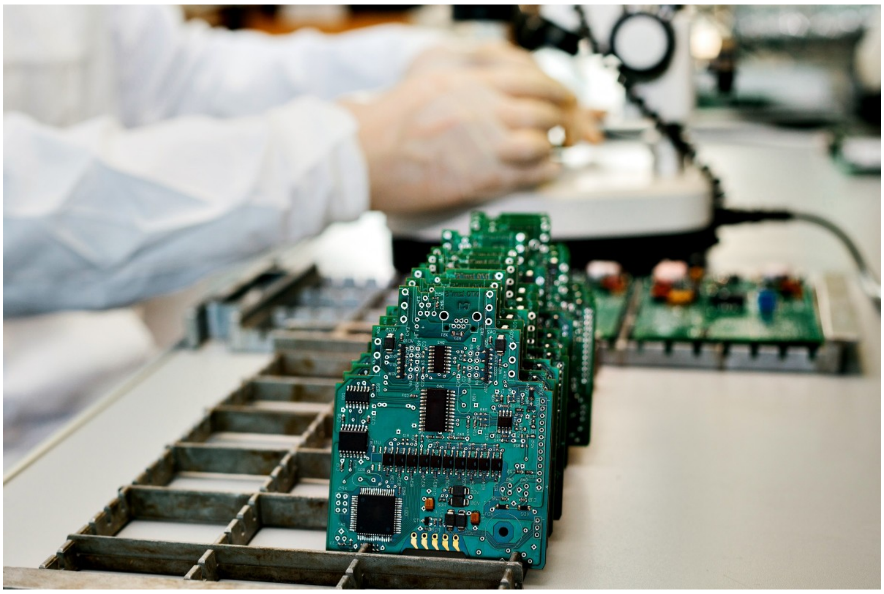
China: forget the super fast GDP growth, focus on chip shortage

High GDP growth in 1Q21 was a mix of base effects and genuine recovery. Without such base effects, China's GDP growth will appear more moderate over the rest of the year. Activity data shows that China is on a recovery path. The main risk concerns chip shortages, which could limit production and export growth in the coming quarters.



Don't be overwhelmed by the high GDP growth figure

China's GDP growth was 18.3%YoY in 1Q21, our estimate was 12%YoY, which was the lowest estimate among economists in the survey, the highest estimate was 22%. The apparent strength of these figures relies on powerful base effects from last year's first quarter (-6.8%YoY in 1Q20). A slight difference in GDP levels estimates results in very different %YoY outcomes, so it is not appropriate to get overwhelmed by what looks like a high growth data release.

Apart from base effects, there was some recovery of activity in the Chinese economy. But again, we need to read those growth numbers with caution.

Chip shortage is a risk to investment, production, exports and domestic sales.

- **Fixed asset investments** in 1Q21 (25.6%YoY in March) were dominated by railway infrastructure (66.6%YoY YTD) and technology-related investment (40.4%Yoy) aimed at improving cross-city / cross-province transportation networks and building faster momentum in technology R&D to achieve technology self-reliance. This will continue. We expect investment in technology to keep going as this is still important for China's future growth. But chip shortages may delay the process of both digital and transportation infrastructure.
- **Industrial production** (+14.1%YoY) was moderate compared to other activity measures due to slower export demand for clothing, slower production of smart devices (which could also be due to chip shortages), and tighter anti-pollution policies on commodity refineries.
- **Retail sales** (34.2%YoY) continued to recover well. Catering (+91.6%YoY), which is still affected by social distancing measures, has recovered to pre-Covid level. As international travel is still restricted and consumers are compelled to spend within China. We have to keep in mind that once international travel re-open, Chinese households will spend on overseas trips again, and domestic sales on luxury items could return to a lower level. Chip shortages could also affect retail sales.

Looking forward: moderate growth, China-US relationship, chip shortage, monetary policy

There are several points we would like to highlight for the rest of 2021 on the Chinese economy.

1. The high GDP growth in 1Q21 will not persist over the rest of the year. Most quarters should experience moderate growth because without base effects to swell the comparison, “super-high” growth will be very hard to repeat. Quarter on quarter growth rates should continue to stabilise between 1% to 2%. Domestic consumption will continue to be the stabiliser of the economy, and digital infrastructure investment will be the backbone of future growth.
2. China-US relations will be critical for China's economic growth, mostly in technology development. It is likely that the US will continue to put more pressure on China on this topic.
3. Concern about chip shortages is becoming a practical issue for businesses, from investment to production to exports and domestic sales. How long this bottleneck will take to clear is unclear.
4. We don't think there will be any tightening of monetary policy. The central government has restarted deleveraging reform focusing on the weak cash flow of real estate property developers. So, there is room for a relaxation of monetary policy. Moreover, as the economy is recovering, too relaxed a monetary policy stance could induce asset bubbles rather than boosting investment in the real economy.

Forecasts

Our GDP forecasts are 5.5%YoY, 5.0%%YoY and 5.5%YoY for 2Q21, 3Q21 and 4Q21 respectively.

And therefore, the full-year forecast has changed to 8.6% from 7.0%.

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