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Global Markets Research
Research Alert

China: Added signs of slowdown

China's economic growth eased further in August, with retail sales showing a marked slowdown
Authorities are likely to continue to tolerate some short-term pain, to mitigate medium-term risks
We expect USD/CNY to stay relatively stable in the coming quarters

Market Implications

We expect limited Chinese yuan (CNY) strength over the coming year. Our end-2021 and end-2022 USD/CNY forecast stands at 6.45 and 6.40 respectively (versus 14 September's 6.4386 close).

Yuan strength (refer to Figure 2 for China's CFETs RMB index – a gauge of CNY movements against major currencies) has been partly a result of positive fundamentals (previously a leading recovery story and current account surplus). Reduced robustness in domestic growth, and some stabilisation in export demand in the coming year should be less favourable towards more CNY strength.

China growth should bottom out in 3Q-2021, slightly recovering by end-2021, after the recent Covid-19 delta variant outbreak. However, China's Covid-19 strategy continues to be a key market focus, as it can potentially shape macro trends going forward.

Examining the August Data Breakdown

China's economic slowdown may persist near-term before slight improvements by the end of the year. In August, retail sales and industrial production growth slowed further (Figure 3). Consumer spending on restaurants, as well as consumer goods, pulled back as China struggled with the delta variant of Covid-19. For industrial production, manufacturing and power supply production slowed.

This followed pessimistic readings of PMIs, which reflected low new orders (and new export orders). The fallout in manufacturing PMI came mainly from large enterprises, as medium and small enterprises saw PMI readings improve from July.

In contrast, China's current account surplus still looks relatively positive (Figure 4). In 1H-2021, China's current account surplus is around 1.5% of GDP, which is just below the 1.9% seen in 2020 (according to our calculations).

August trade surplus (USD 58.3bn) was the highest since January, even as import growth stayed relatively healthy (Figure 5). Export

Figure 1: Key forecasts

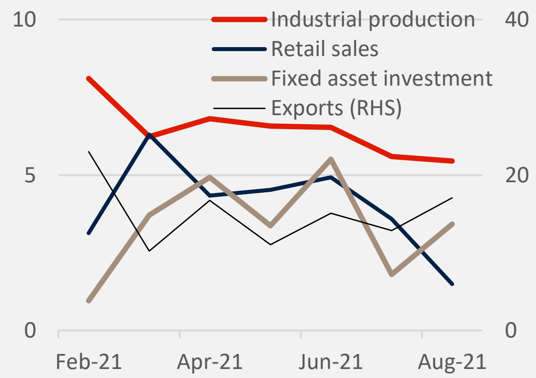
	2021F	2022F
GDP	8.5	5.7
Inflation (avg)	1.3	2.5
USD/CNY (end-period)	6.45	6.40

Source: HL Bank

Figure 2: China CFETS RMB index (based on BIS currency basket)

Source: Bloomberg, HL Bank

Figure 3: Key China data (2019-2021 CAGR %)



Source: Bloomberg, HL Bank

growth is broadly supported by US, Europe, Japan, South Korea and ASEAN.

For inflation, CPI (for consumers) eased to 0.8% y/y in August, continuing the trend seen since May. This was helped by lower food prices (-4.1% y/y), and some easing in transport & communication inflation (5.9% y/y from 6.9% prior).

However, producer price pressures are still high. The 9.5% y/y print for PPI is the highest on record since 2008. Producer prices have been supported by elevated commodity prices.

Having high producer inflation and low consumer inflation means that authorities are more focused on imbalances between upstream and downstream companies, and less on high PPI hitting CPI.

Policy Outlook

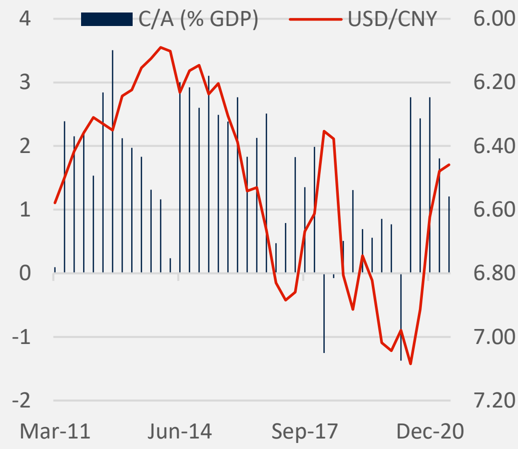
Following the release of August data, the National Bureau of Statistics struck a neutral note, commenting that the overall trend of improvement in China's economy remains unchanged. They attributed the slowdown to the delta variant and flooding. NBS said that "the economic recovery still needs to be solidified". NBS viewed that the employment situation is relatively stable.

We continue to expect nuanced policy changes. Authorities have continued with its policy stance in recent months. The PBOC kept to its measured policy approach by rolling over its medium term loans coming due, rather than injecting more liquidity. M2 growth has also been relatively range bound (8.2% y/y in August), signalling at policy stability.

Markets continue to expect a reserve requirement ratio cut, but not on the various interest rates. Indeed, China kept its 1-year medium-term lending facility at 2.95% on 15 September.

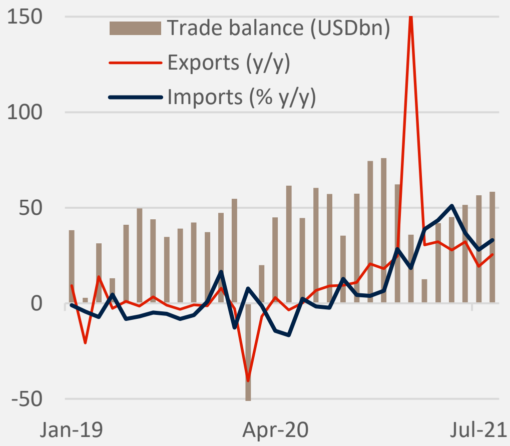
With monetary conditions looking tight and restrictive, we note that China has tried to maintain currency stability in recent weeks. Since August, daily PBOC fixings have been higher than the previous day's USD/CNH closing levels (Figure 6). This comes as the CFETS RMB index stayed at highest levels since late-2015.

Figure 4: Current account, vs. USD/CNY (avg)



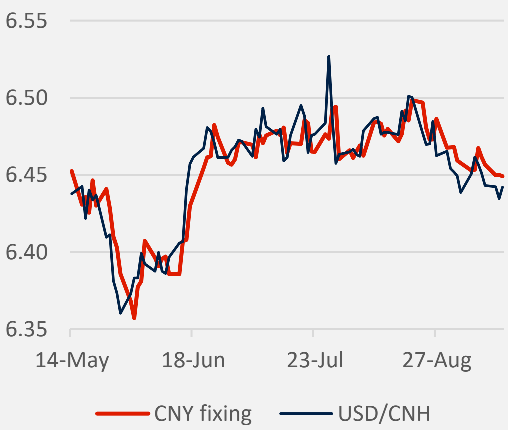
Source: Bloomberg, HL Bank

Figure 5: China's trade trends



Source: Bloomberg, HL Bank

Figure 6: USD/CNH, compared to PBOC fixings



Source: Bloomberg, HL Bank

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