Economic Watch

China | 2022 “Two Sessions” prioritizes stabilizing growth

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The annual “two-sessions” of China, namely the National People’s Congress (NPC) and the Chinese People’s Political Consultative Conference (CPPCC), are always the top priority in China’s political agenda every year. It commenced in Beijing on March 5th 2022 and lasted for around one week.

In the week-long sessions, delegates from around the country will review the Government Work Report promulgated by Premier Li Keqiang which discussed the most important issues concerning various dimensions of China’s national affairs, ranging from the summary of last year’s pandemic control endeavors and economic achievements to the announcement of 2022 key policy targets, from concluding the past year’s accomplishment of the first year of the14th Five-year Plan to outline the blueprint of China’s long-term new growth model.

This year’s “two sessions” are particularly important amid growth slowdown, as the market expects the authorities will announce the new stimulus package with monetary and fiscal policy initiatives to alleviate the economic hardship. Indeed, after achieving “first-in, first-out” of the pandemic and the growth peak in Q1 2021, the economy went all the way down from 18.4% y/y growth in Q1 2021 to 4% y/y in Q4 2021, due to the regulatory reforms and “common prosperity” strategy which were pressed ahead heavily in the past year. For China, 2021 has been a year of regulatory storms, but 2022 will be a year of soft-landing. In addition, due to China’s “first-in, first-out” of the pandemic and “zero tolerance” strategy, the main character of Chinese economy at the current stage is its unsynchronized business cycle, inflation cycle thus unsynchronized policy cycle with the rest of the world, which provides the authorities a large policy room to conduct easing monetary and fiscal measures. Altogether, unlike other economies, China’s domestic uncertainties dominate external uncertainties as the main risks for growth.

Thus, key topics in this year’s “two sessions” include how to provide monetary and fiscal policy support to stimulate growth and how to balance between regulatory storms, carbon neutrality and other structural reforms with growth priority. The market is particularly concerned about the following questions in the “two sessions”: (i) to what extent the ongoing easing monetary policy could transmit to the real economy and the fiscal expansion could stimulate infrastructure investment; (ii) to what extent the authorities would release real estate sector restrictions to rebuild market sentiments and stimulate real estate activities; (iii) to what extent the authorities would adopt regulatory forbearance to avoid devastating regulatory storms as of 2021; (iv) whether and when to give up “zero tolerance” strategy which added large cost of local government fiscal balance and dragged consumption recovery.

Here are the highlights of this year’s ‘two sessions”:

- **GDP growth target for 2022 at “around 5.5%” and other economic targets are also promulgated.** The 5.5% growth target is a bit beyond our previous expectation of 5% and at the same time higher than the average growth of 2020 and 2021 which is 5.2%. The target is also higher than the IMF’s China growth forecasting at 4.8% and market consensus forecasting at 5.2%. The Premier Li Keqiang also emphasized that 5.5% target requires more policy support and more efforts of the whole society. Beyond the growth target, in terms of employment, China also set a target of creating over 11 million new urban jobs this year, and a surveyed urban unemployment rate of 5.5%, both figures are the same with the previous year's targets. The inflation target is set to be around 3% while household income growth will be in line with GDP growth. (Table 1)

- **Structural reforms, carbon neutrality target and regulatory storms will temporarily give way to the growth priority.** Chinese authorities seem to be flexible to adjust the pace of structural reforms and regulatory measures according to the business cycle dynamics, although balancing growth and structural reforms has always been a challenge for them. For instance, in the previous year, due to China's "first-in, first-out" of the pandemic, the authorities took use of this precious time-window to press ahead a series of regulatory storms targeting on disorderly capital expansion sectors such as real estate, after-school tutoring, internet etc., to push ahead carbon neutrality target and strict carbon emission standard, and to swiftly normalize the previous easing monetary and fiscal measures in the pandemic time to avoid debt overhang. However, after realizing that the above structural reforms have largely dragged on growth after Q2 2021, this year seems to be a turnaround to prioritize stabilizing growth instead. As we notice from the government work report in "two sessions", it does not mention property tax or annual target of reduction in energy consumption per unit of GDP, neither it mentions "common prosperity". Thus, it clearly signals that in 2022, in face of growth slowdown and housing sector crash, the authorities would like to adopt regulatory forbearance to prioritize growth target, thus temporarily structural reforms, regulatory storms and carbon neutrality target will all give way to the growth priority.
- **Expansionary fiscal policy stance to stimulate growth.** In particular, the government work report clarified that: (i) Fiscal budget will be approximately -2.8% of GDP; although it looks smaller than previous year's -3.2% fiscal deficit budget, it is actually more expansionary to equivalently -3.8% of GDP by taking into account of the cross-year fiscal surplus transferred from 2021. (ii) Tax cut/refund and fee deduction with the total scale of RMB 2.5 trillion, compared with the scale of RMB 1 trillion in 2021. (iii) Maintain the special local government bonds issuance quota at RMB 3.65 trillion, the same scale of the previous year in a bid to support infrastructure investment.
- **Accommodative monetary policy to stabilize growth but will refrain from resorting to a deluge of strong stimulus policies.** The government work report announced that M2 and total social financing annual growth are set to be in line with the nominal GDP growth rate which we estimate will be around 8.5%. In addition, the authorities also emphasized the monetary policy will refrain from resorting to a deluge of strong stimulus policies, considering the FED interest rate hike and the financial instability risks such as debt overhang of local government and SOEs etc. Under this circumstance, we anticipate 1-2 LPR and RRR cut this year with the timing before the FED materializes interest rate hike and central conducts bank balance sheet reduction. The authorities also emphasized the targeted credit expansion, particularly to SMEs, Covid-19 related sectors and agricultural sector. Beyond that, the government work report also mentioned that the authorities will keep the RMB exchange rate generally stable at an adaptive, balanced level.
- **The government work report also highlighted the potential risks in 2022 and outlined the long-term Chinese new growth model:** (i) Imported inflation and high commodity price due to the global commodity price surge by Russia-Ukraine war; (ii) Capital outflows and RMB depreciation due to the US FED tightening; (iii) Implicit local government debt sustainability; (iv) Housing sector default risk, etc. In the medium-to-long term, China will stick on the "new growth model", underpinned by "three pillars": common prosperity, self-sufficient technology under "Dual circulation" strategy and carbon neutrality. This new growth model indicates Chinese growth engine is transforming from real estate driven to high-end manufacturing, technology and green economy driven. (see our China Economic Watch: Understanding China's new growth model) The long-term new growth model is not set to be subject to any change, although in the short term, it might give way to growth priority and the Chinese authorities indeed have always been trying to balance the short-term growth and long-term sustainability.

Table 1. COMPARISON OF 2020 AND 2021 TARGETS SET BY GOVERNMENT WORK REPORT

	2021 target	2021 actual	2022 target
GDP	6%	8.1%	5.5%
CPI	3%	0.9%	3%
M2	In line with nominal GDP growth	8.7%	In line with nominal GDP growth
Total social financing	In line with nominal GDP growth	10.3%	In line with nominal GDP growth
Fiscal Deficit	-3.2%	-3.7%	-2.8%
Special Covid-19 Government Bond	No issuance	No issuance	No issuance
Local Government Bond	RMB 3.65 trillion	RMB 3.65 trillion	RMB 3.65 trillion
Survey unemployment rate	5.5%	5.1%	5.5%
Urban employment	11 million	12.69 million	11 million

Source: BBVA Research and 2022 Government Work Report

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