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MACRO MORNING BRIEFING

March 7, 2024

Takeaways From China's Annual Two Sessions

The government work report (GWR) delivered by China Premier Li at the country's recent "two sessions" meetings unveiled targets for key economic variables this year: GDP growth of "around" 5.0%, after 5.2% in 2023; an increase in headline inflation (CPI) of "around" 3.0%; a deficit-to-GDP ratio of 3.0% and government deficit of CNY 4.06trn; and an urban unemployment rate of "around" 5.5%. The GWR strikes a cautious note with multiple mentions of challenges ahead. Premier Li reiterates that the foundation of China's sustained economic recovery and growth is not solid enough, as evidenced by a lack of effective demand, overcapacity in some industries, and lingering and hidden debt risks.

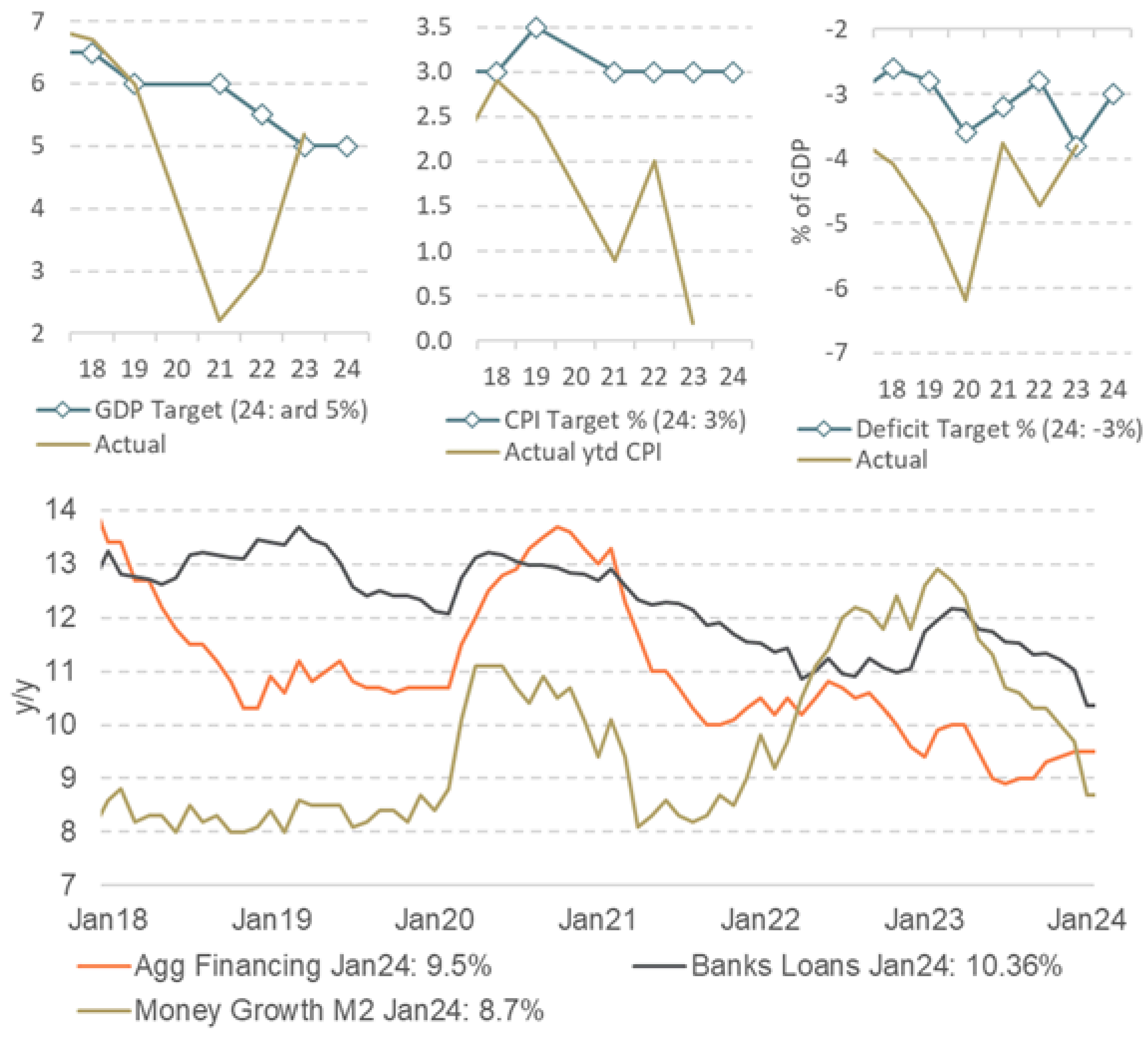
Local markets' initial reaction to the GWR and the macroeconomic targets has been mixed. USDCNY has been stable around 7.21. The government bond curve bull flattened, the 10y CGB yield making new lows 2.31% (COVID-2020 low 2.50%), with the 3y-10y segment hovering at the lower end of the historical range, around 22bp. The Shanghai Composite Index has held above the psychological round number of 3000.

The 3% deficit-to-GDP ratio target is mild compared to some market expectations for stronger fiscal expansion. Last year, China revised the deficit-to-GDP ratio higher, to 3.8% from 3.0%, along with an additional CNY 1trn in government bond issuance in Q4. In our view, the "lower" ratio should not be interpreted as China re-engaging in fiscal tightening as in 2022, when the deficit as a percent of GDP was lowered to 2.8% from 3.2% in 2021.

The GWR committed to boosting funding, including CNY 3900bn of special-purpose bonds for local governments, an increase of CNY 100bn from 2023, as well as new ultra-long special Treasury bonds worth CNY 1000bn a year for several years. The latter, which will not be included in the deficit calculation, will be used for implementing major national strategies, such as "high-quality development".

One of the main focuses this year is the is notion of “new productive forces”. This emphasizes spurring industrial innovation and new tech-related industrialization while shifting away from traditional 'heavy' growth drivers such as infrastructure. This is paramount – a medium- to longer-term aim to become self-reliant in technology. The share of strategic industries, e.g., new energy, high-end equipment and biotechnology, in China’s GDP has increased substantially over the years, from 7.6% in 2014 to 13% in 2022. The share of these industries' contribution to GDP is projected to rise to 17% by 2025.

Exhibit #1: China Economic Targets And Credit Growth



Source: BNY Mellon Markets, Bloomberg L.P.

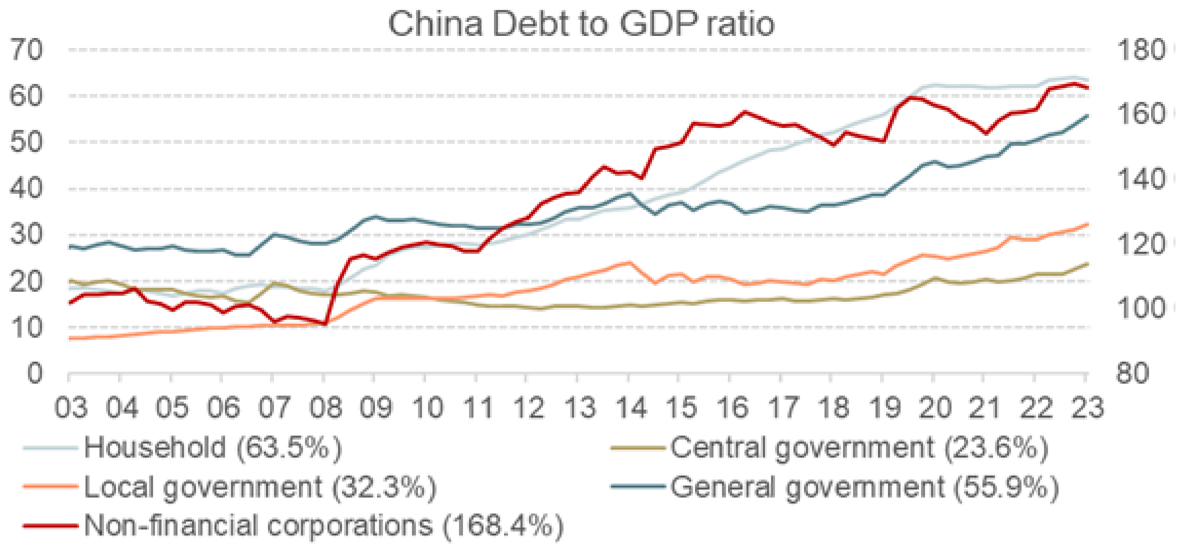
While proactive fiscal/prudent monetary policy remains the preferred strategy, we believe more efforts are needed to quicken normalisation of credit-transmission and revive credit growth, which has been hovering at multiyear lows. M2, loans by financial institutions and aggregate financing grew 8.7%, 10.4% and 9.5%, respectively, as of January.

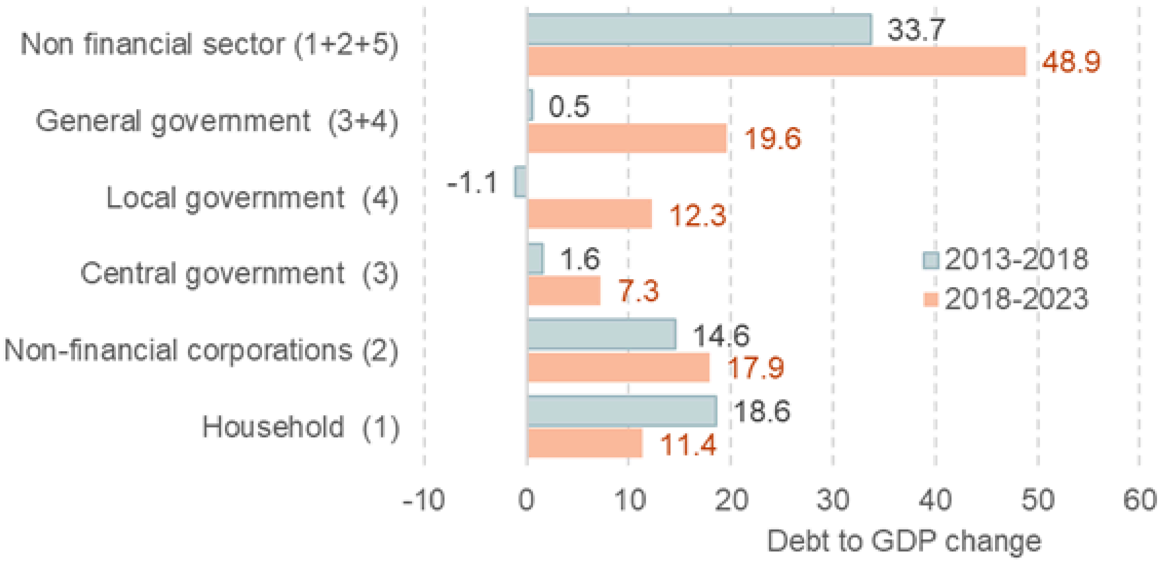
As in previous years, the new GWR calls for maintaining adequate liquidity at a proper level, as well as aggregate financing and money supply staying in step with growth and CPI projections. We expect China to continue to maintain sufficient liquidity in the banking system – with a chance of further cuts to interest rates or relaxation of lending standards.

China's cautious approach to fiscal expansion might be motivated by a concern to safeguard financial stability. The country's macro leverage ratio, which measures total outstanding non-financial debt as a share of GDP, surged to a new record high in 2023, at 287.8%, a 13.5ppt increase versus 2022. The macro leverage ratio has risen 48.9ppt over the past five years (2018-23), following a 33.7ppt rise over the prior five-year period.

The macro leverage ratio is a sum of household, non-financial corporation, and general government debt. The general government's debt-to-GDP ratio, which consists of local government and central government debt, has been relatively steady and contained at 55.9% of GDP, up 19.6ppt from 36.3% in 2018. Non-financial corporations and households account for the bulk of the rise of debt over the past decade. Households' debt accumulation has calmed somewhat, though, hovering around 63-64% in 2023 after doubling from 30% in 2012 to 60% by H2 2020. Non-financial corporations' debt-to-GDP has risen strongly over the past two years, from 154.1% in 2021 to 168.4% in 2023.

Exhibit #2: China Macro Leverage Ratio



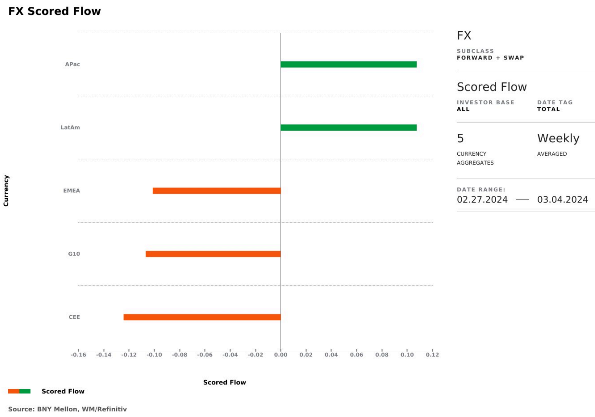


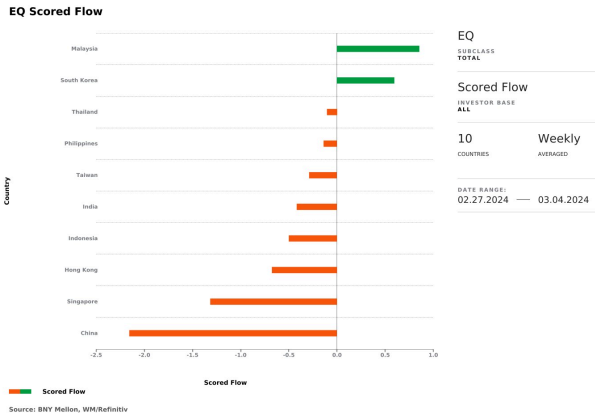
Source: BNY Mellon Markets, Bloomberg L.P.

FX flows over the past week were relatively muted in aggregate. APAC currencies posted light buying, weekly average scored flows of 0.11, while CEE counterparts had light outflows, -0.12 as of March 4. iFlow shows APAC FX the most underheld and profitable group. LatAm and EMEA are the most overheld, and G10 remains in neutral territory. Notables in APAC FX were a recovery of sentiment towards THB, which posted a third week of inflows after persistent outflows since November, and a reversal to MYR inflows with profit-taking emerging as USDMYR hit all-time highs. CNY had another week of steady and moderate inflows, this following what was aggressive selling during the first half of February.

APAC equity flows varied: large outflows from China, Singapore and Taiwan, but strong demand for South Korea. Among APAC sovereign bonds, iFlow shows outflows from China and Thailand but moderate demand in the rest.

Exhibit #3: APAC FX Flows Moderate, Equity Flows Vary





Source: BNY Mellon Markets, Bloomberg L.P.

Please direct questions or comments to: iFlow@BNYMellon.com

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