

# MACRO OUTLOOK

## Beijing Makes Pro-Growth Pivot to End the Year

Houze Song

OCT 2021



w/p

## KEY TAKEAWAYS

---

- Policy tightening for much of 2021 will be relaxed for the remainder of the year;
- Disruptions from the property sector and the energy crunch should moderate as Beijing offers more support;
- The pro-growth bias heading into a political transition year will likely continue to hold;
- As such, the worst is likely behind us, as quarter-on-quarter growth in the fourth quarter will likely rebound to above 5%.



## THE WORST HAS PASSED

Regulatory crackdowns on the tech sector, the Evergrande crisis, and an ongoing energy crunch all seem to bode ill for growth in 4Q2021. In fact, third-quarter growth of 4.9% was the weakest quarterly growth since China lifted the national lockdown at the end of 2020.

Concern of an unabated growth slowdown is warranted. But there are good reasons to believe that growth will instead stabilize going into the end of year, chief among them a reversal of the broad policy tightening that has defined much of the year.

Indeed, the lackluster growth in 2021 has much to do with Beijing's hawkish stance on a spate of growth-negative policies [that it signaled](#) as "reforms" in late 2020. It meant what it said, as these reforms took the form of property sector deleveraging and the flurry of unprecedented regulatory actions on tech companies.

But what Beijing described as "...a rare window of opportunity for policy reform" is coming to a close, as the July Politburo meeting clearly signaled that an adjustment toward "economic policy transition" is forthcoming. During a late August inspection tour, President Xi Jinping [also told](#) local officials to "strive hard to fulfill this year's development targets."

As a result, in the coming months Beijing will likely focus on implementing existing policies rather than introducing new measures that would disrupt the economy. In fact, some of Beijing's recent actions in the tech sector, such as [requiring platform companies](#) to provide insurance to gig workers, have [not made](#) much progress. And Beijing is unlikely to push harder in these areas in the near future.

It's certainly not lost on policy mandarins that 2022 is the 20th Communist Party Congress when new top leaders will be selected. Historically, Beijing has tended to prioritize growth ahead of major Party congresses and political transitions to ensure broad stability. It's a period where the leadership prefers to mitigate as much downside risk as possible. For example, in early 2017, Beijing suspended the deleveraging campaign to ensure solid growth ahead of the 19th Party Congress.

The energy supply shock of the past few months was of course unexpected and will likely modestly affect growth. Although a coal shortage is mainly responsible for the energy crunch, Beijing's push for meeting energy targets has also had some impact.

Each province has two assigned caps: 1) total energy consumption and 2) energy-intensity reduction, which is defined as energy consumption per unit of GDP. As the industrial sectors roared back to life post-Covid, factories started running at full tilt, which increased the energy consumption of many provinces where industries are concentrated. This prompted numerous local governments to shut down factory production to meet energy targets.

The energy situation should see improvement, however. It appears Beijing has realized that it was mistaken to punish regions whose energy consumption rose on the back of an industry rebound. The National Development and Reform Commission, China's top economic agency but also *de facto* energy regulator, has already [quietly modified](#) the energy policy.

Essentially, Beijing will allow energy consumption growth in the near term so long as provinces continue to focus on reducing their energy intensity. In other words, of the two energy caps, only one matters at the moment.

When it comes to the coal shortage, it is unlikely to have a significant impact on the economy in the fourth quarter. For one, power plants will have a bit of reprieve, as October through November is usually the low season for overall power demand. This should buy power plants some time to prioritize rebuilding coal inventories in order to sustain normal operations.

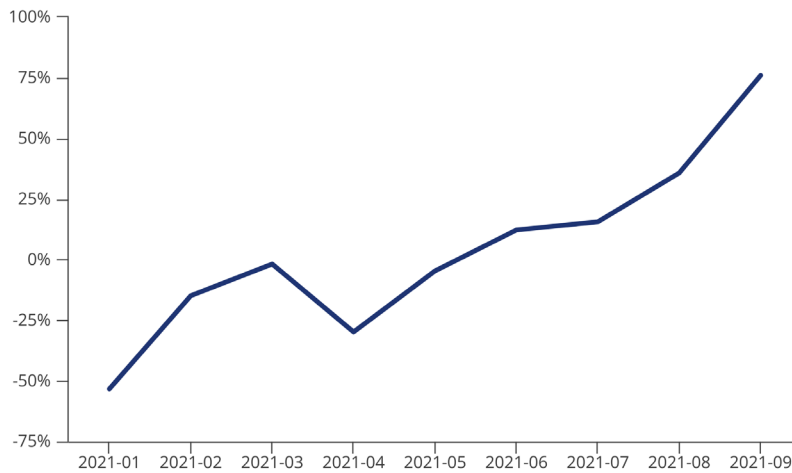
Given that the recent average coal inventory is just 11 days, about half of what it would be normally, the rush to restock inventory is necessary to prevent the sorts of blackouts that happened in northeast China. This coal demand will likely put additional pressure on already high coal prices, which is why the Chinese government is also working to alleviate demand pressures.



For instance, Beijing has mandated that annual steel production should exceed last year's. At this rate, it appears that steel production in 4Q2021 should be about 5% lower than in the same period in 2021. That should significantly lower coal demand for the rest of the year.

Meanwhile, Beijing has also been working on the supply side, having already ramped up coal imports from every country except Australia. September's imports, for example, jumped a whopping 76% (see Figure 1).

**Figure 1. China Has Been Ramping Up Coal Imports Significantly**



Source: Wind.

In addition, Beijing has capitalized on this energy crisis to continue pushing for more flexibility in electricity prices. This means power plants can charge higher prices to end users, which would ensure electricity supply to factories that are willing to pay a premium.

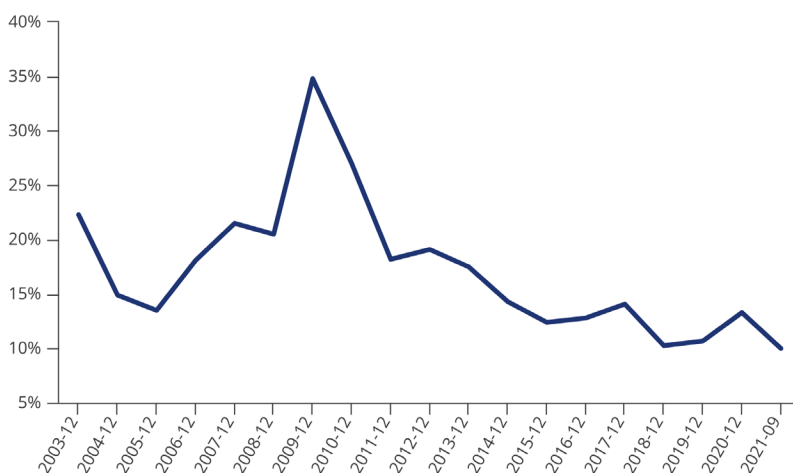
## PRO-GROWTH PIVOT IN THE WORKS

Taken together, the recent period of hawkish policies and growth disruptions will likely yield to a more pro-growth environment. As such, we expect more easing of credit.

This is needed because the People’s Bank of China (PBOC) arguably overshoot on credit tightening this year. It took to heart the “reform” window of opportunity and pursued deleveraging and regulatory actions with vigor, in large part because they have been delayed as a result of the pandemic.

Consequently, the PBOC prioritized tackling debt in the property sector, which in turn put the squeeze on land sales. These actions were effective, as the pace of credit growth decelerated to 10%, the lowest level since 2003 (see Figure 2). This meant that through the end of 3Q2021, total new credit was nearly 5 trillion yuan (~\$750 billion) less than over the same period in 2020—quite surprising as 2020 had much less economic activity than 2021.

**Figure 2. Credit Growth at Its Lowest Level since 2003**



Source: Wind.



This large contraction in credit as the economy rebounded was highly disruptive. For example, new mortgage lending in the third quarter was about 500 billion yuan (~\$77 billion) lower than last year, which explains why property sales had similarly fallen off a cliff.

We believe the PBOC is largely satisfied with its deleveraging effort and deems the pace of credit growth appropriate for now. As such, further credit tightening is unlikely to be in the cards, reinforced by the PBOC's latest policy statement that it [plans to](#) "stabilize credit growth." Moreover, the central bank also [softened its stance](#) on property borrowing, which should [help to stabilize](#) the property sector.

In the coming months, the pro-growth tilt in policy should become more obvious. As a result, despite the disappointing growth in the third quarter, we think there is a high probability that China's quarter-on-quarter growth will exceed 5% in the fourth quarter.