

China Watch

Group Economics
Emerging Markets Research

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Virus containment key to strong recovery

- Economic growth back to 5% yoy in Q3
- September macro data show momentum remains strong as we head into Q4
- Containment of covid-19 is key factor to China's growth outperformance
- Exports profit from supply side policies and pandemic related demand
- 14th Five-Year Plan covering 2021-25 will be in focus next week
- Revising our end-2020 USD-CNY forecast

China back to 5% annual real GDP growth in Q3

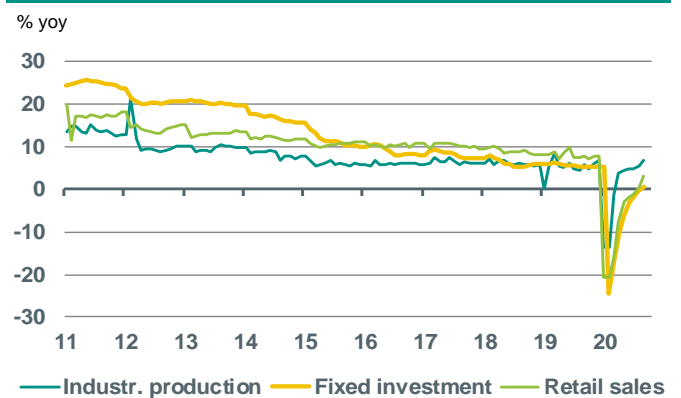
China's GDP data published on Monday show that the world's second largest economy was already back to almost 5% annual growth in Q3 (+4.9% yoy, vs +5.5% expected and +3.2% in Q2). That is impressive, given that China faced a historic, covid-19-driven contraction in Q1 (-6.8% yoy). Quarterly growth in Q3 came in at 2.7% qoq (consensus: +3.3%, and after a surge in Q2: +11.5%). The fact that growth came in a bit lower than expected partly likely reflects the pick-up of imports in recent months, but also illustrates that some service sectors (such as transport) take longer to recover fully from the covid-19 shock. All in all, now we have the Q3 numbers available, we have revised our 2020 annual growth forecast marginally, from 2% to 1.8%. We have kept our annual growth forecast for 2021 unchanged at 8%, once more adding that the much higher annual growth rate next year is mainly driven by base effects as the extreme weak Q1-20 will fade out of the numbers.

China back to 5% annual GDP growth in Q3



Source: Bloomberg,

Retail sales, fixed investment now also back to yoy growth



Source: Thomson Reuters Datastream

September macro data show momentum remains strong as we are heading into Q4

China's recovery from the covid-19 shock has been led by industry and by the supply side, but - with a lag - domestic demand is also rapidly normalising. That was illustrated by the monthly activity data for September. Industrial production accelerated by 6.9% yoy in September

(consensus: 5.8%, August: 5.6%). Retail sales growth rose to 3.3% yoy (consensus: 1.6%, August: 0.5%). Urban fixed investment improved to 0.8% yoy ytd (consensus: +0.9%, August: -0.3%). So, although the catch-up effects from the covid-19 collapse in Q1 have clearly faded compared to Q2, growth momentum remains strong as we head into Q4. Bloomberg's monthly GDP estimate jumped to a 15-month high of 6.8% yoy in September.

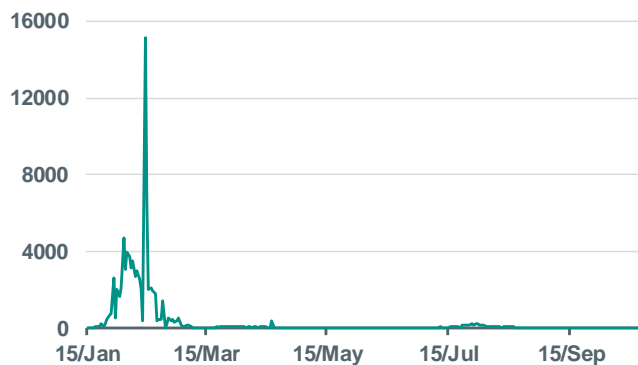
What explains China's outperformance in recovering from the covid-19 shock?

All in all, China is still on track to be the only key economy for which we expect positive annual growth this year (1.8%). That contrasts sharply with the annual contractions of almost 5% and 7.5%, respectively, that we expect for the US and the eurozone this year. In our view, the key factor explaining China's outperformance stems from the fact that the country has been successful in getting the pandemic under control relatively quickly, even though it was the origin of covid-19 in late 2019. That success is a function of effective policy (lockdowns and other security measures, track and trace and extensive testing) and a different governance model with for instance softer privacy laws enabling the use of advanced IT-infrastructure.

Experience with past epidemics also plays a role, as the authorities were better prepared in terms of stockpiles of medical supplies and action plans. Community discipline (self-quarantining, wearing face masks and general adherence to social distancing) is also a crucial factor. China has also experienced second waves, but so far these have been quite small relative to the size of the population (but also in absolute terms) as the authorities have generally reacted swiftly and decisively to keep contagion in check. Although second waves have had some effects on the local level, they have therefore so far hardly hampered the overall macro-economic recovery from the initial covid-19 shock.

Renewed covid-19 outbreaks are marginal so far ...

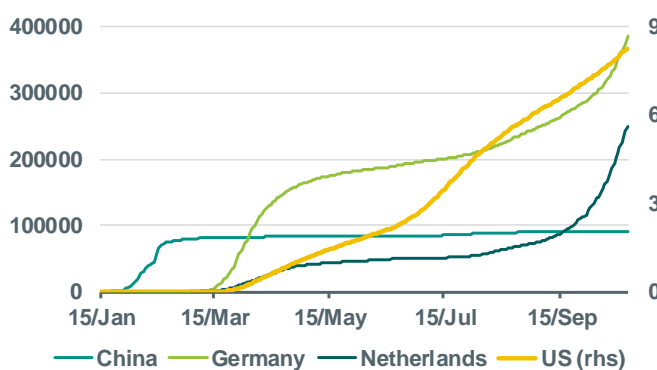
Daily new confirmed covid-19 cases in China



Source: Bloomberg

... with China much more in control of the virus than others

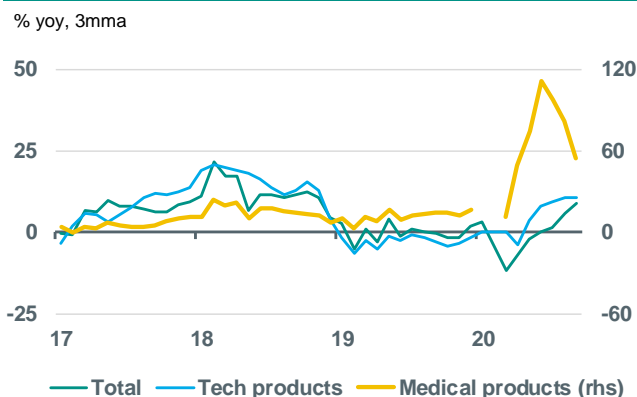
Total confirmed covid-19 cases (#, US in millions on right-hand scale)



Source: Bloomberg

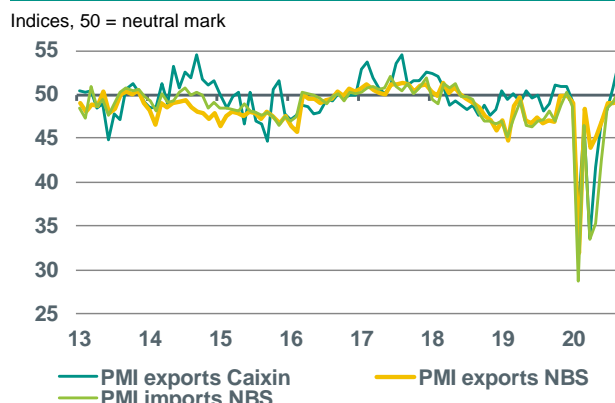
What also contributes to China's recovery is the effective, targeted engineering of government support. Whereas in most developed economies support has been targeting the demand side, in China the focus has been on the supply side. That has facilitated Chinese factories in restarting production for the global market earlier than its competitors. In addition, China's exports have in a way profited from the pandemic, as exports of medical supplies outperformed and so did exports of computers/tech products (reflecting the global shift to working from home). China is relatively strong in many of these industries. All this was visible in solid Chinese exports, even though global growth and trade underwent a lockdown-related collapse in Q2. The improved prospects for exports as well as imports are also visible in a clear improvement of the related PMI subindices, which are now back above the neutral 50 mark.

Chinese exports do well despite (or thanks to) covid-19



Source: Bloomberg, Thomson Reuters Datastream, ABN AMRO GE

Prospects for exports and imports have improved

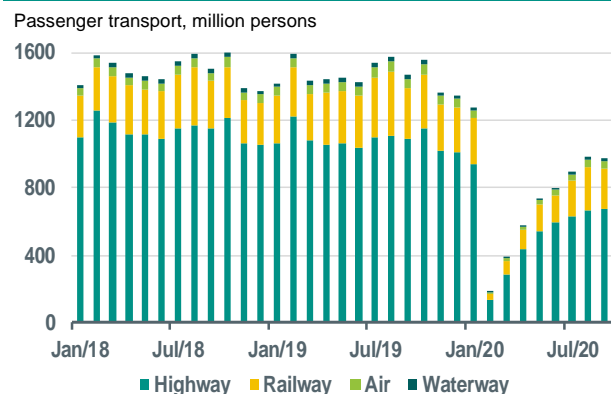


Source: Thomson Reuters Datastream

Not yet completely back to normal

Despite China's lead in recovering from the covid-19 shock, not everything is fully back to normal. Some sectors are still lagging behind, partly reflecting behavioural changes from the pandemic. While passenger transport has recovered from the collapse in early 2020, it has stagnated at levels comparable to 65% of 2019 levels. Moreover, while domestic air traffic is back to almost 90% of 2019 levels, cross-border air traffic is still in the doldrums reflecting strict quarantine policies in China and also similar policies abroad. If we look more closer to retail sales, it seems that 'big ticket items' like furniture and construction & decoration items are underperforming, which may also point to the fact that consumer are still a bit cautious. Overall consumer confidence is also not yet back to pre-corona levels, but also not that far below it.

Passenger transport stuck at 65% of pre-corona levels



Source: CEIC

Some 'big ticket' items seem to underperform in retail sales

Retail sales by product category, % yoy

	February	March	April	May	June	July	August	September
Cultural & office appliances	-11.3	6.0	8.3	3.0	8.6	2.4	0.9	13.5
Household articles (daily use)	-10.7	-0.8	7.5	16.9	17.5	7.0	13.8	11.8
Sports & recreation	-6.0	12.7	18.2	24.3	9.3	15.0	9.7	
Food, beverages, tobacco	-4.0	7.3	10.1	6.1	5.7	1.8	0.9	6.8
Books, newspapers, magazines		4.8	-10.8	12.3	18.0	15.3	17.0	6.5
Clothing	-34.2	-36.3	-20.1	-2.5	-2.9	-4.8	2.2	6.3
Total consumer goods	-21.1	-16.6	-7.9	-3.0	-1.0	-2.6	-1.0	2.3
Catering	-42.2	-46.0	-29.7	-17.0	-12.4	-10.3	-6.2	-1.5
Communication appliances	-9.6	7.4	14.5	13.8	20.8	14.9	32.1	-2.5
Electronic & video	-33.5	-30.7	-11.1	1.2	6.5	-4.0	4.1	-3.3
Medicine	-16.0	10.8	-12.2	-12.9	-10.0	-14.0	-10.1	-9.8
Petroleum & related products	-26.1	-18.1	-13.3	-13.2	-12.3	-13.0	-13.4	-11.0
Furniture	-44.7	-33.5	-19.6	-11.3	-13.8	-15.9	-14.0	-11.8
Construction & decoration	-42.4	-20.9	-14.6	-7.6	-8.9	-13.0	-16.0	-12.8

Source: ABN AMRO Group Economics, Thomson Reuters Datastream

14th Five-Year Plan covering 2021-25 will be in focus next week

Next week, on 26-29 October, China's 14th Five-Year Plan (2021-2025) will be discussed during the so-called Fifth Plenum of the CCP's 19th Party Congress. The CCP will discuss the major goals for economic development and structural reforms for the coming years. Main outcomes of the meeting are expected to be published after the meetings. Given the still uncertain external environment, the CCP may perhaps this time refrain from specifying an average 5-year growth target. It is likely that the so-called 'dual circulation' strategy will be a key topic next week. This strategy aims at strengthening further the role of domestic demand in China's growth model while safeguarding China's position as international trade hub (with more focus on import substitution of critical goods like semiconductors and probably also more focus on regional instead of global supply chains). After next week's meeting, plans will normally be worked out further in the Central

Economic Working Conference typically held in December. After the government for the first time in decades did not adopt a growth target for 2020 due to the uncertainties related to the pandemic, a growth target or range for next year will normally be adopted in March 2021 at the annual session of the National People's Congress.

Revising our 2020 USD/CNY forecast (Georgette Boele)

Since June USD/CNY has declined by 7% from 7.15 to 6.65 today. There are several reasons for this. First, general weakness of the dollar because of lower safe haven demand and negative US real yields. Second, the relative strong Chinese economy. Third, China seems to be in control of the Covid-19 crisis with no second wave. Fourth, financial markets have started to price in that Democratic candidate Biden will win the US elections and that the tensions between the US and China will ease. Investors are testing the willingness of Chinese authorities to let the yuan rise further. Chinese authorities have tried to limit the rise by fixing the yuan at a weaker level, while also tweaking some regulation. In the near-term the yuan may strengthen further but we think that there is a limit to its strength. It is likely that Chinese authorities will take stronger measures to stop the rise. Moreover, if Biden wins the elections a 'Buy-the-Rumour, Sell-The-Fact' reaction is on the cards. We also expect a temporary dollar recovery if Biden wins. Biden will probably have a less confrontational and a less erratic approach to China, but some of the structural issues will stay. We think that investors are too optimistic that a Biden win will dramatically improve the relationship between the US and China. We lowered our forecasts in USD/CNY to reflect these dynamics and our base case of a Biden win. Our new year-end forecast in USD/CNY is 6.75 (from 7). Our forecast for the end of next year remains 7.

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	3.0	2.5
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	6.8	7.0
EUR/CNY (eop)	7.8	7.8	7.8	8.0	8.8

Economic growth, budget balance, current account balance for 2020 and 2021 are rounded figures

Source: EIU, ABN AMRO Group Economics

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