China’s economy continues to recover in 2021, boosted by record trade surplus, but headwinds remain.

Government may accelerate rollout of supportive policies to strengthen market confidence.

Government-led financing and lower interest rates boost credit expansion.

Recovery trajectory remains unchanged, but a slowdown is looming

China’s economy registered an impressive recovery in 2021 as a whole, but the momentum eased in the final months of last year. China’s gross domestic product (GDP) grew by 4% year on year in Q4 2021, down from 4.9% seen in Q3 but slightly higher than market expectation of 3.8%. In 2021 as a whole, the economy expanded by 8.1% annually.

The industrial sector appeared to experience continued steady growth, with curbs on soaring raw material prices and solid global demand. Industrial production expanded by 4.3% year on year in December 2021, up from 3.8% seen in November. The yearly growth of producer prices eased further to 10.3% in December, compared to 12.9% as recorded in November. Furthermore, the official manufacturing PMI remained in expansionary territory at 50.1 in January 2022, down from 50.3 in December 2021.

Fresh outbreaks of Covid-19 and the reintroduction of lockdown measures in some cities such as Xi’an have restrained people’s mobility as well as consumers’ activities. The yearly growth of retail sales decelerated further to a disappointing 1.7% in December 2021, down from 3.9% in the previous month. On a two-year average basis, it rose by 3.9% from the same period in 2019. Consumer prices saw a modest 1.5% annual growth in December, down from 2.3% in November. In the meantime, the urban unemployment rate edged up by 0.1 percentage points month on month in December to 5.1%.

Fixed asset investment for the whole year of 2021 increased by 4.9% year on year, down from the 5.2% annual growth seen in the first 11 months of 2021. Meanwhile, property investment further dropped to 4.4% yearly growth in 2021, compared to a 6% increase in the first 11 months of 2021. The total floor space of new housing projects saw a yearly decrease of 11.4%.

Mainland China GDP Growth

Source: National Bureau of Statistics of China, data as of 17/1/2022
Looking ahead, China’s economic outlook remains challenging, with flare-ups of Covid-19 and sluggish investment induced by property woes that likely persist in the near term. The Chinese government is poised to further accelerate its implementation of multiple policies to enhance market confidence in economic stability.

**Record trade surplus supports China’s economy in 2021**

Fuelled by solid global demand for Chinese-made goods, particularly medical equipment and electronic products that facilitate working from home, China’s exports reported stellar annual growth of 29.9% in 2021, up considerably from the 3.6% seen in 2020. For the full year of 2021, China registered a record trade surplus of USD 676.43 billion, up from USD 523.99 billion in 2020.

The disparity between China’s Covid-19 situation and the global pandemic contributed to a widening trade balance. Many developing countries are suffering from rapid Omicron outbreaks and production disruptions. Meanwhile, ultra-loose monetary policies in the advanced economies and their intermittent lockdowns fuelled demand for goods and imports. For example, the trade surplus with the US, one of America’s grudges against China, rose 25.1% year-on-year in 2021 to USD 396.6 billion.

**Lower interest rates and government-led financing boost credit**

Following the reductions of the required reserve ratio (RRR) for banks and 1-year loan prime rate (LPR) in December 2021, credit conditions showed signs of easing. The annual growth of M2 money supply further accelerated from 8.5% in November to 9% in December. Outstanding total social financing rose by 10.3% yearly in December, faster than the 10.1% seen in November.

Meanwhile, the People’s Bank of China (PBOC) announced on 17th January, 2022 that it would cut the 1-year medium-term lending facility (MLF) rate from 2.95% to 2.85%. Subsequently, the PBOC further lowered the 1-year LPR by 10 basis points to 3.7% on 20th January, after a cut of 5 basis points in December 2021. The 5-year LPR, which is typically a reference for mortgages, was also lowered by 5 basis points to 4.6%.

Compared to the second half of 2021, the monetary environment is now expected to be accommodative, with lower interest rates and increasing government financing. In late-December 2021, the Chinese government announced an early allocation of CNY 1.46 trillion for local government special-purpose bonds in 2022, earlier than the issuance of special bonds last year beginning in March. In early January, some provinces and cities such as Zhejiang, Anhui, and Shanghai announced infrastructure investment worth hundreds of billions of yuan with the issuance of local bonds.

However, decreasing revenues from land sales may worsen hidden debt problems in local government finances. In view of bleak property market sentiment, annual growth of local government land sale revenues decelerated rapidly, dropping from 22.4% in the first half of 2021 to only 3.5% in 2021 as a whole. In 2020, the land sale revenues registered an annual growth of 15.9%.
Home prices continue to decline

Housing prices continued to drop for 3 months in a row, but fell more slowly – at just 0.2% month on month– in December 2021. On an annual basis, home prices increased by just 2.9% in 2021, the slowest pace in 6 years. The property market downturn may also put financial strain on developers with higher credit ratings. Against this backdrop, market sentiment is expected to remain subdued in the near term.

Looking forward, China is expected to continue its policy emphasis on better meeting the reasonable needs of home buyers and restraining property speculation. In early January, the Chinese authorities announced a plan to build 6.5 million government-subsidised rental homes in 40 major cities, providing affordable housing for the need of 13 million people during the 14th Five-Year Plan (2021 – 2025) period.

Financial markets decelerate with position adjustments by institutional investors

In the stock market, A-shares dropped by 7.7% between end-December 2021 and 28th January, 2022. Institutional investors appeared to lock in profits before long Lunar New Year holiday with moving away from the hottest stocks, where positive drivers have largely been priced in, fuelling downward pressure on the market as a whole. Nevertheless, credit boosts from lower interest rates and loosening financing are expected to reinforce investor confidence in government policies to stabilise the economy, bolstering market sentiment going forward.

In the foreign exchange market, the onshore CNY decreased by a marginal 0.08% against the US dollar between end-December 2021 and 31st January, 2022, trading at CNY 6.3613 per US dollar. During the same period, the offshore CNH also edged down by 0.21%. The CNY were seen supported in the first half of January. Seasonal corporate demand for the renminbi (RMB) in foreign exchange conversion remained solid ahead of the long Lunar New Year holiday. However, the CNY weakened in late January in view of strengthening US dollar. The open attitude of the US Federal Reserve as regards more aggressive monetary tightening actions fuel market expectation of more rate hikes than earlier, boosting the US dollar. Over the course of January 2022, the US dollar strengthened by 0.91%.
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