Economic Research

June 2021

Market Monitor – Mainland China

Economic recovery eases pace

Supply side recovery prevails…

The Chinese economy continues to recover, but at a more moderate pace. Supply side policy remains the key driver of economic growth. The official and Caixin manufacturing purchasing managers indices stayed in the expansionary zone at 51.0 and 52.0 in May, respectively, while exports grew at 32.3% year-on-year in April. Supported by robust external demand, the 2-year average annual growth of China's industrial production stood at 6.8% in April.

Investment recovered further, mainly driven by public investment. The 2-year average growth of investment by state-owned enterprises grew at 5.1% during the first four months of 2021, while that by private firms grew to 2.4%, up from 1.1% in Q1 2021.

…but the nascent recovery in consumption is held back

However, the nascent recovery of private consumption seen in March failed to advance in April, with the 2-year average growth in retail sales dropping to 4.3%, down from 6.3% in March. This may be due to consumers holding back their spending before the Labour Day Holiday. Core inflation (excluding food and energy) grew at 0.7% in April, far below the 1.6% seen in 2019.

Partly affected by weak retail sales, money supply M2 grew at 8.1% in April, undershooting market expectation and down from 9.4% growth in March. Moreover, banks reduced their loan approvals to keep this year's loans to the level of 2020 as part of the government's goal of reducing financial risk. As a result, April's rise in total social credit also missed market expectations.

- **China's economic recovery moderates in April. Despite downside risks arising from the pandemic and commodity prices, China's recovery is expected to continue.**
- **In view of weak retail sales figures and monetary data, the PBOC is expected to adjust its pace of monetary tightening.**
- **House prices continue to rise despite the government's policies to curb the surge.**

Overall recovery will continue

Looking ahead, the Chinese economy is expected to remain on track for recovery. External demand is expected to remain solid following the easing of lockdown measures in the Western economies. Moreover, investment is expected to keep up growth momentum. Meanwhile, local governments are expected to invest in new infrastructure, such as 5G communications, and to renovate old towns. A brightening global economic outlook and enhancements or extensions to fiscal support (including a further reduction in profits tax for eligible small firms and the extension of labour-related subsidies until end-April 2022) are expected to stimulate investment from private firms.

The survey-based unemployment rate slid to 5.1% in April, the lowest since December 2019. The tighter labour market is expected to push up household incomes, fuelling increased consumption. A buoyant domestic tourism industry reflects the fact that consumption is recovering. Domestic tourism revenues during the Labour Day holiday rising to 77.0% of the pre-pandemic level, compared to the 56.7% of the pre-pandemic level seen in the China Ming Festival holiday.

PBOC will adjust the pace of monetary tightening

Downside risks, though unlikely to derail recovery, are nonetheless mounting. On the external front, tensions with the West are building. The US still has a tough stance on China, while the EU has suspended its Comprehensive Agreement on Investment with Beijing.

On the domestic front, scattered local confirmed cases of the coronavirus, such as those in Anhui and Liaoning provinces in mid-May, and in Guangdong recently, could cloud the revival of consumer and business sentiment.

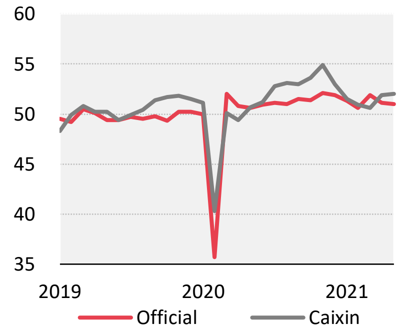
Meanwhile, high commodity prices have come under the spotlight, with the producer price index rising to 6.8% year-on-year in April, the highest since October 2017. The State Council has named high commodity prices as an issue twice in eight days, and stepped up to stabilise commodity prices and prevent the surge from spilling over into consumer prices. Tariffs will be waived for certain commodities, while export tax rebates will be cancelled for certain steels. Malicious speculation in the commodity market will be prohibited. Monetary support will be provided to small and medium firms to deal with the rise in raw material prices.

In its Q1 2021 Monetary Policy Report, the People's Bank of China (PBOC) considered the pickup in inflation to be transitory. With consumption still lagging and monetary data missing expectations, the PBOC is expected to adjust its pace of monetary tightening.

Risk containment remains the major task

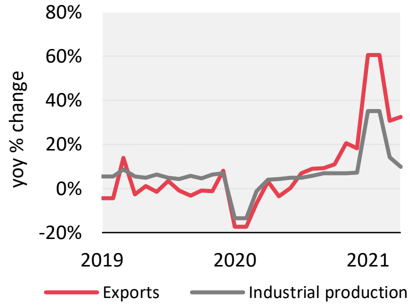
Meanwhile, the central government continues to tighten its grip to safeguard against potential risks, especially in the platform economy and financial markets. The latest

Manufacturing PMI



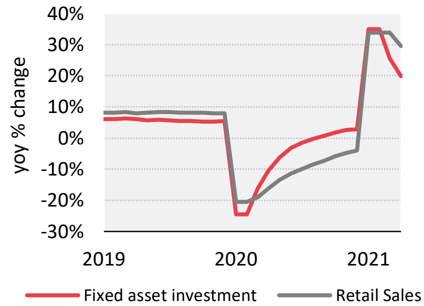
Sources: National Bureau of Statistics of China, Caixin, IHS Markit, as of 1/6/2021

Exports and Industrial Production



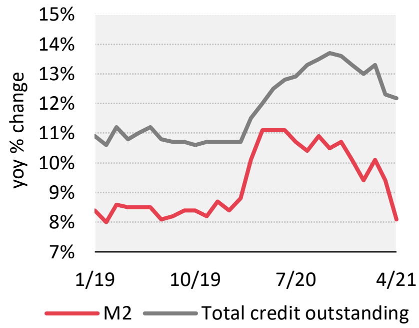
Note: Figures for January and February are the average of the two months.
Sources: General Administration of Customs, National Bureau of Statistics, data as of 31/5/2021

Cumulative Fixed Asset Investment and Retail Sales



Source: National Bureau of Statistics of China, data as of 31/5/2021

Credit Growth



Source: The People's Bank of China, data as of 31/5/2021 measures including fining internet companies such as Meituan and Pinduoduo for infringing consumer rights. Meanwhile, the Financial Stability and Development Committee recently signalled a further crackdown on bitcoin mining and trading in China in response to the extreme price volatility of crypto-currencies. They also stressed that financial institutions and payment companies are banned from providing services related to crypto-currencies.

Housing prices rebound amid further market restrictions

Risks in the housing market remain one of the regulators' main concerns. 51 rounds of market restrictions were implemented by the central and local governments in April, the most so far in 2021. The government has also been working on reforms in real estate tax as one means to contain house prices. Nevertheless, prices continued to surge by 0.6% monthly, the highest since July 2020. Though prices have stabilised in hotspot cities like Shanghai and Shenzhen, they have risen unrelentingly in the lower-tier cities.

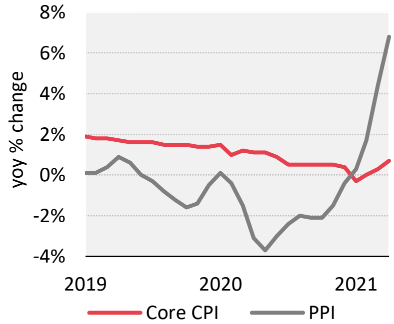
Market sentiment weighed on by US-China tensions and China's regulation of the platform economy and crypto-currencies

In the stock market, A-shares have risen 4.9% in May. The tensions between China and the West, as well as China's tighter control of tech giants and crypto-currencies, has dampened investor confidence. However, the government has rolled out policies in response to the recent surge in commodity prices, which alleviated investor concern over China's inflation issue. Meanwhile, the continued recovery in the Chinese economy and the uptick in vaccine, nuclear, and semi-conductor-related shares have boosted market performance.

In the foreign exchange market, both the CNY and CNH appreciated by 1.6% against the US dollar in May, a result underpinned by the weaker US dollar. The US dollar index dropped 1.4% amid inflation fears. China's continual economic recovery and responses to the inflation issue also helped support the renminbi. In view of the recent rapid renminbi appreciation, regulators urged the market multiple times to have rational expectations on renminbi. In addition, the PBOC will rise the required reserve ratio for foreign currency by 2 percentage points to 7.0% starting from 15th June. This move will increase the cost of exchanging foreign currencies and thus curbing the short-term rise in renminbi.

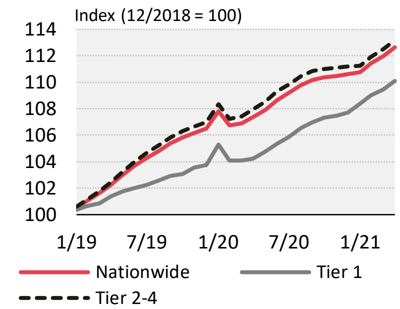
Looking ahead, the financial markets will be supported by China's economic recovery. That said, the tension between China and the West may be a looming risk. Meanwhile, the trend of the US dollar will dictate that of the renminbi. Recent market concern about US inflation may serve to keep the US dollar weak and boost the renminbi.

Yearly Change in Prices



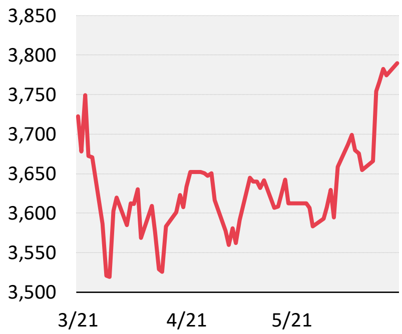
Source: National Bureau of Statistics of China, data as of 31/5/2021

New Commercial Home Prices Index by Tiers



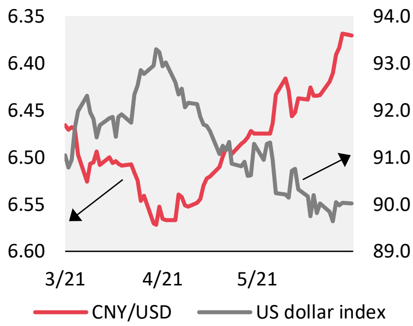
Sources: National Bureau of Statistics of China, BEA Economic Research Department, data as of 31/5/2021

A Share Index



Source: Bloomberg, data as of 31/5/2021

RMB/USD vs USD Index



Source: People's Bank of China, Bloomberg, data as of 31/5/2021

Disclaimer

This document is prepared by The Bank of East Asia, Limited (“BEA”) for customer reference only. Other than disclosures relating to BEA, the content is based on information available to the public and reasonably believed to be reliable, but has not been independently verified. Any projections and opinions contained herein are as of the date hereof, are expressed solely as general market commentary, and do not constitute an offer of securities, nor a solicitation, suggestion, investment advice, or guaranteed return. The information, forecasts, and opinions contained herein are as of the date hereof and are subject to change without prior notification, and should not be regarded as any investment product or market recommendations. This document has not been reviewed by the Securities and Futures Commission of Hong Kong, Hong Kong Monetary Authority, or any regulatory authority in Hong Kong.

BEA will update the published research as needed and as required by the law. In addition to certain reports published on a periodic basis, other reports may be published at irregular intervals as appropriate without prior notice.

No representation or warranty, express or implied, is given by or on behalf of BEA, as to the accuracy or completeness of the information and stated returns contained in this document, and no liability is accepted for any loss arising, directly or indirectly, from any use of such information (whether due to infringements or contracts or other aspects). Investment involves risks. The price of investment products may go up or down. Past performance is not indicative of future performance. The investments mentioned in this document may not be suitable for all investors, and the specific investment objectives or experience, financial situation, or other needs of each recipient are not considered. Therefore, you should not make any investment decisions based solely on this document. You should make investment decisions based on your own investment objectives, investment experience, financial situation, and specific needs; if necessary, you should seek independent professional advice before making any investment.

The views and opinions in this document do not constitute the official views of BEA.

This document is the property of BEA and is protected by relevant intellectual property laws. Without the prior written consent of BEA, the information herein is not allowed to be copied, transferred, sold, distributed, published, broadcast, circulated, modified, or developed commercially, in either electronic or printed forms, nor through any media platforms that exist now or are developed later.

For more information, please visit our webpage at https://www.hkbea.com/html/en/bea-about-bea-economic-research.html. For any enquiries, please contact the Economic Research Department (email: lerd@hkbea.com, tel: (852) 3609-1504, post: GPO Box 31, Hong Kong).