CHINA ECONOMICS UPDATE

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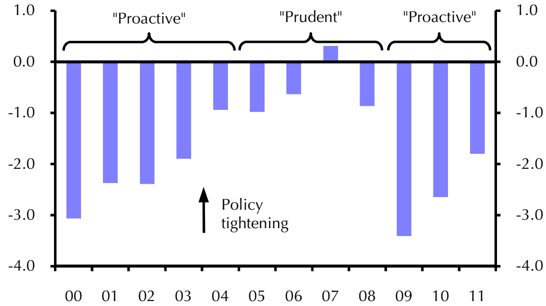
CAPITAL ECONOMICS
凯投宏观

Policymakers embrace pro-growth stance

- **It takes some reading between the lines in today's statement on policy priorities for 2012 to find evidence that the policy setting has changed. Nonetheless, the shift is real.**
- The Economic Work Conference which concluded today is a forum for ensuring that the leadership's views on policy priorities for the coming year are communicated to and agreed by officials from across government. It takes place behind closed doors but there is a lengthy concluding statement.
- There had been some expectation that the Conference would signal a decisive shift in policy stance, but that was quashed on Friday when the Politburo announced that monetary policy would remain "prudent" and fiscal policy "proactive", exactly the same as this year.
- The statement fleshes out what this may mean for policy in practice. On the monetary side, credit growth will be "reasonable" and the priority in investment will be in completing ongoing projects. On the fiscal side, the government will "continue with structural tax cuts". Property market controls will remain in place, but the government also pledges to increase property supply. **At first glance, stability is the central theme. The government says it hopes to keep growth and prices stable, and policy too.**
- **But there are significant changes nonetheless.** For most of the last year, officials reiterated that controlling inflation was the primary task. Now, this goal is preceded by the goal of maintaining stable growth. The pledge to keep policy stable is more likely a signal that there will be no loosening on the scale seen in 2008 rather than that there will be no changes at all.
- **Indeed, past experience suggests that "prudent" monetary policy and "proactive" fiscal policy can encompass a variety of stances**. Policy loosening at the end of 2008 was accompanied by a formal switch of fiscal policy from prudent to proactive. But most episodes of fiscal tightening over the past decade have also occurred when fiscal policy has been formally "proactive". (See Chart 1.)
- There is often a lag between changes in policy and how policy is described. When monetary policy changed from "prudent" to "tight" at the end of 2007, benchmark interest rates had in fact already almost peaked. (See Chart 2.) In this regard, the decision last month to lower the required reserve ratio (RRR) is more significant than the decision not to change how policy is described.
- **In practice, policy will have to be loosened significantly in 2012 to keep growth stable**. Exports have barely risen recently and, given the euro-zone's problems, are likely to worsen before they get much better. Within China, there are signs new construction is stalling as property sales have dried up.
- Data released today show that loan growth has continued to slow. Interbank rates have fallen but remain historically high – a sign that monetary conditions are still relatively tight. **As things stand, the economy is heading for sub-8% GDP growth**. With a once-in-a-decade leadership change at the end of next year, officials' minds are likely to be focused increasingly on shoring up growth.
- Policy loosening is likely to take the form of a larger lending quota and multiple RRR cuts. If the euro-zone debt crisis takes a severe turn for the worse, which we think very likely, China's government would probably cut benchmark interest rates in an attempt to shore up confidence. (See our *China Watch*, 30th November, for our forecasts).

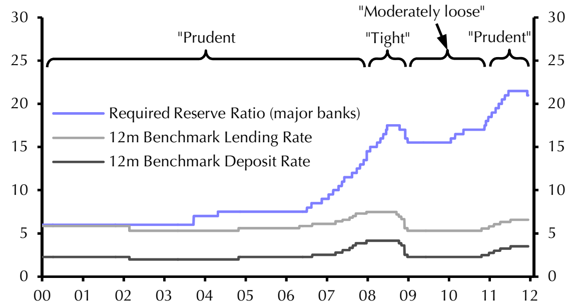
Mark Williams Chief Asia Economist (+44 (0)20 7811 3903, mark.williams@capitaleconomics.com)

Chart 1: Official Description of Fiscal Policy & Cyclically-Adjusted Fiscal Balance (% GDP)



Sources – IMF, Caixin, Capital Economics

Chart 2: Official Description of Monetary Policy & Key Monetary Policy Rates (%)



Sources – Bloomberg, Caixin, Capital Economics