

Market Monitor – Mainland China

Domestic Demand Continues to Pick Up



The Chinese economy continues to recover, yet the market concerns the mild and uneven recovery

The Chinese economy has continued to recover. On the external front, exports maintained a robust growth in May with a yearly growth of 27.9%, after April’s 32.3% growth. Although the contribution from pandemic-related goods dropped, exports were reinforced by revived demand from the developed countries. The solid export sector also helped the manufacturing sector sustain a strong 2-year average growth of 6.6% in May, surpassing the pre-pandemic level of around 5.9%.

On the domestic front, retail sales growth improved further in May at 4.5% in terms of 2 year average growth, up from 4.3% in April. The recovery in domestic tourism during the Labour Day holiday stimulated catering spending and offset the drag from car sales. Yet the recovery was deemed modest and uneven, especially when compared with the pre-pandemic level of 8.0%.

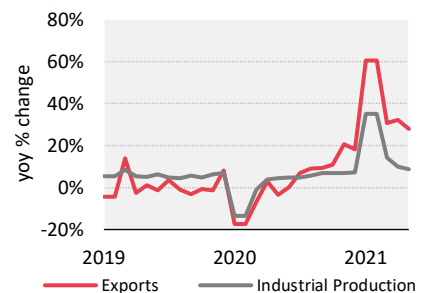
There was a similar story in fixed asset investment. The 2-year average growth picked up further during the first five months of 2021 at 4.2%, but this was below the 2019 level of 5.4%. The recovery in private investment is a bright spot, with 2 year growth increasing from 2.4% to 3.3%. This improvement made up for the drop in infrastructure-related investment, which dragged down the 2 year average growth of investment by state-owned enterprises from 5.1% to 4.7%. The government’s efforts to deleverage in response to financial risks has started to feed into the infrastructure-related sector, including railways and water resource management. This has also resulted in a slower growth in total social credit outstanding, which slid from 11.7% in April to 11.0% in May.

Chinese economy continues to recover, but there are market concerns about uneven or declining economic growth.

Given the uneven recovery and potential threats both external and domestic, the PBOC is expected to further soften its pace of monetary tightening.

Financial markets are impacted by tensions between China and the West.

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 30/6/2021

Promising economic outlook clouded by tension with the West and scattered local confirmed coronavirus cases

Looking ahead, the Chinese economy is expected to keep up its growth momentum, but with some moderation in the second half of the year. External demand is expected to remain solid following the revival of global demand amid the easing of lockdown measures in major economies. But tensions between China and the West could weigh on multi-lateral trade and investment. The US will ban its firms from investing in a number of Chinese companies, including China General Nuclear Power Corporation, China Mobile Limited, and the Costar Group, effective from early August. The G7 also reached a consensus on the need to counter China and introduced a Build Back Better World (B3W) initiative to help cover the USD 40 trillion infrastructure needs of developing countries.

Meanwhile, domestic demand is expected to grow. Private investment will likely be supported by the pickup in global economic momentum and the extension of fiscal support. At the same time, the monthly increase in government bond issuance is also expected to partially support infrastructure spending in the coming months. In addition, private consumption is expected to be boosted by a tighter labour market, with the survey-based unemployment rate having edged down to a two-year low of 5.0% in May. But the rebound in domestic demand will be constrained by the lack of policies to spur consumption or increase household income. Besides this, consumer sentiment could also be clouded by scattered local confirmed cases of the coronavirus.

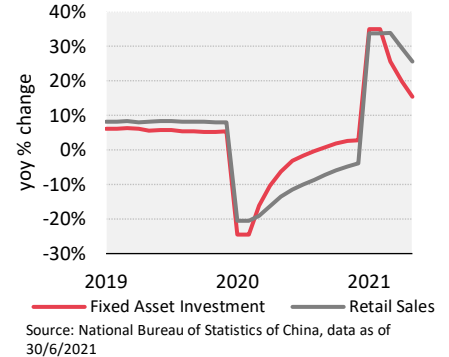
On the supply side, the lengthening of delivery times and surging commodity prices are expected to weigh on the manufacturing sector. The producer price index soared to 9.0% in May, the highest since October 2008. Although the rise is due to the low base in 2020 and the normalisation of production activity across the world, there is market concern about its impact on firms' profitability and the potential impact on consumer prices. The government supplements supply by using the state's stocks as a means to contain price surges, while urging coal enterprises to ramp up production in accordance with safety guidelines.

In view of the uneven economic recovery and the potential risks, the People's Bank of China (PBOC) is expected to keep its rate unchanged and further soften its pace of monetary tightening to solidify the recovery. No further broad-based monetary tightening is expected, so that the economy can grow without further moderation.

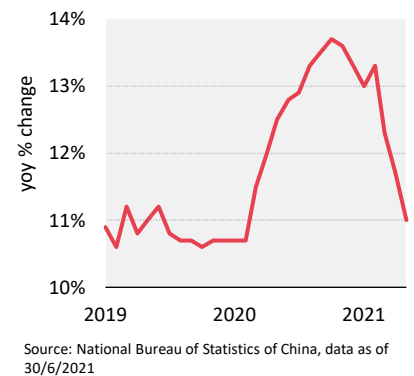
Financial markets impacted by government efforts to slow renminbi appreciation and by China-US tensions

In the stock market, A-shares by dropped 0.7% in June. The government's efforts to slow renminbi appreciation have limited foreign capital flow into the stock market to some extent. Tensions between China and the West, coupled with worse-than-expected economic figures, weighed on the stock market performance. Tighter government rules on cryptocurrencies and the tuition industry also caused share prices to plunges in those sectors.

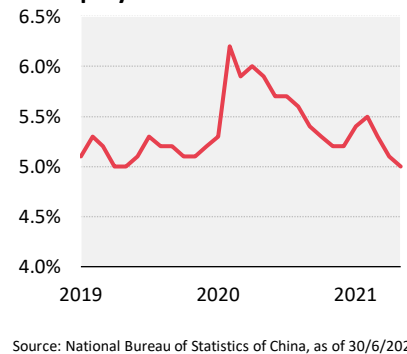
Cumulative Fixed Asset Investment and Retail Sales



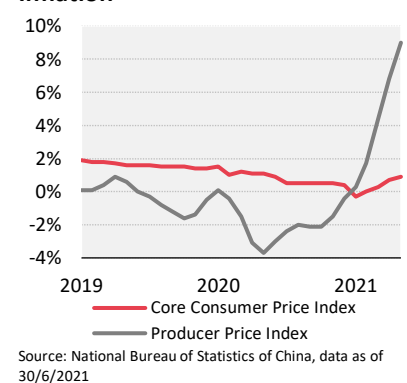
Total Social Credit Outstanding



National Survey-based Unemployment Rate



Inflation



Economic Research

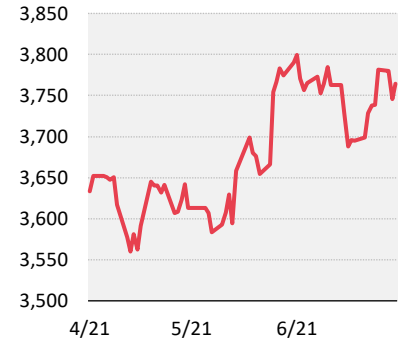
July 2021

Nevertheless, some sectors were resilient against these factors. Semiconductor-related shares benefited from the new government initiative to develop third-generation chips with a range of monetary and fiscal support. The elevated demand for chips in downstream industries amid the global recovery has boosted chip-related shares. Military-related companies, especially aerospace firms, also saw a surge in share prices following a successful spaceship launch and a continued rise in national defence expenditure.

In the foreign exchange market, the CNY and CNH depreciated by 1.4% against the US dollar in June, while the CNH by 1.5%. In response to the renminbi's appreciation in the previous months, the regulators raised the required reserve ratio for foreign currency and encouraged more rational market expectations of the renminbi. An additional qualified domestic institutional investor (QDII) quota of USD 10.3 billion has been granted to 17 financial institutes to facilitate capital flow. Increased domestic demand for the US dollar can lessen the appreciation pressure on the renminbi. Government measures to normalise the renminbi have since been helped by a strengthened US dollar after the Federal Reserve adopted a more hawkish stance. The US dollar index rose 2.9%.

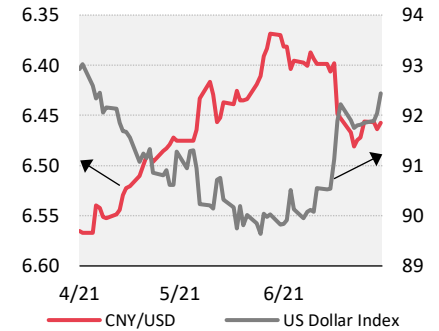
Looking ahead, China's economic recovery will support the performance of the financial markets. The trend of the renminbi will be dictated by that of the US dollar and by the Chinese government's response to a stronger currency at home.

A Share Index



Source: Bloomberg, data as of 30/6/2021

RMB/USD vs US Dollar Index



Sources: People's Bank of China, Bloomberg, data as of 30/6/2021

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