China | The broad-based economic recovery after lifting “zero Covid”

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China’s January-February economic activities data were announced today, indicating the economy is rebounding significantly after the authorities lifted “zero Covid” policy on December 7, 2022. After the first 2 months of the high infection period, the economy is currently going back to the righ track. On the other hand, policy support is also the key to the ongoing economic recovery. The recently concluded “two sessions” this week not only secured a stable political leadership transformation, but also set up the “around 5%” growth target together with a series of policy stimulus measures, helping to rebuild market sentiments. (See our recent Economic Watch: China | Understanding 2023 Government Work Report and State Council reforms) Altogether, we anticipate Chinese economy to bounce back to 5.2% after its growth sliding to 3% in 2022, which is in line with the statistical base effect as well as the 20th National Congress’ growth target of 2020-2035 to “double GDP or GDP per capita” that requires an annual growth of around 4.7% during this period.

2023 wil be definitely the “Year of China” amid the recession risk in the US and the EU and the related financial risks triggered by aggressive FED interest rate hikes. The recent failure of Sillicon Valley Bank illustrates this potential cotangion effect. Due to China’s unsynchronized growth cycle, policy cycle and inflation cycle with the advanced economies, the economic rebound of China will be comprehensive and broad-based, not only for investment and domestic consumption (although exports will be dragged by weak external demand), but also for financial sector which will attract more portfolio inflows and FDI amid a stronger RMB and better-performed Chinese financial markets.

The Januray-February economic data outturns indeed confirmed our “broad-based” recovery story. On the supply side, the year-on-year growth of industrial production accelerated to 2.4% from 1.3% y/y in the previous month, although a bit lower than the market consensus at 2.6% y/y, and its seasonal adjusted m/m growth also improved to 0.26% m/m and 0.12% m/m respectively, higher than 0.06% m/m in December 2022. By categories, the highest growth sector is solar battery which registered 40.8% y/y growth in Jan-Feb, following that is new energy cars by 16.3% y/y, both in line with the nation’s 2060 carbon neutrality target. The rebound of industrial production was mainly due to the lifting of “zero Covid” policy and lockdown measures, normalizing the industrial production activities in enterprises. (Figure 1)

On the demand side, Jan-Feb retail sales eventually ended its multi-year negative growth and bounced back to 3.5% y/y from -1.8% y/y in December 2022 (market consensus: 3.5%), right after the abandon of “zero Covid” and social distancing measures. Its month-on-month growth also ticketed up significantly to 0.61% m/m compared with -0.07% m/m in December. By component, the largest growth is medicine sales (19.3% y/y) due to the outbreak of Covid-19 and high infection rate in the transition period right after the lifting; following that is restaurant sales which jumped to 10.2% y/y from -14.7% y/y in the previous month. Other sectors of retail sales also accelerated, including wines and smoke (6.1% vs. prior: -7.3% y/y), clothing (5.4% vs. prior: -12.5% y/y), domestic appliance (-1.9% vs

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prior: -13.1%) and cosmetic (3.8% vs prior: -19.3% y/y) etc. Altogether, we expect a continuing retail sales pick-up after the peak of infection rate passed in February supported by various consumption stimulus measures and higher income expectations. (Figure 4)

On the other hand, fixed-asset investment (FAI) also ticketed up from 5.1% ytd y/y in December to 5.5% ytd y/y in Jan-Feb (market consensus: 4.4% ytd y/y). The highlight of FAI is that the housing investment which significantly shrank its declining from -10% ytd y/y to -5.7% ytd y/y. By components, infrastructure FAI which is supported by easing fiscal measures (expansionary local government bond issuance) marginally declined to 9% ytd y/y (see our recent Economic Watch: China | Will infrastructure investment become a key growth stabilizer?), which surpassed the infrastructure FAI at 8.1% ytd y/y and real estate FAI at -5.7%. That means, the ongoing fixed asset investment recovery is led by the shrinking negative growth of housing investment, but the room of infrastructure and manufacturing investment will be limited.

Going forward, the real estate sector needs more time to achieve a soft-landing. (See our recent China Economic Watch: China | Real estate sector needs a soft-landing) (Figure 2 and 3) And we anticipate the recently promulgated "16-point plan" by Chinese authorities will largely alter the market sentiments on real estate. That means, the real estate sector is anticipated to bottom out in 2H 2023.

Beyond the January-February economic indicators, the credit data also have registered a strong rebound which significantly surpassed market expectations. In particular, total social financing which is the aggregate gauge of China's total credit condition accelerated significantly to RMB 5980 billion in January and RMB 3160 billion in February; new yuan loans also jumped to RMB 4900 billion in January and RMB 1800 billion in February, leading to M2 growth ticketed up to 12.9% y/y in February, higher than 12.6% in January. Outstanding loan growth also improved to 11.6% this month from 11.3% in January. The credit boom was driven by the accelearing demand of enterprises medium-to-long term borrowing as well as improving households' housing mortgage, indicating a gradual repairment of balance sheets for both households and enterprises amid economic recovery.

In sum, 2023 will become the "Year of China" amid global recession fears in the US and EU due to the aggressive central bank's interest rate hike. The hike also triggered financial market instability such as the recent failure of Silicon Valley Bank (SVB) and related banks in the US, which might have spillover effect to the financial system in the US and other vulnerable emerging markets. After lifting "zero Covid" policy at end-2022 as well as promulgating housing market stimulus and the expansionary fiscal and monetary measures to support growth, we expect 2023 China GDP growth will reach 5.2%, compared with "around zero" growth in the US and EU.

However, several caveats are noteworthy for Chinese economy: First, external demand in 2023 will be very weak which we forecasts -2% export growth in 2023, thus how to stimulate growth by domestic demand, particularly consumption and housing investment will be the key to economic success. Second, rebuilding market confidence and repairing household and enterprises' balance sheets will also be essential in 2023. After three years of lockdown, China experienced "balance sheet recession" both in enterprises and households as households are reluctant to borrow to consume and enterprises are reluctant to borrow to invest amid economic slowdown. Thus, expansionary fiscal policy and more targeted monetary easing are anticipated in 2023 to support economic recovery and housing market soft-landing. (See our recent Economic Watch: China | Understanding 2023 Government Work Report and State Council reforms)

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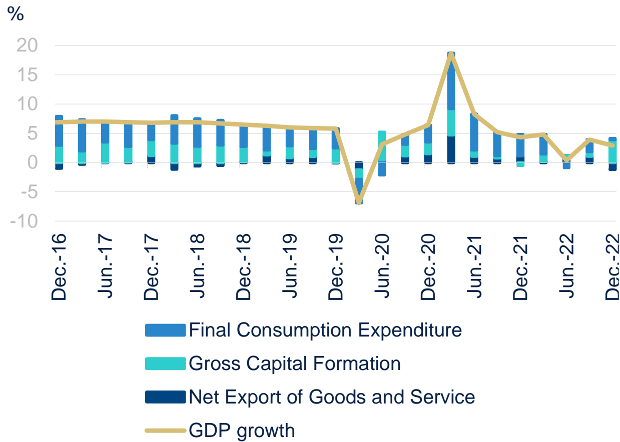
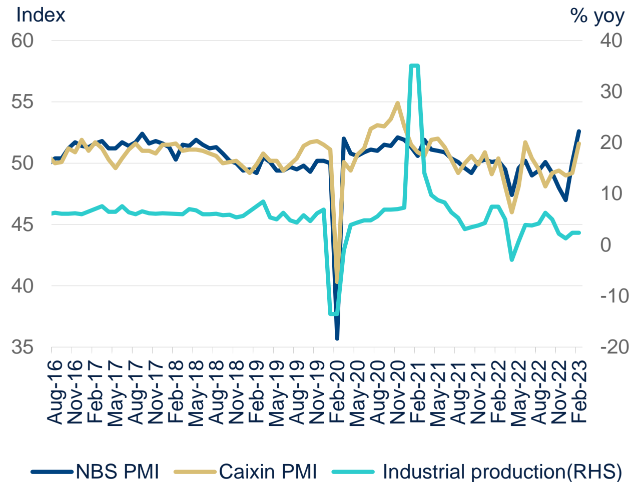
Figure 1. **WE PREDICT 2023 CHINA'S GDP WILL BE 5.2%**



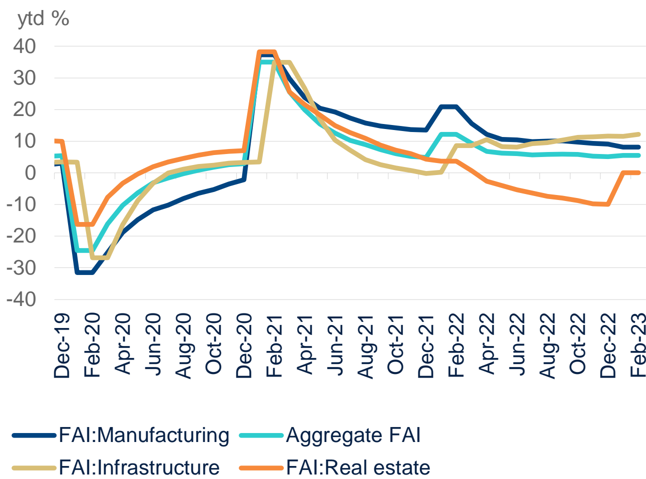
Source: CEIC and BBVA Research

Figure 2. **INDUSTRIAL PRODUCTION REBOUNDED TO 2.4% FROM 1.3% PREVIOUSLY AND PMIS ALSO JUMPED TO ABOVE 50**



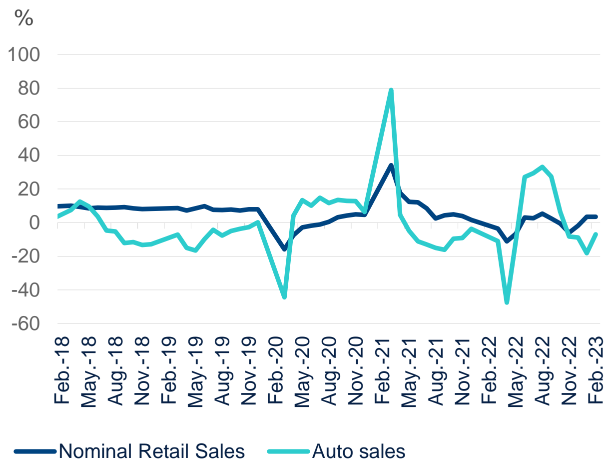
Source: CEIC and BBVA Research

Figure 3 FIXED ASSET INVESTMENT ALSO ACCELERATED SUPPORTED BY SHRINKING NEGATIVE GROWTH OF HOUSING INVESTMENT



Source: CEIC and BBVA Research

Figure 4 RETAIL SALES ALSO ENDED ITS NEGATIVE GROWTH AND BACK TO 3.5% FROM -1.8% PREVIOUSLY



Source: CEIC and BBVA Research

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