Li Keqiang on his way to deliver the work report at the 5 Mar 2019 NPC convention

Li Keqiang's work report: easing into the downturn

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unleashing internal demand a macroeconomic theme, with opening of markets and export upgrade also in focus

Unleashing internal demand through state-led infrastructure investment, tax cuts, and consumption promotion is the macroeconomic theme; this flows from strategies set at the December 2018 Central Economic Work Conference and quarterly Politburo economic meetings. Top items on the domestic agenda include gingering up the domestic market by 'improving weak links', supporting private business, reforming markets, and enforcing fair competition. Internationally, the state pledges to open goods and factor markets, and foster rule-based institutions. Facing trade war pressure, China aims to diversify and upgrade its exports by developing new competitive advantages.

employment first

'employment first' becomes priority amid growing slowdown pressures

'Employment first policy', a new expression in top-level documents, makes it a macroeconomic priority in response to mounting unemployment pressure in the slowing economy. In the past, employment was generally considered social rather than economic policy; labour market indices did not previously influence central bank policies, says Cai Fang 蔡昉 Chinese Academy of Social Sciences vice president, but their time has now come. A measure of development and social stability, Liu Yuanchun 刘元春 Renmin University vice president says structural challenges include labour shortages in big cities and oversupply in small cities as well as general deterioration in the welfare of the labour force. Structural unemployment is trickier to deal with than aggregate unemployment, argues Liu Wei 刘伟 Renmin University president, because the latter can be solved with rapid growth: the former depends on specific groups of workers on both the supply and demand sides.

lowered growth target

the 6.0-6.5 percent GDP target reflects a slight downward adjustment compared to previous years

The report fleshed out quantitative macroeconomic targets that attracted contention in the run-up to the Two Sessions. The GDP target is set at 6.0-6.5 percent, a slight downward adjustment compared to 6.5 percent in 2017 and 2018 and 6.5-7.0 percent in 2016. As long as GDP growth reaches 6.2 percent over the next two years, the 2020 objective of doubling GDP is achievable, says Huang Shouhong 黄守宏 State Council Policy Research Bureau director. Lowering the growth target is consistent with gradual economic transition, says Liu Yuanchun, and accords with shifting growth drivers, unsolved institutional problems, distorted resource allocation, and a diminishing demographic dividend.

fiscal adjustment

rising fiscal deficit for infrastructure expansion and tax cuts

2019 fiscal deficit is set at 2.8 percent, slightly lower than the market expectation of 3 percent but still 0.2 percent larger than 2018. Approved special local bond quota increased y-o-y by C¥800 bn, reaching C¥2.15 tn. Li Keqiang 李克强 says the moderate deficit rise leaves policy space for the future, and expanded local spending capacity will be invested in railways, highways, logistics, urban facilities, disaster control and civil aviation. Ambitious VAT cuts are also rolling out, estimated at C¥713.2 bn based on 2018 tax revenues by Tang Dajie 唐大杰 Wuhan University. State investment and tax cuts are key to strengthen both ends, says Liu Shangxi 刘尚希 Chinese Academy of Fiscal Sciences president, as the former boosts domestic demand and the latter incentivises market participants.

interest rate cuts on the horizon

monetary easing set to continue this year

Monetary easing is expected to continue in 2019. The report specifies that M2 and aggregate social financing should be consistent with nominal GDP growth, implying that current 8.1 percent M2 growth can still rise to match 9.7 nominal GDP growth, says Lian Ping 连平 Bank of Communications chief economist. As M2 weakens as an indicator, argues Lu Zhengwei 鲁政委 Industrial Bank chief economist, this expression simply means monetary policy should serve development goals. It has been over ten years since government work reports referred to reducing the real interest rate, so recourse to it now seems to foreshadow further interest rate cuts. But while policy rates may drop, Lian argues benchmark lending and deposit rates will not, given low money market rates and spillover effects on the exchange rate and capital flows.

what are the experts saying?

Huang Shouhong 黄守宏

State Council Policy Research Bureau (SC-PRB) director

Chief consultant to the State Council, Huang has been lead drafter of government work reports in recent years. Prior to promotion to the leadership position of SC-PRB, he directed the rural affairs department where he was often on the team drafting the No. 1 Document on agricultural and rural affairs. Lowering the GDP target, says Huang, is acceptable when employment, income growth and the environment improve. Higher-than-expected growth in 2017 and 2018, complex challenges, and downward economic pressure all constrain growth prospects this year, and justify lowering the target. Under the new normal, while demand-side management through stimulus remains important, there is an increasing awareness of efficient production factor allocation on the supply side.