Economic Watch

China | 2021 Outlook: Better settle in for a respite

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2021 marks the first year of China's new 14th five-year plan that it sees as most essential to confront the "middle income trap" and to construct a "modest advanced economy". Better settle in for a long-haul. After experiencing 2017 over-deleveraging and economic slowdown, 2018 China-US trade war, 2019 African Swine Flu and this year's most unprecedented coronavirus pandemic flare-up together with the arduous work of containing it, it is tempting to conclude that Chinese economy might have a precious respite in 2021. In particular, China's first-in first-out of the Covid-19 pandemic and the ongoing V-shape snap-back, the vaccine advancement, together with a comparatively less severe China-US relation and a "no sharp turnaround" policy stance will make the next year quite a good time window for a recuperation:

First, vaccine development, mass production and distribution will add impetus for global economic recovery, although it might not be a game changer for Chinese economy to come roaring back. According to countries' plan of vaccination, it is anticipated that most advanced economies will complete at least 70% of coverage in 1H 2021 while emerging economies will achieve hear immunity in 2H 2021. That means, economic activities will gradually start to re-invigorate in Q2 of the next year, benefiting China's external demand and normalization of some specific industries such as airline, catering and tourism etc.

Second, from the policy perspective, "no sharp turnaround" is the main stance of the next year, announced in the recently concluded Annual Central Economic Conference, dispelling the recent worries of early exit of accommodative measures. That means, accommodative fiscal and monetary measures are still on hold to conserve the economic recovery trotting ahead amid elevated global uncertainties. (See our recent China Economic Watch: China | What will be the monetary policy stance in 2021?)

Third, China-US tensions will be kind of alleviated under Biden's new presidency in the short-term. This provides a good time window for Chinese authorities to take a breath to barrel ahead unabated tasks such as domestic structural reforms and financial liberalization. More importantly, two sides are anticipated to enhance cooperation in global public health, environmental protection and non-proliferation of nuclear weapons, although this cannot gloss over tariffs and phase-one deal to be still held at least in 2021, let alone the long-term ideological tension and technology competition. (See our recent China Economic Watch: China | The impact of Biden's victory on Chinese economy and the Sino-US relationship)

Fourth, the recent continuously expansionary trade balance and current account balance, together with a deflationary environment, provide the authorities more room for policy maneuver. Due to the repeatedly record-breaking export growth and trade balance, the shedding outbound tourism and education which significantly narrowed the previous service trade deficit, as well as the large capital inflows due to the historical high interest rate differential between China and other economies, the current account surplus will reach a record-high (expected to be around 1.9% of GDP) this year. All of these expanded China's foreign reserve and enhance RMB exchange rate fundamentals. In addition, the current deflationary environment also provides a lot of policy room for accommodative monetary measures.

However, the above analysis definitely cannot gloss over the fact that Chinese economy is still fraught of elevated uncertainties, let alone the long-term structural issues. To name a few, the still raging pandemic globally before the vaccine fully covers and group immune system completely constructed, the effectiveness and safety of the first-generation vaccine, the economic blow to low income groups and SMEs, the questionable sustainability of good-performing exports and current account, and the possibly dramatical turnaround of China-US relation etc. More importantly, it also cannot gloss over China's long-term challenges after the short-term Covid-19 shock fully dissipates, lingering around long-await SOE reform, financial liberalization, shadow banking as well as corporate and local government debt overhang etc.

To deal with the inevitable uncertainties as well as the long-term challenges, from the policy perspective, in 2021, better settle in for a long-haul. China's 2021 policy initiatives are summarized in the recently concluded Annual Central Economic Work Conference which was held on December 16-18th. While emphasizing on "no sharp turnaround", the authorities clearly signaled the policy continuity and consistency will be the main stance in 2021. Some of the policies have already been included and discussed in the meeting of the Political Bureau of the Communist Party of China Central Committee (CPCCC) on December 11th which is normally redeemed as the prelude for the annual Central Economic Work Conference. (see our recent China Economic Watch: China | Understanding policy signals of the December CPC Politburo meeting)

Based on the Annual Central Economic Work Conference, there are at least six concentrations of 2021 policy outlook which cover comprehensively almost every perspective of Chinese economy:

Maintain the policy continuity while keep the economy's performance in a "reasonable range" in 2021. Due to the statistical low base effect, we expect the next year's growth will reach 7.5% from this year's 2.2%, supported by the consumption and manufacturing investment recovery, as well as the continuing momentum of exports. Under this circumstance, the authorities still emphasize the policy continuity, suggesting that the neutral and accommodative monetary policy will be the main stance of the next year to take care of the ongoing recovery, amid the normalization of fiscal and monetary policy from the pandemic period. (see our recent China Economic Watch: China | What will be the monetary policy stance in 2021?) In addition, the authorities continue to concentrate on the "six stability" (ensure stability in employment, financial operations, foreign trade, foreign investment, domestic investment, and expectations) and " six protection" (ensure security in job, basic living needs, operations of market entities, food and energy security, stable industrial and supply chains, and the normal functioning of primary-level governments), indicating the concern of the future uncertainties surrounding China-US relation, the pandemic-led global recession and rising domestic financial instabilities, etc.

Promote the demand-side reform and management. The government will press ahead the so-called "demand-side reform", with the concept first being raised in the high-level Politburo meeting and the Central Economic Conference. Straightforwardly, the demand-side reform definitely includes the implication of stimulating domestic demand. But beyond that, it also indicates quite a lot of long-term structural reforms to achieve the growth engine transformation from the export-driven to consumption-driven, including (i) the income distribution reform and social insurance policy adjustment to increase the willingness of consumption of low-income groups and (ii) the "new infrastructure" investment such as 5G, AI, Block Chain, Cloud computing etc. to move ahead with the traditional infrastructure investment. In addition, the authorities will also foster the dynamic equilibrium of China's supply and demand side recovery in the post-pandemic time, mitigating the uneven recovery feature, thus further implementing the newly mentioned "internal circulation" and "dual circulation" growth model.

Implement Anti-monopoly measures. In order to prevent the disorderly expansion of capital, the authorities recently unveiled draft regulations aimed at rooting out monopolistic practices in the internet industry, seeking to curtail the growing influence of corporations such as e-commerce giant Alibaba Group and Tencent Holdings etc. The new rules establish a framework for curbing anti-competitive behavior such as colluding on sharing sensitive consumer data, alliances that squeeze out smaller rivals and subsidizing services at below cost to eliminate competitors. In addition, the suspension of Ant Financial Group IPO which is the sub-group of Alibaba Group also gave an alarm of rising shadow banking expansion.

Curb financial risks, particularly in bond default and over-heating housing market. The recent wave of zombie SOE bond default and overheating housing market in tier-1 cities also raised the authorities' concern. That means, although the monetary policy will remain neutral and accommodative, financial regulation will be certainly further strengthened in 2021. Specifically, the Central Economic Conference also emphasized the regulation on rental market of housing, particularly in tier-1 cities, which might suppress housing price to a large extent.

Boost technology innovation and upgrade self-sufficient supply-chain. No matter who is going to the White House, China-US tech war will be long-lasting in the future. (see our recent China Economic Watch: China | The impact of Biden's victory on Chinese economy and the Sino-US relationship.) By realizing this, and based on the experience of US's sanctions on large amount of Chinese tech companies, China will boost its ability to ensure control over and self-sufficiency in its industrial chains and supply chains, particularly to improve science and technology innovation.

Environment protection target: 2030 peak of Carbon commission and 2060 carbon neutrality. The authorities started to realize that environment protection always be the foundation of cooperation with the advanced economies particularly Europe, given the ongoing escalating conflicts with the US. This explains why it is regarded as one of the important perspectives in the recent five-year plan, Politburo meeting and Central Economic Conference. Domestically, there may be general acceptance of the need for environmental protection as it has long-term benefits for China as well, but it remains a test of political will (long-term vs. short-term) and implementation going forward. In particular, the sector that we expect to receive policy support is alternative and cleaner energy. China's foreign energy dependence is now at the historical high, 73% for crude oil in 2019 compared to 61% in 2015. Renewable energy consumption only accounts for 15.3% of the total energy consumption in 2019. Unlike the reduction of production capacity required by environmental regulations in the past, reliance on environment friendly and renewable energy sources such as hydropower and nuclear projects, wind and solar energy, etc. will likely accelerate over the coming five years. In addition, we also expect higher environmental protection standards to build a Green Economy. Finally, the authorities will also increase the infrastructure investment in environmental protection related equipment and service etc., with its growth rate higher than other categories of infrastructure investment.

Looking ahead, after a rough start of the year suffering the brunt of the Covid-19 pandemic flare-up in China, V-shape economic recovery has set in across China and it is leading the way for the global economy to snap-back. China's GDP growth will appear strong next year, but that's the easiest part. After the plunge in 2020, statistical base effect will flatter readings everywhere in the world. The true difficult part is the policy mechanism design to balance between fostering economic recovery and curbing financial risks, let alone a series of lingering long-await issues which might disparage China's medium to long term outlook. Besides dwelling on the specific figure of 2021 GDP growth prediction, all of these need to be carefully considered. Thus, quite a bit of perseverance is indeed needed to regain all of the lost ground, to get the economy back to the pre-Covid growth in the short term, as well as to deal with the long-term issues in a bid to maintain a sustainable impetus of growth in the long run.

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