Industry led recovery to continue

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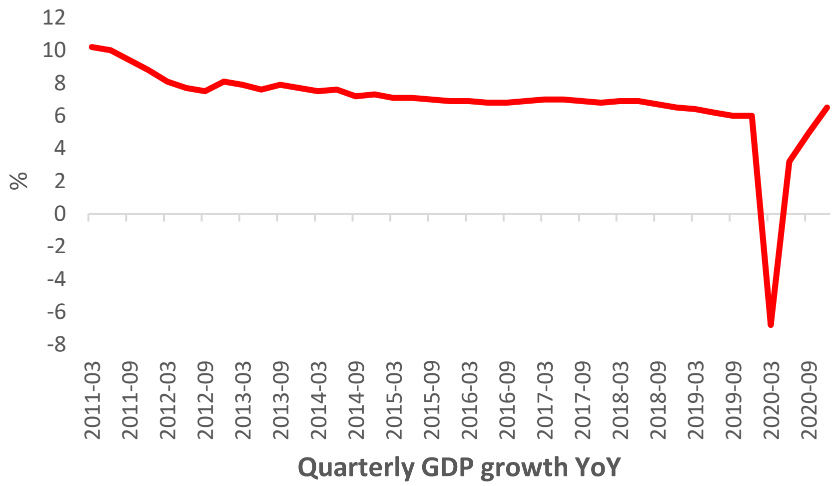
- **China's GDP topped CNY100 trillion for the first time in 2020.**
- **GDP per capita has exceeded US$10K for the second consecutive year.**
- **Private consumption remained the key drag while investment played an important counter cyclical role.**
- **Although China has created 11.86 million urban jobs, more than target, the income growth has been affected by the pandemic.**
- **The recent resurgence of virus is a double-edged sword. It may yield unexpected boost to industry sector as factories may restart post CNY operation earlier because some migrant workers will not travel back to hometown for CNY holiday for the first time.**
- **External demand is likely to remain supportive in 2021.**
- **The economic growth in 1Q could accelerate to about 20% yoy.**
- **PBoC is expected to remain neutral in monetary policy.**

The Chinese economic growth accelerated further in the fourth quarter of 2020 to 6.5% yoy, beating market expectation, on the back of resilient external demand and improving domestic demand. Despite the pandemic, China's GDP topped CNY100 trillion for the first time in 2020. This also means China's GDP per capita has exceeded US$10K for the second consecutive year in 2020. This marked a good ending for China's 13th five-year plan.

Chart 1: The Chinese economy reaccelerated to 6.5% in 4Q.



For 2020, private consumption was the main drag with total private consumption hovered around CNY55 trillion, barely changed from that in 2019. Capital formation, on the other hand, rose further to about CNY45 trillion up from CNY42.86 trillion in 2019. This showed that investment play an important counter cyclical role to offset the shock to consumption from the pandemic.

For December data, both retail sales growth and fixed asset investment growth missed the expectation although China's industry production beat market expectation nicely. The weaker than expected retail sales were mainly attributable to two factors, in our view, including the recent resurgence of virus in some parts of China and still sluggish income growth.

Although China has successfully created 11.86 million urban jobs, much higher than the annual target of 9 million jobs, the income growth has been affected by the pandemic. The nominal disposable income rose by 4.7% in 2020 while the real disposable income grew by 2.1% yoy. On positive note, disposable income in rural areas rose by 6.9% in nominal term and 3.8% in real term, faster than that in urban areas. The faster income growth in rural area is helpful to narrow the income gap.

Resurgence of virus is a double-edged sword

Although the recent lockdown in some cities ahead of Chinese New Year holiday may affect consumption outlook, the recent resurgence of virus may also yield unexpected boost to China's industry sector. As some migrant workers have decided not to travel back to their hometown for Chinese New Year due to concerns about the virus, this may give factories room to restart their post CNY operations earlier than usual to meet the strong external demand.

As such, we think the strong industrial output is likely to continue in the new year, which will further underpin China's growth despite rising uncertainty about consumption.

Chart 2: Recovery of real disposable income remained slow

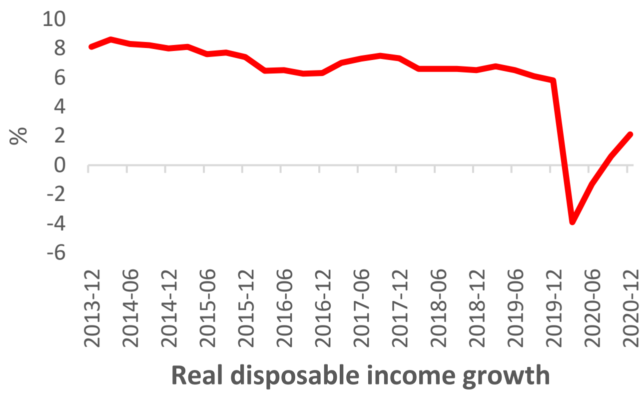
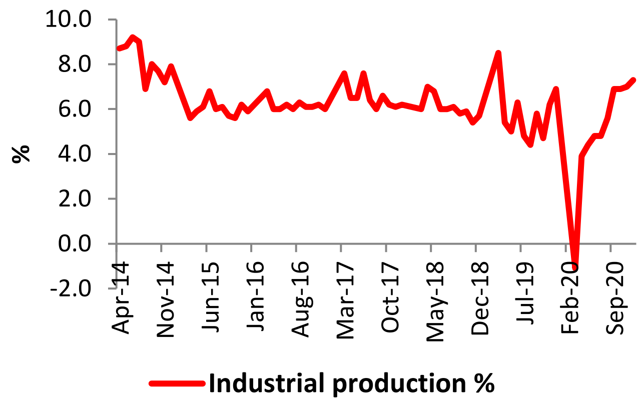


Chart 3: Production is likely to lead the recovery in the beginning of the new year.



External demand is likely to remain supportive.

The recent trade data in November and December proved that China's exporters have benefited from resurgence of virus globally. We expect this support from external demand is likely to continue for three reasons.

First, the increasing confrontational stance from Trump Administration has limited impact on the US-China trade flow. Total US-China trade hit

US$526.5 billion in 2020, only down marginally 2.54% from that in 2019. However, it still exceeded US$524 billion in 2016 when President Trump first took over the office. Meanwhile, China's trade surplus with the US in 2019 remained strong at US$291.7 billion, on par with US$295.6 billion in 2019. The incoming Biden Administration may also give hope that the new Administration will not escalate tension further.

Second, the trend of supply chain shift continued in 2020 judging by the strong trade linkage between China and ASEAN. China's trade surplus with Vietnam reached a record of US$35.33 billion, a sign of increasing supply chain collaboration between China and Vietnam. The successful conclusion of RCEP negotiation in November 2020 together with the trend of supply chain shift are likely to further underpin the regional trade between China and ASEAN.

Third, the return to vaccine induced normalcy in developed markets may create a mismatch between demand and supply when most of alternative production centres in the world are still struggling to fight the virus. The only country which may fill the gap is China. As such, we think China could be one of the key beneficiaries of the earlier than expected rollout of vaccine, which will further underpin China's recovery in the first half of 2021.

Overall, we expect China's 1Q growth to accelerate further to about 20% yoy partially due to low base effect.

Chart 4: China's trade surplus widened to record high.

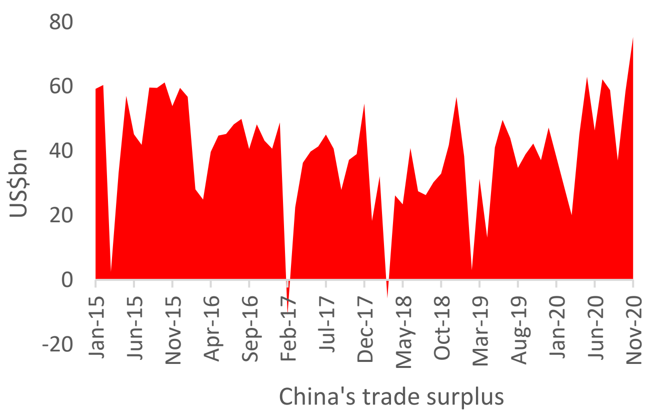
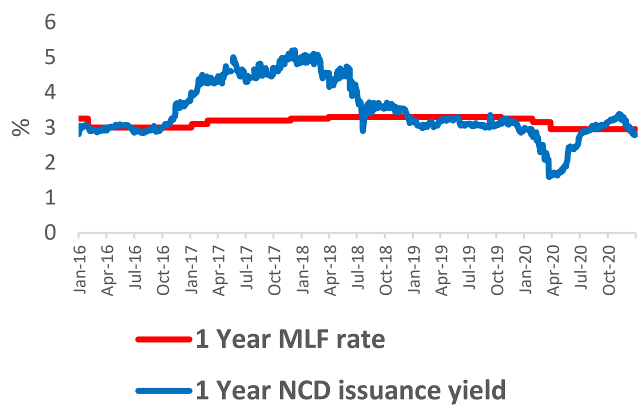


Chart 5: Falling funding costs



PBoC is expected to remain neutral in monetary policy

For the first time in six months, PBoC did not fully roll over the maturing MLF and TMLF. The CNY500 billion MLF injection last week was short of the aggregate of maturing CNY300 billion MLF and CNY240.5 billion targeted MLF. The net withdrawal of long-term liquidity was mainly attributable to the recent decline of NCD issuance yield, which has been below the MLF rate since the beginning of 2021. This shows PBoC will continue to play its balancing game although its deputy Governor reiterated that there is no urgency for U-turn of monetary policy in the latest press conference.

The borrowing cost for enterprise has fallen by 51bps in 2020 to 4.61%, lowest in record. The magnitude of decline is also bigger than that of LPR. This suggests that there is no urgency for PBoC to change its monetary policy against the backdrop of improving macro picture.

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