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China Economics Update: 1Q data confirms solid recovery owing to normalization in activities

中国经济评论: 1 季度数据确认经济稳健复苏

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Stronger-than-expected 1Q GDP reflects solid recovery in consumption and support from trade. In-person services, in particular catering, were a key driver of consumption growth, though auto sales also contributed. We raise our 2023F growth forecast from 5.1% to 5.3% to reflect the stronger start to the year.

Macro policies to remain supportive. We expect continued policy measures in support of the recovery, including employment- and consumption-related policies. Front-loaded local government special bond issuance will support infrastructure investment amid global economic uncertainty. We expect the PBoC to maintain abundant liquidity and refrain from cutting interest rates as the economic outlook improves.

强于预期的一季度 GDP 反映了消费的稳健复苏和外贸的超预期支持。线下服务，尤其是餐饮，是消费复苏的主要推手。汽车销售也有所贡献。我们将 2023 年增长率预测从 5.1%上调至 5.3%，以反映年初的强劲表现。

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Stronger-than-expected 1Q 23 GDP

Sequential 1Q GDP growth rebounded to 2.2% QoQ, better than consensus and our own forecast. Furthermore, the sequential 4Q22 GDP growth estimate was raised from flat to 0.6% QoQ. On a YoY basis, GDP growth rose from 2.9% YoY in 4Q22 to 4.5% YoY in 1Q23, well above the consensus expectation of 4.0% YoY and our own forecast of 3.1%.

By sector, the rebound was led by services following the exit of Covid mitigation measures. Growth in services output accelerated from 2.3% YoY in 4Q22 to 5.4% YoY in 1Q23. By contrast, industrial output growth slowed by 0.1ppt from the previous quarter, growing only 3.3% YoY in 1Q23.

Mar data: Strong retail sales in contrast to weaker-than-expected industrial production and investment

Industrial production (IP) growth accelerated from 2.4% YoY in Jan-Feb to 3.9% in Mar, but ended the month below the consensus expectation for a 4.4% YoY rise, and our own growth forecast of 2.9%. By sector, mining output growth slowed sharply, from 4.7%YoY in the first two months to 0.9% YoY in Mar, possibly reflecting increased safety checks as reported by Reuters. In contrast, manufacturing production growth accelerated for the second month to 4.2% YoY in Mar (Fig 1). Growth in electricity and utility production output rose from 2.4% YoY to 5.2% YoY, supported by manufacturing demand.

Retail sales surge driven by in-person consumption. Year-on-year growth jumped from 3.5%YoY in the first two months to 10.6% YoY in Mar, well above the consensus forecast of a 7.5% rise. Catering jumped 26.3% YoY in Mar because of continued normalization and base effects. Growth in online sales accelerated almost 10ppt to 16.6% In Mar, indicating that e-commerce continues to support spending despite the opening-up process. Goods spending was also solid, rising 9.1% YoY, driven by a 15.2% YoY rebound in car sales (Fig 2). Housing-related spending fell slightly in Mar following a rebound in the first two months of the year.

Nevertheless, sequentially, retail sales growth averaged 0.4% MoM in 1Q23, still below the average of 0.7% MoM in 2019 prior to the pandemic.

Fixed-asset investment (FAI) growth slowed to 4.8%YoY in Mar by our estimate (Fig 3) with broad-based easing across all key sectors. By category:

- **Infrastructure investment growth was strong.** Investment in traditional infrastructure fields such as utilities management, transportation, and postal services, increased 8.7% YoY, a tad softer than the pace in the first two months. Growth in broad infrastructure investment, including power production and supply, decelerated by roughly 1ppt to 10.9% YoY. We continue to expect solid infrastructure investment growth ahead as the *Government Work Report* *(GWR)* emphasized medium-term goals such as the green transition and industrial upgrades.

- **Manufacturing investment growth slowed** to 6.2% YoY in Mar; however, investment in high-tech, machinery, and autos continued to grow strongly. High-tech manufacturing investment grew 15.2% YoY in 1Q23. 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 remained soft**, falling 7.2% in Mar YoY after some improvement at the beginning of the year. Despite recent policy support, which took some liquidity pressure off developers, the government continues to emphasize the long-term transformation of the property sector. Property developers remain cautious about the sector outlook.

Other property indicators mixed in Mar. On the one hand, the year-on-year contraction in property starts and floor space under construction widened from 9.4% YoY and 4.4% YoY to 29% YoY and 34.2% YoY, respectively. The weak property starts data is consistent with the view that developers are still wary of starting new investment projects. On the other hand, property completions jumped 32%, buoyed by policy measures designed to ensure housing project completions. The contraction in property sales eased 0.1ppt to 3.5%YoY. Nevertheless, high frequency data points to a resumption of the soft momentum in property sales witnessed in recent weeks. Since the beginning of Apr, average weekly property sales for 30 large Chinese cities slowed more than the average between 2017 and 2019 (Fig 4).

The unemployment rate fell but job market pressure continues. The surveyed jobless rate fell by 0.3ppt to 5.3% in Mar (Fig 5), its lowest level since Jan 2021. We highlighted the potential mismatch between labor market demand and supply last month as the economy re-opens. As the recovery gained momentum, overall employment improved. By contrast, the unemployment rate among young people picked up 1.5ppt to 19.6%, the highest level since Jul 2022.

Strong exports and credit, but weak inflation

Chinese Mar trade beat market expectations by a wide margin. In US dollar terms, exports jumped 14.8% YoY in Mar, more than offsetting a 7.1% YoY decline in the first two months. In our view, strong Mar exports reflect the rush by manufacturers to deliver backlog orders following disruptions in the first two months caused by the Chinese New Year holiday and Covid outbreaks. Exports to ASEAN (35.4%YoY) were the main driver of strong exports. Growth to the EU rose to 3.4%YoY after five months of sharp decline. Exports to the US continue to fall, though the pace of contraction eased from 31.8% YoY to 7.7%. The annual contracting pace in imports also narrowed from 9.2% YoY in Jan-Feb to 1.4%, signaling recovering domestic demand.

Total social financing (TSF), a broad credit measure, posted upside surprise again in Mar. TSF growth accelerated for the second consecutive month to 10% in Mar. Bank loans continued to lead the charge in credit expansion, growing 11.7%. Medium- to long-term corporate loans remain the driver of strong bank lending, pointing to solid business investment amid the recovery. Medium- to long-term household loans also rebounded in Mar, adding further evidence of stabilization taking place in the property sector. The pace of government bond issuance eased slightly in Mar, but remains solid at 13.5%.

Inflation pressure remains muted. Headline inflation eased for the second consecutive month to 0.7% YoY in Mar, the slowest pace since Mar 2021. Food prices fell over the month. Falling energy prices over the year were also a drag. Core inflation, excluding food and energy, remained weak at 0.7% YoY and flat MoM in Mar, suggesting underlying domestic demand may take time to recover.

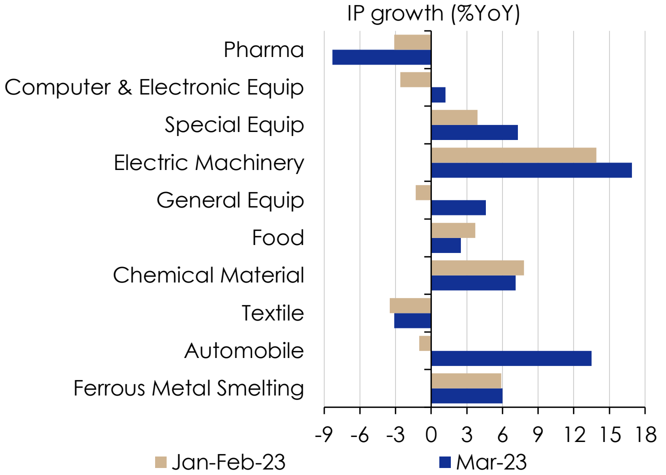
Our view:

Solid consumption and trade data supported stronger-than-expected 1Q GDP data. However, sequential retail sales growth remains below the pre-pandemic trend. A growing number of local governments have offered cash handouts and other incentives to boost consumption of electric vehicles. However, the continued recovery in consumption will hinge on the improving outlook for household income and employment. Softer global growth will weigh on the trade outlook. We expect slower sequential growth following the strong sequential rebound, though we raise our annual growth forecast from 5.1% to 5.3%, to reflect the strong start to the year.

We expect the fiscal policy stance to remain supportive in 2023F. Despite the strong 1Q23 GDP report, it is still early days for the current recovery. Local government special bond issuance has picked up, with a third of the 2023 quota issued in 1Q. The front-loaded special bond issuance bodes well for steady infrastructure investment growth later this year. On 14 Apr, Premier Li Qiang chaired a State Council executive meeting to discuss policies to stabilize employment, such as providing more assistances to vulnerable groups like college graduates, migrant workers, and the unemployed. We expect continued policy support for labor markets.

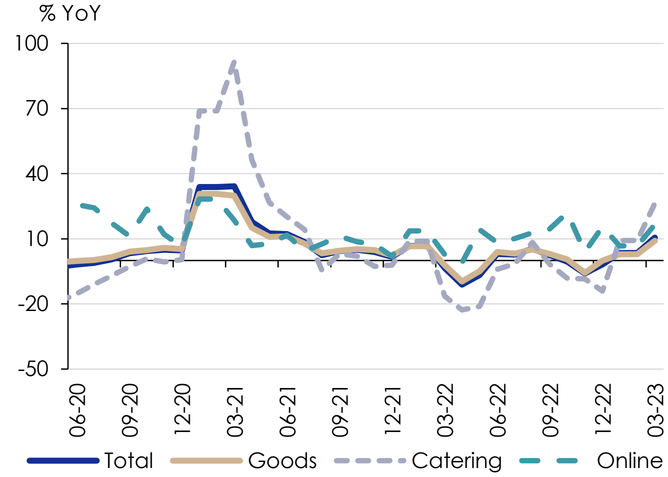
Accommodative monetary policy will continue amid global growth uncertainty and low domestic inflation. On 17 Apr, the PBoC injected RMB170b at a steady one-year medium-term lending facility (MLF) rate of 2.75%, more than the RMB150b in maturities. In an accompanying statement following the 1Q Monetary Policy Committee, the PBoC upgraded its domestic growth outlook, but acknowledged additional policy support would be needed to buttress the recovery. Targeted structural monetary tools are likely to be deployed to channel credit into prioritized areas. We expect the PBoC to focus on ensuring sufficient liquidity, though strong bank loan growth in 1Q may reduce the likelihood of another RRR cut in the near term. Interest rate cuts are unlikely, in our view, unless signs of economic weakening re-emerge.

Fig 1: Output in electric machinery led the rebound



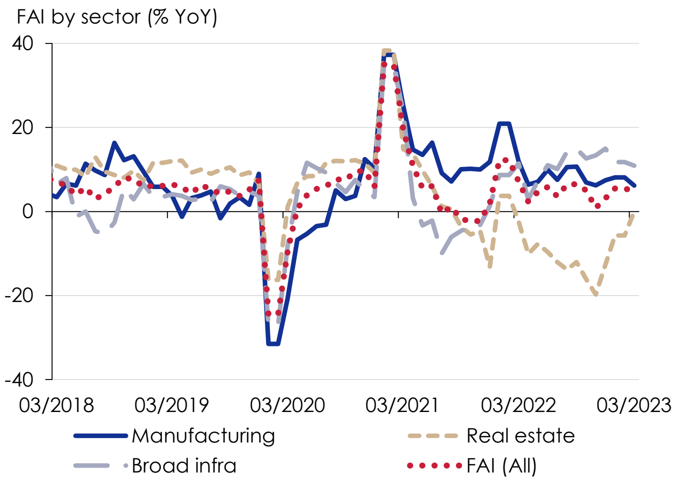
Source: NBS, CCBIS

Fig 2: Catering led the rebound in retail sales



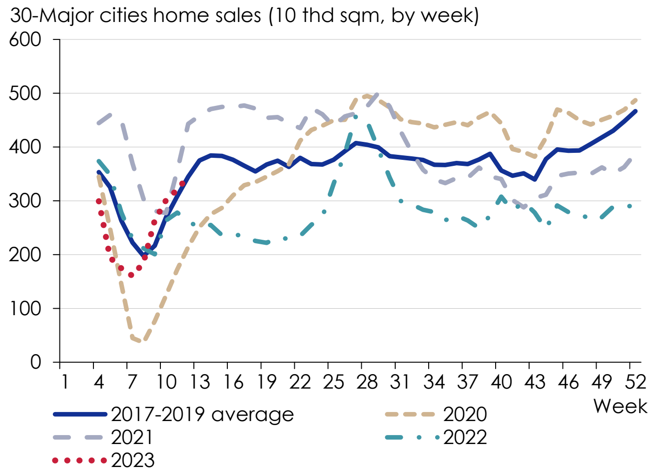
Source: NBS, CCBIS

Fig 3: Investment growth held steady in Mar



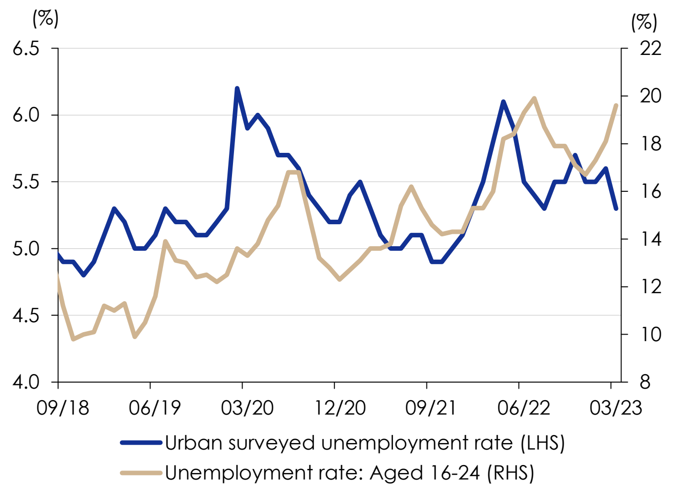
Source: NBS, CCBIS

Fig 4: Housing sales slowed in recent weeks



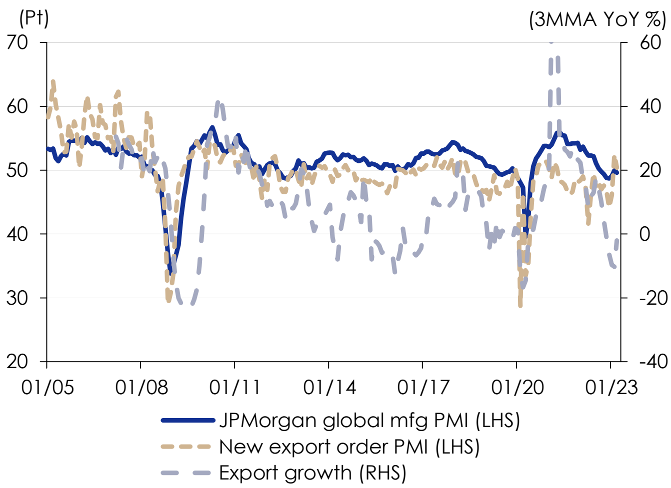
Source: NBS, CCBIS

Fig 5: The overall unemployment rate fell but youth unemployment still high



Source: NBS, CCBIS

Fig 6: The sluggish global growth outlook remains a drag on exports



Source: CEIC, CCBIS

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