CIO Memo

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China's Q3 GDP indicates continual recovery

Key take aways

- China's Q3 GDP confirmed that China is on a recovery track. Consumption becomes the new growth driver.
- China's A-share equity market declined slightly as the Q3 GDP was below expectations.
- We remain constructive on Chinese equities due to the steady economic recovery, pro-growth policies and low valuation. Chinese equities may benefit in case of any stabilization of U.S-China relations after the election.

1. What happened?

China released its Q3 GDP data today. China's GDP growth was at 4.9% YoY in Q3 this year, up from 3.2% in the previous quarter. In the first three quarters of the year, China's GDP growth turned positive to +0.7% YoY, compared to -1.5% in 1H 2020. Nonetheless, the Q3 GDP growth was below market consensus of 5.2%.

GDP breakdown showed that the secondary industry growth rose to 6.0% YoY in Q3 (vs. 4.7% in Q2), indicating a continual manufacturing recovery. The manufacturing sector capacity utilization ratio already went up to the pre-coronavirus level at 76.7% in Q3 2020 (vs. 74.4% in Q2), compared to 76.6% in 2019. Meanwhile, the service sector recovery was relatively slower at 4.3% growth in Q3 (vs. 1.9% in Q2).

September activity data continued to improve. Industrial production increased 6.9% YoY in September, compared to 5.6% in August. Fixed asset investment growth accelerated to 0.8% YoY in Jan-Sep, compared to -0.3% in Jan-Aug.

Retail sales increased 3.3% YoY in September, up from the 0.5% rise in the previous month. The retail sales in clothing & shoes, medicine, culture and office goods were strong in the month. Besides, automobile sales were also robust with double-digit growth at 11.2% YoY in September.

2. How did markets react?

China's benchmark Shanghai Composite Index declined 0.7% on Oct 19, possibly due to the below-consensus Q3 GDP. Hong Kong's Hang Seng Index increased 0.6% on the day. As of 6pm Hong Kong Time on Oct 19, CNY appreciated 0.2% against USD to 6.683. The overnight SHIBOR rose to 2.19% on Oct 19, compared to 2.02% on the previous trading day.

3. What does it mean for investors?

China's Q3 GDP confirmed that the economy is on a steady recovery track. The manufacturing sector already started to improve since Q2 this year, as the Covid-19 pandemic was largely under control in the country. Since Q3, we note that consumption is becoming the new growth driver.

Q3 GDP missed market expectations, possibility due to the below-trend growth in the service sector and the relatively slow infrastructure capex investment. However, we think growth could gain momentum in Q4, with the continual improvement in service and consumption sectors.

We retain our full-year China GDP forecast at 2% in 2020, as we think China's growth could return to the trend level at around 6% in Q4. We think China could continue to stimulate the economy through pro-growth fiscal policies, including supporting the new infrastructure construction of 5G networks, data centres, renewable energy projects, etc. Meanwhile, monetary policy could continue to tighten given the PBoC's concerns over credit expansions especially in property sector.

We think the key risks to Chinese economy include any further escalation of U.S.-China tensions, any tightening risks in the PBoC monetary policies and possible weakness in external demand amid the re-imposition of social distancing measures in developed markets.

With this Q3 growth number, China is already largely back to pre-crisis growth levels – being expected to post 2% full year GDP growth as the only major economy in the world.

Despite the below-consensus Q3 GDP, we remain constructive over Chinese equities. We think Chinese equities will be supported by the steady economic recovery, the pro-growth fiscal policies and the relatively low valuations. In case of any stabilization of U.S.-China relations after the U.S. election, we think Chinese equities may benefit.

Glossary

CNY is the currency code for the Chinese yuan.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

The Hang Seng Index (HSI) includes the 50 largest companies traded on the Hong Kong stock exchange.

The People's Bank of China (PBoC) is the central bank of the People's Republic of China.

The Shanghai Composite Index contains all shares traded on the Shanghai exchange.

SHIBOR is the Shanghai interbank offered rate - the rate at which banks are prepared to lend to each other.

USD is the currency code for the U.S. Dollar.

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