **Coupled with recent RRR cut announcement, we still see further room for interest rate and RRR reductions ahead, with a slim chance of interest rate cuts by end-1Q16. The next reduction in RRR is likely to be in 2Q16, as shown in the table.**

China: Interest Rate and RRR Forecasts							
%	2Q15	3Q15	4Q15	1Q16F	2Q16F	3Q16F	4Q16F
1-year Benchmark Lending Rate	4.85	4.60	4.35	4.10	3.85	3.85	3.85
1-year Benchmark Deposit Rate	2.00	1.75	1.50	1.25	1.00	1.00	1.00
Reserve Requirement Ratio	18.50	18.00	17.50	17.00	16.00	15.00	15.00

Source: UOB Global Economics & Markets Research Estimates

Premier Li reiterated that RMB exchange rate will be stability at reasonable range and this suggests **relatively low likelihood of large-scale depreciation/valuation of the RMB. More important though is that with the RMB referencing a basket of currencies, the USD/RMB exchange rate is likely to see greater volatility and more flexibility going forward, even if the basket as a whole stays relatively stable.** We are still keeping our forecasts intact, with our call at 6.60/USD at end-2Q16, and towards 6.45 by end-2016. The recent stability of the onshore and offshore RMB prices suggests that speculative activities are now kept at bay. However, depreciation pressure on the currency remains significant as there is still room for a USD rebound against EM currencies, as uncertainty on the US Fed interest rate hike cycle remains.

FX OUTLOOK	07-Mar-16	End 1Q16F	End 2Q16F	End 3Q16F	End 4Q16F
USD/JPY	113.7	118	119	120	122
EUR/USD	1.100	1.10	1.11	1.11	1.12
GBP/USD	1.421	1.42	1.41	1.39	1.41
AUD/USD	0.741	0.74	0.74	0.75	0.76
NZD/USD	0.679	0.65	0.65	0.66	0.67
USD/SGD	1.377	1.42	1.44	1.43	1.41
USD/MYR	4.076	4.15	4.25	4.20	4.10
USD/IDR	13,132	13,500	13,400	13,300	13,200
USD/THB	35.4	36.2	36.5	36.8	37.0
USD/PHP	46.9	47.5	48.0	47.0	46.0
USD/INR	67.1	67.9	69.0	70.0	71.1
USD/TWD	33.1	33.9	34.1	33.9	33.6
USD/KRW	1,198	1,220	1,250	1,200	1,180
USD/HKD	7.76	7.80	7.80	7.80	7.80
USD/CNY	6.507	6.55	6.60	6.47	6.45

Source: Bloomberg, UOB Global Economics & Markets Research

Link

Complete Text of 2016 Work Report (Chinese), 2016年政府工作报告(全文实录), 5 March 2016 <http://bit.ly/1TB3Xt3>



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