China Flash

NPC meeting announcements in line with expectations

The National People's Congress (NPC) opened on March 5, with key events marked by the government's Work Report for 2012, macro targets, and the central government budget. Announcements so far have been in line with expectations. As has been widely reported, the 2012 GDP growth target has been lowered to 7.5%, from 8.0% in recent years. While global markets have reacted negatively to the lower target, it is fully in line with expectations and is consistent with underlying targets presented in last year's 5-year Development Plan. Also, as in past years, the growth target is likely to be exceeded by a considerable margin, and does not affect our projection of 8.3% GDP growth for 2012. In the meantime, we are evaluating ongoing policy announcements, including key fiscal priorities. We are also awaiting key inflation and activity data for January/February due out tomorrow.

- **We view the official growth target as a floor, rather than a projection of the expected growth outturn.** Indeed, in the past, actual growth outturns have consistently exceeded targets by a considerable margin (Chart). Our projection of 8.3% growth for 2012 remains intact, with continued downside risks owing to the uncertain external environment, along with domestic financial fragilities in the property sector.
- **As flagged in the 5-year Development Plan, a lower growth target reflects a renewed focus on rebalancing and the quality of growth**. As such, the central government may be sending a signal that its priority is no longer focused on achieving high growth outturns as an end in themselves, but rather on enhancing the quality of growth, including through social protection and environmental improvements.
- **The lower growth target also reflects a recognition that China's medium-term growth potential is declining.** We estimate potential growth will decline from around 9% at present to 8% by 2016 due to the effects of population aging, lower capital accumulation, and declining growth of total factor productivity.
- **On policies, the NPC has re-stated the government's "proactive fiscal and prudent monetary" policy mix.** In addition to growth, key targets include inflation (4.0%), the budget deficit (1.5%), and M2 growth (14.0%). Our projection is that the target for inflation is likely to be met with a margin (we expect average inflation of 3.3% in 2012), and as such, it leaves scope for expansionary policies to support growth as needed.
- **The budget deficit target is supportive of growth.** While the officially announced budget target of 1.5% of GDP does not look particularly expansionary on paper (up from an outturn of 1.3% of GDP last year), in reality it contains a significant dose of stimulus. Including a transfer of 0.5% from surplus revenues from last year (deposited in a fiscal stability fund), the budget deficit would be closer to 2.0% on a comparable basis from last year. This is broadly in line with our previous projections for fiscal policy, which will include measures to boost domestic consumption through structural tax cuts and subsidies, social spending, as well as support to SMEs through financing, favorable tax treatment and government procurement. In our view, there is also additional room for spending to support growth if downside risks to the external outlook materialize.
- **We are awaiting tomorrow's release of monthly inflation and activity indicators,** for a further reading on growth momentum. While recent PMI outturns have been encouraging, weaker electricity usage could be a sign of lower production. For now, we expect tomorrow's data to confirm that the economy is averting a hard landing. We project inflation of 3.2% y/y for February (from 4.5% in January) due to favorable base effects from the Chinese New Year and falling food prices. We also expect industrial production for January/February to moderate to 11.5% y/y from 12.8% in December, but still in with our 8.7% y/y Q1 growth projection.

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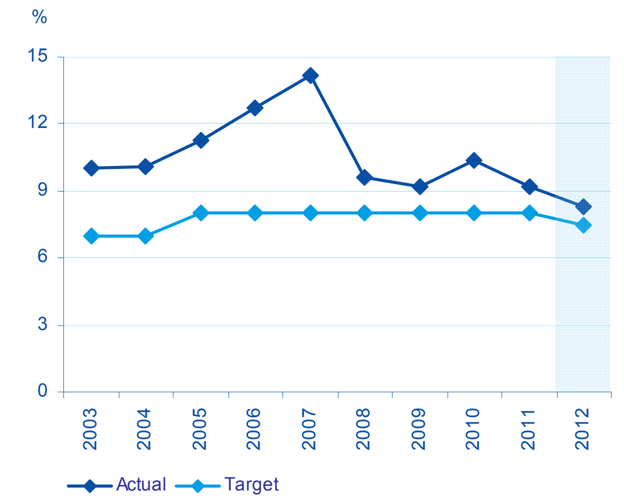
Chart 1
Actual vs. Targeted GDP outturns



Source: Government work report, CEIC and BBVA Research estimates

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