HSBC Global Research

3 November 2022

Getting back on track

Why China's growth could top 5% in 2023

Free to View
Economics - China

- While headwinds persist, we remain constructive on China and keep our 5.2% growth forecast for 2023…
- …predicated on a gradual relaxation of COVID-19 measures, housing market stabilisation, and continued policy stimulus
- The full note discusses the potential bull and bear case scenarios

Jing Liu
Chief Economist Greater China
The Hongkong and Shanghai Banking Corporation Limited

Erin Xin
Economist, Greater China
The Hongkong and Shanghai Banking Corporation Limited

Why we stick with 5.2%: Multiple challenges continue to impact China's economy. COVID-19 restrictions are denting activity in the major cities, especially given the case resurgence lately, the property sector is still weak, and the consumption recovery is sluggish. Despite this, we remain constructive on China's growth outlook and keep our 2023 forecast at 5.2%. In our base case, we see China further fine-tuning and gradually relaxing some COVID-19 restrictions in 2023, the housing market stabilising, and continued policy support along with improved policy implementation. This, combined with a low base, is why we see 5.2% growth next year as achievable.

Inside our base case: One of the key assumptions embedded in our growth forecast is a gradual relaxation of the COVID-19 policy next year. However, any shift would hinge on a few essential conditions, including sufficient vaccination coverage, treatment drug availability, and a global scientific consensus on the pandemic. To be clear, we do not expect any major policy shifts in the near term, but we acknowledge China is making steady progress in its vaccination coverage, upgrading its vaccines, as well as medicine development. Regarding the housing market, more measures are being rolled out to provide funding and stabilise expectations. We also expect more stimulus policies and better implementation following the recent political reshuffle.

Bear and bull cases: Given all the uncertainty, the full note provides a Bear and a Bull scenario analysis, where we take into account eventualities such as whether the housing market correction continues and whether the COVID-19 restrictions continue for longer. Or, on the other hand, whether the policy mix could prompt a moderate housing market rebound, or if stronger policy, including more stimulus or less COVID-19 uncertainty, can push the economy onto a faster recovery track.

This is a Free to View version of a report with the same title published on 03-Nov-22. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

Issuer of report: The Hongkong and Shanghai Banking Corporation Limited

View HSBC Global Research at:
https://www.research.hsbc.com

Steady recovery

- Our 5.2% GDP forecast for 2023 assumes a gradual relaxation in COVID-19 restrictions, a stable housing market, and policy support…
- …based on a gradual relaxation of COVID-19 measures, recent moves to help the housing market, and better policy implementation
- The full note lists potential surprises to the upside and downside for the growth rate in 2023

What supports our 5.2% forecast for GDP growth in 2023?

COVID-19 containment measures to be gradually relaxed in 2023
In our base case, COVID-19 containment measures should be gradually relaxed in 2023. We see this hinging on three conditions: i) continuous progress in vaccination coverage and upgraded vaccines, ii) wide availability of COVID-19 anti-viral drugs and enhancement of the public health response capacity, and iii) scientific consensus on the COVID-19 pandemic ending globally.

Although we do not expect any major policy shift in the near term, the authorities continue to lay the groundwork for future relaxation. On the vaccinate rate, 90.2% of the Chinese population have received two doses, as of 12 October 2022, out of which 57.2% have also had a booster dose. In particular, the booster coverage in the elderly population (aged 60 years old and above) has gradually increased to 67.3% (Chart 1). Though the ratio is still lower than the ideal level, it is higher than the whole population, indicating the prioritised efforts to cover the elderly.

China has also made steady progress in developing vaccines and vaccination methods. The National Health Commission has been promoting so-called 'sequential immunisation' (序贯接种) since February (CCTV, 19 February 2022), backed by studies showing that this method could be more effective. Basically, when a different type of vaccine is administered as the booster, many more antibodies can be generated compared to the three doses of inactivated virus vaccines (SCMP, 24 May 2022 and 17 June 2022). Since 26 October 2022, Shanghai has started administering Cansino's adenovirus-vectored inhalable COVID-19 vaccine as a booster dose, less than two months after the vaccine obtained emergency use approval from the National Medical Products Administration (4 September 2022). Jiangsu province will soon start administering an inhalable vaccine to residents (Jiangsu Provincial Centre for Disease Control and Prevention, 2 November 2022). This might mark the start of a nationwide booster campaign.

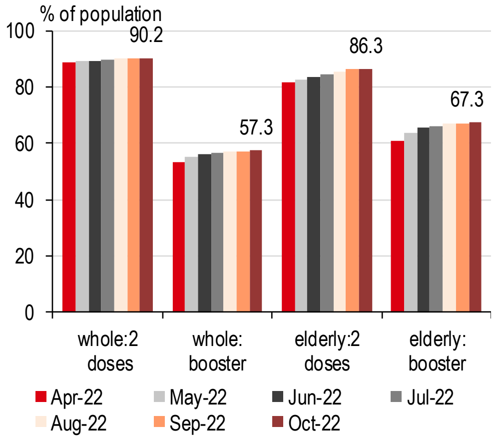
COVID-19 antiviral drugs are also becoming more accessible in China. In July, China granted conditional approval for the home-grown COVID-19 antiviral drug Azvudine (Nature, 26 July 2022). The production capacity of Azvudine is at a level to treat over 14m patients per year and is expected to triple (China Daily, 15 August 2022).

Regarding the scientific consensus on the pandemic globally, the recently concluded United Nation's General Assembly assessed that the pandemic is not over, but the end is "in sight". The World Health Organization's (WHO) Director-General, Tedros Adhanom Ghebreyesus, noted encouraging signs of a decreasing mortality rate and increasing vaccination rates.

Nonetheless, the WHO highlighted that more work needs to be done and that policymakers need to take action, including testing, clinical management and vaccinations. At the same time, global experts are monitoring changes to the virus, especially during this winter. Some expect that the WHO may announce the end of pandemic in 2023 (The Standard, 1 September 2022).

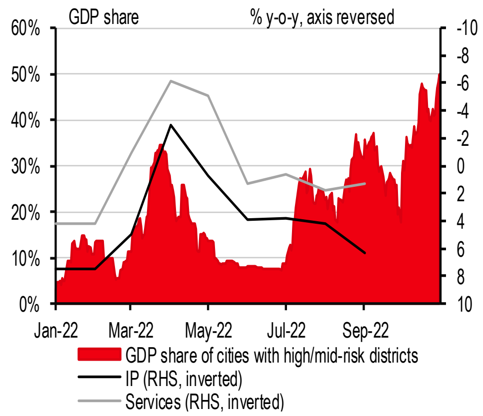
Some relaxations are already underway. For example, China increased the number of international flights to 840 per week between 30 October 2022 to 25 March 2022, a 106% increase from the same period in 2021 (people.cn, 26 October), though this is still less than 5% of the pre-pandemic level of c18,000 flights per week. At the same time, the authorities are more pragmatic about entry and exit requirements to facilitate business integration with the rest of the world. On 25 October 2022, the National Development and Reform Commission (NDRC) released a new policy to promote foreign investments in the manufacturing sector, among which, the document urged the granting of express passes and easing cross-border travel for foreign executives and their family members (Bloomberg, 25 October 2022). Meanwhile, Beijing announced that mainland residents could travel to Macau by using an online visa system from 1 November 2022, streamlining the travel requirements and paving the way for mainland travel groups to visit Macau after three years of pandemic restrictions (RTHK, 31 October 2022).

Chart 1: Vaccination rates increasing, especially among the elderly



Note: Elderly population includes 60 years old and above.
Source: CEIC, HSBC

Chart 2: Containment measures adjusted to reduce the impact on economic activity



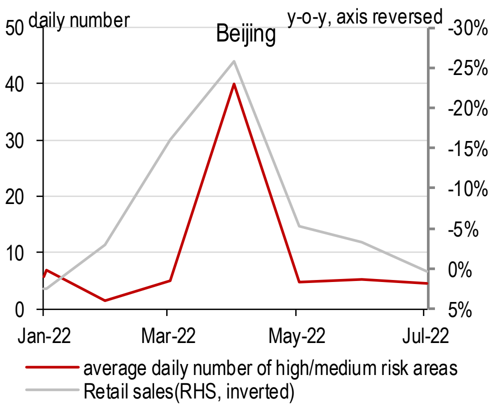
Note: Data end 30 October 2022.
Source: Wind, CEIC, HSBC estimate

Negative impact on production and logistics more limited

China has imposed strict measures to contain the spread of COVID-19 since the first outbreak in 2020. The transmissible nature of the Omicron strain has made it more challenging this year. In late March 2022, Shanghai entered a two-month city-wide lockdown. Shanghai alone represents 3.8% of national GDP, but it is a centre for supply chains and logistics networks for the Yangtze River Delta, which itself accounts for one quarter of national GDP. Therefore, while business and factory operations in Shanghai were primarily affected, the escalation of containment measures across the country severely disrupted transportation and the industrial supply chain. 2Q22 GDP growth, therefore, came in lower than many had expected (0.4% y-o-y vs. Bloomberg: 1.2% y-o-y). Beijing has since coordinated efforts to ensure production and logistics continue as smoothly as possible.

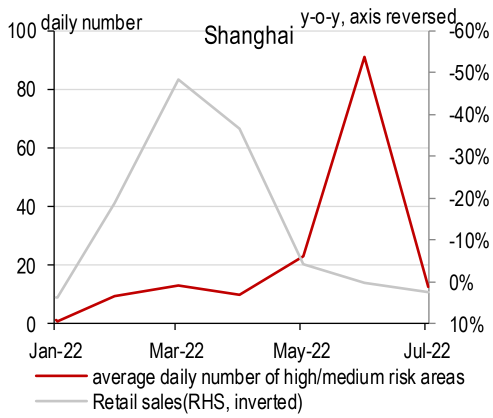
In 3Q22, there was a broad-based recovery in economic data, despite the escalation in COVID-19 measures, as manifested by regions put under partial or full lockdown: since mid-August 2022, cities with designated high-risk and medium-risk areas accounted for more than 30% of the national economy (Chart 2). September 2022's industrial production growth, especially manufacturing, was the fastest since February 2022, suggesting a strong supply-side rebound, as well as still resilient exports. This may imply better pandemic management at the local level. Local administrations have imposed swifter and more targeted lockdowns as the first reaction to identified infections to avoid wider and lengthier lockdowns. Large cities that are economically important have made PCR testing a routine after the Shanghai lockdown. Anecdotal evidence suggests that factories have implemented so-called “closed-loop management” systems to keep production going even amid outbreaks. Logistics disruptions have been greatly reduced as well.

Chart 3: Beijing: Retail sales and COVID-19 restrictions are inversely correlated



Source: Wind, CEIC, HSBC

Chart 4: Shanghai: A steady rebound in retail sales since April 2022

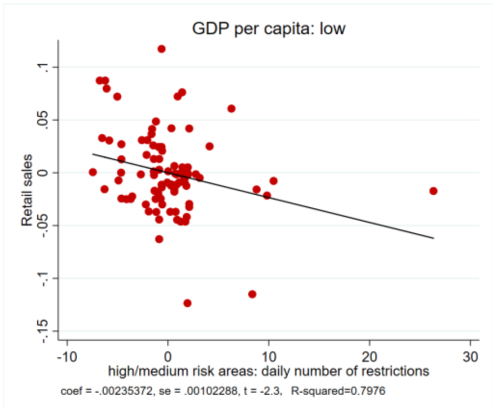


Note: Shanghai imposed a two-month citywide lockdown in late March 2022, while not many areas were designated “high/medium risk”.
Source: Wind, CEIC, HSBC

Chart 5: COVID-19 restrictions negatively impact retail sales growth…

Note: The sample includes tier-1 and tier-2 cities.
Source: Wind, CEIC, HSBC estimate

Chart 6: …and is more salient in less-developed cities as measured by GDP per capita



Note: “low” – tier-1 and tier-2 cities with below the median GDP per capita.
Source: Wind, CEIC, HSBC estimate

Housing market

Housing market to stabilise in 2023

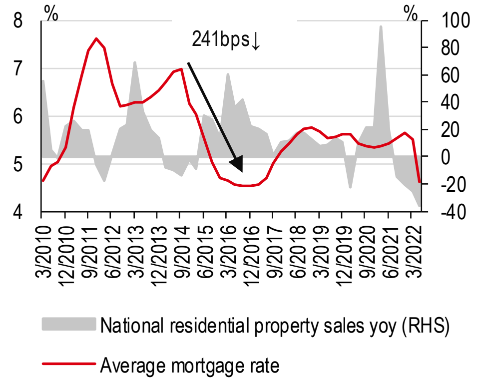
It has been a challenging year so far for the property sector, with national residential housing sales dropping c29% y-o-y in value terms for the first nine months in 2022 (down 26% y-o-y for commercial buildings).

Various measures have been rolled out by both the central and local governments with a goal of stabilising the housing market, with the recent ones being: i) the People’s Bank of China (PBoC) and the China Banking and Insurance Regulatory Commission (CBIRC) allowed some cities to relax mortgage rate lower limits for first-time homebuyers from October 2022, facilitating further mortgage rate cuts; ii) the PBoC’s Monetary Policy Committee (MPC) urged the central bank to consider increasing the quota of special loans extended by policy banks to 'ensure deliveries of homes' and guide commercial banks to provide funding support for the healthy development of the real estate market (pbc.gov.cn, 29 September 2022); and iii) at the local level, more cities have introduced measures to stimulate demand, such as allowing residents to use housing provident funds – a savings and retirement account that employees can use to supplement commercial mortgages for home purchases – for down payments (CCTV, 28 October 2022).

The authorities still have more options. In the previous cycle, the average mortgage rate was lowered by 241bp between September 2014 and September 2016 (Chart 7), while in the first six months of 2022 the rate dropped 101bp. It is also interesting to note that pledged supplementary lending (PSL) – a special lending facility under which the PBoC provides loans to policy banks for their re-lending for specific purposes – saw the first net increase in over two years of RMB108bn in September 2022 (Chart 8). In the previous housing cycle, PSL funding was used as cash compensation for residents whose homes were demolished in shanty town renovations, which helped the property market turn around. It remains unclear whether this is just one data point or the restart of the PSL tool.

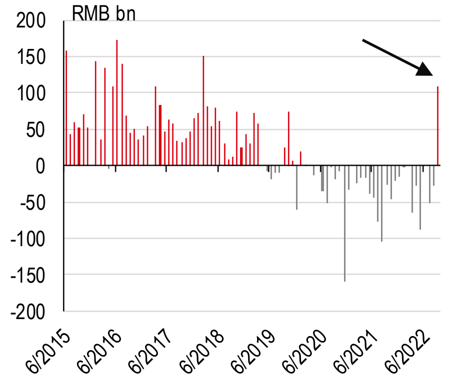
On a related note, China has planned to renovate c219,000 old urban residential communities between 2021 and 2025, according to the 14th Five-year Plan (2021-25) (Xinhua, 11 January 2022). A recent development too is that the Ministry of Finance announced central fiscal subsidies to support Shenzhen's old town renovation and public housing construction (Ministry of Finance, 31 October 2022). Conceivably, China can potentially use one tool (PSL) to achieve two goals (renovating urban residential communities and stabilising the housing market).

Chart 7: There is still room for further mortgage rate cuts



Source: CEIC, HSBC

Chart 8: First net increase of pledged supplementary lending in over two years



Source: CEIC, HSBC

Economic policies to focus on supporting growth

We expect further easing to help growth fully recover. In the next few months, the annual Central Economic Work Conference in December 2022, the once every five years National Financial Work Conference – the exact time has not yet been announced but will likely be after appointments of the top financial regulators – and the National People's Congress in March 2023 will likely announce detailed measures. Most of the support will likely come in the form of increased fiscal support and better implementation of already announced policy. Monetary policy is also likely to remain accommodative with a focus on quantity-based and structural tools, namely, targeted liquidity injections to policy-preferred sectors or areas.

Fiscal policy will likely take the lead with a continued focus on infrastructure
On the fiscal side, infrastructure investment will likely remain an important tool. There has been accelerated issuance of special local government bonds, as well as policy banks' credit and equity investments in infrastructure projects. The concern remains about the weakening local fiscal stance as local fiscal revenues are under pressure from slower economic growth, as well as the decline in land sales so far this year, while expenditures are rising in relation to public health and social welfare spending. The central government might be better positioned to provide funding either by drawing down its reserves or issuing Treasury bonds, given its low debt-to-GDP ratio (20.6% as of September 2022, according to the National Institution for Finance & Development).

Boosting consumption
The government wants to lift consumption spending by encouraging the purchase of consumer durables. For example, the authorities have issued consumption vouchers and tax cuts to support the purchase of automobiles. Car sales have seen a significant rebound since the implementation of tax cuts in June 2022 (effective until December 2022), rising by double-digit y-o-y growth, compared with a decline of 9.9% in the first five months of 2022.

With consumption remaining one of the areas under most pressure, the government is likely to expand its support and better implement targeted support. As we have highlighted above (see Chart 6), less economically well-off cities' retail sales are relatively more sensitive to COVID-19 disruptions. Therefore, providing more targeted support to less economically developed areas or lower income groups, which have been more directly impacted by COVID-19, can result in more effective use of fiscal support.

Additionally, more targeted measures for hard-hit small- and medium-sized enterprises (SMEs) (such as through credit guarantees, tax cuts, or further government waivers for rent and utilities) can help to keep small businesses afloat. With SMEs accounting for over 85% of urban employment, continued support should help alleviate some labour market pressure. This should, in turn, lead to a positive feedback loop of stable jobs and continued incomes, which should help improve consumer confidence and allow for further spending. On the whole, we expect consumption to see growth of 2.1% this year, followed by a further gradual recovery to 5.6% in 2023.

Monetary policy will likely be accommodative
The PBoC has the space to remain accommodative in light of lower inflationary pressure as core CPI remains below 1% y-o-y. Given the divergent monetary policy, especially with the US, we expect the PBoC to rely more on quantity-based tools. In particular, we expect a 25bp cut to the broad-based required reserve ratio (RRR) in the rest of the year, with a further 50bp cut in H1 2023. Targeted tools like additional relending quotas for growth areas like green investment for clean coal or manufacturing upgrading, as well as hard-hit SMEs, are also likely. Further window guidance for banks to increase their lending to the real economy should also continue into 2023. In all, we expect total social financing (TSF) growth to stay elevated and generally sustain double-digit growth through to the end of 2023.

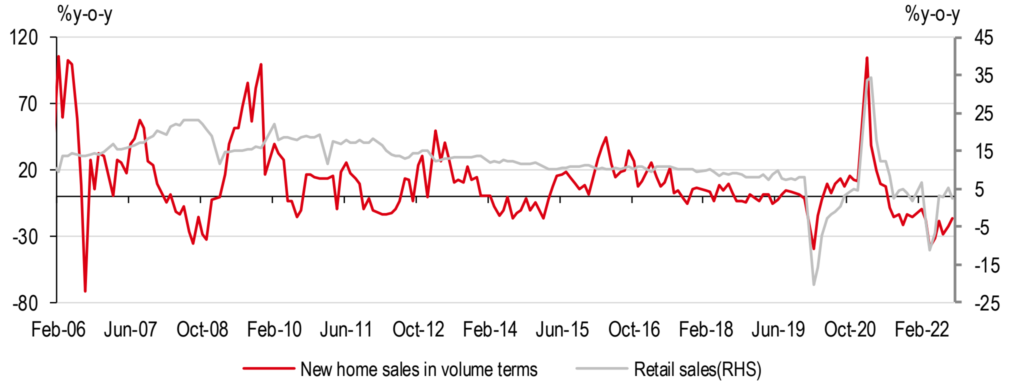
Policy implementation to improve after the 20th Party Congress
The 20th Party Congress unveiled a new leadership and set up a new central goal of "advancing the rejuvenation of the Chinese nation on all fronts through a Chinese path to modernisation" (Xinhua, 16 October 2022). Economic growth is a necessary condition for China to realise its long-term goal, though there will be more emphasis on quality and inclusive growth, as well as security.

We expect policy implementation to improve in the coming months as the reorganisation of officials is finalised. At the local level, it is well documented that officials are more driven towards regional economic growth at the beginning of their tenure, as relative economic performance will play an important role in career advancement.[1] At the central government

[1] For example, see Chen, Zhuo, Jie Chen, and Jian Chen, "Political cycle, official tenure, and real estate investment," China Economics Studies, No. 6, pp. 75-88, November 2021; Luo, Weijie and Shikun Qin,

level, a reorganisation of top economy officials may show the same effect, especially at a time with elevated growth headwinds. Policy coordination may also improve across government agencies and among different levels of governments.

Chart 9: Housing sales and retail sales are positively correlated



Source: Wind, HSBC

Conclusion

China's recovery is likely to continue. In our base case, the recovery trajectory should continue to solidify into 2023. While consumption may continue to see only a gradual recovery, we expect it to continue, nonetheless, as continued COVID-19 measures should be further fine-tuned and the property market may have reached a trough and should continue to improve. Meanwhile, investment-led growth from manufacturing and infrastructure are likely to remain key drivers for growth. Accounting for a lower base, this would drive a growth recovery of 5.2% for 2023.

However, there are many uncertainties ahead – both positive and negative – which inform our bear and bull scenarios. For more details, please contact your HSBC representative.

"China's Local Political Turnover in the Twenty-First Century," Journal of Chinese Political Science, Vol. 26, pp. 651–674, 2021.

Disclosure appendix

The following analyst(s), who is(are) primarily responsible for this document, certifies(y) that the opinion(s), views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Jing Liu and Erin Xin

This document has been issued by the Research Department of HSBC.

HSBC and its affiliates will from time to time sell to and buy from customers the securities/instruments, both equity and debt (including derivatives) of companies covered in HSBC Research on a principal or agency basis or act as a market maker or liquidity provider in the securities/instruments mentioned in this report.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking, sales & trading, and principal trading revenues.

Whether, or in what time frame, an update of this analysis will be published is not determined in advance.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at *www.hsbcnet.com/research*.

Additional disclosures

1. This report is dated as at 03 November 2022.
2. All market data included in this report are dated as at close 02 November 2022, unless a different date and/or a specific time of day is indicated in the report.
3. HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking, Principal Trading, and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.
4. You are not permitted to use, for reference, any data in this document for the purpose of (i) determining the interest payable, or other sums due, under loan agreements or under other financial contracts or instruments, (ii) determining the price at which a financial instrument may be bought or sold or traded or redeemed, or the value of a financial instrument, and/or (iii) measuring the performance of a financial instrument or of an investment fund.

Disclaimer

Issuer of report
The Hongkong and Shanghai Banking Corporation Limited

.

[1203031]