BBVA Research

China Economic Outlook

March 2023

Creating Opportunities

BBVA Research

01

Global economy: financial instability risk and recession fear

Creating Opportunities

Main messages

Recent developments

Supply shocks have eased while demand has remained resilient, triggering upward growth surprises and reducing the odds of a recession in the short-run. Headline inflation has fallen, but core figures remain sticky. After a temporary decoupling, markets are now in line with central banks' indications that interest rates still have some room to rise and the easing cycle will take some time to unfold; financial volatility has increased, but remains contained.

Growth outlook

Global growth is forecast to reach 2.8% in 2023 (0.5pp higher than the previous forecast) and 3.3% in 2024 (unchanged forecast), after having reached 3.2% in 2022. Positive incoming data and lower energy prices favor an upward revision in 2023 GDP forecasts in the US and, mainly, in the Eurozone, while the easing of covid restrictions supports a sharper recovery in China. Still, a growth slowdown is likely ahead amid higher inflation and interest rates.

Inflation and rates outlook

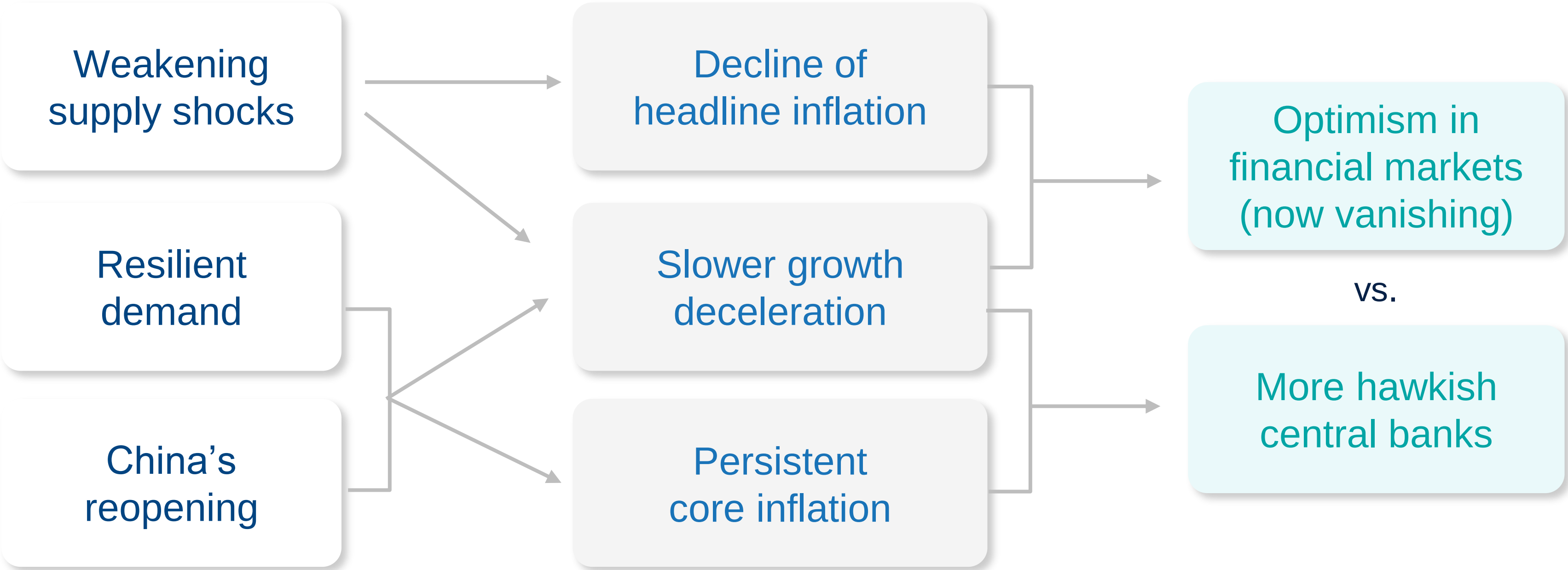
Persistent core inflation and robust labor markets will force central banks to deliver higher than expected policy rates and no rate cuts before 2024. Inflation is expected to decline gradually as supply shocks wane and demand weakens, but it will remain above the 2% target in both the US and the Eurozone at least till the end of 2024.

Risks

The main risk is that inflation proves to be more persistent than expected, due to tight labor markets, second-round effects, demand-driven recovery in China, war disruptions, etc., triggering further monetary tightening, and then, potentially, a recession, stagflation or, even, financial instability.

Weakening supply shocks, resilient demand and China’s reopening back growth, but also inflation fears despite the recent drop in headline measures

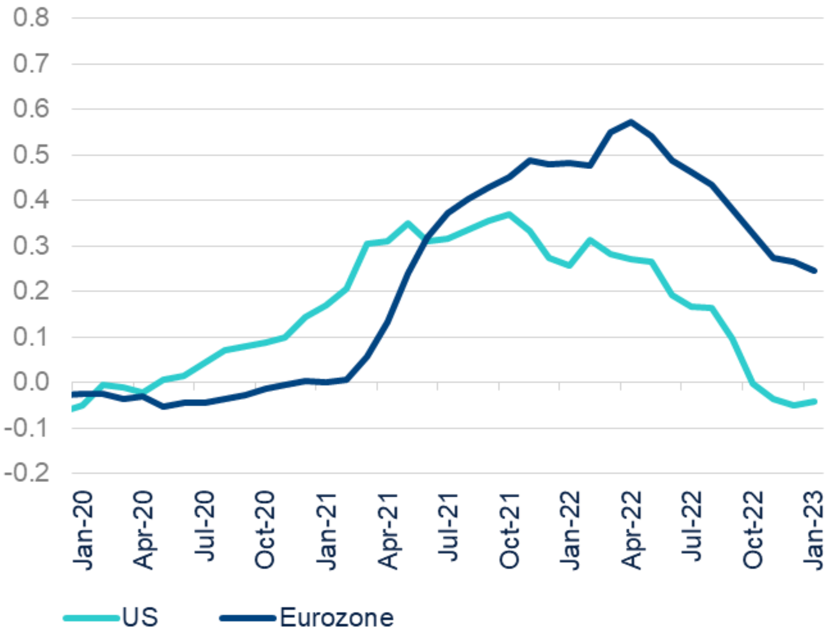
RECENT DEVELOPMENTS IN THE WORLD ECONOMY



Weakening supply shocks: bottlenecks and commodity prices have eased; mild weather and healthy storage have helped to push gas prices down

BBVA RESEARCH BOTTLENECK INDEX

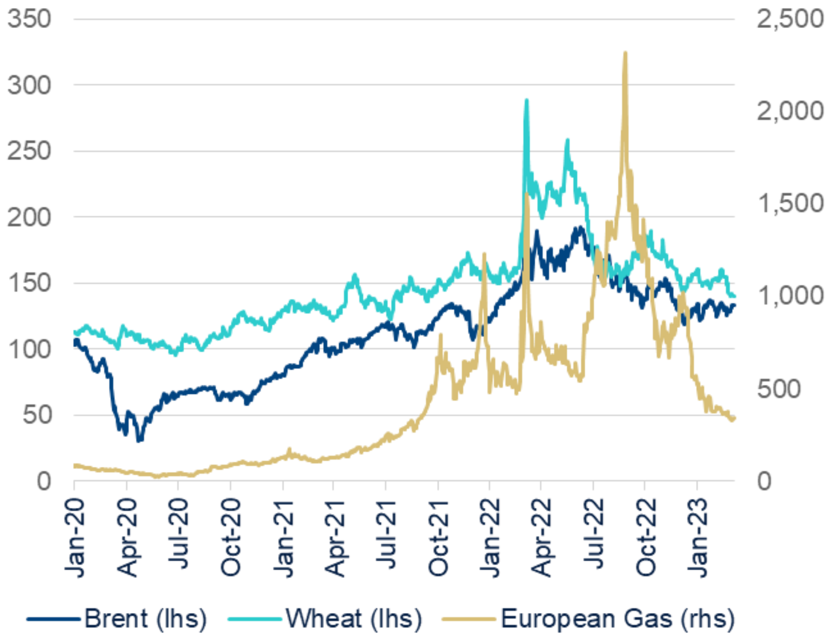
(INDEX: AVERAGE SINCE 2003 = 0)



Source: BBVA Research.

COMMODITY PRICES

(INDEX: 2019 AVERAGE = 100)

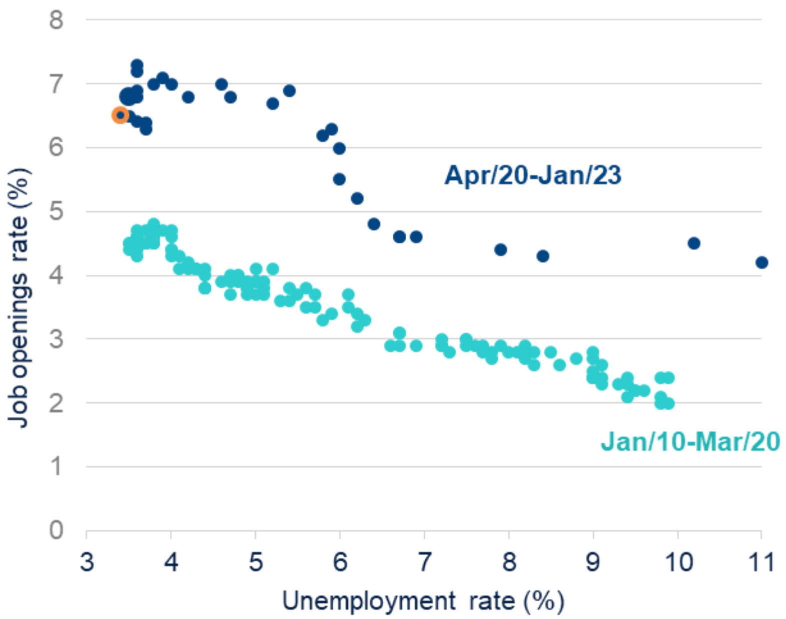


Source: BBVA Research based on data from Bloomberg.

Resilient demand: labor markets remain tight, backing private consumption and fueling concerns about more persistent price pressures

US: BEVERIDGE CURVE (*)

(MOST RECENT MONTHLY DATA HIGHLIGHTED IN ORANGE)



(*) Unemployment: share of labor force. Job openings: share of sum of employment and job openings.
Source: BBVA Research based on data from FRED.

EUROZONE: BEVERIDGE CURVE (*)

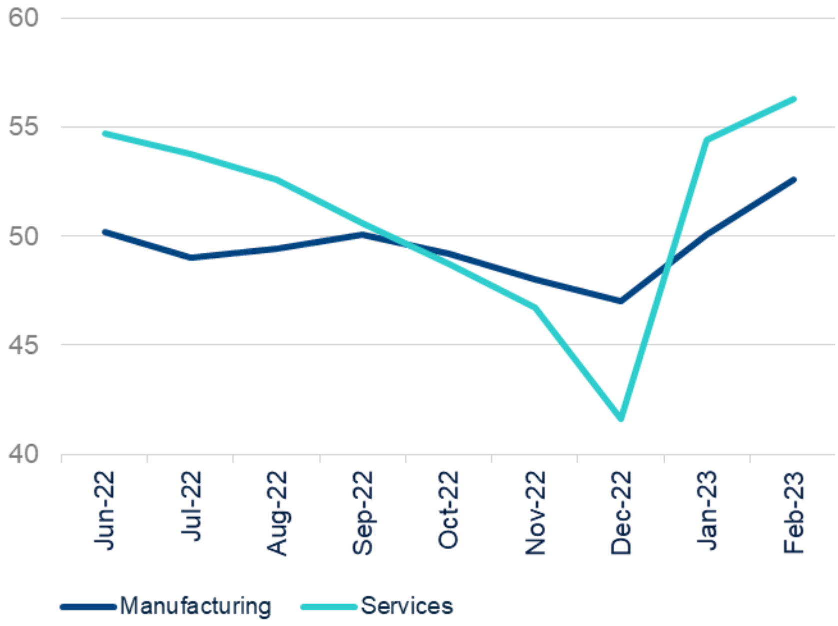
(MOST RECENT MONTHLY DATA HIGHLIGHTED IN ORANGE)

(*) Unemployment: share of labor force. Job openings: share of sum of employment and job openings.
Source: BBVA Research based on data from Eurostat.

China's reopening: after an initial negative impact on activity, unexpected easing of covid restrictions has boosted economic activity

CHINA PMI INDICATORS

(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)

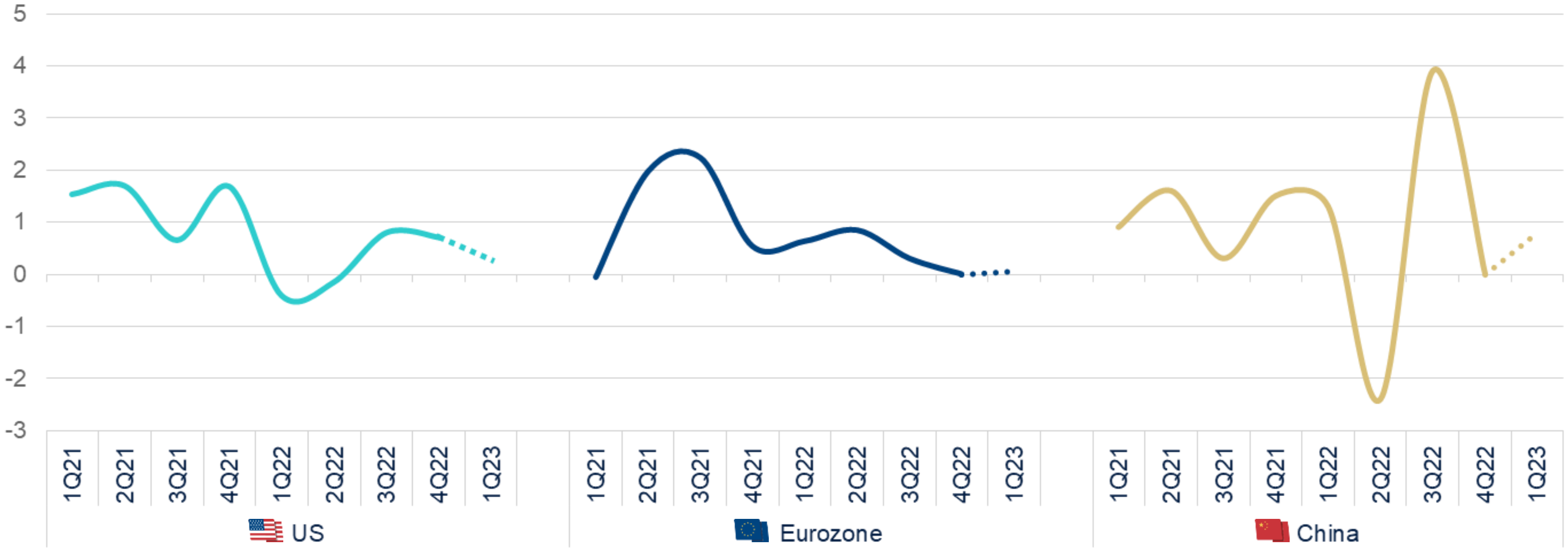


Source: BBVA Research based on data from Haver.

- China's flexibilization of covid policies was faster than expected; together with the measures to stabilize the real estate sector, it suggests that the focus is now on growth.
- The reopening initially drove infections up, contributing to the sharp downward surprise of 4Q22 GDP.
- But a solid recovery is now underway according to more recent data.
- The demand recovery pace compared to the rhythm of supply normalization, in a protectionist context, will be key for global activity and inflation dynamics.

Growth has slowed less than forecast, suggesting a recession is now less likely in the US and EZ; after a very weak 4Q22, activity is improving in China

GDP: REAL GROWTH (*)
(Q/Q %)

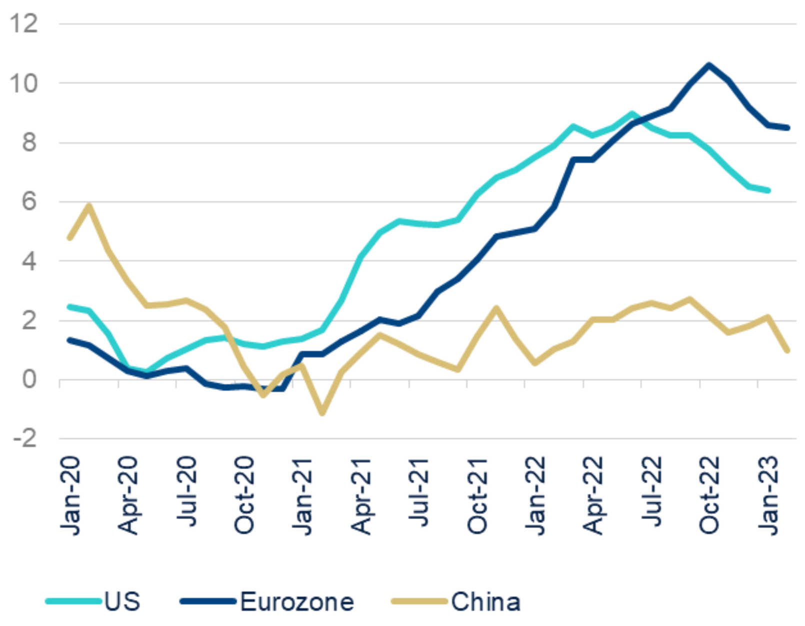


(*) BBVA Research growth forecasts for the 1Q23.
Source: BBVA Research based on data from Haver.

Headline inflation is falling, mainly on declining energy prices, but resilient consumption is still contributing to keep core figures at very high levels

INFLATION: CPI

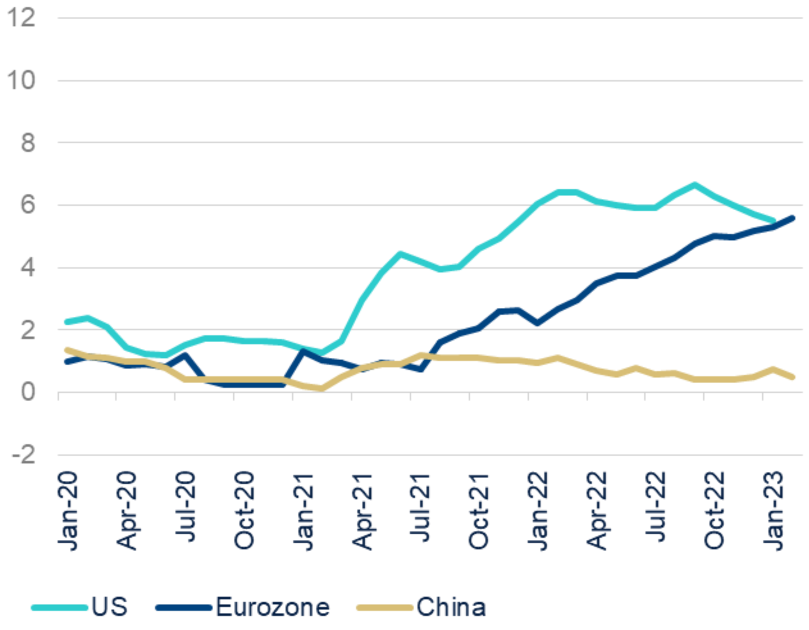
(Y/Y %)



Source: BBVA Research based on data from Haver.

CORE INFLATION: CPI

(Y/Y %)

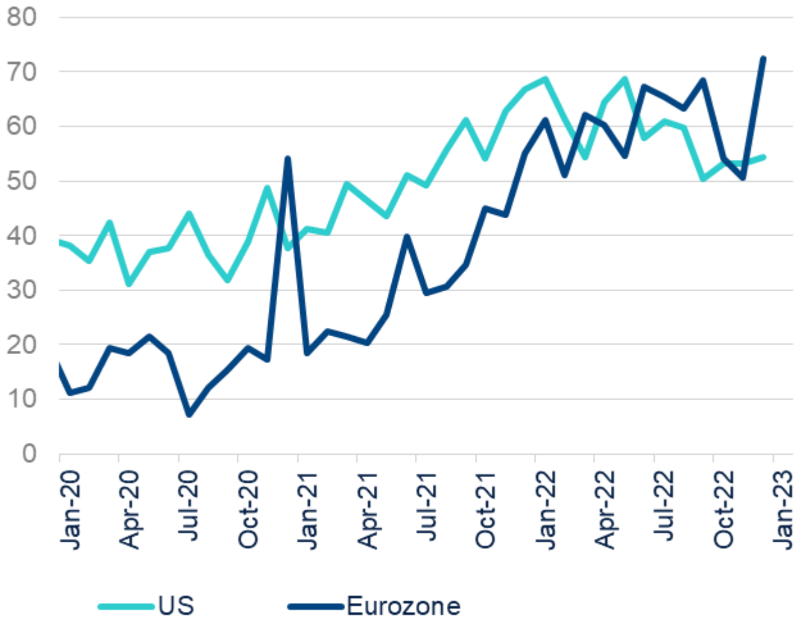


Source: BBVA Research based on data from Haver.

Price adjustments have become less widespread and frequent in the US, but there are no clear signs yet of improvement in the Eurozone

ITEMS OF THE CPI BASKET WITH ANNUALIZED MONTHLY INFLATION HIGHER THAN 4%

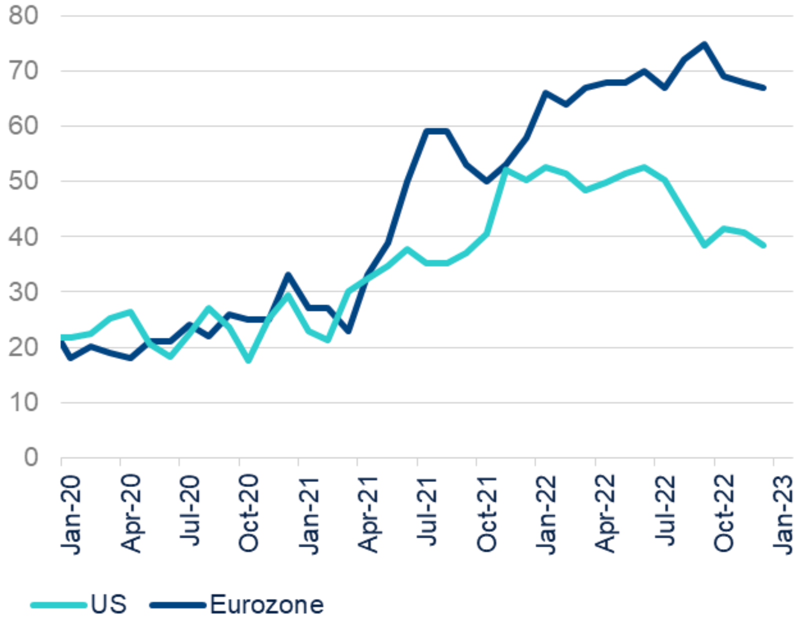
(SHARE OF TOTAL 2-DIGIT CPI ITEMS)



Source: BBVA Research based on local statistics.

ITEMS OF THE CPI BASKET WITH THREE CONSECUTIVE MONTHLY PRICE RISES

(SHARE OF TOTAL 2-DIGIT CPI ITEMS)

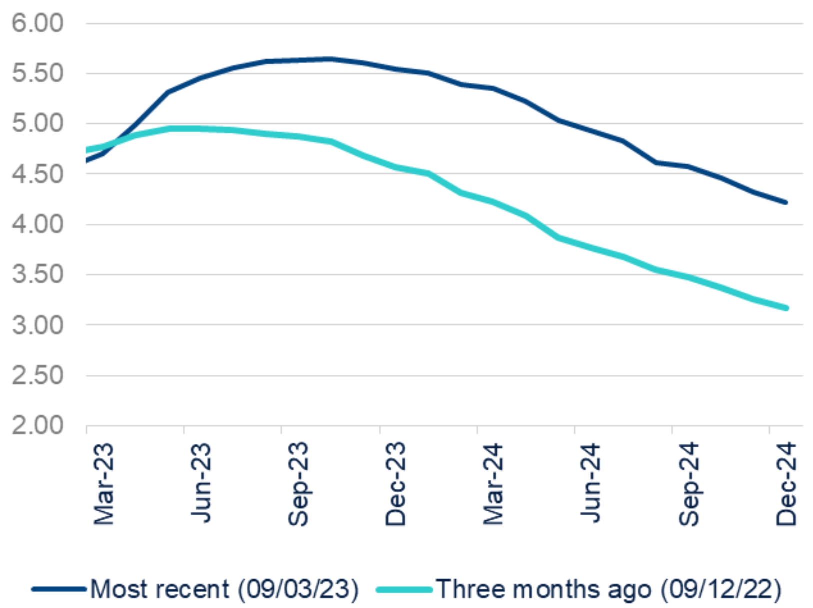


Source: BBVA Research based on local statistics.

After a temporary decoupling, markets are now in line with central bank's view that rates have room to rise and the easing cycle will not be immediate

IMPLIED FED INTEREST RATE IN FED FUND FUTURES

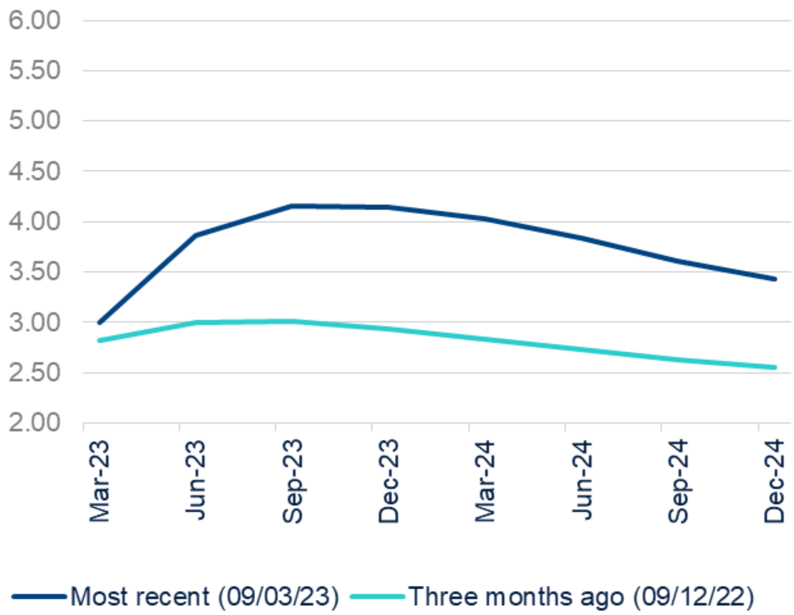
(%)



Source: BBVA Research based on data from Bloomberg.

IMPLIED ECB INTEREST RATE IN EURIBOR FUTURES (*)

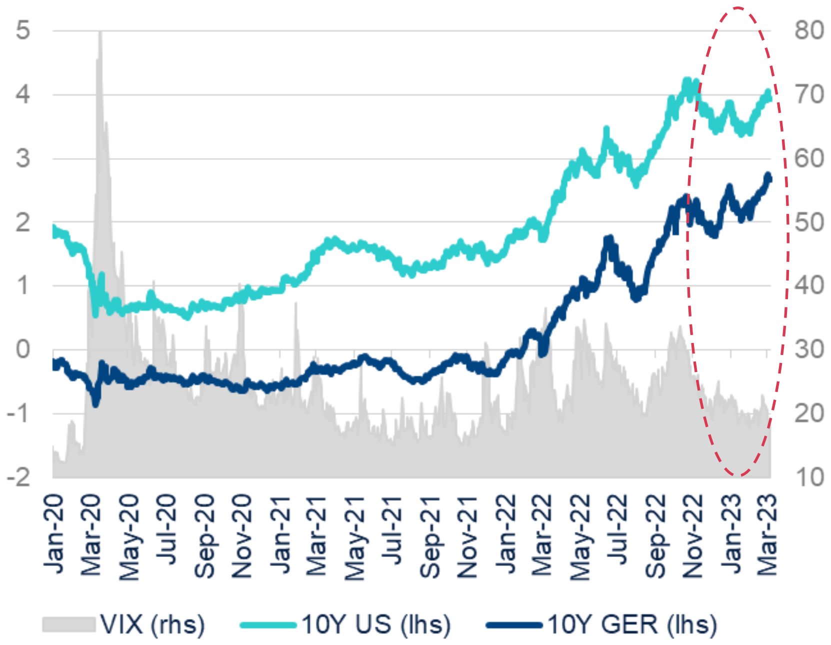
(%)



(*) Interest rate of the ECB deposit facility.
Source: BBVA Research based on data from Bloomberg.

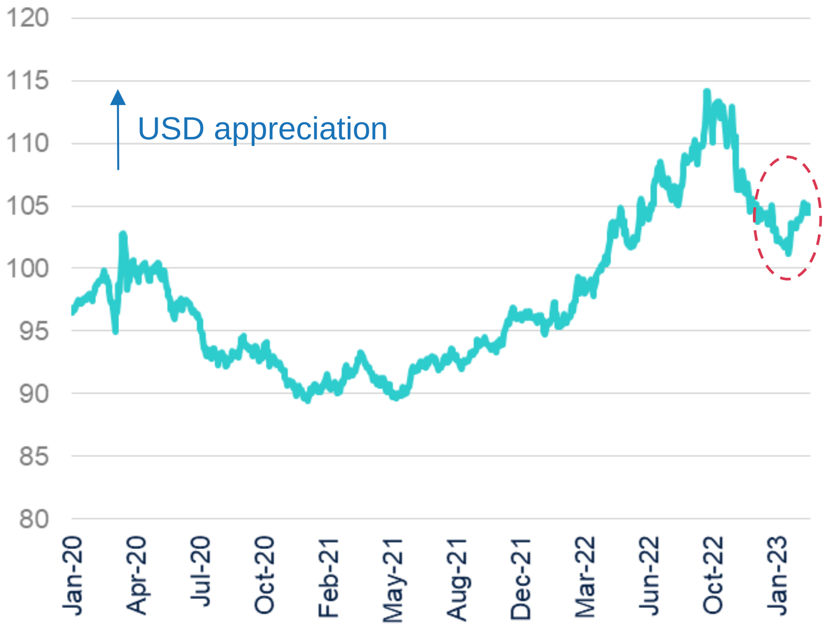
The recent increase in bond yields, driven by central bank hawkish rhetoric, has provided support to the dollar and fueled volatility, albeit limited

US AND GERMANY 10-YEAR BOND YIELDS, VIX
(%, INDEX)



Source: BBVA Research based on data from Bloomberg.

US DOLLAR INDEX: DXY
(INDEX)



Source: BBVA Research based on data from Bloomberg.

BBVA Research baseline scenario: interest rates will be higher for longer to ease demand and curve inflation down

BBVA RESEARCH BASELINE SCENARIO: MAIN ASSUMPTIONS AND FEATURES

COMMODITIES AND BOTTLENECKS

Commodity prices to remain under 2022 levels, but China's demand and supply issues will limit downward corrections and favor rebound of oil prices in 2H23.

Supply bottlenecks to continue normalizing.

EUROPEAN GAS

Prices assumed to remain somewhat higher than ongoing levels, mainly from mid-2023.

Gas reserves to be enough to prevent shortages, even under relatively unfavorable scenarios.

FINANCIAL AND MONETARY CONDITIONS

More restrictive monetary policy, also through monetary tightening programs.

A strong dollar, higher sovereign yields and modest capital inflows into riskier assets are expected.

ACTIVITY AND PRICES

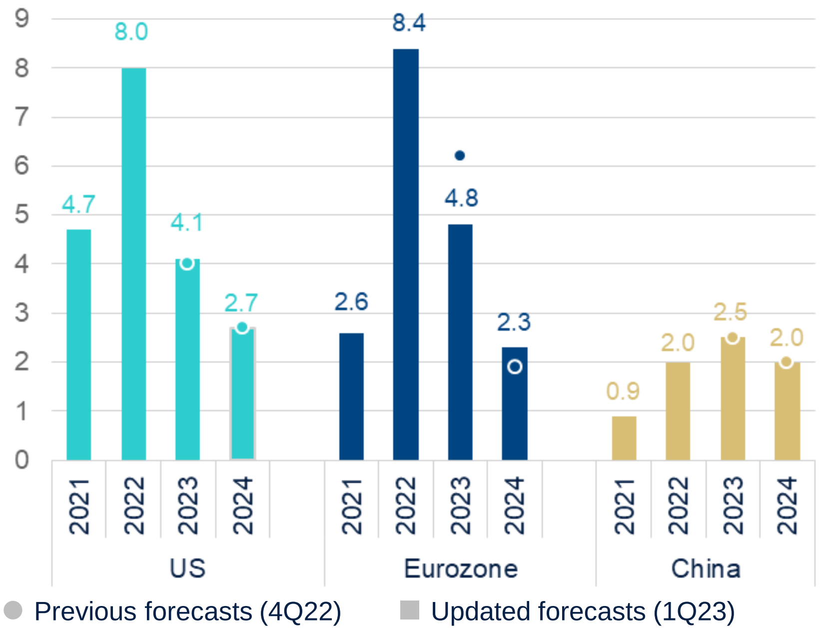
Monetary tightening will pave the way for demand deceleration.

Price and wage pressures will gradually ease and price and wage spirals will be avoided.

Inflation will continue trending downwards, but slower demand deceleration will prevent it from converging to the target over the next two years

INFLATION:CPI

(Y/Y %, PERIOD AVERAGE)



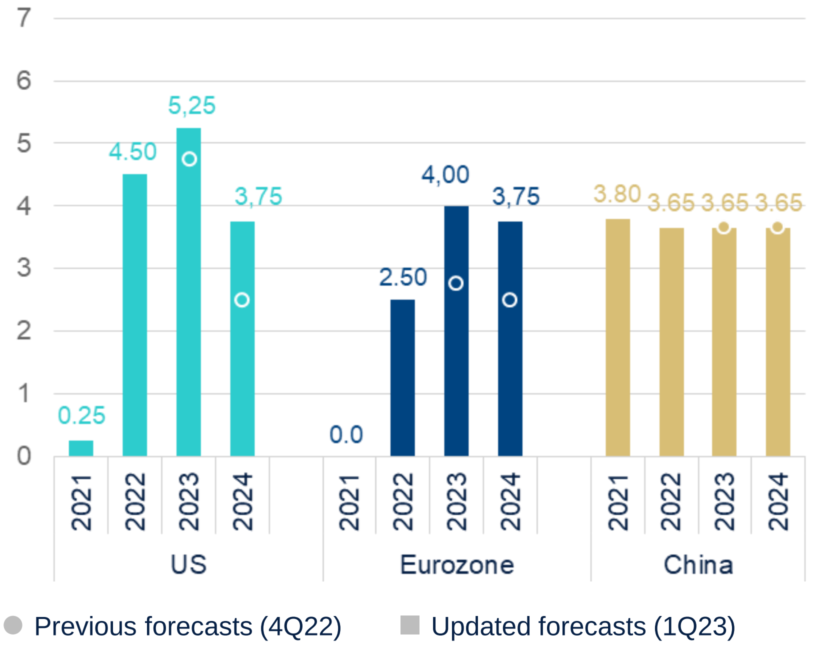
Source: BBVA Research.

- Downward surprises in headline inflation pave the way for lower-than-expected price pressures in the short-run both in the US and the EZ.
- Still, sticky core prices amid more resilient labor markets as well as scarcer room for further falls in energy prices will keep inflation high for longer than expected.
- In China, inflation will probably remain under control, but the risk is that higher domestic demand coupled with the impact of protectionist measures more than offset the effects from the supply normalization, which would add to inflation pressures.

Central banks will remain focused on inflation: interest rates will rise more and will be kept higher for longer than expected

MONETARY POLICY INTEREST RATES (*)

(%, END OF PERIOD)



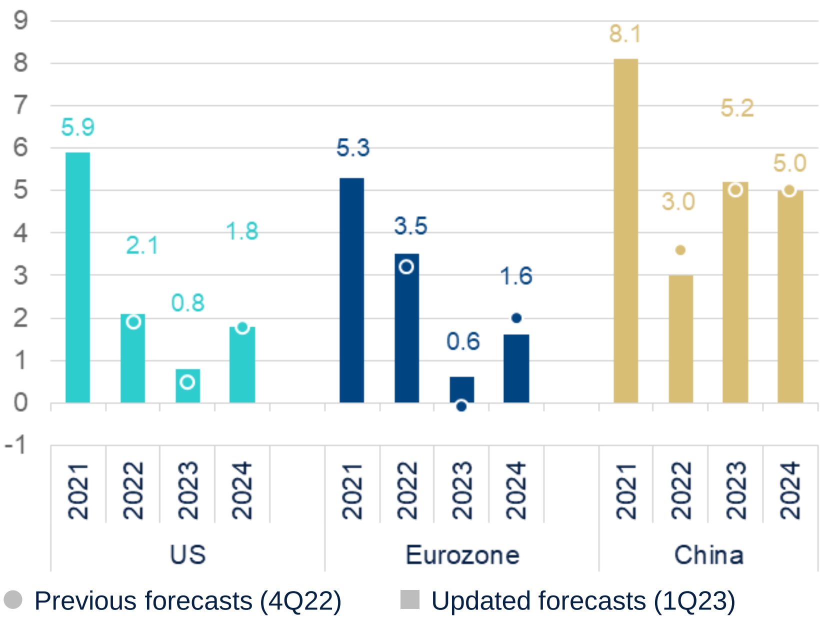
(*) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on Bloomberg data.

- Terminal interest rates will be higher than expected, but uncertainty is large due to the volatile inflation dynamics, the unexpected resiliency of demand and doubts about the power of monetary policy in this context.
- One option is to accelerate quantitative tightening in exchange for smaller additional rate hikes, but that entails financial instability risks.
- The most likely is that rates soon reach 5.25%-5.50% in the US and 4.00%-4.25% in the euro zone.
- High rates can be expected for longer, given the slow process of disinflation.

Better growth prospects for 2023: a softer deceleration in both the US and the Eurozone, and a stronger rebound in China

GDP: ANNUAL GROWTH IN REAL TERMS (*)

(%)



(*) Previous forecasts: 0.5% in 2023 and 1.8% in 2024 in the US, -0.1% in 2023 and 2.0% in 2024 in the Eurozone, 5.0% en 2023 and 5.0% in 2024 in China.
Source: BBVA Research.

- Global GDP is expected to grow 2.8% (0.5pp higher than forecast) in 2023 and 3.3% (0.0pp) in 2024, after having grown 3.2% in 2022.
- 2023 forecasts have been revised up in the US and the EZ on positive incoming data (resilient demand) and lower energy prices.
- Upward revision in 2023 GDP also in China: the reopening will support consumption and supply-side normalization; policy stimuli will back investment.
- Deceleration prospects remain in place due to monetary tightening and high inflation, but some factors (private sector's balance sheets, NGEU in Europe) will be supportive and a deep recession will likely be avoided.

In an uncertainty context, the main risk is that sticky inflation requires extra monetary tightening, triggering a recession, stagflation or financial instability

MAIN RISKS

MORE PERSISTENT INFLATION AND TIGHTER MONETARY POLICY:

- stronger demand (tight labor markets, fiscal stimulus, etc.)
- demand-driven Chinese recovery
- higher energy prices on the war or other factors
- wage-price spirals

→

GLOBAL RECESSION OR STAGFLATION

FINANCIAL INSTABILITY

MAIN UNCERTAINTIES

GEOPOLITICAL TENSIONS

US-CHINA RIVALRY (DEGLOBALIZATION, ETC)

ENERGY TRANSITION AND CLIMATE CHANGE

SOCIAL TENSIONS AND POPULISM

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02

China: economic rebound after lifting “zero Covid”

Main messages

Economic rebound after reopening

2023 will be the "Year of China" after the authorities lifted "zero Covid" policy amid the global economic slowdown. There has been a fast recovery and economic normalization after the first 1-2 month high infection period (80% of the total population infected based on the survey data) in December 2022 and Jan 2023. We raise our 2023 GDP to be 5.2% from 5% previously, based on faster-than-expected "zero Covid" lift and better-than-expected economic resilience in US and EU.

Main growth engine is domestic consumption and investment

The economic recovery has been comprehensive, while the main growth engine in 2023 will be domestic consumption, infrastructure and manufacturing investment instead of external demand, as exports will be dragged by growth slowdown in US and EU. In addition, financial sector will attract more portfolio inflows and FDI amid a stronger RMB and better-performed financial markets. President Xi and Biden's G20 meeting gave some positive signal on China-US relationship, together with the accomplishment of the political leaders transformation after 20th National Congress and "two sessions", providing comparatively stable political environment.

"Two Sessions"

The annual "two sessions" in March have always on the priority of China's political agenda. The top agenda of this year is to secure a smooth transformation to President Xi Jinping's third-term accompanied by reshuffling the State Council; together with setting the 2023 economic targets. The new government leadership is also expected to send a policy signal to support economic recovery and China's long-term reforms and development, helping to rebuild market confidence.

Main messages

Main risks

The economy was mainly dragged by three risks: (i) How to rebuild market confidence and to repair the household and enterprises' balance sheets; (ii) Real estate crash; although recently the authorities have promulgated "16 point Plan" to support housing market, its effectiveness is still challenging ahead; (iii) weak external demand in 2023 will significantly drag China's exports.

Reflation risk is contained

Economic rebound is naturally expected to lead to rising inflation particularly in the service sector. And the market also anticipate China's reopening will increase global commodity demand thus a higher global commodity price will spillover to global inflation. However, reflation risk seems contained at the current stage as supply side could quickly catch up to meet rising demand domestically.

The “two sessions” accomplished top political leadership transformation and set economic targets for 2023

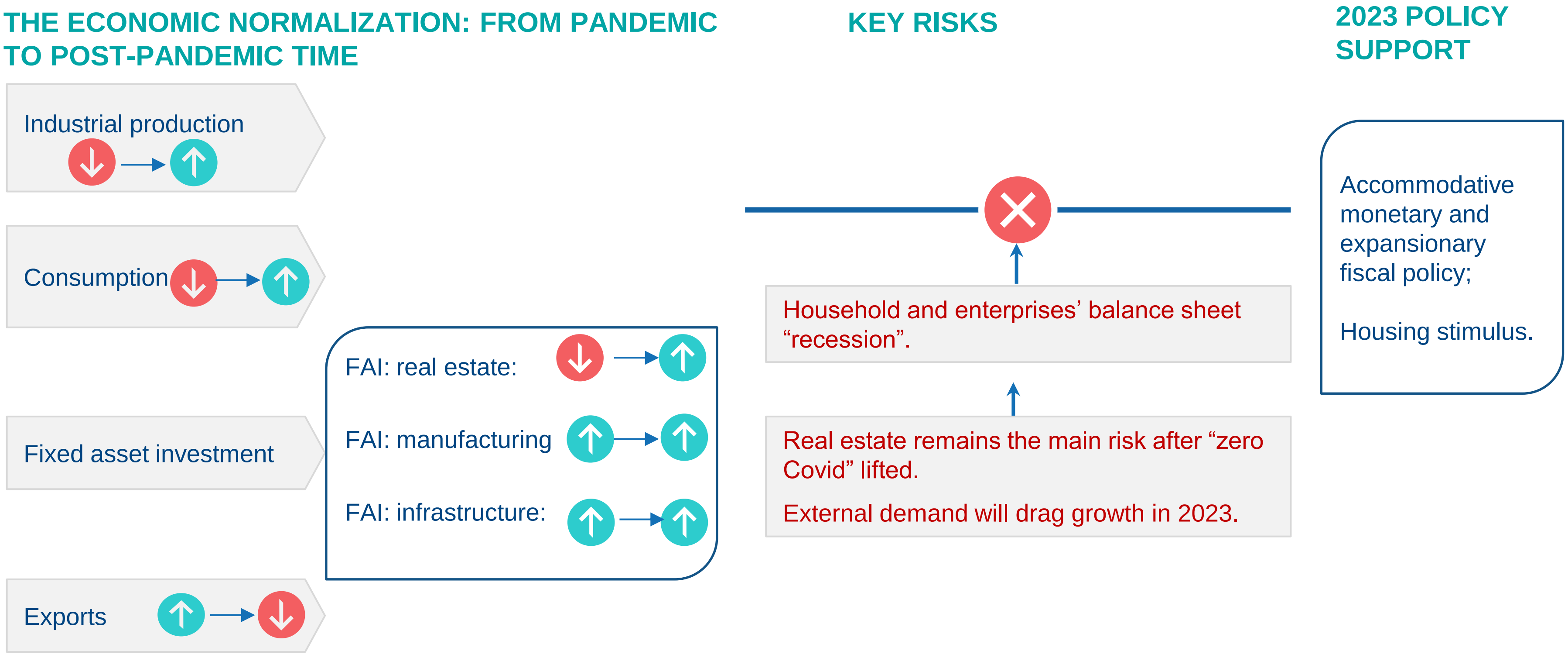
There are four important themes of this years’ “two sessions”: top political leader transformation, State Council reform, 2023 economic targets and policy stimulus. Based on the 20th National Congress of the Communist Party of China (CPC) in October 2022, the “two sessions” secure a smooth transformation to President Xi Jinping’s third-term accompanied by reshuffling and reforming the State Council. The incumbent Premier Li Keqiang stepped down together with most of the existing cabinet members. The reappointment of Yi Gang as PBoC governor indicates the policy consistency and the integration to global financial system given Yi’s US-educated background.

Key 2023 economic targets: (i) The “around 5%” growth target is in line with our expectation. (ii) employment target: to create 12 million new urban jobs this year, and a surveyed urban unemployment rate of 5.5% which is in line with the 2022 target. (iii) The inflation target is set to be around 3%; (iv) household income growth will be in line with GDP growth; (v) to maintain a balanced Balance of Payments (BoP).

Key monetary and fiscal policy target: (i) The genera fiscal deficit budget is 3%, higher than the previous year’s 2.8%; (ii) Local government bond issuance quota is RMB 3.8 trillion, higher than last year’s RMB 3.65 trillion; (iii) To maintain expansionary fiscal policy and prudent monetary policy; (iv) The policy should prioritize stimulating domestic consumption and constructing modernized industrial system.

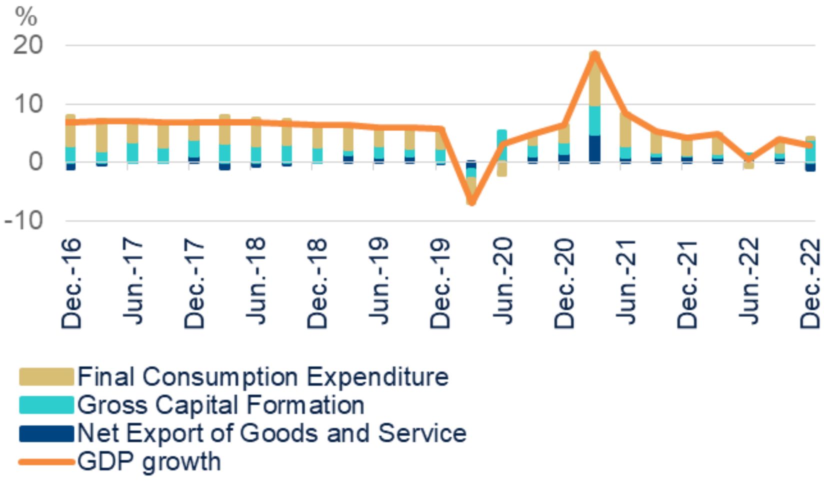
State Council reform: (i) To establish the super regulator for the financial sector- National Financial Regulatory Administration to replace and unify the previous China Banking and Insurance Regulatory Commission (CBIRC). (ii) To restructured its Science and Technology Ministry to concentrate resources on achieving technology breakthroughs. (iii) To establish National Data Bureau to deal with national security and to promote digital economy.

Post-pandemic economy: from 1-2 month high infection period to economic normalization



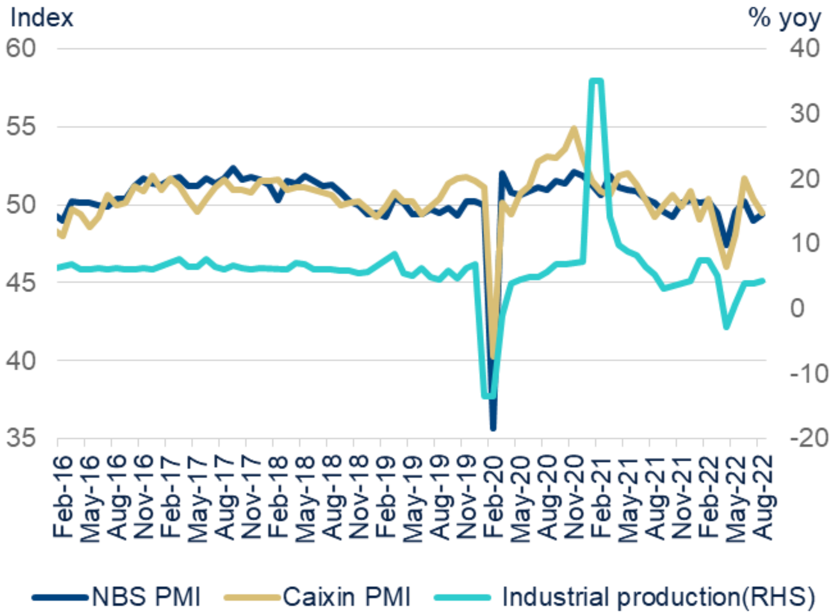
Growth is anticipated to bounce back after lifting “zero Covid”; 2023 quarterly growth pattern will be “N-shape” due to base effect

GDP IS ANTICIPATED TO BOUNCE BACK TO 5.2% IN 2023 FROM 3% IN 2022



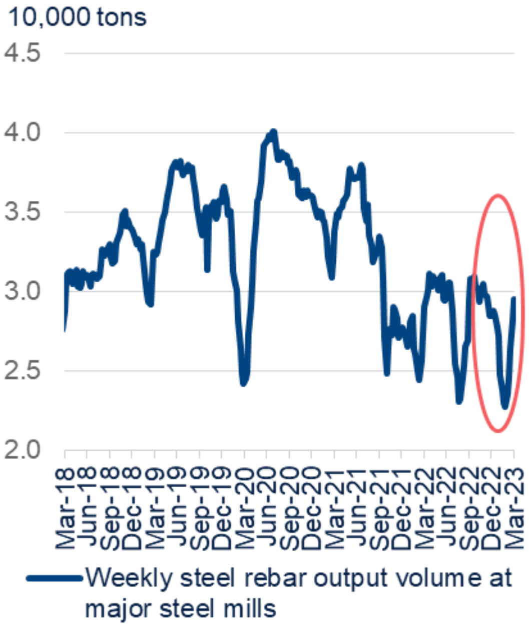
Forecast	2023Q1	2023Q2	2022Q3	2023Q4
Y/Y%	3.2	6.3	4.7	6.3
Q/Q%	0.8	0.6	2.6	2.3

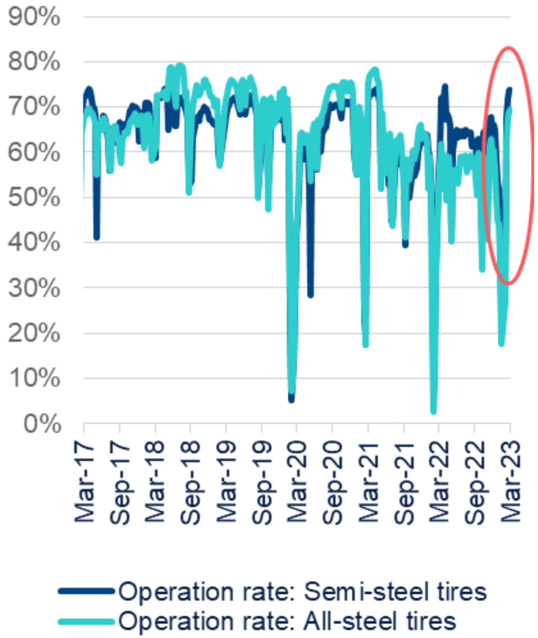
NBS PMI REBOUNDED SIGNIFICANTLY TO 52.6 IN FEBRUARY; INDUSTRIAL PRODUCTION ALSO JUMPED TO 2.4% IN JAN-FEB FROM 1.3% IN DEC 2022



Source: BBVA Research.

High frequency indicators show the temporary drop in Dec-Jan after lifting the "zero covid" due to high infection rate, but bounced back afterwards

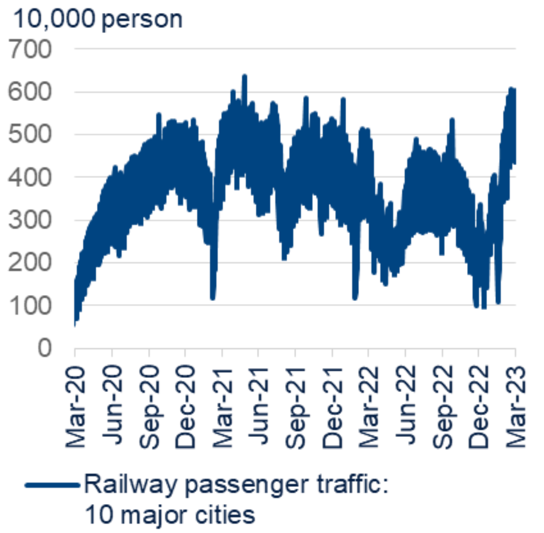




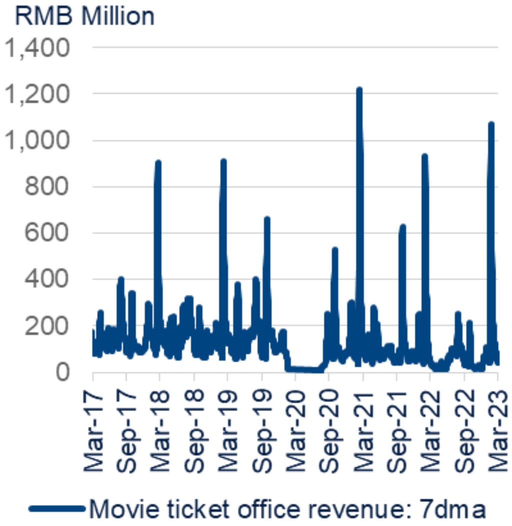
Source: CEIC and BBVA Research..

High frequency indicators also show Lunar New Year mobility and consumption rebound, although not fully recovered to the pre-pandemic level

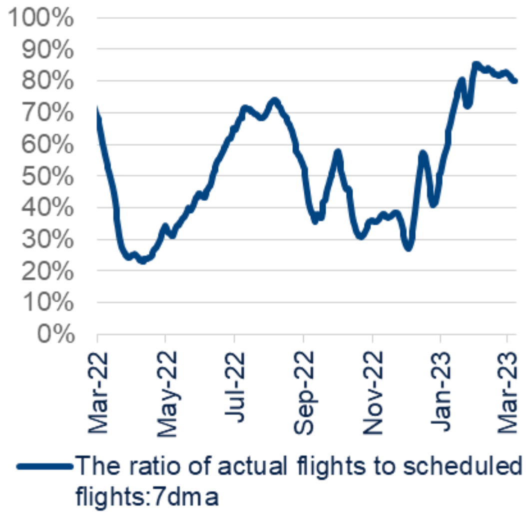
PEOPLE MOBILITY BY TRAIN GRADUALLY PICKED UP



MOVIE BOX OFFICE REVENUE HIGHLY CORRELATED WITH LOCKDOWN POLICY



AIRLINE INDUSTRY ALSO PICKS UP SIGNIFICANTLY

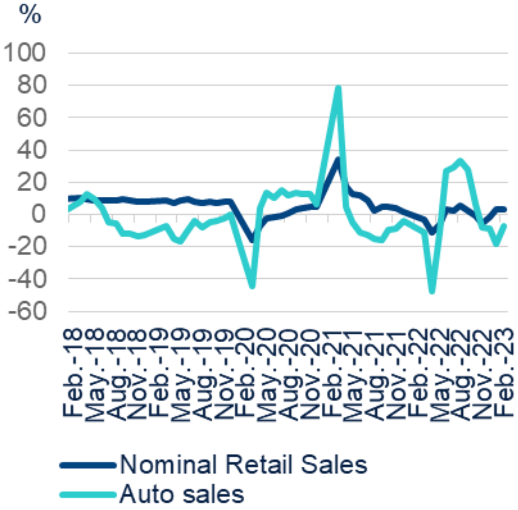


Source: WIND and BBVA Research.

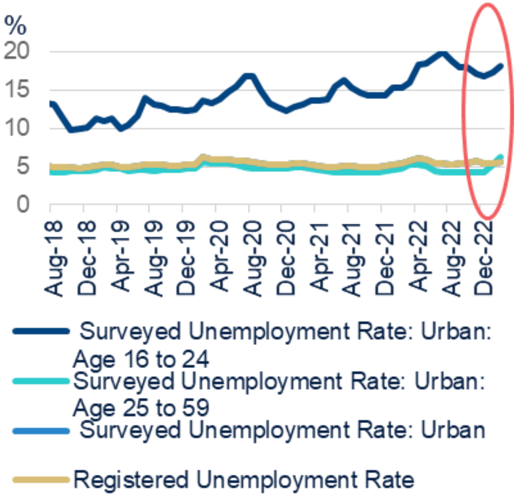
"Revenge spending" during Chinese Lunar New Year: Movie box office revenue ramped up to RMB 6.5 billion, historically 2nd highest no. of tourists growth revved up to 162% (88.6% of 2019 level) while tourism income increased by 30% (73% of 2019 level); growth of travelers by airlines reached 79.8% (71% of 2019 level) and by railways reached 57% growth (79% of 2019 level).

Retail sales rebounded: service sector recovery helps support employment and income expectation, together with high excess savings

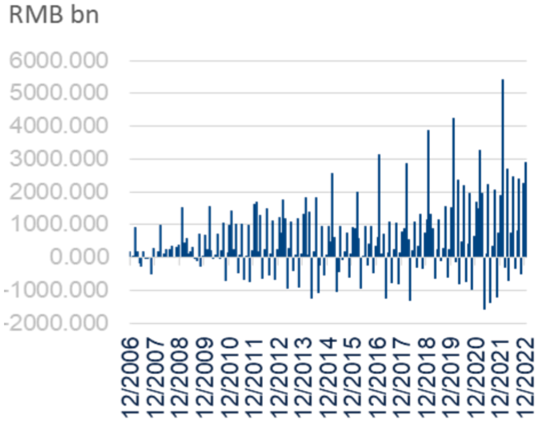
RETAIL SALES BOUNCED BACK TO POSITIVE GROWTH



AFTER RE-OPENING, UNEMPLOYMENT RATE DECLINED



THE EXCESS SAVINGS DURING PANDEMIC TIME ESTIMATED TO BE RMB 4.4 TRILLION

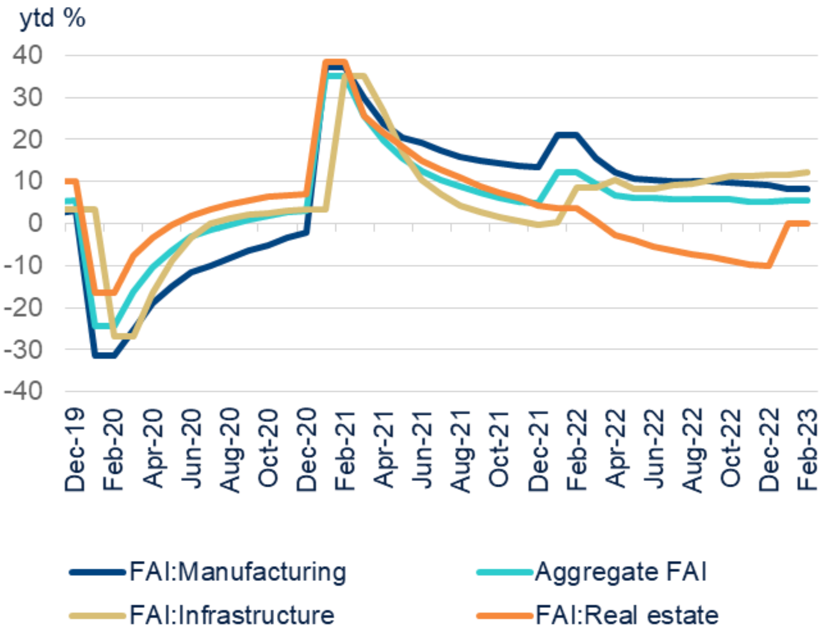


Source: CEIC and BBVA Research.

It is expected to be "lower unemployment-income increasing-consumption increasing" positive feedback cycle in post-pandemic time. However, we need to identify consumption "REBOUND" and "REVERSION". The repairment of household balance sheet and the rebuild of consumer confidence may need a longer time to fully go back to the pre-pandemic level.

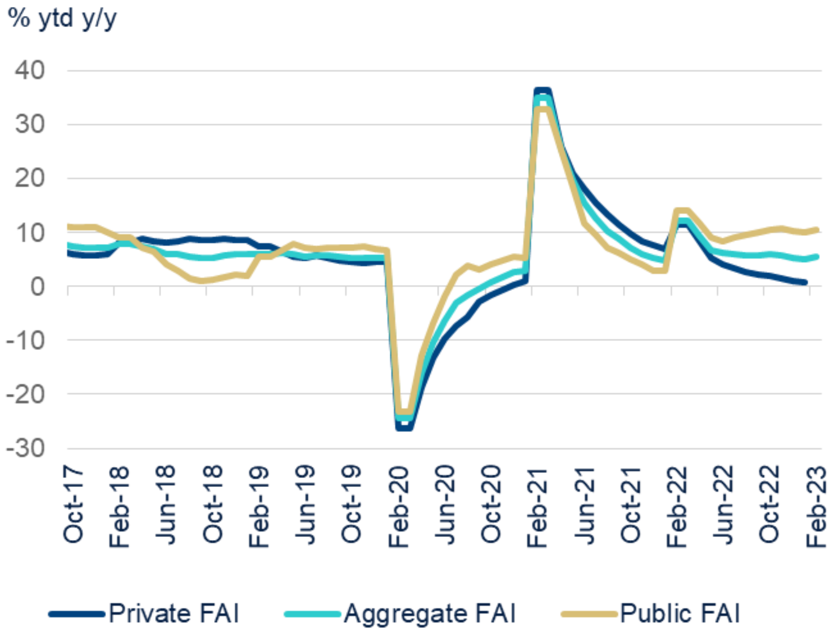
FAI: infrastructure and manufacturing FAI will be the main engines for growth recovery in 2023, while housing investment is expected to shrink the decline

THE HIGHLIGHT OF JAN-FEB FAI IS THE HOUSING FAI SIGNIFICANTLY SHRANK ITS NEGATIVE GROWTH



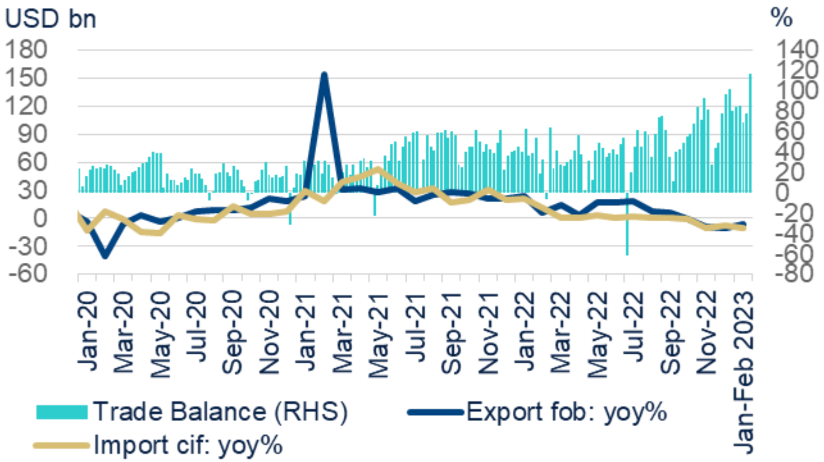
Source: CEIC and BBVA Research.

PUBLIC FAI LED THE INVESTMENT RECOVERY DUE TO THE FISCAL STIMULUS

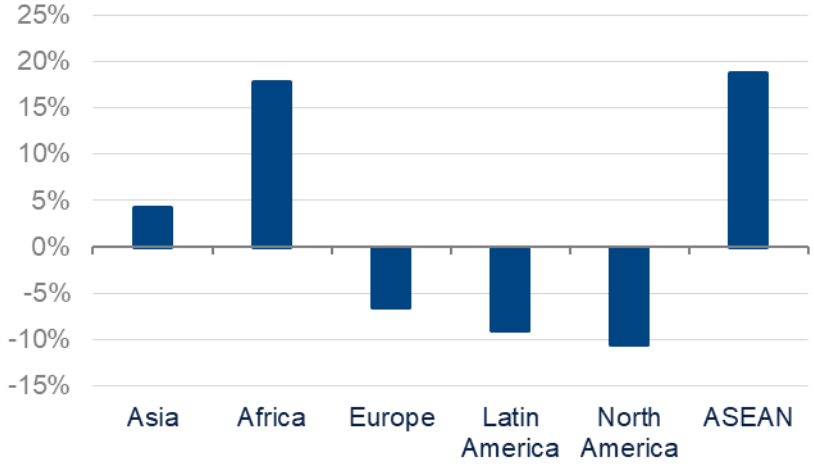


China's exports: from 30% high growth in pandemic time to currently negative growth due to economic slowdown in US and EU

EXPORTS DIPPED TO -6.8% IN FEB FROM -9.9% IN JAN; IMPORTS EXPANDED THE DROP TO -10.2% FROM -7.5%



CHINA'S EXPORTS GROWTH TO THE US, EUROPE AND LATAM RECORDED NEGATIVE

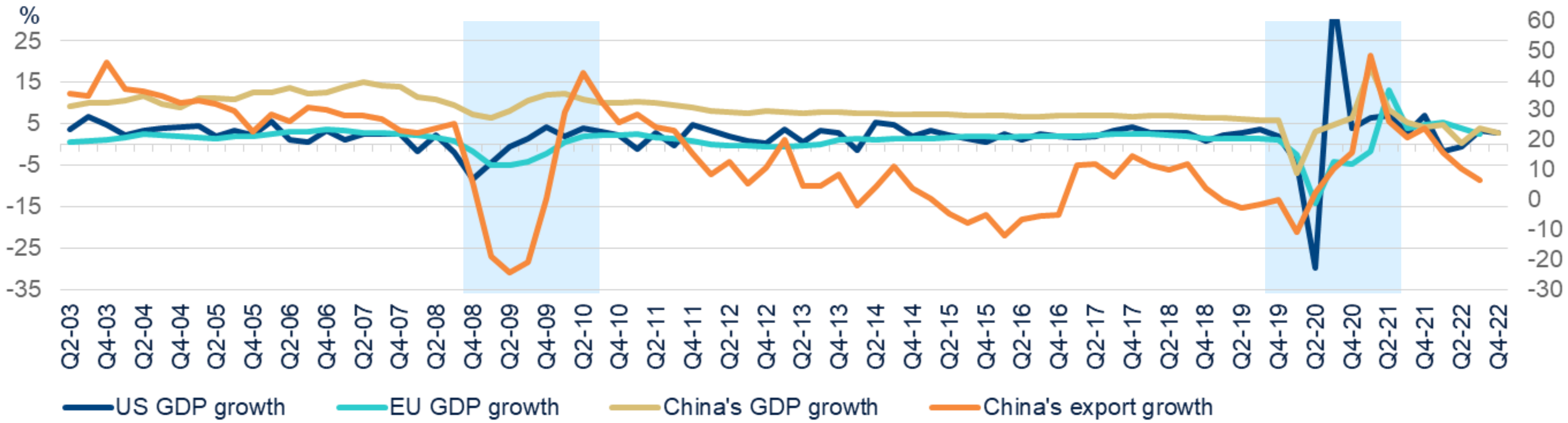


Source: CEIC and BBVA Research.

We anticipate export growth will decrease by 2% in 2023 while imports increased by 2%, leading shrinking current account. It drags GDP growth by 0.8% in 2023. Foreign tourists after re-opening will significantly increase current account deficit, leading current account to GDP ratio declines from 2.5% in 2022 to 1% in 2023.

The US and EU slowdown will drag on China's exports in 2023, but not necessarily on China's GDP growth due to the dominance of domestic demand

CHINA HAS UNSYNCHRONIZED BUSINESS CYCLE WITH THE US AND EU IN PANDEMIC TIME

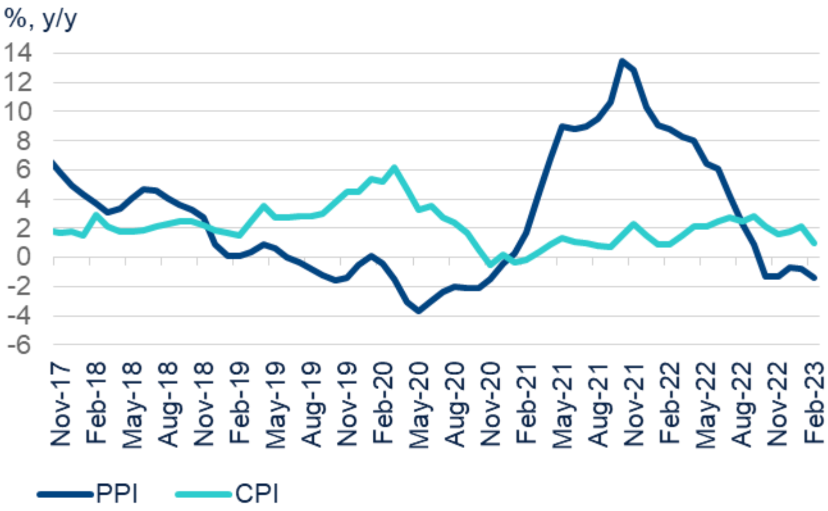


- In 2008-09 GFC, China's exports growth dipped to -30%, but GDP growth was robust at more than 5%, due to RMB 4 trillion fiscal stimulus to support investment and consumption domestically;
- In 2020-22 Covid-19 Pandemic, China's business cycle was not synchronized with the world, EU and US slowdown led to 30% exports growth;
- 2023 China's GDP will be mostly supported by domestic investment and consumption, the impact of exports slowdown is very limited on GDP growth.

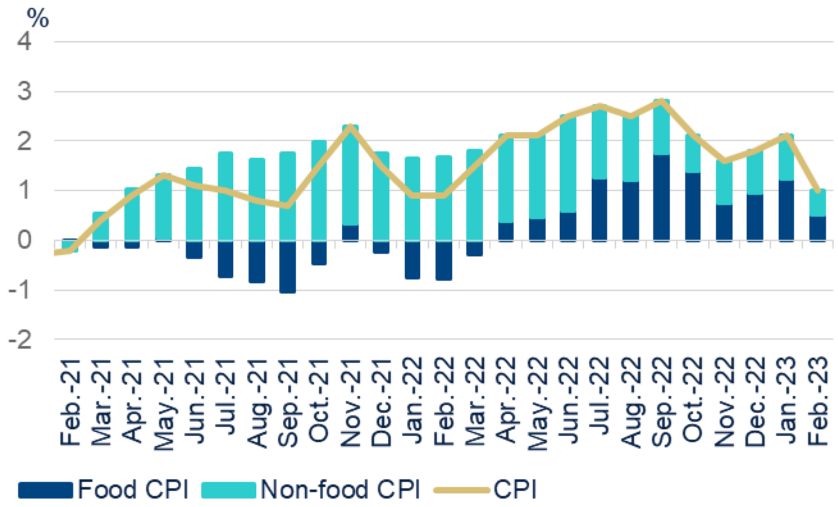
Source: CEIC and BBVA Research.

Reflation or Deflation? Inflation is expected to rise after reopening, but generally it is contained currently and is not expected to significantly spillover to global inflation

CPI DECREASED FROM 2.1%TO 1% IN MARCH; PPI ALSO DECLINED FROM -0.8% TO -1.4% IN MARCH



CPI DIPPING WAS DRIVEN BY FOOD PRICE, PATICULARLY PORK PRICE

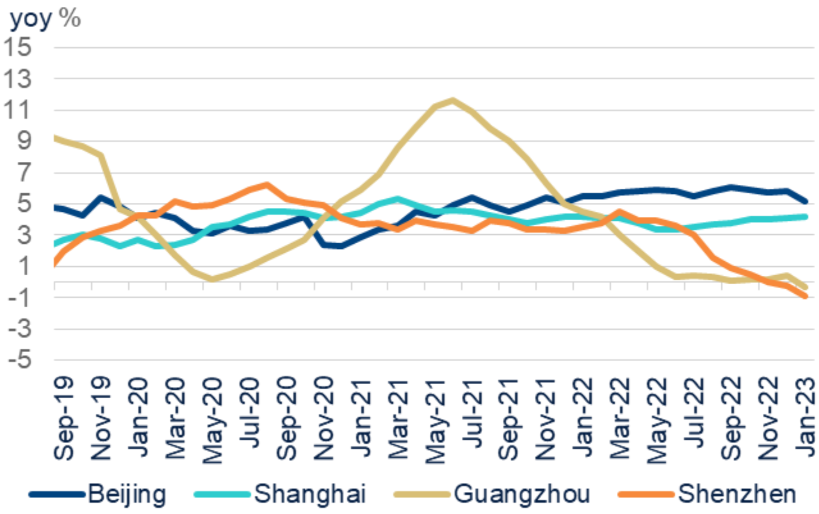


Source: CEIC and BBVA Research.

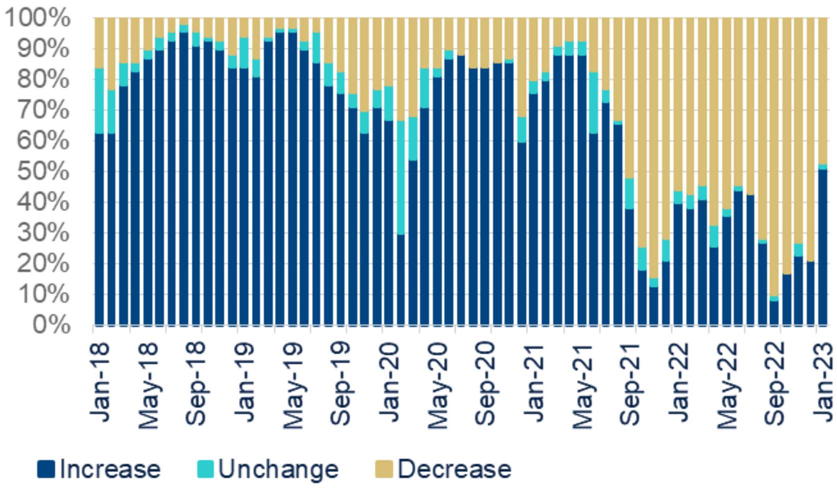
China will not add significant inflation pressure to the world after re-opening and the current level of both CPI and PPI are contained. (i) Unlike the US, Chinese authorities did not directly transfer cash to household, (ii) pandemic stimulus in China was contained, (iii) the downward adjusted global commodity price, PPI will remain negative.

China's housing crash was policy-driven amid regulatory storms in 2021, indicating ongoing policy turnaround will support housing soft-landing in 2H 2023

HOUSING PRICES DROPPED IN MAIN LARGE CITIES



MORE CITIES REPORTED HOUSING PRICE INCREASE IN 70-CITY SURVEY COMPARED WITH THE LAST MONTH

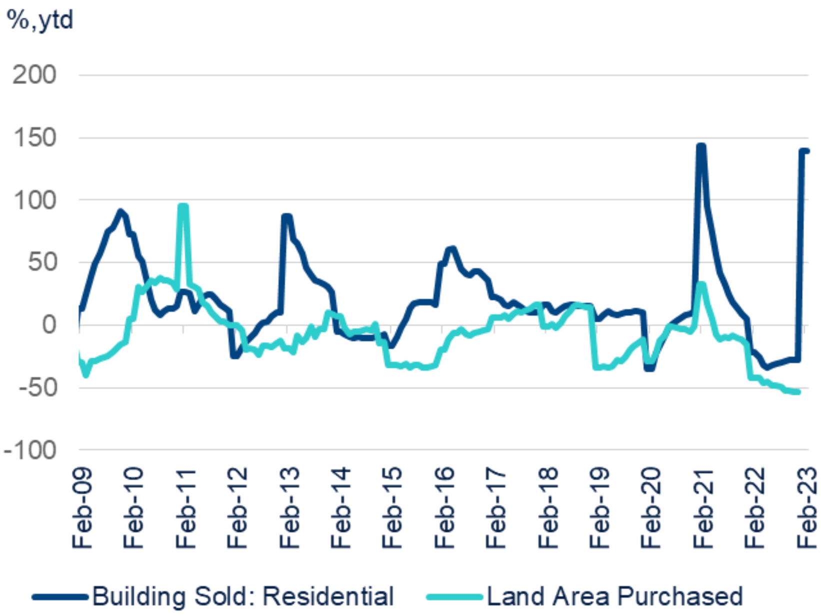


Source: CEIC and BBVA Research.

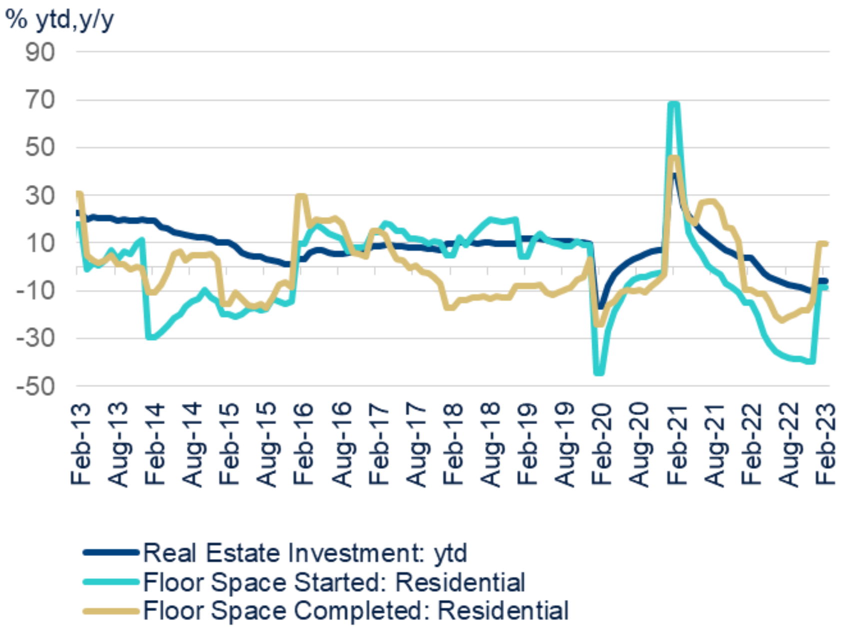
December 2022 real estate policy stimulus "16-Point Plan" is a comprehensive stimulus package which not only supports State-owned housing developers, but also private developers; not only to supports demand side but also supply side which various kinds of financing tools.

Housing activity indicators along the real estate value chain picked up significantly amid housing stimulus measures

BUILDING SOLD SLIGHTLY PICKED UP, ALTHOUGH LAND SALES REMAIN LACKLUSTER



FLOOR SPACE STARTED COMPLETED ALSO PICKED UP AMID POLICY SUPPORT



Source: CEIC and BBVA Research.

Some baseline scenario outlook of China's real estate sector

The current round of housing crash will not lead to nationwide housing collapse or financial crisis given the authorities' powerful intervention ability and lifting of "zero Covid".

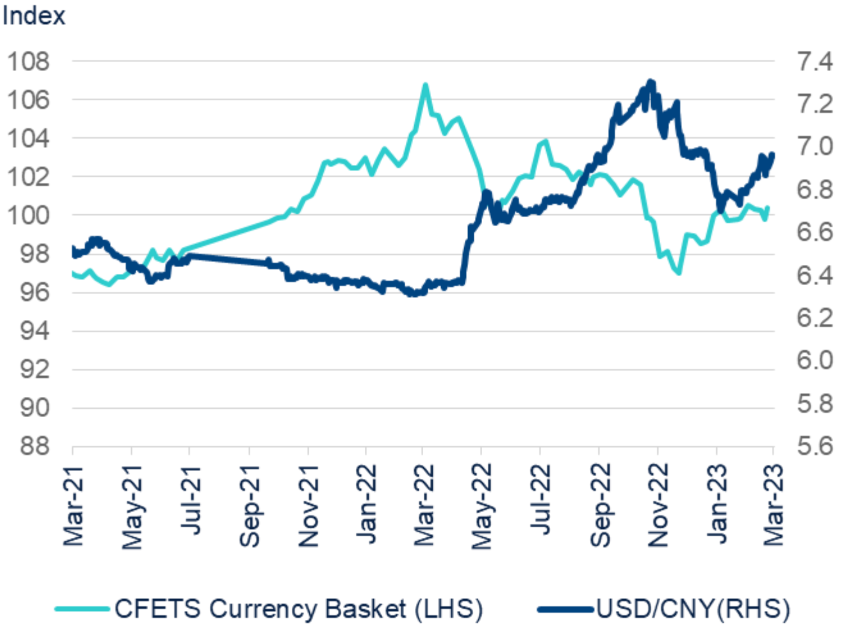
The worst time has passed. Housing market is anticipated to bottom out amid a series of stimulus, as housing has always been counter-cyclical measure in the past decades and it is extremely policy-driven.

There will be diversification of real estate development between tier-1 cities and tier-3 and tier-4 cities: outlook of housing market in large cities still robust, but the outlook is deteriorated in small cities.

It is a long-term challenge for Chinese authorities to balance growth (stimulated by real estate) and financial stability, as well as a challenge to apply the "new growth" model to replace "old growth model" (based on housing and infrastructure stimulus); but the current stimulus is still too far-away to enter the discussion whether it means the imbalances in the real estate sector will continue as the soft-landing has not achieved yet.

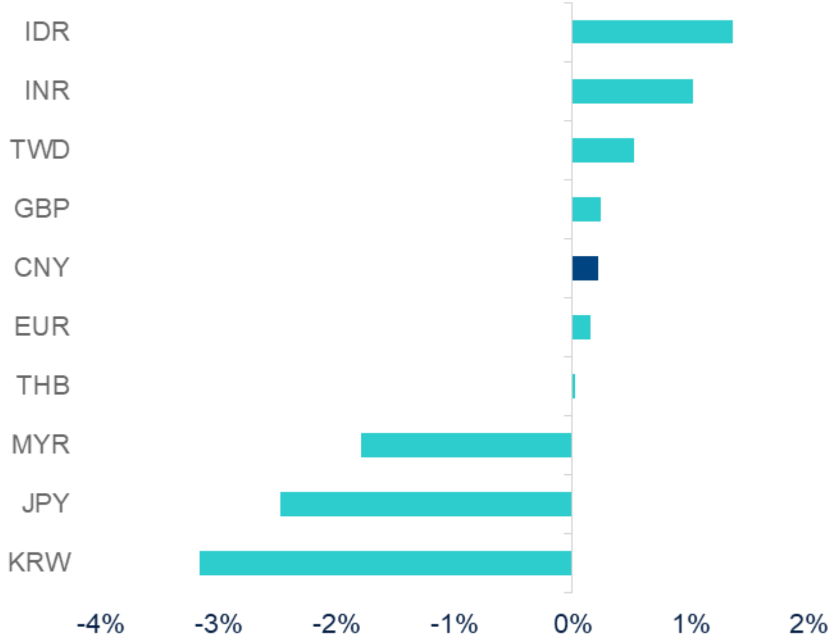
RMB exchange rate reversion as the FED enhanced the hawkish stance

RMB EXCHANGE RATE VOLATILE ACCORDING TO USD DXY FLUCTUATION AND FED HIKE PATH UNCERTAINTIES



Source: CEIC and BBVA Research.

AMONG THE MAIN AM AND EM CURRENCIES, RMB DEPRECIATED MODESTLY SINCE IN 2022



RMB exchange rate reversion as the FED enhanced the hawkish stance (2)

Several factors support RMB exchange rate:

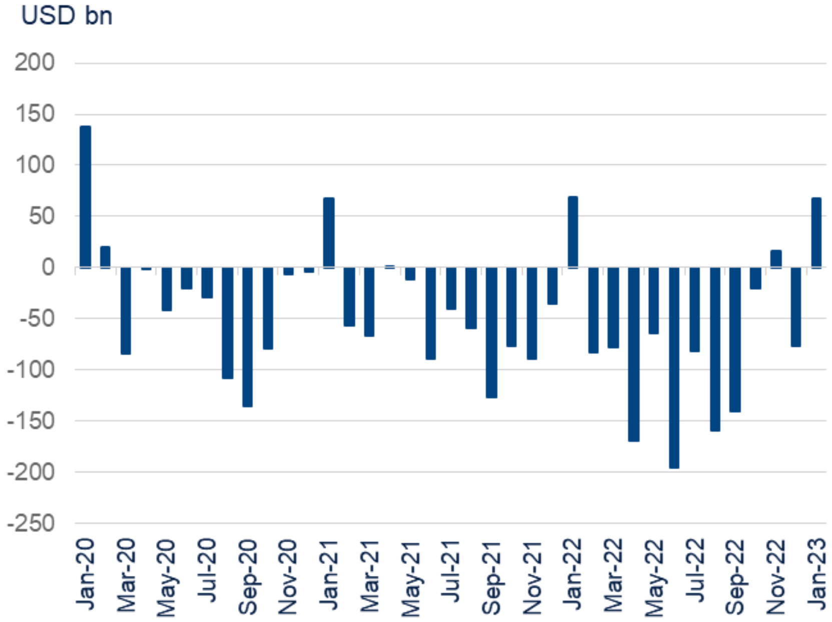
FED will eventually stop interest rate hike at 2H 2023, supporting RMB exchange rate.

China's "zero Covid" lifting significantly stimulate financial market sentiments, leading to a soaring stock and bond market, attracting portfolio inflows;

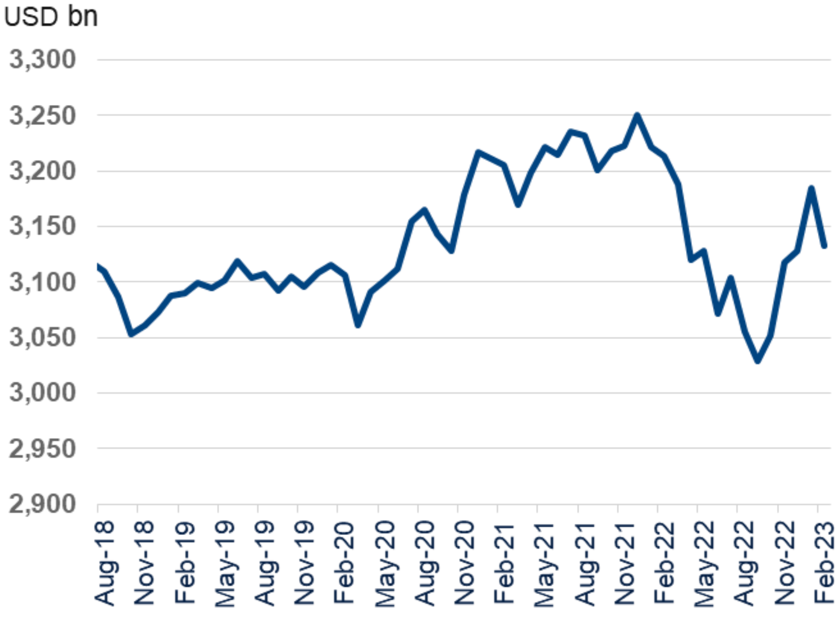
From the natural interest rate perspective in a longer term, as in the general equilibrium a country's natural interest rate should be equivalent to its natural growth rate. China's potential growth is higher than the US (China 4.5%, US around 2%), providing a justified support for long-term attractions for capital inflows, supporting RMB outlook.

Accelerating capital inflows and foreign reserves due to “zero Covid” lifting and an overshooting stock market

ACCELERATING PORTFOLIO INFLOWS DUE TO THE OVER-REACTED STOCK MARKET OF “ZERO COVID” RELAXATION



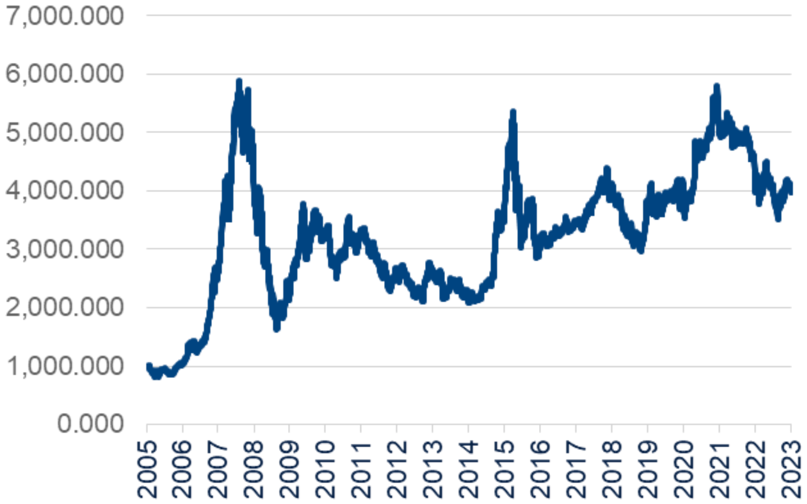
FOREIGN RESERVES ALSO ANTICIPATED TO TREND UP



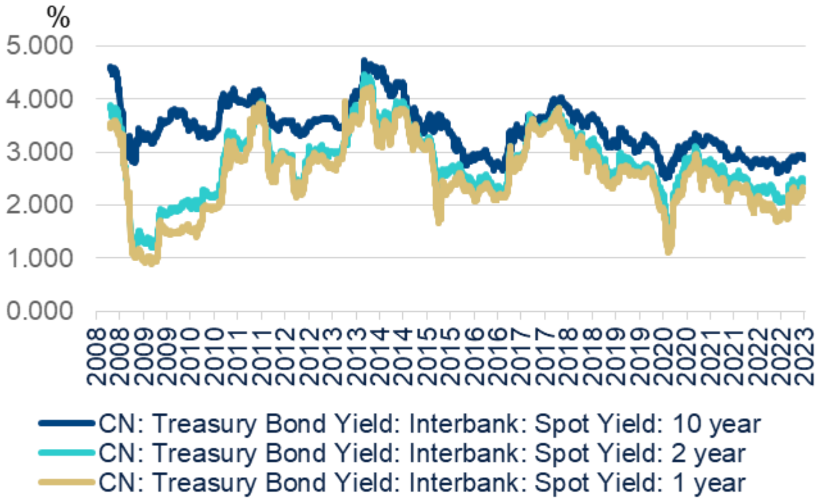
Source: CEIC and BBVA Research.

Financial markets started to tick up after re-opening and housing stimulus, the worst time was already passed, attracting portfolio inflows

SHANGHAI-SHENZHEN 300 INDEX TICKED UP RECENTLY DUE TO “ZERO COVID” LIFT, ATTRACTING CAPITAL INFLOWS



BOND YIELD ALSO PICKED UP RECENTLY, SHRINKING INTEREST RATE DIFFERENCE WITH THE US (10-YEAR BOND FORECAST: 3.3% END-2023)



Source: CEIC and BBVA Research.

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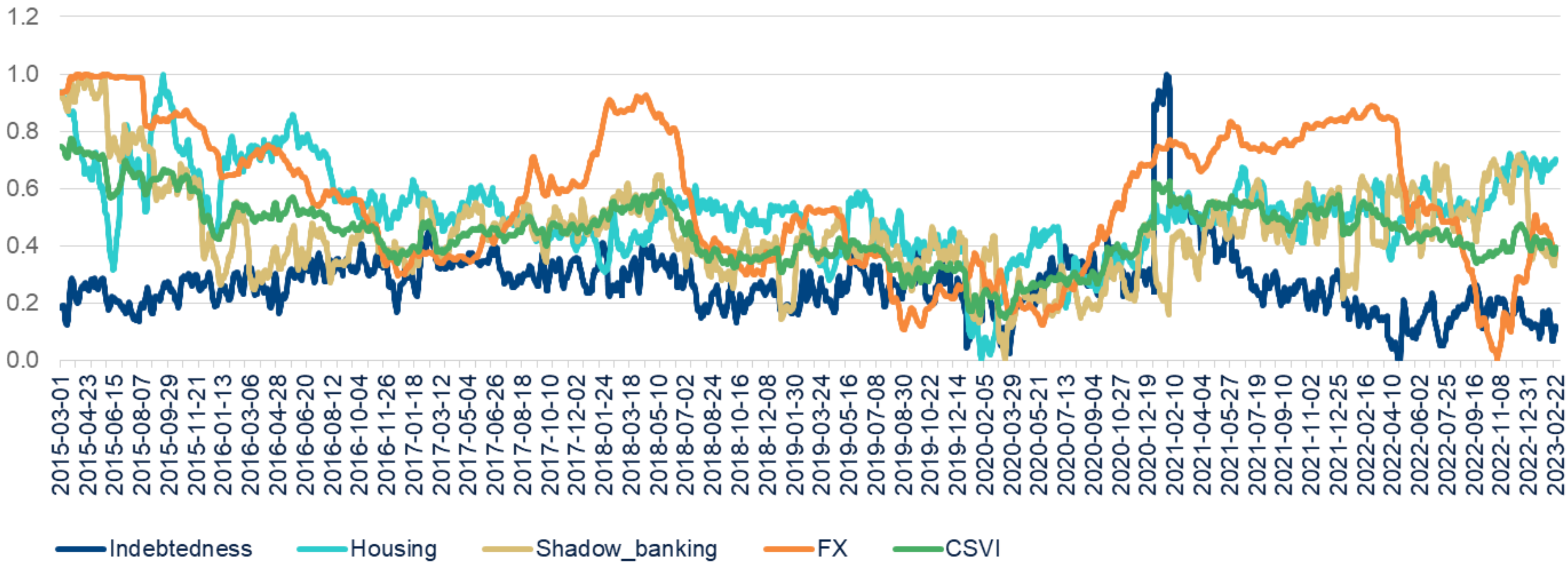
In January 2023, portfolio inflows to stock market reached USD 110 billion, higher than the 2022 whole year total equity inflow.

Big Data: China's Economic Uncertainty Index

CHINA'S ECONOMIC UNCERTAINTY INDEX MODERATED RECENTLY AFTER LIFTING "ZERO COVID"



Source: GDELT and BBVA Research.

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03

Expansionary monetary and fiscal policy to support recovery

Main messages

Monetary policy

The PBoC has maintained LPR and MLF unchanged since the interest rate cut in August 2022. That means, the central bank remains prudent monetary policy amid the FED hike cycle, as the interest rate cut will enlarge China-US yield reversion and trigger RMB exchange rate depreciation and capital outflows. Monetary policy will be more relying on quantity tools rather than price tools, such as RRR cuts and targeted easing measures to SMEs and pandemic-affected sectors.

Fiscal policy

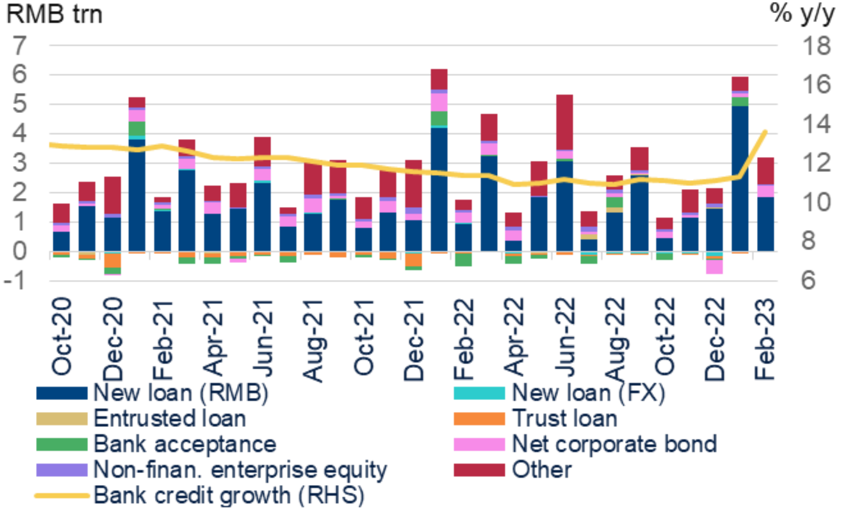
Expansionary fiscal policy focuses on expanding local government bond issuance and raising the fiscal deficit budget to GDP ratio to 3% from 2.8% in the previous year. In particular, the authorities expanded local government quota of 2023 from RMB 3.65 trillion in 2022 to RMB 3.8 trillion to support infrastructure investment, which was announced in March "two sessions", although it is a bit lower than the actual local government bond issuance of RMB 4.15 trillion in 2022.

Housing policy

Housing policy has got a sharp turnaround starting from late 2022 amid the housing crash and economic slowdown. The authorities acknowledge that housing is the important factor to secure growth recovery after lifting "zero Covid", thus, on top of the "16-point plan" which was promulgated at end of 2022, stimulus policies of housing market have been implemented both from supply and demand side.

Credit expansion in the following months will come mostly from policy side, instead of proactive "balance sheet" expansion by household and enterprises

TOTAL SOCIAL FINANCING AND NEW RMB LOANS REBOUNDED IN JAN-FEB, SUPPORTED BY MORTGAGE AND ENTERPRISES BORROWING



Source: CEIC and BBVA Research.

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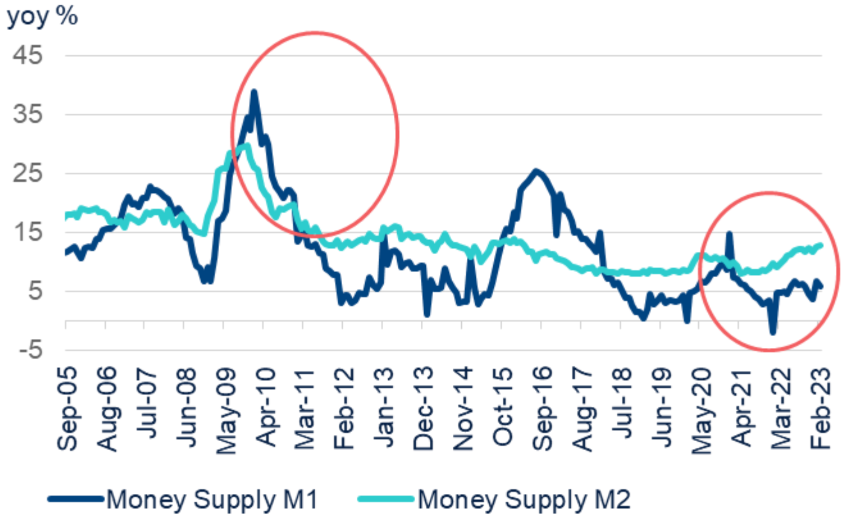
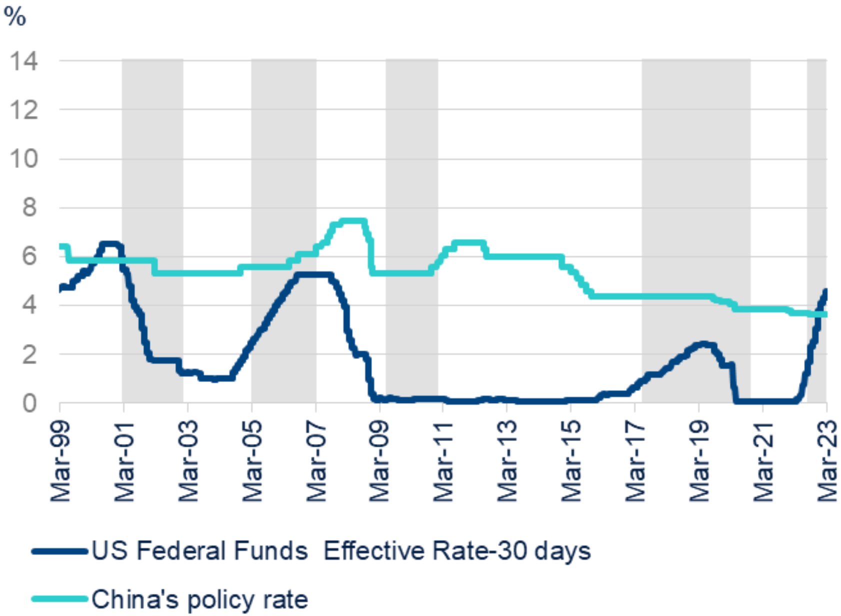
…LEADING TO A SURGING M2 GROWTH



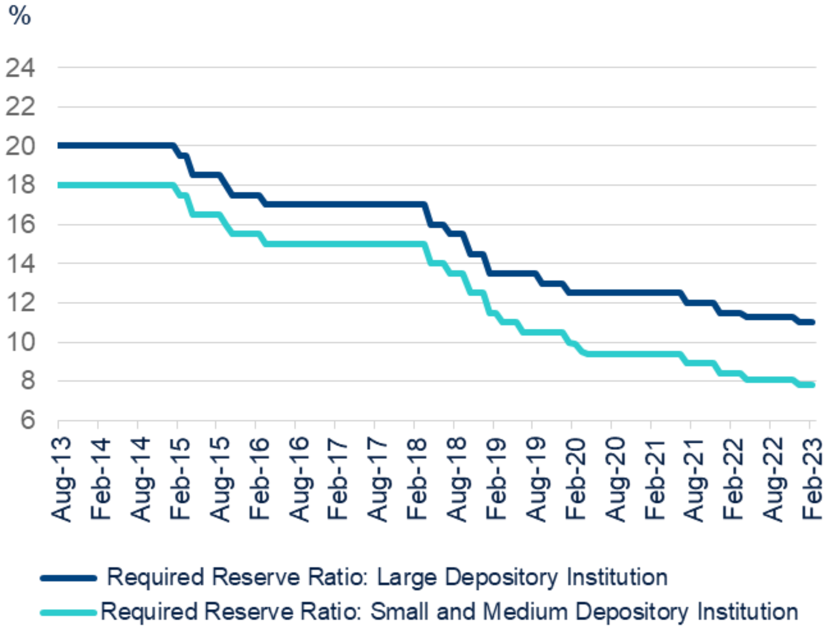
Enterprises need to wait until they foresee a high investment return to proactively expand their "balance sheet", during this process, economic normalization (investment return back to previous track) and rebuilding market confidence at central government level will be the key.

Monetary policy remains easing, but more on quantitative, structural tools (MLF, repo, RRR cut) and targeted easing, instead of price tools (policy rate cut)

CHINA IS NOT ANTICIPATED TO CUT POLICY RATE DURING FED HIKE CYCLE, BASED ON HISTORICAL EXPERIENCE



THE EASING MONETARY POLICY FOCUS ON QUANTITATIVE TOOLS, SUCH AS RRR CUT



Source: CEIC and BBVA Research.

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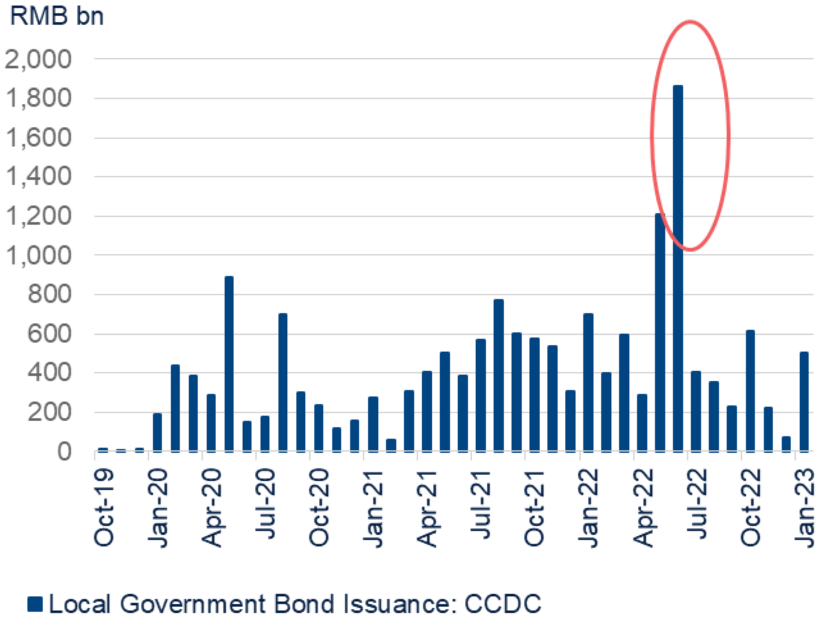
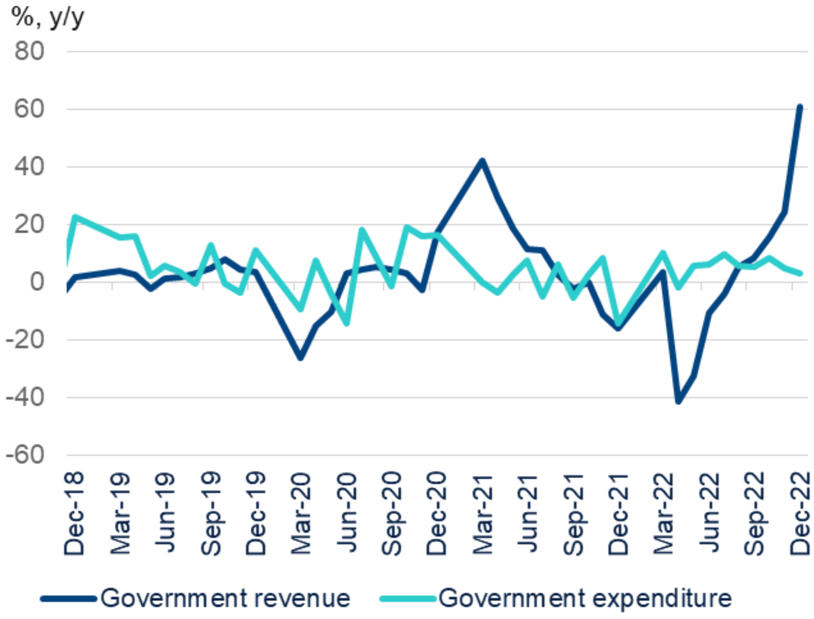
More fiscal stimulus in 2023 to support growth recovery

“TWO SESSIONS” ANNOUNCED RMB 3.8 TRILLION LOCAL GOVERNMENT BOND ISSUANCE QUOTA TO SUPPORT INFRASTRUCTURE INVESTMENT



LOCAL GOVERNMENT FISCAL REVENUE REBOUNDED SIGNIFICANTLY AFTER REOPENNING



Source: CEIC and BBVA Research..

Recently announced fiscal stimulus to support recovery and rebuild market sentiments

2023 fiscal deficit budget will be 3% of GDP, higher than previous year's budget at 2.8%;

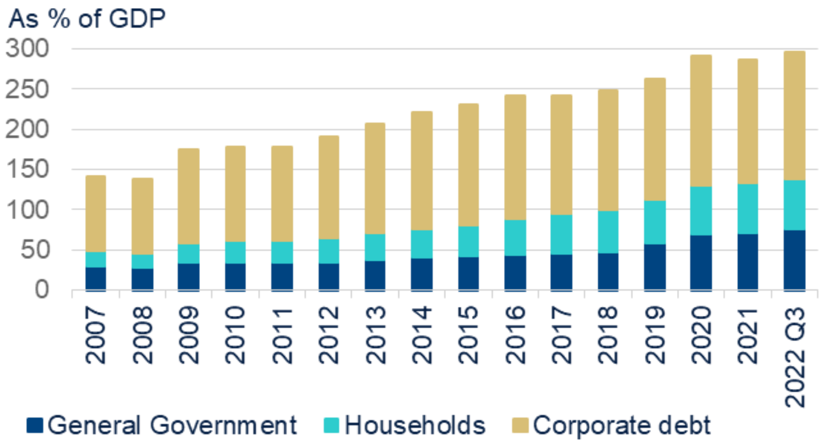
2023 local government bond quota is announced to be RMB 3.8 trillion, higher than 2022's quota at RMB 3.65 trillion, although lower than the actual local government bond issuance at RMB 4.15 trillion.

To release **consumption coupon** in the areas of tourism, restaurant, furniture, domestic appliance etc. in order to stimulate retail sales, with the total amount more than RMB 2 billion. But unlike the US, China did not directly transfer cash to household.

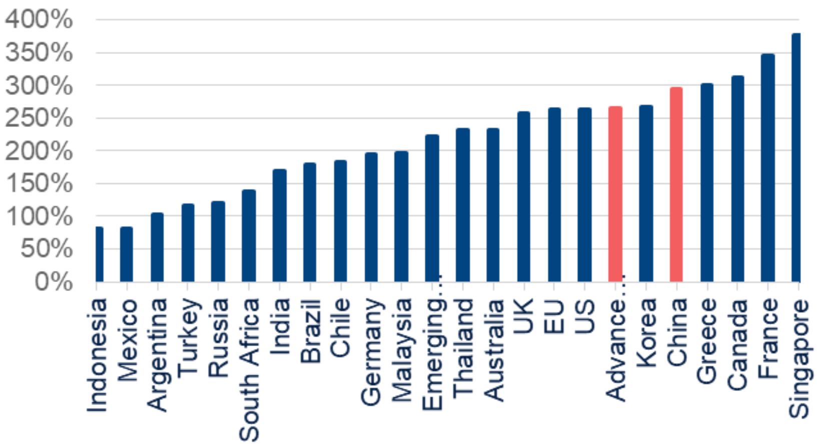
The room for further tax cut and fee reduction is limited; The "two sessions" did not mention the tax cut target figure but emphasize the tax cut and fee reduction will continue as announced in 2022 two sessions.

China's debt overhang issue focus on local government debt and corporate debt, while household debt and central government debt remain sustainable

CHINA'S MACRO LEVERAGE RATIO REACHED 273.9% TILL Q3 2022



CHINA'S MACRO LEVERAGE RATIO IS HIGHER THAN EMERGING MARKETS AVERAGE



- The intrinsic reason of debt problem is China's growth model depends heavily on investment, through issuing local government debt and corporate debt (most of them are SOE debt), rather than directly transferring cash to household to stimulate consumption (US model).
- But we should not worry too much about debt issue at the moment: (1) China's Covid-19 stimulus was very contained compared with US and EU, and compared with 08-09 GFC RMB 4 trillion stimulus; (2) After regulating on local government debt and LGFVs in 2018-2019, fiscal discipline at the local government level has been established. (3) The only remaining issue should be SOE's soft budget constraint problem.

Source: CEIC and BBVA Research.

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Forecast: China’s main economic indicators

BASELINE SCENARIO

	2019	2020	2021	2022	2023	2024	2025
GDP （%）	6.1	2.3	8.1	3	5.2 ▲	5	4.5
CPI（%）	2.9	2.6	0.9	2	2.5	2	2
PPI (%)	-0.3	-1.8	8.1	4.2	0.5 ▼	0.7	1
Interest rate (LPR, %）	4.1	3.85	3.8	3.6	3.6	3.6	3.6
RMB/USD exchange rate	7	6.5	6.36	6.9	6.7 ▲	6.6	6.6

Source:CEIC and BBVA Research.

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China's forecasting: decomposing GDP growth

BASELINE SCENARIO

	2019	2020	2021	2022	2023	2024	2025
GDP （%）	6.1	2.3	8.1	3	5.2	5	4.5
Personal consumption	6.27	1.70	7.90	2.00	6.50	4.80	4.50
Government consumption	8.50	1.60	10.00	3.50	5.50	5.00	4.00
GCFC	5.00	1.40	6.20	4.00	5.30	5.00	5.20
Inventory Change	-0.80	-12.30	2.50	9.50	-1.03	8.30	2.80
Export	-0.10	3.60	30.00	8.00	-1.00	3.10	2.21
Import	-1.00	-1.05	29.00	10.00	1.00	2.80	3.20

Source: CEIC and BBVA Research.

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China Economic Outlook

March 2023

Creating Opportunities