

# China: Q3 GDP and the future of zero-covid policy

## Two-tier recovery will likely continue in the coming months

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AUTHOR  
DONG CHEN  
dochen@pictet.com

FLASH NOTE

### SUMMARY

- After a merely 0.4% in Q2, Chinese GDP expanded by 3.9% from one year ago in Q3, beating expectations.
- The rebound in industrial production was one of the main drivers behind the GDP rebound, helped by monetary policy easing and fiscal support.
- In comparison, the improvement in household consumption was limited, likely due to the persistent covid restrictions.
- The property sector shows limited signs of improvement. Housing sales in September contracted less than in the previous month, but most developers remain stressed.
- There are no clear signs that the authorities' zero-covid policy will change meaningfully in the near term. In our view, we will need to see a pick-up in vaccination momentum, a strengthening of China's health system and a change in the official narrative about the pandemic before covid controls can be gradually phased out.

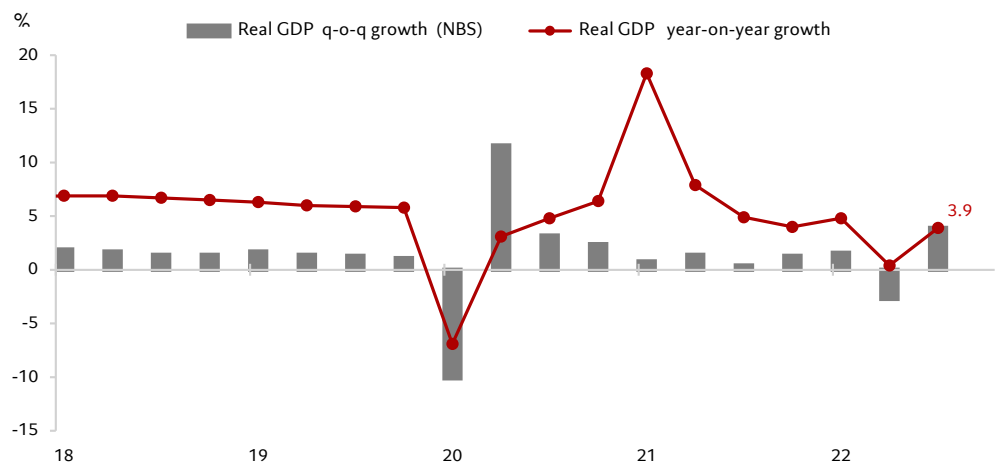
### Q3 GDP BEATS EXPECTATIONS

China's GDP figures for Q3 were finally released on Monday, along with activity data for September, nearly a week behind the original schedule—presumably due to clashes with the Chinese Communist Party's (CCP) 20<sup>th</sup> Congress.

According to the National Bureau of Statistics, Chinese GDP expanded by 3.9% year-over-year (y-o-y) in Q3, beating market expectations and up from a mere 0.4% increase in Q2. In sequential terms, the economy rebounded by 3.9% quarter-over-quarter (q-o-q) after a contraction of 2.7% in Q2 (Chart 1).

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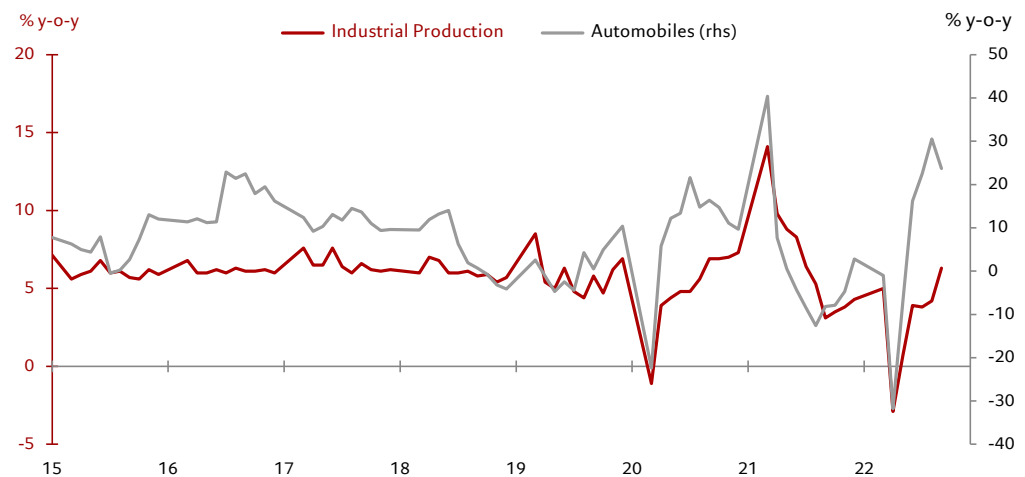
**Chart 1. Growth in Chinese real GDP**



Source: Pictet Wealth Management, National Bureau of Statistics of China, October 2022.

The improvement in industrial activity was one of the main drivers behind the GDP rebound. Industrial production grew by 6.3% y-o-y in September, up from 4.2% in August and 3.8% in July (Chart 2). This represents a great improvement over Q2, when industrial production expanded by only 0.6% y-o-y (and a contraction of 2.9% in April), due to covid lockdowns in some major cities including Shanghai. Automobile output posted further solid growth of 23.7% y-o-y in September, although this was lower than in August (30.5%).

**Chart 2. Growth in industrial production and automobile output**

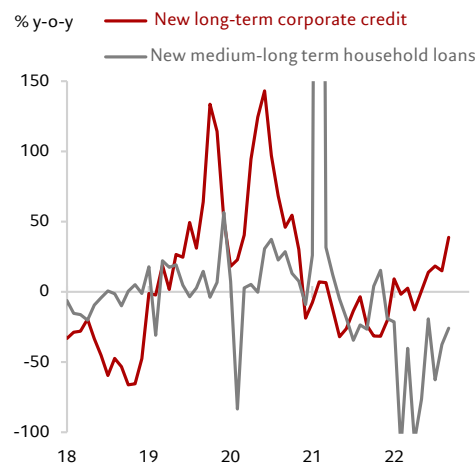


Source: Pictet Wealth Management, National Bureau of Statistics of China, October 2022.

The rebound in industrial activity is consistent with the recent improvement in credit growth, helped by easing monetary policy from the People’s Bank of China (PBoC) and government fiscal support for infrastructure investment. Long-term corporate credit has risen notably in recent months, although consumers’ credit demand has remained muted due to weak property sales (Chart 3). Overall, the credit impulse continued to improve in September (Chart 4).

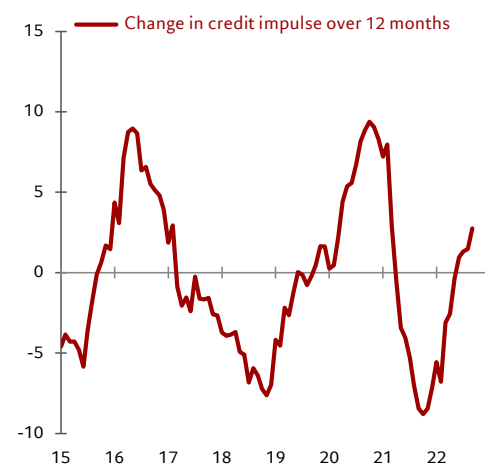
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**Chart 3. Growth in credit by sector**



Source: Pictet Wealth Management, PBoC, October 2022.

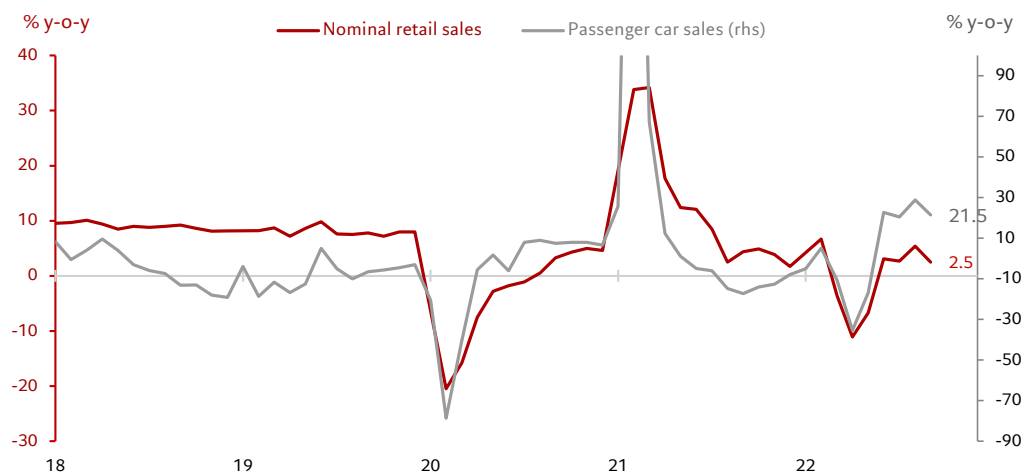
**Chart 4. Change in credit impulse**



Source: Pictet Wealth Management, PBoC, October 2022.

In comparison, the improvement in household consumption has been very limited, likely due to persistent covid restrictions. Nominal retail sales grew by 2.5% y-o-y in September, down from 5.4% in August. Auto sales, which had been boosted by government tax incentives, also started to moderate in September, although they were still fairly elevated (Chart 5). That said, compared to the lockdown-induced slump in Q2 (-4.9% y-o-y), the improvement in consumption is still obvious (3.5% y-o-y in Q3) and also contributed to the GDP rebound. However, any further improvement may be limited in the absence of meaningful relaxation in covid controls.

**Chart 5. Growth in retail and passenger car sales**



Source: Pictet Wealth Management, National Bureau of Statistics of China, October 2022.

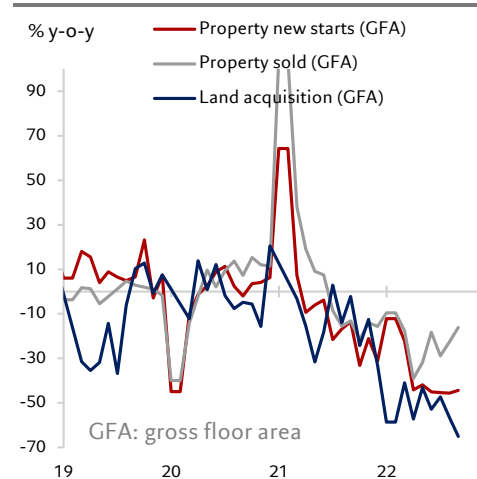
The property sector shows limited signs of improvement. Housing sales contracted by 16% y-o-y in September, somewhat better than the 22% contraction seen in August (Chart 6), but most developers remain under pressure. Funds available to all developers contracted by 24.5% y-o-y in September, almost unchanged from the

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previous month, while land acquisitions by developers continued to plummet (-65% y-o-y).

Housing prices continued to decline last month, although only moderately. Among the 70 major cities, housing prices declined by 3.8% y-o-y in tier-3 cities, a slight deterioration from 3.7% in the previous month. But prices were up by 2.7% in tier-1 cities compared to one year ago (Chart 7). We do not expect a general collapse in housing prices in China as there is no sign of a demand-driven bubble at the national level.

**Chart 6. Housing-sector indicators**



Source: Pictet Wealth Management, National Bureau of Statistics of China, October 2022.

**Chart 7. Changes in housing prices**



Source: Pictet Wealth Management, National Bureau of Statistics of China, October 2022.

Overall, the latest data releases out of China paint a mixed picture of the economy, with the industrial sector improving much faster than household consumption due to the uneven impact of the on-going covid restrictions. This means we are seeing a 'two-tier' recovery.

Previously, we had been flagging potential downside risk to our GDP growth forecast of 3.2% for the Chinese economy in 2022, mostly due to the uncertainties related to covid restrictions. However, given the positive surprise in Q3 GDP, we have decided to keep our current forecast unchanged for the time being.

## WHEN WILL THE ZERO-COVID POLICY CHANGE?

The zero-covid policy (ZCP) is evidently one of the strongest headwinds to the Chinese economy right now (the other being the on-going property slump). A crucial question then is when might ZCP change?

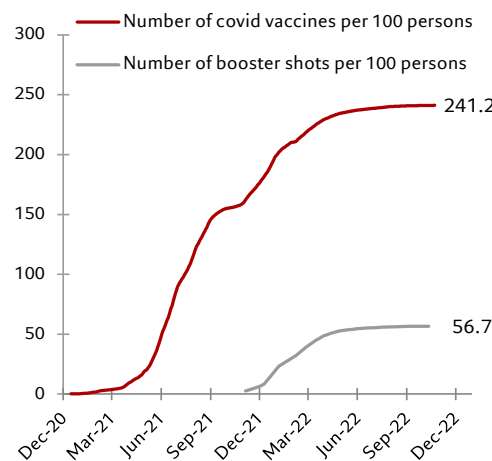
The Chinese Communist Party's 20th Congress, which ended last Saturday, did not provide any clear signs on this score.

There have been a lot of debate regarding the reasons behind the Chinese government's insistence on ZCP, which has proved to be extremely costly to both the economy and society at large. But regardless of the underlying reasons for this insistence, we think we will need to see three developments before there is any meaningful relaxation of ZCP.

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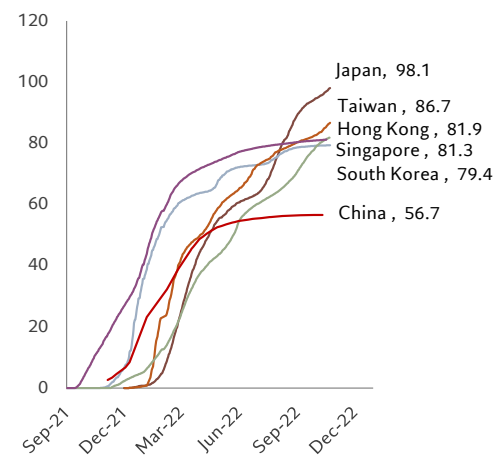
First, we will need to see a notable pick-up in vaccinations, especially booster shots. The pace of vaccination in China has stalled since May (Chart 8) and booster coverage in China lags significantly behind some Asian peers (Chart 9). There have been doubts about the effectiveness of China's domestic-made vaccines. However, recent evidence from Hong Kong (where people can choose between a Chinese inactivated vaccine, Sinovac, and Pfizer's mRNA vaccine) shows that the difference in the efficacy of the two against severe and fatal cases becomes negligible after three doses, although the Chinese vaccine performs much more poorly if people receive only one shot.<sup>1</sup> This means that China could improve the immunity of its population significantly if its booster-shot campaigns were stepped up, even if a domestic mRNA vaccine is not ready. We believe such campaigns are a necessary pre-condition for relaxing the current stringent covid restrictions.

**Chart 8. Covid vaccines and booster shots administered in China**



Source: Pictet Wealth Management, Wind, as of 26 October 2022

**Chart 9. Booster shots administered per 100 persons in select Asian economies**



Source: Pictet Wealth Management, Wind, as of 26 October 2022

Second, given the size of China's population, the government probably needs to significantly strengthen the country's health system to deal with the inevitable surge in infections were ZCP to be relaxed. Some indications are pointing in the right direction. For example, there have been media reports of new isolation facilities being built in large cities like Shanghai.

Third, and probably most importantly, we need to see a gradual shift in the government's narratives about the pandemic and ZCP so as to prepare the population of 1.4 billion mentally for a change in policy. This is extremely important because the Communist Party's credibility is tied to the idea hammered home for more than two years that ZCP is the right approach. Without a shift in narratives, a policy U-turn will be almost impossible from a political perspective. Unfortunately, we have yet to see any positive development on this score.

Progress on each of the three points mentioned above will require time. Thus, we are not expecting any imminent change in ZCP. The next major focus of attention will be the National People's Congress (NPC) in March 2023, when the reshuffle of

<sup>1</sup> "Vaccine effectiveness of two and three doses of BNT162b2 and CoronaVac against covid-19 in Hong Kong", by M.E. McMenamin et al., 2022 (preprint). A summary result is quoted by [The Economist on 19th April 2022](#).

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the communist party leadership will be fully completed. We think ZCP could be gradually phased out after the NPC meetings. In the meantime, the economy's two-tier recovery could continue.

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