ECONOMIST INTELLIGENCE | CORPORATE NETWORK

EICN Executive Insight

Q4 2022

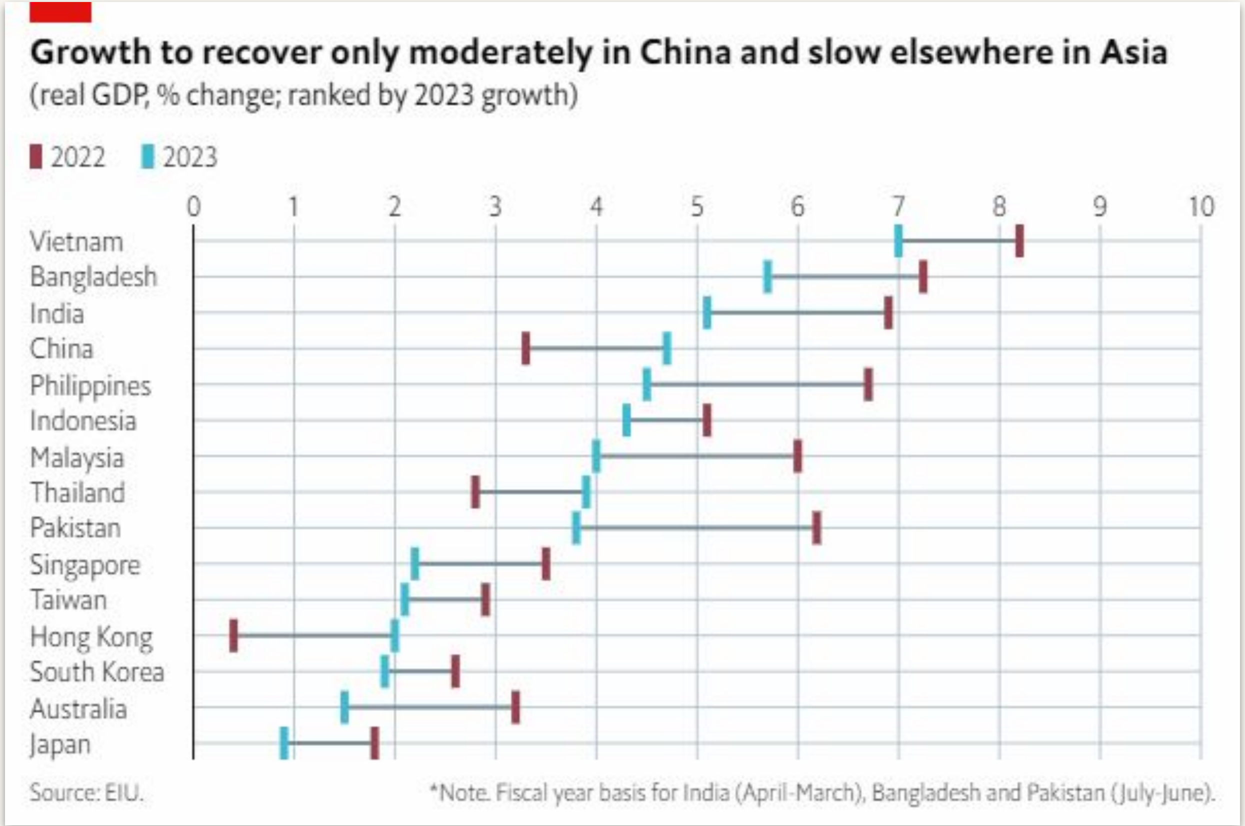
China

Contents

November 2022

ECONOMIST INTELLIGENCE CORPORATE NETWORK

Regional summary for Asia - from export boom to bust



Global economy is set to slow sharply in 2023 after two years of rebound

APAC GDP at 3.5% after slowdowns in EU, US and China

Global consumer inflation remains high, at a forecast 3.6% in 2023 (down from 4.4% in 2022)

Price pressures will be uneven, not felt as much in Asia but continuation of monetary tightening in the West will result in export demand slowdown

Global slowdown to drag on export-reliant Asia

High inflation in the US and Europe's energy crisis, softer demand for Asian exports already discernible this year

US → 15% of trade, EU → 10% of trade

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Inflation data show persisting economic weakness in China

Q4: CPI climbed by 2.1% year on year, PPI contracted by 1.3%

Fickle demand will depress prices for an extended period, as stringent covid-19 policies continue in 2023

Government efforts to help to deliver unfinished housing projects marginally bolstered demand

Producer prices to edge up sequentially in the Q4, but deflation will be still in place as external demand withers

Weakness in domestic demand continues to depress consumer prices

Core CPI edged up by 0.6% year on year in October, annual growth to be close to 0.9% this year - far below historical trends

Pronounced tendency to save (rather than consume) among households and incessant covid-19 outbreaks

CPI will accelerate to 2.9% in 2023, compared to 2.0% to close off the year

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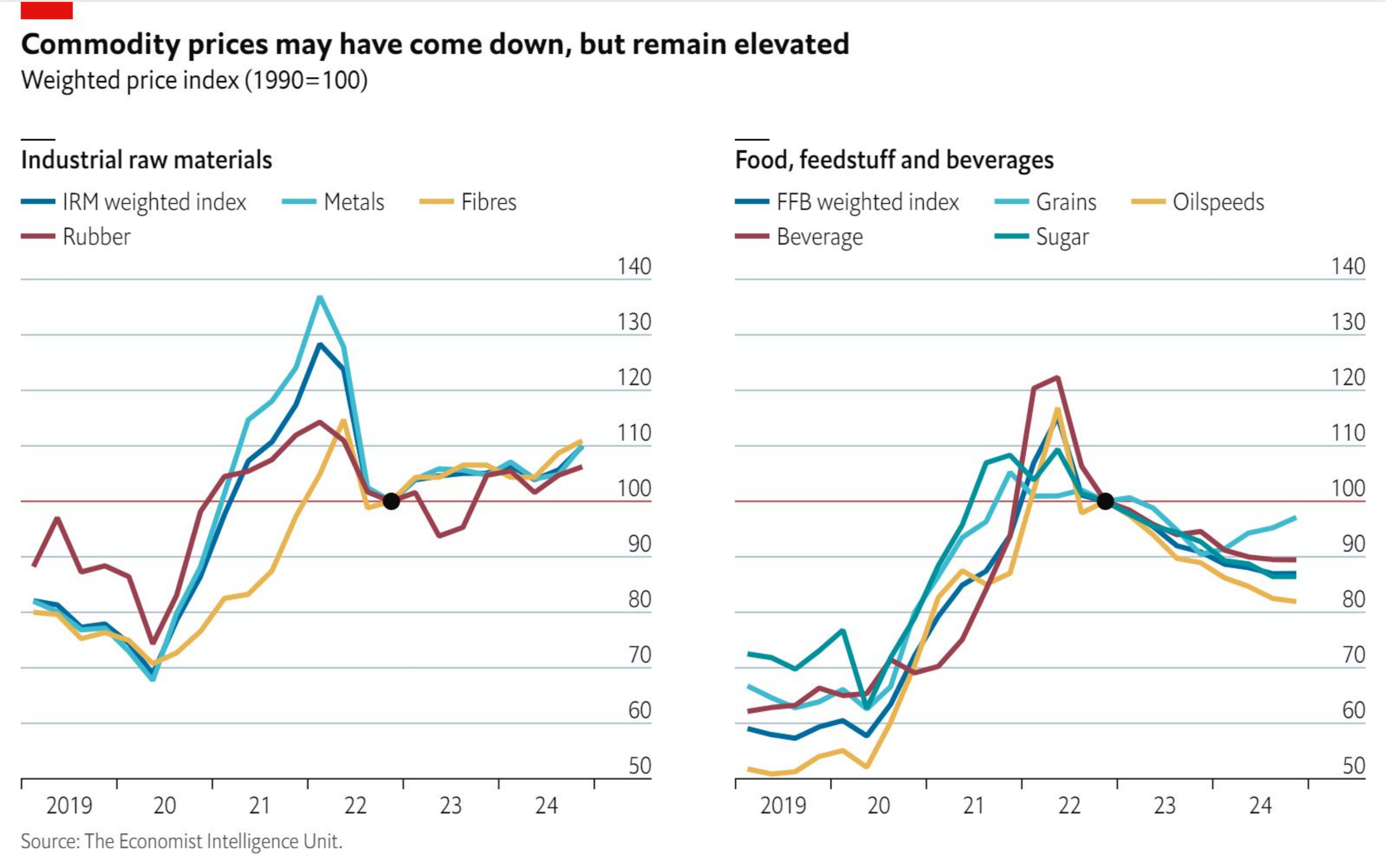
Commodities: Fall-off in prices are coming, but not for everything



Foodstuff: Grain prices will remain high in 2023-24 (60% higher than in '19)

Supply-chain issues and rising shipping costs from energy prices

Base metals: Continuation of supply constraints counteracts slowing industrial activity in China

Policy-led decisions to boost construction and manufacturing in China will keep a high floor under base metal prices

Copper and aluminium prices will be the fastest to rise

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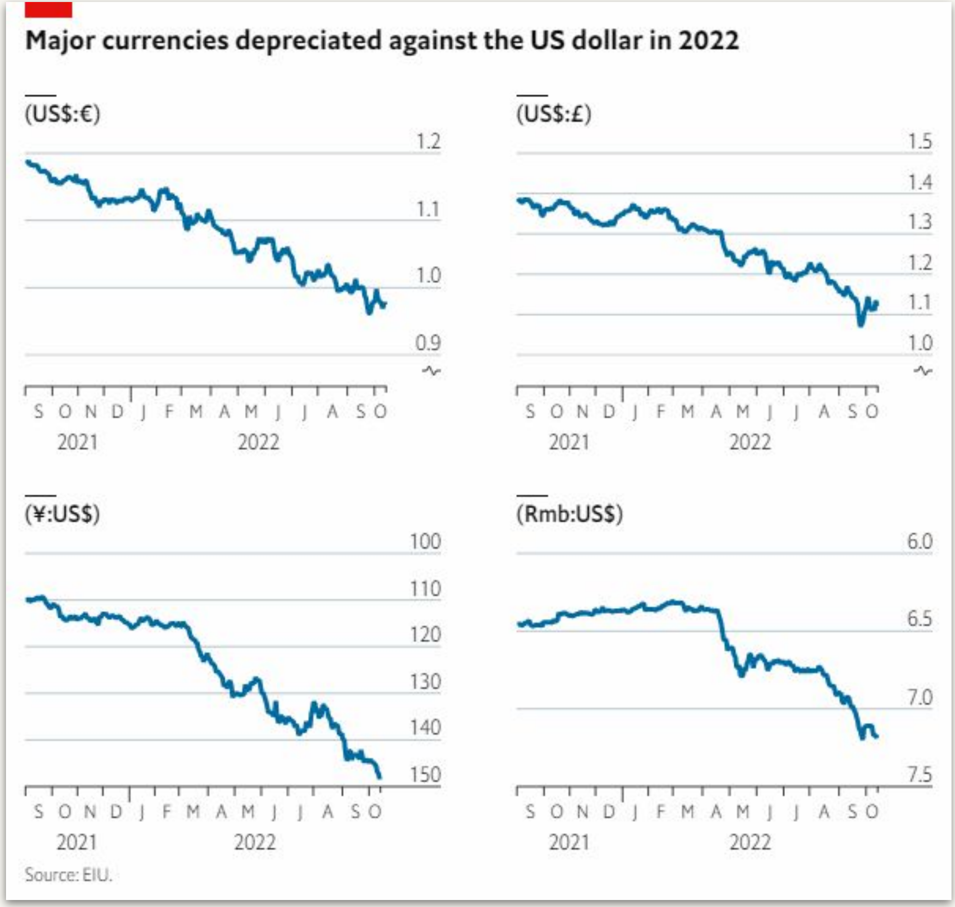
Exchange-rate review - how long can the US dollar stay strong?



USD start to depreciate from its current peak
Fed might pause its monetary tightening in the first quarter of 2023, but risk of additional rate rises if US inflation and employment are higher than expected

BOJ will not raise interest rates to buoy the yen

Monetary policy in the US and Japan will continue to diverge; the underlying cause of yen weakness

Intervention provides some support, but depreciatory pressures on the yen will return

Slow growth in China weighs on the renminbi

Capital flight as investors reassess returns, but strict capital controls in place

Monetary policy to remain accommodative in 2023

Volatility in EM currencies will persist

Wide external deficits, increased balance of payment fragilities for import-dependent EMs adds risk

Energy exporters more shielded

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Data sets - Output, prices and unemployment

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For further data, please use our Asian Data Tool

Nov 2022	Gross domestic product, % change a year ago				Industrial production, % change on a year ago		Consumer prices, % change on a year ago		Unemployment rate, %
	Latest	Quarter*	2022	2023	2022	2023	Latest	2022	Latest
China	+3.9 Q3	16.5	+3.3	+4.7	5.3	4.9	2.1 Oct	2.0	5.5 Oct
Hong Kong	-4.5 Q3	-10.0	-2.5	+2.5	-0.6	2.6	4.3 Sep	2.0	3.9 Sep
Japan	-1.2 Q3	-1.2	+1.8	+0.9	-2.1	1.6	3.0 Sep	2.2	2.6 Sep
South Korea	+3.0 Q3	+1.1	+2.6	+1.5	4.0	1.8	5.7 Oct	5.2	2.4 Oct
Vietnam	+13.7 Q3	No Data	+7.9	+6.7	16.9	10.9	4.3 Oct	3.3	2.3 Sep
United States	+1.8 Q3	2.6	+1.7	+0.1	4.1	-0.2	7.7 Oct	8.0	3.7 Oct

*% change on previous quarter, annual rate

Data sets - Trade, interest and exchange rates

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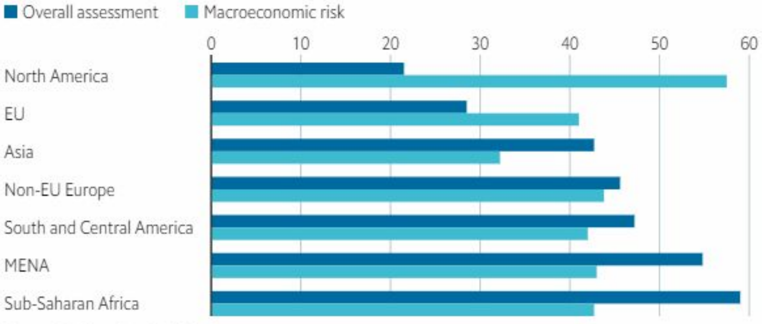
For further data, please use our Asian Data Tool

Nov 2022	Current-account balance	Budget balance	Interest rates		Currency units	
	% GDP, 2022	% of GDP, 2022	10-yr gov't bonds, latest	change on year ago, bp	23 Nov, per US$	% change on year ago
China	2.5	-7.1	2.7	-6.0	7.15	-10.8
Hong Kong	4.3	-6.4	3.7	220	7.82	-0.4
Japan	1.9	-6.1	nil	-8.0	140	-17.7
South Korea	1.1	-3.2	3.9	155	1,352	-12.0
Vietnam	-0.9	-3.8	3.7	85	24,800	-9.7
United States	-3.7	-3.7	3.7	204	-	-

Regional Roundup

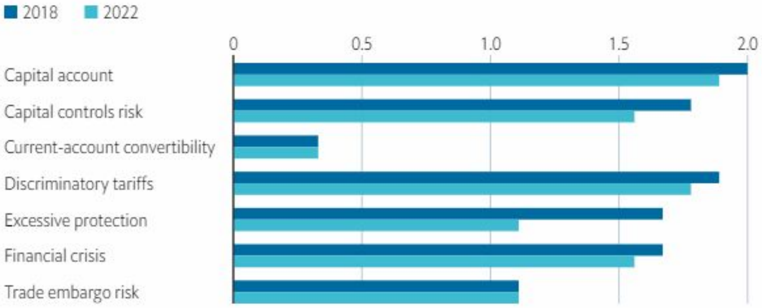
Turbulent times: Navigating business risk in APAC

Macroeconomic risk in Asia-Pacific is lower than in other major regions
(Operational Risk score, 0-100; lower score = less risk)



Source: EIU, Operational Risk Service.

ASEAN countries have become more open to trade and international transactions
(ASEAN average *Foreign trade & payment risk* indicator score, 0-4; lower score = lower risk)



Source: EIU, Operational Risk Service.

Who's doing better?
Advanced regional economies such as Singapore, Australia and New Zealand

South-east Asian economies have progressed the most in recent years, supported by trade and investment liberalisation. Risks attached to taxes, the labour market and infrastructure in India have also been lowered, boosting that country's appeal to global firms.

Who's doing worse?
Myanmar, Afghanistan and Pakistan are characterised by security risks, inadequate governance and economic mismanagement.

Trade: a source of resilience, a harbinger of decline

Economic rebound in 2021 from the slump caused by the covid-19 pandemic demonstrated significant resilience, particularly in countries with a dynamic export-oriented manufacturing sector (e.g. Japan and Korea

However, reliance on external demand also represents an increasing downside risk against a backdrop of a slowing global economy and rising geopolitical risks in the Asia-Pacific region

Upswing in Macroeconomic risk as growth slows

Who's vulnerable?

Labour intensive economies catering to western demand (Bangladesh and Cambodia)

↑Unemployment, ↓ Household incomes

Risk of a balance-of-payment crisis increases for countries that rely on fuel imports

America and China try to get along

Signs of progress at a meeting between Xi Jinping and Joe Biden at the G-20 summit, reductions in geopolitical risk

Mr Xi sought meetings with a range of counterparts, including from Western countries and overall struck a conciliatory tone

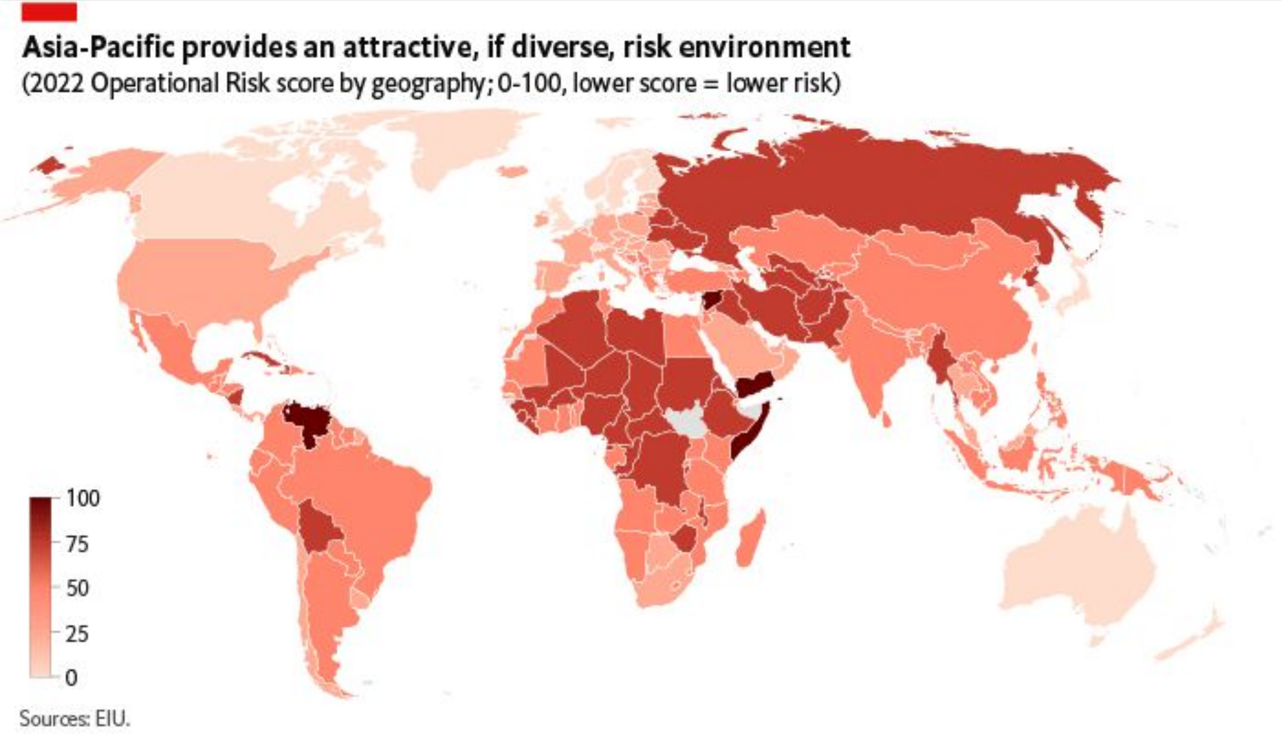
Both sides committing to resume high-level dialogue on issues including food security and economic affairs.

Areas to watch for meaningful change in Chinese policy will include trade purchasing commitments and concessions, with the lifting of punitive tariffs on Australian goods among realistic possibilities.

Diplomatically, China will play a more constructive role in mediating the crisis that would be caused by a North Korean nuclear test than it has done in the Russia-Ukraine conflict. Restraint ahead of Taiwan's elections in January 2024 would be a further indication of change.

Some sensitivity to the pitfalls of a hardline approach, and possibly a recognition that a co-operative attitude will make it more challenging for the US to persuade countries in Asia (and elsewhere) to follow its approach towards China

Looming geopolitical risks



APEC leaders issued a joint declaration

Most members strongly condemned the war in Ukraine...

...but recognised that "there were other views and different assessments of the situation and sanctions"

Concerns over the prospect of a bifurcation of global trade and investment

Pushing for further progress on FTAAP, opportunities in decarbonisation, food and agricultural sectors

Risk Scenarios / Risk Intensity

Deteriorating US-China relations intensify polarisation in APAC → 16

China imposes a severe trade embargo on Taiwan → 15

Military conflicts in the region severely disrupt trade flows → 10

Major clashes with China break out in the South China Sea → 10

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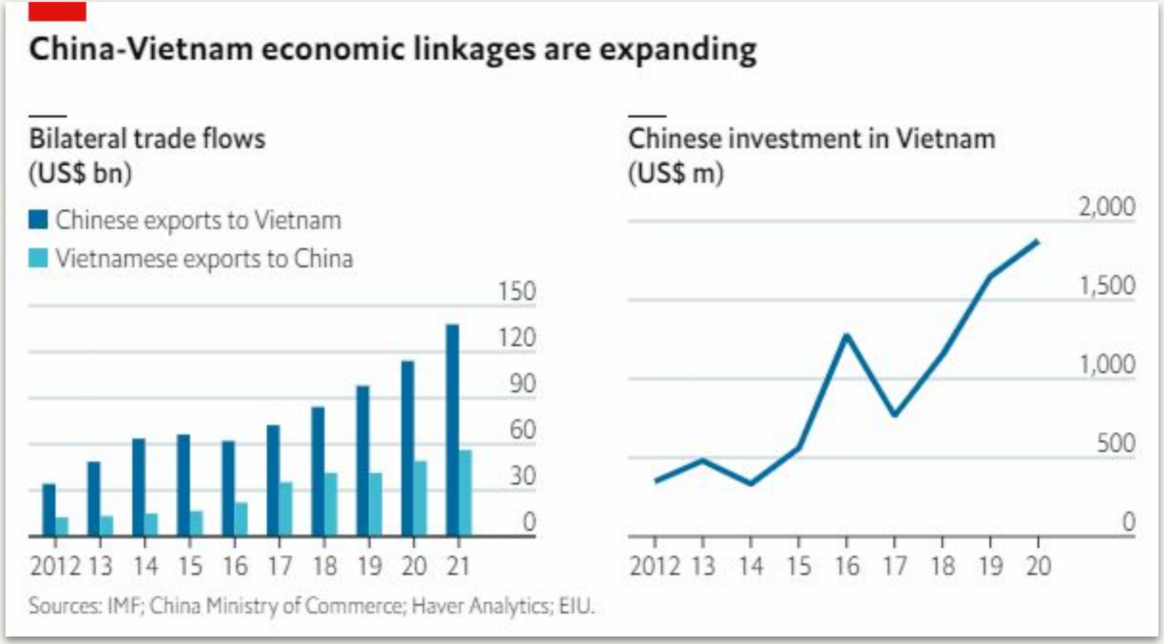
China courts Vietnam amid rising geopolitical tensions

China's efforts to resist the formation of a "like-minded" coalition aimed at curbing China's regional influence

Cooperation in a number of areas, including **enhancing supply-chain linkages** and investment promotion in sectors including **healthcare, clean technology and information technology**

Bilateral economic ties are strong and have expanded significantly in the last decade, as lower-end Chinese industries have migrated to Vietnam to benefit from cheaper labour costs and lower tariffs in key export destinations
(partly as a result of the US-China trade war)



We retain a positive outlook for the China-Vietnam economic relationship, particularly as Chinese and foreign investors increasingly adopt **"China+1" strategies** to **hedge against future economic and geopolitical risks**, and as provisions under the RCEP improve the attractiveness and competitiveness of regional supply chains in Asia.

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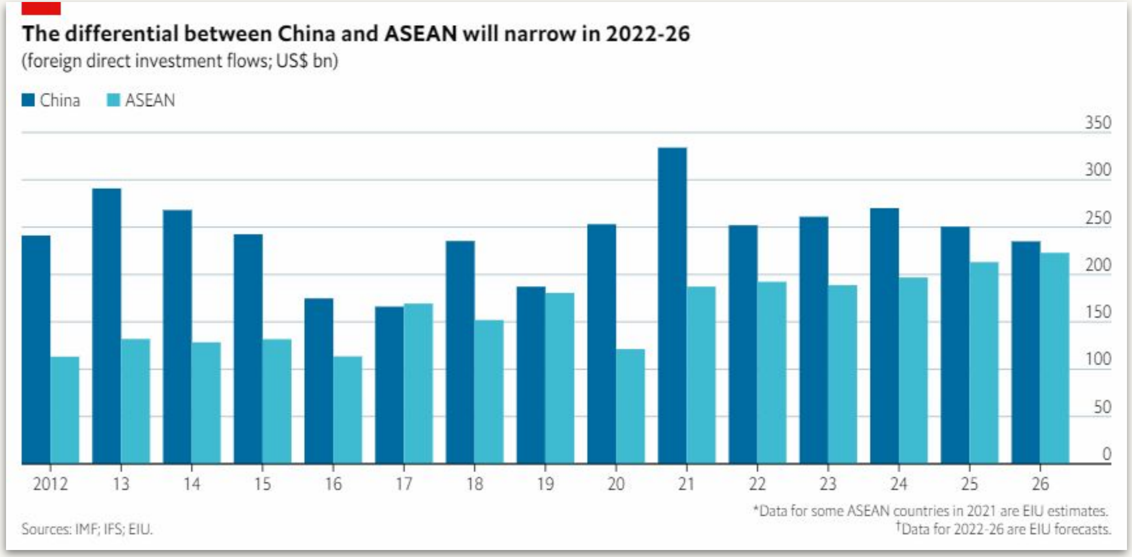
20th party congress: China's next five years of diplomacy



Ties with Russia remain important, but a China-Russia bloc will not form
Deepening economic cooperation with Russia, including in commodities trade spanning energy and agricultural inputs, as well as some strategic technologies (although these will be limited by US export controls)

Cross-Strait turbulence will deepen, but an invasion of Taiwan is unlikely
Likelihood of US intervention continues to deter a direct Chinese invasion of Taiwan

China to enhance its military harassment of Taiwan in 2023, in the (misguided) hopes of frustrating the electoral chances of the DPP

The chorus for decoupling will grow louder
Supply chain fragmentation will therefore remain a major theme in 2023-27, but China's robust economic linkages with the world will make this a painful process

Issues of **resource inefficiency** and **higher costs** tied around supply-chain duplication, as companies aim to stay compliant with Western sanctions, investment restrictions and tariffs while maintaining their operational footprints in China.

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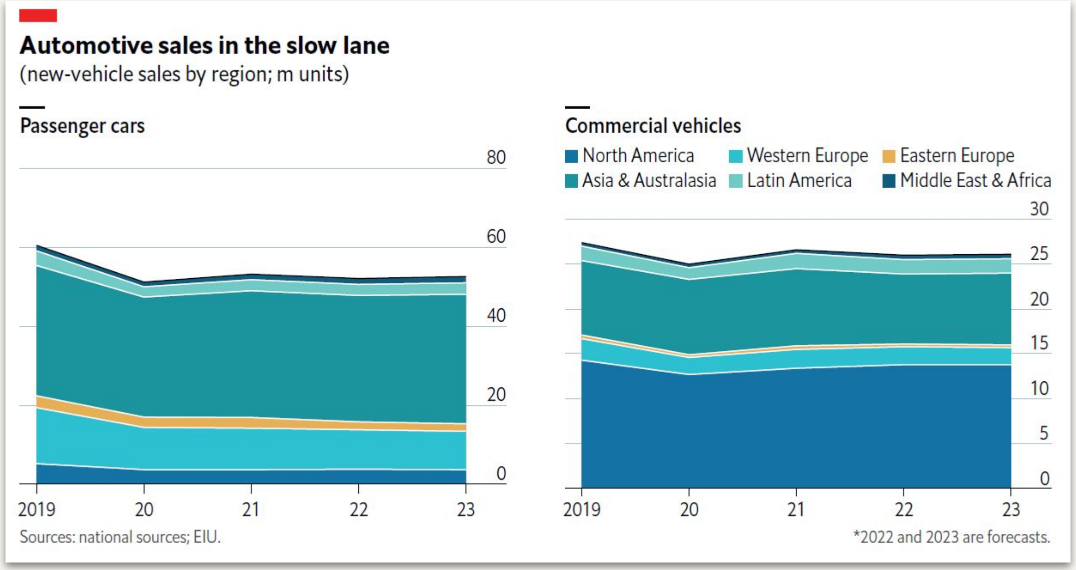
Industries in 2023

Automotive, Consumer goods, and Healthcare

Auto: Recovery has been held back by supply-chain problems



Auto: Sales will remain muted
Global new-vehicles sales will remain flat in 2023: new-car sales will rise by 0.9% and new commercial vehicle (CV) sales will fall by 1.3%.

Sales of electric vehicles (EVs) will be the only bright spot, growing by 25%, but governments will restructure their incentive schemes.

Automotive supply chains will remain a weak link
Semiconductors will remain in short supply, new capacity not due to come into operation until 2024

Challenges in acquiring metals such as nickel, cobalt, steel and aluminium

Incentives for electric vehicles will be restructured
China has extended tax breaks and purchase subsidies available for buyers of new energy vehicles until end 2023.

Automakers are also investing in recharging solutions, including battery swapping

India is also planning to implement a battery swapping policy in the 2022/23 fiscal year (April-March), as part of its aim to electrify all new vehicles by 2030

No uniform battery standards, and end-of-life battery recycling is lacking

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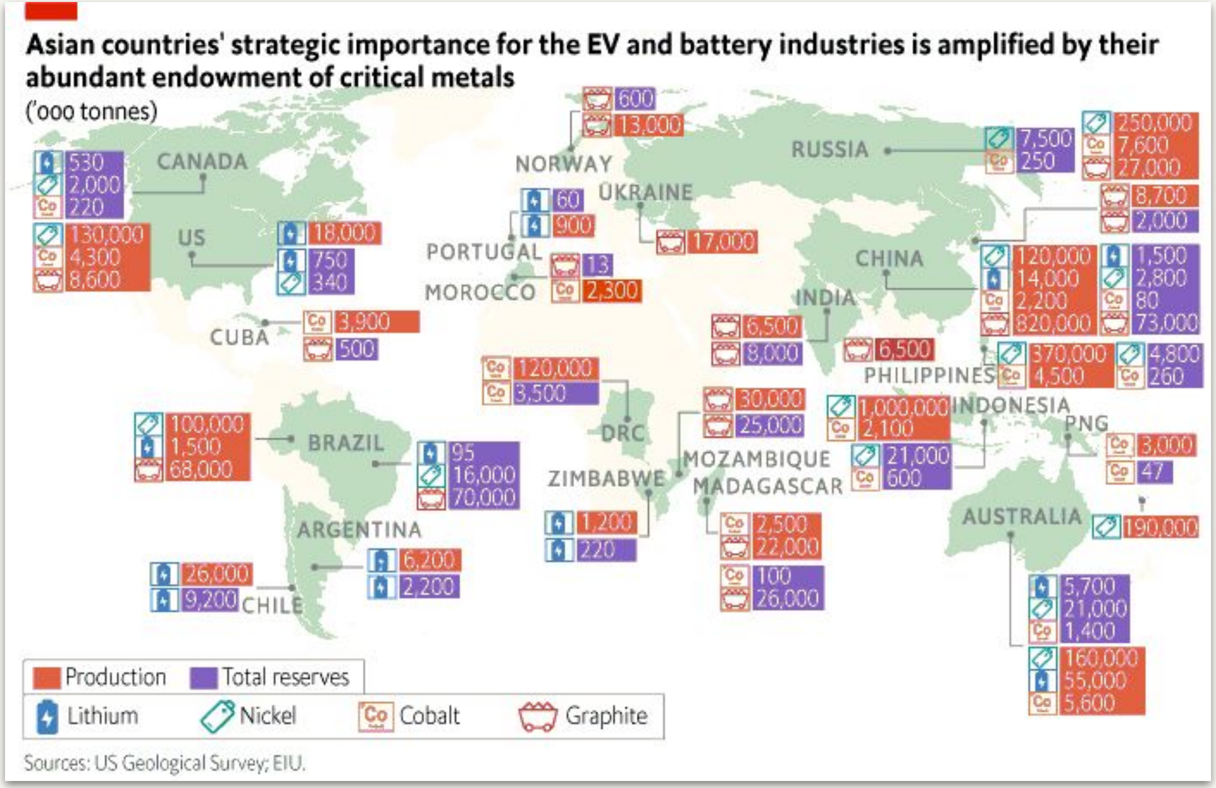
Auto: Battery supply chain offers risks and opportunities in Asia

Indo-Pacific Economic Framework provides opportunities to combine natural resources, financing and production



China unmatched in the competition for batteries resources

Established supply chain, business friendly labour and environmental policies spur foreign investment

Vast outreach in the mining sector in many countries allows easy sourcing

Efforts to establish new supply chains will accelerate

Challenges in acquiring metals such as nickel, cobalt, steel and aluminium

Screening of FDI will tighten and emergence of "friend-shoring"

Semiconductors will remain in short supply, with new capacity not online until 2024

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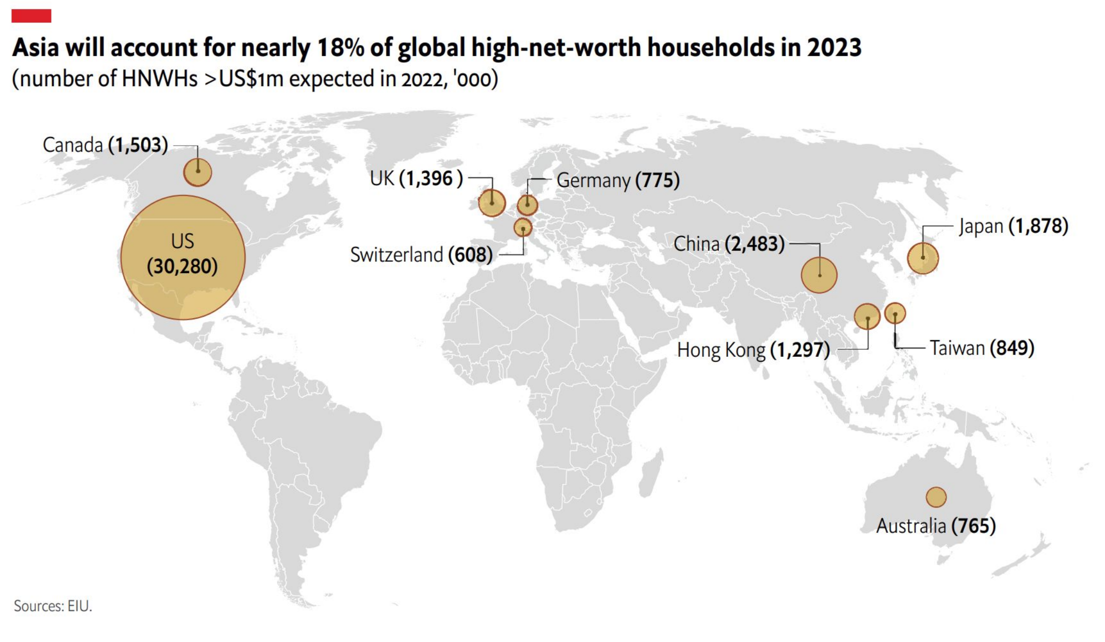
Consumer goods: Retailers respond to pricing pressures

Inflation will push up global retail sales by a robust 5% in US-dollar terms in 2023



High inflation will squeeze profits…
Higher costs for raw materials and logistics, but also by labour and energy costs

… and retail jobs

Invest in automating backend processes

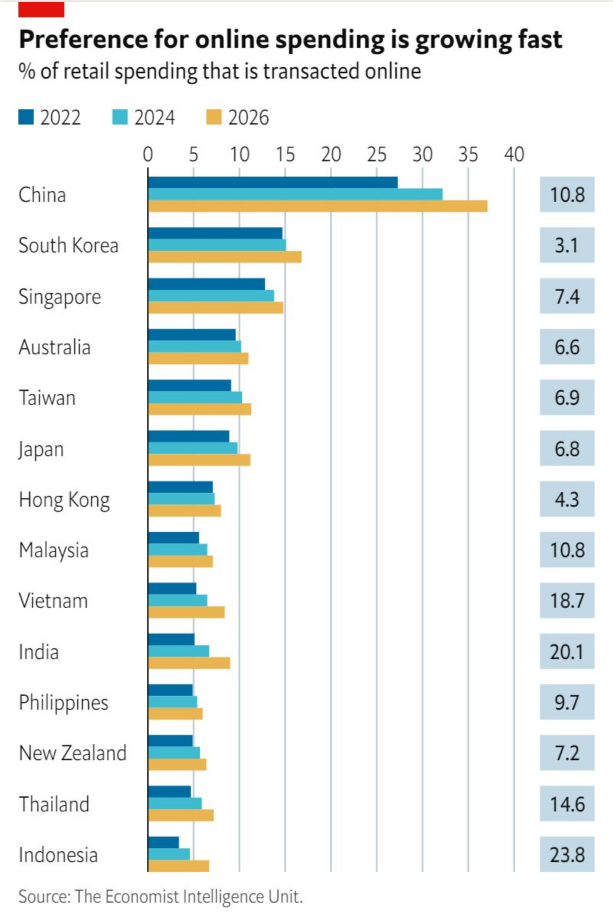
Online retail growth will shift to EMs
Growing middle class, increasing internet penetration and policy focus on digitalisation

Opportunities for marketplaces, logistics and payment service providers to enable Asia's SMEs to go digital

Economic slowdown in China will bring fresh challenges for luxury brands

China's consumer spending will be lacklustre as the government maintains its zero-covid policy and a slowdown in important trade partners, such as the US and EU, weigh on the domestic economy

E-commerce: New technological behaviours after covid



Direct-to-consumer (DTC), omnichannel and data-driven sales are the new key trends

While data, the tech and the platform are all crucial, what is most crucial is the interaction with the customer

The most likely outcome is a hybrid future - leverage on tech, but maintain a physical presence

Rise of superapps in Asia

What makes an app “super”?

All-in-one platforms that offer ride-hailing, food delivery, entertainment, financial products

Government largely supportive of indigenous super apps (for now...)

Regulatory concerns around transparency, data protection, privacy, cybersecurity

Leverage platforms to meet financial-inclusion targets and to reach those with limited access to banking

More growth to come

With greater internet connectivity and financial literacy, esp. for developing Asia

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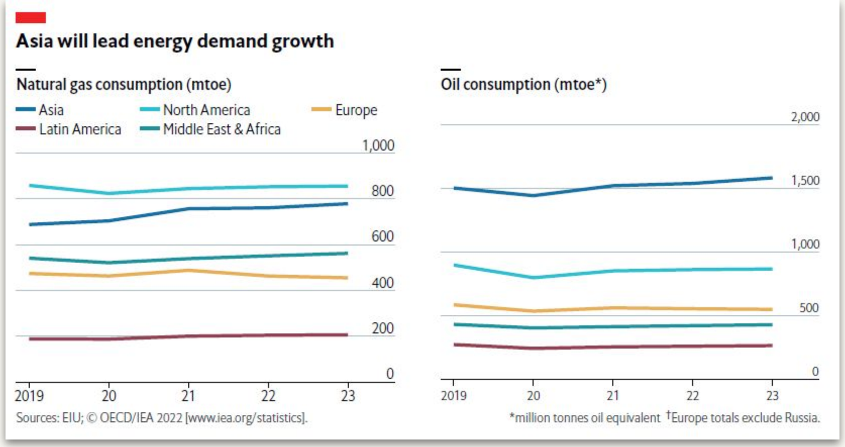

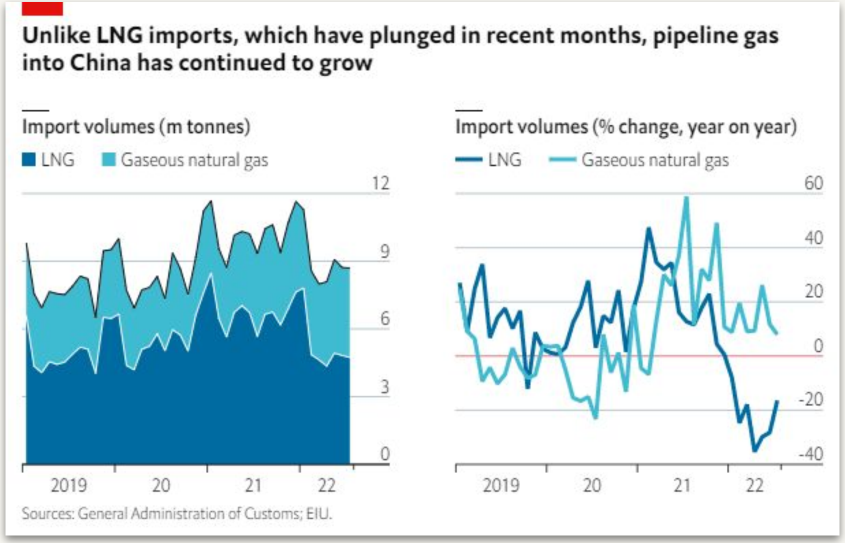

Energy: China eyes more natural gas from Russia and Central Asia

Natural gas usage flat, but coal and oil consumption will grow
Gas demand in Asia will rise by 2.4% in 2023, on track to become the largest global market for natural gas by 2027

Coal and oil consumption will benefit from increased policy focus on energy security

Growth in renewable energy will stay strong
Solar and wind energy consumption will surge by 11% during 2023 as more projects come online

Global renewables capacity addition to grow at an annual average rate of 10% during the next ten years

Commodity price boom will divert some investment towards fossil-fuel projects, higher interest rates slows transition down

Energy crises caused by extreme weather will encourage coal usage
Sentiment shifts in favour of reliable energy supplies, comeback for nuclear energy for China in 2023

China and India, where hydro power accounts for more than 10% of total electricity generation, are most likely to do increase coal usage

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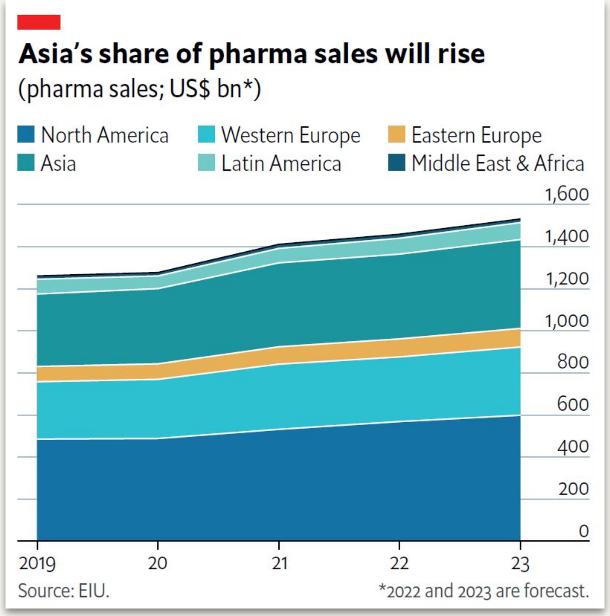
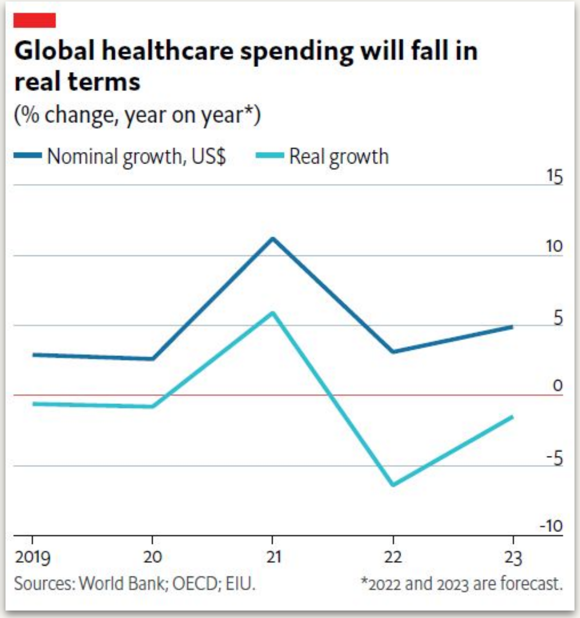
Healthcare: Spending growth will fail to match inflation





Healthcare spending growth will fail to match inflation

Total healthcare spending (public and private combined) to rise by 4.9% in nominal US-dollar terms in 2023, propelled by higher costs and wages

Gap between spending and costs will be most acute in Europe, as well as in developed Asian countries such as Japan and South Korea.

OECD data suggest that after the global financial crisis of '08-09, spending on **preventive care and pharmaceuticals was squeezed the most**

Pharmaceutical and biotech companies will see margins narrow - Global pharmaceutical sales to rise by 5% in US-dollar terms, much of this growth will reflect higher input costs, while regulators will push down on pricing

China's steady centralisation of its drug purchasing system will make price negotiations tenser there

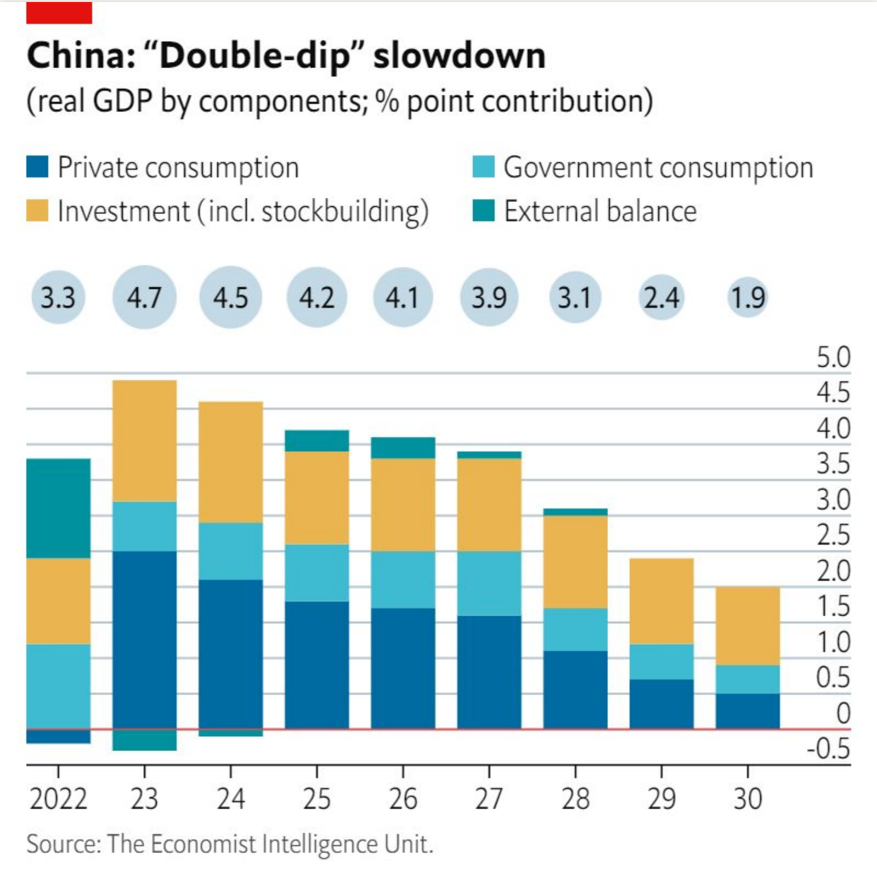
2023 is also a key year for patent expiry - Although the value of global patent expiries will not peak until 2028, the prospect of a drop in revenue will prompt drugmakers to dip into the market with bolt-on acquisitions, especially given that market valuations for their targets will be low

Countries at a glance

Near-term forecasts and headlines for:

China & Hong Kong

China: Domestic economic picture is fragile



We expect growth to decelerate to (a planned revision of) 3.3% in 2022, missing the official target of 5.5%, as strict pandemic controls depress household spending and the government provides moderate support through public investment.

"Zero-covid" framework to last throughout 2023, continuing to depress activity in the private sector.

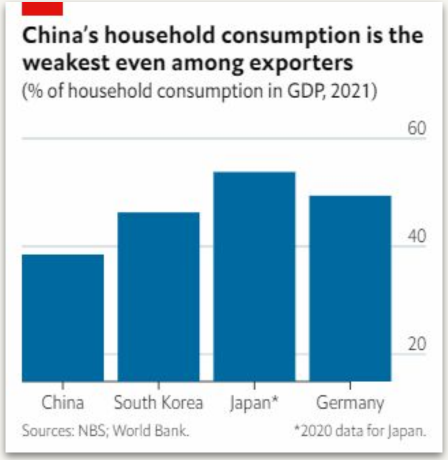
Other areas of economic stress will derive from weakness in the property sector, worsening issues around bad credit and slowing external demand.

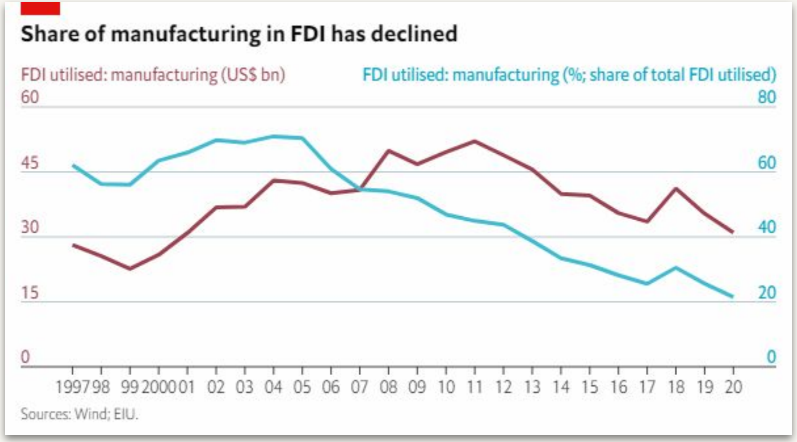
Deepening geopolitical frictions will also inflict disruptions to supply chains and cross-border investment, as sanctions, tariffs, export controls and other policy measures challenge the operations of multinational firms.

Headlines:

- 20th party congress: China's next five years of economy
- "Double-dip" slowdown hits China's economy
- Household pessimism holds back China's credit growth
- China eases "zero-covid" policy but full exit still far off

20th party congress: China's next five years of economy





Long (zero) covid continues to cloud the economy

- Mr Xi's administration will contemplate eventual exit approaches for the zero-covid doctrine, commencing in 2023
- Risk that a large-scale outbreak runs out of control in 2023, bringing an abrupt end to carefully choreographed plans

Pro-consumption shift will be held back by institutional inertia

- Prolonged fears of unemployment and shrinking wealth will have a lasting impact on consumer behaviour
- Oversized share of the government in the economic output relative to households
- Authorities will still rely on trivial, one-off measures to boost demand

"Dual circulation" to sharpen the manufacturing edge

- International circulation focused on foreign trade and investment will remain a pillar of the economy
- Concerns over foreign dependency and a hollowing out of industries will continue to spur investment in domestic manufacturing capacity, reinforcing long-held mercantilist and pro-industry model

Increased state sway will be a double-edged sword

- State-owned enterprises will play a bigger role in providing a backstop for the economy, and are well positioned financially to expand their remit and provide support, absorb surplus labour
- Expansion of state presence could be at the expense efficiency, price distortion, supply-demand mismatch

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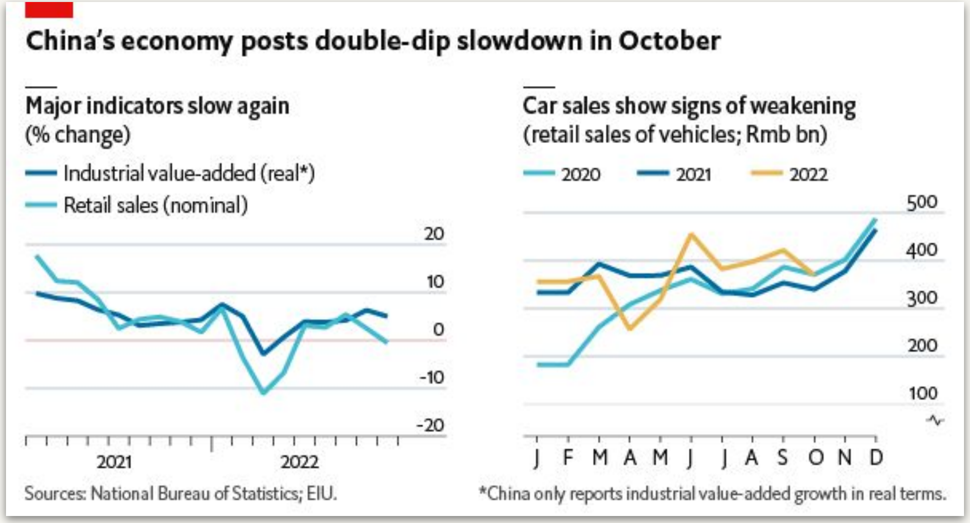
"Double-dip" slowdown hits China's economy



China's economy was caught in a "double-dip" slowdown in October. Growth in industrial value-added (IVA) moderated to 5% and retail sales fell by 0.5% after a brief recovery in September

EIU expects momentum to remain tepid in the remainder of 2022 and early 2023, despite the partial relaxation of zero-covid protocols, with recovery more likely to take shape by mid-2023

Automotive industrial performance rose by 18.7% year on year. Other sectors recording strength included electric machinery (16.3%) and chemicals (9.8%), which are probably benefiting from high energy prices and production costs elsewhere

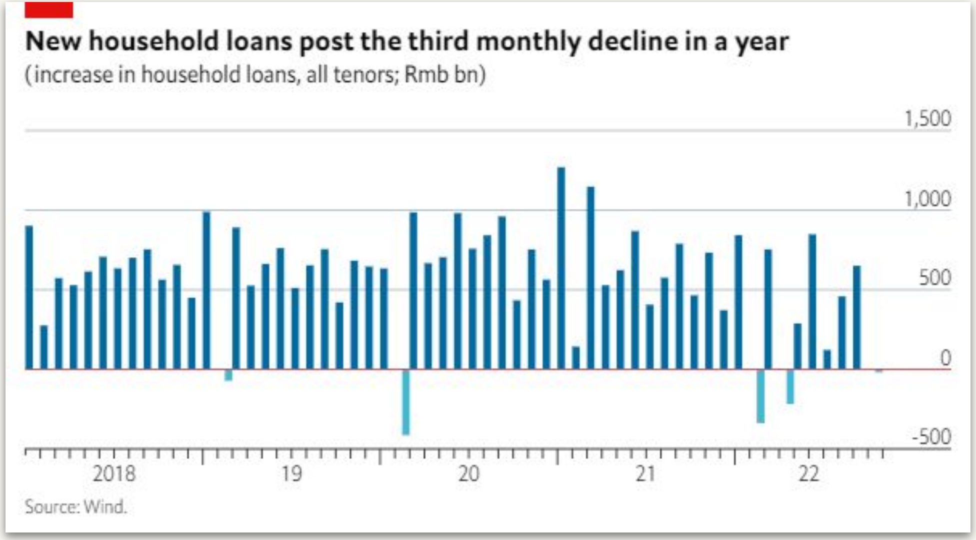
Fixed-asset investment maintained steady growth of 5.8% in January-October, with the extended weakness in property investment overshadowing infrastructure spending

State-backed investment to remain stable into the first quarter of 2023, having recorded 8.7% growth in January-October, as generous credit supply translates into actual investments

Recent upgrades in policy easing will probably stabilise the market by the first half of 2023, although the property sector is not expected to drive growth in that year.

We recommend that clients prepare for economic shocks in the coming one to two quarters as further policy adjustments occur. A consumption-led recovery will not materialise until mid-2023, after public panic subsides and infection rates stabilise.

Household pessimism holds back China's credit growth



China's credit growth slowed sharply in October, according to data released by the PBC. Renminbi bank loan issuance in October tumbled to Rmb615.2bn (US$86.3bn), a quarter of September's reading and the lowest level since 2018.

The flow of total social financing, the broadest measure of credit, dropped to Rmb907.9bn.

The credit flow would have been worse were it not for supportive credit policies

New corporate loans have stabilised at Rmb462.3bn, probably reflecting the issuance of bail-out funds to distressed housing development projects, concessional lending for equipment upgrades and infrastructure investment.

These helped to offset the slowdown in credit demand due to subdued business vigour, as manifested by a contraction in the PMI in October.

Authorities will maintain an accommodative stance in order to backstop the economy in 2022-23

In particular, in the light of the tepidity in property transactions, the PBC is likely to sanction a further cut to the five-year loan prime rate (the benchmark mortgage rate) this year.

With supportive credit policies and the transition towards a more flexible approach to covid-19 mitigation, we expect private credit demand to pick up marginally in 2023.

China's exit from the "zero-covid" policy will boost economic growth—and the death toll

(economic growth, % change, quarter on quarter)

(Economic and health consequences under different scenarios)

Scenario	Probability	Economic impact	Peak ICU bed occupancy	Death toll
— Uncontrolled*	N/A	N/A	1m (15.6x capacity)	1.6m
— Inertia	40%	4.7% growth in 2023. Depressed economic vigour throughout 2023-24.	Below capacity	Lower than average annual influenza-related excess deaths (80,000)
— Chaos	35%	Boosting economic growth by about 0.5 percentage points in 2023 (to 5-5.5%), with momentum more consequential for 2024 and beyond. Heavy disruption followed by improvement in private consumption and investment, and stimulus.	190,000-220,000 (2.8x capacity)	460,000-490,000
— Agile	25%	Boosting economic growth by about 1 percentage point in 2023 (to 5.5-6%), with momentum more consequential for 2024 and beyond. Disruption followed by recovery in confidence, boosting private consumption and investment.	60,000-90,000 (1.2x capacity)	130,000-160,000

Source: EIU.

* For reference only

China eases "zero-covid" policy but full exit still far off

We have outlined three scenarios for how China's zero-covid agenda will evolve:

"**Inertia**", where covid control is loosened very slowly;
"**Chaotic end**", where a highly transmissible coronavirus variant will emerge and bring an end to the doctrine;
or an "**Agile exit**", where China will accelerate the exit process in 2023

Adjustments include cutting the quarantine time for close contacts and travellers, easing restrictions on international travel and streamlining mobility controls for residents.

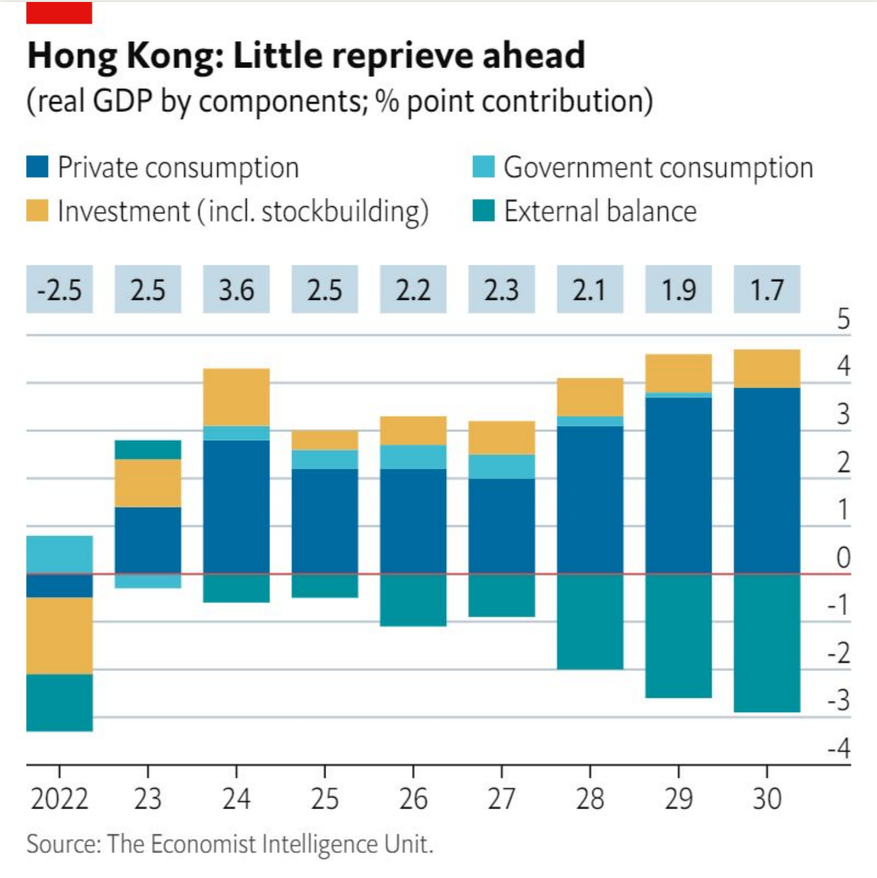
This is in line with our baseline forecast that China is slowly hollowing out the definition of zero-covid and relaxing controls, but inertia will ensure that the doctrine remains well into 2023.

In the coming months the relaxation will inevitably lead to a rise in the caseload—a step towards "living with covid". Consequently, we see the risk of a chaotic end as high, although the probability of an optimistic agile exit has also risen.

EIU has raised the probability of an agile exit in 2023 to 25%, up from 15%, as China begins to contemplate a pivot.

We recommend clients to watch for subtle shifts in propaganda messaging, vaccine development and the distribution of antiviral drugs as signals of a changing policy stance, and to prepare for sudden economic shocks.

Hong Kong: Population decline and deteriorating external conditions



EIU assumes that the majority of mobile workers with transferable skills who have sought to leave Hong Kong for such reasons have already made their move.

Resident population decreased by 1.6% year on year in mid-2022, to 7.3m. EIU believes that the population will begin to rise again from 2023, but the recent decline will be a constraint on growth.

The population shrinkage has restricted expenditure, largely in the form of private consumption, and contributed to a contraction in the economy in the first half of 2022.

A smaller population now also means lower demand for consumer-facing businesses and the potential for greater difficulty in hiring staff.

Headlines:

- Little reprieve ahead for Hong Kong's economy
- Key takeaways from Hong Kong's annual policy address

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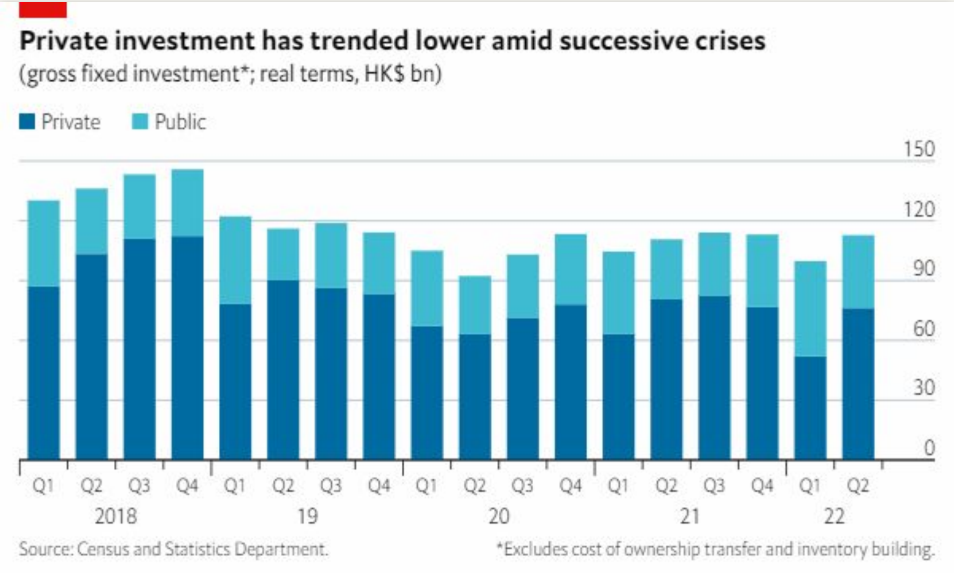
Little reprieve ahead for Hong Kong's economy



Hong Kong's economy suffered a steep contraction in Q3 2022. Domestic demand and investment was weaker than EIU had forecast. Many of the trends behind the poor performance are yet to reverse, including stagnating population growth, slumping asset markets, weak demand for office real estate and a lack of foreign tourists. Amid a slide into global economic downturn, a recovery in Hong Kong's real GDP to 2018 levels is unlikely before 2024.

Private domestic demand is struggling to recover - private consumption, recorded no growth on a year-on-year basis, leaving it at a lower real level than in the same quarter of 2017. Gross fixed investment declined by 14.3% year on year.

An economy firing on few cylinders

A scenario in which the local economy enters a deep recession with a surge in unemployment remains outside our baseline forecast. Another year of stagnating domestic demand is a safe assumption, though.

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Hong Kong's lustre dims

Hong Kong, despite being a mature economy, has seen its attractiveness to multinational firms decline as a result of institutional and demographic changes

Main concerns of international businesses

- Uncertainties over legal and regulatory system
- Prospects for foreign trade
- Lack of infrastructure upgrades
- Emigration of foreign workforce leaves skill gaps

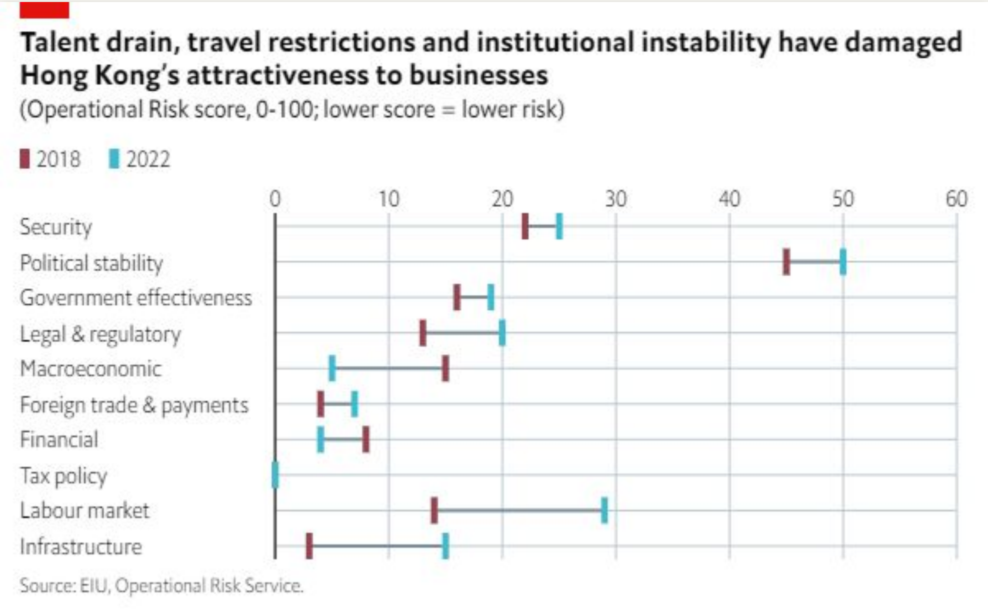
Hong Kong retains exceptional qualities

International trade and financial hub

Ultra-low tax regime highly competitive globally

Common law system for commercial cases remains unaltered and its financial regulatory system exemplary

Broad access to domestic and international financing, and the territory still holds a unique role as a trade and financing centre linking mainland China with the world



Key takeaways from Hong Kong's annual policy address

New efforts to attract foreign labour

New policies announced aim to make it easier both for foreign workers to enter the territory and for local firms to hire overseas labour

Removal of the need for organisations to prove that positions that are covered by the migrant "Talent List" cannot be filled locally

Infrastructure construction will act as a major economic stimulus in the latter part of our forecast period (2023-27), and the plans confirm the government's focus on building out large parts of northern Hong Kong

Six major infrastructure developments will be brought forward

Projects are likely to boost economic growth through an uptick in public fixed investment in the latter part of our forecast period, when actual construction begins

The authorities will not pursue radically different approaches to increasing the supply of residential land, but will lean more on temporary units to ease acute shortages in housing supply

Bureaucratic reform and regulatory streamlining, as well as added political pressure from the central government on housing issues will allow Mr Lee to be more successful in meeting his targets

Emphasis on the role of temporary public housing reduces waiting times for government-provided housing to 4.5 years by 2026/27, from six years

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