Economic Research

April 2022

Market Monitor – Mainland China

Supportive Policies Expected to Help Economy Weather Shocks

Economic performance beats expectation, but risks remain

Macroeconomic indicators combining the first 2 months of 2022 beat market expectations on account of the Winter Olympic Games and government-led infrastructure investment. Nevertheless, China's economy remains vulnerable due to a resurgence of Covid-19 confirmed cases and the Russia-Ukraine military conflict.

Retail sales during January and February grew by 6.7% year on year, exceeding market expectations of 3% annual growth. With a boost from the Winter Olympics, product sales such as equipment for skiing and other ice sports helped the retail sales achieve better-than-expected growth.

In the first 2 months of 2022, industrial production accelerated by 7.5% from a year earlier, well above the market-expected growth rate of 4%. Producer prices continued to ease from the highs recorded last year, while annual growth decreased from 9.1% in January to 8.8% in February. On the external front, China's exports fared better than expected in this January-February period, rising by 16.3% year on year. Nonetheless, the worsening Covid situation poses a threat to factory operations as lockdown measures are reintroduced. Against this backdrop, the urban unemployment rate continued to increase moderately, rising by 0.2 percentage points to 5.5% in February. The official manufacturing producer managers' index (PMI) decreased to 49.5 in March from 50.2 in February.

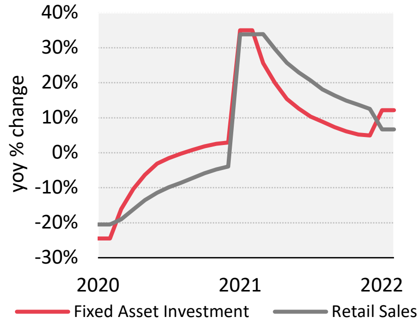
Fixed asset investment saw a robust growth in the January-February period, increasing by 12.2% year on year. Helped this year by front-loading local government special purpose bonds, infrastructure investment accelerated by a substantial 8.1% on a yearly basis in the first 2 months of 2022, up from 0.4% annual growth in 2021. However, the annual growth of property investment decelerated to 3.7% in January-February, after having recorded 4.4% yearly growth for 2021 as a whole.

China's economy performs beyond expectations in the first 2 months of 2022, but multiple headwinds still remain.

Government sets its economic growth target alongside supportive fiscal policies, and sets out path towards a green transition.

Financial markets decline with rising uncertainty amid a worsening Covid-19 situation and the Russia-Ukraine crisis.

Cumulative Fixed Asset Investment and Retail Sales



Source: National Bureau of Statistics of China, data as of 15/3/2022

Looking ahead, the worsening Covid-19 situation and property weakness continue to cloud the momentum of economic recovery. Moreover, the military conflict between Russia and Ukraine will also likely drag down global economic recovery, leading to slower trade growth and further acceleration of energy prices.

Government outlines the direction of policy support

According to the 2022 Government Work Report delivered in mid-March, the government has set a target for gross domestic product (GDP) growth of 5.5% in 2022. To achieve this target, the government will implement supportive fiscal policies with tax-and-fee reductions in an attempt to support businesses and alleviate their financial burdens, particularly for the small and medium-sized enterprises (SMEs). Tax refunds and cuts are expected to reach CNY 2.5 trillion in 2022. Priority for value-added tax (VAT) credit refunds will be given to sectors such as manufacturing, scientific research and technical services, as well as ecological environmental protection. Furthermore, fiscal support to local government remains substantial, with transfer payments from central government to local governments rising by CNY 1.5 trillion to CNY 9.8 trillion, an annual increase of 18%.

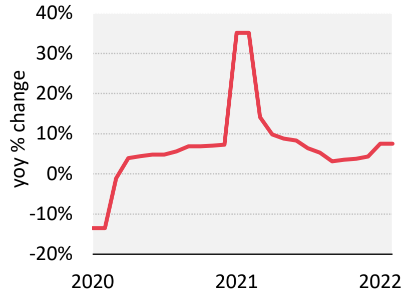
In terms of longer-term sustainable development, the government outlined its plan to lower carbon emissions and accelerate the transition towards green energy. While the government will upgrade coal-fired power plants to be cleaner and more efficient in order to reduce carbon emissions, it will also methodically increase its share of alternative energy use, including from wind and photovoltaic power bases. Moreover, the indicators used for assessment will transition from energy consumption to carbon emissions, signalling the intention to avoid non-discretionary implementation of power restrictions as seen in October last year. At the same time, the government also signalled more investment to reduce carbon emissions with more efficient energy infrastructure.

Credit expansion slows down, implying need for greater policy loosening

Major monetary indicators revealed that credit conditions continue to expand modestly in February, but the pace appeared to soften after the Lunar New Year compared to previous months. M2 money supply increased by 9.2% year on year in February, down from 9.8% as seen in January. Meanwhile, outstanding total social financing rose by 10.2% from a year earlier in February, a slower pace compared to the 10.5% recorded in the previous month.

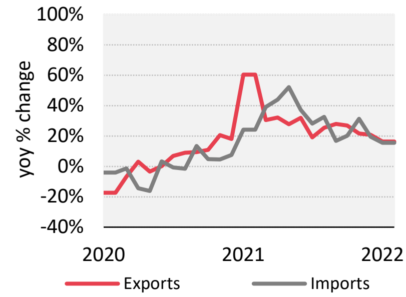
The conflict between Russia and Ukraine has added to economic uncertainty, in addition to the Covid-19 pandemic and property woes. Weakening economic expectations amid multiple domestic and external shocks have created a drag on credit demand. Meanwhile, the low inflationary pressure provides room for further monetary loosening. Consumer prices in China increased by 0.9% in February, unchanged from the level recorded in January. In a bid to achieve its economic growth target, the People’s Bank of China (PBOC) is expected to strengthen its accommodative monetary policy to help bolster the real economy.

Industrial Production



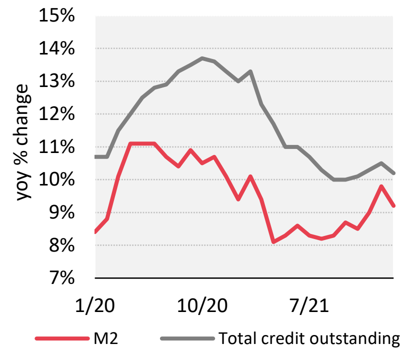
Note: Figures for January and February are the average of the two months.
Source: National Bureau of Statistics of China, data as of 15/3/2022

Exports and Imports



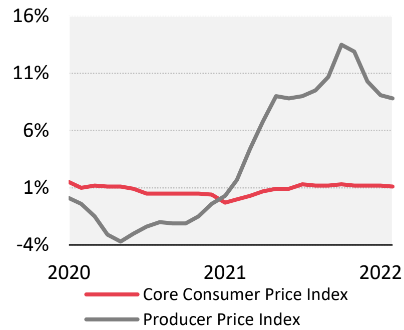
Note: Figures for January and February are the average of the two months.
Source: General Administration of Customs, data as of 7/3/2022

Credit Growth



Source: The People's Bank of China, data as of 11/3/2022

Inflation

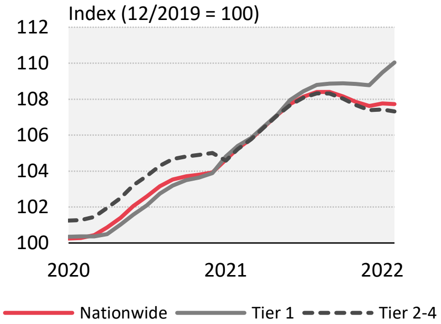


Source: National Bureau of Statistics of China, data as of 9/3/2022

Home price rises stall despite some policy relaxation

Home prices remained stable monthly in February, compared to a 0.1% gain in January. Home-buying sentiment varies across cities, with tier-1 cities recording a monthly growth and tier-3 or below cities reporting the opposite. Despite the reduction of the key interest rate for mortgages, market sentiment and activity continue to be sluggish amid the renewed spread of Covid-19. Clearer and more substantial policy support and clarification regarding the property sector is needed to incentivise home-buyers and keep home prices from dropping further.

New Commercial Home Prices Index by Tiers



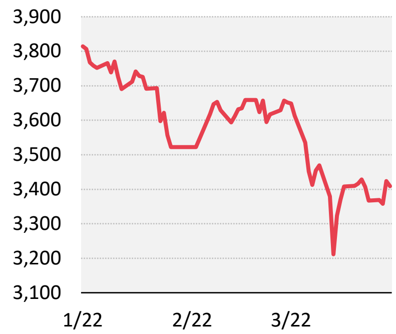
Sources: National Bureau of Statistics of China; BEA Economic Research Department, data as of 16/3/2022

Financial markets decline amid increasing uncertainty

In the stock market, A-shares dropped by 6.1% between end-February and 31st March. In the domestic market, the resurgence of Covid-19 cases in mid-March has caused the reintroduction of stringent lockdown measures in some cities such as Shenzhen and Shanghai, the major hubs for manufacturing and the technology sector. The massive lockdown measures have raised concern over China's ability to achieve its economic targets. Russia's invasion of Ukraine has heightened concerns, weighing further on Chinese stocks. In light of serial shocks, Vice-Premier Liu He signalled that the government would roll out support to ensure the stability of the economy and capital markets in mid-March. These remarks had the effect of soothing fears, leading to a rebound in the market.

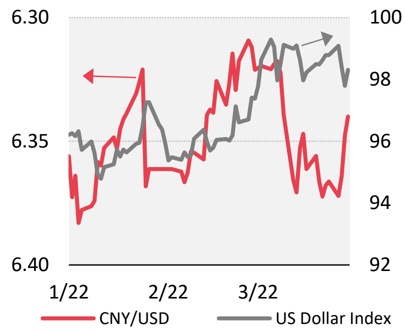
In the foreign exchange market, the onshore CNY decelerated by 0.49% against the US dollar between end-February and 31st March, trading at CNY 6.34 per US dollar, while the offshore CNH also depreciated by 0.64% during the same period. Aside from increasing uncertainty in China's economy, the Chinese yuan weakened as the US dollar strengthened. The war between Russia and Ukraine has accelerated risk-averse sentiment globally. Moreover, the US Federal Reserve (Fed) also implied possible further rate hikes at its upcoming meetings. The growing risk-averse sentiment and expectation of more rate hikes by the US Fed have accelerated demand for the US dollar. The US dollar index had grown by a robust 1.66% as of 31st March. However, the Chinese yuan appeared to rebound since late-March.

A Share Index



Source: Bloomberg, data as of 31/3/2022

RMB/USD vs US Dollar Index



Sources: People's Bank of China, Bloomberg, data as of 31/3/2022

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