China Macro Brief

Reading the policy signals from the March 27 politburo meeting

The statement from the Politburo meeting on March 27 [1] delivered a clear message of dialing up policy supports on both fiscal and monetary fronts. More specifically, the Politburo is now working on a fiscal relief package that involves raising the general budget deficit, issuing special treasury bonds, and expanding the quota for local government special construction bonds. Meanwhile, monetary policy is expected to stay accommodative and continue to guide down the funding cost of the real economy.

The politburo meeting statement indicates a re-evaluation of the shock from COVID-19 outbreak on economic growth, especially from the recent escalation of the pandemic overseas. After recalibrating the potential magnitude and duration of the external demand shock, macro policies may step up in epidemic relief efforts[2]. It was clearly stated in the statement that "the evolution of COVID-19 pandemic domestically and overseas points to a sizable negative shock to global growth and international trade." Although the domestic capacity utilization rate has been on a steady recovery trend since mid-February, when the government started to forcefully promote production resumption after the nation-wide "lock-down", external demand started to deteriorate rapidly since mid-March. Amidst the rapid escalation of the pandemic globally, overseas economic activities have come to a standstill[3]. Consequently, the pace of recovery started to slow for overall capacity utilization in China as well. At this point, while domestic demand in China has not fully restored, external demand has started to deteriorate rapidly. The Politburo meeting statement last Friday indicates a sober understanding of the current macro conditions, which prompted the government to potentially summon the issuance of special Treasury bond, a policy tool that hasn't been activated in more than 2 decades. Meanwhile, potentially raising the general budget deficit ratio from 2.8% in 2019 also conveys a clear message of loosening. In addition, it was made clear that the fiscal relief will come as a "package" with a comprehensive range of policy tools, rather than a stand-alone policy change.

(Continues next page)

[1] http://www.xinhuanet.com/politics/leaders/2020-03/27/c_1125778940.htm

[2] See China Macro Brief, *Recalibrating the impact of COVID-19 & the needed fiscal stimulus*, published on March 29, 2020; and China Macro Thematic Report, *Cutting growth forecast amidst escalating global COVID-19 pandemic*, published on March 23, 2020.

[3] See China Views, *What should China do if overseas economies press the "pause" button?* (in Chinese), published on March 1, 2020.

Eva YI
Analyst
SAC Reg. No.: S0080515050001
SFC CE Ref: AMH263
eva.yi@cicc.com.cn

Hong LIANG
Analyst
SAC Reg. No.: S0080513050005
SFC CE Ref: AJD293
hong.liang@cicc.com.cn

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Unlike the policy response to the 2008 GFC, the policy relief this time round will likely primarily leverage on fiscal (rather than monetary) expansion. While the policy emphasis will likely fall on policies to lift the overall living standard. In our view, the "package" may involve a wider range of measures than explicitly mentioned by the politburo meeting, including expanding government borrowing, lowering tax and fees (incl. the social security contribution, the SSC), mobilizing the idle fiscal reserves, and releasing the restrained consumption demand. According to our latest recalibration, the combined economic loss from the battle against COVID-19 domestically and overseas may amount to 7-8ppt of GDP. As the cash flow for corporate and household sectors have been strained, a fiscal "relief package" is in urgent demand. Our recent GDP downgrade has already factored in a sizable fiscal expansion, part of it dedicated for epidemic relieves. According to our baseline forecast, "broadly-defined" fiscal deficit may expand by 6-7ppt of GDP[4], more specifically, we expect policy relief in the following categories:

- Government and quasi-government financing may expand, tax and fees (incl SSC) will likely be lowered. The general government budget deficit ratio may be raised in 2020 from 2.8% in 2019, the special treasury bond issuance may commence again this year after more than 2 decades, local government special construction bond quota may be lifted YoY, In addition, we cannot rule out the possibility of issuing a special low-cost government bond dedicated to epidemic relief. In addition, the fiscal expansion in China under the broadest definition also includes expansion of policy bank bond issuance quota, lowering SSC rate, as well as the "transfer" of profitability of SOEs to the private sectors via lowering/waiving the cost of utilities, interest rates, rent, highway tolls, and etc[5].

- Aside from the expansion of government financing and tax cuts, mobilizing idle fiscal reserves may also help support aggregate demand growth, esp. consumption demand, without adding to overall leverage. The "idle" fiscal reserves mentioned above includes the housing fund reserve (of 5.8 trillion Rmb), reallocating SOE assets to replenish the SSF, as well as the >Rmb 4 trillion in plain fiscal deposits.

- In addition to deficit expansion and fiscal reserve mobilization, releasing the previously-constrained consumption demand may be "inevitable". Apart from "consumption vouchers" that are already being issued by local governments, we expect some loosening to the previously-highly-constraining automobile and property purchase restrictions. In a broader sense, pouring more resources into upgrading the urban infrastructure (including paved roads, drainage system, low-income housing), as well as building modern city agglomerations.

- Meanwhile, monetary policy may loosen in coordination with the fiscal relieves: we expect another 40bp of LPR cut and 150bp more in RRR cuts in the remainder of 2020; furthermore, the probability may rise for a benchmark deposit rate cut as external demand weakens.

We will closely monitor the magnitude, timing, and specific policy tools included in the potential fiscal relief package. 2-4Q2020 growth is expected to rebound visibly from 1Q2020, under the conditions of synchronized fiscal and monetary policy expansion. However, under the base case, full-year economic growth may still register notable deceleration from last year. In the near term, much of global economic activity comes to a standstill as containment measures against COVID-19 tightened. Available high-frequency data indicate that the short-term disruption to external demand will likely exceed that of the 2008-09 GFC by various measures. However, in our base case, we have already factored on a 6-7ppt expansion of broadly-defined fiscal deficit, and coordinated monetary loosening; consequently, we foresee a pickup in GDP growth from 2Q2020 onwards. Following the 9.3% YoY contraction of 1QGDP, we expect GDP to expand by 4.3% YoY, 5.8% YoY, and 6.4% YoY in 2-4Q2020, averaging

[4] See China Macro Brief, *Recalibrating the impact of COVID-19 & the needed fiscal stimulus*, published on March 29, 2020.
[5] See China Macro Brief, *Quantifying the Loosening Impulse post COVID-19*, published on March 15, 2020.

at 5.5% YoY over the three quarters[6]. In this regard, ours is not by any account a “bearish” outlook in the context of the once-in-a-century pandemic – China may end up being the only major economy registering positive growth this year. On the other hand, lifting annual growth back to >5% YoY level may require broadly-defined fiscal deficit expansion of ~9ppt[7] -- fiscal relief of this magnitude, if realized, may render China’s relief package one of the most generous so far – Germany proposed a fiscal package of ~3% of GDP last week, and the US has drawn up a fiscal package of ~6% of GDP after netting out bank loans. Since China has already managed to drastically reduce the overall economic impact of COVID-19 by the early adoption of highly-effective containment measures, we still adopt a more moderate rate of fiscal expansion (6-7ppt expansion of our broadly defined deficit) as our central case. Going forward, the growth trajectory hinges on the interplay of China’s policy relief efforts, as well as the evolution and eventual impact of the pandemic.

6 See China Macro Thematic Report, *Cutting growth forecast amidst escalating global COVID-19 pandemic*, published on March 23, 2020.
7 See China Macro Brief, *Recalibrating the impact of COVID-19 & the needed fiscal stimulus*, published on March 29, 2020

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China International Capital Corporation Limited
28th Floor, China World Office 2, 1 Jianguomenwai Avenue, Beijing 100004, P.R. China
Tel: (+86-10) 6505 1166
Fax: (+86-10) 6505 1156

United States
CICC US Securities, Inc
32th Floor, 280 Park Avenue
New York, NY 10017, USA
Tel: (+1-646) 7948 800
Fax: (+1-646) 7948 801

United Kingdom
China International Capital Corporation (UK) Limited
25th Floor, 125 Old Broad Street
London EC2N 1AR, United Kingdom
Tel: (+44-20) 7367 5718
Fax: (+44-20) 7367 5719

Singapore
China International Capital Corporation (Singapore) Pte. Limited
6 Battery Road,#33-01
Singapore 049909
Tel: (+65) 6572 1999
Fax: (+65) 6327 1278

Hong Kong
China International Capital Corporation (Hong Kong) Limited

29th Floor, One International Finance Centre
1 Harbour View Street Central, Hong Kong
Tel: (+852) 2872 2000
Fax: (+852) 2872 2100

Shanghai
China International Capital Corporation Limited – Shanghai Branch
32nd Floor Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, P.R. China
Tel: (+86-21) 5879 6226
Fax: (+86-21) 5888 8976

Shenzhen
China International Capital Corporation Limited – Shenzhen Branch
72th Floor,PingAn Finance Center
5033 Yitian Road, Futian District
Shenzhen, 518048, P.R. China
Tel: (+86-755) 8319 5000
Fax: (+86-755) 8319 9229

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中金公司