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Fundamentals Flash

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AFFIN HWANG CAPITAL

China NPC: Pivot towards Quality Growth

China's annual National People Congress (NPC) comes to a close soon after a 2-week parliamentary session. In the following interview Huang Juin Hao, Senior Portfolio Manager of Affin Hwang AM gives a rundown what happened in the NPC and market implications.

1) What were the key takeaways of China's NPC this year?

At the NPC, the government work report targets for 2019 have been announced and most of the targets have been largely in-line with market expectations. The keys numbers were for GDP growth to come in between 6% - 6.5%, which would represent a slowdown from 2018's 6.6% growth.

The government has placed particular emphasis on creating 11 million new urban jobs and keep registered urban unemployment rate within 4.5%. Tax cuts in VAT (value-added tax), corporate and households would also provide relief amounting to RMB 2 trillion, which was the same as 2018's prior announced business tax shift to VAT.

2) Were there any surprises this year that went against market expectations?

There were 5 surprises which differed from market expectations

i. The **fiscal deficit which the government expected to come to 2.8% of GDP**. Market expectations were for the deficit to be at 3.0%, given tax cuts of RMB 2 trillion, planned fiscal spending of above RMB 23 trillion and a deficit of RMB 2.76 trillion. This implies fiscal revenue of RM 20 trillion, which is 10-12%, higher than 2018.

ii. China also plans to issue **RMB 2.15 trillion of special local government bonds**, compared to last year's issuance of RMB 1.35 trillion.

iii. More **discretion was given to local governments**. For example, Premier Li called for more substantial cuts to the social security tax rates. Specifically, the employer's contribution rate for pension insurance will now be allowed to be lowered to 16% at the local government's discretion.

iv. There was **no mention of targets for shantytown redevelopment targets and industry overcapacity reduction**. However the government noted that both programs will continue.

v. Lastly, the phrasing of "promoting stable foreign investment growth" in last year's report has been reworded to "increasing the attraction to foreign capital"; and Premier Li promised to further open the market to allow for the operation of wholly foreign-owned enterprises in more industries. This suggests China is determined to have a **more open attitude towards foreign capital**.

3) Do you think recent stimulus measures announced by Beijing such as tax cuts and increased bond issuance will be enough to prop-up growth?

Policy stimulus in China often goes beyond traditional monetary and fiscal stimulus which makes judgement of stimulus measures compared to historical stimulus rather difficult. Supply side capacity reforms or capacity cuts done in 2015-2016 is one such example, whilst property easing measures done in 2008-09 is another. Much of the fiscal easing in the past has been done outside of the government's budget, via local government financing vehicle (LGFV), public-private partnership (PPP) projects and shadow banking credit.

We also know that credit efficiency and fiscal spending impulse is falling. This means that it now requires more debt or spending to generate the same amount of growth given higher debt/GDP ratios. The interest payment burden is much higher than previous stimulus periods.

Judging purely on the headlines and market expectations, estimates for reserve requirement ratio (RRR) cuts this year are expected to be in the same magnitude as in 2015-2016, but without the tailwind of benchmark rate cuts. The announced tax cuts amounting to RMB 2 trillion is similar in magnitude to 2018's tax cut, so we do not see any additional stimulus from there. The increase in special local government bond issuance, an increase of RMB 800 billion is equivalent to 0.8% of GDP.

While this appears small, we bear in mind that the government has given itself room to manoeuvre given no hard targets were set for shantytown redevelopment. For comparison, last year the government had spent RMB 1.74 trillion or 1.9% of GDP on these projects. We should expect that these and some of the other measures such as capacity reduction, will be used only as and when needed to help to cushion the economy from a sharp slowdown.

Also, what has been announced has thus far has been shy on implementation details, and the government has stated that the main focus of fiscal policy will be on quality of growth rather than on quantity. So we should expect less emphasis to be placed on meeting the targeted GDP growth range of 6% - 6.5%, but instead the focus will be on quality of growth.

4) How has emerging markets (EMs) responded to some of the headline news and stimulus measures so far from Beijing? Are markets convinced that this isn't a prolonged slowdown for China?

Market consensus appears to be that generally the announced targets and measures have been largely in-line with expectations, aside from the aforementioned few surprises. Also, as mentioned previously, policy stimulus often goes beyond the traditional monetary and fiscal targets, so it is too early to tell. We will need to see the extent and implementation of non-traditional policy measures.

We believe that China has given itself sufficient policy options and leeway to react and help stimulate the economy, given that there were no targets set for capacity reduction nor shanty-town redevelopment. These or other forms of non-traditional policy stimulus could come into play should Beijing decide it is needed or required.

We believe the market is very aware of this and are convinced that there will not be a sharp slowdown for China.

China has also reiterated many times that they will be focusing more on quality of growth rather than quantity. This is a strong signal that the growth target is not a hard target for Beijing and that China will be focusing on promoting more sustainable growth. This implies less focus on secondary industries (manufacturing, infrastructure-related growth) and more towards tertiary consumption and services-oriented growth.

5) Besides growth and the economy, did the NPC focus on anything else in its agenda?

The NPC is not over, but the main agenda has been presented in the form of the work report. What typically happens after the work report is presented is that the NPC will hold a series of plenary sessions. The CPPCC (China People Political Consultative Conference) will advise the government on the policy matters and implementation after which the NPC will ratify legislation of the respective policies.

The CPPCC has just concluded their annual session on Wednesday afternoon which indicates that the NPC is on track for Friday's 4th plenary meeting and legislative voting on the draft reports and work reports to bring them into law.

Given the high emphasis placed on quality growth, creating urban jobs and measures to improve training for workers, we should expect more color on the implementation of policies on tertiary Services, employment, urban job creation and education upskilling to be rolled out following the conclusion of the NPC.

These could lift uncertainty in certain sectors such as the private higher education sector which has been awaiting clarity following a series of policy drafts. Other sectors with a high proportion of service industry workers could also benefit from implementation clarity over social insurance payments, such as the property and hotel management sector.
