Market Commentary

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China's NPC meeting: The way back to normal

- **Beginning on March 5, the annual meeting of China's National People's Congress will set China's economic and political agenda for 2021.**
- **We expect policy to withdraw some of its support, with the main negative impulse coming from fiscal policy. Monetary policy will normalise only cautiously, in our view. We expect no explicit growth target to be set for this year.**
- **The new Five Year Plan (FYP) is likely to promote the targets of the recent Dual Circulation Strategy, e.g. improving private consumption, getting more independent from international supply chains and fostering technological advancement. Another topic will be the greening of the economy.**

On March 5, the **annual meeting of the National People's Congress (NPC)** will start and set the economic and political goals for this year. The NPC is China's highest national legislature with just short of 3000 people. The session typically lasts for 10 days.

Economically, the following three topics are in focus:
1) the **Government Work Report,** which contains the key policy and reform agenda for 2021,
2) the **Fiscal Budget Report**, which will make more precise the pace of fiscal consolidation, and
3) the **14th Five-Year Plan (FYP)**

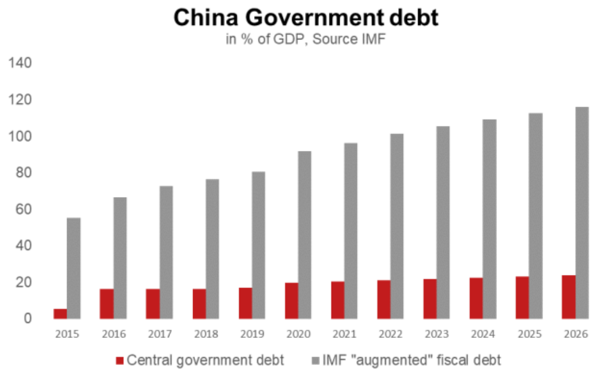
After China has recovered in a rather V-shaped fashion from the Covid-19 crisis, the overriding topic of this year's NPC session will be on how to secure its continuation while at the same time **return to more normal policies.** The second topic, as expressed in the FYP, will be the envisioned **structural change of the economy.**

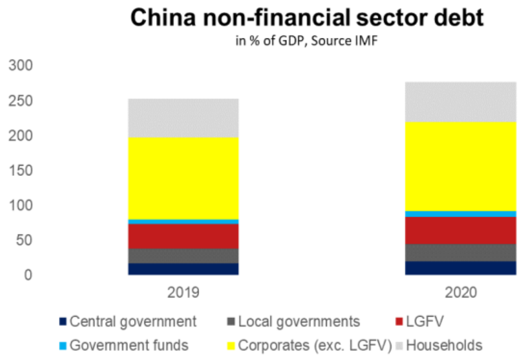
Regarding growth, it is already a widespread market belief that **Beijing will skip an explicit growth target** (like last year). Growth rates – typically expressed in year-on-year terms – will be too much dominated by base effects from last year's strong fluctuations. For instance, the consensus forecast for Q1 2021, which compares with the GDP drop of 6.4% yoy in Q1 2020, expects a reading north of 18% yoy. Subsequently growth rates will slow, but total 2021 growth will easily surpass "normal" growth after the 2.3% result in 2020. Given these fluctuations, it looks safer not to communicate an explicit goal. However, this does not mean that Beijing has no implicit aims. "True" ambitions will likely be more found in the targeted drop in the (registered) unemployment rate (back to 4.5% after 5.5% in 2020) and the urban job creation. These figures will show how Beijing assesses progress to re-integrate parts of the service sectors as private consumption is still a laggard in the recovery.

Beijing's cyclical policy stance is expected to be a **gradual normalisation pace**, as already discussed at last December's Economic Work Conference. Laggards of the recovery still need support, but any overheating is not warranted either. Moreover, according to the last IMF Article IV report, China's non-financial sector debt has risen significantly in 2020 by 24 pp to 277% of GDP. Thus, a return to deleveraging policies (shadow banking, real estate sector) will range high on the agenda without producing a fiscal cliff.

China's fiscal budget plans will be central to the gradual normalisation. In 2020 the broad fiscal deficit had been allowed to reach 11.5% of GDP, but de-facto it likely fell short of 9.5% due to the strong recovery. This year's fiscal consolidation will take place on several levels: The central government official deficit is expected to return to 3% of GDP, after 3.6% in 2020. There will probably be no issuance of special China Government

Bonds (vs RMB 1tr in 2020) and only RMB 3-3.5 tr in special Local Government Bonds (after RMB 3.75tn). This all points to a **negative fiscal impulse of around 2.5 pp in 2021.**





Given this already substantial fiscal brake, **we do not expect the BPoC to significantly tighten its policy** but to slowly shift to a more normal stance. If any, we can imagine a first key rate hike only towards the end of this year. Despite some liquidity issues, January fresh credit/TSF growth was at or near record highs, reflecting the PBoC's cautious stance, in our view. Growth rates of outstanding credit only edged down. Regarding the leverage of the economy, we expect basically only a consolidation which will be helped by a nominal GDP annual growth rate of around 10.5% this year. However, this would still imply some slowing of fresh credit (e.g. fresh bank credit increased by 16.8% yoy in 2020, after 4% in 2019). Nevertheless, the monetary impulse has peaked and will turn negatively which we expect to be increasingly felt in H2.

Finally, the 14th FYP will give some guidance regarding the growth targets over the medium term. China already embarked on the concept to **promote high-quality growth** instead of purely quantitative expansion. Moreover, the recently announced **dual circulation strategy** will probably come into play again. This implies, that China will promote private consumption, getting relatively less dependent on foreign demand. To support consumption could involve a further reform of the hukou system (local household registration) in order to promote urbanisation as well as to broaden the scope of social security. China will also aim at getting more independent from international supply chains, especially with regard to technological headwinds from the US-China trade conflict. China will continue to foster domestic technological advancement. It will also continue to be open for direct investment as it could enhance the transfer of know-how. The ultimate reasoning behind this strategy is to raise total factor productivity again as its slowing was the main reason for the high debt-to-GDP ratio. China also fosters the shift towards a **greening of the economy**. Although carbon neutrality is targeted only by 2060 (ten years later than in the EU), the new FYP will need to set the stage to reach 2030 interim goals.

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