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# 4Q2022 Macro Outlook: No Course Correction

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## 4Q2022 Key Takeaways:

- On the back of a lackluster 3Q recovery, 4Q growth isn't likely to improve. We expect 4Q y-o-y growth to come in around 3%.
- Labor market and household savings trends continue to show weakness, suggesting meek consumption in the near term.
- Moreover, stimulus already peaked in 3Q and will not be a contributor to growth through the end of year.
- Although politically significant, the 20th Party Congress is peripheral to 4Q economic outcomes. In particular, it will have little impact on Zero Covid or property policies.

Although the Chinese economy saw a modest rebound in 3Q2022, the true extent of recovery is less than meets the eye, which can be seen in labor market conditions and household confidence. Meanwhile, a challenging external environment will likely lead to a deceleration of export growth, just as the US Federal Reserve's monetary tightening is hindering Beijing's ability to ease further.

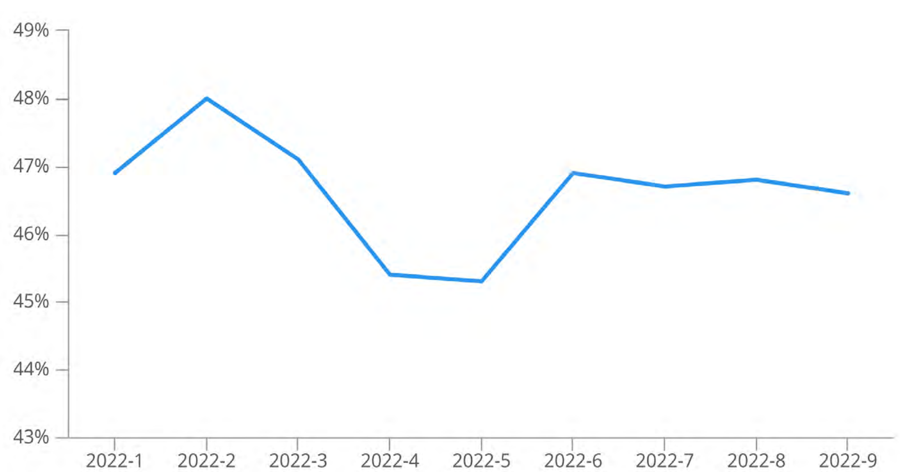
While the 20th Party Congress' political outcome is still being digested, it will have negligible impact on 4Q economic prospects. That's because a course correction on Zero Covid isn't forthcoming, which means the biggest constraint on growth will remain in place. As a result, the Chinese economy will continue to underperform into early 2023, with 4Q growth likely to be ~3%.

## Lackluster Recovery, Persistent Weakness

The improvement in headline economic indicators over the summer, including unemployment, masked labor market weaknesses. Despite 3Q GDP growth of 3.9% and headline unemployment rate remaining static at 5.5%, true unemployment is likely worse. During economic slowdowns, China tends to understate the unemployment rate because it doesn't account for migrants and recent graduates who have left a weak job market. By not counting these groups of workers, headline unemployment can appear lower than in reality.

Conversely, rural migrant unemployment remains moderate because most unemployed migrant workers leave cities to find work back home. It is no surprise that the employment component of the services PMI was subdued during 3Q—since migrant workers tend to be concentrated in services—an indication of further contraction in hiring (see Figure 1).

**Figure 1. Services Employment Keeps Getting Worse**



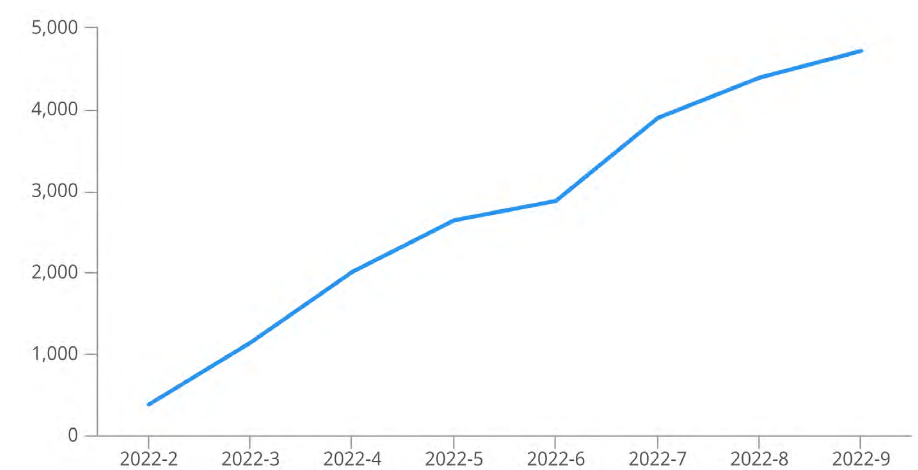

Note: Below 50 indicates contraction.

*Source:* National Bureau of Statistics.



Beyond the weak labor market, Chinese households and the private sector continue to deleverage. Despite slower income growth, which is only 3.2% after accounting for inflation, households' year-to-date savings are 4.4 trillion yuan (~$630 billion) higher than over the same period in 2021 (see Figure 2). That Chinese households are now saving a bigger share of a smaller pie indicates that their confidence remains low.

**Figure 2. Elevated Household Savings (billion yuan)**




*Source:* Wind.

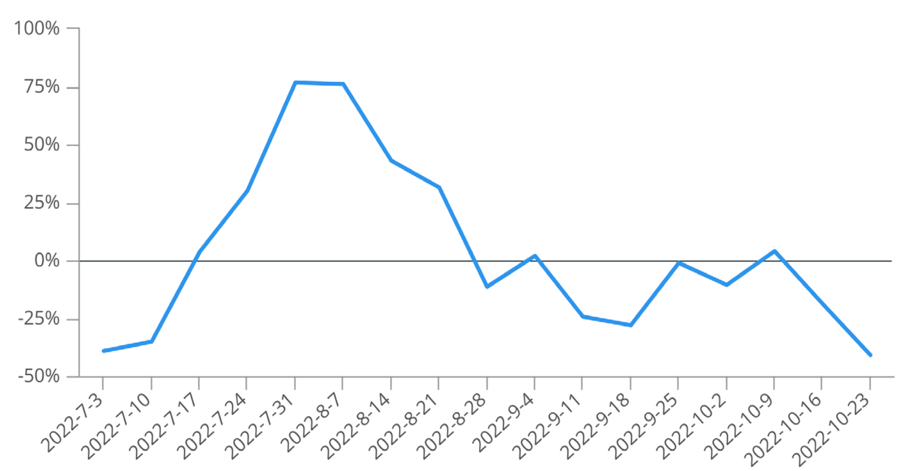
The private sector, too, continues to be in distress with little help in sight. Not only has industrial firms' profit growth fallen-8.3% so far this year, private firms are spending more on servicing their debt than investing into their future. Indeed, the private sector has only borrowed 105 billion yuan ($15 billion) since June but has repaid 190 billion yuan ($27 billion) of debt over the same period.

*Stimulus losing momentum*

On top of weak private consumption and investment, two more factors will exacerbate downward pressure on growth: Beijing's stimulus running out of steam and the softening of exports.

Even as Beijing disburses another 500 billion yuan (~$71 billion) of fiscal stimulus, its total 4Q fiscal spending is nonetheless expected to be at least 900 billion yuan (~$128 billion) smaller than in 4Q2021. An additional factor that weighs on the fiscal picture is the continuing decline of land sales since 2H2021, which will likely contribute another 500 billion yuan (~$71 billion) to the revenue shortfall (see Figure 3).

**Figure 3. Land Sales Growth Contracting at More Than 20% (y-o-y)**

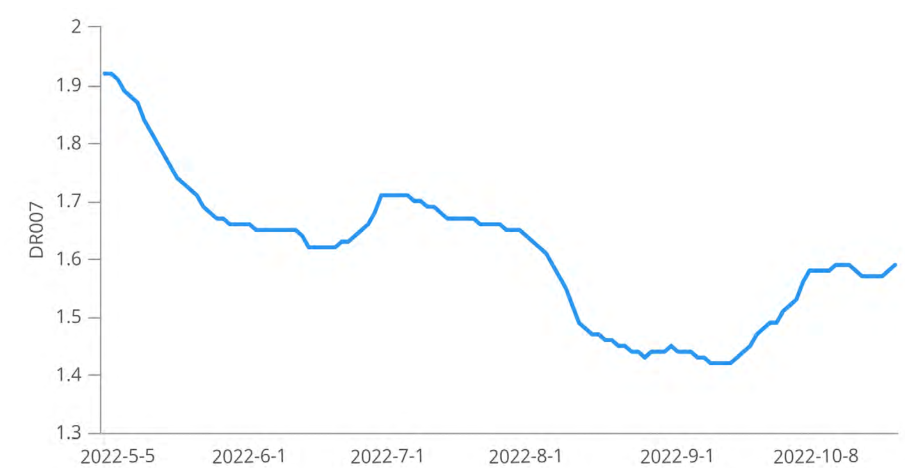



Note: The notable bump in July and August can most likely be attributed to "fake" land sales to local government financing vehicles (LGFVs) to exaggerate local revenue. Beijing has apparently caught wind of such practices and has recently warned local governments against manipulating land sales.

*Source:* Wind.

Meanwhile, monetary easing has already peaked. Since late August, the People's Bank of China (PBOC) has been gradually raising the short-term interest rate. For instance, the seven-day collateralized borrowing rate (DR007) for banks, a proxy for liquidity conditions, is now about 60 basis points higher than its August low (see Figure 4). And even if the PBOC can continue easing, it is not clear that it should do so in an environment of aggressive tightening by the US Fed, which could trigger disorderly yuan depreciation a la 2015.

**Figure 4. Peak Monetary Easing Already Reached**




Note: DR007 is the interest rate on seven-day repos with rate securities as pledges for deposit-taking institutions in the inter-bank market.

*Source:* Wind.

Finally, exports is also at risk of losing momentum, particularly as recession concerns pervade Western markets. China's export growth has slowed sharply from 17.9% to 7.1% between July and August, while the container freight index shows that shipping cost has fallen by nearly 30% since summer, indicating gloomier months ahead for exports.

## No Near-Term Course Correction on Covid and Property

While many are understandably poring over 20th Party Congress documents and speeches for clues on the economy, near-term economic policy will be determined elsewhere. As politically consequential as the Party Congress is in setting an overall direction, it is just that: a political event. Concrete decisions on the economy likely won't take place until the Central Economic Work Conference in December.

Those decisions include Zero Covid and supporting the property sector, which will determine the extent of pessimism or optimism on 4Q growth and into 2023. While it is possible that Beijing will prepare to shift from "politics first" to "economy first" now that the Party Congress is over, expectations of a pivot on Zero Covid and property should be tempered.

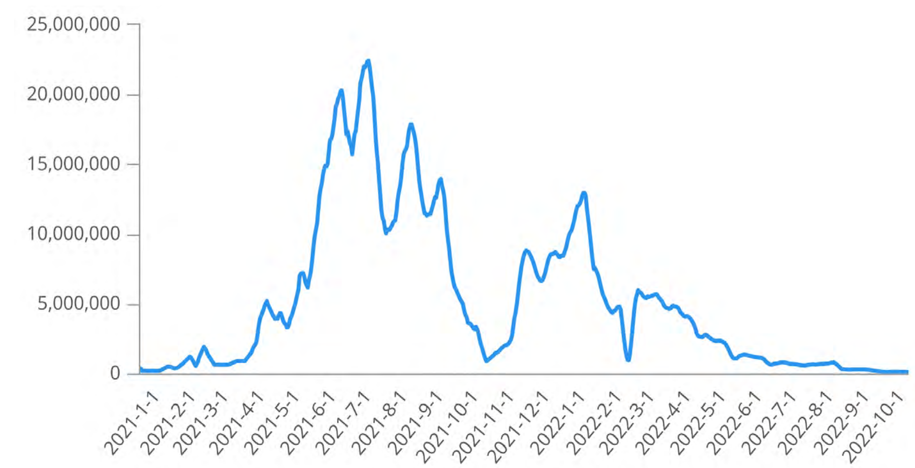
That's because practical difficulties of shifting to a co-existence approach on Covid, as well as residual political considerations, will continue to prevent Beijing from adopting a more growth-friendly posture. To be sure, Beijing will likely reassess Covid's public health threat and could begin relaxing around the margins, such as less stringent travel restrictions and quarantine, especially as President Xi Jinping and other top leaders are travelling internationally. But that is still a far cry from decisively moving to co-existence.

To execute such a Plan B requires complex preparations and public messaging, involving much higher vaccination rates, an effective booster shot, potentially importing foreign mRNA vaccines, and upgrading health facilities in rural areas.

So far, Beijing has not moved meaningfully on any of those fronts, with daily vaccinations in the low six figures, or less than 1% of its peak level (see Figure 5). When it comes to resourcing its hospitals to handle a surge in cases, Beijing has been subsidizing equipment purchases. But this program so far seems perfunctory and is voluntary, which means hospitals can choose to not upgrade their equipment. If Beijing were serious about preparing China for coping with Covid, it would more aggressively pour resources into hospitals and make the equipment upgrades mandatory.



**Figure 5. China's Daily Vaccination Now at a Record Low**




*Source*: Wind.

*Property will remain a drag on growth*

The Chinese government has been trying to stabilize the property sector by cutting mortgage rates and relaxing property purchase restrictions. While that may buy Beijing some time, the outlook on property remains rather grim because of the lack of demand and of household confidence in the economy.

Reversing that sentiment requires a significant policy adjustment that might be even more difficult than shifting from Zero Covid. The issue at hand isn't what to do but whether the new leadership will make a political decision to bail out private developers. Without a large-scale rescue package for private developers, which account for some 70% of property sales, the sector isn't likely to recover soon.

A private-sector bailout of this magnitude would be unprecedented, so it's understandable why Beijing has serious reservations about taking such action. In the immediate aftermath of the Party Congress, there is even less political appetite to make such a bold move, particularly as the new leadership is preoccupied with other priorities such as forming the new government.

As such, private developers will be hung out to dry. In such an environment, even the healthiest private developers will want to conserve cash rather than make new investments, leaving the property sector in the doldrums.

## Risks Building

With stimulus petering out and the absence of a reset in Beijing's public health approach and macroeconomic policy, growth will likely deteriorate in coming months. Because the barriers to adjustment are high in the near term, the Chinese government will have little choice but to accept another quarter of subpar economic performance.

The risk is that Beijing becomes accustomed to muddling through and overly complacent about its ability to weather economic downturns. Financial vulnerabilities are accumulating, as there are signs that the property fallout is distressing local government and regional banks' finances. For example, Lanzhou, the capital of Gansu province, recently defaulted on its LGFV bond.

Rather than dissipating, these challenges are likely to intensify instead. That means Beijing's delay in making some tough decisions on the economy will only exacerbate these risks going into 2023.