BBVA Research

China Economic Outlook

4Q21

Creating Opportunities

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01

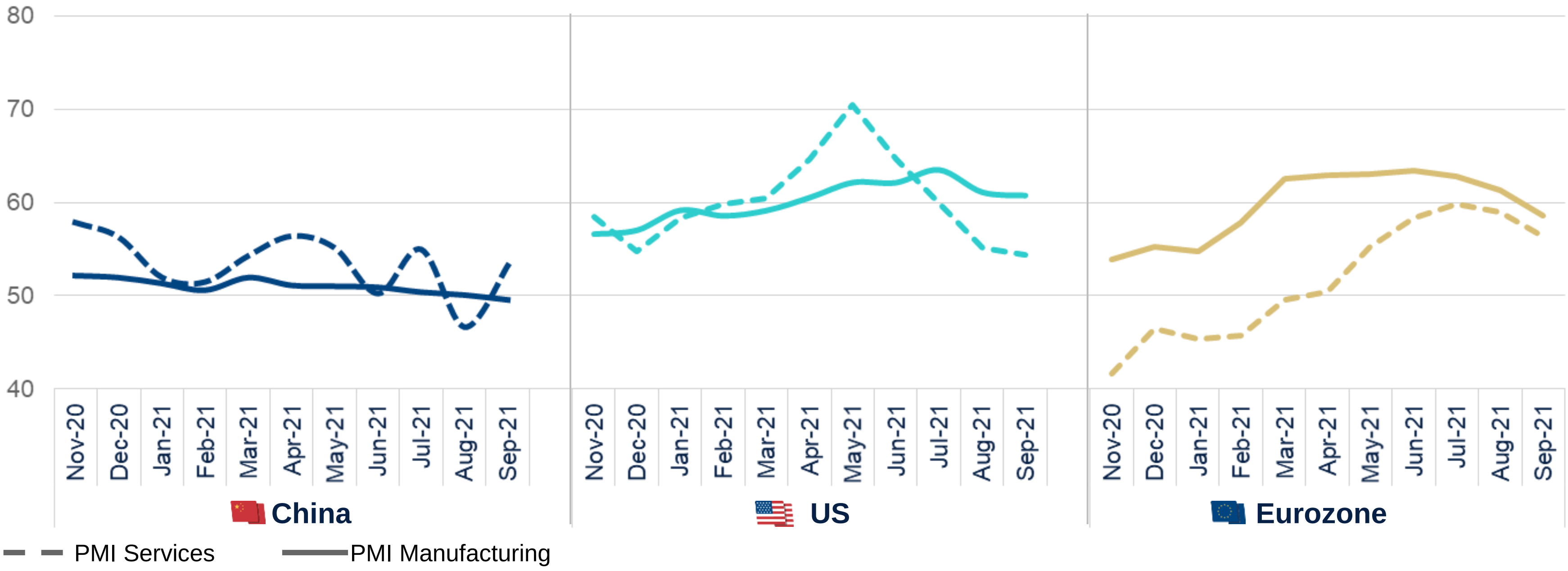
The bumpy global recovery

Creating Opportunities

Growth is moderating, mainly in the US and China, after a strong rebound driven by the economic activity reopening in the first half of the year

PMI

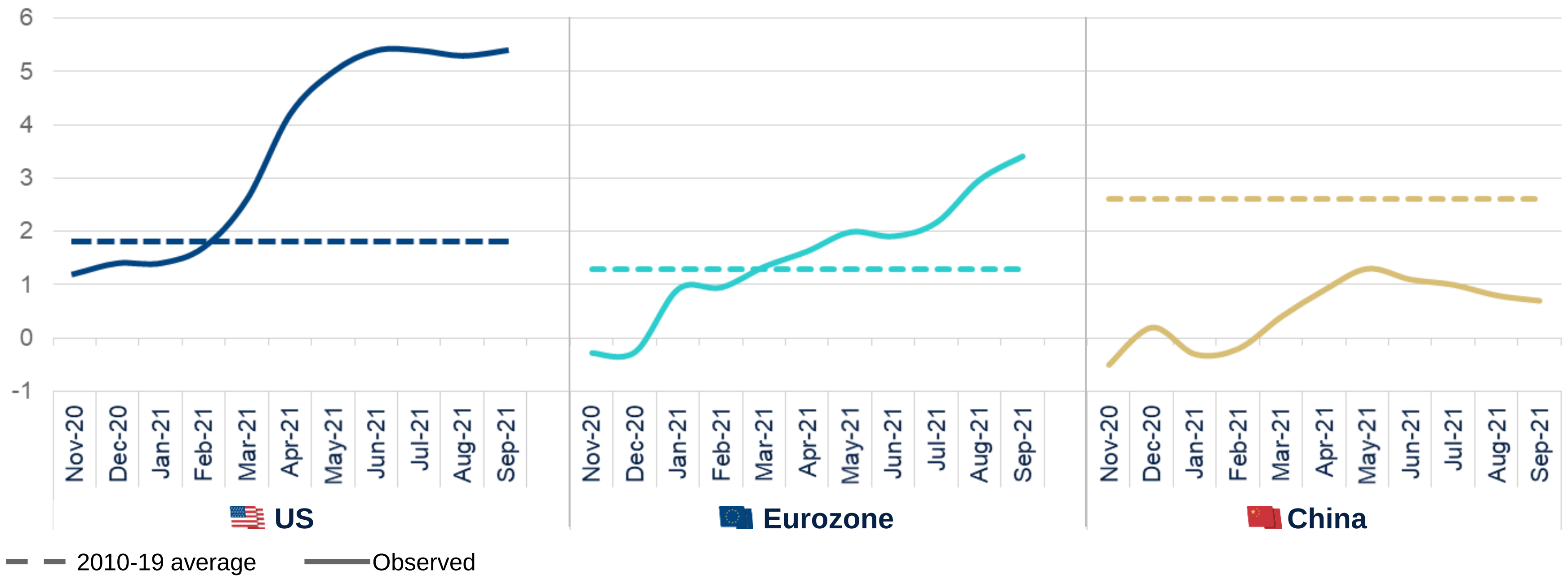
(HIGHER THAN 50: EXPANSION; LOWER THAN 50: CONTRACTION)



Source: BBVA Research based on data by Haver.

Inflation remains high, more in the US than in Europe

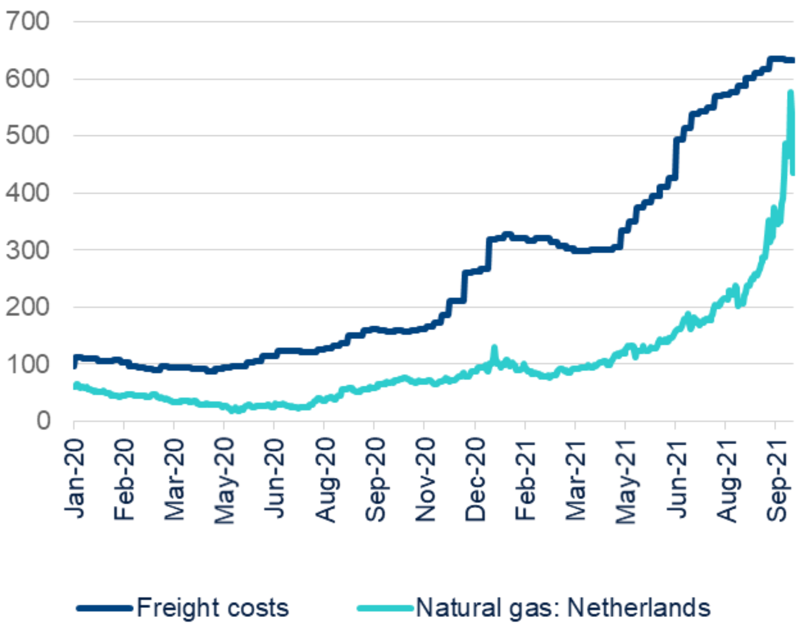
INFLATION: CPI
(Y/Y %, END OF PERIOD)



Source: BBVA Research based on local statistics.

Supply chain disruptions have contributed to both the growth moderation and the increasing inflationary pressures

FREIGHT COSTS AND GAS PRICE (*)
(INDEXES)



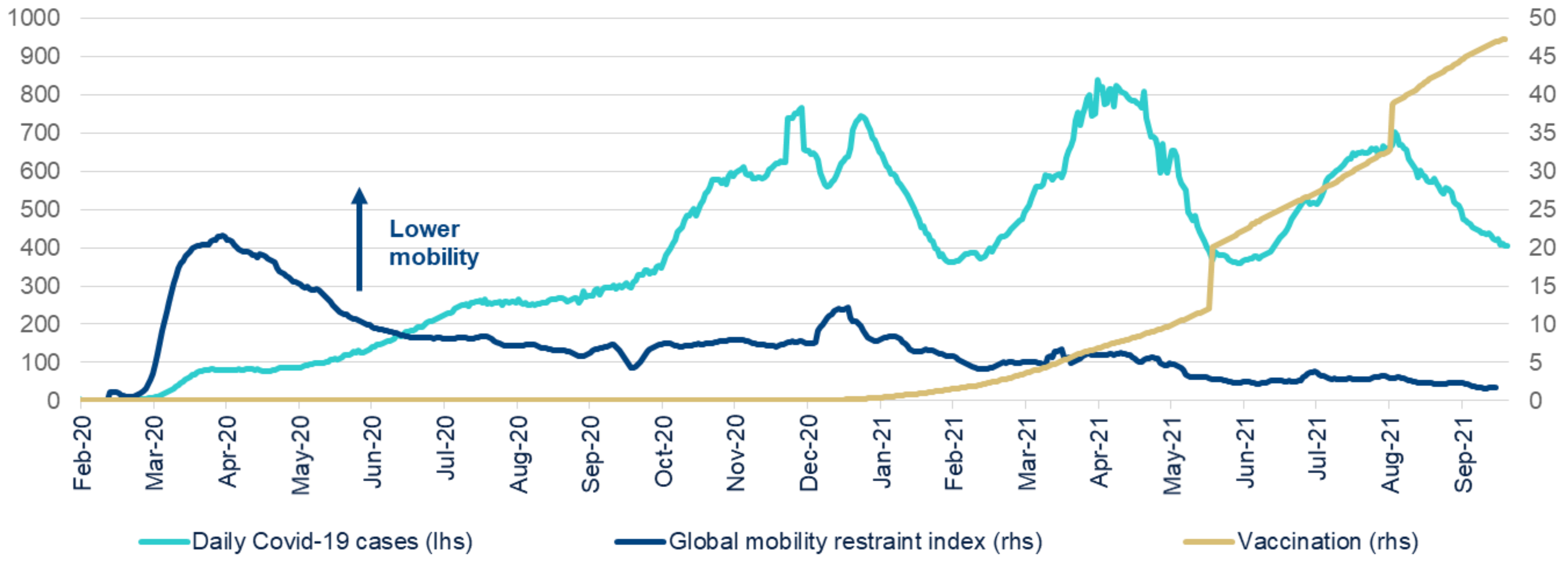
(*) Freight cost: world composite indicator. Gas price: Duct natural gas future.
Source: BBVA Research based on data by Bloomberg.

- More significant and persistent bottlenecks than anticipated, particularly in the manufacturing and transport sectors
- Moreover, the price of some commodities, mainly in the energy sector, has risen significantly
- A number of factors are behind these strong and unexpected cost pressures:
  - supply rigidity, especially given the expansion of the Delta strain in China and the US
  - labor shortage in some sectors
  - demand resilience and rapid activity reopening
  - higher demand for goods vs. services
  - weather disruptions
  - energy transition policies
  - trade protectionism
  - geopolitical tensions

Vaccination has reduced the economic impact of the new contagion waves, but the Delta variant remains a concern, particularly in China and the US

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)

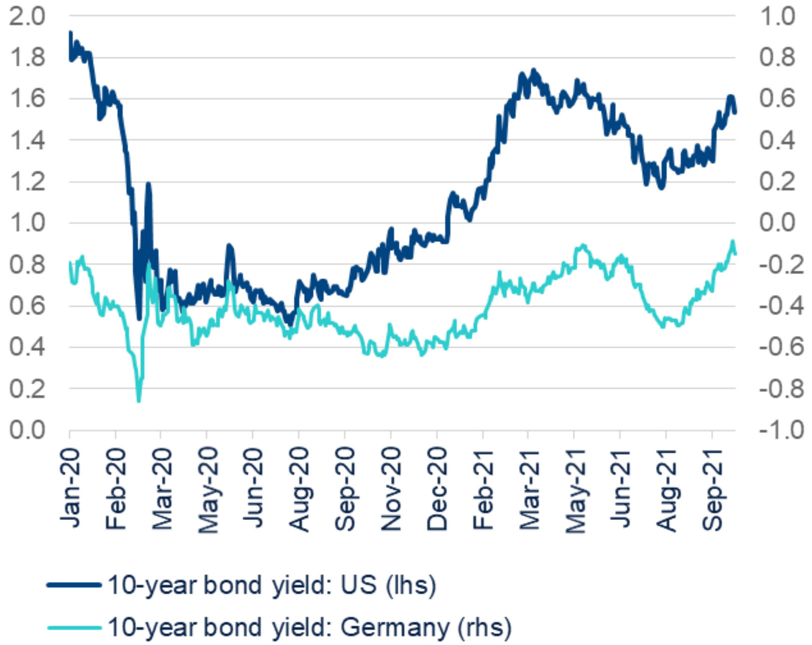


(*) The mobility restraint index reflects changes with respect to the period of reference (January 3 to February 6 2020). Higher values represent lower mobility.
Source: BBVA Research based on data by John Hopkins University, Google and Our World in Data.

The announcement by the Fed that the tapering will start in 2021 puts pressures on bond yields and supports the dollar

10-YEAR BOND YIELDS

(%)



Source: BBVA Research a partir de datos de Bloomberg.

- US bond yields have increased due to the prospect that the Fed will begin to withdraw stimulus somewhat earlier than expected and also on higher inflation expectations.
- Bond yields have also risen in the Eurozone, with the ECB reducing the PEPP purchases.
- The dollar has appreciated against the euro and emerging currencies.
- Capital flows to emerging markets have eased.
- Financial volatility has been limited, despite the concerns about the debt crisis of the Evergrande real estate group in China.

The recovery will continue, but will lose momentum due to the ongoing supply shocks, which will temporarily pressure inflation and central banks

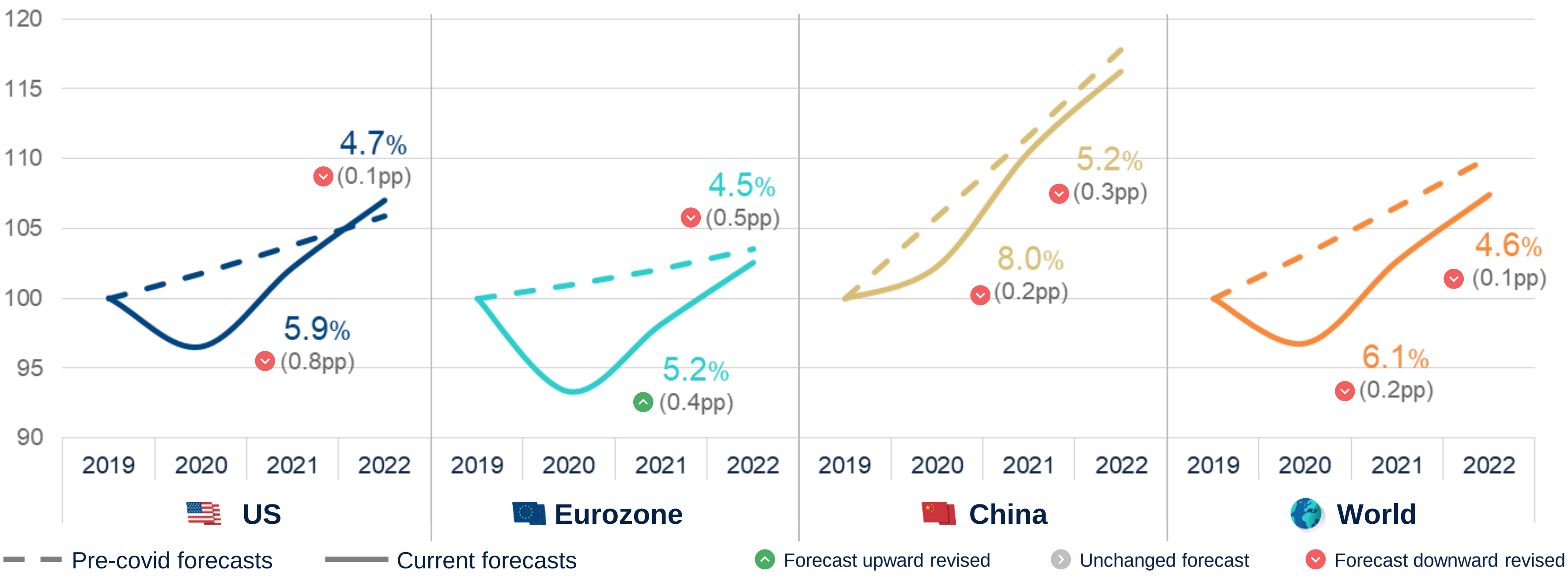
MAIN FEATURES OF BBVA RESEARCH'S GLOBAL ECONOMIC SCENARIO

Bottlenecks	Larger impact than expected on activity (to the downside) and inflation (to the upside); negative effects expected until around mid-2022.
Economic policies	Expansionary fiscal and monetary policies in the G3 despite the gradual withdrawal of stimuli (Fed: tapering in 4Q21 and starting rate hikes in 4Q22).
Pandemic	Convergence towards "normality"; eventual new waves will have a lower impact on activity.
Growth and inflation	Robust growth, although somewhat weaker than previously estimated; relatively high inflation, though losing strength from 2022 onwards.
Financial markets	Risk assets pressured by the withdrawal of monetary stimulus by the Fed; a US dollar somewhat more appreciated than expected.
Emerging economies	Complex environment: lagged exit from the pandemic, inflation pressures on CBs, declining global liquidity (capital flows); positive commodity prices for exporters.
Risks	Mostly negative: persistence of supply shocks, stimulus withdrawal, slowdown in China, pandemic (new strains, incomplete vaccination), etc..

Global growth will be less robust than anticipated, mainly due to the supply shocks and the somewhat faster slowdown in China

REAL GDP

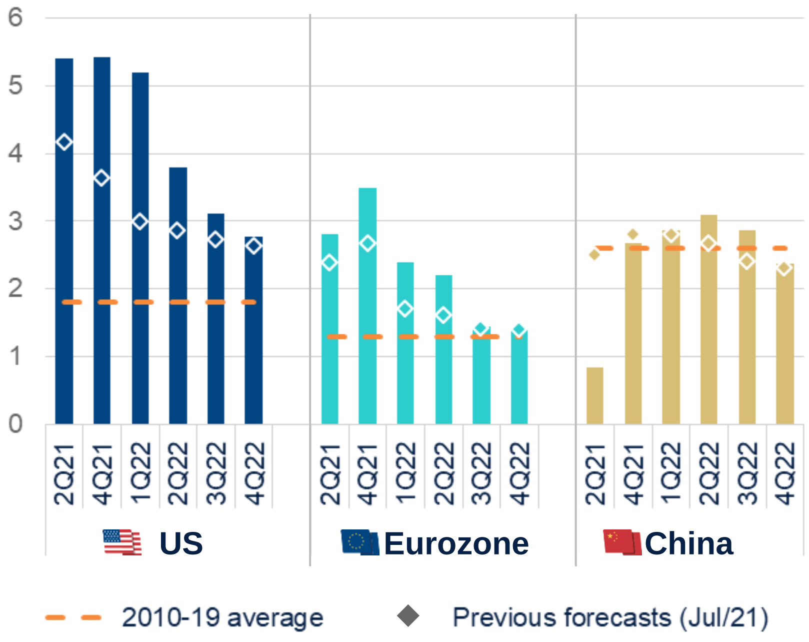
(LINES: GDP LEVEL 2019=100, FIGURES: FORECASTS AND CHANGES WITH RESPECT TO THE PREVIOUS ONES)



Source: BBVA Research.

Inflation will remain higher than previously expected and above previous decade's levels, but will gradually slow down in 2022

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

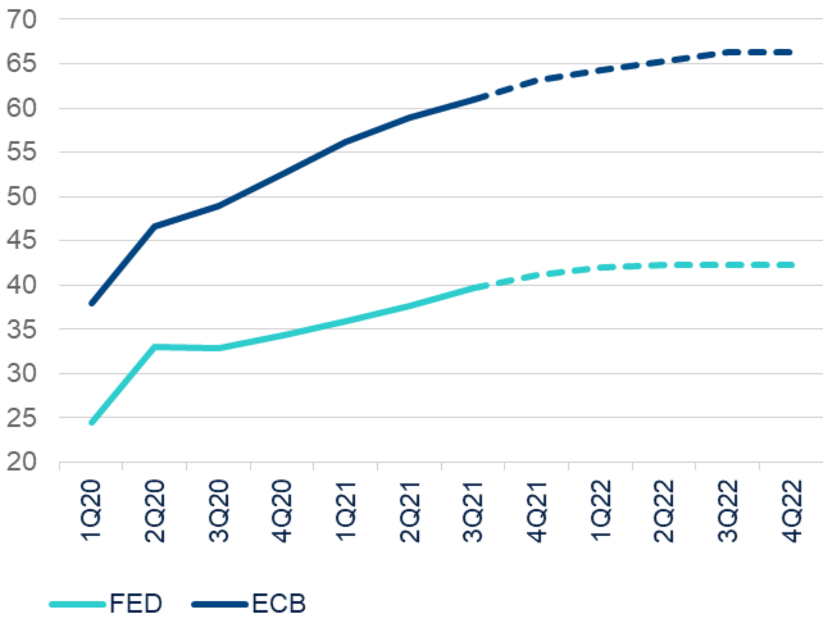


Source: BBVA Research.

- Inflation forecasts in the US and the Eurozone have been revised upwards.
- More favorable base effects, the transitory nature of most supply shocks and the absence of generalized wage pressures should allow inflation to moderate from 2022 onwards.
- Risks are biased to the upside; anchoring expectations is key.
- Inflation in China remains low due to positive base effects, but rising production costs and energy prices will create upward pressure in the coming quarters.

The Fed will soon begin withdrawing monetary stimulus; the ECB will be more patient and the PBoC will adopt additional measures to support activity

FED AND ECB BALANCE SHEETS
(SHARE OF GDP)



Source: BBVA Research based on data by the Fed and the ECB..

US

- Fed expected to start the withdrawal of stimulus earlier than expected: tapering in Q4 and increases in rates in one year.
- New investment-focused fiscal stimulus (7% of GDP), despite political uncertainty.

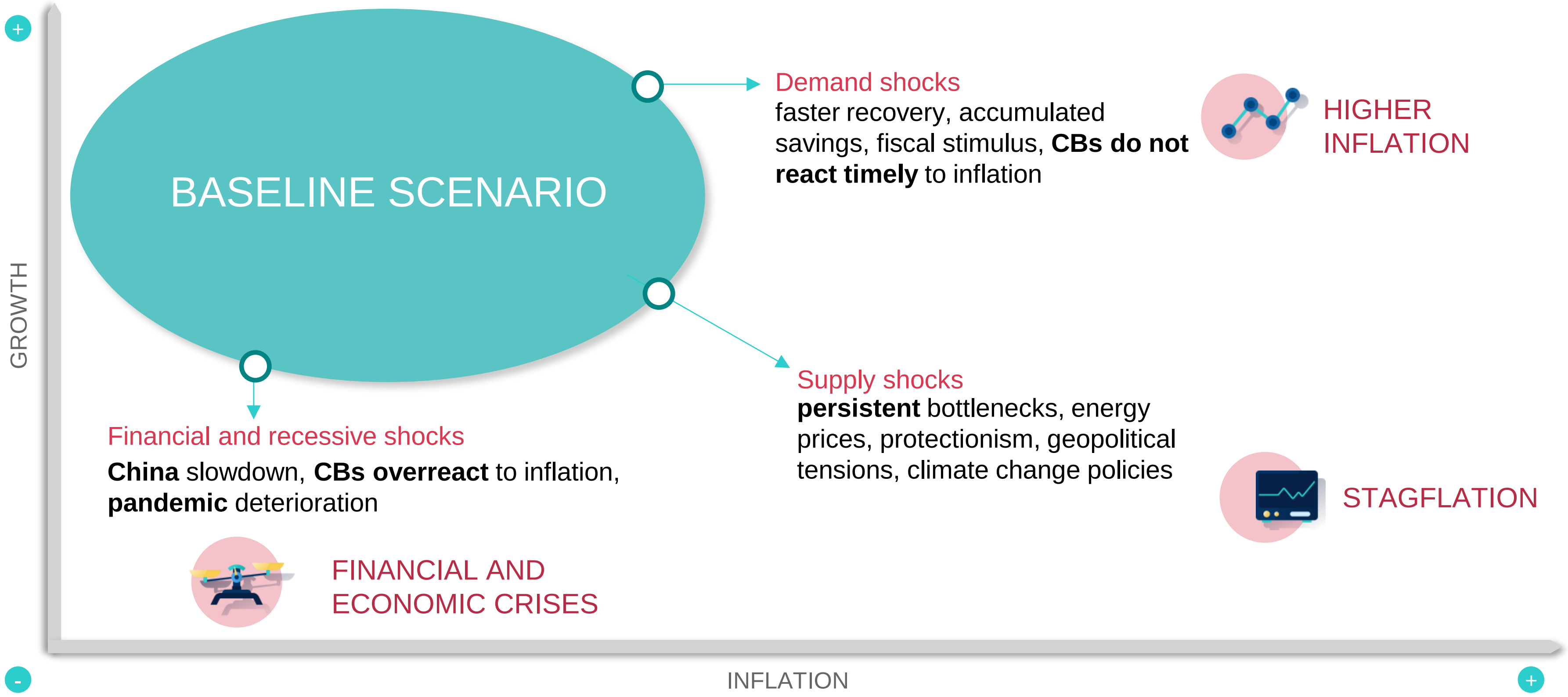
Europe

- The ECB is closer to ending the PEPP, but will remain patient with inflation and rates.
- Implementation of NGEU funds and support measures to offset energy rises.

China

- new stimulus to reduce the effect of regulatory measures (in real estate and financial sector) and supply shortages.

Risks: supply shocks, the withdrawal of stimuli, the slowdown in China, among other factors, could generate more negative global scenarios



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02

China’s slowdown amid regulatory storms, default risks and power crunch

Main messages

Growth slowdown

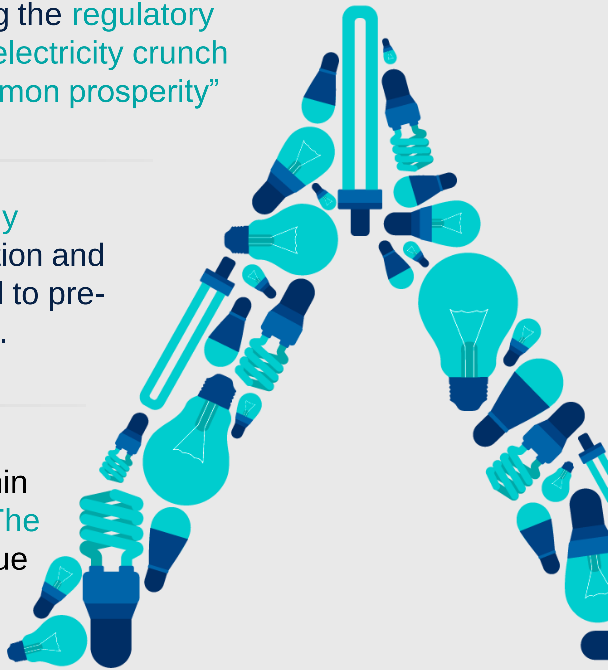
Growth has slowed down in China after a strong rebound in Q1. GDP slowed to 4.9% y/y in Q3 from 7.9% in Q2, and is expected to further dip to 3.5% in Q4. A number of growth headwinds, including the regulatory storms, default risk of large real estate companies, the electricity crunch and the authorities' new campaign to press ahead "common prosperity" and social equality etc. weigh on the outlook.

The economic structure is unbalance

Economic structure remains unbalanced as the economy depends too much on exports while domestic consumption and investment keep lackluster. To regain all the lost ground to pre-pandemic growth, quite a bit of perseverance is needed.

Coexistence of high PPI and low CPI

Compared with high inflation pressure in US and the EU, China's CPI is still at bay as decelerating pork prices within the African Swine Flu cycle dominates the CPI reading. The pass-through effect of surging PPI to CPI is still limited due to both low pork prices and other administrated prices of utility and electricity.



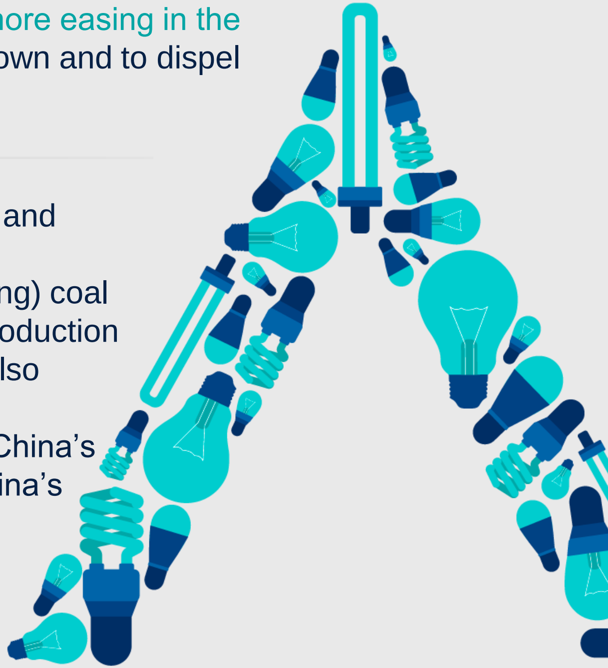
Main messages

More easing measures ahead to dispel market worries

Diverging with the QE Tapering and potential interest rate hike in the advanced economies, China's monetary policy will be more easing in the rest of the year to deal with the economic growth slowdown and to dispel the worries of the global investors.

Main downside risks ahead

(i) Regulatory reforms directly crackdown these sectors and triggered market panic; (ii) Electricity crunch due to the mismatch of a fixed electricity price and a flexible (soaring) coal price and aggressive carbon emission target lowered production capacity; (iii) "Common prosperity" and social equality also initiated the market worries, particularly for the private enterprises. (iv) Default risk of Evergrande, the largest China's real estate developer might have contagion effect to China's financial markets.



Chinese economy: positive and risk factors

Positive factors

Vaccination will add impetus for global economic recovery; strong exports continue to support growth.

From policy perspective, the PBoC has large policy room to conduct easing measures, dispelling the market worries of recent regulatory storms.

Low inflation environment, which is unsynchronized with other economies, provides the authorities more room for policy maneuver.

An eased Sino-US relation and certain external arrangements such as RCEP and CPTPP are expected to help China to improve its relation with other countries.

Risk factors

Regulatory storms on several targeted sectors to promote "common prosperity" and social equality, weigh on growth and market sentiments.

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

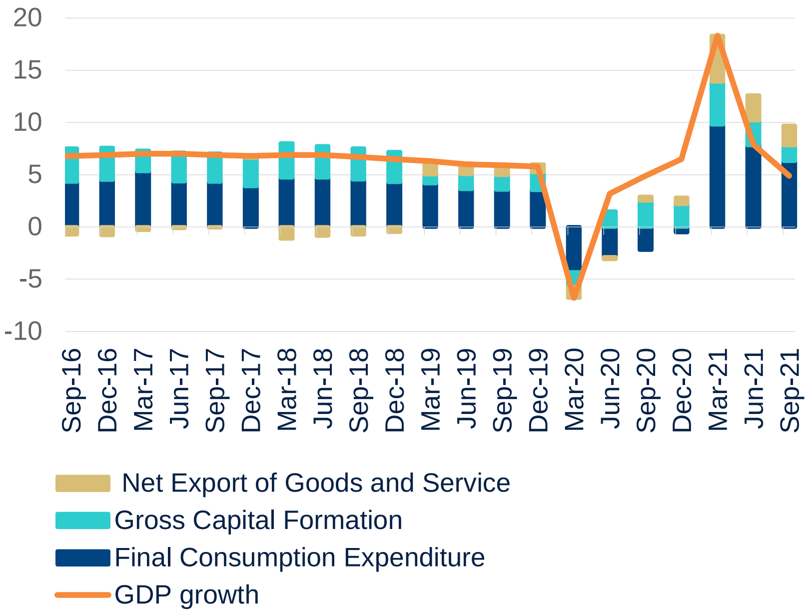
Financial vulnerabilities deteriorate in the aftermath of the pandemic : large real estate firm's default risk, SOE debt overhang, housing market bubble etc.

Electricity crunch and soaring coal price, together with global energy crisis.

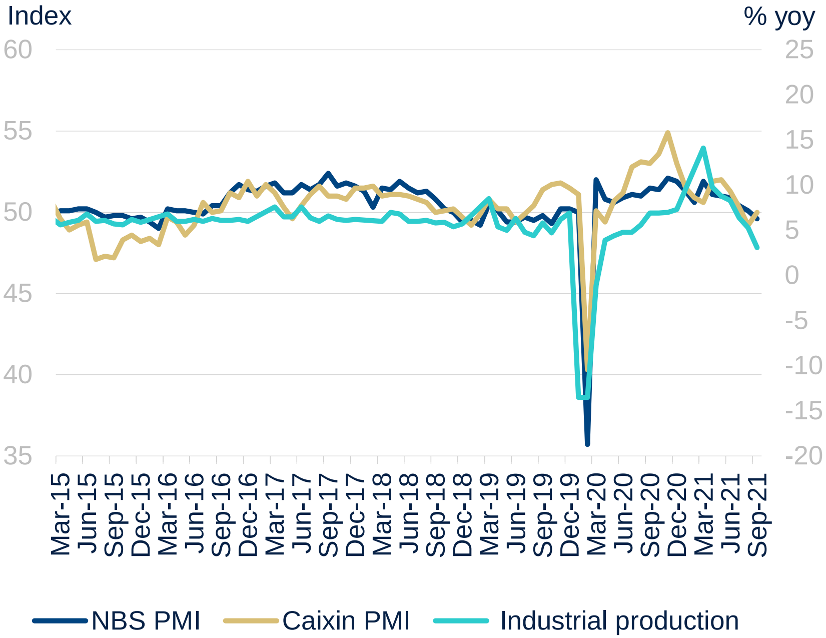
China and US has long-term ideological confrontation and technology competition.

Growth slowdown with an unbalanced structure

GROWTH SLOWED TO 4.9% IN Q3 FROM 7.9% IN Q2; Q3 Q/Q GROWTH ALSO DECELERATED TO 0.2% FROM 1.2% (%YoY)



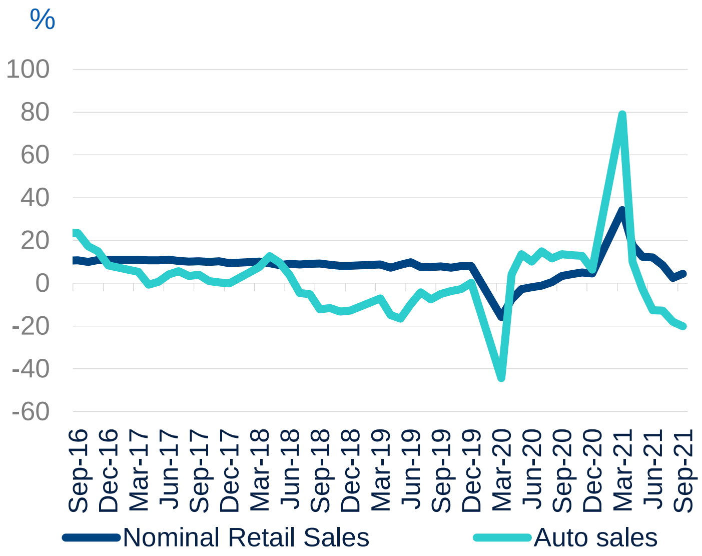
BOTH INSUDTRIAL PRODUCTION AND PMIS DECELERATED FROM THE PREVIOUS READINGS (INDEX, %YOY)



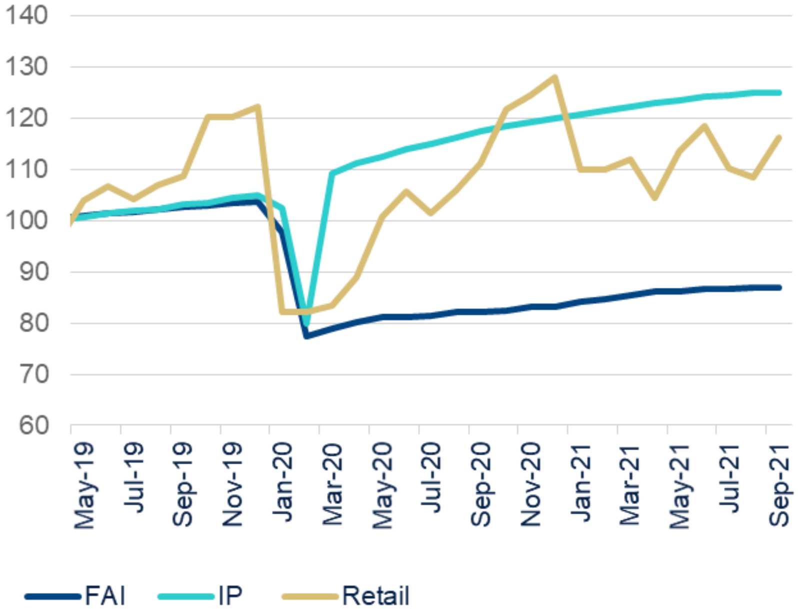
Source: CEIC and BBVA Research.

Although ticketed up in September, retail sales remain lackluster

ALTHOUGH RETAIL SALES GROWTH PICKED UP TO 4.4% FROM 2.5% IN THE PREVIOUS MONTH, STILL NEED PERSEVERENCE TO CATCH UP PRE-COVID (%)



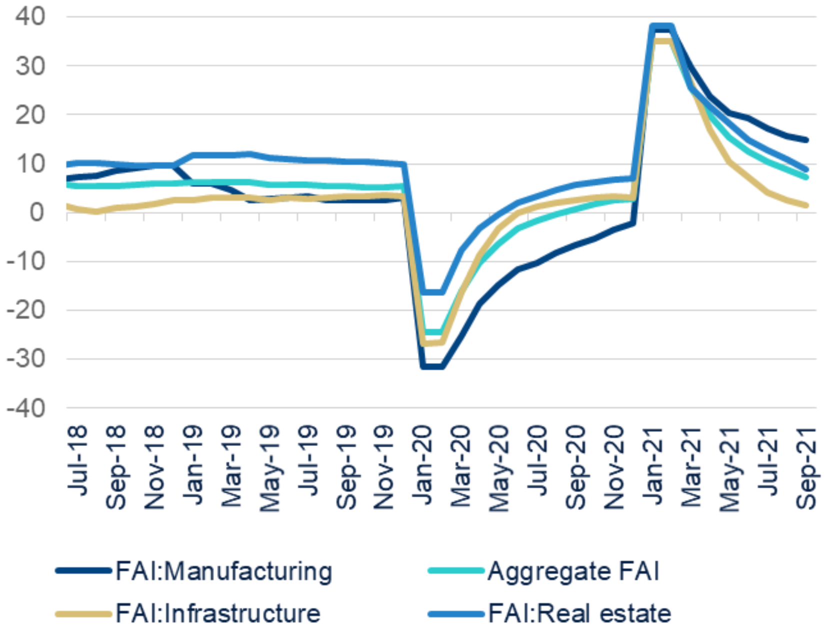
EXCEPT FOR INDUSTRIAL PRODUCTION, BOTH RETAIL SALES AND FAI HAVE NOT CAUGHT UP WITH THE PRE-PANDEMIC LEVEL (2019 MAR=100, SA FOR FAI AND IP)



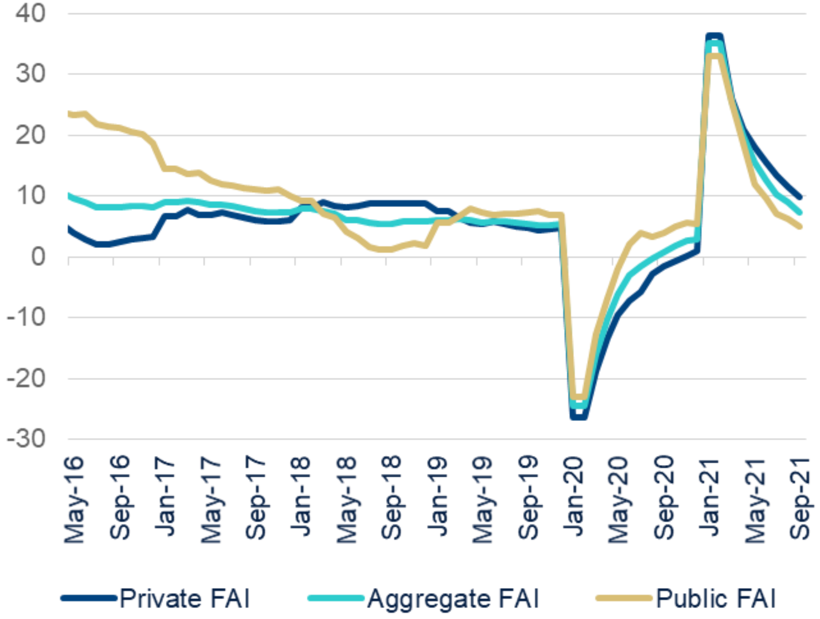
Source: CEIC and BBVA Research.

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

MANUFACTORY INVESTMENT LED THE FAI GROWTH (% YTD)



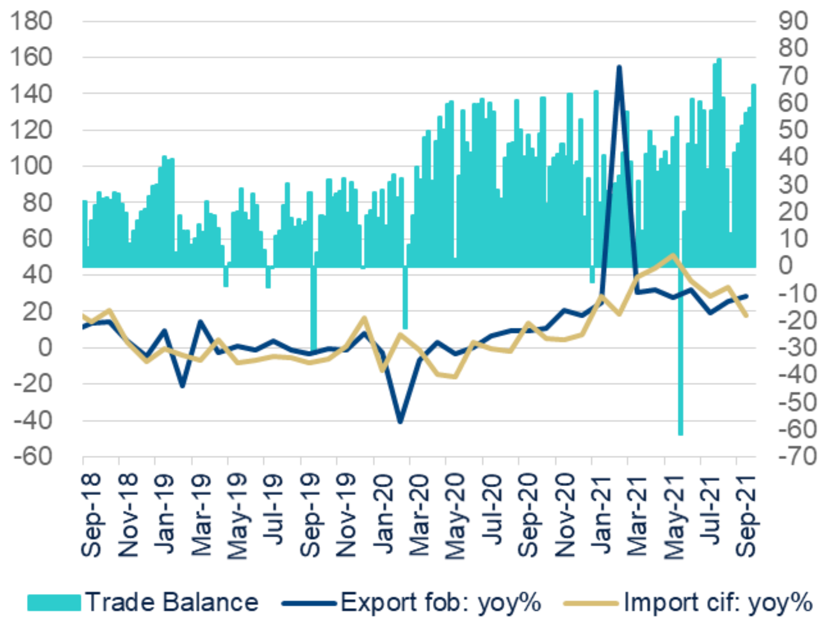
WE ANTICIPATE PUBLIC FAI WILL PICK UP AS THE AUTHORITIES SPEEDS UP LOCAL GOVERNMENT BOND ISSUANCE TO STIMULATE GROWTH (% YTD, Y/Y)



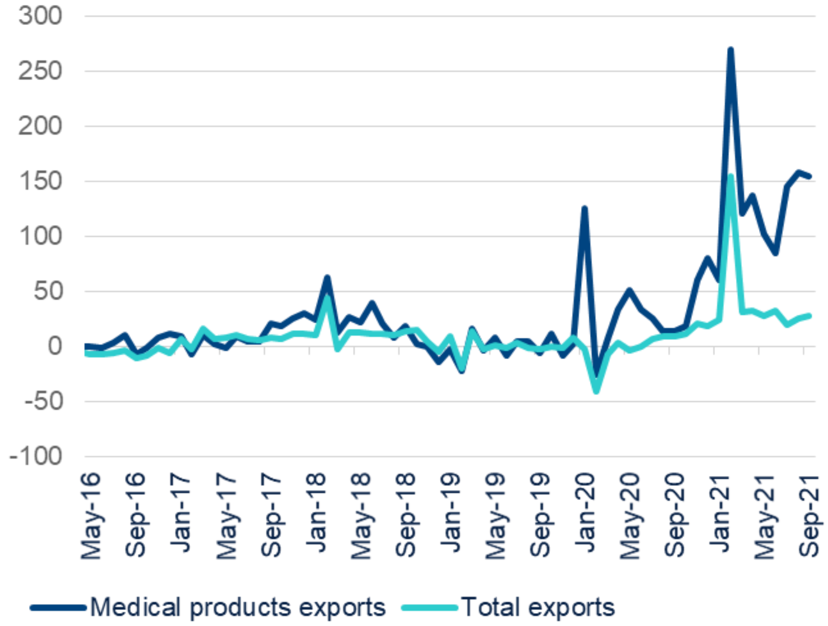
Source: CEIC and BBVA Research.

Exports maintained its momentum to be the main growth engine while imports decelerated amid sluggish domestic demand

SEPTEMBER EXPORTS REGAINED ITS STRONG MOMENTUM; WHILE IMPORTS DECLINED BOTH FOR VOLUME AND VALUE (% YOY, USD BN)



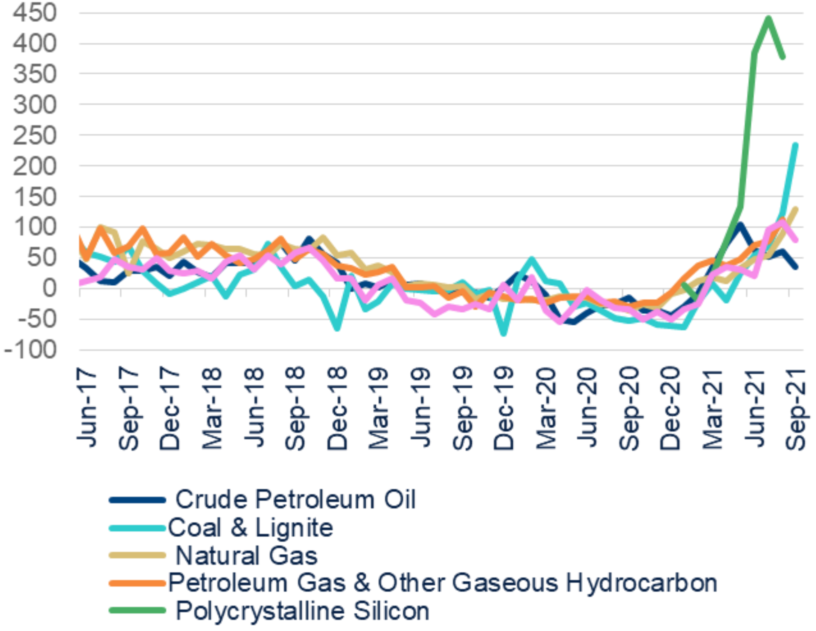
GLOBAL ECONOMIC RECOVERY MIGHT NORMALIZE CHINA' STRONG EXPORTS, BUT IT IS STILL TOO EARLY TO MATERIALIZE (% Y/Y)



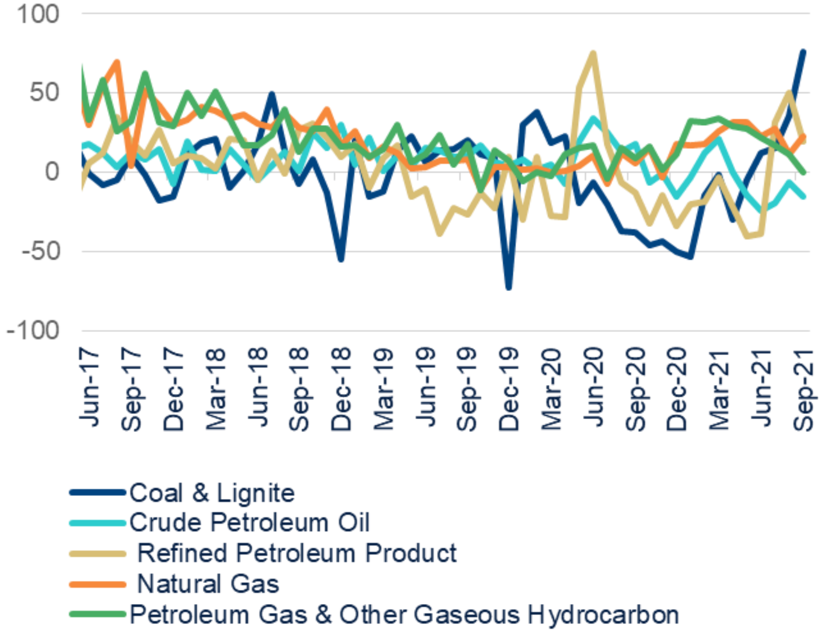
Source: CEIC and BBVA Research.

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)



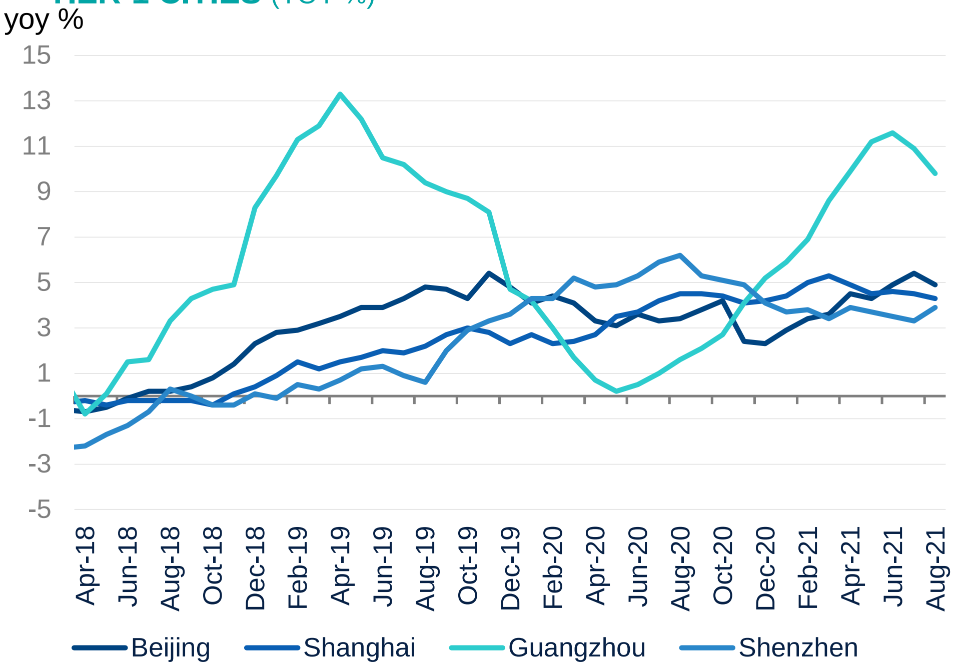
HOWEVER, THE IMPORTS VOLUME HAS NOT INCREASED AS SIGNIFICANTLY AS THE VALUE (%Y/Y)



Source: BBVA Research and CEIC

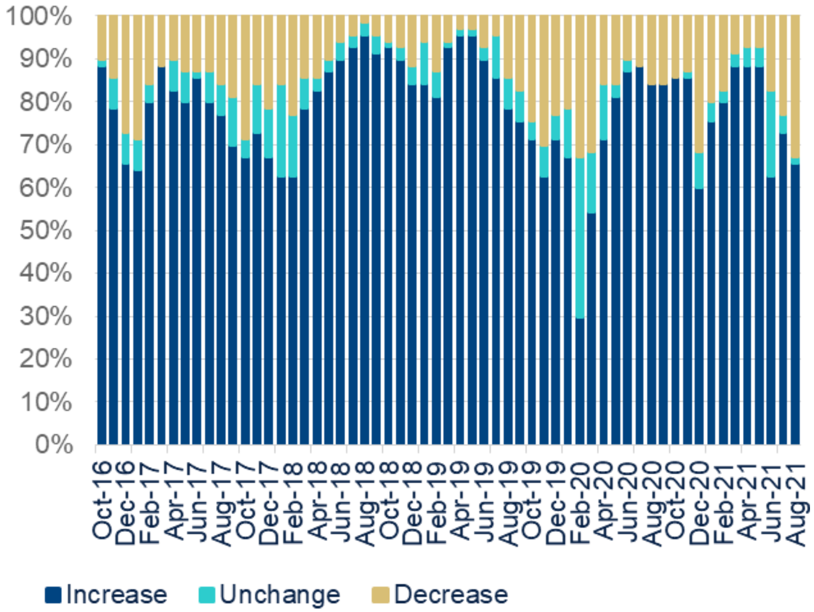
Housing market is the key targeted sector of the regulatory storms; the default risk of Evergrande has some contagion but not systemic risk to the economy

REGULATORY MEASURES PARTICULARLY "THREE RED LINES" CURBED HOUSING PRICE SOARING IN TIER-1 CITIES (YOY %)



Source: CEIC and BBVA Research.

THERE ARE INCREASING NUMBER OF CITIES THAT REPORTED HOUSING PRICE DECREASING (M/M GROWTH)



Evergrande: a policy-induced crisis

THE BALANCE SHEET OF EVERGRANDE (RMB BN)

Assets	2301.2	Liabilities and Equity	2301.2
		Bank loans	216.3
		Overseas bond issuance	100.6
Inventory	1406.7		
Other current assets	498.2	Other liabilities	1633.9
Non-current assets	396.2	Owner's Equity	350.4

The liquidity issue of Evergrande is due to its holdings of large amount of Inventory (land and buildings under construction), which cannot be liquidated immediately to pay back its debt.

FINANCIAL EXPOSURE OF EVERGRANDE

- Evergrande's liabilities (RMB 2.3 trn) rank No.1 among real estate developers (liabilities for the 2nd Country Garden: RMB 1.76 trn; 3nd Vanke: RMB 1.52 trn)
- According to the regulation tightening policy ("Three Red Lines"), in 2020, out of 224 listed developers:
  - 51 of them failed to pass any (including Evergrande), estimated liabilities RMB 6.4 trn
  - 105 developers failed to pass one or two lines
  - only 68 developers passed all of the lines
- Foreign holdings of Evergrande's bonds:
  - Total amount of outstanding overseas bonds at USD 15.4 bn (vs USD 223.8 bn for all the Chinese developers)
  - Main holders: Allianz, Ashmore and BlackRock, UBS, HSC Royal bank of Canada

Evergrande: Why we don't think it is a systemic risk

EVERGRANDE DEFAULT

Potential transmission channels

Banks: high NPLs Bondholders: loss		Bank runs; Bond fire sales
Loss of confidence in other developers	Developers fail to rollover debt	Bank runs; Bond fire sales
Developers dump housing market	Steep drop in housing prices	Financial crisis

Probability

Very unlikely: Evergrande's exposure of banks and bond market is limited (in terms of the entire financial system).

Low Probability:

1. The authorities can effectively intervene to fine-tune their tightening against developers (ie. allowing them to borrow from banks).
2. All developers' issued USD bonds to be expired by end-2021: only 11.3 Bn USD.
3. All big banks passed the authorities' stress test (including property market stress scenario).

Low Probability:

1. Housing demand has been suppressed by tightening policies (home purchase restrictions, mortgage limits).
2. Policy loosening will largely offset negative shocks. 3.Official stress test results show banking sector is resilient to housing price drops.

Bottom line: the liquidity problem of Evergrande and other developers is in essence policy-induced. The authorities' intervention can effectively alleviate the situation. Evergrande has a great chance to be liquidated under the authorities' supervision. After its fall, the tightening policies against property developers is anticipated to be fine-tuned.

Evergrande: what's next and implication for growth?

THE AUTHORITIES' LIKELY REACTIONS

The authorities will not bailout Evergrande directly

- Less systemic risk (a property developer not bank).
- Still hold valuable assets (land reserves).
- It's private rather than state-owed company.

The most likely reaction would be following HNA model

- Form a debt-payment committee composed of government representatives and important debt holders.
- Liquidate good assets to pay back debt.
- Equity holders take the final loss, likely being wiped out.
- Institutional debt holders share the loss not covered by equity part, trying best to protect individual debt holders (home buyers paid in advance).

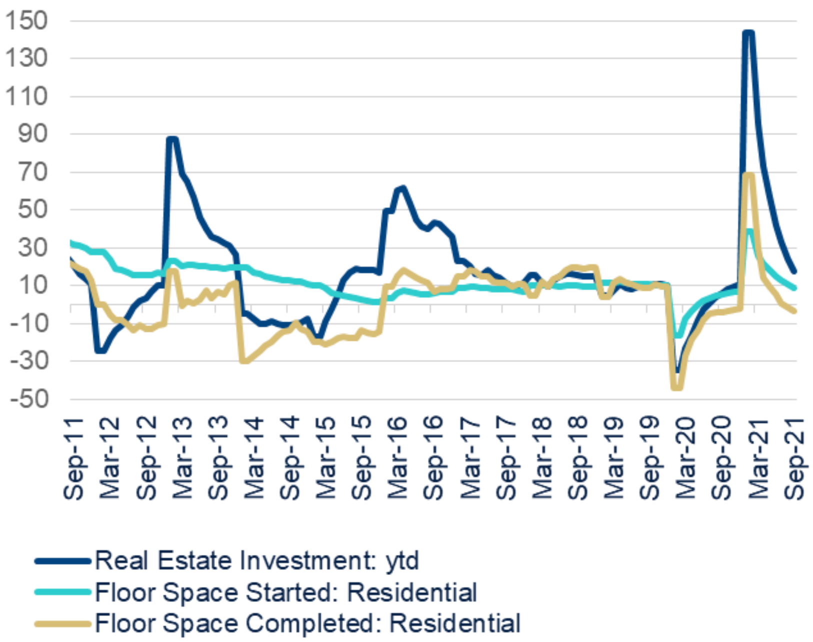
ECONOMIC CONSEQUENCE

- Evergrande's liabilities (RMB 2.3 trn) is equivalent to 2% of Chinese GDP.
- Real estate sector counts for around 29% of Chinese total GDP.
- In our baseline scenario, Evergrande crisis will lead to around 1% decrease of GDP; in the risk scenario, it will lead to 2.5% drop of GDP.
- The authorities will likely fine-tune its tightening on the property market and developers to stabilize the economy in the coming months. More pro-growth fiscal and monetary policy.

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

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

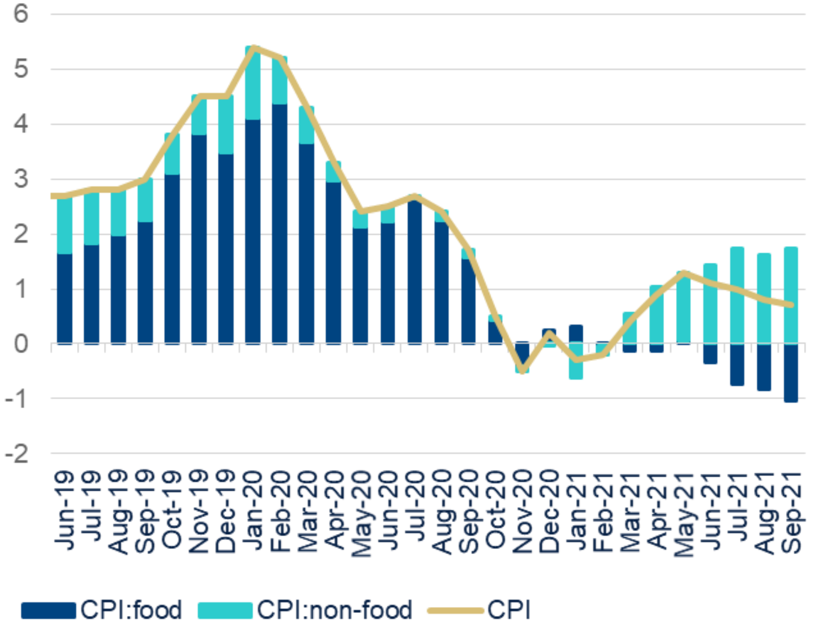
…SO DID THE REAL ESTATE INVESTMENT AND THE STARTED/COMPLETED FLOOR SPACE (% YTD, Y/Y)



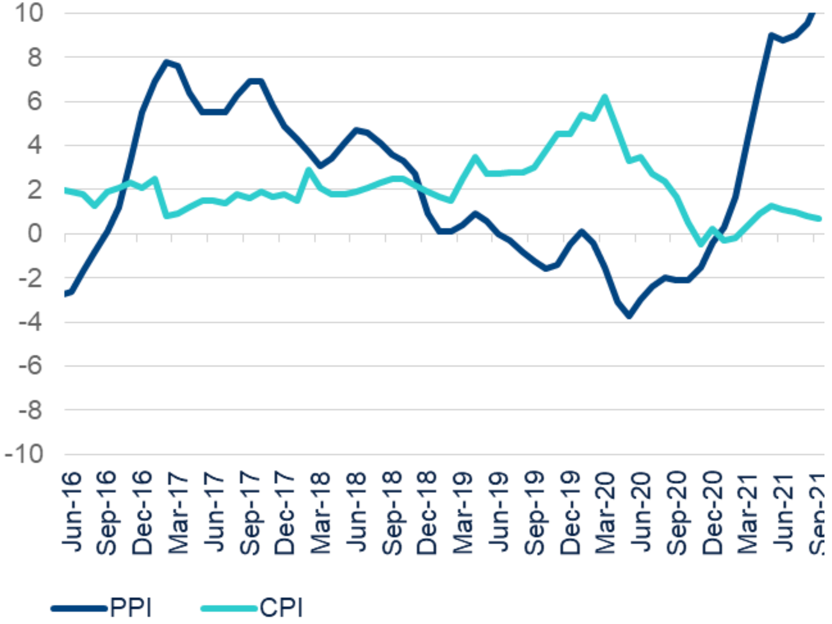
Source: CEIC and BBVA Research.

Low inflation environment remains, as pass-through effect from PPI to CPI is weak, but recent power crunch and electricity price hike will enhance this effect

CPI FURTHER MODERATED IN SEPTEMBER, WHICH IS STILL DOMINATED BY DECELERATING PORK PRICE WITHIN THE AFRICA SWINE FLU CYCLE (% YOY)



PPI CONTINUED ITS SURGING TREND, AMID SOARING GLOBAL COMMODITY PRICES(% YOY)



Source: CEIC and BBVA Research.

Recent electricity crunch: a short-term issue with limited impact

ALL EYES ON CHINA'S POWER SHORTAGE NEWS

Widening power shortages have halted production at numerous factories, also influenced shops and households.

Provincial authorities ordered heavy industry to curb use so that the province could meet its energy use target.

WHAT ARE THE REASONS BEHIND?

- Incentive problem: The current price mechanism of coal which is flexible and electricity which is fixed (subject to the authorities' adjustment) discourages coal-fired power plants from generating more electricity to meet the increasing demand.
- Then what are reasons for coal price spurt?
  Except for a soaring global commodity price, China's authorities' administrative orders to reduce coal mining due to the security consideration and environmental protection also plays a role. The ban of Australian coal imports also counts, but not the primary reason.
- Aggressive carbon neutrality target which assigned to local government level…
  …so that the local government top officials have to meet these emission targets for their promotion and succession. The easiest way is to simply reduce the production capacity of the polluted enterprises through an administrative way.

Electricity crunch: what's the authorities' reaction and implication for growth?

THE AUTHORITIES' LIKELY REACTIONS

In the short term, it can be fixed given Chinese governments' super powerful intervention capability:

- the authorities will raise the electricity price, allowing some transmission to general inflation.
- the authorities will increase imports of energy.
- electricity ration will continue in certain regions and industries. It will become more targeted, mainly affecting the industries with high pollution or not in line with the authorities' industrial policies.

In the long run, there should be a balance between carbon neutrality target and growth target.

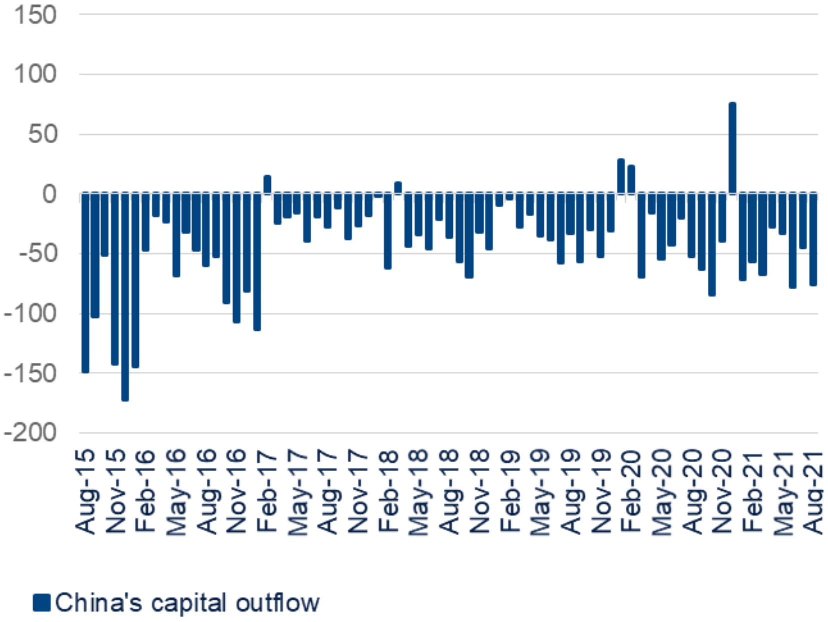
- the carbon neutrality pledge will put more constraints on China's growth.
- Both central and local governments will consider adjusting their industrial policies.

ECONOMIC CONSEQUENCE

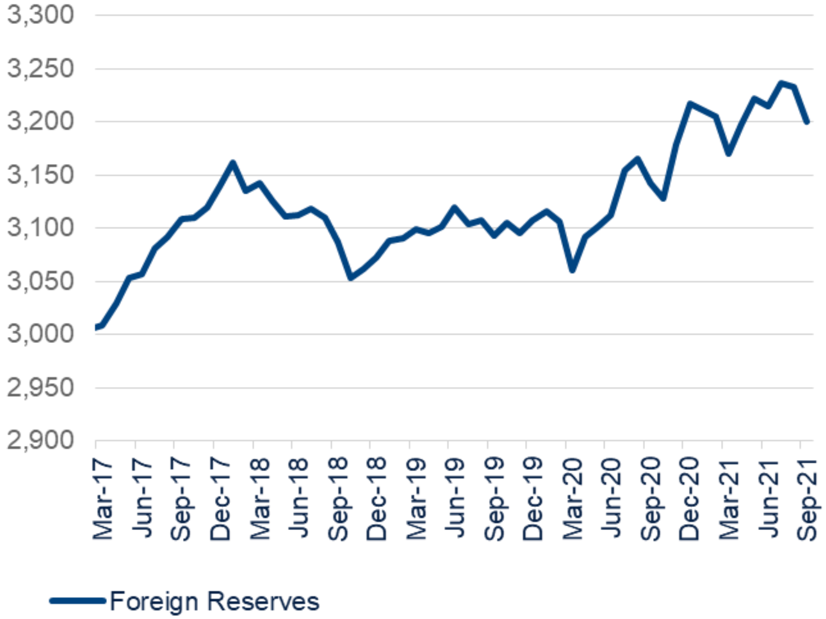
- It is all about the inflation, both domestically and globally. Although we talk a lot about China's low inflation environment, power crunch will enhance transmission from PPI to CPI.
- The electricity crunch is equivalent to a further production capacity reduction, which will drag on growth from supply side.
- The situation calls for more easing measures in the rest of the year to deal with growth slowdown and to dispel market panic. That means, a diverging monetary policy with the US and EU in the following year.

Capital outflows are under control but will be concerned with the US QE Tapering and potential interest rate hike

CAPITAL OUTFLOWS ARE ANTICIPATED WITH US QE TAPERING DUE TO "SEARCHING-FOR-YIELD"(USD BN)



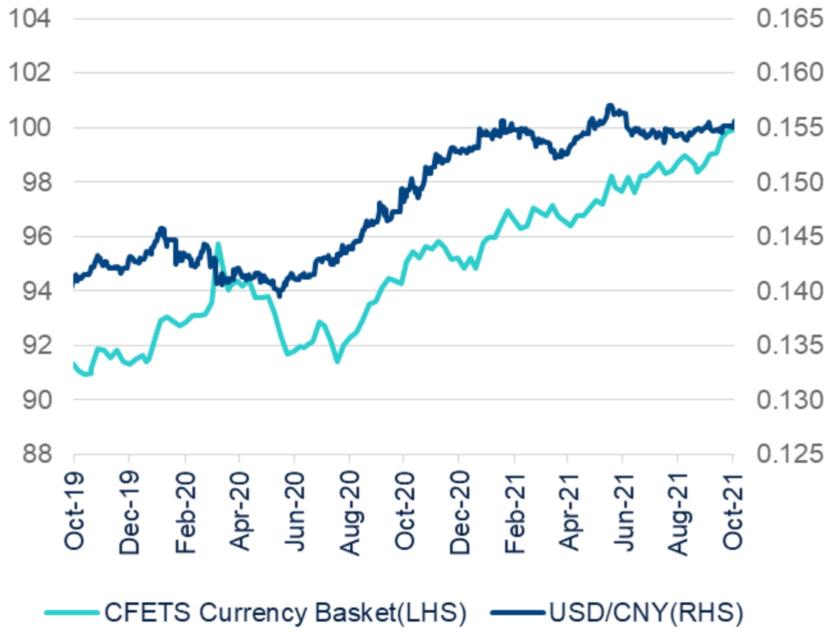
FOREIGN RESERVES DECLINED MARGINALLY BUT GENERALLY REMAIN STABLE IN THE PAST MONTHS (USD BN)



Source: CEIC and BBVA Research.

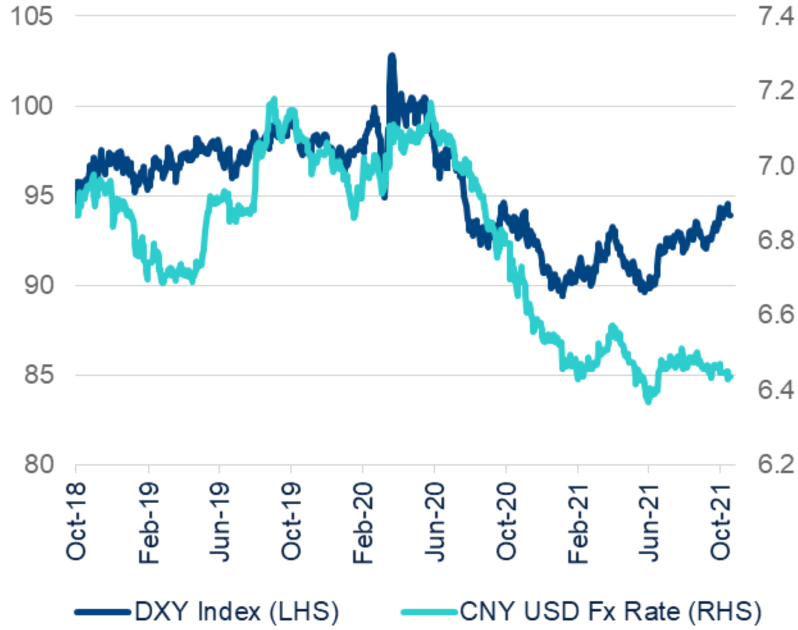
RMB to USD exchange rate is expected to depreciate due to the QE Tapering , a strong USD ahead and China's easing monetary measures

RMB EXCHANGE RATE HAS BEEN CENTERING AROUND 6.43-6.5, TWO-WAY FLUCTUATION IS ANTICIPATED



Source: xxxxxxxxxxx

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



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03

Policy easing measures to dispel the market worries

Main messages

More easing monetary policy ahead

Due to the closed capital account and low inflationary environment, the PBoC could manage its independent easing monetary policy, diverging with advanced economies. We anticipate at least one more RRR cut and one interest rate cut in the rest of the year. More innovative tools will be deployed such as SLF, MLF and more targeted easing measures.

A more easing fiscal policy

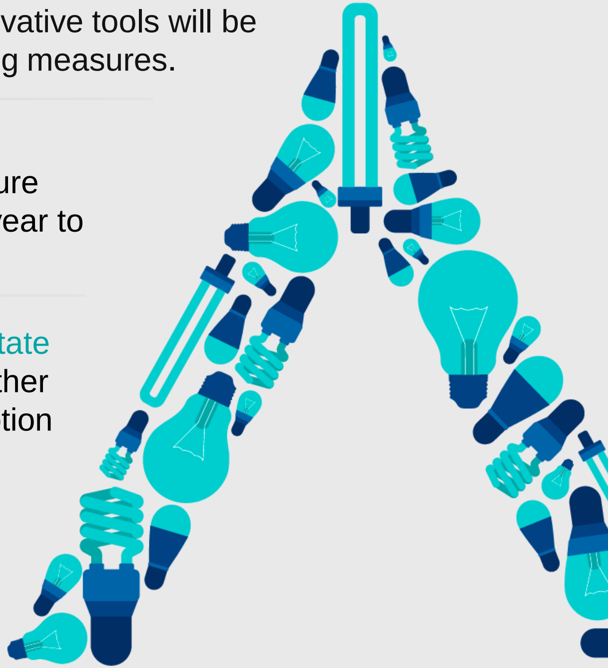
The authorities will speed up the issuance of local government bond. Thus, we anticipate the infrastructure investment will significantly pick up in the rest of the year to support growth.

Regulatory storms are set to continue

Regulation tightening on after-school tutoring, real estate and monopolistic e-commerce giants will continue. Other sectors, such as medical, gaming, high-end consumption are also to be targeted.

Common prosperity, social equality and carbon neutrality

The authorities' priority is transforming from pursuing GDP figures previously to social equality. A series of reforms such as tax reforms and "third-time" re-distribution are in line with this direction.



New Role Model of Growth: Germany not the USA

GERMAN MODEL: WHAT APPEALS TO CHINESE	POLICY IMPLICATIONS
Strong manufacturing capacity	“Hard tech” (5G, chips, NEV) not only “Soft tech” (Fintech)
Policy emphasis on climate change	Carbon neutrality by 2060 More support for Green tech
Good solution to housing affordability problem	Tightening on housing market (fine-tuning but no turnaround)
Less income inequality and equal opportunity	Tax scheme reforms Crack down on internet giants

(unnecessary) New concepts and misunderstandings

COMMON PROSPERITY

Nationalization of private enterprises?

DUAL CIRCULATION

Closing the door to the rest of the world?

	Headline individual capital gains tax rate (%)	Property tax rate (%)	Inheritance tax rate (%)
China	No	No	No
US	20%	Varied across states, eg. New Jersey: 2.13% New Hampshire: 1.89%	No inheritance tax. However, there is an estate tax with a top rate of 40%
UK	Range from 10% to 20%	28%	40%
Germany	25%	No taxes on wealth or capital employed, only minor local authority tax on property, but could be offset by an additional trade tax reduction	50%
Spain	26%	3%	34%
France	30%	3%	60%

- In terms of tax scheme, China is more capitalist than many other countries! The “common prosperity” should and will be achieved through tax scheme reforms, rather than clamping down private enterprises.
- "Dual circulation” strategy is not closing the door to the rest of world. It’s more like a reaction to US high-tech embargo. China needs to have their plan B for advanced technologies and products in the worst case. It’s a malleable framework, pending on the geopolitical and international factors.

Regulatory storm is progressivism in nature, aiming to address long-term challenges which also of concern for all the countries

Fintech companies	Clampdown on Ant Finance and other Fintech companies reflects China's efforts to shadow banking activities;
Internet giants	Tightening regulations on monopoly behaviors of internet giants are in essence not different from US and Europeans actions on Google, Facebook etc.
Enhance human capital	Eliminating after-school tutoring business and limiting adolescent time of video game are leveling the playing field and enhance human capital;
Policy initiatives	These policy initiatives are progressivism in nature, attempting to tackle a number of challenges to all the countries: tech-induced market monopoly, ever-widening wealth gap; global climate change; housing affordability; rising trade protectionism etc.

Chinese government need to do more and do better

Reasonable doubts

These are very ambitious goals, which are challenging to the entire human society. It remains an open question whether China can overcome them or not.

The Chinese approach is too blunt. There is lack of transparency in policy making and lack of communications in announcement. As a result, these policy initiatives, albeit with good intention, could lead to market confusion and even panic.

These policy initiatives are at the cost of growth. However, China cannot abandon growth. The communist regime legitimacy is based on continuous economic prosperity. The competition with the US requires for a remarkable performance of the economy. China needs to walk on a fine line.

Potential side effects

Frequent governmental interventions could expand the size of public sector and crowd out private sector. It is set to increase the government's debt level.

Domestic entrepreneurs will feel discouraged and confused when they are unable to tell which sector will be the next clampdown target.

Ever worse is that many of them could feel threatened if they (mis)interpret that China's authorities will nationalize their enterprises.

By the same token, international capital could shun China's market or require for a higher premium for their investment return in China. Even more clash with other countries could be possible.

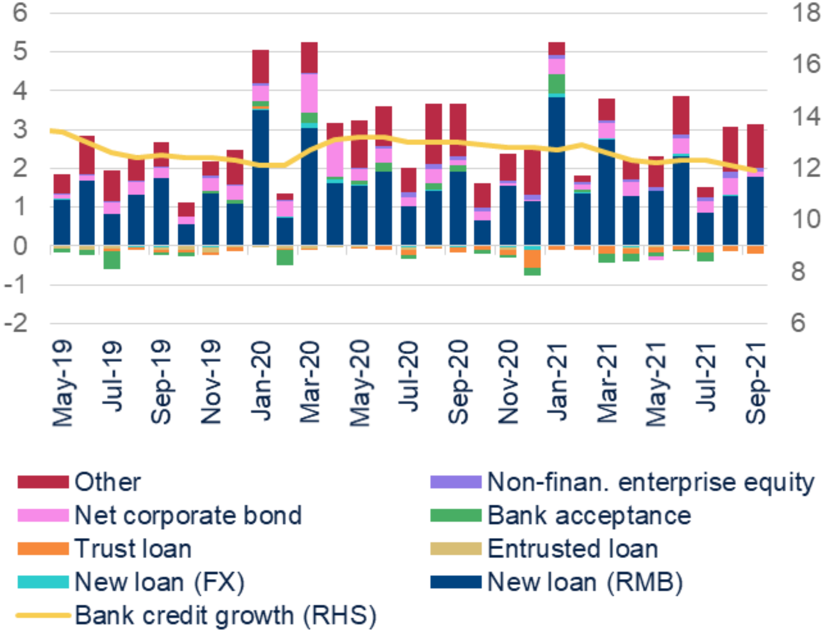
Brain drain and capital exodus could take place if the country fails to retain its talents, in particular entrepreneurs.

The authorities are aware of associated risks but the jury is still out

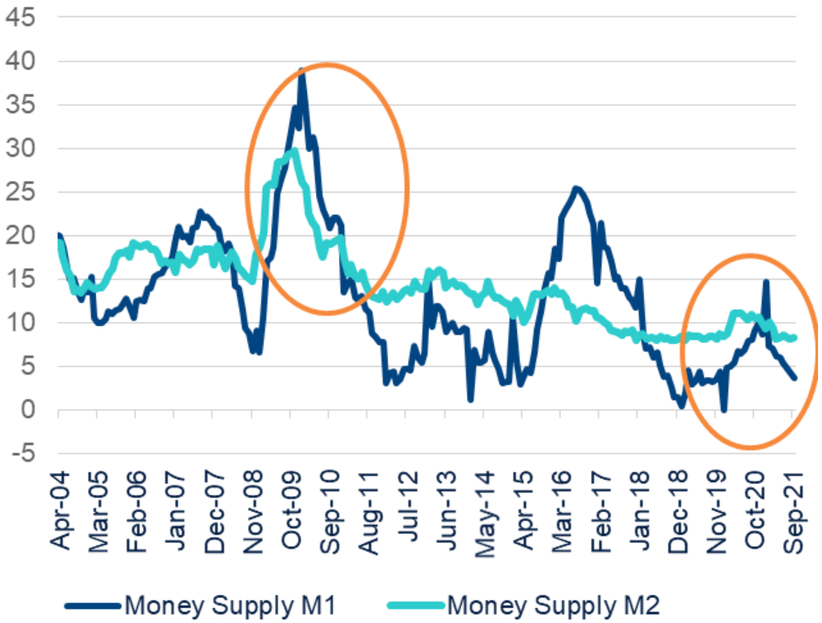
Market communications	Better market communications to clarify policy intentions (from President and other top officials).
Strategic industries	More support for strategic industries (i.e. Huawei) and SMEs.
International capital	More liberalizing measures to attract international capital (shortening negative list and opening more free-trade zones).
Domestic financial market	Opening domestic financial market to foreign capital to press ahead financial liberalization.

An expansionary total social financing and M2 are anticipated in the rest of year

TOTAL SOCIAL FINANCING AND NEW YUAN LOANS ARE SET TO EXPAND TO DEAL WITH GROWTH SLOWDOWN (RMB TRN, %YOY)



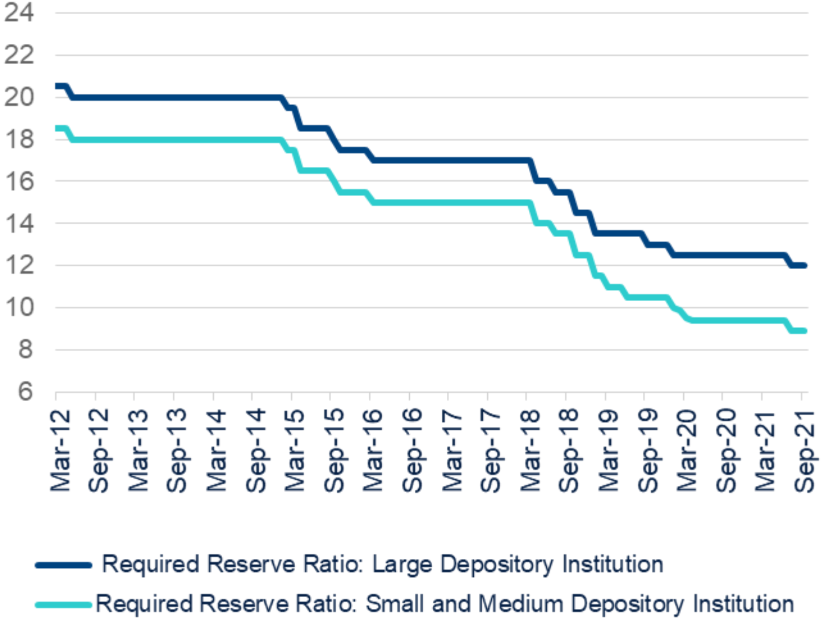
THE M2 TARGET SET BY THE "TWO SESSIONS" IS TO BE IN LINE WITH NORMINAL GDP GROWTH, AROUND 9.2% BY OUR ESTIMATION (Y/Y)



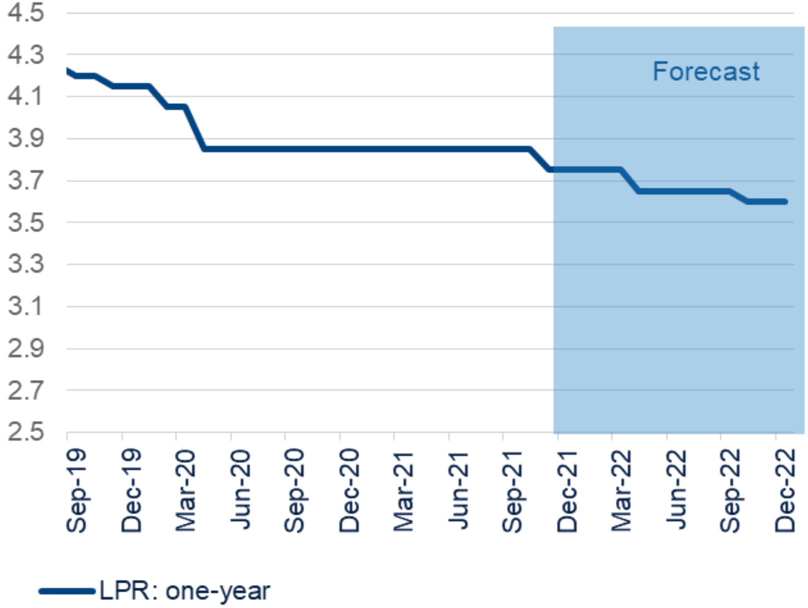
Source: CEIC and BBVA Research.

The PBoC is set to adopt more monetary easing measures to stimulate growth, diverging from the advanced economies' liquidity tightening

THE PBOC ANNOUNCED THE RRR CUT IN JULY 9TH, WHICH HAS NOT BEEN IMPLEMENTED SINCE APRIL 2020 1-2 RRR CUT IS ANTICIPATED (%)



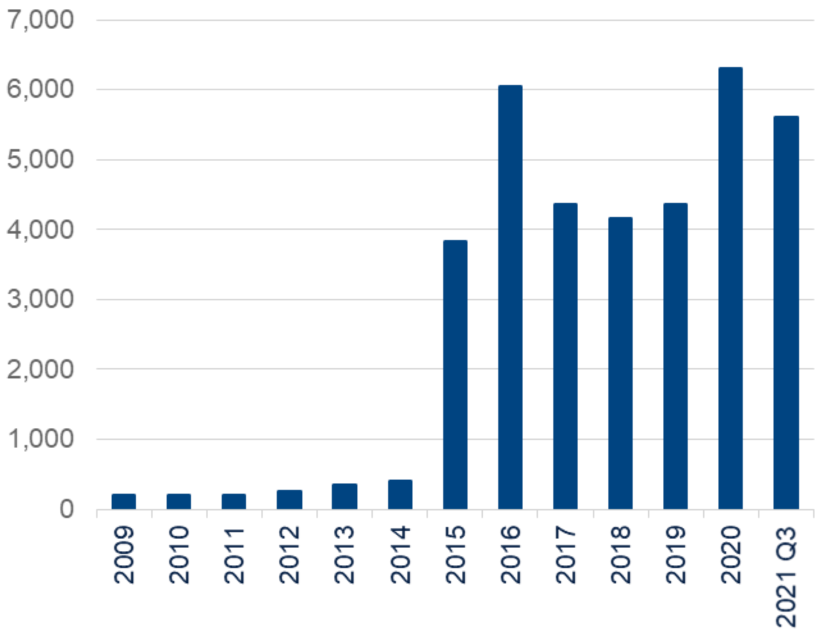
DUE TO CLOSED CAPITAL ACCOUNT, CHINA COULD MAINTAIN INDEPENDENT MONETARY POLICY FOR INTEREST RATE CUTS (%)



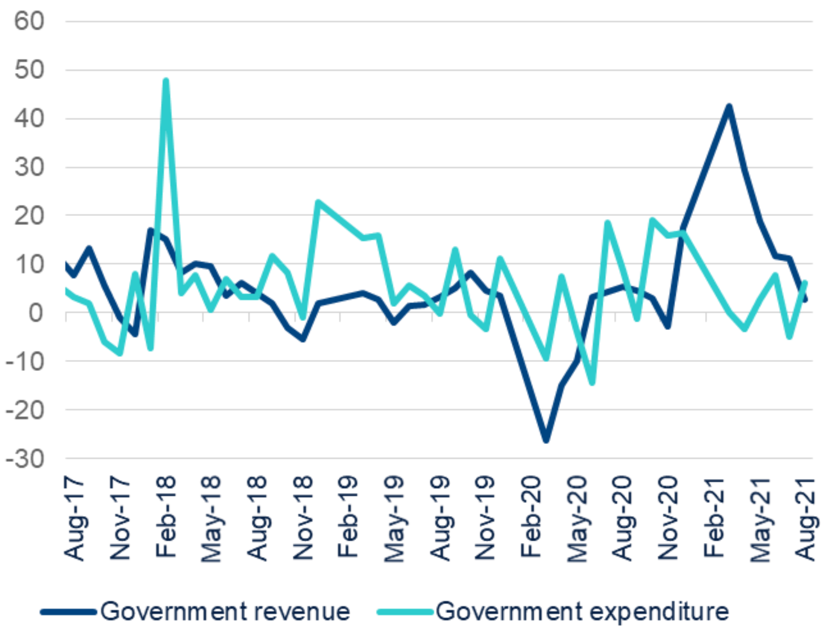
Source: CEIC and BBVA Research.

Fiscal stimulus particularly speed-up of local government bond issuance is anticipated

LOCAL GOVERNMENT BOND ISSUANCE IN 1H 2021 IS MUCH LESS THAN THE QUOTA SET (RMB bn, ytd)



CHINA STILL HAS A LARGE POLICY ROOM FOR FISCAL EASING IN THE REST OF THE YEAR(%)



Source: CEIC and BBVA Research.

BBVA Research

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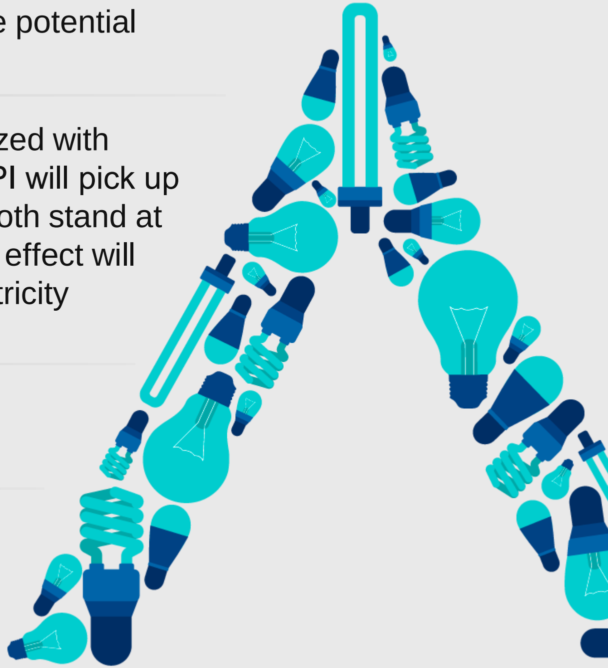
Projections

Creating Opportunities

Main messages

Growth slowdown will continue	We lower our 2021 GDP prediction to 8% y/y from 8.2% previously (Bloomberg consensus: 8.2%, IMF: 8%); we also lower our 2022 GDP forecast from 5.5% to 5.2% which is set to converge to the potential growth after the large swings in 2020 and 2021.
Inflation	We expect 2021 CPI will decelerate to 1.2%, unsynchronized with advanced economies' high inflation expectations, while PPI will pick up to 6.8% on average. Our forecasts of 2022 CPI and PPI both stand at 2.8%. The convergence of them reflects the pass-through effect will become stronger when the authorities addressed the electricity shortage by raising its price.
Interest rate	We anticipate one interest rate cut in 2021 and two cuts in 2022, and at least one more RRR cut in 2021.
RMB to USD	Weak RMB to USD exchange rate amid a stronger USD DXY in potential QE Tapering and interest rate hike. We maintain our prediction at 6.5 at year end of 2021 and 2022.



Economic indicators forecasting

BASELINE SCENARIO

	2019	2020	2021	2022
GDP （%）	6.1	2.3	8	5.2
CPI（%）	2.9	2.5	1.2	2.8
PPI (%)	-0.3	-1.8	6.8	2.8
Interest rate (LPR, %）	4.1	3.85	3.75	3.6
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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