
# China in 2023

## Key points

- Chinese Covid-19 cases are surging as restrictions around quarantine, testing and travel have been eased quicker than expected. High case numbers pose a risk to the healthcare system (especially in rural areas) and economic activity but the disruption should be temporary, especially as vaccination rates have risen significantly and are comparable to other major countries (although booster numbers need to rise), and Covid variants are milder now, compared to earlier strains.
- Chinese March quarter GDP growth is likely to be low as a result of high Covid cases but this will be followed by a strong rebound in growth in the second half of the year as consumption normalises. We expect above consensus GDP growth of 6% in 2023 (compared to 2% in 2022).
- In the short-term, Chinese shares have room to increase given the big sell-off in 2022 but there are longer-term geopolitical risks around investing in China, including risks in the tech sector from US trade controls.

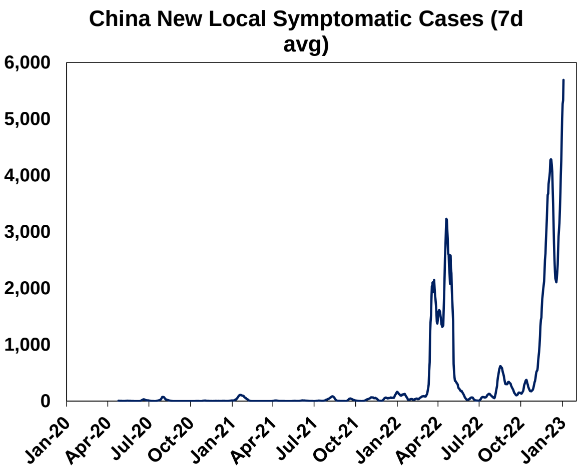
## Introduction

China has now moved away from its strict zero-Covid restrictions imposed during the pandemic which has taken commentators and markets by surprise as restrictions were removed quickly and simultaneously which reflects economic and social pressure faced by policymakers, especially after recent protests. This *Econosights* looks at the outlook for China in 2023 in the midst of the explosion in Covid-19 cases.

## The current Covid wave

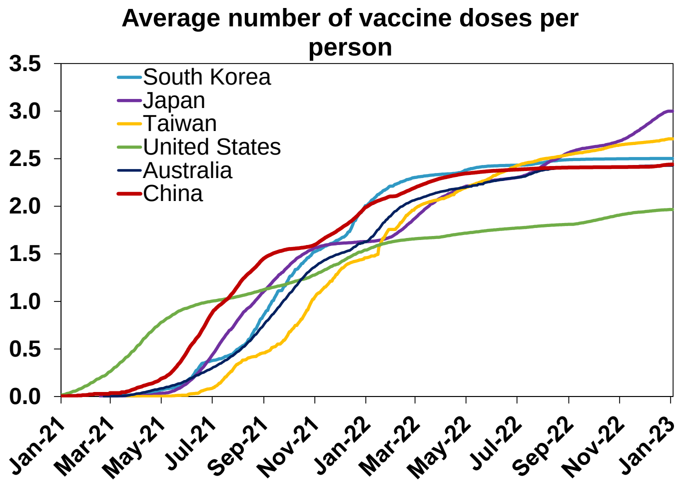
China's strict Covid-19 restrictions in 2022 faced a lot of criticism internally and globally because it restricted Chinese GDP growth through dampening consumer spending, manufacturing activity and tourism flows which weighed on the global economy, given China's significance to global trade. Chinese policymakers slowly started to lift restrictions in late 2022 and the release of the "Overall Plan" on 26 December 2022 was the last step towards removing some of the Covid-19 restrictions including ceasing: quarantine requirements on those with Covid-19, close contact tracing, mandatory PCR testing, risk-zoning of population areas and border checks and slowly restarting international travel both into and out of China.

While a zero-Covid policy was never a sustainable option for the long-term, a slower re-opening would have made more sense, giving more time for preparation of increasing booster vaccinations, sourcing antivirals and lifting intensive care and ventilator capacity in hospitals. Covid case numbers are now exploding, with new local symptomatic cases averaging ~6K/day (see the chart below), above earlier outbreaks in 2022 which saw case numbers peaking at around 3K/day (note that China has stopped publishing asymptotic cases so these numbers understate the actual number of new inflections). Lower levels of mass testing also mean that new cases are being understated.




Source: Bloomberg, Chinese Centre for Disease Control and Prevention, AMP

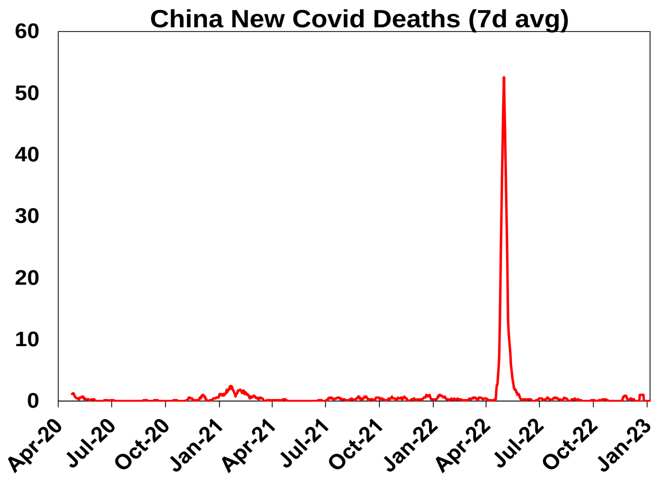
The next few weeks (and probably until the end of the first quarter) will be challenging for China as case numbers remain high (it is probably too soon to say that cases have peaked) and multiple waves of Covid cases are likely (as has been the experience around the world). The risk is that hospitals outside of Tier-1 and Tier-2 cities become overwhelmed which will disrupt GDP growth. But, the experience from the rest of the world shows that the disruption to the economy from surging Covid cases is temporary. And there are reasons to be optimistic. Vaccination rates in China are now in line with other major countries and above the US in terms of vaccine doses per person (see the chart below).




Source: ourworldindata.org, AMP

Around 93% of the Chinese population is vaccinated, and 91% of those over 60 are vaccinated. Arguments around less effective Chinese vaccines also look tenuous as recent studies have shown that multiple doses of China's Sinovac vaccine look just as effective as Pfizer's vaccine. As well, mRNA vaccinations are available for foreigners and the latest Covid variants are milder compared to earlier strains.

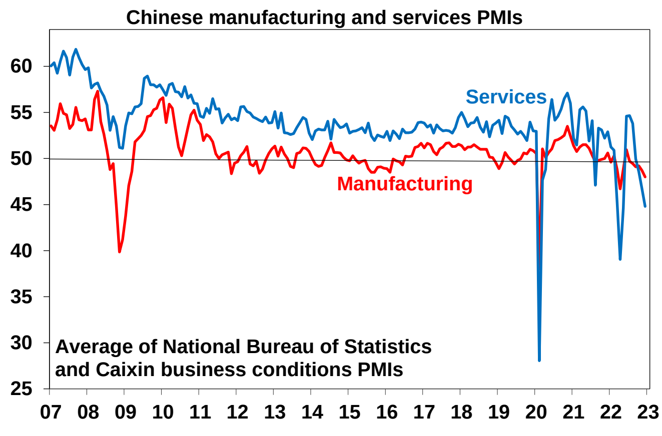
Unfortunately, hospitalisation data is not available and the official counted deaths from Covid-19 appear way too low (and below outcomes earlier this year – see the chart below), so there is uncertainty about the reliability of the official death count due to a narrow definition used by authorities.




Source: Bloomberg, AMP

## Economic activity indicators

The disruption to economic activity from the current Covid-19 wave will be temporary. The Purchasing Manager's Indices (PMI's) for December remained in contraction for manufacturing and services activity (but were more negative for the services sector) across both the official PMI measure (which samples more large firms) and the Caixin measure (which samples smaller firms) – see the chart below. Other economic indicators have been mixed. Tourism spending has been lower than usual over the New Year holiday period but subway use in January has been picking up across major cities. The Chinese New Year holiday period starts on 21 January – 27 January and is usually an important time for travel and spending so watching the indicators around this time will be important.




Source: Bloomberg, AMP

December quarter 2022 GDP growth is likely to be negative, followed by positive but low GDP growth in the March quarter due to the disruption from high Covid cases. However, this disruption to activity is likely to be temporary and a strong rebound in GDP growth in the second half of 2023 is expected (the major advanced economies all had a strong rebound in growth in 2022 as all restrictions were virtually removed) driven by strong growth in consumption, government-driven infrastructure spending and less drag from the property sector (which was negatively impacted in 2022 from government regulation). Export growth is likely to be constrained by very low global GDP growth. We expect Chinese GDP to increase by ~6% in 2023, after 2% in 2022 and above government targets and consensus estimates of around 5%. The strong rebound in GDP growth is likely to push inflation up, to 3-4% per annum in 2023, after oscillating between 2-3% in 2022 but this is still much lower than inflation across the advanced world in 2022. So inflation is unlikely to be a problem for China in 2023 which means that there is scope to easy monetary and/or fiscal policy, if it is required.


Source: Bloomberg, AMP

## The impact on the rest of the world

China is the largest country in the world in Purchasing Power Parity terms (which adjusts individual country prices into a global comparison after accounting for exchange rates and purchasing power in each country which allows a better sense of living standard comparison), making up 19% of global GDP (US is ~15%). So, changes in Chinese GDP growth are very important for the global economy. Global economic growth is expected to be poor in 2023, rising by 2.5% (usually global growth averages at around 3% per annum) as growth across the major advanced economies is weighed down by high (but declining) inflation and high interest rates, with a high risk of recession across these countries. The improvement in Chinese GDP growth in 2023 will be a positive offset for global growth.

Geopolitical tensions between China and the rest of the world will remain high as there is pressure around tech dominance between the US and China, implications from the US ban of semiconductor chips or equipment used to make semiconductors to China, risks around a China/Taiwan war (we think the risk is low in 2023), and the current political tensions as some countries have imposed restrictions on Chinese inbound passengers, requiring proof of a covid test before flight.

Australia-China relations have improved since Anthony Albanese became Prime Minister but Chinese trade restrictions on some Australian exports remain in place (after starting in 2020). There is some talk of a loosening in coal export bans which would be positive for Australian GDP growth, although most of the goods impacted by trade restrictions have managed to find other export markets. A restart of Chinese tourism would be beneficial for Australian tourism market and universities, which used to benefit from large inflows of Chinese students.

## Implications for investors

Chinese equities are down by ~13% since early 2021 because of the poor growth environment driven by zero-Covid policies and rolling lockdowns. The better economic environment in 2023 means there could be short-term upside for Chinese shares. But investors need to keep in mind that Chinese shares are a volatile asset class and that there are geopolitical risks with investing in China (especially for long-term investors).

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