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China Outlook 2022: Growth risks to remain in Year of the Tiger

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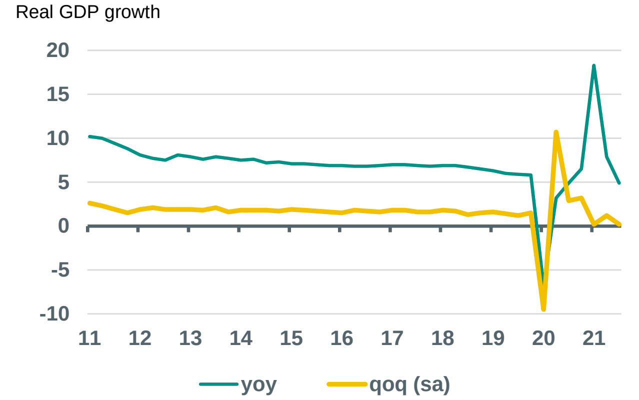
- **Strong full-year annual growth masks exceptionally weak, pandemic-driven qoq growth this year**
- **We have lowered our annual growth forecasts for 2021 and 2022 to 8.0% and 5.3%, respectively**
- **Zero-tolerance covid-19 policy, Omicron and real estate add to risks…**
- **…but we expect further piecemeal policy easing and other measures to stabilise growth**

On 1 February 2022, China's Year of the Tiger will start. The tiger is seen as the animal king in the Chinese zodiac, being associated with 'strength, the exorcism of evils and braveness'. Whether these characteristics will prove symbolic for China's economy in 2022 remains to be seen. Over the past two years, the economy followed an unusually volatile, pandemic-driven growth pattern. Thanks to a strong base effect from the initial covid-19 shock in Q1-2020, annual growth will reach ±8% in 2021, which would be the highest pace since 2011. While this reflects China's strong initial rebound from the pandemic, the recovery has clearly stalled this year, reflecting zero-tolerance covid-policies and other self-inflicted headwinds. We have lowered our growth forecast for 2022 to 5.3%, and see risks still tilted to the downside (see our recent publication *Will the Chinese Dragon keep flying* for more background on China's longer-term growth challenges and scenarios).

Looking back at 2021: Strong average annual growth masks weak quarterly growth

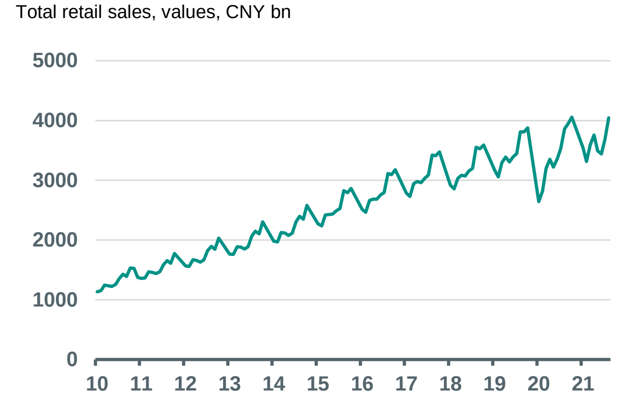
In sequential growth terms, the rebound from the pandemic shock has clearly stalled this year. In Q1-Q3 2021, qoq growth averaged a meagre 0.5%, with hardly any growth in Q1 and Q3. This stalling momentum, combined with base effects, is also reflected in a plunge in yoy growth, from 18.3% yoy in Q1 to 4.9% yoy in Q3. China's slump is to a large extent 'self-inflicted'. First, a zero-tolerance covid-19 policy has been kept in place, although (Delta) flare ups in terms of case numbers remain very low from an international perspective. This has depressed (services) consumption and this explains why consumption continues to lag in the recovery. Second, with annual growth easily surpassing the rather conservative growth target of 'above 6%' adopted in March 2021, policy makers have seized the opportunity to address longer-term financial stability risks. For instance, tackling leverage in real estate, with the 'three red lines' policy constraining finance for property developers. Drags from real estate intensified further following Evergrande's woes. The government also intensified and expanded a regulatory crackdown on internet companies. Third, Beijing's aim to address environmental issues resulted in a power crunch, hitting industrial production in recent months and triggering a spike in energy prices. With pandemic drags fading compared to the summer, and energy policies having been eased in the meantime, we anticipate quarterly growth to pick-up in Q4-2021 (but yoy growth to fall further), although we have cut our full-year 2021 growth forecast to 8.0% (from 8.3%).

High average yoy growth in 2021 masks weak qoq growth



Source: Bloomberg, Refinitiv

Recovery of private consumption is lagging



Source: Refinitiv

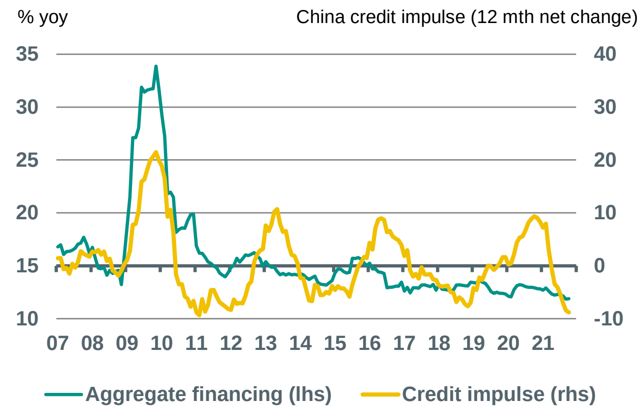
Outlook for 2022: Omicron makes loosening of zero-tolerance covid-19 policy less likely

Looking forward to 2022, the recent emergence of the Omicron variant in South Africa (which looks even more contagious than Delta) brings another layer of uncertainty. Although it is still early days for an overall assessment, at this stage Omicron seems to have reduced the likelihood that China will ease its zero-tolerance covid-19 policy soon. China's leadership has profiled itself as the global champion of pandemic control and seems to tolerate the macroeconomic costs so far, while the population also seems to approve of its approach. While China has ramped up its vaccination rate sharply, uncertainty regarding the effectiveness of China's vaccines – certainly in relation to new variants – does not make a regime change likely at this stage. For sure, cross-border traffic will remain highly restricted. Domestically, a careful easing of policy after the Beijing Winter Olympics in February may be on the cards (should the effects of Omicron prove manageable), but Beijing has already indicated it will not mirror the 'stop-go policies' of European governments, nor the *laissez-faire* approach of the US.

… but we expect further piecemeal policy easing and other measures to stabilise growth

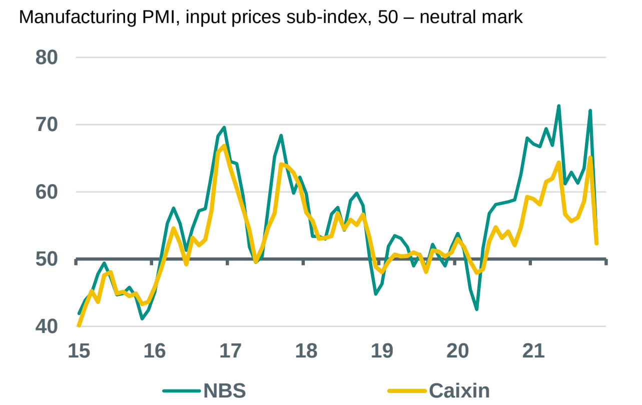
What does all of this mean for the outlook? Following the high, pandemic-driven, volatility of qoq growth rates in 2020-21, we expect some normalisation in 2022, but Omicron is the wild card. Risks from virus flare-ups remain, both on the demand and the supply side. The adherence to strict covid-19 policies will keep a lid on the further recovery in private consumption. We should add that China's zero-tolerance covid-19 policy has become more targeted over time (partly thanks to the use of IT), with lockdowns and other mobility restrictions now much more localised than in the initial phases of the pandemic. What is more, while – on balance – Omicron looks to be a risk-negative for China at this stage, it may have a positive effect as well. So far, China's ongoing export strength can be partly attributed to a global (pandemic-related) demand shift to goods, and Omicron may delay a rotation back to services. Meanwhile, we expect investment to pick up in 2022, as we foresee a further piecemeal easing of macro policies. Following a State Council meeting in early December, the PBoC announced another 50bp RRR cut per mid-December, in line with our expectations, and we have pencilled in another 50bp cut for next year. Moreover, we anticipate ongoing moderate fiscal support in the form of increased space for local governments to finance infrastructure, including climate-related, projects. We also expect Beijing to take measures to contain the drags from the real estate sector. Policy inaction would mean that annual growth in 2022 will likely fall below Beijing's preferred trajectory next year. China's 2022 growth target will be announced at the annual National People's Congress in early March 2022, but we may already get a glimpse of this at the Central Economic Working Conference later this month.

Credit cycle to bottom out on piecemeal easing steps



Source: Bloomberg

Cost price pressures ease



Source: Refinitiv

We expect producer price inflation to ease and consumer price inflation to rise

In the course of this year, China's producer price inflation has accelerated sharply, reaching a 26-year high of 13.5% yoy in October. This acceleration, which has contributed to global inflation fears, is largely driven by commodity-related sectors, resulting from the global rise in commodity prices, and aggravated by a domestic power crunch. We expect annual PPI inflation to come down next year (although potential supply shocks from Omicron could delay this process going forward). A relaxation of energy policy has already caused a downward correction of energy and other commodity prices. This was also reflected in a sharp drop in the sub-indices for input prices in China's latest manufacturing PMIs. Meanwhile, the most recent data confirm that the pass-through of higher cost prices into consumer price inflation (CPI) and core inflation is still limited, partly reflecting the still weak state of domestic demand. The gap between PPI inflation and CPI inflation reached a record-high of 12%-points in October. Still, with signs of this pass-through starting to rise and the food price cycle (dominated by pork prices) turning, we expect consumer price inflation to rise to an average of 2.5% in 2022, from 1.0% this year.

Key forecasts for China

	2020	2021e	2022e	2023e
Economic outlook (% yoy)				
GDP	2.3	8.0	5.3	5.2
CPI inflation	2.5	1.0	2.5	2.0
Unemployment rate (urban areas)	5.2	5.0	4.9	4.8
Interest and exchange rates (eop)				
1-Year Best Lending Rate	4.35	4.35	4.35	4.35
1-Year Loan Prime Rate	3.85	3.85	3.85	3.85
USD/CNY	6.54	6.40	6.20	6.15
EUR/CNY	8.00	7.04	6.51	6.15