GENERALI INVESTMENTS

Market Commentary

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Macro & Market Research, Generali Insurance Asset Management S.p.A. SGR

China's Q1 GDP growth: Strong year-on-year growth amid weak momentum

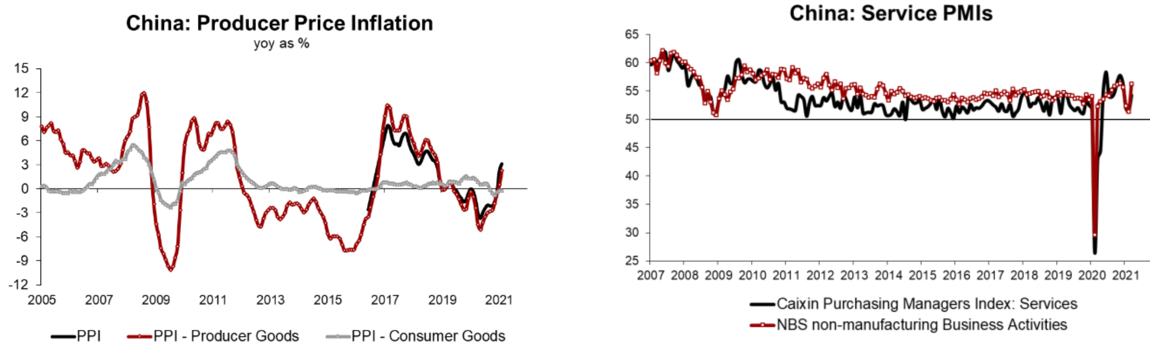
- **China's Q1 GDP growth accelerated to 18.3% yoy while the growth momentum was the lowest on record (except Q1 2020).**
- **We expect it to normalise in Q2 while yoy growth could cool into a range of 7% to 8% yoy.**
- **These fluctuations are embedded into a generally less supportive monetary and fiscal stance.**
- **The PBoC already slowed money expansion. We expect the bulk of withdrawal of fiscal support only after the 100th anniversary of the Chinese Communist Party on July 1.**

This morning, China's statistical office published its Q1 2021 GDP growth estimate alongside with other monthly real activity data for March.

GDP growth accelerated from 6.5% yoy in the final quarter of last year to **18.3% yoy**. The year-on-year comparison comprises significant base effects as China's economy slumped by -6.4% yoy in the first quarter last year amid the Covid-19 shutdown of large parts of the economy. At the same time, **on a quarter-on-quarter basis, sequential growth dropped back to its weakest pace (except for Q1 2020) over the last decade with 0.6% qoq** The weakness had been visible in the development of manufacturing and service PMIs especially in January and February. In part they had been hit by the (limited) Covid-19 outbreak prior to the Chinese New Year, which led to large cancellations of travel and renewed uncertainty. Moreover, the catch-up during the recovery phase has largely run its course. Service PMIs rebounded in March, but manufacturing PMIs failed to provide a clear signal. Overall, **we expect the growth momentum to normalise in Q2** from the low level in Q1 (notwithstanding new Covid-19 outbreaks). Overall, this normalisation **will be embedded in less government support** from monetary and fiscal policy over the year. While separate monetary data earlier this week showed the PBoC to slow money growth a bit, we see the bulk of the withdrawal of fiscal support only after the 100th anniversary of the founding of China's Communist Party (CCP) on July 1. We expect Q2 yoy growth to cool amid weakening base effects into the range of 7%-8% and stick to our view of a growth rate of 8.4% in 2021. However, **risks are now a bit tilted to the downside** given the soft sequential growth in Q1. Other risk factors could prove manufacturing inflation and more drastic measures to cool the property sector.

Looking into the details, real Q1 growth was mainly driven by the manufacturing sector which expanded by 24.4% yoy while the service sector stayed behind with 15.6% yoy. This confirms the view that the growth

momentum was predominantly hampered by the Covid-19 outbreaks. Nominal growth advanced to 21.2% yoy, which implies a GDP deflator of 2.9% yoy. This is a significant increase from 0.5% yoy in Q4 and mainly driven by the manufacturing sector (3.3% yoy), given the recent (global) rise in producer input prices. The implicit deflators in the primary sector (agriculture, extraction) rose by 3.2% yoy and in the service sector by 2.6% yoy. Separate data earlier this week had shown PPI inflation to advance to 4.4% yoy. However, the spill-over to CPI inflation is typically low. In fact, CPI inflation dropped by 0.5% mom which is the typical price pattern around the Chinese New Year. On a yoy basis, CPI inflation is still low at 0.4% yoy.



With regard to monthly indicators, the impact of base effects generally eased from the Jan-Feb peak but are still blurring the data. IP growth slowed from 35.1% in Jan-Feb to 14.1% in March (compared to a Reuters consensus forecast of 17.2% yoy). The pace of IP expansion looks basically comparable to last month with some fluctuations due to less working days. A significant driver was exports which moderated but are still very healthy. Fixed asset investment growth eased from 35.0% in Jan-Feb to 25.1% in March. Underlying, investments have likely quickened a bit, led by infrastructure investment. Property investment remained strong and housing inflation picked up further (4.6% yoy). Given the 3-red lines approach (a policy approach published in autumn last year) shadow funding channels to finance property purchases will come under even more scrutiny and the sector will likely soften, going forward. Finally, retail sales growth picked up from 33.8% in Jan-Feb to 34.2% in March, despite less dominant base effects. This is in line with services PMIs rising significantly in March.

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