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China's Government Work Report: First Impressions

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The government work report (GWR) presented by China's Premier Li Qiang to the National People's Congress (NPC) contained few surprises. The report, duly approved by the Communist Party's Politburo meeting of 29 February, projected gross domestic product (GDP) growth target of "around 5%" and offered some modestly supporting macroeconomic policies to get there (Table 1). This support will be needed, as the consensus forecast of Focus Economics, a research firm, put the average expectation among banks and other analysts at 4.6 %, the same growth the IMF projected in January this year. Provincial governments, which have already published their forecast in the past couple of months, projected on average growth of 5.4%, with few provinces below 5%. This suggests that the "around 5%" had already been agreed upon at the Central Economic Work Conference of the Central Committee of the Communist Party of China (CPC) in December last year.

Early reactions to the target call it "ambitious" and this is likely to have been intentional. One of the key and intractable problems the government has been struggling with is the expectations of people and investors ever since the COVID-19 lockdowns and regulatory crackdown on internet platform companies and others. China's leadership is aiming for a major reorientation of the economy towards what it dubs to be "high quality growth". While few would disagree with such an objective, a burning question is how much growth that would imply. After all, it is overall growth that determines investment opportunities and jobs, and insecurity concerning growth prospects is holding back demand. Choosing an ambitious indicative target signals that China is still seeking relatively high growth, despite the challenges the country faces.

TABLE 1 CHINA: GOVERNMENT TARGETS AND OUTCOMES 2021-24

	2024 Target	2023 outcome	2023 target	2022 outcome	2022 target	2021 outcome	2021 target
GDP Growth (%)	Around 5	5.2	Around 5	3.0	Around 5.5	8.1	>6
Jobs Creation (mn)	>12	12.4	~12	12.1	>11	12.7	>11
Unemployment (%)	Around 5.5	5.2	<5.5	5.6	<5.5	5.1	~5.5%
Budget Deficit (% GDP)	3	3.8	3.0 (3.8) *	2.8	2.8	3.1	3.2
LG Bonds (RMB Tr.)	3.9	3.8	3.8	4.0	3.65	3.58	3.65
Special Treasury bonds (tr. RMB)	1	1					
LG Transfers	10.2	10.3	10.1tr.	-	9.7tr.		
Tax & fee cuts	tbd	"additional 2.2tr." **	Measures to be extended	3.46tr.	2.5tr.	1.1tr.	-
CPI Inflation (%)	~3	0.2	~3	2.0	~3	0.9	~3
Grain output (mn tons)	>650	695	>650	685	>650	681	>650
Total Social Financing (% growth)	In line with projected nominal GDP	9.5%	In line with projected GDP	9.6	In line with projected GDP	10.3	In line with projected GDP
Balance of Payments	"basic balance"		"basic balance"		"basic balance"		"basic balance"
Total debt to GDP	tbd		No target	-	Stable	-	Stable
Energy Intensity decline (%)	-/- 2.5	"short of expectations"	-/-2	-	No target	-	-/-3

Source: Various government work reports, budget reports and planning reports 2021-24, HSBC, UBS.
* Revised to 3.8 in October 2023
** not clear whether this is beyond the measures already implemented
~= around

Premier Li did not mince words on those challenges:

> *"The foundation for China's sustained economic recovery and growth is not solid enough, as evidenced by a lack of effective demand, overcapacity in some industries, low public expectations, and many lingering risks and hidden dangers. Furthermore, there are blockages in domestic economic flows, and the global economy is affected by disruptions. Some small and medium-sized enterprises (SMEs) face difficulties in their operations. We are confronted with both pressure on overall job creation and structural employment problems, and there are still many weak links in public services. Some primary-level governments are facing fiscal difficulties".*

The lack of domestic demand coupled with growing capacity for manufacturing is becoming a key issue for China. For one, it has started to affect prices and some see the spectre of deflation looming for China. Last year, the consumer price index was barely in positive territory, at 0.2% increase, but the GDP deflator, reflecting prices for all outputs, declined by 0.6%, and even 1.6% in the last quarter. Combine this with falling asset prices—notably in real estate and the stock market—and the risks of a deflationary spiral become real. In this context, the government's indicative target for consumer price inflation at 3% for the year seems optimistic.

A second problem with lacklustre domestic demand is the swift expansion of China's external surpluses, particularly in manufacturing, which is giving rise to renewed trade tensions. The EU has announced an investigation into China's electric vehicle (EV) exports, which it argues is boosted by inappropriate subsidies and overcapacity in China's car industry. The United States already has a 25% tariff on Chinese vehicles and President Biden has recently tagged China's EVs as a security risk. Presidential hopeful Trump has already announced he would slap a 60% tariff on all Chinese exports to the United States. While these policies of the EU and the United States may be flawed, it does provide additional reason to seek higher domestic demand.

DOMESTIC DEMAND

In the medium term, households should play a larger role in demand, which can be done by reforms in the labour market, social security, tax system and household registration system.

Nevertheless, these reforms, even if desired by the Chinese leadership, will take time. In the short term, government stimulus is key. China has been reluctant to embark on a stimulus programme in recent years, even amid the challenges of COVID and the real estate slump. In part this seems to be motivated by the notion that the money would reignite the real estate bubble and be wasted on real estate development or infrastructure that no one will use. This need not be the case as there are numerous issues that await responses from the government which would stimulate demand.

Prime among them is the country's green transition, which requires massive investment in new energy. China is pretty much on track for its 2060 goals, but the government could well decide to accelerate the transition and frontload the needed investments. According to estimates by Tsinghua University, the net zero goal could cost about 100% of 2020's GDP that allows for plenty of "good" investments. A second promising area is subsidies for households to buy more of the outputs of China's surging EV manufacturing. This would equally help the energy transition and reduce protectionist pressures from abroad. These and other measures would meet Li Qiang's call in the government work report: "*We should appropriately enhance the intensity of our proactive fiscal policy and improve its quality and effectiveness*".

FISCAL POLICY TO THE RESCUE?

Any meaningful economic stimulus would have to come from the fiscal side. With debt levels at well over 300% of GDP, monetary policy will continue to be "prudent" and total social financing will grow in line with GDP. Even though enterprises' appetite for borrowing seems to be gradually returning, this offers little stimulus.

With a headline budget deficit of 3% of GDP, the same as last year's budget, it will be the special items in the budget that should provide this stimulus. Among those is a (off-budget) special bonds issue of RMB1 trillion (about 0.7% of GDP), carry-overs from unspent money from last year and withdrawals from the stabilisation fund. UBS, an investment bank, estimates that the overall projected deficit on a cash basis will be 8.2% of GDP, compared to 7% in 2023. Much of the fiscal punch will depend on the uptake by local governments of the RMB3.9 trillion (2.8% of GDP) in bonds that they are allowed to issue. It is unclear whether all of them would want to use their quota as the real estate slump has greatly reduced revenues from land lease sales. Moreover, financing through the "backdoor" by means of local government financing vehicles (LGFV) is likely to be much more limited, given that the sector is consolidating its debts. Further, debt, including LGFV debt, is high and accounting for approximately over 80% of GDP.

While the government has pledged more support for the real estate sector and dropped the ominous "housing is for living in, not for speculation" slogan, it is reluctant to bail out real estate developers on a large scale. Social housing and policy support loans may give some relief to property developers, but demand for housing will only stabilise at much lower levels than that before COVID.

Alleviating some of the debt burdening local governments could also help restore the levers of macro-economic policies. In 2023, the government had already announced its support for resolving some of the local government debt problems, using some of the proceeds of local bonds issue. Unexplored thus far is the use of state asset sales to pay down some of the debt. Some of the most highly indebted provinces have plenty of valuable state assets. For instance, in Guizhou, total government debt at the end of 2022 was RMB1.2 trillion. At the same time, the government also owns 60% of Moutai, a liquor company, currently valued at RMB2.1

trillion. While it is a highly enjoyable drink, *baijiu* is hardly a strategic industry—or to use the new term, a *new productive force.*

NEW PRODUCTIVE FORCES

The government work report focused on "new productive forces", a new concept introduced by President Xi Jinping last year. This is part of the broader project of High Quality Growth (an oft-repeated term in the government work report), which can broadly be interpreted as more innovative, productivity-driven growth. This year's government work report puts it as the number 1 priority (Table 1), one notch up from last year and ahead of domestic demand (number 3). To support China's structural economic transition to new growth areas, the report stresses developing modern industries and improving productivity. New emerging sectors include those in which China already leads (e.g. EV, solar, wind and high speed rail) and those with cutting-edge technologies (such as hydrogen, new materials and innovative drugs). In addition, the government vowed to advance industrial digitisation and AI, increase R&D and innovation, improve public data usage, and bring forward some digital infrastructure construction.

The government seems well on the way to achieving the transformation: research and development spending is now 2.6% of GDP, outpacing the level of the EU, and bank loans that used to go to real estate, are now flowing into manufacturing. Industrial policy has also been transformed: the new Party Central Commission for Science and Technology is now directing and coordinating the efforts, promoting not only the modern industrial system, but also the "future industries", i.e. those still in the research stage, but which one day may be the leading industries in the world, such as advanced AI, humanoid robots, brain-computer interface and quantum computing. During the "Two Sessions", the stocks of some of the enterprises engaged in these future industries (such as Ubtech Robotics and Beijing Fourth Paradigm Technology Co.) doubled in value on the Hong Kong stock market.

Despite the acknowledgment of the premier, the issue of overcapacity received scant attention in the government work report. In general, China is more focused on developing the new industries rather than resolving issues in the older industry. Some of these issues are triggered by industrial policy itself: once declared a priority sector, every local government wants to be a part of it. The problem is that even loss-makers stay in the game for a long time. This is a problem for not only China, as its productivity growth is held back by the laggards, but also other countries, which face competition from industries that sell on the world market at cut-throat prices. This is the main complaint of the EU with regards to EVs today, and addressing the issue is therefore key to averting the risk of more trade tensions.

NO PRESS CONFERENCE

Perhaps the biggest news coming out of the NPC meetings thus far is the scrapping of the post-NPC press briefing by the premier. This breaks a 30-year tradition and passes on an opportunity to explain the government's policy directions. Past press conferences, even though tightly managed, were a rare opportunity for Chinese and overseas press to interact with the second most senior policymaker. Dropping the presser may have something to do with Premier Li Qiang's personal preferences, but it is more likely a further sign of the dominance of the CPC in policymaking in the country and the State Council's full support for the party.

The new direction was already quite clear from last year's press conference, Li Qiang's first (and now last), in which he expressed his job is to implement whatever the CPC Central Committee has decided. At a 19 February meeting he reiterated that the State Council must "follow the instructions" of the Central Economic Work Conference (CEWC). The CEWC last December called for "加强经济宣传和舆论引导，唱响中国经济光明论" (Strengthen economic propaganda and public opinion guidance, and promote a positive narrative about the bright prospects for the Chinese economy). The premier's presser could have done just that, and it is regrettable that the presser has been dropped.

TABLE 2 PRIORITIES OF GOVERNMENT FROM THE GWR 2022-24

Priority #	2024	2023	2022
1	Striving to modernize the industrial system and developing new quality productive forces at a faster pace	Expanding domestic demand	Achieving stable macroeconomic performance and keeping major economic indicators within the appropriate range
2	Invigorating China through science and education and consolidating the foundations for high-quality development	Accelerating the modernization of the industrial system	Keeping the operations of market entities stable and maintaining job security by strengthening macro policies
3	Expanding domestic demand and promoting sound economic flows	3. Unswervingly consolidating and developing the public sector and unswervingly encouraging, supporting, and guiding the development of the non-public sector	Steadfastly deepening reform to strengthen market vitality and internal momentum for development
4	Continuing to deepen reform and boosting internal momentum for development	Intensifying efforts to attract and utilize foreign investment	Further implementing the innovation-driven development strategy and strengthening the foundation of the real economy
5	Pursuing higher-standard opening up and promoting mutual benefits	Effectively preventing and defusing major economic and financial risks	Expanding domestic demand and promoting coordinated regional development and new urbanization
6	Ensuring both development and security and effectively preventing and defusing risks in key areas	Stabilizing grain output and advancing rural revitalization	Boosting agricultural production and promoting all-around rural revitalization
7	Making sustained efforts to deliver in work relating to agriculture, rural areas, and rural residents and taking solid steps to advance rural revitalization	Continuing the transition to green development	Pursuing higher-standard opening up and promoting stable growth of foreign trade and investment
8	Promoting integrated development between urban and rural areas, advancing coordinated development between regions, and optimizing regional economic layout	Meeting people's basic living needs and developing social programs	Continuing to Improve the Environment and Promoting Green and Low-Carbon Development
9	Enhancing ecological conservation and promoting green and low-carbon development		Ensuring and improving the people's wellbeing and promoting better and new ways of conducting social governance
10	Ensuring and improving the people's wellbeing and promoting better and new ways of conducting social governance		

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Best regards,
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