China's NPC 2018: Seeking progress while maintaining stability

March 2018

The event…
The annual National People's Congress (NPC) started on 5 March 2018 with Premier Li Keqiang delivering the annual government work report, announcing key economic growth targets and mapping out major policy initiatives aiming at promoting high-quality economic development going forward.

China was largely on track with its policy targets in 2017, and key targets set out for 2018 are broadly in line with our expectation. We hold the view that top leadership will further fine tune growth rates to drive continued efforts in deleveraging, which is necessary and conducive to reduce and eventually remove the discount international investors has placed on Chinese equities due to the country's high debts level.

Below is a table comparing the key targets announced this year and last year.

Key government policy targets[1]

	2018 Target	2017 Target	2017 Actual
Real GDP Growth %	Around 6.5%	Around 6.5%	6.9%
CPI Growth %	Around 3.0%	Around 3.0%	1.6%
Fiscal deficit to GDP ratio %	2.6% of GDP	3.0% of GDP	3.7% of GDP
M2 growth %	Reasonable growth	Around 12.0%	8.2%
Reduction in CO_2 emission per unit of GDP	3.9%	4.0%	5.1%
Reduction in steel capacity[2]	30mnt	50mnt	>50mnt

What we think…

China delivered solid economic performance and made notable headway on reforms in selected areas in 2017. We believe the lowered economic guidance in 2018 demonstrate the government's commitment to remain focused on tackling structural issues that are impeding economic sustainability in the long term.

Visible progress on deleveraging and capacity reduction
Chinese economy grew 6.9% in 2017, its first upturn since 2010 and well above the government's growth target of "around 6.5%". We believe steady growth in the service sector and domestic consumption played a vital role in accelerating the expansion. With the economy on solid footing, the government has made positive progress on reining in leverage (actual M2 growth in 2017 at 8.2% vs target at around 12.0%) and reducing excess industrial capacity (capacity cut in the steel sector fully achieved in the first half of 2017).

Key policy targets guided down in 2018
The government keeps real GDP growth target this year at around 6.5% without mentioning "aiming for better outcome" as appeared last year. Budgeted fiscal deficit is set to narrow to 2.6% of GDP from 3.0% in 2017; and M2 growth target was not announced but expected to remain reasonable to ensure stable liquidity conditions. We believe Chinese government has signalled tolerance towards slower economic expansion as long as it can bring about growth with better quality; however with a parallel aim to maintain stability, we expect policy makers to be gradual and prudential with implementation.

Continuous rebalancing efforts towards sustainable growth in the long term
Consistent with previous years, deepening reforms continues to take policy priority. In particular, the government has pledged to step up supply-side structural reform by reducing additional excess capacities in the energy and materials sectors. The importance of fighting pollution was again being addressed during Premier Li's speech. We expect it will lead to strong enforcement of environmental protection rules in 2018, driving more disciplined supply-side controls. In addition, innovation has also

[1] Source: Xinhuanet, JP Morgan, National Development and Reform Commission, 5 March 2018
[2] Mnt stands for million metric tons.

been brought forward as a top agenda. We believe reform measures highlighted in the government work report represent ongoing efforts by the government to rebalance the economy towards a more sustainable path less driven by investments and debts, with an ultimate goal to deleverage and reduce systemic risks.

Appointment of key policy makers and Constitution revision
This year's NPC will also mark major reshuffle of top policy makers overseeing the financial and economic sectors including vice premiers, central bank governor among others. China earlier announced proposed revision to remove the term limit in Constitution on the president and vice-president. We expect it to be ratified, opening the possibility for President Xi to stay in power beyond 2023.

Conclusion:
Even though the rebalancing efforts may lead to slower government-guided growth in the short term, we believe it is a necessary step that China needs to take in order to bring stability in the long term. In our view, high leverage is still the very long-term problem that confronts Chinese economy and discourages investment flows towards China market that will otherwise drive further re-rating of Chinese shares. We are encouraged with the recent positive development on deleveraging and the government's reiterated focus on broad-based reforms. We believe despite bringing short-term pain they are the course of actions that will help deliver long-term gain by fixing the real issue of high leverage.

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