



FOR PROFESSIONAL INVESTORS – 20 July 2022

# Chi Time

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## China's growth crosscurrents – What's new?

*A bend in the road is not the end of the road... unless you fail to make the turn.*

*Helen Keller*

China's weak, 0.4% YoY, GDP growth in Q2 22 could be as bad as it gets because the intensity of policy easing to boost growth has been rising and, crucially, Beijing's Zero-Covid policy has become more flexible to reduce its drag on the economy. However, growth headwinds have also increased due to the recent increase in mortgage delinquency, the impact of which is still uncertain. Any recovery looks set to be gradual at best, leaving 2022 growth short of the government's 5.5% target, although the medium-term outlook is improving.

### Missing the growth target

Growth is set to improve from June onward. However, even if GDP were to grow by 5% to 6% in the second half of the year (an optimistic assumption), full-year 2022 growth will undershoot the official 5.5% target significantly (Exhibit 1). The market consensus for 2022's growth rate is between 3% and 4%.

In June, there were signs of recovery amid lighter Covid restrictions and macroeconomic policy support. Notably, industrial output gained 4.0% YoY (up from 0.7% in May) as car and electric equipment production improved. Retail sales rose by 3.1% (after -6.7% in May) boosted by strong car and catering sales. Fixed asset investment grew by 6.0% (versus 4.7% in May) supported by 13% higher infrastructure investment.



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**Exhibit 1: China GDP growth**

	%YoY	full-year
2020 Q1	-6.8%	
2020 Q2	3.2%	
2020 Q3	4.9%	
2020 Q4	6.5%	2.3%
2021 Q1	18.3%	
2021 Q2	7.9%	
2021 Q3	4.9%	
2021 Q4	4.0%	8.1%
2022 Q1	4.8%	
2022 Q2	0.4%	
2022 Q3A	5.8%	
2022 Q4A	6.1%	4.3%

A = assumption

sources: CEIC, BNP Paribas Asset Management 19 July 2022

**Policy stimulus & risk**

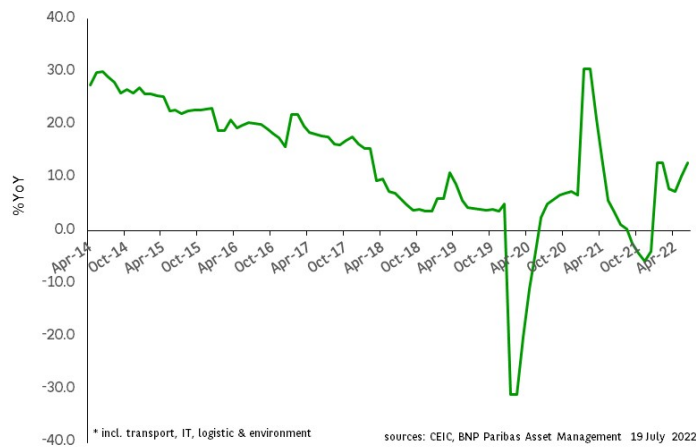
The policy easing after April's Politburo meeting and a steady easing of lockdown measures allowed China's stock market to stage a notable rebound since late April. This recently ended after an Omicron sub-variant caused a flare-up in Covid curbs in a number of cities (Exhibit 2).

**Exhibit 2: Shanghai Composite index**

sources: CEIC, BNP Paribas Asset management 19 July 2022

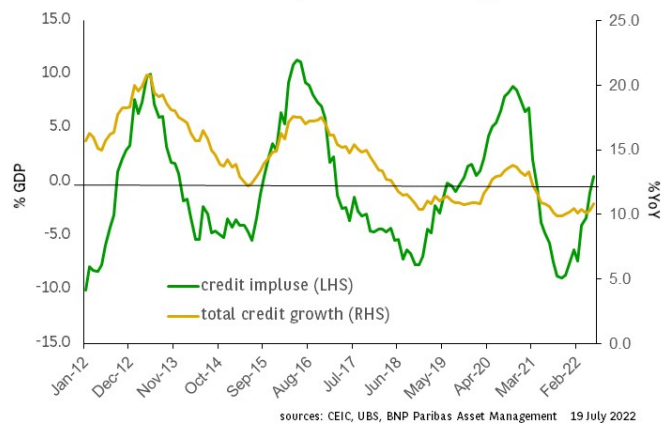
In general, Beijing has intensified policy support since Q2 22 by accelerating special local government (LG) bond issuance, increasing tax rebates, pumping more liquidity and relaxing property policies. More easing will likely come in the form of new infrastructure spending<sup>1</sup> and funding. Infrastructure investment is already showing a robust recovery (Exhibit 3). Funding will include bringing forward RMB1.5 trn in special LG bonds from the 2023 quota, easing local government financial vehicle (LGFV) funding conditions and increasing policy bank lending (estimated to be RMB800 bn) to environmental projects.

**Exhibit 3: Infrastructure investment growth\***

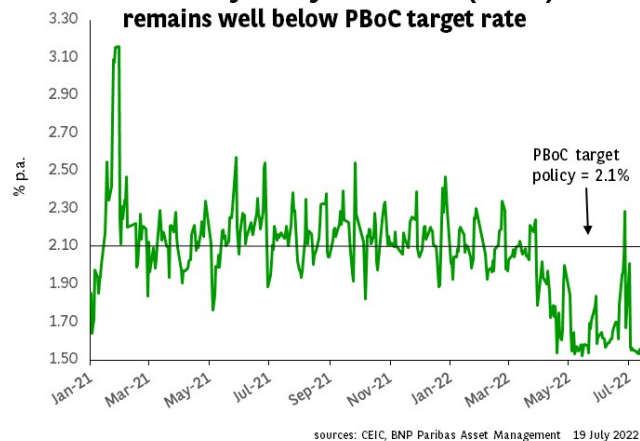


Unlike in the most of the world, high inflation is less of a problem for China. Headline consumer price has averaged around 2.0% YoY and core inflation around 1.5% YoY since 2013. This allows China's monetary policy to remain accommodative in the face of global monetary tightening. As a result, aggregate financing has recovered (Exhibits 4) and the key money market rate DR-007 has remained well below the PBoC's target of 2.1% (Exhibit 5).

**Exhibit 4: Credit impulse and credit growth**



**Exhibit 5: Key money market rate (DR007)  
remains well below PBoC target rate**



The biggest risk to growth is the Zero-Covid policy, which has created uncertainty hurting production and the supply chains, mobility and, especially, the capital goods and consumer sectors. The resultant loss of confidence and economic disruption are problems monetary easing cannot resolve effectively. Hence, we expect Beijing to intensify the fiscal stimulus to lift aggregate demand directly.

### What's new?

After more than a year of regulatory tightening on the tech and related sectors, this headwind to growth may finally be abating as investigations in some large and fintech and e-commerce companies are concluded. Future regulatory reform will focus on policy implementation rather than introduction of new regulation. This should clear much of the policy uncertainty in the system.

Further relief could come from the increased flexibility of the zero-Covid approach since June. Lockdowns are now swift and targeted, while quarantine periods have been shortened. Only non-essential services are being suspended, PCR testing in high-risk areas is more frequent and low-risk areas are being reopened more quickly. This new approach should reduce the broad-based disruption from lockdowns, help protect supply chains and reduce policy uncertainty.

However, with a growing number of homebuyers not making mortgage payments, there is a new risk to growth. This concerns housing units bought on pre-sold terms that are not being completed and delivered to homebuyers by cash-strapped developers. Since presales significantly increased developers' leverage, rising the mortgage-payment boycott could create a credit crunch for developers and lead to defaults in offshore US dollar bond markets (where they have borrowed heavily) and more non-performing loans at local banks.

There is a potential contagion risk, with rising mortgage delinquency hurting homebuyer confidence, further suppressing property sales and forcing more developers to suspend projects. This could feedback to hurt confidence, leading to more mortgage delinquencies and creating a downward spiral of property woes.

### What can Beijing do?

To contain systemic risk, Beijing may relax property market policy further, though no wholesale bailout is expected. In addition to keeping liquidity ample, it may mobilise local government, SoE and LGFV resources to kick-start suspended projects to help preserve public confidence by signalling that housing completion is an over-arching priority. State developers may also take over weak developers to allow exit of the bad players and help consolidate the property market.

Recently, regulators have asked the China Construction Bank to set up a fund to buy property projects under construction and convert them into long-term rental apartments. If this practice is implemented more widely, it could amount to a Troubled Asset Relief Program (TARP) of the kind the US government set up following the 2007-08 Global Financial Crisis to purchase toxic assets to stabilise the financial system.

### Market implications

Macroeconomic crosscurrents may trap CGB yields in a range of 2.8% to 3.0% in the coming months, with upside being constrained by growth concerns and monetary accommodation and downside by credit risk concerns and recovering credit impulse. Policy risk will create volatility for Chinese stocks in the short-term, but the market is sensitive to domestic good news, especially from the Zero-Covid Policy flexibility, setting the stage for an eventual recovery.

The medium-term outlook seems to be clearer for China than the West, where clouds have started to gather in US (which faces recession) and Europe (which is suffering from its Russian energy dependence). Thus, in

relative terms, the divergence in China's monetary policy and GDP trends from the West could prompt markets to reallocate assets into China-related assets later.

### References

<sup>1</sup> As we argued recently, China needs a Keynesian solution to save growth in addition to monetary easing. See "*Chi Flash: Saving China's Economic Growth*", 25 April 2022.

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