CCXI & CCXAP – Research & Commentary

Difficulties in Economic Entities and Partial Financial Risks Draw Particular Attention when Macro Data Indicates a High Growth Rate

Hong Kong, 27 April 2021 -- A report titled "The Economic Recovery Continues with Persistent Risks and Asset Allocation Continues to Favor Commodities: Review and Outlook of the Macroeconomic Landscape and the Allocation of Major Assets Categories in Q1 2021" has been recently published by the Research Institute of China Chengxin International Credit Rating Co. Ltd. ("CCXI Research Institute"). According to the report, the macro policies still need to strike a balance between stabilizing economic growth and preventing risks, given that the national economy as a whole is falling back from a strong rebound which is due to a low base according to the macro statistics to the potential growth level after the low base effect is deducted. In particular, the persistent co-existence of difficulties in economic entities and partial financial risks highlight the necessity of macro policies to achieve the abovementioned balance. As estimated by the report, China will post an annual GDP growth of approximately 8.8% in 2021, and the output gap may disappear in 2022. As to the allocation of major asset categories, both stock and gold prices have fallen in the first quarter of 2021, and commodities are, therefore, more recommended in the short term.

The report pointed out that the highest economic growth rate in the first quarter of 2021 since China started keeping quarterly records available is credited to a combination of many factors, such as a low base of previous year, a strong economic recovery, and a surge in staggered export growth, but the two-year average growth rate with the base effect deducted returns to the potential level in general. From the production side, the two-year compound growth rate of the secondary industry and industry has recovered to the level before the pandemic. The average two-year growth rate of the tertiary industry still falls far from the pre-pandemic level, but the sector's contribution to growth has gone up slightly. On the demand front, neither investment nor consumption pushed the two-year compound growth rate back to the pre-pandemic level in the first quarter. Nevertheless, infrastructure, manufacturing as well as real estate investment and total retail sales of consumer goods all rebounded to a certain extent in March. Exports in the first quarter grew better than expectations but the compound growth rate in March went down somewhat, compared with January and February. The pandemic has amplified data fluctuations. China's economy grew a record 18.3% in the first quarter of 2021 compared to the same quarter last year, but the year-on-year growth rate with the low base effect deducted stood at 5.0%, lower than 5.4% and 6.1% in the third and fourth quarters of last year. With the Chinese economy returning to its potential growth rate, macroeconomic policies have also shifted in due course. The financial data have been steadily tightened overall.

The report held that there are still concerns about economic operation despite the high-flying macro data, which is manifested in two aspects: some economic entities still operate in difficulty and partial financial risks may appear due to the short supplies of output and credit. From the consumption perspective, consumption recovery was still weaker than production one in the first quarter. The two-year compound growth rate of total retail sales of consumer goods came at 4.2%, which was lower than the industrial growth rate and its pre-pandemic level as well. The two-year average consumption expenditure growth rate with the price factor deducted only stood at 1.4%, Especially, the income gap might widen in the economic recovery. It will take time for the marginal propensity to consume to bounce back. On the front of enterprises, total losses of loss-making industrial enterprises remained at a high level in January and February, after a sharp year-on-year fall. In particular, the losses of private industrial enterprises surpassed the levels in the same periods of 2019 and 2020. Furthermore, the manufacturing industry saw its capital expenditure in the first quarter probably growing negatively, which indicated that companies were still quite reluctant to expand investment. Coupled with the increasing prices of upstream materials, the PPI and PPIRM scissors difference reverse widened in the first quarter. In this context, the profitability of some downstream companies might be squeezed. There is still room for the economy to release more inherent momentum. In the financial point of view, the output gap has gradually narrowed but not completely disappeared in the first quarter. The credit gap may expand somewhat as the macro policy makes a turn. The coexistence of output and credit gaps may lead to the accelerated release of credit risks in some areas. In addition, judging from the financial data of bond issuers, the proportion of speculative and Ponzi financiers in the economies might have risen in 2020, so financial vulnerabilities are expected to increase as a result of the credit cycle downturn this year.

China's economy may grow by 8.8% throughout 2021, a prediction that the Report makes considering the overall stable operation at home thanks to the "no-sharp-turn" macro policy and the increasing uncertainty abroad. Internationally, the recovery of demand in major European and American economies will continue to underpin China's external demand, while the production resumption there is expected to weaken the effect of staggered growth China's exports are benefiting from. China may show a widened balance of payment, as countries across the world roll out varying economic stimulus packages in terms of intensity, timing, and effect. The US Senate's *Strategic Competition Act of 2021* may escalate the game among major powers. As shown by internal policies, the revenue in the national general public budget and the revenue of the government-managed funds nationwide posted an upward cumulative year-on-year growth rate quarter by quarter, but the recovery in economic entities still needs the continuous support of fiscal policies such as tax cuts. Besides, China faces more, not less, pressure from the expenditures in such fields as the drive to ensure stability on six major fronts and security in six major areas, the improvement to people's well-being, and technology. Therefore, there will still be a fiscal "decrease in revenue and increase expenditure". Under the fiscally tight-balanced circumstance, local government special-purpose bonds play an increasingly prominent role. In the first quarter, the monetary adjustment results were "in stable volume and fair price", and the monetary policy tried to remain neutral in the turn. Future liquidity adjustment may be based mainly on open market operations (OMO), medium-term lending facilities (MLF) and deposit reserve. Macroeconomic policies will overall continue to consider both stabilizing growth and preventing risks. Based on the policy stability, China may grow by 8.8% throughout 2021, and the output gap may disappear in 2022.

The report recommended that the short-term allocation ratio for major asset categories should be: commodities>stocks=bonds>gold. Stock market volatility may increase in the second quarter. In 2021, a year when aggregate financing contracts and financing environment tightens marginally, it is suggested to prefer individual shares over indexes, and make choices carefully by considering economic fundamentals. The bond yields may move up with fluctuation in the short term, but there is limited room for them to go up. Overseas economies continue to recover, and developments in commodities are still promising in the short term. The industrial sector benefiting from the economic recovery presents great certainty, and the opportunity to be long gold hasn’t come yet.

To obtain the full report, please call our Customer Service Hotline +852-2860 7111.

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