China's speedy recovery

GDP upgrade: starting the year off right

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Economics - China

- With the worst of COVID-19 in the rear-view mirror, a faster-than-expected consumption and labour market recovery…
- …supported by stronger policy stimulus for the property sector and new growth drivers…
- …are set to help take GDP growth to 5.6% (from 5.0%) in 2023 and 5.5% (from 5.8%) in 2024

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GDP growth gets a lift: Things are looking up. The worst of the COVID-19 impact looks to be behind us, as does the risk of another large outbreak caused by travel during the Chinese New Year holiday period. This puts China on track to stage a strong recovery this year, and we now no longer see a drag in the first quarter. The stronger start to the year will likely allow growth to reach 5.6% this year (up from our previous estimate of 5.0%) and continued momentum into 2024 will likely see growth reach 5.5% (from 5.8%), both above consensus (5.1% for 2023 and 5.0% for 2024).

Consumption rebound: The recovery will likely be led by a rebound in consumption, especially services, which was hit particularly hard during the pandemic. With signs of a recovery in consumer confidence, pent-up demand amid normalisation, and stronger economic activity supporting the labour market, we think services consumption stands to benefit the most. We also see a pick-up in goods demand from lower income households, especially for discretionary items. An additional push from excess savings will likely lift y-o-y consumption growth to 8.5%.

Property market stabilisation: Since the end of last year, the government has released policy measures aimed at providing sufficient funding for developers and lifting household demand for housing. Policy easing has further picked up pace, with the lowering of mortgage rates and easing of home purchase restrictions in certain cities. While housing sales remain sluggish, partly on account of the impact of COVID-19 and the Chinese New Year holiday period, we think they will stabilise in the coming months. We expect property investment to recover to a moderate 4% growth in 2023.

Policy support: Policymakers will convene at the National People's Congress on 5 March 2023 to set China's economic and policy targets for the year. The focus is likely to be on ensuring a solid recovery this year, led by pro-growth policies. Fiscal policy will likely be more expansionary (we expect a fiscal deficit of 3.2%, up from 3.0%) and we see larger special local government bond issuance at RMB4.0trn (up from RMB3.65trn). Monetary policy will likely provide liquidity support. There is also expected to be increased support for new growth areas to ensure high-quality, sustainable development.

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China GDP upgrade

- We revise our growth forecast to 5.6% (from 5.0%) in 2023 and 5.5% (from 5.8%) in 2024…
- …as the reopening is progressing at a faster pace than expected; an expanding Q1 should lay a solid foundation for 2023
- Pent-up demand for both services and goods will likely lead the recovery, with lockstep policy support setting the economy on the right track

A stronger start to the year

The pace of reopening is beating expectations

We are raising our GDP forecasts, as the pace of reopening is beating expectations and the largest impact from COVID-19 looks to be behind us. The pick-up in activity is solidifying, particularly in the consumption of services. Stronger confidence is being seen by both households and businesses (PMI rebounded in January for the first time in three months). The lockstep pro-growth policies should further help to lift activity in the coming quarters, particularly in the property sector and new growth areas.

After a stronger-than-expected Q1 (during which we no longer expect GDP to contract), the economy is set for a robust recovery in the coming quarters. The stronger Q1 provides a solid base for growth to build on this year. Aided by further, swifter normalisation, as well as tailwinds from pro-growth policies, we now see annual GDP growth reaching 5.6% in 2023, up from our previous forecast of 5.0%. The momentum carrying through into 2024 should help to sustain growth at 5.5% in 2024 (adjusted down from our previous forecast of 5.8% due to some base effects).

Worst of the COVID-19 impact is behind us

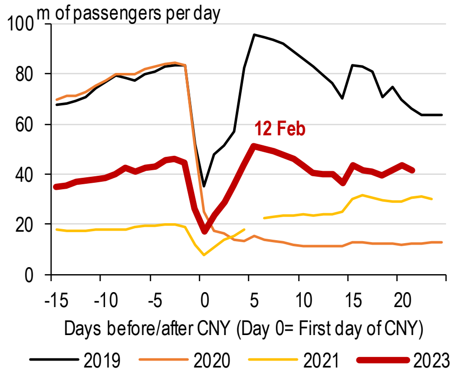
High frequency data suggest that the recovery has been on a more solid footing since the start of the year. PMI survey data returned to expansion for the first time in three months in January, while traffic activity data show improvement as well. It is likely that the worst is behind us and the previously anticipated drag on activity was likely frontloaded into December 2022 and January 2023. This gives the recovery a clear slate to start the year, and we no longer expect GDP to contract in Q1.

Consumption rebound – led by services, while aided by goods

Activity is showing signs of picking up further

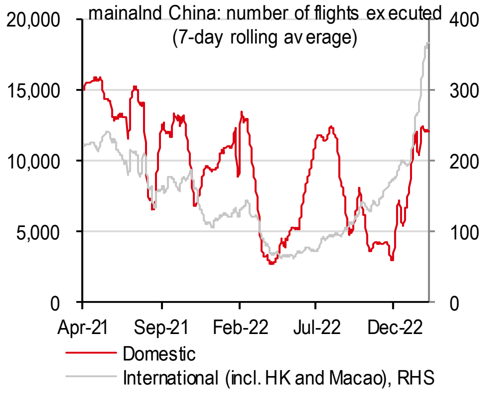
Activity is showing signs of picking up further, particularly in services. Mobility data show a significant increase during the holiday season – it reached over 50% y-o-y for the comparable Chinese New Year period – but it is still only half of pre-pandemic levels (relative to 2019). Although there is still a way to go before a full recovery is reached, another factor may help explain the gap: an early winter break for university students and early Chinese New Year holidays for some migrant workers. Due to the COVID-19 outbreak in late 2022, many universities started their winter breaks more than 20 days before the Chinese New Year (163.com, 28 November 2022); similarly, migrant workers returned home earlier due to COVID-19-related furloughs and redundancies. There are over 40m university students and c300m migrant workers in China, so early departures in any significant numbers will distort passenger trip statistics. Suffice to say, Chinese New Year travel bounced back to over 50% of the pre-pandemic 2019 level.

Chart 1: Total domestic passenger trips during the Chinese New Year were c50% of the 2019 level



Source: Ministry of Transport, Wind, HSBC

Chart 2. The number of domestic and international flights continued to improve



Source: Wind, HSBC

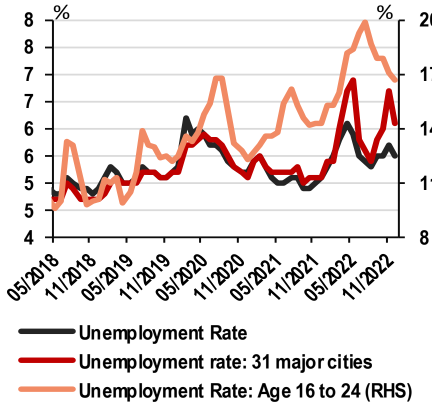
There are signs of a continued recovery, particularly in services. Box office revenue data have shown persistent strength, while tourism, both domestic and international, is also picking up. On 6 February, outbound tour groups resumed and the remaining travel restrictions between mainland China and Hong Kong were lifted. The number of mainland Chinese visitors more than tripled to 90,986 during the weekend of 11-12 February from the previous weekend (28,553), according to the Immigration Department of the Hong Kong SAR, 12 February 2023, although this is still less than one-third of pre-pandemic daily flows.

The labour market is also showing signs of improvement

Meanwhile, the labour market is also showing signs of improvement, as the unemployment rate has edged down, though it remains higher than pre-pandemic levels. With the Chinese New Year celebrations and the recent COVID-19 waves, it will take some time for migrant workers to fully return to cities. However, there are signs that this hard-hit group may start to see improvements in their labour prospects. Anecdotal evidence shows that shortages in low-skilled labour are starting to pick up, as new orders are placed amid the reopening. For example, recruiters from garment factories in Guangzhou have held up cardboard signs on the street to attract qualified job seekers and bring them directly to the factories (Caixin, 3 February 2023).

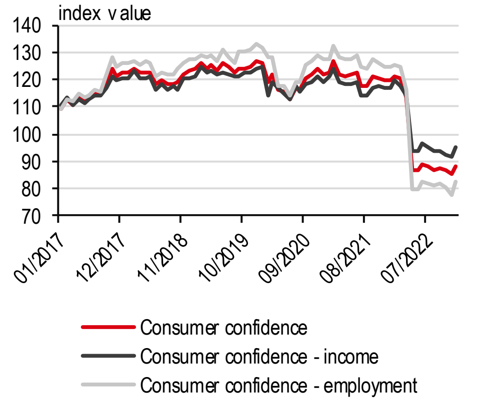
However, a more solid consumption recovery will depend on a lift in household confidence. There was already a more pronounced pick-up in confidence in December following the relaxation of COVID-19 measures (Chart 4), though such momentum will need to be sustained. It is likely that with a further normalisation in activity and continued improvement in the labour markets, this will help to translate to a larger boost in confidence.

Chart 3. Labour market pressure is easing



Source: CEIC, HSBC

Chart 4. Consumer confidence is showing signs of improvement



Source: CEIC, HSBC

Consumption recovery would start with services, followed by discretionary goods as job market improves

What might be the areas of consumption to revive? While more of the consumer spending will likely be driven by services, lower income households should drive some pick-up in goods demand. The pent-up demand for services is not a new story, essentially all economies normalising from the pandemic restrictions have seen different levels of a services recovery, and China will likely be no exception. The Chinese New Year spending data already show signs of this. However, the pick-up in goods demand was not so common in other economies: in the US, for instance, with incomes supported by various stimulus packages, goods demand was exceptionally strong during the lockdowns but has flat-lined in volume terms since mid-2021 as spending rapidly rotated to services.

In China's case, along with the recovery of services consumption, as has been the case in other economies in the process of reopening, we expect the labour market to improve for the services sector – which employs a large number of people in the low-income percentiles. Goods consumption, especially discretionary purchases, should then see a strong pick-up, supported by lower income households. The ongoing policy emphasis to help reinvigorate consumption this year – such as through tax breaks or consumption coupons at the local level – will further help to revive consumption. We expect retail sales to grow 8% in 2023 (unchanged), while consumption overall may see a stronger pick-up to 8.5% (from 7.5%) on account of a larger boost from services consumption.

Property market to see a stronger recovery mid-year

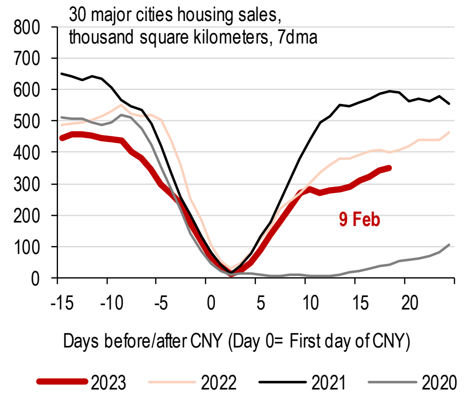
Housing sales have remained weak at the start of this year

Housing sales data have remained weak at the start of this year, despite the rollout of a number of easing policies in recent months, particularly the 16 measures announced in November[1]. However, we think the weakness in property sales is still largely a reflection of COVID-19 disruptions. As overall economic activities normalise and shift away from the pandemic, the government has stepped up efforts to revive housing demand. To reduce the cost burden for homebuyers, the People's Bank of China (PBoC) announced on 5 January that it would allow cities with persistent home price declines for at least three consecutive months to lower or remove the mortgage rates floor for first-time homebuyers. Local governments have also been easing home purchase restrictions in recent months: for example, Wuhan, a tier-2 city with a population of over 12 million, allows local families to buy an additional home in areas with purchasing restrictions since 6 February. Notably, warming up of the housing market is seen in some top-tier cities that earlier relaxed home purchasing restrictions such as Chengdu and Nanjing. This time the housing market rebound will likely be a differentiated story starting in top-tier cities, where net population inflows and solid economic prospects continue to attract buyers.

While the property sector's weakness may persist in the near term, we expect the policy measures and further easing of home ownership requirements to provide further support for a pick-up by mid-year. The stabilisation in the property sector will help to boost demand, both directly (Chart 6), as well as more broadly through the wealth effect.

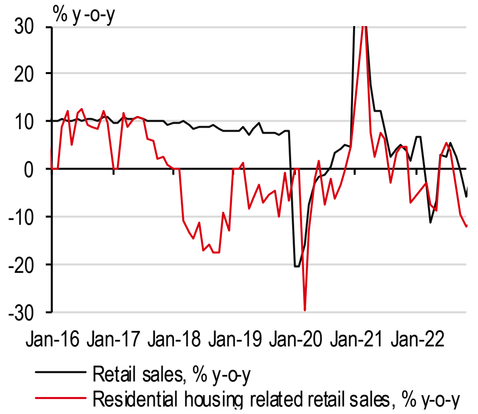
[1] New measures to further optimize China's pandemic control" ("关于进一步优化新冠肺炎疫情防控措施、科学精 准做好防控工作的通知"): http://www.gov.cn/xinwen/2022-11/11/content_5726144.htm

Chart 5. Housing sales are weaker than last year's levels



Source: Wind, HSBC

Chart 6. Housing-related retail sales have underperformed broader retail sales



Source: CEIC, HSBC

Policy support will be pro-growth

The final push for a stronger recovery will come from continued policy support. At the Central Economic Work Conference (CEWC) in December 2022, the government said its economic goals would be pro-growth for 2023 (Xinhua, 16 December 2022). The lockstep pro-growth policy mix will continue at least throughout 2023 and likely into 2024.

Fiscal policy is likely to play a leading role among the pro-growth policy mix

Fiscal policy is likely to play a leading role, with a wider fiscal deficit: we now expect a punchier stimulus package with the national general budget deficit reaching 3.2% in 2023 (up from our previous forecast of 3.0% and from 2.8% in 2022), as well as continued support for infrastructure investment through steady special local government bond issuance (we expect RMB4.0trn, up from our previous forecast of RMB3.65trn). Meanwhile, new growth areas like green development and manufacturing upgrading will likely receive targeted support through preferential tax policies, direct government funding or government guarantees.

On the monetary policy front, we see the PBoC remaining accommodative to sustain TSF (total social financing) growth in double digits at 10% y-o-y. Beijing is likely to stick with quantity-based tools like RRR (reserve requirement ratio) cuts (we expect 50bp of cuts in H1) and targeted tools like relending quotas for green investment and manufacturing investment. While we see further interest rate cuts as less likely, we think there could still be room for a 5bp cut in key policy rates to signal stronger support.

We think overall inflationary pressures will remain manageable

While the reopening and recovery will undoubtedly lead to a pick-up in activity and likely lead to demand-pull pressure for prices, we think overall inflationary pressures will remain manageable. We see the annual average CPI inflation picking up to 2.8% in 2023 (from our previous forecast of 2.5%) with core CPI likely to see a stronger recovery to over 1.5% y-o-y in H2. PPI will likely see flat growth (0.1% y-o-y) with disinflation in the beginning of the year, owing to lower global commodity prices, followed by reflation amid the recovery. While activity is picking up and the labour market recovery is ongoing, a full recovery will take time, which will prevent overall price pressure from getting out of hand and, in turn, a wage-price spiral.

On the whole, we believe the supportive credit policy from both fiscal and monetary fronts will help key pillars of growth to continue chugging along – manufacturing investment and infrastructure investment will remain strong, though the pace of growth may taper a bit this year, to 5.3% and 5.6%, respectively, following their outperformance in 2022.

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