21 December 2021

Research China

Stimulus picks up ahead of CPC Congress in '22

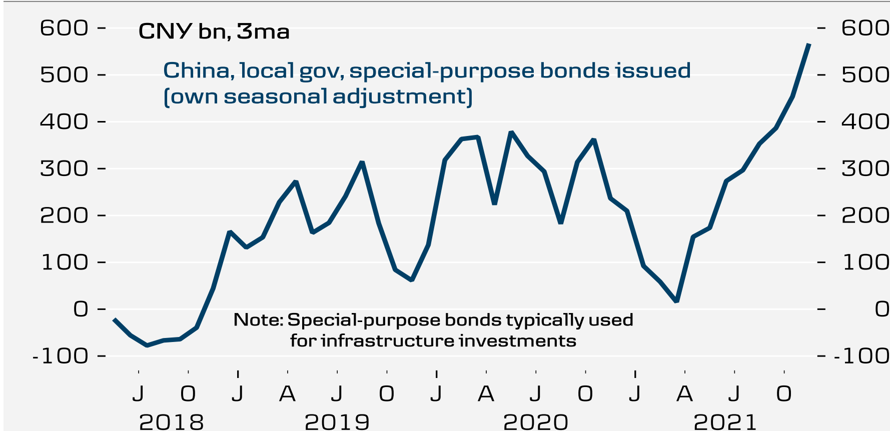
- **China is sending a clear signal of stimulus as stability is the key word in 2022 ahead of the 20th CPC National Congress in the autumn.**
- **Stimulus will likely be calibrated to drive a moderate recovery back to trend growth. Recent comments from Chinese think tanks point to a GDP growth 'target' of "5% or higher" after hitting around 3% in H2 2021.**
- **2021 has been a year of 'crackdowns' and new regulations creating uncertainty over China's economic strategy. We believe the pace of new regulation is likely to slow down but not go away. It will benefit SME's while weighing on big tech.**
- **A turn in the business cycle normally points to upside for the Chinese stock market. While it may be challenged by a more difficult global risk environment, we look for decent returns in Chinese equities in 2022.**
- **Easing of monetary policy while the Fed is tightening should underpin a gradual turn of USD/CNY.**

After being surprisingly quiet on the stimulus front for some time, China has recently sent a clear signal that focus for 2022 will be on stabilizing the economy. The message from the annual three-day Central Economic Work Conference (CEWC) in December, with participation by President Xi Jinping, could not have been clearer with the Chinese character for stability mentioned 25 times in the closing statement. Below some key quotes:

"*China's economic development is facing **a triple pressure of demand contraction, supply turbulence, and weakening expectations***"

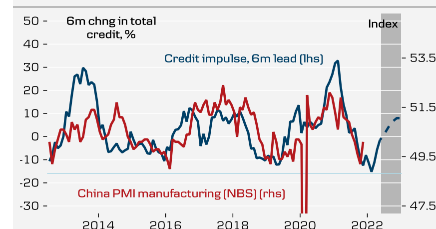
"*... **next year we will hold the 20th Party Congress**, which is a major event in the political life of the Party and the country. We shall **maintain a stable and healthy economic environment**...*"

Infrastructure investments ready to pick up again as provinces have funding ready



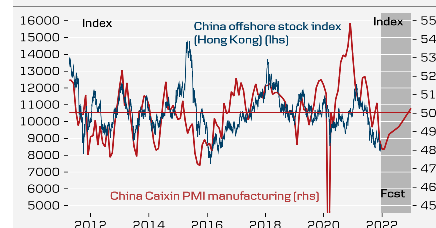
Source: Macrobond Financial, China Ministry of Finance

Credit impulse has bottomed paving way for recovery in 2022



Source: Macrobond Financial, NBS, PBoC, Danske Bank

A rebound in the economy normally drives higher equity markets as well



Source: Macrobond Financial, Caixin, PBoC, Danske Bank. Note: Past or current performance is no indication of future performance.

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*"All regions and departments shall assume responsibility for the stability of the macroeconomy, **all parties/aspects shall actively launch policies conducive to economic stability**, and the release of the force of the policies shall be appropriately earlier."*

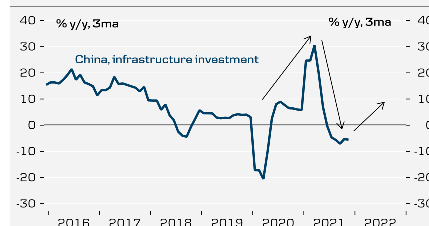
"*We shall ensure the intensity **of fiscal spending** and accelerate the progress of spending. Implement new policies to **reduce taxes and fees**, strengthen support for **small and medium-sized enterprises**... and carry out appropriate **forward-thinking infrastructure investment...** We shall guide financial institutions to increase support for the real economy*.

Focus shifts from long term to short term

At the same conference in 2020 the focus was on long term issues such as fighting financial risks, deleveraging, property sector risks and taking steps on anti-monopoly regulation. It came on the back of a strong recovery in 2020 from the Covid crisis. **This year the situation has reversed**. China's growth is under considerable downward pressure and China has faced question marks over its commitment to the private sector following crackdowns in different sectors. **China is now shifting focus back to the shorter term** and stabilizing the economy. A stable macroeconomic environment is also key for underpinning longer term investments by the private sector and for supporting the small and medium sized enterprises (SME's) that China wants to nurture. The 20th CPC National Congress is also coming up in the autumn and China will aim for maximum stability heading into this Congress, which is held every five years.

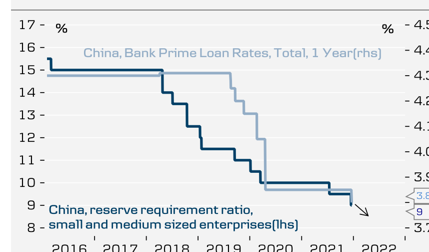
China is now rolling out a string of stimulus measures within monetary as well as fiscal policy that include cuts in banks' reserve requirement ratios, rate cuts, front-loading of infrastructure investments, improved access to finance and reductions of taxes and fees for SME's, see box below for a full overview.

From fiscal stimulus to tightening in 2021 - back to easing in 2022



Source: Macrobond Financial, NBS, Danske Bank

Monetary policy easing has resumed



Source: Macrobond Financial, PBoC

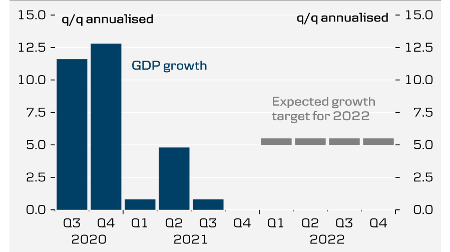
Overview of Chinese stimulus measures – actual and expected

- **Monetary policy easing**
  - Cuts in reserve requirement ratio. Two cuts this year, most recently on 6 Dec. Further reduction expected in Q1.
  - Increased financing access for SME's, see, *State Council*.
  - PBoC has launched reduced rates on *green loans* (1-year rate of 1.75% on 60% of principal)
  - Rate cuts. China cut the leading 1-year Loan Prime Rate 5bp on 20 Dec. More expected in Q1.
- **Fiscal policy**
  - Infrastructure spending frontloaded (transport, energy, 5G, cloud , NEV charging)
  - Cuts in fees and costs for SME's.
  - Possibly incentives to spur a rise in private consumption.
- **Property sector easing**
  - More bank lending for developers
  - Easier rules for developer financing
  - Easier lending standards for mortgage loans
  - Reduction in mortgage rates in some provinces
- **FX policy:**
  - FX reserve requirement lifted from 7% to 9% to halt appreciation of CNY.

Source: Misc. media reports, PBoC, China's State Council

We don't expect a massive boost to growth or a sharp upturn in the credit cycle as Chinese leaders repeatedly state they will not revert to the big stimulus policy as seen in 2008-09. Focus is now on quality over quantity and stimulus aims at supporting long term goals as well. **We look for policy easing to be calibrated to hit a growth target that is likely to be set at 5% or '5% or higher'.** At least several influential think tanks have promoted this lately. The target is usually announced at the annual National People's Congress in March. It would be the lowest target in decades but still implies a lift from the growth rate in H2 2021 averaging around 3% (q/q annualised). It also points to some upside risk to our 4½% GDP growth forecast for 2022.

GDP target expected at 5% or '5% or higher' – to be announced in March



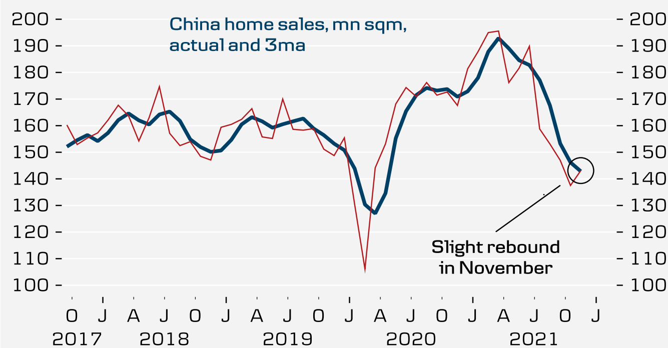
Source: Macrobond Financial, NBS, Danske Bank

We already see moderate effects policy easing y as the credit impulse has bottomed out in recent months and the issuance of special-purpose bonds by local governments have seen a considerable lift in H2 as guided by the central government (see charts on front page). The funds from these bonds are aimed at financing an infrastructure boost in H1 2022 after a sharp slowdown of these investments in 2021.

Property sector to stay weak for some time but not collapse

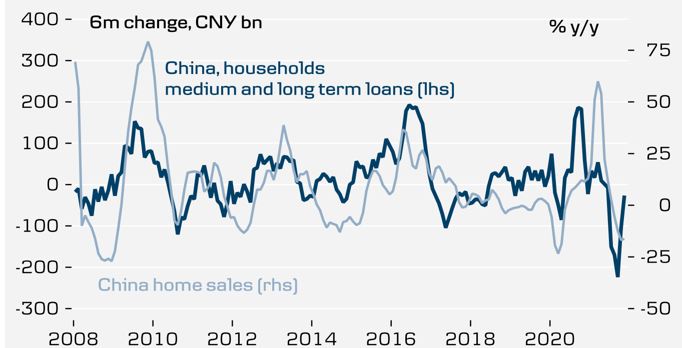
The main drag on the Chinese economy currently is the property crisis as home sales and construction has seen a big hit. We expect the sector to be a continued drag in H1 2022 but that a gradual lift will take place in H2. As expected China has stepped in with stabilizing measures in the property market (see box above) and while we expect to see more defaults in coming quarters, the heightened focus on stability in 2022 suggests that Beijing will use the tools necessary to avoid widespread contagion, see also *China – Moderate recovery in 2022*, 8 December 2021.

Tentative signs of stabilisation in home sales



Source: Macrobond Financial, NBS

Rebound in household lending underpins home sales



Source: Macrobond Financial, NBS, PBoC

China may temper crackdowns after blitz of regulations in '21

The past year will also be remembered as the year with crackdowns on big tech and a flurry of new regulations and interventions within gaming, private education and foreign listings of companies with huge amounts of data, like the ride-hailing company Didi.

Given the high focus on stability, China will probably slow down the pace of new regulations, albeit not stop it. One challenge with the crackdowns and new regulations has been the unpredictable nature of some of them and that they came within a short time span. It has hurt foreign investor sentiment, which in turn, hurts Chinese companies financing conditions.

An important reason the new regulations are not likely to stop completely is that, China sees it as a necessary step in building efficient and fair markets. The crackdown on

big tech is thus related to limiting dominant market positions and market abusive behaviour. The smaller companies will benefit from the crackdowns as it creates a more level playing field and reduces entry barriers, see for example comments by AI expert and venture capitalist Kai-Fu Lee *here*.

Judging from the Central Economic Work Conference, **China is going to launch a kind of traffic light system** to make a more predictable and law-based system of supervision of large corporates. In the statement from the CEWC it says: "*We shall incentivize the capital's role as an active part of the production factors and control its negative effects. We should be establish "traffic lights" for capital to strengthen supervision in accordance with the law, and the barbaric expansion of capital should be prevented*."

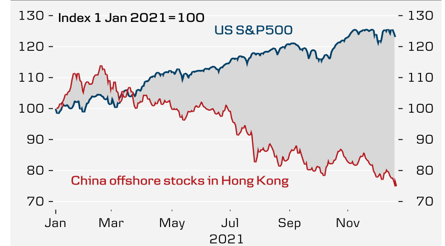
Upside for Chinese stocks and USD/CNY

If indeed China manages to drive a moderate recovery in 2022, it should provide upside for Chinese offshore equities, which tend to be quite cyclical in nature (see chart on front page). We also see quite attractive valuation in the offshore market after the sharp declines this year, which happened on the back of the double whammy from a sharp cyclical slowdown as well as the hit to investor sentiment from the above mentioned crackdowns. Large tech companies listed on the Hong Kong stock exchange have also been directly hit by the regulation. Developers have also been hit hard but should in our view stabilize and recover during 2022 as home sales climb slowly higher.

We do expect equity volatility to stay quite high, not least in the short term, as the economy is yet to bottom. But as we see more clear signs of a recovery during 2022, we expect it to lift Chinese stocks. China is still a high-risk market, though, as 2021 has also proven.

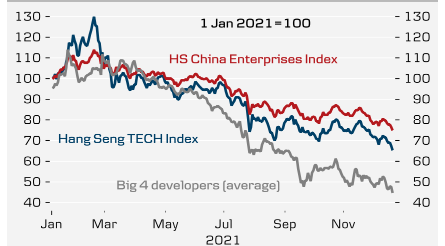
For USD/CNY, we expect the easing of monetary policy alongside rate hikes by the Fed to finally lead to a turning point for the cross. CNY has been trading very strongly in 2021 on the back of a high trade surplus, but we also expect this to come down during 2022 as the US demand for goods is expected to moderate. We expect USD/CNY to move towards 6.80 in 12M from the current level of 6.37.

Strong underperformance of Chinese offshore stocks in 2021



Source: Macrobond Financial, Bloomberg, Danske Bank. Note: Past or current performance is no indication of future performance.

Not least developer stocks and tech has taken a beating in 2021



Source: Macrobond Financial, Bloomberg, Danske Bank. Note: Past or current performance is no indication of future performance.

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Report completed: 20 December 2021, 21:53 CET

Report first disseminated: 21 December 2021, 06.45 CET