CHINA

NEW DISRUPTIONS

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. The Chinese authorities are bound to accelerate the easing of economic policy

After improving in the first two months of 2022, China's economic growth slowed again in March. According to the latest purchasing managers' indexes (PMI), 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 all declined and dropped below the 50 threshold in March. 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.

In the services sector, activity began to pick up in January-February, and growth in retail sales volumes also accelerated (+4.9% y/y vs. less than 2% in Q4 2022). Yet this rebound was cut short. 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 population was vaccinated at the end of March, but the ratio is much lower among the elderly). On March 24th, the cities and regions imposing strict lockdown measures (such as Jilin and Dongguan) accounted for about 9% of China's GDP while those imposing less restrictive measures accounted for more than 30% of GDP; the situation has worsened in recent days. 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, retail, mobility, etc.) are being hard hit, a situation that could last for several more weeks. This situation is not helping the property market, which is still in the midst of a correction. Average house prices are falling slowly (the average price for the 70 biggest cities has dropped by about 2% since July 2021) and transaction volumes continue to fall (-10% y/y in January-February), which is adding to the troubles of property developers.

After accelerating since October, industrial growth slowed again in March. It is 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 down significantly in 2022.

The direct impact of the war in Ukraine on China's economic activity should be moderate. On the one hand, Chinese exports to Russia and Ukraine account for only 2.3% of total exports, while its imports from these two countries account for less than 3% of total imports. On the other hand, the surge in global commodity prices should have only a mild impact on the consumer price index and households' purchasing power in the short term, thanks notably to the existence of partial controls on energy and grain prices.

In contrast, producer price inflation is expected to stay high (it averaged 8.1% in 2021), which should restrain industrial activity. Moreover, some sectors may also experience supply-chain problems, at least for products coming from Ukraine. China is dependent on Russia and/or Ukraine for supplies of oil (14% of its total oil imports), wood (19%), industrial metals (about 7%), certain grains (50% for corn, less than 1% for wheat) and fertilizers (22%).

GROWTH & INFLATION

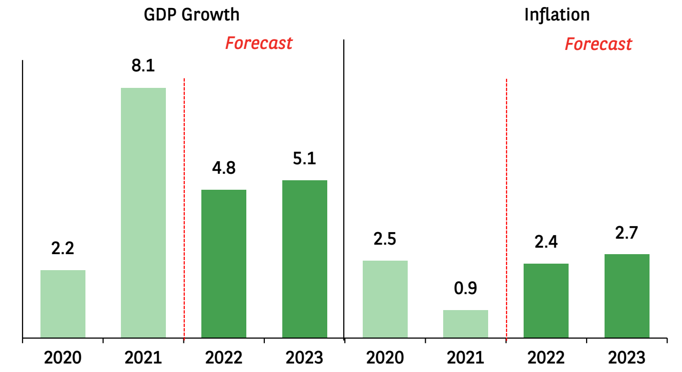

CHART 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CHINA: ECONOMIC GROWTH SLOWING AGAIN IN MARCH

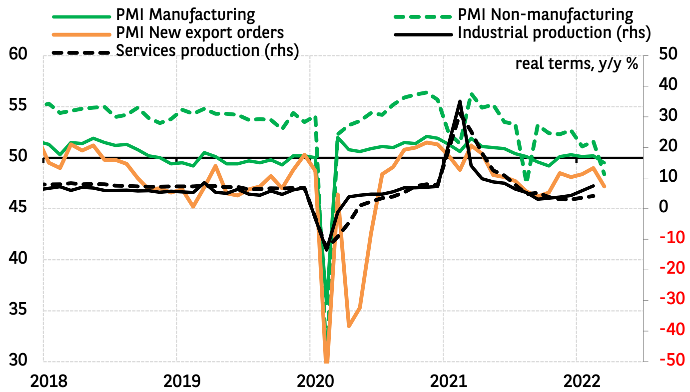

CHART 2 SOURCE: NBS

In this environment, China's official economic growth target, which has been set at 5.5% for 2022, seems to be very ambitious. The authorities are currently ramping up fiscal and monetary policy easing measures.

4 April 2022

Christine Peltier
christine.peltier@bnpparibas.com