CHINA

RECOVERY

China's economic activity started to rebound in late January, driven primarily by services and household consumption. Meanwhile, the crisis in the property and construction sectors has subsided. In the manufacturing sector, the growth recovery has remained moderate, hindered by the fall in automobile production and weakening exports. Economic momentum will remain strong in the short term. However, a number of significant downside risks to growth persist.

Following the abandonment of the zero-Covid policy in early December, the lifting of all restrictions on mobility and the end of the disruptions caused by the surge in the number of infections in December-January, Chinese economic growth has rebounded since the end of January. The recovery has been primarily driven by services, while the improvement in industry turned out to be more modest (Chart 2).

Activity in the services sector and household consumption have recovered more quickly than expected. After several months of contraction, retail sales volumes increased by around +2% YoY in January-February, despite the decline in car sales due to the end of tax incentives. Consumer price inflation remained low (+1.6% YoY in January-February vs. +1.8% in Q4 2022).

The crisis in the construction and real estate sectors has eased: new construction projects, housing sales and real estate investment all continued to contract in January-February YoY, but at much slower rates than in previous months. In addition, the average house price in the 70 main cities rose slightly in February (+0.1% MoM) after falling for 18 months (the total house price drop has been limited to 5.2% since July 2021).

In the manufacturing sector, the recovery in activity and investment has remained moderate: total automobile production fell sharply (but production of new energy vehicles continued to rise robustly), and export-oriented sectors were affected by global demand weakening.

Against this difficult but more reassuring backdrop, the National People's Congress held its annual meeting in Beijing at the beginning of March. The government notably announced its main macroeconomic objectives for 2023. The growth target was set at "around 5%", indicative of the cautious realism of the authorities. This target of 5% should in fact be easily reached, thanks to the momentum provided by post-Covid catch-up effects and the rebound in private demand and services activity. The dynamics seen in January-February will continue in the short term, and real GDP growth figures could improve thanks to greater base effects in Q2 2023. At the same time, by setting a low growth target for 2023, the authorities are first, counting on moderate support from fiscal and monetary policies, and second, recognising the existence of high downside risks.

These risks are firstly linked to the situation in the real estate sector: government support measures and the lifting of mobility restrictions should help stall the collapse of activity. Nevertheless, housing sales and new construction projects should remain hindered by the still poor confidence of potential buyers, the persistent financial difficulties of a large number of property developers and the slow pace of their debt restructuring. Secondly, the weak financial position of local governments, increasing risks in the financial sector, requiring fiscal consolidation efforts and constraining their capacity to resort to debt, should weigh on public investment. Moreover, downside risks are also emerging from the weak international environment, which is clouding the outlook for Chinese exports and, therefore, for production and investment in the manufacturing sector.

Uncertainties are also related to the labour market: its recovery could be limited, particularly if the rebound in industrial activity remains moderate, and this would continue to weigh on household sentiment and income. In fact, the urban unemployment rate rose slightly again in February 2023, reaching 5.6% on average across the country, and 18.1% for the 16-24 age group (compared to 5.2% and 11.9% respectively in 2019).

Structural factors of the growth slowdown add to these short-term downside factors (in particular, China's demographic dynamic and the slowdown in productivity growth). Lastly, private-sector confidence and demand could continue to be affected by internal regulatory risks (lack of visibility, increased control of the State and the Communist Party) and geopolitical tensions.

GROWTH & INFLATION

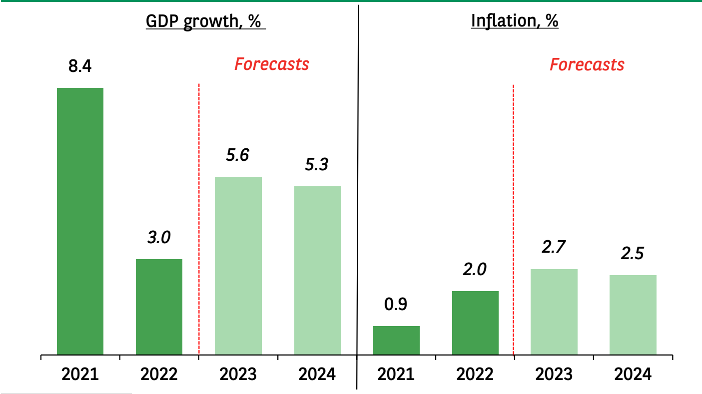

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

CHINA: POST-COVID RECOVERY

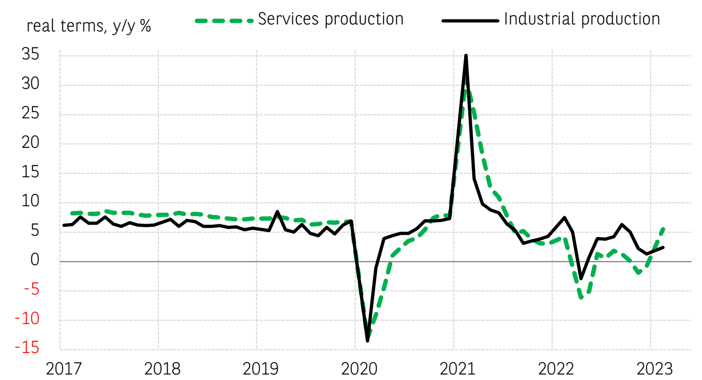

CHART 2 SOURCE: NBS, BNP PARIBAS

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