Creating Opportunities

Economic indicators

China | The economy has rebounded with deflationary caution in the post-Covid era

Jinyue Dong

April 18, 2023

China's Q1 2023 GDP growth reached 4.5% y/y, higher than the market consensus at 4% and our BBVA forecast at 3.2%, suggesting a higher-than-expected economic recovery in the first quarter of 2023 after lifting "zero Covid" policy in December. China's March economic activities data were announced today as well, among which, industrial production and retail sales are significantly stronger than the previous readings, although fixed asset investment has marginally moderated dragged by sluggish housing investment. That means, consumption has started to dominate investment to be the main pillar of the economic recovery after the first 2 months of the high infection period passed.

2023 will be the "Year of China" amid the recession risk in the US and the EU and the credit crunch risk together with bank crisis triggered by aggressive FED interest rate hikes. The recent failure of Silicon Valley Bank etc. and Credit Suisse crisis illustrates this potential contagion effect. Due to China's unsynchronized growth cycle, policy cycle and inflation cycle with the advanced economies, the economic rebound of China this year will be comprehensive and broad-based, not only for production, investment and consumption (although exports will be dragged by weak external demand), but also for the financial sector which will attract more portfolio inflows and FDI amid a stronger RMB and better-performed Chinese financial markets.

However, some caveats are noteworthy when we talk about "Year of China": First, March inflation data (CPI: 0.7% vs. prior: 1%; PPI: -2.5% vs. prior: -1.4%) show that China is entering an "atypical" deflation cycle, which means deflation amid economic recovery. The deflationary environment needs our particular attention, because as long as deflation expectation is formed by households and enterprises, it is difficult to reverse it. Among which, an alleviation of "balance sheet recession" for households and enterprises and to rebuild market confidence at the central government level will be the key.

Second, we have to also identify economic "rebound" from "reversion". Given the low base effect of 2022, achieving a significant higher growth figure is easy in 2023, however, after removing base effect, the economy is still some way from a complete normalization as of pre-pandemic era, let alone a better performance than that.

Third, the transmission mechanism from expansionary monetary and fiscal measures to private investment and consumption growth is still not satisfactory. China's ongoing policy stimulus, similar to RMB 4 trillion packages in 08-09 Global Financial Crisis, goes directly to SOEs and the replacement of maturing local government bond, but how to transmit the policy stimulus to private investment and consumption should be the key of the economic recovery going forward.

Altogether, the recovery calls for more policy support at the central government level to help alleviate "balance sheet recession" of households and enterprises. The recently concluded "two sessions" indeed 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) We anticipate Chinese economy to bounce back to 5.2% after its growth sliding to 3% in 2022, in line with IMF 5.2% forecast and market consensus 5.3%, as well as the 20th National Congress' growth target of 2020-2035 to "double GDP or GDP per capita" which requires an annual growth of at least 4.7% during this period.

Specifically, March economic data outturns confirmed our "broad-based" recovery story. On the supply side, the year-on-year growth of industrial production accelerated to 3.9% y/y from 2.4% in the previous month, although a bit lower than the market consensus at 4% y/y, and its seasonal adjusted m/m growth maintained 0.12% m/m as of the previous month. By categories, the highest growth sector is solar battery which registered 69.7% y/y from 40.8% y/y in Jan-Feb, following that is electronic vehicles which increased to 33.3% y/y from 16.3% y/y in Jan-Feb, 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 for manufacturing and other enterprises. (Figure 1)

On the demand side, March retail sales further expanded to 10.6% y/y from 3.5% y/y in Jan-Feb (market consensus: 7.4%) as the first two high infection months of Covid-19 passed after lifting "zero Covid" policy, which led a significant rebound of off-line consumption activities. The month-on-month growth of retail sales also expanded at 0.15% m/m compared with 0.61% m/m in the previous month. By component, the largest growth is jewelry which achieved 37.4% y/y growth, reflecting consumers' pent-up demand during pandemic time; following that is restaurant sales which jumped significantly to 37.2% y/y from 10.2% y/y in the previous month. Other sectors of retail sales also accelerated, including wines and smoke (9% vs. prior: 6.1% y/y), clothing (17.7% vs. prior: 5.4% y/y), and cosmetic (9.6% vs prior: 3.8% y/y) etc. Altogether, we expect a continuing retail sales pick-up going forward, supported by various consumption stimulus measures, higher income expectations together with lower unemployment rate in the post-pandemic era. (Figure 4)

Also from the demand side, fixed-asset investment (FAI) marginally moderated to 5.1% ytd y/y from 5.5% ytd y/y in Jan-Feb (market consensus: 5.7% ytd y/y). The main drag of FAI is the still sluggish housing investment (-5.8% ytd, y/y; vs. prior: -5.7% ytd y/y), although it shrank its decline from -10% ytd y/y in December 2022. By components, infrastructure FAI which is supported by easing fiscal measures (expansionary local government bond issuance) marginally declined to 8.8% ytd y/y from 9% ytd y/y in the previous month (see our recent Economic Watch: China | Will infrastructure investment become a key growth stabilizer?), which surpassed the manufacturing FAI at 7% ytd y/y and real estate FAI at -5.8% ytd y/y. That means, fixed asset investment moderation is led not only by the sluggish housing investment, but also a slowdown of manufacturing investment amid external demand declining. (Figure 2 and 3)

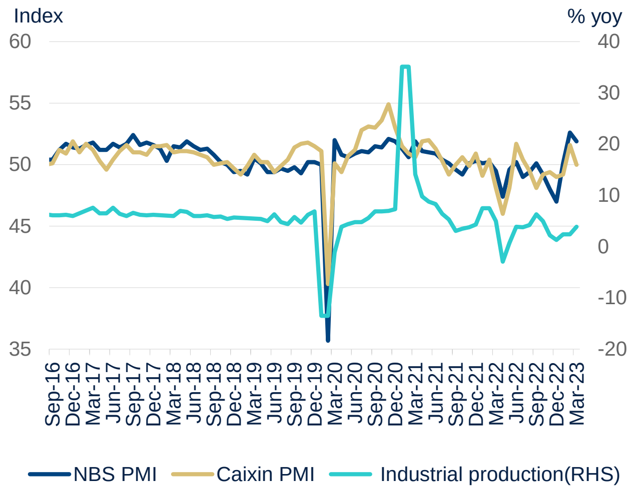
Going forward, we believe the room for infrastructure and manufacturing investment recovery will be limited. In addition, the real estate sector needs more time to achieve a soft-landing. (See our recent China Economic Watch: China | Real estate sector needs a soft-landing) We anticipate the recently promulgated "16-point plan" by Chinese authorities will largely alter the market sentiments on real estate, and indeed we observed housing price and housing transactions in some tier-1 and tier-2 cities have already rebounded together with other housing indicators such as floor space started and completed etc. That means, the real estate sector is anticipated to bottom out in 2H 2023.

Beyond the March economic indicators, March credit data also registered a strong rebound which significantly surpassed market expectations, as the easing monetary measures help to support post-pandemic recovery. In particular, total social financing which is the aggregate gauge of the credit condition rose to RMB 5,380 billion (RMB 3,160 billion previously); new RMB loans also ticked up to RMB 3,890 billion from 1,810 billion in the previous month, leading to outstanding loan growth increasing to 11.8% from 11.6% in the previous month. The credit boom was driven by the accelerating demand of enterprises particularly SOEs' medium-to-long term loans as well as improving households' housing mortgage, indicating a gradual repairment of balance sheets for both households and enterprises amid economic recovery in the post-Covid era.

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) among others in the US and Credit Suisse crisis, 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.

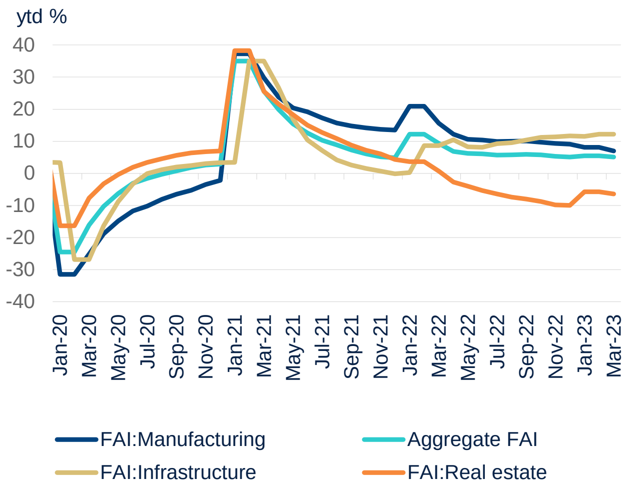
However, amid the economic recovery, Chinese economy is entering into an "atypical" deflation cycle, as the consumption demand compared with the supply stimulated by the expansionary measures is still lackluster. Stimulus measures went directly to SOEs and to the replacement of local government bond, but were not smoothly transmitted to consumption demand and private sector investment. Global commodity price deceleration is also the important factor for a deflationary PPI which spillover to CPI. We should pay particular attention because as long as deflation expectation is formed among households and enterprises, it is difficult to alter. In addition, external demand in 2023 will be very weak which we forecast -2% export growth in 2023, thus how to stimulate growth by domestic demand will be the key to economic success. Finally, rebuilding market confidence and repairing household and enterprises' balance sheets will also be essential in post-Covid era.

Figure 1. **INDUSTRIAL PRODUCTION FURTHER EXPANDED FROM THE PREVIOUS MONTH**



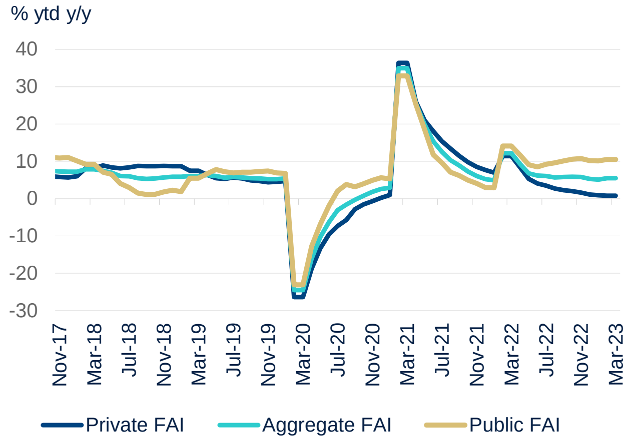
Source: CEIC and BBVA Research

Figure 2. **INFRASTRUCTURE INVESTMENT LED FIXED ASSET INVESTMENT GROWTH BUT REAL ESTATE REMAINS NEGATIVE**



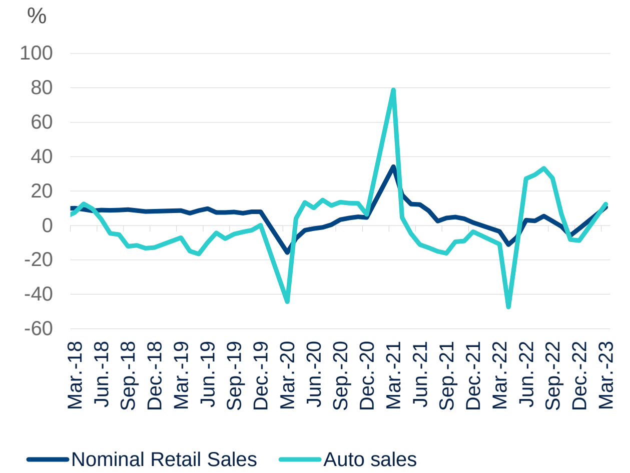
Source: CEIC and BBVA Research

Figure 3. **PUBLIC FAI LED THE FAI GROWTH DUE TO EXPANSIONARY FISCAL MEASURES**



Source: CEIC and BBVA Research

Figure 4. **RETAIL SALES PICKED UP SIGNIFICANTLY IN MARCH**



Source: CEIC and BBVA Research

DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA on its website www.bbvaresearch.com.

ENQUIRIES TO:
BBVA Research: Level 95, International Commerce Centre, Austin Road West, Kowloon, Hong Kong.
Tel. + 2582 3111 / Fax. +852-2587-9717
bbvaresearch@bbva.com www.bbvaresearch.com