Research

China Economic Outlook

3Q21

Creating Opportunities

BBVA Research

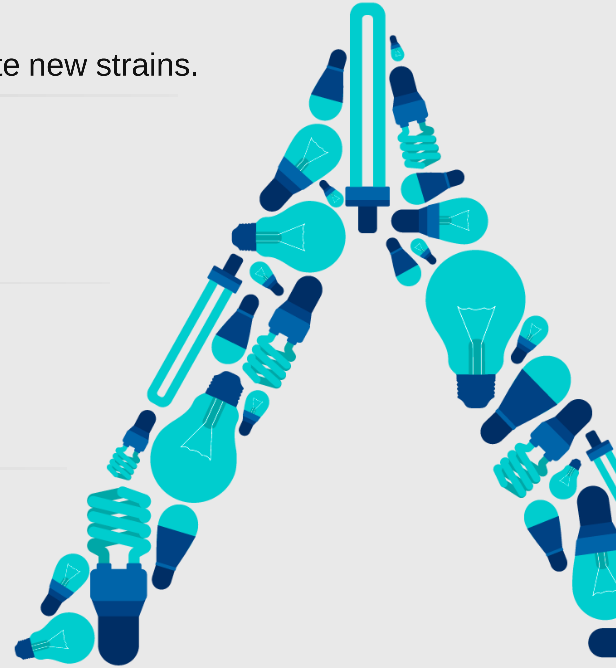
01

Global recovery gains some momentum with continuing stimulus

The recovery is gaining momentum, favored by an increasing control of the pandemic and policy stimuli, but inflation is a rising source of concern

RECENT EVOLUTION OF THE GLOBAL ECONOMY

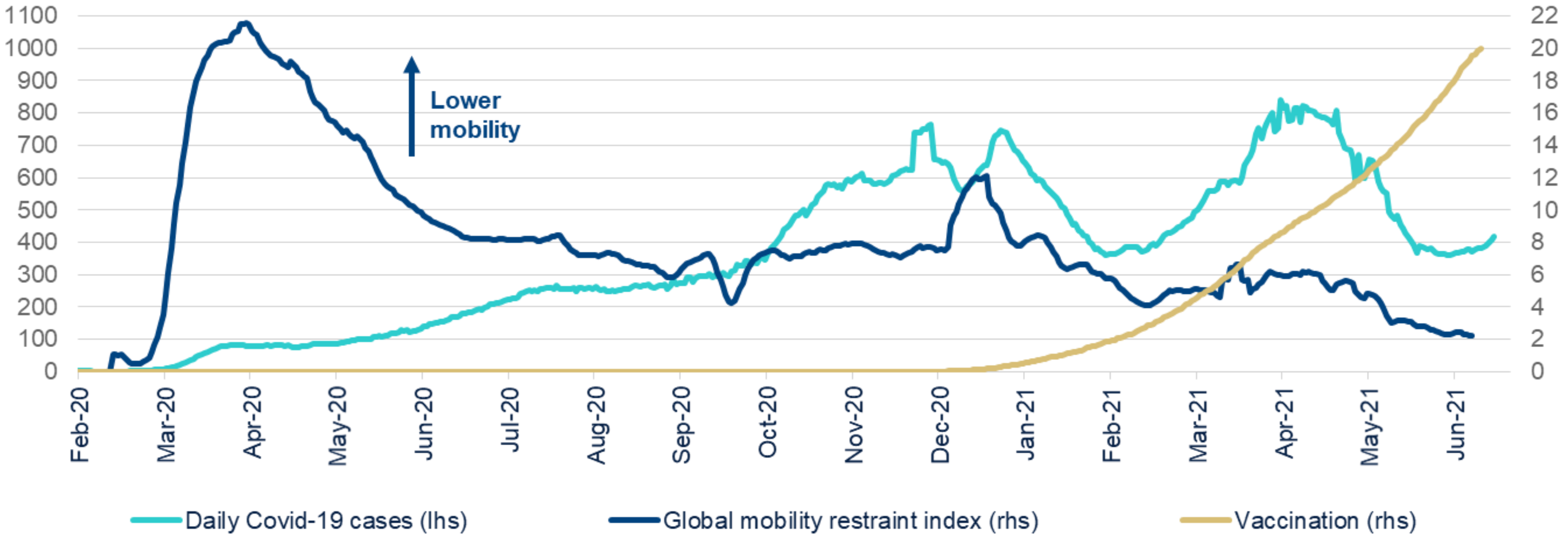
Covid-19	Acceleration of vaccination; declining infections despite new strains.
Activity and inflation	Solid recovery; significant rebound of inflation.
Economic policy	Focus on growth, but the withdrawal of stimuli by the Fed and the ECB is getting closer
Financial markets	A more complex environment, despite the still ample global liquidity.



The acceleration of vaccination has paved the way for a reduction of infections and an economic reopening, mainly in developed countries

WORLD: DAILY CODIV-19 CASES, POPULATION VACCINATED AND MOBILITY RESTRAINT INDEX (*)

(THOUSANDS OF CONTAGIONS, 7-DAY MOVING AVERAGE; SHARE OF THE POPULATION WITH AT LEAST ONE DOSE OF THE ANTI-COVID VACCINES; MOBILITY RESTRAINT: 7-DAY MOVING AVERAGE)

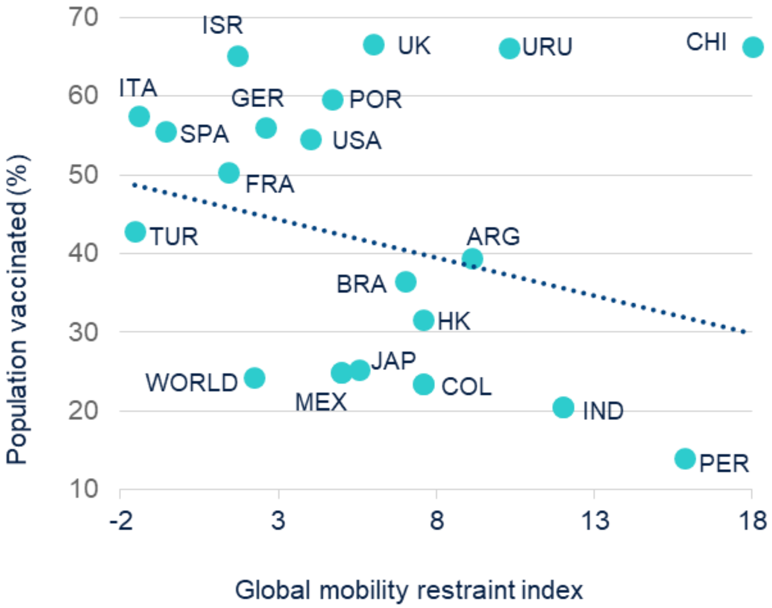


(*) The mobility restraint index reflects changes with respect to the period of reference (January 3 to February 6 2020). Higher values represent lower mobility. Vaccination data does not include figures for China.
Source: BBVA Research based on data by John Hopkins University, Google and Our World in Data.

Vaccination has already reached much of the population in the US and Europe, and is accelerating in emerging countries

POPULATION VACCINATED AND MOBILITY RESTRAINT (*)

SHARE OF THE POPULATION WITH AT LEAST ONE DOSE OF THE VACCINES; MOBILITY RESTRAINT INDEX: 7-DAY MOVING AVERAGE)

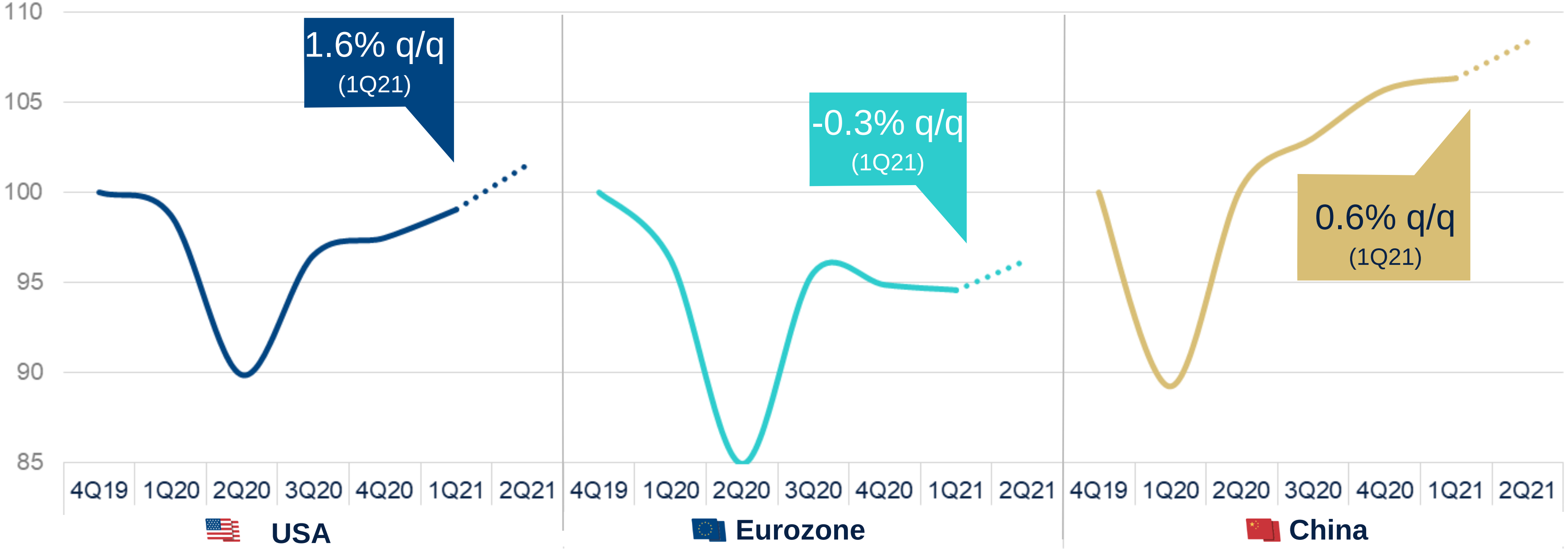


- Vaccination has reduced infections and increased mobility in the US and Europe.
- Vaccine inoculation has recently accelerated in Latin America, although infections remain at high levels.
- Recent outbreaks in countries with advanced vaccination (UK, Israel, Spain, Chile, etc.) maintain the concerns about new strains.
- Still, the available evidence suggests that the main vaccines are effective against the new variants of the coronavirus.

(*) The mobility restraint index reflects changes with respect to the period of reference (January 3 to February 6 2020). Higher values represent lower mobility. Vaccination data does not include figures for China.
Source: BBVA Research based on data by John Hopkins University, Google and Our World in Data.

Growth accelerates somewhat more than expected in the US, restarts in Europe, and remains high in China despite the recent moderation

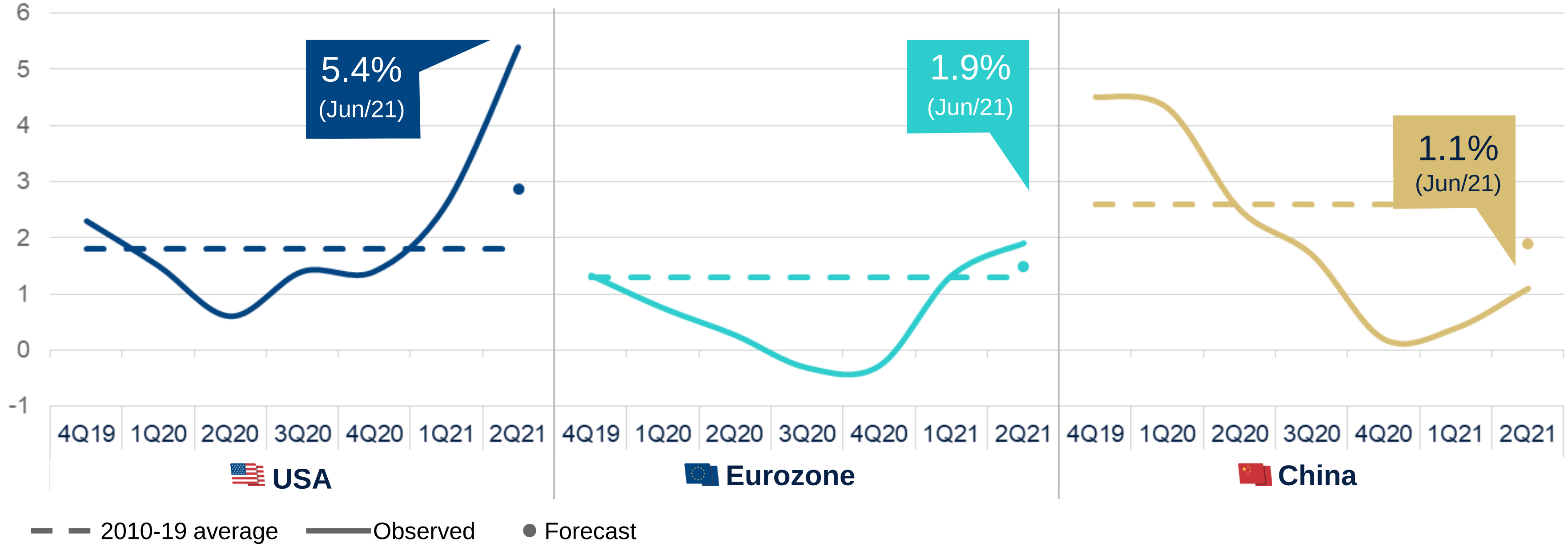
REAL GDP LEVEL (*)
(4Q19=100)



(*) Observed data till 1Q21. 2Q21: BBVA Research forecasts.
Source: BBVA Research based on local statistics.

Inflation surprises to the upside, mainly in the US, driven by the reopening, supply bottlenecks and commodity prices

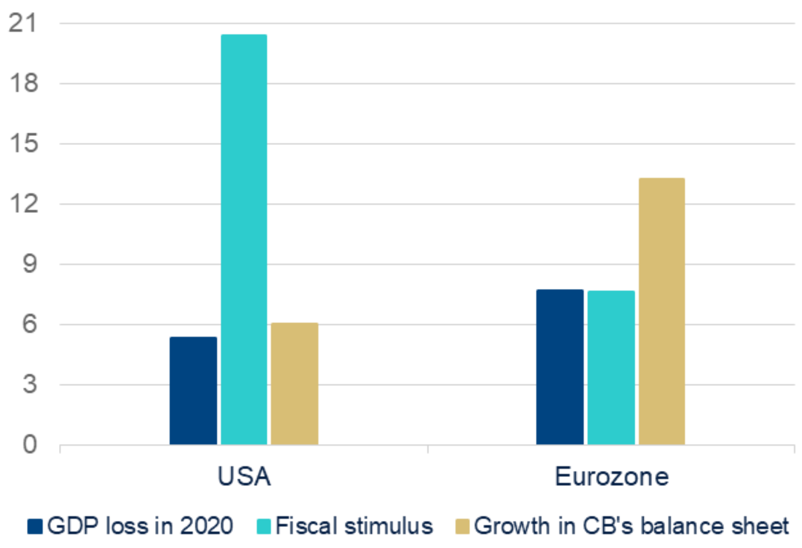
INFLATION: CPI (*)
(Y/Y %, END OF PERIOD)



(*) Forecast: BBVA Research Apr/21 estimations.
Source: BBVA Research based on local statistics.

Inflation and significant fiscal stimuli increase the pressure on central banks, which, however, remain focused on the recovery

GDP LOSS IN 2020 AND STIMULI FROM 2021(*)
(PP, % OF GDP)



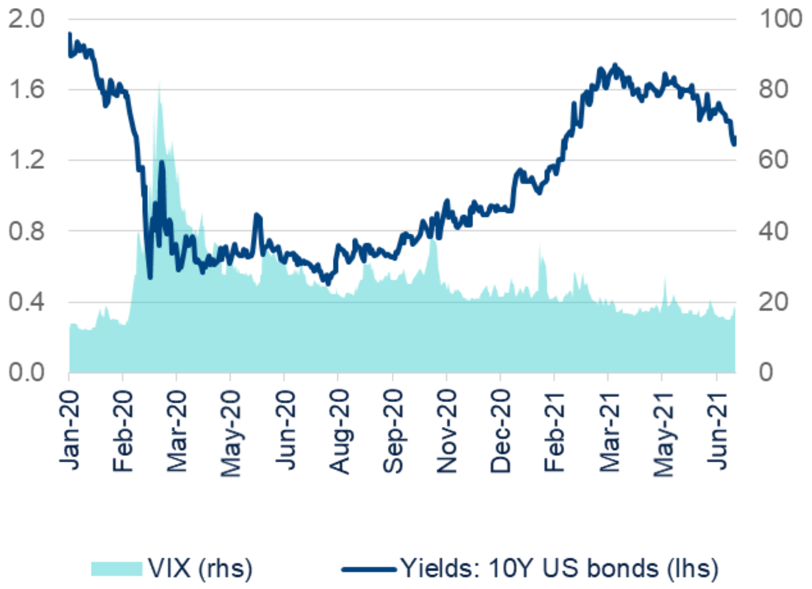
(*) GDP loss in 2020: difference between forecast GDP before the crisis and the actual data. Fiscal stimuli: US: USD 0.9tn approved in Dec/20, USD 1.9tn approved in Mar/21, and further USD 1.5tn expected ahead; UE: NGEU and measures announced by the main countries in the region. Central bank's balance sheet: expected accumulated expansion between the end of 2020 and the end of 2022.
Source: BBVA Research.

- The Fed has suggested that it will soon begin to discuss tapering bond purchases and that it will bring forward rate hikes, but not until 2023.
- Political debate in the US about additional fiscal stimuli, possibly less significant than anticipated and more focused on investment.
- In Europe, after the approval of the NGEU, the details for its implementation are being finalized; suspension of fiscal targets in 2021-22 increases scope for further stimulus.
- The ECB maintains a high rate of asset purchases; strategic review: “symmetric” inflation target of 2%.

Markets are more convinced that the Fed will act to control inflation; the prospect of stimulus withdrawal generates volatility

10-YEAR US BOND YIELD AND VIX

(%, INDEX)

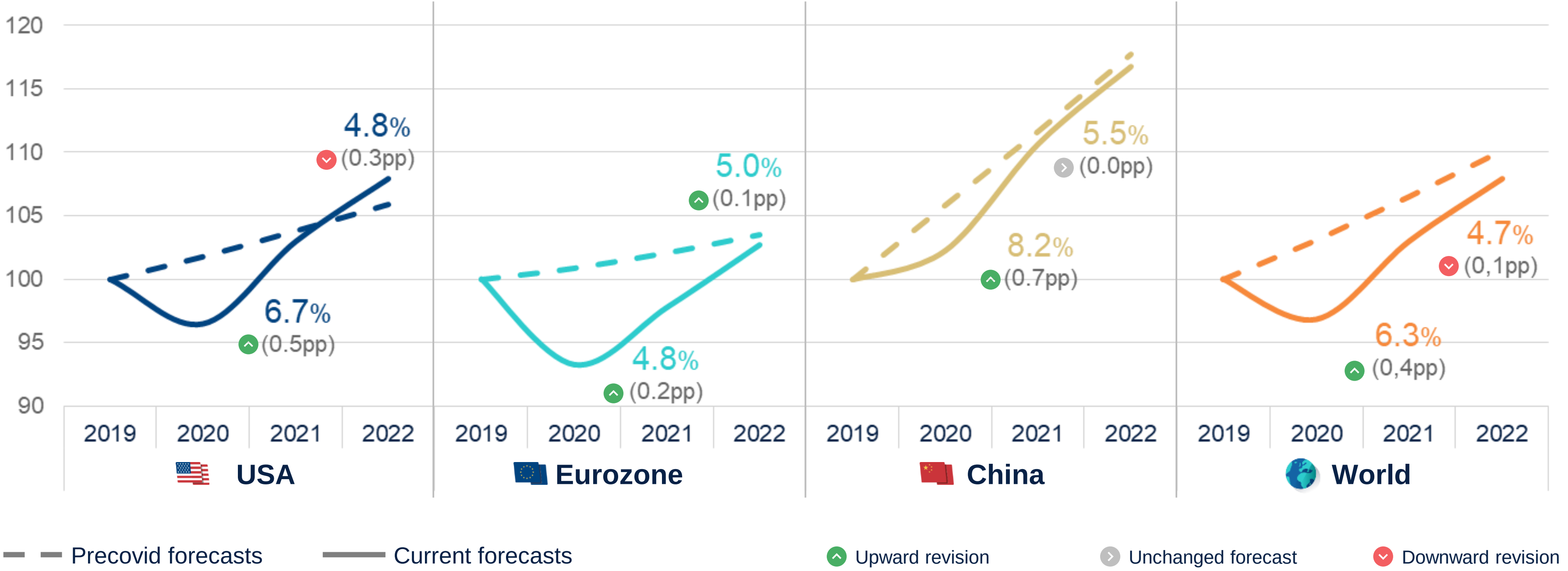


Source: BBVA Research based on data by Bloomberg.

- Short-term bond yields have risen in the US on the prospect of higher rates in early 2023 (or earlier).
- Long-term bond yields have fallen on the view that inflation will be controlled, the stabilization of growth expectations and lower bond supply.
- The rise in short-term rates has appreciated the US dollar and generated volatility ...
- ... but global liquidity continues to back equity markets, certain risk assets and moderate flows into emerging markets.

Global growth will be stronger than expected in 2021 and will ease in 2022

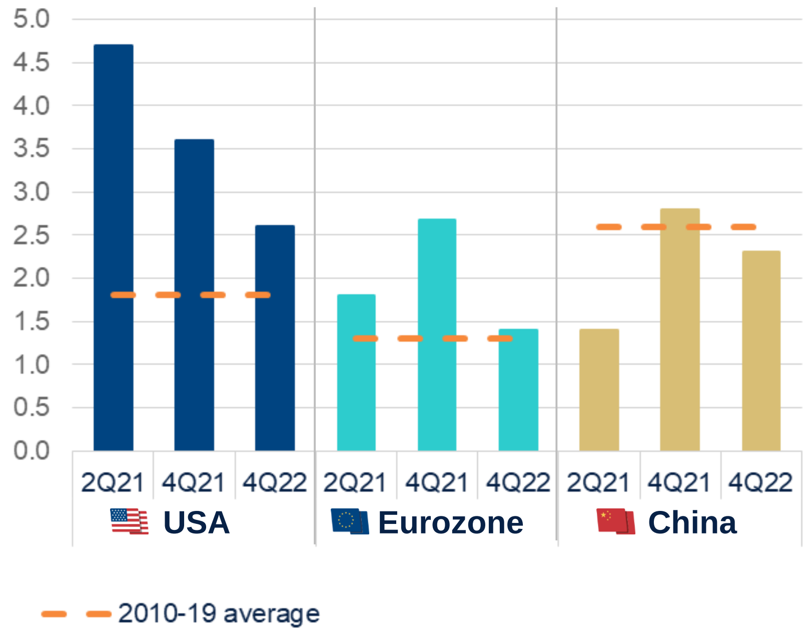
REAL GDP (LINES: GDP LEVEL 2019=100, FIGURES: GROWTH FORECASTS AND, BETWEEN PARENTHESIS, CHANGE WITH RESPECT TO PREVIOUS FORECASTS)



Source: BBVA Research.

Inflation in the US and Europe is expected to slow down, but it will remain above the previous decade's levels, in an environment of increasing risks

INFLATION: CPI
(Y/Y %, PERIOD AVERAGE)

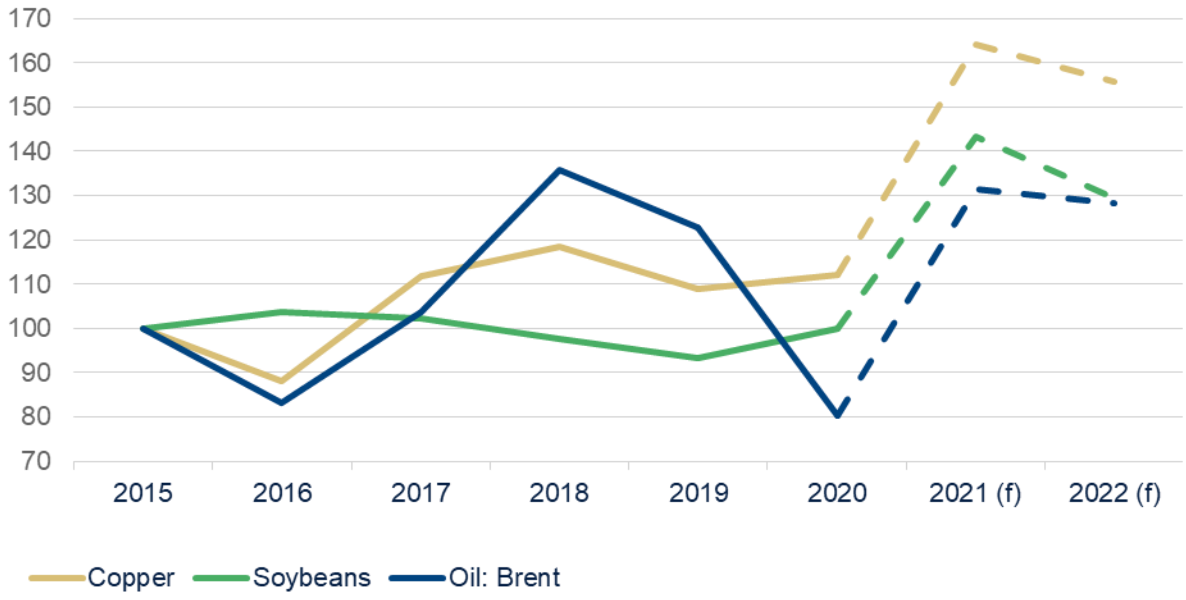


Source: BBVA Research.

- Expected moderation of inflation
  - more favorable base effects
  - lower commodity prices
  - bottlenecks will ease on greater supply
  - absence of widespread wage pressures
- Inflation "normalization": above 2010-19 levels
  - CBs more tolerant with inflation
  - more supportive fiscal, social and labor policies
  - trade protectionism
  - energy transition and change in relative prices
  - labor market tensions
- In China, inflation will rise moderately on demand recovery and less positive base effects.
- Monetary and fiscal policies will be key for the future inflation dynamics.

Commodity prices have increased more than expected, mostly on the back of high demand, but should ease -remaining high though- as supply catches up

COMMODITY PRICES: ANNUAL AVERAGES
(ÍNDEX: 2015 = 100 AVERAGE)



	2021 (f)	2022 (f)
COPPER ($ per ton)	4.1	3.9
SOYBEAN ($ per lb)	502	454
BRENT ($ per barrel)	69	67

(f) Forecast.
Source: BBVA Research.

Economic policies remain focused on supporting growth, but monetary policy keeps also an eye on inflation, and will gradually shift to exit policies

	PROSPECTS FOR MONETARY POLICY	PROSPECTS FOR FISCAL POLICY
US	Tapering in the beginning of 2022 and stable interest rates until 1Q23 (slightly earlier than expected)	Additional stimulus of around 7% of GDP, more long-term and investment-focused than previous bills
Eurozone	Accommodative stance and scale down of bond purchases (PEPP) from Sep/21 New strategy: “symmetric” inflation target of 2%;	NGEU: minor short-term impact; potentially greater in the long run Fiscal rules: suspended at least in 2021-22
China	Unchanged rates in 2021-22; lower dynamism of credit and regulatory tightening	Gradually less expansionary

Risks: inflationary pressures increase the room for policy mismanagement and open the door for more negative macroeconomic scenarios

INFLATIONARY RISKS

on larger demand pressures, slow supply response or unanchoring of expectations, specially if central banks don’t react timely to inflationary pressures

FINANCIAL RISKS

particularly in public and private debt markets, and in emerging economies (weaker exchange rates, earlier hikes of local policy rates), mostly if central banks overreact (or markets perceives this way) to inflationary pressures.

EPIDEMIOLOGIC RISKS

new strains, slow vaccination in EMs...

OTHER RISKS

evolution of accumulated savings, investment and potential GDP, social unrest, deglobalization, strategic rivalry between the US and China...

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02

China's growth moderated with a more balanced structure

Main messages

The pace of economic recovery

moderated in Q2 2021 to 7.9% y/y from Q1's record-high year-on-year growth rate of 18.3%, mostly due to the low base of last year. On sequential terms, the growth expanded to 1.3% q/q in Q2 from 0.6% q/q previously, broadly in line with our projected trajectory of a full-year growth at 8.2% (Bloomberg consensus: 8.5%, IMF: 8.4%).

The supply and demand gap further narrowed

making the economic structure more balanced. However, To regain all the lost ground of consumption and investment, a bit of perseverance is still needed.

Inflation risk got eased

and both CPI and PPI passed their peaks in June, thanks to the African Swine Flu Cycle which dominated the CPI, and the authorities' measures to "expand the reserved commodity supply" leading to PPI moderation; the pass-through effect from PPI to CPI is quite limited in China.

Main messages

The authorities' policy stance

The authorities' policy stance turned to be more easing amid growth moderation but a neutral while accommodative policy stance will remain in 2H. Chief among the policy initiatives is the RRR cut in July, which has not been implemented in more than one year. The authorities are taking a balance between defusing the financial risks and stimulating growth.

US-China tensions remain

after President Biden took office. The bilateral confrontations seemingly spill over to more fronts and involve more countries.

2H 2021 Chinese economy: positive and risk factors

Positive factors

Vaccination will add impetus for global economic recovery.

From policy perspective, the PBoC started to conduct some easing measures such as RRR cut, dispelling the worries of an early exit of accommodative policy.

An eased inflation risk and continuing strong exports momentum provides the authorities more room for policy maneuver.

Certain external arrangements such as RCEP and EU-China CAI are expected to help China to improve its relation with other countries.

Risk factors

Tightening regulations of monopolistic e-commerce giants and internet firms to list overseas, might weigh on growth and market sentiments.

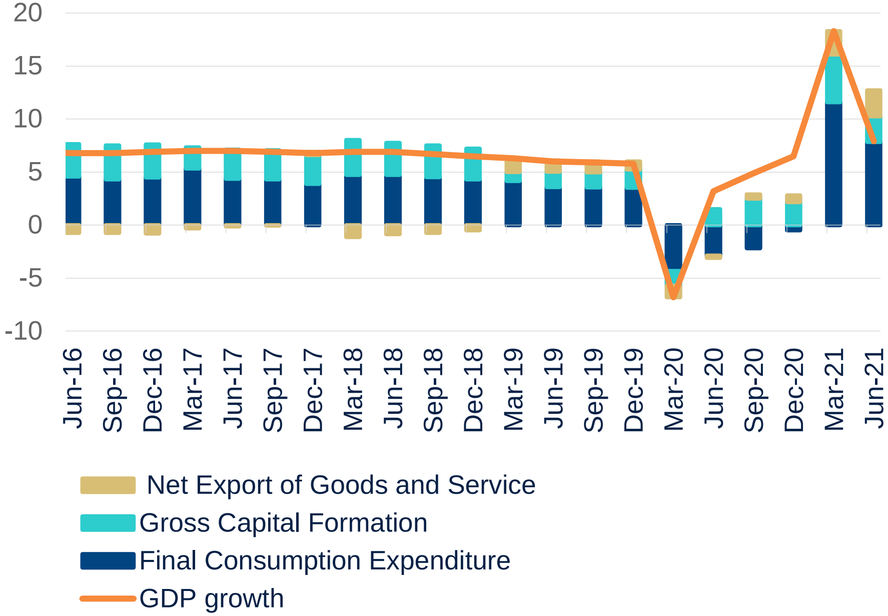
Export sustainability is uncertain. The weaker-than-expected consumption and manufacturing investment recovery might weigh on growth.

Financial vulnerabilities deteriorate in the aftermath of the pandemic : SOE debt overhang, housing market bubble and shadow banking etc.

The tensions between China and the USA are intensifying as the Biden administration pursues a long-term ideological confrontation and technology competition against China.

Moderated growth momentum with a more balanced structure

GROWTH MODERATED IN Q2 2021 FROM 18.6% Y/Y IN Q1 TO 7.9%, BUT MOSTLY DUE TO THE BASE EFFECT; Q2 Q/Q GROWTH EXPANDED TO 1.3% FROM 0.6%



PMIS ALSO MODERATED ITS MOMENTUM IN JUNE, SO DID THE INDUSTRIAL PRODUCTION

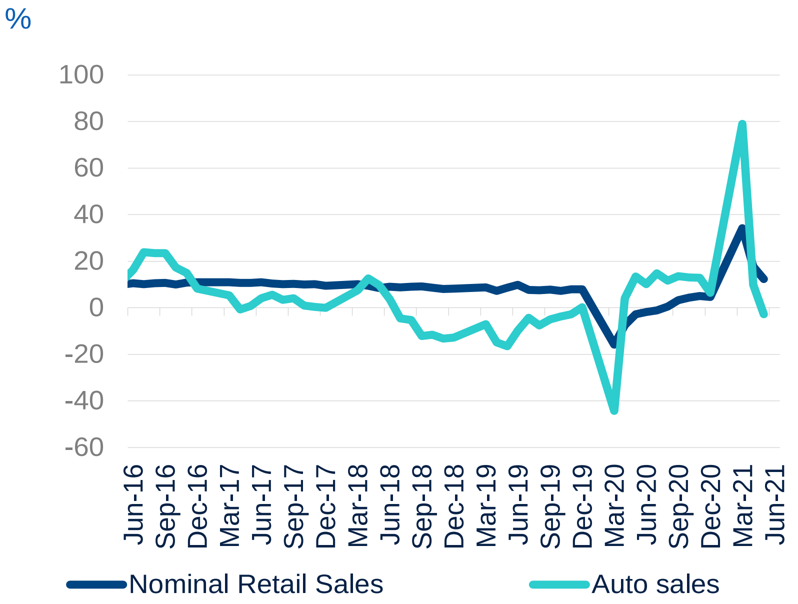
		2020			2021					
	Mean	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Industrial Production	14.7	6.9	7.0	7.3	35.1	35.1	14.1	9.8	8.8	8.3
CPI	0.4	0.5	-0.5	0.2	-0.3	-0.2	0.4	0.9	13	11
Retail sales	17.5	4.3	5.0	4.6	33.8	33.8	34.2	17.7	12.4	12.1
Auto Sales	65.0	13.0	12.8	6.4	7.6	4718	79.0	9.9	-2.7	-12.7
Exports	39.1	10.9	20.5	18.1	24.7	154.8	30.6	32.3	27.9	32.2
Imports	25.6	4.7	4.3	7.0	27.3	17.6	38.2	43.1	511	36.8
Manufactory PMI	514	514	52.1	519	513	50.6	519	511	510	50.9
Non-manufactory	54.7	56.2	56.4	55.7	52.4	514	56.3	54.9	55.2	53.5
Caixin PMI	52.2	53.6	54.9	53.0	515	50.9	50.6	519	52.0	513
FAI	17.3	18	2.6	2.9	35.0	35.0	25.6	19.9	15.4	12.6
Credit	12.5	13.7	13.6	13.3	13.0	13.3	12.3	11.7	11.0	11.0

Contraction	Slow-down	Growth	Boom

Source: CEIC and BBVA Research.

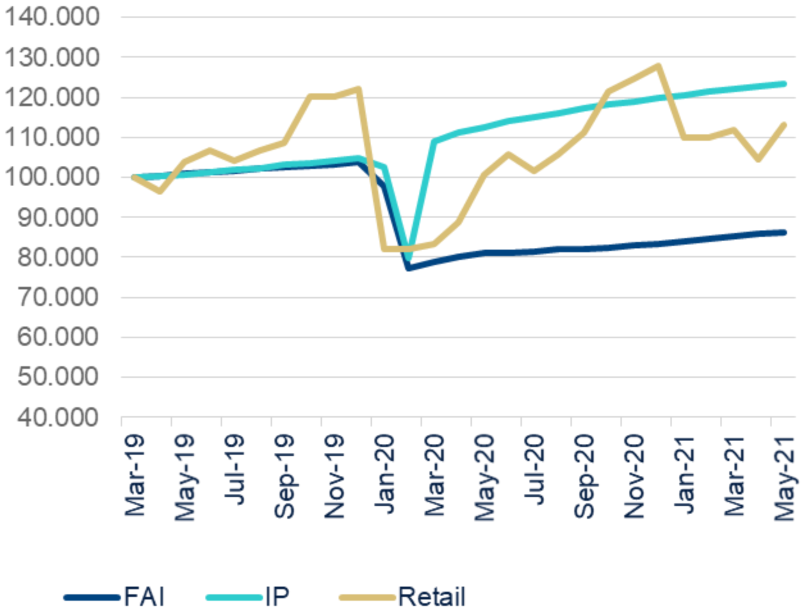
Supply-demand gap closed gradually, although perseverance is still needed to regain all the lost ground of consumption and investment

RETAIL SALES GROWTH DECELERATED TO 12.1% IN JUNE FROM 12.4% PREVIOUSLY, PARTICULARLY AUTO SALES DECLINED SIGNIFICANTLY (%)



THE LEVEL OF RETAIL SALES AND FAI STILL LAGGED BEHIND THAT OF THE PRE-PANDEMIC TIME

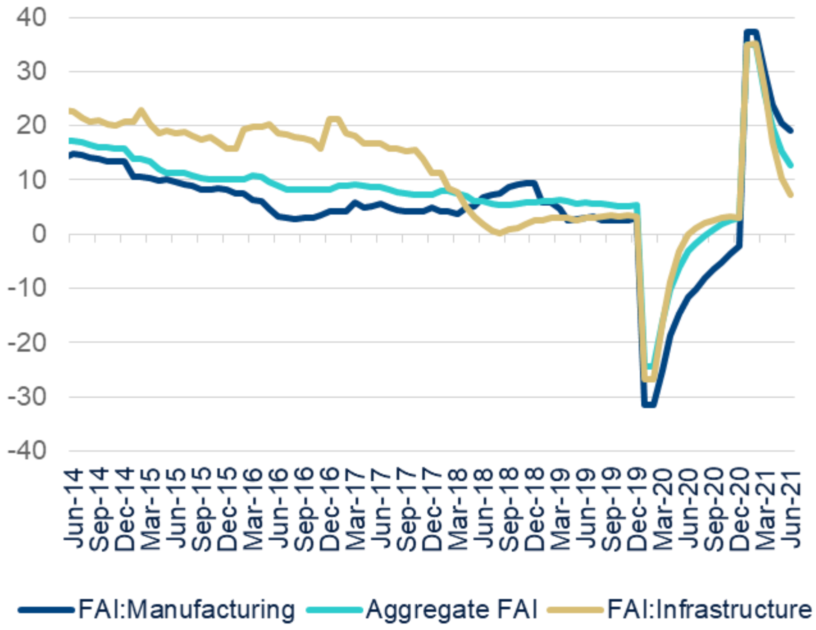
(2019 MAR = 100, SA FOR FAI AND IP)



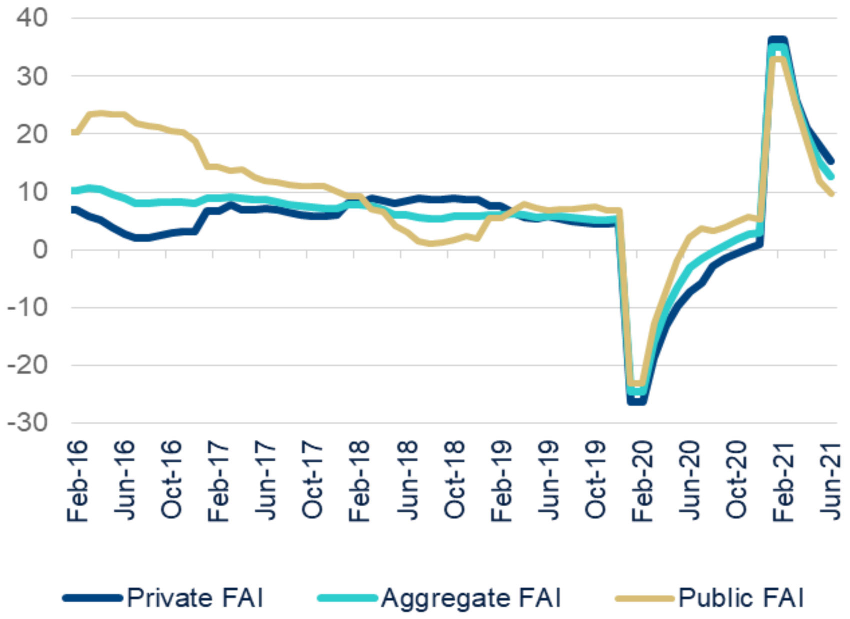
Source: CEIC and BBVA Research.

Manufacturing FAI is poised to surpass real estate and infrastructure FAI to spearhead the FAI growth

MANUFACTORY INVESTMENT LED THE FAI GROWTH IN JUNE (% YTD)



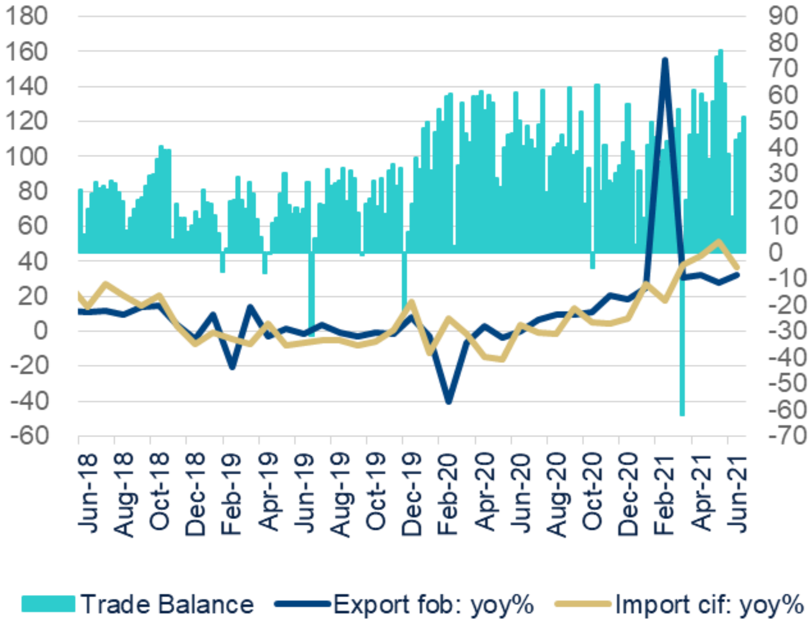
DUE TO FISCAL NORMALIZATION, INFRASTRUCTURE FAI SLOWDOWN; TIGHTENING FINANCIAL REGULATION SUPRESSES HOUSING FAI (% YTD, Y/Y)



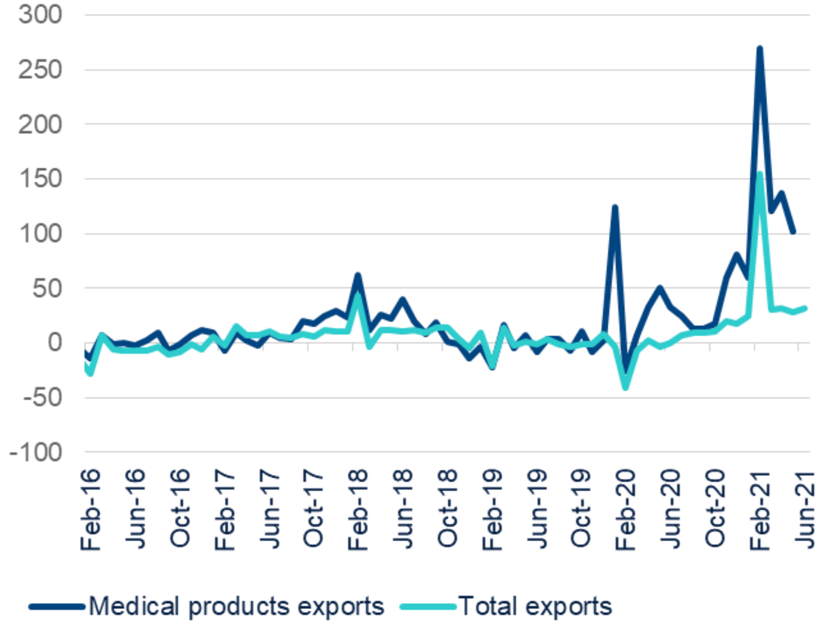
Source: CEIC and BBVA Research.

Imports passes its peak in June amid global commodity price moderation, while China's exports maintained its momentum

JUNE EXPORTS REGAINED MOMENTUM AS OTHER REGIONS ARE GRAPPLING WITH DELTA VARIANT; IMPORTS PASSED ITS PEAK (% YOY, USD BN)



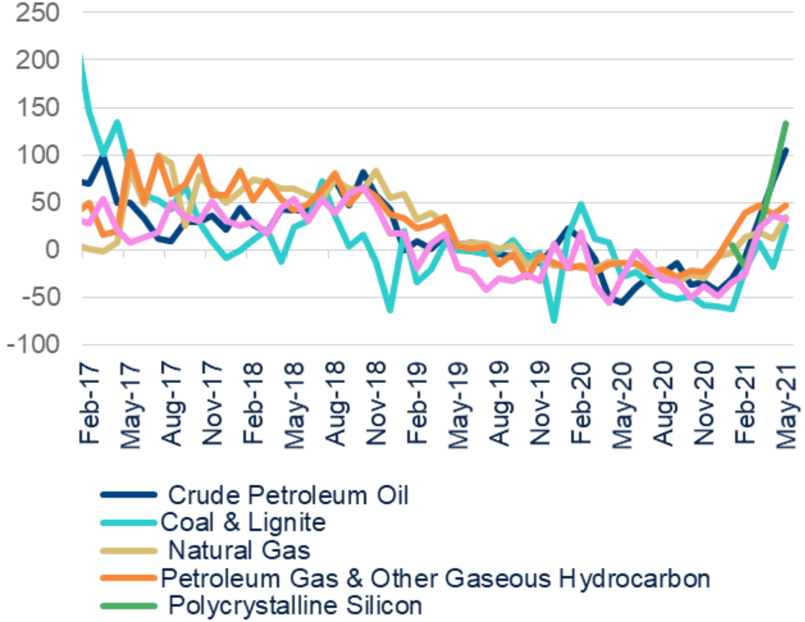
THE MARKET WORRIES GLOBAL RECOVERY MIGHT NORMALIZE CHINA' STRONG EXPORTS, BUT IT IS STILL TOO EARLY TO BE MATERIALIZED (% Y/Y)



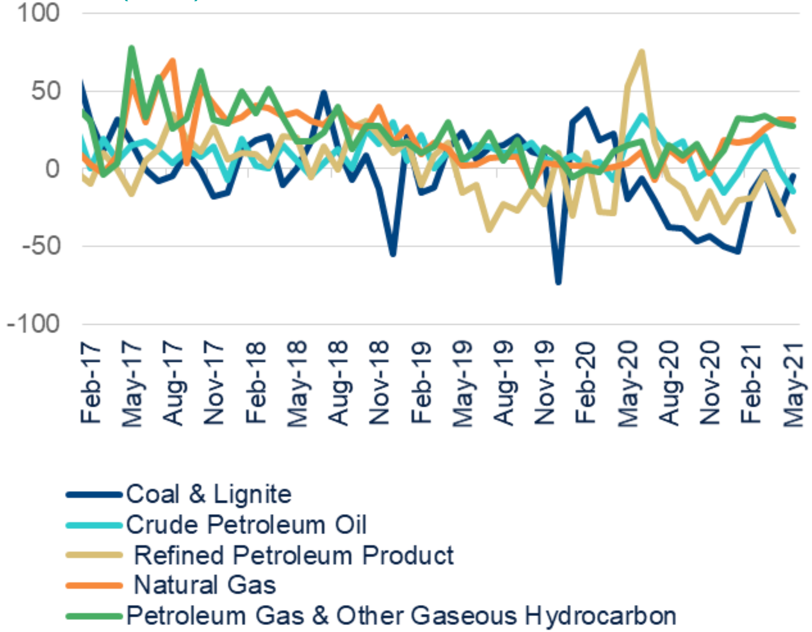
Source: CEIC and BBVA Research.

Global commodity price surge raised the imports value sharply, but not for the import volume

GLOBAL COMMODITY PRICE SURGED IN THE RECENT MONTH, PUSHING UP CHINA'S IMPORTS VALUE (%Y/Y)



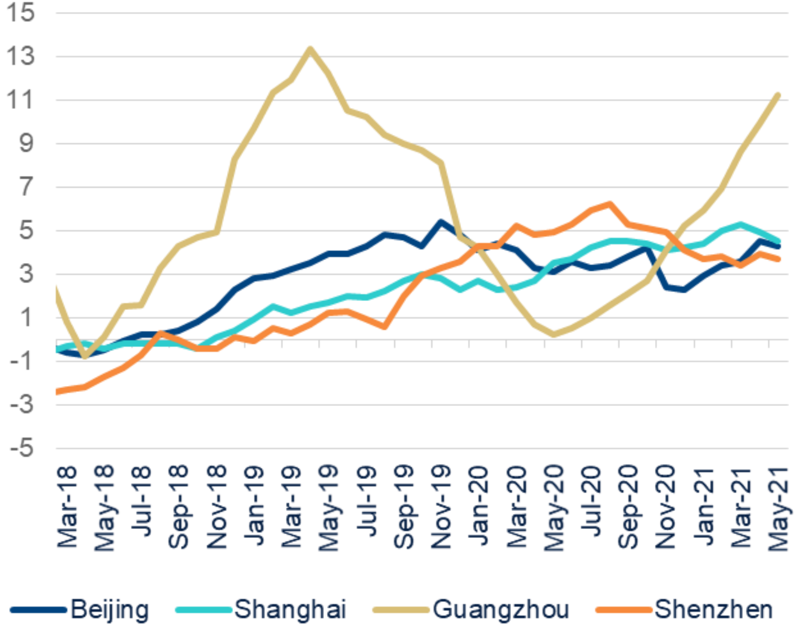
HOWEVER, THE IMPORTS VOLUME HAS NOT INCREASED AS SIGNIFICANTLY AS THE IMPORTS VALUE (%Y/Y)



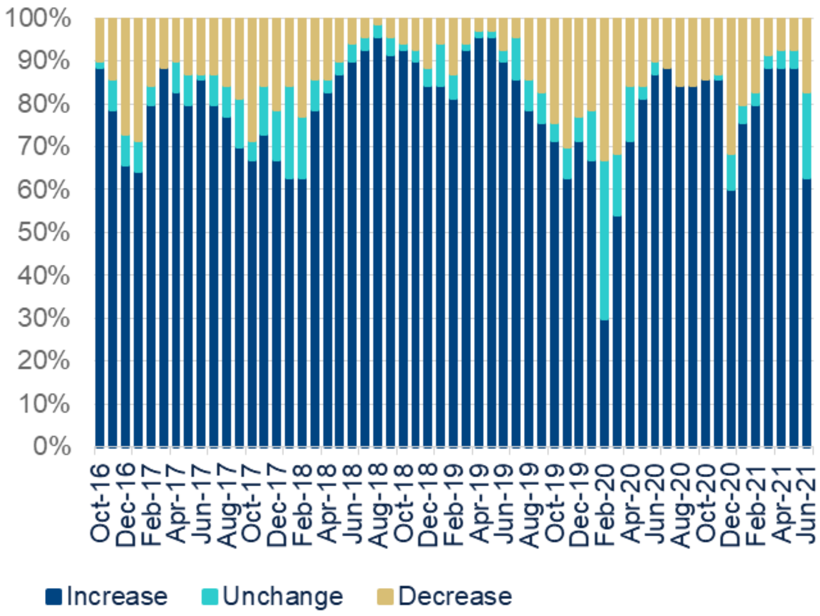
Source: CEIC and BBVA Research

Housing market is the stabilizer of Chinese economy; macro prudential rather than a tightening monetary policy is the key to curb surging housing price

THE RECENT FINANCIAL REGULATION MEASURES CURBED HOUSING PRICE SOARING IN TIER-1 CITIES EXCEPT FOR GUANGZHOU (YOY %)



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

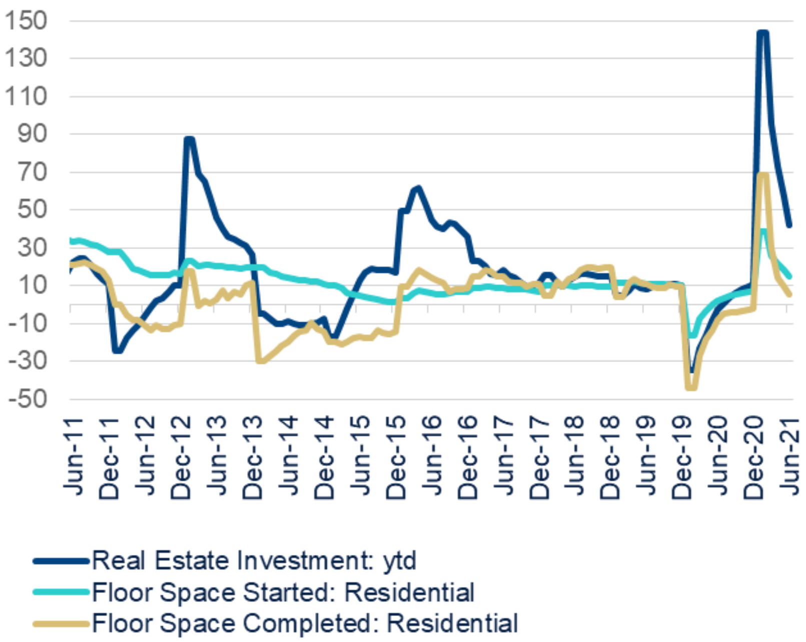


Source: CEIC and BBVA Research.

…housing sales and investment moderated together with the authorities' clampdown of overheating housing market

THE GROWTH RATE OF RESIDENTIAL BUILDING SOLD AND LAND PURCHASE DROPPED IN MAY (% YTD, Y/Y)

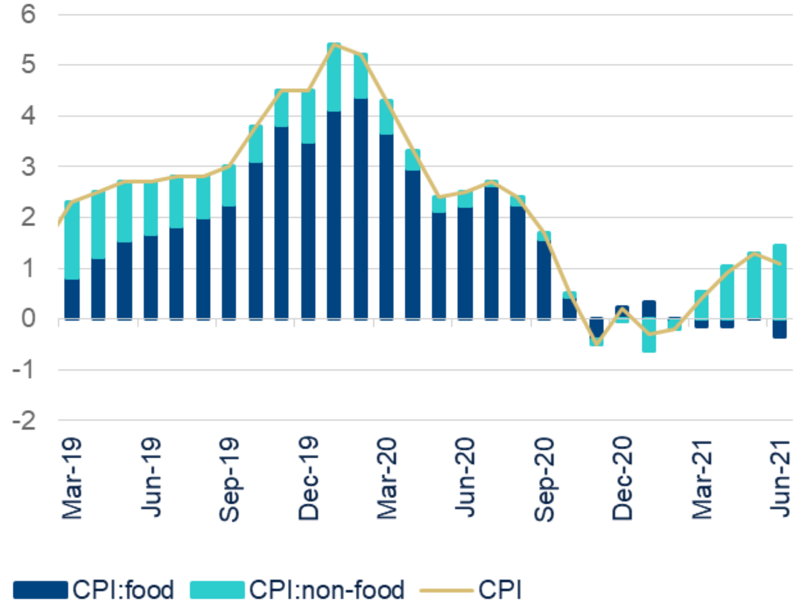
…SO DID THE REAL ESTATE INVESTMENT AND THE STARTED/COMPLETED FLOOR SPACE (% YTD, Y/Y)



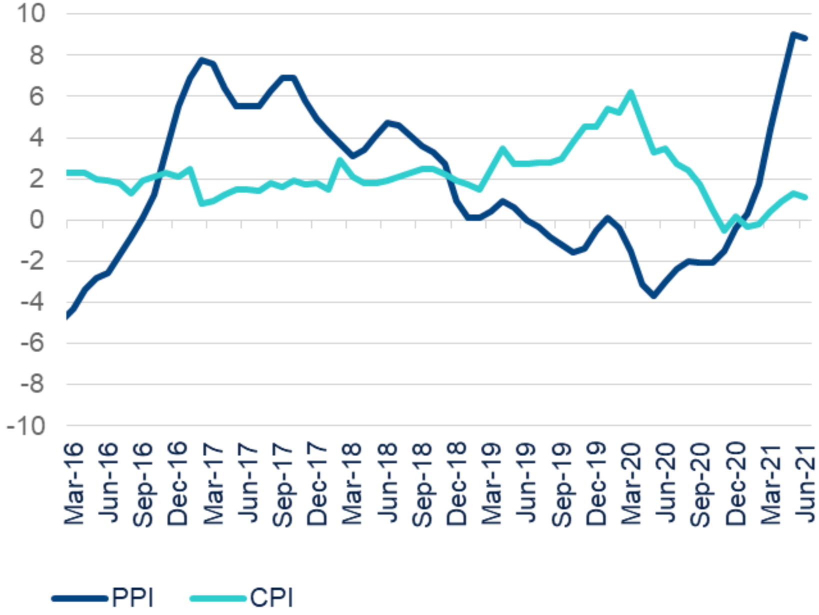
Source: CEIC and BBVA Research.

Inflation risk has been eased as both CPI and PPI passed its peak in June

CPI MODERATED IN JUNE, WHICH IS STILL DOMINATED BY THE AFRICA SWINE FLU CYCLE (% YOY)



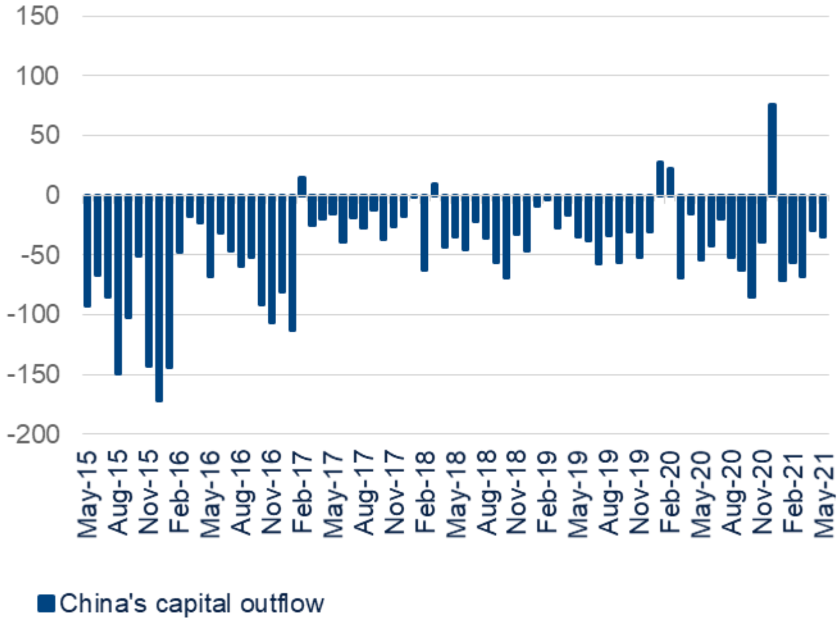
PPI REVERSED ITS SURGING TREND IN JUNE, AMID THE AUTHORITIES' MEASURES TO EXPAND THE RESERVED COMMODITY SUPPLY (% YOY)



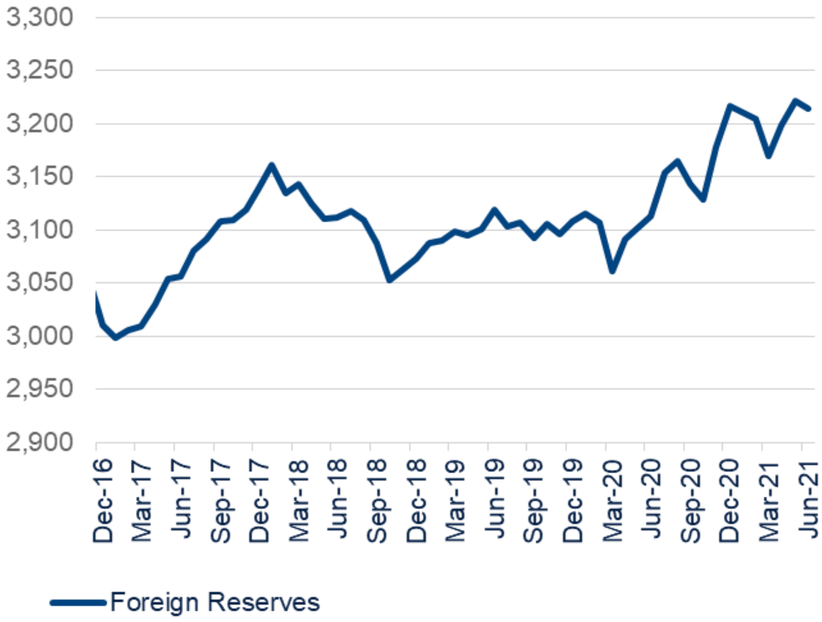
Source: CEIC and BBVA Research.

Capital outflows are under control

ESTIMATED CAPITAL INFLOWS ACCELERATED AS THERE WILL STILL BE SOME TIME BEFORE THE FED QE TAPERING (USD BN)



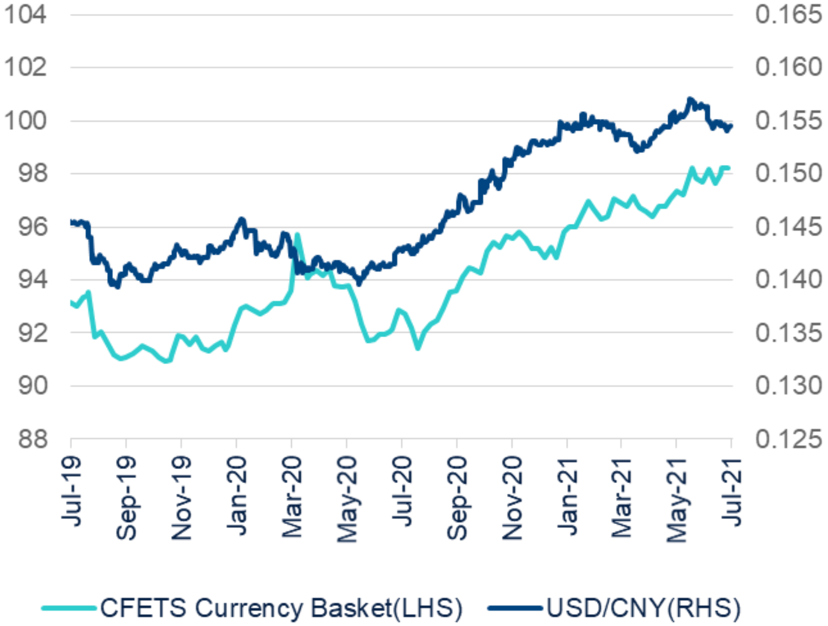
FOREIGN RESERVES DECLINED MARGINALLY IN JUNE BUT GENERALLY REMAIN STABLE IN THE PAST MONTHS (USD BN)



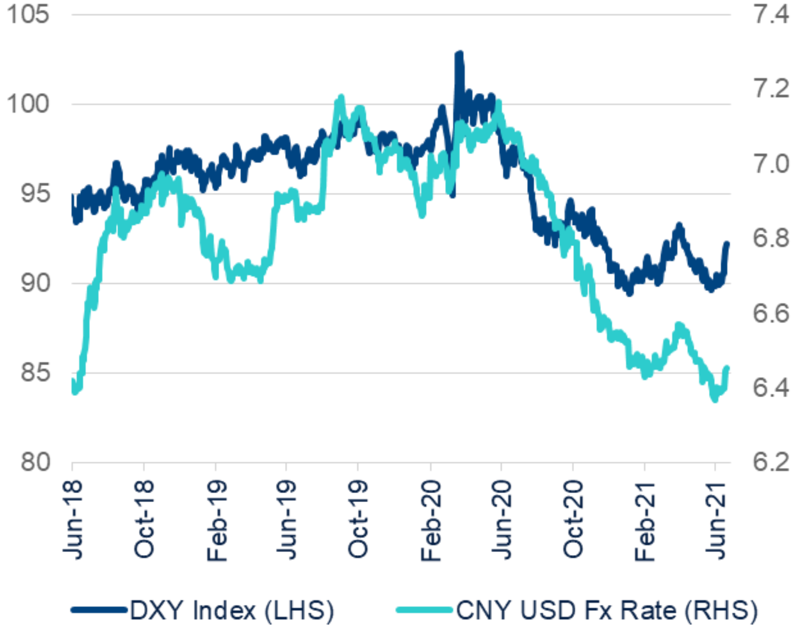
Source: CEIC and BBVA Research.

RMB to USD exchange rate reversed its appreciation at end-May due to PBoC's intervention and a stronger USD DXY

RMB REVERSED ITS APPRECIATION AT END-MAY, DEPRECIATED BY 1.3% IN JUNE SINCE PBOC ANNOUNCED TO CUT FOREIGN CURRENCY RRR



RMB EXCHANGE RATE HAS A STRONG RELATION WITH THE USD DXY INDEX



Source: CEIC and BBVA Research

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03

Policy stance has no “sharp turnaround”

Main messages

A neutral but still accommodative monetary policy

"without a sharp turnaround" is the main stance in 2021. The authorities started to take some easing measures to deal with growth moderation, chief among them is the RRR cut in July, but this does not indicate the beginning of another easing cycle.

Quantitative monetary tools

As the US QE Tapering is on the way, as an emerging market, China should follow the interest hike steps when the US hikes its interest rate to avoid large capital outflows. As the authorities are striking a balance between stimulating growth and defusing financial risks, no interest rate cut is expected in the rest of the year; only quantitative tools are anticipated.

Fiscal policy normalization

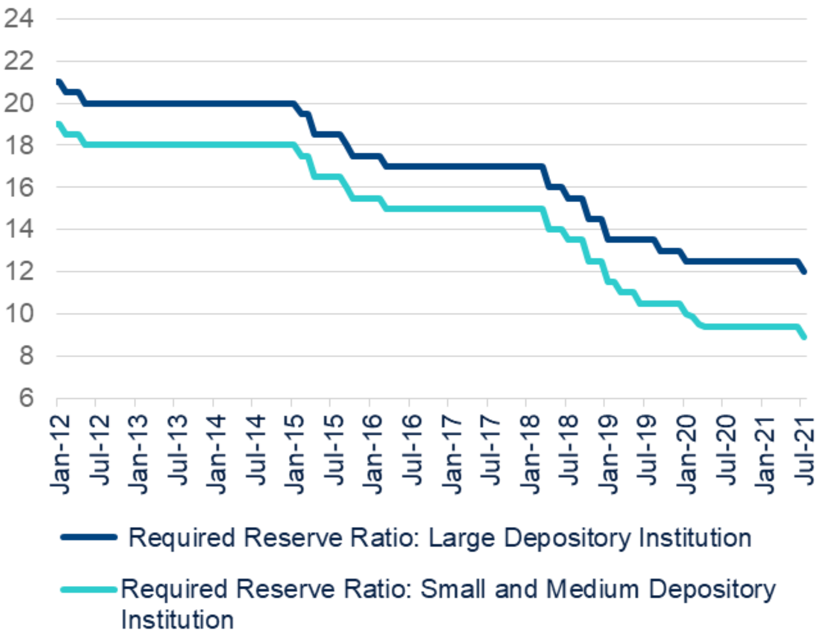
is the main stance in 2021. The "Two Sessions" announced a reduction of local government bond issuance and no more special government bond issuance. Fiscal consolidation of approximately 3.2% of GDP fiscal deficit relative to 2020's 3.6%.

A tightening regulation

has been enhanced to curb monopolistic behavior of E-commerce giants and tech firms' overseas listing. Meanwhile, macro prudential policies on housing market continue.

The PBoC started to take some "policy surprise" measures such as RRR cut in July, amid growth moderation

THE PBOC ANNOUNCED THE RRR CUT IN JULY 9TH, WHICH HAS NOT BEEN IMPLEMENTED SINCE APRIL 2020 WHEN CHINA WAS GRAPPLING WITH COVID-19 (%)

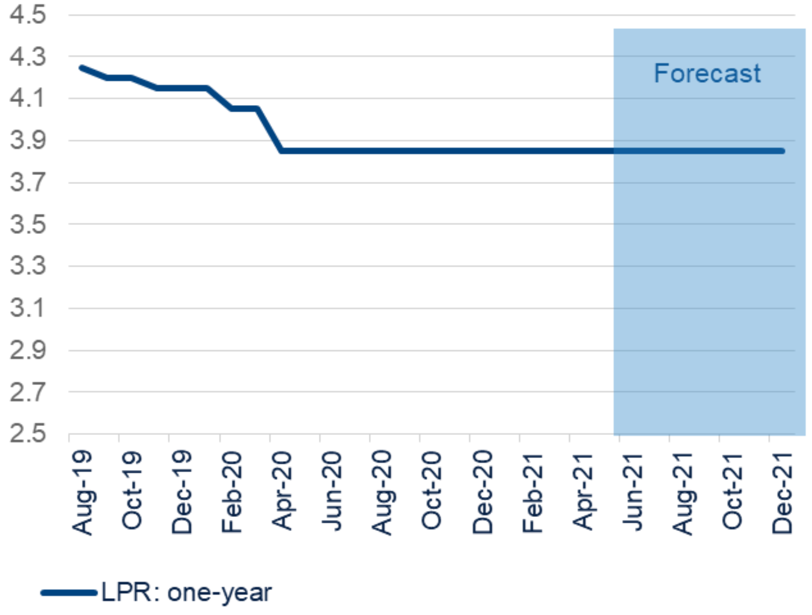


Source: CEIC and BBVA Research.

- The surprising RRR cut in July raised the growth deceleration fears of the market;
- The 0.5% universal RRR cut will release around 1 trillion yuan (around USD154.19 billion) in long-term liquidity to help underpin an economic recovery and deal with soaring commodity price;
- July RRR cut came as a surprise to the market as China has held the monetary policy normalization stance since May 2020 after "first-in, first-out" of the pandemic while the PBoC last time's RRR cut was in April of the last year, more than one year ago, when the Chinese economy was still grappling with the coronavirus.

However, the RRR cut does not indicate the beginning of another easing monetary cycle: a preemptive easing does not mean an aggressive easing…

A NEUTAL BUT STILL ACCOMODATIVE MONETARY STANCE INDICATES NO ADJUSTMENT OF LPR IN 2H 2021 (%)

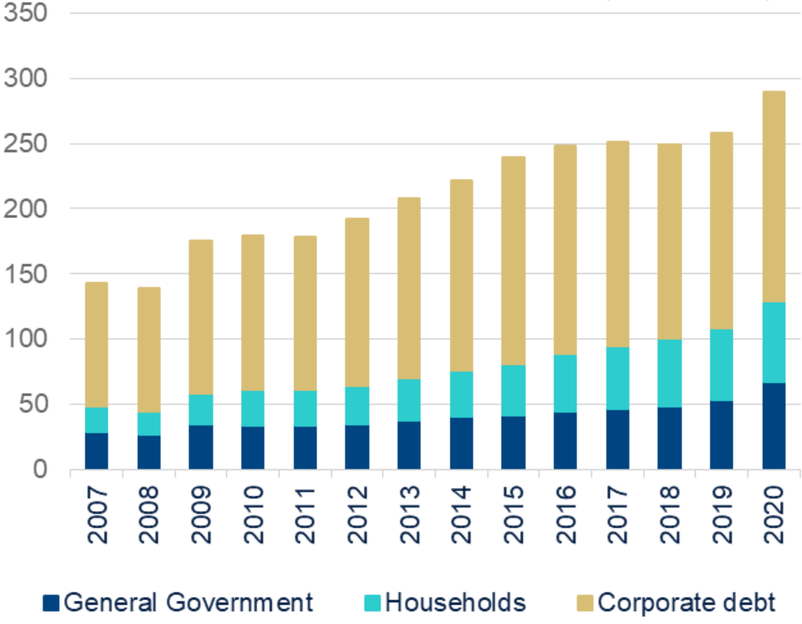


Source: CEIC and BBVA Research.

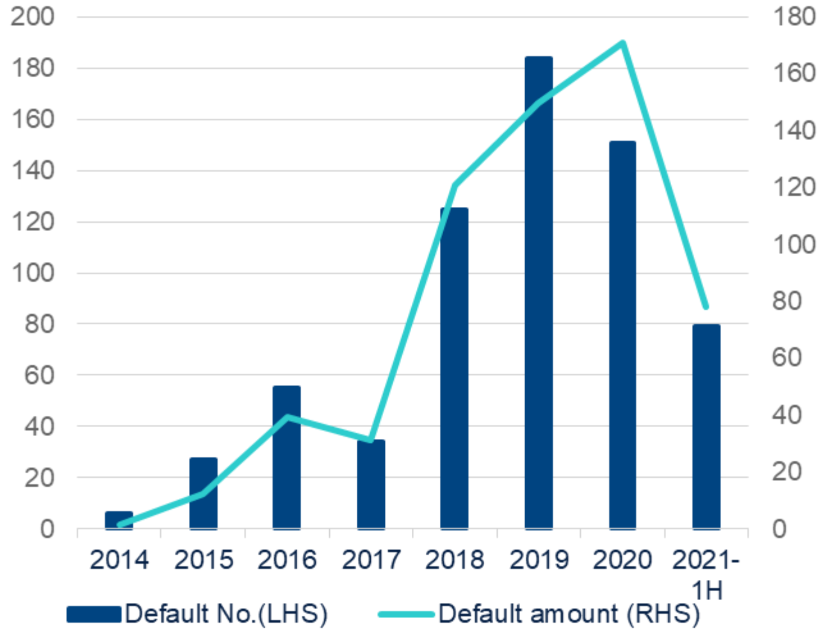
- Several factors decide this year's monetary policy normalization should avoid "sharp turnaround", neither turnaround to aggressive easing nor to aggressive tightening:
- "No sharp turnaround to aggressive tightening": uncertainties of global economic recovery, unsatisfactory vaccine coverage, China-US confrontations, debt overhang and fading exports momentum etc. added more headwinds on growth; China will follow US FED Tapering but it is not time yet of the beginning of the Tapering;
- "No sharp turnaround to aggressive easing": (i) China has achieved the "first-in, first-out" of the pandemic and economic recovery, although consumption is weaker-than-expected, still on a right track; (ii) it is not realistic to start another easing cycle when the US FED started to discuss QE Tapering, which will further enlarge interest differential and trigger capital outflows.
- All in all, the PBoC needs to strike a balance between stimulating growth and defusing financial risks.

…as financial stability is still a big challenge in the aftermath of Covid-19: Debt overhang problem due to the stimulus measures in 2020 1H

MACRO LEVERAGE RATIO HAS BEEN INCREASING IN THE PAST YEAR, INCLUDING GOVERNMENT, HOUSEHOLD AND CORPORATE DEBT (As % of GDP)



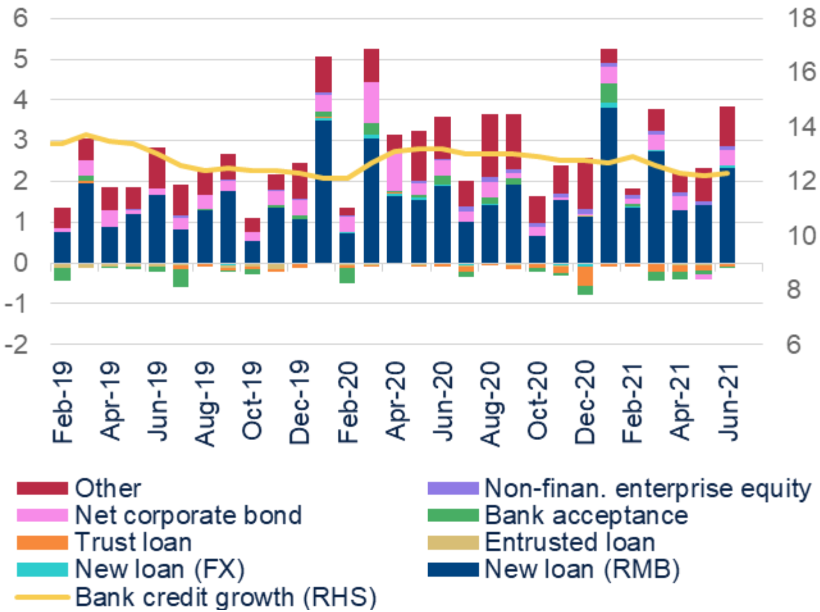
SOE DEFAULT AT END-2020 INCREASED RISKS FOR FINANCIAL STABILITY (RMB BILLION)



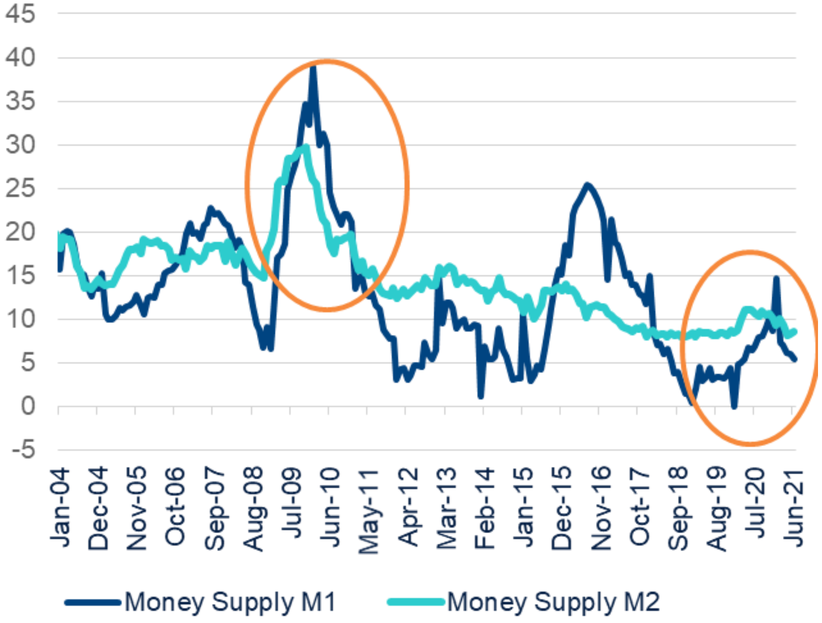
Source: CEIC and BBVA Research.

A neutral while accommodative monetary policy remains the policy stance of 2H 2021

TOTAL SOCIAL FINANCING AND NEW YUAN LOANS ALSO EXPANDED MODESTLY IN RECENT MONTHS (RMB TRN, %YOY)



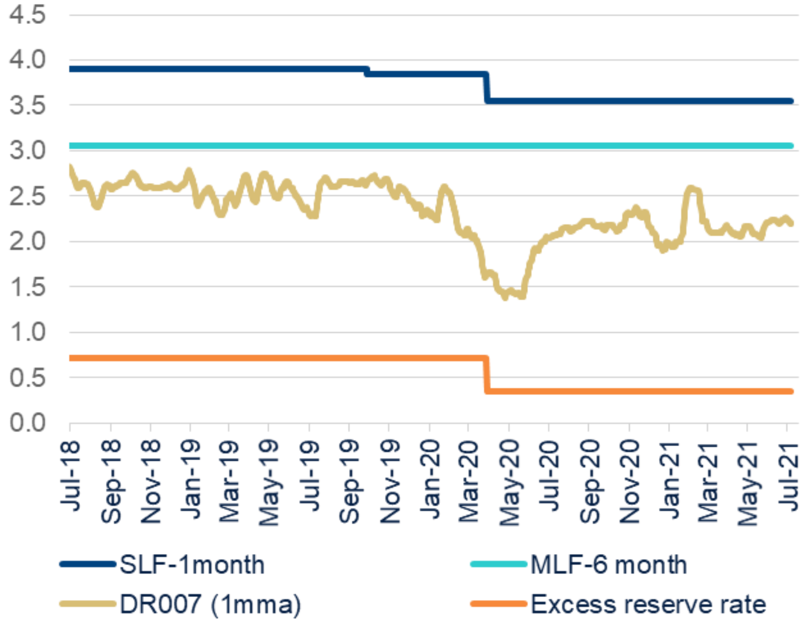
THE M2 TARGET SET BY THE "TWO SESSIONS" IS TO BE IN LINE WITH NORMINAL GDP GROWTH, AROUND 9.9% (Y/Y)



Source: CEIC and BBVA Research.

Although no LPR cut is anticipated, more policy tools to fine-tune the liquidity to support post-pandemic recovery

UNDER CORRIDOR SYSTEM FORMED IN 2016-17, THE PBOC HAS CREATED NEW POLICY TOOLS TO SOLVE TRANSMSSION PROBLEM (%)

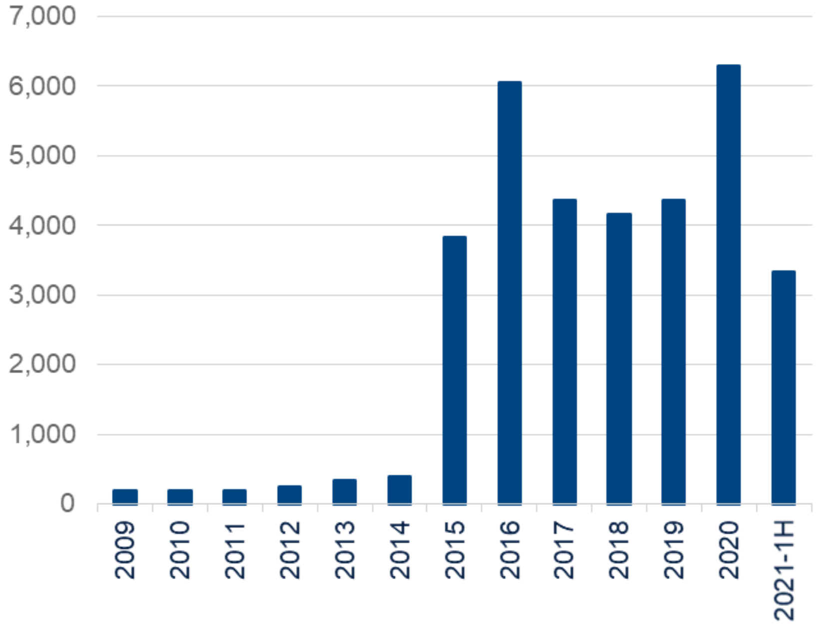


Source: CEIC and BBVA Research.

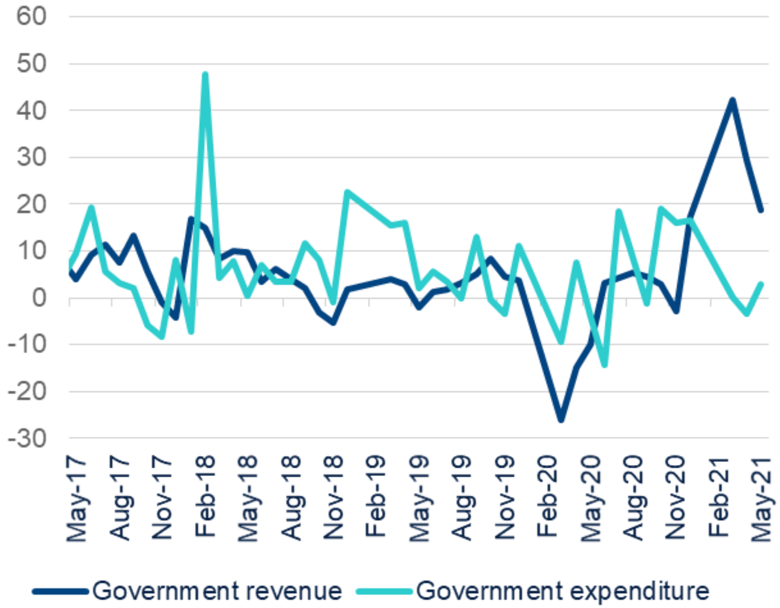
- China has multiple monetary policy targets: stabilizing inflation, promoting economic growth, maintaining employment, promoting financial stability and maintaining Balance of Payments,
- And multiple monetary policy tools: policy rate-DR007 (7-days Reverse Repo rate), LPR (Loan Prime rate; MLF (médium-lending facilities) rate; SLF rate (standing lending facilities), LPR (loan prime rate); Excess RRR and RRR, Re-lending and re-financing, PSL (pledged supplementary lending), SLO (Short-term Liquidity Operations);
- That means, only quantitative tools are expected, such as an expansion of MLF, a lower DR007, RRR cut etc. No LPR cut expected.

No further fiscal stimulus anticipated in 2021 as well

NO ADDITIONAL ISSUANCE OF SPECIAL TREASURY BONDS IN 2021 WHILE REDUCING SPECIAL-PURPOSE BOND ISSUANCE FROM RMB 3.75 BN TO 3.65 BN



A SIGNIFICANT GAP BETWEEN THE GOVERNMENT REVENUE AND EXPENDITURE INDICATES A TIGHTENING FISCAL POLICY STANCE (%)



Source: CEIC and BBVA Research.

The crackdown on Didi Chuxing indicates a new round of tightening regulations on e-commerce giants and tech firms

Didi Chuxing, the largest Chinese ride-hailing Company lost one-fourth of its market value in the US stock market.

Chinese regulators announced an investigation on the company's data security, and forced its app to remove from the mobile phone's app stores domestically.

Didi crackdown s part of the recent tightening regulations on the tech sector. Since 2020, authorities have promulgated anti-monopolistic law, with Alibaba and Tencent, the most high-profile targets.

Main takeaways

- The Chinese authorities will certainly tighten the regulations on the overseas listing companies, blocking the lucrative pipeline from some Chinese companies to raise capital in the US market.
- Chinese firms, in particular tech companies, will be forced to choose other market to do IPOs rather than the US.
- China will emphasize on data regulations in a bid to blocking foreign governments' access to Chinese data.

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04

Projections

Main messages

GDP growth forecast

Based on the low base effect, we forecast 2021 GDP growth to bounce back to 8.2% (Bloomberg consensus: 8.5%; IMF: 8.4%), an upward revise from our 7.5% forecast in Q2 2021. The 2021 “Two Sessions” set a conservative and easy-to-achieve growth target at 6%, indicating the authorities’ consideration of global uncertainties and the turbulence led by US QE Tapering ahead, and to leave more space to curb financial risks and press ahead structural reforms.

Employment Target

China also set a target of creating over 11 million new urban jobs this year, compared to a target of 9 million last year, and a surveyed urban unemployment rate of 5.5%, compared to around 6% last year.

Main messages

Inflation forecast

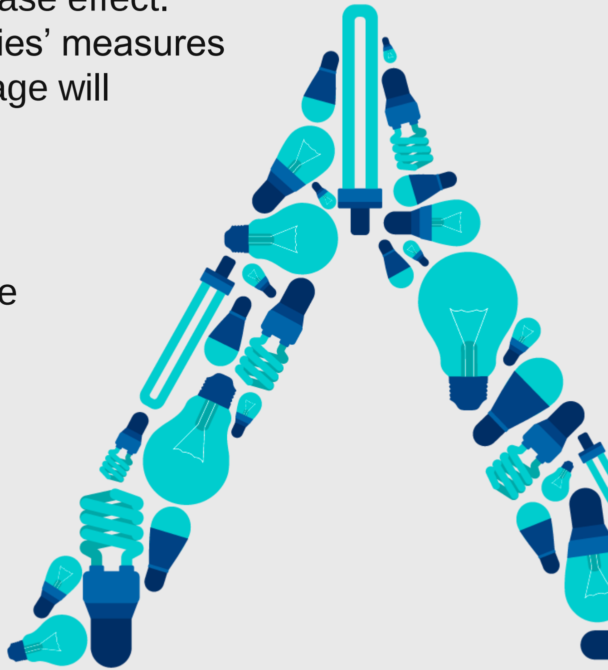
Inflation is expected to achieve 1.7% in 2021, due to the significant ease of African Swine Flu and high base effect. PPI passed its peak in June, due to the authorities' measures to expand reserved commodity supply, on average will achieve 6.5% in 2021.

Monetary policy outlook

No anticipation of interest rate cut in 2021, that means, the recent RRR cut does not indicate the beginning of another easing cycle.

RMB to USD forecast

RMB to USD exchange rate reversed its previous appreciation trend amid a strong USD DXY amid Tapering steps. We maintain our prediction at 6.5 at year end of 2021.



Economic indicators forecasting

BASELINE SCENARIO

	2019	2020	2021	2022
GDP （%）	6.1	2.3	8.2	5.5
CPI（%）	2.9	2.5	1.7	2.5
PPI (%)	-0.3	-1.8	6.5	1.7
Interest rate (LPR, %）	4.1	3.85	3.85	3.85
RMB/USD exchange rate	7.0	6.5	6.5	6.5
Fiscal deficit to GDP (%)	-4.9	-6.5	-4	-3.5

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China Economic Outlook

3Q21

Creating Opportunities