

Research Institute China: Macro, Money & Policy

8 November 2022

6:42 minute read

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#Data indicators

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Politics takes centre stage

Q3 GDP was delayed - likely to avoid highlighting this year's growth target was out of reach during the Party Congress - and then came out stronger than expected

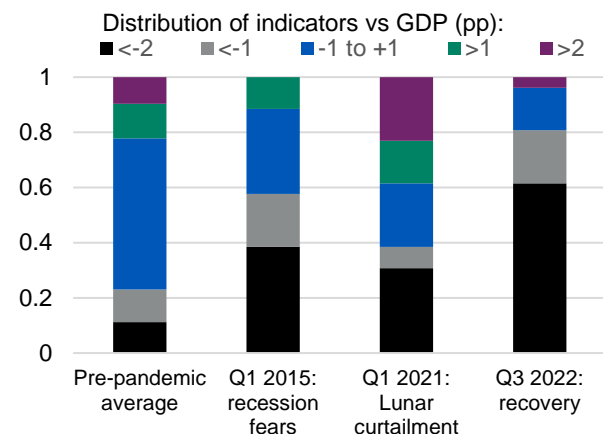
Key takeaways

- Q3 GDP data and the associated monthly series were delayed due to the 20th Party Congress. When released they comfortably beat our and market consensus expectations, showing a very strong sequential rebound (+3.9% q/q).
- This release is notable in exceeding the broad distribution of key monthly indicators. One would need to believe that the tertiary sector as a whole defied lacklustre consumer confidence to fully discount the weakness across the spectrum of indicators.
- Our China Activity Indicator points to a more modest recovery in Q3, while month-on-month momentum eased in September. Moreover, PMIs for October imply activity faded further as Covid-restrictions have risen, suggesting growth in Q4 could be soft.
- Even if infrastructure ramps up further there is no plausible quarter-on-quarter growth rate which can rescue 2022's annual growth target (~5.5%).
- President Xi's keynote speech at the 20th Party Congress signalled policy continuity, with existing trends towards a greater focus on security and domestic resilience reinforced.
- Xi's consolidation of power across the Politburo - combined with the opaque nature of China's political apparatus - amplifies the potential for sudden policy changes and periods of heightened market volatility.
- Markets remain on tenterhooks that a move away from 'Zero Covid' could be forthcoming. We remain sceptical, given the slowdown in the booster rollout and the recent NHC press conference which poured cold water on a rapid pivot.

A sizeable rebound was expected following on from Q2's GDP contraction, but the official GDP data was particularly strong.

We expected a fairly 'V'-shaped recovery in Q3 following on from Q2's -2.7% q/q contraction, but the +3.9% q/q growth rate comfortably beat our and consensus expectations. Given the GDP release had been unexpectedly postponed some commentators speculated that GDP could have been subject to political interference.

Figure 1: The distribution of monthly indicators is skewed to values below the official GDP release



Source: Haver, aRI (November 2022)

It is impossible to truly refute or verify Chinese GDP, or any other country's GDP for that matter. Only trade data can be independently checked against the figures released by trading partners (and discrepancies here are minimal), while most indicators originate from the National Bureau of Statistics (NBS) or other government departments.

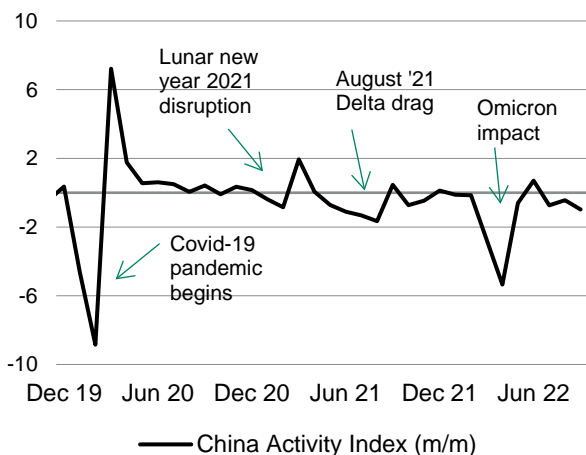


Considering the distribution of data indicators, adjusting their means and variance to that of GDP, is one way to consider whether GDP is stronger or weaker than one might have expected. Put simply, a selection of indicators will almost always be above or below GDP, so it is only when a large proportion disagree that one may consider the weight of evidence to cry foul.

Considering 25 of the main indicators we track, one can see that the proportion of indicators more than 2 percentage points below Q3's q/q growth is unusually large (light and dark blue bars, Figure 1), implying that GDP growth is unusually strong relative to the distribution of indicators.

That said, not all indicators are created equal. Retail sales did post a strong quarterly growth rate (+5.1% q/q), but given an implied net trade drag, a less ebullient industrial sector and marked weakness in the property sector, one would need to assume that the Tertiary sector as a whole (perhaps aided by favourable deflators) defied lacklustre consumer confidence and also recovered very sharply to be confident in the official measure.

Figure 2: The China Activity Indicator (CAI) declined modestly in September



Source: abrdrn, Refinitiv, Haver. (October 2022)

A similar logic to the distribution of indicators helps to motivate the use of principal component analysis, which underpins our China Activity Indicator. Principal components aim to summarise an array of data into independent (orthogonal) factors, and similar to an individual series one can compare the CAI to GDP to create a cross-check.

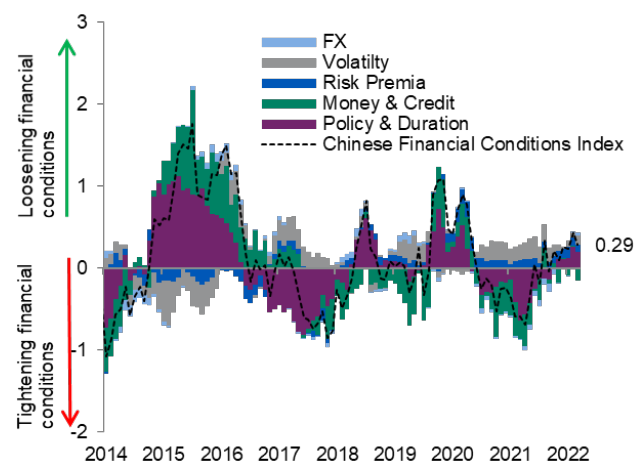
And similar to the mass of indicators, our monthly CAI did not show enough momentum through the quarter to be confident about the strength of official GDP in Q3. Indeed, our CAI moderated further in September (see Figure 2) and given the declines in October's PMIs we should expect a soft start to Q4.

As a result, we have unwound around half of the news generated by Q3's upside surprise in the latest forecast, which takes our official GDP forecast for 2022 in-line with consensus at 3.3%. But since we have reason to aim off the strength of the official figure the latest release adds to the gap between the aRI GDP estimate and official. We remain well below the 4.8% consensus for 2023 due to our judgements on: global recession, 'Zero Covid' and the property sector (see Box on page 4).

Financial conditions tightened marginally on the month, but the overarching trend of marginal policy easing from the authorities continues.

Our China financial conditions index tightened slightly in September, but at 0.29 remains in a modestly loose position relative to the long-term average (see Figure 3).

Figure 3: Financial conditions tightened in September



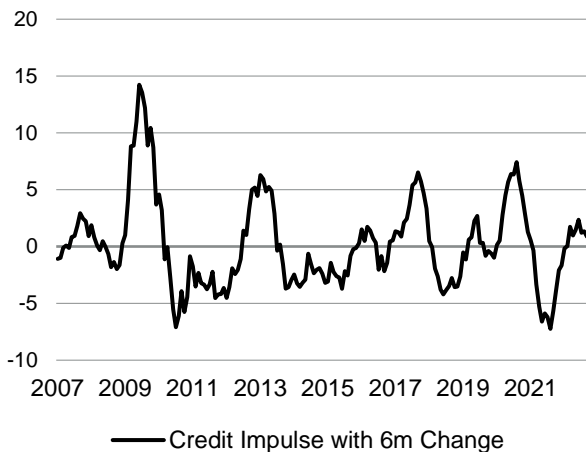
Source: Haver, Bloomberg, aRI (October 2022)

Whilst some of this tightening came through higher government bond yields, the main driver of the tightening was Money & Credit factors – in particular the short run changes in the monetary aggregates M1 & M2.

The credit impulse was also a little softer on the month (see Figure 4). This indicates that despite the upside surprise in credit flows through September - printing at RMB 3.5tn, 0.8tn above consensus expectations – credit growth is out pacing GDP by less than it was six months ago. However, there were signs in the monthly credit report that government bond issuance - which has been particularly soft following on from the drive to issue the annual local government bond quota by June - is increasing again, while the infrastructure drive is likely also supporting 'shadow' financing flows.



Figure 4: Credit impulse still positive but softer



Source: Haver, aRI (October 2022)

Policy makers continue to take incremental steps to ease and also lean against FX depreciation.

Data released in early October revealed that the PBoC restarted Pledged Supplementary Lending (PSL) at the end of September, extending RMB 100bn to three policy banks. Thus far the support via PSL is only marginal, but this is a policy to watch: providing cheap loans to fund ‘shanty town’ development could be a powerful easing measure which would go a long way to relieve pressure on the beleaguered property sector if significantly expanded.

However, property easing continues to loosen only incrementally. The PBOC and CBIRC may have ordered the six largest banks to provide RMB 600bn (\$84bn) of net credit to help finance mortgages, and support developers via loans and corporate bond purchases, but the additional low of credit beyond what would have happened anyway is likely to be very modest.

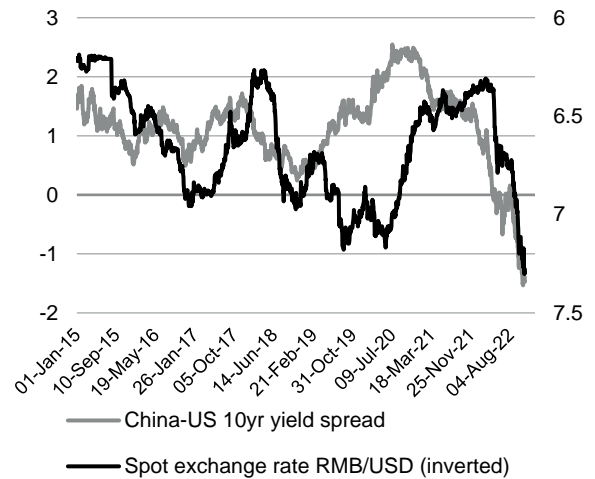
To put this in context, if developer funding flows were running at current monthly rates and the six banks add another 150bn on top, this would push total annual funding to 16.1tn, still 1.7tn short of 2019’s annual figure. Or put another way 600bn is only boosting the annual flow by 3.8%.

The PBOC continues to signal some discomfort with the RMB’s depreciation. The most recent step was to raise the cross-border macro-prudential leverage ratio to 1.25 from 1. This allows banks to borrow more from abroad, which can support the currency as funds are converted. Similar to previous steps (cutting the FX reserve requirement ratio), this is partly a signalling device.

Looking further ahead, a weakening external environment, a still strong trade-weighted currency, low inflation and domestic headwinds from ‘Zero Covid’ and property sector woes implies that objections to further currency depreciation are unlikely to spur a strong defence of the currency. The

end of the 20th Party Congress also removes political motivations for (relative) stability.

Figure 5: Spreads to the US continue to hit record lows, while the RMB continues to slide against the USD



Source: Haver, aRI (November 2022)

The 20th Party Congress revealed Xi’s consolidation of power, largely signalling policy continuity.

The composition of the new Politburo, and its upper echelon: the seven member Politburo Standing Committee, indicate that Xi has achieved near complete control and, with no indications of a successor, is lining up for four or more terms at the helm of the Chinese Communist Party (CCP).

This consolidation of power brings both opportunities and risks. Vested interests may be easier to overcome, helping to drive through Xi’s policy agenda and tackling a growing list of challenges. But the weakening of checks & balances within the CCP and the greater association between policies and Xi, arguably raises the bar for policy reversal and could weaken the decision making process.

We will need to wait until the December Central Economic Work Conference for further indications of the contours of policy setting, while full confirmation of the appointment of key personnel may not happen until the “Two Sessions” in March. Li Qiang - the former party secretary of Shanghai, and a close ally of Xi - is set to take over as Premier, but we will need to wait for other positions to be confirmed.

The change to the economic team will be stark. New Politburo members are set to take over at the Finance Ministry, PBOC, CBIRC and NDRC. Liu He - who led China’s trade negotiations with the US and is regarded as a key figure in economic decision making - is also due to step down, with He Lifeng (the current NDRC Chair) widely expected to be his successor. Overall, the consolidation of



Xi's power mutes the signal from any one appointment in terms of the policy direction.

Given the Congress largely emphasised continuity and China's direction under Xi has been one of evolution rather than revolution, it raises the question: why did markets react so negatively?

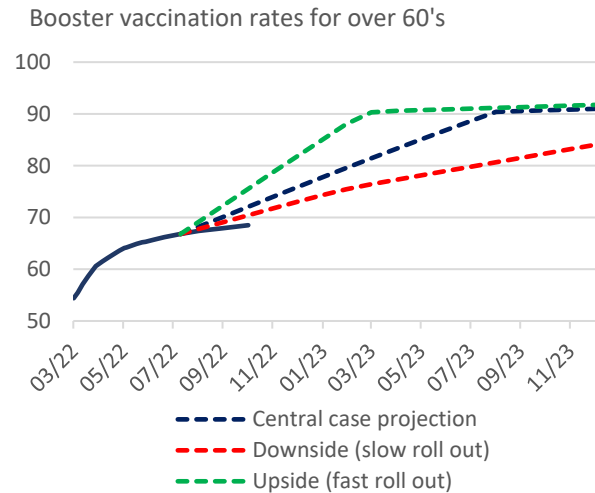
The consolidation of Xi's power may have been a contributing factor, but ignoring the outlook for 'Zero Covid' and minimal mention of the woes facing the property market are also likely explanations. Indeed, Chinese markets have been particularly sensitive recently, reacting sharply and positively to: rumours of re-opening, the People's Daily article which toned down the health warnings on Covid and the potential pathway for allowing the BioNtech vaccine to be used within China, following the meeting between Chancellor Scholz and President Xi.

The press conference on November 5 poured cold water on hopes for a policy pivot. Officials from the National Health Commission said that 'dynamic clearing' would continue and that current measures are 'completely correct, as well as the most economical and effective'. A push to increase vaccinations amongst the elderly was however planned.

Given the recent slowdown in the booster roll out for the over 60s – and even lower vaccination rates amongst the over 80s – our best guess is that a vaccination drive (reinforced by a marked step up in CCP communications) is needed just to get coverage back on track. Indeed, recent

booster shots have fallen below the downside scenario of the last forecast round (see Figure 6). As such, we maintain our judgement that re-opening hopes will be dashed, leaving a move to endemic living until Q4 2023.

Figure 6: Booster rollout for the over 60's has slowed below our previous downside projection.



Source: Haver, aRI (November 2022)

Our latest China forecasts:

- **Activity:** A stronger Q3 pushed up on both our aRI and official GDP forecasts, although we did not upgrade the aRI estimate one-for-one, reflecting the weaker steer from the distribution of indicators and the CAI. An earlier exit from 'Zero Covid' remains an upside risk, while a growing drag from the property sector and the global recession limit 2023 growth to 3%.
- **Inflation:** Unlike the rest of the world, inflation is not a barrier to policy easing in China. Headline inflation remains fairly modest (2.8% y/y), while core CPI has been contracting on a month-on-month basis (-0.8% annualised, 3 month average).
- **Monetary policy:** The PBOC continues to adopt incremental easing, but overall policy easing is increasingly being driven by infrastructure spending financed by local government bond issuance. Headwinds from property, "Zero Covid" and the global recession are likely to contribute to further fiscal announcements, complemented by further rate cuts (-30bps).

	2021	2022	2023	2024
aRI GDP (%)	7.8%	2.5%	3.0%	3.8%
Official GDP (%)	8.6%	3.3%	3.6%	4.2%
CPI (%)	1.0%	2.2%	1.0%	2.3%
Policy Rate (%)	2.2%	2.0%	1.7%	1.6%

Authors

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US-081122-183452-5

