28 April 2023

China GDP upgrade

Consumption jump-starts the recovery

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Economics - China

- China's recovery has started on a strong footing, led by consumption that's set to stay strong for the coming quarters
- Property sales surprised to the upside, but their sustainability remains the big debate; sector-wide stabilisation will take time
- We revise up 2023f GDP growth to 6.3% (from 5.6%) on the solid momentum but revise down 2024 to 5.0% (from 5.5%)

The grand re-opening: China's economic recovery is off to a flying start. Growth in the first quarter came in stronger than expected, at 4.5% y-o-y, with the bounce-back being relatively broad-based. As a result, we now expect China to grow at an even faster 6.3% clip this year, up from our previous forecast of 5.6%. But, as the recovery broadens out even more, there is likely to be a slight slowdown in momentum, and so we foresee growth cooling to 5.0% in 2024e (from 5.5% previously).

Spend, spend, spend: Consumption stands out as the driving force of the recovery given that spending was so depressed during the pandemic. We expect consumers to keep on buying, though the consumption recovery will likely be differentiated. Travel and tourism have fully recovered domestically, but outbound travel needs time to get back to pre-pandemic levels. We expect double-digit consumption growth this year.

Property progress: The real estate market has also seen some green shoots, with policy easing filtering through in the form of lower mortgage rates, loosened home purchase requirements, and increased funding support for developers. Home sales returned to positive growth in March for the first time since mid-2021. However, the sector needs time to recover fully – new home starts are still falling and have yet to stabilise. By H2, though, property investment is likely to grow again on the back of increased confidence in the sector and policy-easing measures taking effect.

Headwinds: Global demand remains uncertain, and there's still labour market pressure. The youth have been hit particularly hard by the slowdown in recent years, with one in five unemployed. Thus, Beijing is not likely to change its policy tone: a pro-growth mindset will mean ongoing fiscal support and continued accommodative monetary policy. This should help to keep up investment in manufacturing and infrastructure and support a broader-based recovery.

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NEW GDP FORECASTS

▲ 6.3%

2023e GDP growth forecast revised up from 5.6%

Summary of our key forecasts

% y-o-y	2023e	2024e
Real GDP	6.3	5.0
Real GDP breakdown by expenditure		
Private consumption	10.0	7.7
Government consumption	4.0	3.2
Gross capital formation	5.3	4.0
Net exports, contribution ppt	-0.2	-0.1
Major economic indicators		
Retail sales*	12.0	10.0
Fixed asset investment*	5.1	5.2
Industrial production**	5.9	5.1

*Denotes growth in nominal terms
**Denotes growth in real terms
Source: HSBC estimates

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China GDP upgrade

- China's recovery is starting on a strong footing, led by a recovery in consumption which is likely to stay elevated in the coming quarters
- 1Q home sales were a positive surprise, though their sustainability remains up for debate; sector-wide stabilisation will take time while ongoing policy easing serves to underpin investment
- We revise up 2023 GDP growth to 6.3% (from 5.6%) on the better recovery momentum but revise 2024 down to 5.0% (from 5.5%)

A strong start to the year

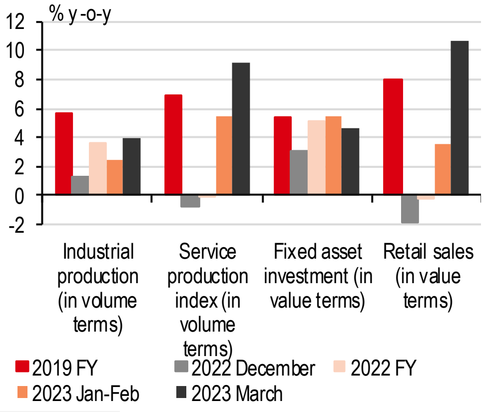
China's recovery has been faster and stronger than we expected. The Q1 GDP print came in above expectations, driven mostly by a rebound in consumption and services (see chart 1). But this also reflects a more front-loaded recovery. As such, we see the sequential pace moderating later this year as the recovery broadens out, though it will likely still be fast enough to ensure the overall recovery continues to gain traction. We revise up our GDP forecast to 6.3% for this year, up from 5.6% previously. The strong recovery this year, though combined with the softer pace of growth in 2024, leads us to lower our 2024 forecast to 5.0% (from 5.5% previously).

Table 1. HSBC GDP forecast changes

Mainland China	Q1 2023	Q2 2023f	Q3 2023f	Q4 2023f	Q1 2024f	Q2 2024f	Q3 2024f	Q4 2024f	2023f	2024f
GDP, % y-o-y, new	4.5	8.5	5.9	6.5	5.5	5.0	4.8	4.9	6.3	5.0
GDP, % q-o-q, new	2.2	1.6	1.4	1.2	1.2	1.1	1.2	1.3	n/a	n/a
GDP, % y-o-y, old	*2.2*	*7.4*	*5.5*	*6.9*	*7.1*	*5.8*	*4.8*	*4.7*	*5.6*	*5.5*
GDP, % q-o-q, old	*1.0*	*2.3*	*2.0*	*1.4*	*1.2*	*1.1*	*1.0*	*1.3*	*n/a*	*n/a*

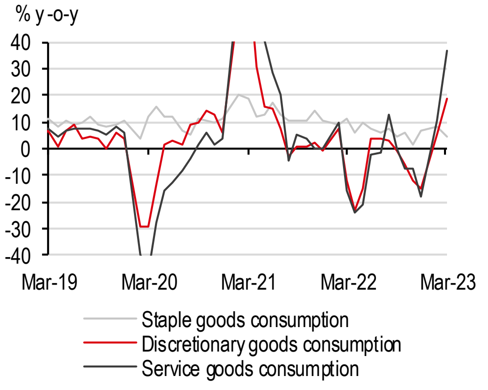
Source: HSBC forecasts. n/a – not applicable

Chart 1. China's economic recovery is starting off strong



Source: CEIC, HSBC

Chart 2. A consumption recovery led by services



Source: CEIC, HSBC

Consumption recovery to be V- and K-shaped

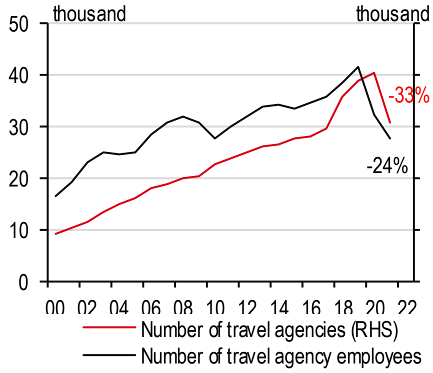
The key driving force behind the recovery has been consumption, which is understandable as this was so heavily depressed during the pandemic. The V-shaped recovery in retail sales (growth was double digits during March) has been underpinned by pent-up demand, particularly in services consumption (see chart 2). Domestic tourism in Q1 returned to roughly 90% of its 2019 levels, while dining out (catering sales growth rebounded to 26.3% y-o-y in March) and goods related to consumers venturing out more (clothing sales, cosmetics and jewellery) also saw a strong rebound with double-digit growth.

But some categories of durable goods may see a softer pace of growth, highlighting that there's a K-shaped or divergent recovery across the consumption sector. Demand for car sales has been dented as the government has reduced its support for the sector, prompting aggressive price cuts and the roll out of subsidies by car companies and local governments to help boost sales. Meanwhile, electronic goods are also facing weaker demand as China emerges from the pandemic with less demand for the types of products needed to work or study at home.

On the tourism front, domestic tourism has already rebounded as capacity has ramped back up and there's pent-up demand. However, Chinese travellers are yet to venture overseas in large numbers. By the end of March, Chinese outbound travel volumes had returned to just 18% of their pre-pandemic levels. Bottlenecks like backlogs in receiving visas from overseas countries and passport approvals, prior limits on outbound travel group destinations as well as a need for airlines to build back their international capacity have all contributed to the delay.

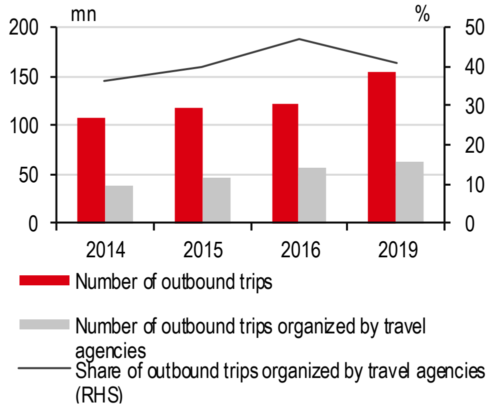
Outbound tour groups historically made up about 40% of China's total outbound trips (c155m in 2019) (see chart 4), and 70% of trips to destinations other than Hong Kong and Macau. But the resumption of group tours has only been piecemeal. As of 15 March, a total of 60 countries are permitted for outbound group tours. In addition, and as shown in chart 3, during the pandemic the number of travel enterprises shrank by over 20% and employment in the sector fell by over 30% (end 2021 levels versus their recent peaks). Outbound travel services likely suffered the most, so it will take time to see a full recovery in outbound tours.

Chart 3. A shrinking of the travel industry has contributed to a slower ramp up in outbound travel



Source: CEIC, HSBC

Chart 4. Outbound tour groups make up about 40% of all outbound trips



Source: CEIC, HSBC

International flight capacity also needs to recover further with airlines still needing approvals from the Civil Aviation Administration to restart air routes. As of mid-April, international flight capacity was at just 30% of 2019 levels, contributing to the delay in the rebound of international travel. The government estimates that international routes will recover to about 75% of pre-pandemic levels during the summer and autumn seasons (CAAC, 24 March). International travel should therefore pick up further in the coming months as air routes are restarted and backlogs decline, which could lead to a larger drag on the current account services deficit in the coming quarters.

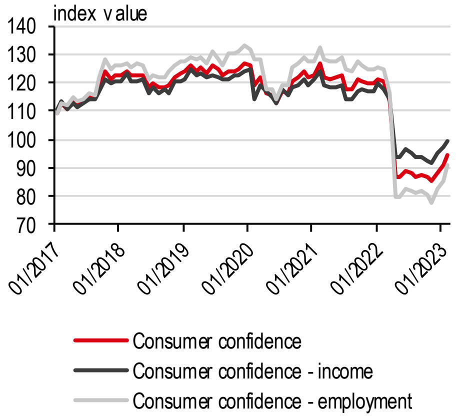
Consumption recovery to be sustained

Will the strength in China's consumption continue? It's highly likely. Even if some of the initial pent-up demand wears off, there is still an elevated level of excess savings that's been accumulated during the pandemic and which can be tapped into. Household deposits have stayed high in Q1, although the savings rate has already returned back to trend levels in Q1 2023 on the back of the re-opening (see chart 6). This goes hand in hand with the already strong consumption recovery.

The consumption recovery among lower income groups depends more on jobs as they may not have such large savings to draw upon. The good news is the services-led recovery has brought back many jobs – the surveyed unemployment rate dropped 0.3ppt to 5.3% in March, reflecting job creation alongside the recovery. That will likely continue to be a tailwind for discretionary goods consumption (see chart 2).

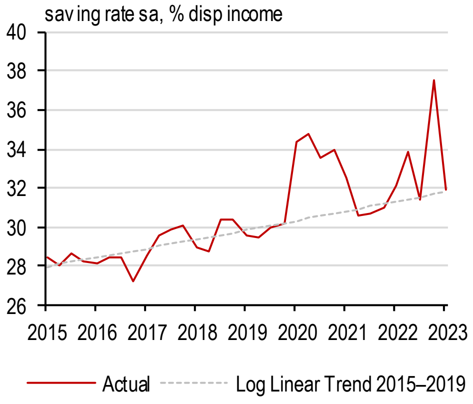
Meanwhile, a broader economic recovery should help to lift confidence levels for both businesses and households, creating a virtuous circle that can further sustain the consumption recovery. On the whole, we see consumption growth likely reaching c10%, up from our previous 8.5% estimate, and led by a bounce-back in services consumption.

Chart 5. Consumer confidence is picking up, but still needs more time



Source: CEIC, HSBC

Chart 6. Excess savings accumulated during the pandemic provides dry powder

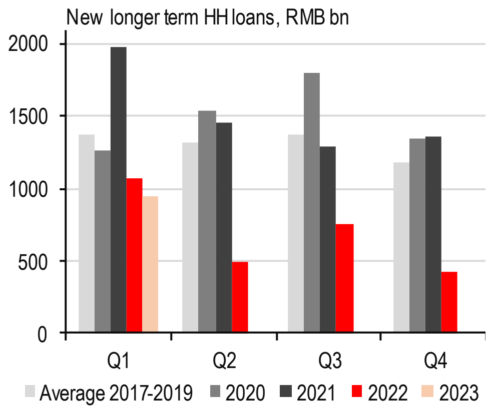


Source: CEIC, Eviews, HSBC

Property market to see a modest pickup in H2

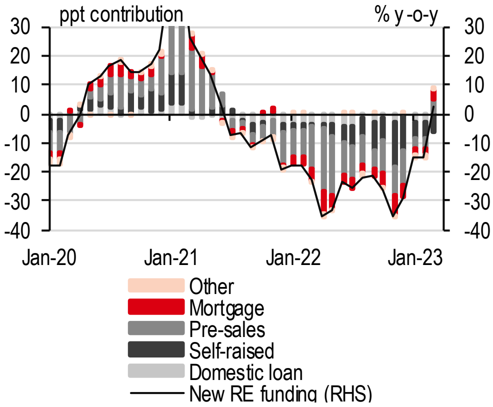
After being dragged down last year, the property sector (in terms of real estate investment) is set to see a modest bounce in growth this year. New home sales returned to positive growth in March for the first time since mid-2021, a faster-than-anticipated bounce back and due to policy easing since the end of last year. Mortgage rates have fallen while local governments have lifted requirements on home purchases. Longer-term household loans, which tend to be linked more closely with mortgages, started to rebound in Q1 (orange bar in chart 7) relative to the more depressed levels seen in Q2-Q4 2022 (red bars). Meanwhile, developers have been thrown a lifeline with increased bank loan issuances and a return of pre-sales income (chart 8).

Chart 7. Longer-term household loans are starting to recover



Source: CEIC, HSBC

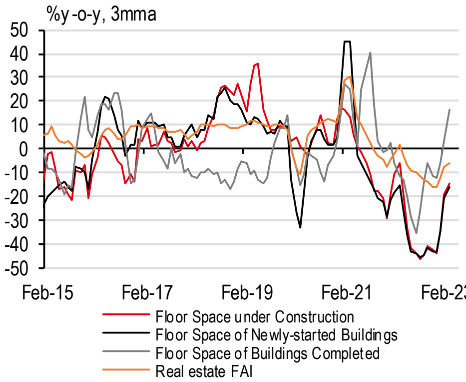
Chart 8. Developer funding is being supported by bank lending and pre-sales



Source: CEIC, HSBC

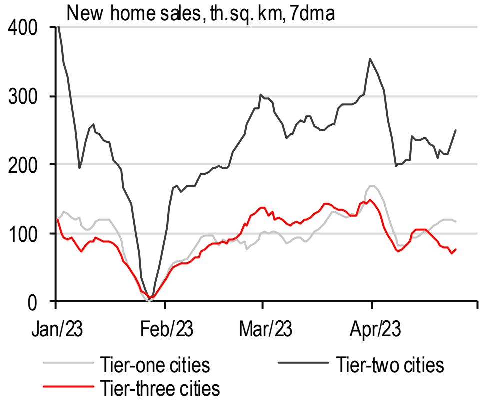
However, it may still take time for the sector to fully stabilise. Q1 property investment shrank, down by 5.8% y-o-y in Q1, while new floor starts have continued to contract (down 27% y-o-y in March, see chart 9). This points to a still weak longer-term outlook as construction has mostly been focused on completing already started housing projects.

Chart 9. New floor starts remain weak as confidence still needs time to recover



Source: CEIC, HSBC

Chart 10. Home sales in tier-3 cities are down in April as demand remains weak



Source: Wind, HSBC

Even though there have been green shoots in the property sector, the rebound hasn't all been even which suggests it will too be a K-shaped recovery. Demand for property in more economically developed and larger cities has remained robust, contributing to a spike in home sales. However, despite an initial bounce, home sales in lower-tier cities have started to fall again in April (chart 10) given oversupply as well as relatively weaker economic activity.

Meanwhile, Beijing announced on 25 April the completion of its unified real estate registration system, helping to pave the way for an eventual property tax. But we expect the rollout of this tax to be low on Beijing's priority list, as the property sector has yet to fully stabilise. A broader-based recovery would likely be a prerequisite and, even then, it is likely to come first in the form of more pilots (in addition to Shanghai and Chongqing) rather than a nation-wide policy.

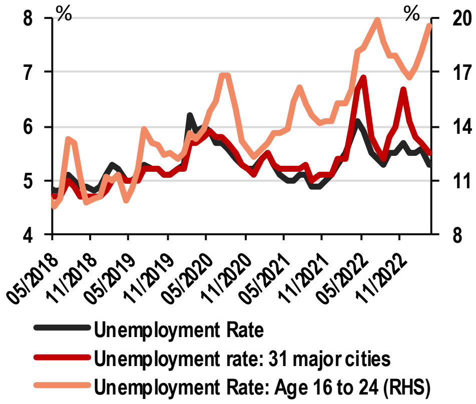
In all, we expect that, as more property policy support comes through, this will contribute to a modest rebound in H2 of property investment, with full-year growth expected to reach 3.9% (unchanged). That said, policymakers are likely to adhere to the principle that "housing is for living in, not speculation". Thus, while property will likely stabilise this year, it is unlikely to drive overall growth.

Policymakers to keep a pro-growth mindset

Despite the strong growth tailwinds, the pace of the recovery could still be held back. Export growth continues to face uncertainties and the labour market still needs time to recover. And while exports jumped in March, net exports contributed to a net drag on growth in the first quarter. Signs of slowing global demand for goods like electronics, which were favoured during the pandemic, may keep exports soft this year, while a widening services deficit due to Chinese travellers going overseas will likely result in a modest net exports drag this year.

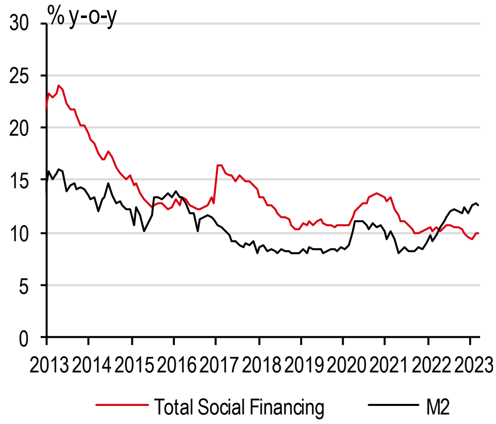
Meanwhile, labour market pressure may not dissipate in the short term. Roughly one in five youths are currently unemployed (chart 11), while a record 11.6m college students will graduate this summer. To try to help alleviate some of the pressure, the government is holding more online and offline job fairs, encouraging entrepreneurship (e.g. promoting exchanges and mentorships, providing entrepreneurship training, and making it easier to conduct business), encouraging further vocational training and looking to increase the number of public sector jobs.

Chart 11. Nearly one in five youths are unemployed



Source: CEIC, HSBC

Chart 12. Monetary policy will stay accommodative



Source: CEIC, HSBC

Overall, the pro-growth stance will likely remain, but we don't expect massive policy stimulus. On the fiscal front, policymakers have already announced a larger issuance quota for special local government bonds as well as a positive fiscal impulse. But there will still be challenges as LGFVs face rising debt obligations amid a long-term structural decline in funding from land sales which means they will need to turn to other sources of funding. On this front, the economic recovery should help to replenish some government revenues. Total government revenues rose 0.5% y-o-y in Q1 and will likely continue to pick up in tandem with increased economic activity. Meanwhile, ongoing fiscal support in the form of special local government bonds as well as direct government funds will help investment growth. This should keep both infrastructure and manufacturing investment supported this year, though growth is likely to moderate from the roughly 10% pace (for both) to 5.6% and 5.3% this year, respectively (unchanged).

Monetary policy will continue to remain accommodative, but the elevated inflationary pressure and recent banking turmoil in the US and Europe is likely to have made the PBOC warier about financial stability. Inflationary pressures remain benign, with lower-than-expected prints in Q1 leading us to lower our headline CPI and PPI inflation forecasts (see table). That said, we expect a broader economic recovery to lead to reflation, though at likely manageable levels. More monetary easing is likely to come through to encourage investment as well as support ongoing government bond issuance. We expect most of the monetary support to come through in the form of liquidity tools, such as another 25bp cut to the required reserve ratio (RRR) in Q2. This should help total social financing growth to expand at a double-digit pace this year.

Table 2. HSBC CPI forecast changes

Mainland China	Q1 2023	Q2 2023f	Q3 2023f	Q4 2023f	Q1 2024f	Q2 2024f	Q3 2024f	Q4 2024f	2023f	2024f
CPI, % y-o-y, new	1.3	1.4	2.3	3.0	3.3	2.9	2.2	1.8	2.0	2.5
PPI, % y-o-y, new	-1.6	-2.5	0.6	2.0	3.0	3.0	2.4	2.0	-0.4	2.6
CPI, % y-o-y, old	*1.6*	*2.1*	*2.9*	*3.3*	*3.4*	*2.8*	*2.5*	*2.5*	*2.5*	*2.8*
PPI, % y-o-y, old	*-1.3*	*-2.0*	*1.1*	*2.6*	*3.4*	*3.2*	*2.6*	*2.2*	*0.1*	*2.9*

Source: HSBC forecasts

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