Economic Research

August 2021

*Market Monitor – Mainland China*

# Recovery Momentum Continues


## China maintains recovery momentum

The Chinese economy has picked up further. Although the economy expanded at 7.9% in the second quarter, slightly below the market expectation of 8% growth, and significantly down from the first quarter's 18.3% growth, due to the waning effect of the low base in 2020. In terms of 2-year average growth, the recovery pace accelerated to 5.3% in the second quarter from 5.0% in the first quarter.

The economic growth in the second quarter was mainly supported by the export sector. Exports remained robust, with a 32.2% growth in June, benefitting from strong external demand.

Meanwhile, domestic demand evinced a persistent recovery. The 2-year average growth of fixed asset investment reached 4.4% for the first half, up from 4.2% over the first five months. The continued pickup in manufacturing investment compensated the sluggish performance in infrastructure investment, which is limited by the slow start of the issuance of local government special bonds. The 2-year average growth of manufacturing investment quickened to 2.6% in the first half from 1.3% in the January-May period. The strong export sector and the recovery in domestic demand boosted investor confidence about the production outlook.

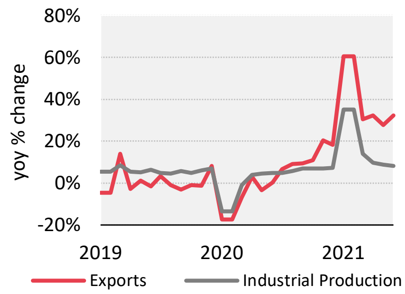
Consumption is underpinned by the improvement in the labour market and stable income growth. The 2-year average growth of retail sales accelerated to 4.9% in June, up from 4.5% in May.

**Chinese economy picks up further, but moderation is expected due to waning base effect.**

**In view of the uneven recovery and potential risks, the government has provided support to the economy.**

**Market concern over slowing economic growth weighs on financial market performance.**

**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 23/7/2021

## Outlook stays stable, yet risks lie ahead

In the coming months, the economic outlook remains stable for China, though the yearly growth is expected to lessen given the fading base effect. Elevated input costs and softening global demand amid a resurgence of Covid-19 cases might cap China's export growth. Tensions with the US will also weigh on China's export and foreign investment.

The manufacturing sector, despite being supported by strong exports, faces risks including high commodity prices and measures to cut carbon emissions. Although the yearly increase in the producer price index eased from the 9.0% in May, it remained elevated at 8.8% in June. High input costs are bound to cap the profitability of manufacturers. The official manufacturing purchasing managers' index (PMI) moderated to 50.4 in July, while the Caixin manufacturing PMI dropped further to 50.3 from 51.3 in June.

The recent rainstorm in Zhengzhou of the Henan province cost the economy CNY114.2 billion directly, with over 300 people dead. But as the Henan province accounted for 5.4% of national GDP in 2020, the adverse impact to the overall economy is expected to be limited.

In general, revival in market sentiment amid a more promising outlook is expected to support domestic demand. But with growth in investment and consumption still significantly lower than the pre-pandemic level of 5.4% and 8.0% respectively, the scale of recovery hinges on the effectiveness of policies to spur domestic demand. Moreover, the widespread Covid-19 outbreak that started from Nanjing is also adversely affecting tourism and spending during the summer holiday.

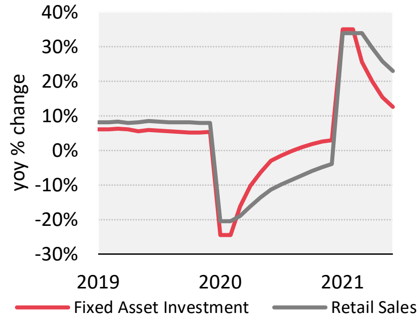
As the recovery in domestic demand remains weak compared to external demand, and in response to the risks for the manufacturing sector, the government has been taking steps to solidify economic recovery. The People's Bank of China (PBOC) has trimmed the required reserve ratio (RRR) by 50 basis points from 15th July to support small firms. This is also a pre-emptive move to counter the moderation in economic growth and a potential liquidity crunch during the tax season in late-July. This move is expected to release a total of CNY1 trillion of long-term liquidity and reduce the capital cost for financial institutions by CNY13 billion each year. The fine-tuning of monetary policy to better support the economy has led to a pickup in money supply M2 growth, which edged up to 8.6% in June from 8.3% in May.

## Home prices rise less quickly amid restrictions

The monthly growth in housing prices eased slightly in June at 0.5%, down from 0.6% in May. Policies to cool the market, including selling restrictions and tightening in real estate funding, have started to kick in. Second-hand home prices have also risen more slowly, especially in Shenzhen, which saw a monthly decrease for two consecutive months.

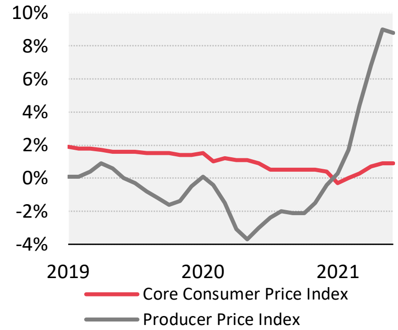
In the coming months, the rise in home prices is expected to slow further. The tighter credit environment for the property market, including restrictions on individual

**Cumulative Fixed Asset Investment and Retail Sales**



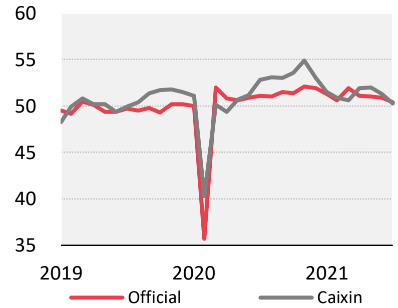

Source: National Bureau of Statistics of China, data as of 23/7/2021

**Inflation**



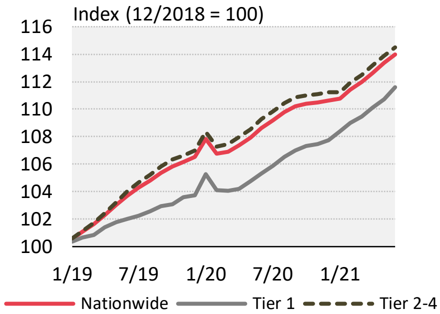

Source: National Bureau of Statistics of China, data as of 23/7/2021

**Manufacturing Purchasing Managers' Index**




Sources: National Bureau of Statistics of China, Caixin, IHS Markit, data as of 2/8/2021

**New Commercial Home Prices Index by Tiers**




Sources: National Bureau of Statistics of China, BEA Economic Research Department, data as of 23/7/2021 mortgages, is also expected to limit the rise in housing prices. In addition, developers may speed up the preparation of new flats to improve cash flow ahead of two significant land auctions in the second half.

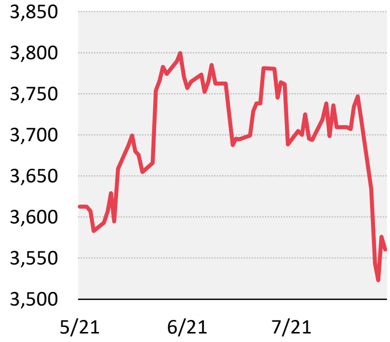
## Financial markets affected by market concern over moderating growth

In the stock market, A-shares by dropped 5.4% between end-June and end-July. While the reduction in RRR boosted market sentiment, the reduced PMI and China's increased clampdown on the tech sector and private education sector dragged down market performance.

In the foreign exchange market, the CNY depreciated by 0.1% against the US dollar during end-June to end-July, while the CNH rose by 0.1%. The lower-than-expected economic growth and the uneven recovery triggered some market concern. However, the renminbi is boosted by a weaker US dollar, which saw a 0.3% decrease in the US dollar index over the same period. The US Federal Reserve has yet released its asset purchase tapering schedule, and loose monetary policy is expected to continue.

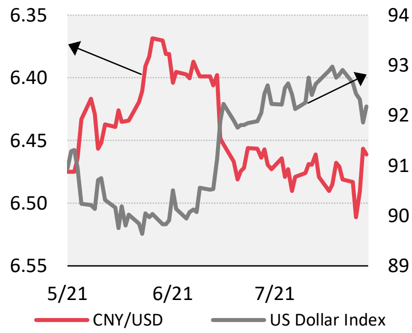
Looking ahead, the financial market is expected to perform well, underpinned by China's continued recovery. But uneven recovery between sectors could dent market gains. The ongoing global pandemic may also increase risk aversion and support the US dollar, putting pressure on the renminbi.

**A Share Index**




Source: Bloomberg, data as of 31/7/2021

**RMB/USD vs US Dollar Index**




Sources: People's Bank of China, Bloomberg, data as of 31/7/2021

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