Economic Watch

China | Understanding 2023 Government Work Report and State Council reforms

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March 13, 2022

China's annual "two sessions", namely the National People's Congress (NPC) and the Chinese People's Political Consultative Conference (CPPCC) officially concluded today, which have always been the top priority in China's political agenda every year. (See our previous Economic Watch: China | What do we expect from 2023 "two sessions"?)

The main takeaways of this year's "two sessions" include four important perspectives: 2023 growth target and a series of other key economic targets; 2023 monetary and fiscal policy outlook; the State Council institutional reforms and top political leadership transformation.

In general, the "around 5%" growth target and other economic targets are in line with the market expectations, considering the challenges to rebuild market sentiments and repair households and enterprises' balance sheets after lifting three-year "zero Covid" policy. Amid FED interest rate hike cycle, monetary policy is described as prudent and "targeted", excluding possibilities of LPR cut in the rest of the year; while the expansionary fiscal policy remains the main growth stimulus. Finally, a series of reshuffling and restructuring of State Council departments in technology, financial regulation and data bureau indicate the authorities' determinations to deal with China-US technology war, technology self-sufficiency, financial stability concerns as well as national security.

Altogether, the new generation of top political leadership in China together with the new structured State Council is anticipated to promulgate more policy stimulus in various perspectives to secure a strong economic rebound and housing market soft-landing after lifting "zero Covid" at end-2022.

Here are some highlights of the main takeaways of this year's 'two sessions" and the 2023 Government Work Report:

- **Institutional Reform of the State Council:** The authorities have conducted some important institutional reforms of the State Council which is the country's chief administrative authorities. The State Council reforms will cement President Xi's control of the entire state apparatus to tackle different kinds of domestic and international challenges. Thee important highlights of the State Council reforms include:

  (i) The "two sessions" announced to establish the super regulator for the financial sector- National Financial Regulatory Administration to replace and unify the previous China Banking and Insurance Regulatory Commission (CBIRC), consolidating financial system regulation and oversight, which aimed at closing loopholes with multiple agencies monitoring different aspects of financial industry. The setting up of the new super financial regulatory body comes as the authorities seeks to rein in large corporate and financial institutions that may bring systemic financial risks through regulatory arbitrage among previous multiple authorities. Meanwhile, we need to pay attention that China Securities Regulatory Commission (CSRC) will be maintained and its next step's policy focus will be to press ahead registration-based IPO system.

(ii) In the high-tech area, the authorities restructured its Science and Technology Ministry to concentrate resources on achieving technology breakthroughs and self-sustained supply chain as well as to meet the challenges from other countries' high-tech sanctions and potential decoupling, amid the long-lasting China-US technology war and the US's efforts to block China's access to key technology.

(iii) The "two sessions" also announced to establish National Data Bureau, which will be run by the National Development and Reform Commission (NDRC), and will absorb some of the functions of the Office of the Central Cyberspace Affairs Commission that oversees China's internet. The new data bureau will cover the exchange of information resources across industries and promote smart cities. In recent years, China has strengthened oversight on data with the belief that data has become a strategic economic resource, and concerned that unchecked collection by private firms could allow rivals to weaponize information on national securities. Except for dealing with national security issue, the establishment of National Data Bureau is also in line with the "new growth model" and "new infrastructure" investment in a bid to prioritize digital economy in China. (see our previous Economic Watch: China | Will infrastructure investment become the key growth stabilizer in 2022?

- **Top leadership reshuffle:** Based on the outcome of the 20th National Congress of the Communist Party of China (CPC) held in October 2022, the top agenda of this year's "two sessions" is expected to secure a smooth transformation to President Xi Jinping's third-term. Except President Xi' continuation of presidency, the new premier Li Qiang took place of the incumbent Li Keqiang at this year's "two sessions". In the meantime, the majority of incumbent Vice Premiers and Ministers are to be replaced. The new Premier Li Qiang, who has a long history of working under President Xi, is anticipated to loyally enforce President Xi's policy without compromise at the State Council. Another surprising appointment is the reappointment of Dr. Yi Gang who has the US PhD educational background and used to be tenured professor in the US University to continue his next term as the PBoC's Governor, indicating the authorities' willingness to understand and integrate into the global financial system and global central bank cooperation, particularly to facilitate dialogues at the central bank level with the US and other various international organizations.

- **GDP growth target for 2023 is set to be at "around 5%" and other economic targets are promulgated.** The "around 5%" growth target is in line with our expectation in our previous Economic Watch: China | What do we expect from 2023 "two sessions"?, which considers China's recent reopening of its economy at end-2022 thus there are many challenges ahead to stimulate domestic demand and to rebuild market confidence after three years of "Zero Covid" policy. It is also in line with IMF's China 2023 growth forecasting at 5.2% and market consensus forecasting at 5.1%. While a faster growth rate is expected, there are other policy targets announced, including sustainable and high-quality growth instead of pursuing the growth figure per se. Other economic targets of 2023 were also promulgated in the Government Work Report are listed below:

(i) The employment target is to create over 12 million new urban jobs this year, and a surveyed urban unemployment rate is set at 5.5%.

(ii) The inflation target is set to be around 3%, which in our opinion is easy to achieve given the current domestic deflationary environment and dipping global commodity prices.

(iii) Household income growth is set to be in line with nominal GDP growth which is around 7% based on our forecast.

(iv) The economic targets also include a more balanced Balance of Payments (BoP) in 2023 and to promote export quality and growth.

(v) The Government Work Report also highlights the determination of reducing carbon emission, controlling the consumption of fossil fuels and reducing the energy consumption per GDP unit.(Table 1)

- **Expansionary fiscal policy and prudent monetary policy to support growth recovery after lifting "zero Covid".** Several key figures on fiscal expansion in 2023 include:

(i) Fiscal budget is announced to be 3% of GDP which is higher than the previous year's deficit budget at 2.8%.

(ii) No tax cut and fee reduction figures were announced in this year's "two sessions", but it mentioned tax cut and fee reduction policy will continue from the previous year.

(iii) The special-purpose local government bonds issuance quota is set to be RMB 3.8 trillion in a bid to support infrastructure investment, higher than the previous year's RMB 3.65 trillion announcement but lower than last year's actual total local government bond issuance at RMB 4.15 trillion.

From the monetary policy perspective, M2 and total social financing annual growth is announced to be in line with the nominal GDP growth rate which we estimate will be around 7%. In addition, the monetary policy will be more "targeted" and 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, RMB depreciation and capital outflows etc. Under this circumstance, we anticipate there will be no LPR cut throughout 2023 and 1-2 RRR cut this year after FED actually stops rate hike in the second half of this year. The authorities also re-emphasize the targeted easing measures, that means more structural and quantitative monetary policy tools instead of price tools will be deployed in 2023.

Table 1. COMPARISON OF 2022 AND 2023 TARGETS SET ANNOUNCED BY THE GOVERNMENT WORK REPORT

	2022 target	2022 actual	2023 target
GDP	5.5%	3%	Around 5%
CPI	3%	2%	3%
M2	In line with nominal GDP growth	In line with nominal GDP growth	In line with nominal GDP growth
Total social financing	In line with nominal GDP growth	In line with nominal GDP growth	In line with nominal GDP growth
Fiscal Deficit	-2.8%	-3.2%	-3%
Special Government Bond	No issuance	No issuance	No issuance
Local Government Special Bond	RMB 3.65 trillion	RMB 4.15 trillion	RMB 3.8 trillion
Survey unemployment rate	5.5%	5.6%	5.5%
Urban employment	11 million	12.06 million	12 million

Source: BBVA Research and 2022, 2023 Government Work Report

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