

## CHINA UPDATE

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## Export Growth to Slow as Developed-World Consumers Shift Spending Back to Services and Away from Made-In-China Goods

The drivers of 2020's V-shaped recovery have faded

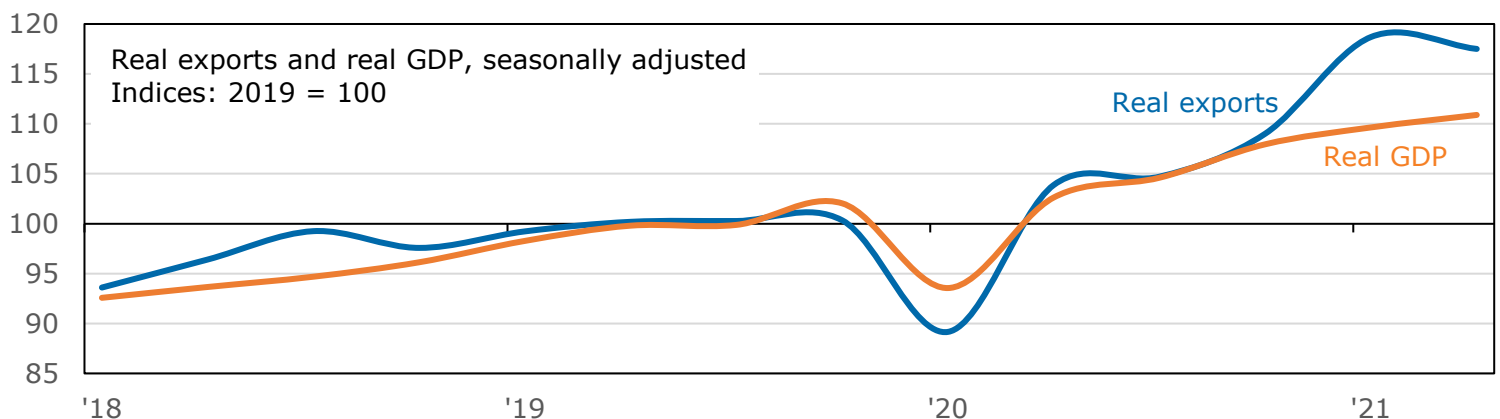
China's economy faces new challenges as its developed-world export markets emerge from the pandemic. After controlling the pandemic's spread in the spring of 2020, China reopened its economy earlier and with fewer restrictions than other large economies. Real GDP plunged 8.7% in quarterly seasonally-adjusted terms in the first quarter of 2020 (not annualized), bounced back to its pre-crisis level in the second quarter of that year, and continued to grow well above trend through the end of 2020. But the expansion lost momentum in 2021, with real GDP growth of just 0.4% in the first quarter of 2021 and 1.3% in the second quarter.

Consumers in developed markets are buying fewer made-in-China goods; China has tapered crisis-era stimulus programs

China's 2021 slowdown is due in part to the pandemic coming under control in advanced economies. In the U.S., Western Europe, and other developed countries, demand for Chinese exports surged in 2020 as governments restricted activity and distributed stimulus, and people spent more time at home. Consumers in these countries redirected spending away from restaurants, travel, entertainment, and other high-contact services, and toward consumer goods—many of which were made in China. As a result, Chinese exports grew much more quickly than real GDP from mid-2020 through early 2021 (See Chart). But consumers in advanced economies began to shift spending back to domestically-produced services in the first half of 2021 as their countries were vaccinated and pandemic restrictions were lifted, sapping demand for goods exported from China.

More contagious coronavirus variants also are contributing to China's 2021 slowdown. China controlled the pandemic much better than most Western countries in 2020 with a combination of mass testing, contact tracing, and strict lockdowns. These measures have kept coronavirus cases orders of magnitude lower than in the U.S., but the Chinese economy's reopening has stalled as delta and other variants prolong the rolling regional lockdowns that drag on services. This was particularly apparent in the first quarter of 2021, when restrictions on travel and activity led to a drop in retail sales ahead of the Lunar New Year holiday. China's reliance on domestically-manufactured vaccines

CHART: AN EXPORT BOOM PROPELLED 2020'S V-SHAPED RECOVERY, BUT IT IS ALREADY FADING



is likely to drag on the service sector recovery, since those vaccines seem less effective than those available in the West.

China used considerably less stimulus against this downturn than the 2008-09 recession

The tapering of Chinese stimulus programs is another reason growth is slowing. As tallied by the IMF, China's fiscal stimulus from the start of the pandemic through April 2021 was equivalent to roughly 5% of 2020 GDP, with another 3% of GDP in liquidity, loan guarantees, and other contingent aid. The U.S. provided roughly 26% of its GDP in direct fiscal stimulus over the same period, and another 2% in liquidity support. China's monetary response was smaller than the U.S.'s too, and much smaller than the response to the 2008-09 downturn. The People's Bank of China (PBoC) cut its 7-day reverse-repo policy rate a modest 0.3 percentage point to 2.2% in the first quarter of 2020, pushing credit growth higher in the second and third quarters of 2020. The ratio of aggregate credit provided to nonfinancial borrowers and Chinese GDP increased 26 percentage points during the pandemic, much less than its 41 percentage point increase during the 2008-09 downturn, and also much less than the 49 percentage point increase in the United States between the fourth quarter of 2019 and the second quarter of 2020. The People's Bank of China has signaled since the second quarter of 2021 that they would "maintain growth of the money supply and aggregate financing at a rate basically matching nominal GDP" for the full year of 2021, meaning a neutral monetary policy stance.

Chinese monetary policy to stay neutral as the Fed gets closer to withdrawing stimulus

Rising inflation will prevent the PBoC from loosening monetary policy in response to weaker trend growth. Huge swings in pork prices kept headline inflation low in the first half of 2021; pork in the CPI basket (historically a large driver of food price inflation) rose more than 100% year-over-year between January and March 2020 and fell 43% in the same terms in July 2021. But inflation will pick up in the fourth quarter of 2021 and into 2022 as pork-related base effects fade; meanwhile, fuel prices were up 25% year-over-year in July, which will pass through to higher prices of other consumer goods and services in coming months. The surveyed unemployment rate in urban areas fell to 5.0% in May and June, its lowest since the second quarter of 2019; Chinese authorities are less concerned by unemployment than they were at the beginning of the year. As a result the PBoC will keep growth of aggregate financing growth at around 11% in year-ago terms in the second half of 2021 and in 2022, necessitating another 0.5 percentage point cut to the reserve requirement ratios (RRR) for commercial banks in 2022.

The yuan is forecast to depreciate modestly, ending 2021 at 6.60 per U.S. dollar and ending 2022 at 6.75, as the Federal Reserve tapers its quantitative easing program and draws nearer to raising the Federal Funds rate.

#### CHINA BASELINE FORECAST TABLE, THIRD QUARTER OF 2021

	1Q'21a	2Q'21a	3Q'21f	4Q'21f	1Q'22f	2Q'22f	3Q'22f	4Q'22f	2020a	2021f	2022f
Real GDP, Y/Y%	18.3	7.9	7.5	7.5	7.6	7.3	6.4	5.9	2.3	10.1	6.9
Industrial Production, Y/Y%	24.5	9.0	8.0	7.0	6.8	6.4	6.0	5.0	2.8	10.3	6.0
Fixed Asset Investment, Cumulative YTD, Y/Y%	25.6	12.6	10.0	9.0	5.0	6.0	7.0	7.0	2.9	9.0	7.0
CPI Inflation, Quarterly/Annual Average, Y/Y%	0.0	2.5	3.4	3.3	3.1	2.5	2.0	1.5	2.5	2.3	2.3
PPI Inflation, Quarterly/Annual Average, Y/Y%	2.8	10.0	8.0	7.0	7.5	1.0	1.2	1.5	-1.8	7.0	2.8
Unemployment Rate, Surveyed Urban Areas, % NSA	5.3	5.0	5.1	5.1	5.2	4.9	5.0	5.0	5.6	5.2	5.0
Money Supply M2, Period-End, Y/Y%	9.4	8.6	8.0	7.5	8.2	8.0	7.9	7.9	10.1	8.4	8.0
7-Day Reverse Repo Rate, Period-End, %	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20
1-Year Deposit Rate, Period-End, %	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
1-Year Loan Prime Rate, Period-End, %	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
Reserve Requirement Ratio, Period-End, %	12.5	12.0	12.0	12.0	11.5	11.5	11.5	11.5	12.5	12.0	11.5
Yuan per US dollar, Period-End	6.57	6.46	6.55	6.60	6.65	6.70	6.72	6.75	6.53	6.60	6.75

Table sources: Bloomberg, China National Bureau of Statistics, People's Bank of China, China Customs, PNC Economics

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