Economic Watch

China | Growth slowdown in Q3 calls for more easing measures

Jinyue Dong / Betty Huang

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The Q3 GDP outturn, together with September real economic indicators, were released by the National Bureau of Statistics today, further confirming the growth slowdown. The Q3 GDP decelerated remarkedly to 4.9% y/y from 7.9% in Q2 while its quarter on quarter growth also moderated to 0.2% q/q from 1.2% q/q previously. Quite a number of headwinds weigh on growth, including the recent power crunch, the contagion effect of Evergrande default risk and regulation storms targeted on "common prosperity" and social equality that cracked down a number of sectors. In terms of September economic activity indicators, both industrial production and fixed asset investment tumbled from the previous reading, while retail sales picked up amid less social distancing concern after COVID-19 flare-ups in some provinces were under control, although it still needs a lot of perseverance to catch up with the pre-pandemic growth. To reflect growth slowdown and the headwinds stated above, we lowered our 2021 GDP forecast to 8.0% from 8.2% (Market consensus: 8.2%; IMF: 8%), which still way above the conservative official target of 6% announced in the "two sessions" this year.

On the supply side, the year on year growth of industrial production slumped to18 months low to 3.1% y/y from 5.3% y/y in the previous month (market consensus: 4.5% y/y), and the seasonal adjusted m/m growth also weakened to 0.05% m/m, compared with 0.31% m/m previously. Apart from the authorities' shutdown of high-polluted sectors to meet carbon neutrality target, persistent semiconductor shortages due to the disruption of global value chain and the recent abrupt electricity crunch stemming from the coal shortage severely hit production. In addition, the floods in Shanxi province also aggregated the energy shortage, as it is reported there are over 60 coal mines that have been shut down due to the floods. By categories, the steel production growth tumbled to -21.2% y/y compared with -13.2% y/y in the previous month; crude oil growth dipped to -16.1% y/y compared with -11.1% y/y in August; the growth of cement also slowed to -13.0% y/y from -5.2% y/y growth in the last month. All of these sectors' deceleration reflected electricity crunch and coal shortage. By a sharp contrast, electric vehicle remains the pillar of industrial production growth although it marginally decelerated to 141.3% y/y from 151.9% y/y in the previous month. Following that is the integrated circuits and industrial robots which registered 21.4% y/y and 19.5% y/y respectively, benefiting from the carbon neutrality initiatives and industry policy transformation from prioritizing consumption to the "profession, refinement, specialty, innovation" type of high-end manufacturing. (Figure 1)

On the demand side, fixed-asset investment (FAI) trended down to 7.3% ytd y/y from 8.9% ytd y/y previously (market consensus: 7.9% ytd y/y). By components, the previous pattern remains as manufacturing FAI surpassed the infrastructure FAI and real estate FAI to lead the investment growth, although all of them registered deceleration readings. The slowdown of infrastructure and real estate investment are dragged by the stagnation of local government bond issuances amid previous fiscal policy normalization and the recent negative spill-over effect of Evergrande's crisis to the property sector, respectively. In particular, manufacturing FAI decelerated to 14.8% ytd y/y (prior: 15.7% ytd y/y), higher than the infrastructure FAI at 1.5% ytd y/y (prior: 2.9% ytd y/y) and real estate at 8.8% ytd y/y (prior: 10.9% ytd y/y) respectively. Looking ahead, as the local government bond issuance is

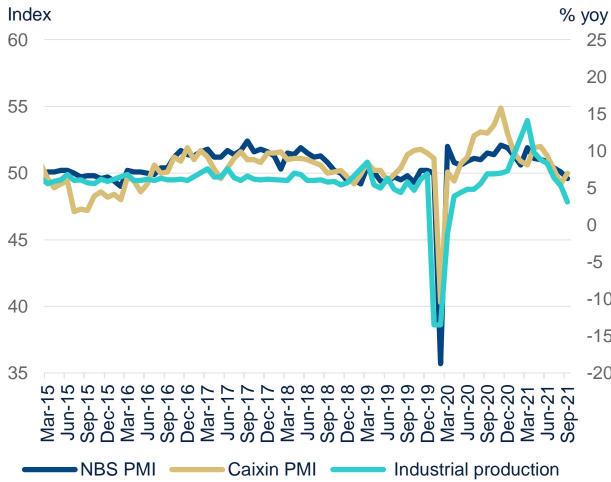
anticipated to rev up in the rest of the year to support growth, the infrastructure investment is set to ramp up, while manufacturing FAI is poised to continue to spearhead the FAI growth. (Figure 2 and 3)

On the other hand, retail sales' year-on-year growth bounced back to 4.4% from 2.5% y/y previously (market consensus: 3.3% y/y), with its month-on-month growth also rising from 0.17 m/m to 0.3% m/m; however, it still needs a lot of perseverance to catch up with the pre-pandemic growth. The pick-up of retail sales shows the consumption strengthened due to a relaxation of the Covid-19 control after its flare-ups in some regions have been contained. By component, communication equipment and household appliances showed a significant growth increase, which ticked up to 22.8% y/y and 6.6%y/y respectively from -14.9% y/y and -5.0% y/y in August. In addition, restaurant sales growth also rebounded to 3.1% y/y from -4.5% y/y previously. (Figure 4)

The weaker-than-expected Q3 GDP reflects the authorities' intention to concern more about the long-term structural issues instead of the short-term growth figures, taking use of the favorable time window of China's "first-in, first-out" of the pandemic to pursue "common prosperity" and social equality. However, the authorities' original good willingness unfortunately coincidentally met with the recent power crunch, production curbs under the carbon neutrality pledge, real estate giant's default, bottle-neck of global supply chain and soaring energy price, etc., leading to a faster-than-expected growth deceleration. In addition, growth slowdown also exposed the vulnerability of its anti-virus strategy as authorities' zero tolerance to the pandemic has become increasingly unaffordable and the situation will get worse when the rest of the world eventually finds a way to coexist with the virus.

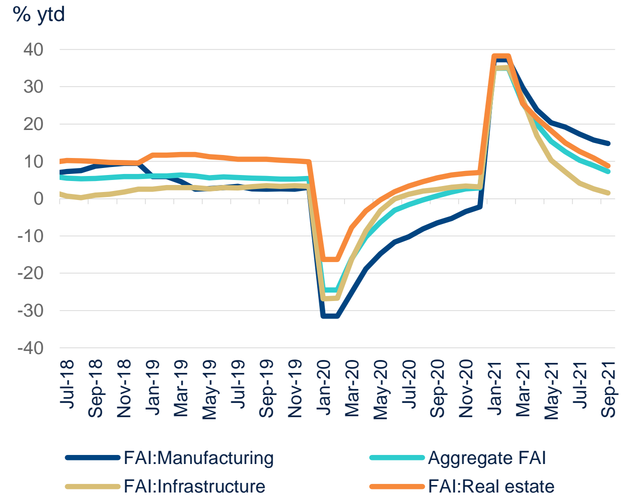
The slowdown of China's economic growth will certainly prompt the authorities to deploy more pro-growth fiscal and monetary policy initiatives in the rest of the year to stimulate growth. Due to the comparatively closed capital account and independent monetary policy, as well as the contained inflation environment which is contrast with that of the advanced economies, China will have quite a diverging monetary policy with the advanced economies in the rest of the year and year follows. That means, by contrast with the US QE tapering and potential interest rate hikes among other economies, we anticipate that the authorities will have more loosening monetary measures, such as to implement 1-2 more RRR cuts (50-100 bps cumulatively) and 10-bps cut in LPR in the coming months. From the fiscal policy perspective, local government bond issuance is also expected to accelerate in the rest of the year to boost infrastructure investment. Beyond that, the recent regulatory forbearance particularly on real estate sector might add further impetus for economic growth given the large share and strong spillover effect of housing sector to the whole economy. All in all, the authorities are aware of the growth deceleration and will strike a balance between stimulating growth and pressing ahead structural reforms going forward.

Figure 1. **INDUSTRIAL PRODUCTION HIT 18 MONTHS LOW**



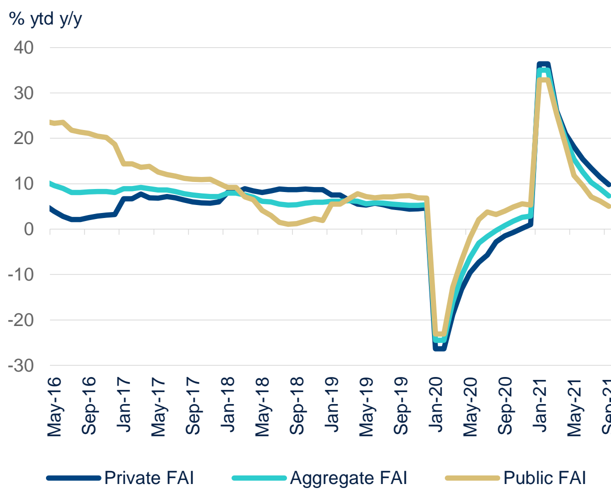
Source: CEIC and BBVA Research

Figure 2. **MANUFACTURING FAI SURPASSING INFRASTRUCTURE AND REAL ESTATE TO LEAD THE FAI GROWTH**



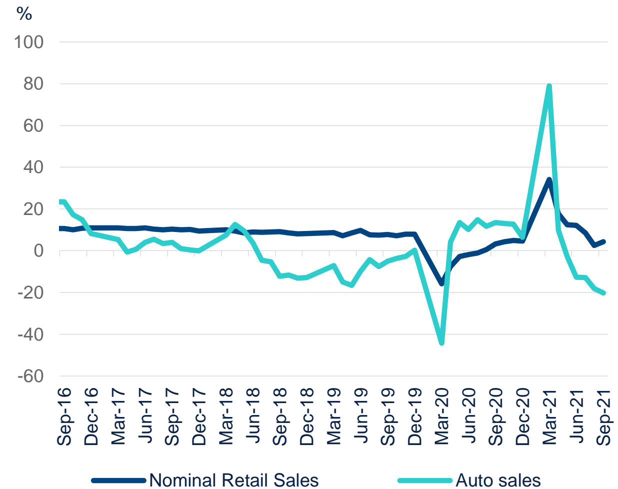
Source: CEIC and BBVA Research

Figure 3 **PRIVATE FAI SURPASING PUBLIC FAI AMID FISCAL POLICY NORMALIZATION**



Source: CEIC and BBVA Research

Figure 4 **RETAIL SALES REBOUNDED DUE TO A RELAXATION OF COVID-19 CONTROL**



Source: CEIC and BBVA Research

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BBVA Research: 43/F, Two International Finance Centre - 8 Finance Street. Central, Hong Kong.
Tel. + 2582 3111 / Fax. +852-2587-9717
bbvaresearch@bbva.com www.bbvaresearch.com