CHINA

SHIFTING TOWARDS A MEDIUM-TERM PERSPECTIVE

At the end of the annual "Two Sessions", China's major political event, Beijing announced its economic targets for 2021 as well as the priorities of its new five-year plan. By setting this year's real GDP growth target at simply "more than 6%", which is lower than forecasts, the authorities are signalling that the economic recovery following the Covid-19 crisis is no longer the main focus of concern. In the short term, they will continue to cautiously tighten monetary policy and gradually scale back fiscal support measures. Above all, the authorities have affirmed their medium-term development strategy, which aims to boost innovation and drastically expand China's technological independence.

THE RECOVERY HAS PEAKED, ECONOMIC GROWTH REMAINS VIGOROUS

The Chinese economy ended the year 2020 on a solid note with real GDP growth of 6.5% year-on-year (y/y) in Q4. Industrial production and exports continued to report robust performances that went beyond a simple catching-up movement. Meanwhile, private consumption and the services sector continued to close the gap after they entered the rebound phase much later following the Q1 2020 lockdown.

Economic indicators for the first part of 2021 are hard to interpret due to major base effects generated by the abrupt shutdown of activity in Q1 2020. In fact, in the first two months of 2021, the growth rates for industrial production, activity in the services sector, investment and retail sales were all abnormally high on a year-on-year basis (above 30%).

On the supply side, industrial production was still robust in the first two months of the year, in spite of a few signs of a slowdown in the automotive sector (which accounts for about 15% of industrial activity) resulting from the global shortage of microchips. Industrial production was largely supported by strong external demand. Exports rose 60% y/y in January-February 2021, driven by sales of technological goods and medical devices, as well as consumer goods and automotive parts.

Meanwhile, the momentum of domestic demand growth has lost some of its vigour at the beginning of 2021, with the notable exception of real estate investment. Private consumption of goods and services was curbed by new lockdown restrictions that were introduced in late January and February in response to a surge in contaminations in the regions around Beijing and Northeast China. In addition, the situation of households is still fragile, undermined by last year's downturn in income and a weaker labour market. After falling continuously since spring 2020, the urban unemployment rate rose to 5.5% in January-February from 5.2% in December. Besides, the share of precarious jobs remains higher than pre-crisis levels. Finally, about 5 million migrant workers who lost their jobs in Q1 2020 (and are not counted among the official unemployed) have yet to find work again (286 million jobs were held by migrant workers at year-end 2020).

Private consumption is expected to strengthen in the short term, if for no other reason than the improvement in the health situation. The epidemic is under control, lockdown restrictions have been lifted and the vaccination campaign – which was very slow through mid-March – is projected to accelerate. The authorities also seem to be planning a few temporary measures to encourage household spending.

FORECASTS

	2019	2020e	2021e	2022e
Real GDP growth (%)	6.1	2.3	9.2	5.3
Inflation (CPI, year average, %)	2.9	2.5	1.8	2.8
Official budget balance / GDP (%)	-2.8	-3.6	-3.2	-3.0
Central government debt / GDP (%)	17.0	19.5	20.8	22.2
Current account balance / GDP (%)	0.7	1.9	2.1	1.7
Total external debt / GDP (%)	14.5	16.3	15.1	15.8
Forex reserves (USD bn)	3 108	3 217	3 272	3 312
Forex reserves, in months of imports	15.0	16.3	15.2	14.5

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

A DYNAMIC PROPERTY SECTOR, FOR HOW LONG?

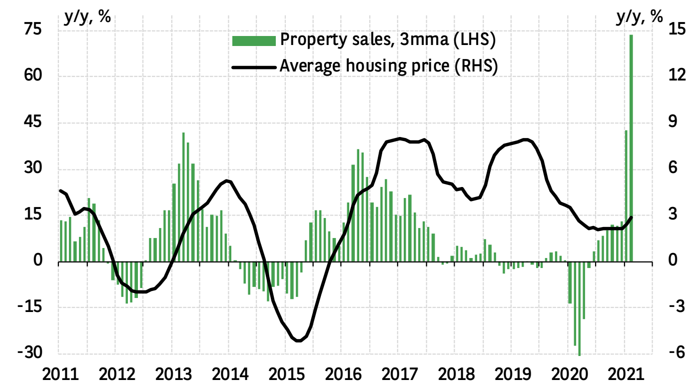

CHART 1 SOURCE: NBS, MACROBOND

As to investment, enterprises in the manufacturing sector have been very cautious in January-February. Manufacturing investment is nonetheless expected to gain momentum in the short term becauseexport prospects remain strong, industrial capacity utilization rates are high (78% in Q4 2020, the highest level in three years) and corporate profits are on the rise. This goes along with a rebound in producer prices (+1% y/y in January-February, after 18 months of deflation), driven up by higher industrial commodity prices. Additionally, the authorities' plans to increase investment in the technology sectors should rapidly become visible.

CAUTIOUS NORMALISATION OF ECONOMIC POLICY

Following the annual plenary sessions of the National People's Congress (NPC) and the Chinese People's Political Consultative Conference (CPPCC) in March – two core institutions of China's political system – the authorities announced their key macroeconomic targets for 2021. They are calling for real GDP growth of "more than 6%" and inflation of 3%. By setting an economic growth target well below forecasts, the authorities are signalling that the economic recovery is no longer the main focus of their concerns. They are enlarging the manoeuvring room of economic policy, notably to better combat risks in the financial sector.

In the short term, the authorities are aiming to contain growth in corporate and local government debt, which rose sharply last year (total domestic debt of the non-financial sector was estimated at 280% of GDP at year-end 2020, up from 255% at year-end 2019). Yet this must be orchestrated carefully, without undermining the economic recovery or aggravating the difficulties of corporates that have been hit by last year's epidemic shock.

Credit policy will be tightened cautiously, mainly by adjusting the prudential framework. Moreover, the authorities will slow infrastructure projects, which are mainly financed through domestic bond issues by local governments. Beijing very moderately scaled back quotas of bond issues authorised in 2021 for both the local and central governments. Total quotas were reduced to RMB 7,200 bn in 2021 from RMB 8,500 bn in 2020. In addition, the authorities also lowered the government's "official" deficit target to 3.2% of GDP in 2021, from 3.6% of GDP in 2020. These cutbacks signal a very gradual and prudent withdrawal of fiscal and quasi-fiscal support measures in the year ahead.

Investment growth in public infrastructure has already slowed in recent months, a trend that is bound to continue. In contrast, there were still no signs of slowdown in property investment in early 2021, despite new prudential rules imposed on real estate developers since August 2020. Low domestic interest rates and ample household savings have continued to encourage real estate transactions. House price inflation even accelerated slightly in January-February (+2.7% y/y) after holding relatively stable since spring 2020.

THE 14TH FIVE-YEAR PLAN

Last month the authorities also unveiled the targets for the new Five-Year Plan for 2021-2025. At the heart of Beijing's strategy is the development of the technology sector. China aims to sharply reduce its dependence on foreign technological knowhow and goods, and to become a world leader in the scientific field. Spending on research & development will be increased by at least 7% a year (after a 10% increase in 2020), with a special focus on boosting fundamental research efforts and increasing the number of patents with a high technical content (from 6.3 patents per 10,000 residents in 2020 to 12 patents in 2025). This should accelerate China's catching-up movement with the more advanced countries. Moreover, the manufacturing sector will have to continue to rise the value chain, and the share of the digital economy is projected to be increased from 7.8% of GDP in 2020 to 10% in 2025. The authorities have announced several measures to help corporates, including tax deductions and subsidies.

The 14th Five-Year Plan also calls for other reforms, which were not spelled out in detail, but yet the country's challenges and medium to long-term goals are well identified. Beijing is striving to achieve "common prosperity". On the one hand, China's industrial, economic

CHINA'S R&D SPENDING TO BE STRENGTHENED

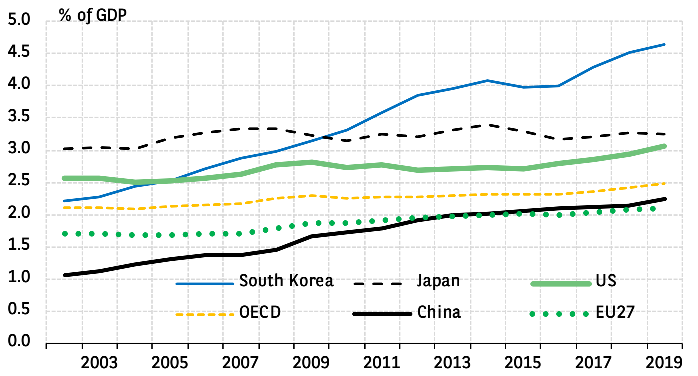

CHART 2 SOURCE: OECD DATA (2021), GROSS DOMESTIC EXPENDITURES OF R&D

and social development will certainly rely on technology. On the other, priority will also be given to bolstering the health and social protection system, wealth redistribution and reducing inequalities, and reforming the hukou permanent resident system to improve access to public services for the entire population.

China's ageing population was also identified as a major challenge. The median age of the Chinese population rose from 30.8 in 2010 to 38.4 in 2020 (similar to that of the US); the active population has been declining continuously since 2013; and the dependency ratio rose from 36.5% of the active population in 2010 to 41.4% in 2020. Measures are being explored to encourage natality, to postpone the retirement age (which is currently only age 50-55 for women and age 60 for men) and to extend the average duration of university education. Improvements in education, coupled with investments in innovation, are aimed at boosting productivity. Lastly, the "quality of economic growth" will also be improved by developing green industries and promoting measures to fight climate change; Beijing's goal is to be carbon neutral by 2060.

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