China: What to expect from the Two Sessions

The highlight of China's 'Two Sessions' for businesses and economists is the government work report, which is usually published on 5 March. It will give us clues about the main direction of government policies. Here's what we expect

Background to this year's Two Sessions

This year's government work report should continue the central theme set out in the 14th Five Year Plan. This means a continued emphasis on the actionable steps to achieving peak carbon emissions by 2030.

However, economic growth should also feature prominently in the report, as activity was slow in the fourth quarter.

These two goals - reducing carbon emissions and driving economic growth - in some sense conflict with one another, as stronger economic activity would inevitably lead to higher carbon emissions. How the government balances these competing goals will be our main focus.

GDP target at 6%

It is not clear if the government will announce a GDP growth target in its work report. But as it did so last year, we expect it to do so again. And we think this target could be 6% or more, which is consistent with GDP targets from local governments as they prepare for the Two Sessions. Inflation is not a concern right now as it is fairly low at less than 1% year-on-year. And we believe that without a very abrupt increase in energy prices, this low inflation environment should remain for the rest of the year.

Fiscal policy will also be a key focus. The increase in the fiscal deficit should be fairly stable at 3.2% of GDP, but as GDP increased in 2021 from 2020, the size of fiscal deficit will increase as well. We expect a moderate rise in local government special bonds, which are the main source of funds for local government projects. On this front, we believe the Chinese government could try to achieve both of its main aims by building 'green' infrastructure, which both reduces carbon emissions and drives economic growth.

In terms of monetary policy, we expect the government to describe its approach as "proactive and flexible". In other words, China remains in easing mode.

We expect only a very brief mention of international trade as China doesn't want to touch on this topic given that the Phase One trade agreement has come to an end, and talking too much before any formal talks with the US may not be sensible.

What to expect at the Two Sessions

	2018	2019	2020	2021	**2022**
GDP target	around +6.5%	+6% to 6.5%	nil	'+6% or above	**'+6% or above**
CPI target	around 3%	around 3%	around 3.5%	around 3%	**Around 3%**
Fiscal balance (% GDP)	-2.6%	-2.8%	-3.6% or more	around -3.2%	**Around -3.2%**
Monetary policy	neutral	neutral	flexible	flexible	**Proactive n flexible**
Approval of special local government bond limit	CNY1.35 trillion	CNY2.15 trillion	CNY3.75 trillion	CNY 3.65 trillion (actual issuance 3.4676 trillion)	**CNY 3.85 trillion**

Source: Ministry of Finance China, ING

Impact on the market

If the government does not set a target for GDP growth, the market will be left to make up its own mind, and uncertainty usually triggers a dip. The size of the fiscal deficit is a double-edged sword; if the deficit is too small, the market may be concerned that the economy lacks the necessary stimulus to drive growth, while too much spending could raise questions about the indebtedness of the government or local governments.

In terms of monetary policy, there is uncertainty about whether the forthcoming RRR cut will be a targeted one for SMEs or a broader cut. We should know more about this from the wording on monetary policy. Any mention of the yuan exchange rate will also catch the attention of market participants. The yuan is very strong right now. If the government work report suggests the need for the currency to "weaken" or "depreciate," this could trigger a dive in the yuan's exchange rate. However, we don't expect such words to appear in the report. Instead, we expect more subtlety, perhaps mentioning "two-way volatility", which would not give away anything about the timing of a possible depreciation in the yuan.