7 March 2016

China cuts GDP growth target to 6.5-7% in 2016

Event

- At the annual National People's Congress that convened on March 5th, China's Premier Li Keqiang announced preliminary economic reform plans and key economic targets for 2016. The Chinese government lowers its growth target to 6.5-7% and projects a fiscal deficit of 2.18 trillion yuan or equivalent to 3% of GDP. The People's Bank of China (PBOC) will also maintain adequate market liquidity and set to expand money supply (M2) by 13%YOY, the first M2 growth target for China.

Analysis

- **The Chinese government pledged to pursue proactive fiscal policies.** The lower growth target at 6.5-7% in 2016 leaves more room for China to implement economic reforms. Nonetheless, the government is ready to use more fiscal tools to prevent the economy from hard-landing. The fiscal deficit for 2016 is projected at 2.18 trillion yuan or 3% of GDP, an increase from 2.3% target in 2015. In this deficit, the government plan to spend more than 2 trillion yuan of investment budget for transport infrastructure. In addition to fiscal stimulus, the PBOC will keep its monetary policy accommodative to maintain market liquidity. On March 1st, 2016, the PBOC announced a cut of the reserved requirement ratio (RRR) by 50 bps to 17%.

- **China's attempt to curb overcapacity in the industrial sector poses a risk to the economy in 2016.** The Chinese government aims to implement "supply-side reforms" as a central objective for 2016. It will reduce overcapacity in heavy industries through mergers to alleviate the oversupply problem especially in the steel and coal industries. Additionally, the government will reform inefficient state-owned enterprises by allowing inefficient loss-making firms (zombie companies) to fail. Such reform poses a major risk for the economy as the industry sector, which accounts for over 40% of China's GDP, will continue to slow down. Furthermore, mergers and shutdowns will lead to large-scale layoffs that could put pressure on domestic consumption.

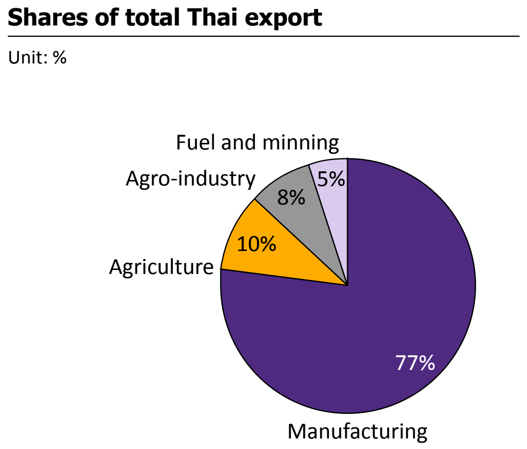
- **The Chinese government emphasized on the important of service industry as a new economic driver.** The 2016 "supply-side reforms" focuses on service and technology sectors that have been expanding. The government addressed that current manufacturing sector, which concentrate on heavy industries, does not match the changing domestic demand. Therefore, the government plans to support small businesses, especially in the services sector, as a new growth driver through corporate tax cut and investment incentives.

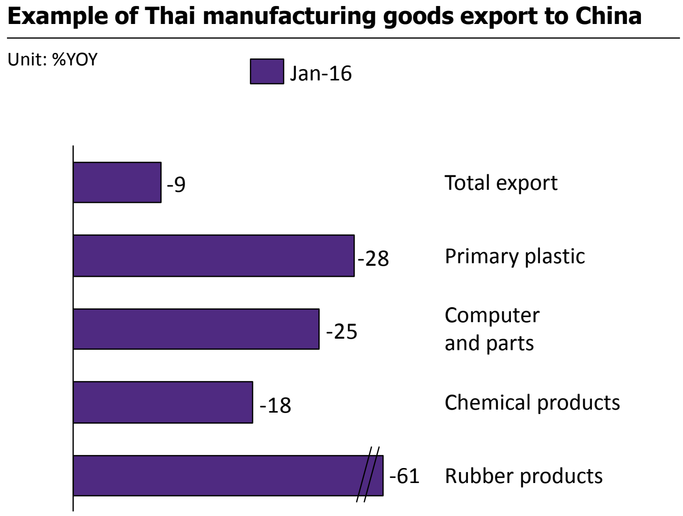
Implication

- **China's slowing industrial sector resulting from the reforms will affect Thai manufacturing exports in 2016.** Manufacturing goods, which make up more than 77% of all Thai exports, is likely to continue to shrink this year (figure 1). This will hinder the recovery of overall Thai exports. Moreover, the sluggish manufacturing sector in China also hurts Thailand's key trading partners such as ASEAN-5 and Japan. It also adds risks to the global economy. Moreover, the risks of rising unemployment in China from “supply side reforms” will hamper domestic consumption, and thus stalling consumer goods exports from Thailand, as well as tourism that has been growing rapidly.

- **In the long run, China's transition towards a services and consumption driven economy presents opportunities for Thai businesses.** Thai businesses should seek to offer products and services targeting modern Chinese consumers. They should enhance their technological competitiveness as China shifts away from heavy industries. Thai businesses should prepare to join China's new production chains and ride on the new wave. Currently, China's consumption sector can still expand at a fast rate as reflected in its retail sales that grew 10.7%YOY in 2015. Moreover, China's spending on tourism also rose 66.6% in the first three quarters of 2015. Another consumer trend in China is the move towards e-commerce. During 2012-2015, consumer spending through e-commerce in China increased at an annual rate of 46% (Figure 2). This corresponds to the government's intention to make consumption the key driver for the economy and also its goal move China's into higher technological capability.

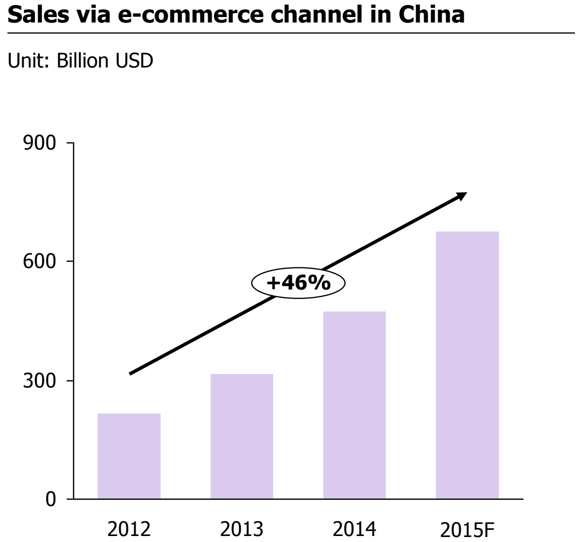
Figure 1: Manufacturing goods, which make up more than 77% of all Thai exports, is likely to continue to shrink in 2016





Source: EIC analysis based on data from Ministry of Commerce

Figure 2: During 2012-2015, consumer spending through e-commerce in China increased at an annual rate of 46%



Source: EIC analysis based on data from KPMG and eMarketer

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