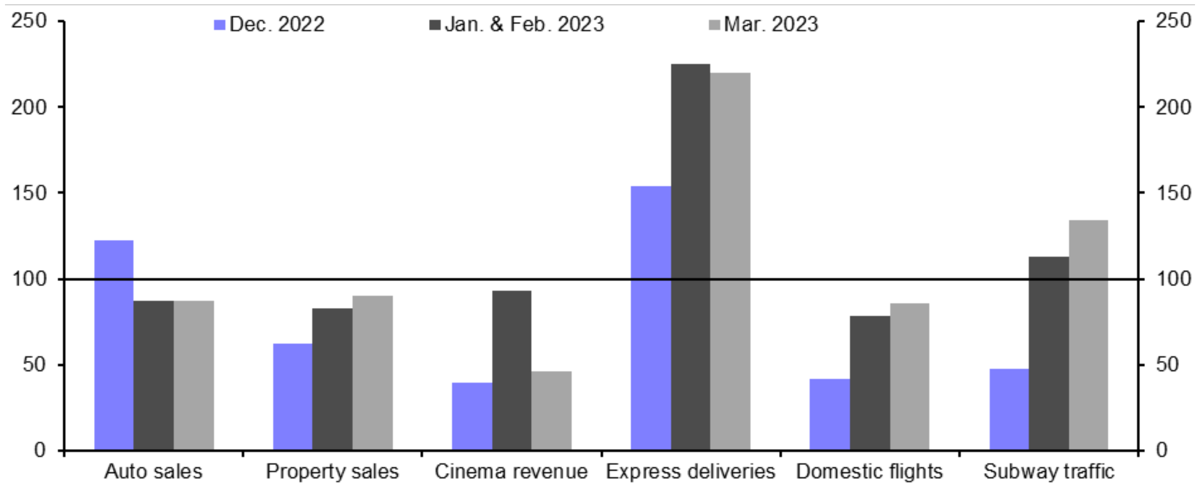
CHINA CHART BOOK

Uneven consumer recovery slowing down

- Consumer spending jumped during the first two months of the year as virus disruptions faded. The March retail sales data won't be published for another couple of weeks. But the data we have so far suggest that the consumer recovery remained uneven last month and may have lost some momentum. Admittedly, the official services PMI continued to climb in March, reaching a decade high and implying, on paper at least, that the recovery gathered pace. But the survey can be distorted by swings in sentiment. Other early indicators show smaller improvements last month or even a partial reversal of previous gains. (See Chart 1.) Sector-specific factors are partially to blame – car sales have been hit by the withdrawal of subsidies for electric vehicles, for example. But the general picture seems to be that while consumers have been quick to return to the streets and public transit, they have been slower to step up discretionary spending on big ticket items or long-distance travel. We think the consumer recovery will gradually even out over the coming quarters. But now that the initial boost from lifting virus restrictions has passed, the recovery will be slower from here onwards. (For more see the Consumer page of our latest *China Economic Outlook*.)
- **Output & activity indicators** show a further strengthening in services and construction activity.
- **Consumer indicators** point to a rebound in spending following the pivot away from zero-COVID.
- **Business indicators** suggest that although profit margins are under pressure, sentiment is on the mend.
- **Property indicators** show a turnaround in home sales but continued caution among developers.
- **External indicators** suggest that exports regained some ground as supply chain strains eased after reopening.
- **Inflation indicators** have ticked up due to reopening effects, but the impact has been marginal.
- **Monetary indicators** signal that credit demand is returning.
- **Financial markets** lost some momentum as foreign inflows eased.
- **Hong Kong indicators** suggest that the city's economy is on the mend thanks to the return of tourists.

Chart 1: Consumer Spending Indicators (% of 2019)



Sources: WIND, CEIC, Capital Economics

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Output & Activity

- The China Activity Proxy (CAP), our in-house alternative to official GDP, suggests that output jumped at the start of 2023 but is still below its pre-pandemic path **(2)**. Much of the improvement was driven by the services sector, where unlike in industry and construction, activity remains weaker than a year ago **(3)**.
- The return of workers to construction sites and factories boosted industrial output **(4)**. Optimism surrounding reopening appears to have kept manufacturing investment strong despite cooling global demand **(5)**. And the front-loading of government borrowing this year shored up infrastructure investment. However, property investment softened further as developers continued to err on the side of caution.
- The improvement in economic activity continued in March. The PMIs suggest that a further strengthening of services and construction activity appears to have outweighed the fading reopening boost to the industrial sector **(6)**. But this doesn't necessarily imply that sequential growth is still accelerating. During the initial post-lockdown recovery in 2020, the composite PMI continued to rise long after q/q GDP growth had already peaked **(7)**.

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

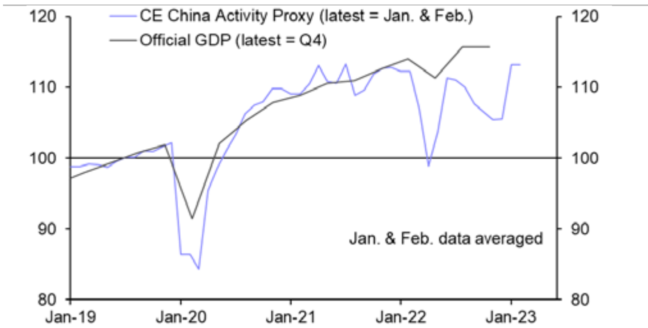


Chart 3: CAP – Sector Proxies (2019 = 100, seas. adj.)

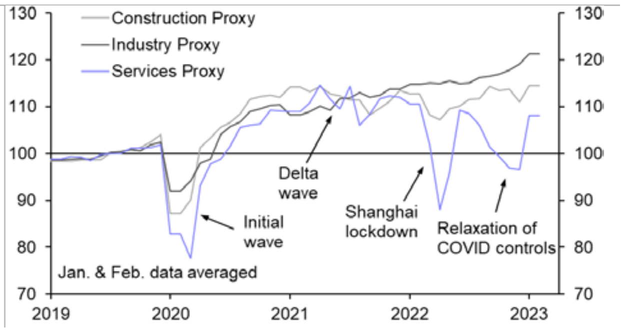


Chart 4: CE Industrial Output Index (2019 = 100, seas. adj.)

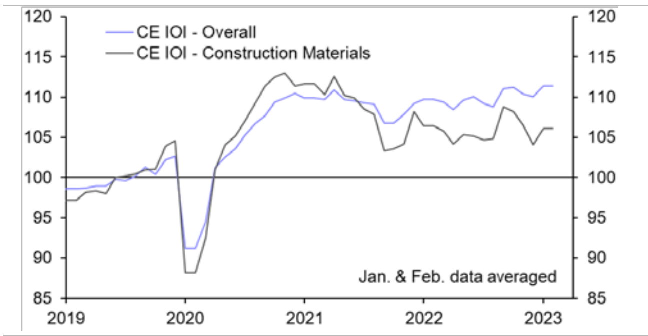


Chart 5: Fixed Investment (Dec. 2019 = 100, seas. adj.)

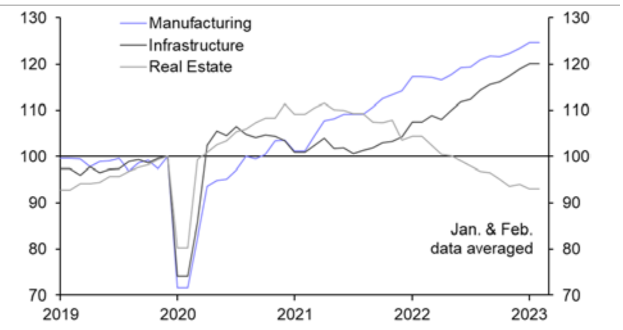


Chart 6: PMIs

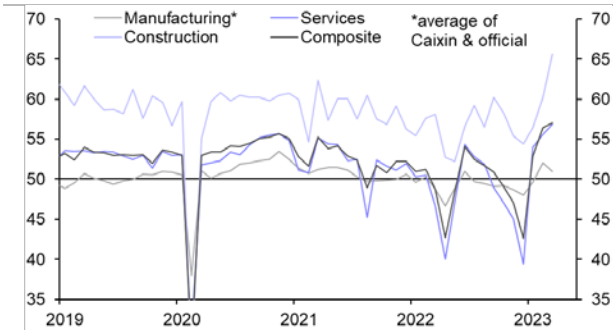
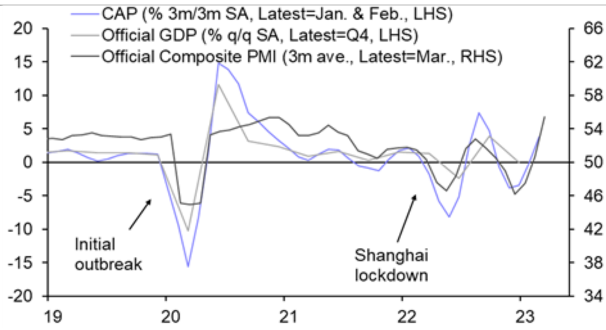


Chart 7: Official GDP, CE China Activity Proxy & Official Composite PMI



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

Consumer Spending

- Domestic consumer activity rebounded strongly at the start of the year thanks to the removal of virus restriction and an improvement in sentiment **(8)**. Retail sales more than reversed their decline late last year and is now at a record high. In particular, in-person services such as catering have been the main beneficiaries from the reopening **(9)**. And our mobility tracker suggests more people have returned to the streets in recent weeks **(10**) as fear of COVID-19 has faded. This has kept optimism among businesses about the immediate outlook for services close to the highest in over a decade **(11)**.
- Although joblessness remained high among the youth, the overall unemployment rate began to drop back at the start of this year **(12)** and there is scope for further declines as labour-intensive consumer-facing service industries continue to bounce back following the pivot away from zero-COVID.
- The long-awaited recovery in outbound tourism is still at a very early stage **(13)**. That is likely due to supply-side constraints such as delays in visa application processes and a lack of capacity on international airline routes rather than a lack of demand.

Chart 8: Refinitiv/IPSOS Primary Consumer Sentiment Index (3m ave.)

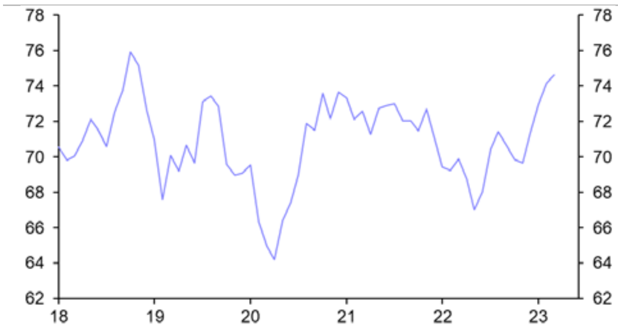


Chart 9: Retail Sales (Dec. 2019=100, seas. adj.)

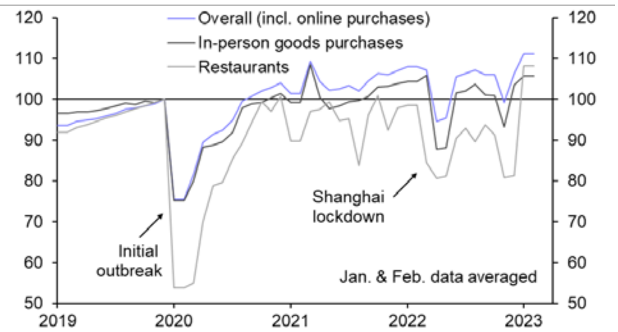


Chart 10: CE China Mobility Tracker* (% of 2019)

Chart 11: Services PMIs – Business Expectations Index (Official & Caixin Ave.)

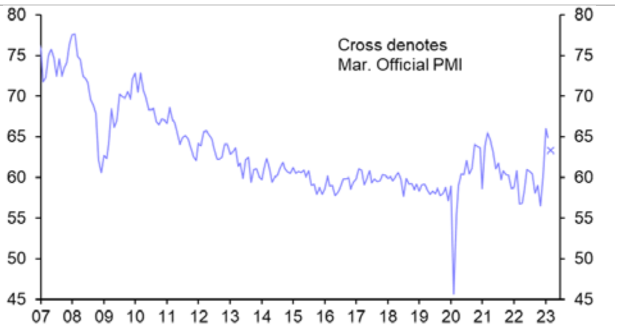


Chart 12: Surveyed Unemployment Rate (%, seas. adj.)

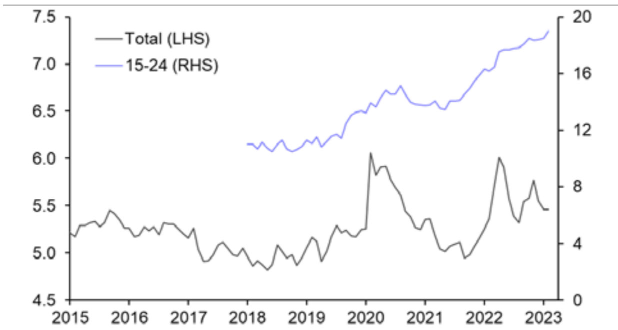
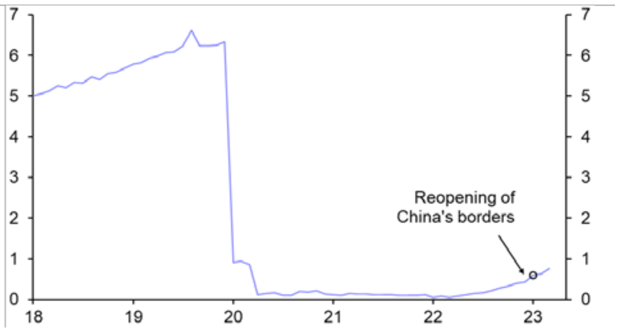


Chart 13: International Flights (person-km bn, seas. adj.)



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

Business

- Official surveys, which skew toward large firms and heavy industry, suggest that profit margins remained under pressure at the start of 2023 **(14)**. This comes despite easing supply chain problems following reopening **(15)**. Stubbornly high inventories of finished goods relative to sales **(16)** suggests persistent weakness in demand is to be blamed. Indeed, the hit to export sales late last year has only partially recovered **(17)** pointing to considerable weakness abroad.
- Consistent with a deterioration in business conditions, inventory turnover slowed at the start of the year, while firms took longer to pay their suppliers **(18)**.
- Although the current operating environment remains challenging, the dismantling of the zero-COVID policy has at least removed one key source of uncertainty. As a result, survey-based measures of corporate investment intentions suggest that business sentiment is on the mend **(19)**.

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

Chart 15: Manu. PMIs – Suppliers' Delivery Times (Official & Caixin Ave.)

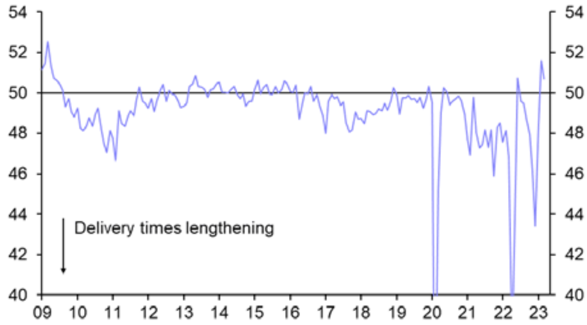


Chart 16: Final Goods Inventory (days of sales, seas. adj.)

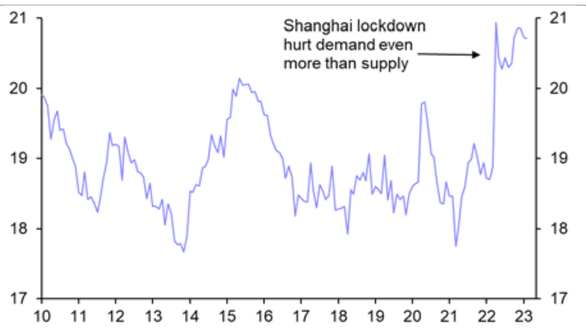


Chart 17: Industrial Sales (Dec. 2019=100, seas. adj.)

Chart 18: Industrial Firms - Inventory & Accounts Receivable Turnover (days, seas. adj.)

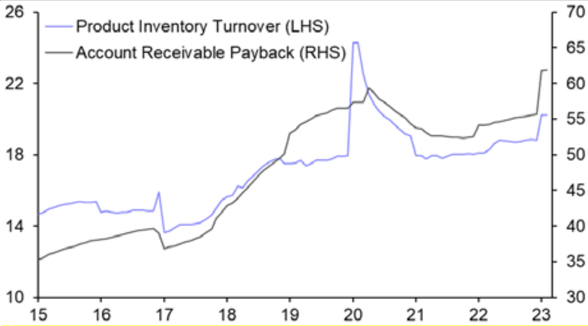
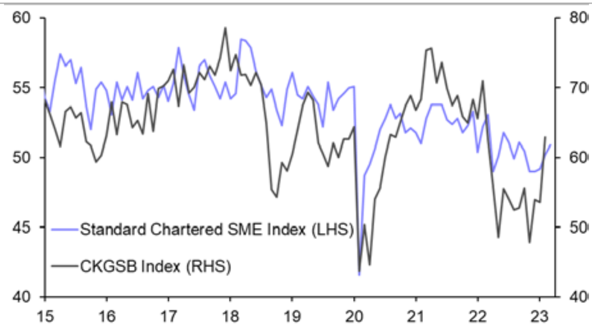


Chart 19: Future Investment Intentions



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

Property

- A turnaround in the housing market appears underway. Sales in large cities have ticked up since the start of the year **(20)**. And home prices rose in February for the first time in 18 months **(21)**. Part of the reason has been substantial policy easing, including sharp declines in mortgage rates **(22)**. More consequential has been the lifting of the zero-COVID policy which boosted homebuyers' sentiment meaningfully.
- Constraints on developer access to financing have been eased recently too, ending a period of deleveraging and giving them more breathing room **(23)**. 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 **(24)**. What's more, developers remain cautious and appear keen to keep their pipelines lean – demand from developers in land auctions are still subdued **(25)**. As such, overall construction activity may continue to weaken for a while longer.

Chart 20: New Home Sales (million sqm, seas. adj.)

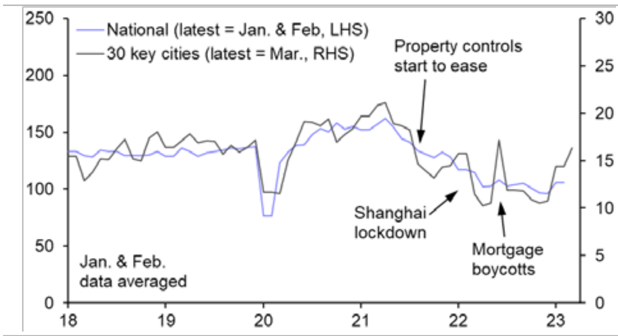


Chart 21: New House Price (% m/m, 70 city ave.)

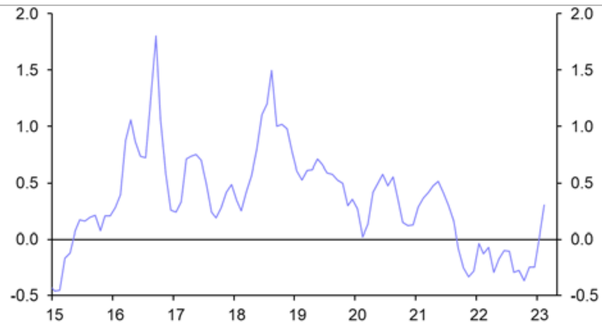


Chart 22: Mortgage Rates for First-time Buyers (%)

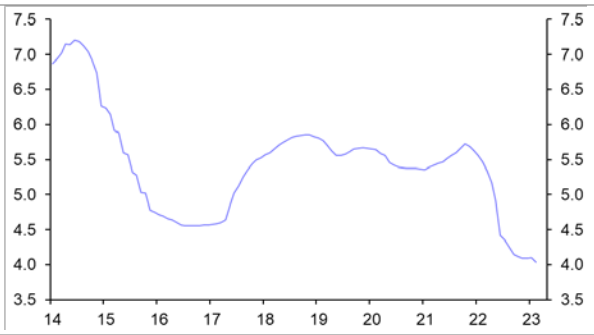


Chart 23: Developer Financing (% of trend GDP, seas. adj.)

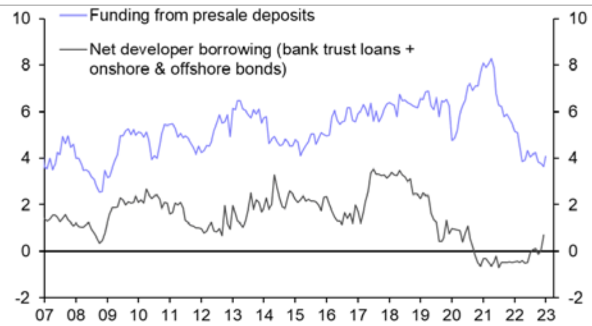


Chart 24: Property Construction Activity (12m ave.)

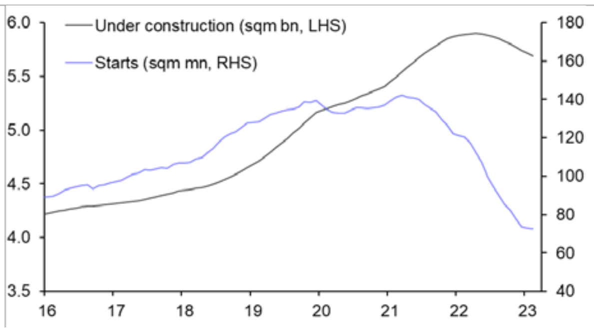


Chart 25: Land Market Indicators

Sources: CEIC, Wind, Capital Economics

External Trade

- After falling sharply late last year, exports regained some ground in January and February **(26)**, reflecting a temporary boost from reopening as supply chain strains eased. This uptick was especially pronounced for shipments of electronics **(27)**, but it is likely to be short-lived given the ongoing drag from the reversal of pandemic-related shifts in foreign demand.
- The weak global economic backdrop is also a headwind. While container throughput has continued to rise **(28)**, this could be misleading as container utilization looks to be decreasing, with empty containers accumulating at ports. Freight rates are consistent with waning shipping demand **(29)**.
- Imports were little changed at the beginning of the year **(26)**, despite the strong rebound in activity after reopening. Both imports for domestic use and those for re-export stagnated **(30)**, suggesting that reopening has not provided much support to import demand – shipments of energy have declined for the past couple of months **(31)**, for example. But we expect imports to rebound before long, as the recovery in long-distance travel boosts fuel demand.

Chart 26: Goods Trade ($bn, seas. adj. 2010 prices)

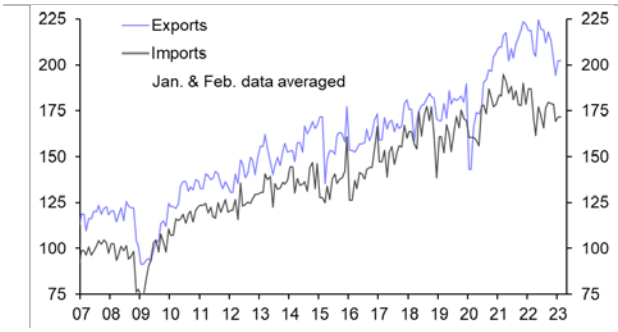


Chart 27: Exports by Product ($, Dec. 19 = 100, seas. adj.)

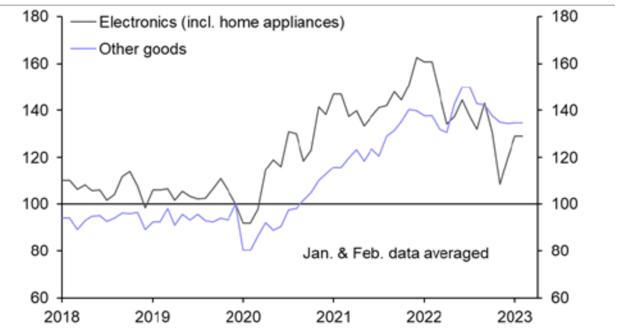


Chart 28: Exports & Seaport Traffic (2019 = 100, SA)

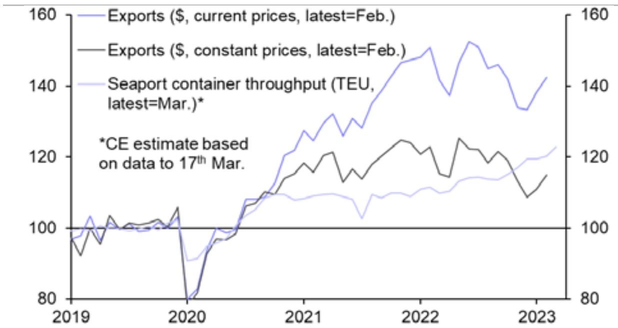


Chart 29: Container Freight Rates for China/Asia Outbound Routes (Dec. 19 = 100)

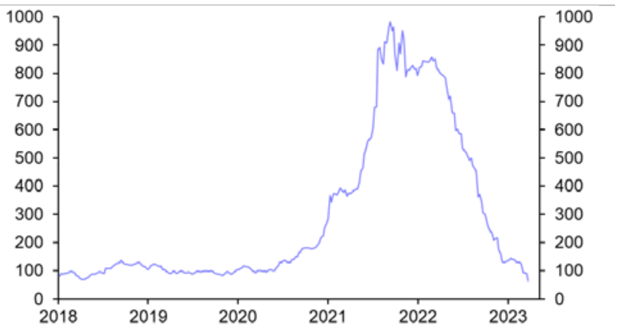


Chart 30: Import by Use ($bn, seas. adj.)

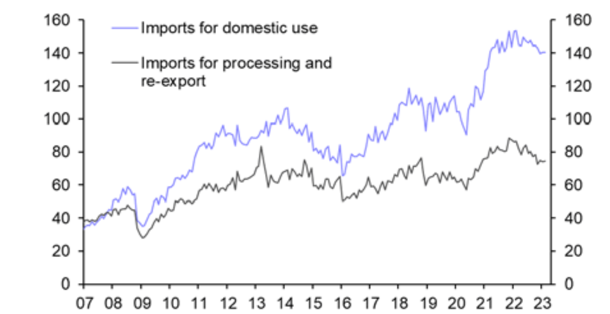
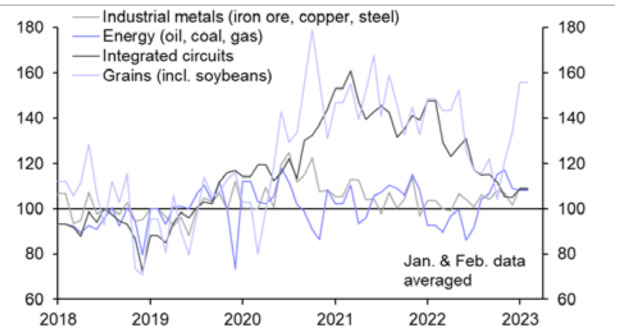


Chart 31: Imports Volumes by Product (2019 = 100, seas. adj.)



Sources: CEIC, Refinitiv, CPB, Capital Economics

Inflation

- Core inflation edged up at the start of the year **(32)**, due to a pickup in demand for travel and other in-person services following reopening **(33)**. But the impact has so far been marginal.
- We anticipate a bigger impact from reopening before long. But it is unlikely to push up inflation as much as it did in other countries. One reason is that China is reopening during a period when global growth is slowing, which helps to moderate the impact on prices, particularly for commodities. Although China's reopening will probably push up oil prices somewhat, we still think fuel price inflation will stay muted in the coming months thanks to a strong comparison base. **(34)**
- Factory gate prices stopped declining m/m last month **(35)**, as China's reopening helped to stabilise global commodity prices. But consumer durable prices dropped back, as supply chain disruption caused by the reopening wave of infections eased **(36)**. And weekly data suggest that output prices at Chinese factories stayed stable in recent weeks **(37)**.

Chart 32: Consumer Prices (% y/y)

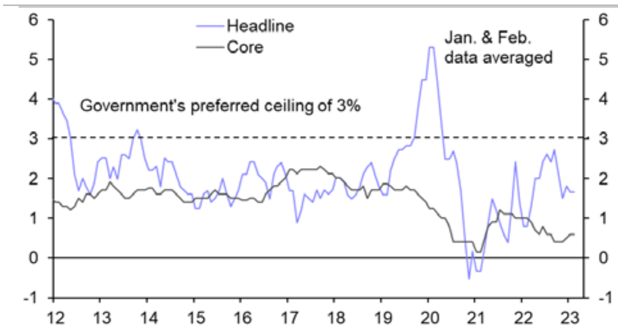


Chart 33: CPI – Tourism Services (% y/y*)

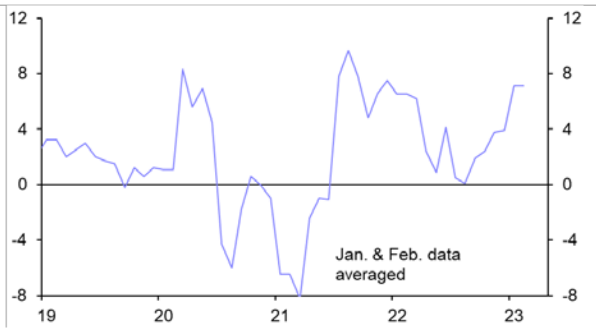


Chart 34: Oil & Vehicle Fuel Prices (% y/y)

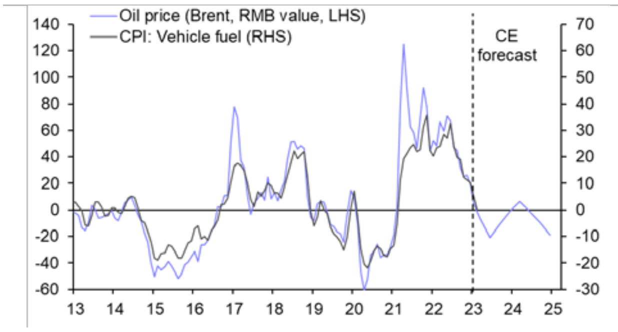


Chart 35: Producer Prices

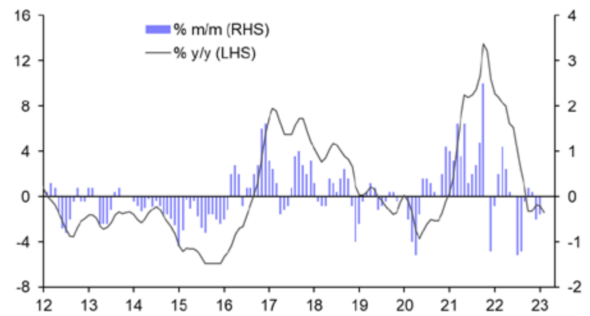


Chart 36: PPI – Durable Consumer Goods (% m/m)

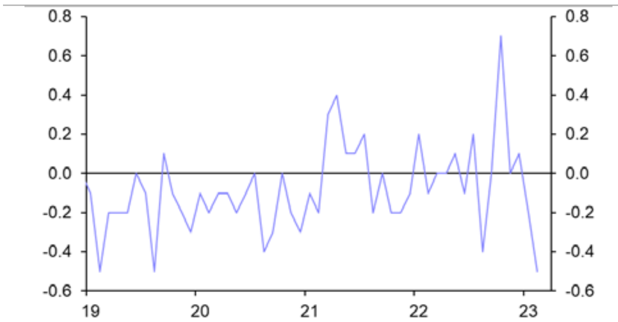
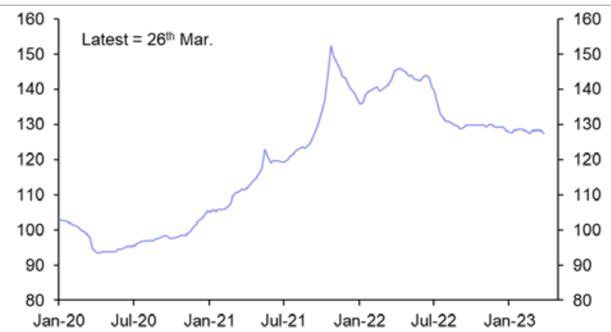


Chart 37: Weekly Producer Prices (23rd Feb. 20 = 100)



Sources: CEIC, Refinitiv, Capital Economics

Monetary

- The reserve requirement ratio (RRR) for banks was reduced by 25bp last month **(38)**. Unlike previous RRR cuts, the PBOC did not explicitly ask banks to pass on the decline in their funding costs to borrowers. Instead, the main goal appears to be to provide some financial relief to the banks, who have suffered from declining profit margins.
- While the RRR reduction could still lead to a slight decline in lending rates, it won't have a lasting impact on liquidity conditions – interbank rates don't have much room to fall before hitting the rate on offer from the PBOC **(39)**, beyond which further declines can't be sustained without policy rate cuts. We don't expect reductions in the near term, particularly given the neutral monetary stance signalled at the National People's Congress and the regulatory concerns around mortgage prepayments. Similarly, December's RRR cut was not followed by cuts to the main policy rates **(40)**.
- Quantitative controls on bank lending have been relaxed since late 2021, but this failed to translate into stronger credit growth last year **(41)** due virus disruptions that dented appetite to borrow. However, credit growth has already started to rebound this year, thanks to reopening. Bank loan growth jumped to a 14-month high last month, driven by faster lending to both households and corporates **(42)**. And broad credit growth accelerated for the first time since September **(43)**.

Chart 38: Required Reserve Ratio (%)

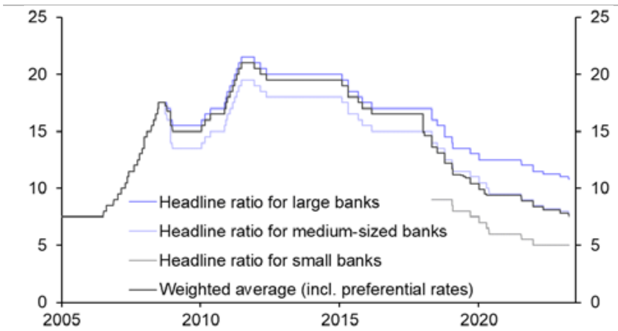


Chart 39: 7-Day Pledged Repo Rate (%)

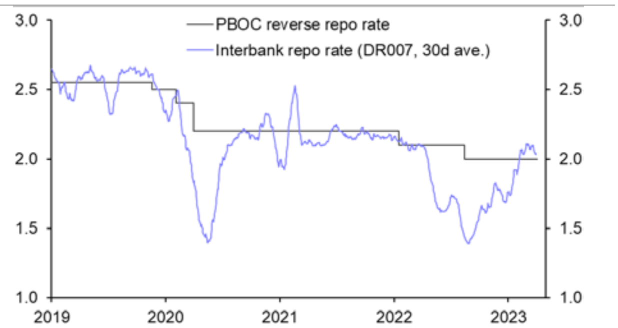


Chart 40: PBOC Policy Rates (%)

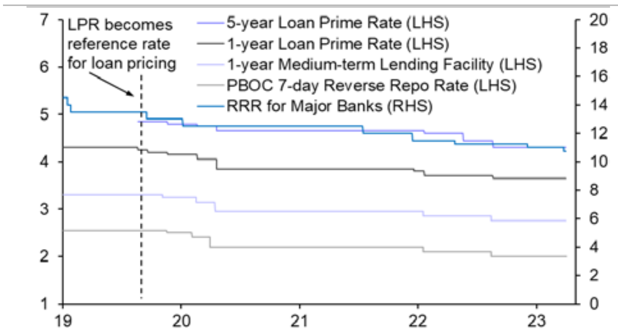


Chart 41: Bank Lending & Loan Approval Conditions

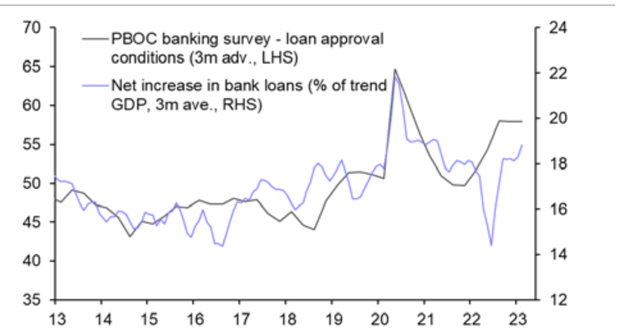


Chart 42: RMB Bank Loans (Outstanding, % y/y)

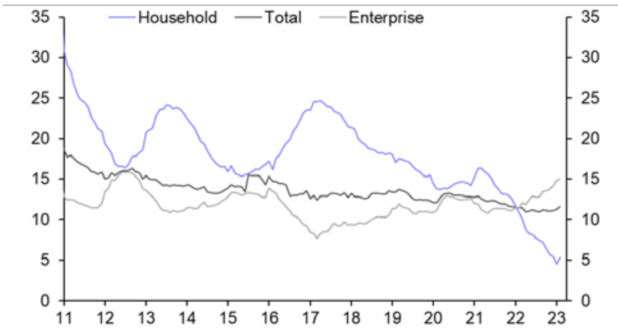
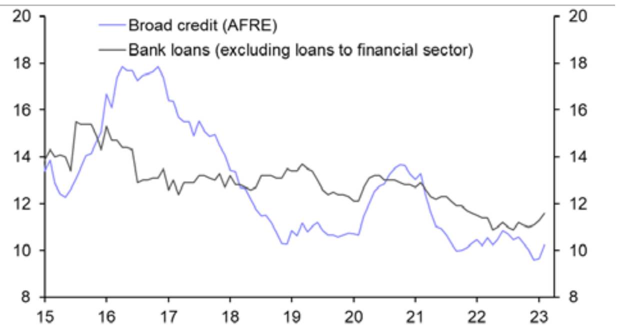


Chart 43: Growth of Outstanding Credit (% y/y)



Sources: CEIC, Wind, Refinitiv, Capital Economics

Financial Markets

- The reopening rally in Chinese stocks has lost some momentum **(44)**, partly because much of the economic boost from reopening has already happened and the National People's Congress (NPC) meeting signalled a relatively restrained approach to policy support. Foreign flows into Chinese stocks have eased recently after surging earlier this year **(45)**. But we think Chinese equities have potential for further gains – their valuations remain depressed compared to developed market equities **(46)**.
- The renminbi has regained some ground against the US dollar recently **(47)**, due to a sharp shift in expectations for US monetary policy amid the recent banking sector turmoil. While China's financial system has its own vulnerabilities, it has limited direct exposure to foreign banks. And there are currently few signs of liquidity problems in China's banking system – credit spreads on the NCD issuance of higher-rated vs lower-rated banks have stayed low **(48)**.
- In addition, the price of offshore bonds has recovered over the past few months **(49)**, as investors have responded positively to the substantial policy easing in the property market.

Chart 44: Equity Indices (20th Jan. 2020 = 100)

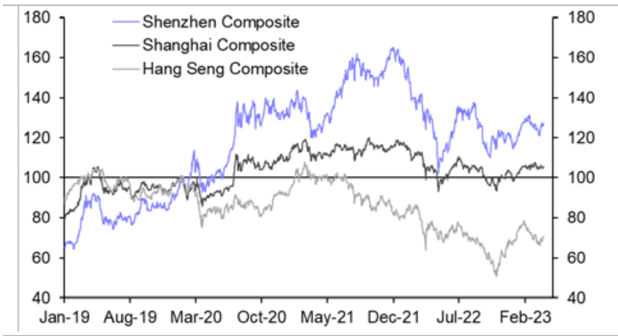


Chart 45: Net inflows to mainland equity markets via SH-HK & SZ-HK Stock Connect ($bn, 30d ave.)

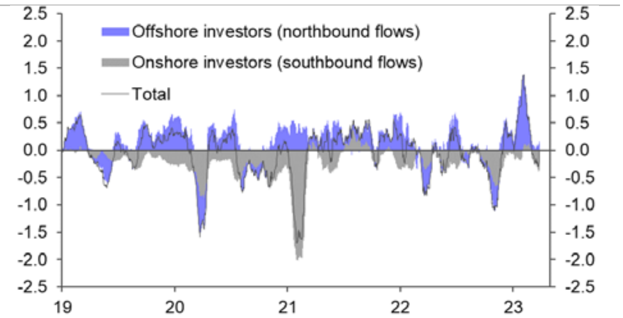


Chart 46: MSCI China vs MSCI World Forward PE Ratio

Chart 47: Renminbi Exchange Rate

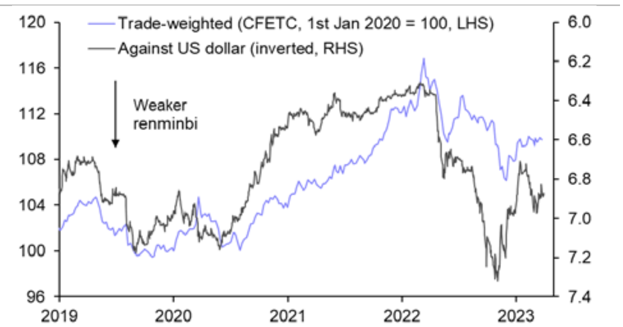


Chart 48: Negotiable Certificate of Deposit (NCD) Credit Spread (AA minus AAA+)

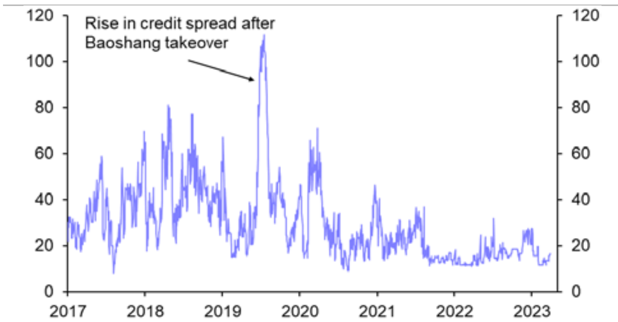
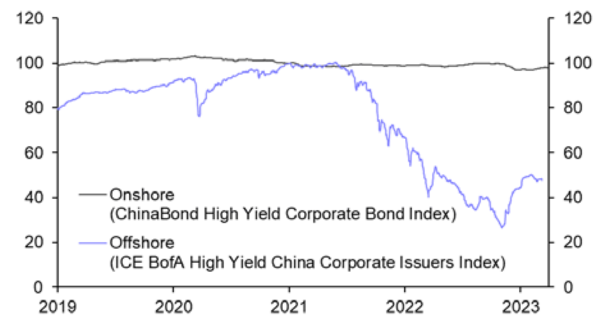


Chart 49: China High Yield Corporate Bond Indices (100 = 4th Jan. 2021)



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

Hong Kong

- Hong Kong's economy was unchanged q/q in Q4 following a contraction in Q3. Most signs suggest things are looking up this quarter now that almost all virus-related measures have been dropped.
- Admittedly, there are still some headwinds in the near-term. The pandemic-related boost to goods trade has gone into reverse **(50)**. 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 **(51)**. Encouragingly, there are some signs that home prices have stabilised after reaching a five-year low **(52)**. This partly reflects an improvement in sentiment, but it also suggests that policy support is taking effect.
- More significant is the boost from the return of foreign visitors. Arrivals have continued to rebound strongly **(53)** and currently stand at a third of 2018 levels. Until a full recovery is achieved, fiscal policy should shore up areas hardest hit by COVID such as consumption and the tourism and transportation industry **(54)**. The wider improvement in economic conditions has helped to bring the unemployment rate back down near its pre-pandemic levels **(55)**.

Chart 50: Goods Exports (Dec. 2019 = 100, seas. adj.)

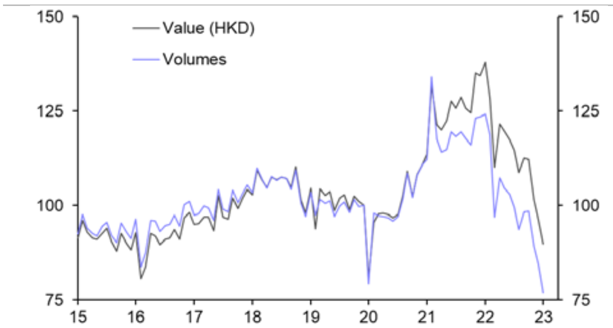


Chart 51: Interest Rates (%)

Chart 52: HK Residential Property Prices (2005 = 100)

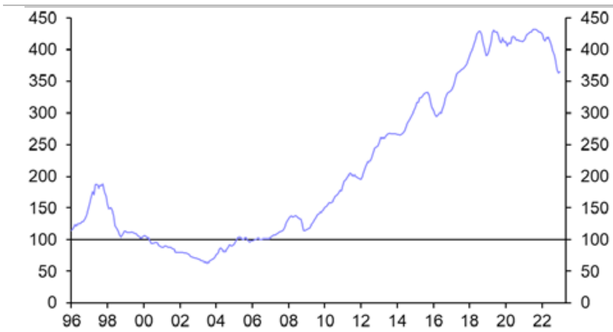


Chart 53: Hong Kong Passenger Arrivals Breakdown (mn, seas. adj.)

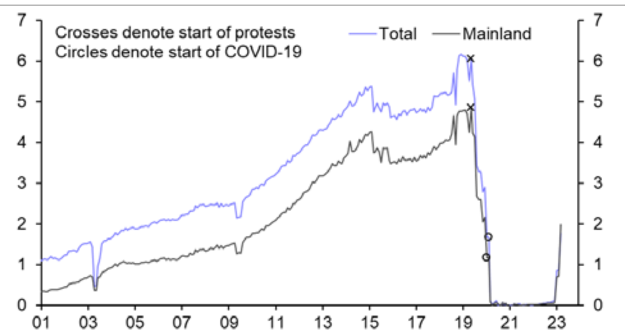


Chart 54: Hong Kong Budget Balance (% of GDP)

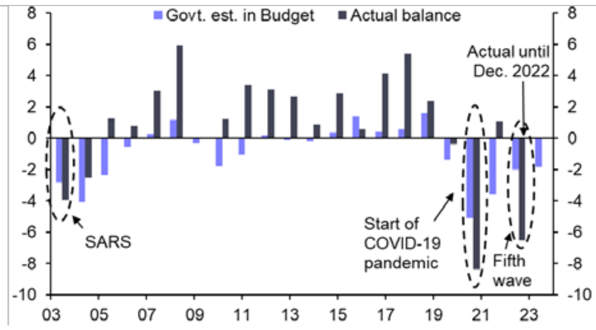
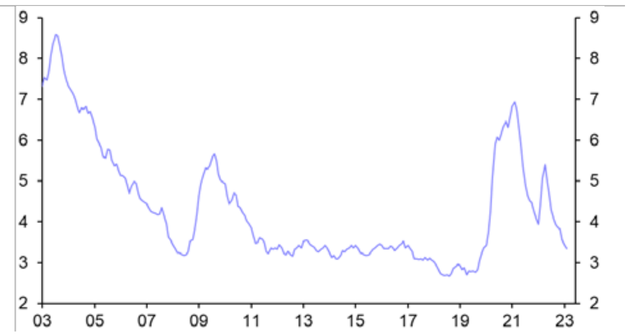


Chart 55: HK Unemployment Rate (%, seas. adj.)



Sources: CEIC, Capital Economics