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Global Markets Research

Research Alert

China: Growth Momentum Staying Weak

3Q GDP showed a cloudy economic outlook near-term, with subdued domestic momentum

Producer prices are likely to stay elevated before coming off in 3-6 months

Neutral government and monetary policy is likely to be neutral for USD/CNY

Summary

The economy slowed to 4.9% y/y in 3Q, from 7.9% in 2Q. September metrics showed a slowdown in industrial production and fixed asset investment. Retail sales rebounded. We anticipate that current downside risks (tight policy, bottlenecks and high input prices) to dissipate by mid-2022, helping with a modest recovery in 2022. Growth will likely be supported by net exports in the meantime.

Authorities are likely to maintain policy settings in the coming year, unless further downside risks materialise. We only see a potential reserve requirement ratio cut, and no changes to its policy rates.

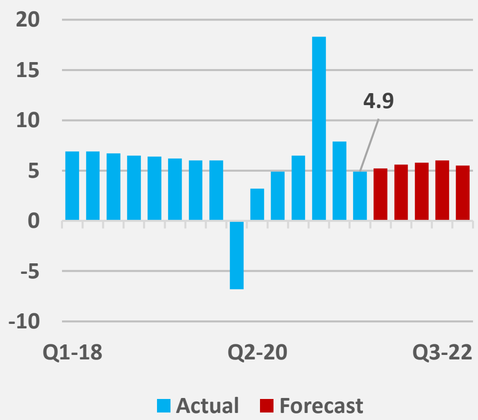
We anticipate relatively range-bound USD/CNY moves between now and end-2022, helped by a neutral monetary policy, raised current account surplus and a stable currency policy stance.

Figure 1: Key forecasts

	2021F	2022F
GDP	8.5	5.7
Inflation (avg)	0.8 (1.3)	2.2 (2.5)
USD/CNY (end-period)	6.45	6.50

Note: Previous forecast in brackets. Source: HL Bank

Figure 2: China GDP Forecasts (% y/y)



Source: Bloomberg, HL Bank

Economic Outlook

The economic outlook over the next few quarters is on China's economic growth stabilising at 4.5 to 5.5% (Figure 2). We forecast China's GDP growth at 5.7% in 2022, from 8.5% in 2021. This comes after 3Q GDP came in at 4.9% y/y, from 7.9% a quarter ago. The economy grew by a mere 0.2% q/q, weighed down by recent downside risks to growth.

Growth is likely to be subdued as a result of tight government policies, meant to reduce imbalances in income equality and the housing market. At the same time, supply-side shortages are likely to limit near-term growth potential. On the flipside, growth is likely supported by positive export growth and net export contribution to growth (Figure 3 shows China's projected current account surplus), stabilisation in private consumption and some private investments.

Retail sales (+4.4% y/y in September) appear to stay subdued in recent months, despite a recent rebound (Figure 4). Low growth in spending in restaurant/catering, consumer goods items (clothing, household electronics and automobiles) hint at cautious spending in some discretionary items. It is however noteworthy that spending in jewellery and communication applications were relatively buoyant.

Industrial production (+3.1% y/y in September) look like it has been dragged by recent power shortages. This particularly weighed down on manufacturing, as compared to mining or power supply. We think that the current trend may correct itself in 3-6 months' time, as bottlenecks are resolved. This should help with a rebound then.

Fixed asset investment (+7.3% y/y YTD) continue to be weighed down by state-owned investments, as private investments also slowed. We estimate that FAI contracted in September (Figure 4).

The government anticipates producer prices (PPI) to stay elevated. Should bottlenecks be resolved in 3-6 months, we anticipate that this will fade by 6 months (Figure 5). Inflation has been below 1% y/y in recent months, but will likely head higher over the coming year, as producers pass higher input costs to consumer purchases.

Policy Outlook

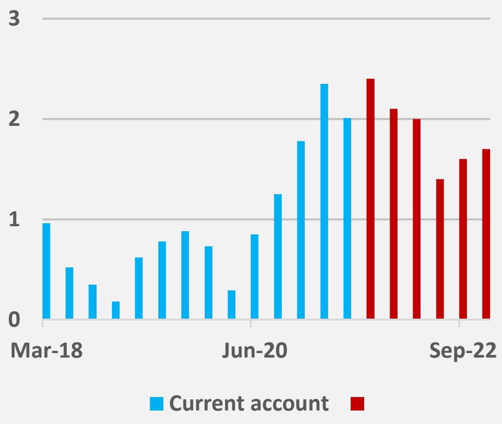
We believe that authorities are likely to maintain its current restrictive fiscal and monetary stance, unless significant downside risks (from current levels) materialise. YTD growth has been higher than the 2021 target of "6% and above". We believe that China may decide to do away with a GDP growth target next year, or have it at around "5% and above", which should not be too difficult to reach.

Despite a relatively weak 3Q GDP print, the stance from the press conference held by the National Bureau of Statistics appear to be relatively composed. The NBS expects near-term headwinds (e.g. power crunch) to be limited, and flagged several positives such as a lower unemployment rate, narrower personal income gap between rural and urban areas, as well as strong performance in balance of payments. Housing prices are getting stable, according to the NBS. The NBS flagged that there is room for China to adjust monetary policy when needed. We expect no changes to its policy rates, with a potential adjustment in the reserve requirement ratio for now.

Market Implications

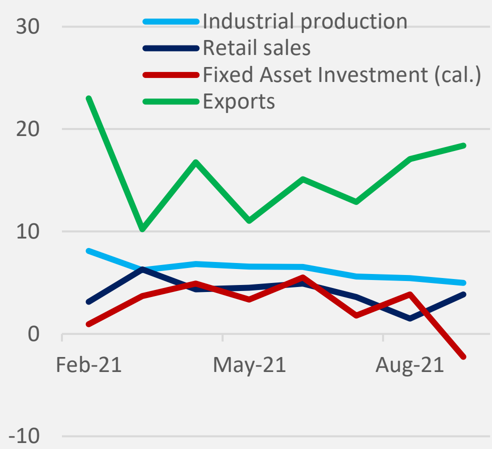
On FX, we expect some stability on USD/CNY. With the USD likely to strengthen further over the coming year, we see slight upsides in USD/CNY to 6.50 (from current levels of c.6.43) by end-2022. China will likely continue to pursue a currency stability policy, evidenced by recent daily PBOC USD/CNY fixings close to USD/CNH levels. The CNY is likely to stay strong compared to other currencies, as the CFETs RMB Index continues its ascent since July 2020.

Figure 3: China current account outlook (% GDP)



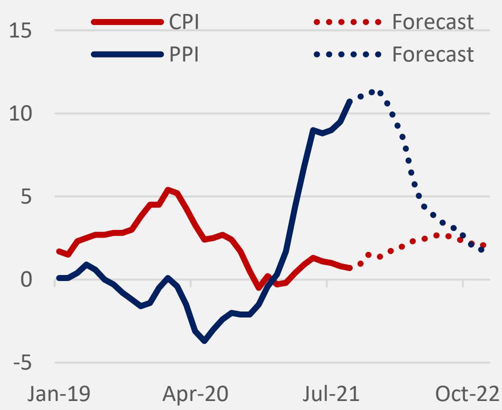
Source: Bloomberg, HL Bank

Figure 4: Key China data (2019-2021 CAGR %)



Source: Bloomberg, HL Bank

Figure 5: China inflation outlook



Source: Bloomberg, HL Bank

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