CHINA

SHAKEN BY THE REAL ESTATE CRISIS AND THE OMICRON VARIANT

Economic indicators for the fourth quarter of 2021 confirm that China's economic growth has been heavily constrained by the crisis in the real estate and construction sectors, the authorities' zero-Covid strategy and the persisting weakness of household consumption. Export activity remains buoyant. However, it could start flagging in the very short term due to weaker momentum in global demand and the Omicron wave's repercussions on factory production and the transportation of goods. The Chinese authorities are gradually easing their monetary and fiscal policies to support economic activity. At the same time, they are expected to continue cleaning up the property market, reducing financial risk and tightening regulation.

THE EXPORT SECTOR: A SOLID GROWTH DRIVER

China's economic growth slowed considerably in the second half of 2021. After a very sharp rebound following the Covid-19 shock, economic growth fell from 7.9% year-on-year in Q2 2021 to 4.9% in Q3 and 4% in Q4. China's National Bureau of Statistics (NBS) estimates that in seasonally adjusted terms, real GDP growth was 1.3% quarter-on-quarter in Q2, 0.7% in Q3 and 1.6% in Q4. The acceleration in the fourth quarter appears to have been mainly driven by the improvement in the manufacturing sector after the difficulties of the summer.

In fact, since mid-2021, manufacturing activity has suffered from supply-side constraints arising from supply-chain disruptions (including shortages of microchips affecting the automotive sector and congestion in ports) and most importantly from power cuts hitting factories in September and early October. The authorities responded rapidly, asking coal mines to increase production and authorising power companies to raise their selling prices to consumers to as much as 20% above the regulated tariff. Industrial growth then recovered gradually after slowing in Q3, accelerating from 3.1% y/y in September to 4.3% in December (chart 1).

In 2021 as a whole, the manufacturing sector posted growth of 9.8%. It has been driven to a large extent by exports, which have remained very solid. According to General Administration of Customs data, exports were up 22.9% y/y in USD terms in Q4 and up 29.7% in the year as a whole (vs. 4% in 2020). Meanwhile, total import growth reached 30% in 2021 (after falling 0.4% in 2020), driven by higher commodity prices. China's trade surplus hit a record USD 689 billion, 30% more than in 2020.

In the immediate future, exports are likely to suffer as the latest wave of Covid-19 affects the production and transportation of goods, and as global demand growth may become less buoyant. In fact, growth in the manufacturing sector could slow again in Q1 2022 due to disruption affecting factories in a large number of regions as a result of lockdown measures introduced to slow the new epidemic wave.

In 2022, assuming that production of goods continues to normalize in the rest of the world and supply-chain pressures ease, China is likely to see its market share fall slightly after the large gains seen in the last two years. China accounted for 15% of total world goods exports in 2020 and the first nine months of 2021, vs. 13.3% in 2019.

THE PROPERTY CRISIS CONTINUES AND SPREADS THROUGHOUT THE ECONOMY

The services sector posted growth of 8.2% in 2021, but again the headline figure masks a sharp slowdown in the second half of the year: activity growth in the services sector decelerated from 10.9% y/y in June 2021 to 3% in December (chart 1). Firstly, activity has been held back by the regulatory tightening implemented in many sectors that Beijing regards as sensitive, such as digital service platforms, video games and tutoring.

Moreover, services in many regions have been affected by the successive waves of Covid-19 and travel restrictions. In the last few weeks, the spread of the Omicron variant has resulted in drastic restrictions as the authorities have maintained their zero-tolerance approach to the pandemic.

FORECASTS

	2019	2020	2021e	2022e	2023e
Real GDP growth (%)	6.0	2.2	8.1	5.0	5.5
Inflation (CPI, year average, %)	2.9	2.5	0.9	2.1	2.5
Official budget balance / GDP (%)	-2.8	-3.7	-3.2	-3.0	-3.0
Central government debt / GDP (%)	17.0	20.6	21.0	22.6	23.9
Current account balance / GDP (%)	0.7	1.9	1.9	1.8	1.8
Total external debt / GDP (%)	14.5	16.3	15.7	15.5	15.5
Forex reserves (USD bn)	3 108	3 217	3 250	3 310	3 360
Forex reserves, in months of imports	14.9	16.3	13.1	12.3	11.7

e: ESTIMATE & FORECASTS

TABLE 1

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

SLOWDOWN

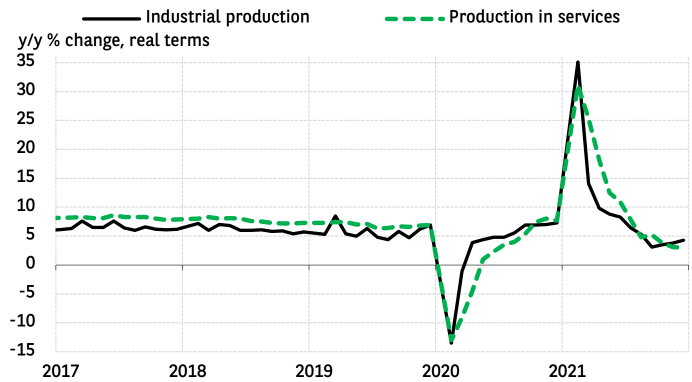

CHART 1

SOURCE: NBS, BNP PARIBAS

Lastly, the real estate crisis continued and spread to the rest of the economy in the second half of 2021. Developers have been subject to tighter macro-prudential rules and credit conditions since mid-2020, and this has caused a sharp correction in the real estate and construction sectors. Developers have experienced increasing cash-flow and funding problems. Real estate investment fell by 3%-5% y/y in September-November and by 14% y/y in December. Construction projects, new building starts and housing sales have collapsed since July (in December, they were down by 35% y/y, 31% and 16% respectively). The average house price has started to fall, and the decline is expected to continue in the near future (chart 2).

Private consumption has remained depressed. In real terms, retail sales rose by less than 2% y/y in August-October and by 0.5% in November. They were probably flat year-on-year in December. Inflation is not putting a great deal of pressure on household spending: consumer price inflation only accelerated slightly in 2021 and remained low. It even fell at the end of the year, reaching 1.5% y/y in December.

However, private consumption remains severely constrained by factors that are likely to remain in place in the short term: the authorities' strict zero-Covid strategy, weaker sales of home appliances and equipment due to the decline in house sales, negative wealth effects resulting from the correction in property prices, and consumer concerns about Covid risks and about further deterioration in the labour market. As a matter of fact, job losses at property and construction companies, and at some firms in the services sector (particularly SMEs and in the digital industry) constrained growth in household income in H2 2021.

The number of jobs created in urban areas hit a historically low level in Q4 2021 (they were 12% less than in Q4 2019). The unemployment rate calculated by the NBS from survey data was 5.1% in December, up from 4.9% in September and October (which was the lowest since the Covid-19 crisis began). The latest unemployment rate remains in line with the annual averages for 2018 and 2019, but its recent rise is symptomatic of the labour market's current weakness. In particular, youth unemployment remains high at 14.3% at the end of 2021 vs. 12.2% at the end of 2019.

FISCAL AND MONETARY POLICY EASING

The economic growth slowdown in H2 2021 was largely caused by the tightening of economic policy, the regulatory environment and prudential rules in the real estate sector. These measures form part of Beijing's medium-term strategy, which aims to make China's growth model more sustainable, less dependent on credit, greener and more inclusive, and to promote "common prosperity" under the government's control. As a result, the policies implemented in recent months have had multiple aims: to reduce corporate debt levels and reduce financial risk, to clean up the property market and moderate the cost of housing, to increase control both over activities related to social issues (such as education and wealth distribution) and over enterprises that collect data (especially in the digital industry), and to limit the expansion of digital groups that have overly dominant positions in their market.

The authorities are likely to maintain this course and their medium-term objectives in 2022, despite the short-term consequences on economic growth. However, they are gradually loosening their policy mix in order to mitigate these effects and support domestic demand. On the fiscal policy front, local government bond issuance has accelerated since October. Public investment in infrastructure projects may finally show signs of recovering, even though local governments are likely to remain cautious.

CRISIS IN THE PROPERTY AND CONSTRUCTION SECTORS

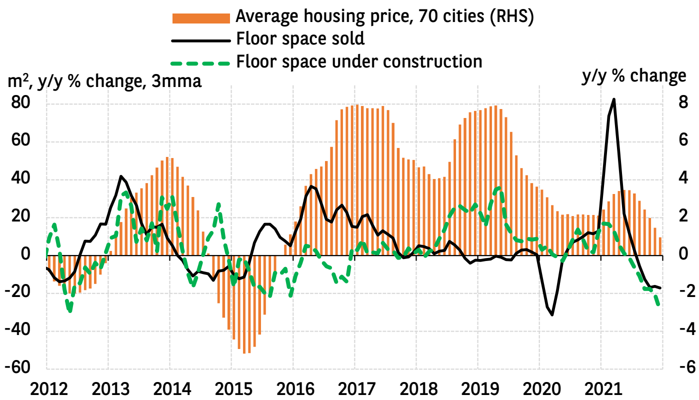

CHART 2 SOURCE: NBS, BNP PARIBAS

In the real estate sector, the authorities have made adjustments to avoid a devastating collapse in the market, without changing the macro-prudential limits imposed on developers. Mortgage lending conditions and developers' access to certain types of short-term financing have been eased in recent weeks. Growth in real estate-related bank lending (loans to developers plus mortgages) already stabilised at 5.3% y/y in Q4 2021.

Most importantly, the central bank has gradually loosened monetary and credit conditions since December. It started with some targeted measures (including lending programmes for SMEs and agriculture and to support efforts to reduce carbon emissions). Then, on December 20th, it reduced the reserve requirement ratios (from 12% to 11.5% for the largest banks) and cut the one-year loan prime rate (by 5 basis points to 3.8%). On January 17th, the central bank announced a reduction in the medium-term lending facility (MLF) rate from 2.95% to 2.85% (vs. 3.25% at end-2019, just before the Covid-19 crisis struck), the first cut since April 2020. Growth in total credit to the economy, which had slowed between the end of 2020 and September 2021, recovered very slightly in Q4 (reaching 10.3% y/y in December). It is likely to accelerate gradually in the near term, especially since further interest rate cuts are expected.

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