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Arjen van Dijkhuizen

Senior Economist

Tel: +31 20 628 8052

arjen.van.dijkhuizen@nl.abnamro.com

China: Normalisation continues

- **Supply/demand gap is closing further**
- **October activity data show momentum still strong**
- **Fading pork price inflation brings CPI at 11-year low**
- **We have changed our USD-CNY view**

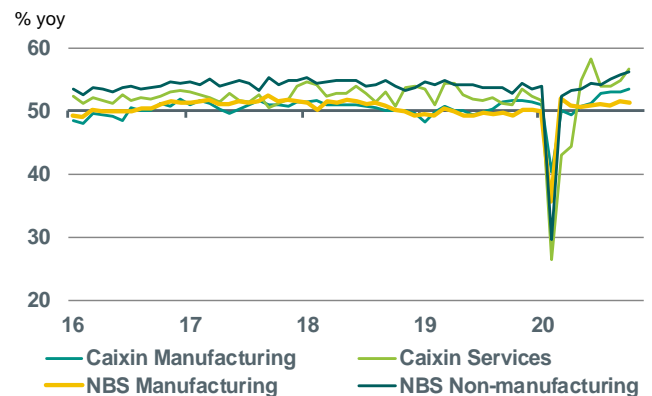
1. Supply/demand gap is closing further

Incoming macro data confirm that China's economic recovery from the covid-19 shock continues to strengthen and broaden. Initially, this recovery was led by the supply side and by industry, partly reflecting targeted government policies aimed at getting production up and running again as soon as possible (this contrasts a bit with policies in advanced economies, which mainly targeted the demand side). These policies are illustrated by a V-shaped recovery of for instance industrial production, while also having supported Chinese exports throughout the year (as Chinese firms came 'out of lockdown' quicker than foreign competitors). That said, the demand side is showing a clear recovery as well. Pandemic support is feeding through in a revival of public investment and credit growth. Moreover, China's success in containing the pandemic has enabled the phasing out of restrictions and a rebound in confidence, supporting consumption as well. And while the services sectors formed the 'epicentre' of the covid-19 shock, services PMIs have surpassed manufacturing PMIs again in the course of this year. This was typically the case before the pandemic broke out.

2. October data show momentum still strong

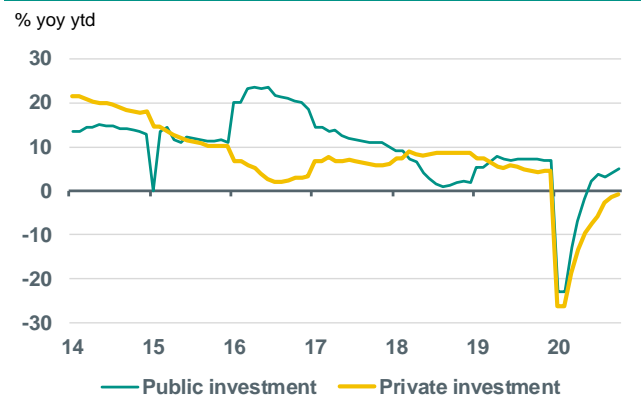
The October data show that growth momentum remains strong at the start of the final quarter of this year. Industrial production growth was stable at 6.9% yoy, while growth of both retail sales and fixed investment picked up further. Retail sales accelerated to 4.3% yoy (September: 3.3%), although coming in below expectations (consensus: 5.0%). China's official urban unemployment rate has fallen back to almost pre-corona levels (October: 5.3%, vs 5.4% in September and 5.2% in December 2019). Urban fixed investment accelerated to 1.8% yoy ytd (September: 0.8%, consensus: 1.6%). To a large extent, this is a reflection of pandemic fiscal support, with public investment (+4.9% yoy in Jan-Oct) still doing better than private investment (-0.7%). All in all, Bloomberg's monthly GDP growth estimate rose to a 16-month high of 6.9% yoy in October (September: 6.75%). Still, the pace of acceleration has come down in recent months, as catch-up effects from the covid-19 collapse are fading.

Growth momentum strong at start of Q4



Source: Refinitiv

Public investment in the lead



Source: Refinitiv

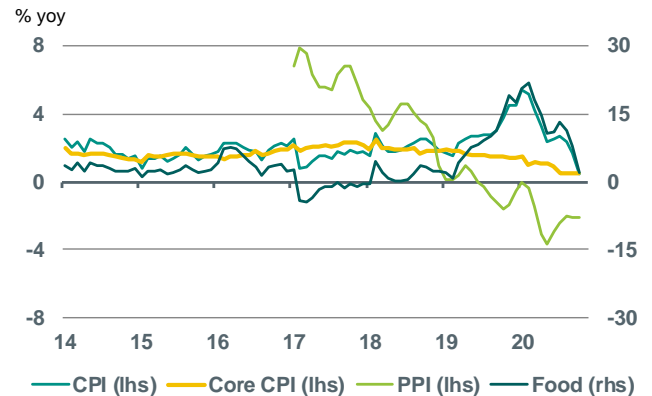
3. Fading pork price inflation brings CPI at 11-year low

Despite China's stark recovery from the covid-19 shock, headline inflation has fallen sharply in the course of this year. CPI peaked at 5.4% yoy in January, but has come down rapidly since to reach an eleven-year low of 0.5% yoy in October. These inflation dynamics are to a large extent driven by the food price cycle, particularly pork prices. Due to the impact of an earlier largescale swine flu outbreak on China's hog population and production, pork price inflation has risen sharply reaching a peak of 135% yoy in February 2020. Since then, partly due to a turnaround in production and imports, pork prices have come down rapidly again. In October, annual pork price inflation turned negative again for the first time since February 2019. Due to these large swings, pork prices have had a significant effect on the overall food price index and on China's CPI. Meanwhile, core inflation (excluding volatile components such as food) had already fallen to a ten-year low of 0.5% yoy over the past few months. Producer price inflation is still in negative territory even despite China's recovery. This to a large extent reflects past corrections in energy prices.

4. We have changed our USD/CNY view (Georgette Boele)

Since 2013, Chinese authorities have allowed the Chinese yuan to move more freely. This has been a gradual, step-by-step approach. If the movements turned out to be too fast or too substantial, the authorities have dampened the move. Since June, the yuan has rallied strongly versus USD. That reflects general dollar weakness, China's success in getting control over the pandemic, the subsequent sharp economic recovery and more recently the pricing in of a Biden victory in the US presidential elections. We long held the view that the yuan was on a long-term depreciation path versus USD. We have changed this view. We are now more optimistic on the outlook for the yuan in the medium to long term. That is because we expect general dollar weakening next year because of negative real rates in the US and a very accommodative Fed for years to come. Moreover, the yuan will gradually start to play a more crucial role in financial markets and central bank reserves, although this is not a process of years but of decades. That said, we believe that upside potential is limited in the near term, as the US will do a growth catch-up and markets may be a bit too optimistic on US-China relations under a Biden-administration. All in all, we have changed our USD/CNY forecasts. Our new year-end forecasts for 2020 and 2021 are 6.50 (was 6.75) and 6.40 (was 7.00), respectively.

Pork prices key driven of recent inflation volatility



CNY has rallied strongly versus USD in recent months



Key forecasts for the economy of China

	2017	2018	2019	2020e	2021e
GDP (% yoy)	6.8	6.6	6.1	1.8	8.0
CPI inflation (% yoy)	1.5	1.9	2.9	2.7	2.0
Budget balance (% GDP)	-3.7	-4.1	-4.9	-6.5	-5.0
Government debt (% GDP)	16	16	17	22	26
Current account (% GDP)	1.6	0.2	1.0	2.0	1.5
Gross fixed investment (% GDP)	42.0	43.0	42.4	39.3	38.1
Gross national savings (% GDP)	44.8	44.1	44.1	41.1	39.6
USD/CNY (eop)	6.5	6.9	7.0	6.5	6.4
EUR/CNY (eop)	7.8	7.8	7.8	7.7	8.0

Budget balance, current account balance for 2020 and 2021 are rounded figures

Source: EIU, ABN AMRO Group Economics

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