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Article

China: Stability and Growth - the new year resolutions

Two words sum up China's 2018 economic policy targets: "stability" and "growth". The aim is to control the momentum of reform so that risks are minimised, with growth continuing to come from consumption and infrastructure investments

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The Economic Work Conference was held from 18-20 December 2017. This conference is the foundation of next year's economic policies in China. It is a closed-door event followed by a statement.

Xi's "new era" thoughts get attention, again

Xi's "new era" thoughts were quoted in the work conference, as to be expected after Xi has consolidated his power in the Party. One of Xi's new era thoughts is to grow the middle class, still the main pillar of economic growth.

Reforms are double-edged swords. They could lead to risks, and growth

The top item at the work conference was to "avoid systemic risks", exactly in line with Xi Jinping's 19th Congress speech. This looks to be closely linked to the reforms the government has planned for 2018 - aiming to cut corporate overcapacity and to implement financial deleveraging reform, with more regulations to be in place in 2018. These two reforms, especially on financial deleveraging, could trigger risks if not carried out properly. But if successful then China's economy could enjoy another cycle of strong growth.

The chance of systemic risk is low, with reform under micro-management

We believe that any chance of systemic risk is low. Policy makers are highly aware of the risks that financial reforms could bring, and we expect the regulators to implement financial deleveraging carefully and gradually. This is where stability and growth come together.

What does a "prudent neutral monetary policy stance" really mean?

The work conference statement describes the monetary policy stance as "prudent" and "neutral". We do not interpret this as implying a tighter policy stance or indeed the reverse.

These descriptors have been present for most of 2017, and the central bank (PBoC) has raised rates or tightened or loosened liquidity when it needs to. So the description alone is just too

general to conclude how tight liquidity might be or whether policy interest rates might be higher, with any hikes at a faster speed.

This vagueness gives the central bank more room for manoeuvre with financial reforms in 2018. Although we forecast three 5bp rate hikes in 2018 by the PBoC, we also do not rule out that the central bank might inject liquidity into the interbank market to lower short-end interest rates when rates are rising faster than PBoC expectations.

Aggressive fiscal spending to achieve pollution reduction in three years

As expected, pollution was an important item on the working conference agenda. We think that having a clear blue sky in three years time means the government needs to invest a lot of money. Reducing pollution will take a long time because the country needs to build up new energy facilities to replace traditional energy sources, the major source of pollutants.

China is still at the investment stage for clean energy. Although usage of clean energy has grown at double-digit rates, the base is lower than traditional energy usage. We expect that there will be significant government spending and PPP on these infrastructure projects, putting pressure on government spending over the coming three years.

Expect even larger state-owned enterprises

The statement envisions that state-owned enterprises will become even larger. This has already been a case with combining a big coal SOE with a big electricity SOE. We expect this model to develop further in 2018. The government also wants to modernise SOE corporate governance, made difficult in that Party members might be on governing boards and so drive businesses towards a pro-national strategy which may not be the most profitable strategy for a corporate.

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