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Making Sense of the Two Sessions

Big plans, but also trade-offs

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Summary

- The Two Sessions meetings in China have recently concluded and the outline of the 14th Five Year Plan has been approved.
- The overarching aim of China's plans, in our view, is self-reliance.
- Essentially, China wants to become less dependent on other countries, while keeping countries dependent on China (using its huge domestic market as leverage).
- China sees that its previous credit and investment driven growth model is cracking and that the external environment is getting more hostile.
- Technological advancement is viewed as a sort of master key that will unlock the door to sustained economic growth, as well as the door to being less dependent on foreign technologies in strategic areas, such as semiconductor production.
- Unlocking both doors might prove to be quite challenging, however, as (i) achieving technological advancement is easier said than done and (ii) China's policies to achieve economic growth that is less credit-driven and more technology-driven, while also reducing debt and maintaining financial and domestic stability, has inherent trade-offs.
- China's attempt to have it all could ultimately backfire, forcing the country to return to some of its old growth model, with even higher debt levels as a result.
- When push comes to shove, we believe China will sacrifice growth for resilience and deleveraging for domestic stability.

The Two Sessions conclude

China's annual Two Sessions meetings, during which the government budget and an outline of China's 14th Five Year Plan (FYP) was approved¹, concluded on 12 March. In this report, we catch our readers up on what the main short and long-term goals of China are, whether we believe it will be able to achieve them and what practical ramifications this might have².

The outline of the FYP indicates that China's has a **clear desire to become more self-reliant**, in areas ranging from food to technology, albeit with a focus on the latter. It has defined various

¹ The Two Sessions are one of China's biggest political events. During this event, China's main political bodies (the Political Consultative Conference and National People's Congress) meet to discuss the country's upcoming economic, military, trade and environmental policies. This includes discussing and approving the government budget and (once every five years) approving the new Five Year Plan. The Five Year Plan is essentially a blueprint for how China wants to achieve its long term economic, political and societal goals.

² For a concise overview, we refer to Table 1 in the Appendix, which contains a selection of the various quantitative targets set out in the Work Report that was released after the start of the Two Sessions. The Work Report discusses the main targets that are included in the outline of China's Five Year Plan.

targets to increase spending on R&D and basic research. In addition, key manufacturing areas and technologies in which China wants to excel have been identified.

Economic growth remains important, but **high economic growth does not seem to be as important as it once was**. An indication of this reduced importance is the observation that there is no explicit GDP growth target for the coming five years (although there is one for this year, namely "more than 6%").

Financial stability and reducing public and private debt have become more prominent goals, and monetary and fiscal stimulus look set to be scaled back somewhat. However, scaling back stimulus may not rhyme with maintaining financial stability. China's corporate and real estate sector are very indebted, so there is a significant risk in our view of tightening too much, thereby initiating a debt crisis. Although this is not our base case, Chinese policy makers may have to tread a fine line.

Reducing public debt also contrasts with China's plans of investing in key manufacturing areas and "frontline technologies", or its social plans. Of course, part of that is included in the fiscal budget, but given the modesty of the targeted budget (3.2% of GDP) we think the risk of exceeding it is high, especially since achieving the level of excellence required in the key technological areas is no easy feat. China has not been able to pull that off in, for example, semiconductors despite years of R&D expenditures of more than 2% of GDP. In addition, **China's plans to increase efficiency and productivity while also increasing domestic manufacturing in strategic areas will likely prove contradictory**. Also, China ambitions to reduce CO₂ output will likely contrast with economic growth in provinces dependent on coal production. Finally, China's stance on sovereignty issues (Hong Kong and Taiwan) will not help China's desire to maintaining cordial international trade relations.

In short, like any other economy, China faces a number of trade-offs, although we believe some of these tangents can become quite pressing. In the next chapters, we delve more deeply into various aspects of China's economy and how they relate to its short and long-term plans.

Table 1: Solving China's puzzle of trade-offs will not be an easy task!

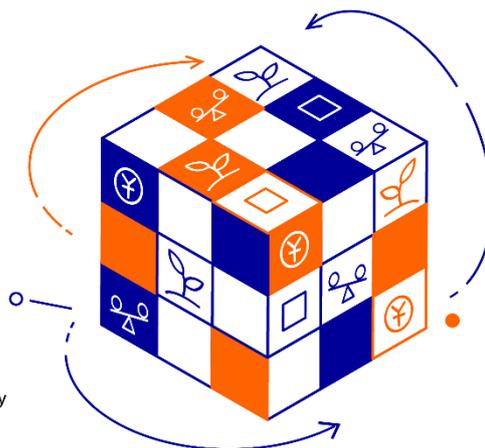
China's puzzle



Greener energy means less growth in the regions that produce it



Deleveraging comes at the expense of financial stability



Resilience and control means sacrificing efficiency



Reducing public debt clashes with investment and social plans



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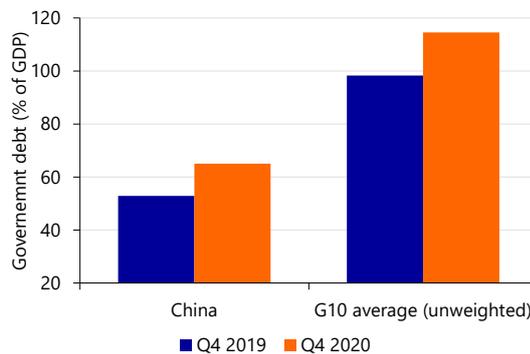
Source: RaboResearch

Government debt

The coronavirus has not let China off the hook in terms of increasing debt. Despite the [headlines](#) about China's modest fiscal stimulus during the corona crisis, government debt in China has increased pretty much in line with the G10 since 2020 (figure 1), from 53% of GDP to 65% in 2020. To an extent, this could be because government stimulus was not branded as specific stimulus to fight the economic effects of the coronavirus while it likely was used for that purpose.

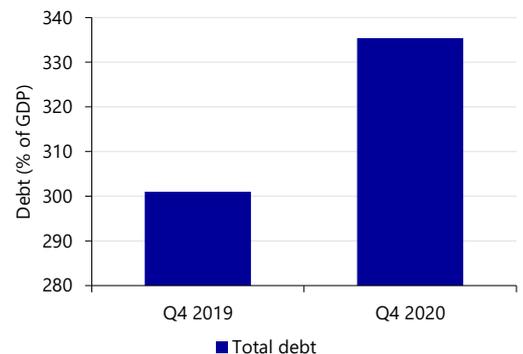
Together with public, household, non-financial corporate and financial corporate debt, that brings China's total debt load to 335% of GDP in 2020, up from 301% in 2019 (figure 2). Thus, China, just like other major economies in the world, is walking away from the corona crisis with a sizable increase in its debt-load, which was already high in comparison to other countries to start with.

Figure 1: Public debt has increased in China as much as it has in the G10 since Covid-19



Source: IIF Global Debt Monitor, RaboResearch

Figure 2: Total debt has risen as well, to 335% of GDP

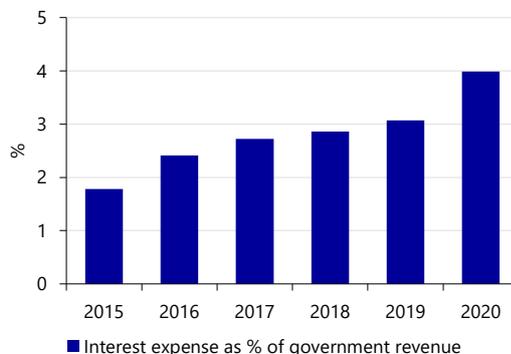


Source: IIF Global Debt Monitor, RaboResearch

That means China's economy is more vulnerable to downturns in future. For the government it also means that fewer of its revenues can be used to finance social expenditures and investments as the share of revenues taken up by interest payments has increased as well.

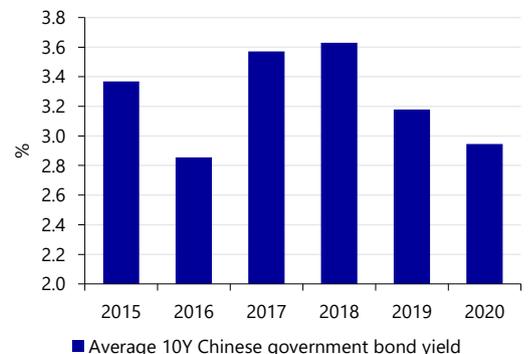
Interest costs are not a big part of the government's revenue, but they have doubled in the past five years, from 1.8% in 2015 to 4% in 2020, even though the yield on 10 year Chinese government bonds was (on average) higher in 2015 than in 2020 (3.4% vs 2.9%). Admittedly, this is not necessarily a big problem for China. However, the problem will more likely grow than it will shrink, unless Chinese government bond yields or debt decline over the coming years.

Figure 3: The part of government revenue used for interest expense has doubled since 2015



Source: Macro bond, IMF, RaboResearch calculations

Figure 4: Even though the government can borrow against relatively favourable rates

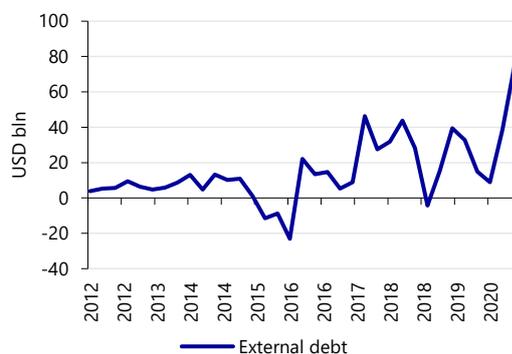


Source: Macrobond

Another important implication here is that the Chinese government might choose to finance public expenditure more via channels that are not officially counted as public debt, such as Local Government Financing Vehicles (see the next chapter for a discussion). The consequence could be

that China's meets its official fiscal deficit target of 3.2% of GDP, while its actual fiscal deficit (and with it public debt) might still increase.

Figure 5: External borrowing has taken off in China since 2016



Moreover, foreign investors have significantly increased their purchases of Chinese government and corporate bonds in recent years (figure 5). Although it is still modest in overall terms (15% of GDP), one can argue that it does make it more vulnerable to any swings in global market sentiment.

Source: State Administration of Foreign Exchange, China

Corporate debt

The biggest contributor to China's overall debt load is corporate debt. Corporate debt has jumped from an already staggering 149% of GDP in 2019 to 165% in 2020 (figure 6). Moreover, corporate defaults are on the rise. Chinese corporate bond defaults have almost doubled between January 2019 and February 2021, from 1.1% of their outstanding par value to 2%³.

Unsurprisingly, the spread between AAA and BBB corporate bonds has risen as well and now stands at 14.9%, the highest level since our data goes back (figure 7). So clearly, financial markets are expecting more defaults for weakly rated corporates in China, a development we previously highlighted [here](#).

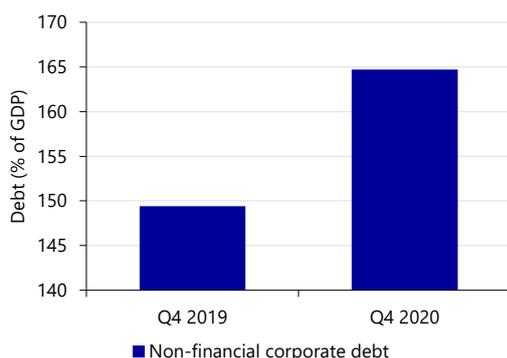
Rising default risks for the corporate sector have important implications for government debt as well. The distinction between corporate and government debt in China is much less clear cut than in most developed countries.

Specifically, part of corporate debt could be considered public debt if implicit government guarantees are included. A big part of local government financing for example, is done via so called Local Government Financing Vehicles (LGFVs). LGFVs are used to issue bonds by local governments to finance specific projects (such as a real estate or infrastructure project). LGFVs are not counted as public debt, but are [believed](#) to have a strong implicit government backing, and as such should be counted as public debt [according to the IMF](#).

That means China's public debt is potentially much higher (92% of GDP according the IMF) than the official figure. However, we note China's the overall debt figure does not change despite the reclassification because overall debt figures (such as those compiled by the Institute of International Finance, IIF) include corporate as well as government debt. IIF currently includes LGFV financing as corporate debt, while the IMF counts it as government debt. Although financial markets know, to a certain extent, that China's government debt might be higher than official figures suggest, an official reclassification of corporate debt as government debt could have implications for China's perceived sovereign risk.

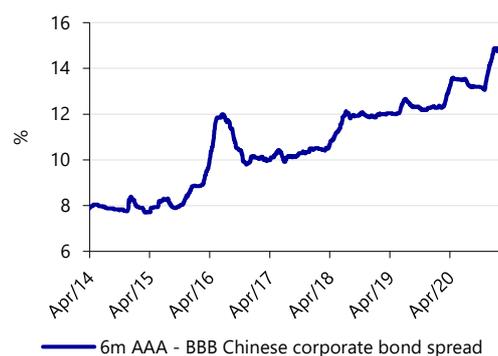
³ Based on data from the China Securities Index Company (accessed via Macrobond), using the ratio of 12 month rolling par value of defaulted bonds to the 12 month rolling par value of outstanding bonds.

Figure 6: Corporate debt has jumped



Source: IIF Global Debt Monitor

Figure 7: The market is clearly pricing in higher default risk



Source: Macrobond

More generally, China's high overall debt load makes its corporates as well its government more vulnerable to economic shocks, government finances become less flexible as a larger part of the governments revenues are used for debt service. Moreover, the taxes that will have to be raised in the future to repay the government debt create inefficiencies (welfare losses).

Finally, since capital is limited, government borrowing can crowd out private borrowing (they both compete for the same limited amount of capital), this can leave firms investing less. Given that private investments are more likely to be in productive assets than government investments, this would hurt productivity and economic growth. For the interested reader, [here](#) is an overview of studies that show how high debt levels negatively affect economic growth.

Real estate

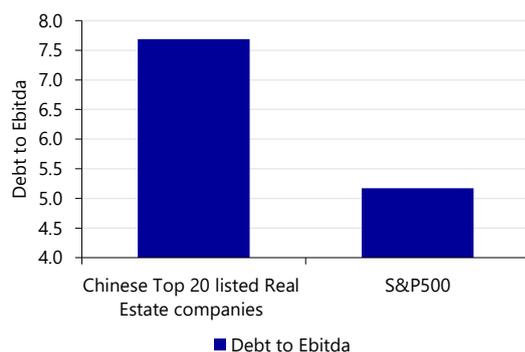
Against the backdrop of high debt levels, the real estate sector warrants a special mention because of its importance to the Chinese economy. China's top banking regulator (Guo Shuqing) has [openly stated](#) that he is worried about risk of a bubble in the Chinese property market. Moreover, the Work Report presented during the Two Sessions mentions that China wants to "keep the prices of land and housing as well as market expectations stable". So it is clear that the government wants to do something about excessive house price rises in China.

However, reigning in house price rises without sparking a debt crisis will be a very delicate balance act. There is a decent chance that the government might be forced to ease constraints again further down the line. Because the real estate market in China is (i) very debt laden (figure 8) and (ii) very important for the Chinese economy. To corroborate the latter:

- About 30% of bank loans are to the real estate sector (figure 9).
- 11% of the disposable income of Urban residents is generated through property income
- Real estate accounts for 70% of the wealth for Chinese people, according to [some estimates](#).
- Construction and Real Estate services are about 15% of the economy, which is higher than in many developed countries (the Eurozone average is 11.5% according to Eurostat). This is likely an underestimation given that large parts of the manufacturing sector (for example cement and steel production) are also closely related to the real estate sector.
- Almost one in five people in China (18%) work in construction or real estate.

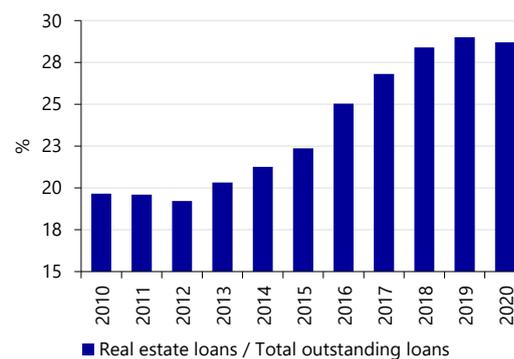
Unusual house price rises tend to be followed by banking crises ([Reinhardt and Rogoff, 2008](#)) and two of China's biggest real estate companies, [Evergrande](#) and [China Fortune Land Development](#), have already ran into trouble with repaying high debt loads. The potential for such type of debt repayment problems to destabilize China's economy should not be underestimated. Although a real estate crisis in China is not our base case assumption, we do see it as a major source of risk in the medium to long term future.

Figure 8: China's largest real estate developers carry a sizable debt burden



Note: The average of 20 largest Chinese listed real estate companies by revenue, using the most recent available data (spanning from 2019 to 2020)
Source: Bloomberg, RaboResearch calculations

Figure 9: Chinese banks are highly exposed to the real estate sector



Source: Macrobond, PBoC

With that in mind, we think a decline in the real estate sector is not something the Chinese government can or is willing to afford. **Easing house price pressures without sparking a debt crisis in the real estate sector (and via that for the whole economy) will be one of the most delicate balancing acts China will have to do, and as such we think it will likely have to peddle back from this goal.**

Monetary policy

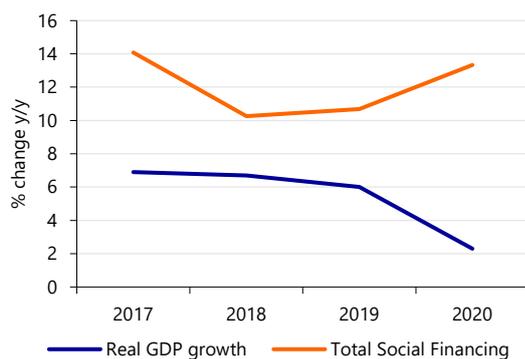
Monetary policy in China looks set to tighten. Beijing's target to let credit (Total Social Financing, TSF) grow in line with the economy is a clear indication of that. TSF growth is normally well above GDP growth (figure 10).

We think monetary tightening will take place via targeted policies for specific sectors. For example restricted lending to the real estate sector. We have seen a glimpse of this in 2020, when the China Banking and Insurance Regulatory Commission [announced limits](#) on property loans for Chinese banks in December last year. The regulator, for example, has capped this to 32.5% for mortgages and 40% to overall real estate for large commercial banks.

We believe it is less likely that the PBoC will tighten via its interest rate toolkit given China's higher debt load and since the PBoC has not used that instrument aggressively after the outbreak of the coronavirus. After an initial cut in the 1 and 5 year Loan Prime Rate (the benchmark rate against which new loans and floating rate loans are priced), the PBoC has not stimulated the economy via its interest rate tools, despite occasional spikes in interbank rates (figure 11).

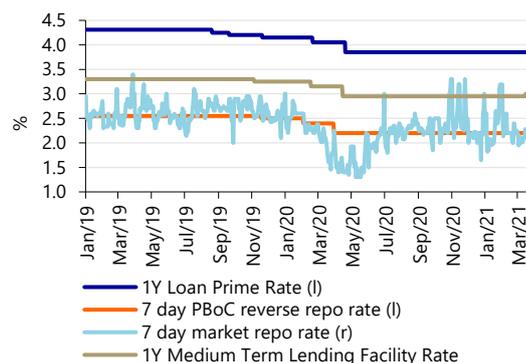
In any case, **the risk of tightening too much, is very high, especially as it poses a great risk to the overheated and debt laden real estate sector in China (see chapter Real Estate). If reduced liquidity leads to unforeseen effects in China's real estate or banking sector, the PBoC might have to reverse course and loosen monetary policy again. The outcomes would be that China's debt load increases even further.**

Figure 10: The new TSF target implies tightening since TSF normally grows much faster than GDP



Source: Macrobond, NBS

Figure 11: The PBoC has not used its interest rate tool kit that much to conduct monetary policy

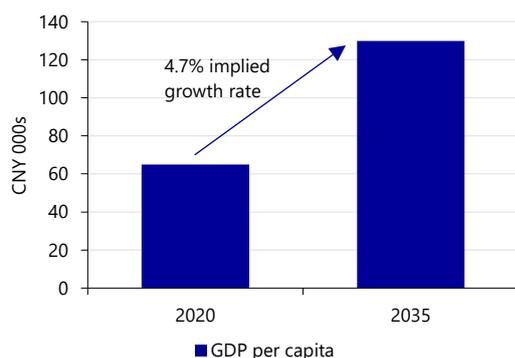


Source: Macrobond, PBoC

Productivity and long term growth

An ambitious, albeit implied, growth rate

Figure 12: The doubling of GDP per capita by 2035 implies an ambitious growth rate



Source: Macrobond, IMF World Economic Outlook

China's 2021 growth target of "more than 6%" has been widely covered in the press, but it is one of the less ambitious targets on the bigger scale of things. What is more interesting is that there is no explicitly defined growth target in the 14th Five Year Plan for the medium to long term future. That said, there seems to be an implicit one. President Xi Jinping has previously indicated that China's GDP per capita will double by 2035. A doubling of the current real GDP per capita (CNY 65K) by 2035 implies an annual compounded growth rate of 4.7% (figure 12). We think that is optimistic, and we will explain why below.

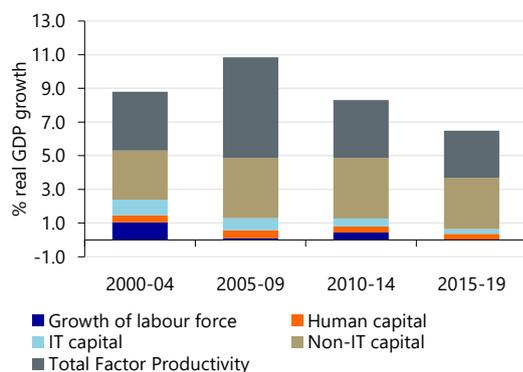
Raising productivity

China's economic growth has historically been driven to a large extent by capital deepening (adding more capital per worker), as exemplified by its large investment-to-GDP ratio (43% in 2019). In fact, as figure 13 shows, more than half of the economic growth of China has been driven by capital deepening, while a smaller (and declining) percentage (c. 40%) has been due to Total Factor Productivity (TFP) growth⁴. A big part of this was due to urbanisation. Much of urbanisation, however, has run its course, 61% of Chinese now live in cities, while this was 39% in 2002 (figure 14). And although there is potential for this to continue (the G7 average urbanization rate is 81%), the actual increase of people moving to cities might not be as high as it has been

⁴ To give a bit more background. In the labour productivity version of a standard Solow growth model (the typical model economists used to estimate long term economic growth and which is used for 'growth accounting'), economic growth is driven by labour productivity and growth of the labour force (see [here](#) for an explanation). Labour productivity itself is driven by Human capital (e.g. education per worker), IT-capital (e.g. computers,) non-IT capital (e.g. infrastructure and real estate) and Total Factor Productivity (TFP). TFP is the economic growth left after accounting for the contribution of capital and growth of the labour force (more specifically the total hours worked). TFP then, loosely speaking, is interpreted as capturing the state of technology in a country.

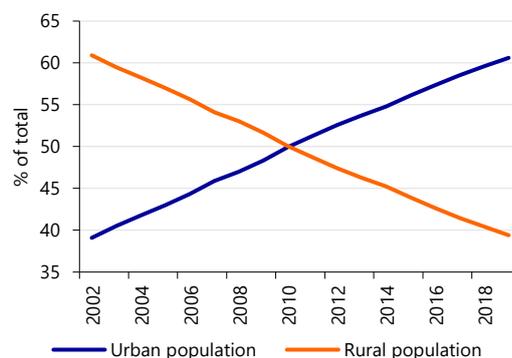
before. A part of China's urbanization efforts will simply be a reclassification of migrant workers that live and work in urban areas but are not counted as being part of the urban population⁵.

Figure 13: Growth in the past 20 years has been driven by non-IT capital investment



Source: The Conference Board

Figure 14: In part driven by investments needed to accommodate urbanization



Source: Macrobond, NBS

More capital deepening will not likely add as much growth as it used to. Standard economic textbooks teach us that capital deepening improves labour productivity (since the capital per worker increases) but does generally not add to technological progress (so no growth in TFP).

To keep using macroeconomic textbook terms, capital-deepening leads to a move *on* the production function of a country, not *of* the [production function](#). For the latter, TFP has to increase, which in practice means either human capital or IT-capital has to increase. Figure 13 shows that China's contribution from human and IT-capital have been much smaller and as a result, its TFP has steadily declined over the years.

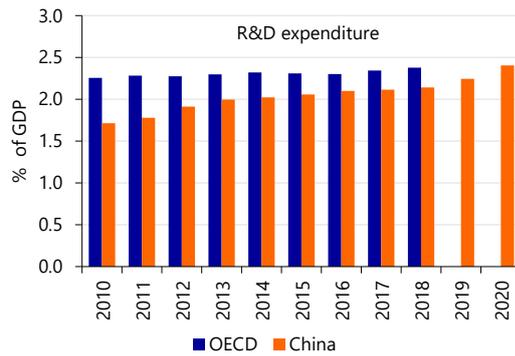
In order to increase TFP, therefore, China needs to invest more in IT-capital and human capital. Beijing's focus seems to be more on IT-capital, given its R&D spending targets (see Table 1 in the Appendix). However, R&D investments take time to translate into innovations and simply spending more on R&D does not necessarily increase innovations (and thus technological progress). We have seen an example of the latter in China's recent past in terms of TFP improvement.

Figure 15 shows that R&D investments in China have already been quite decent in the past 10 years, compared to the OECD average. That has helped China move up the [Global Innovation Index](#) to the top 14th spot in 2020 (35 in 2013). However, despite years of relatively high R&D investments and efforts to innovate, TFP growth has still declined over the past 10 years (figure 16). This demonstrates that turning R&D and innovation efforts into actual TFP growth is easier said than done. One explanation for this issue is that the absorption of technology in an economy [depends on institutional quality](#), a feature on which China does not score particularly high.

Moreover, at least part of China's technological progress until now has relied on [mandatory technology transfers](#) from foreign firms. This, however, looks set to become increasingly difficult for China given the recent tensions with for example the US, Australia and Japan. Even in the recent (CAI) investment deal with Europe, which we discussed [here](#), there are provisions regarding this subject.

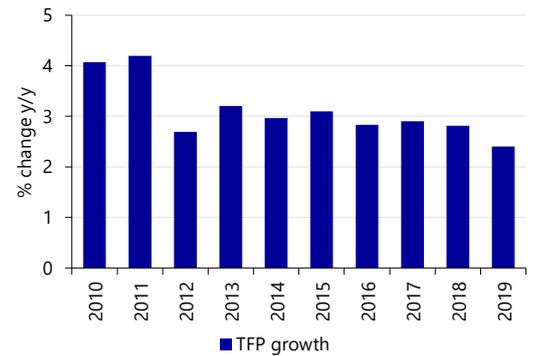
⁵ The reason that these migrants are not counted as part of the urban population is because of China's *Hukou* registration system. One of the aspects of this system is that people who are born in a certain area, are counted as being part of that area irrespective of where they end up living and working.

Figure 15: R&D expenditure in China has caught up the OECD average



Source: Macrobond, NBS, OECD

Figure 16: Yet, TFP has trended down over the same period



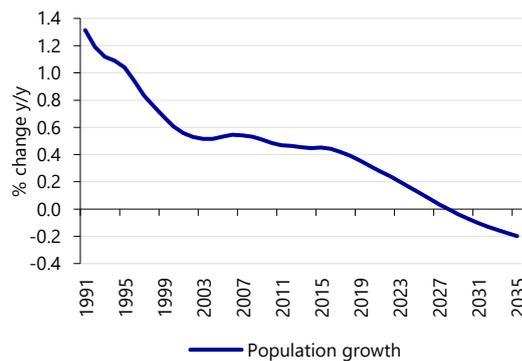
Source: The Conference Board

Beijing's plans to raise productivity focus relatively little on improving human capital, which arguably has the bigger potential to improve TFP. Human capital has contributed very little to economic growth in China, as we showed in figure 13.

Education is key, but the government seems to be targeting quantity over quality here with an emphasis on years of education (11.3 years per person, see Table 1 in the Appendix), without combining this with improving the quality of schools. The latter is essential. Chinese children do well on PISA test scores, but that mainly reflects urban children in the [richer cities](#), not the poor ones in rural areas. The children of rural migrants are not allowed to go to such schools since they are a public service to which people without [Hukou](#) have no access.

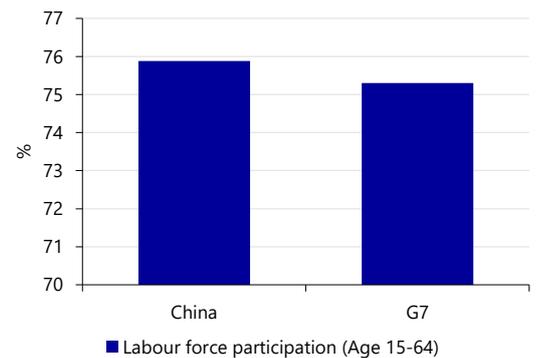
We should also note that economic growth will not likely come from an increase in China's labour force either. China's population is projected to decline from 2030 onwards (figure 17) and its participation rate (the percentage of the working-age population that wants or has a job) is already relatively high (Figure 18).

Figure 17: Population growth in China is projected to become negative in 2030



Source: Macrobond, US Census Bureau

Figure 18: While labour force participation is already higher than the G7 average



Source: Macrobond, World Bank

All in all, we think China will struggle to increase TFP growth, despite increased R&D investments. China has not been able to turn around its structural decline in TFP in the past years and its emphasis on physical rather than human capital suggests it may be missing out on low hanging fruit. Moreover, China's strategy of increased self-reliance (which implies producing more goods domestically, especially in the technology sector) will likely hurt rather than help productivity, since it implies less trade and FDI, key factors that are [known to benefit](#) TFP growth. **This is a good example where some of its goals become contradictory.**

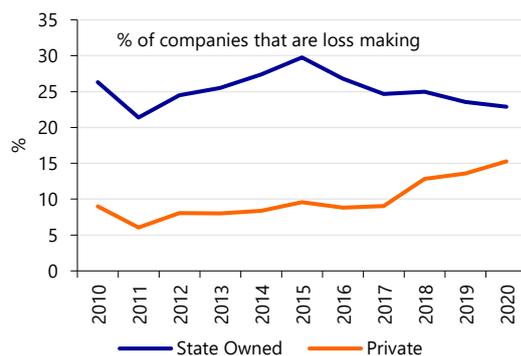
SOE reform

Another one is SOE reform. Beijing plans to maintain an important role for SOEs in its economy stating that it wants to “*enhance the strength, quality, and size of SOEs*”. There have been efforts to increase efficiency and reduce debt among SOEs. However, until now that has been done mostly through mergers rather than bankruptcies, which has led to fewer but larger SOEs, [according](#) to the Peterson Institute for International Economics. Chinese SOEs are indeed notoriously inefficient, almost a quarter of them are loss-making (figure 19). **Still, inviting more efficiency might prove tougher than Beijing imagines, for two main reasons.**

First, if further consolidation of SOEs were to occur via bankruptcies it could have a big impact on employment in China. About 14% of the Chinese urban labour force works for SOEs (figure 20) and SOEs make up about [20%](#) of GDP. Given this difficulty, it seems likely that SOEs will continue to be drag on TFP given their weak productivity. Any consolidation, we think, will happen in non-strategic areas, so outside high-tech, biotech and the key manufacturing and technology areas targeted in the 14th Five Year Plan (see the last chapter for which these are).

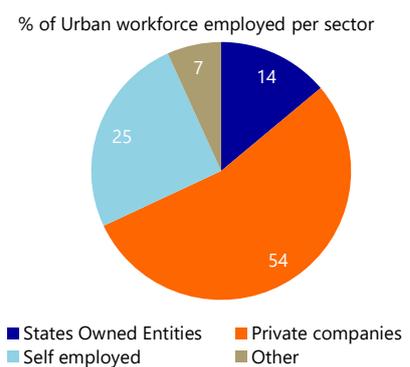
Second, one of the ways Beijing wants to improve efficiency is by increasing the share of private ownership in SOEs. However, having partial private ownership in an SOE (say 20%) does not mean you can influence decision-making. The decision-making still often rests with the SOE. That implies that market discipline (and thus efficiency gains) might not be as big as Beijing imagines.

Figure 19: Almost a quarter of SOEs are lossmaking



Source: Macrobond, NBS

Figure 20: A sizable part of the urban labour force works for an SOE



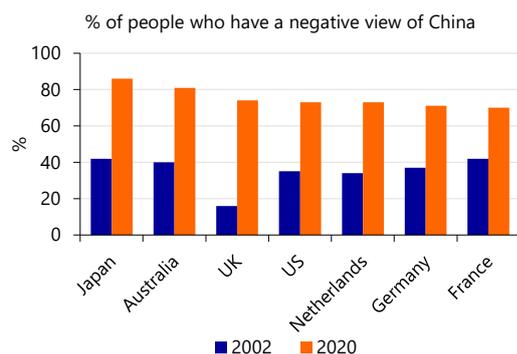
Source: Macrobond, NBS

Geopolitics

As we already touched upon in the previous paragraph, tensions between the China and the US and between China and India, Australia and Japan are here to stay. The US, from its side, is not backing down, despite its new leadership. Together with these other three countries it has formed a strategic alliance ([the Quad](#)) specifically to act as a counterweight to China.

Beijing realizes very well that even if the US' stance on China (or at least its way of communicating) changes every four years, the US structurally now sees China as a strategic rival and its population's views toward China are becoming increasingly negative, as they have in other countries as well (figure 21). That corroborates what we have previously argued; being [tough on China](#) is one of the few things both Democrats and Republicans agree on, and US presidents will be mindful of that. Thus, the US will continue to keep pressure on China.

Figure 21: Around the world, people’s views on China have become more negative



Source: [Pew Research](#)

require higher wages. Those could hurt China’s competitiveness, leading to lower exports.

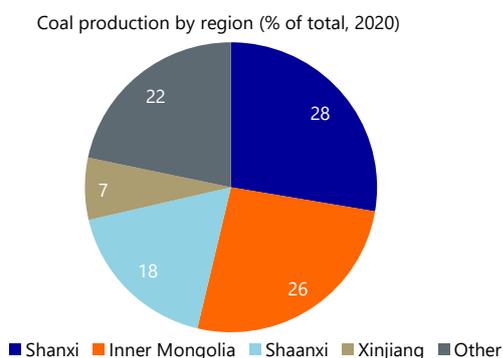
Beijing is likely to maintain its stance on Hong Kong. The Work Report, for example, mentions that China will “guard against and deter external forces’ interference in the affairs of Hong Kong and Macau”. Another example is that the Chinese government has recently passed a law that reduces the share of democratically elected lawmakers in Hong Kong. In essence, this means China has a growing direct influence on Hong Kong’s politics.

Taiwan is likely to remain of key strategic importance to the mainland as well. The Work Report released during the Two Sessions mentions that China “will remain highly vigilant against and resolutely deter any separatist activity seeking Taiwan Independence”. Taiwan has become especially important because one of the [three](#) leading global semiconductor firms (TSMC) is based there. Given the extreme concentration of top-of-the-line semi-conductor manufacturers, this sector (and Taiwan with it) will likely be caught between China and US tensions.

More generally, China will not likely become less assertive globally. It plans to increase its military budget by 6.8% to 1.355 CNY trillion.

Green ambitions

Figure 22: China’s coal production is heavily concentrated in four regions



Source: Macrobond, NBS

As a final issue we would like to highlight that China’s target is to achieve a greener economy, but that it comes with higher costs. Especially the target to generate 20% of its energy from non-fossil fuels by 2025 could hurt GDP growth in regions that are dependent on coal production. Most notable are Shanxi, Inner Mongolia, Shaanxi and Xinjian, which together account for 78% of China’s coal production (Figure 22). The economies of these provinces could be hit hard if coal production goes down substantially. Indeed, that might be the reason that the green energy target for the coming year is not that ambitious.

After all, the target of 18% CO2 emission per unit of GDP is the same as the target of the previous Five Year Plan, and according to [some calculations](#) imply that CO2 emissions will actually increase by 1% per year until 2025. The more likely avenue through which China will try to cut its carbon footprint is reduced support for fossil fuel related projects in other countries, as it has done recently in [Bangladesh](#). The question this raises is whether China can maintain its assertion of

being at the forefront of global leadership in turning around climate change. Or would it be one of the first goals to be ditched at the expense of higher economic growth if needed?

What will this mean in practice?

China's plans for the coming five to fifteen years are ambitious. We have argued in this report that some of these plans will be difficult to achieve and some contain inherent trade-offs. In our view, China cannot have its cake and eat it too. **It will have to make some tough choices along the way and, if pressed, renege on some of its stated plans.** That obviously has implications for businesses operating in China or for those who are otherwise dependent on its economy.

First of all from a broad economic perspective. **Despite high economic growth in the short term, the years of high growth in China are over**, as are the years of high and consistent rises in house prices. That has implications for investors and firms dependent on the real estate sector. Debt levels in general will not likely decline in China, rather we believe there is a good chance that they will increase further, which implies higher credit risk, all else equal. Meanwhile, China seems to have shifted back from focussing on services to manufacturing, implied by its emphasis on eight key manufacturing areas (see Table 1 in the Appendix for a list). That could go against growth in the services sector and, as such, may also be at odds with its goal of nurturing domestic consumption. But also on a more detailed level will China's plans and the issues that come with it have implications:

- Although China is actually saying that it is opening up its economy and its financial system, how this operates in practice is something that still needs to be demonstrated. Foreign firms trying to access the Chinese market in key strategic areas might still find it difficult to gain a foothold, unless they are willing to share their knowledge with local parties.
- In any case, multinational corporations might find themselves caught between geopolitical tensions between China and the US, Australia and Japan. The semiconductor industry specifically might be targeted because of such tensions as well.
- There are upsides for Chinese firms operating in the manufacturing and technology areas Beijing has identified as key. Firms operating in these areas (e.g. semiconductors, electric cars, 5G, AI and biotechnology) will likely benefit from one form of government support or another.
- **For fintech firms and e-commerce giants, there could be major downsides.** The government's recent [crackdown](#) on large internet companies suggest Beijing is serious about breaking the monopolies of internet giants in China. There is another contradiction here with Beijing's wish to raise the digital part of economy to 10% of GDP. The digital economy is dominated by a handful of big players. Tmall (owned by Alibaba), JD.com and Pinduoduo for example, control 89% of retail e-commerce sales in China. If broken up, it remains to be seen how quickly they will be replaced by smaller firms. Moreover, aggressively cracking down on big internet companies could destabilize financial markets in China, which are also [dominated](#) (in terms of market capitalization) by the same firms.
- Finally, China's demand for coal might not decrease as much as news headlines suggest.

As a final takeaway, we note that China's implicit long-term growth goal remains ambitious (see the chart below with our medium and long-term growth projections) and that several policy goals contain inherent trade-offs. Achieving a reduction debt and maintaining financial and domestic stability could be at odds with its aim to become more technology-driven. When push comes to shove, we believe China will sacrifice growth for resilience and deleveraging for domestic stability.

Table 2: GDP growth forecasts

<i>% change y/y</i>	<i>2019</i>	<i>2020</i>	<i>2021</i>	<i>2022</i>	<i>2023</i>	<i>2024</i>	<i>2025</i>
Real GDP	6.1	2.3	7.7	5.6	4.2	4.1	4.0

Source: RaboResearch

Appendix

Table 3: Selected targets for the 14th Five Year Plan

<i>Target</i>	<i>Difficulty</i>	<i>Comment</i>
Short term economic goals		
GDP growth of "above 6%" for 2020	Easy	Favourable base effects
Unemployment rate of 5.5%	Easy	Does not include the 30% of China's workforce who are migrant workers
Inflation around 3%	Medium	There might be wide disparities within consumption basket
Fiscal		
Fiscal deficit of 3.2% of GDP for 2020	Easy	However, the effective deficit is likely to be much higher
Quota for local government special purpose bond issuance quota of CNY 3.65 trln	Easy	Slightly less than last year
VAT relief for small-scale taxpayers	Medium	Could lead to a larger than expected fiscal deficit
Curb government debt: "Strictly implement the risk prevention and control of local government debt"	Challenging	See chapter Government Debt
Monetary		
Current account "almost balanced"	Medium	China's is more likely to run a current account surplus
"Keep the RMB exchange rate generally stable at an adaptive, balanced level"	Medium	Current account surplus and foreign reserves allow for intervention when needed
Increase money supply in line with economic growth	Challenging	Very delicate balance not to step on the breaks too soon
Green goals		
Carbon emissions will peak by 2030	Challenging	Tough given relative underwhelming goals
Generate 20% of energy from non-fossil fuels by 2025	Challenging	Could hurt economic growth in coal dependent provinces
70% of the heating in northern China will be 'clean'	Challenging	Could hurt economic growth in coal dependent provinces
Income, GDP and productivity		
Labour productivity grows faster than GDP	Easy	A declining population implies that labour productivity will be above GDP growth.
Disposable income to grow in line with GDP growth"	Medium	Has also been the case historically (approximately)
Double GDP per capita by 2035	Challenging	Implied growth rate will be difficult given China's population and slowing TFP growth
Education		

Raise years of schooling for the working-age population to 11.3.	Easy	However, the quality of education might not improve
Social		
95% of the population will have a pension	Medium	Will increase public debt
Hukou reform and urbanization: raise the percentage of permanent urban residents to 65	Challenging	Could lead to a larger than expected fiscal deficit
Technology		
Share of "basic research" to total R&D expenditure more than 8%	Easy	In 2020, basic research was already 6% of total R&D expenditure
Digital economy to be 10% of GDP	Medium	Goes against desire to curb monopolies in e-commerce
100% tax deduction for R&D expenses of manufacturing firms	Medium	Could lead to a larger than expected fiscal deficit
Self-sufficiency in 'top of the line' semi-conductor production	Challenging	High end semiconductor production is not concentrated in mainland China
Focus on key manufacturing areas and technologies ⁶	Challenging	Could lead to a larger than expected fiscal deficit and no guarantee for success
Military		
Military budget increase by 6.8% (1.355 CNY trln)	Easy	But could invite geopolitical backlash
SOE reform		
Allow mixed ownership in 200 SOEs	Medium	Does not necessarily translate to more efficiency
Increase efficiency among SOEs	Challenging	Could lead to higher unemployment and hurts social stability

Source: English version of Work Report presented at March 2021 NPC, accessed via [SCMP](#), and various online sources.

⁶ The key manufacturing areas in which China wants to excel according to its Five Year Plan are: Rare earth refining and mining, robotics, aircraft engines, electrical cars, high-end medical equipment, innovative medicine (vaccines etc.), machinery (agricultural, shipbuilding, aviation) and navigation (Beidou). The key technologies China wants to focus on are: 5G and quantum computing, AI and integrated circuits (semiconductors), neuroscience, genetics and biotechnology and space exploration.

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