BBVA Research

# China Economic Outlook

1Q21

Creating Opportunities

BBVA Research

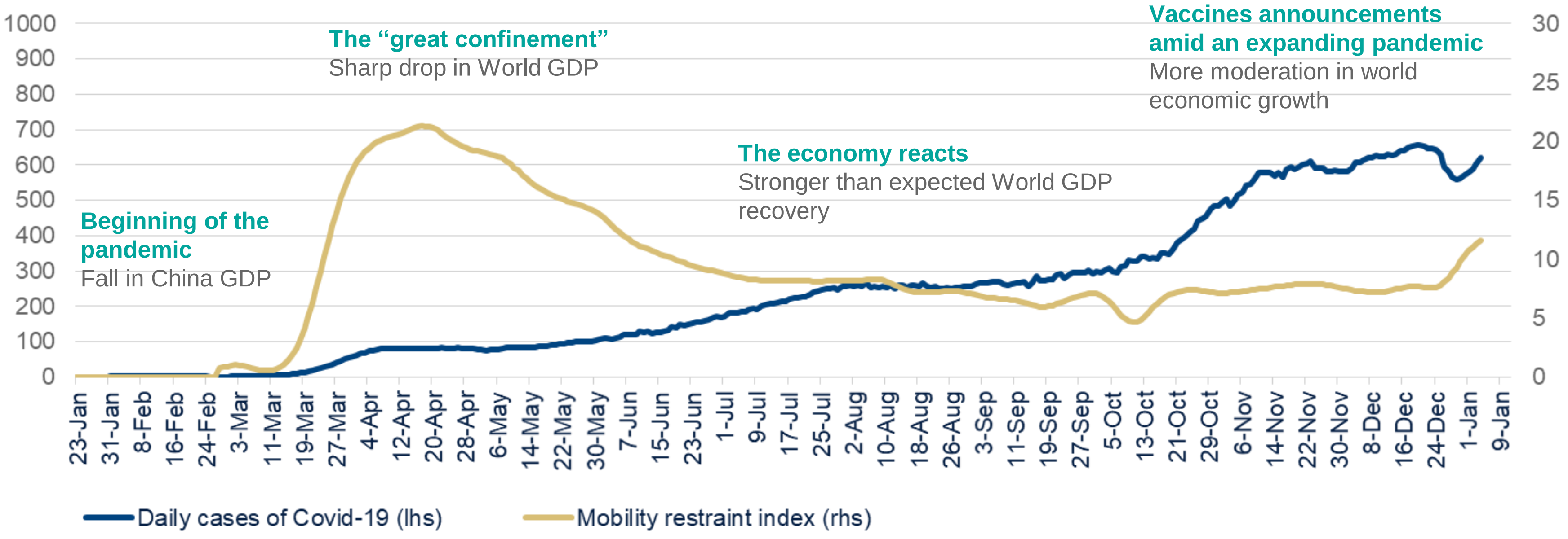
# 01

# Global recovery: all about vaccines and policy stimulus

# Covid-19 vaccines are a key progress after a year marked by the expansion of the pandemic, lockdowns and an economic crisis

## WORLD DAILY CASES OF COVID-19 AND GLOBAL MOBILITY RESTRAINT INDEX (*)

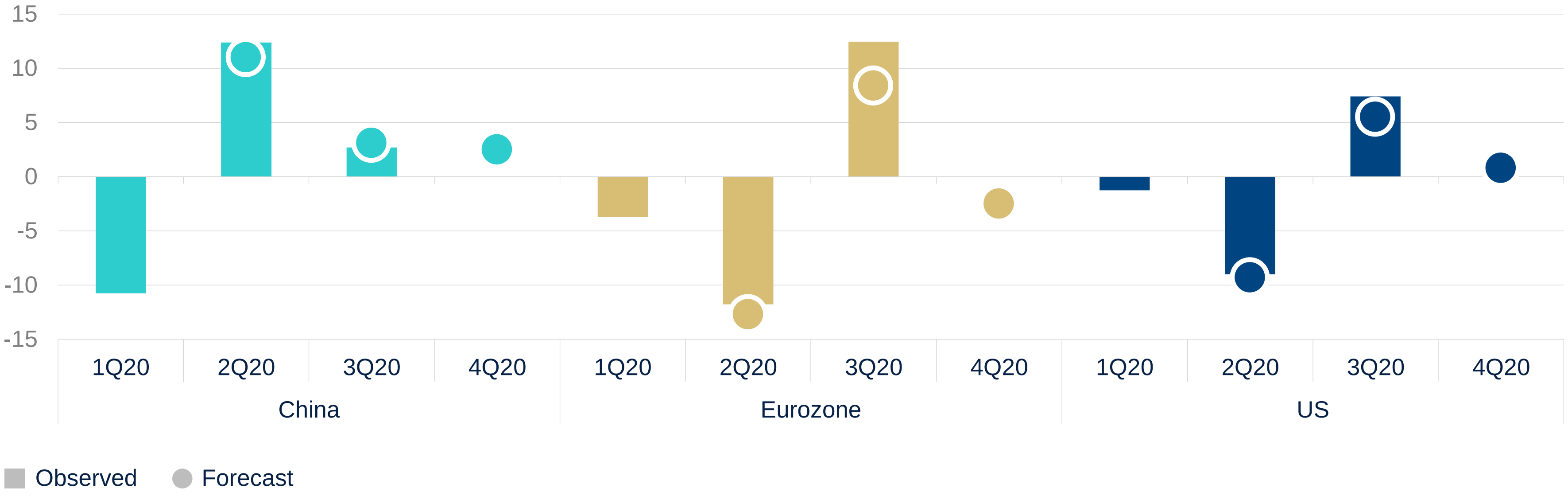
(DAILY CASES:THOUSANDS OF PEOPLE, 7-DAY MOVING AVERAGE; INDICATOR: HIGHER VALUES INDICATE LOWER MOBILITY )




*: The mobility restraint index reflects changes with respect to the period of reference (January 3 to February 6 2020). It is the simple average of all countries within Google Mobility Reports..
BBVA Research based on data from John Hopkins University and Google.

# Economic growth has picked up significantly more than expected in the third quarter, but has moderated in the fourth due to the increase in infections

## GDP: OBSERVED AND FORECASTED
(Q/Q %)

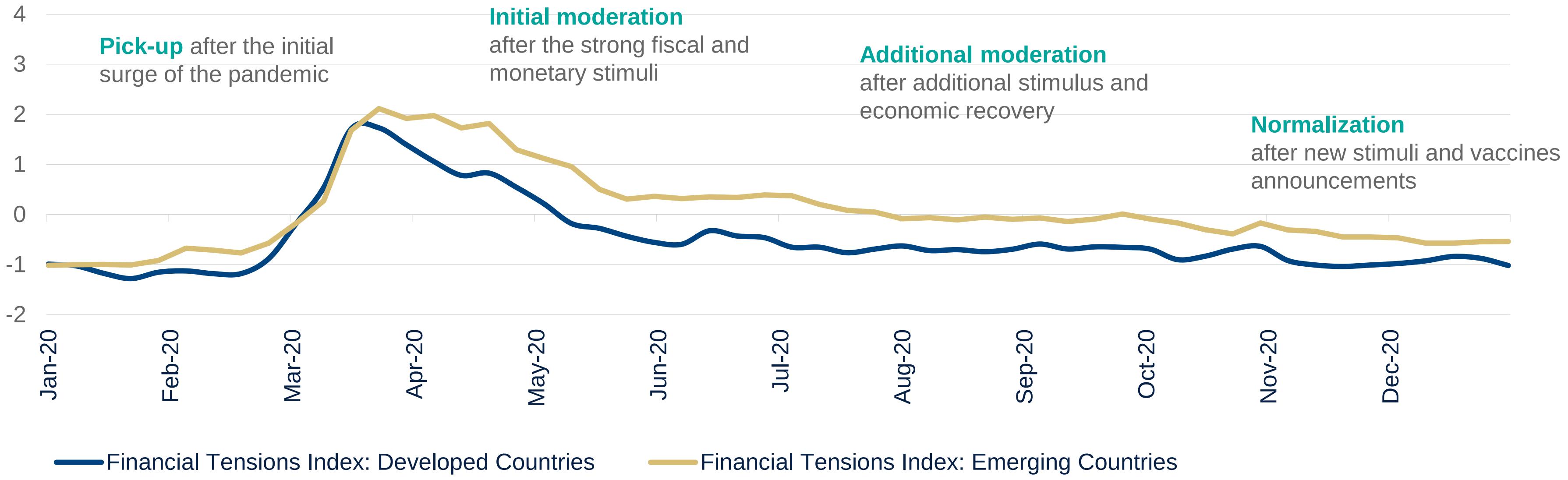



Source: BBVA Research based on own data and Haver.

# Financial tensions have converged to pre-crisis levels, thanks to economic stimulus and the vaccines

## FINANCIAL TENSIONS

(FINANCIAL TENSIONS INDEX: AVERAGE FROM 2006 = 0)

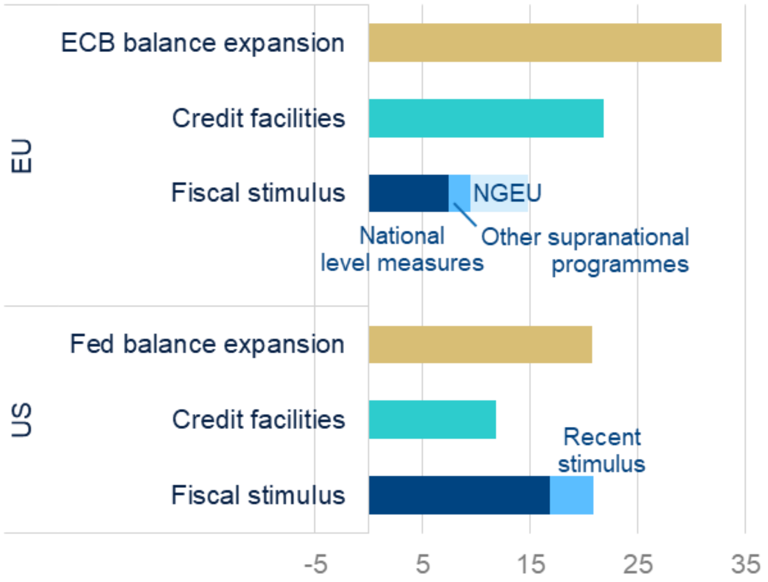



Source: BBVA Research.

# Economic policy remains committed to the recovery: reinforced monetary stimulus, NGEU approval, and new fiscal measures in the US

## FISCAL STIMULUS AND CREDIT FACILITIES*

(% OF GDP)




* Fiscal stimulus: expenditure increases and tax cuts, excluding resources used in credit programs. In the case of the Eurozone, national level measures represent the average stimulus launched in Germany, France, Italy and Spain while supranational measures include the EIB measures and the SURE. Credit Programs: in the case of US it includes the Fed credit facilities. For the Eurozone it represents the average of Credit Guarantee Funds in Germany, France, Italy and Spain. CBs balances: expected accumulated increase between 2020 y 2021.
Source: BBVA Research based on local statiistics.

- ECB: new stimuli announced in December, including the extension of the asset purchasing programme.
- Fed: economic support through zero level interest rates and quantitative easing.
- Fiscal policy in Europe: NGEU funds will be available from around mid-year.
- Fiscal policy in the US: imminent additional stimulus package of at least 0.9 trillion dollars.

# A large-scale distribution of vaccines will pave the way for economic recovery, which will be gradual and heterogeneous across countries

## MAIN ASSUMPTIONS BEHIND FORECASTS, UNDER A HIGHLY UNCERTAIN ENVIRONMENT

### COVID-19

**Massive distribution of vaccines** in the main economies in 1H21 and afterwards in the others.

**Return to “normality” in 2022**

### Economic Policy

**Stimulus will be maintained**, or even amplified, at least until the recovery consolidates

### Financial Markets

**Volatility and risk aversion will remain relatively low,** in 2021-22.

# Economic growth will slow down more than expected in the short-term, due to rising contagions, but it will invigorate from mid-year on

| | US | Eurozone | China | World |
|---|---|---|---|---|
| 2019 | 2.2 | 1.3 | 6.1 | 2.9 |
| 2020 | -3.6 (upwardly revised) | -7.3 (upwardly revised) | 2.2 (unchanged) | -2.6 (upwardly revised) |
| 2021 | 3.6 (downwardly revised) | 4.1 (downwardly revised) | 7.5 (unchanged) | 5.3 (downwardly revised) |
| 2022 | 2.4 | 4.4 | 5.5 | 4.1 |

- Forecast upwardly revised
- Unchanged forecast
- Forecast downwardly revised

Source: BBVA Research.

# Uncertainty will remain high, despite improved prospects

## Epidemiological uncertainty

- Virus strains and new waves of contagions.
- Vaccines: distribution pace, effectiveness, social rejection.
- Herd immunity.
- "New normalcy" and social preferences.

## Financial uncertainty

- Deterioration of corporate, public sector and banking balance sheets (NPL, bankruptcy, debt, restructurings).
- Financial tensions.
- Flows into emerging markets.

## Economic uncertainty

- Stimulus effectiveness.
- Savings evolution.
- Significant disruptions in sectors and value chains.
- Inflation and oil prices.
- Lagged recovery in emerging economies.
- Impact of the pandemic on potential GDP.

## Geopolitical uncertainty

- China – US rivalry.
- Social unrest.
- New US government.
- Protectionism.

BBVA Research

02

# 2021 Chinese economy: better settle in for a respite

# Main messages

Vaccination, accommodative monetary policy with “no sharp turnaround”, possible alleviation of China-US tension under Biden’s presidency and deflationary environment give Chinese authorities a chance for a short respite in 2021.

Q4 2020 GDP growth achieved 6.5%, beyond a complete V-shape recovery and higher than pre-Covid growth. However, to regain all the lost ground in every perspective of economy, quite a bit of perseverance is still needed.

The uneven recovery feature that the supply side lags behind the demand side has been mitigating. However, although industrial production already goes back to pre-Covid growth, demand side retail sales and FAI, albeit improving significantly, still far from that.

Exports have continuously shown a strong resilience amid the global pandemic, supported by the pandemic-related and work-from-home shipments; however, we need to be cautiously positive on its sustainability in 2021 when the world economy normalizes with the vaccination.

Amid escalating US-China tensions in almost every fronts, EU-China Comprehensive Agreement on Investment which was signed at end-2020 became the game-changer of international relations.

# 2021 Chinese economy: time for a short respite

## Positive factors

Vaccine development, mass production and distribution will add impetus for global economic recovery.

From policy perspective, normalization but “no sharp turnaround” is the main stance for 2021, dispelling the worries of an early exit of accommodative measures.

Expansionary trade balance and current account balance, together with a deflationary environment, provide the authorities more room for policy maneuver.

China-US tensions will be comparatively alleviated under Biden’s presidency in the short-term. RCEP and EU-China CAI become the game-changer of international relations.

## Risk factors

Financial risks are on the rise: recent SOE bond default, over-heating housing market and shadow banking.

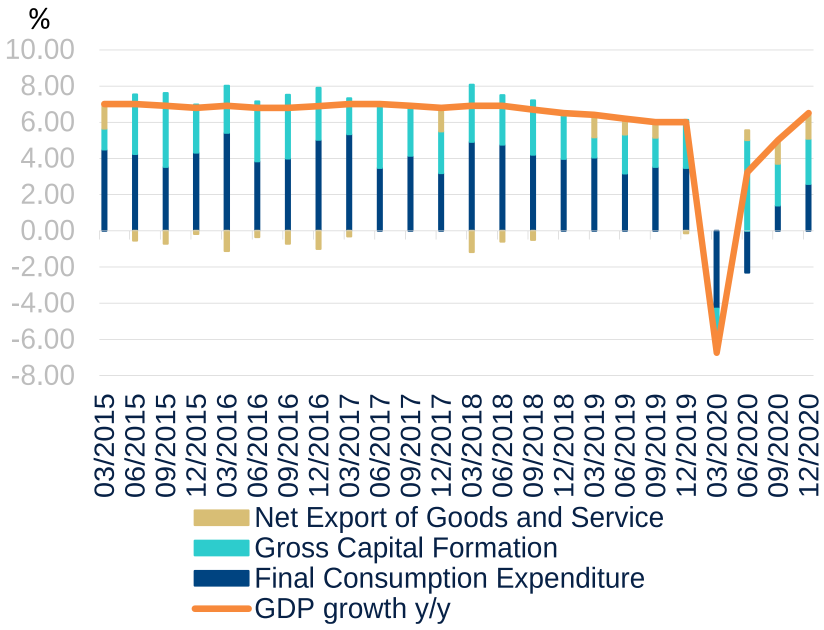
Tightening regulations of monopolistic e-commerce giants, internet firms and shadow banking, as well as “passive deleveraging” might weigh on growth.

Export sustainability is questionable amid global recovery.

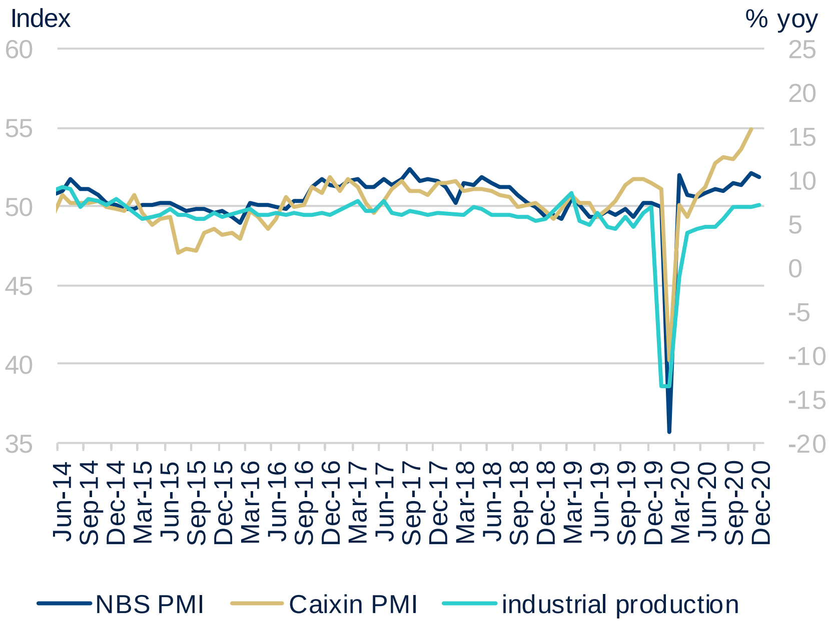
The lingering and unsettled China-US tensions and recently escalating finance war.

# Economic growth: beyond a complete V-shape recovery in Q4 2020

## GROWTH PICKED UP SIGNIFICANTLY IN Q4 FROM 4.9% Y/Y IN Q3 to 6.5% Y/Y, HIGHER THAN THE PRE-PANDEMIC GROWTH



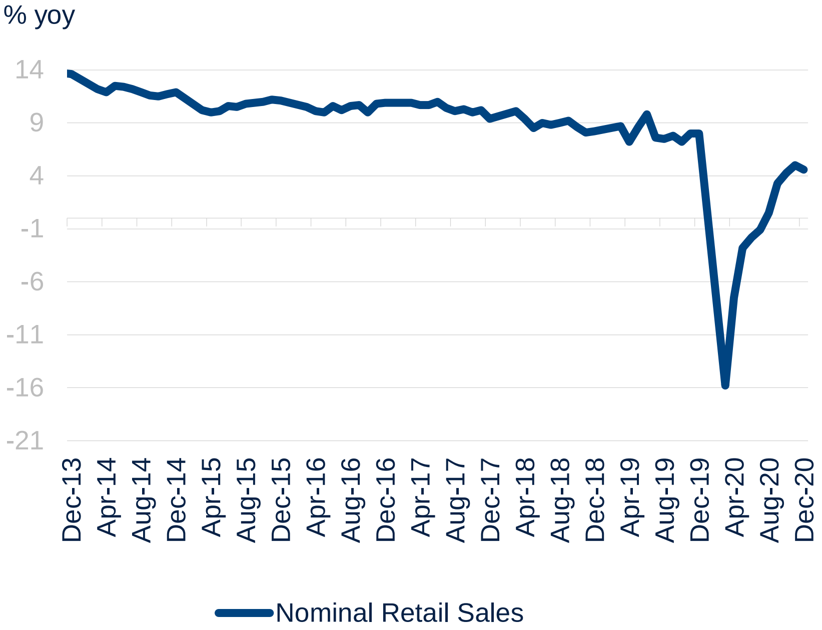

## PMIS REMAINED IN THE EXPANSIONARY TERRITORY AND INDUSTRIAL PRODUCTION ALREADY HIGHER THAN PRE-PANDEMIC GROWTH



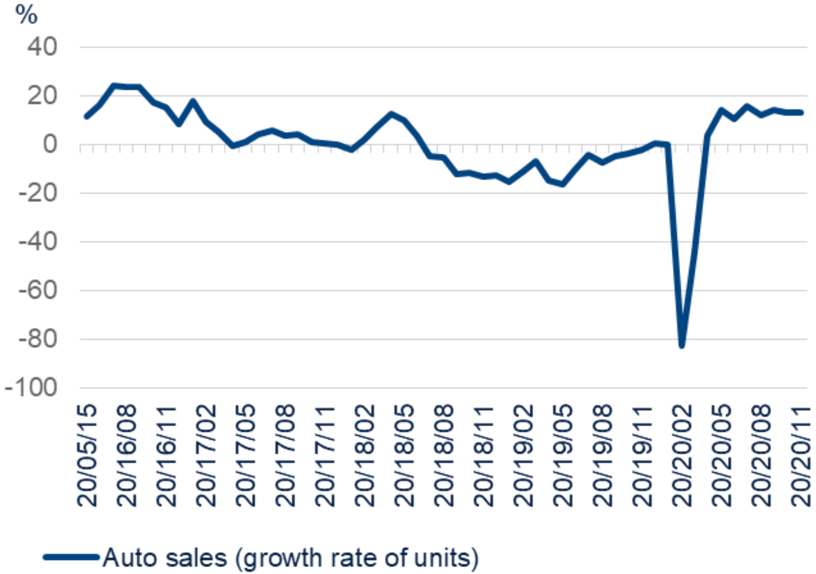

Source: CEIC and BBVA Research.

# Gradual close of supply-demand gap becomes the new growth engine in 2021

## RETAIL SALES DECLINED TO 4.6% IN DECEMBER FROM 5% PREVIOUSLY, DUE TO THE RECENT FLARE-UP OF NEW AFFECTED CASES IN NORTHEN CHINA



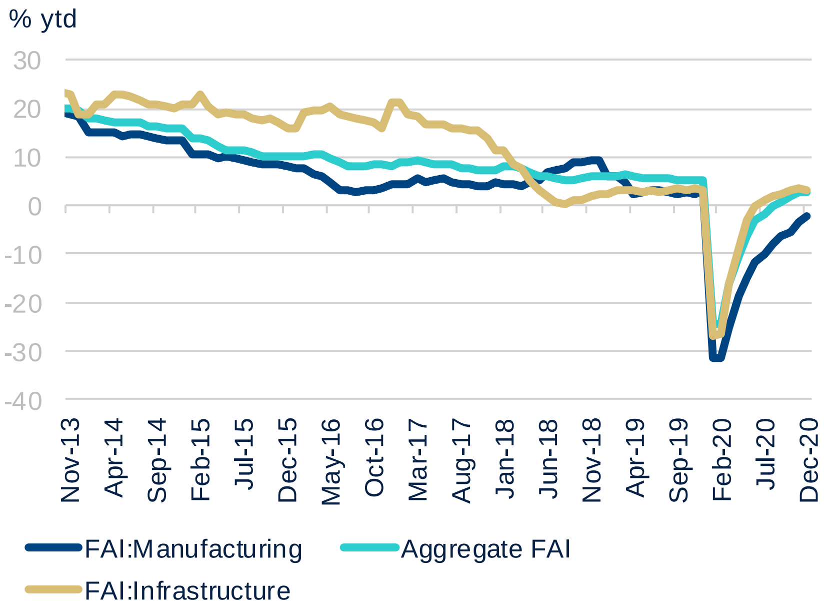

## AUTO SALES RECOVERY SUPPORTED RETAIL SALES, REFLECTING STRONG DEMAND IN POST-COVID TIME



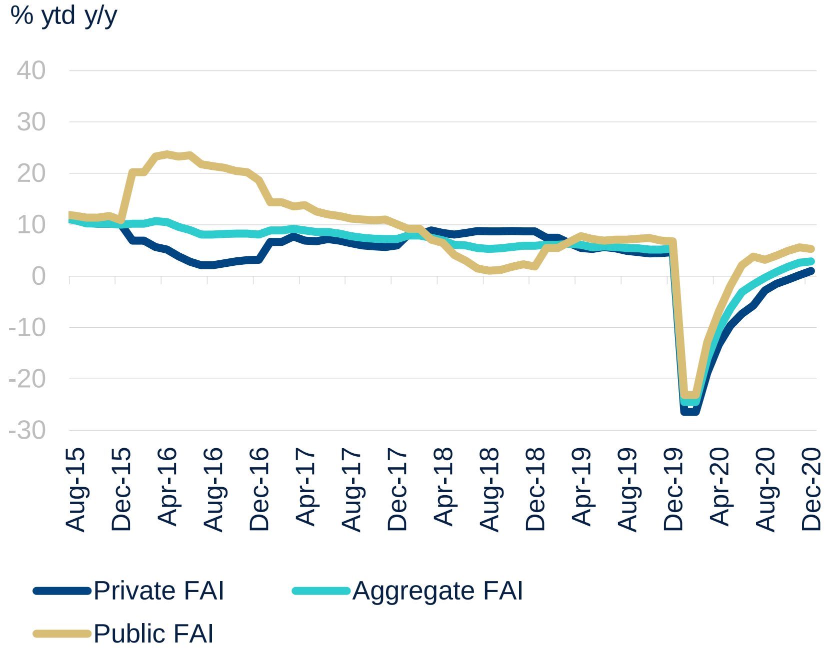

Source: CEIC and BBVA Research.

# Real estate and infrastructure FAI led recovery, manufacturing FAI lagged behind; but for 2021, this situation will be reverted

## MANUFACTORY INVESTMENT STILL IN NEGATIVE TERRITORY, LAGGING BEHIND REAL ESTATE AND INFRASTRUCTURE, AMID SLUGGISH SENTIMENTS



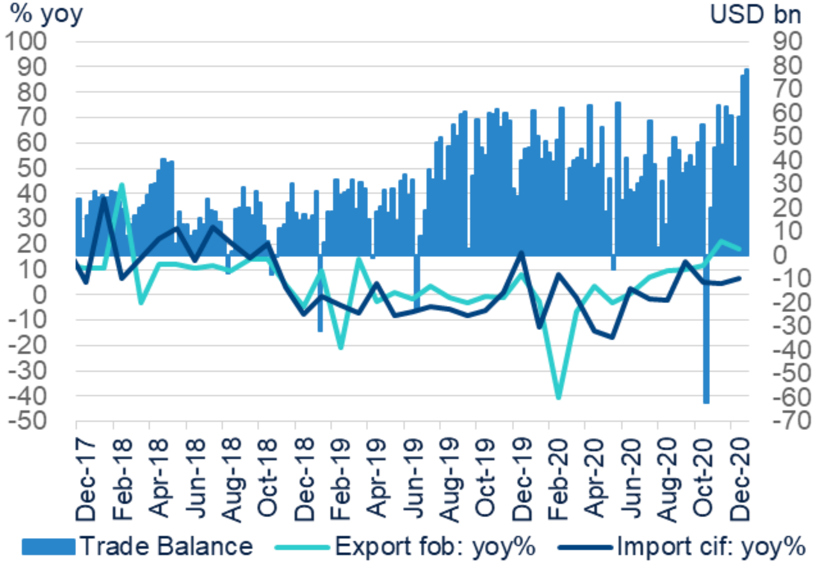

## DUE TO FISCAL STIMULUS EXIT, INFRASTRUCTURE WILL SLOWDOWN; WHILE TIGHTENING REGULATION SUPRESSES HOUSING INVESTMENT IN 2021



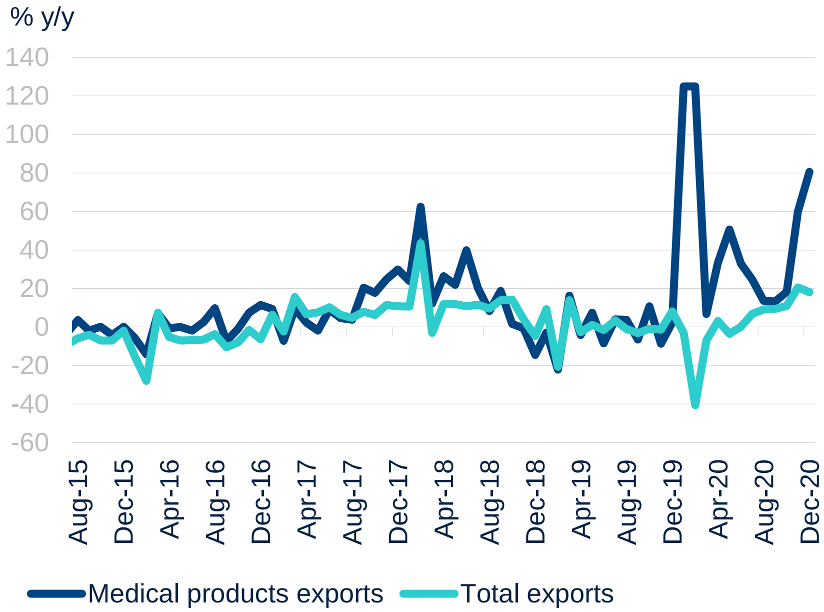

Source: CEIC and BBVA Research.

# Global pandemic raging still support China's exports while we are cautious about its sustainability amid global normalization in 2021

## EXPORT GROWTH OF 2020 ACHIEVED 3.5%, SHOWING REMARKEDLY RESILIENCE AMID PANDEMIC



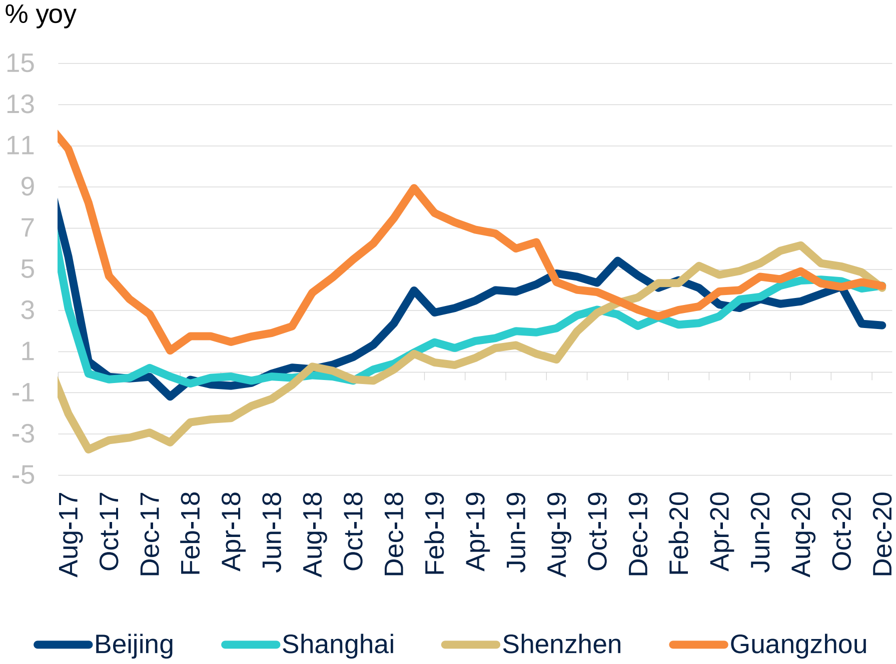

## GLOBAL ECONOMIC RECOVERY AND RMB APPRECIATION TREND MIGHT NORMALIZE CHINA' EXPORTS GROWTH IN THE FUTURE



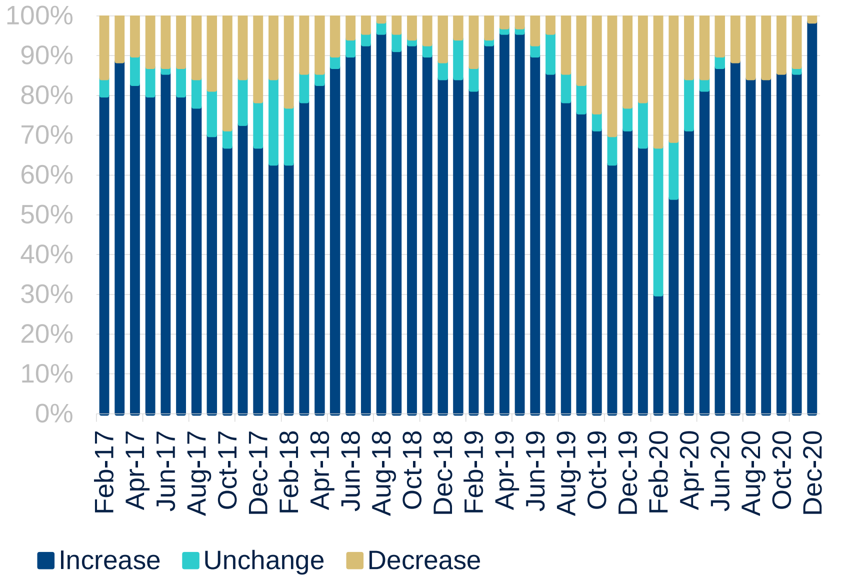

Source: CEIC and BBVA Research.

# More regulatory measures on heating housing market, especially in tier-1 cities

## THE RECENT FINANCIAL REGULATION MEASURES CURBED HOUSING PRICE SOARING



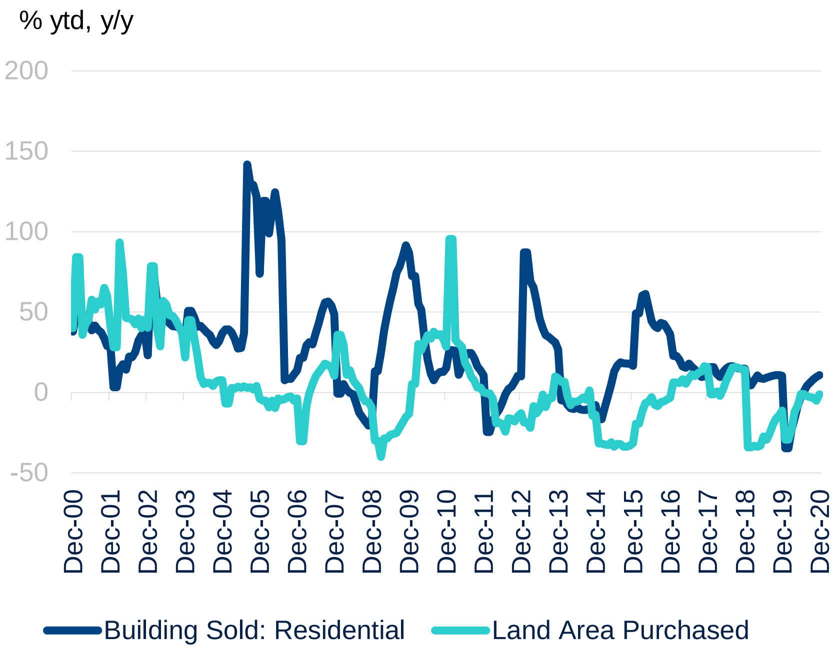

## STILL, THERE ARE INCREASING NUMBER OF CITIES THAT REPORTED HOUSING PRICE BOUYANT, RAISING THE AUTHORITIES' CONCERN (M/M GROWTH)



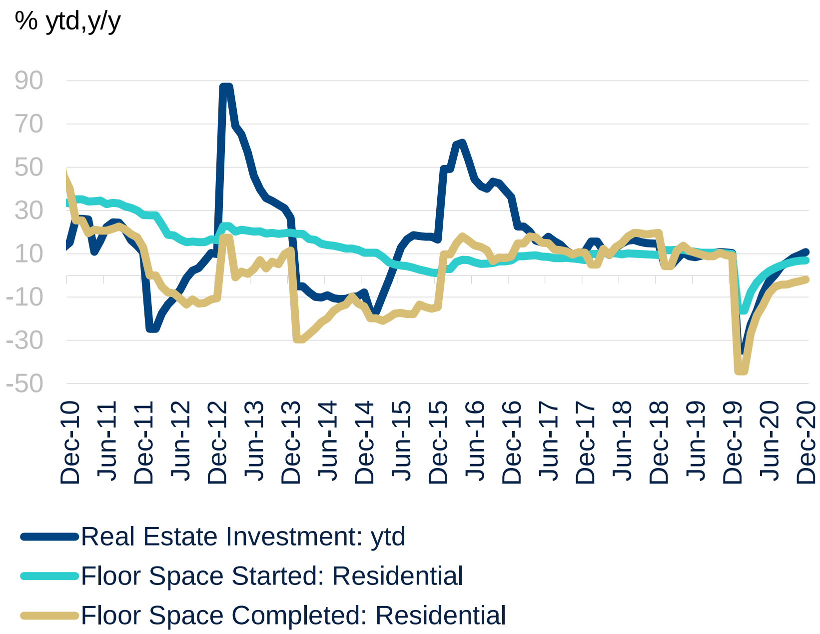

Source: CEIC and BBVA Research.

# …housing sales and investment in post-pandemic time showed a strong recovery, supporting post-pandemic growth

## THE GROWTH RATE OF RESIDENTIAL BUILDING SOLD AND LAND PURCHASE PICKED UP…



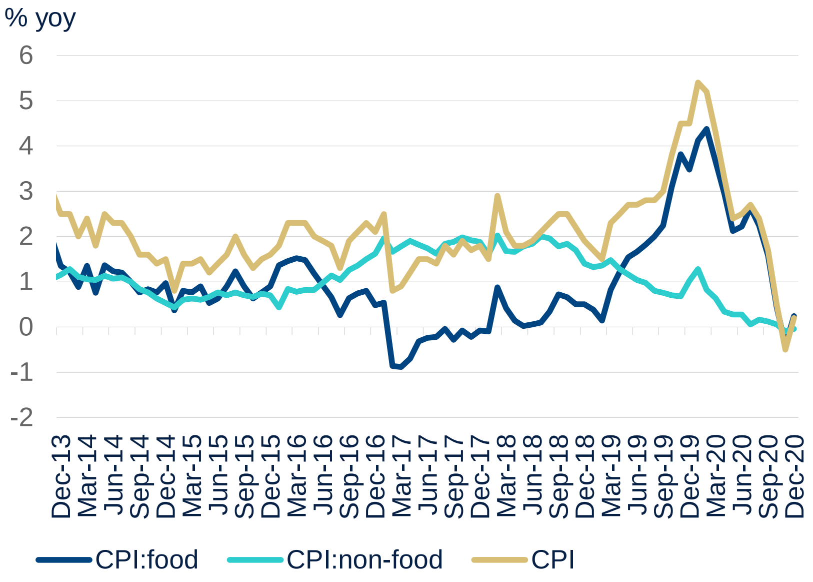

## …WHILE REAL ESTATE INVESTMENT ALREADY WENT BACK TO PRE-COVID GROWTH



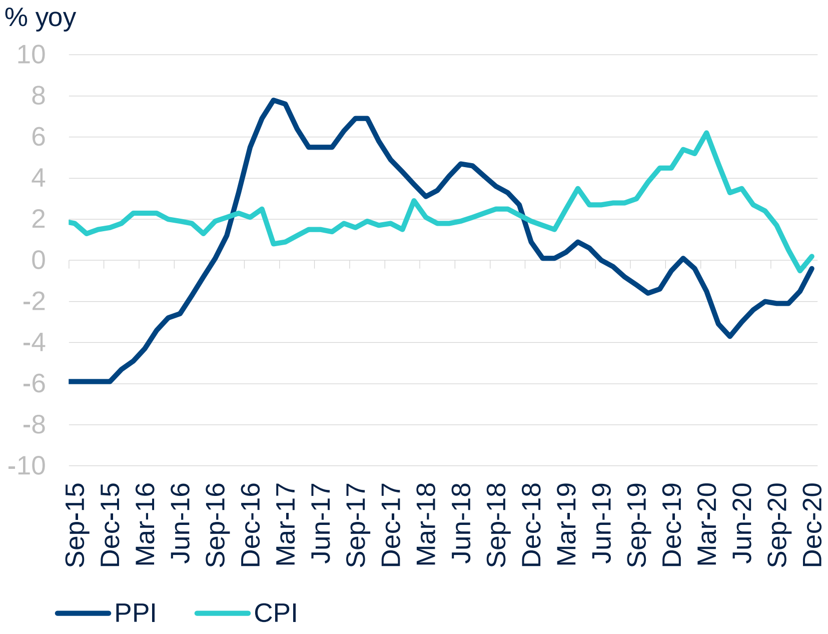

Source: CEIC and BBVA Research.

# CPI swings around zero while PPI narrows its decline

### CPI ENTERED INTO NEGATIVE IN NOVEMBER DUE TO THE EASE OF AFRICA SWINE FLU AND HIGH BASE EFFECT



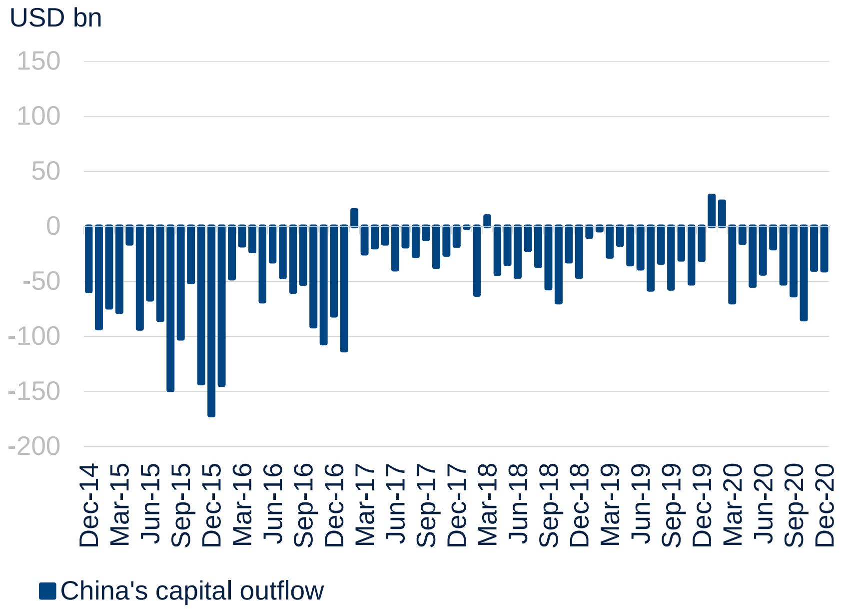

### PPI REMAINED IN NEGATIVE REGION FOR THE PAST YEAR AMID SLUGGISH COMMODITY PRICE, BUT NARROWED SHRINKING AS DEMAND SIDE RECOVERS



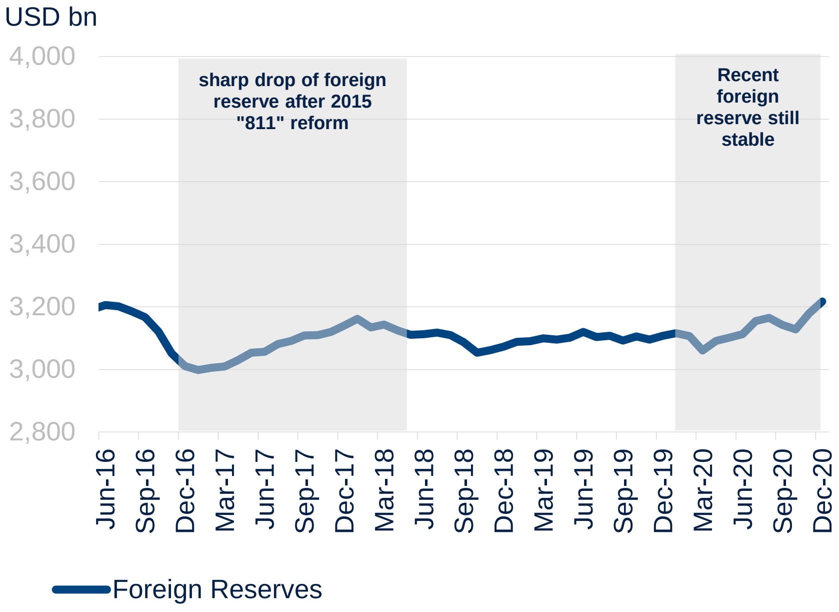

Source: CEIC and BBVA Research.

# China has attracted portfolio inflows due to historical high interest rate differences with the advanced economies

## BUT ESTIMATED CAPITAL OUTFLOWS EVEN HIGHER THAN INFLOWS, LARGELY DRIVEN BY VALUATION EFECT, AND HIGH TRADE SURPLUS



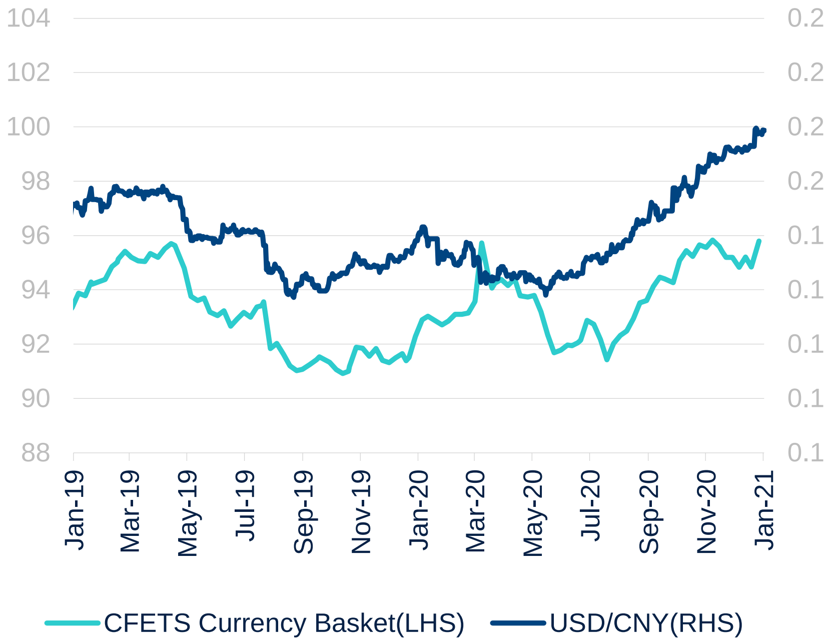

## FOREIGN RESERVES INCREASED STEADILY IN THE PAST MONTHS




Source: CEIC and BBVA Research.

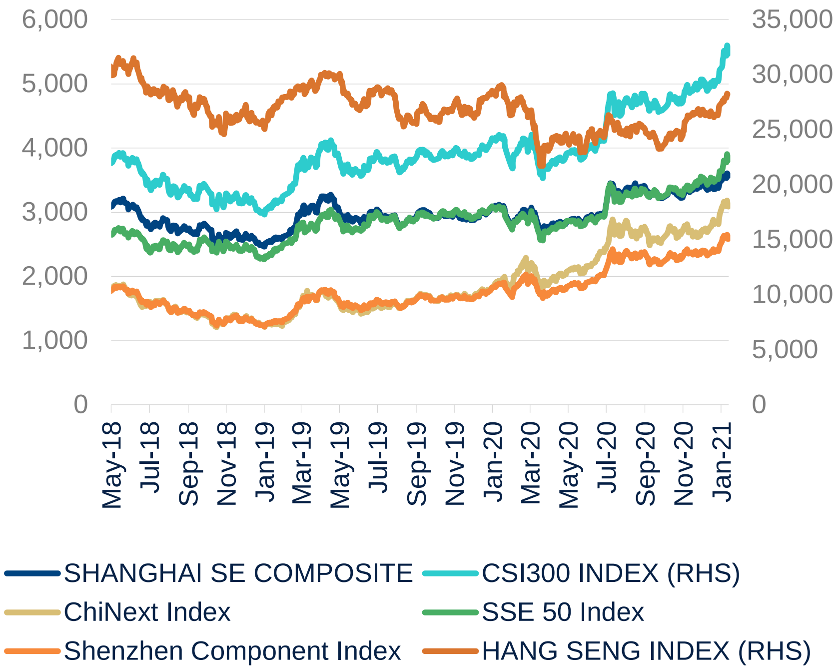
# RMB appreciation and stock run-up triggered financial stability concern

## RMB TO USD EXCHANGE RATE HAS ENTERED INTO A SOFT APPRECIATION TREND WITH WEAK DXY




Source: CEIC and BBVA Research.

## BIDEN'S WIN IN PRESIDENT ELECTION, RCEP AND EU-CHINA CAI ALSO INCRESES RISK APPETITE FOR CHINA'S STOCK MARKETS IN THE SHORT TERM



BBVA Research

03

# Policy normalization “no sharp turnaround” and Chinese way of multinationalism

# Main messages

Monetary policy, normalization is the main stance in 2021. But there will be "no harsh turnaround" indicated by the December Annual Central Economic Conference. That means, a neutral but still accommodative monetary policy, together with a tightening financial regulation will be the main stance in 2021.

Financial regulation has been significantly strengthened for recent SOE bond default (debt evasion), heating housing market and monopolistic e-commerce giants.

No more fiscal stimulus measures are anticipated in 2021, reversing the room for future uncertainties.

The accomplishment of Regional Comprehensive Economic Partnership (RCEP) and EU-China Comprehensive Agreement on Investment (EU-China CAI) indicates China's way of multilateralism to reach out other trade partners dealing with the escalating tensions with the US.

China's 2021 comprehensive policy initiatives are summarized in the December Annual Central Economic Work Conference. It emphasizes six concentrations on monetary, fiscal, anti-monopolistic measures, financial regulation, technology advancement and environmental protection.

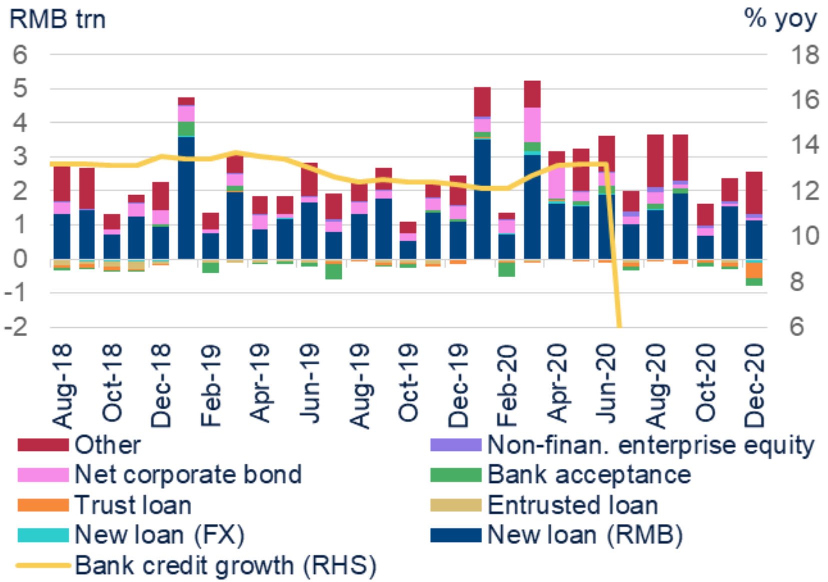
# Recent SOE bond default and housing bubbles in tier-1 cities raised the PBoC's concern on financial risks…

## SOE BOND DEFAULT AND DEBT EVASION LED TO A SPIKE OF BOND YIELDS AND NEGATIVELY SPILLOVER TO BOND MARKET, ALTHOUGH WE INTERPRET IT AS PARTIAL AND REGIONAL PHENOMENON


Source: xxxxxx.

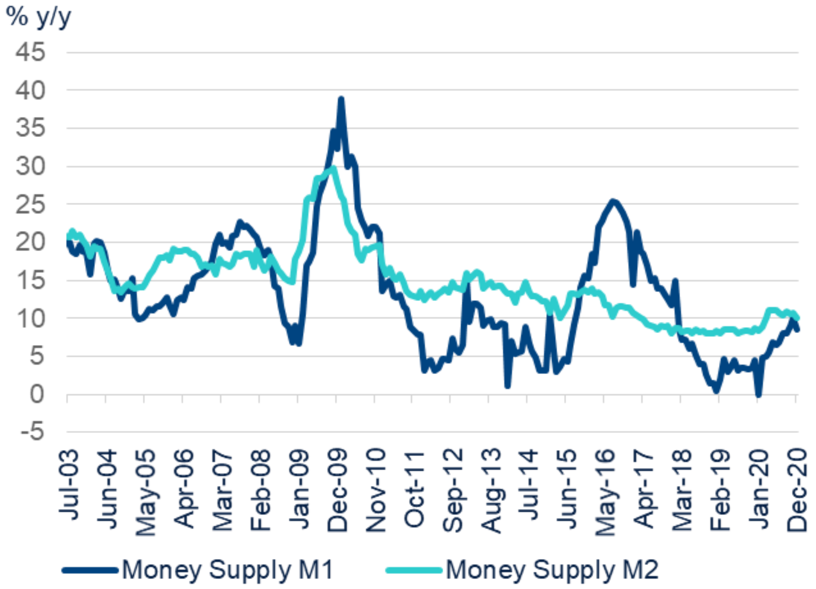
# …leading to a hot debate of 2021 monetary policy stance: to remain neutral while accommodative or starting tightening cycle to curb financial risks?

## SHRINKING CREDIT IN DEC DRAGGED BY OFF-BALANCE-SHEET LENDING AND BOND ISSUANCE: ALL ABOUT REGULATION AND IMPACT OF SOE BOND DEFAULT




Source: CEIC and BBVA Research.

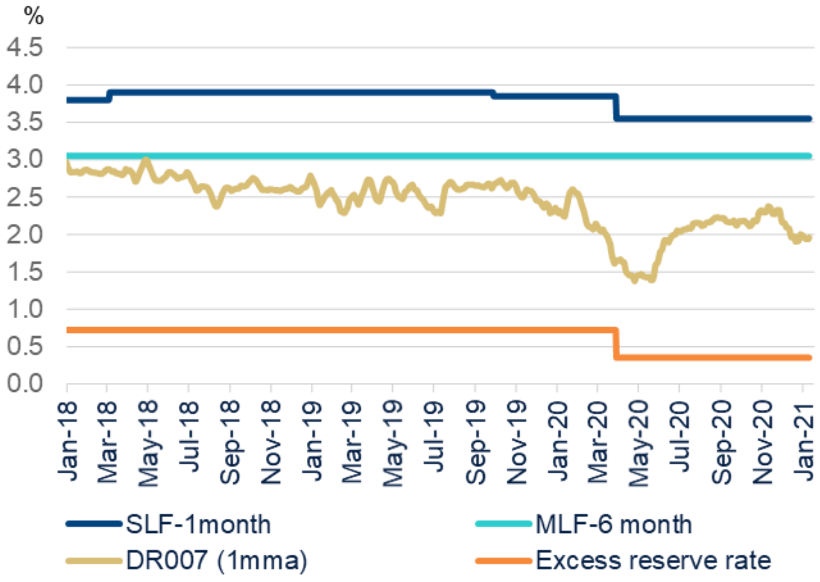
## M2 GROWTH SLOWED TO 10.3% IN DECEMBER FROM 10.7% PREVIOUSLY, AMID POLICY NORMALIZATION



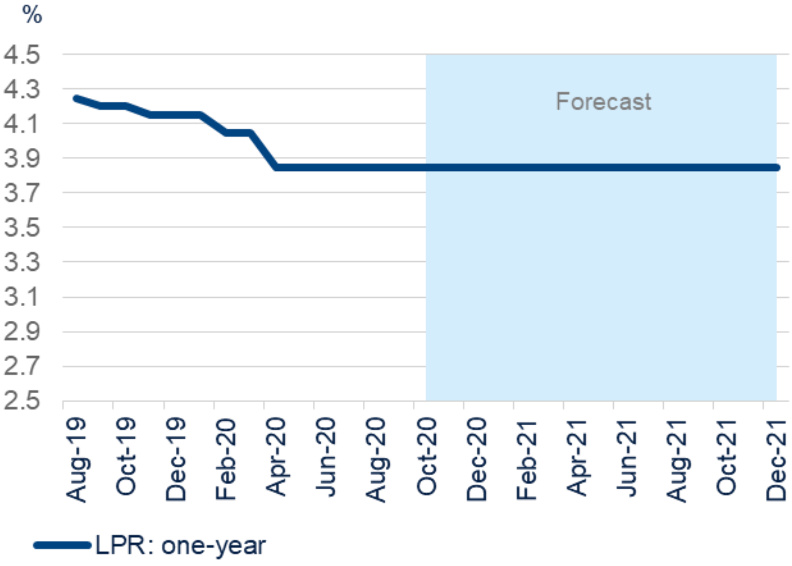

Source: Wind & BBVA Research.

# No LPR and MLF cut is anticipated in 2021, while a rising interbank rate is expected to curb financial risks

## DR007 TRENDS UP, REACHING PRE-PANDEMIC LEVEL UNDER CORRIDOR FRAMEWORK, TO CURB FINANCIAL RISKS



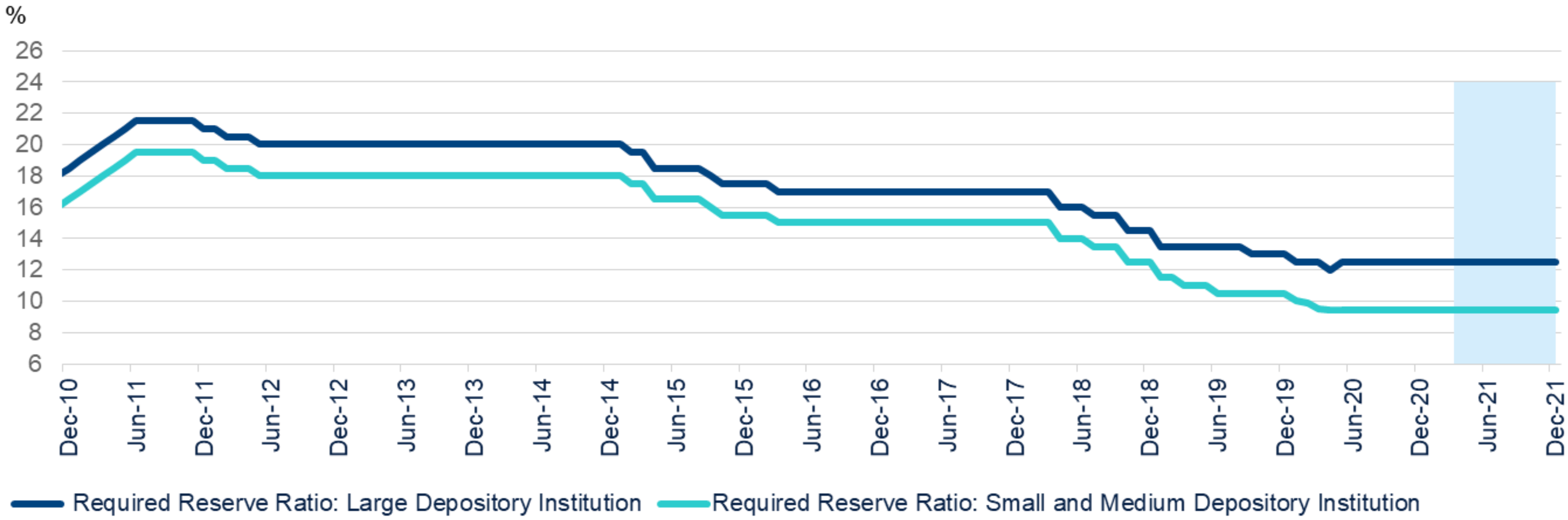

## THE PBOC MAINTAINED LPR AT 3.85% SINCE APRIL 2020, AND IT IS EXPECTED NO LPR CUT IN 2021




Source: BBVA Research and CEIC.

# No anticipation of RRR cuts amid monetary policy normalization

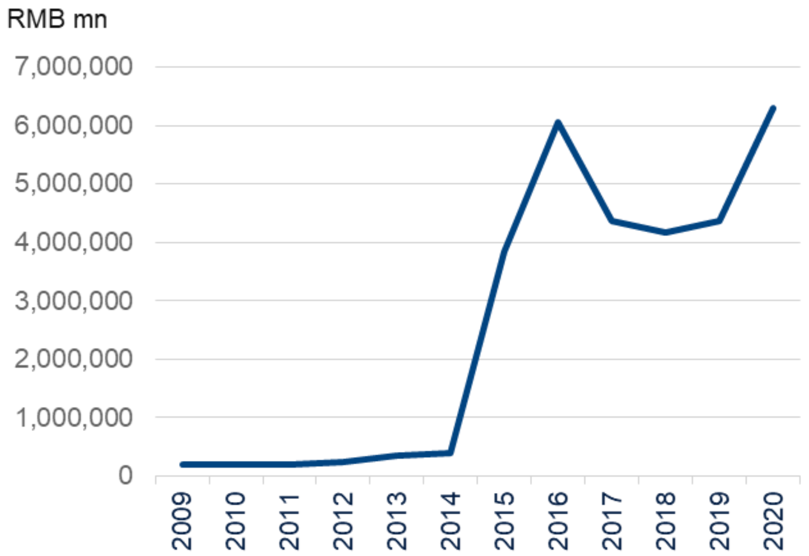
## THREE RRR CUTS DURING THE PANDEMIC PERIOD, WHILE NO ANTICIPATION OF FURTHER CUTS IN 2021 AMID GROWTH RECOVERY



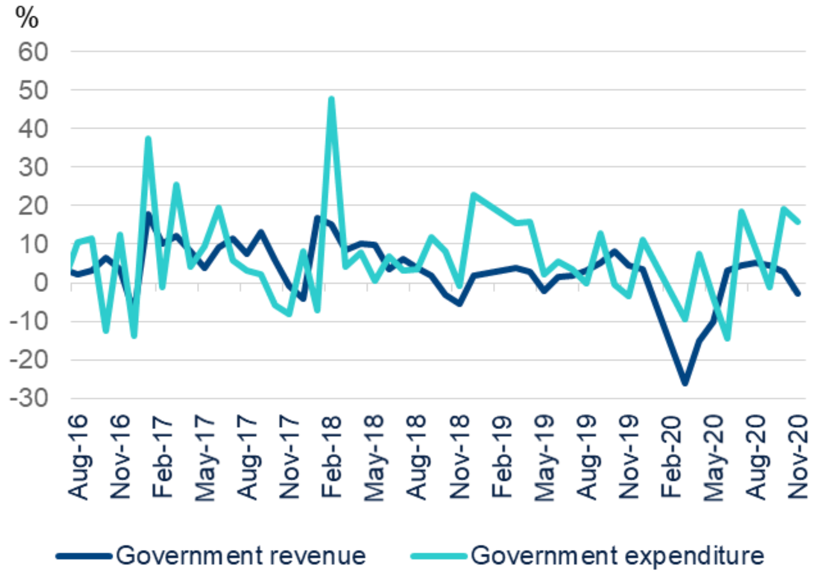

Source: Haver & BBVA Research.

# No further fiscal stimulus anticipated as well

## AFTER A SURGE IN 2020, LOCAL GOVERNMENT BOND ISSUANCE IS ANTICIPATED TO BE DECELERATING IN 2021




## A SHRINKING GOVERNMENT REVENUE AND INCREASING EXPENDITURE CALL FOR A HALT OF NEW FISCAL STIMULUS




Source: CEIC and BBVA Research.

# 2021 policy outlook: Six concentrations of policy initiatives promulgated on December Annual Central Economic Conference

Maintain the policy continuity while keep growth in a “reasonable range” in 2021.

Promote the demand-side reform and management.

Implement Anti-monopoly measures.

Curb financial risks, particularly in bond default and over-heating housing market.

Boost technology innovation and upgrade self-sufficient supply-chain

Environment protection target: 2030 peak of Carbon commission and 2060 carbon neutrality.

# EU-China CAI: a game-changer to Sino-US tensions

| | EU-China Comprehensive Agreement on Investment (EU-China CAI) |
|---|---|
| Contents | It guarantees an unprecedented level of access to EU investors in China, allow EU companies to buy or establish new companies in key sectors, help level the playing field for EU companies in China and commit China to rules on state owned enterprises and transparency in subsidies. |
| Economic implications | 1. Provides China a way to alleviate the hardship with the US gracefully.<br>2. Promotes reciprocity in China-EU investment relationship and re-invigorate the bilateral investment which largely lags behind the bilateral trade.<br>3. Catalyzes structural reforms and opening-up policy in China and boost bilateral growth. |
| Noteworthy Caveats | 1. It creates conflicts with US President Biden, who has emphasized the multilateralism for rallying with the transatlantic allies to put pressure on China;<br>2. For the scope of the EU-China CAI, it only covers a subset of a possibly future free trade deal between the two sides.<br>3. The true success of the EU-China CAI hinges on the implementation. |

# The contents (1): Ambitious opening by China to European investments: Examples of market access commitments by China

**Manufacturing**: China has made comprehensive commitments with only very limited exclusions. In terms of the level of ambition, this would match the EU's openness.

**Automotive sector**: China has agreed to remove and phase out joint venture requirements. China will commit market access for new energy vehicles.

**Financial services:** Joint venture requirements and foreign equity caps have been removed for banking, trading in securities and insurance, as well as asset management.

**Health (private hospitals):** China will offer new market opening by lifting joint venture requirements for private hospitals in key Chinese cities: Beijing, Shanghai, Tianjin, Guangzhou and Shenzhen

**R&D (biological resources):** China has agreed not to introduce new restrictions and to give to the EU any lifting of current restrictions in this area that may happen in the future.

**Telecommunication/Cloud services:** China has agreed to lift the investment ban for cloud services. They will now be open to EU investors subject to a 50% equity cap.

**Computer services**: agreed to bind market access for computer services; will include a 'technology neutrality' clause, which ensure that equity caps imposed for value-added telecom services will not be applied to other services

**Business services**: China will eliminate joint venture requirements in real estate services, rental and leasing services, repair and maintenance for transport, advertising, market research, management consulting and translation services, etc.

# The contents (2): Improving level playing field – making investment fairer

## State owned enterprises (SOEs)

CAI seeks to discipline the behaviour of SOEs by requiring them to act in accordance with commercial considerations and not to discriminate in their purchases and sales of goods or services. China also undertakes the obligation to provide specific information to allow for the assessment of whether the behaviour of a specific enterprise complies with the agreed the CAI. If the problem goes unresolved, EU can resort to dispute resolution under the CAI.

## Transparency in subsidies

CAI fills one important gap in the WTO rulebook by imposing transparency obligations on subsidies in the services sectors. Also, it obliges China to engage in consultations in order to provide additional information on subsidies that could have a negative effect on the investment interests of the EU.

## Forced technology transfers

The provisions consist of the prohibition of several types of investment requirements that compel transfer of technology: requirements to transfer technology to a joint venture partner, as well as prohibitions to interfere in contractual freedom in technology licencing. These rules would also include disciplines on the protection of confidential business info collected by administrative bodies from unauthorised disclosure.

## Standard setting, authorisations, transparency

China will provide equal access to standard setting bodies for our companies. China will also enhance transparency, predictability and fairness in authorisations. The CAI will include transparency rules for regulatory and administrative measures to enhance legal certainty and predictability, as well as for procedural fairness and the right to judicial review, including in competition cases.

# The contents (3): Embedding sustainable development in our investment relationship

CAI binds the parties into a value based investment relationship grounded on **sustainable development principles**. The relevant provisions are subject to a specifically tailored implementation mechanism to address differences with a high degree of transparency and participation of civil society.

**Labour and environment**, not to lower the standards of protection in order to attract investment, not to use labour and environment standards for protectionist purposes, as well as to respect its international obligations in the relevant treaties. China will support the uptake of corporate social responsibility by its companies.

Importantly, the CAI also includes commitments on **environment and climate,** including to effectively implement the Paris Agreement on climate.

China also commits to working towards the ratification of the outstanding **ILO (International Labour Organisation)** fundamental Conventions and takes specific commitments in relation to the two ILO fundamental Conventions on forced labour that it has not ratified yet.

# RCEP: another regional trade agreement under China-US escalating tensions

| | Regional Comprehensive Economic Partnership (RCEP) |
|---|---|
| Contents | 1. Significantly reduces the tariffs and non-tariff barriers of members including China, Japan, Korea, Australia, New Zealand and ASEAN 10.<br>2. Establish common rules for e-commerce, trade, and intellectual property.<br>3. Unifying the preexisting bilateral agreements between the 10-member ASEAN and five of its major trade partners. |
| Economic implications | 1. Enhances real economic linkages and intensify the spill-over effect of China's high growth to other economies through trade, promoting post-Covid regional recovery.<br>2. Strengthens the supply chain synchronization regionally that has been disrupted by Covid-19 and China-US decoupling;<br>3. China's new strategy of multilateralism to deal with the ongoing China-US tensions. |
| Noteworthy Caveats | 1. RCEP does not necessarily mean China could downplay the economic cooperation with the US and the EU.<br>2. Unlike the EU and NAFTA, economic integration in Asia has much more barriers, as members are at different economic development stage with different languages, institutional schemes and culture etc. |

BBVA Research

# 04

# Projections

# Main messages

Based on low statistical base effect, we forecast 2021 GDP growth to bounce back to 7.5% (Bloomberg consensus: 8%; IMF: 8.5%). But that is the easy part, the base effect will flatter the growth outturn of 2021 everywhere in the world.

Inflation is likely to stay in the deflationary territory in the following months, due to the significant easing of African Swine Flu and high base effect. PPI is anticipated to turn positive in 2H 2021, together with shrinking supply-demand gap and rising commodity prices.

No anticipation of interest rate cut and RRR cut in 2021 amid monetary normalization stance.

RMB to USD exchange rate has entered into soft appreciation trend due to the weak USD DXY cycle, good economic fundamentals (growth differentials), expansionary current account surplus as of the strong exports, and the expanding interest rate differentials between China and other advanced economies etc. We predict it to be 6.6 at year end of 2021.

# Economic indicators forecasting

## BASELINE SCENARIO

| | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|
| GDP （%） | 6.1 | 2.3 | 7.5 | 5.5 |
| CPI（%） | 2.9 | 2.5 | 1.7 | 2.5 |
| Interest rate (LPR, %） | 4.1 | 3.85 | 3.85 | 3.85 |
| RMB/USD exchange rate | 7.0 | 6.5 | 6.4 | 6.5 |
| Fiscal deficit to GDP (%) | -4.9 | -6.5 | -4 | -3.5 |

BBVA Research

# China Economic Outlook

1Q21

Creating Opportunities