CHINA

ANOTHER ABRUPT SLOWDOWN

After a strong start in 2022, China's economic growth slowed in March. Headwinds are expected to persist in the very short term. Firstly, the rapid surge in the number of Covid-19 cases has led many regions to impose severe mobility restrictions. Secondly, the property market correction continues. Thirdly, producers and exporters will be affected by the impact of the war in Ukraine on commodity prices and world trade. Therefore, China's official economic growth target, which has been set at 5.5% for 2022, seems highly ambitious. The Chinese authorities are accelerating the pace of fiscal and monetary easing.

After improving in the first two months of 2022, China's economic growth slowed again in March. According to the purchasing managers indexes (PMI) released in late March, activity has been eroding in the manufacturing and non-manufacturing sectors, and expectations for domestic and international demand have also deteriorated. The corresponding PMIs and their components have all declined, dropping below the 50 threshold (chart 1). The slowdown is bound to continue in the very short term due, domestically, to a new wave of the Covid-19 pandemic and the ongoing correction in the property market and, externally, to the impact of the war in Ukraine on commodity prices and world trade.

A NEW SURGE IN COVID-19 CASES AND LOCKDOWN MEASURES

In the services sector, activity began to pick up in January-February (+4.2% y/y vs. +3.3% in Q4 2021), and growth in retail sales volumes also accelerated (+4.9% y/y vs. less than 2% in Q4). Yet this rebound was cut short in March ; activity in the services sector contracted by 0.9% y/y and retail sales volumes fell by nearly 5%.

Many provinces have introduced strict mobility restrictions to counter a very strong surge in the number of Covid-19 cases, as China maintains a zero-Covid strategy while vaccination coverage is insufficient (86% of the entire population had received 2 doses of the vaccine at the end of March, but only 82% in the 70-79 age group and 51% in the over-80 age group). In the first week of April, the cities and regions that had imposed total or very strict lockdown measures (including Shanghai and Jilin) accounted for about 12% of China's GDP. Cities imposing less restrictive measures accounted for more than 50% of GDP (up from 30% just two weeks earlier). Although the authorities should seek to limit the impact of these restrictions on factory output, some production sites are currently reporting disruptions. Above all, merchandise transport and a number of other services sectors (leisure, retailing, mobility, etc.) are being hard hit, a situation that could last for several more weeks.

The health crisis is not helping the property market. The correction let up somewhat in January-February thanks to the very slight easing of financing conditions, but it is worsening again. Average house prices are decreasing slowly (the average price for the 70 biggest cities has dropped by about 2% since July 2021) and transaction volumes continue to fall (-17% y/y in March vs. -10% in January-February), which is adding to the troubles of property developers.

After accelerating since October (+7.5% y/y in January-February, vs. 3.9% in Q4 2021), industrial growth slowed again in March (+5% y/y). It should remain hampered by anti-Covid measures and sluggish domestic demand, as well as by the slowdown in world demand and new supply chain disruptions triggered by the war in Ukraine. After an extremely solid performance in 2020 and 2021, exports are expected to slow significantly in 2022. High commodity prices will drive up the cost of imports, and China's trade and current account surpluses are bound to shrink rather quickly.

FORECASTS

	2019	2020	2021	2022e	2023e
Real GDP growth, %	6.0	2.2	8.1	4.8	5.1
Inflation, CPI, year average, %	2.9	2.5	0.9	2.4	2.7
Official budget balance / GDP, %	-2.8	-3.7	-3.1	-2.8	-3.0
Official general government debt / GDP, %	38.6	45.9	46.9	49.8	52.2
Current account balance / GDP, %	0.7	1.9	1.8	0.5	0.8
External debt / GDP, %	14.5	16.3	15.5	16.1	16.3
Forex reserves, USD bn	3 108	3 217	3 250	3 210	3 230
Forex reserves, in months of imports	14.9	16.3	12.6	10.6	10.0

TABLE 1

e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

ECONOMIC GROWTH SLOWING AGAIN IN MARCH

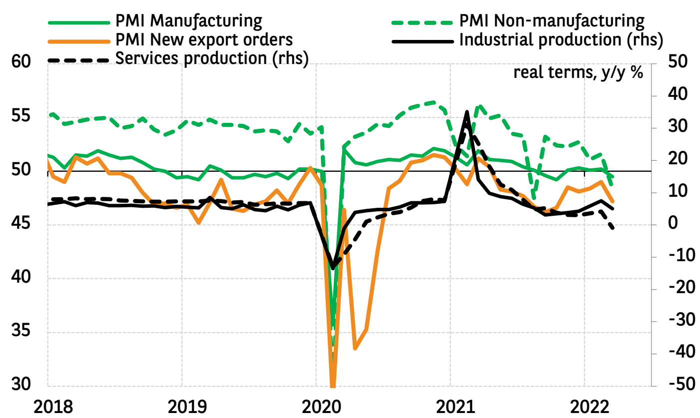

CHART 1

SOURCE : NBS

REPERCUSSIONS OF THE WAR IN UKRAINE

The direct impact of the war in Ukraine on China's economic activity should be moderate. On the one hand, China's exports to Russia and Ukraine account for only 2.3% of total exports, while its purchases from these two countries account for only 3% of total imports. Trade and financial ties between Russia and China have increased over the past decade in an environment marked by US and European sanctions against Moscow. In 2020, nearly 20% of their trade flows was denominated in RMB.

Ties between the two countries are currently being maintained, but they are unlikely to be strengthened much in the short term. China has only limited capacity to increase imports of Russian goods given the current economic slowdown and also due to logistical constraints (lack of pipelines, cost of shipping goods). Moreover, even though Beijing officially denounces the international sanctions against Moscow, Chinese institutions are likely to comply with them out of fear of secondary sanctions by its main trading partners (the United States and the EU absorb 33% of Chinese exports).

On the other hand, the surge in global commodity prices should have only a mild impact on China's consumer price index (CPI) and household purchasing power in the short term, thanks notably to the existence of partial controls on energy and grain prices. China can also draw on its grain reserves, which are very comfortable (at year-end 2021, it was estimated that wheat stocks could cover at least a year of local consumption). Moreover, the decline in meat prices over the past year has maintained deflationary pressures on food prices (-3.1% y/y in Q1 2022). CPI inflation was only 1.5% in March (up from 0.9% in January and February) and should be comfortably below 3% in 2022.

In contrast, producer price inflation is expected to stay high (8.7% y/y in Q1), which should strain industrial activity. Some sectors will also face supply chain problems, at least for products coming from Ukraine. China is dependent on Ukraine for supplies of corn (over 50% of its total corn imports), barley (26%) and sunflower oil (59%). Meanwhile, imports from Russia are likely to operate more normally. About half of these imports are made of oil (which accounted for 14% of China's total oil imports in 2020). China also depends on Russia for supplies of timber (19% of total timber imports), fertilizers (22%) and industrial metals (about 7%).

IMMEDIATE MEASURES TO BOOST GROWTH

During the annual National People's Congress meeting in early March, the authorities presented their macroeconomic goals for 2022. China's official economic growth target, which has been set at 5.5% for 2022, seems to be very ambitious in the current environment, especially after a mixed Q1 performance (real GDP grew by 4.8% y/y, reflecting two solid months of growth followed by an abrupt slowdown in March). Policy easing, which has been underway since Q4 2021, is expected to be accelerated in the weeks ahead.

Beijing set its official budget deficit target[1] at 2.8% of GDP in 2022, down from 3.1% in 2021. This reduction does not foreshadow any fiscal tightening, but should be seen more as an indication of the authorities' cautious approach and their determination to contain the slippage in public accounts. In fact, the government is considering major stimulus measures. They will be partly financed by the carryover of funds that were budgeted but not used in 2021. Moreover, as is often the case in China, stimulus measures will also be covered by "government-managed funds"[2] and other quasi- and extra-budgetary funds. In its 2022 budget report, the finance minister is projecting a general budget deficit[3] of 4.7% of GDP (vs. an actual deficit of 3.8% in 2021), a government funds deficit of 3.4% (vs. 1.4% in 2021), and a consolidated budget deficit for all government bodies[4] of 7.3% (vs. 4.4% in 2021). These figures give a more exact (but still incomplete[5]) idea of the significant size of the stimulus planned for 2022. The main measures will comprise new public infrastructure investment (especially in transport, water conservation, irrigation and digital facilities) as well as major subsidies

SLIGHT EASING IN DOMESTIC CREDIT CONDITIONS

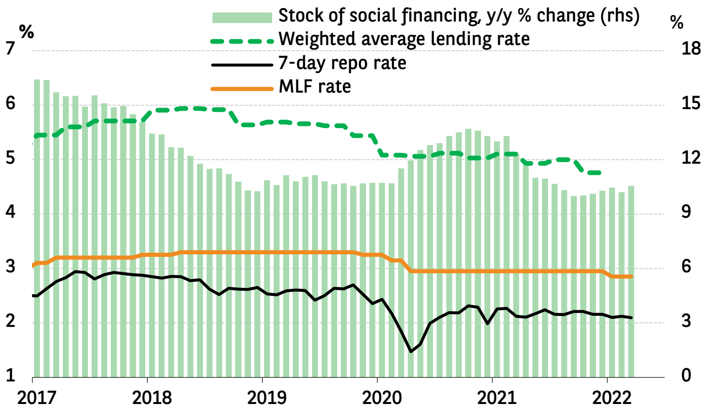

CHART 2

SOURCE : PBOC

and tax cuts notably aimed at supporting small and mid-sized enterprises and the manufacturing industry. The 2022 budget report also mentions measures to support households.

Monetary policy and credit conditions have been gradually eased since Q4 2021, via targeted measures (such as lending programmes to support SMEs, rural area development and innovation), the reduction in reserve requirement ratios (which were lowered from 12% to 11.5% in December for the large banks) and interest rate cuts. Mortgage lending conditions and access to short-term financing for property developers were also eased slightly, the main goals being to help developers to complete existing development projects, reassure households and contain the crisis in the real estate sector. New interest rate cuts are expected in Q2 2022. Total social financing growth, which had slowed during the first three quarters of 2021, has barely picked up since October (chart 2).

Lastly, after months of regulatory tightening in the digital services sector, the authorities announced some policy adjustments in mid-March. This has reassured investors and might lift some of the obstacles to economic growth in 2021.

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1 For a definition of China's various fiscal balances, see "China's public finances, a tangled web", Eco Conjoncture, BNP Paribas, Sept. 2021.
2 These funds are managed outside of the general budget, essentially by local governments, and mainly financed through land sales proceeds and special bond issues.
3 The general government deficit (central government + local governments), excluding transfers from other public accounts.
4 General government budget + government-managed funds + budget of state capital operations + social security fund.
5 The budget report does not take into account extra-budgetary operations, which are notably covered by local governments' financing vehicles.