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HANG SENG BANK

China Macro Monthly

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Key macro indicators (%)

	2020	2021forecast
GDP	2.3	7.5
Inflation	2.5	1.6
Consumption	-3.9	8
Investment	2.9	6.2

Sources: National Bureau of Statistics; Hang Seng Bank China

An estimation: Where did the growth in 2020 come from?

China's GDP growth in 2020 is 2.3%, beyond the expectation of many people. Why does this happen? We need to compare the two ways of GDP calculation, namely production method and expenditure method. The GDP published by Chinese Bureau of Statistics is calculated based on the production method, that is, the total output reported by the primary, secondary and tertiary industries (corresponding to agriculture, industry and service industry respectively). It can be simply understood as total supply. The breakdown shows that the post-pandemic industrial recovery was very impressive, with the growth rate of manufacturing industry in the fourth quarter reaching 7.3%, which is the highest since 2015. The fastest growing service industries are information technology, finance and real estate, together contributing to 60% of GDP growth, while the contribution of these three industries had been remaining at around 20% in the past 10 years.

However, if GDP was estimated according to the expenditure method (the sum of consumption, investment and net export), the implication would be completely different. First of all, consumption comes from residents and the government: in 2020, residents' consumption dropped by 1.6% (which usually accounts for 70% of total consumption). Although the government consumption data has not yet been released, if we assume that its trend is consistent with fiscal expenditure, it would be roughly the same as the previous year's level, so the total consumption is estimated to drop by about 1.1%. Secondly, the investment comes from fixed assets investment (up 2.9%) and inventory. The investment was mainly driven by the government and state-owned enterprises, while the private sector has only turned positive since August, and the increase was limited due to the tight funding constraints. In contrast, the best performance was made by external demand: net exports rose by 27.4% (denominated in RMB). Therefore, according to our estimation, among the 2.3% GDP growth, only 1.3% was driven by domestic demand, with the rest 1% pulled by the external demand.

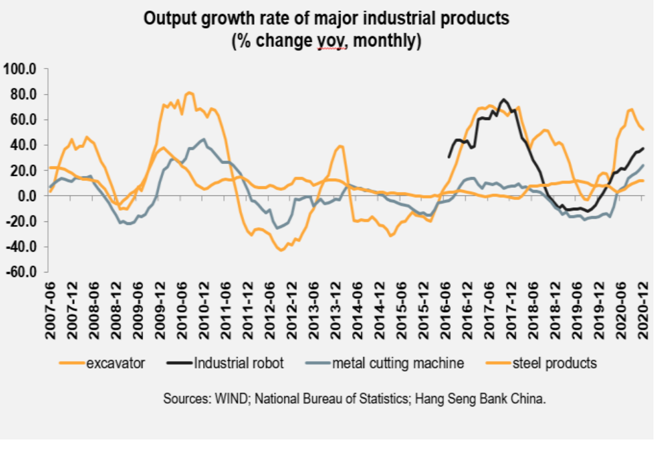
Why does the market generally underestimate the growth in 2020?

Firstly, the net export was underestimated. Due to the weak control of pandemic overseas and the subsequent increasing dependence of the world economy on Chinese production, the export almost maintained double-digit growth in the second half of the year. In the same period, imports were shrinking, which was due to the unrecovered domestic consumption capacity as well as the sharply declined services imports (including overseas study, cross-border tourism and shopping, etc.). Therefore, the difference between the two (net exports) rose sharply and finally contributed 43% of GDP growth, which was never seen in the past decade. The contribution rate of net exports usually fluctuated within the range of plus or minus 10%.

Secondly, the expansion of industrial capacity was underestimated. The industrial investment in 2020 exceeded many people's expectations. Among the investment, some contributed to export to meet overseas demand, with the others converted into industrial capacity and inventory. Breaking down the inventory in 2020, the industries with the fastest inventory growth were mostly concentrated in manufacturing, including electronics, machinery and equipment, pharmaceuticals and furniture. The industries with insufficient inventory were concentrated in the upstream, including mining (especially coal and natural gas) and non-ferrous metals.

The beginning of a capacity expansion cycle?

The expansion of industrial capacity in 2020 was evident, which was reflected in three dimensions: first, digital infrastructure investment (5G base station, big data center); second, traditional infrastructure-related industries covering upstream building materials (steel and cement) and midstream construction machinery (excavators and heavy trucks) and third, manufacturing (machine tools, industrial robots). At the end of 2020, the growth rate of the above industrial outputs climbed to double digits. During the "14th Five-Year Plan" period, China may enter a new stage of industrial expansion booming, and at the meantime, upgrade its infrastructure and manufacturing industries under the background of emission reduction. Historical data shows that capacity expansion period usually comes with the upward trend of interest rates and asset prices.



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