Mizuho Economic Outlook & Analysis

July 26, 2022

The COVID-hit Chinese Economy

The economy will return to cruise speed only in 2023, with a V-shaped recovery unlikely

< Summary >

◆ The Chinese authorities have put together a stimulus package of infrastructure spending, etc., to deal with the slump in consumer activity and real estate investment due to COVID-19, but a large-scale slowdown appears unavoidable. Growth in 2022 is unlikely to hit the target of approximately +5.5%.

◆ Fiscal spending will be used to counteract the side effects of the “Zero COVID” policy in the latter half of 2022 too. However, local government real estate revenues have fallen on the real estate market slowdown, with this likely to offset the impact of fiscal mobilization. The growth rate will probably hit +4.0% in 2022.

◆ A full recovery will probably take place from 2Q 2023 onwards, after the end of the “Zero COVID” policy. The consumption recovery is being held back by the COVID-hit employment and earnings situation, so the growth rate will probably remain at +5.0% in 2023, close the lower limit of the economy’s cruise speed.

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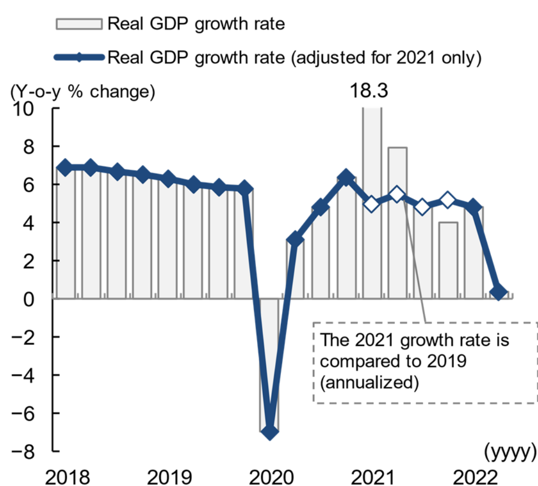
1. Though China avoided negative growth, consumer activity and real-estate investment is moving sluggishly

At +0.4% year-on-year, China's real GDP growth rate over 2Q 2022 was down sharply on the +4.8% y-o-y figure recorded in 1Q **(Chart 1)**. There had been reports about negative growth. Although China just managed to avoid this scenario, the economy still bears the scars of the April surge in COVID-19 infections and the Shanghai lockdown. The quarter-on-quarter figure stood at −2.6% (1Q: +1.4%), with quarterly growth slumping to its lowest level since the first COVID-19 wave struck in 1Q 2020.

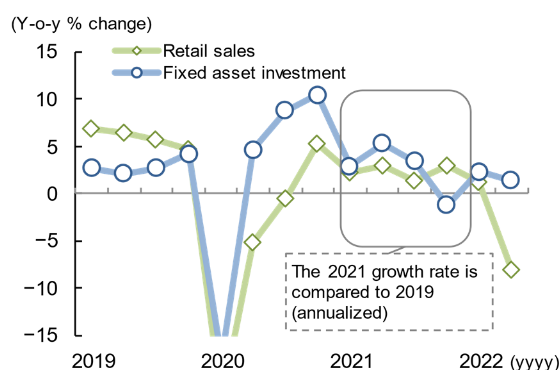
Consumer activity was hit hardest by the rise in infections. At −4.6% y-o-y, the retail sales data for 2Q 2022 contracted on the previous year (1Q: +3.3% y-o-y) **(Chart 2)**, with dining out and drinking services contracting sharply (−15.6% y-o-y) on restrictions on opening times, for example. On a monthly basis, the retail sales data of June bounced back by +3.1% y-o-y, but this still remains some way off the growth recorded in pre-pandemic 2019 (+8.0% y-o-y), due to strict prevention measures.

Chart 1: Real GDP growth rate



Source: Made by MHRT based upon releases by the National Bureau of Statistics of China and CEIC

Chart 2: Retail and investment indicators



Note: Retail sales = Total retail sales of consumer goods

Source: Made by MHRT based upon releases by the National Bureau of Statistics of China and CEIC

Though fixed asset investment performed better than retail sales, it still slowed to +4.5% y-o-y in 2Q (1Q: +9.3% y-o-y) (**Chart 2**). At −9.2% y-o-y, investment in real estate development contracted sharply as real-estate sales slumped on the COVID-19 crisis (1Q: +0.7% y-o-y). Manufacturing investment also dipped as productive activity was curbed by lockdowns in Shanghai and elsewhere. At +8.6% y-o-y, infrastructure investment growth remained strong on the government's economic policies (1Q: +10.5% y-o-y), but not strong enough to cover the fall in investment in real estate development.

Real GDP growth in 1H 2022 was up +2.5% on the same period last year, though this

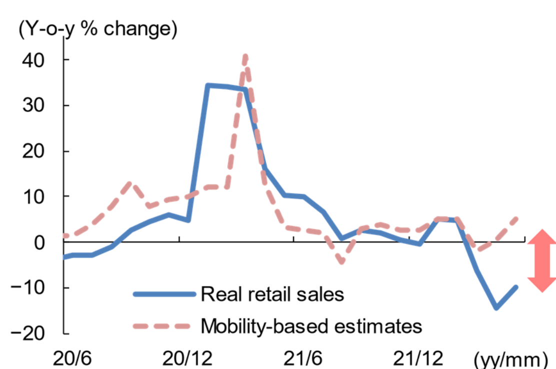
was far below the target of around 5.5% announced at the National People's Congress (NPC) in March. This report takes a look at consumer activity and real-estate investment, the two main factors behind the 2Q slowdown. It then examines the prospects for China's economy based on the government's "Zero COVID" policy.[1]

2. The economy faces strong headwinds in 2022, with a full recovery unlikely until 2Q 2023 onwards

(1) Consumer sentiments have been hit by the persisting "Zero COVID" policy

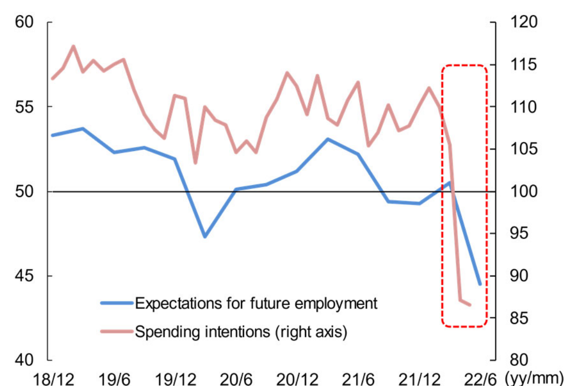
The "Zero COVID" policy was substantially tightened in the wake of Shanghai's explosive outbreak and long-term lockdown (March 28–May 31), with this becoming one factor behind the consumption slowdown. This policy aims to help local governments swiftly detect outbreaks, with more cities now obliged to carry out periodic PCR testing of all residents,[2] for example. In other words, the policy aims to nip outbreaks in the bud by detecting infected people, so even when outbreaks occur, they can be handled through localized lockdowns and strictly-enforced isolation. Obligatory periodic testing is often accompanied by the imposition of business restrictions on service industries such as dining out and drinking, so it tends to lead to decreased opportunities for consumption. China's medical capacity is not so strong, so the "Zero COVID" policy is maybe a necessary prevention measure. Nonetheless, its economic burden cannot be overlooked. Strong prevention measures mean there is little chance of another major outbreak occurring like in Shanghai, but as long as the "Zero COVID" policy remains in place, consumer activity (particularly services like dining out and drinking) will inevitably be suppressed.

Chart 3: Retail sales (real)



Source: Made by MHRT based upon releases by the National Bureau of Statistics of China, Autonavi, CEIC, and wind

Chart 4: Survey of consumers and depositors



Source: Made by MHRT based upon releases by the National Bureau of Statistics of China, the People's Bank of China, and CEIC

[1] The formal title is the "Dynamic Zero COVID" policy. The policy aims to prevent infections through mass testing, isolating the infected, and localized lockdowns.

[2] According to Huatai Securities, 49 out of 91 cities with populations over 5 million are obliged to carry out periodic PCR testing of all residents (as of July 19), up by around ten cities compared to early May.

There also appear to be other factors behind the recent slowdown in consumer spending, apart from COVID-related restrictions on mobility and dining out/drinking businesses, etc. **Chart 3** shows retail sales (real), a good indicator for understanding the state of consumer activity, and estimates of retail sales based on the number of people venturing outside (road congestion data).[3] The decline in opportunities to venture outside (due to tough prevention measures) is directly linked to falling consumption (retail sales). As such, the two retail sales indicators usually move in tandem. However, they have diverged recently. In other words, the slump in the retail sales data is quite pronounced compared to the data on people venturing outside. This is probably because consumer sentiments are worsening as the employment situation deteriorates. Companies are growing more wary of employing people given the risk of further COVID-19 outbreaks. In March this year, the urban surveyed unemployment rate topped the government target (of below 5.5%). It then breached 6% in April for the first time since the pandemic hit in March 2020.[4] A survey of consumers and depositors also shows a clear decline in spending intentions in line with a fall in expectations for future employment **(Chart 4)**, with consumers keeping a tighter hold on their purse strings.

So how long will the Chinese government pursue its "Zero COVID" policy? As previously noted,[5] the timing will depend on (1) domestic political trends and (2) the development and diffusion on the Chinese mainland of messenger RNA vaccines (hereinafter "mRNA vaccines"). As for (1), the "Zero COVID" policy or any other policies are unlikely to shift much until this autumn's National Congress of the Chinese Communist Party[6] or next spring's NPC, when a series of policies will be announced based on the deliberations of the National Congress. With regards to (2), China is currently undertaking clinical trials of several China-made and foreign-made candidates, with production set to commence some time in 2022.[7] However, it will take some time before mRNA vaccines are available for everyday use, so there is no room for optimism just yet.

Based on these all these variables, it seems the "Zero COVID" policy will be lifted by 2Q 2023 at the earliest **(Chart 5)**. There are high hopes that consumer activity will bounce back in earnest when mobility restrictions and other curbs on services consumption are lifted thereafter, but these hopes should be taken with a pinch of salt. This is because the employment and earnings environment has been hit by COVID-19, as mentioned above, and this is delaying the consumer sentiment recovery.

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[3] The real retail sales figures up until May 2022 are estimates based on the road congestion data (simple average of 100 cities) during 2020−2021 and the year-on-year real retail sales data (indexed using the retail price index).

[4] See "Youth Employment Remains High in China" by Naoki Tsukioka *(*Mizuho RT Express, July 22, 2022) for details about the employment situation.

[5] See "Outlook of the Decelerating Chinese Economy" by Hideki Ito (Mizuho Insight, October 28, 2021).

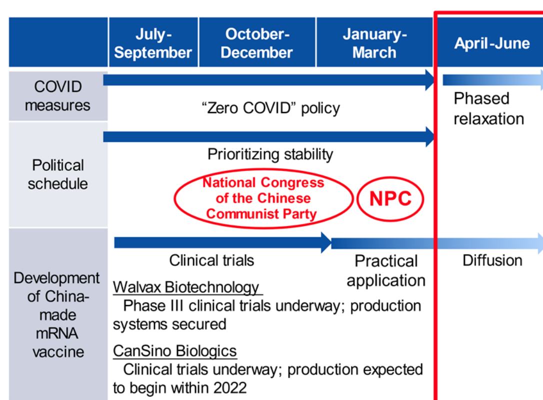
[6] This is the Chinese Communist Party's highest decision-making organ and it usually meets once every five years to decide leadership structures and key policies. It debates important policy issues and selects members of the Central Committee, including the top leadership.

[7] "新冠 mRNA 疫苗国内上市时间表" (China Times, June 11, 2022) and "国内企业持续发力 mRNA 疫苗临床研究又有新进展" (Institute of Medical Biology, June 10, 2022).

(2) Real estate investment will bottom out some time after entering 2023

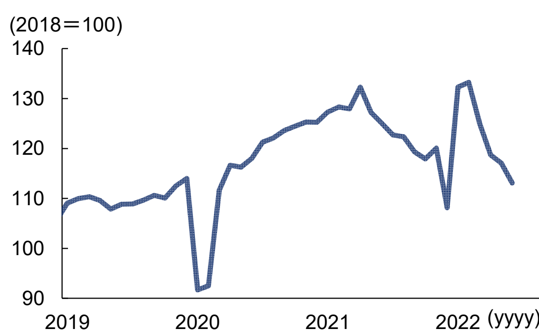
Investment in real estate development showed some signs of recovery at the start of 2022, but it slowed again from March **(Chart 6)** as opportunities to sell housing real estate were curbed by showroom shutdowns, etc. on the spread of infections in spring. When infections peaked in Shanghai and nationwide in April, real estate sales in terms of floor space plummeted by a record −39.0% y-o-y. The original (last year) slowdown was due in part to restrictions on lending to property developers. Signs of a recovery then emerged after these restrictions were tweaked, but the industry was then hit by a COVID-related demand shock, with investment in real estate development facing a double-bottomed slump.

Chart 5: The outlook for the "Zero COVID" policy



Note: The chart only lists representative examples of vaccine development; vaccine schedules are MHRT estimates based on various reports, etc.
Source: Made by MHRT based upon various reports

Chart 6: Investment in real estate development



Note: The investment figure is a seasonally adjusted figure produced by MHRT; the cost denotes the average cost in 70 cities.
Source: Made by MHRT based upon releases by the National Bureau of Statistics of China and CEIC

As the situation deteriorated, the government eased deposit rules and other purchasing restrictions in a bid to stimulate real demand for property. Furthermore, in May the People's Bank of China and China Banking and Insurance Regulatory Commission announced a lowering of the mortgage rate for first-time property buyers. Thanks to these measures, the real estate sales in terms of floor space figure (an indicator of demand) is showing signs of bottoming out.

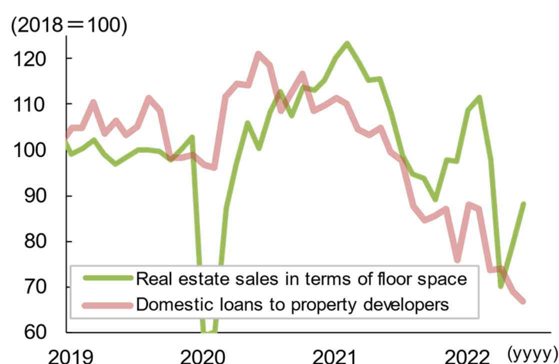
In contrast, leading supply-side indicators (outstanding domestic loans to property developers) are still trending lower **(Chart 7)**. As outlined in **Chart 8**, when the real estate market has slowed in the past, the outstanding loan balance usually bottoms out around six months before investment in real estate development does. Housing stock inventories also remain at high levels[8] and this also putting a brake on new investments. Given this, it

[8] In June 2022, the stock of completed housing was up +13.5% y-o-y (floor space basis) and over 10% on the start of the year. The last time the figure topped 10% was in 2016.

seems investment in real estate development will bottom out some time after entering 2023.

On the other hand, many observers have voiced concerns about the direction of the real estate sector given the prolonged property market slump, the resultant deteriorating financial strength of medium- to large-scale domestic property developers, and reports about defaults. Since the pandemic started, commercial banks on the mainland have not released details of the non-performing loan (NPL) ratio of loans to the real estate sector, but results already announced by large state-owned commercial banks and joint-stock commercial banks (note: excluding Hengfeng Bank) suggest the situation may already have worsened substantially (**Chart 9**, the NPL ratio was around 3.5% at the end of 2021). The NPL ratio of commercial banks as a whole had moved stably theretofore (2021: 1.73%). As mentioned before, it will take time before the real estate market recovers, so the financial strength of property develops could deteriorate further from here on.

Chart 7: Real estate indicators



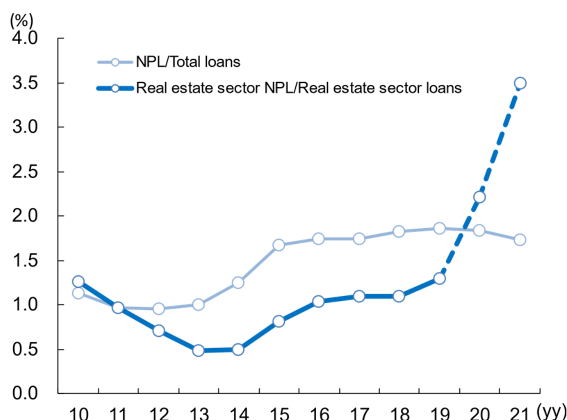
Note: The data is seasonally adjusted by MHRT.
Source: Made by MHRT based upon releases by the National Bureau of Statistics of China and CEIC

Chart 8: The interrelation between real estate loans and investment in real estate development

The bottoming out period after a slump		Lag
Domestic loans to property developers	Investment in real estate development	
August 2008	February 2009	6 months
August 2011/ March 2012	July 2012	4−11 months
March 2015	October 2015	7 months
February 2021 (*note)	August 2021 (*note)	6 months

Note: The bottoming-out period is based on a same-period previous-year (3-month moving average) comparison; the period for 2021 is based on a comparison of the period when the year-on-year decline occurred, not a bottoming-out period.
Source: Made by MHRT based upon releases by the National Bureau of Statistics of China

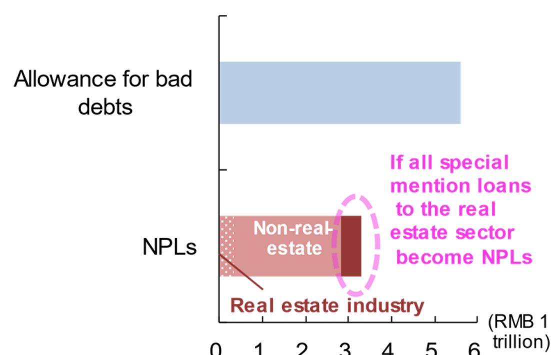
Chart 9: The NPL ratio of commercial banks



Note: The NPL ratio of loans to the real estate sector in 2020 and 2021 is calculated from publicly-released figures from large state-owned commercial banks and joint-stock commercial banks (excluding Hengfeng Bank).

Source: Made by MHRT based upon releases by the China Banking and Insurance Regulatory Commission and CEIC

Chart 10: Commercial bank allowance for bad debt/NPL amount



Note: As of the end of 2021. The amount of bad or special mention loans to the real estate sector is calculated from publicly-released figures from large state-owned commercial banks and joint-stock commercial banks (excluding Hengfeng Bank).

Source: Made by MHRT based upon releases by the China Banking and Insurance Regulatory Commission and CEIC

However, these corporate bankruptcies are unlikely to lead to a commercial bank crisis or pose other risks to the financial system. This is because Chinese financial institutions are protected by regulations (though these have been relaxed in recent years) and thus find it easy to remain relatively profitable, while the NPL coverage ratio for commercial banks as a whole stands at a healthy 197%. Furthermore, even if all special mention loans to the real estate sector become NPLs, the bad debt allowance would probably cover this **(Chart 10)**. Of course, this estimate is based on an overview of commercial banks as a whole and there is no guarantee that each bank is safe, so caution will be needed.

(3) The impact of further fiscal policies will be limited

As consumer activity and real estate investment slumps on moves to tackle COVID-19, it seems less likely that China will hit its growth rate targets. Under these circumstances, the government has implemented a flurry of economic stimulus measures. Of particular note is a comprehensive package[9] released in May containing 33 measures to stabilize the economy. The scale of this year's economy stimulus bears comparison with the policies announced in FY2020, before the pandemic.

The next move will probably be fiscal mobilization through the issuance of special government bonds **(Chart 11)**. This would follow a similar move in 2020, when the authorities ignored the budget deficit target of around 2.8% of GDP to issue RMB 1 trillion of bonds to pay for prevention measures, etc. Authority figures have hinted recently about

[9] See "China Announces New Stimulus Measures" by Naoki Tsukioka (Mizuho RT Express, May 30, 2022) for details about the policy package.

the issuance of special government bonds, with some voices calling for issuances of around RMB 1.5 trillion (1.3% of nominal GDP; equivalent to JYP 30 trillion).[10] However, Premier Li Keqiang ruled out any excessive fiscal mobilization at the July 19 World Economic Forum when he said the authorities would not be employing large-scale stimulus.

Chart 11: Fiscal policies (compared to 2020)

Item (Unit: RMB 1 trillion)	2020	2022 (as of end of June)
Tax cuts/refunds	2.6	2.5 ⇒ 2.7 (added in May)
Social insurance premium exemptions	1.7	Corresponding to grace periods, etc.
Infrastructure investment from central budget	0.6	0.64
Local government special bonds (infrastructure investment)	3.75	3.65 (instruction to accelerate the issuance and usage of the bond quota)
Special government bonds (for prevention measures, etc.)	1.0	(The authorities might examine issuances of around RMB 1.5 trillion)

Note: In addition to the figure mentioned above, over RMB 1 trillion of local government special bond issuances will probably be rolled over from last year too.

Source: Made by MHRT based upon releases by Chinese Ministry of Finance, etc.

Chart 12: The fiscal situation

		2022 budget (RMB 1 trillion)	As of June (total) (RMB 1 trillion)	Y-o-y change
General public budget	Revenues (A)	21.01	10.52	−1.19
	Value-added tax		1.91	−1.61
	Expenditures (B)	26.71	12.89	0.72
	Hygiene and health related (including PCR testing)		1.13	0.08
	Balance (A-B)	−5.70	−2.37	−1.91
Government-managed fund budget	Revenues	9.86	2.80	−1.11
	Revenue from the transfer of land-use rights		2.36	−1.08
	Expenditures	13.90	5.48	1.31

Source: Made by MHRT based upon releases by Chinese Ministry of Finance and CEIC.

What effect would it have on the economy if RMB 1.5 trillion special government bonds were issued? To answer this question, we need to look at the current fiscal situation. As **Chart 12** shows, as of the end of June, the general public budget (equivalent to the general account) and the government-managed fund budget (equivalent to the special account) had lower revenues than during the same period last year. The general public budget saw a striking fall in value-added tax (VAT) revenues on 2022's centerpiece policies of tax cuts and tax refunds. Tax refunds were rushed through in an effort to stimulate the economy, with the original budget actually envisaging these revenues would fall in the first half of the year. Meanwhile, the government-managed fund budget saw revenue from the transfer of land-use rights down a huge RMB 1.08 trillion on the same period last year. This is income earned from selling the rights to use land owned by local governments. It is a major source of income and it accounts for one third of total local government revenues. Usually, property developers, etc. purchase land-use-rights from local governments when investing in real estate projects, so the slowdown in the real estate market has led directly to a fall in revenues from the transfer of land-use rights. It seems

[10] "PBOC Adviser Says China GDP Target 'Difficult' to Achieve" (Bloomberg, June 25, 2022) and "政策重点应在需求侧，可发1.5 万亿消费特别国债" (Sina Daily, July 15, 2022).

this substantial fall was not envisaged in the original budget and it is hard to see situation improving in the latter half of the year given how long it will probably take for real estate investment to bottom out.

With this fiscal situation in mind, it seems the forthcoming issuance of special government bonds will be used partly to offset the shortfall in real estate revenue, with the actual scale of any new fiscal mobilization likely to be limited. In other words, it is hard to imagine a RMB 1.5 trillion bond issuance leading to a significant upswing in the growth rate.

3. With the global economy slowing, attention is focused on a Chinese economic recovery, but there is no room for excessive optimism

(1) The growth rate is expected to hit +4.0% in 2022 and +5.0% in 2023, with a V-shaped recovery unlikely

This report will conclude with an overview of the outlook for the Chinese economy, based on the points discussed above.

The economic situation in the latter half of 2022 will not be much different from the situation in the first half, with economic policies used to deal with the pandemic-related downswing. The economy will be weighed down by the loss of spending opportunities due to tough COVID restrictions, a slide in consumer activity on the deteriorating jobs environment, and the sluggishness of the real estate market. The authorities will probably introduce some new stimuli, including the issuance of special government bonds, but with local governments seeing a fall in land revenue, this stimuli is unlikely to push the growth rate up significantly, with the real GDP growth rate expected to hit +4.0%.

As the "Zero COVID" policy is phased out, there will probably be a service-sector-led recovery in consumer activity in 2023, with real estate investment also set to bottom out. However, the growth rate will probably remain at +5.0%, close the lower limit of the economy's cruise speed. The consumption recovery is being held back by the COVID-hit employment situation. The global economy is also slowing as the US economy stalls on FRB rate hikes and the European economy deteriorates on the Ukraine situation, for example. As such, it is hard to imagine the Chinese economy undergoing a V-shaped recovery.

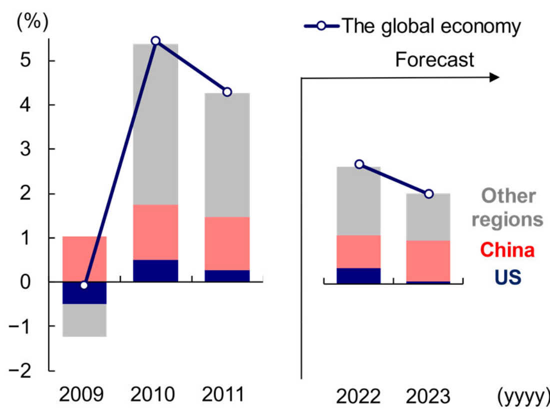
(2) China will find it hard to drive the global economy

At the same time, the global economy looks set to slow toward 2023, so attention will focus on the Chinese economy, with observers expecting China's growth rate to pick up somehow. These observers remember how the global economic recovery after the 2008 financial crisis was driven by Chinese economic growth on the back of a RMB 4 trillion

stimulus package. Indeed, Mizuho's global economic outlook (as of July 2022)[11] expects China's contribution to global economic growth to rise by +0.9% in 2023, not dissimilar to the situation in 2009 **(Chart 13)**.

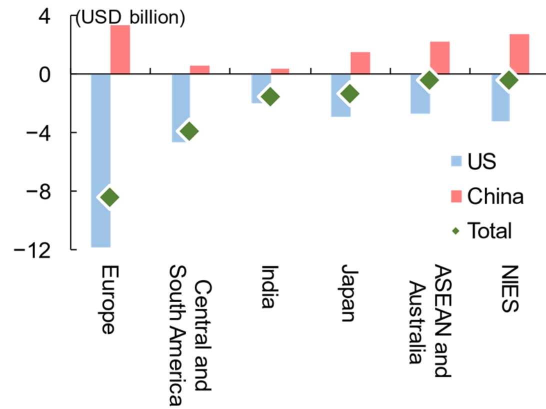
However, as **Chart 14** shows, though the impending US recession will have a huge global impact, China's recovery lacks momentum, as mentioned above, so China will not be able to counterbalance this impact on its own. In fact, this impact is unlikely to be offset even by strong growth in Asian countries and regions with strong economic ties to China, so it seems 2023 will be a tough year for the global economy.

Chart 13: Global GDP growth rate (contribution by region)



Note: The figures from 2022 onwards are MHRT forecasts. The contribution levels are calculated based on the IMF's GDP share data (PPP basis).
Source: Made by MHRT based upon releases by the IMF and statistics from each country and region

Chart 14: The impact of US/Chinese growth rate fluctuations on the global economy



Note: The chart shows the expected impact of the changes in the outlook for the US and Chinese economies from 2022 to 2023 (MHRT forecasts) on the global economy. Europe comprises 28 countries, ASEAN five countries (Indonesia, Thailand, The Philippines, Vietnam and Malaysia) and Central and South America two countries (Mexico and Brazil).
Source: Made by MHRT based upon the OECD's TiVA

[11] For further details, refer to MHRI's "FY2022−FY2023 Economic Outlook", July 26, 2022

Reference

Refer to the original Japanese report by clicking the URL below for the reference material.
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