

# China Flash

## “Third Plenum” conclusion lays groundwork for reforms, though lacking in details

As scheduled, China’s “Third Plenum” ended yesterday with the issuance of a Communiqué describing the meeting’s main conclusions, albeit in rather vague terms (as we expected). A follow-up document is anticipated in another week or so that should provide further details. While a full interpretation must await those details, we believe the Communiqué is broadly consistent with the new leadership’s repeated emphasis on reform, in particular the “decisive” role of the market in allocating resources. Among the positives are an emphasis on land policies to harmonize rural/urban integration, fiscal reforms to improve center/regional financial relations, the establishment of a high-level government team to design and facilitate implementation of reforms, judicial reform, and the goal of achieving “decisive results” by 2020. Among possible disappointments is an emphasis on the role of the State as a pillar in the economy which could be read as support for state-owned enterprises, and by extension, a lack of willingness for reform in this area. In addition, we found it surprising that the financial sector received little mention, although given the focus on developing market systems forthcoming details may well include steps in this area.

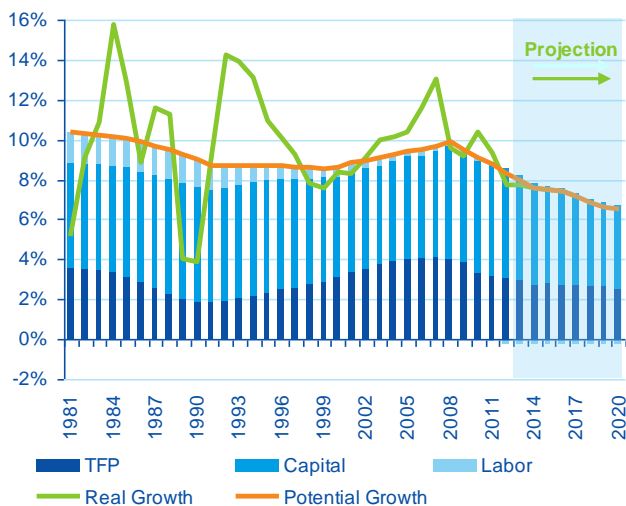
- **The Communiqué lays the groundwork for reforms, but is lacking in some areas.** Despite lacking specifics (which is not surprising given that such Communiqués have historically lacked detail), the document is broadly in line with our expectations for reform. In addition to the items mentioned above, the Communiqué mentions the need to relax investment access, accelerate the establishment of free trade zones, and enhance economic openness. In addition, references are made to “rule of law”, public administration reform, and social well-being. At the same time, however, the Communiqué makes repeated emphasis on the role of Socialism and the Party in guiding the economy. The emphasis on the roles of the State as a pillar in the economy could be seen as recognition that vested interests will be an impediment to deeper reform. It is also disappointing that no mention is made of reform to the “Hukou system” which is needed to facilitate urbanization, nor relaxation of the one-child policy given worries over aging population.
- **Our medium-term scenario foresees gradual rebalancing and slowing potential growth, with downside risks.** As described in our [China/Asia Outlook](#), we expect potential growth to slow from almost 8% at present, to 6½% by 2020 (Chart 1). We anticipate a gradual decline in growth, with rebalancing toward domestic consumption, and a larger share of the services sector (Chart 2). However, given slow progress to date (Chart 3), there are no assurances that rebalancing will quickly enough to avoid a sharper slowdown in growth. In this regard, reforms as envisaged in the Communiqué will be key.
- **The devil is in the details.** We remain cautiously optimistic that forthcoming details will reaffirm expectations of economic reforms needed to guide the economy to a more healthy and sustainable growth path. In the coming days in weeks we will be assessing details as discussed above, especially in the financial sector where further interest rate liberalization is needed (removal of the deposit rate cap) along with careful attention to the sequencing of reforms with gradual capital account opening.

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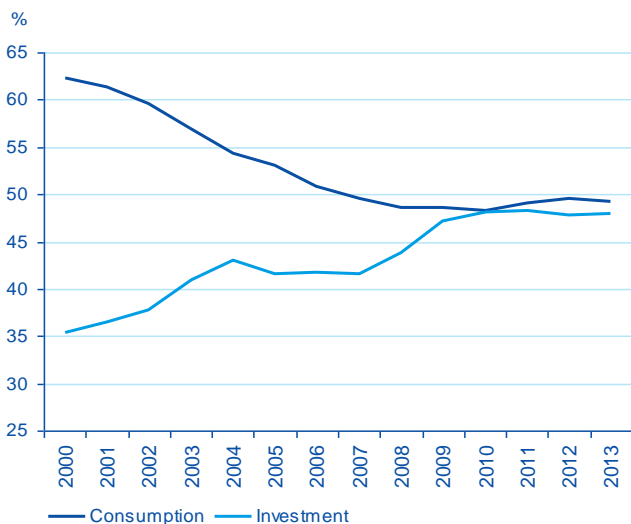
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Chart 1  
**China's potential growth is gradually slowing**



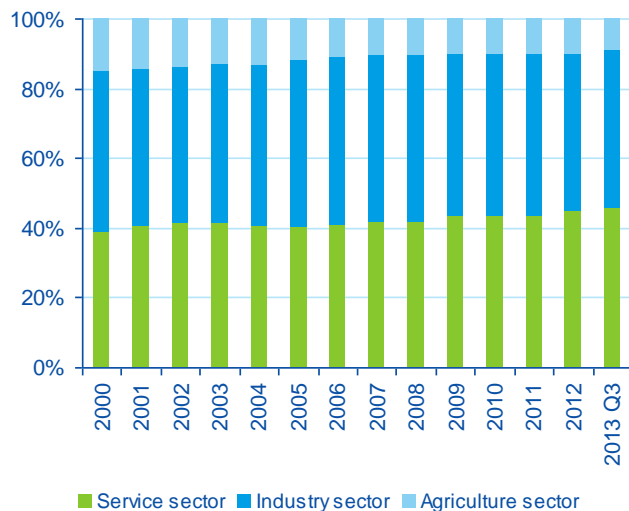
Source: BBVA Research

Chart 3  
**Rebalancing toward domestic consumption remains disappointingly slow...**



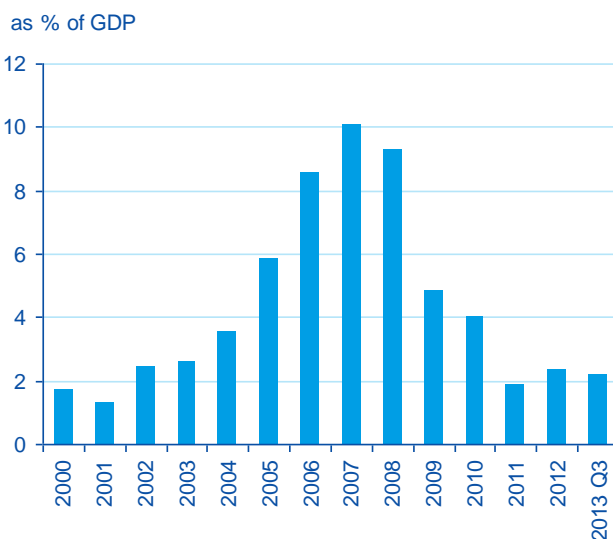
Source: CEIC and BBVA Research

Chart 2  
**Encouragingly, the share of the service sector is rising**



Source: CEIC and BBVA Research

Chart 4  
**...while the a narrowing of the current account surplus is a positive sign**



Source: CEIC and BBVA Research

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