

Market Commentary

January 18, 2021

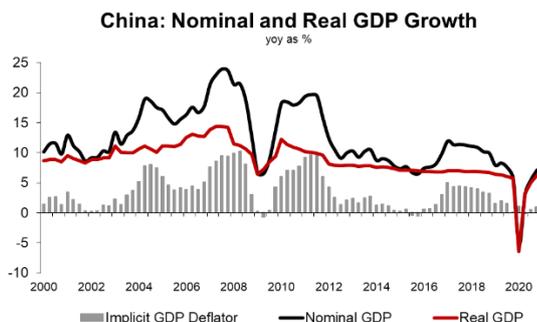
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China's Q4 GDP growth surprised on the upside, but risks to the outlook have increased

- This morning, China published its Q4 GDP growth alongside with December monthly activity data. Q4 growth accelerated to 6.5% yoy which lifted total 2020 GDP to 2.3%.
- December real activity data were more mixed. While exports came in strongly, important domestic demand components were a bit unsteady.
- Total Social Financing and money supply surprised on the downside. While some prominent SOE defaults may have prompted more caution in the bond sector, we see the PBoC to already shift its monetary policy to a more neutral stance.
- More generally, less supportive monetary and fiscal policy in 2021 implies a slowing monetary and fiscal impulses and thus less growth dynamics over the course of the year.
- Risks have risen of late due to fresh local outbreaks of Covid-19. Even given a successful containment, consumer confidence could suffer again a bit. We stay on the more cautious side and maintain our below-consensus growth forecast of 7.8% in 2021.

This morning, China published its Q4 GDP growth alongside with the December monthly activity data. Q4 growth accelerated to 6.5% yoy, significantly up from the Q3 result of 4.9% yoy. It came also in better than the Reuters consensus forecast of 6.1% yoy. The result lifted China's total 2020 GDP to 2.3%. Thus, China is one of the few countries in the world with a positive 2020 GDP growth rate despite the Covid-19 pandemic.

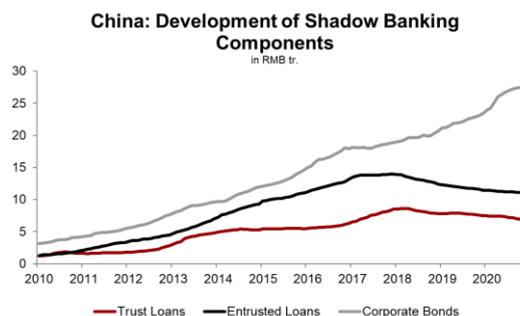
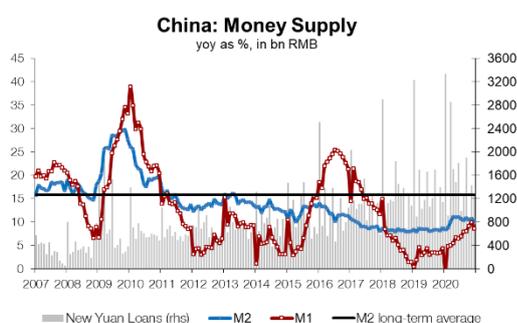
A detailed breakdown of the growth figures is not yet available. What is officially known are the cumulative, annual real growth rates of sectors. They show that that the primary sector (agriculture, fisheries, mining) advanced by 3% in 2020 which is only marginally lower than 2019 (3.1%). However, manufacturing (2.6% in 2020 compared to 4.9% in 2019) and services (2.1% compared to 7.2% in 2019) suffered significantly. In addition, Q4 quarterly nominal yoy growth figures reveal that manufacturing increased by 6% yoy in Q4 (after 3.8% yoy in Q3) and services by 7.8% yoy (after 5.9% yoy in Q3). The data suggest that overall services have likely contributed the most to the acceleration of Q4 growth. Retail trade, catering and accommodation were able to further normalise due to the successful pandemic control last year. And despite some high-profile defaults of large SOEs, the financial sector has probably benefitted from still high credit expansion and the friendly yoy stock market development.



Monthly data can help to shed more light on the demand side development. First, exports were very strong. After rising by 20.6% yoy in November, they slowed only slightly to 18.1% in December. On a seasonally adjusted basis, exports increased by 17.6% yoy in Q4, while imports remained just below 5% yoy. Thus, net

exports supported GDP growth significantly. This also helped industrial production to keep its fast pace (7.3% yoy after 7.0% in November). Meanwhile, important domestic demand components were a bit unsteady in December. Retail sales weakened to 4.6% yoy in December, from 5.0% in November. However, the catering component continued to improve under the influence of very low Covid-19 cases in Q4. Cumulated urban fixed asset investment continued to rise (which are the official data) but weakened in yoy terms in December. This was due to all major components, i.e. manufacturing investment, infrastructure as well as property investment.

Separate credit data over the last week showed that new yuan loans continued to expand moderately while Total Social Financing (TSF) disappointed. Some of the difference can be attributed to the Corporate Bonds component which was much less buoyant than before. Thus, the slowing might still also reflect more caution after the SOE defaults. However, money supply also receded. M2 growth dropped from 10.7% yoy in November to 10.1% yoy, M1 growth from 10.0% yoy to 8.6% yoy. The drop is ever more surprising as (transactional) money demand typically increases by the end of Q4 and the PBoC provides more liquidity. Thus, against the backdrop of strong growth, the PBoC likely has already started to shift towards a more neutral stance of monetary policy. This will also slow the credit impulse over the course of the year, suggesting growth dynamics to recede over 2021 (causality is less clear than in other countries as the central bank is not independent and money supply may also reflect government credit needs). Moreover, we expect less support not only from the central bank but also from the fiscal side in 2021. The official central government deficit is likely to recede to around 3%, down from 3.6% in 2020. The government will likely also halt the issuance of special CGB (after RMB 1 tr this year) and lower the local governments bond quota to CNY 3.25 tr (CNY 3-3.5 tr), after RMB 3.75 tr last year. In sum, this could already amount to a negative fiscal impulse of about 2 pp of GDP. Consequently, we expect the PBoC not to become outright restrictive but stick to a neutral stance.



Nevertheless, risk also increased. China has recently witnessed some local outbreaks of Covid-19. Absolute numbers are still on low levels (about 100 daily cases). The authorities responded forcefully and put regions under quarantine again (11 regions with about 29m inhabitants), in order to prevent a further spreading of the virus. There is a good chance that these measures will succeed. However, the Chinese New Year 2021 begins on February 12, and holidays will be at least from February 11–17. Typically, this is a period of enormous travel. Depending on the development of the outbreaks, the government could limit travel again like last year which would hit the transport sector. Moreover, as seen during last year, certain services could be well come under pressure again by a renewed loss of confidence among consumers. As a consequence, we remain a bit more cautious regarding 2021 growth and stick to our previous outlook of 7.8%, below the current consensus of 8.4%.

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