建银国际 CCB International

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Big Picture 2022 Macro Outlook (2022 宏观经济展望):

Policy fine-tuning to manage the economic transition (产业周期坚挺，政策微调支持转型)

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预计制造业保持坚挺，支持明年的经济增长。四季度数据有望企稳回升。出口、产业升级、绿色投资及驱动下，明年工业需求预计保持旺盛，抵消建筑业需求的低迷。劳动力市场及消费复苏较为缓慢。随着疫情影响的消退，预计明年消费将进一步向常态化回归。

政策微调以应对通胀及债务风险，宏观政策偏向选择性支持。国内供应政策的调整加上海外流动性边际收紧，预计明年 PPI 增势将会有所缓和。但成本压力持续，CPI 通胀和国内利率预计上行。地产信贷政策边际上略有放松，但预计行业去杠杆持续，弱资质地产商将继续面临融资压力。今年收紧后，明年财政政策有望适度宽松以支持就业及收入增长。预计流动性保持稳定宽松，信贷增长趋稳，结构化信贷工具支持产业转型。

海外通胀及货币边际收紧将推高无风险利率。发达国家经济保持扩张，稳健的消费及商业投资将持续利好全球经济增长及贸易。奥米克戎(Omicron)变种病毒会是近期的一个风险因素，但各国再次进入封锁的门槛更高。随着供应瓶颈的消退，美国通胀在明年下半年有望稍微缓和，QE 缩减完成后，我们预计美联储或于明年年底开始加息。经济和政策基本面，包括财政赤字与通胀溢价，意味着长端利率将面临上行压力。美元可能继续偏强。

人民币汇率升值空间不大：有别于与上一轮的联储收紧周期带来人民币汇率的贬值压力，目前海外加速配置境内证券，叠加贸易周期坚挺，继续支持对人民币资产的需求。但持续的资金流入也意味着人民币趋向高估的可能。预计央行继续抑制单边升值预期，兑美元汇率双向波动可能上升。全球流动性收紧和美元走强对中资美元债影响较大，将增加内需行业所面临的压力。

Strong industrial cycle will continue to drive growth in 2022F as the supply transformation continues. Industrial earnings have been boosted by domestic and global manufacturing demand and the price cycle, while in the process decoupling from the credit cycle as we anticipated. In the coming year, industrial demand is likely to remain buoyant driven by domestic upgrade needs, green investment and global capex recovery, offsetting sluggish construction demand. Industry trends (higher margin and asset efficiency) and FDI data bode well for medium-term supply efficiency. Meanwhile, job and consumption recovery have been slow. We expect consumption to normalize further next year as the constraints from the pandemic fade somewhat.

In the coming year policy fine-tuning is expected to be used to manage inflation and debt risks, and macro policy support will be selective. We expect PPI inflation to moderate as domestic supply policies adjust and global liquidity tightening slows world commodity prices. However, cost pressure remains, and consumer price inflation is likely to pick up. While liquidity policies have eased at the margin, deleveraging is likely to persist in construction-related sectors, with weaker players in the property sector continuing to face funding pressure. We expect macro policies to have a pro-growth tilt, with a more supportive fiscal stance next year to support job growth and household income amid pandemic concerns. The PBoC will maintain a stable liquidity environment in a reflationary environment, while credit growth is likely to stabilize, with incremental support to structural areas, in particular green investment.

Global inflation and monetary policy exit from the ultra-loose stance will push up global risk-free rate. Developed markets remain in an expansionary phase, and solid consumption and business investment is positive for world growth and trade. The Omicron variant remains a near-term risk, but the bar for the world economy to return to a protracted lockdown is high. US consumer inflation could moderate somewhat in 2H next year as supply bottlenecks dissipate, although the reading will stay above the Fed's medium-term target. We expect the Fed to act behind the curve, commencing its hikes towards the end of next year. Economic and policy fundamentals (e.g., higher fiscal deficit and likely higher inflation risk premium) imply long-term interest rates will face upward pressure. The US dollar will likely extend its strength.

Limited scope for further RMB strength: A strong dollar implies limited scope of further RMB appreciation. However, different from previous periods of global tightening, RMB is still supported by the persistent global investment demand and favorable cyclical conditions. We expect more policy signals to reduce the one-way bet. Tighter global liquidity could add to the funding pressure of some corporate borrowers and widen the differentiation of offshore credits.

Our forecast tables are presented in Tables 1-3 on page 2, 13, and 15

China: Industrial cycle strong, supply transformation accelerated

Industry growth has been leading the recovery this year, despite the tighter credit (Fig 1): External demand helped, with Chinese trade proving resilient with a stronger global market share than before the pandemic (Fig 2). The domestic industrial cycle also picked up further. Consolidation and restructuring within the industrial sector since 2016 has helped reduce overcapacity and improve profitability across a range of sectors (Fig 3), which has been positive for corporate demand. Structural trends gathered pace post pandemic, including digitalization, the energy transition, consumer upgrades, and supply chain security, all leading to accelerated business investment by expanding industries. Several traditional industries sped up their upgrades to meet new technology and environmental requirements (Fig 4).

As we argued previously, recent restructuring implies that China's industrial growth is becoming incrementally less tied to the credit-intense construction and housing sectors (*CCBI–Sustained industrial cycle despite credit tightening* Apr 2021). Combined with further reforms and opening up, the result should be more efficient, less capital and land intensive growth. Recent data shows that asset efficiency improved in many traditional sectors (Fig 5), which will help lift return to assets. FDI surged post pandemic, a harbinger of future productivity gains (Fig 6).

Recent policies signal adjustment aimed at managing transition pain. While the supply transformation taking place has been generally on track, especially in manufacturing, some risk has emerged. The government's energy goals were tested this year, with supply cuts adding to the energy crunch and upstream price hikes. Also, while the housing slowdown and deleveraging policies were in keeping with a transition in growth, market worries over a potential debt crisis escalated. Moreover, protracted weakness in consumer spending raised questions about the sustainability of the recovery and long-term rebalancing. Policies have been adjusted in response, beginning with supply curbs, which were eased to reduce energy shortages. Marginal liquidity support was also provided to aid property developers. Finally, intra-cyclical fiscal support was indicated to support domestic demand.

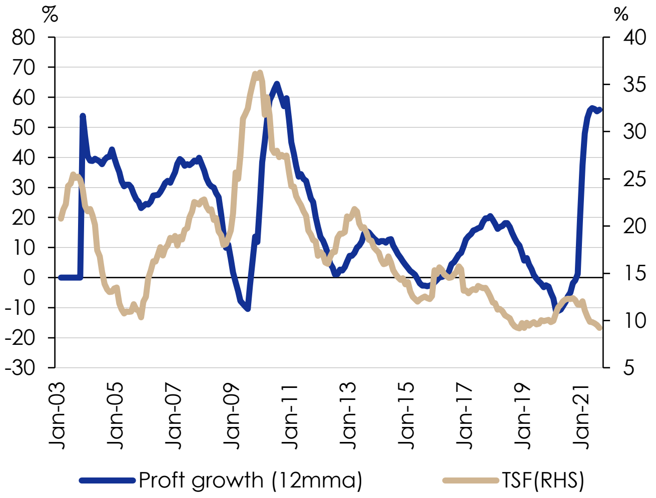
In our view, 2022 will be a year of further supply transformation on the one hand and policy fine tuning on the other, ensuring a balanced medium-term transition albeit with some pain in the near term. The industrial cycle is likely to stay firm. The global recovery is still buoyant, with solid consumption and business investment demand. We expect China to benefit from the uptrend in global growth while domestic corporate investment will remain strong. Green investment in particular, is poised to accelerate further, backed by additional policy support. We also expect consumption to normalize further as the pandemic becomes more endemic and manageable, although periodic variants (Omicron being just the latest example) and government responses will still affect the pace of consumption. Table 1 lays out our key economic forecasts.

Table 1: Key economic forecasts for China

	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F	2020	2021F	2022F	2023F
Real GDP (YoY %)	3.3	3.8	5.0	5.6	6.1	2.3	8.0	5.2	5.5
IP (YoY %)	3.7	4.4	5.0	5.2	5.5	2.8	10.5	5.0	5.8
FAI (YoY YTD %)	5.3	2.4	2.5	4.9	5.0	2.9	5.3	5.0	5.0
Exports (YoY %)	18.2	11.4	15.3	12.8	10.8	3.6	28.5	12.5	9.6
Imports (YoY %)	14.8	9.5	8.1	11.3	15.8	-0.6	27.7	11.2	9.0
CPI (YoY %)	2.2	2.3	3.0	3.5	3.1	2.5	1.0	2.9	2.5
PPI (YoY %)	12.5	9.7	5.9	3.8	1.3	-1.8	8.2	5.2	3.1
Total social financing (YoY %)						13.3	10.0	9.5	9.5
US$/RMB (EOP)						6.5	6.4	6.3	6.4
China 7-day repo (EOP %)						2.2	2.2	2.2	2.4
Reserved requirement ratio (EOP %)						12.5	12.0	12.0	12.0
China 10-year bond yield (EOP %)						3.1	3.1	3.4	3.6
Budget balance (% of GDP)*						-7.4	-6.4	-6.0	-5.7

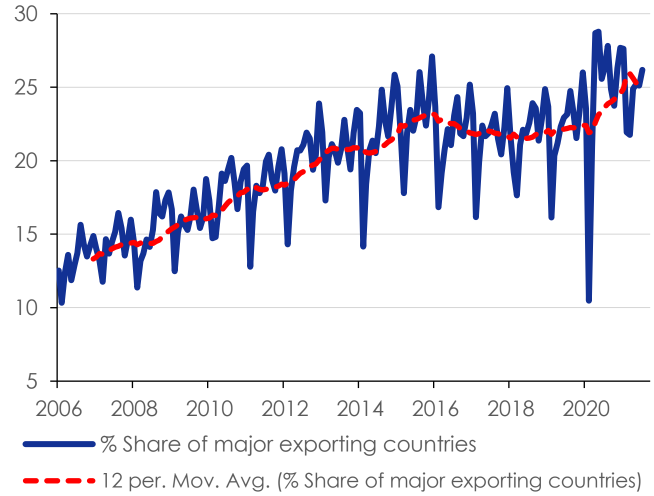
** Budget balances in this table include official budget deficit, epidemic-prevention bonds in 2020 and special purpose bonds*
Source: NBS, CEIC, Bloomberg, CCBIS estimates

Fig 1: Chinese credit cycle continues to fall, while the industry cycle remains strong



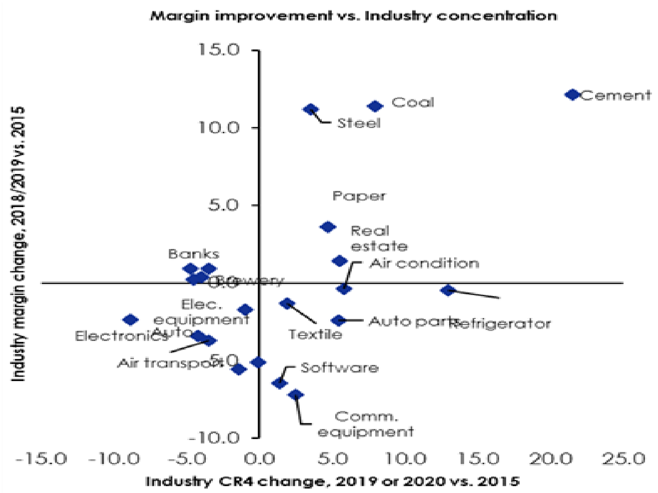
Source: CEIC, CCBIS

Fig 2: Exports have provided strong support



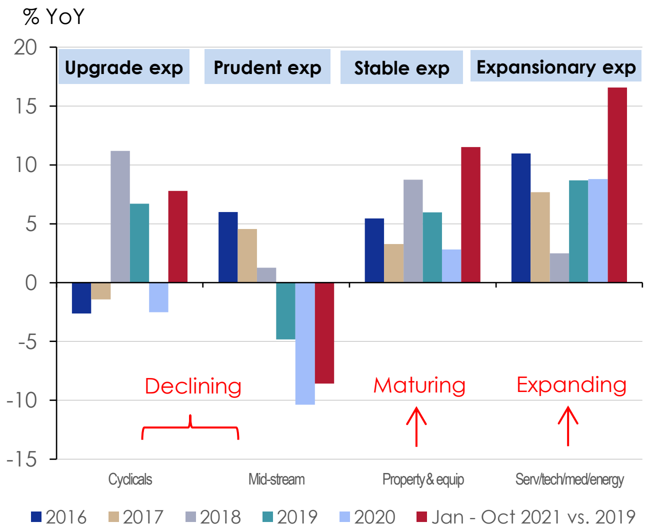
Source: CEIC, CCBIS

Fig 3: Consolidation helped the recovery in margins



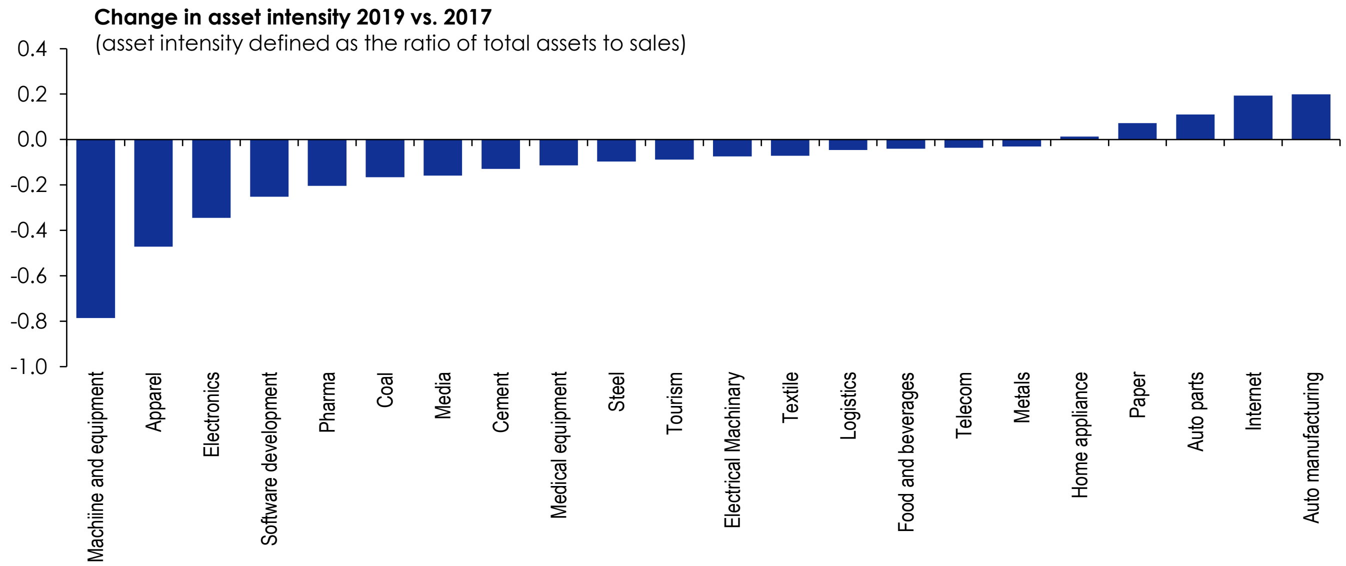
Source: CEIC, CCBIS

Fig 4: Business investment has picked up



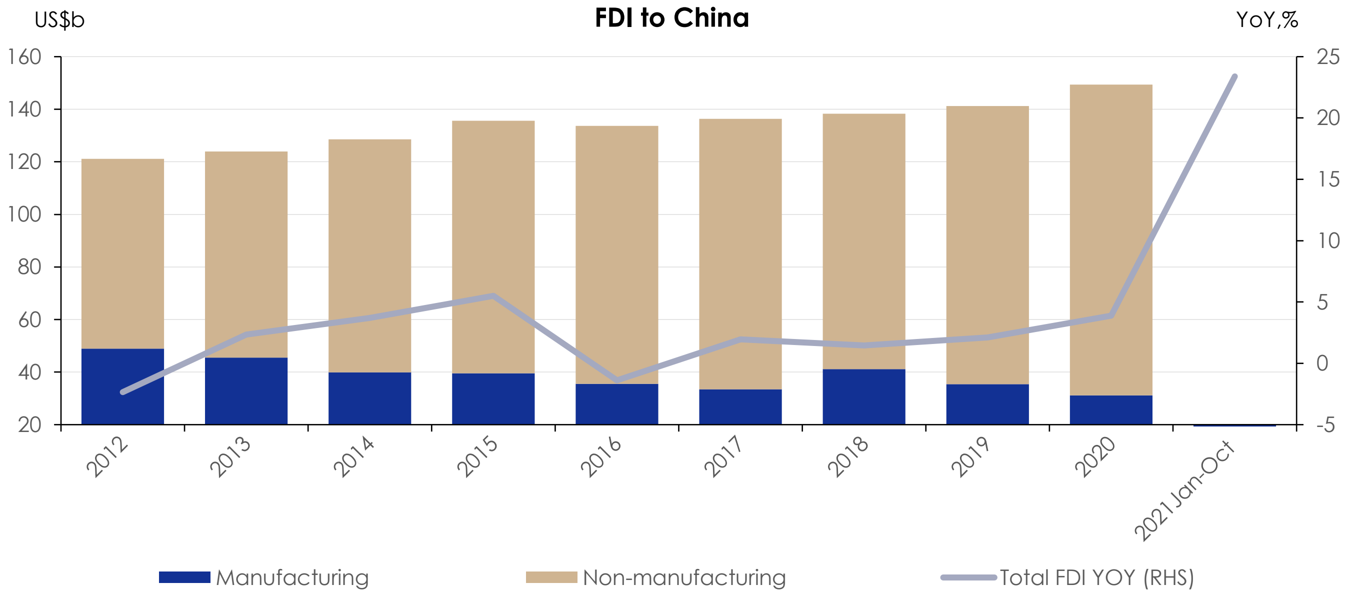
Source: CEIC, CCBIS

Fig 5: Many traditional sectors have increased their asset efficiency



Source: CEIC, CCBIS

Fig 6: Surging FDI following the opening up, positive for future productivity gains



Source: CEIC, CCBIS

Key issues to address for a steadier recovery

As the supply adjustment has stayed on track, we expect the policy adjustment to mainly focus on managing risks and ensure a steadier transition consistent with the economy's medium-term goals. There are several important issues that require policy's balancing act. We discuss our expectations in turn:

Issue 1: How will the energy transition be balanced with growth/inflation considerations?

Chinese government maintains the so-called "dual control" targets, which envisages an annual cut of energy and emission intensity (defined by energy consumption per unit of GDP) by 2.9% during the 14th FYP period (or down 13.5% by end-2025). In recent years China has typically met or exceeded such annual targets, especially in years when the service sectors expanded fastest. However energy intensity rose in early 2021, as the strong manufacturing and export demand post-pandemic, which, coupled with slow growth in services, has made the overall economic recovery more energy intensive (Fig 7). In turn, the government hardened energy-related supply constraints, and industrial production slowed since 3Q21, largely dragged by policy-induced capacity reduction of energy-intensive sectors and emerging power shortages. Upstream material in particular coal prices surged nearly 70% in the first ten months of this year, exceeding the rise in global prices in recent months in light of the supply cut (Fig 8).

The government has adjusted policies at the margin since Oct to ease the energy shortage and price pressure. The question remains to what extent policies can continued to be eased. In our view, as the improvement in energy efficiency and increase in renewable energy sources take time, further supply constraints on coal power and high energy intensive sectors are likely unavoidable in the next-few years to reach energy saving targets. As high-energy intensive sectors mostly concentrate on the upstream, the upward pressure on prices are likely to remain in place. By contrast, as these sectors account for around 20% of Chinese industries, the growth impact is relatively modest. This is supported by simulation exercise:

- **Growth impact from energy transition is moderately negative:** While curbs to upstream production and investment are negative to growth, the large investment involved for the transition offsets the demand shortfall. In recent years, spending in energy transition have outpaced that of traditional transportation infrastructure (Fig 9), and renewable energy has significantly exceeded fossil fuels in newly installed energy capacity. IEA estimates that China's total annual investment for green transformation could amount to RMB4t in 2030, driven mostly by electricity generation, networks, and end-user equipment, up more than 10% from the average levels for the last five years. While an aggressive scenario sees negative growth impact of around 1ppt[1] in the next five years, we estimate around 0.3-0.5ppt annual growth could be shaved off growth in the next few years on a more paced transition, and the impact is smaller in later years as investment and productivity benefit kicks in.
- **Inflation will be a bigger constraint**. The aggressive energy scenario assumed above calculates that PPI inflation could rise by an additional 5ppt each year in the next five years, and the impact will last through the next ten years. While actual impact is likely smaller as the government adopts a less extreme path of de-carbonization, buoyant global manufacturing could still add to the pressure in the next few years.

Some moderation in PPI next year on policy adjustments, but cost pressure remains

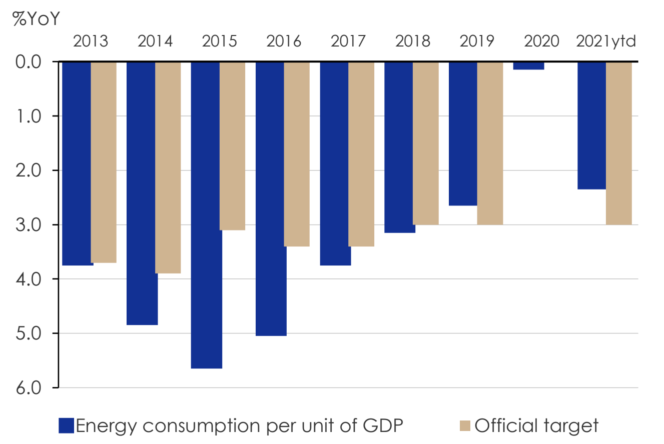
Given the inflation implications, we expect the government to continue with a more flexible approach as in recent months, adjusting energy policies when needed, while accelerating the development of a wide range of technologies to increase energy efficiency, reduce emission, and expand the capacity of renewables. In the next few years, the pickup in services activities could also help to reduce the energy intensity of the economy, loosening the needed supply cuts to meet government targets somewhat. Our baseline assumes that the growth imbalance between high-energy intensive sector and the rest of the industrial sector will narrow, and we expect **some moderation in PPI increase in next year few years** (Fig 10). Contributing factors include supply adjustment, likely friendlier energy saving targets, and incrementally tighter global financial conditions that will help to dampen the momentum of international prices.

Higher costs will see some transmission into consumer prices: Despite the rising costs the overall CPI has been well contained in China this year, estimated to rise 1% from a year ago. Falling pork prices alone shaved around 1.4ppt off the headline inflation. However, recent signs point to a reversal of the falling trend as pork prices climbed near 60% since early Oct. Moreover, rising costs and stronger consumption after pandemic controls are relaxed should support a rise in consumer goods and services prices. In Oct, consumer good prices already accelerated due to rising costs in

[1] *A scenario analysis conducted by Oxford Economics assumes raising the real global carbon prices to between US$600-800/tCO2 by 2060 (in 2010 US$), an aggressive path considered likely to keep global warming below 1.5°C. Chinese output growth will be lowered by an average of 1ppt on average in the next five years, but rising faster in subsequent years as investment benefit kicks in. Such an aggressive transition simply assumes higher taxes and carbon prices to curb fossil fuel demand in the near-term, without accounting for mitigating technology such as the use of clean coal to manage the tradeoff, and thus can be considered an upper bound of the growth impact. But even with such a scenario the growth impact appears modest.*

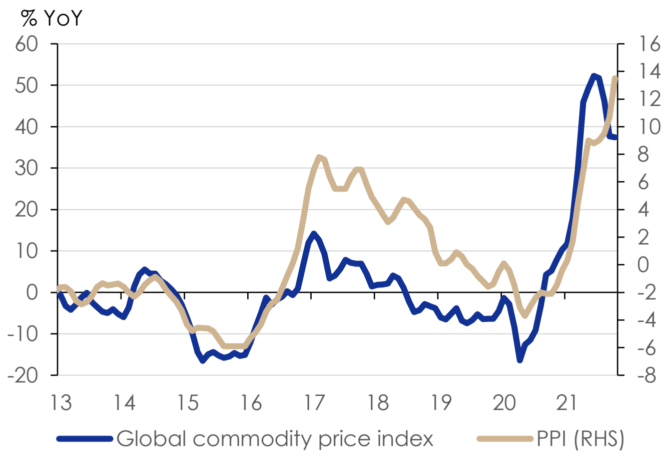
food-related items as well as transportation. We expect food prices to top 3% for the full year, with accelerating pace in the 2H22 judging from potential bottoming of pork prices, and headline CPI to average 2.9% next year. More pass-through of higher costs to downstream prices will add to this pressure.

Fig 7: China's reduction in energy intensity by end of Sep vs. official annual target



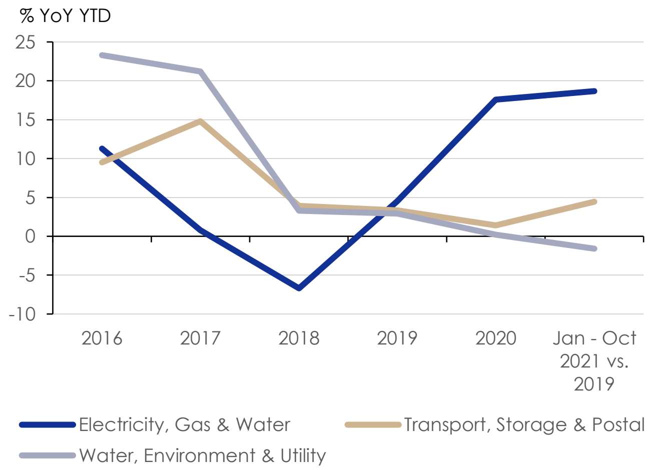
Source: Wind, CCBIS

Fig 8: Domestic prices continued to surge in recent months, reflecting supply constraints



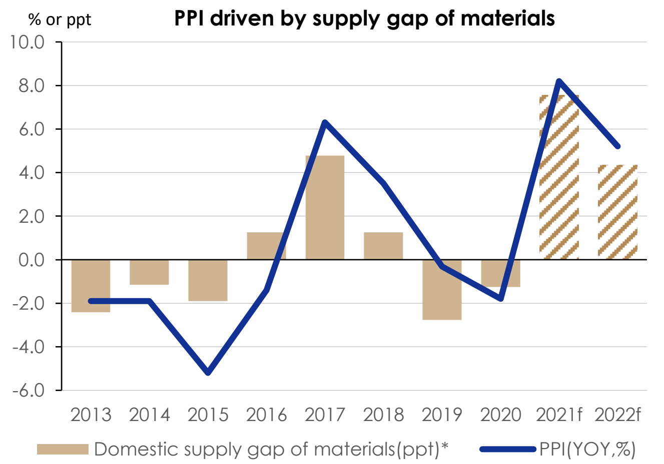
Source: Wind, CCBIS

Fig 9: Investments in energy have picked up the most among major infrastructure FAI



Note: 2021 YTD growth is compared to 2019 levels. Source: Wind, CCBIS
Source: CEIC, CCBIS

Fig 10: As supply gaps of materials narrow somewhat we expect price pressure to moderate next year



** Measured as difference in growth rates of non-material and material*
Source: CEIC, CCBIS

Issue 2: How will debt risks be managed?

A series of high profile property sector defaults have tested the property debt market. At 2%, the default rate for China's property sector and the offshore bond market in general is still modest by international standards. Nevertheless, recent cases have raised concerns about the outlook for the sector as seen from recent downgrades by rating agencies, and the credit spread for offshore high-yield bonds (property sector accounts for over 70%) surged over 1,000 bps since July in the wake of recent defaults, in contrast to the steady IG yield performance.

Housing market slowdown could imply further funding pressure on weaker players: Property developers built up leverage after 2016, in contrast to the deleveraging trend of other highly indebted corporate sectors. The government has tightened its regulatory requirements since last Aug, pushing developers to improve their balance sheet. Meanwhile, housing sales slowed in recent months after a stellar 1H (Fig 11), and we expect another 5-10% decline in property sales and flat property sector investment next year, and the cycle is likely to be more protracted albeit shallower than previous downturns. This is likely to prompt more deleveraging, divestment, and consolidation within the sector.

Government data shows liquidity position is solid for the sector as a whole. However, weak players will remain under pressure in our view, given the tight onshore and offshore borrowing conditions (Fig 12), large refinancing needs in the coming year, and rising reliance on dollar borrowing which makes the sector more vulnerable to global financing tightening (Fig 13).

Marginal easing to contain the spread of individual risks, reversal of policies unlikely: Partial easing of mortgage requirements at the local level and relaxation of bank loans to developers are already under way, which should help to reduce liquidity stress. Several factors help to limit the spillover: (1) the government retains policy room to adjust onshore funding conditions; we estimate the cost of new funding for developers at end-Oct, including onshore/offshore borrowing, was about 2.8ppt higher than it has been for years, a still modest increase compared with the sharp rise in offshore financing costs (Fig 14); (2) housing prices are steady, supported by still-low interest rates, helping reduce concerns about the collateral level and financial stability; and (3) growth impact is contained by the aforementioned industrial cycle. Thus while marginal policy easing is likely to continue, the general policy direction towards housing is unlikely to revert, in our view.

Fig 11: Home sales face more slowdown

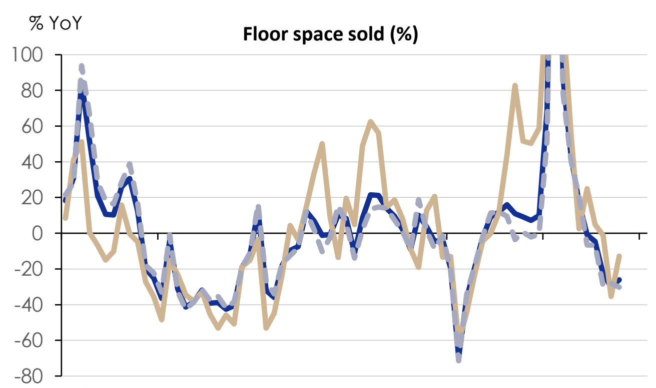


Fig 12: Tighter funding conditions for developers in recent years