



# CHINA BEIGE BOOK

*Independent Data. Actionable Insights.*

## Facts vs Expectations: The Misunderstood Path of China's Economy Into 2022

September 22, 2021

Since Covid hit China in early 2020, conveying a clear macroeconomic view has been difficult, not least because of nonsensical year-over-year comparisons. It's only this quarter that trends are becoming clear, with CBB's Q3-21 data showing China's recovery from the pandemic is ending and evidence on the economy's 'new normal' piling up. Be it prospects for growth, consumption, or stimulus, the real story is not what most analysts have been telling you.

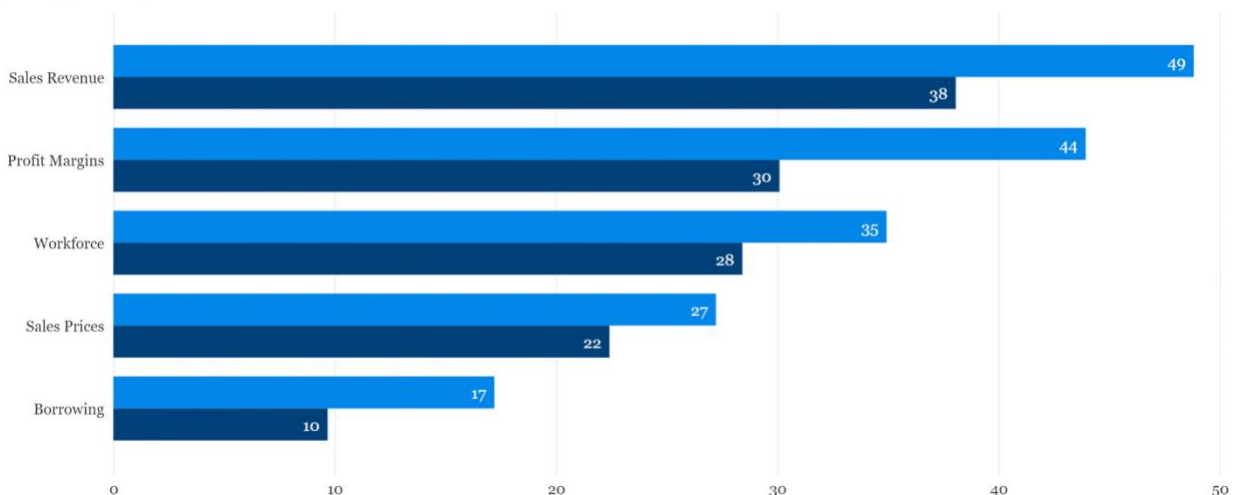
Importantly, this should also serve as a corrective to market expectations for 2022.

### 2020-21: Consensus Retail & Stimulus Forecasts Miss the Mark

There is little disagreement that China's mid-2020 Covid recovery was overwhelmingly driven by industry, with retail and services lagging. Yet for many it was an article of faith that this imbalance would not last, predictions rife that we would see consumer spending catch up in 2021 as the recovery spread. **China Beige Book data told a different story.** Deeming this "[Another False Retail Dawn](#)," we dismissed the notion that a consumer boom was imminent. Our data into mid-2021 showed sharply decelerating retail revenue and profits, weakening sales price gains, and the lowest level of borrowing in CBB history. Retail has gone nowhere.

### Chart 1: Retail Headline Performance Metrics (Diffusion Index)

● 2021-Q1 ● 2021-Q2

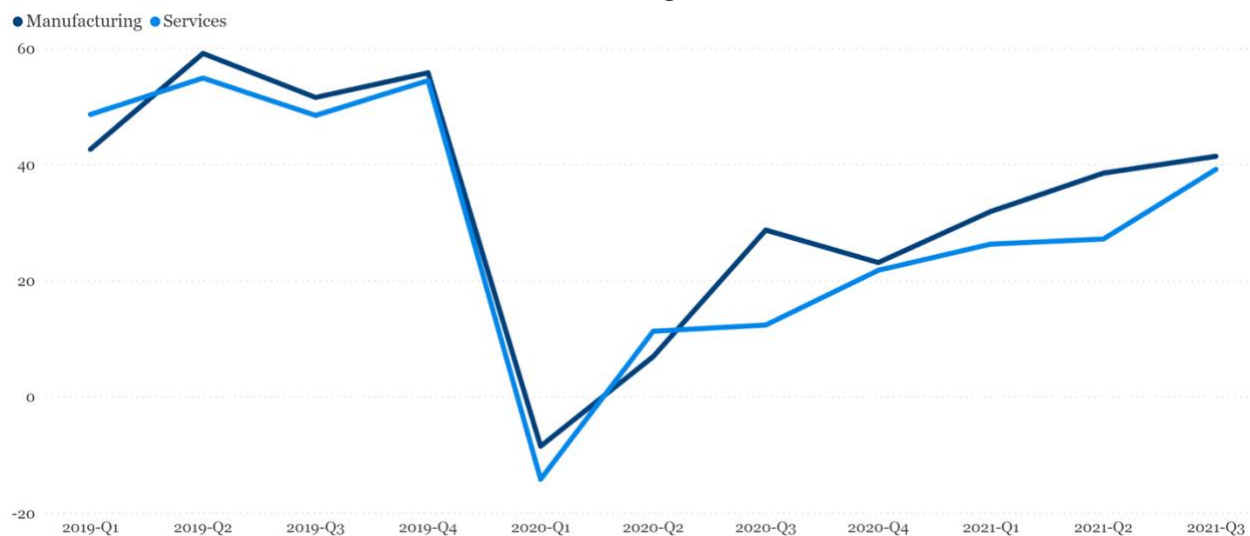


Yet this miss had a cascade effect. **When the consumer spending surge never materialized, market sentiment flipped in summer 2021**, with July's RRR cut further contributing to the notion that policymakers were now on the defensive. The new consensus: China's economy must be in trouble! And that, of course, necessitates more aggressive stimulus.

With the Beijing Olympics in early 2022 and the critical 20<sup>th</sup> Party Congress following next fall, it is likely the Party will find it useful at some point to ease monetary conditions. **But these are political considerations based on a political calendar.** There is no sign of easing now, more the opposite.

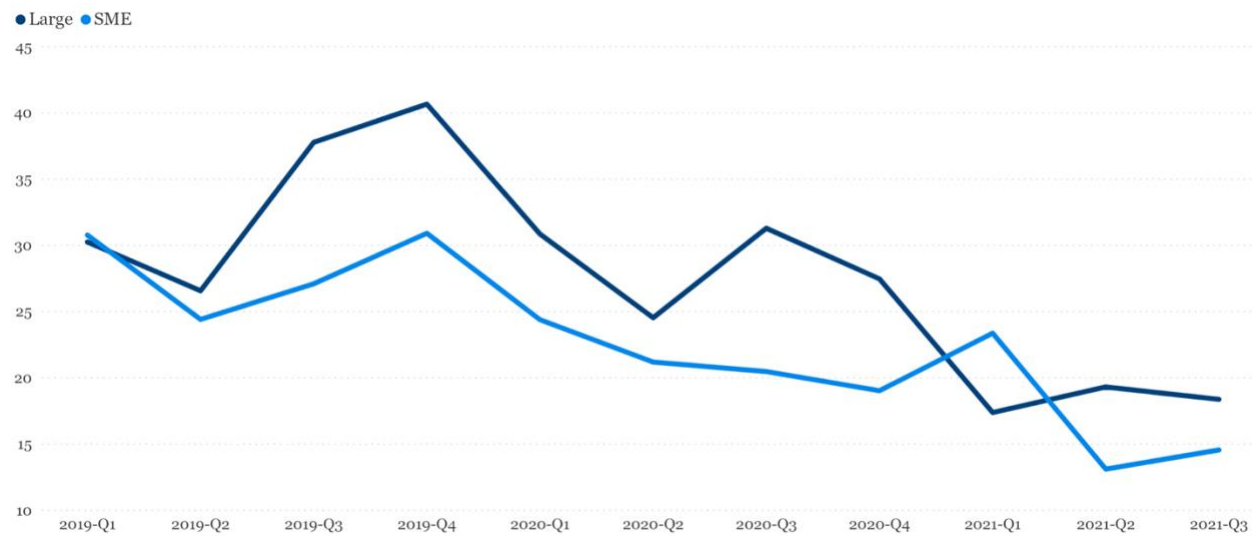
This second miss – on quick stimulus – continues to flummox analysts, but it shouldn't. After all, the idea that a weakening economy has generated pressure on Beijing to stimulate is flawed, for the simple fact **the economy has not been doing as poorly as commonly thought.** As CBB data show, while the consumer story remains a disappointment, other key areas, including much-discussed services employment, are still doing well enough.

**Chart 2: Workforce Growth Across Manufacturing & Services**

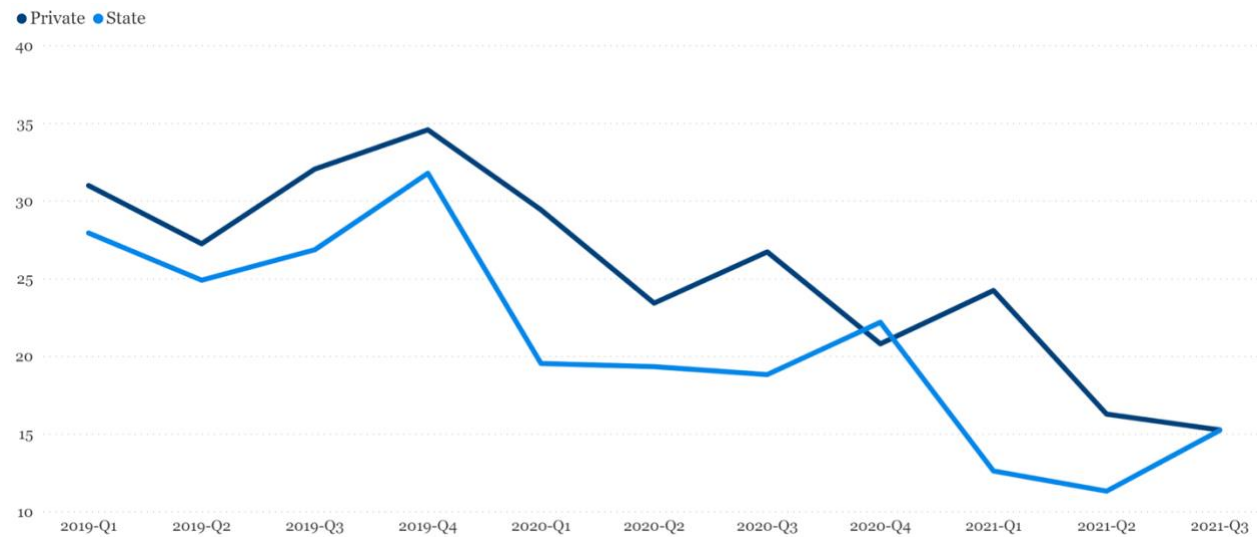


This has allowed the central government to finally do what it said it was going to do – address financial risk by capping credit expansion. Sure enough, **third-quarter credit conditions remain relatively tight**, defying the broad expectation of monetary policy capitulation.

**Chart 3: Corporate Borrowing: Large Firms vs SMEs**



**Chart 4: Corporate Borrowing: State vs Private Firms**

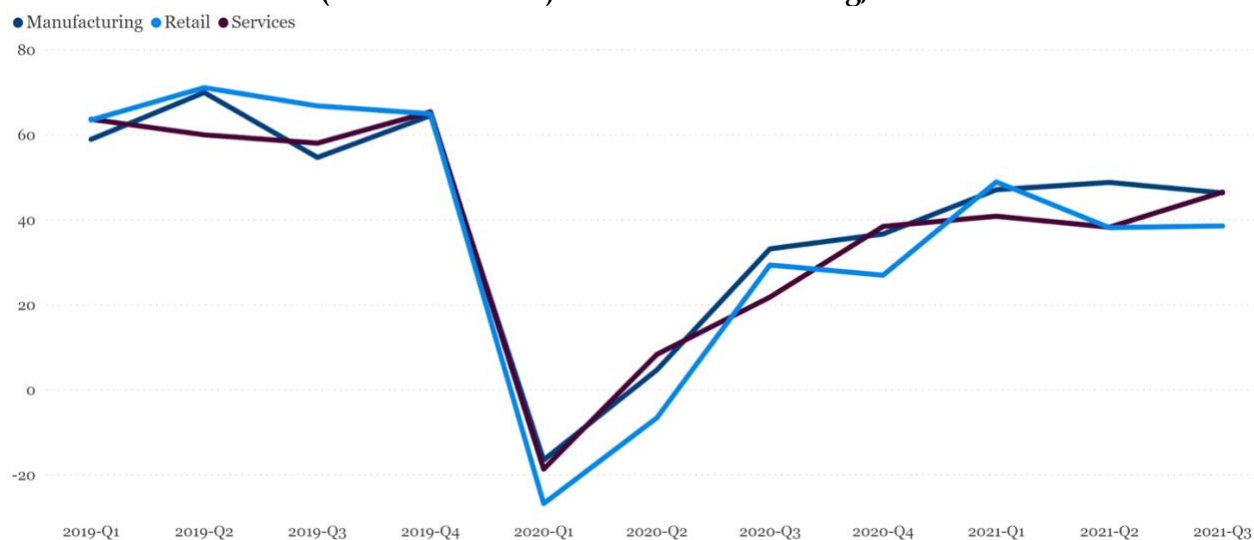


## Xi's View of 2021

Looking forward, we see similar mis-assessments.

The recovery from Covid – the initial bounceback – is over. New CBB data show that manufacturing has peaked, Property is past its short-term peak (see our [Evergrande/Property note](#)), and both retail and commodities have lost at least their near-term momentum. Job growth continues, but at a snail's pace. It's true that there's been almost no topline improvement in economic growth over the past half year.

**Chart 5: Sales Revenue (Diffusion Index) Across Manufacturing, Retail and Services**



**But this is far from the popular narrative of a flailing economy.** Investors are clearly unhappy with the Party’s recent policy crackdowns, and the implosion of Evergrande means that parts of the property sector are headed for a period of pain and restructuring.

**Beijing, however, has its own lens through which it views its stewardship of the economy.** In late 2020, a decision was made to discontinue the looser conditions created for Covid recovery. **This is being accomplished.** In mid-2021, the Party decided to curb excessive growth in the property sector, and **it is accomplishing this too.**

Dangerous inflation was supposed to be 2021’s greatest challenge, yet producer prices have not reached consumers, slashed into profits, or affected international competitiveness. Our Q3 data say sales price and wage inflation are presently muted – **another accomplishment.** This makes politically-timed 2022 stimulus more palatable, and is another reason for Beijing to judge 2021 as more successful than outside critics.

## Shift Your Expectations for 2022 & Beyond

China’s 2021 economy has proven unequal to the powerful growth story that many analysts forecasted back in the congratulatory days of 2020. **But that story was never realistic.** Nor is the latest narrative correct in its fixation on deep, short-term trouble. Instead, the Party is for now most concerned about instability from systemic problems, such as perceptions of wealth inequality, rather than growth-for-growth’s sake. Greater stimulus is coming, but not due to the flawed belief that the economy requires it.

Investors may be seeing red, and foreign analysts may assign poor marks. **But CBB data say the Party is likely pleased with its results to date.** Stimulus is less urgent, and medium-term growth will be more subdued, than market consensus is expecting. If the paradigm has truly shifted, this may be the death knell of Beijing's traditional growth model. **You should be preparing for a different type of Chinese economy in 2022 than the one you've long been accustomed to.**

