ICBC Standard Bank

China Macro Outlook

Path towards policy normalisation amidst ongoing pandemic risks

February 2021

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Strong 2020 GDP growth justifies room for gradual policy normalisation

- After a challenging Q1, China ended 2020 on a high note: with 2.3% annual growth and 6.5% growth yoy in Q4, exceeding consensus and recovering beyond pre-pandemic output levels.
- Lifting China's GDP beyond the CNY 100tn threshold during a pandemic is indeed a significant milestone for Beijing. That said, the so-called 'V-shaped' recovery so-far is heavily reliant on investment and unexpected resilience in exports.
- Private consumption in itself remained a growth laggard throughout 2020, and it is now facing renewed challenges from sporadic Covid-clusters and local lockdowns. New measures to further unleash domestic consumption are expected to be outlined during March meetings.
- That said, the robust 2020 performance still justifies room for gradual policy normalisation in 2021 – especially fiscal policy – to continue economic rebalancing towards private consumption-based growth.
- Recent shift in PBoC's monetary stance towards risk prevention against re-inflating asset bubbles, curbing excessive short-term borrowing, has already put banks and property developers under tighter regulatory scrutiny. This has also triggered an unexpected episode of interbank liquidity squeeze in January. Given this context, we think the central bank is unlikely to seek an immediate exit from the highly accommodative credit policy in the near term.
- On the other hand, the yuan is on course to receive further support from macro fundamentals including replenishing trade surplus, commitment to gradual policy normalisation, a low interest rate environment and sufficient yield differentials between US and China. PBoC appears to prefer more two-way volatility.
- In a nutshell, with China's recovery still facing lingering threats from the global pandemic, 2021 macro policy tone is likely to remain flexible and data dependent – with emphasis on "stability". Policy normalisation is likely to be rolled out at a gradual and managed pace, especially as precautionary policy buffers are needed in the event of domestic or external uncertainties that may hinder 'dual circulation'.

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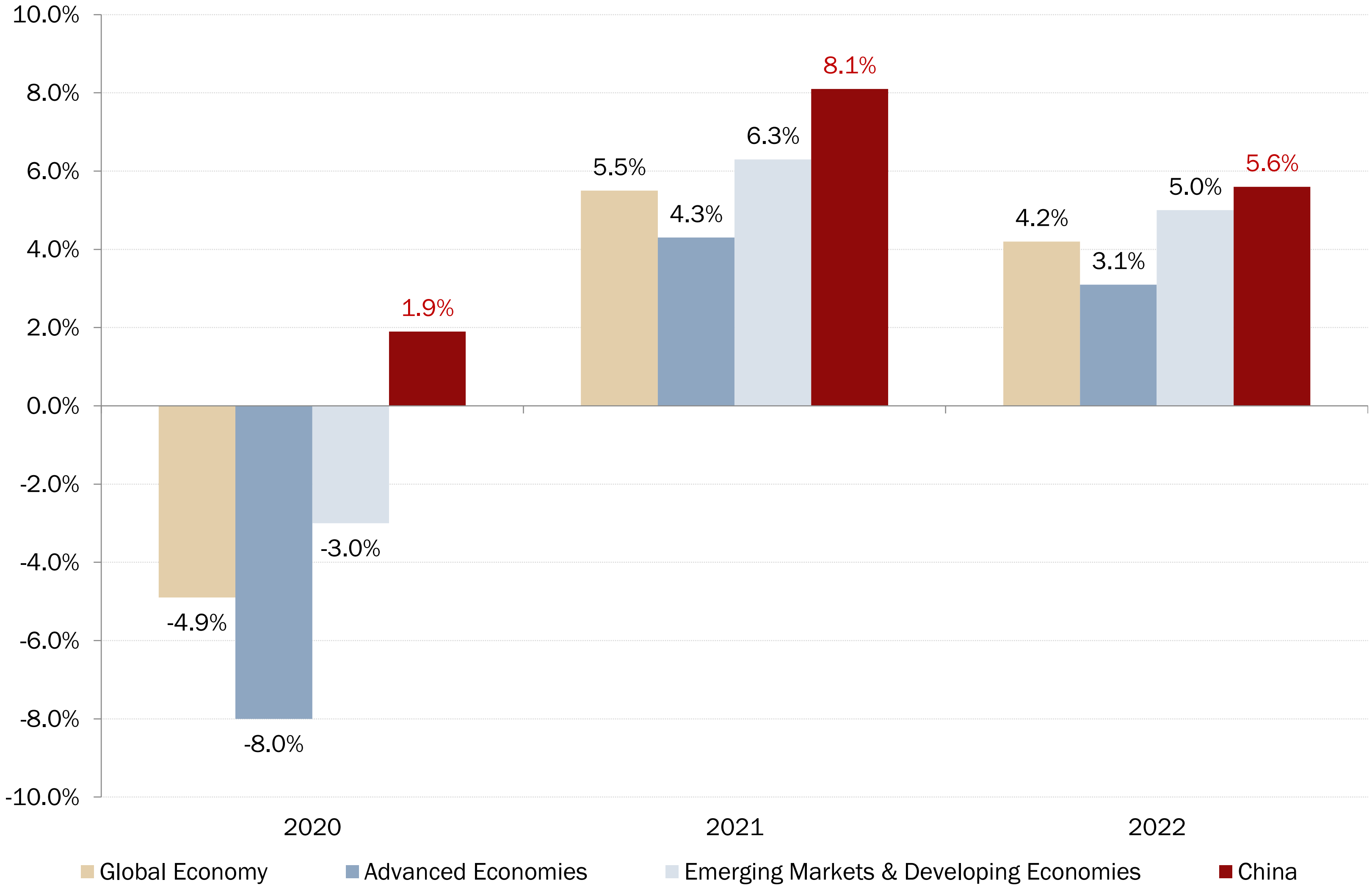
China remains on course to lead global recovery in 2021 and beyond

IMF World Economic Outlook Growth Projections (Jan 2021 WEO Update)



Source: IMF, ICBC Standard

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Most economies are expected to recover from the severe pandemic shock

Growth outlook of key economies

	2020	2021	2022
Advanced Economies	-4.9	4.3	3.1
US	-3.4	5.1	2.5
Euro Area	-7.2	4.2	3.6
Germany	-5.4	3.5	3.1
France	-9.0	5.5	4.1
Italy	-9.2	3.0	3.6
Spain	-11.1	5.9	4.7
UK	-10.0	4.5	5.0
Japan	-5.1	3.1	2.4
Canada	-5.5	3.6	4.1
Emerging Markets and Developing Economies	-2.4	6.3	5.0
China	**2.3**	**8.1**	**5.6**
India	-8.0	11.5	6.8
Russia	-3.6	3.0	3.9
Brazil	-4.5	3.6	2.6
South Africa	-7.5	2.8	1.4
Nigeria	-3.2	1.5	2.5
Saudi Arabia	-3.9	2.6	4.0

Source: IMF (WEO Jan 2021), ICBC Standard

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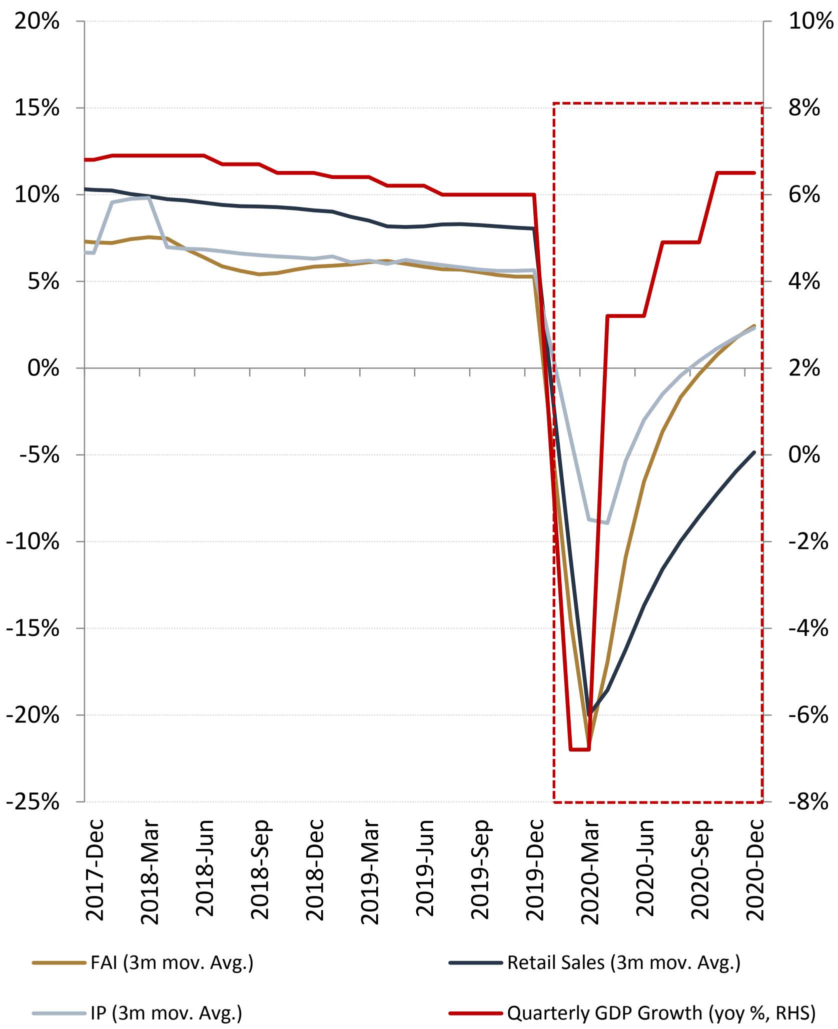
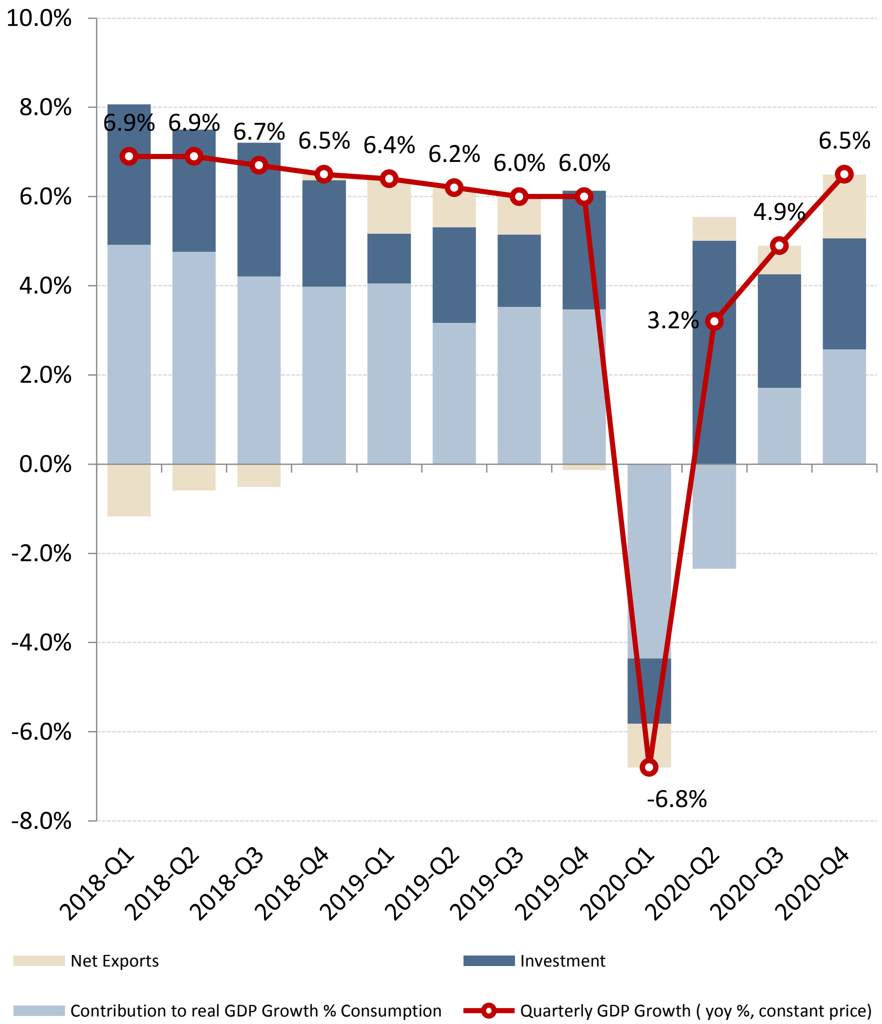
Solid growth recovery in Q4 exceeded the pre-pandemic output level

China's economy expanded by 6.5% yoy in Q4 vs. 4.9.% in Q3



Source: WIND, ICBC Standard

But the recovery was unbalanced and heavily relied on public support



Source: WIND, ICBC Standard

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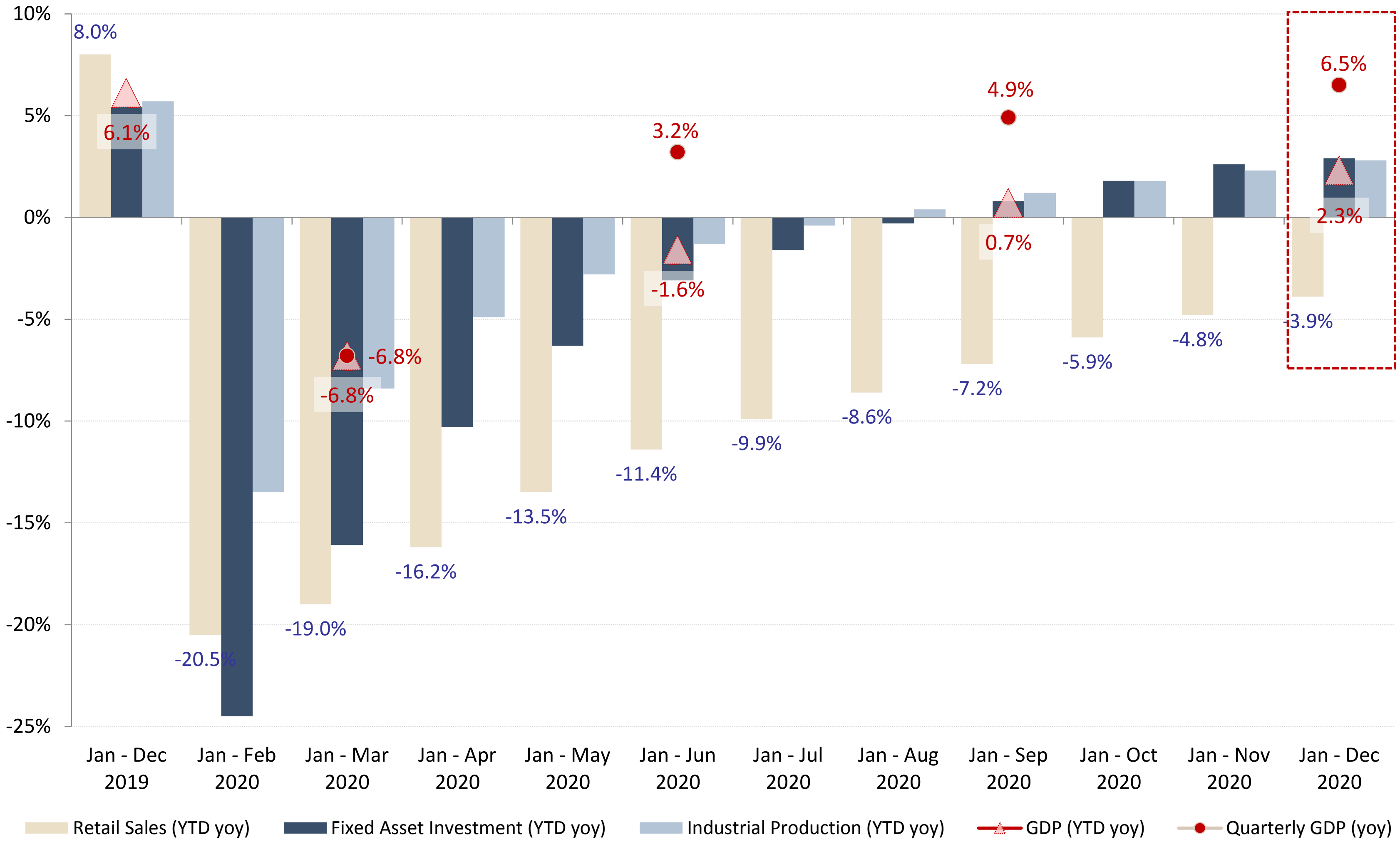
But consumption remained as a growth laggard throughout 2020

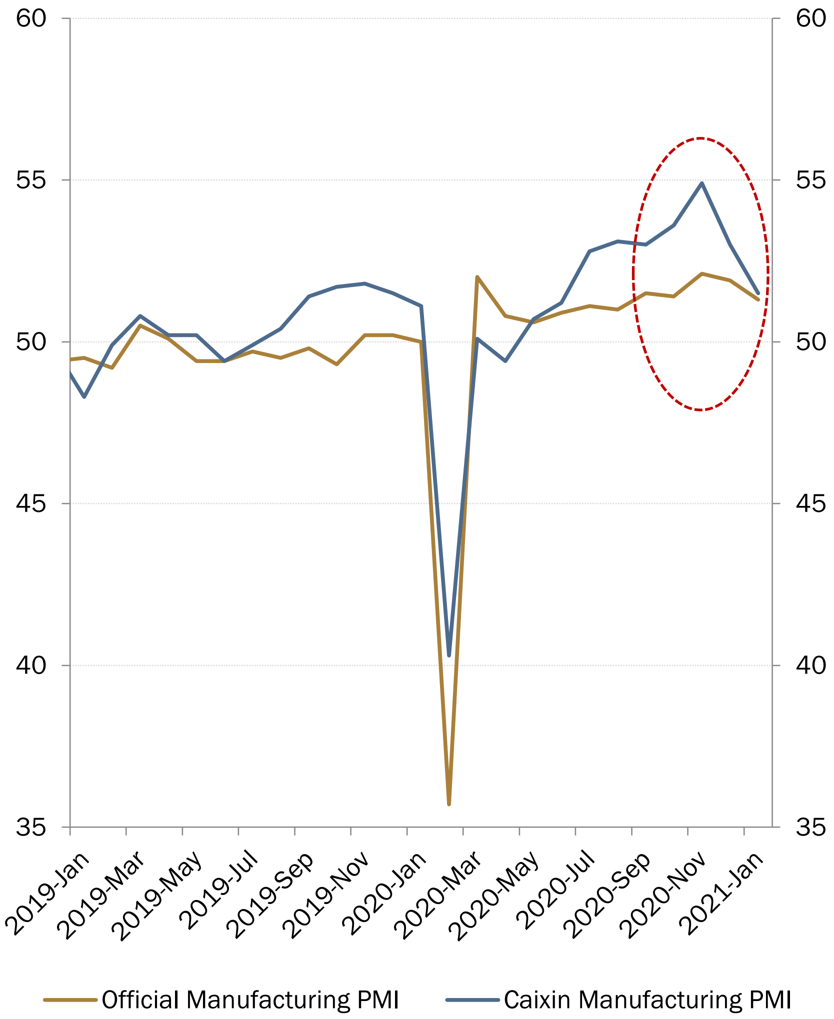
Retail sales failed to catch up with supply-side recovery in 2020 and is facing renewed lockdown challenges to reverse the declining trend



Source: WIND, ICBC Standard

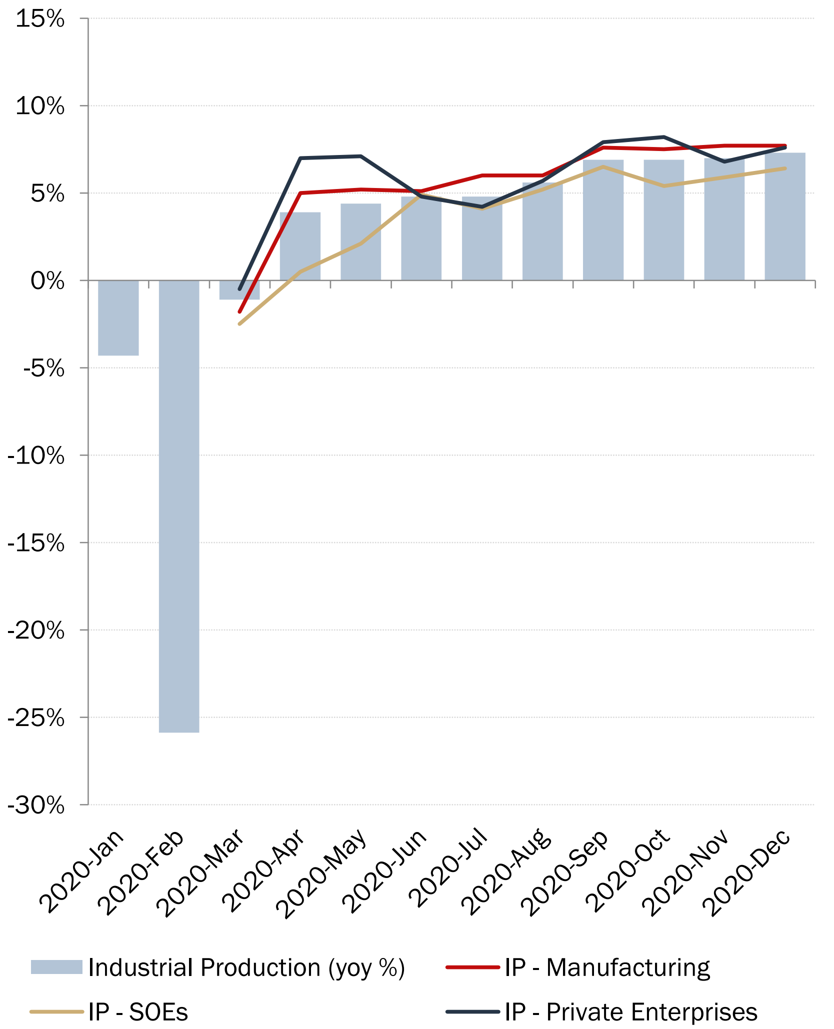
Strong supply-side recovery started to show early signs of plateauing

PMI began to moderate from post-lockdown high towards year-end



Source: WIND, ICBC Standard

Manufacturing and private firms led the supply-side recovery



Source: WIND, ICBC Standard

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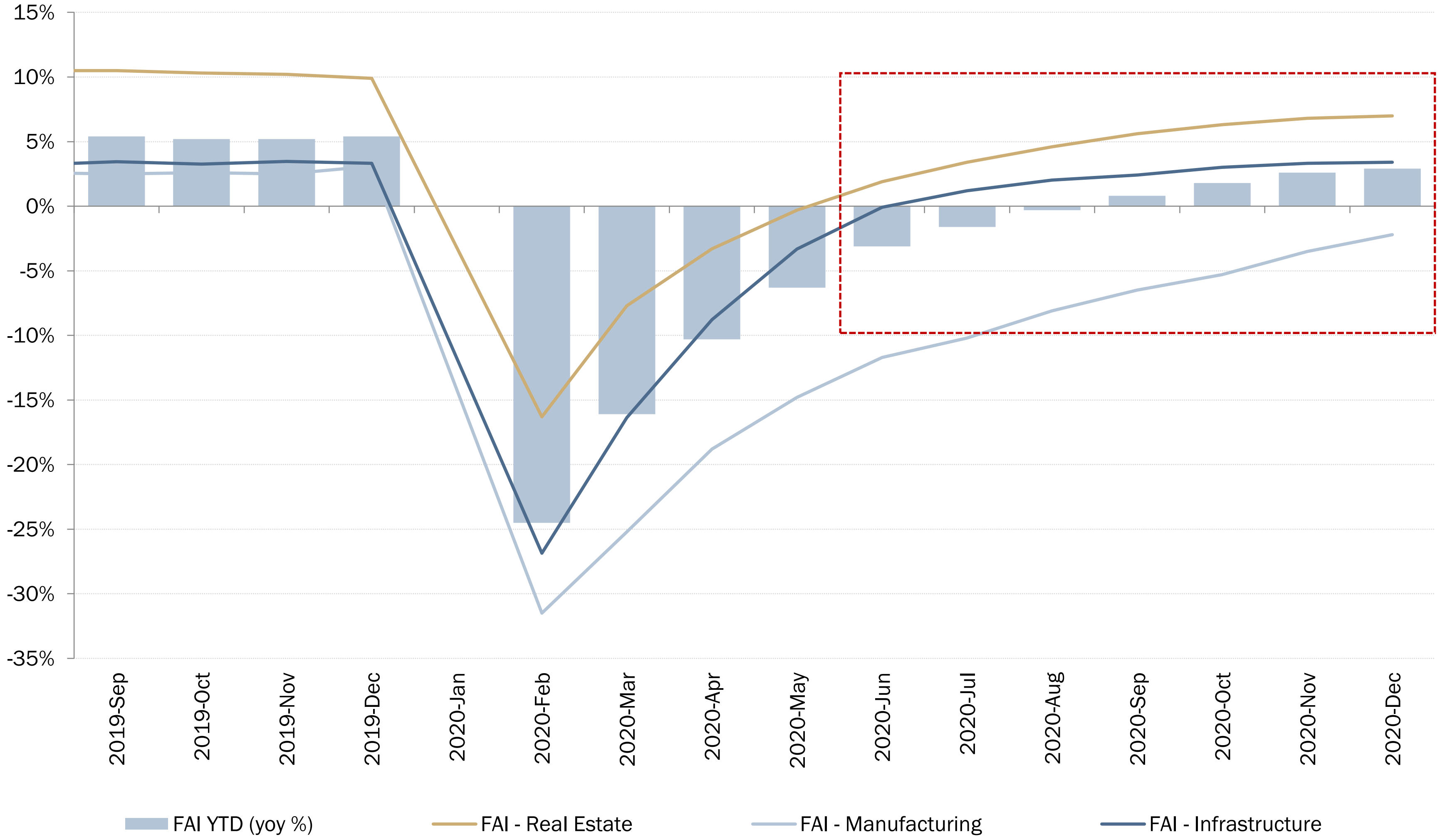
Property and infrastructure-led investment rebound is slowing down

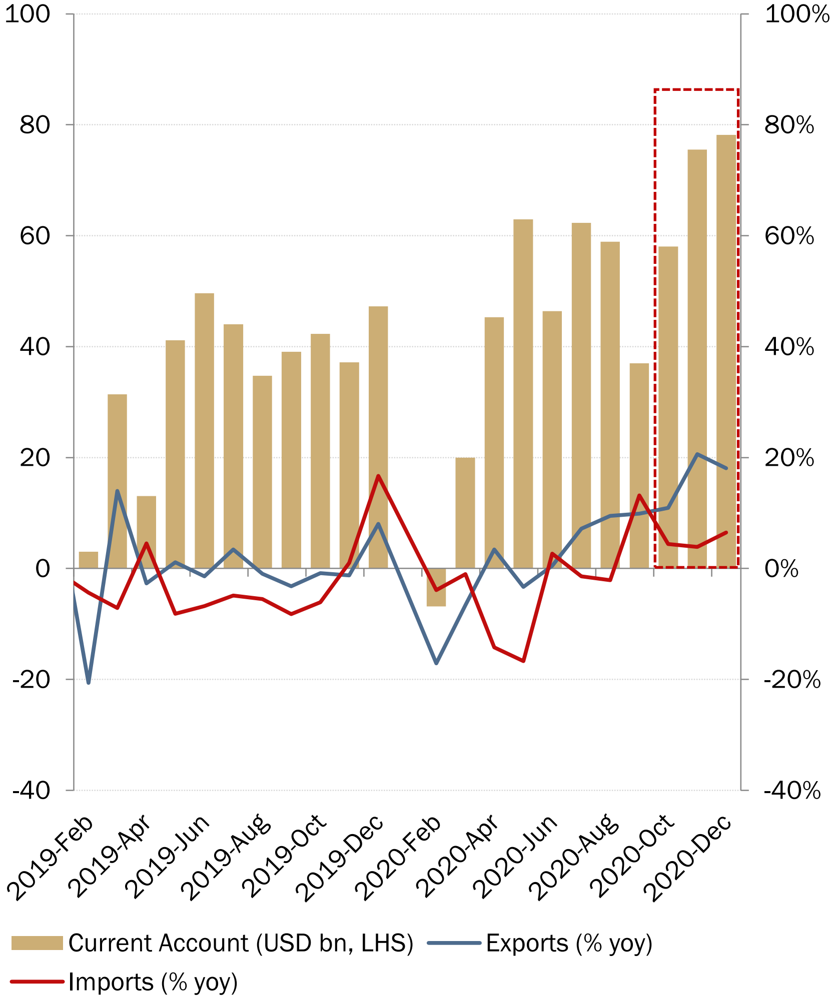
YTD FAI resumed positive growth in September but the rebound was primarily led by real estate and infrastructure investment



Source: WIND, ICBC Standard

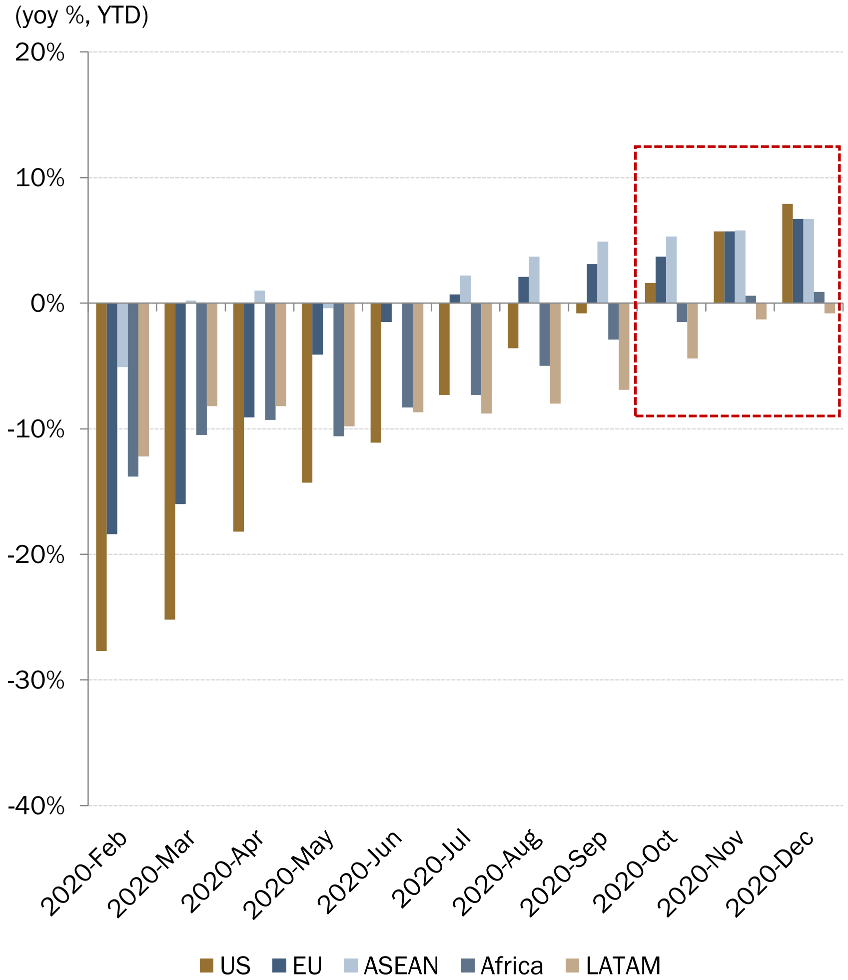
Exports benefited from unexpected demand for pandemic-related goods

Q4 trade growth was gained by taking a greater share of global exports, which also boosted current account surplus to record highs



Source: WIND, ICBC Standard

Notable pick up in exports to US further aided exports rebound in Q4 led by ASEAN and the EU in (YTD exports, yoy %)



Source: WIND, ICBC Standard

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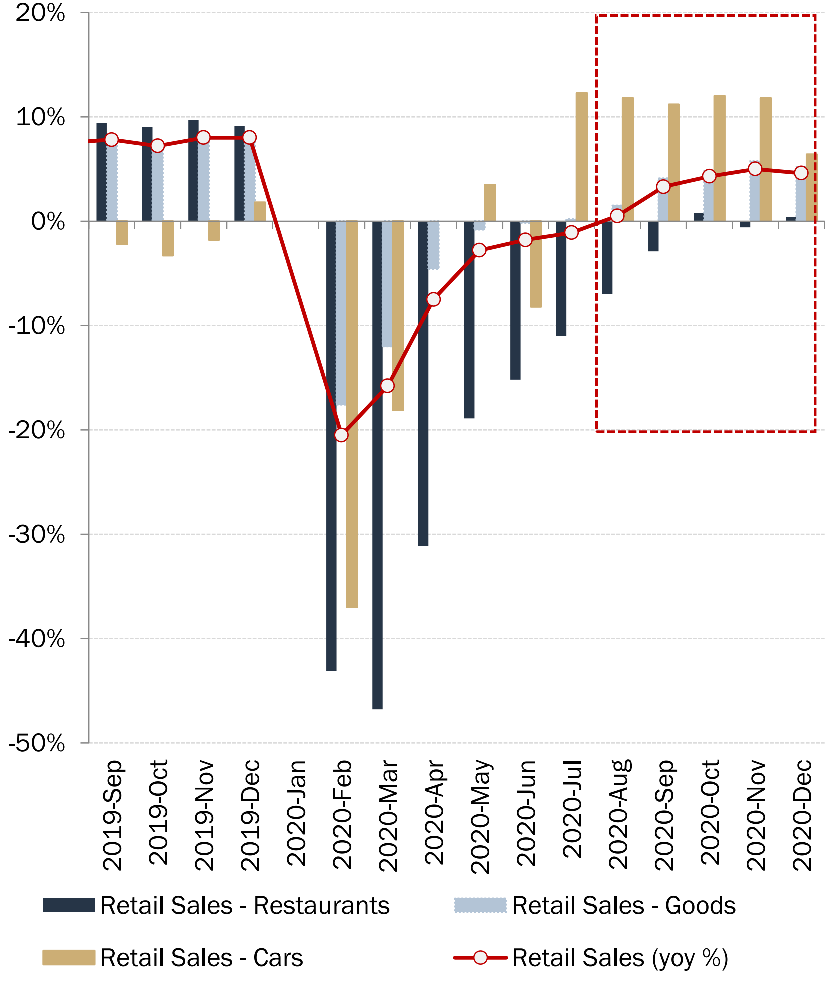
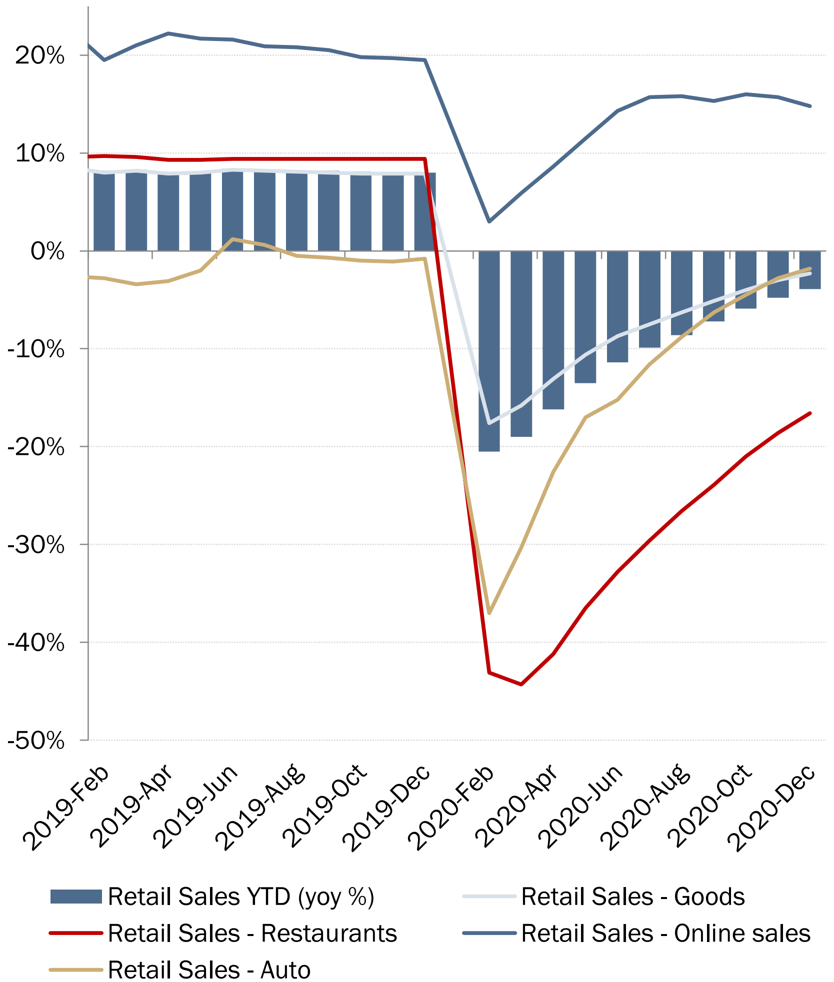
Consumption faces fresh lockdown pressure despite notable Q4 rebound

Monthly growth momentum in retail sales began to gather pace since Sep. led by pick-up in auto sales and consumer goods



Source: WIND, ICBC Standard

But e-Commerce has been indispensable in driving the recovery of retail sales as other segments all remained negative in YTD terms



Source: WIND, ICBC Standard

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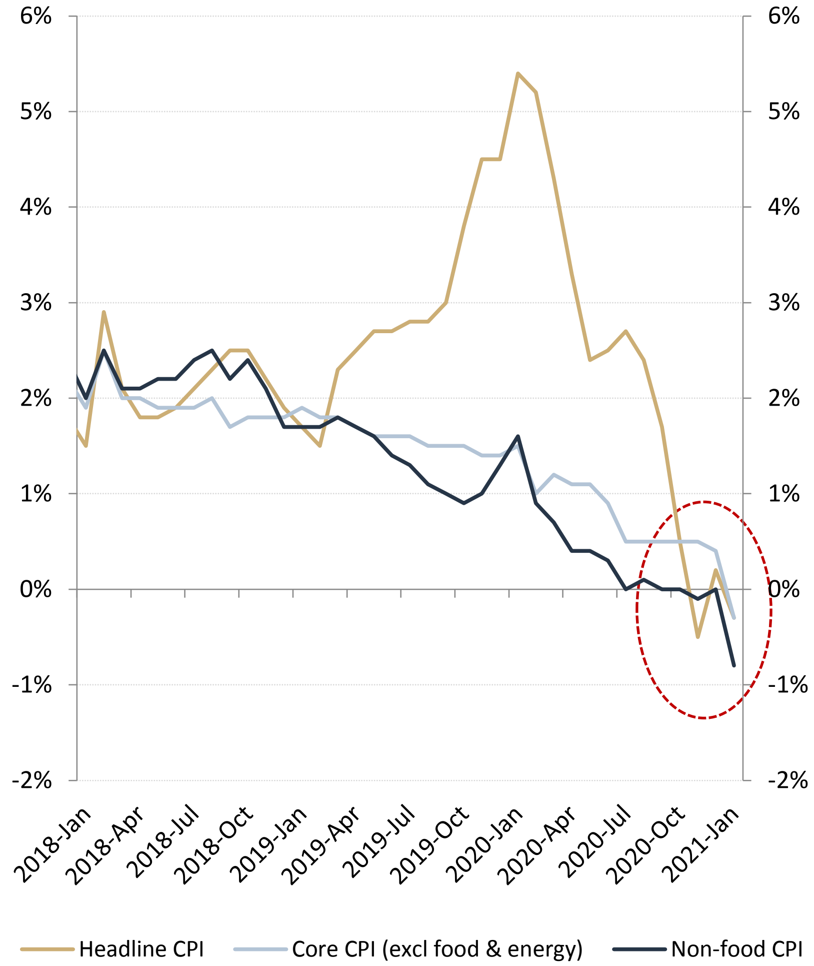
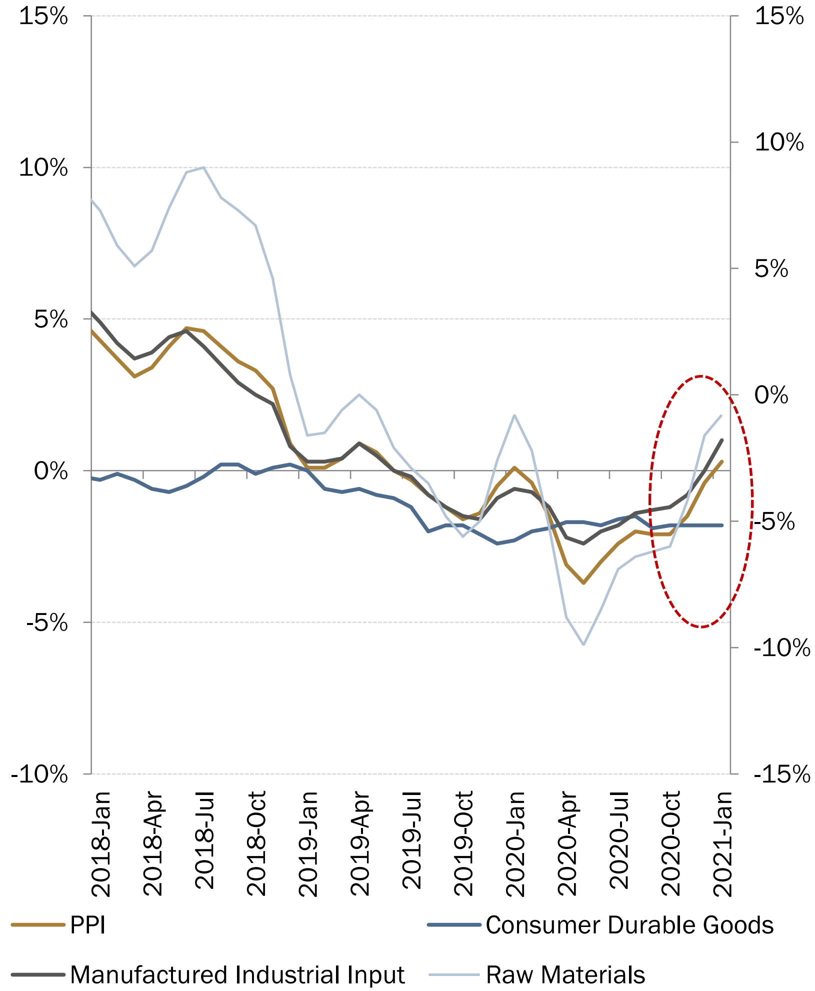
Inflation divergence reflects weaker recovery momentum in consumption

Core CPI remained below 1.0% in Q4 and further dipped into deflation territory due to high base effect



Source: WIND, ICBC Standard

Factory deflationary pressure finally reversed the trend in Jan 2021 supported by rising commodity prices



Source: WIND, ICBC Standard

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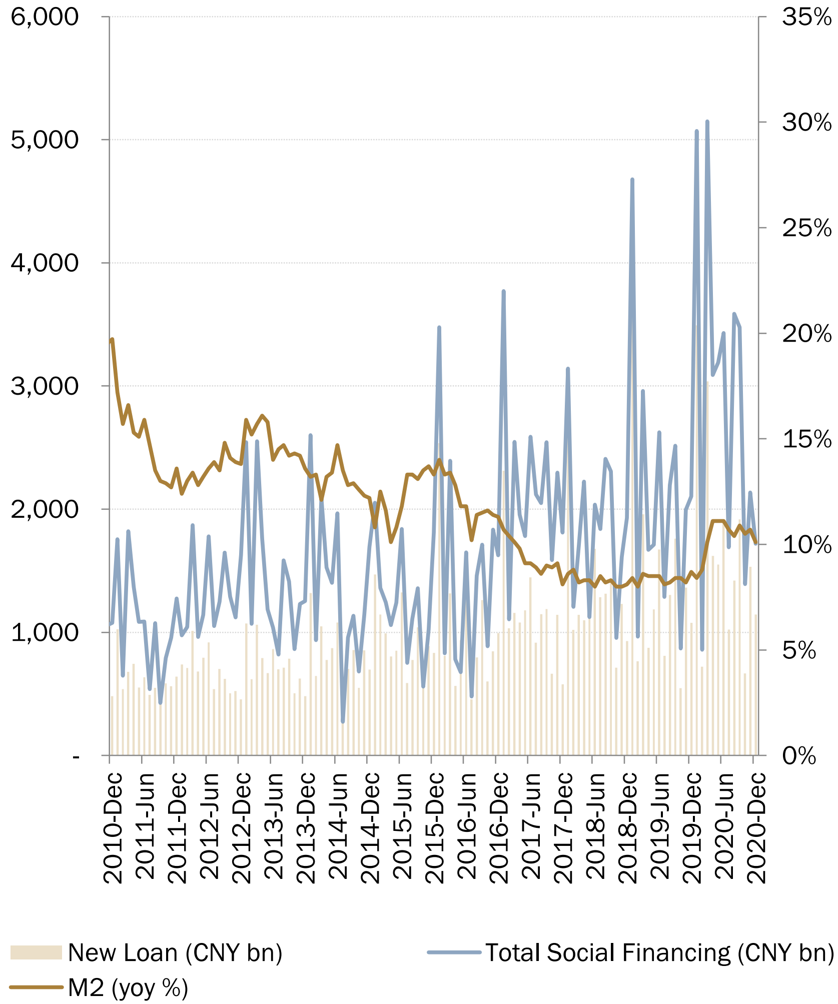
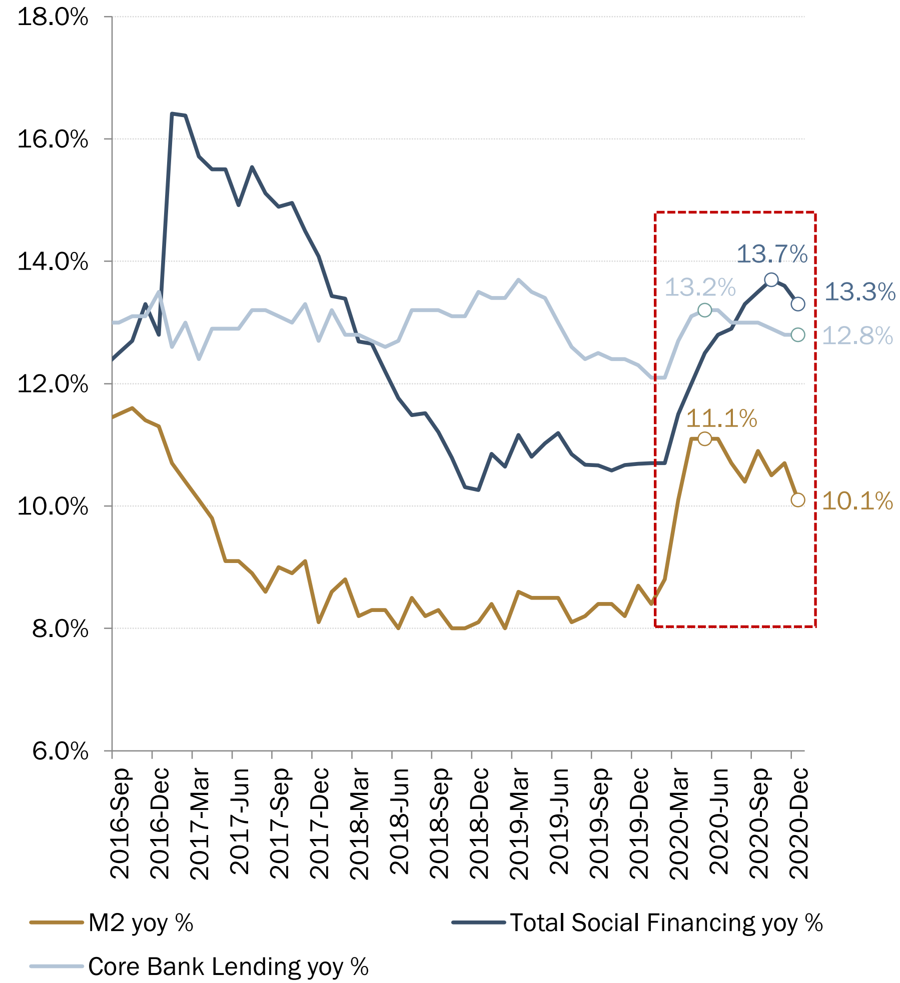
PBoC may gradually shift away from its highly accommodative credit policy

Q2-Q3 2020 saw the highest pace of credit expansion since GFC with considerable growth of bank lending and total social financing



Source: WIND, ICBC Standard

Double-digit growth in broad social credit since March began to show signs of moderation towards year-end



Source: WIND, ICBC Standard

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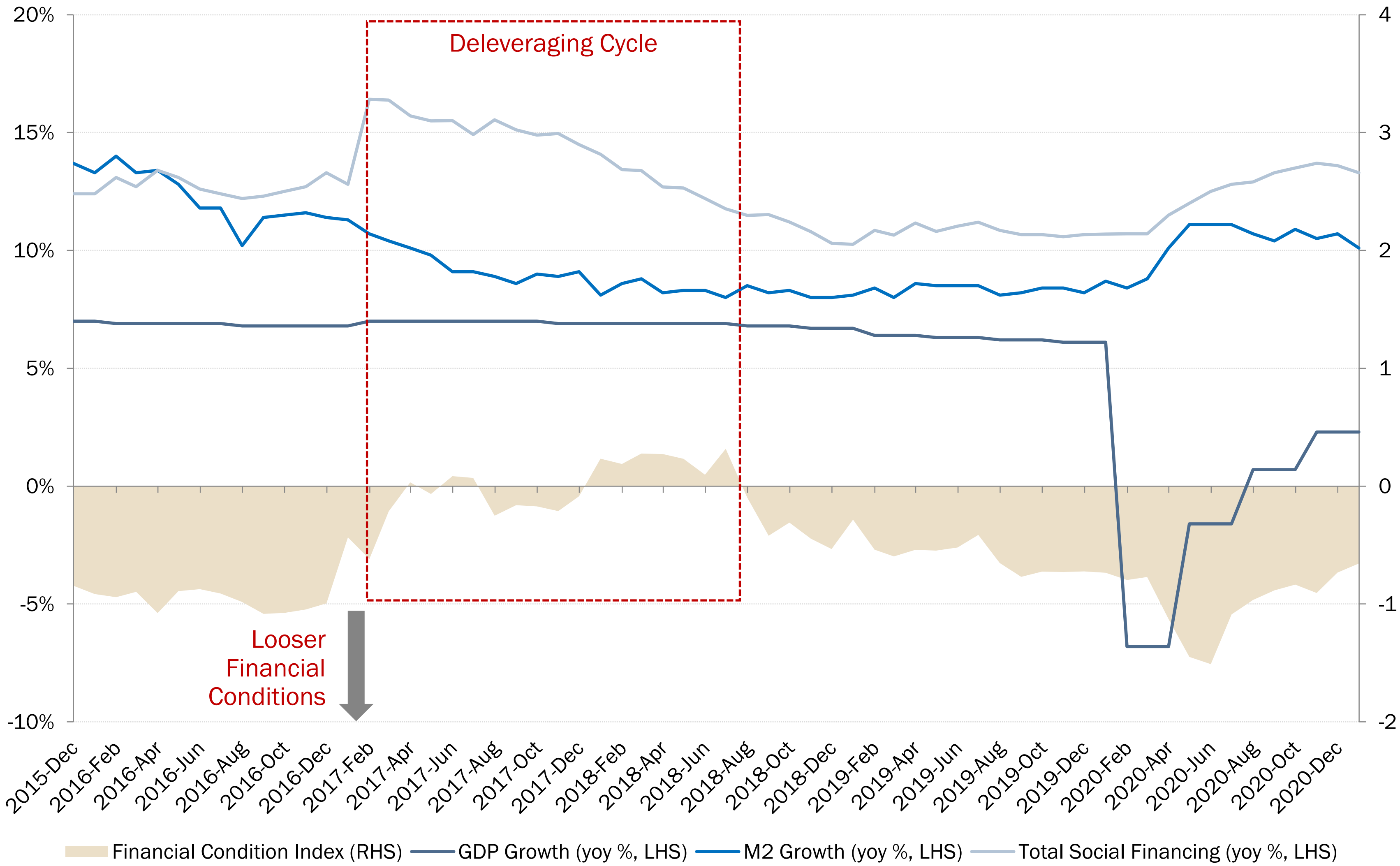
...with extra caution against risks of re-inflating asset bubbles

Financial conditions marginally tightened since June as regulatory tone shifted towards curtailing speculative investments



Source: WIND, ICBC Standard
Note: Negative reading of Caixin Financial Condition Index reflects loose financial condition, and positive reading means tighter financial condition in the onshore China market.

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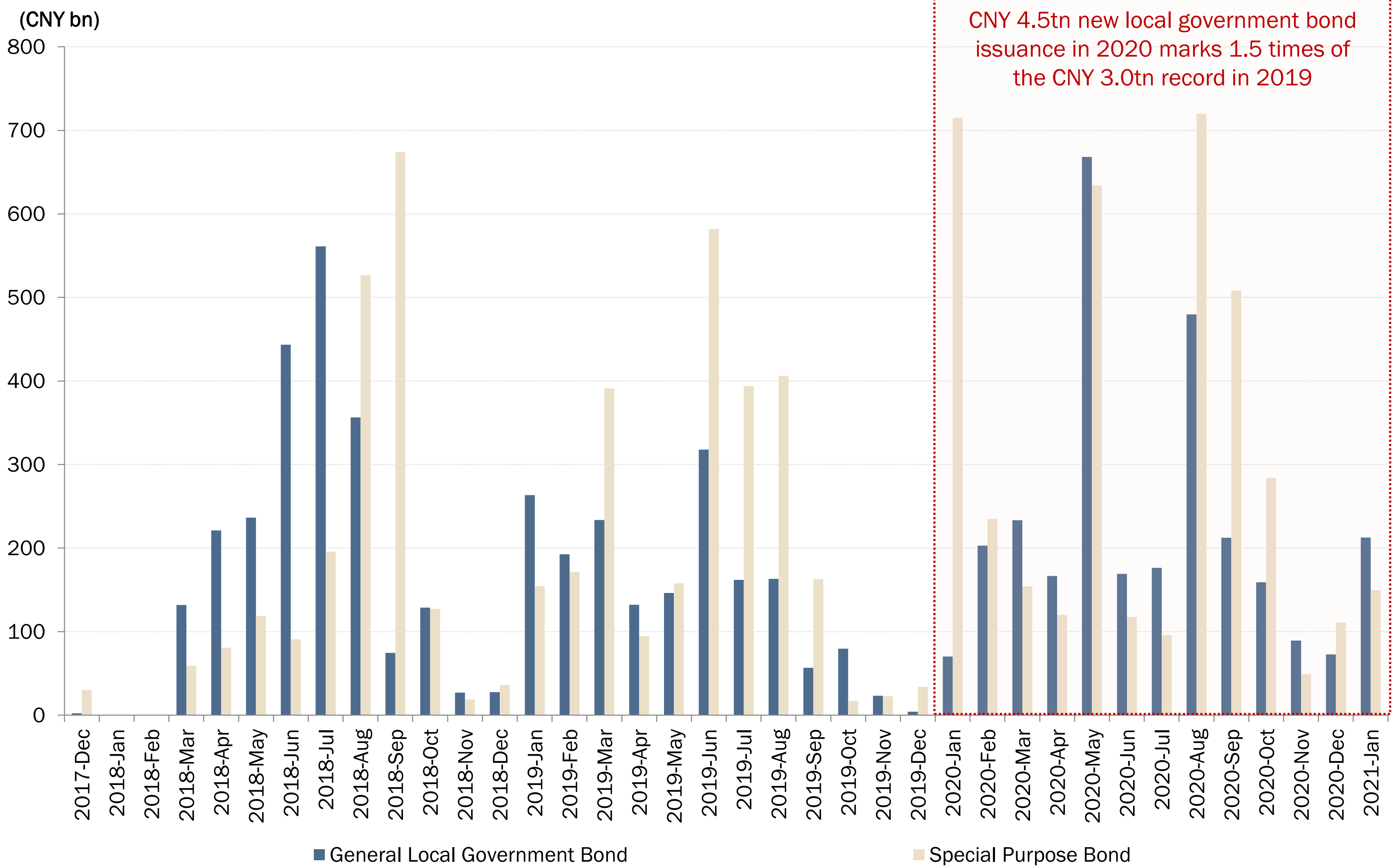
Ultra-proactive fiscal policy is likely to be normalised at the NPC meeting

Over CNY 4.5tn of local government bonds new issuance in 2020 dwarfs records in the past ten years

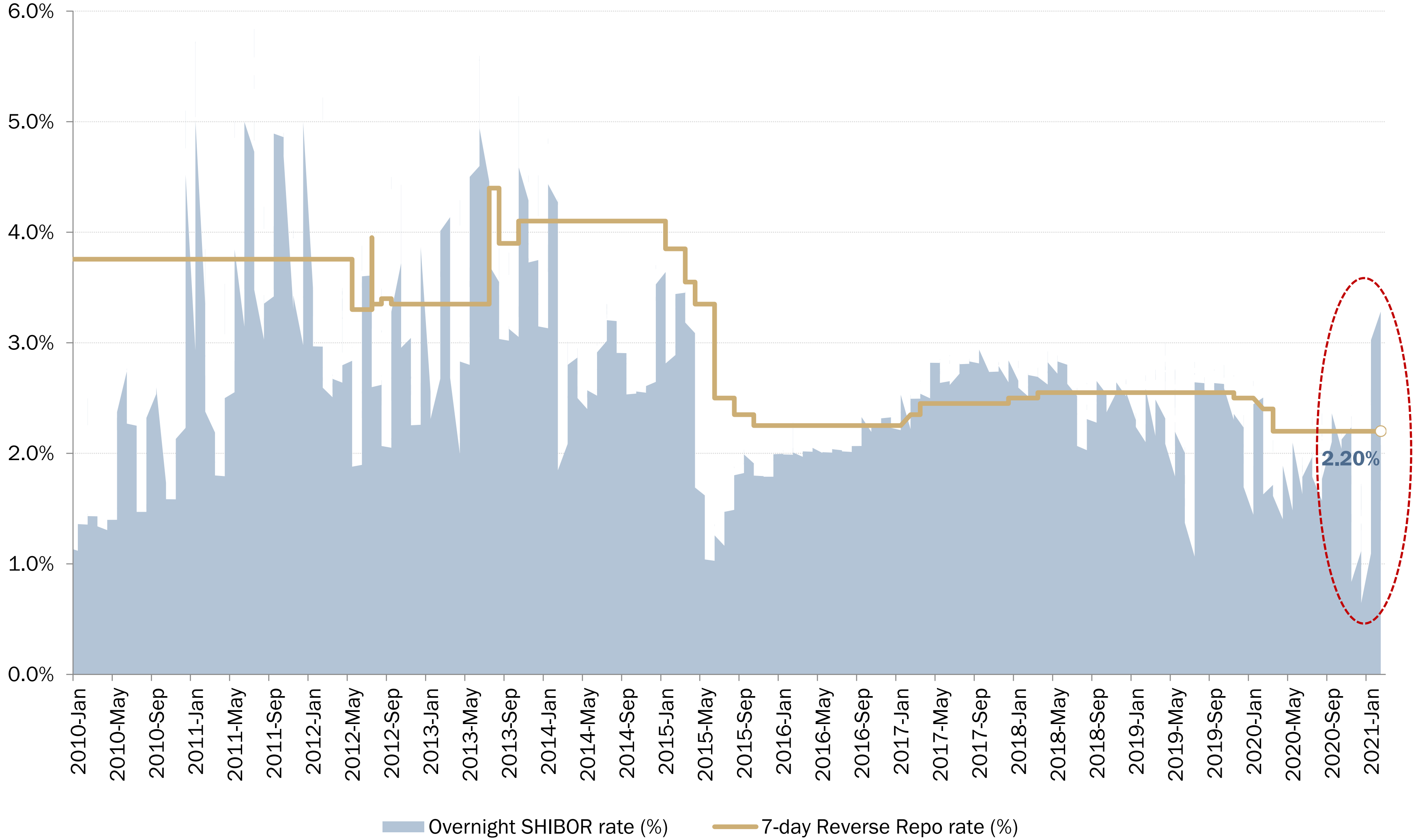


Source: WIND, ICBC Standard

Note: * NPC meeting in May has approved CNY 3.75tn worth of special purpose bond quota for 2020. By the end of H1 2020, more than CNY 2.37tn worth of special purpose bond have already been issued, accounting for nearly 65% of the annual quota.

Front-end interbank rates saw heightened volatility in Jan-2021...

Overnight and 7-day rates went through volatile movements in Jan, but PBoC remained determined to hold 7-day OMO rates unchanged



Source: WIND, ICBC Standard

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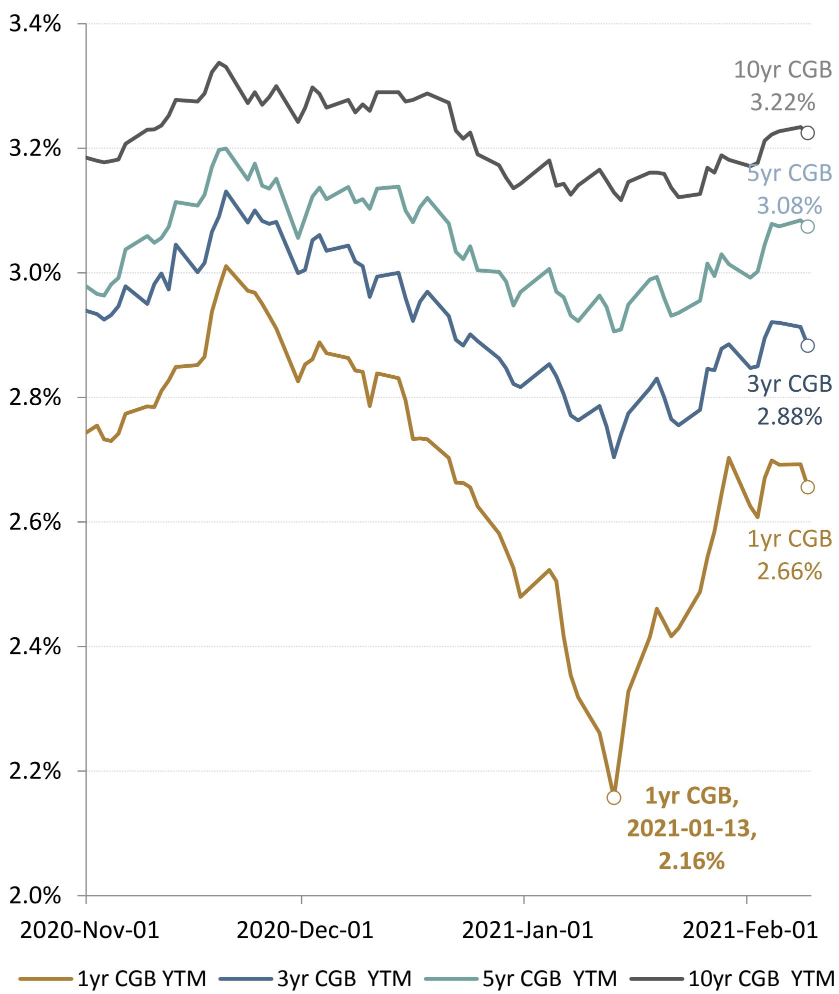
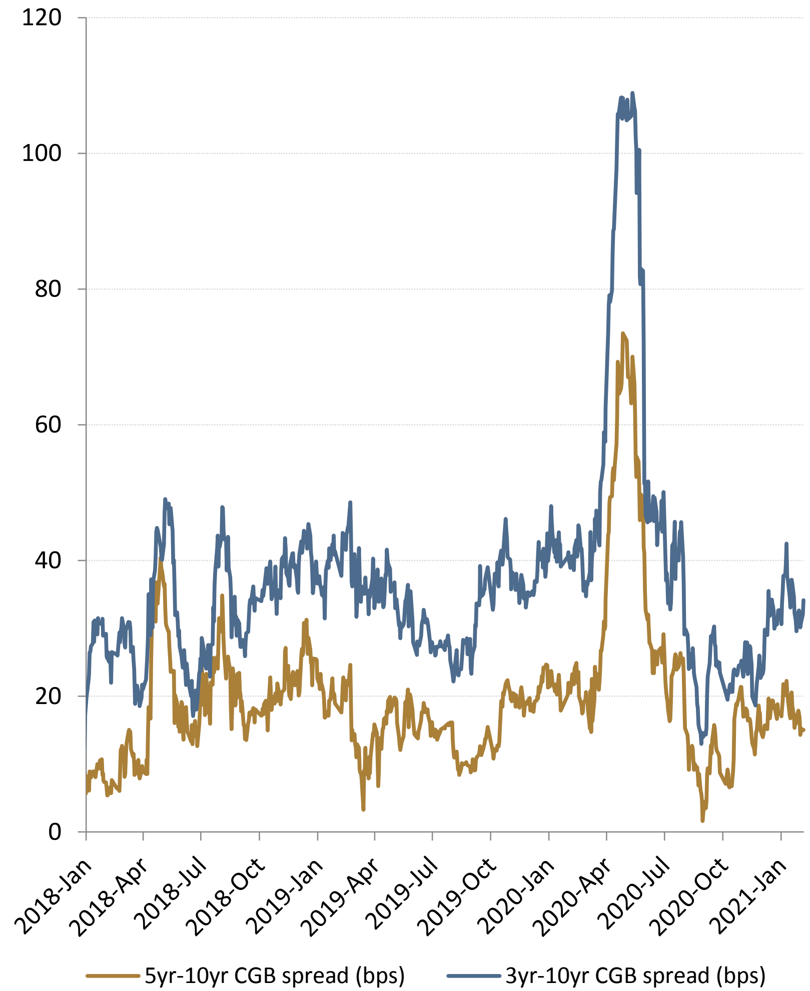
...leading to notable movements of CGB yields across different tenors

Yield of 1yr CGB notably bounced back in Jan 2021 due to front-end liquidity squeeze in the interbank system



Source: WIND, ICBC Standard

Yet CGB yields are likely to remain range bound in the near term as markets await further policy clarities after the Chinese New Year



Source: Bloomberg, ICBC Standard

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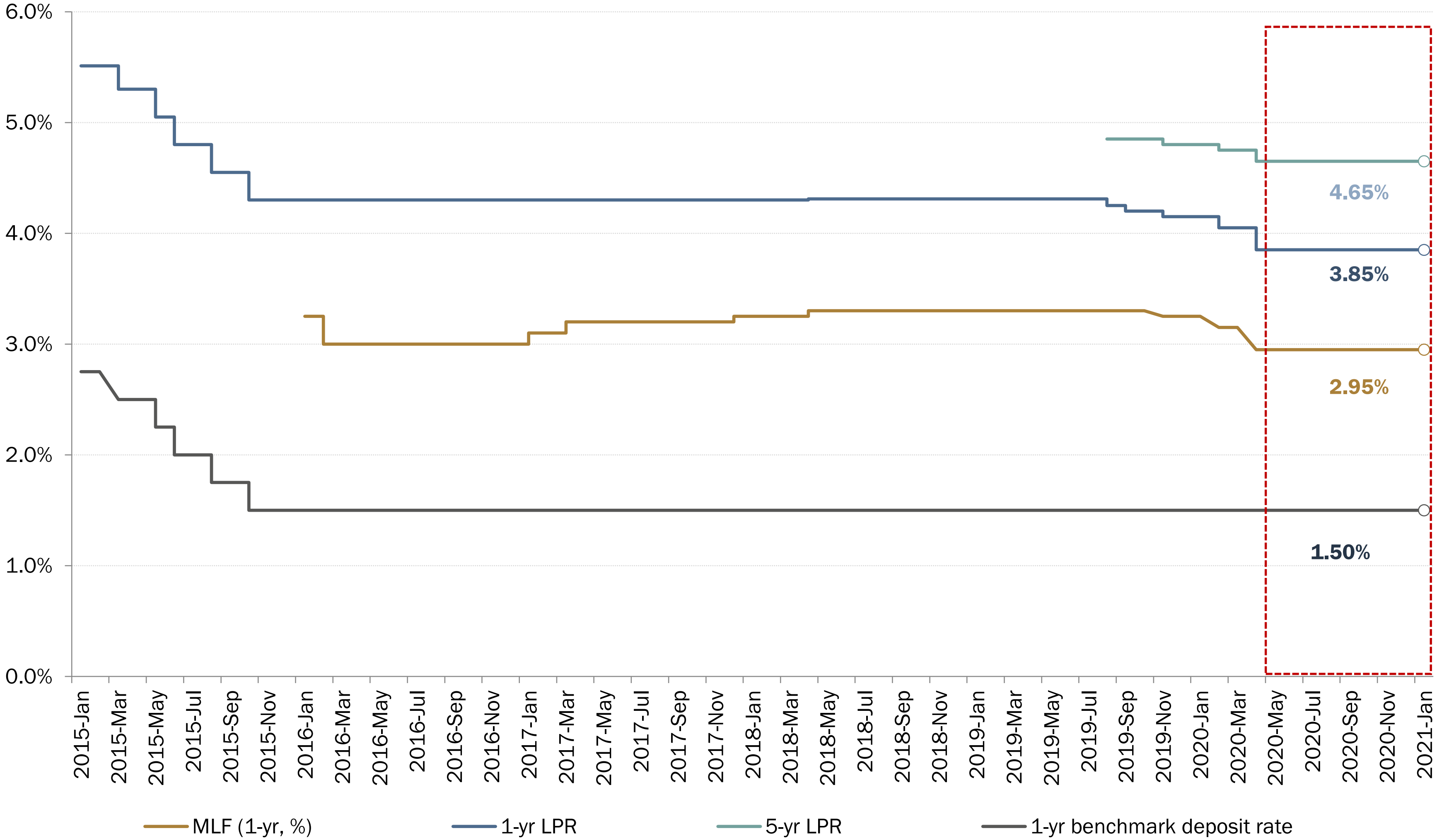
But PBoC is determined to hold policy rates and absorb excessive liquidity

Longer-term benchmark rates remain unchanged since last May and are likely to remain so for longer as near-term rate hike highly unlikely



Source: WIND, ICBC Standard

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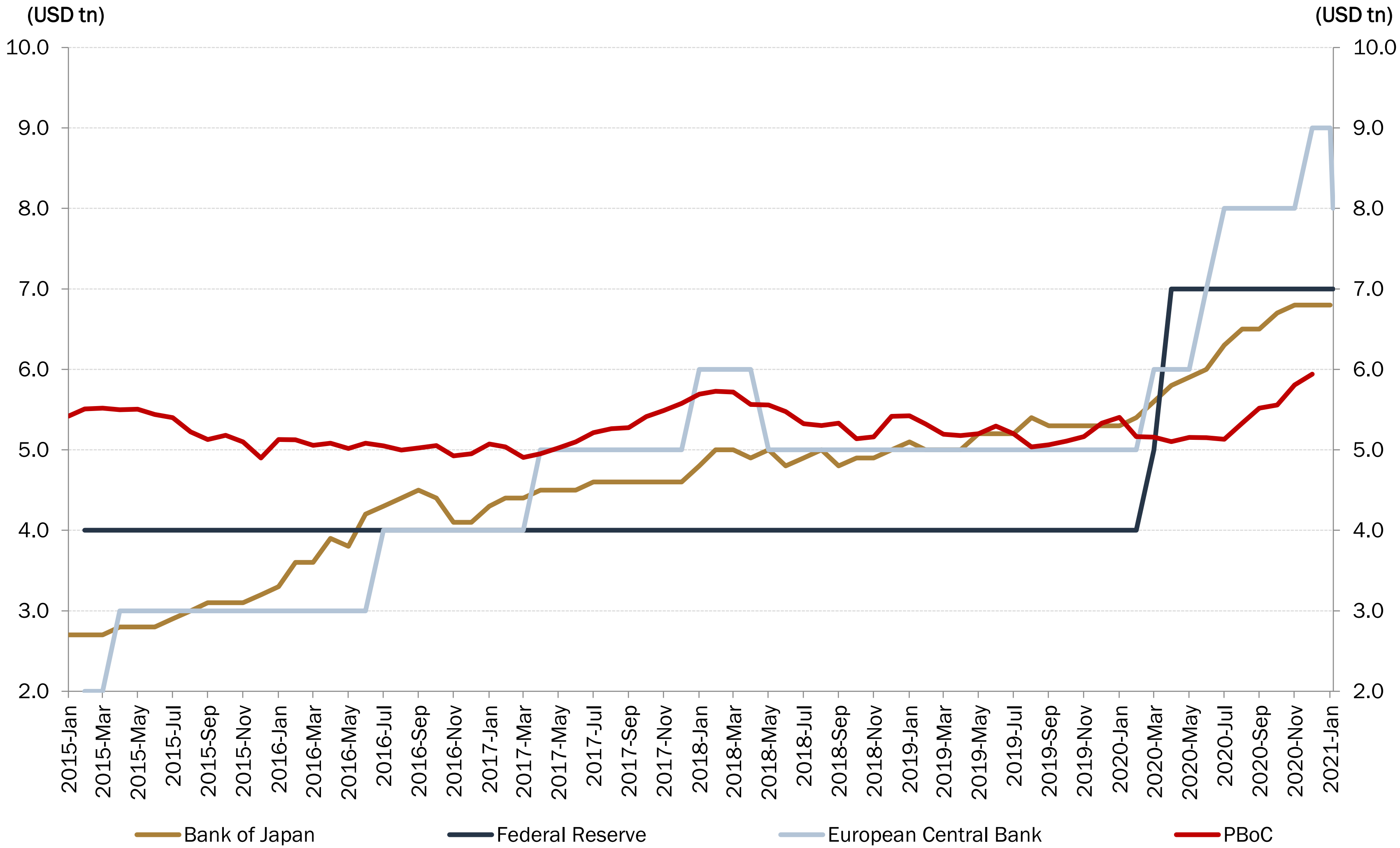
PBoC balance sheet expansion is very timid compared to peers...

Balance sheet growth of major central banks (monthly, USD tn)



Source: WIND, ICBC Standard

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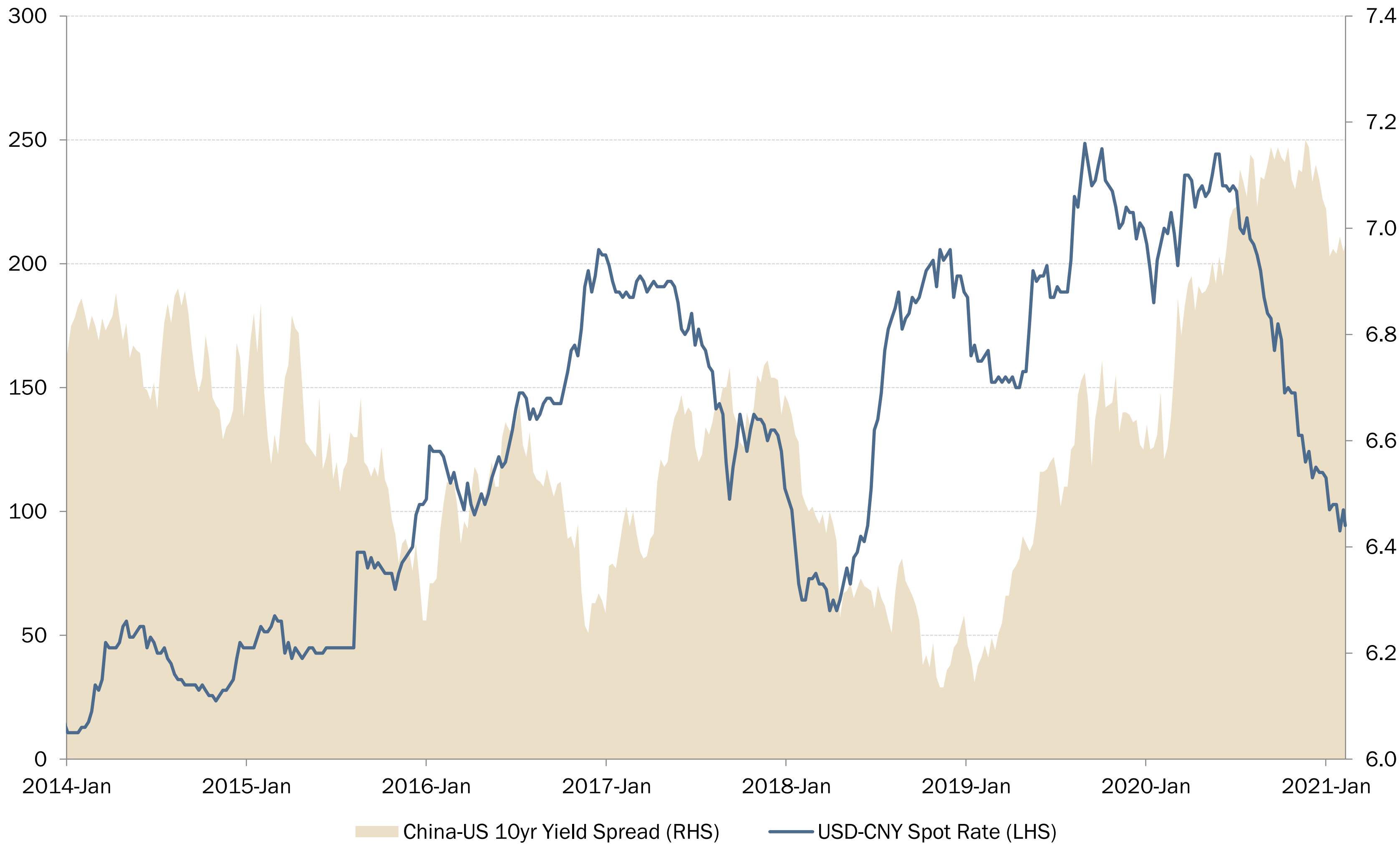
... while rate differentials between China and US remain significant

Yield spread between China-US 10yr government bond remains at above 200bps



Source: WIND, ICBC Standard

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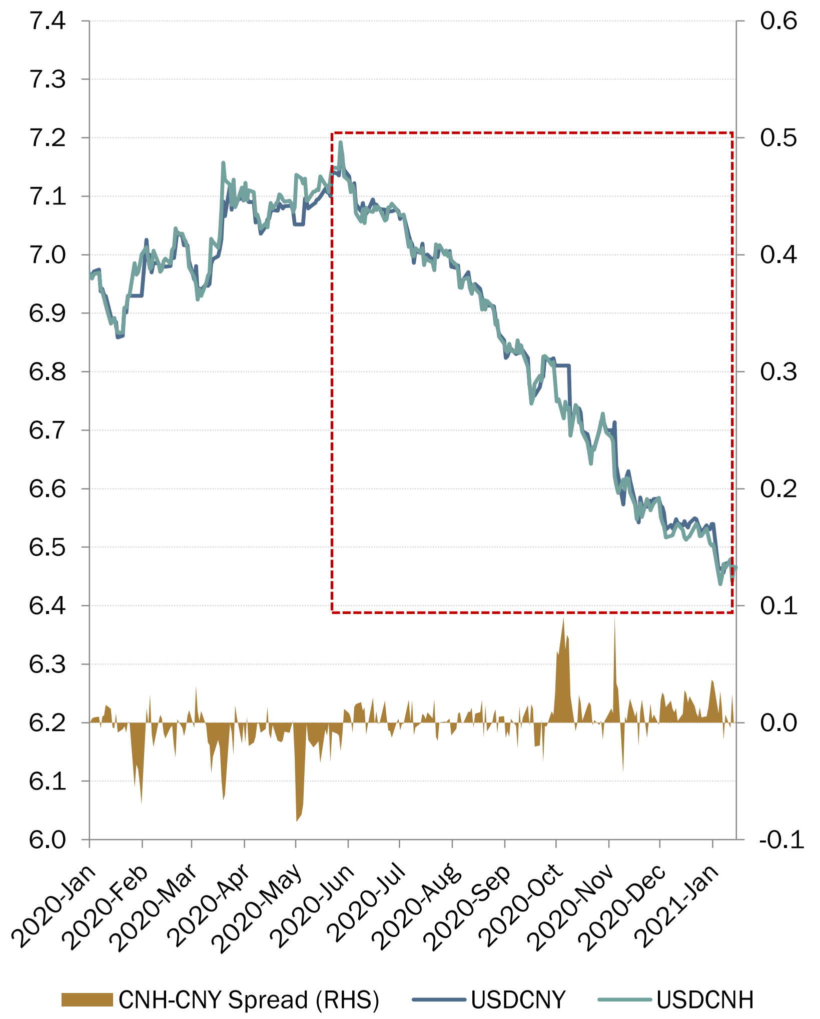
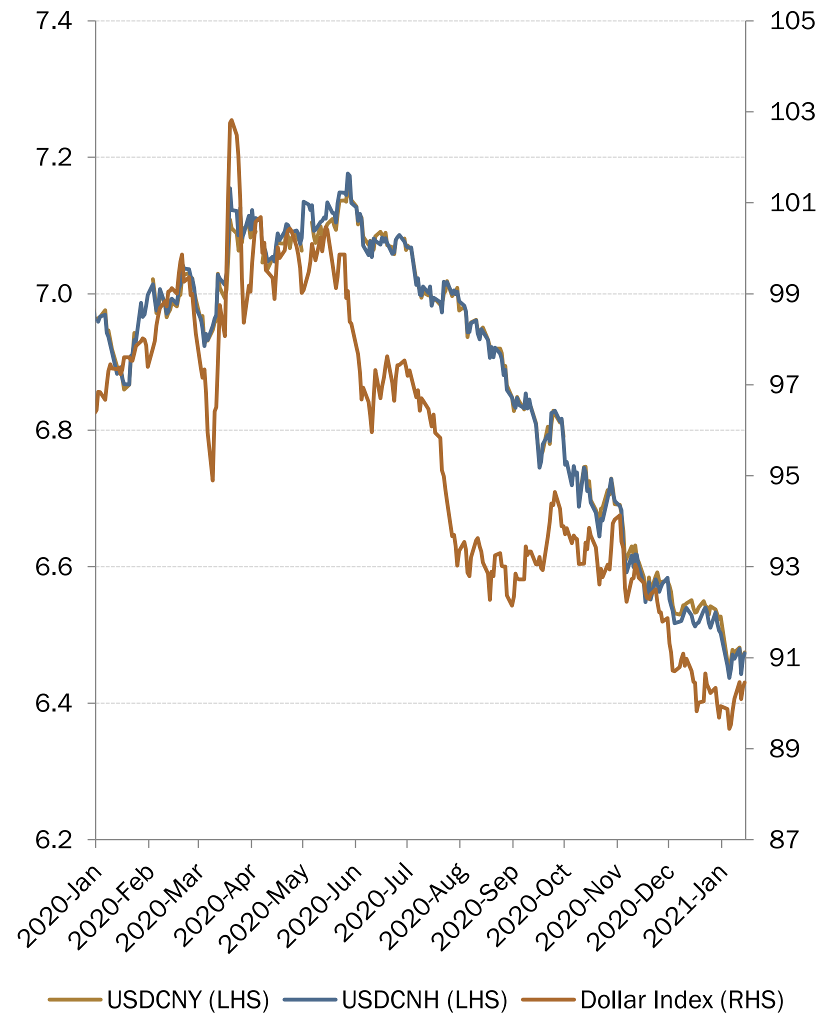
Dollar weakness and macro-recovery continue to support the yuan

Yuan has appreciated by more than 8% against USD in H2-2020



Source: WIND, ICBC Standard

Persistent dollar weakness supported extended yuan rally



Source: Bloomberg, ICBC Standard

Yuan's two-way fluctuation and balanced capital flows to be key focuses

Recent yuan rally may have limited strength to break record lows

Source: WIND, ICBC Standard

PBoC markedly reduced dollar weighting in the CFETS RMB Index

Top 15 basket currencies in the CFETS RMB Index

Currency	New Weighting (Jan 2021 - present)	Old Weighting (Jan 2020 -Dec 2020)	Old Weighting (Jan 2017 - Dec 2019)	Weighting Change (Present vs 2020)
USD	18.79%	21.59%	22.40%	↓ -2.80%
EUR	18.15%	17.40%	16.34%	↑ 0.75%
JPY	10.93%	11.16%	11.53%	↓ -0.23%
KRW	9.88%	10.68%	10.77%	↓ -0.80%
AUD	5.89%	5.20%	4.40%	↑ 0.69%
MYR	4.31%	3.70%	3.75%	↑ 0.61%
RUB	3.85%	3.65%	2.63%	↑ 0.20%
HKD	3.59%	3.57%	4.28%	↑ 0.02%
THB	3.19%	2.98%	2.91%	↑ 0.21%
SGD	3.12%	2.82%	3.21%	↑ 0.30%
GBP	3.00%	2.75%	3.16%	↑ 0.25%
SAR	2.71%	2.16%	1.99%	↑ 0.55%
CAD	2.26%	2.17%	2.15%	↑ 0.09%
MXN	2.11%	1.98%	1.69%	↑ 0.13%
AED	1.69%	1.57%	1.87%	↑ 0.12%

Source: CFETS, ICBC Standard

Appendix I: Market awaits further policy clarity at the March NPC meeting

Key economic targets in the past Government Work Reports (2018 – 2020)

		2020		2019	2018
GDP	GDP Target (%)	**"Endeavour to achieve the 13th FYP target"**		6.0% - 6.5%	6.50%
	Actual GDP (CNY bn)	--		99,086.50	91,928.11
	Previous GDP growth rate (yoy %)	*6.10%*		*6.70%*	*6.90%*
Fiscal	Official Fiscal Deficit (CNY bn)	**3,760**	↑	2,760	2,380
	Official Fiscal Deficit Ratio (% GDP)	**> 3.6%**	↑	2.8%	2.6%
	Special Bond Quota (CNY bn)	**3,750**	↑	2,150	1,350
	Special Bond Quota (% GDP)	**3.75%**	↑	2.18%	1.47%
	Special Sovereign Bond (CNY bn)	**1,000**	↑	NA	NA
	Broad Fiscal Deficit Ratio (% GDP)	**> 8.5%**	↑	5.0%	4.1%
	Railway Infra-Investment (CNY bn)	**900**	↑	800	732
	Road and Water Transport Infra-Investment (CNY bn)	NA	-	1,800	1,800
	Tax Cuts (CNY bn)	**2,500**	↑	2,000	1,100
Social	Household Disposable Income Growth (yoy %)	"Same as nominal GDP growth rate"	=	"Same as nominal GDP growth rate"	6.5%
	Urban New Job Creation (mn)	**9.0**	↓	11.0	11.0
	Unemployment Rate (%)	**6.0%**	↑	5.5%	5.5%
	Poverty Reduction (mn)	10 estimated ("Eliminate extreme poverty")	=	10	10
Monetary	CPI (%)	**3.5%**	↑	3.0%	3.0%
	New Loan Growth for SMEs (%)	**> 40%**	↑	30%	--
	M2 (yoy %)	**"Markedly higher than 2019"**	↑	"Same as nominal GDP growth rate"	"Reasonable growth"
	Total Social Financing (yoy %)				

Source: WIND, ICBC Standard

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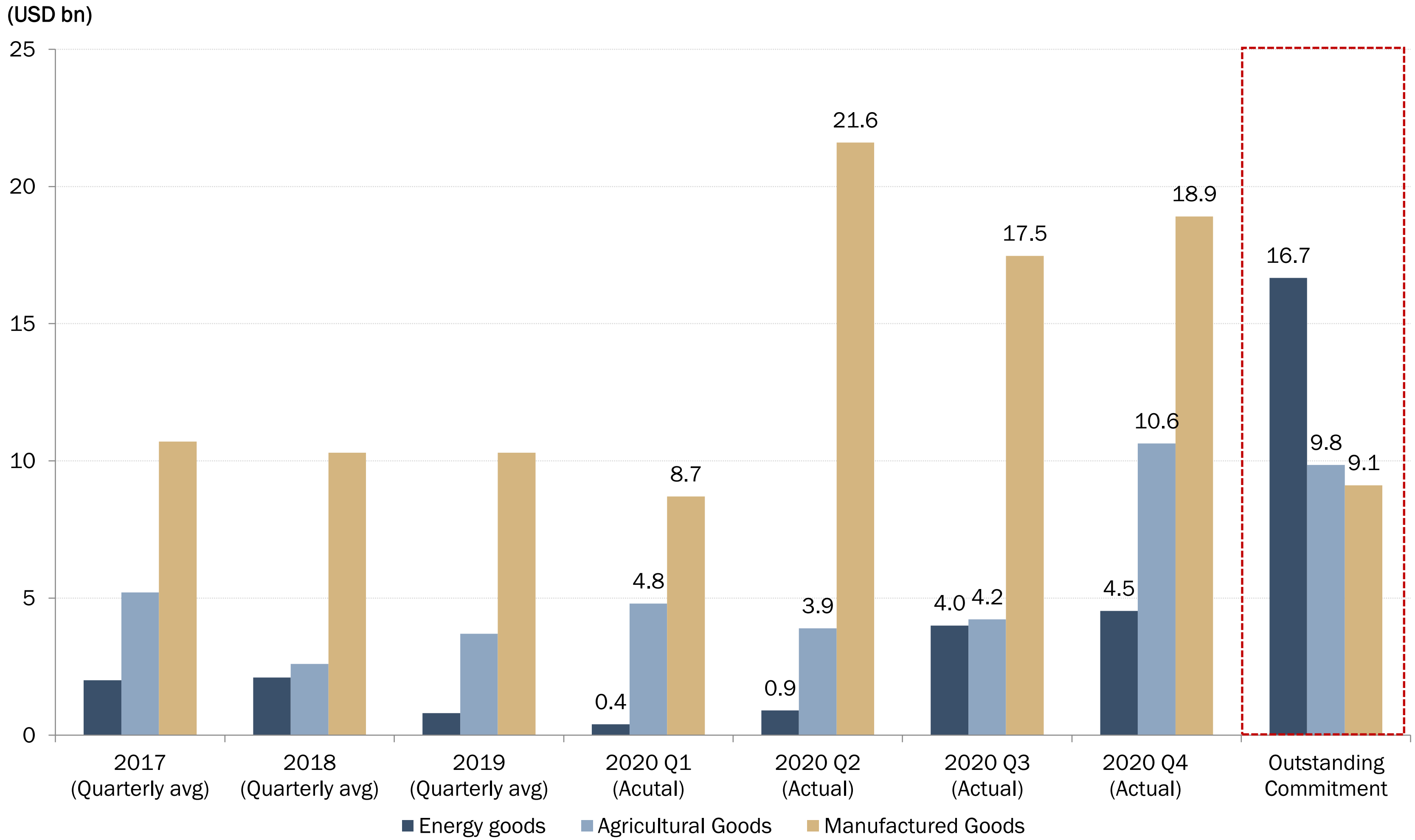
Appendix II (a): Phase-One deal remains incomplete

China has accelerated manufactured goods purchasing from the US since May, but the actual Phase-One purchase of goods across agricultural, manufactured and energy sectors all missed the targets by the end of 2020.



Source: PIIE, ICBC Standard

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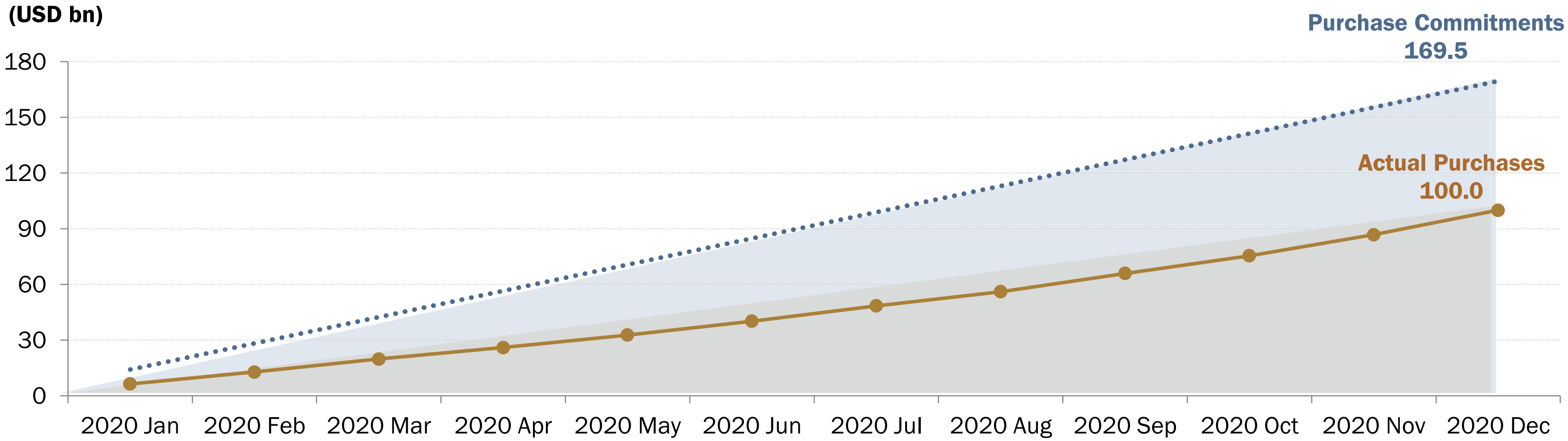
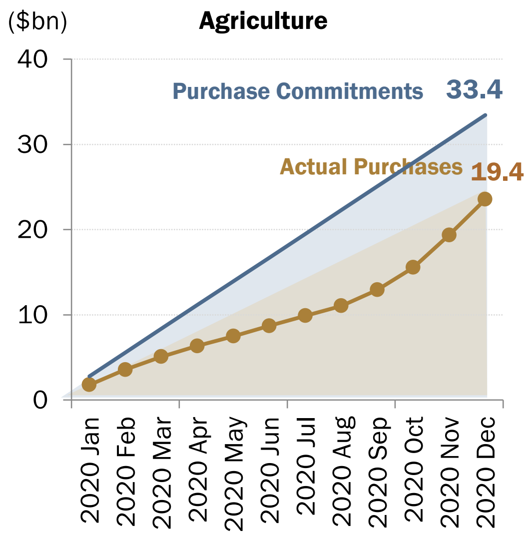
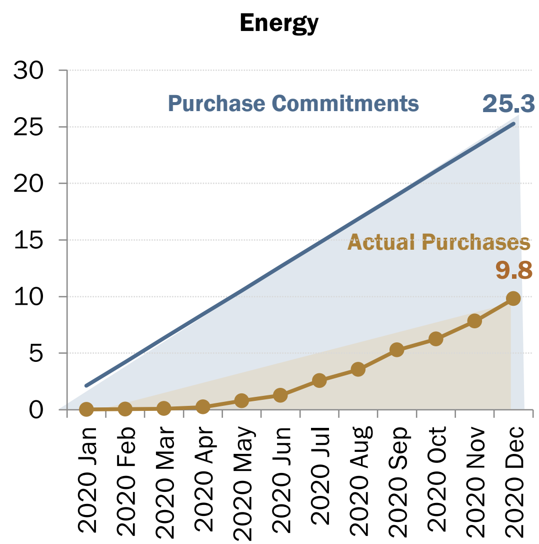
Appendix II (b): Shortfall of the Phase One deal might be too big to ignore

By the end of 2020, China has purchase $100bn worth of goods from US, yet still only accounted for less than 60% of the Phase One target







Source: PIIE, ICBC Standard

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Appendix III: "Six guarantees" have been Beijing's top policy priorities in 2020

Timeline	Policy Measures since end-March *(see Appendix for previous measures)*	Fiscal Policy	Monetary Policy
Mar.27 (Politburo meeting)	A key Politburo meeting marked **Beijing proposal to increase its fiscal deficit to 3.5% as a share of GDP (from a de-facto 3% ceiling)**, issue special sovereign debt and allow local governments to sell more infrastructure bonds as part of a package to stabilise the economy. The ramped-up spending on infrastructure investment could be backed by as much as **CNY 2.5-2.8 trillion worth of local government special bonds.** Beijing is also likely to have to **lower its economic growth target for 2020**, down from the original target of around 6% agreed in December 2019.	Y	
Mar.30	The PBOC reduces the interest rate on 7-day reverse repurchase agreements to 2.2% from 2.4% while injecting CNY 50 billion into the banking system. The rate cut was the largest of its sort since 2015.		Y
Mar. 31	The State Council called for lower reserve-requirement ratios for smaller banks, more infrastructure bond issuances by local governments, and other steps including tax exemptions on new-energy vehicle purchases. A State Council meeting pledged **another 1 trillion CNY of funding through the central bank's relending and rediscounting program**, a cheaper credit line for small commercial lenders.	Y	Y
Apr. 3 (Politburo meeting)	Politburo leaders in a statement pledged a raft of measures to **strengthen the role of the market in land use, capital markets and labour mobility** to build a more efficient economy. The Politburo also called for improvements to the country's stock market infrastructure, faster development of the bond market and actively expanding financial-sector opening., and interest rates reform.	Y	
	PBoC announced cut of targeted Reserve Ratio Requirement (RRR) for smaller banks by 1.0 percentage points in two phases. The targeted RRR cut will release around CNY 400 billion into the banking system.		Y
Apr. 17 (Politburo meeting)	The Politburo **for the first time put forward the goal of "six guarantees (六保)",** which includes ensuring residents' employment, a basic livelihood and market participation, food and energy security, supply chain stability, and grassroots operations. 'Full-employment and undisrupted functioning of social fabrics' as well as 'people's livelihoods' have been identified as top priority by the government.	Y	
Apr. 17-20	**PBoC cut MLF rate by 20bps** to 2.95% from 3.15%, the lowest since 2017, and injected CNY 100bn via 7-day repo. The one-year LPR was subsequently lowered to 3.85% from 4.05%, and the five-year tenor dropped by 10bps to 4.65% down from 4.75%.		Y
Apr. 20	MoF approved another CNY 1tn quota for special purpose bonds to be placed by end-May. **NDRC outlined the five-year "New Infrastructure investment plan" worth CNY 10tn from 2020. 24 provinces have submitted CNY 8tn worth of infrastructure investment projects for 2020 so far** (see next slide).	Y	
Apr. 21	State Council lowered the bad-loan coverage ratio for medium-small sized banks by 20 bps in phases, to unleash additional credit to support small and micro-sized businesses.		Y

Source: WIND, ICBC Standard

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Appendix IV: China’s COVID-19 emergency relief policy package (Feb-Mar)

Timeline	Policy Measures	Fiscal Policy	Monetary Policy
Feb. 1	Import tariffs exemption for medical materials used in epidemic control until March 31.	Y	
	PBoC strengthened countercyclical adjustments of monetary policy through open market operations. Together with other financial regulators, the PBoC rolled out 30 policy measures to support enterprises.		Y
Feb. 3-4	PBoC added a net CNY 150bn liquidity to the interbank market. The total injection announced was CNY 1.6tn, the largest single-day addition of its kind since 2004.		Y
Feb. 5	State Council announced support for debt financing and insurance for virus-impacted firms, and **allowed local government to sell another CNY 848bn of bonds before March**.	Y	
Feb. 6	PBoC issued credit support for **enterprises heavily affected by the epidemic** (small and micro companies and key manufacturing sectors) **to borrow at record-low rate of 1.6%** through state-owned commercial banks. PBoC also provided CNY 300bn for large banks and selected local banks in Hubei and other severely-hit provinces.		Y
Feb. 9	State Council announced **total spending worth CNY 80.55bn as emergency funds** to mitigate against COVID-19 related shocks to the economy.	Y	
Feb. 15	**Various tax relief measures worth CNY 1tn (or about 1% of GDP)**, including reductions in employers' required social insurance payments, lower electricity fees and VAT waivers.	Y	
Feb. 17-20	PBoC lowered MLF rate by 10bps to 3.15% from 3.25%, the lowest since 2017, and injected CNY 100bn via 7-day repo. PBoC lowered the benchmark borrowing costs for new corporate and household loans. The one-year LPR was lowered to 4.05% from 4.15%, and the five-year tenor was lowered to 4.75% down from 4.8%.		Y
Mar. 4	7 provinces announced **investment projects** worth CNY 25tn with **CNY 3.5tn to be fully allocated within 2020**	Y	
Mar. 12-13	PBoC allows a higher cap of 1.25 on foreign debt, a move aimed at helping smaller and private companies raise more funds overseas. PBoC also cut Reserve Requirement Ratio (RRR) by 0.5 - 1.0 percentage points for banks, freeing up an additional CNY 550bn liquidity to the interbank market to help virus-impacted companies. The RRR for large banks is currently 12.5%. Qualified joint-stock commercial banks would enjoy an additional cut of 100 bps.		Y

Source: WIND, ICBC Standard

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