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China | Unsynchronized business cycle calls for unsynchronized policy cycle

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When the rest of the world are grappling against high inflation and the pandemic, China has “first-in, first-out” and completed the policy normalization from the pandemic mode as early as of mid-2020. However, the economy has entered the slowdown trend for most time of the past year after its peak in Q1 2021, due to a series of regulatory storms, real estate crackdown and the authorities’ moves to pursue “common prosperity”. Indeed, China’s unsynchronized business cycle with the rest of the world calls for an unsynchronized policy easing measures. That means, when the US FED speeds up to tighten its monetary policy, China is anticipated to adopt a series of easing measures in 2022 to deal with the ongoing growth slowdown.

Indeed, the 2021 Q4 GDP outturn, together with December real economic indicators released by the National Bureau of Statistics today again confirmed the growth slowdown with an unbalanced economic structure, although the final reading is higher than the market expectation thanks to the recent easing measures. The 2021 Q4 GDP decelerated to 4.0% y/y from 4.9% in Q3, but its quarter on quarter growth significantly picked up to 1.6% q/q from 0.2% q/q previously. It concludes China’s 2021 GDP growth at 8.1% (BBVA forecast: 8%; Bloomberg consensus: 8%) and the average of 2020 and 2021 GDP growth at 5.1%. In terms of December economic activity indicators, an unbalanced structure continues as the supply side industrial production picked up significantly while fixed asset investment and retail sales from the demand side tumbled from the previous readings. A lot of perseverance still needed for the demand side to catch up with the pre-pandemic growth. Look ahead, main growth headwinds of 2022 include the real estate slowdown which deteriorates local government revenue and imposes adverse spillover effect to the linked industries, the deceleration of exports which used to be the main engine of growth as well as the ever-higher economic cost of maintaining “zero tolerance” of the pandemic. Thus, on top of the recent two RRR cuts and one LPR cut, there are more monetary and fiscal easing measures are anticipated. To reflect these growth headwinds but with policy room for stimulus, we maintain our 2022 GDP forecast at 5.2% (Bloomberg consensus: 5.2%; IMF: 5.6%).

On the supply side, the year on year growth of industrial production picked up to 4.3% y/y from 3.1% y/y in the previous month, higher than the market consensus at 3.6% y/y, and its seasonal adjusted m/m growth also accelerated to 0.42% m/m from 0.37% m/m previously. The supply-side pick-up benefits most from the eased electricity crunch as the authorities have made the previously fixed electricity price flexible as well as China’s self-sustained supply chain which to some degree solved global supply disruption problem domestically. By categories, the heavy-industry all narrowed its declining in December: steel production growth picked up to -5.2% y/y from -21.2% y/y in the previous month and crude oil growth ticked up to 1.7% y/y from -16.1% y/y previously. In addition, due to the authorities’ policy prioritization to support green economy and high-end manufacturing, electric vehicle remains the pillar of industrial production growth with its growth at 113.5% y/y. Following that is the wind electricity and solar electricity production which registered 30.1% y/y and 18.8% y/y respectively, benefiting from the authorities’ carbon neutrality initiatives. (Figure 1)

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On the demand side, both fixed-asset investment (FAI) and retail sales remain lackluster. In particular, FAI trended down to 4.9% ytd y/y from 5.2.% ytd y/y previously (market consensus: 4.8% 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 thanks to strong exports, although all of them registered deceleration readings. In detail, manufacturing FAI decelerated to 13.5% ytd y/y, higher than the infrastructure FAI at 0.4% ytd y/y and real estate at 4.4% ytd y/y respectively. Although the local government has already allocated RMB 1.4 trillion of special local government bond in Q4, it is still yet to be reflected in the infrastructure reading. In addition, real estate investment continues to moderate although the authorities started to ease financing conditions to secure a soft-landing of housing sector as the weakening market sentiments are difficult to change. (See our recent China Economic Watch: China | Real estate sector needs a soft-landing) Looking ahead, as the local government bond issuance is anticipated to rev up in 2022 to around RMB 3.8-4 trillion to support growth, the infrastructure investment is set to ramp up. (Figure 2 and 3)

On the other hand, retail sales' year-on-year growth decelerated sharply to 1.7% from 3.9% y/y previously (market consensus: 3.7% y/y), mainly due to the recent Omicron variant flare-ups in some Chinese cities and thus more strict social distancing measures have been imposed. By component, restaurant consumption growth dropped to -2.2% y/y compared with -2.7% in the previous month, and automobile sales continued to decline to -7.4% y/y compared with -9% y/y of the previous month. The slowdown of retail sales is highly related to the slowdown of household income as well as a weakening income expectation. Chinese government's persistence of "zero tolerance" strategy on pandemic by contrast of other countries' "co-existence" heavily weighs on China's consumption recovery. (Figure 4)

As we mentioned at the beginning, China's unsynchronized business cycle and inflation cycle call for an unsynchronized policy cycle. The slowdown of China's economic growth with an unbalanced structure will certainly prompt the authorities to deploy more pro-growth fiscal and monetary policy initiatives to stimulate growth in 2022. Due to the closed capital account and the contained inflation environment which is contrast with that of the advanced economies, China will have easing monetary and fiscal policy diverging from the advanced economies in 2022, as promulgated in the recently closed Central Economic Work Conference.

That means, by contrast with the US FED QE tapering, interest rate hikes and central bank balance sheet shrinking, we anticipate that the authorities will have more loosening monetary measures, such as to implement 2-3 RRR cuts and 2-3 LPR cuts in 2022. Today's move of the PBoC again confirmed this easing stance. The PBOC has lowered its 7-day reverse repo rate, the main rate that provides short-term liquidity to banks, from 2.2% to 2.1% and also cut its 1-year MLF rate from 2.95% to 2.85%, thus it is almost certain that the Loan Prime Rate (LPR) will be lowered on January 20th, following a 5bp cut in December 2021. From the fiscal policy perspective, local government bond issuance is set to accelerate to RMB 3.8-4 trillion to boost infrastructure investment. Moreover, tax cut and fee deduction are also anticipated in 2022. Beyond that, the recent regulatory forbearance particularly on real estate sector might add further impetus for growth given the large share and strong spillover effect of housing sector to the whole economy. More importantly, we expect the authorities will set a lower growth target in 2022 to "around 5%". All in all, the authorities are fully aware of the growth deceleration and will strike a balance between stimulating growth and pressing ahead structural reforms going forward.

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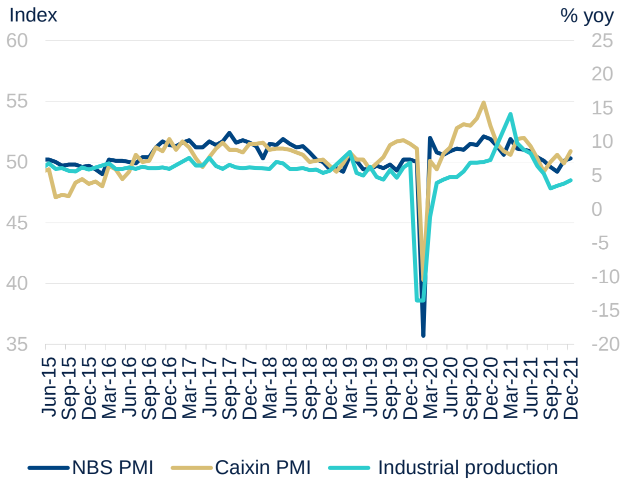
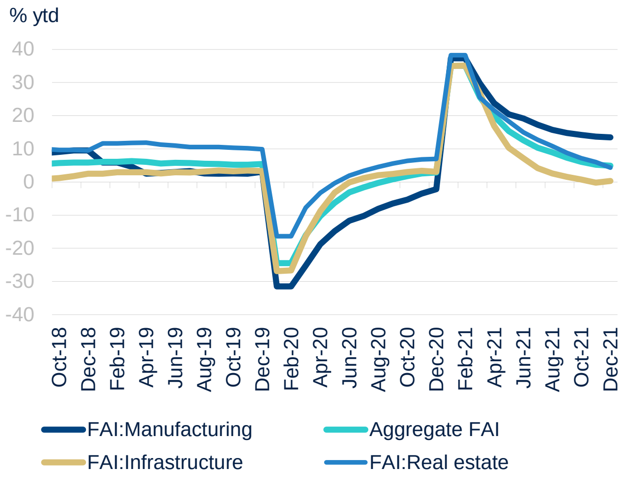
Figure 1. **INDUSTRIAL PRODUCTION PICKED UP IN DECEMBER**



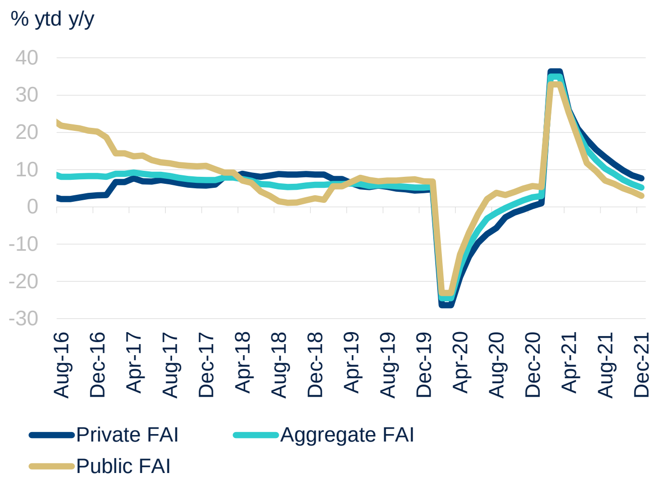
Source: CEIC and BBVA Research

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



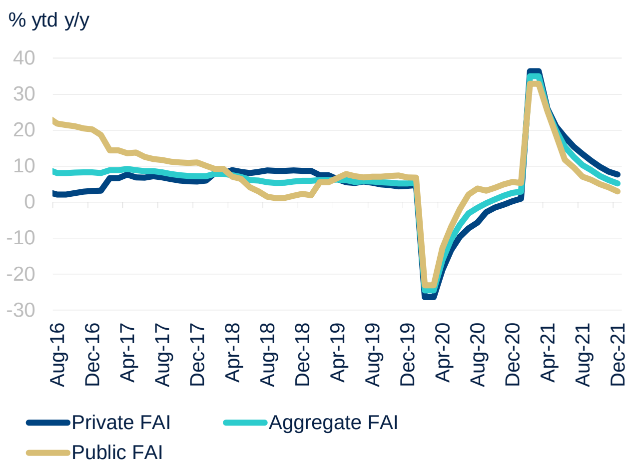
Source: CEIC and BBVA Research

Figure 3 PRIVATE FAI SURPASING PUBLIC FAI



Source: CEIC and BBVA Research

Figure 4 RETAIL SALES DIPPED DUE TO THE VIRUS FLARE-UPS AND THE MORE STRICT SOCIAL DISTANCING MEASURES



Source: CEIC and BBVA Research

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