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China Economics Update: A gradual recovery is unfolding

中国经济评论: 复苏稳步开始

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Jan-Feb economic data confirms a gradual recovery is unfolding, and we expect a further recovery. Investment beat expectations thanks to a faster-than-expected turnaround in real estate investment. Other property indicators also exhibited notable improvement. The recovery in retail sales was driven by offline consumption. However, industrial production grew slower than expected, possibly reflecting the disruption from Chinese New Year (CNY). We expect the data to reflect further evidence of a recovery as the economy normalizes.

Macro policies to remain supportive. A larger fiscal deficit and higher local government special bond quota is consistent with the supportive policy stance in aid of a sustained recovery. We expect steady investment, solid net exports, and a recovery in consumption, to drive growth. We expect the PBoC to maintain abundant liquidity while refraining from cutting interest rates as the economic outlook improves.

2 月的经济数据证实经济逐步复苏，我们预计复苏将持续。房地产投资下行有所收敛，推动整体投资增速改善。房地产行业的其他指标也有好转。线下消费的复苏推动社会零售销售回暖。但受农历新年的影响，工业生产增速不及预期。随着经济正常化，我们预计数据将进一步改善。

宏观政策预计维持支持取态。2023 年适当扩大的财政赤字和适当提高的地方政府专项债额度，与支持持续复苏的政策立场一致。我们预计稳定的投资和消费复苏，加上净出口坚挺，将支持增长。在经济前景改善的情况下,我们预计央行将维持充裕的流动性，降息可能不大。

A broad economic recovery at the start of 2023

Industrial production (IP) growth rebounded from 1.3% YoY in Dec to 2.4% YoY in Jan-Feb, though the result was below the consensus expectation for 2.6% YoY growth. Sequential IP growth accelerated from -0.1% MoM in Dec to an average of 0.2% MoM over the first two months of 2023, which was nevertheless below the average of 0.6% MoM in 2019. The rebound in industrial production was consistent with rising survey-based manufacturing PMI as China kicked off its economic reopening. However, the CNY in 21-27 Jan 2023 and the Covid outbreak at the start of the year delayed workers' return to work, disrupting factory operations.

By sector, mining output growth slowed slightly from 4.9%YoY in Dec to 4.7% YoY in Jan-Feb, while manufacturing production accelerated from 0.2% YoY in Dec to 2.1% YoY in Jan-Feb (Fig 1). Electricity and utility production grew by 2.4%YoY, slower than Dec's 7% YoY.

Retail sales improved notably following China's economic reopening. Year-on-year growth rebounded to 3.5% following three consecutive months of contraction in 4Q22, in line with consensus. Sequentially, retail sales growth rebounded to an average of 0.3% MoM, though it remains below the average of 0.7% MoM in 2019 prior to the pandemic. The removal of Covid restrictions led to a 9.2% YoY rise in catering spending in Jan-Feb. Fuel spending rose 10.9% YoY in Jan-Feb because of the normalization of travel and tourism. By contrast, online spending growth slowed to 6.7% YoY, though it continued to outstrip overall growth in retail sales, underscoring the staying power of e-commerce. Housing-related spending rose slightly in Jan-Feb, consistent with improving property sales. A 6.5% YoY contraction in car sales was a drag on overall retail sales (Fig 2).

Fixed-asset investment (FAI) growth rebounded to 5.5% YoY in Jan-Feb by our estimate (Fig 3), thanks to a turnaround in real estate investment. By category:

- **Infrastructure investment growth eased, but it remains strong.** Investment in traditional infrastructure fields such as utilities management, transportation, and postal services, grew 9.0% YoY, down from 14.3% YoY growth in Dec. Growth in broad infrastructure investment, including power production and supply, eased to 11.8% YoY. As re-iterated in the *Government Work Report* *(GWR)*, steady growth of infrastructure investment is expected, led by the green transition and industrial upgrades.
- **Manufacturing investment growth rose slightly** to 8.1%YoY, the third consecutive monthly pick-up, led by machinery, autos, and the high-tech sectors. High-tech manufacturing investment grew at an average of 19.2% YoY in Jan-Feb. Our view is that industrial upgrades amid the green transition, growing indigenous technology, digitalization, etc., is supporting a new capex cycle in China.
- **Real estate investment improved** as the annual decline in the sector eased from 12.2% YoY in Dec to 5.7% YoY in Jan-Feb, better than the forecast of an 8.5% YoY decline. Efforts on the part of policymakers to stabilize the real estate sector, including through greater liquidity support and measures to ensure housing project completions, have lent support to the sector.

Other property indicators improved across-the-board at the start of 2023. The year-on-year contraction in property starts eased from 44.3% YoY in Dec to 9.4% YoY in Jan-Feb. The slowing pace of floor space under construction narrowed from 48.2% YoY in Dec to 4.4% YoY. Property sales also improved from -31.5% YoY in Dec to 3.6% YoY in Jan-Feb. Property completions grew by 8% YoY in Jan-Feb, the first expansion since Dec 2021, thanks to policy measures to ensure housing project completions. High-frequency data shows average weekly property sales among 30 large Chinese cities in early Mar have surpassed the average between 2017 and 2019, supported by pent-up demand and optimism, particularly in large cities (Fig 4). However, the trend slowed in recent weeks.

Employment unexpectedly deteriorated in Jan-Feb. The unemployment rate ticked up by 0.1ppt to 5.6% in Feb (Fig 5). In the same period, the unemployment rate among young people in China picked up 0.8ppt to 18.1%, the highest level since Aug 2022. The deteriorating employment situation suggests the recovery in employment will take time. However, it may also reflect some mismatch between labor market demand and supply at the beginning of the economic re-opening. The CNY may have complicated this mismatch as workers return to their hometowns after three years of Covid.

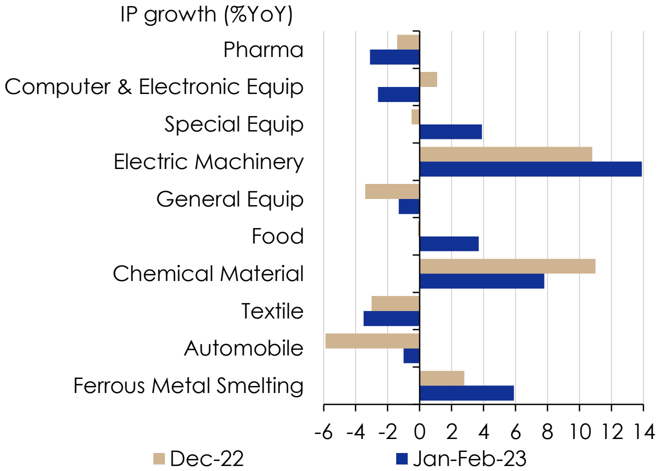
Our view:

The data points to an incipient recovery and further improvement is expected. The recovering pace of retail sales remains below the pre-pandemic trend. The *GWR* has reiterated the importance of boosting consumption and employment. Policymakers are also likely to deliver supportive measures such as spending on new energy vehicles (NEV). Broad improvement in the real estate sector is likely to continue because of targeted policy support. The strength of a recovery in housing demand will depend on whether or not the economy continues to improve, particularly in the areas of household income and employment. Meanwhile, the *GWR* reiterated the regulatory focus on preventing disorderly expansion. Industry-side consolidation is likely to continue and weaker players remain under pressure. Chinese exports in Jan-Feb were better than expected, as the annual contraction in exports eased. Despite the likely global slowdown, we expect net exports to remain solid given the changes we see in regional supply chains.

We expect supportive macro policy stance to continue in 2023F. A cautious growth target of "around 5%" suggests the government is focused on delivering steady and high-quality growth rather than strong near-term growth that risks overstimulating the economy. Furthermore, the 2023 *GWR* unveiled a set of slightly more expansionary fiscal measures than 2022 to aid the economic recovery. Continued and targeted fiscal support will help lift employment and accelerate the economic recovery. The local government special bond quota increased from RMB3.65 trillion in 2022 to RMB3.8 trillion in 2023. The higher 2023 special bond quota could support public infrastructure investment into strategic areas.

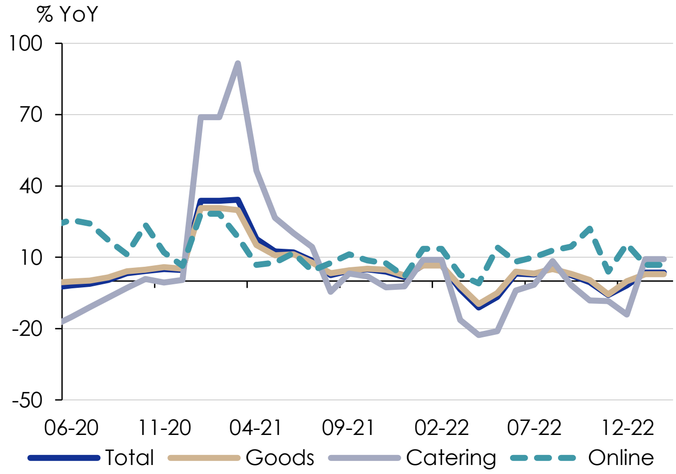
Monetary stance will stay accommodative amid global uncertainty. On 15 Mar, the PBoC injected RMB281 billion via the one-year Medium-term Lending Facility (MLF), the largest monthly liquidity injection over the past two years via the MLF. The MLF rate was unchanged at 2.75%. Cumulatively, the PBoC has injected a total of RMB548.5 billion into the banking system in 1Q 2023. The liquidity injection via the MLF reduced the likelihood of RRR cuts in the near term. We expect the PBoC will hold interest rates steady while ensuring liquidity conditions remain supportive amid signs of an economic recovery. Following strong credit expansion in the first two months of this year (read here for details), the chances of an additional RRR cut in 2023F is much lower than it was before the beginning of the year, although it remains on the table as a possible policy measure.

Fig 1: Output in electric machinery led the rebound



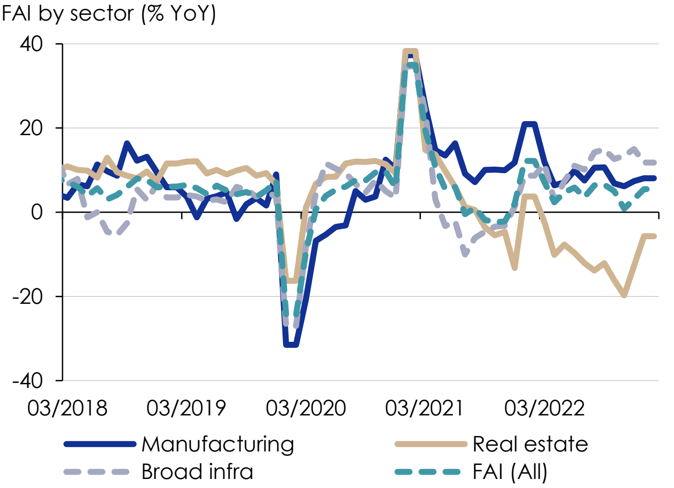
Source: NBS, CCBIS

Fig 2: Retail sales growth rebounded in Jan-Feb



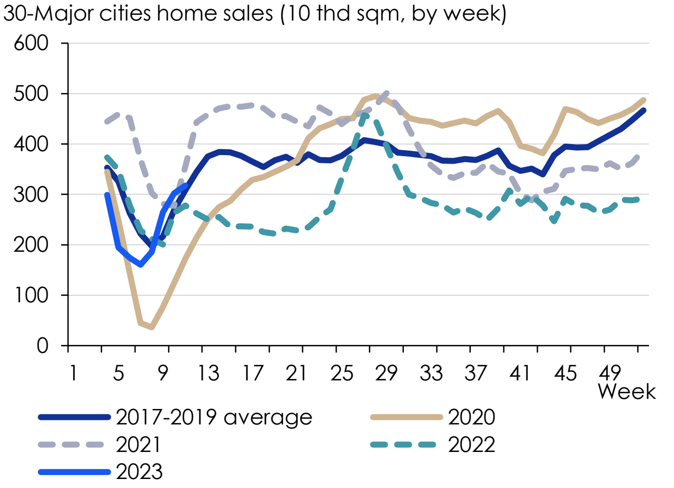
Source: NBS, CCBIS

Fig 3: real estate investment rebounded notably



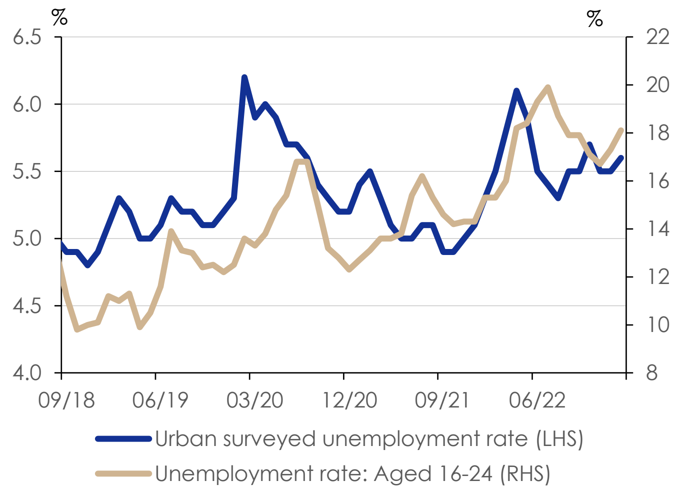
Source: NBS, CCBIS

Fig 4: Housing sales are improving



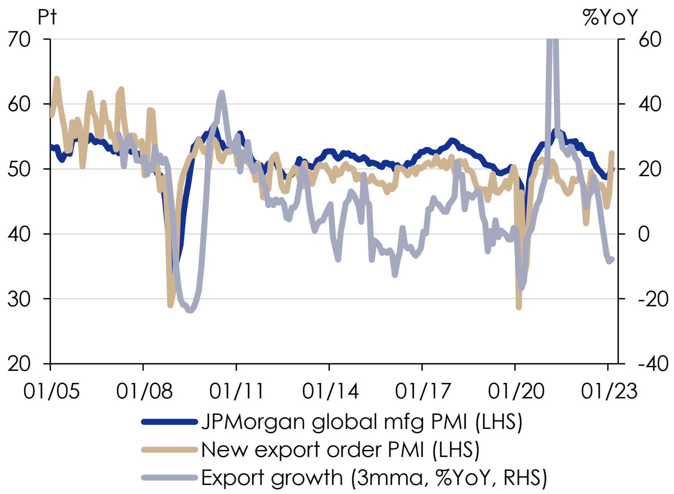
Source: NBS, CCBIS

Fig 5: The unemployment rate rose unexpectedly



Source: NBS, CCBIS

Fig 6: The contraction in exports eased



Source: CEIC, CCBIS

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