

China Economy

Recovery was underway

China's economy held a steady course on its way to recover in the first two months. Service activity, housing market and infrastructure investment all beat expectations while industrial output was below the consensus as exports slumped, SMEs were cautious on capacity & inventory expansion and rural migrant workers returned to city factories later than usual. We maintain China's GDP growth forecast at 5.4% for 2023 as retail sales and service consumption should be the most important drivers for economic resumption this year. We slightly revise up the FAI growth forecast for 2023 from 4.7% to 5% as housing market recovery should be better than expected. China's exports of goods are expected to drop 3.5% in 2023, but downside risk exists due to overseas recession and disinflation. The sharply inverted yield curve, recent failure of US Silicon Valley Bank and plunge of global banks' stock prices all indicate a recession may come soon. China has to maintain easing credit policy to boost domestic demand. The PBOC will keep money market rates moderately fluctuating around its repo refinancing rates in 2Q23 and may ease liquidity supply in 2H23 as domestic economic recovery slows with overseas recession.

■ China economy resumes as the recovery pace varies by sector

- Industrial output was below expectations as the YoY growth of value added industrial output (VAIO) slowed from 3.6% in 2022 to 2.4% in 2M23. The sharp decline of exports, cautious attitude of small & medium manufacturers and late return of rural migrant workers after Chinese New Year holiday has hurt the industrial output. We note rural retail sales grew 4.5% YoY in 2M23, higher than the growth of urban retail sales at 3.4%, indicating rural migrant workers returned to city factories later than usual.

- Both service activity and housing market performance were much better than the consensus thanks to the rapid reopening and easing credit policy. The service output index rose 5.5% YoY in 2M23 after dropping 0.1% YoY in 2022. Housing sales and starts significantly improved as gross floor area (GFA) sold for commodity buildings and GFA started respectively dropped 3.6% and 9.4% YoY in 2M23 after plunging 24.3% and 39.4% YoY in 2022.

- Retail sales slightly beat expectations by picking up 3.5% YoY in 2M23 after dropping 0.2% YoY in 2022. Spending on medicine, catering, petroleum products and food was very strong, while that on alcohol & tobacco, clothing, cosmetics, gold & jewelry, furniture and construction & decoration materials noticeably improved. However, retail sales in auto, communication equipment and cultural & office goods further deteriorated with sharp YoY declines.

- Fixed asset investment (FAI) was better than expected as its YoY growth rose from 5.1% in 2022 to 5.5% in 2M23. Property development investment dropped 5.7% YoY in 2M23 after declining 10% in 2022. Infrastructure investment strongly picked up 12.2% YoY in 2M23 after rising 11.5% YoY in 2022. Manufacturing investment growth was solid with slight slowdown from 9.1% in 2022 to 8.1% in 2M23.

■ We maintain the GDP growth forecast for 2023 at 5.4% with retail sales and service GDP expected to grow 6.8% and 6.2% respectively

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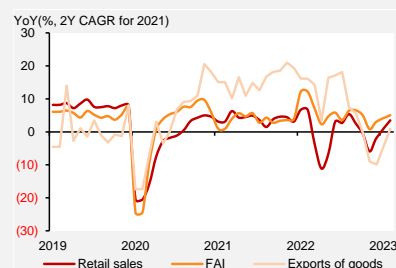
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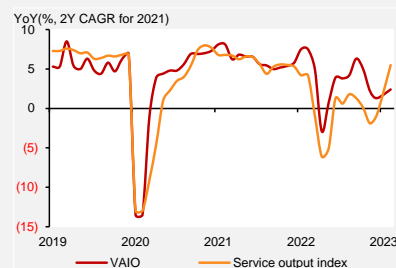
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Source: Wind, CMBIGM



Source: Wind, CMBIGM

- Retail sales and service consumption should be the most important drivers for China's economic resumption this year. Traffic flow and outgoing activity has resumed quickly after the reopening, supporting a strong recovery of consumption in transport, travel, catering, hotel, recreation, clothing & footwear and personal care. Catering revenue jumped 9.2% YoY in 2M23 after dropping 14.1% YoY in last December. Retail sales in alcohol & tobacco products, clothing & footwear and cosmetics respectively picked up 6.1%, 5.4% and 3.8% YoY in 2M23, compared to the YoY declines of 7.3%, 12.5% and 19.3% in last December.

- The housing market recovery has been better than expected thanks to accommodative credit policy, confidence improvement and a release of postponed demand by the lockdowns. It should be positive for household durables like furniture and home appliance started to recover. Auto sales may also gradually rebound as economy further improves and producers start to stimulate demand by lowering prices. Electronic equipment may be the last sector to recover as consumer income and confidence further improves.

- Urban employment condition and consumer confidence should gradually improve. The slight decline of urban surveyed unemployment rate in February compared to last December was because most SMEs were still cautious to expand employment and supply capacity. While rural migrant workers returned to cities, it took longer for them to find a job than usual. **We slightly revise up the FAI growth forecast for 2023 from 4.7% to 5%**

- Property development investment has recovered faster than expected. Its performance should be better than the market consensus (-3%~-5% YoY for 2023).

- Infrastructure investment was also stronger than our expectations. By sector, FAI in public utility, railway transportation and public facility management jumped 25.4%, 17.8% and 11.2% YoY in 2M23, compared to the YoY increases of 19.3%, 1.8% and 10.1% in 2022. China is building its new energy supply system with huge investment in alternative power generation, thermal power facility as backup in emergency and smart grid. Meanwhile, the fixed investment in railway transportation and metro facility is recovering along with the significant improvement of traffic flow and mobility. However, the FAI in water conservancy and health & social welfare has sharply slowed down. **Looking forward, infrastructure investment growth may slow from 11.5% in 2022 to 8% in 2023 due to base effect as well as the policymaker's concern about local government contingent debt risk.**

- Manufacturing investment growth was in line with expectations. By industry, the investment in raw chemical materials and non-ferrous metals boomed thanks to China's low energy cost and supply chain advantage. Auto, electrical equipment, computer & electronic equipment and special equipment also maintained strong FAI growth as China continued to consolidate the supply chain advantage and upgrade the factories with new technology and equipment in those sectors. **Looking forward, we expect the FAI growth in manufacturing may slow from 9.1% in 2022 to 6% in 2023 due to base effect and overseas recession. The investment in high-end equipment should remain strong this year.**

■ **We expect China exports of goods to drop 3.5% in 2023 due to overseas recession and disinflation**

- Industrial delivery value for exports dropped 4.9% YoY in 2M23 after rising 5.5% YoY in 2022. The exports of goods rose 0.9% YoY in 2M23, down from

the growth of 7% in 2022. With the price factor deducted, the exports volume should maintain YoY declines in the first two months.

- Global economy will see a recession with disinflation in 2023 with the sharply inverted yield curves, the recent failure of few small banks in the US and plunge of global banks' stock prices as the early warning indicators.

- We expect China exports of goods to drop 3.5% in 2023 after rising 7% in 2022. The YoY growth rates of exports for the four quarters are expected to be at -9%, -6%, -3% and 2.5%, respectively.

■ **China will maintain easing credit policy to support domestic demand resumption**

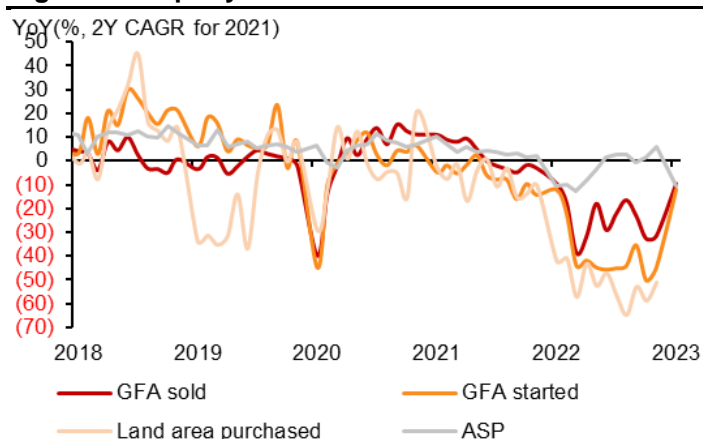
- While the proactive fiscal policy is below expectations, China's credit policy should be very accommodative this year. The central bank has to maintain easing credit policy to relieve debt risk and boost the growth. Property developers, LGFVs and SMEs still face liquidity pressure, while China's GDP growth remains below the potential growth as the reflation is very mild.

- The money market rate hike in the past two months was mainly because of a sharp increase of loan supply which pushed up liquidity demand while the PBOC became cautious on further liquidity loosening in face of strong new credit and better-than-expected housing market in 2M23. As money market rates rose to above the PBOC's repo refinancing rates, the additional upside room should be limited. We expect money market rates may mildly fluctuate around the repo refinancing rates in near term. As domestic recovery pace may slow with overseas recession after a few months, we expect the central bank may ease liquidity condition in 2H23.

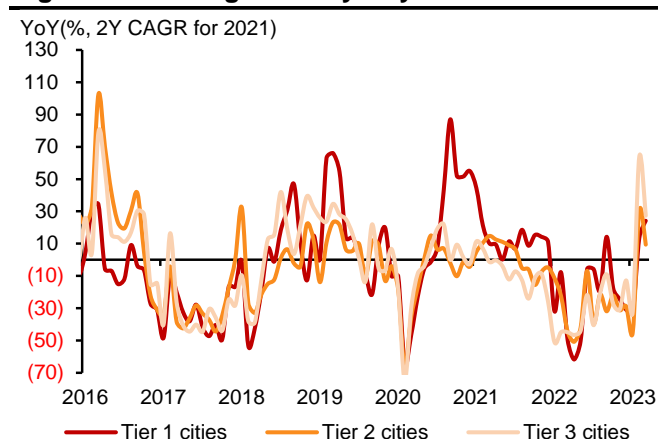
Figure 1: China Economic Indicators

YoY(%)	2019	2020	2021	2022	Jan - Feb. 23
GDP	6.0	2.3	8.4	3.0	
VAIO	5.7	2.8	9.6	3.6	2.4
-Mining	5.0	0.5	5.3	0.6	4.7
-Manufacturing	6.0	3.4	9.8	(2.0)	2.1
-Public utility	7.0	2.0	11.4	(2.2)	2.4
Delivery value for exports	1.3	(0.3)	17.7	5.5	(4.9)
Service output index	6.9	0.0	13.1	(0.1)	5.5
GFA sold for commodity building	(0.1)	2.6	1.9	(24.3)	(3.6)
GFA started for commodity building	8.5	(1.2)	(11.4)	(39.4)	(9.4)
Urban FAI (YTD)	5.4	2.9	4.9	5.1	5.5
-Property development	9.9	7.0	4.4	(10.0)	(5.7)
-Manufacturing	3.1	(2.2)	13.5	9.1	8.1
-Infrastructure	3.3	3.4	0.2	11.5	12.2
Retail sales	8.0	(3.9)	12.5	(0.2)	3.5
Exports of goods	0.5	3.6	29.9	7.0	0.9
Imports of goods	(2.7)	(0.6)	30.1	1.1	(2.9)

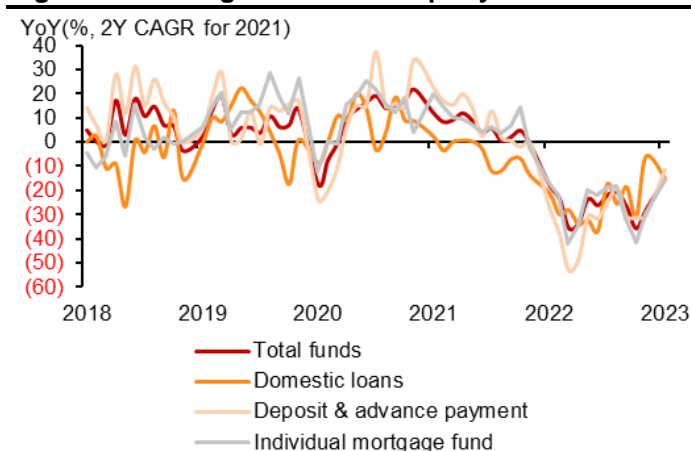
Source: Wind, CMBIGM estimates

Figure 2: Property Market Indicators

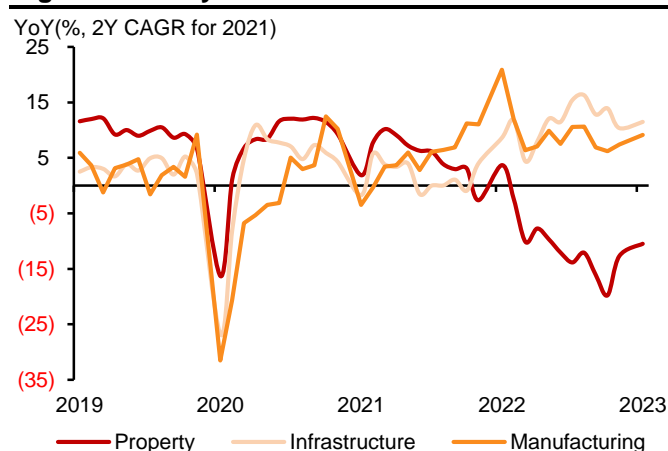
Source: WIND, CMBIGM

Figure 3: Housing Sales by City

Source: WIND, CMBIGM

Figure 4: Funding Source for Property Investment

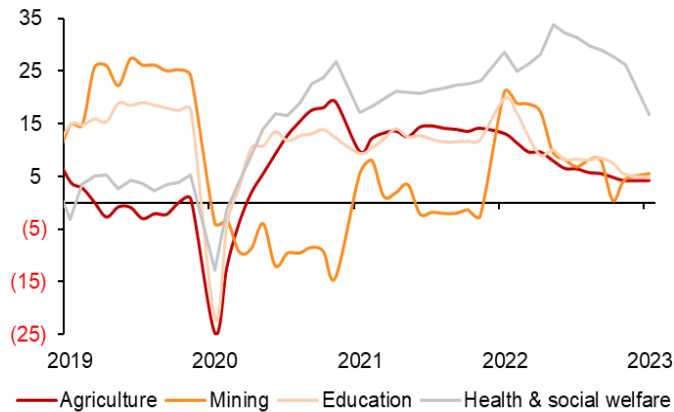
Source: WIND, CMBIGM

Figure 5: FAI by Sector

Source: WIND, CMBIGM

Figure 6: FAI in Agriculture, Mining & Social service

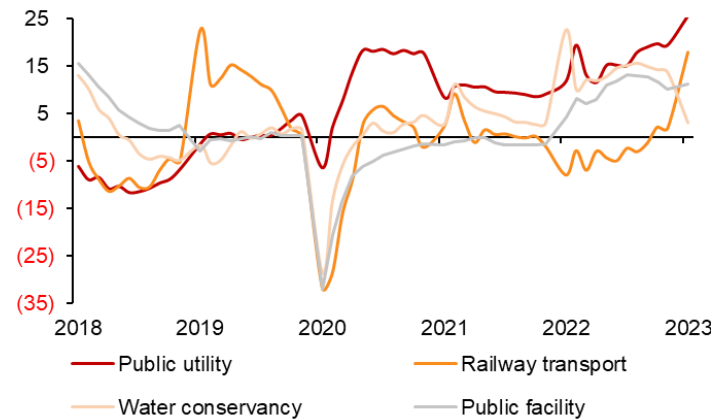
YoY(%), 2Y CAGR for 2021, YTD)



Source: WIND, CMBIGM

Figure 7: FAI in Infrastructure Sectors

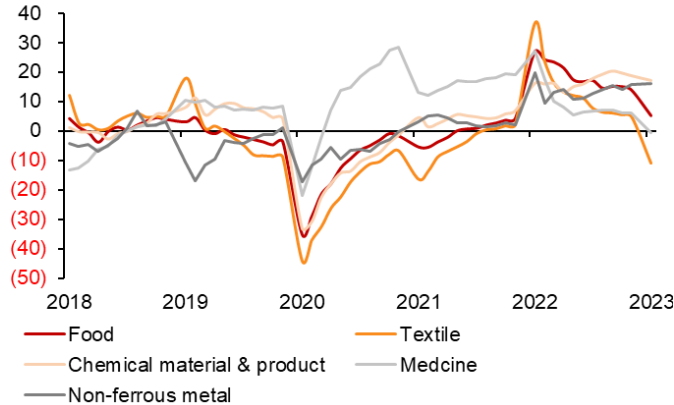
YoY(%), 2Y CAGR for 2021, YTD)



Source: WIND, CMBIGM

Figure 8: FAI in Manufacturing Industries (I)

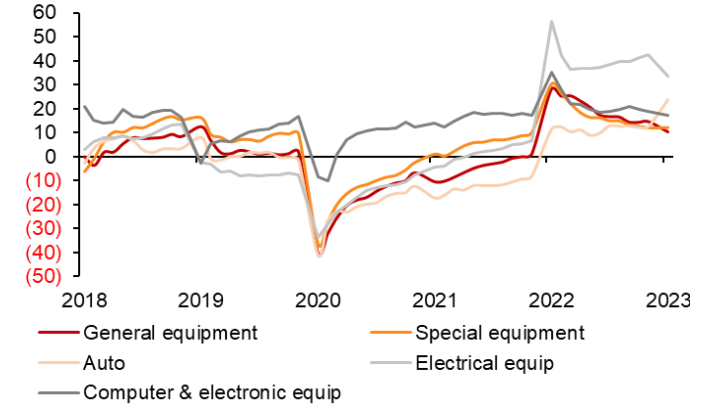
YoY(%), 2Y CAGR for 2021, YTD)



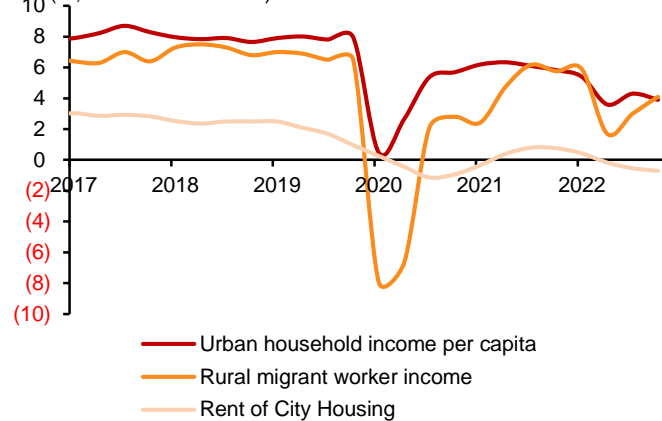
Source: WIND, CMBIGM

Figure 9: FAI in Manufacturing Industries (II)

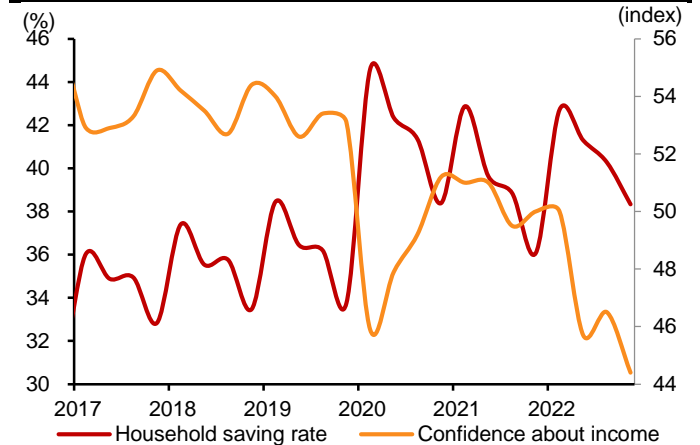
YoY(%), 2Y CAGR for 2021, YTD)

**Figure 10: Household Income & Housing Rent**

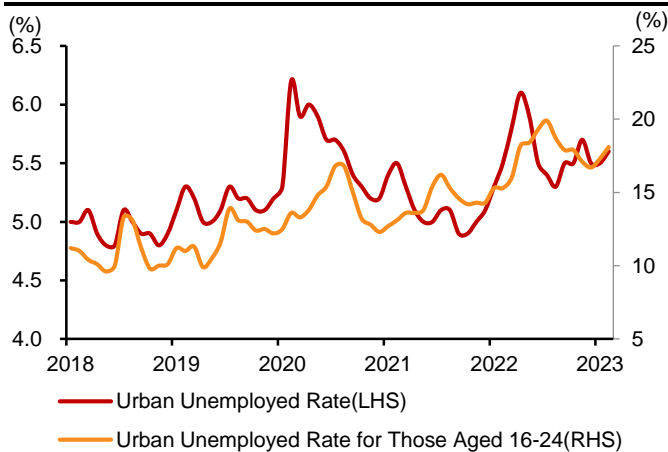
YoY(%), 2Y CAGR for 2021)



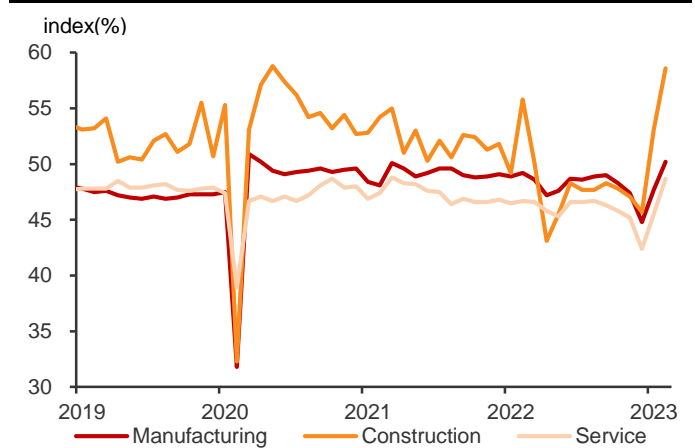
Source: WIND, CMBIGM

Figure 11: Consumer Confidence

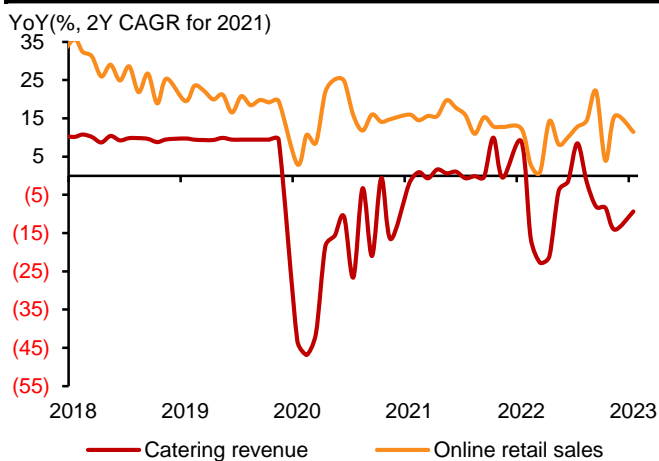
Source: WIND, CMBIGM

Figure 12: Urban Surveyed Unemployment Rates

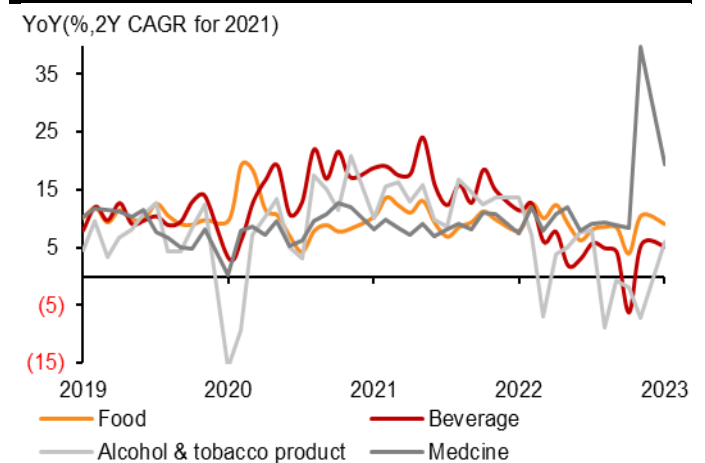
Source: WIND, CMBGM

Figure 13: Employment Index

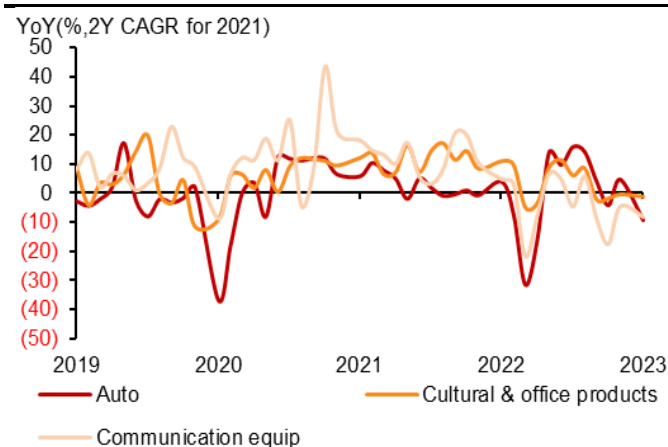
Source: WIND, CMBGM

Figure 14: Catering & Online Retail Sales

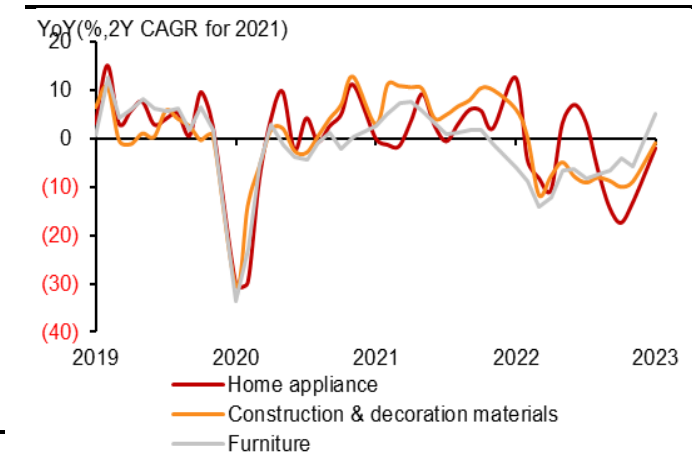
Source: WIND, CMBGM

Figure 15: Retail Sales of Staples

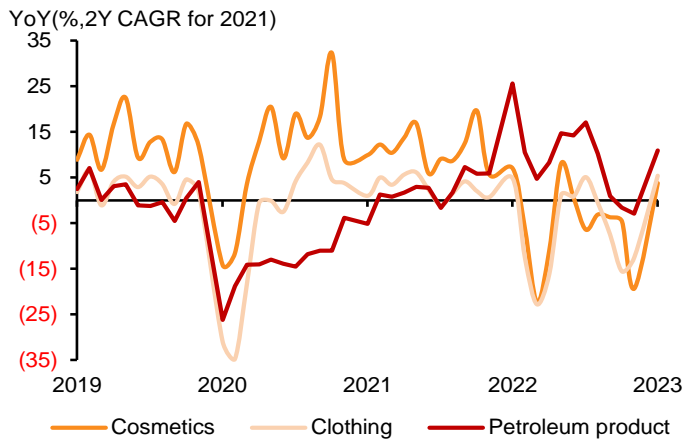
Source: WIND, CMBGM

Figure 16: Auto & Electronic Retail Sales

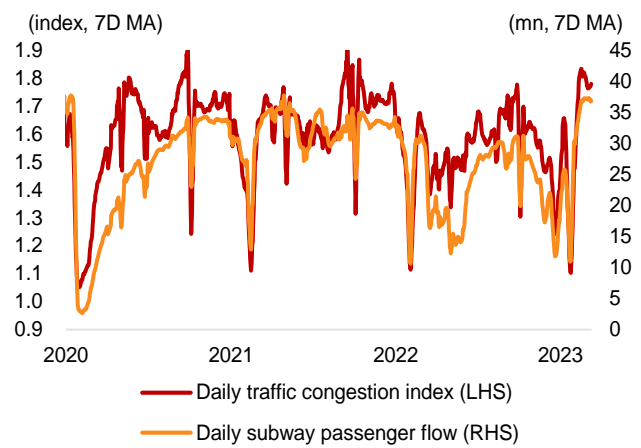
Source: WIND, CMBGM

Figure 17: Household Furniture & Appliance Retail Sales

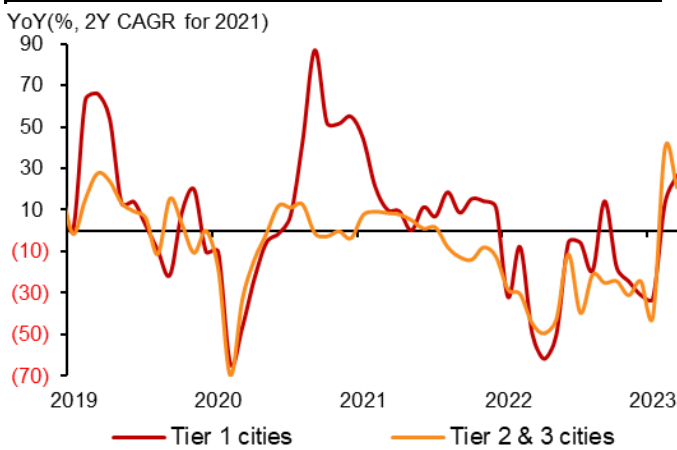
Source: WIND, CMBGM

Figure 18: Retail Sales of Non-durables

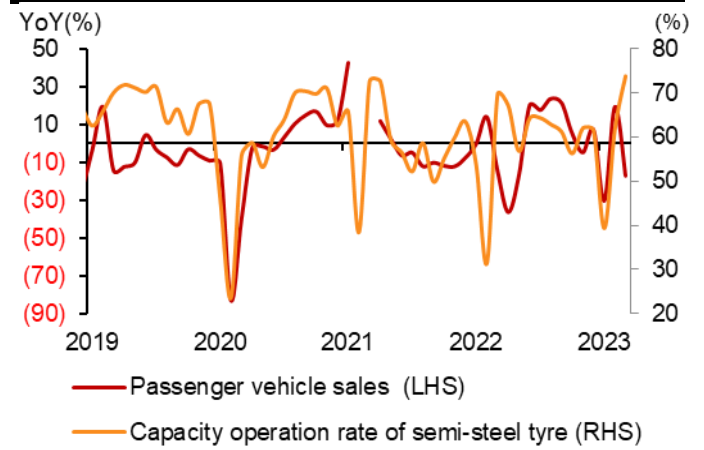
Source: WIND, CMBGM

Figure 19: Mobility Indexes in Tier-1 Cities

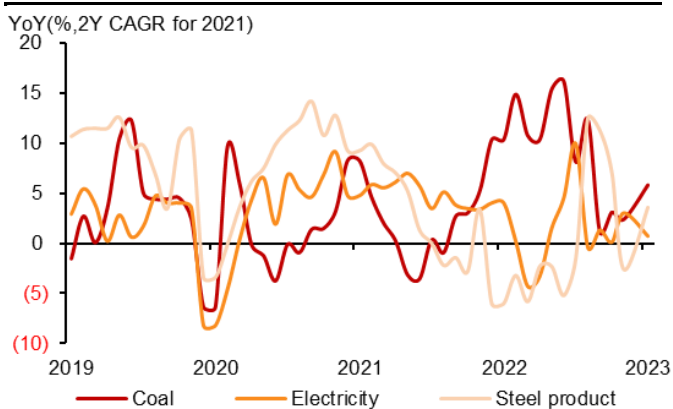
Source: WIND, CMBGM

Figure 20: Commodity Building Sales

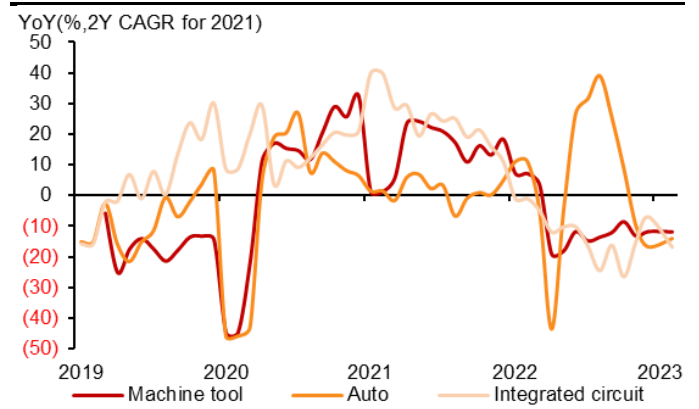
Source: WIND, CMBGM

Figure 21: Auto Sales

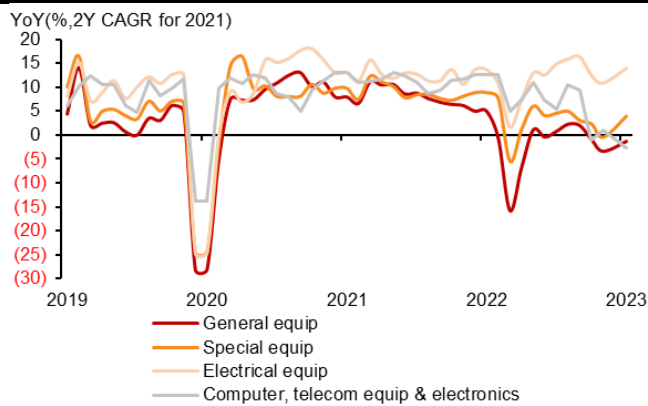
Source: WIND, CMBGM

Figure 22: VAIO in Energy & Steel Product

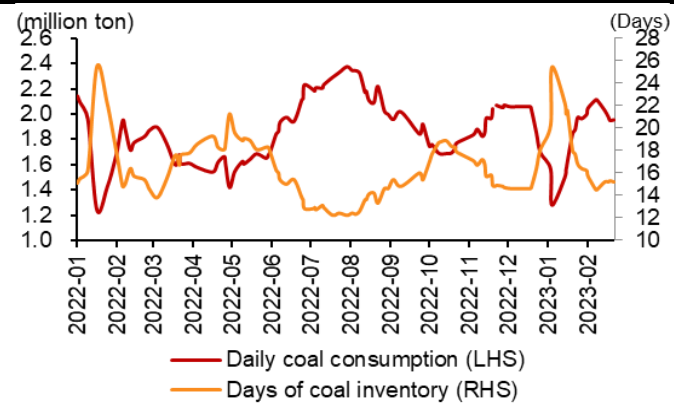
Source: WIND, CMBGM

Figure 23: VAIO in Capital Goods & Auto

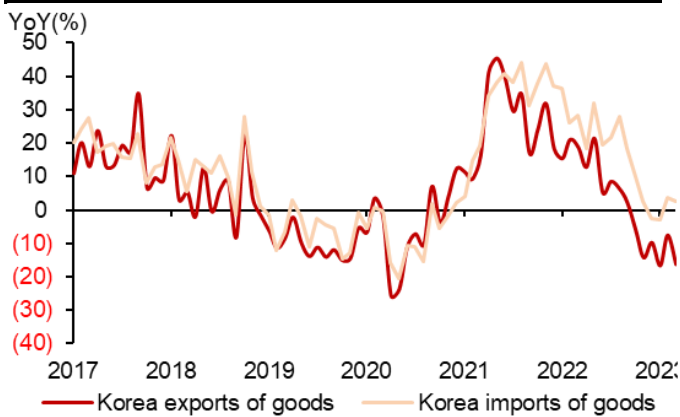
Source: WIND, CMBGM

Figure 24: VAIO in Equipment

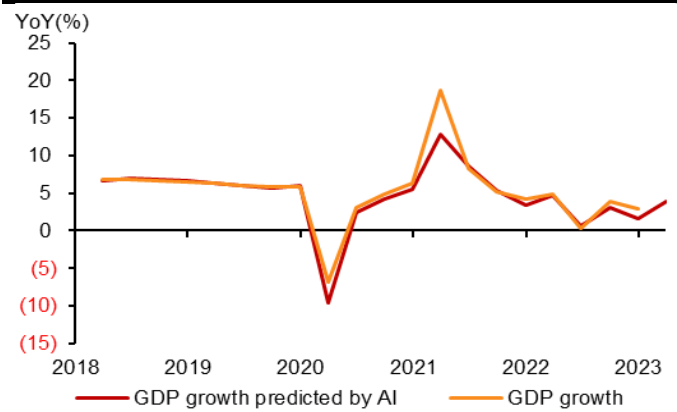
Source: WIND, CMBGM

Figure 25: Power Generators' Coal Consumption

Source: WIND, CMBGM

Figure 26: Foreign Trade of South Korea

Source: WIND, CMBGM

Figure 27: China GDP Growth

Source: WIND, CMBGM

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