

MARKET COMMENTARY

China: Weak Q3 growth amid multiple headwinds

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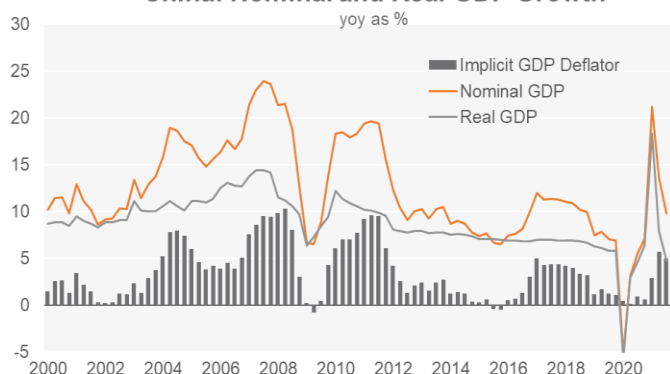
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- China's Q3 2021 GDP growth diminished to 4.9% yoy and 0.2% qoq. The very weak growth dynamics reflect the multiple headwinds over the quarter, including Covid-19 lockdowns, power outages, the real estate sector woes and regulatory tightening measures.
- September data releases revealed the marked hit from power cuts on industrial production. Property investment slowed about 2 pp to 4% yoy. Retail sales were soft but surprised on the upside compared to the consensus forecast as Covid-19 lockdowns eased. Export remained strong.
- Looking ahead, we expect the Q4 yoy growth rate to recede further while quarterly growth dynamics could improve a bit, provided Covid-19 lockdowns remain under control and power outages can be minimised. The PBoC recently pledged orderly lending to all sectors, including property and power supply. Nevertheless, more real estate firms are likely to report liquidity problems. Generally, monetary policy has become more difficult against supply shortages. We continue to expect targeted measures (but no broad-based reflation cycle) and stick to our view of a RRR cut as a reassuring signal (albeit with less confidence now). The PBoC's main policy tool will be liquidity management.

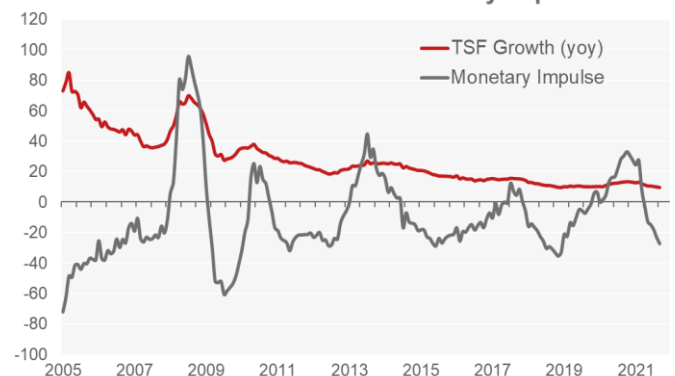
In Q3 2021, China's GDP growth diminished to 4.9% yoy, down from 7.9% in Q2. While base effects played a role, the main culprit were the multiple headwinds which brought growth dynamics down to 0.2% qoq. The secondary industry (including mining, manufacturing and construction) was the main driver of the slowing while the service sector weakened only slightly from its already soft pace. The effects from power outages were most visible in September. Industrial production slumped to 3.1% yoy, down from 5.3% yoy in the month before. Most naturally, energy-intensive industries like chemicals and ferrous/non-ferrous metals suffered in the first place.

Fixed-asset investment was another weak spot. In September, cumulative growth diminished to 7.3% yoy ytd, after 8.9% yoy ytd in the month before. Among the subcomponents, manufacturing investment held up, suggesting that the regulatory tightening measures implemented in Q3 will likely have a more long-term effect. Infrastructure investment remained weak, although the LGB issuance accelerated recently. Local governments look to remain reluctant to invest amid Beijing's tight grip on local shadow debt. Meanwhile, China's deleveraging policy for the real estate sector (three-red-lines approach, BPoC lending caps) together with Evergrande (and other property developers) woes increasingly mirror in property investment. It slowed from 5.9%

China: Nominal and Real GDP Growth



China: Growth of TSF and Monetary Impulse



yoy to 4.0% yoy of late. Other housing indicators, like floor space "newly started" and "under construction" also weakened. We expect the sector to remain under pressure. Beijing is likely to stick to its policy approach in order to put the sector on stronger footing over the medium term. That said, China will try to manage this process as smooth as possible.

By contrast, retail sales surprised on the upside, at least compared to the consensus forecast. They recovered from 2.5% yoy in August to 4.4% yoy in September, after multiple Covid-19 lockdowns had been removed. End of September, there was another outbreak. China's zero tolerance policy towards Covid-19 amplifies the effect in the short run. Provided, further multiple lockdowns can be prevented, private consumption could improve in Q4, after the start (Golden week holiday) was likely on the weak side (the government discouraged travel due to Covid-19). Finally, exports, the second bright spot and an important growth driver is likely to slow, given that demand in advanced economies will more and more focus on the service sector.

On the monetary side of the economy, PPI inflation accelerated from 9.5% yoy in August to 10.7% yoy in September mainly due to coal prices (more generally energy prices, and supply disruptions like in the rest of the world). Nevertheless, so far the impact on CPI inflation has been small. CPI inflation even moderated 0.1 pp to 0.7% yoy on falling food prices while core CPI remained unchanged at 1.2% yoy.

Meanwhile, monetary policy has not changed course so far. Total Social Financing (TSF) growth fell further by 0.3 pp to about 10% yoy. Consequently, the credit impulse (the change of the annual growth rate of TSF) deteriorated further. M2 growth improved marginally to 8.3% yoy. However, looking ahead, in a recent press conference, the central bank pledged to ensure orderly financing for sectors (real estate and power supply) and to maintain stable liquidity in the banking sector. Given the supply constraints monetary policy is in a more difficult situation, in which targeted measures will likely play an even more important role. The PBoC is likely to support sound developers in order to prevent them from falling victim to tightening credit conditions towards the sector. There were also news that regular disbursement of mortgages could be accelerated. Targeted measures could also help the power sector. In addition, green lending will likely be stepped up. All in, we see liquidity management as the preferred tool of the PBoC in the short run. We stick to our view of a RRR cut as a signal, but are less convinced than before that it will already come in Q4.

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