PICTET WEALTH MANAGEMENT

China Q1 GDP surprises on the upside

Expect further improvement in domestic demand and the housing sector

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AUTHORS
DONG CHEN
dochen@pictet.com
LING CHEN
lichen@pictet.com

FLASH NOTE

SUMMARY

- Chinese Q1 GDP growth came in stronger than expected at 4.5% y-o-y in Q1 23 (2.2% q-o-q seasonally adjusted). The upside surprise was mainly driven by household consumption, as well as a surprising resurgence of exports in March.
- Growth in fixed-asset investment was less strong. While infrastructure and manufacturing investment continued to hold up, property investment showed only limited improvement. The recovery in housing demand remains gradual.
- The labour market showed some improvement in March. The unemployment rate declined below the government's target, but employment conditions for youth remained challenging.
- Weakening global growth will likely weigh on Chinese exports in the months ahead, and the rebound in domestic demand will likely be gradual. But muted inflation in China allows policy makers to focus on boosting growth.
- In light of the stronger-than-expected GDP figures in Q1, we have decided to revise up our 2023 full-year GDP forecast for China to 5.5% from 5.0% previously.

UPSIDE SURPRISE DRIVEN BY CONSUMPTION REBOUND

Chinese GDP expanded by 4.5% year-over-year (y-o-y) in Q1, or 2.2% quarter-over-quarter (q-o-q, seasonally adjusted), according to the Chinese National Bureau of Statistics. The growth rate beat market consensus estimates of 4.0%.

The rebound in household consumption was the main driver of growth in Q1. Nominal retail sales jumped to 10.6% y-o-y in March, up from 3.5% in the previous two months and beat market expectations by a big margin. The upside surprise was mainly driven by a surge in catering services (+26.3% y-o-y), while consumer good sales was less impressive, except for gold, silver and jewellery (+37.4% y-o-y). Retail sales of housing-related products such as home appliances and housing decorations contracted in March, and furniture sales only rose by low single digits, suggesting the housing recovery in China remains sluggish.

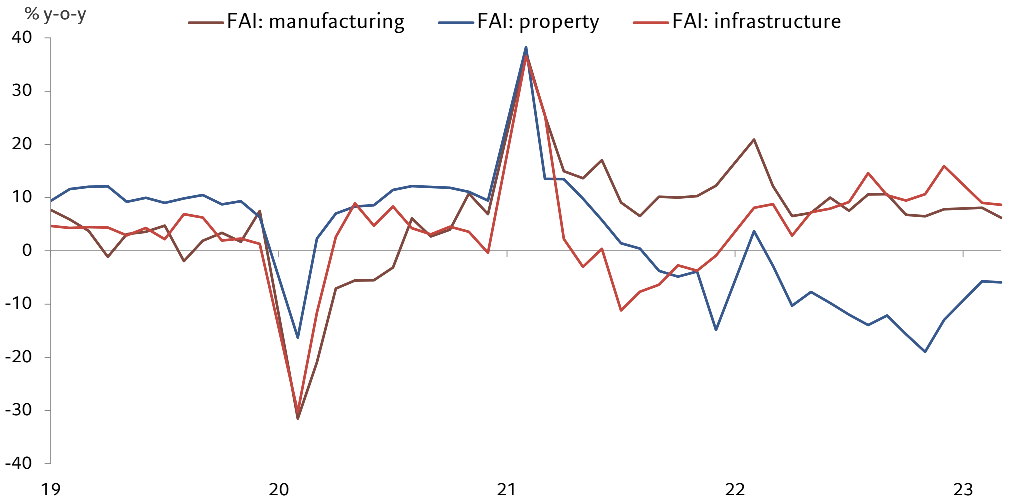
Chart 1: Growth in nominal retail sales by major category

Source: Pictet Wealth Management, Wind, National Bureau Statistics as of 18.04.2023

HOUSING RECOVERY IS SLOW

Growth momentum in fixed-asset investment (FAI, excluding property) continued to hold up, growing at 5.1% y-o-y in Q1, albeit this was below market expectations of 5.7%. The growth in FAI was mainly driven by growth in the infrastructure sector, which stayed strong at 8.7% y-o-y in March, according to our estimates (Chart 2). In contrast, property investment declined by 5.9% y-o-y in March, worse than the 5.7% drop in the previous two months.

Chart 2: Growth in fixed assets investment (FAI) by sector



Source: Pictet Wealth Management, Wind, National Bureau Statistics as of 18.04.2023

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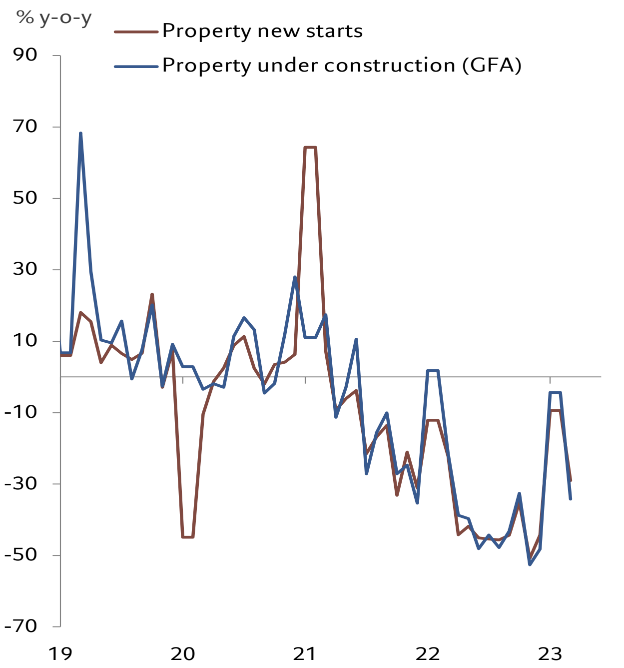
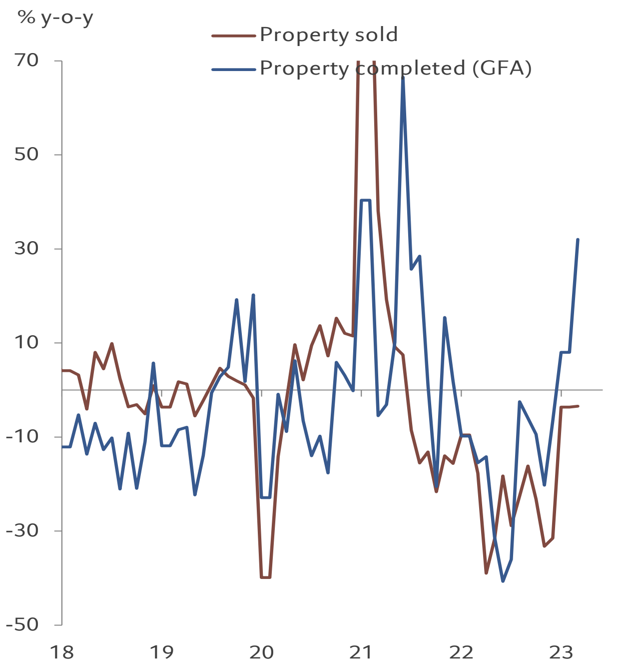
New project starts and property under construction both slumped in March (Chart 3A), suggesting that many developers' financial situation remained difficult, despite the credit support measures announced in late 2022. Property completion has picked up significantly due to the government's efforts to reduce unfinished projects. But property sales have yet to follow, as it will take time before home buyers' confidence recovers (Chart 3B).

Chart 3A: Growth in property new starts and property under construction



GFA: gross floor area.
Source: Pictet Wealth Management, Wind, National Bureau Statistics as of 18.04.2023

Chart 3B: Growth in property sold and property completed



GFA: gross floor area.
Source: Pictet Wealth Management, Wind, National Bureau Statistics as of 18.04.2023

EXPORT STRENGTH UNLIKELY TO SUSTAIN

On the external front, demand for Chinese goods will likely continue to decline against the backdrop of weakening global growth. Chinese exports surprisingly surged by nearly 15% y-o-y in March after a few months of contraction, but this may reflect fulfillment of order backlogs after covid lockdowns and the long Lunar New Year holidays in early 2023.

Plenty of evidence suggests this strong export momentum cannot be sustained. For example, Chinese imports related to processing and assembly activities contracted sharply by -23.4% y-o-y in March. This measure usually has a strong correlation with Chinese exports. Also, the sharp drop in the ISM manufacturing index in the US (to 46.3 in March, its lowest level since May 2020), the slump in Vietnam's export growth (-14.8% y-o-y in March, compared with +11.0% in February), and muted purchasing manager indexes in other North Asia exporting countries (Japan, South Korea and Taiwan) all point to a gloomy outlook for global demand (Chart 4). We maintain our view that Chinese export growth will likely stay in a down-cycle in the near term.

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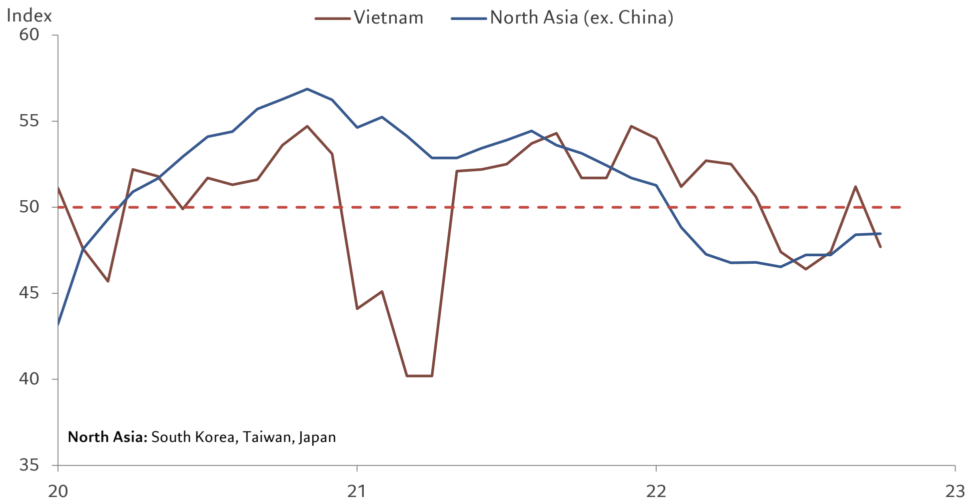
Chinese industrial production rose by 3.0% y-o-y in Q1, also missing market consensus of 3.5%. In particular, manufacturing activities in most downstream sectors (such as textile, food processing, rubber and plastics, communication equipment etc.) contracted in the first quarter. In contrast, infrastructure-related activities (railway and other transport equipment manufacturing) grew by 9.3% y-o-y in Q1, up from 2.9% in the same period of last year on the back of supportive policies.

Chart 4: PMIs of selected Asian economies



Source: Pictet Wealth Management, Bloomberg Finance L.P. as of 18.04.2023

POLICICES WILL LIKELY STAY SUPPORTIVE WITH LOW INFLATION

Both headline and core inflation in China went down to 0.7% y-o-y in March, below our expectations and likely reflecting the still-modest recovery in domestic demand and lower commodity prices. This led us to revise down our full-year inflation forecast from 3% to 2% recently. Muted inflation could encourage Chinese policy makers to push through more supportive policies in order to sustain growth momentum.

Indeed, Chinese credit growth has consistently beat market expectations since the beginning of 2023, mainly driven by the strong momentum in new corporate loans and government bonds (Chart 5). Meanwhile, the People's Bank of China (PBoC) cut the required reserve ratio (RRR) for commercial banks by 25bps in late March, signalling continued, prudent monetary easing.

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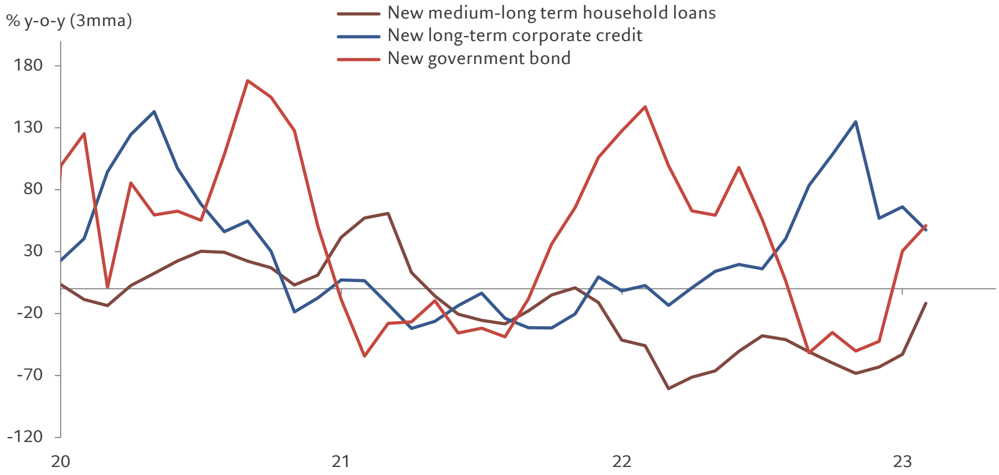
Chart 5. Growth in new credit by major type (3-month moving average)



Source: Pictet Wealth Management, Wind, PBoC as of 18.04.2023

Looking forward, we expect targeted policy support to continue, with the recovery of household confidence and employment being the key focus this year. The overall unemployment rate declined to 5.3% in March (below the government's target of 5.5%), but the job market for youth (15-24 age group) remained challenging, with the youth unemployment rate rising further to 19.6%.

To summarise, China's post-covid recovery is well underway, but the pace is still uneven. There is clearly room for further improvement in domestic demand and the housing sector. In light of the stronger-than-expected GDP figures in Q1, we have decided to revise up our 2023 full-year GDP forecast for China to 5.5% from the previous 5.0%. We expect Q2 GDP growth to be stronger in y-o-y terms due to a flattering base effect (essentially the Shanghai lockdown last year). But on a sequential basis, Q1 probably marked the peak of growth momentum in China. We expect the recovery to moderate in H2 as global demand wanes.

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