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CHINESE ECONOMY HIT HARD BY LOCKDOWNS IN APRIL

WE REMAIN CAUTIOUS ON GROWTH OUTLOOK DESPITE POLICY SUPPORT

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SUMMARY

- The Chinese economy plunged in April, with consumption, investment and exports all decelerating sharply as a result of stringent zero-covid policies.
- In response to the sharp slowdown, the Chinese authorities have lately announced more policy support. In our view, however, Beijing's insistence on zero covid policy remains the dominant headwind and will likely limit the effectiveness of any stimulus measures.
- We expect the strength of any potential rebound of the Chinese economy to be moderate in the absence of any meaningful changes in the government's covid policies and more decisive stimulus measures. As such, we remain cautious on China's growth outlook in the near term and have decided to lower our Chinese GDP growth forecast for 2022 to 4.0% from 4.5%.

The economy took a heavy hit on widespread lockdowns

The Chinese economy slowed sharply in April amid widespread covid containment measures, including strict lockdowns in some major cities. Industrial production contracted by 2.9% year-over-year (y-o-y) in April (down from a growth of 5.0% in March), primarily led by the manufacturing sector. The auto sector was hit particularly hard, plunging by 31.8% y-o-y in April (compared with a 1.0% drop in March), as a result of the prolonged lockdowns in some of China's major auto production hubs, including Shanghai and Jilin province.

CHART 1: GROWTH IN RETAIL SALES IN CHINA (NOMINAL AND REAL)

Source: Pictet Wealth Management, National Bureau of Statistics of China, Wind, as of May, 2022

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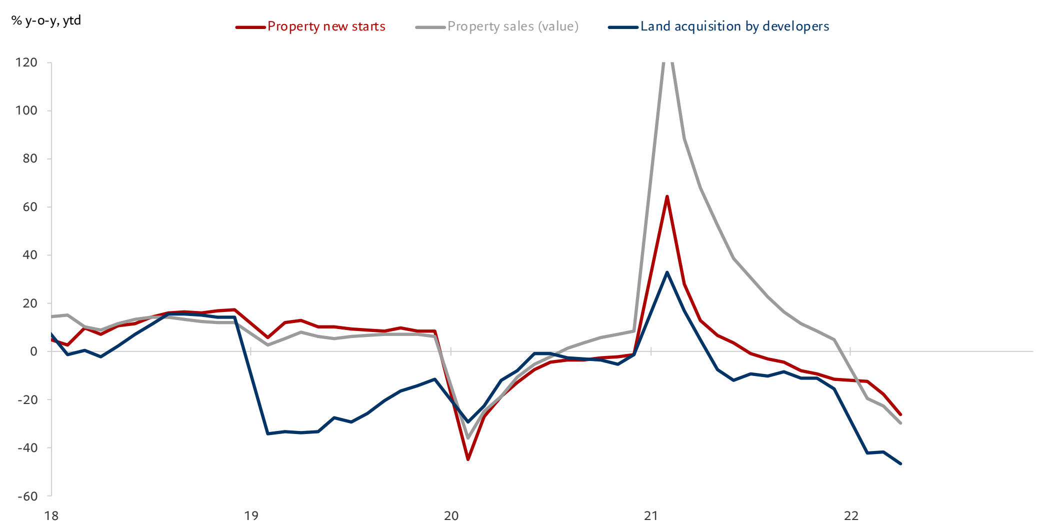
The covid restrictions led to a sharp decline in consumption in April. Retail sales slumped by 11.1% y-o-y, steeper than the 3.5% drop registered in March. In real terms, retail sales contracted by 14% last month (*Chart 1*), the most severe contraction since March 2020.

Fixed-asset investment (FAI) was also hit hard in April, despite fiscal support for infrastructure investment through front-loaded government bond issuance. In fact, investment growth in all three main sectors (manufacturing, infrastructure and property) decelerated sharply, especially in the property sector. Real-estate investment was down by 10.1% y-o-y in April, with all major sector indicators continuing to point downward (*Chart 2*). In particular, land acquisition by developers contracted by nearly half in the first four months of the year (-46.5% y-o-y year-to-date (ytd)), pointing to extremely weak sentiment and the vulnerable financial positions of property developers.

CHART 2: MAJOR PROPERTY SECTOR INDICATORS IN CHINA



Source: Pictet Wealth Management, National Bureau of Statistics of China, Wind, as of May, 2022

Export growth also slowed quite notably in April—to 3.9% y-o-y, the weakest level since the pandemic started and down from 14.6% in March.

With all the three sources of growth (consumption, investment and exports) decelerating sharply, China's labour market is coming under increasing pressure. The unemployment rate rose to 6.1% in April, up from 5.8% in the previous month and well above the government's target of 5.5%. In 31 major cities, unemployment reached 6.7%.

Step up in policy support is not enough

While the Chinese authorities have recently stepped up policy support in response to the sharp deceleration, it seems insufficient to offset the strong growth headwinds. In April, the People's Bank of China (PBoC) announced a 25 bps reduction in the required reserve ratio (RRR) for all commercial banks, but decided to kept the policy rate (medium-term lending facility (MLF) rate) unchanged at 2.85%. This move was below our expectations,

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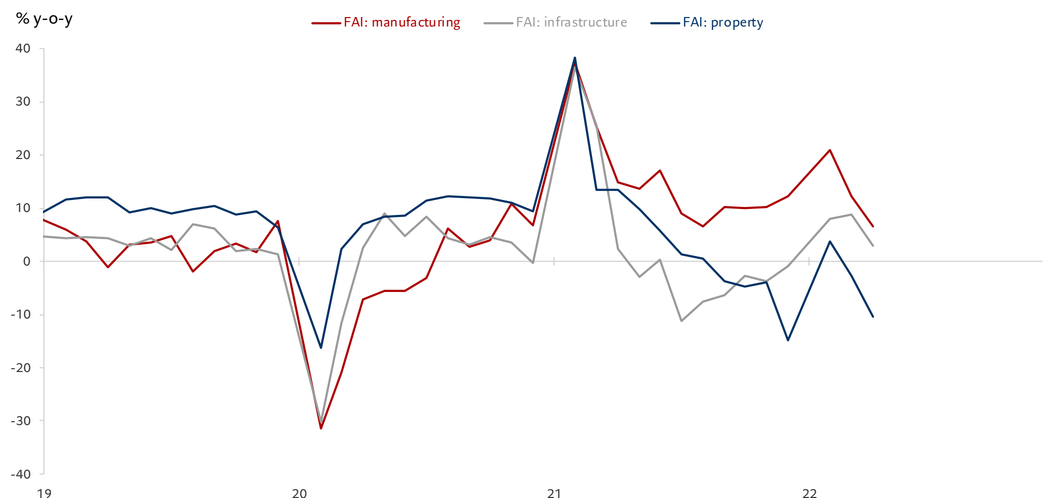
suggesting reluctance to resort to more aggressive monetary stimulus, possibly due to concerns about renminbi depreciation and capital outflows.

The PBoC has also introduced measures to support housing sales, including a 20 bps cut in the minimum mortgage rate for first-time homebuyers, followed last week by a 15bps reduction in the five-year loan prime rate (LPR), which serves as the benchmark for mortgage loans. While these measures could benefit new home buyers, we think the impact on the overall housing market could be limited. The property sector's current woes mainly stem from the acute liquidity problems faced by many property developers as a result of the introduction last year of tight regulations on leverage. A series of bond defaults by some highly indebted developers has sapped market sentiment. On top of that, the sector has been hurt by prolonged covid restrictions, which have limited household mobility and consumer demand. Hence, modest rate cuts are unlikely to lead to a strong rebound in housing sales, in our view.

On the fiscal front, the front-loading of government bond issuance has clearly supported infrastructure investment since the beginning of this year. However, momentum was broken in April by mobility restrictions and workplace closures, with investment growth dropping to 2.9% y-o-y in the infrastructure space, down from 8.1% and 8.8% in February and March (*Chart 3*).The slump in land sale revenues collected by local governments will likely further constrain infrastructure investment going forward.

Finally, while the Communist Party's Politburo at its April meeting promised to "promote healthy development of internet platforms", suggesting an easing of the regulatory crackdown on the tech sector, we are still awaiting policy follow-through.

CHART 3: GROWTH IN FAI BY SECTOR



Source: PWM - AA&MR, Wind, as of May, 2022

Zero-covid policy remains the dominant growth headwind

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Despite the mounting economic costs, the Chinese government reiterated its determination to stick to its zero-covid policy (ZCP) in a high-level meeting held recently. According to our estimate, regions that represent around 60% of Chinese GDP are still under various degrees of containment, despite the marked decline in new daily covid infection cases over the past week. Multiple high-frequency data also indicate persistent weakness in economic activity. For example, cinema box office sales dropped by 87% y-o-y (seven-day moving average, 7d ma) during the Labour-Day holiday week, while metro passenger (7d ma) in the eight major cities was only 50% of its 2021 level in mid-May. Social restrictions are only being lifted very gradually in Shanghai and some other cities, while restrictions have actually been stepped up in Beijing. In our view, while we may have passed the peak in strict lockdown measures, those still in place could mean the recovery in economic activity is slow.

In conclusion, while there have been some positive developments in terms of policy support recently, the modest scope of the policy stimulus announced so far could mean their impact is limited. More importantly, we have not seen any concrete evidence that the Chinese government is going to reverse its ZCP in the near term, with the possibility of repeated lockdowns given the highly transmissible nature of the Omicron variant. Hence, although we expect some sequential improvement in the economy in May after the slump in April, China's recovery will likely be slow and limited given the duration and intensity of restrictions. Consequently, we remain cautious on Chinese growth and have decided to lower our Chinese GDP growth forecast for 2022 to 4.0% from 4.5% previously.

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