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Topics China's economic is expected to accelerate again in 2021

China's economic growth slowed in the January-March period due to tighter restrictions on activities and government measures to curb overheating. However, the pace of recovery is expected to accelerate again in the April-June period, supported by the easing of restrictions on activities and an increase in exports.

■ The pace of growth has slowed

In China, the pace of economic recovery slowed as the quarter-on-quarter real GDP growth rate for the January-March period dropped to 0.6% from 3.2% in the previous period (real GDP grew 18.3% year on year).

As a background to this, it can be pointed out that restrictions on activities have been strengthened. Since the beginning of this year, as the number of new coronavirus cases has increased, the government has once again restricted the movement of people across provinces, cities, and autonomous regions. The government also called for people to refrain from returning to their hometowns during the Chinese New Year.

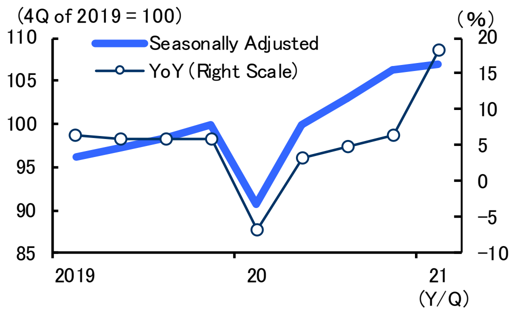
As a result, crowds in the city decreased again, and the number of subway passengers during the first half of February 2021 in Wuhan, Guangzhou, and Shanghai dropped to 50%, 60%, and 70%, respectively, compared to that during the first half of January 2020.

Because local governments took measures to stimulate consumption, such as the distribution of local gift certificates and tickets to local tourist spots, the downward pressure caused by activity restrictions was alleviated to some extent. However, personal consumption, which had been on a recovery trend, fell slightly in January and February.

It is also noteworthy that the government's measures to restrain overheating in the real estate market have begun to be effective in some areas. In the past, there was a bubble in the real estate market as land acquisition by real estate development companies rapidly increased and real estate prices soared in response to monetary easing triggered by the economic downturn due to COVID-19. Against this backdrop, the government has introduced a series of measures to curb overheating, including tighter regulations on housing purchases, stricter conditions for financing by real estate developers, and regulations on the total amount of housing loans.

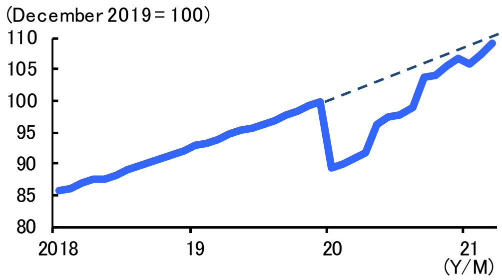
As a result, the acquisition of land by real estate developers has been restrained since the beginning of this year, and has fallen to a level lower than that prior to the outbreak of COVID-19. However, due to the economic recovery and low interest rates, households' willingness to invest in housing has been strong, and housing sales as measured by floor space have remained at a level significantly higher than that prior to the outbreak of COVID-19. Among 70 major cities, the prices of newly built houses rose in 62 cities in March, an increase of six cities from the previous month. This indicates that there has been an upward trend on the whole. Under such

＜Real GDP＞



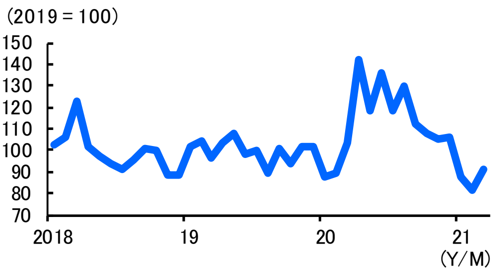
Source: Prepared by The Japan Research Institute, Limited, based on "System of National Accounts" by the National Bureau of Statistics of China

＜Retail Sales (Seasonally Adjusted)＞



Source: Prepared by The Japan Research Institute, Limited, based on "Total Retail Sales of Consumer Goods" by the National Bureau of Statistics of China
Note: Prepared based on seasonally adjusted month-over-month figures announced by the government

＜Land Area Acquired by Real Estate Developers (Seasonally Adjusted)＞



Source: Prepared by The Japan Research Institute, Limited, based on Wind Database
Note: Major 100 cities

circumstances, the government is stepping up measures to curb overheating housing demand and real estate prices.

■ The pace of recovery will accelerate again

Looking ahead, the pace of economic recovery is expected to regain lost ground, driven by personal consumption and exports. In fact, personal consumption is picking up, with retail sales in March surging 1.8% from the previous month. As the number of new coronavirus cases remained low, the government relaxed restrictions after the Chinese New Year, and crowds in the city have almost returned to pre-coronavirus levels.

The recovery in personal spending is expected to continue due to the government's measures to stimulate consumption, improvements in the employment and income environment, and the reversal of accumulated savings. Specifically, the government announced that it would expand subsidies for the purchase of cars, home appliances, and furniture in rural areas, and local governments also announced subsidies to promote sales of electric vehicles for local manufacturers. In March, the unemployment rate fell to pre-coronavirus levels at 5.3% and disposable income bottomed out. Taking into account the easing of restrictions on activities, the accumulated savings are expected to be directed to consumption going forward.

In addition, with the continued growth in global demand for information and communications equipment, the U.S. economy is expected to heat up due to additional economic measures and the progress made in COVID-19 vaccination programs. Therefore, the continuing trend of growth in exports is also anticipated to provide economic support.

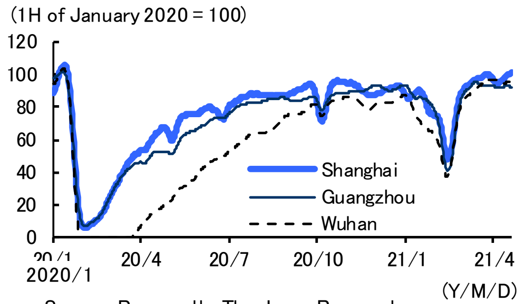
However, fixed asset investment is expected to slow down due to the government's restraint measures, particularly in areas where there is overheating. At present, capital goods imports are increasing at a pace much faster than the conventional expansion trend, and the rate of credit growth exceeds the economic growth rate, indicating overheating in capital investment and finance.

Against this backdrop, the government intends to curb investment and credit. At the National People's Congress (NPC) in March, the government set this year's goal of keeping the ratio of total social loans outstanding to GDP unchanged from the previous year, and also set a target for 2021 to 2025 in the 14th Five-Year Plan. In March, financial authorities ordered banks to tighten their lending.

As described above, while the growth of capital investment is forecast to slow down, it is predicted that personal consumption and exports will continue to expand steadily. The real growth rate in 2021 is expected to be high at 9.0%, reflecting a large upward revision of quarterly GDP statistics. In 2022, policy guidance that takes into account the balance between consumption and investment will likely result in a growth rate of 5.1%, the same level as the potential growth rate.

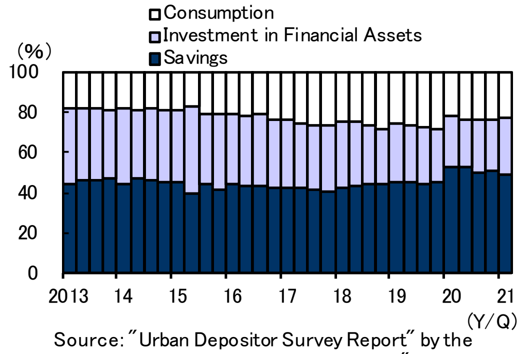
(Shinichi Seki)

<Number of Subway Passengers (HP Filter)>



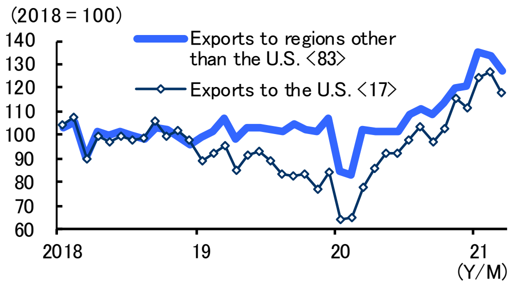
Source: Prepared by The Japan Research Institute, Limited, based on "Subway Passenger Volume" by Wind Database

<Household Consumption, Savings and Investment Appetite>



Source: "Urban Depositor Survey Report" by the People's Bank of China Note: Survey on "Which Item Was Increased." The survey covered 20,000 households nationwide.

<Exports by Region (Seasonally Adjusted, U.S. Dollar Basis)>



Source: Prepared by The Japan Research Institute, Limited, based on "Trade Statistics" by the General Administration of Customs Note: Figures in < > indicate share in 2020.

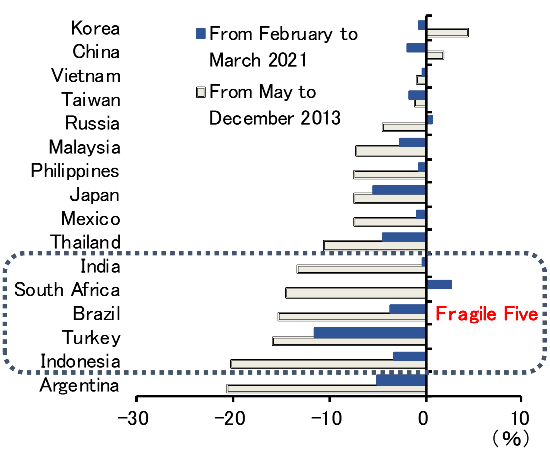
Topics Asian FX market stability will be tested in the post-COVID-19 era

The risk of turmoil in Asian forex markets has declined since 2013. However, if U.S. monetary policy and other measures are normalized soon, Indonesia, the Philippines, and India could face severe downward pressure on their currencies.

■ Asian currencies have shown stability amid the COVID-19 pandemic

There is growing concern that money flows into emerging economies will flow back out as U.S. monetary policy shifts toward normalization. We predict that while there will be no policy change by the U.S. Federal Reserve in 2021, discussions on a gradual reduction (tapering) of asset purchases will begin. In such a situation, there is a risk of the same kind of "taper tantrum" as caused turmoil in emerging markets when the U.S. Federal Reserve hinted in May 2013 that it would scale back its quantitative easing program. In Asia, currency vulnerabilities in India and Indonesia have been a cause for concern. These two countries experienced significant currency depreciation in 2013 and are among the so-called "Fragile Five," along with Turkey, South Africa, and Brazil.

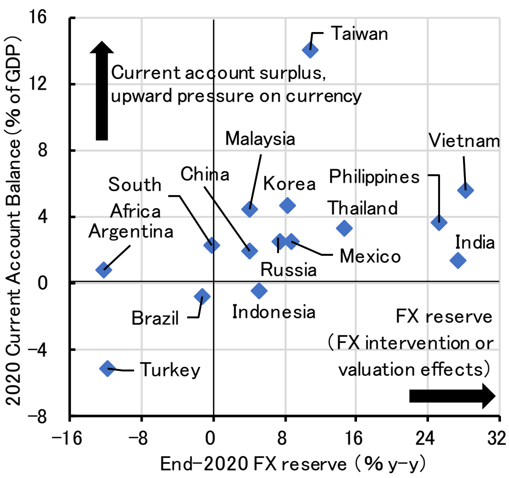
＜Emerging Market Currencies＞



Source: JRI, based on CEIC

The current account balance is one of the most important indicators for measuring currency stability, because it vividly shows the actual demand and supply situation between foreign and domestic currencies. In many emerging Asian economies, current account balances are improving due to an increase in IT-related exports and a decrease in imports due to sluggish domestic demand. In March of this year, there was a phase in which concerns became heightened over a return of the taper tantrum due to a rise in U.S. interest rates, but the rate of depreciation of major Asian currencies has remained small against the background of an improvement in the current account balance.

＜Current Account Balance and FX Reserve＞



Source: JRI, based on CEIC

Throughout 2020, as the U.S. dollar depreciated alongside the improvement in each country's current account, some emerging economies in Asia took intervention measures by actively buying U.S. dollars and selling their own currencies. This has led to an increase in forex reserves and has contributed to the stability of Asian forex markets. According to an exchange rate report released by the U.S. Department of the Treasury on April 17, many Asian countries and regions are under surveillance, and are suspected of intentionally devaluing their currencies. Thus, outside of the early days of the COVID-19 pandemic, dealing with the appreciation of currencies was more of an issue in Asia than dealing with currency depreciation.

■ There are three downside risks to watch out for in the post-COVID-19 era

Asian forex markets have generally been stable, but uncertainty is expected to increase in the future. In particular, attention should be paid to such risks as: (1) normalization of U.S. monetary policy, (2) re-expansion of current account deficits in emerging Asian economies, and (3) excessive fiscal and monetary easing in emerging Asia.

Firstly, in the United States, a robust economic recovery is expected as a result of steady progress in COVID-19 vaccination programs. The additional economic stimulus package enacted on March 11 could cause the economy to overheat. Therefore, there is a risk that the U.S. Federal Reserve will normalize its monetary policy at a rate faster than the market expects.

Secondly, in Asian countries and regions, domestic demand may also recover sharply if vaccination programs proceed more smoothly than expected. In such a case, imports will surge and the current account balance will deteriorate significantly, which will once again increase pressure toward foreign currency outflow and currency depreciation. In Asia, the IMF projects that India, Indonesia, and the Philippines will either fall back into current account deficits or post bigger deficits in 2021, which poses concerns about the risk of increasing pressure for weaker currencies (see table below).

In the wake of the COVID-19 pandemic, fiscal and monetary policies were actively implemented in Asian countries and regions. As a result, the fiscal balance of many countries is expected to be worse than in 2013. In Indonesia, although the increase in the fiscal deficit is relatively small, the central bank has implemented direct underwriting of government bonds after temporarily eliminating fiscal discipline rules that limit the deficit to 3% of GDP. As foreign investors hold a high percentage of the Indonesian government bonds, it is possible that foreign investors will react negatively to increasing fiscal risks. In the Philippines, inflation has risen above the central bank's target, while policy interest rates remain at record lows. This will put downward pressure on the local currency, and if the currency falls, it could lead to a vicious circle that further accelerates inflation.

■ Guard cannot be relaxed despite reduction in risks

According to the IMF's "Assessment of Reserve Adequacy (as of March 8)," while Turkey and South Africa continue to suffer from a shortage of foreign exchange reserves, most Asian countries and regions have no problems. In Asia, which has not only abundant forex reserves but also an improved current account balance, the risk of a major currency depreciation is low, as it was in 2013. However, in the process of economic normalization, there is still a possibility that the aforesaid trigger will cause market turmoil. In particular, Indonesia and India as part of the Fragile Five, as well as the Philippines, need to be aware of the risk of a rapid amplification in downward pressure on their currencies.

(Minoru Nogimori)

＜Indicators Assessing Currency Market's Stability＞

	Current Account Balance (% of GDP)			Fiscal Balance (% of GDP)		Inflation (2021Q1、% y-y)		ARA Metric (%)	
	2013	2020	2021 (IMF forecast)	2013	2021 (IMF forecast)		Inflation target (%)	End-2012	End-2020
Turkey	▲ 5.8	▲ 5.1	**▲ 3.4**	▲ 1.5	**▲ 5.7**	**15.6**	5	98.0	**74.7**
Indonesia	▲ 3.2	▲ 0.4	**▲ 1.3**	▲ 2.2	**▲ 6.1**	**1.4**	2～4	90.1	**115.6**
India	▲ 2.7	1.3	**▲ 1.2**	▲ 7.0	**▲ 10.0**	**4.9**	2～6	142.9	**198.9**
Brazil	▲ 3.2	▲ 0.9	**▲ 0.6**	▲ 3.0	**▲ 8.3**	**5.3**	3.75	158.8	**150.5**
South Africa	▲ 5.8	2.2	**▲ 0.4**	▲ 4.3	**▲ 10.6**	**3.0**	3～6	78.7	**68.7**
Philippines	4.0	3.6	**▲ 0.4**	0.2	**▲ 7.4**	**4.5**	2～4	256.2	**236.9**
Thailand	▲ 2.1	3.2	**0.5**	0.5	**▲ 4.9**	**▲ 0.5**	1～3	225.7	**252.2**
China	1.5	1.9	**1.6**	▲ 0.8	**▲ 9.6**	**▲ 0.0**	3.5	157.4	**76.4**
Mexico	▲ 2.5	2.5	**1.8**	▲ 3.7	**▲ 3.4**	**4.0**	2～4	122.9	**128.5**
Argentina	▲ 2.1	0.8	**2.3**	▲ 3.3		**40.6**		63.1	**90.1**
Vietnam	3.6	5.5	**2.4**	▲ 6.0	**▲ 4.7**	**0.3**	4.0		
Malaysia	3.4	4.4	**3.8**	▲ 3.5	**▲ 4.4**	**▲ 0.1**		105.7	**118.6**
Russia	1.5	2.3	**3.9**	▲ 1.2	**▲ 0.8**	**5.5**	4.0	163.6	**341.0**
Korea	5.6	4.6	**4.2**	0.6	**▲ 2.9**	**1.1**	2.0	112.5	**107.2**
Taiwan	9.7	14.0	**14.5**	▲ 3.2	**▲ 2.8**	**0.8**			

Source: JRI, based on IMF and CEIC

Note: ARA (Assessing Reserve Adequacy) Metric is a ratio of an actual reserve to a composite of reserve adequacy indicators measured by exports, broad money, short-term debt, and other liabilities, assessing the appropriate level of FX reserves. The metric for many countries assumes floating exchange rates, but for China assumes a fixed exchange rate (In case of floating rates in China, the metric rises to 134% at end-2020). Data at end-2014 is used for Argentina, instead of end-2012.