China Watch

CHINA GROWTH – THIS TIME IT'S DIFFERENT

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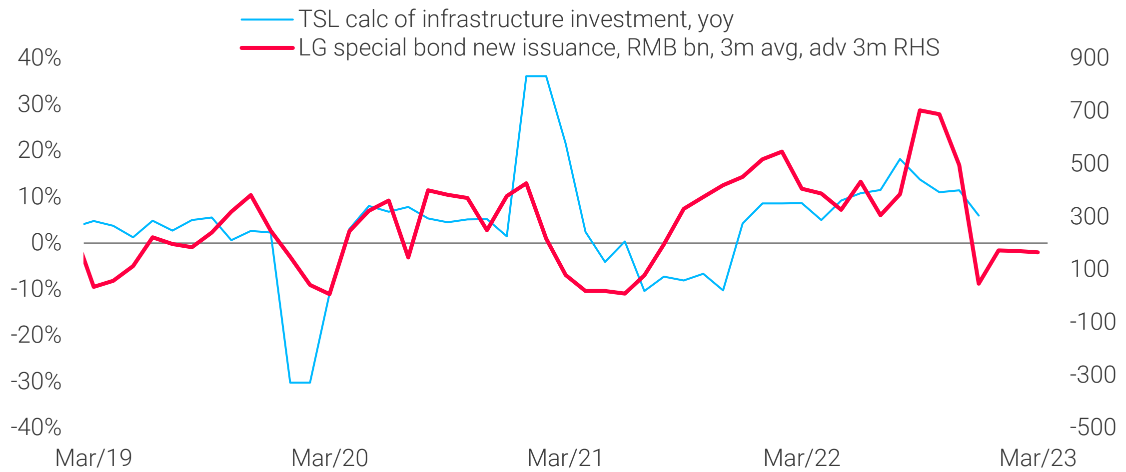
- **For the first time, consumers will lead China's recovery**
- **Investment drivers - property, manufacturing and infrastructure - are all on the back foot**
- **Growth in 2023 could be the least commodity-intensive for many years**

China is gearing up for what is likely to be its least commodity-intensive period of growth in many years. For the first time, a cyclical recovery will be led by the consumer, not by credit-fuelled infrastructure and property investment. Household spending – largely on services – will be the main driver of activity this year. Oil consumption will rise on increased mobility, but the recovery in crude imports will be curbed by industry, which accounts for some 40% of total usage. As for metals, slowing infrastructure and manufacturing FAI, together with still falling property investment, means imports will likely be flat to negative yoy. This is not a typical China growth story.

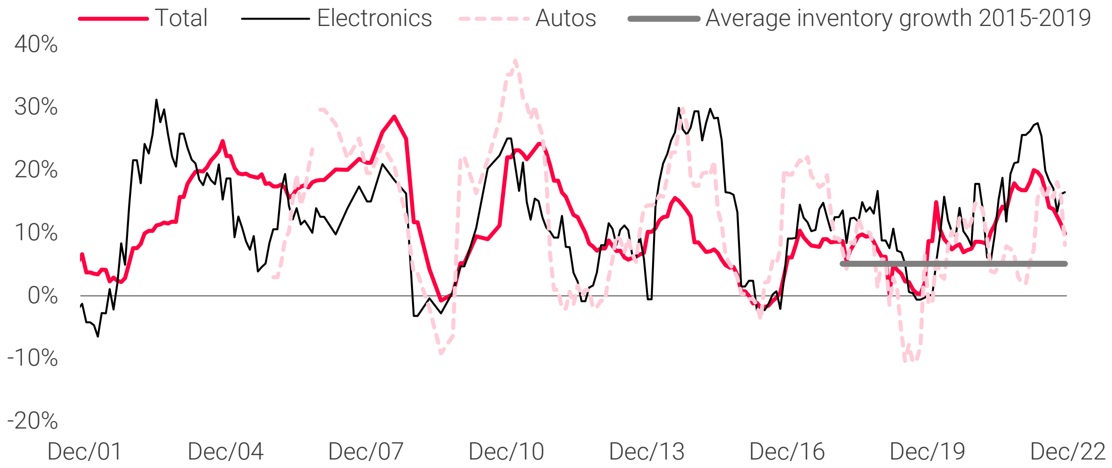
The troika of property, infrastructure and manufacturing FAI account for the bulk of industrial commodity demand. Of these, the last two have enjoyed significant above-trend growth for the past 12-24 months. Pre-Covid infrastructure investment growth averaged 4% yoy during the period 2018-2019, while it reached a high of 18.2% yoy in 2022 – the fastest growth rate since early 2017. Manufacturing FAI grew at 9.1% last year, which is 5 ppts above pre-Covid trend. Mean reversion is coming.

Chart 1: Infrastructure to return to trend



Sources: NBS, PBoC, TS Lombard.

Chart 2: Inventory build coming to an end



Sources: CEIC, TS Lombard.

Politics determines infrastructure spending and the messaging on fiscal and monetary policy suggests a supportive backdrop but no major stimulus campaign. Beijing and the MoF are signalling increased concern about local government debt risks. We think the headline fiscal stance to be announced at the National People's Congress in March will appear strong: we expect increases in the local government special-purpose bond quota – from RMB3.65trn in 2022 to RMB3.8trn this year – and the deficit to rise to 3.2%, up from 2.8%. However, much of the funding will go towards resolving local government debt. Beijing is opening the front door and closing the back one. With consumption driving growth, they are hoping to ease infrastructure spending and resolve some of the Covid-19 and property-related scarring of balance sheets. We think full-year growth of infrastructure spending will slow to 5% yoy.

Chart 3: Export led manufacturing boom coming to an end

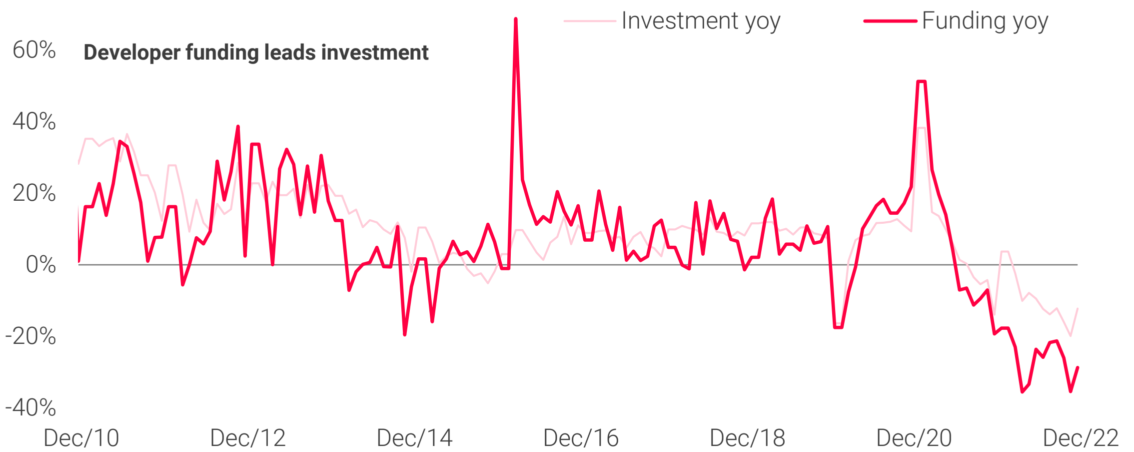
Sources: CEIC, TS Lombard.

Exports and profit growth lead manufacturing. Manufacturing has been one of the clear pandemic winners. While there may be much talk of de-/re-globalization, China exports are at record highs thanks to surging global goods demand. That spending is now clearly slowing: our economists for the US and the Euro Area forecast full-year growth of 0.8% and -0.1%, respectively. Global trade bellwethers Korea and Taiwan reinforce the poor outlook for goods. Rising domestic demand will keep factories going; but given high inventories, it is unlikely that 2023 will be another bumper year for manufacturing investment. We put full-year manufacturing FAI at 3% yoy.

Property is driven by finance in the short term, land supply in the medium term and demographics in the long term. Developer funding and demand projections lead real estate investment, with advanced sales still the key source of finance. For investment to recover, households need to buy the dip and/or Beijing must provide much more stimulus. Neither looks particularly likely: housing is still "for living in not for speculation"; and while support is steadily increasing, it is highly selective. By channelling funding to the largest developers, central authorities are guiding a consolidation of the supply side. This has significantly lowered the risk of a disorderly financial fallout but done little to address prospective home buyers' concerns. More policy attention is being directed towards the demand side, particularly mortgage rates; however the cost of financing has not been an issue, while price expectations and developer solvency remain key. Our base case is for a modest bottoming in sales on ultra-low base effects and reopening; while this will contribute to a relative improvement in investment, property sector FAI will still record a full-year contraction of 7% yoy.

All in all, the impact of the investment troika and by extension industrial metal demand look set to moderate in 2023 even as China reopens.

Chart 4: Property still far from a positive growth contribution



Sources: NBS, TS Lombard.