



Economic Insight

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Comments on 2017 China's Government Work Report

ABCI Research

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- China cuts 2017 target to about 6.5%, indicating the government is shifting its priorities from pro-growth to ones that emphasize on financial risk control, deleveraging, and supply-side structural reforms. With the economic deleveraging and destocking taking place, we expect China's economic growth to slow slightly to 6.5% for 2017.
- CPI target is set at 3.0%, the same as that in 2016. We expect CPI to remain at 2.0% in 2017 due to moderating economic growth and easing housing prices in more cities, while PPI would continue to rebound in 1H17 on the low base.
- The government lowers both the M2 and total social financing targets to 12.0% from 13.0% in 2016, suggesting monetary policy would become more prudent than 2016 and overall leverage ratio of the economy would be lowered.
- The fiscal deficit target is left unchanged at 3.0%, meaning the central government will maintain a proactive fiscal policy in 2017 to support economic growth through the acceleration of infrastructure investment projects, tax and fee reductions, and local debt swap schemes.
- The new job's target is raised to 11million, while the registered unemployment rate target is set at below 4.5%. We believe the two targets can be achieved as the job market has remained tight.

China achieves the economic growth target in 2016

China's Premier Li Keqiang delivered his annual government work report to the National People's Congress on March 5, 2017. The report reviewed the economic performance in 2016 and set targets on a number of economic indicators for 2017.

As shown in Exhibit 1, China's economy grew 6.7% in 2016, meeting the economic growth target of 6.5%-7.0%, though the pace of economic expansion was the slowest recorded since 1990. Target for the new urban jobs created, another important economic indicator, was satisfactorily fulfilled, reaching 13.1 million in 2016.

Exhibit 1: China's economic indicators in 2016 – targets VS actual performance

Economic indicators	Target	Actual
Real GDP growth, %	6.5-7.0	6.7
New urban jobs created, mn	above 10.0	13.1
Registered urban unemployment rate, %	below 4.5	4.0
Fiscal deficit as the proportion of GDP, %	3.0	3.8(e)
CPI, %	about 3.0	2.0
M2 growth, %	about 13.0	11.3

Source(s): 2017 Government Work Report, ABCI Securities
(e) refers to the estimate of ABCI Securities

Encouragingly, the adjustment of economic structure has continued to make positive progress. A breakdown of the GDP components shows consumption was still the key growth driver, contributing to 4.3 percentage points to the economic growth in 2016 (Exhibit 2). Investment only added 2.8 percentage points to overall growth, while net exports of goods and services reduced growth by 0.4 percentage



point. Meanwhile, the tertiary sector accounted for 51.6% of the economy in 2016, up from 50.2% in 2015 and above the secondary sector's share of 39.8%.

Exhibit 2: Contribution to China's real GDP growth (percentage points)

Economic items	2014	2015	2016
Consumption (household + government)	3.6	4.1	4.3
Investment (private + public)	3.4	2.9	2.8
Net exports of goods & services	0.3	-0.1	-0.4
Real GDP growth %	7.3	6.9	6.7

Source(s): NBS, ABCI Securities

China cuts 2017 GDP growth target to about 6.5%

Compared with the 2016 economic growth target of 6.5%-7.0%, China sets 2017 target to about 6.5% (Exhibit 3), which is slight lower than the 6.7% growth in 2016. Meanwhile, the government states that it will seek a better growth result in practice. In our view, the lower growth target shows the government is shifting its priorities from pro-growth to ones that emphasize on financial risk control, deleveraging, and supply-side structural reforms. With the economic deleveraging and destocking taking place, we expect China's economic growth to slow slightly to 6.5% for 2017.

Exhibit 3: China's economic targets for 2017

Economic indicators	Target	ABCI Forecast
Real GDP growth, %	about 6.5%	6.5%
New urban jobs created, mn	above 11.0	13.0
Registered urban unemployment rate, %	below 4.5	4.0
Fiscal deficit as the proportion of GDP, %	3.0	3.5
CPI, %	about 3.0	2.0
M2 growth, %	about 12.0	10.5

Source(s): Bloomberg, ABCI Securities

CPI target is set at 3.0%, the same as that in 2016. We believe CPI target is a soft guidance rather than a hard target as the PBOC deputy governor, Yi Gang, stated CPI would probably be at 2-3% in 2017. We expect CPI to remain at 2.0% in 2017 due to moderating economic growth and easing housing prices in more cities, while PPI would continue to rebound in 1H17 on the low base.

While the report pledges to maintain a stable and neutral monetary policy in 2017, it lowers both the M2 and total social financing targets to 12.0% from 13.0% in 2016, indicating monetary policy would become more prudent and the overall leverage ratio of the economy would be lowered. We expect M2 and total social financing to grow 10.5% and 12.0% in 2017 at the backdrop of deleveraging. Meanwhile, we maintain our call that the PBOC would keep interest rates steady in 2017, while RRR would be slashed by 50 basis points twice given the mild inflation pressure and foreign exchange reduction.

The fiscal deficit target is left unchanged at 3.0%, suggesting the government will maintain a proactive fiscal policy in 2017 to support growth. The tax and fee reduction will reduce fiscal revenue by about



RMB 550billion. The quota for special local government bond is lifted to RMB 800billion from RMB 400billion in 2016. We expect faster growth in fiscal expenditure than in fiscal revenue to result in another small fiscal deficit in 2017, with the headline ratio approaching to about 3.5% of GDP.

The new jobs target is raised to 11million for 2017 from 10million in 2016, while the registered unemployment rate target is set at below 4.5%, same as that in 2016. We believe the two targets can be achieved as new jobs creation was at 13million and the registered unemployment rate was only at 4.0% in 2016. Another reason is that the job market has remained tight, with the urban labor demand-to-supply ratio staying at 1.1 in 4Q16.

The report pledges to deepen supply-side structural reform, including capacity reductions in the steel and coal sectors, destocking in property market, deleveraging, mixed ownership reforms in SOEs and so on. Meanwhile, the report highlights four areas of accumulated financial risks, including distressed assets, bond market default, shadow banking, and internet finance.

Premier Li vows to pay high attention to environmental protection in the report. With concerns of air pollution escalating and China's emphasis on sustainable development, we believe the environmental protection, clean energy and healthcare sectors would enjoy higher growth and better profitability than most sectors in 2017. Meanwhile, we maintain our view that the materials and industrials sectors will continue to improve as supply-side reforms would further support producer inflation.



China Economic Indicators

	2015				2016						2017			
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Real GDP (YoY %)	6.8	---	---	6.7	---	---	6.7	---	---	6.7	---	---	6.8	---
Export Growth (USD, YoY %)	(1.4)	(11.2)	(25.4)	11.5	(1.8)	(4.1)	(4.8)	(4.4)	(2.8)	(10.0)	(7.3)	0.1	(6.1)	7.9
Import Growth (USD, YoY %)	(7.6)	(18.8)	(13.8)	(7.6)	(10.9)	(0.4)	(8.4)	(12.5)	1.5	(1.9)	(1.4)	6.7	3.1	16.7
Trade Balance (USD bn)	60.9	63.3	32.6	29.9	45.6	50.0	48.1	52.3	52.1	42.0	49.1	44.6	40.8	51.3
Retail Sales Growth (YoY %)	11.1	10.2		10.5	10.1	10.0	10.6	10.2	10.6	10.7	10.0	10.8	10.9	---
Industrial Production (YoY %)	5.9	5.4		6.8	6.0	6.0	6.2	6.0	6.3	6.1	6.1	6.2	6.0	---
PMI - Manufacturing (%)	49.7	49.4	50.2	50.1	50.1	50.0	49.9	50.4	50.4	50.4	51.2	51.7	51.4	51.3
PMI - Non-manufacturing (%)	54.4	53.5	53.8	53.5	53.1	53.7	53.9	53.5	53.7	53.7	51.2	50.9	51.9	54.6
FAI (YTD) (YoY %)	10.0	10.2		10.7	10.5	9.6	9.0	8.1	8.1	8.2	8.3	8.3	8.1	---
CPI (YoY %)	1.6	1.8	2.3	2.3	2.0	1.9	1.8	1.3	1.9	1.9	2.1	2.3	2.1	2.5
PPI (YoY %)	(5.9)	(5.3)	(4.3)	(3.4)	(2.8)	(2.6)	(1.7)	(0.8)	0.1	0.1	1.2	3.3	5.5	6.9
M2 (YoY %)	13.3	14.0	13.4	12.8	11.8	11.8	10.2	11.4	11.5	11.5	11.6	11.4	11.3	11.3
New Lending (RMB bn)	598	2510	727	1370	556	986	1380	464	949	1220	651	795	1040	2030
Aggregate Financing (RMB bn)	1815	3425	825	2404	751	660	1629	488	1470	1720	896	1740	1630	3740

World Economic/Financial Indicators

Equity Indices				Global Commodities				Bond Yields & Key Rates			
	Closing price	Chg. WTD (%)	P/E	Unit	Price	Chg. WTD (%)	Volume (5-Day avg.)		Yield (%)	Chg. WTD (Bps)	
U.S.				Energy				US Fed Fund Rate	0.75	0.00	
DJIA	20,954.34	(0.24)	19.36	NYMEX WTI	USD/bbl.	53.10	(0.43)	529,183	US Prime Rate	3.75	0.00
S&P 500	2,375.31	(0.33)	21.89	ICE Brent Oil	USD/bbl	55.84	(0.11)	222,622	US Discount Window	1.25	0.00
NASDAQ	5,849.18	(0.37)	42.23	NYMEX Natural Gas	USD/MMBtu	2.87	1.41	174,178	US Treasury (1 Yr)	0.5325	0.00
MSCI US	2,261.21	(0.33)	22.33	China Qinhuangdao Port Thermal Coal ²	USD/Metric Tonne	61.80	N/A	N/A	US Treasury (5Yr)	2.0192	1.02
Europe				Basic Metals				US Treasury (10 Yr)	2.4944	1.64	
FTSE 100	7,350.12	(0.33)	39.17	LME Aluminum Cash	USD/MT	1,865.75	(0.96)	14,391	Japan 10-Yr Gov. Bond	0.0710	(0.70)
DAX	11,958.40	(0.57)	18.24	LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	1,876.50	(0.82)	46,651	China 10-Yr Gov. Bond	3.4500	2.70
CAC40	4,972.19	(0.46)	19.44	CMX Copper Active	USD/lb.	5,845.75	(1.05)	17,181	ECB Rate (Refinancing)	0.00	0.00
IBEX 35	9,804.10	0.06	18.22	LME Copper 3- mth Rolling Fwd.	USD/MT	5,858.00	(1.00)	36,387	1-Month LIBOR	0.7728	(0.28)
FTSE MIB	19,449.85	(1.09)	N/A	Precious Metals				3 Month LIBOR	1.1017	4.77	
Stoxx 600	373.27	(0.52)	25.42	CMX Gold	USD/T. oz	1,225.70	(0.07)	250,486	O/N SHIBOR	2.4041	3.51
MSCI UK	2,138.21	(0.34)	40.61	CMX Silver	USD/T. oz	17.76	0.08	73,777	1-mth SHIBOR	4.1016	1.65
MSCI France	141.18	(0.41)	19.35	NYMEX Platinum	USD/T. oz	977.70	(1.65)	18,977	3-mth HIBOR	0.9403	(0.08)
MSCI Germany	150.98	(0.51)	18.87	Agricultural Products				Corporate Bonds (Moody's)			
MSCI Italy	54.14	(1.06)	N/A	CBOT Corn	USD/bu	378.25	(0.66)	187,332	Aaa	3.95	10.00
Asia				CBOT Wheat	USD/bu	459.50	1.32	68,758	Baa	4.64	(9.00)
NIKKEI 225	19,344.15	(0.64)	22.74	NYB-ICE Sugar	USD/lb.	19.15	(1.90)	48,825			
S&P/ASX 200	5,761.39	0.55	19.85	CBOT Soybeans	USD/bu.	1,036.50	(0.10)	121,365			
HSI	23,667.01	0.49	13.12								
HSCEI	10,224.51	0.79	8.42								
CSI300	3,451.15	0.68	15.45								
SSE Composite	3,239.20	0.65	18.51								
SZSE Composite	2,029.57	1.38	44.86								
MSCI China	64.64	0.19	14.17								
MSCI Hong Kong	13,186.57	(0.05)	13.86								
MSCI Japan	930.94	(0.26)	18.92								

Note:

1. Data sources: Bloomberg, National Bureau of Statistics of China, ABCIS (updated on date of report)
2. The price is Coal 5500 kcal/kg FOB Spot Price

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.0584	1.2225	0.7612	113.91	1.0120	6.8990	7.7654	7.1200
Chg. WTD (%)	(0.36)	(0.54)	0.21	0.11	(0.41)	0.01	(0.03)	0.14



Disclosures

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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return - 6% \leq Stock return < Market return rate
Sell	Stock return < Market return - 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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