Theme:

China

Policy pendulum swings towards growth

China's policymakers are now committed to delivering a growth rebound in 2023. After a dismal 2022, GDP is expected to rise 5.5 per cent during 2023 before easing to 4.9 per cent in 2024. Strict COVID-19 controls have been dismantled faster than anticipated. Official economic targets will be released in March, and policies are geared towards engineering a domestic recovery. We are thus choosing to revise our 2023 CPI inflation forecast upward to 3.0 per cent. Combined with Fed hawkishness, the USD/CNH exchange rate will weaken to 6.60 by the end of 2023 and to 6.45 at end-2024.

After China's yearly Central Economic Work Conference (CEWC), the country signalled a renewed focus on growth. During 2023 the emphasis will be on annual growth targets. With renewed policy support, a growth target of above 5 per cent is quite likely. Our forecast is GDP growth of 5.5 per cent during 2023, but there are clear upside risks. Policymakers are intent on a recovery in growth, which is expected to come from higher domestic consumption. Major R&D investments in high tech sectors will also be accelerated, specifically in various parts of the energy sector and in artificial intelligence (AI).

A clear focus on growth. Economic targets for 2023 will be released in March, but policymakers have already set in motion an economic plan for a rebound in the coming months, including increased fiscal spending. But they will need to think about cost sharing between the central and local governments. Unnamed sources suggest that Beijing is also considering raising the 2023 special purpose bond quota to RMB 3.8 trillion from RMB 3.65 trillion in 2022. The cap on the general budget deficit will likely be increased to 3.0 per cent of GDP from the 2022 target of 2.8 per cent.

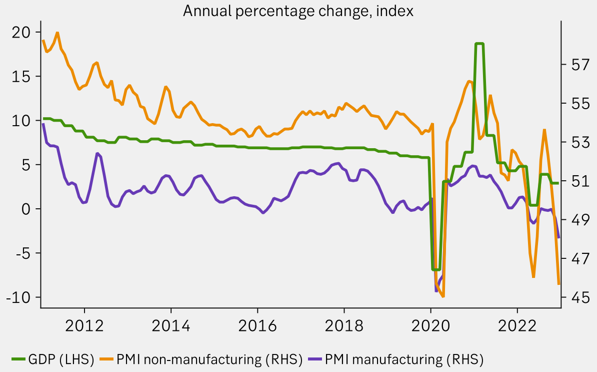
Key data
Year-on-year percentage change

	2021	2022	2023	2024
GDP	8.1	3.0	5.5	4.9
CPI	0.9	2.0	3.0	2.4
Fiscal balance	-3.8	-4.9	-4.5	-4.0
Bank reserve req,%**	11.5	11.00	10.50	10.50
1-year loan prime rate, %**	3.80	3.60	3.60	3.60
7d reverse repo rate, %**	2.20	2.00	2.00	2.00
USD/CNY**	6.36	6.90	6.60	6.30

*% of GDP **At year-end. Source: IMF, SEB

The spread of COVID-19 had a deep impact on domestic activity. The rapid dismantling of COVID controls contributed to a rapid spread of the virus and a deep decline in domestic activity during November and December, dampening GDP growth. China has also decided to do away with mass testing, which makes official figures of daily infections and mortality unreliable.

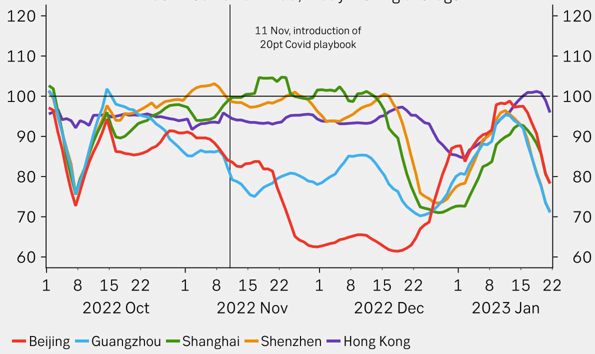
COVID infections dampened growth in Q4
Annual percentage change, index



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics (NBS), Macrobond, SEB

Higher COVID transmission in the near term, but an economic recovery further ahead. The sharp decline in traffic in China suggests widespread COVID transmission. Since the turn of the year, however, mobility indicators are fast rebounding in cities where infection waves seem to have peaked. But the situation is not stable, and the extended Lunar New Year holidays will likely spread the virus further, resulting in volatility in domestic activity. But once the wave of infections has peaked, a full-bodied recovery may emerge.

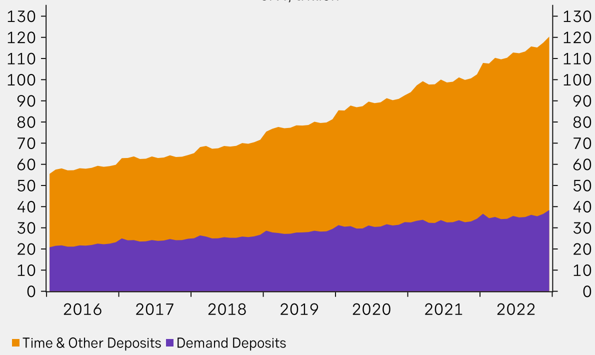
Traffic congestion is quickly rebounding
Index Dec 2020 = 100, 7-day moving average



Source: China Ministry of Transport, Macrobond, SEB

High savings will provide another tailwind to consumption. During the pandemic, consumer confidence fell sharply. This prompted households to save much more. Their financial position is thus very strong, and there is plenty of room for higher consumption once the economy recovers.

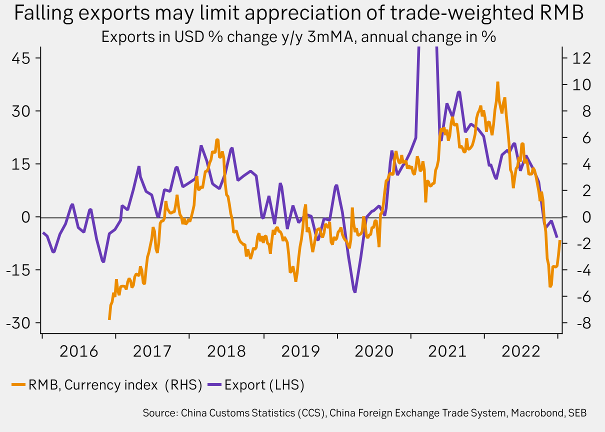
Elevated household deposits can boost spending
CNY, trillion



Source: People's Bank of China (PBoC), Macrobond, SEB

Policy support for the embattled property sector is intensifying. Aside from pledges of direct financing lines to selected developers, China is looking to relax restrictions on borrowing. This may be the biggest adjustment that Beijing can make to ease refinancing conditions. The previous rounds of support have already allowed some of the developers to issue equity, reducing the risk of defaults by the end of Q4 2022. Even so, household confidence in the sector may take time to recover. Moreover, land sales of local governments have yet to pick up, which is still capping the ability of developers to raise pre-selling revenues.

Increased inflationary pressures after China's reopening. Global commodity prices have already found support and climbed despite concerns about an imminent worldwide recession. Meanwhile, the recovery of household spending will not be limited to goods purchases – in stark contrast to the spending pattern that emerged in developed economies. Along with the rebound in consumer sentiment and spending, demand for international travel by Chinese households will pick up. Thus, the rise in private spending will be more balanced. Overall, we are upwardly revising our 2023 CPI inflation forecast to 3.0 per cent from our previous forecast of 2.1 per cent. The lag in inflation will allow the People's Bank of China (PBoC) to maintain a supportive policy and lower the reserve requirement ratio in Q1.



Positive drivers will allow the USD/CNH exchange rate to approach 6.60 by end-2023. The sharp appreciation of the yuan against the US dollar since December can be explained by China's policy shift towards prioritising growth and by the decline of the dollar. Beyond expectations of a Chinese growth rebound and a better-functioning property sector, the market will likely want to see rising activity indicators in the coming months. Meanwhile, external demand for exports is already waning, while the improvement in domestic demand should prop up imports. A deepening contraction in exports may prompt policymakers to limit the appreciation of the trade-weighted Chinese currency in H2. Moreover, pent-up demand for international travel by Chinese tourists will inevitably lead to a deterioration in the service trade account. Overall, we expect the current account surplus to narrow in 2023. Yet foreign capital inflows will likely pick up, providing an offset to the tighter current account surplus.