

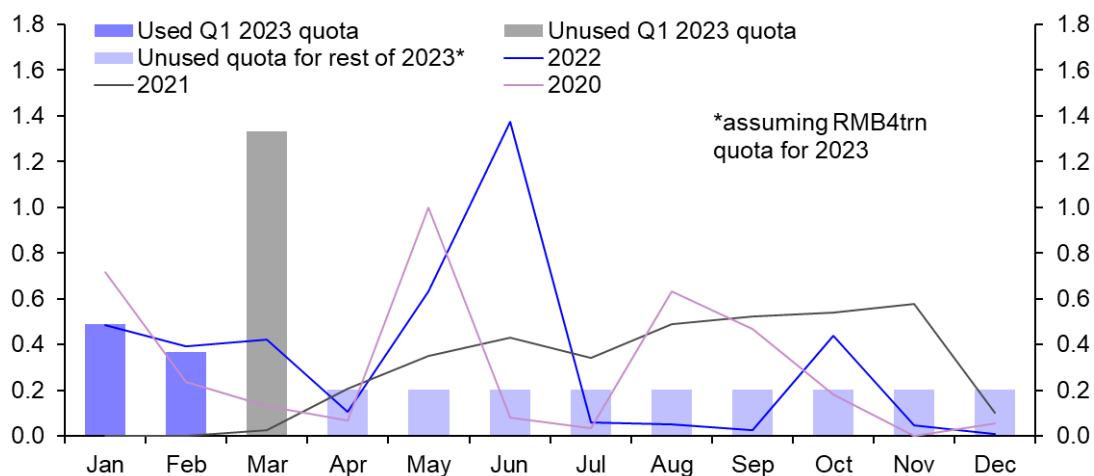


# CHINA CHART BOOK

## A near-term fiscal boost

- Local governments have stepped up their borrowing since the start of the year. They issued RMB860bn in special bonds over the course of January and February, up from an average of RMB105bn per month during the second half of 2022. Special bonds are crucial to the economic outlook as they make up over half of new fiscal borrowing and are the main financing channel for government-funded infrastructure projects. The recent pace of issuance is roughly on par with that in early 2020 and 2022, both years in which officials were keen to quickly roll out support to a struggling economy. And it could soon ramp up further – local governments have been given Q1 issuance quotas totalling RMB2.19trn, 50% higher than last year and the maximum permitted under Chinese budget laws. Even if the Q1 quota isn't fully utilised, issuance could exceed RMB1 trillion in March. (See Chart 1.) Admittedly, this pace of issuance won't be sustained for long. Media reports suggest that the full year quota may be set at around RMB4trn, in line with actual issuance last year. But even if the full-year fiscal stance is little changed, the front-loading of borrowing should help to support the near-term economic recovery.
- **Output & activity indicators** show that economic momentum was strong at the start of 2023.
- **Consumer indicators** point to a rebound in consumer spending as infections ebb.
- **Business indicators** suggest that sentiment has improved now that virus disruption has faded.
- **Property indicators** show early signs of a reversal in the sector's fortunes.
- **External indicators** suggest that the downturn in exports has continued.
- **Inflation indicators** show some modest price pressures due to reopening.
- **Monetary indicators** signal that credit demand is on the mend.
- **Financial markets** have lost some momentum, with the reopening rally partially unwinding.
- **Hong Kong indicators** suggest that the return of tourists and supportive fiscal policy are driving a recovery.

Chart 1: New Local Government Special Bond Issuance (RMBtrn)

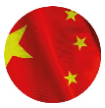


Sources: WIND, CEIC, Capital Economics

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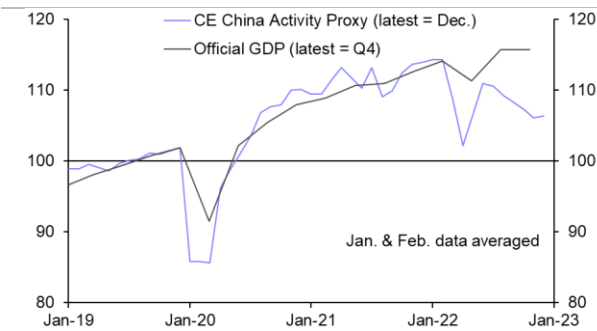
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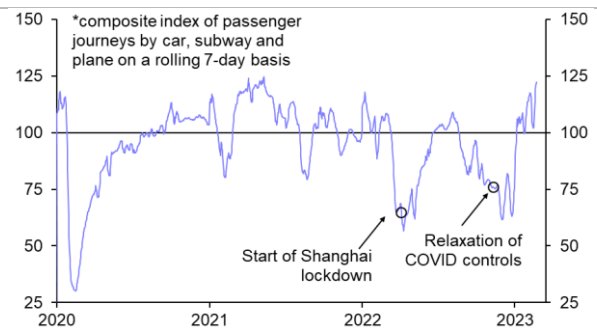
# Output & Activity

- Official GDP was **unchanged** q/q in Q4 despite extensive disruption from quarantine requirements and subsequently from a huge wave of infections. Our in-house alternative, the **China Activity Proxy (CAP)**, suggests output contracted sharply in Q4 before stabilising in December **(2)**.
- The monthly cycle of data releases is always interrupted around the Lunar New Year, with most high-profile series for January not available until March. In the meantime, high frequency data offer some sense of economic momentum. Our mobility tracker suggests people have returned to the streets **(3)** now that virus cases have dropped back. The January services PMIs point to a strong rebound in services activity too **(4)**.
- After falling at the turn of the year, steel production has ticked up recently **(5)**. This probably reflects a step up in infrastructure spending. Meanwhile, the January manufacturing PMIs point to an improvement in industrial activity although lingering disruption from the reopening wave continued to hold back production at some firms **(6)**. More timely data suggest that the industrial sector has continued to strengthen this month **(7)**.

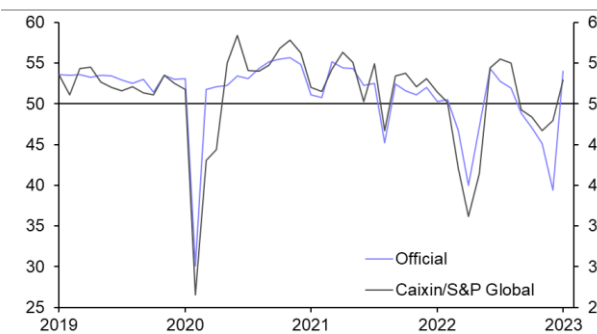
**Chart 2: CE China Activity Proxy & Official GDP (2019 = 100, seas. adj.)**



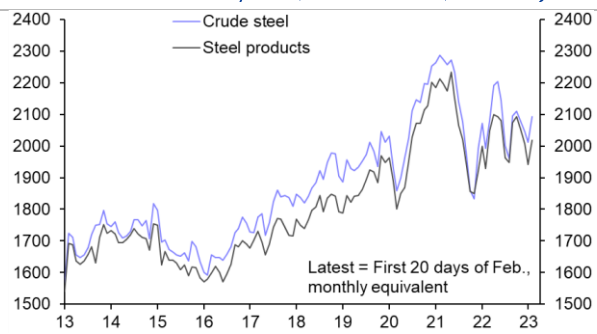
**Chart 3: CE China Mobility Tracker\* (% of 2019)**



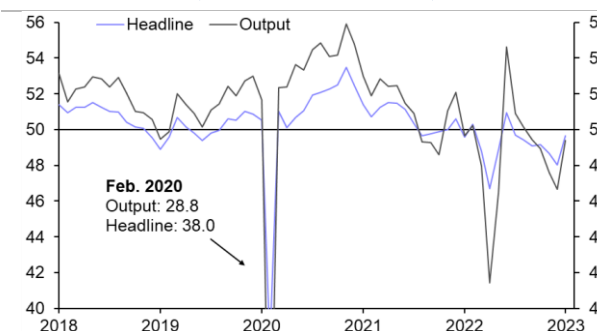
**Chart 4: Services PMIs (Official & Caixin Ave.)**



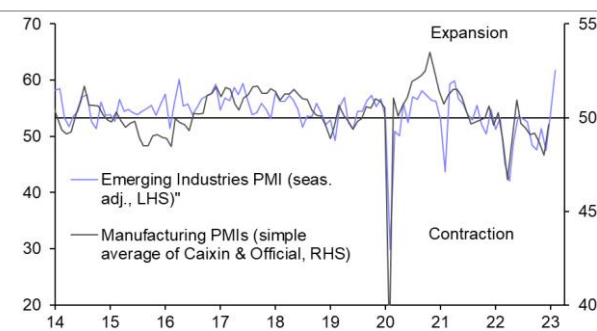
**Chart 5: Daily Steel Production by Large & Medium Producers (monthly ave., '000s tonnes, seas. adj.)**



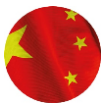
**Chart 6: Manufacturing PMIs – Headline & Output (Official & Caixin Ave.)**



**Chart 7: Manufacturing PMIs**



Sources: CEIC, Wind, S&P Global, Capital Economics



# Consumer Spending

- Disruption to economic activity from repeated lockdowns led to weakness in the labour market. Despite edging down slightly in January, the unemployment rate remained elevated, especially among the young (8). This partly explains why household income growth in China has been knocked off course to a greater extent than elsewhere (9). As such, although the household savings rate has been higher than normal, the amount of money being saved has been below its pre-pandemic trend for the past two years (10).
- Domestic consumer activity appears to have rebounded in recent weeks. For instance, subway ridership is far higher than normal (11). Service sectors are likely the main beneficiaries. Optimism about the immediate outlook for services is the highest in over a decade (12).
- A long-awaited recovery in outbound tourism is, by contrast, still at a very early stage (13). That is likely due to supply-side constraints such as delays renewing passports and a lack of capacity on international airline routes rather than a lack of demand.

Chart 8: Surveied Unemployment Rate (% , seas. adj.)

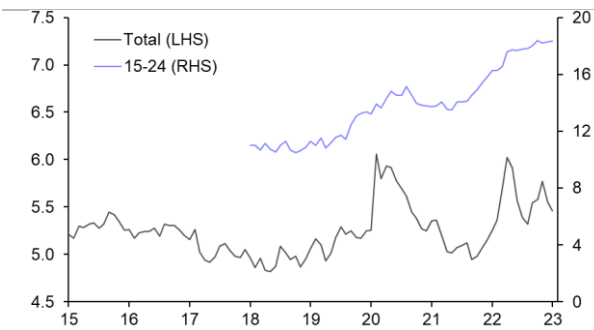


Chart 9: Household Disposable Income – Cumulative Deviation from Pre-Pandemic Trend (%)

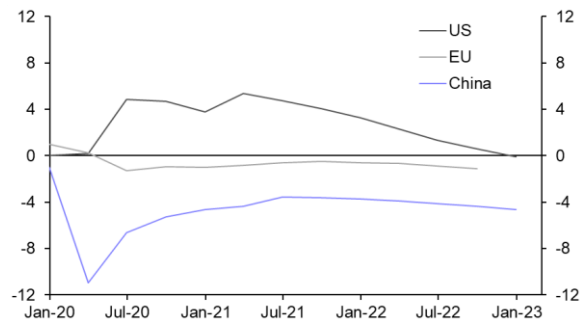


Chart 10: Household Savings (RMB trn, seas. adj.)

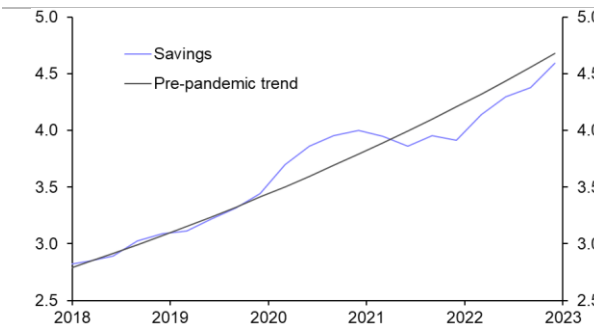


Chart 11: Subway Ridership (% of 2019, 7d ave.)

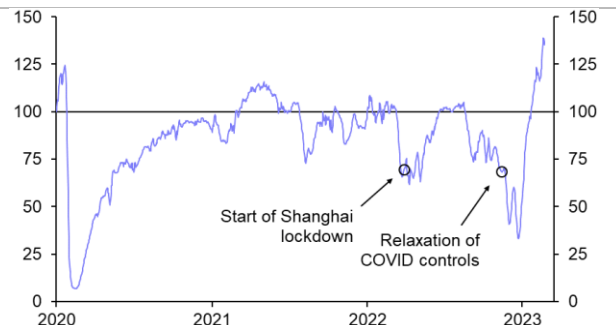
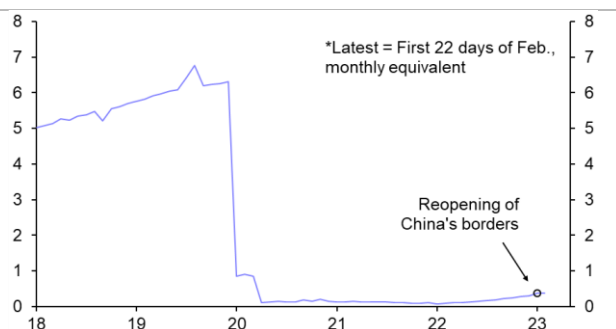


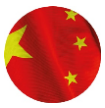
Chart 12: Services PMIs – Business Expectations Index (Official & Caixin Ave.)



Chart 13: International Flights (person-km bn, seas. adj.)



Sources: CEIC, Wind, S&P Global, Capital Economics



# Business

- Official surveys, which skew toward large firms and heavy industry, suggest that profit margins were under pressure throughout much of 2022 (14). Weakness at home and abroad made it hard for firms to pass on higher input costs in full. And supply chains came under renewed strain late last year, first due to lockdowns then due to labour shortages caused by surging infections. Even amid these disruptions, inventories of finished goods have risen relative to sales (15) suggesting that while output has been affected, demand has slumped even more.
- Consistent with a deterioration in business conditions, inventory turnover slowed last year and firms took longer to pay their suppliers (16). The share of firms that are loss-making also rose, ending the year just a touch under the peak reached during the initial outbreak in 2020 (17).
- Encouragingly, more timely survey-based measures of corporate investment intentions suggest business sentiment has improved in recent weeks (18). This is partly thanks to easing supply chain problems (19) as the initial reopening wave of infections ebbs and recovered workers return.

Chart 14: Net Profit Margins (% , seas. adj.)

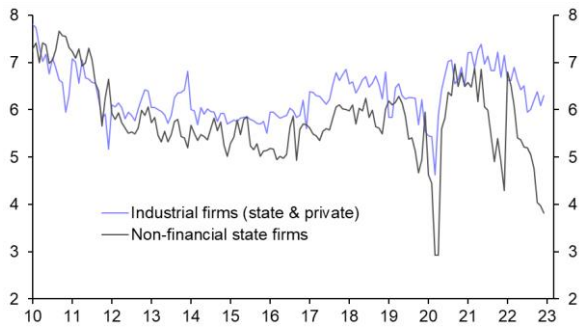


Chart 15: Final Goods Inventory (days of sales, seas. adj.)



Chart 16: Industrial Firms – Inventory & Accounts Receivable Turnover (days, seas. adj.)

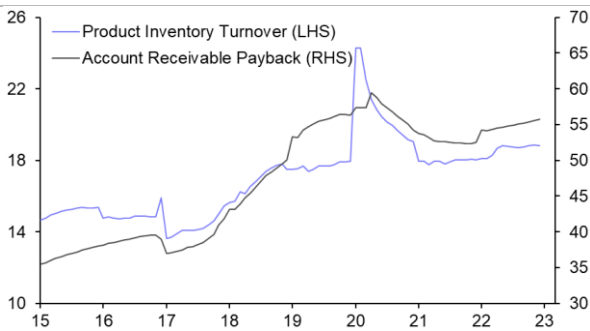


Chart 17: Loss-making Share of Industrial Firms (% , seas. adj.)

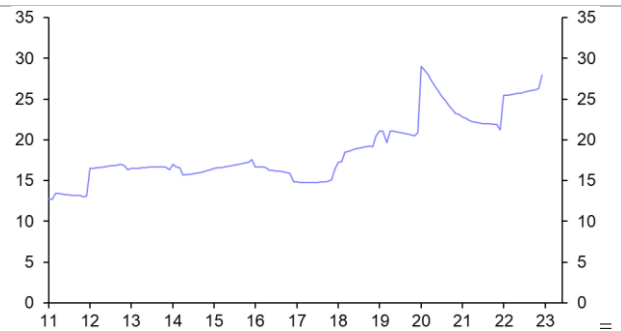


Chart 18: Future Investment Intentions

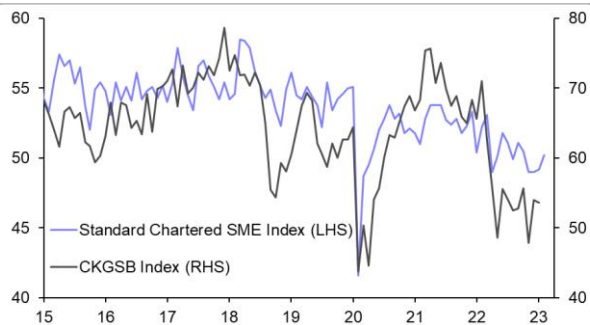
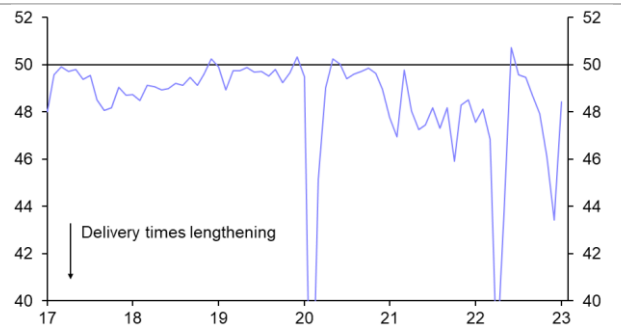
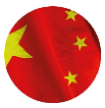


Chart 19: Manu. PMIs – Suppliers' Delivery Times (Official & Caixin Ave.)



Sources: CEIC, S&P Global, Bloomberg, Capital Economics



# Property

- The housing market took a beating last year, with new home sales tumbling by around a half from their peak in early 2021. Substantial policy easing, including sharp declines in mortgage rates (20), failed to drive a turnaround amid depressed consumer sentiment.
- But green shoots are now appearing in the housing market following the lifting of the zero-COVID policy. Sales in large cities have ticked up since the start of the year (21). And home prices stopped falling in January after a 16-month decline (22).
- Constraints on developer access to financing have been eased recently too, ending a period of deleveraging and giving them more breathing room (23). This has led to a decline in defaults on their bonds (24). But it probably won't drive an imminent turnaround in construction activity. The recent collapse in new housing starts has yet to fully feed through into lower floor space under construction due to delays finishing existing projects (25). As more of these projects are completed and cautious developers keep their pipelines of new projects lean, overall construction activity may continue to weaken for a while longer.

Chart 20: Mortgage Rates for First-time Buyers (%)

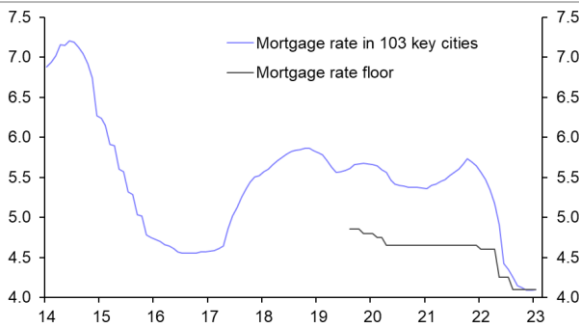


Chart 21: New Home Sales (million sqm, seas. adj.)

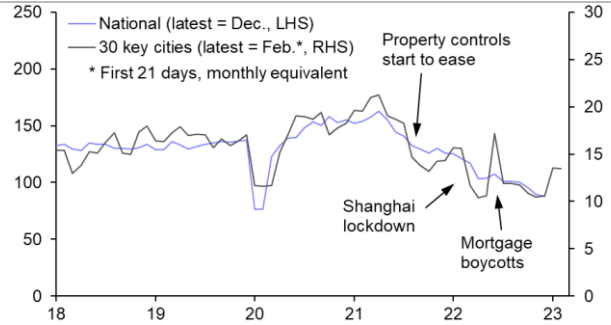


Chart 22: New House Price (% m/m, 70 city ave.)

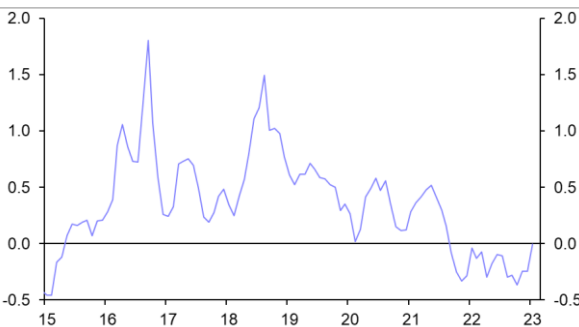


Chart 23: Developer Financing (% of trend GDP, seas. adj.)

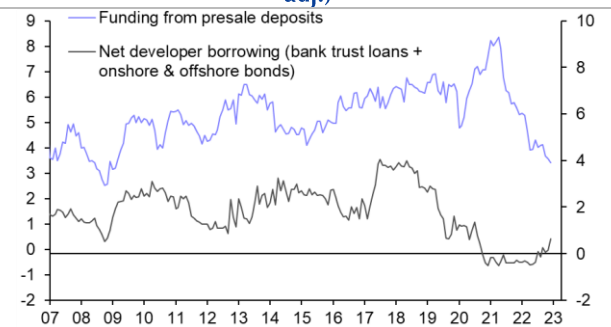


Chart 24: Real Estate Sector Bond Defaults (RMB bn)

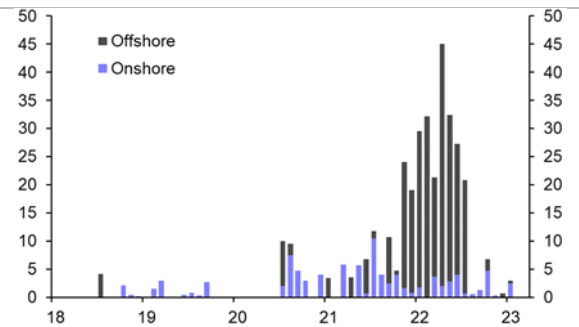
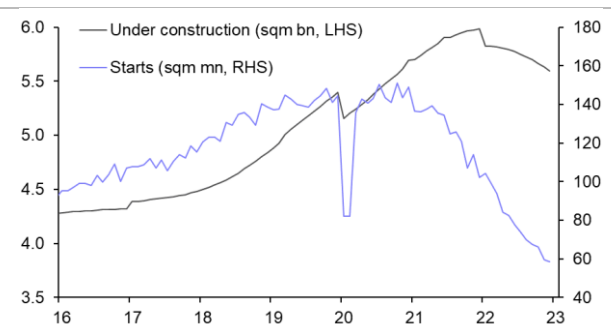
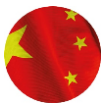


Chart 25: Property Construction Activity (seas. adj.)



Sources: CEIC, Wind, Bloomberg, Capital Economics



# External Trade

- China’s exports boomed for much of the pandemic, as global consumers, stuck at home and with additional cash from fiscal transfers, spent more on Chinese-made products. But a reversal of these pandemic distortions, along with a broader downturn in global demand, is now putting pressure on Chinese exports.
- Trade data for January and February will be combined due to the Lunar New Year holiday and won’t be published until March. But Korea and Taiwan’s data suggest that Asia’s export machine continued to sputter at the start of the year (26). The downturn probably has further to run. Export orders remained depressed in January (27). And freight rates out of China are consistent with subdued demand (28). Admittedly, port container throughput has continued to rise recently. But container utilisation appears to be declining, with media reports suggesting that empty containers are piling up at ports (29).
- Imports stagnated last year as virus disruptions held back domestic demand. But with the zero-COVID policy now in the rear-view mirror, prospects have brightened. Although they remain weak, imports orders ticked up in January (30). And high-frequency data show a jump in the capacity of ships arriving at Chinese ports in recent weeks (31).

Chart 26: Goods Exports (\$, Dec. 19 = 100, seas. adj.)



Chart 27: Exports & PMI Export Orders

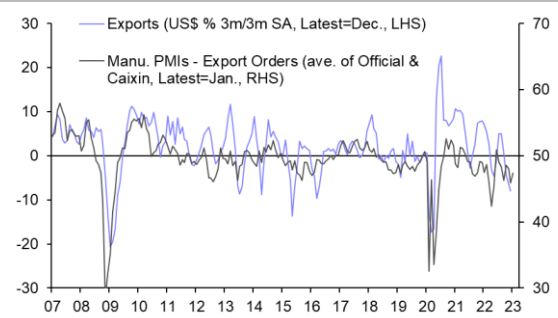


Chart 28: Container Freight Rates for China/Asia Outbound Routes (Dec. 19 = 100)

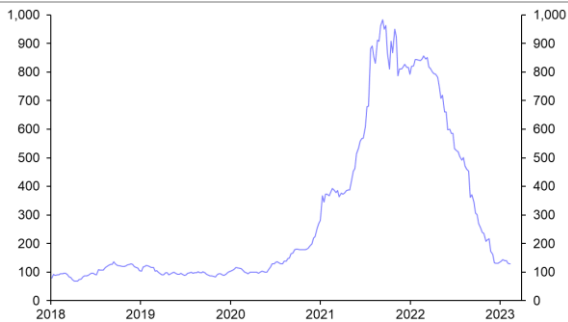


Chart 29: Port container throughput (TEU mn, seas. adj.)

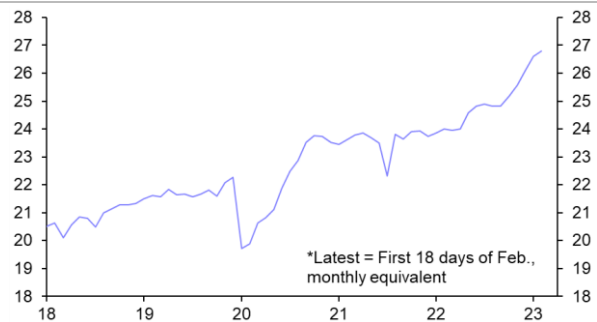


Chart 30: Imports & PMI Import Orders

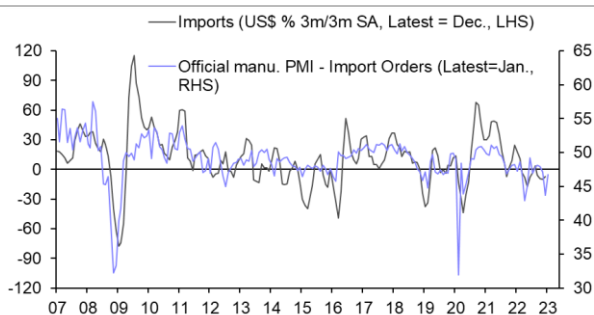
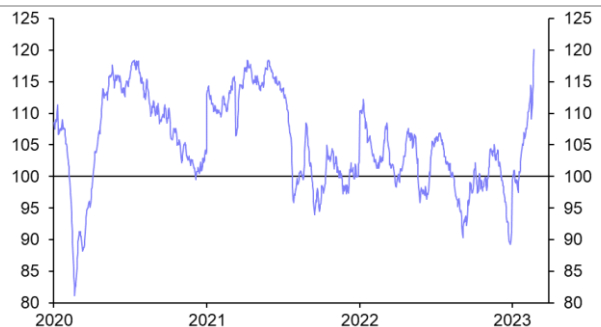
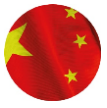


Chart 31: Deadweight Tonnage of Ships Arriving at Chinese Ports (% of 2019, 30d ave.)

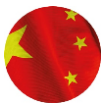




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Sources: CEIC, Refinitiv, CPB, Capital Economics

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# Inflation

- Consumer price inflation has picked up over the past two months, driven by higher core inflation (32). The primary cause has been a surge in the cost of travel (33) and other in-person services that have seen a post-reopening upswing in demand.
- We believe that the increase in China’s CPI will not be as large as it was in many other countries during their reopening. This is partly because China is opening at a time when growth in the rest of the world is slowing, which will mitigate the impact on prices, especially commodities. Even accounting for higher oil prices due to China’s reopening, we still expect further declines in fuel price inflation in the coming months thanks to a higher base for comparison (34).
- Producer prices fell further in January (35). Consumer durable prices declined for the first time since August, as supply chain disruption caused by the reopening wave of infections eased (36). And weekly data suggest that output prices at Chinese factories have edged down again in recent weeks (37).

Chart 32: Consumer Prices (% y/y)

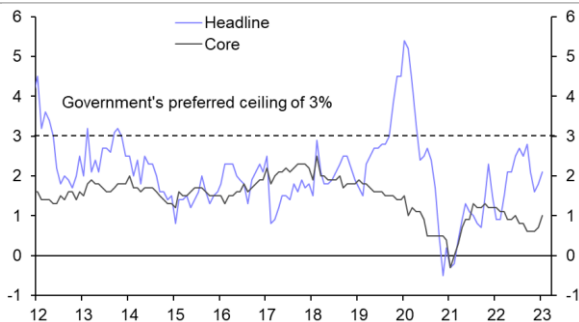


Chart 33: CPI – Tourism Services (% y/y\*)

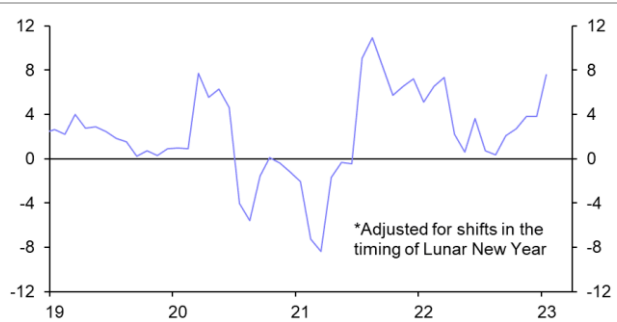


Chart 34: Oil & Vehicle Fuel Prices (% y/y)

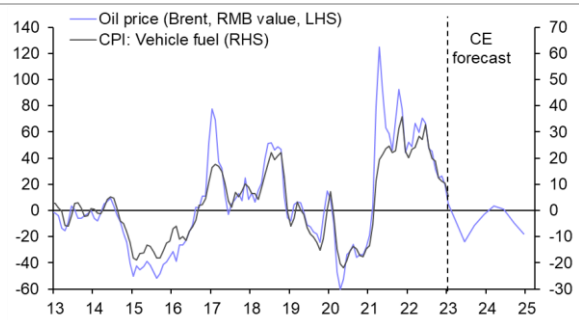


Chart 35: Producer Prices

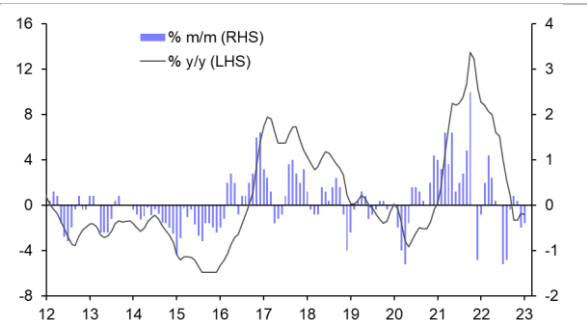


Chart 36: PPI – Durable Consumer Goods (% m/m)

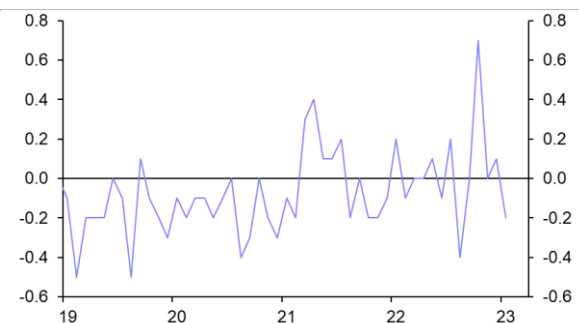
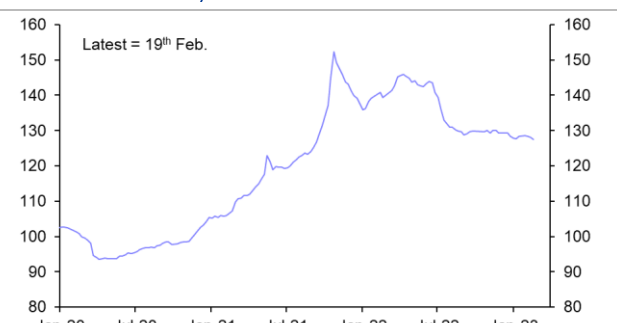


Chart 37: Weekly Producer Prices (23<sup>rd</sup> Feb. 20 = 100)



Sources: CEIC, Refinitiv, Capital Economics





# Monetary

- The PBOC has kept its key policy rates unchanged since August (38). As signs of recovery have emerged, the case for future cuts has diminished. One additional concern is the recent wave of mortgage prepayments. While interest rates available on new mortgages have fallen more than 160bp in this cycle, the five-year LPR that determines how rates change on existing mortgages has fallen only 35bp (39). It is now cheaper for some homeowners to take out new consumer loans to repay mortgages.
- Easy availability of credit wasn't sufficient to lift lending last year amid weak demand (40). One consequence was a slump in interbank rates. But these have risen steadily in recent weeks and have now converged with the rate on offer from the PBOC (41). That's a sign that credit demand has been rising.
- Credit data now show the same. Bank loan growth jumped to a 10-month high last month, driven by faster lending to corporates (42). Broad credit growth still slowed last month (43), but this can be entirely explained by there being fewer working days in January this year than last, due to shifts in the timing of the Lunar New Year holiday.

Chart 38: PBOC Policy Rates (%)

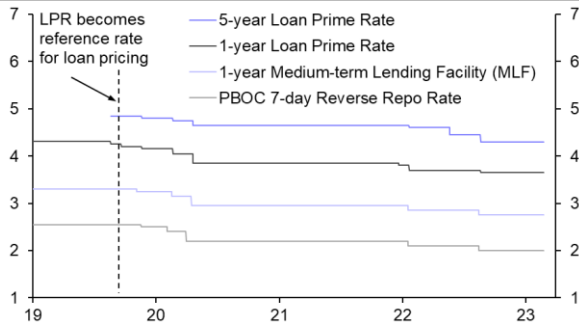


Chart 39: Mortgage Rate and 5-year LPR (%)

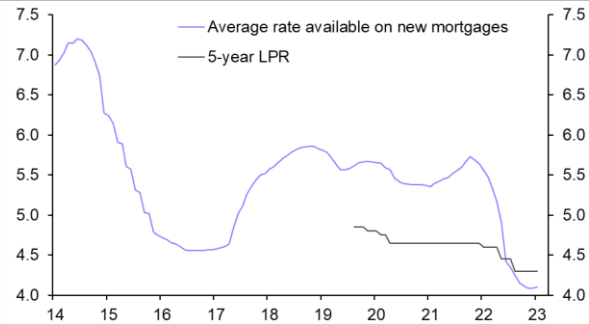


Chart 40: Bank Lending & Loan Approval Conditions

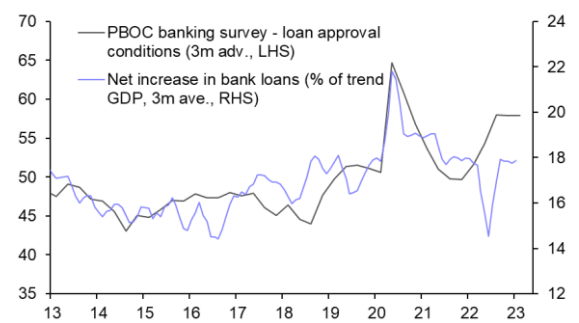


Chart 41: 7-Day Pledged Repo Rate (%)

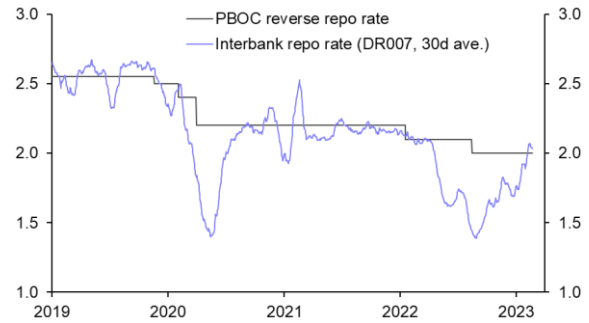


Chart 42: RMB Bank Loans (Outstanding, % y/y)

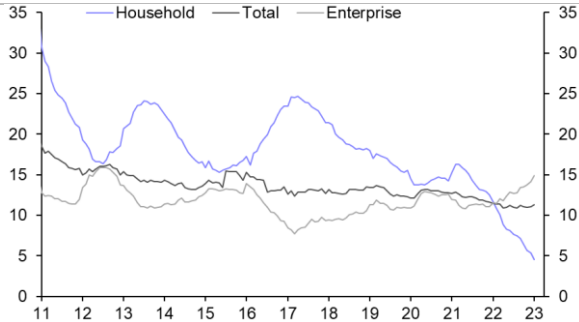
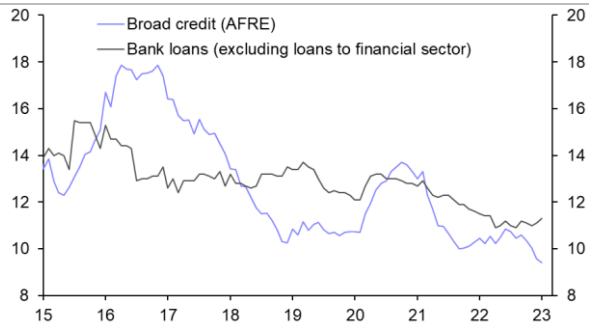
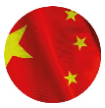


Chart 43: Growth of Outstanding Credit (% y/y)



Sources: CEIC, Wind, Refinitiv, Capital Economics



# Financial Markets

- China’s stocks rallied following its rapid reopening, but those moves have lost some momentum this month (44), partly due to renewed focus on US-China tensions triggered by the “spy balloon” incident. Nonetheless, we think Chinese equities have room for further gains – their price/earnings ratios are not particularly high when compared with the valuations of developed market equities (45) and we think the near-term economic recovery will be stronger than most anticipate.
- Following persistent foreign outflows from Chinese stock for much of last year, there has been a rapid reversal recently (46). This contributed to a rally in the renminbi, although the currency has since given back some of its recent gains against the dollar (47). Despite this reversal, the PBOC has refrained from using its daily fixing rate to push back against depreciation, as it did late last year (48).
- Meanwhile, the price of offshore bonds has rebounded over the past few months (49), as investors have responded positively to the shift towards greater policy support for property developers.

Chart 44: Equity Indices (20<sup>th</sup> Jan. 2020 = 100)

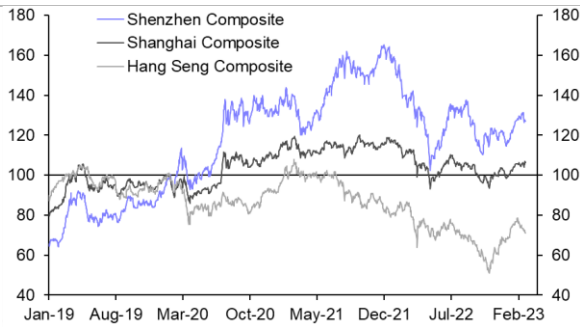


Chart 45: MSCI China vs MSCI World Forward PE Ratio



Chart 46: Net inflows to mainland equity markets via SH-HK & SZ-HK Stock Connect (\$bn, 30d ave.)

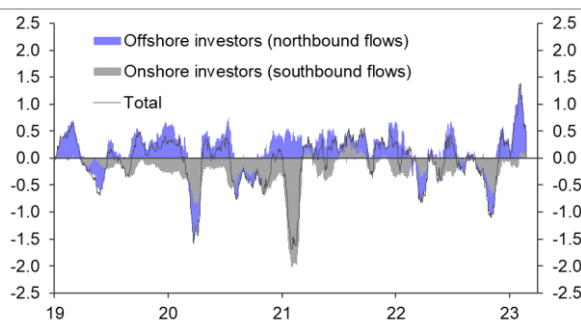


Chart 47: Renminbi Exchange Rate

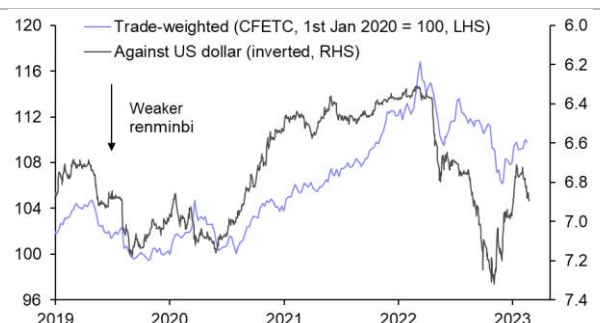


Chart 48: USD/CNY Fix vs Previous Close

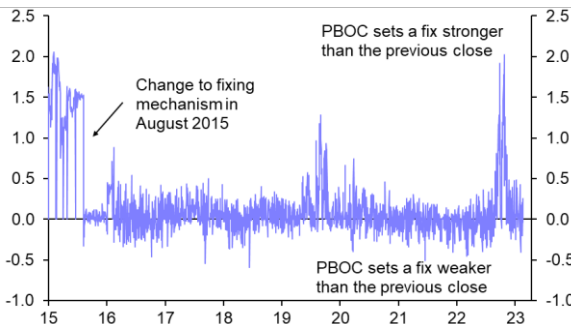
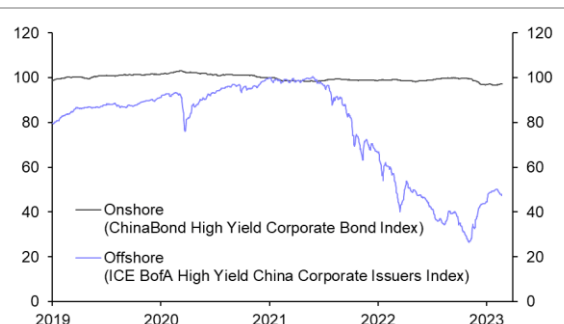
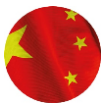


Chart 49: China High Yield Corporate Bond Indices (100 = 4th Jan. 2021)



Sources: CEIC, Refinitiv, Wind, Bloomberg, Capital Economics



# Hong Kong

- Hong Kong’s economy was **unchanged** q/q in Q4 following a contraction in Q3 (50). The breakdown shows that this was largely due to a further decline in goods exports and investment (51). This was offset by a pick-up in consumption, services exports and government spending thanks to the removal of most virus-related border requirements and improving consumer confidence.
- Encouragingly, things are looking up this quarter. Admittedly, there are still some headwinds in the near-term. The pandemic-related boost to goods trade has gone into reverse (52). Weakness in foreign demand may weigh on exports a while longer before the global picture improves later this year. And even though interest rates are likely to drop back later in the year, they will remain high for some time (53) which will weigh on investment and the housing market.
- But this will be more than offset by the boost from the return of foreign visitors. Arrivals have rebounded strongly since border restrictions were eased at the turn of the year, and currently stand at 20% of 2018 levels (54). What’s more, fiscal policy will **remain supportive** this year (55), particularly in areas hardest hit by COVID such as consumption and the tourism and transportation industry.

Chart 50: Hong Kong GDP

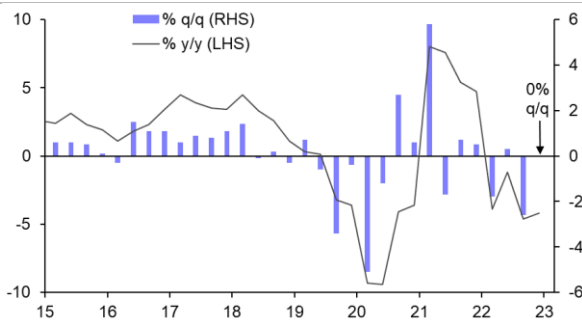


Chart 51: GDP Breakdown (Q1 2019 = 100)

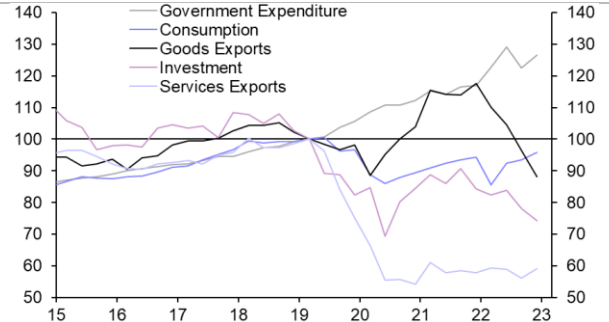


Chart 52: Goods Exports (Dec. 2019 = 100, seas. adj.)

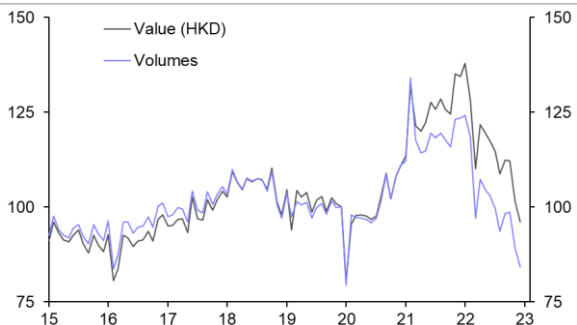


Chart 53: Interest Rates (%)

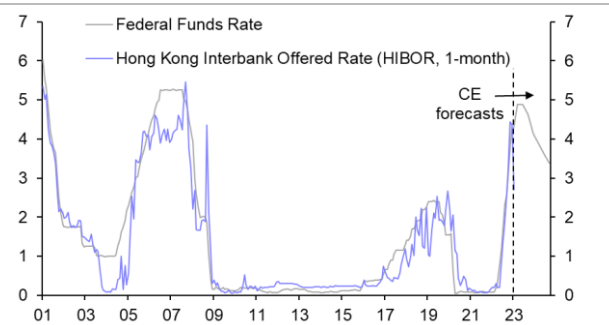


Chart 54: Hong Kong Passenger Arrivals Breakdown (% of 2018)

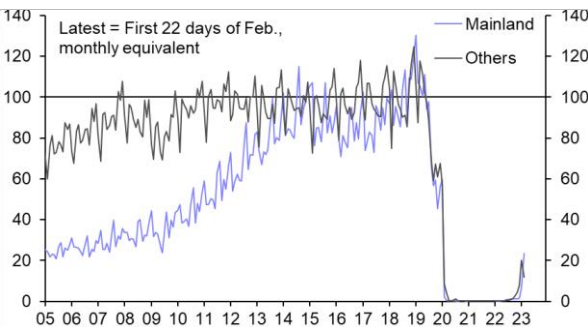
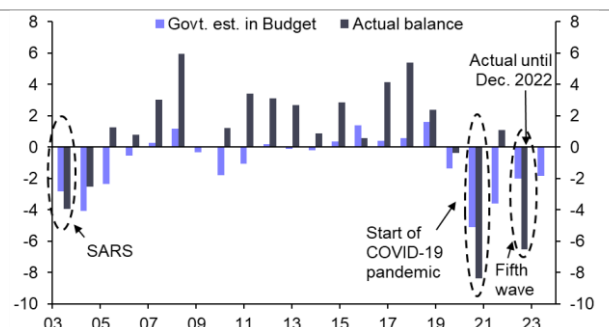
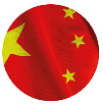


Chart 55: Hong Kong Budget Balance (% of GDP)



Sources: CEIC, Capital Economics



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