Economic Research

April 2021

Market Monitor – Mainland China

Economic Recovery Provides Rooms for Deleveraging

Domestic epidemic drags on economic performance in the near term

Over the Lunar New Year in February, while the pandemic situation remained volatile abroad, China's official manufacturing purchasing managers index (PMI) continued to expand but slipped to 50.6, down from 51.3 in January. New export orders plunged to 48.8. Meanwhile, the Caixin manufacturing PMI dropped to a nine-month low of 50.9, down from 51.5 previously. But the slowdown in the manufacturing sector is expected to be short-lived after the accelerating economic recovery in the US and other Western economies following mass vaccination and large-scale stimulus programmes.

Despite retail sales showing a strong growth of 33.8% and investment of 35.1% in the first two months of 2021, both saw a slower growth from December after excluding base effects. Retail sales grew by 6.4% when compared with the 2019 figure, translating to a 3.2% yearly growth, which is lower than the 4.6% growth seen in December. By a similar calculation, investment grew 1.7% yearly, down from a 2.9% growth in December. The slower growth is mainly caused by the re-implementation of social distancing measures in January and February in view of a surge of new infections.

Meanwhile, consumer demand remains lacklustre. Non-food inflation continued to stay in negative territory at 0.2% yearly in February, after a 0.8% drop in January. Coupled with ebbing food inflation, this meant that headline inflation dropped 0.2% in February.

- **Domestic pandemic dampens short-term consumer sentiment, but China's recovery will not be derailed.**
- **With the economy stabilised, the government is expected to take the opportunity to deleverage, including in bonds and the housing market.**
- **Financial market has been weighed on by high US treasury yields and market concern over policy normalisation.**

Recovery remains on track nevertheless...

Despite the setbacks, other February economic figures show China remaining on track for recovery. Export growth beat market expectation with a staggering 60.6% year-on-year growth in the first two months of 2021 (the low base of comparison was a major factor). Yet even compared to the 2018 and 2019 figures, exports still saw a robust growth of above 25%. Global demand for anti-pandemic goods such as masks and medical equipment remained solid during the pandemic, while the rise of remote working boosted demand for electronic products.

Credit figures are also showing positive signals. Outstanding total social financing grew 13.3% year-on-year in February, up from 13.0% in January. The increase in credit is mainly constituted by the rise in corporate loans, reflecting firms' strong demand for funds and an uptick in the economy.

Looking ahead, China's fast recovery from the pandemic will be continually supported by the manufacturing sector and exports, despite challenges arising from the pandemic outbreak and global demand headwinds. However, the Government Work Report lacks novel policies to stimulate consumption, which may undermine the government's effort to restructure the economy and boost demand. Gradual normalisation of monetary and fiscal policies will also weigh on economic growth in the latter half of the year.

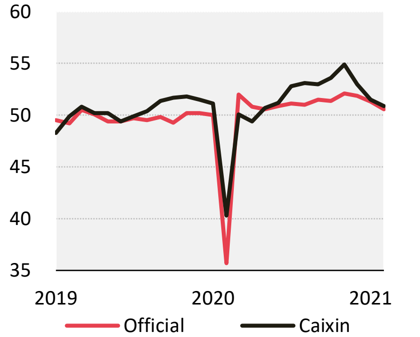
...and provides rooms for deleveraging

Against the backdrop of steady economic recovery, the government has more room to focus on deleveraging. This year's Government Work Report set an economic growth target of 6% or above, which is much lower than the market consensus forecasts of over 8% growth. This provides rooms for the government to undergo structural reform and normalise fiscal and monetary policies. It also provides buffers against risks such as another outbreak or a renewed trade spat with the US.

Meanwhile, the amount of local government special-purpose bonds to be issued in 2021 is reduced to CNY 3.65 trillion, down from last year's CNY 3.75 trillion but up from CNY 2.15 trillion in 2019. This shows that the government is set to handle the local government debt issue, which has been exacerbated by the pandemic outbreak, albeit at a more moderate pace than the market previously expected. Bloomberg estimates that the ratio of local government debt to combined fiscal revenue jumped to 90% in 2020, up from 83% in 2019. The official government debt-to-GDP ratio also surged to 45.8% at end-2020 from 38.5% at end-2019.

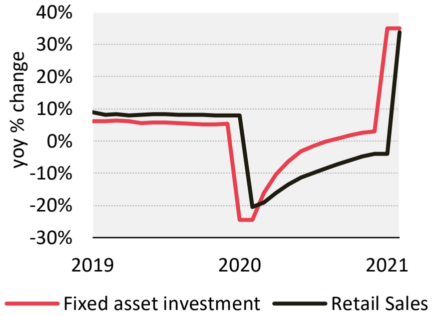
After some state-owned enterprises (SOEs) – including Brilliance Auto and Yongcheng Coal and Electricity – defaulted on their bonds in November, the government has been strengthening regulations and information disclosure in the bond market. The People's Bank of China (PBOC) has proposed enhancing the legal system of the bond market and the mechanism for handling bond defaults. The State-owned Assets Supervision and Administration Commission of the State Council (SASAC) will also establish an early-warning system for the risks regarding SOE debts. Supervision over the SOEs debts will be strengthened through utilizing more information for advanced identification and responses to bond default risks.

Manufacturing PMI



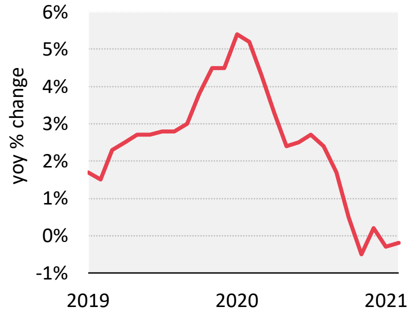
Source: National Bureau of Statistics of China, Caixin, IHS Markit, as of 15/3/2021

Cumulative fixed asset investment and retail sales



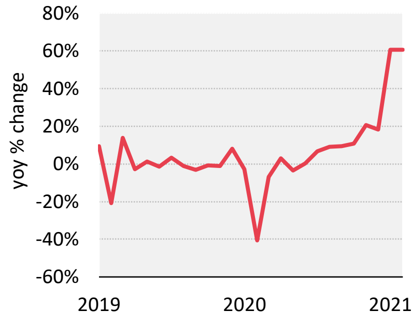
Source: National Bureau of Statistics of China, data as of 15/3/2021

Inflation rate



Source: National Bureau of Statistics of China, data as of 15/3/2021

Exports



Source: National Bureau of Statistics of China, data as of 15/3/2021

Moreover, the government is beginning to address risks in the internet economy to foster a healthy development of the digital economy. Following the launch of rules targeting the platform economy, the government penalised five group-buying firms, including Meituan Select and the Tencent-backed Shixianghui due to illegal price subsidies to gain market share. Similar actions are expected to be more frequent in the coming months as the government strives to provide a competitive market for innovation.

More market restrictions ahead for the housing market

The asset bubble issue in the housing market has triggered regulator concern. The government reiterated that "housing is for living in, not for speculation" in the Government Work Report 2021. Despite the more stringent movement restrictions however, home prices saw an accelerated monthly growth of 0.6% in February, up from 0.1% growth in January. Worse, looking at the secondary market, prices are soaring fast in the 4 tier-one cities, with a month-on-month rise of between 0.9% and 1.3%. To stabilise the home price surge in certain hotspots, more market restrictions are being rolled out. After at least 87 rounds of restrictions were rolled out in various cities in the first two months of 2021, 10 more rounds were launched during 1st to 3rd March.

The housing market is expected to remain roughly stable throughout the year amid further rounds of market restrictions. More targeted policies will be imposed in hotspot cities to stabilise housing prices and land prices. In the meantime, regulators will limit the amount of liquidity entering the housing market. 22 local governments, including Beijing and Shenzhen, will centralise the announcement of land sales and land auctions. They will also hold no more than three land auctions in 2021 in order to stabilise land prices.

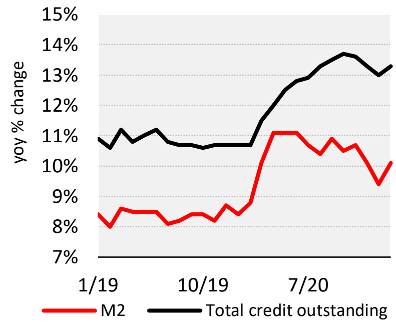
Market sentiment is weighed on by high US treasury yields and concerns over policy normalisation

In the stock market, the A-share index has dropped by 2.1% between end-February and 29h March. Although China's strong economic data provides some support to the stock market, market sentiment is being dampened by deleveraging policies and the potential reduction of stimulus measures. Chairman of the China Banking and Insurance Regulatory Commission Guo Shuqing warned about the bubbles in the housing market and global financial market. Furthermore, high US treasury yields undermined the attractiveness of the Chinese stock market and put pressure on its performance.

In the foreign exchange market, the CNY and the CNH both have depreciated by 1.5% against the US dollar between the end of February and 29th March. High US treasury yields and the improving US economic outlook boosted the US dollar. The US dollar index has risen by 2.3% over the same period.

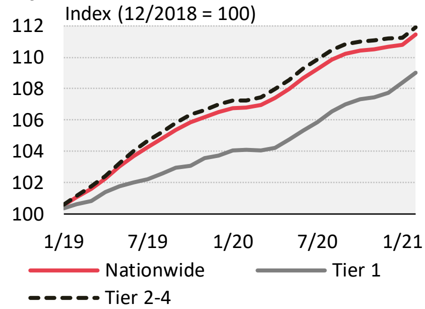
In the coming weeks, sustainable economic growth will support the performance of China's financial markets. Yet as the economy stabilises from the pandemic, the market will keep an eye on the tapering off of stimulus, which will limit market confidence. At the same time, vaccination progress in the US and the corresponding brighter economic outlook will support a stronger US dollar and weigh on the renminbi.

Credit Growth



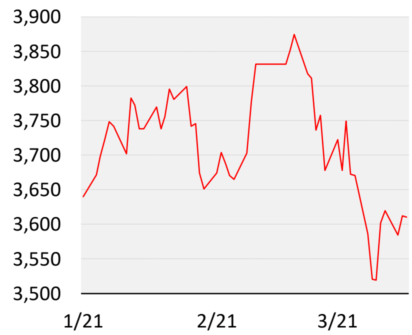
Source: The People's Bank of China. Data as of 15/3/2021

New commercial home prices index by tiers



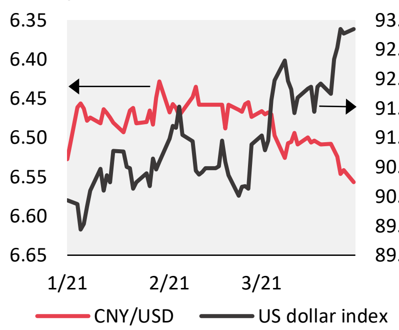
Sources: National Bureau of Statistics of China, BEA Economic Research Department, data as of 15/3/2021

A Share Index



Source: Bloomberg. Data as of 15/3/2021

RMB/USD vs USD Index



Source: People's Bank of China, Bloomberg, data as of 15/3/2021

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