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China Economics Update: Softer Nov data, but a sustained recovery ahead

中国经济评论: 11 月数据偏弱，但未来持续恢复可期。

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Weaker-than-expected Nov economic data mostly reflects a surge in Covid disruptions to consumption and the industrial sectors, before the latest relaxation in late Nov. The slowdown in production was particularly notable in the high tech and auto sectors as Covid controls were tightened in Nov, likely contributing to the soft trade data. Weakness in consumption and real estate deepened. On a positive note, corporate and public investment was solid, partly offsetting sharp deceleration elsewhere.

Surging Covid cases are likely to hinder any recovery in growth over the next two months, but a sustained recovery is likely to emerge early next year. The international experience suggests rising cases may dampen a recovery at the initial stage of re-opening. Meanwhile, traffic flows have picked up in Guangzhou, the center of the earlier outbreak, pointing to the start of a recovery in activity several weeks after the easing in Covid restrictions. We expect economic growth to rise to 5.4% next year.

Macro policies to remain supportive. We expect continued policy accommodation with a supportive fiscal stance next year. While liquidity is likely to stay abundant, the prospects of an economic recovery are likely to dissuade the PBoC from making any further rate cuts. The government's supportive stance towards the property sector is likely to continue in light of the sluggish sales, in our view.

11 月经济数据不及预期，凸显在各地解封以前新冠疫情对消费和生产的影响。高科技和汽车行业生产明显走弱，显示疫情封控对供应链的冲击，也可能导致了贸易数据的疲软。消费和房地产行业的放缓加剧。积极的一面是，企业和公共部门投资保持稳健，部分抵消了其他方面投资的快速下滑。

新冠感染病例的攀升意味着未来 1-2 个月经济增长仍有下行压力，但预计明年年初开始经济开始持续修复。国际经验表明，在疫后重启初期，病例的上升可能会干扰经济的复苏。但数据显示部分城市已开始回暖。广州在 11 月爆发了新一波的疫情。随着疫情防控的放松，广州的交通流量开始逐步复苏。我们预计明年经济增速将达到 5.4%。

预计宏观政策将保持支持取态。我们预计明年政策将继续保持宽松。促增长的积极财政政策继续发力。央行预计保持流动性充裕，但经济前景好转可能会限制其进一步降息。由于销售持续疲软，预计政府对房地产行业的支持立场将继续。

Soft Nov data across the board

Industrial production (IP) contracted 0.3% MoM to 2.2% YoY in Nov**,** well below the consensus forecast of a 3.7% YoY rise. Weaker-than-expected IP data reflects Covid disruptions to manufacturing.

- **Mining** output rebounded in Nov from Oct's cyclical low. However, Covid uncertainty and the imposition of environmental restrictions in winter suggests mining output may remain soft in the near term.
- **Manufacturing production** decelerated for the second consecutive month to 2.0% YoY in Nov. The broad-based slowdown across major manufacturing industries highlights the impact of tighter Covid controls in Nov before an easing in Covid policy (Fig 1). In particular, the lockdown at the world's largest iPhone factory in early Nov weighed heavily on production in related industries, as output of computer and electronic equipment contracted 1.1% YoY in Nov after having grown nearly 10% YoY every month since Mar 2021 (Fig 1).
- **Electricity and utility production** contracted 1.5% YoY, reflecting soft demand from industrial sectors amid Covid disruptions.

The contraction in retail sales worsened from 0.5% YoY in Oct to 5.9% YoY in Nov, reflecting Covid disruptions and poor sentiment. Catering spending weakened further in Nov, contracting 8.4% YoY (Fig 2). The extension of tax rebates on purchases of new energy vehicles until 31 Dec 2023 has supported strong growth in car sales since Jun 2022, yet auto sales nevertheless decelerated sharply from previous months. Growth in online sales slowed to 3.9% YoY, in part reflecting weak sales during the "Double Eleven" shopping festival this year. Adjusting for price increases, we estimate the contraction in real retail sales accelerated to 7.6% YoY in Nov.

Fixed Asset Investment (FAI) growth slowed sharply to 0.8% YoY in Nov by our estimate (Fig 3), because of accelerating falls in real estate investment. By category:

- **Infrastructure investment growth remains solid having played a key role in stabilizing investment growth.** Investment growth in traditional infrastructure fields such as utility management, transportation, and postal services, rose 10.6% YoY in Nov, the third-fastest pace of growth since Mar 2021. Growth in broad infrastructure investment accelerated to 13.6% YoY as investment in the utilities sector such as power generation and transmission grew 25% YoY in Nov, pointing to solid investment amid the green transition.
- **Manufacturing investment growth eased** to 6.2% YoY in Nov, demonstrating resilience amid the macro slowdown. Recent credit data showed an improvement in medium- to long-term bank lending to corporates. Government policy will continue to facilitate industrial upgrades amid the green transition, growing indigenous technology, digitalization, etc., consistent with our view of the new capex cycle in China, notwithstanding macro challenges.
- **The fall in real estate investment** accelerated to 20% YoY in Nov, consistent with continued sluggishness in the sector.

Property indicators weakened across the board in Nov. The contraction in property starts and completions widened from 35% YoY and 9%, to 50.8% YoY and 20%, respectively, while property sales fell 33% YoY. The average new home price among 70 large cities contracted by 0.2% MoM in Nov, the 15th monthly contraction in a row. Property price weakness was more profound in lower-tier cities.

Weekly property sales among 30 large cities tracked sideways at recent bottoms (Fig 4), although recent efforts by the regulator have lifted sentiment towards property developers. We expect some improvement in property activity next year as the economic recovery unfolds after the relaxation of Covid restrictions; however, progress is likely to start after a delay of a few months.

The labor market softened due to Covid uncertainty. Unemployment ticked up 0.2ppt to 5.7% in Nov (Fig 5). Despite a small decline, the unemployment rate among young people remains elevated at 17.1%.

Other data

Trade data surprised to the downside in Nov. In US dollar terms, export growth fell 8.7% YoY, the most since 1Q 2020 and weaker than the consensus forecast of a 3.9% YoY decline, likely reflecting supply disruptions, especially in the case of high tech products. Imports contracted 10.6% YoY, which was softer than expectations. The trade surplus eased slightly to US$70b, nevertheless exceeding expectations. Exports to major developed markets slowed sharply, led by a 25.4% YoY decline in exports destined for the US. Despite this notable slowdown, exports to ASEAN continued to grow at a pace of 5.2% YoY in Nov. ASEAN's share of China's total trade continues to climb as the regional bloc strengthens economic ties.

Headline inflation eased from 2.1% YoY in Oct to 1.6% YoY in Nov. **Weaker-than-expected headline inflation was driven by easing food inflation**, down 3.3ppt to just 3.7% YoY in Nov. Core inflation, excluding food and energy, was unchanged at 0.6% YoY for the third straight month. Soft domestic demand disrupted by Covid continued to weigh on inflation in the near term. However, we expect a sequential pick-up in inflation once economic re-opening gains traction and domestic demand recovers in 2023F.

Total Social Financing (TSF) growth rate slowed 0.3ppt to 10.0% in Nov. Slightly softer credit expansion highlights the continued impact of Covid and the struggling property sector. Medium- to long-term loans to households, a proxy for housing mortgages, improved from Oct, but remained well below the level last Nov. Encouraging medium- to long-term bank lending to the corporate sector picked up, suggesting supportive policy continues to drive credit to prioritized industrial sectors.

Our view:

Weaker-than-expected Nov data points to an accelerated economic slowdown amid the current wave of Covid outbreaks that began in early Oct. Consumption has been persistently weak and in Nov Covid disruptions spread to the industrial sectors, causing factories to shut down and supply chains to seize up.

Swift implementation of changes to health policies. Policymakers quickly moved to relax Covid restrictions in response to macro challenges. After the announcement of the initial 20 measures to optimize Covid controls, China's health authorities and local governments loosened restrictions. In certain cities, residents are no longer required to submit to centralized quarantine facilities or take frequent PCR tests. Health authorities recently announced they would stop publishing statistics on asymptomatic cases.

The authorities have shifted focus to ramping up vaccination rates for vulnerable groups and increasing hospital capacity as daily new Covid cases continue to mount. The State Council has urged local governments to speed up vaccination of the elderly, setting a target of 90% for people over 80 years old to have received at least one dose by the end of Jan 2023. In addition, health authorities have called for an increase in the number of hospital ICU beds in anticipation of a rising number of severe cases. *Caixin* reported that Guangzhou authorities are upgrading some makeshift hospitals to designated hospitals dedicated to treating Covid patients with moderate symptoms and seniors with existing health conditions.

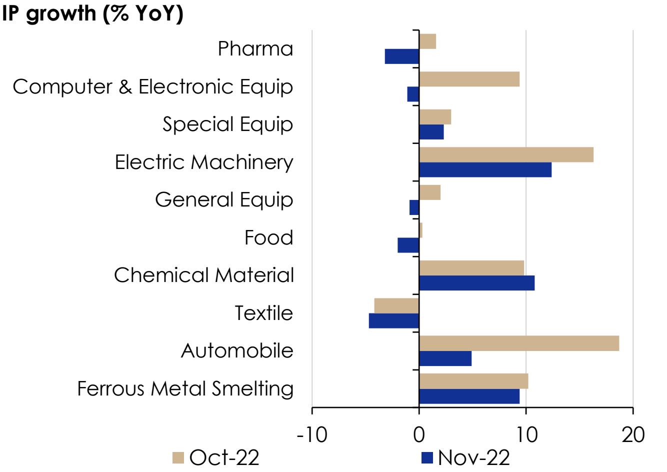
A surge in case numbers will be the key headwind to growth over the next two months. The experience of other countries that re-opened shows that people prefer staying home to avoid contracting the virus at the initial stage of re-opening. Data from other countries suggests the number of workers that will come down with Covid is about to increase rapidly, which may cause temporary labor shortages, potentially weighing on business and factory operations, and even disrupting supply chains.

However, we expect the impact of surging Covid cases on the economy will be temporary and growth will begin to recover early next year. The international experience suggests that the economy will embark on a sustained recovery in the two months after opening up. Daily number of passengers at metro stations in Guangzhou has gradually recovered on the back of Covid policy easing (Fig 6). Recent relaxation in Covid controls bodes well for a sustained economic recovery in China next year, in line with the theme we outlined in our *2023 Outlook*.

Accommodative macro policies next year. On the fiscal side, China's budget deficit is likely to be set around 3% of GDP. Targeted support to prioritized areas, notably the property sector will continue, in our view. As a means of supporting public investment and economic growth, we expect the local government special bond issuance quota will rise to around RMB4t in 2023F. **On the monetary front,** after cutting the Required Reserve Ratio (RRR) by 25bp on 25 Nov, today the PBoC injected RMB150b via the One-year Medium-term Lending Facility (MLF) on a net basis. The MLF rate remained unchanged at 2.75%. We expect the PBoC to leave liquidity conditions supportive while maintaining current policy interest rates in the near term. Further RRR cuts next year are still likely, in our view.

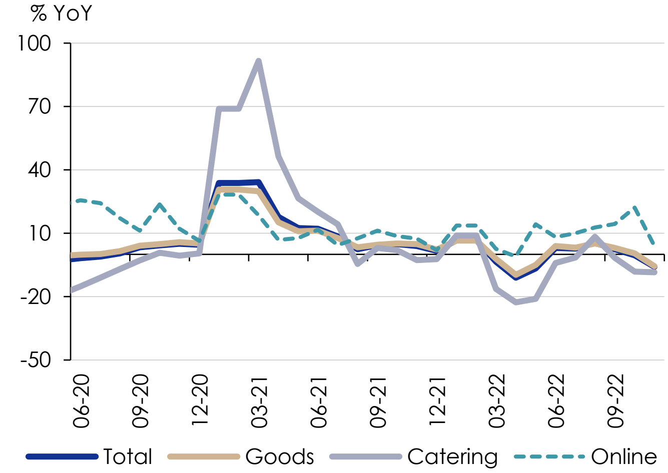
In the meantime, the upcoming Central Economic Work Conference (CEWC) will shed light on the policy agenda for 2023.

Fig 1: Covid impacted manufacturing industries



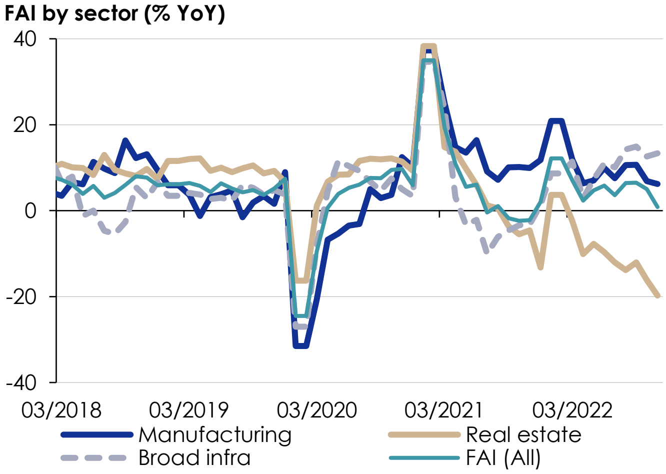
Source: NBS, CCBIS

Fig 2: Retail sales growth weakened more than expected



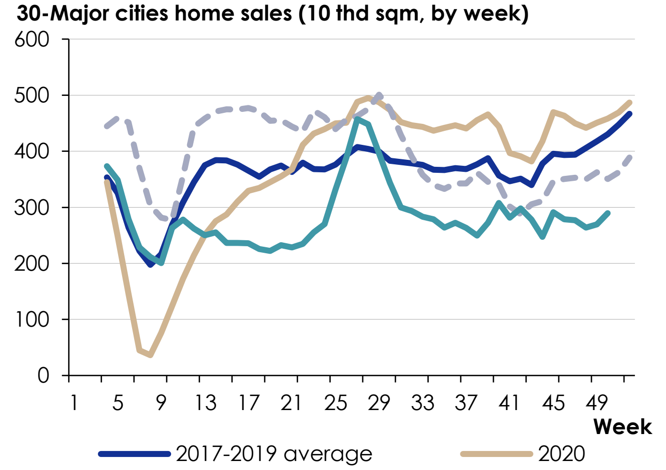
Source: NBS, CCBIS

Fig 3: Infrastructure and manufacturing investment remains supportive



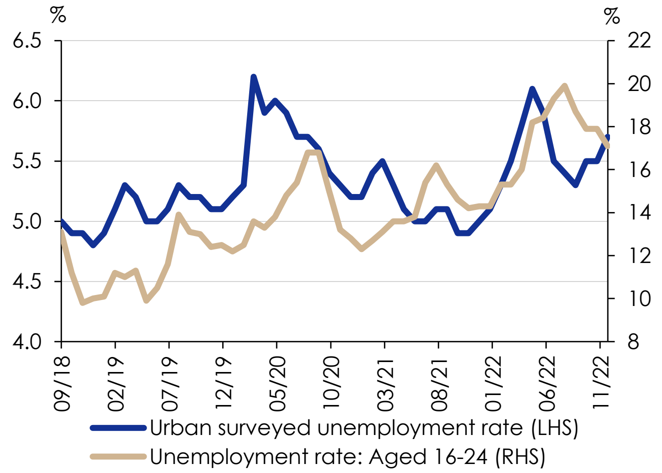
Source: NBS, CCBIS

Fig 4: Housing sales tracked sideways



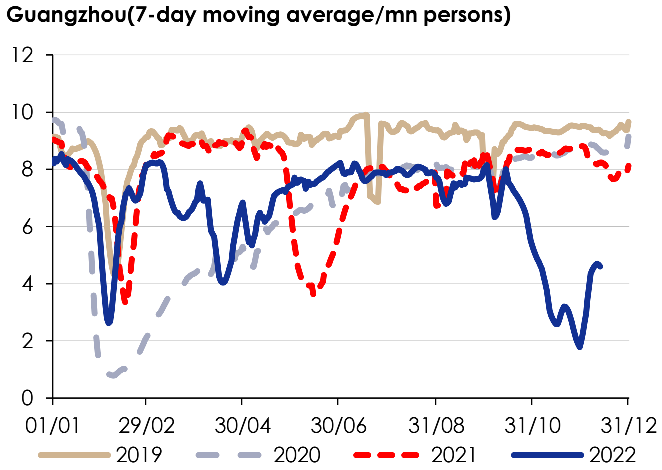
Source: NBS, CCBIS

Fig 5: The unemployment rate ticked up in Nov



Source: NBS, CCBIS

Fig 6: Metro traffic lifted from recent lows in Guangzhou



Source: CEIC, CCBIS

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