CHINA ECONOMICS WEEKLY

Infrastructure supporting services-led recovery

Infrastructure boosting construction activity

The shape of China's post-zero-COVID rebound has become clearer over the past week: primarily services-driven, as expected, but with stronger construction activity too, which appears to be mostly about infrastructure rather than property.

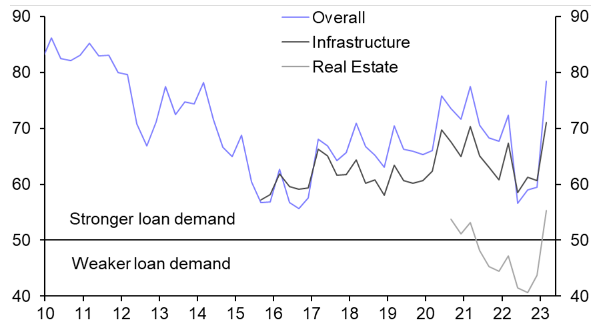
The construction PMI hit a record high in March. Improved sentiment probably skewed the reading to some extent as happened when previous waves of virus disruption ebbed in China. But there is wider evidence that construction activity is picking up in earnest. Cement inventories have fallen in recent weeks, while steel and asphalt output have risen.

A recovery in the real estate sector partly explains the shift. The end of the zero-COVID policy has removed a key source of uncertainty and boosted the confidence of potential homebuyers. High frequency data show a steady increase in home sales since the start of the year. Work on some stalled projects has resumed. But developers, clouded by recent financing problems, remain cautious and are keeping pipelines lean, which is preventing a big step-up in real estate construction.

Instead, it appears that most of the strength is being propelled by infrastructure projects thanks to a front-loading of fiscal support. Issuance of local government "special bonds" was the highest on record in Q1 as a share of the overall annual quota. LGFV and policy bank bond issuance also saw a sizeable pick-up last quarter. All these point to a rush on infrastructure spending by local governments at the start of the year. Meanwhile, the PBOC Q1 survey released earlier this week pointed to a very rapid increase in loan demand with demand from infrastructure projects rising much faster than that from real estate. (See Chart 1.)

One way to think about this infrastructure turnaround is that it represents deliberate front-loading of policy support by officials. High bond issuance in Q1 was specifically intended to provide a fiscal boost following reopening. Issuance and the demand it generates will necessarily be more muted over the rest of the year as quota constraints bite.

Chart 1: PBOC Banking Survey on Loan Demand (diffusion indices)



Sources: CEIC, Capital Economics

Services recovery still going strong

The Caixin services PMI for March released today cast light on the other driver of the recovery. As with the official services index, it rose again to levels only ever seen before in the 2020 lockdown rebound and in 2009. This supports our view that most of the reopening recovery has come from the services sector, which was hit hardest by the zero-COVID policy.

Figures from the Tomb Sweeping Festival holiday which ended yesterday add to evidence of a services rebound – consumer spending was up 29% y/y, while 85% of tourism sites were operating at normal hours. This momentum won't be sustained for too much longer, not least because the economy has already regained so much ground in such a short space of time.

The week ahead

Data next week are likely to provide further evidence of the rebound in credit demand. Thursday's trade figures may show exports under renewed pressure. And Tuesday's inflation data will underline that China's recovery is unspooling quite unlike earlier re-openings elsewhere: we think headline inflation may have dropped below 1%.

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Data Previews

Net New Bank Loans, M2, AFRE (Mar.)

9th – 15th Mar.

Forecasts	Time (China)	Previous	Consensus	Capital Economics
Net New Bank Loans (RMB)	-	+1,810bn	+3,300bn	+3,200bn
M2 (% y/y)	-	(+12.9%)	(+12.7%)	(+12.8%)
Aggregate Financing "AFRE" (RMB)	-	+3,160bn	+4,565bn	+3,900bn

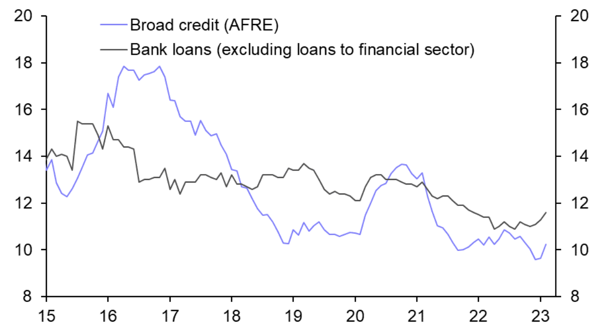
Loan demand roaring back

Reopening has rekindled credit demand. Bank loan growth rose to a 14-month high in February, and broad credit growth accelerated for the first time since September. (See Chart 2.) As Chart 1 shows, the PBOC bank survey suggests that loan demand increased the most last quarter in over a decade.

Headline y/y loan growth in March will be held back by a stronger base for comparison from a year ago, when regulatory controls were eased. Even so, we expect it to have held steady. A recovery in home sales should have supported mortgage lending, and the improvement in business sentiment should have boosted wider appetite for borrowing. Year-on-year growth in other forms of credit was probably stable too. High frequency data point to slightly weaker corporate and government bond issuance last month. But we think this was offset by an uptick in shadow credit.

We expect broad credit growth to take another step up over the coming months as borrowing remains strong and base effects become more flattering.

Chart 2: Broad Credit & Bank Loans (outstanding, % y/y)



Sources: CEIC, Capital Economics

CPI, PPI (Mar.)

Tue. 11th Apr.

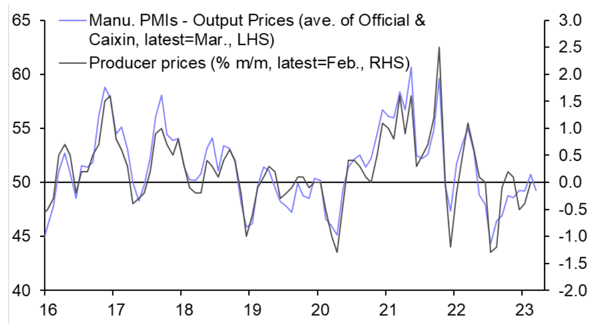
Forecasts	Time (China)	Previous	Consensus	Capital Economics
CPI (% y/y)	09.30	(+1.0%)	(+1.0%)	(+0.9%)
PPI (% y/y)	09.30	(-1.4%)	(-2.5%)	(-2.6%)

Reopening effects offset by lower food and fuel inflation

Core inflation edged up at the start of 2023, driven by a jump in demand for travel and other in-person services. Reopening effects probably put further upward pressure on core inflation last month. However, this will have been more than offset by a decline in food inflation, thanks to lower pork prices, and fuel price deflation, due to a higher base for comparison – oil prices jumped early last year due to the Russian invasion of Ukraine. As a result, headline inflation looks set to drop below 1% for the first time in over a year.

Factory-gate deflation will also have deepened. As with CPI, base effects will be largely to blame. But the manufacturing PMIs point to a small decline in prices last month too. (See Chart 3.)

Chart 3: Producer Prices & PMI Output Prices



Sources: CEIC, S&P Global, Capital Economics

Trade (Mar.)

Thu. 13th Apr.

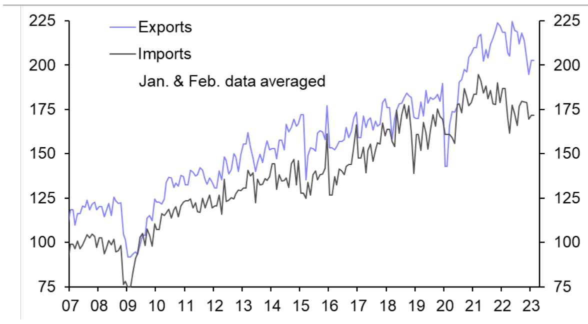
Forecasts	Time (China)	Previous	Consensus	Capital Economics
Exports (USD, % y/y)	-	(-6.8%)	(-7.4%)	(-8.0%)
Imports (USD, % y/y)	-	(-10.2%)	(-7.0%)	(+1.0%)
Trade Balance (USD)	-	+117bn	+41bn	+19bn

Exports haven't bottomed out yet

After falling sharply late last year, exports regained some ground at the start of 2023. (See Chart 4.) But this probably reflects a temporary boost from the fading of virus disruption. And we think exports will have come under renewed pressure from the weak global economic situation. Admittedly, port container throughput has increased recently, but this could be misleading as container utilization appears to be decreasing, with empty containers piling up. Falling freight rates and weak PMI data are still consistent with waning foreign demand.

Imports remained soft at the start of 2023. (See Chart 4 again.) We think they will have strengthened last month following the rapid reopening rebound in activity. In particular, a pick-up in construction should have supported metals demand, while the recovery in long-distance travel will have boosted fuel consumption.

Chart 4: Goods Trade ($bn, seas. adj., 2010 prices)



Sources: CEIC, Capital Economics

Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (China)	Previous*	Median*	CE Forecasts*
April						
Fri 7th		**Chn** Foreign Exchange Reserves (Mar., USD)	-	+3133b	-	-
		HK Good Friday (National Holiday)	-	-	-	-
Mon 10th		**HK** Easter Monday (National Holiday)	-	-	-	-
Tue 11th		**Chn** Consumer Prices (Mar.)	(09.30)	(+1.0%)	(+1.0%)	(+0.9%)
		Chn Producer Prices (Mar.)	(09.30)	(-1.4%)	(-2.5%)	(-2.6%)
Thu 13th		**Chn** Trade Balance (Mar., USD)	-	+116.9b	+41.0b	+19.0b
		Chn Exports (Mar., USD)	-	(-6.8%)	(-7.4%)	(-8.0%)
		Chn Imports (Mar., USD)	-	(-10.2%)	(-7.0%)	(+1.0%)
Also expected during this period:						
9th – 15th		**Chn** M2 Money Supply (Mar.)	-	(+12.9%)	(+12.7%)	(+12.8%)
		Chn Net New Lending (Mar., RMB)	-	+1810b	+3300b	+3200b
		Chn Aggregate Financing "AFRE" (Mar., RMB)	-	+3156b	+4565b	+3900b
11th – 18th		**Chn** Foreign Direct Investment (Mar., RMB)	-	(+6.1%)	-	-
TBC		**Chn** Vehicle Sales (Mar.)	-	-	-	-
TBC		**Chn** PBOC Depository Corp. Survey (Mar.)	-	-	-	-

Selected future data releases and events:

April

Date	Country	Release/Indicator/Event
Sat 15th		**Chn** Home Prices (70 Cities, Mar.)
Mon 17th		**Chn** 1-Year Medium-Term Lending Facility (MLF) Auction (Apr.)
Tue 18th		**Chn** GDP (Q1)
		Chn Spending and Activity Data (Mar.)
Thu 20th		**Chn** 1-Year Loan Prime Rate (Apr.)
Fri 21st		**HK** Consumer Prices (Mar.)
		Chn Foreign Exchange Net Settlement and Receipts (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)*	(3.4)	(7.6)	(4.9)	(6.2)	(3.0)	(5.5)	(5.0)	(4.5)
GDP (CE CAP-derived estimates)	-3.4(-5.9)*	(2.1)	(9)	(5.2)	(10.2)	(-3.1)	(6.5)	(4.5)	(4.0)
Consumer Prices	(+1.0)**	(1.9)	(1.5)	(1.6)	(1.8)	(2.0)	(2.0)	(2.0)	(1.0)
Producer Prices	(-1.4)**	(-1.3)	(-2.9)	(-0.7)	(0.3)	(4.1)	(-1.0)	(0.5)	(0.0)
Broad Credit (AFRE)	(+9.9)**	(10.1)	(10.2)	(10.4)	(10.5)	(9.6)	(10.5)	(8)	(10.5)
Exports (US$)	(-6.8)***	(-11.1)	(-15.8)	(-18.1)	(-8.9)	(7.0)	(-13.5)	(-0.5)	(2.5)
Imports (US$)	(-10.2)***	(3.4)	(-3.4)	(-9)	(-0.4)	(1.1)	(-2.5)	(3.5)	(0.5)
RMB/$†	6.88	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† %	2.87	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†	4,103	4,051	4,300	4,530	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†	20,274	20,400	20,850	21,400	22,000	19,781	22,000	26,000	30,000

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