CHINA VIEW China’s Q4 growth tops pre-COVID level; but more consumption needed to sustain recovery

- **Impact of COVID-19 on the Chinese Economy** - Stronger-than-expected Q4 growth topped the pre-COVID level of Q4 2019. However, China’s economic recovery remains severely unbalanced. Enduring recovery will require continuing policy support for employment growth and SME financing.

- **Investment Trends** - On the back of improving demand and profitability, robust manufacturing investment is likely to persist through the 1H. On the other hand, tightening financing conditions should see both real estate and infrastructure investment gradually slow.

- **Consumption Trends** - Retail growth is slowing. A resurgence of COVID cases in northern China in January has led to heightened travel restrictions that will drag on consumption growth in Q1, perhaps significantly. In the near-term, consumption growth is seriously challenged by both on-going COVID mobility restrictions and weak household income growth.

- **Trade Trends** - China’s exports remain strong. The resumption of industrial production internationally is pushing up demand for China-made intermediate industrial products and capital goods. This new demand stream should serve to hold China’s exports steady even as pandemic-related export demand eventually abates.
Implications for Business

Official GDP growth in Q4 beat market expectations. Some sectors achieved growth notably higher than pre-COVID levels: exports, industrial production, and manufacturing investment. Strong export demand for industrial goods lifted Chinese Industrial Production to a high not seen since early 2018. And yet, China’s recovery remains severely unbalanced. Consumption growth is significantly lagging industrial production; and small business recovery is significantly lagging the large corporate sector.

These imbalances raise concerns over the sustainability of the current recovery. GDP growth is anticipated to slow in the 2H when the low-base effect from 2020 phases out. Whether the 2H slowdown is gradual or not will depend on how fast the government turns down the credit taps on real estate and infrastructure investment; so far, they’re moving slowly, although December’s TSF decline was faster than expected and the PBOCs open market operation that pulled liquidity out of the market in January was unusual.

One big economic question looming for the March National People’s Congress is whether policy support for the SME sector will continue. Recently reported datapoints claim that the PBOC provided roughly RMB 3.9 trillion in loan support to SMEs in 2020 (though small banks), along with 7.3 trillion in loan repayment deferments for all companies, including SMEs. If this support is withdrawn too quickly, defaults will certainly increase.

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