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- **Downward pressure on production heightened.**
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- **Consumption was the bright spot in September. The share of final consumption expenditure to China's GDP growth increased further to 64.8% in the first three quarters.**
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The Chinese economy decelerated further to 4.9% yoy in the third quarter from 7.9% yoy in the second quarter. The large part of deceleration was due to the base effect as China is the first major economy recovering from the pandemic in the second half of 2020. On two-year average after adjusting for the pandemic effect, the Chinese economy grew by 4.9% yoy, down from 5.5% in the second quarter. This 0.6% deceleration was mainly attributable to looming event risks including regulatory tightening, Evergrande debt crisis and recent power shortage.

Downward pressure on production

China's industrial production growth slowed down further to 3.1% yoy in September from 5.3% yoy in August. On two-year average, industrial production slowed down to 5% yoy from 5.4% yoy. Sequentially, industrial production grew by 0.05% mom after seasonally adjusted. This was the lowest mom reading except January and February 2020 when the first outbreak of Covid-19 emerged in Wuhan. Given the lingering power limit and widening gap between PPI and CPI, China's industrial production may continue to face downward pressure in the last quarter of 2021.

Manufacturing investment remains the key driver

Manufacturing investment remained the key supporting factors while property investment slowed down further, and infrastructure investment failed to pick up. Property investment growth decelerated to 8.8% yoy in the first three quarters from 10.9% yoy in the first eight months. The recent property tightening measures and lingering debt crisis are likely to weigh down property investment further.

The hope for infrastructure investment to pick up to partially offset the slowdown of property investment failed to materialize in the third quarter. Infrastructure investment slowed down to 1.5% from 2.9%. The counter cyclical role of infrastructure investment was disrupted by the funding issue. Although the issuance of local government special bond is likely to accelerate, it is unlikely to turn around the weak infrastructure investment completely. As such, infrastructure investment is likely to be the story in 2022.

Manufacturing investment grew strongly by 14.8% yoy in the first three quarters albeit decelerating from 15.7%. Although manufacturing investment in Automobile continued to decline due to uncertainty from chip shortage, manufacturing investment in electrical machinery remained strong due to resilient demand for electrical products. Share of manufacturing in China's GDP in the first three quarters rebounded to 27.4% from 26.1% in 2020.

Chart 1: Manufacturing output growth decelerated though high tech manufacturing remained resilient

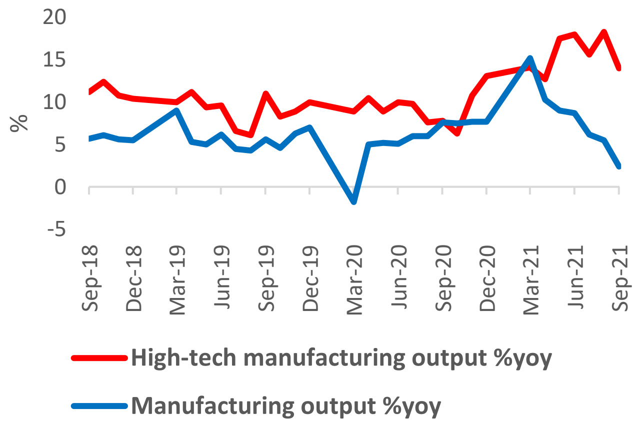
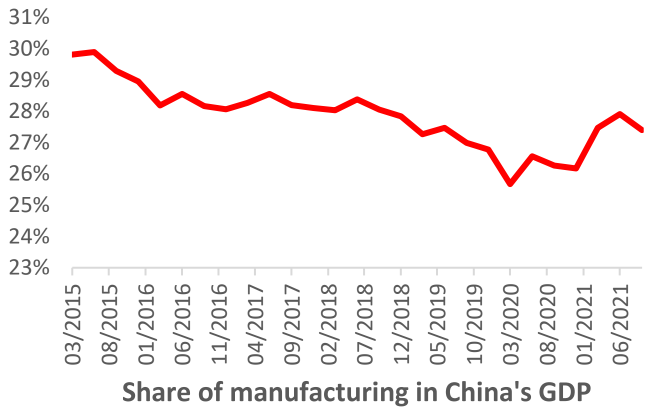


Chart 2: Share of manufacturing in China's GDP rebounded after multi-years decline.



Source: Wind, CEIC, OCBC Bank

Consumption is the key driver

Consumption was the bright spot in September. Retail sales beat market expectation growing by 4.4% yoy. On two-year average, retail sales rose by 3.9% yoy, up from 1.5% yoy in August. Car sales remained the key drag on China's retail sales due to chip shortage. Retail sales excluding Automobile reaccelerated to 6.4% yoy from 3.6% yoy. The outperformance of retail sales was mainly driven by the rebound of catering sales which rose by 3.1% yoy after contracting by 4.5% in August thanks to containment of delta variant outbreak in early September.

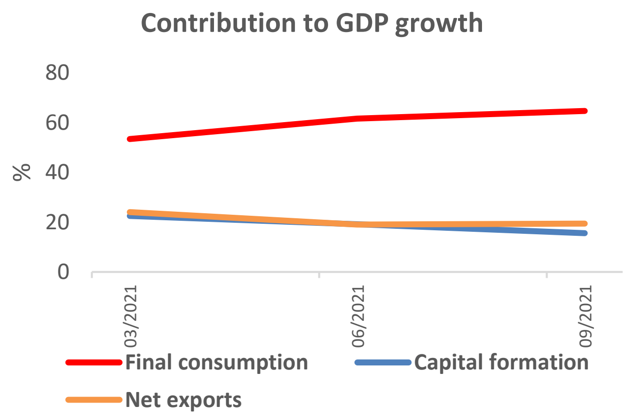
There is positive surprise from China's job market data. China's unemployment rate fell to 4.9% in September from 5.1% despite reshuffle of private education sectors. Youth unemployment rate for aged 16-24 fell further to 14.6% from 15.3% in August and 16.2% in July as more college graduates found the jobs after leaving the schools. In addition, China has created 10.45 million urban jobs by September, completing 95% of its annual target. The improving job market is expected to add more supports to domestic demand.

Overall, amid the recent looming event risks such as Evergrande debt crisis and power shortage, consumption is expected to be the main driver to Chinese growth in 2021. The share of final consumption expenditure to China's GDP growth increased further to 64.8% in the first three quarters up from 61.7% in the first half while share of capital formation to China's GDP growth fell further.

Looking ahead, we expect China's growth to slow down further to 2-3% in 4Q. For the whole year of 2021, China is expected to grow by about 8-8.5%.

Chart 3: Manufacturing output growth decelerated though high tech manufacturing remained resilient

Chart 4: Share of final consumption expenditure to China's GDP growth increased further.



Source: Wind, CEIC, OCBC Bank

Falling expectations on an imminent RRR cut

The widening gap between PPI and CPI to a fresh high in September has been one of the key concerns as it may continue to squeeze the profit margin in the downstream sectors.

The latest messages from PBoC press conference together with the full rollover of MLFs last Friday dialled back market expectation on imminent RRR cut. Although PBoC reckoned the challenges faced by smaller and micro companies due to margin pressures from the widening gap between PPI and CPI， PBoC focused more on other measures such as relending and capital market tools to support smaller companies. In addition, the decline of the average borrowing costs for smaller companies by 19bps in the first three quarters of 2021 may also give PBoC the room to take a wait-and-see approach. This hinted that PBoC may be in no rush to support smaller companies via another RRR cut.

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