Economic Watch

China | New stimulus package not enough to ensure a 5.5% growth target in 2022

Jinyue Dong and Le Xia

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The recent Omicron outbreak in mainland China and the lockdown measures under “zero Covid” policy have significantly changed the previous soft-landing story for Chinese economy. The recent economic activity indicators dipped sharply almost to the level of Q1 2020 when the Covid-19 pandemic first outbroke in Wuhan.

For 2022, Chinese authorities face the “Impossible Trinity” of policy setting among “zero tolerance” Covid policy, synchronized monetary policy and 5.5% growth target. That means, the authorities could only achieve two of these policy targets and abandon another one. Given that at the current stage the authorities are still pledged to maintain “zero Covid” policy, there are only two possible policy mix going forward: (i) if they want “Zero Covid” and 5.5% growth target as announced in “two sessions”, they have to conduct aggressive easing monetary measures, which absolutely unsynchronized with the US FED, leading to capital flight and sharp RMB depreciation; or (ii) if they want “Zero Covid” and a synchronized monetary policy with the US FED to circumvent financial instability, they have to accept a lower growth rate instead of 5.5% target. Based on our understanding of the recent a series of high-level State Council and Poliburo meetings which released the aggressive easing policy stance, the authorities are trying to experiment the policy mix (i), although the ultimate real-world scenario might be (ii). (Chart 1)

Chinese authorities not only prioritized economic growth in 2022 but also promulgated a series of stimulus measures in monetary and fiscal perspectives with actions. On May 26, Premier Li Keqiang spoke at a State-Council teleconference with 100 thousand participants of policy-makers at different hierarchy on how to implement stimulus policies to stabilize growth. In particular, Premier Li emphasized the growth headwinds in March and April in particular are to a certain extent more serious than those experienced in 2020 when the COVID-19 epidemic hit the country, marked by downward indicators for employment, industrial production, power consumption and cargo transportation, etc. Premier Li also underlined the need to urgently support market entities, employment and people's livelihoods and urged swift actions from now on to bring the economy back on track. (Chart 2)

By emphasizing the 33 measures to stabilize the economy proposed at a recent State Council executive meeting, Premier Li issued an order to government departments at different levels to introduce practical implementation measures by the end of May. He also urged local authorities to introduce policies in light of local conditions to help market entities tide over difficulties and stabilize and increase job posts.

These stimulus policies could be summarized below:

- **Fiscal stimulus policy:** (i) To expand tax reduction to RMB 2.64 trillion for 2022 (RMB 140 billion expansion), particularly for SMEs, pandemic-hit enterprises; (ii) To postpones social insurance payment for pandemic-hit SMEs with financial difficulties to year-end, with the total amount of postponed payment at RMB

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BBVA Research: 95/F, International Commerce Center, One Austin Road, Hong Kong.
Tel. +2582 3111 / Fax +852-2587-9717
bbvaresearch@bbva.com www.bbvaresearch.com

320 billion. (iii) Speed-up local government bond issuance in 1H 2022, in a bid to stimulate infrastructure investment which used to be the growth engine for Chinese economy. We predict that real infrastructure investment growth is to be 2.4-4% (nominal growth 4-8%) based on the expansion of the local government bond issuance (RMB 4.73 trillion) and the fiscal surplus transferred from 2021 to 2022 (RMB 1.5-2 trillion), which is estimated to contribute 0.4-0.6% of total real GDP growth. (iv) To expand State's Financing guarantee fund to RMB 1 trillion in a bid to support SME financing.

- **Expansionary monetary policy.** (i) Banks should extent the housing and automobile mortgage payment for individuals and also capital and interest repayment for SME financing to year-end who face difficulties by the lockdown measures; (ii) To shorten the acceptance period for commercial notes from 1 year to 6 months. (iii) To support platform economy enterprises to be listed in foreign stock exchange. (iv) Except for the recent three RRR cuts and two interest rate cuts, more cuts are also anticipated in the rest of the year to inject liquidity into the market.
- **To stabilize supply chain and production.** (i) To optimize "work resumption" policies and secure the production resumption for strategic enterprises. (ii) To cancel the transportation restrictions for the low-risk regions and to secure supply-chain unobstructed by unreasonable pandemic restrictions. (iii) To increase RMB 150 billion urgent lending to airplane sector, and to support them to issue RMB 200 billion bond. In addition, to orderly increase the domestic and international airplines to facilitize people move.
- **Supportive measures for consumption and housing market regulatory forbearance.** (i) To release the previous restrictive measures for automobile purchase and to reduce the car purchase tax by RMB 60 billion aggregately. (ii) To reduce the mortgage interest rate for home-buyers to 20bps below LPR and to promulgate a series of real estate supportive measures according to the different situations in different cities/regions.
- **To maintain energy security.** To expand coal production to sustain energy security amid the economic sanctions posted by the western economies to the Russia-Ukraine war. Although it seems like a policy-turnaround and the previous green economy model gives way to growth priority, expanding coal production indeed could help China maintain energy supply, offset the imported energy inflation and support production resumption.
- **Other relief measures:** To proceed unemployment benefit, and also benefit for people affected by the pandemic lockdown measures. In addition, the authorities also would like to link these benefits to inflation.

Given that Chinese authorities will continue to stick on "zero Covid" policy in the rest of the year based on their announcement in the recent important high-level conferences, there will be "impossible trinity" for China's policy setting in 2022: either China needs to give up synchronized monetary policy with the US FED to continue aggressive easing in order to achive 5.5% growth target which might lead to financial instability, or, the authorities have to give up 5.5% growth target to accept a lower growth in a bid not to conduct aggressive easing measures to circumvent capital flights and sharp currency depreciation. Under the current situation, the authorities are actively exploring the possibility of the former case, although the policy room of aggressive easing has been shrunk significantly amid a trending-up inflation and sharp RMB depreciation. (See our recent Economic Watch: China | China's low inflation environment bears some changes) Look ahead, we predict Q2 GDP will be the trough but the growth will gradually recovery since Q3 based on the course of the pandemic and the effectiveness of the above stimulus package, and the whole year GDP will reach 4.5% y/y for 2022. (see our Economic Watch: China | Shanghai lockdown: most likely scenarios and the impact on global value chain).

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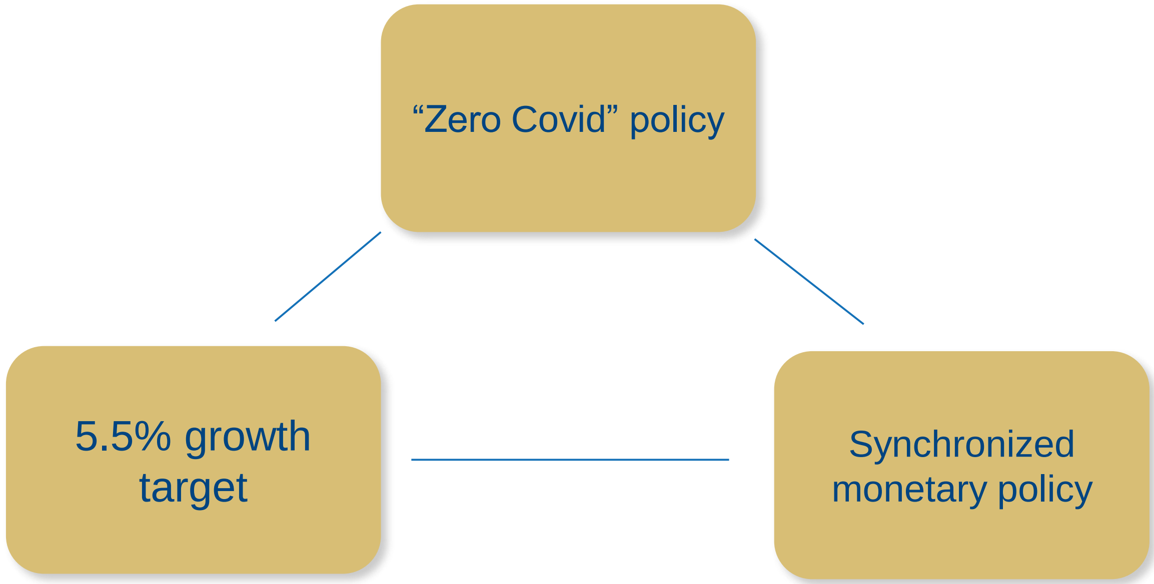
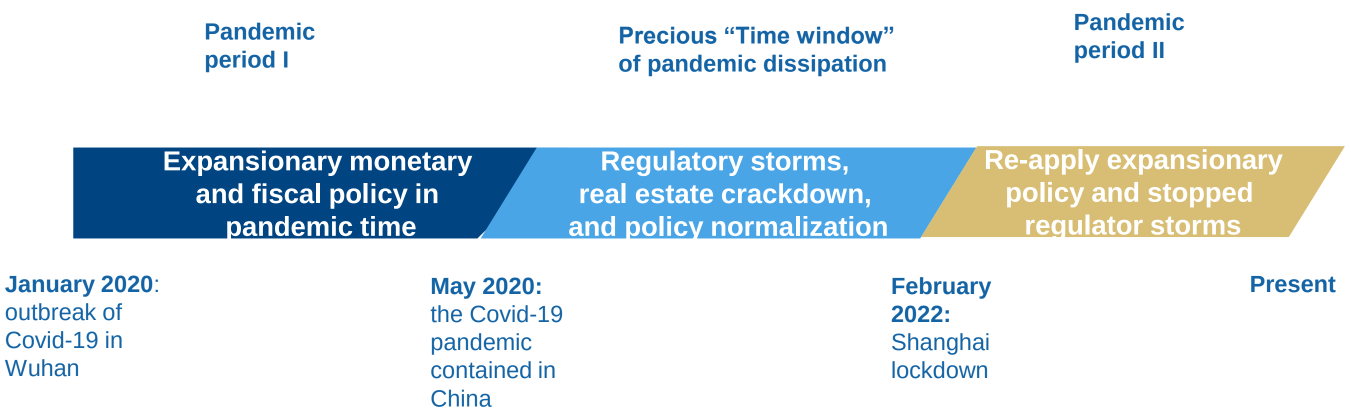
BBVA Research: 95/F, International Commerce Center, One Austin Road, Hong Kong.
Tel. +2582 3111 / Fax +852-2587-9717
bbvaresearch@bbva.com www.bbvaresearch.com

Fugure 1. “**MPOSSIBLE TRINITY” OF CHINESE POLICY SETTING IN 2022**



Source: BBVA Research

Fugure 2. **CHINA’S SEESAW POLICY DURING THE PANDEMIC TIME**



Source: BBVA Research

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