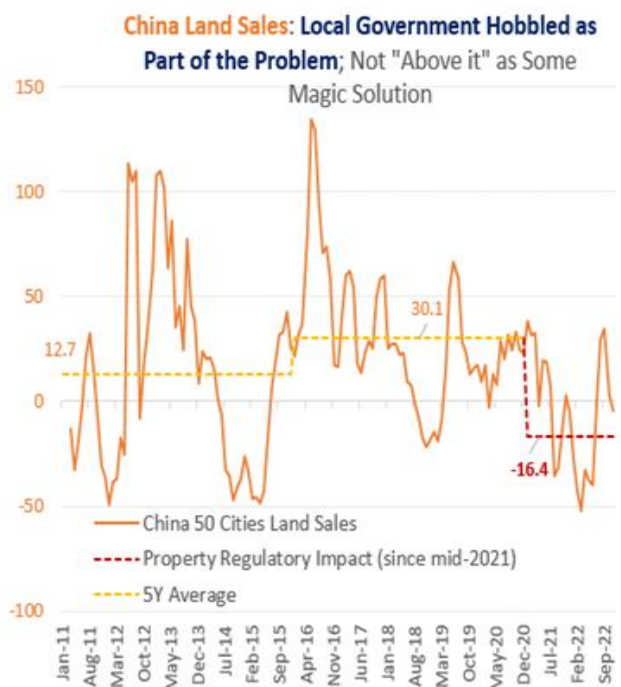
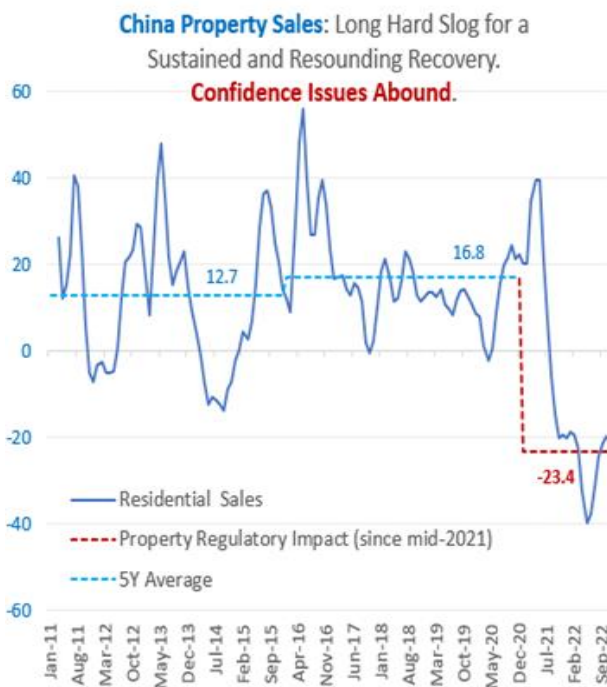
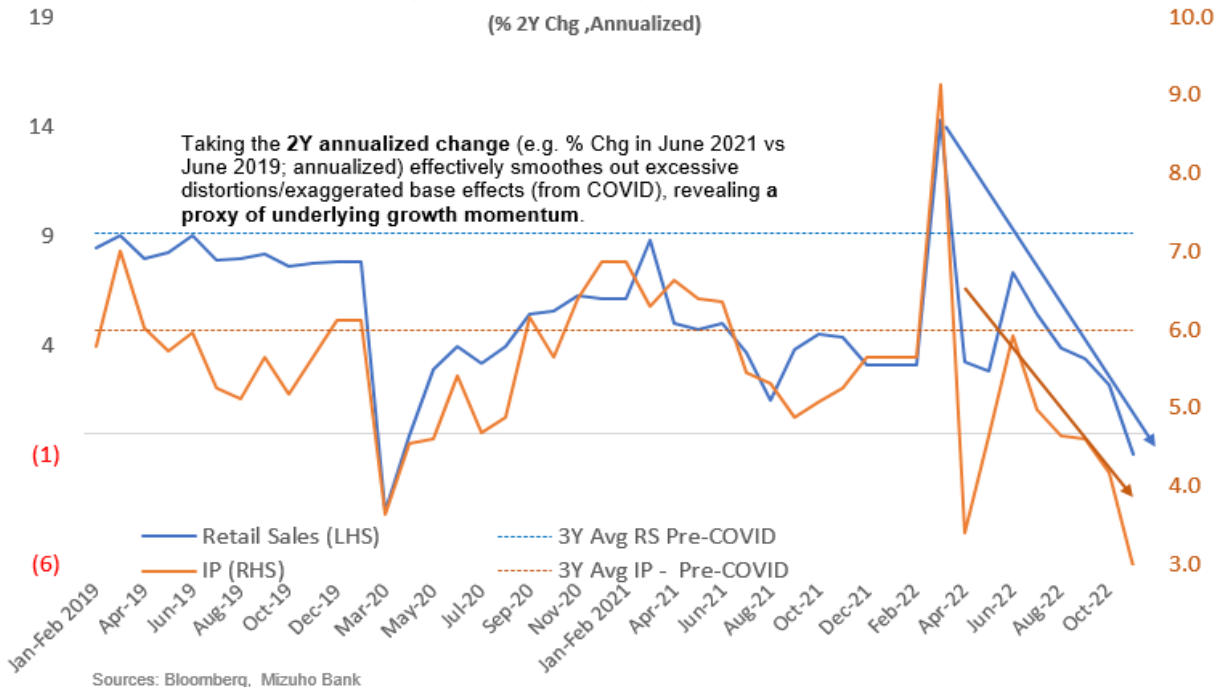


China Outlook: Bumpy, Not Unbridled, Recovery

China's Demand- & Supply-side Growth Drivers Have Decelerated Sharply. Overhang from Regulatory/Policy Risks May Outweigh Impending Cyclical Pick-up; as Structural Impediments Assert



"I'm afraid, my dear Watson, that most of your conclusions were erroneous" - Sherlock Holmes

In a Nutshell: At the **Central Economic Work Conference (CEWC*)**, Beijing declared **unambiguous desire to get economic growth purring on all cylinders**; led by *re-opening* based on dismantling “Zero-COVID”, a suite of property market backstops and *ambitions to boost consumption*. The intent is unmistakable. And encouragingly, the policy initiatives are mostly aligned, if not aptly accentuated.

Nonetheless, the risk is that China will be **hobbled by a bumpy ride out of subpar ~3% growth, not ordained for unfettered acceleration** back above 5%. In *Sherlock Holmes’ words*, *optimists finding cheer in China stimulus hopes are erroneous in thinking it will offset wider risks*. Simply because **cyclical tailwinds from re-opening are constrained** by a “worse-before-better” gestation for “herd immunity”; especially as *confidence deficit hampering a restoration of robust growth multipliers*.

Crucially, **potential growth is also impaired by a conspiracy of structural impediments** such as; i) *gathering geo-political headwinds* (e.g. broadening chips embargo); ii) credit restraint required to check *inherited financial stability risks* and; iii) inevitable *social stability trade-off* imposed by “Common Prosperity”, which is an existential necessity for the Chinese Communist Party. We expect after risks of slipping below 3% growth in 2022, **China’s growth momentum may still fall short of exceeding 5% (at 4.8%) as global headwinds look set to impede in H2.**

Quantity & Quality!

To be sure, the communique from the **CEWC left no doubt** about the **desire, if not necessity, to boost absolute headline growth**. Expressly flagging “*quantity*” over and above what has been a common allusion to “*quality*” of growth suggests a keen awareness to lift the economy from an essentially depressed state. **After a dismal year** of growth threatening go sub-3%, **importance is understandably accorded to baseline quantum of growth**. And so, Beijing is likely to restore growth to “around-5%”.

But **not be at the cost of “quality”**. Specifically, the **binding constraint from financial stability risks suggests more targeted credit channelling to highly-productive, value-add industries**. And so, *pulling all stops to revert back to mainly construction/housing driven gains will not be the play book either*.

Consumption

Instead, it is telling that **boosting consumption gained notable prominence** on the economic policy agenda. Notably, boosting **consumption is the end-objective of “Common Prosperity”** and **critical to** (at least one half of the mechanism for) “*Dual Circulation*”. But for now, the consumption focus is arguably to **ensure that confidence crushed by COVID is restored**.

Exiting “Zero-COVID”

And so, consumption boost objectives are *coupled with treatment-driven management of COVID*; rather than zero infections goals, which have come at hefty economic and social cost. The plan to “*optimize COVID policy in a timely way*” towards a “*new stage*” is **essentially alluding to exiting Zero-COVID policy to rebuild business/consumer confidence**.

Restoring “Animal Spirits”?

Interestingly, despite “*Common Prosperity*” objectives **buried in the consumption, wage, property and social guidance**, **care to avoid express allusions** to the slogan *speaks to sensitivities about the private sector fears of “anti-market” agenda*. Instead, in the context of **assurances of supporting development of private sector and SOEs**, the **desire to convey a market-friendly economic approach to reignite “animal spirits” is evident**.

Moreover, **roping in tech/platform firms to boost employment and the economy** hints at a back-down from uncompromising regulatory crackdown that had chilled confidence and investments; to the detriment of growth. Whereas, *a mutually beneficial private-public sector growth boost is being implied.*

Property Backstop, Not "Boom Town"

That said, the **adherence to "housing is for living, not speculation"** refrain **suggests** that the 16-point plan comprising **emphatic liquidity backstop for the property market** is to **avert a crash and manage a soft-landing**; and **not ignite a boom that perils financial and wider economic stability**. This **inherent restraint is prudent, but nevertheless may inadvertently impedes buyer confidence**. And so, ultimately, property market measures buy time rather than ensuring a durably and convincing turnaround.

Confidence is Pre-condition, Not Panacea

All said, assurances aimed at **confidence restoration** in the private sector via COVID, economic and regulatory channels is *as evident as it is welcome*. But while these policy efforts are **critically necessary for**, they may **not be sufficient to, rapidly and resoundingly get China's growth back to rude health**. And not the least because **confidence takes time to recover**. Consequently, **growth multipliers may be subdued** initially, thereby *holding back the extent of economic boost from policy stimulus*.

Cyclical Constraints

What's more, **cyclical tailwinds from re-opening may inadvertently by somewhat more diminished, and likely delayed**. Certainly **not as imminent and as "big bang"** as fervent optimists might want to believe. For one, between vaccinations and herd immunity a flare-up in infection, potentially exacerbated by winter and Lunar New Year travel, will almost surely interrupt and diminish the re-opening boost that may be expected. And in any case, looking past pent-up activity, *restoration of pre-COVID demand rather than unbridled acceleration to uncharted levels of activity is the baseline*.

Structural Impediments

Crucially, a conspiracy of **structural impediments** also cast a shadow on the efficacy and durability of intended policy boost. The most prominent of these structural challenges, apart from demographics and attendant productivity constraints being; i) *gathering geo-political headwinds* (comprising, but not limited to a broadening chips embargo) that threaten to drag on industrial gains alongside; ii) the *binding limitation to credit growth imposed by financial stability risks* amid elevated debt levels and; iii) *mounting socio-economic trade-offs* imposed by "Common Prosperity" initiatives (that the political leadership likely consider as an existential necessity) stifle capacity for unfettered economic rebound.

Silver Lining, Not Bullet

The upshot being, even as markets cheer re-opening and are seduced by CEWC suite of economic stimulus (details expected in 2023), China's prospects may be hobbled; as re-opening and stimulus are mere silver linings, not silver bullets to gathering global headwinds and China's deep-seated structural challenges. And so, overly optimistic assumptions of linear acceleration need to be reined in to reflect realities of a **bumpy recovery that is not immune to – much less capable of offsetting – global recession risks**. As such, *while policy is directed as boosting growth above 5% in 2023 (after a 3% run in 2022), global headwinds picking up distinctly in H2 may tilt growth a touch below at around 4.8%*.

* Typically, the annually-held CEWC unveils the major economic objectives/policies for the year ahead. As such, presents a reliable guidance of policy focus and aspirations (which may be less obvious). And at this year's CEWC, which wrapped up on 16th December 2022, the intent to revive headline, consumption-driven growth boost is evident.

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