保尔森基金会
PAULSON INSTITUTE

MACRO POLO

1Q2023 Macro Outlook: Post-Covid Rebound Dramatic but Short

Houze Song

1Q2023 Key Takeaways:

- Contrary to some views, we believe the economic rebound will be most impressive in 1Q2023 and then peter out later this year. Put differently, we expect a "square root"-shaped growth (√) in 2023.
- Domestic and external constraints on the usual growth drivers—investment, exports, consumption, and stimulus—will likely generate stronger headwinds to growth than currently expected.
- In particular, the supposed "revenge spending" will likely have a modest impact on growth, as spending down excessive savings won't have an outsized effect on boosting consumption.
- Fundamentally, Beijing appears unwilling to do much more beyond lifting Zero-Covid to buoy growth, so it is likely to set a more realistic growth target of ≤5.5% in March.

While consensus has priced in a 2023 economic rebound, we differ in that we expect an early and dramatic rebound in 1Q2023 that will then moderate for the rest of the year. This is largely because we believe the worst is already behind us when it comes to China's surprising 180-degree turn on Zero Covid, with negative impacts on the economy concentrated in 4Q2022.

Official statistics put quarter-to-quarter growth in 4Q2022 at 0%. But because consumption and the trade surplus both contracted in 4Q, while investment was flat, growth may have actually dipped into negative territory.

Since then, transport data has rebounded strongly, suggesting the first wave of infections has peaked. Judging by China's past experience of re-opening, the initial economic recovery tends to be strong, which is another reason we expect the majority of the damage from the late 2022 lockdown to be undone by the end of 1Q2023.

Looking ahead to the rest of the year, however, we exhibit more caution on growth prospects. We are not as convinced of the consumption boost story resulting from households spending down excess savings. Other growth drivers, too, will be constrained by both domestic and global factors.

Moreover, now that Beijing has gotten rid of the biggest constraint on growth, Zero-Covid, it expects the economy to bounce back without other interventions that could exacerbate debt risks. Since the central government does not seem willing to go the extra mile on stimulating the economy, it will likely set a more realistic rather than ambitious growth target of ≤5.5%.

As such, our bullishness on a strong first quarter won't necessarily endure for the rest of the year. It is more likely for the economy to stall in the second half so that it ends up with a square root-shaped growth for 2023.

First Wave of Infections Peaked

The first wave of infections was intense but relatively short-lived. Based on various leaked estimates, more than 250 million Chinese were infected within the first 20 days of December, while major provinces like Henan and Sichuan likely had as much as 80% of their populations infected by early January. Independent estimates based on internet search of Covid-related terms appear to corroborate these leaked estimates.

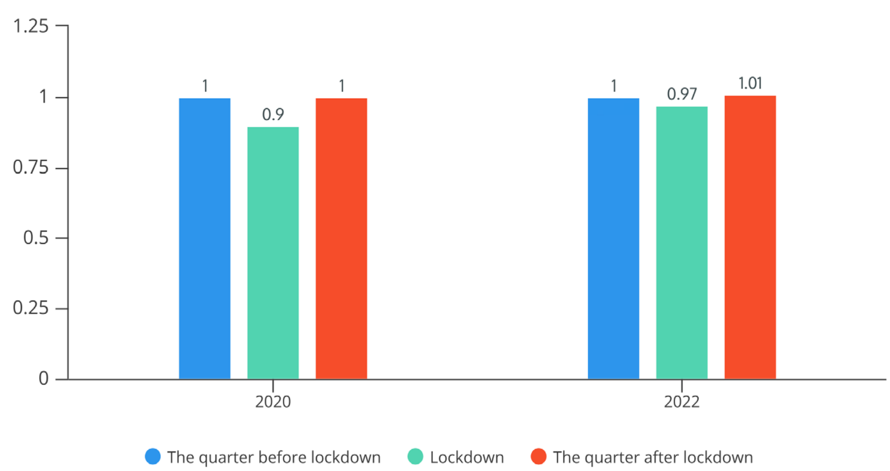
It is reasonable to assume, then, that we are well past the peak of the first wave. And the high percentage of infections could lead to herd immunity faster, potentially moderating future waves in 2023. Public transport data reinforce the observation that most of urban China has been normalizing since late December (see Figure 1).

Figure 1. Subway Ridership Rebounds Significantly Across Major Chinese Cities (millions/day)

Source: Wind.

With the chaos of rapid re-opening behind us, 1Q should see a dramatic rebound. This is both because of the low-base effect and based on experience from past re-openings. During both the 2020 and 2022 re-openings (after the Shanghai lockdown), the economy returned to its pre-lockdown level within a quarter (see Figure 2).

Figure 2. Post-Lockdown Rebounds Tend To Be Strong (GDP level before lockdown = 1)



Source: National Bureau of Statistics (NBS) and MacroPolo.

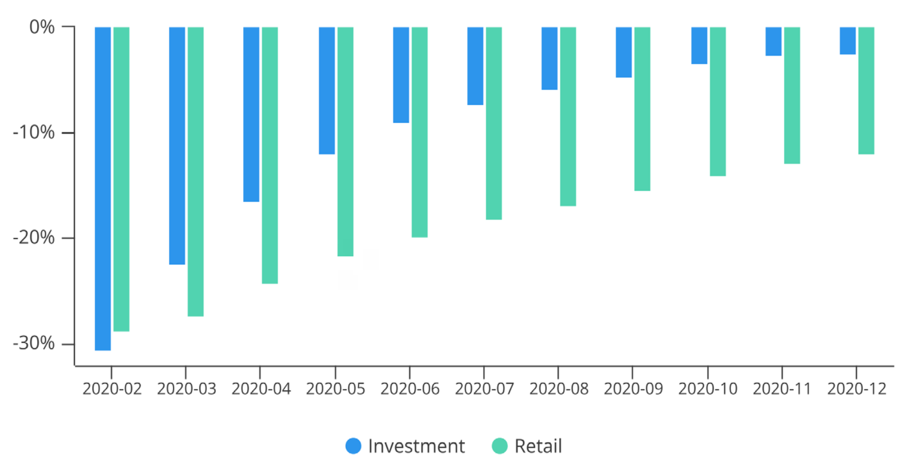
We think 1Q recovery will be similar to, if not better than, previous recoveries for several reasons. One, the high rate of infections means that most people are less fearful of reinfection and will engage in more economic activities. Two, unlike previous re-openings, all Covid-related restrictions have been lifted, such as those on small businesses like restaurants. Three, an earlier Lunar New Year means that economic activity can return to normal by early February, providing additional support for 1Q growth.

Growth Drivers Won't Rev Up Much

But we'd caution against being taken away by what is expected to be a very good first quarter. The picture looks different for the rest of 2023 because growth drivers—consumption, investment, and exports—won't be particularly supportive.

China's consumption will likely underperform in 2023 like it did during the economic recoveries of 2020 and 2022. It is hard to find the fabled "revenge consumption" in the data, as investment recovered much faster than retail during the previous re-openings (see Figure 3).

Figure 3. Post-Lockdown Consumption Has Been Weak (% y-o-y growth)



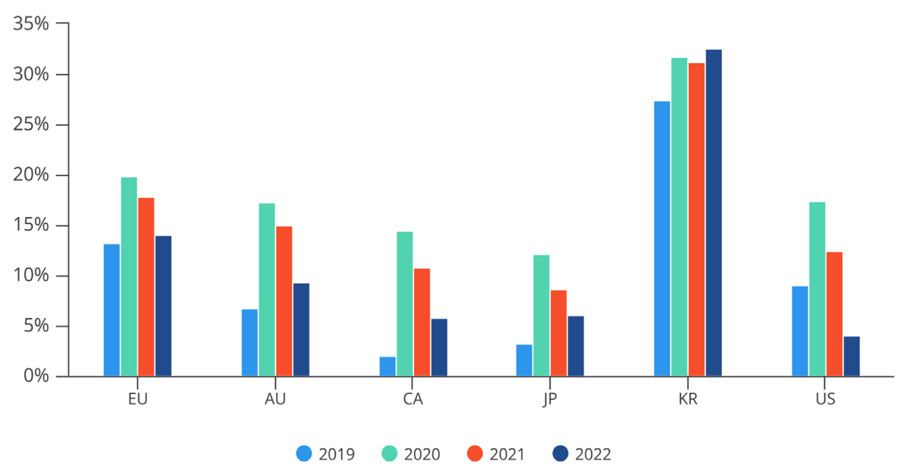
Note: Zero means growth rate is same as previous year, or full recovery.

Source: NBS and MacroPolo.

We are also skeptical of the unleashing of Chinese households' excessive savings accumulated in 2022. For one, excess savings are likely not nearly as high as the $1 trillion some have claimed. Rather, based on household surveys, excess savings last year was more likely in the ballpark of $400 billion, or roughly 2% of GDP.

International experience has also shown that household savings rates don't drop precipitously after re-opening (see Figure 4). Similarly, during China's 2020-21 re-opening, its household savings rate didn't drop to pre-pandemic levels until mid-2021. This means that it will likely be many months before households begin to spend excessive savings.

Figure 4. Household Savings Rate Remains Elevated Post-Pandemic (%)



Note: EU and South Korea data are averages through 3Q2022.

Source: OECD; Statistics Korea; and Wind.

In fact, among advanced economies, only the United States has seen a strong post-pandemic rebound in consumption. But there's strong evidence that the US consumption boost was a direct outcome of generous federal fiscal transfers rather than spending down excess savings.

But no such fiscal transfers are likely in the cards for China. Nor will there likely be significant fiscal spending to bolster investment. Beijing has been telegraphing the message that it has already done more than its fair share of supporting the economy and wants to focus on fiscal sustainability. As a result, we believe both fiscal stimulus and property, which together account for more than 70% of investment, are unlikely to offer much boost to growth.

Debt continues to weigh on property developers. While the flurry of measures announced to stabilize the property sector is positive, these measures will have negligible impact on driving investment. Developers will need to prioritize servicing their debt instead of investing in new projects.

When it comes to exports, the demand for Chinese goods is rapidly declining. Outbound shipping cost, a proxy for export demand, is now falling like a rock. With a global recession still more likely than not in 2023, China likely won't be able to count on another banner year of exports like in 2022. For example, the 2016 global slowdown and China's associated export decline shaved nearly one percentage point off of its growth.

Don't Be Carried Away by 1Q Rebound

Once the initial rebound runs its course, likely around mid-2023, expectations will have to be adjusted as annualized q-o-q growth will likely come in below 5% for the rest of the year.

Provinces appear to be adjusting their expectations already. Most provinces have announced growth goals that are lower than 2022, with targets ranging from 4.5% to 5.5%. Given the low-base effect of 2022, these do not constitute ambitious growth targets. And if provinces are barometers of the national target, it suggests that Beijing will announce a growth target of around 5.5% at the National People's Congress in March.

If so, that should not be interpreted as a stretch goal but a realistic and achievable target that accounts for the myriad challenges and headwinds in 2023. As such, the key risk for the Chinese economy is that it will underperform relative to expectations later this year. We will continue to monitor and update this risk in future outlooks.