The great reopening

Five key China macro themes in 2023

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Economics - China

- After a bumpy transition period, we expect a strong rebound from 2Q23
- Revenge spending will be supported by pent-up demand, improved sentiment, and accumulated excess savings
- Pro-growth policies to stabilize the housing market and boost investment; reflation along reopening but manageable

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China will emerge from COVID-19 and rebound strongly from 2Q23. China is battling its worst COVID-19 outbreak – cases are spiking, drug stocks are running low, and the healthcare system is overwhelmed. Yet the reopening is progressing faster than most expected. Several mega-cities, including Beijing and Shanghai, look to have passed the peak of the first wave and the busiest Lunar New Year travel season since the COVID-19 outbreak began is around the corner, with cross-provincial travel volumes expected to reach c90% of the pre-pandemic level. Chinese tourists will soon be travelling again and a boom in other business sectors will likely follow.

Consumption to come back with a vengeance. Consumption has been a laggard so far but a recovery to the pre-pandemic growth level of c8% is expected in 2023. We expect to see strong pent-up demand for activities and consumption which previously faced restrictions. The economic recovery should boost incomes and improve the consumption outlook, while households can also draw on the cRMB6.6trn in excess savings accrued over the past three years.

The housing market will stabilize. After the important policy pivot in November 2022 a slew of measures has been rolled out at the central government level to channel funding to property developers, while local governments are lifting purchase restrictions to stimulate demand. Once China emerges from COVID-19 the impact of this policy support will materialize; expect a modest rebound in the housing sector in 2023.

CPI and PPI reflation likely but manageable. An economic recovery will bring price pressures but we don't expect inflation to be a thorny issue in China. It will take time to close the negative output gap and absorb slack in the labour market and China won't face the same supply disruptions as many other economies did when they reopened, further containing inflationary pressures.

Policy will focus on growth. The December 2022 Politburo meeting and Central Economic Work Conference both emphasized growth in 2023. Expansionary fiscal policies will take the lead, accompanied by other pro-growth policy stimulus – we forecast GDP will grow 5% in 2023.

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- Reopening will be the dominant theme in 2023, when we expect a strong growth rebound after the bumpy transition
- Consumption will boom, supported by a better labour market, property market stabilization, and accumulated savings
- Policy to refocus on growth, led by more expansionary fiscal policies; mild reflation expected for CPI and PPI but well contained

Emerging from COVID-19

Shaking off the impact of the pandemic

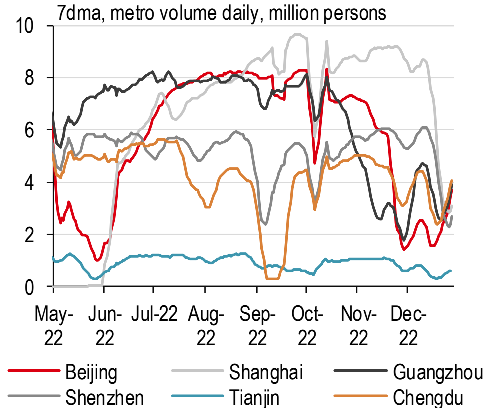
Now all eyes are on 8 January when quarantine will no longer be required

China's reopening is progressing rapidly. The announcement of *10 more calibrated COVID-19 prevention and control measures* (7 Dec 2022) marked the start of the transition from pandemic to endemic. In less than a month, travel is on the road to recovery and the busiest Lunar New Year travel rush since 2019 is around the corner. Cross-provincial travel volumes are expected to bounce back to c90% of the pre-pandemic level (China Railway, 16 Dec 2022). Now all eyes are on 8 January, when quarantine will no longer be required for inbound travellers to China and the country will resume passport issuance for citizens and visa services for foreigners.

That said, China is battling its worst outbreak of COVID-19, with cases spiking, drug stocks running low, and the healthcare system overwhelmed. Headwinds may stiffen as the virus rips through the country, further stretching medical resources and disrupting economic activity. However, the progress of the virus is anything but uniform geographically; some cities have already experienced a rapid surge while others are at the beginning of the first wave. At a press conference on 29 December, Chinese Center for Disease Control (CDC) chief epidemiologist, Wu Zunyou, stated that the outbreak had already peaked in Beijing, Tianjin and Chengdu. However, rural areas may face waves of COVID-19 in the coming weeks as we head into the peak travel period leading up to the Lunar New Year.

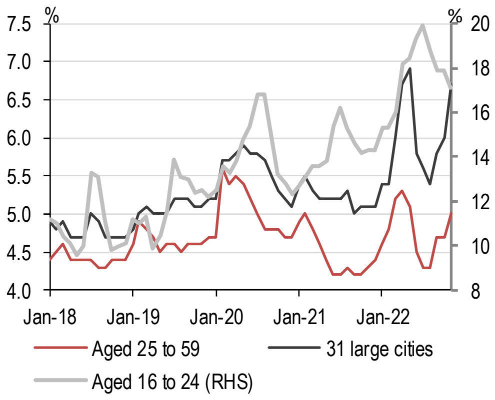
It may be several months before the economy reaches a broader phase of recovery. However, activity has rebounded in cities which have passed the peak of the first wave, with metro data showing a notable uptick in the past few days (chart 1). A boom in business in other sectors will likely follow, based on the experience of other economies as they reopened. We estimate a meaningful rebound starting in 2Q23. Overall, reopening will be the dominant theme in 2023 and going into 2024, boosting GDP growth to 5% and 5.8% y-o-y in 2023 and 2024 respectively.

Chart 1. Some cities have shown signs of a recovery in subway passenger numbers



Source: Wind, HSBC

Chart 2. Unemployment rates among the youth and in large cities remain elevated



Source: CEIC, HSBC

‘Revenge spending’ on the way

Consumption has been a laggard during the early stages of the recovery as persistent disruptions from COVID-19 and uncertainty have kept people cautious. While the near-term hit to consumption remains at risk from waves of infections, there are likely to be strong tailwinds for consumption thereafter.

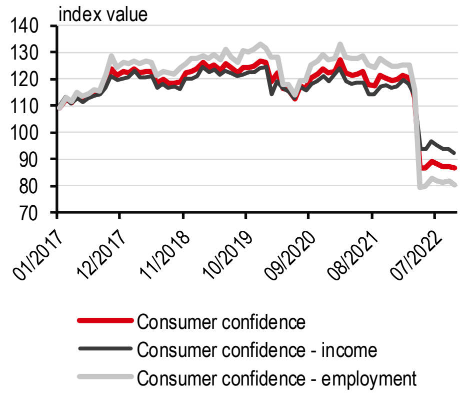
We expect to see pent-up demand for offline activities

For one, we expect there to be strong pent up demand for activities and consumption which previously faced restrictions. Just as behaviour changed during the pandemic, shifting to more online consumption and online business services, we expect to see a return to more offline activities. Travel and tourism, dining out, and entertainment all stand to benefit. On the business side, we should see a broader improvement in activity due to the overall increase in domestic consumption and subsequent boost to the labour market. We expect both consumer and business confidence to improve, which will mean a boon for investment activities as well.

Second, excess savings have built up during the pandemic due to continued uncertainty about COVID-19 and the housing market. We estimate about RMB6.55trn of excess savings have accrued throughout the pandemic, about 5.4% of nominal GDP, which can be unwound to support pent up demand in 2023.

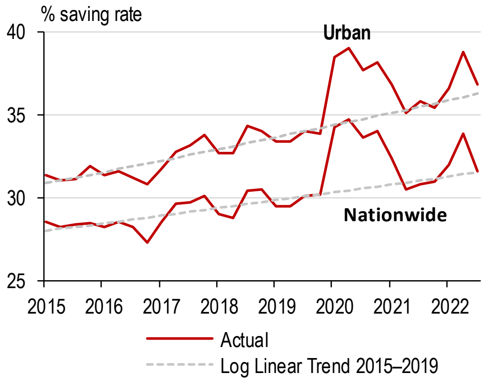
The *Central Economic Work Conference* prioritized a recovery in domestic demand and expansion of consumption for 2023 (16 Dec 2022) and pledged to increase household income, support housing improvements, new energy vehicles, elderly care services and other forms of consumption. More policy support can be expected to lift consumption, such as tax breaks for larger ticket items like durable goods (e.g. new energy vehicles) being extended, and the distribution of consumption vouchers at the local level. This should help lead to a recovery in retail sales and consumption to the pre-pandemic growth levels of around 8% in 2023.

Chart 3. Consumer confidence has been weak



Source: CEIC, HSBC

Chart 4. Excess savings during the pandemic will support a consumption recovery



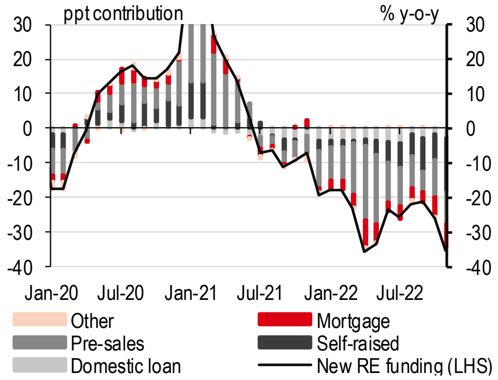
Source: CEIC, HSBC

Property sector stabilization

The property sector has faced stiff headwinds since late 2021

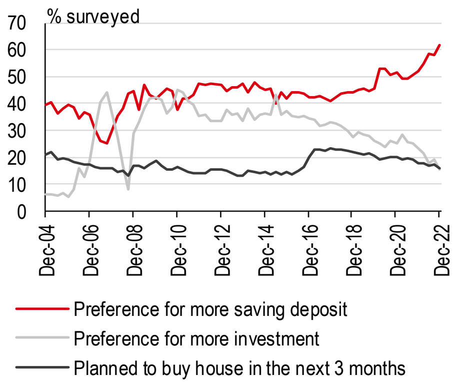
The property sector has faced stiff headwinds since late 2021 as policy tightening increased developers' funding difficulties (chart 5). New home sales by gross floor area fell by 23.3% y-o-y in the first 11 months of 2022, while the increase in longer-term household loans, which are typically linked to household mortgages, was less than half the amount compared to the same period for the previous year (RMB2.6trn vs RMB5.7trn). Given that the property sector accounts for around 25% of GDP when the entire value chain is taken into account, a prolonged housing market correction would lead to a decline in real estate value and a deterioration in banks' balance sheets, further constraining investment and weighing on future growth.

Chart 5. Property developers have had difficulty in getting sufficient funding, but this should turn around in 2023



Source: CEIC, HSBC

Chart 6. Households still have high precautionary savings and a low preference to purchase housing



Source: CEIC, HSBC

With the policy pivot, we expect a modest rebound of the sector

The good news is that there has been a significant turnaround in the direction of policy in recent months. Since November 2022, policymakers have called for a stabilization in the housing market and have taken a 'three arrows' approach to help the supply side – credit support, bond financing and equity financing (see table 1), as well as lifting various purchase restrictions and increasing leverage to stimulate demand.

Table 1: Central government housing stabilisation measures since November 2022

Category	Date	Main points
'1st arrow' *Credit supply*	21/11/2022	PBoC will provide RMB200bn in interest-free loans to Chinese commercial banks for the completion of stalled housing projects.
	24/11/2022	Over 10 banks offer RMB2trn lines of credit to Chinese developers.
	01/12/2022 02/12/2022	PBoC announced a 25bp cut in the reserve requirement ratio (RRR) for all banks, effective 5 December. This will release cRMB500bn over the long term (some of which will filter through into the housing sector). Four state-owned banks received window guidance to extend loans offshore to developers by 10 Dec to help them repay overseas debt.
'2nd arrow' *Bond financing*	08/11/2022	NAFMII announced that it will facilitate the bond issuance by Chinese developers, under the guidance and assistance from the PBoC. The PBoC provides funding support via its relending scheme to facilitate up to RMB250bn of bond issuance.
	23/11/2022	PBoC and CBIRC jointly issued a notice regarding 16 supportive measures to ensure the steady development of China's real estate sector.
	23/11/2022	The first batch of private real estate companies received credit enhancement, and Longfor, Jinhui, and Midea Real Estate received a total of RMB4.7bn in credit enhancement.
'3rd arrow' *Equity financing*	28/11/2022	CSRC rolls out five measures to support equity financing of developers.
	21/12/2022	CSRC allows qualified real estate companies to seek "backdoor" listing, accelerates the development of REITs, and allows listed companies in closely related sectors such as real estate and construction to implement real estate-related restructuring.
Multi-arrows	04/01/2023	FSDC and CBIRC weigh on measures to shore up balance sheets of "systematically important" developers

Source: PBoC, Xinhua News, Securities Times, Bloomberg, Reuters, HSBC

In the near term, the recent disruption from COVID-19 may have further weighed on the housing sector and led to further dips in housing sales. Recent data from the PBoC showed that households remained wary about buying property (Chart 6). However, sector sentiment is improving as evidenced by a rally in housing developers' bonds and stocks since the rollout of the *16 measures to stabilize the housing market* (Nov 2022). We expect the overall policy direction to remain unchanged with the impact materializing as China emerges from the choppy transition period. The property sector may see further stabilization starting in Q2 2023 and for the whole year may grow moderately owing in part to a low base. The benefits of housing market stabilization will extend beyond the impact on housing construction and building materials and lead to a broader consumption recovery due to the wealth effect.

Reflation in both CPI and PPI, but manageable

Inflation has been well contained throughout the pandemic

Inflation has been well contained in China throughout the pandemic owing to subdued consumption. However, the rebound expected will inevitably increase price pressure on both the consumer and the producer side. Over 2022, the gap between CPI and PPI inflation reversed from negative to positive, and is now widening largely due to deflationary pressure in PPI from a high base. With the reopening of China's economy and the ongoing 'super-squeeze' on the supply side, global commodity prices may remain at historically elevated levels. The CPI-PPI gap is expected to narrow and then reverse again, though the overall upward inflationary pressure is likely to remain manageable with CPI reaching 2.5% and PPI 1.1% in 2023.

On the consumer side, prices have slowed in the near term as a result of the hit to activity due to the larger spread in COVID-19 cases. General consumption has been muted, reflected in the weak retail sales data, though with a quick rebound there should be stronger demand pulling through starting in Q2 2023. We expect core inflation to reach a more elevated level of 1.4% this year, but still be well contained compared with other economies.

Why might China be different? One, Chinese households haven't received broad-based direct fiscal handouts, so for lower income groups, the pent-up demand will be less dramatic. Two, it will take time for labour market slack to be absorbed, so we don't see wage inflation anytime soon. Three, China is the last major economy to reopen and won't encounter the supply disruptions that pushed up inflation in other economies. This will help to keep CPI and core CPI inflation in check.

Meanwhile, 'porkflation' is being closely watched

Meanwhile, 'porkflation' is being closely watched. Historically, pork has been a wild card that has driven up China's headline CPI inflation. Indeed, pork prices have risen by double digits since July 2022 due to lower supply following an earlier pork deflation. However, pork prices may soon see downward pressure as the increased reproductive sow supply since April 2022 will transfer to higher pork supply in 2Q23 after the typical three-quarter lag.

Producer prices have been in deflation since October 2022 due largely to a high base, muted property sector activity and softer global commodity prices. While in the near term PPI will continue to see deflationary pressure from these channels, we expect further stabilization in the housing market and fading base effects will pull PPI back into inflationary territory by the end of Q2 2023.

However, we largely expect the pick-up to be manageable. Policymakers are aiming to stabilize the housing market rather than engineer a V-shaped recovery ('housing is for living, not for speculation' was reiterated in the *Central Economic Work Conference* (16 Dec 2022). Additionally, global demand is showing further signs of slowing on the back of persistent inflation and monetary tightening in advanced economies. HSBC's Economics team forecasts global nominal GDP growth to slow to a tepid 1.9% in 2023 from 3.0% in 2022. Slower global growth will in turn weigh on global demand for key commodities, offsetting some reflationary pressure on commodity prices from China reopening.

Policy support will focus on growth

More pro-growth policies will underpin the recovery

More pro-growth policies will underpin the recovery. The Central Economic Work Conference on 16 December 2022 pledged to strengthen counter-cyclical macro policies (加大宏观政策调控力度) to get the economy back on track. We expect fiscal policy will continue to take the lead, while monetary policy will remain accommodative. As the recovery solidifies, policymakers will be able to increase the focus on longer-term sustainable growth targets listed in the 14th Five-Year Plan, which may have hit some obstacles during the pandemic.

Expansionary fiscal policy will take the lead

Liu Kun, China's finance minister, told state media in a recent interview that fiscal policy in 2023 will be more expansionary to support enterprises hit by the pandemic, spur the economy, and stabilize the labour market. He also promised to boost investment via local government special bonds, while guarding against local government debt risks via reforms to local government financing vehicles (Xinhua, 3 Jan 2023).

Fiscal policy will likely see a modest increase in the official budget deficit to 3.0% from 2022's expected 2.8%. There will likely be continued emphasis on infrastructure investment, both new and old. We expect there will be supportive issuance of special local government bonds on par with last year at around RMB3.65trn. Meanwhile, we expect further fiscal support for still recovering areas such as SMEs and consumption and services industries. This is likely to include tax cuts and fee reductions, an increase in government guarantees, provisions or reductions in the cost of government services (e.g. utilities and rent) as well as direct subsidies (e.g. consumption vouchers at the local level). Longer term growth areas like technology and innovation as well as green development are also likely to benefit from direct fiscal support from tax cuts, direct funding support as well as increased government guarantees.

Monetary policy is likely to remain accommodative

Meanwhile, monetary policy is likely to stay accommodative through the provision of ample liquidity support as there is sufficient policy space due to still muted inflationary pressures. However, given the continued divergence in the monetary policy cycle with the rest of the world, we expect China will prefer to use quantity-based tools – including a likely further 50bp cut in the broad-based RRR (required reserve ratio) in H1 2023, the equivalent of about RMB1trn in additional liquidity. While a further interest rate cut may be more limited, we think there is space for a 5bp cut in key policy rates (e.g. 1-year loan prime rate) to signal stronger monetary policy support. Additionally, we think there will be increased use of structural tools like relending quotas for targeted areas like clean coal development and manufacturing upgrading, which would help to support longer-term growth.

Aside from continued fiscal and monetary support, we expect the implementation of regulations to be more transparent and coordinated, which should help limit the disruptive impact to growth. Increased co-operation with relevant stakeholders and departments as well as more clarity and sufficient buffer time for policy implementation can help to ensure smoother transitions for policy changes.

On the whole, policymakers are likely to be growth-minded in the coming quarters, which will help the recovery process after the COVID-19 transition period. We think policymakers are likely to set a growth target of around or above 5% GDP in 2023. And with sufficient policy support to add further tailwinds, this will complement the likely recovery in consumption and stabilization in the housing market, which should help GDP growth to reach 5% in 2023e.

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