



## CIO Memo

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# China: faster growth recovery

## Key takeaways

- China's PMIs for both manufacturing and service sectors were strong in February, indicating a faster-than-expected economic recovery after the re-opening.
- Chinese equities (especially Hong Kong equities) were up today on the back of the positive macro data.
- With valuations now levelling towards long-term medians, further upside is likely to be driven by earnings growth for Chinese equities. We remain constructive on Chinese equities and any market volatility could provide opportunities to add positions, in our view.

## 1. What happened?

China's recent activity data for the first two months of the year suggests an earlier and faster-than-expected recovery. The recovery was strong in both the manufacturing and services sectors after the Chinese New Year. Mobility data, including traffic congestion and subway ridership, are all rising towards 2019 levels, and industrial activity proxies such as steel demand and daily coal consumption were up at the start of the year.

China's manufacturing PMI increased to 52.6 in February (vs. 50.1 in January), much higher than the consensus forecast of 50.6. In particular, new orders PMI rose to 54.1 in February and the PMI for business expectations rose to a one-year-high of 57.5. The positive PMIs were clear indication of improving business sentiment in February, with the continued domestic reopening. The service sector PMI was also robust, rising to 55.6 in February (vs. 54 in January) on the back of the strong consumption recovery in catering, travel and entertainment industries.

Besides, China's monetary policy remains accommodative in order to support the growth recovery. Credit data for January showed stronger corporate loans, particularly short-term loans. Total CNY loan growth accelerated to 11.3% YoY in January 2023 (vs. 11.1% in December 2022). Monetary supply M2 growth accelerated to 12.6% YoY in January from 11.8% in the prior month.

Consumer price inflation has continued to trend upwards to 2.1% YoY in January 2023 from 1.8% in December 2022, reflecting both a low year-earlier base for comparison and higher food inflation. However, the pace of reflation even after reopening is expected to remain mild due to notable slack in the economy. PPI deflation continued in January (-0.8% YoY compared to -0.7% in December), and it is likely to persist due to retreating commodity prices.

## 2. How did markets react?

Following the stronger-than-expected PMI figures, Asian equities rebounded from a two-month low and saw their best daily performance in seven weeks.

Hong Kong's Hang Seng Index jumped 3.2%, led by consumer-tech and developer stocks, while China's CSI 300 index rose by more than 1%. Asian currencies strengthened following the PMI data release, with the CNY rising approximately 0.4% to 6.906 against the dollar.

## 3. What does it mean for investors?

The Two Sessions (technically, the legislative session of the National People's Congress on March 5, and the annual session of the Chinese People's Political Consultative Conference, CPPCC, on March 6) is a closely-watched political event. China is expected to announce their "pro-growth" but "prudent" policy agenda for 2023 on March 5-6. They will also announce inflation and labour market targets for this year.

We expect China's leaders to set out economic goals to bring growth back on track, restore confidence and avoid a build up of financial risks. We are also expecting to see more business-friendly policies and a focus on reviving domestic spending and confidence. Further support for the property market is expected, with discussions about improving housing demand and devoting more resources to addressing housing issues. Besides, this year's Congress welcomes new leaders responsible for economic policies. The new team could be more willing to push for better economic outcomes given that it will be their first year in office.

Our current forecast for China's GDP growth this year is 5%. We think risks are skewed to the upside for our forecasts, particularly if the rebound in private consumption is sharper or more sustained than we anticipate. Besides, we think there is potential for upside corporate earnings revisions on the back of an ongoing recovery in domestic demand in China.

With valuations now levelling towards their long-term median, further upside is likely to be driven by earnings growth for Chinese equities going forward, in our view. Near-term headwinds could come from external factors, including the repricing higher of the expected Fed terminal rate and any escalation of geopolitical tensions. We remain constructive on Chinese equities, however, and any market volatility could provide opportunities for long-term investors to add to positions in our view.



## Glossary

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The **Chinese People's Political Consultative Conference (CPPCC)** consists of delegates from the Chinese Communist Party and other organizations.

The **Chinese National People's Congress** is the Chinese national legislature.

**CNY** is the currency code for the Chinese yuan.

The **Consumer Price Index** is a price index, a weighted average market basket of consumer goods and services purchased by households.

The **CSI 300 Index** consists of 300 A-shares traded on the Shanghai and Shenzhen stock markets.

**GDP** stands for gross domestic product, a measure of the total value of goods and services produced in a country in a given period.

The **Hang Seng Index (HSI)** includes the 50 largest companies traded on the Hong Kong stock exchange.

**M2** comprises M1 plus time and savings deposits in national currency of resident non-bank financial corporations and non-bank non-government sectors with the PBC and banking institutions.

The **Producer Price Index (PPI)** program measures the average change over time in the selling prices received by domestic producers for their output.

**Purchasing manager indices (PMI)** provide an indicator of the economic health of the manufacturing and service sectors and generally are based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. They can be published by public sector or private agencies (e.g. Caixin, Nikkei).

**YoY** is Year on Year growth rate.



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