China | Economic outlook of 2024 and 5.2% conclusion of 2023

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China's 2023 whole year GDP announced today reached 5.2%, in line with our BBVA forecast and market consensus, which is much higher than 3% in 2022 when the country was still grappling with the Covid-19 pandemic. But considering the base effect, the 2022-2023 two-year average GDP growth dipped to 4.1%, significantly off the previous track of "higher-than-6%" before the pandemic time back to 2019.

China's 2023 Q4 GDP and economic activities, which are announced today as well, are also better-than-expected amid the recent policy support. The year-on-year growth rate of Q4 reached 5.2% y/y, higher than 4.9% y/y in Q3 2023, although the quarter-on-quarter GDP growth of Q4 somewhat moderated to 1% from 1.3% q/q in the previous quarter. Following 2023 Q3's recovery, it shows abundant bottomed-out signals after Q2's dipping. The recent economic bottomed-out are mostly supported by consumption (particularly service sector recovery), industrial production underpinned by policy priority of high-end manufacturing and green transformation, infrastructure investment backed by the extra RMB 1 trillion government bond issuance as well as the exports resilience.

However, look ahead towards 2024, we believe the ongoing recovery has not got a solid foundation yet as the deep adjustment of real estate market and local government debt overhang still remain the main risks and these two issues are highly correlated. In addition, deflationary environment and geopolitics risks will persist in the foreseeable future. That means, the weak market sentiments of households and enterprises have not been completely reversed entering into the new year of 2024. We currently maintain our 2024 GDP forecast at 4.4% (Bloomberg consensus: 4.5%, IMF: 4.2%) while we anticipate Chinese government will set the 2024 growth target to be "around 4.5 to 5%" for 2024 in March 2024 "two sessions". We also maintain our 2025 forecast at 4.2%.

Monetary and fiscal policy remain expansionary in 2024 to support growth recovery and to rebuild market sentiments. From the fiscal policy perspective, 2024 fiscal budget is expected to set at 3% in March "two sessions", while the actual 2024 fiscal deficit is anticipated to be 3.5-3.8%. In addition, most of the extra RMB 1 trillion special government bond issued at end-2023 will be deployed to stimulate infrastructure investment in 2024. Targeted tax cut and fee reduction are also anticipated together with the fiscal budget expansion. From the monetary perspective, we anticipate the PBoC to conduct another 2 RRR cuts and 1-2 LPR cuts after FED initiates to cut the federal fund rate. Although deflationary environment provides room for easing monetary measures, monetary policy will be more targeted easing instead of universal easing and more quantitative tools will be applied.

Risks in 2024 in China focus on real estate market, local government debt, supply chain relocation outside China (see our recent Economic Watch: China | Should we worry about the falling FDI?) and geopolitics, but we think the systemic financial risks do not exist in China at the current stage , given the prudent monetary policy and a series of precautionary financial regulation measures. Housing market remains the top priority of the risk, while policy support in both supply side and buy side of housing sector will continue. These policy support not only include lowering existed mortgage's interest rate, lowering down-payment ratio and ease the conditions for 2nd housing purchase in various cities, etc. from the demand side perspective, but also include carefully managing the default cases of developers and promulgating favorable policy to enhance developers' financing ability from the supply side.

Regarding geopolitical risk, China-US confrontations have achieved some marginal improvement recently amid the high-level China-US communications including the visit of Yellen, Blinken and Kissinger to Beijing, Xi-Biden talk in APAC meeting, etc., but the newly elected Taiwan's president and this year's US president election provides a lot of uncertainties for China-US relation going forward. In the long term, the trade war, tech war and finance war with the US will remain.

Here are some analyses in more details regarding the Q4 GDP and the December economic activities:

On the supply side, the year-on-year growth of industrial production accelerated to 6.8% y/y from 6.6%, higher than the market consensus at 6.6% y/y. But its seasonal adjusted m/m growth moderated to 0.52% m/m from 0.87% m/m in the previous month.

By categories, the pillars of China's industrial production are the green economy transformation sectors, the highest growth among them is the EV cars which achieved 43.7% y/y (prior: 35.6% y/y), favored by the national policy support of green transformation and high-end manufacturing. Following EV is solar lithium battery which recorded 35.7% (prior: 44.5% y/y) growth, solar electricity generation 17.2% (prior: 35.4% y/y, in line with the policy initiatives of nation's 2060 carbon neutrality target.

On the demand side, December retail sales also surprisingly declined to 7.4% y/y from 10.1% in the previous month (market consensus: 8%), although the month-on-month growth accelerated to 0.42% from 0.09% m/m in the previous month. The slowdown of retail sales is multi-faceted: the "salary cap campaign" in financial sector and other related sectors together with high unemployment rate in young age group dampened the sentiments of consumers, the wealth effect of dipping housing price and stock price etc. In addition, the retail sales recovery is unbalanced which is tilting toward service sector and non-durable goods but not for durable goods.

By component, the largest growth of retail sales is restaurant sales which achieved 37.7% y/y (prior: 25.8% y/y), the highest among all categories, reflecting that consumers' pent-up demand of outside dinning activities from the three-year lockdown still remains the main support of retail sales. Following that is clothing and textile which achieved 26% (prior: 22%), physical and entertainment products 16.7% (prior: 16% y/y), tobacco and wine 8.3% (prior: 16.2%), jewelry sales 29.4% (prior: 10.7% y/y), while automobile sales significantly moderated to 4% (prior: 14.7% y/y). That means, consumption recovery is happening mostly in service sector and non-durable goods, but not significant in durable goods. (Figure 4)

Also from the demand side, fixed-asset investment (FAI) marginally picked up to 3% ytd y/y from 2.9% ytd y/y previously (market consensus: 2.9% ytd y/y), while its month-on-month growth decreased to 0.09% m/m from 0.21% m/m. The main drag of FAI remained the very sluggish housing investment in December at -9.6% ytd y/y from -9% ytd y/y in the previous month.

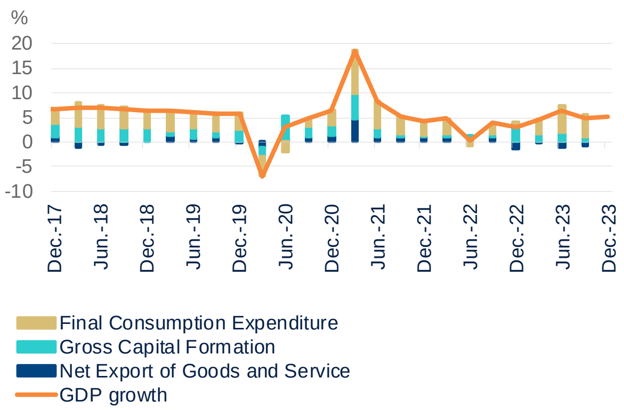
By components, infrastructure FAI which is supported by easing fiscal measures (such as RMB 1 trillion extra government bond issuance at end-2023) reached 5.9% ytd y/y, while the manufacturing FAI improved to 6.5% from 5.8% ytd y/y surpassing infrastructure investment, showing resilience of China's manufacturing sector and the exports sector. However, the multiplier effect from public FAI to private FAI is still very weak, dragged by weak sentiments of private enterprises after experiencing 2021 regulatory reforms and the ongoing housing market crash. (Figure 2 and 3)

Going forward, the real estate sector remains the main drag on growth and seems to need more time to achieve a soft-landing. (See our previous China Economic Watch: China | Real estate sector needs a soft-landing) However, we have to realize that the current round of real estate crash is driven mostly by supply side but not the demand side. The default cases of Evergrande and Country Garden Holding, the largest China's real estate developers, indicate the intrinsic vulnerability and unsustainability of China's real estate developers' business model with very high leverage. This is a typical supply issue. On the demand side, housing demand in particularly in tier-1 and tier-2 cities remains strong but overcapacity indeed remains in small cities. Look forward, we anticipate more supportive moves to circumvent the adverse spillover effect of the large private developers' default risks to other upstream and downstream sectors which will help to underpin market sentiments.

In sum, the recent December economic activities together with 2023 Q4 GDP sent out a series of bottomed-out signals amid the recent monetary and fiscal policy stimulus, which seems to suggest that the worst time has already passed back to Q2 2023. However, we cannot ignore that the Chinese economy still faces a series of challenges going forward, chief among them is the deep adjustment of real estate market, local government debt overhang, deflationary environment and geopolitical risks. Thus, there will still be a long haul to sustain a robust growth momentum and to reverse the market sentiments going forward. The key point to reverse the current situation, we believe, is to implement larger-scale monetary and fiscal stimulus at the central government level instead of at the local government level, such as the recently announced extra RMB 1 trillion fiscal expansion and the expected interest rate and RRR cuts, giving the room for FED interest rate cut in 2024 considering RMB exchange rate depreciation, capital outflows and FDI falling.

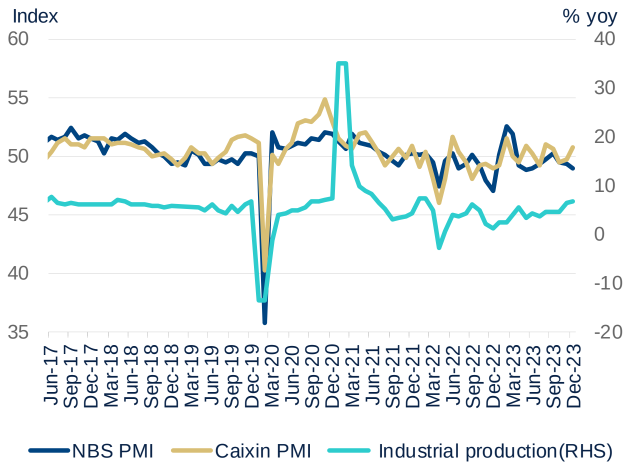
Based on the above, we believe Chinese economy could achieve soft-landing in 2024 with some limited and marginal bounce-back of the real estate sector. In the new year, how to reverse the real estate malaise and to balance stimulus measures and financial stability, is always a constantly challenging job for Chinese authorities.

Figure 1. **2023 Q4 GDP PICKED UP TO 5.2% Y/Y FROM 4.9% IN Q3**



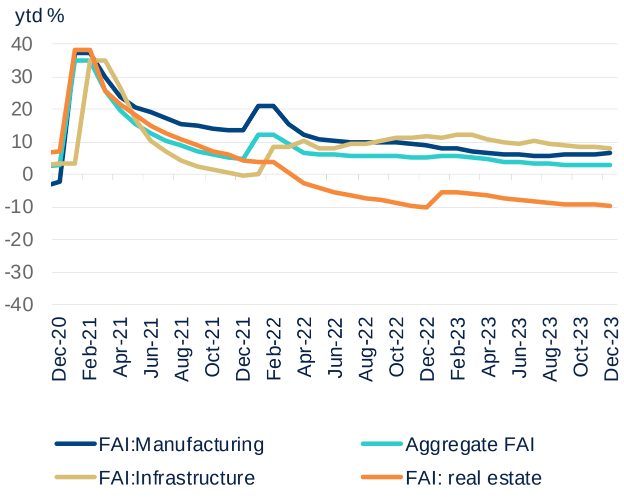
Source: CEIC and BBVA Research

Figure 2. **INDUSTRIAL PRODUCTION IMPROVED IN DECEMBER SUPPORTED BY EV PRODUCTION AND OTHER GREEN TRANSFORMATION SECTORS**



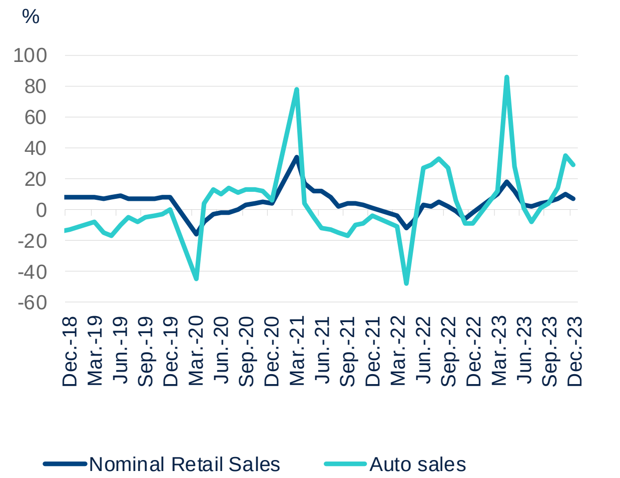
Source: CEIC and BBVA Research

Figure 3. **REAL ESTATE INVESTMENT REMAINED THE MAIN DRAG ON FAI**



Source: CEIC and BBVA Research

Figure 4. **RETAIL SALES MODERATED IN DECEMBER TOGETHER WITH AUTO SALES**



Source: CEIC and BBVA Research

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