FOR PROFESSIONAL INVESTORS – 25 April 2022

Chi Flash

SAVING CHINA'S ECONOMIC GROWTH

You cannot escape the responsibility of tomorrow by evading it today.

Abraham Lincoln

Data on first-quarter growth in China underscores a market concern that a worsening of inflation shocks in developed markets fusing with a sharp slowdown in China's growth could disrupt the global economic recovery. The biggest near-term risk to Chinese growth is its dynamic zero-Covid policy, which is negating the positive effects of Beijing's cautious policy easing. What else can China do to save growth?

Growth to weaken further

GDP grew by 4.8% YoY, mainly on the back of a strong performance in January and February ahead of Covid-related shutdowns. As Omicron hit, however, economic activity in March and April slowed sharply. The risk of faltering growth momentum threatening the government's 5.5% growth target this year is rising.

The Covid-related drag appears to be building as lockdowns in high-risk areas, notably Jilin province and Shanghai, were extended. The slowdown can already be seen in the sharp fall in the purchasing managers' indices for March, weak import growth and sharp drops in passenger and freight traffic volumes.

China's weak growth also aggravates existing supply-chain bottlenecks, dragging on other regions' growth and boosting global inflation.

Beijing will unlikely change its stringent Covid policy for the rest of this year.[1] Thus, the business environment will remain unstable. Chinese companies are reporting acute disruptions in logistics and production. Public confidence is weakening.

Limits of monetary easing

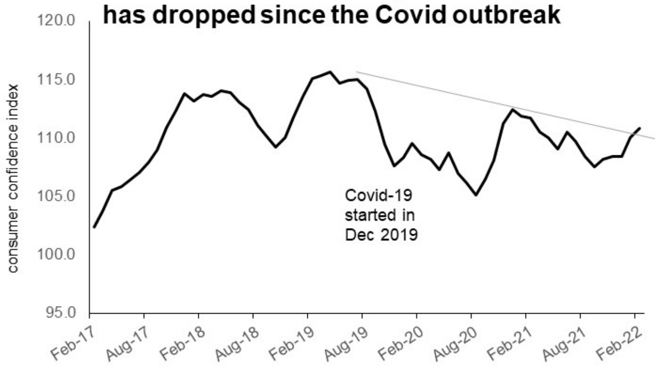
Even though the credit impulse is rising as the PBoC eases policy incrementally (Exhibit 1), monetary easing is ineffective in boosting growth at this stage. This is because:

1) The magnitude of easing is small and, arguably, overly cautious. The PBoC cut the required reserve requirement ratio on 15th April by only 25bp – half of what the markets had expected. The window for significant monetary is closing, with the US Fed readying to raise rates faster and the US 10-year Treasury yield rising above the 10-year Chinese government bond yield.
2) Monetary easing cannot solve problems arising from supply-chain disruption, which is clogging production and hurting business confidence and job growth.
3) The dynamic zero-Covid policy is hurting consumption and confidence (Exhibit 2), boosting household saving intentions (Exhibit 3). Monetary easing is like pushing on a piece of string under these circumstances.

Exhibit 1: Credit impulse

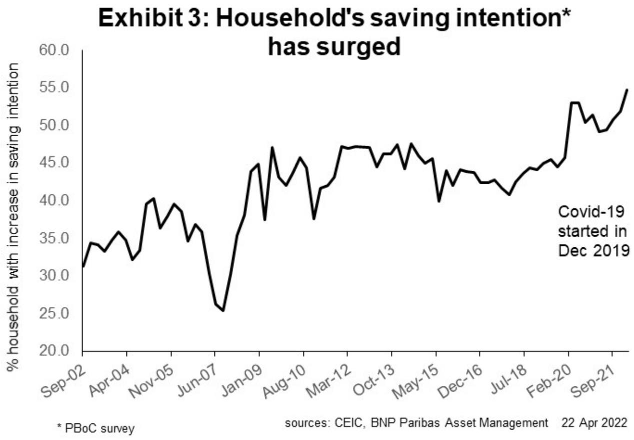
sources: CEIC, UBS, BNP Paribas Asset Management 22 Apr 2022

Exhibit 2: Consumer willingness to spend* has dropped since the Covid outbreak



* NBS survey

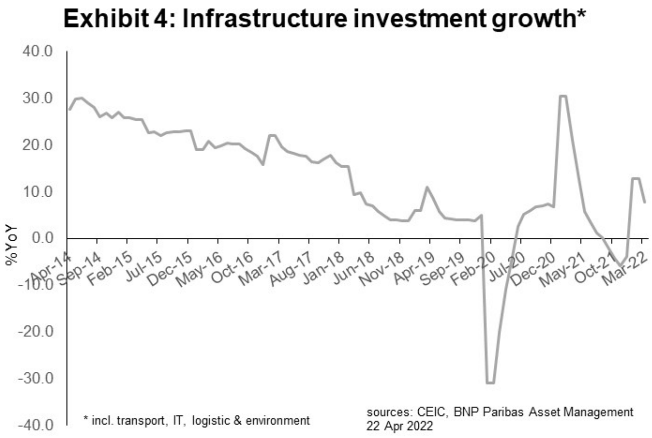
sources: CEIC, BNP Paribas Asset Management 22 Apr 2022



What else can China do?

Since supply-chain disruption and loss of public confidence are areas that Beijing has little control, it will have to focus on easing policy to boost sectors it has effective control. And this means reviving the housing sector to boost construction and accelerating state-led infrastructure investment.

Beijing seems to be employing this Keynesian policy prescription. It has pressured local governments to increase construction, eased property market measures and front-loaded special and local government bond issuance to boost infrastructure investment. The latter has improved markedly in recent months (Exhibit 4).



In a nutshell, to save China's economic growth, monetary easing is a necessary but not sufficient condition. We need to see sustained improvement in the credit impulse feeding through to boost construction and infrastructure investment. These combined will be the necessary and sufficient conditions for stabilising China's GDP growth.

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References

[1] See "Chi Time: China's Zero-Covid Policy – Timing, Benefits, Costs and Impact", 24 November 2021.

Furthermore, letting omicron rip will erode Beijing's hard-won achievements of low infections and deaths. The great success story of the dynamic zero-Covid policy could quickly change to a failure if a large number of people is infected. This could be very damaging to President Xi Jinping in the run up to the cabinet reshuffle at the 20th Communist Party Congress (expected to be held in November this year) when he will also seek a third term as President. So the zero-Covid policy is an inertia

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