China

Outlook

	Average 10-14	2015	2016	2017	2018	2019	2020	Forecasts 2021	Forecasts 2022
GDP growth (%)	8.6	7.0	6.8	6.9	6.7	6.0	2.3	8.3	5.6
CPI Inflation (%)*	2.3	2.7	1.7	1.5	0.1	0.7	1.7	1.3	1.7
Fiscal balance (% of GDP)	-0.5	-2.8	-3.7	-3.8	-4.7	-6.3	-11.4	-9.6	-8.7
Public debt (% of GDP)	35.8	41.5	48.2	51.7	53.8	57.1	66.8	69.6	73.7
Reference rate (%)*	6.0	4.9	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Exchange rate (RMB/USD)*	6.4	6.3	6.6	6.8	6.6	6.9	6.9	6.6	6.4
Current balance (% of GDP)	2.4	2.7	1.8	1.6	0.2	1.0	2.0	1.6	1.3
External debt (% of GDP)	12.6	11.1	11.4	12.0	13.1	13.5	14.0	14.2	14.4

Note: * Annual average.
Source: CaixaBank Research, based on data from national statistical agencies and the IMF.

- **China will prioritise financial stability over growth in 2021.** The economy has bounced back strongly from the pandemic and expects to grow above 8% in 2021. This robust growth provides scope for less expansionary fiscal and monetary policies, which seek to establish the financial stability of a China that wants to be a major player in the global economy. That is why China has the distinction of being the first major economy to grow clearly, while imposing the toughest financial conditions. China is the leading economy on the planet in terms of purchasing power parity and the second in current dollars (somewhat below 20% of world GDP, in both cases), but it has three unresolved issues. Firstly, it seeks to achieve more balanced and quality growth. Thus, the principle of what is known as "dual circulation", expressed at the 14th Congress of the Chinese Communist Party, seeks to give greater weight to private consumption over state investment in infrastructure and prioritise quality exports. The second is to reduce technological backwardness that evokes bitter memories of the past. China has started to reduce the lag in chip manufacturing, evidenced by the technological decoupling imposed by the US (China's goal is to be self-sufficient by 2030). Longer term comes the third and final issue, that of putting up with China's global primacy, which involves managing the rivalry with the United States in a non-disruptive way, guaranteeing stability in the region and consolidating the improvement in the quality life of its citizens.

- **Real shock of COVID-19.** Considering the origins of the pandemic, China had an undeniable success in its containment. Although the official incidence data may be underestimated, the truth is that China was the only major economy that grew in 2020 and the latest mobility figures (passengers on the metro in the eight largest cities, congestion rates) show a full recovery to pre-pandemic levels. China has also developed its first vaccine and during 2021 will continue to benefit from the export of medical supplies to the rest of the world. Other emerging economies have suffered devastating economic and health effects from the pandemic and are far from having overcome them (India is a clear example).

- **Financial vulnerabilities**

  - The strength of the financial system will be the main concern of the Chinese authorities in 2021 and 2022. China's debt (Government and non-financial private sector) exceeds 280% of GDP, more typical of an advanced economy than an emerging one. Efforts to contain its growth have been remarkably successful since 2016, especially in reducing shadow banking, but bad debt remains concentrated in state-owned heavy industry conglomerates. The policy of pursuing defaulters began at the beginning of 2020 but was interrupted by the pandemic. The recovery in activity made it possible to tighten financial conditions again in the second

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Outlook (continued)

half of 2020. Defaults then increased, including major names such as Yongcheng Coal (the coal company with the highest profits in the country) and Shandong Ruyi (owner of Lycra), while yields on AAA bonds (a 4 trillion dollar market) rose 40 bp in a week. The regulator's zeal paid off though. At the start of 2021, quality of debt showed a tentative improvement and the inclusion of Chinese debt in the influential Russell FTSE index (effective in October 2021) was confirmed, which is expected to lead to an automatic readjustment of portfolios in favour of Chinese debt.

- Antitrust legislation on Chinese tech giants, desirable to a certain extent, and the preference for financial stability over growth brought a manageable correction in the Shanghai, Shenzhen and Hong Kong stock market indices. But if antitrust legislation leads to excessive state control, it would stifle growth in the most dynamic sector of the Chinese economy and could have less manageable stock market effects.

Economic policy response

- **Fiscal policy.** The expansionary fiscal policy in 2020, adequate but well below the 2008 stimulus, focused excessively on public investment and there was no direct aid to consumers.
- **Monetary policy.** With the recovery, the People's Bank of China (PBoC) revised its expansionary monetary policy to one more accommodating to growth conditions. But the PBoC made it clear that, after the monetary tightening at the end of 2020, a gradual monetary policy will be followed without sudden changes.

Evolution of the exchange rate. The strength of the renminbi (RMB) will continue in 2021, supported by strong growth and capital inflows. Investments by Chinese companies abroad are offset by the influx of foreign portfolio investors and the strength of direct investment. This has already helped the RMB to appreciate 6.7% against the dollar in 2020. The foreign sector, with exports that will benefit from the global economic recovery and that will offset the increase in imports due to the rise in prices of commodities, will also support the RMB.

Main risks

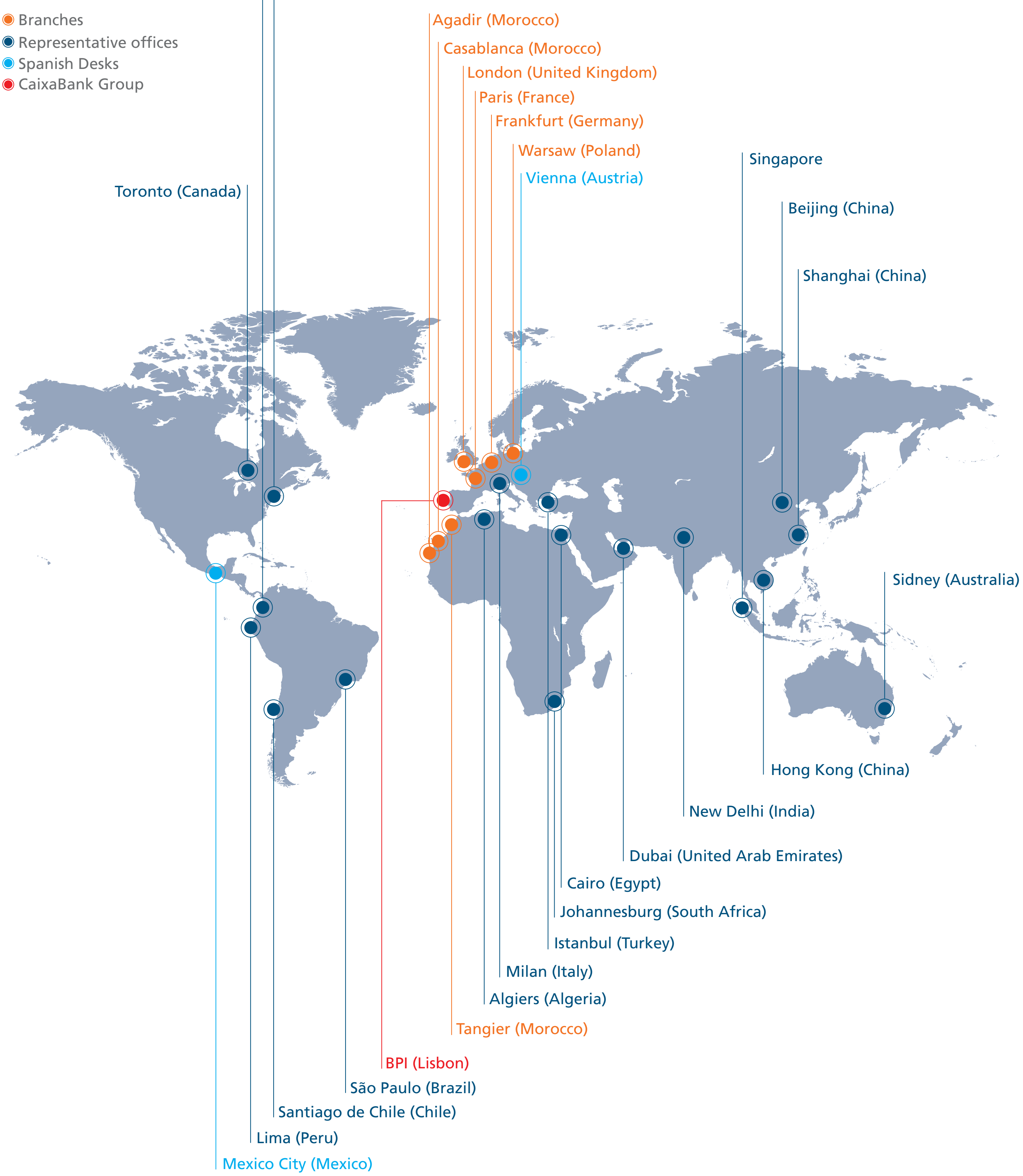
Political balances. Internal political stability will be assured in the coming years with the continuity of leader Xi Jinping, whose main objective is stability in every respect and our central scenario is that Xi will achieve it. But China's effort to regain its central place in global geopolitics entails external risks (of confrontation, albeit mild, with the United States; more tense with regional rivals in other geographical areas, and, in specific aspects, such as rights humans, with Europe). However, China is strongly incentivised to find a balanced path, which makes its global repositioning and improvement in quality of life compatible with human rights and good relations with the other major economies on the planet. A lot depends on it, starting with the Pearl River Bay macro-project, which can make Hong Kong and Guangzhou one of the most flourishing regions on the planet.

Public and corporate debt. A possible sustained recovery in the debt yields of the large economies would diminish the attractiveness of Chinese debt and could reduce the financial inflows of recent years. State conglomerates, the main drivers of bad debt growth, have not been the target of the zeal applied to tech giants and will continue to be at the epicentre of China's debt problems.

	Rating	Last changed	Outlook	Last changed
Standard & Poor's	A+	21/09/17	Stable	21/09/17
Moody's	A1	24/05/17	Stable	24/05/17
FitchRatings	A+	06/11/07	Stable	06/11/07

■ Indicates that the country is rated as "investment grade".
□ Indicates that the country is not rated as "investment grade".

CaixaBank in the world



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