ANDBANK
Private Bankers

Flash note
19/01/2021

Alex Fusté
@AlexfusteAlex
alex.fuste@andbank.com

China will continue to drive global activity in 1H21. Will moderate in 2H. Outlook.

Breakdown of 4Q20 GDP data: The big picture is still that activity will remain strong during the 1H21 and will moderate pace in 2H21.

On the official figures, China's economy expanded at the fastest pace in two years last quarter. GDP grew 6.5% y/y in Q4, up from 4.9% y/y in Q3 (the Bloomberg median was 6.2%). Though the monthly data suggest that growth slowed in December it remains strong and this strength will likely persist during the first half of 2021, before giving way to a weaker second half.

The breakdown of the GDP data shows a pick-up in industry and construction last quarter, but the biggest tailwind was the improvement in service sector growth, from 4.3% y/y to 6.7%.

On a monthly basis, however, the data seen in December were generally a bit weaker than in November, with the services production index dropping back and so too did retail sales. Instead, the industrial activity picked up again to 7.3% y/y (from 7.0% in November).

On the more negative side, Fixed investment expanded at a meagre 2.9% year-to-date, and dragged down the pace of capital spending, that slowed from 9.7% y/y in November to 5.6% in December.

Activity remains strong, which is helping to support the labor market (unemployment rate held steady at 5.2%, the level at which it was at pre-virus). With the labor market largely back to normal, income growth is rebounding and wages among migrant workers expanded at 2.8% y/y.

From all the aforementioned, it can be inferred that the economy will remain robust during the 1H21 as households run down the excess savings they accumulated last year and the tailwinds from last year's stimulus should keep industry and construction strong for a while longer. Favorable base effects will also help keep activity growth rates elevated in the coming months.

Further ahead, and well into the second half of 2021, growth will likely soften as foreign demand for Chinese goods (due to industrial lockdowns in Western economies) will reverse and domestic policy support also starts to be partially withdrawn.

Diplomacy: Tensions between China and the US continue to accumulate in the last phase of Trump's term

Declassified documents (dating from Feb-18) showed principles in which the US operated in Asia Pacific region, including the “vow to defend Taiwan”. Internal administration document showed Indo-Pacific strategy focused on China’s rise, attempting to debunk Beijing's narrative that China regional dominance was inevitable.

The US blacklisted more Chinese entities, now Xiaomi, for its military links along with China National Offshore Oil Corp over its drilling in the South China Sea. This follows December decision to blacklist more than 60 other Chinese companies.

Chinese technology companies - Tencent Music Entertainment Group, online retailer Vipshop Holdings and livestreaming platform Joyy - are seeking secondary listings in Hong Kong in reaction to recent scrutiny from US exchanges.

The Trump administration has notified Huawei suppliers, such as Intel, that is revoking their licenses to sell to the Chinese tech Huawe and the Commerce Department issued intent to deny a significant number of license requests for exports to Huawei.

In parallel, fund and portfolio managers of Western financial entities have been recently required by their respective money laundering departments not to carry out purchase operations on a list of some 35 Chinese companies, based on a North American executive order.

Also, in a joint decision, the UK and US announced import ban on all cotton and tomato products from Xinjiang region over allegations they are made with forced labor from Uighur Muslims. Ban includes products processed in third countries with raw materials sourced in Xinjiang.

By its part, China announced that will strengthen regulation over the rare-earth metals industry in response to ongoing tensions with US. Current regulations focus on production stage mine development, smelting or separation while new draft law seeks to manage "entire industry chain," including refining and product transport to exports, meaning that Beijing could apply the new export control law which strengthens state control over the flow of strategic materials.

In addition, China's foreign ministry announced sanction to US officials who have engaged in "nasty" behaviour over Taiwan. This step comes after Washington’s decision to lift restrictions on contacts between US and Taiwanese officials.

Meanwhile, China tries to regain regional influence through the traditional resource of investments, and has signed an infrastructure deal with Philippines worth $940M for a 71km railway and a CNY500M grant for infrastructure and other projects in Philippines, including $400M bridge project linking Samal island to Davao. China is also pulling 10,000 troops from its border with India, although they could be redeployed within a week.

Biden's focus on climate puts pressure on China's infrastructure program.

Center for Strategic and International Studies member said president-elect Biden's focus on fighting climate makes it harder for China to "greenwash" mega-infrastructure programs, namely its Belt and Road initiative that was launched in 2013. Energy projects, many of them fossil fuel power plants, have been center of initiative and the US still has chance to hold China accountable.

China investors crowding into momentum trades:

Crowded momentum trades in China have pushed stock benchmark near to 13-year high.

Abundance of cash and ultra-low borrowing costs globally are driving savers to stocks, as mutual funds invest the record cash they raised last year.

Momentum trade is beating value, with the gap widening dramatically in January. Spike in turnover, and new money, is compounding the issue.

Financial market outlook

Equities – SHANGHAI Idx: UNDERWEIGHT-MARKETWEIGHT

Equities – SHENZHEN Idx: MARKETWEIGHT-OVERWEIGHT

Bonds – Govies: OVERWEIGHT (10Y Yield target 2.20%)

Forex – CNY/USD: OW (Target 6.25)