China Flash

Official 2013 macro targets set in line with expectations, highlighted by 7.5% growth target

Today's start of the 12-day National People's Congress began with the release of official 2013 macro targets, contained in outgoing Premier Wen Jiabao's Government Work Report. Among the key targets are GDP growth (7.5%), average inflation (3.5%), M2 growth (13.0%), and the fiscal deficit (2.0% of GDP) (Chart 1). The targets are broadly in line with our and market expectations, as described in our recent quarterly China Outlook. Of special significance is that the growth target is unchanged from last year, while the inflation and M2 targets have been lowered (from 4.0% and 14.0%, respectively). The inflation target is ambitious – our 2013 projection for average inflation is 3.3%, with monthly inflation expected to rise to 4.0% or above by end-year – and may reflect an effort to guide down inflation expectations. Taken together, the targets signal the new leadership's intention to maintain policy continuity with respect to a mix of "proactive fiscal policy and prudential monetary policy". As expected, the longer-term sections of the report underscored the government's emphasis on the quality of growth, urbanization, and economic rebalancing through a deepening of reforms.

- **GDP growth target of 7.5% is unchanged from last year and in line with expectations.** The target, unchanged from last year (which was lowered from 8.0% in previous years), was widely expected. Our 2013 growth projection is 8.0% (see China Outlook for details), up from last year's 7.8% outturn (Chart 2) on expectations a further acceleration in growth momentum through mid year, followed by a slowdown as policy stimulus is gradually withdrawn to prevent a further exacerbation of domestic financial fragilities (especially relating to shadow bank lending and local government debt). We believe that the government's target has been set in recognition of the gradual decline in medium-term potential growth (which we expect to fall to around 7.0% by 2020).

- **Inflation target has been lowered to 3.5% (period average).** Although the target is in line with our expectations, it is more ambitious than in previous years (compared to 4.0% last year), and signals the authorities' plans to maintain a cautious approach to monetary policy. It may also be helpful in guiding down inflationary expectations, making it easier for the PBoC to maintain price stability even as growth picks up from last year's cyclical slowdown. We forecast average inflation to rise to 3.3% in 2013 from 2.6% in 2012, with monthly rates expected to rise in H2 due to price pressures and base effects. Keeping inflation below 4% in the coming years will be a challenge in view of rising labor costs.

- **M2 growth target has been lowered to 13% (period average).** The new target is somewhat lower than expectations of around 14%, and down from last year's outturn of 13.8%. In addition to a prudent monetary stance, the target reflects the growing importance of the non-bank financial system as a source of savings and credit growth. We expect the broader measure of credit growth, "Total Social Financing" to grow by about 20% from 22.8% in 2012. We expect interest rates to stay on hold, with any adjustments in the (up or down) to occur in line with liquidity conditions stemming from capital inflows, among other factors.

- **Fiscal policy to support growth, with a higher deficit target of 2.0%.** This fiscal target is in line with expectations, and is expanded from last year's official target of 1.5% of GDP and preliminary outturn of 1.6%. However, it is difficult to assess the economic significance of the target given the accounting practices underlying the budget (which in 2012 placed 0.5% in revenue transfers from the previous year above the line rather than as a financing item) and the substantial impact of local government spending. That said, we interpret the target to be growth supportive, underpinned by tax and tariff cuts to boost consumption, public housing construction, and infrastructure investment.

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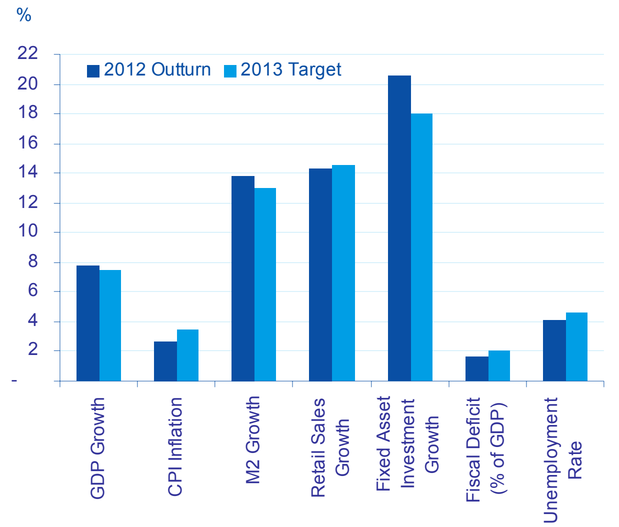
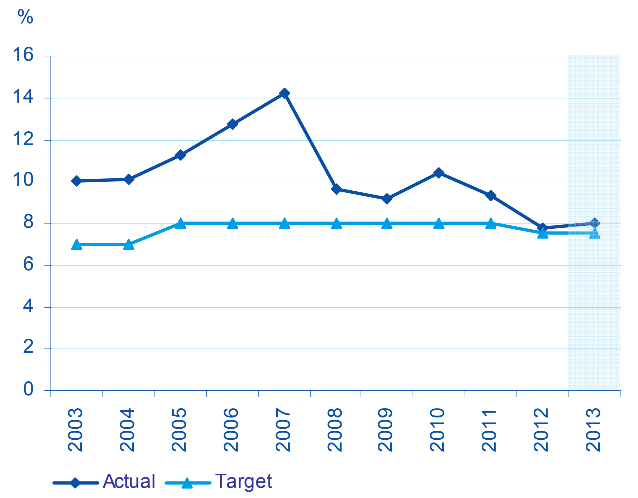
Chart 1
2013 macro targets vs. 2012 outturns



Source: Government Working Reports, CEIC and BBVA Research

Chart 2
GDP growth target at 7.5% for a second year in a row



Source: Wind and BBVA Research

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