CHINA ECONOMICS WEEKLY

What to make of the recovery so far

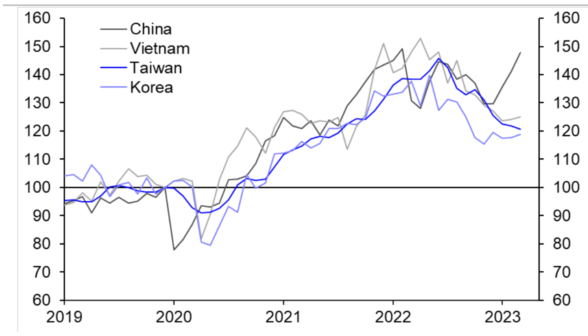
The rebound has exceeded most expectations

Mixed data have contributed to differences in views about the strength of China's recovery and about the need for additional policy support.

For example, the recent drop in both consumer and producer price inflation, as well as the continued year-on-year contraction in imports have been interpreted by some as evidence that the reopening rebound has underwhelmed. In contrast, more upbeat observers point to the services and construction PMIs, which are at decade highs, and the recent jump in exports and credit.

We'll learn more with the March data next week, but we think the bulk of evidence supports the latter view. Admittedly, the PMIs have a history of being distorted by swings in sentiment so we don't take their strength entirely at face value. We also have some doubts about the strength of the apparent turnaround in exports. The monthly figures are noisy, especially around the start of the year. Data from other parts of the region don't show a turnaround in foreign demand. (See Chart 1.)

Chart 1: Goods Exports ($, 2019 = 100, seas. adj.)



Sources: CEIC, Refinitiv, Capital Economics

But we also don't think the data on inflation and import growth are too worrying. In both cases, headline rates have been pulled down by base effects due to the surge in commodity prices when Russia invaded Ukraine a year ago. Once this is accounted for, it becomes apparent that underlying inflation and imports have ticked up recently.

Those increases have so far been modest. But it's worth keeping in mind that both imports and inflation lag the economic cycle. It can be a while before firms respond to shifts in demand by ramping up import orders, especially if they were already sitting on ample inventories. It then takes weeks or even months for the goods to arrive at Chinese customs.

Underlying inflation tends to be even slower to reflect turning points. Core CPI in China is sensitive to the level of unemployment with a lag of around 3 months. And the labour market is itself a lagging indicator of economic conditions. The upshot is that the lack of a more pronounced pick-up in inflation or imports doesn't necessarily imply that economic activity remained subdued in Q1.

In fact, most evidence suggests that the recovery has been robust. The China Activity Proxy (CAP), our in-house alternative to the official GDP figures, jumped in January and February, more than reversing its decline late last year. And while we'll have to wait until next week for a clearer picture of the economy's performance in March, the stronger-than-expected credit data offered some positive signals for investment and home sales.

If anything, the speed and strength of the recovery so far seems to have exceeded most analysts' early expectations. The median forecast for 2023 GDP growth has risen from 4.8% in mid-January to 5.4% today, converging with the forecast of 5.5% that we have maintained since early January. If these forecasts are correct, growth is on track to exceed the government's annual target. We doubt therefore that policy support will be expanded much beyond the plans laid out at the National People's Congress.

The week ahead

We'll get a measure next week of how strong the recovery was for retailers, industry and investment in March and for GDP in Q1. In addition, the PBOC has an opportunity to loosen policy through the LPR. We don't think it will see a need to take it.

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Data Previews

Medium-term Lending Facility Rate/Loan Prime Rate (Apr.) Mon. 17th/ Thu. 20th

Forecasts	Time (China)	Previous	Consensus	Capital Economics
MLF Rate (1-year) (17th Apr.)	09.20	2.75%	2.75%	2.75%
Loan Prime Rate (1-year) (20th Apr.)	09.30	3.65%	3.65%	3.65%

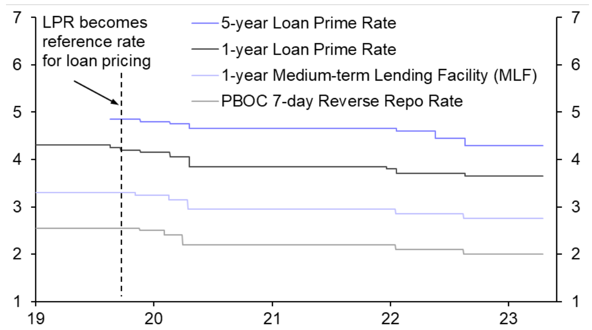
No need to add to broad-based easing

The PBOC has kept its policy rates unchanged since zero-COVID was abandoned (see Chart 2) except for a 25bp reduction to the reserve requirement ratio (RRR). We think it will remain on hold this month.

The PBOC probably won't feel the need to add to broad-based easing, particularly given that credit demand is already recovering. It cut the RRR in March, but our read was that that move was about offering relief to banks, whose profit margins have been under pressure. Some smaller banks reportedly cut deposit rates last week to ease margin pressure.

If the PBOC does decide to provide further support, it will likely use targeted tools, such as re-lending facilities, which are becoming increasingly important, rather than its main policy rates.

Chart 2: Policy Rates (%)



Sources: CEIC, Capital Economics

Activity & Spending (Mar.) Tue. 18th Apr.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
Industrial Production (% y/y)	10.00	(+2.4%)	(+4.0%)	(+2.2%)
Fixed Asset Investment (ytd % y/y)	10.00	(+5.5%)	(+5.7%)	(+5.6%)
Retail Sales (% y/y)	10.00	(+3.5%)	(+7.0%)	(+7.0%)

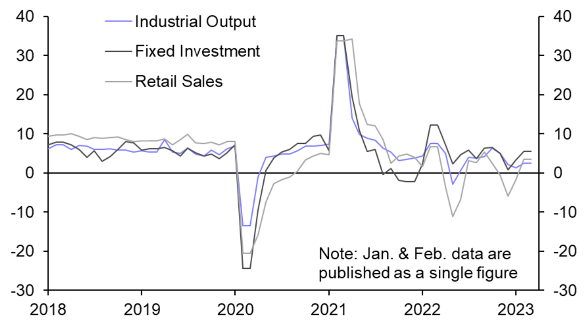
Reopening rebound continues

Retail spending had the most ground to make up and showed the strongest gains in the first two months of the year. (See Chart 3.) It is perhaps unsurprising that some indicators – for example, on mobility and deliveries – suggest that the initial post-reopening surge has slowed more recently. But the recovery still appears to be continuing – the services PMIs have reached new highs – and base effects will give the March figures an extra gloss: Shanghai was on the verge of lockdown at the end of March last year.

By contrast, industry didn't suffer as much as the retail sector during zero-COVID and so there is less room for a further pick-up in output. While the March trade data suggest that foreign demand has been strengthening, the manufacturing PMIs fell last month.

The investment breakdown will be worth a closer look. The front-loading of fiscal support this year should show up in the data for infrastructure. And property investment may show signs of turning a corner.

Chart 3: Activity & Spending (% y/y)



Sources: CEIC, Capital Economics

GDP (Q1)

Tue. 18th Apr. / Wed. 19th Apr.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
GDP % q/q (% y/y)	10.00 (18th)	0.0%(+2.9%)	+2.1%(+3.8%)	+2.0%(+4.0%)
Full sectoral breakdown	09.30 (19th)	-	-	-

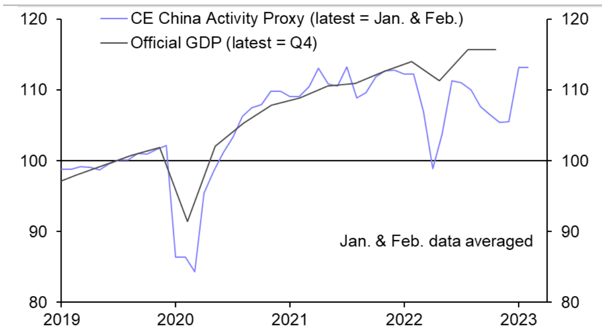
Back to reality

We think that the official GDP data significantly understated the extent of China's economic weakness last year, particularly in Q4, which started with the tightening of zero-COVID constraints on activity across many parts of the country and ended with the disruption of a mass wave of infections passing through China in December.

Officials have a better story to tell for Q1. Our proprietary alternative to the official GDP data, the China Activity Proxy (CAP) is one of many independent indicators that shows a sharp increase in activity at the start of the year. (See Chart 4.) The beaten down services sector appears to have continued to strengthen in March. In annualised q/q terms, GDP will certainly show a sharp pick-up. And we think the official headline figures will tell a broadly accurate story about the pace of y/y growth this year after last year's distortions.

The GDP breakdown is released a day after the headline data and contains some useful information. In particular, the breakdown covering services provides insight into the performance of key sectors such as tech and commercial services, for which high-frequency macro data are scarce.

Chart 4: GDP & CE CAP (2019 = 100, seas. adj.)



Sources: CEIC, WIND, Capital Economics

Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (China)	Previous*	Median*	CE Forecasts*
April						
Sat 15th		**Chn** Home Prices (70 Cities, Mar.)	(09.30)	+0.3%	-	-
Mon 17th		**Chn** 1-Year Medium-Term Lending Facility (MLF) Auction (Apr.)	(09.20)	2.75%	2.75%	2.75%
Tue 18th		**Chn** GDP (Q1)	(10.00)	+0.0%(+2.9%)	+2.1%(+3.8%)	+2.0%(+4.0%)
		Chn Retail Sales (Mar.)	(10.00)	(+3.5%)	(+7.0%)	(+7.0%)
		Chn Industrial Production (Mar.)	(10.00)	(+2.4%)	(+4.0%)	(+2.2%)
		Chn Fixed Asset Investment (Mar., ytd y/y)	(10.00)	(+5.5%)	(+5.7%)	(+5.6%)
		Chn Surveyed Unemployment Rate (Mar.)	(10.00)	5.60%	5.50%	5.50%
		Chn Property Investment (Mar., ytd y/y)	(10.00)	(-5.7%)	(-4.7%)	(-7.0%)
Thu 20th		**Chn** 1-Year Loan Prime Rate (Apr.)	(09.15)	3.65%	3.65%	3.65%
Fri 21st		**HK** Consumer Prices (Mar.)	(16.30)	(+1.7%)	-	(+1.5%)
		Chn Foreign Exchange Net Settlement and Receipts (Mar., RMB)	-	+11.4b	-	-
Also expected during this period:						
14th – 18th		**Chn** Foreign Direct Investment (Mar., RMB)	-	(+6.1%)	-	-
TBC		**Chn** PBOC Balance Sheet Data (Mar.)	-	-	-	-
TBC		**Chn** Government Revenue and Expenditure (Mar.)	-	-	-	-

Selected future data releases and events:

April

Mon 24th		**HK** Unemployment Rate (Mar.)
Tue 25th		**HK** Trade Data (Mar.)
Thu 27th		**Chn** Profits of Large Industrial Firms (Mar.)
Also expected during this period:		
TBC		**Chn** CBRC Data on Assets and Liabilities of Financial Institutions (Mar.)

Main Economic & Market Forecasts

%q/q annualised (%y/y), unless stated	Latest	Q1 2023	Q2 2023	Q3 2023	Q4 2023	2022	2023f	2024f	2025f
Official GDP	0.0(+2.9)*	(3.5)	(7.5)	(5)	(6)	(3.0)	(5.5)	(5.0)	(4.5)
GDP (CE CAP-derived estimates)	-3.4(-5.9)*	(2)	(9)	(5)	(10)	(-3.1)	(6.5)	(4.5)	(4.0)
Consumer Prices	(+0.7)**	(1.3)	(1.5)	(1.7)	(1.9)	(2.0)	(1.5)	(2.0)	(1.5)
Producer Prices	(-2.5)**	(-1.3)	(-1.3)	(-1.3)	(-1.3)	(4.1)	(-1.2)	(0.9)	(0.4)
Broad Credit (AFRE)	(+10.0)**	(10.3)	(10.1)	(10.1)	(10.7)	(9.6)	(10.7)	(8.0)	(7.7)
Exports (US$)	(+14.8)**	(+0.5)	(-15.5)	(-19.0)	(-8.0)	(7.0)	(-11.0)	(-2.5)	(2.5)
Imports (US$)	(-1.4)**	(-7.2)	(-4.0)	(-8.0)	(0.5)	(1.1)	(-4.5)	(3.5)	(1)
RMB/\$†	6.87	6.87	6.90	6.80	6.70	6.95	6.70	6.50	6.40
7-day PBOC reverse repo† %	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
1-year Loan Prime Rate† (LPR) %	3.65	3.65	3.65	3.65	3.65	3.65	3.65	3.65	3.65
1-year MLF Rate† %	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75
10-year Government Bond Yield† %	2.83	2.86	3.10	3.15	3.20	2.85	3.20	2.90	2.60
RRR (major banks)† %	10.75	10.75	10.75	10.75	10.75	11.00	10.75	10.75	10.75
CSI 300 Index†	4,069	4,051	4,321	4,545	4,770	3,872	4,770	5,110	5,468
Hong Kong GDP	(-4.2)*	(1.6)	(3.6)	(8)	(9.3)	(-3.5)	(5.5)	(7.5)	(4.5)
Hang Seng Index†	20,344	20,400	20,850	21,400	22,000	19,781	22,000	26,000	30,000

Sources: Bloomberg, Refinitiv, CEIC, Capital Economics *Q4; **Mar., † End of period