BANK OF CHINA **BOC Research Institute**

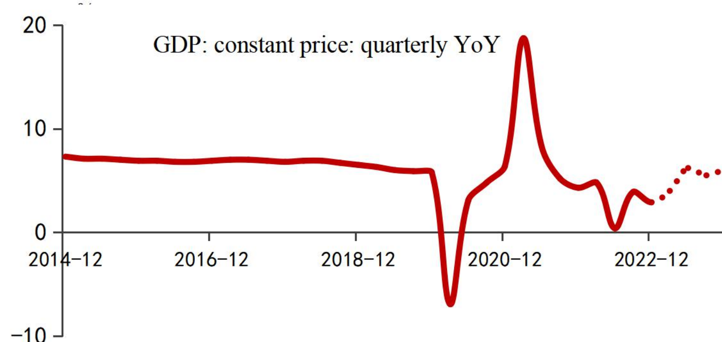
# China's Economic and Financial Outlook

**2023Q2 (Issue 54)** **April 3, 2023**

## Highlights

- 2023Q1 saw China's economy recovering as the fallout from the COVID-19 pandemic faded substantially and the policies to stabilize the economy were front-loaded. Both production and demand improved, employment and price level were generally stable, and market confidence and expectations were buoyed notably. To some extent, the rebound in domestic demand offset the moderation in foreign demand. The overall economic performance showed a momentum of stabilization and recovery. The GDP growth rate for Q1 is estimated around 4.1%.
- Looking ahead to Q2, China's economy will enter into comprehensive recovery in the post-pandemic era. Consumption will maintain a good recovery momentum, investment in infrastructure and manufacturing will continue to grow rapidly, real estate investment will gradually firm up and exports growth will find its bottom with a slowing pace of decline. Given the low base for the same period in 2022, the GDP growth for Q2 is estimated to be 7.6%, up about 3.5 percentage points from Q1, which may be the peak for the year.
- Macro-policies should be more stable to promote positive interaction and circulation among economic recovery, stronger growth momentum and expectations improvement. In addition, external risks and spillovers should be closely monitored and analyzed. We offer the following suggestions: policies should be flexibly refocused to improve the expectations of market players. Financial policies should take into account both ensuring stable growth and guarding against risks to promote sustained and stable economic development. A focus should still be put on stabilizing employment and confidence to sustain the recovery in consumption. Stronger funding support should be provided for projects to boost confidence in private investment. A favorable environment should be created for foreign trade to strengthen comprehensive services for foreign traders. The policy support for both supply and demand sides of real estate should remain on track to cement the footing for property market recovery.

**China's Economy Recovers Steadily after COVID-19**




Sources: BOC Research Institute

**BOC Research Institute**
**China Economic and Financial Research Team**

Team leader: Chen Weidong

Deputy leader: Zhou Jingtong

Team members: Li Peijia
Liang Jing
Zhao Tingchen
Fan Ruoying
Liang Si
Ye Yindan
Liu Chen
Wu Dan
Qiu Yilin
Liu Peizhong
Wang Jing
Zhang Wenwen (Hong Kong Institute of Financial Research)

Contact: Liu Chen

Telephone: 010-66594264

Email: lczs0711@163.com

# China's Economy Recovers Steadily after COVID-19, Requiring More Policy Stability

## -- China's Economic and Financial Outlook (2023Q2)

2023Q1 saw China's economy recovering as the fallout from the COVID-19 pandemic faded significantly and the policies to stabilize the economy were front-loaded. Both production and demand improved, employment and price level were generally stable and market confidence and expectations were buoyed notably. To some extent, the rebound in domestic demand offset the moderation in foreign demand. The overall economic performance showed a momentum of stabilization and recovery. The GDP growth rate for Q1 is estimated around 4.1%. Looking ahead to Q2, China's economy will enter into the comprehensive recovery in the post-pandemic era. Consumption will maintain a good recovery momentum, investment in infrastructure and manufacturing will continue to grow rapidly, real estate investment will gradually firm up and exports growth will find its bottom with a slowing pace of decline. Given the low base for the same period in 2022, the GDP growth rate for Q2 is estimated to be 7.6%, up about 3.5 percentage points (pcts) from Q1, which may be the peak for the year. However, China's economic recovery is on a fragile footing. On the one hand, the external environment remains highly uncertain, for the geopolitical and geoeconomic relations are still complex and volatile, the world economy is further losing steam and global financial markets are more turbulent. On the other hand, the domestic market is still in a post-COVID-19 recovery and the "scarring" effects of the pandemic persist. Macro-policies should be more stable to promote positive interaction and circulation among economic recovery, stronger growth momentum and expectations improvement. In addition, external risks and spillovers should be closely monitored and analyzed. We offer the following suggestions: policies should be flexibly refocused to improve the expectations of market players. Financial policies should take into account both ensuring stable growth and guarding against risks to promote sustained and stable economic development. A focus should still be put on stabilizing employment and confidence to sustain the recovery in consumption. Stronger funding support should be provided for projects to boost confidence in private investment. A favorable environment should be created for foreign trade to strengthen comprehensive services for foreign traders. The policy support for both supply and demand sides of real estate should remain on track to cement the footing for property market recovery.

## I. 2023Q1 Economic Review and Q2 Outlook

### I.1 2023Q1 economic review

#### 1. Consumption, production and confidence improved significantly amid fading fallout from COVID-19

**First, consumption rebounded notably from the pandemic with obvious features of structural recovery.** As the impact of COVID-19 diminished substantially, the growth rate of total retail sales of consumer goods returned to positive range. However, consumption recovery is markedly uneven. **In structural terms, on the one hand,** service consumption recovered faster than commodity consumption, especially in areas requiring human-to-human contact such as tourism and catering. **On the other hand,** commodity consumption was mixed, with consumer staples in good recovery but durables and big-ticket items such as automobiles relatively sluggish. **Second, driven by domestic demand pickup, some of the production sectors recovered obviously faster.** In January and February, industrial value added of enterprises above designated size saw faster

year-on-year growth rate, with manufacturing PMI back to the expansion range. In addition, recovery accelerated in transportation, accommodation, catering, culture and entertainment services. **Third, the sustained economic pickup alongside an optimized COVID-19 policy boosted market players' expectations and confidence.** Enterprises' perceptions of macroeconomic operations and their expectations for business activities have improved significantly amid consumers' stronger confidence and demand for loans.

## 2. The property market picked up, but still some way off from a full recovery

In 2023Q1, the real estate policies worked on both supply and demand sides, coupled with the macroeconomic recovery, to put a floor under the property market. **First, the pent-up demand was released quickly.** Suppressed by the brief peak of coronavirus infections triggered by China's COVID-19 policy optimization and the Chinese New Year holiday, the pent-up demand burst out after the Spring Festival to fuel a transitory pickup in the housing market. **Second, the city-specific policy support was strengthened.** PBOC (People's Bank of China) established a dynamic adjustment mechanism on mortgage rates for first-time home buyers. Local governments have continued to introduce supportive policies such as optimizing housing purchase and sales restrictions, adjusting the housing provident fund loan policy and granting subsidies to homebuyers. **Third, efforts are ongoing to forestall and defuse real estate risks.** China's government has stepped up a raft of measures to "ensure the delivery of housing projects, ensure living standards and ensuring stability", putting the work to forestall and defuse real estate risks on the priority list and making way for continuously improving the financing environment for property developers. **However, it remains to be seen whether the housing recovery is sustainable. First, it will take time to sustain the improvement in residents' expectations.** On the one hand, the policy stance that "houses are for living in, not for speculation" encourages first-time home buyers, so only a limited portion of excess savings will flow to the real estate industry. On the other hand, residents remain concerned about delivery risks in the short term. **Second, the serious divergence among property developers and geographical areas put a damper on full recovery of the market.** On the one hand, state-owned enterprises (SMEs) and some private enterprises led small and medium-sized property developers in recovery of sales. On the other hand, the pent-up demand was well released in first-tier and second-tier cities, while third-tier cities saw a weaker-than-expected recovery of housing sales due to population outflow and overstretched demand.

## 3. Export growth rate remained in negative range,with disparities across regions and products.

Export growth remained weak due to the volatile geopolitical and geoeconomic conditions, subdued overseas demand, weakening price level support and a high comparison base in 2022. **Major trade partners showed widening divergence.** In January and February, China's exports to the US maintained negative growth, its exports to the EU and Japan registered a slower pace of contraction, and its exports to the ASEAN expanded rapidly. **From the perspective of product mix, upstream products and automobiles had a boom, while the exports of labor-intensive products continued to weaken.** However, export growth beat market expectations mainly due to the following factors: **First,** international demand was stronger than expected. The US ISM manufacturing PMI showed improvement in February, and consumer confidence also picked up in Europe and Japan. **Second,** the domestic economy reopened faster after the Spring Festival to unclog the supply and industrial chains. The backlog of orders built up during the COVID-19 peak was cleared, giving a boost to export growth. **Third,** the new forms of foreign trade have become an important driver of export growth, with cross-border E-commerce exports gaining momentum.

## 4. Pro-growth policies were front-loaded for stable economic recovery

**First, the government highly values investment as a key stabilizer of growth.** As the 2023 *Government Work Report* calls for "expanding effective investment", local governments generally planned a larger number of major projects and a bigger size of annual investment. **Second, government funding was front-loaded in support of project implementation.** The quota for local government special bonds was increased **in advance**. Local governments accelerated their issuance of special bonds. With government-funded major projects implemented, infrastructure investment kept growing fast. **Third, credit supply expanded to serve the real economy.** The lending structure was increasingly rationalized to further bolster the real economy. Medium- and long-term corporate loans reached a record high for the same reporting period, with manufacturing investment remaining on fast track. **Fourth, the policy package to secure supply and stabilize price level keeps inflation tamed to favor economic recovery.** Around the Spring Festival, the executive meetings of the State Council crafted plans to secure supply and stabilize prices of energy and commodities vital to people's livelihoods and arranged for spring farming, ensuring adequate market supply during the holiday and improve the ability to stabilize grain supply going forward. The inflation is generally moderate at present.

**I.2 Economic Forecast for 2023Q2:**

**1. Consumption will likely sustain its recovery momentum on a host of tailwinds.**

**First,** the fading economic and social fallout from COVID-19 and the sustained macro-policy support on fiscal, monetary, industrial and other fronts will keep employment on course for improvement in Q2, thus driving up residents' income and expectations and paving the way for consumption recovery. **Second,** as the *Government Work Report* required work to "stabilize consumption of big-ticket items", the sale of big-ticket items stands to ratchet up in Q2 on policy support and improved expectations. On the one hand, with the property market expected to bottom out in Q2, overall consumption will feel a gradually eased drag from housing-related consumption such as home furniture and appliances. On the other hand, automobile manufacturers and local governments have ramped up subsidies to car buyers for a recovery of automobile consumption. **Third,** the supply will expand steadily in some areas of consumption, such as civil aviation and cinemas. The supply constraints will gradually be eased which can further tap consumer demand. **Fourth,** 2022Q2 provided a low comparison base. Overall, consumer spending is expected to grow by about 13% in Q2.

**2. Infrastructure and manufacturing investments will keep growing, and real estate investment will gradually firm up**

**First, the growth of infrastructure investment remained fast.** In terms of funding, the fiscal policymaker has raised the deficit-to-GDP ratio and scaled up the issuance of special bonds, allowing the proceeds of special government bonds to be invested in a wider range of sectors and used as capital more broadly. In terms of projects, infrastructure investment is based on the major project pipeline included in the 14th Five-Year Plan. The project pipeline and preparatory work have been strengthened. **Second, manufacturing investment is still gaining traction.** The recovery in domestic demand will help accelerate production, boost capacity utilization, boost corporate earnings expectations and encourage enterprises to invest. In addition, industrial and credit policies will increase support for manufacturing upgrades and high-tech investment. **Third, real estate investment will gradually firm up.** Driven by policies on both supply and demand sides, the pent-up demand of first-time homebuyers and home upgraders will be unleashed, triggering a gradual recovery in housing sales, land acquisition and land development. However, it still takes time for real estate investment to recover as property developers are under great pressure to destock and recover money from housing sales. Overall, fixed asset investment is expected to grow by about 5.8% in Q2.

**3. Export growth is likely to bottom out for a recovery with structural opportunities**

**From the perspective of "drag" factors, first, the recovery of foreign demand remains uncertain.** Global inflation remains hot. There is a high probability that advanced economies in Europe and the US will raise interest rates in small increments in 2023H1, dampening international demand. In addition, the destocking cycle of major developed countries has not yet ended. The inventory-to-sales ratio of most US commodities goods remains high. **Second, the comparison base in 2022 is fairly high. From the perspective of "boost" factors, first, foreign demand is partially bolstered in some regions.** Stronger demand from the ASEAN countries will boost the growth of China's export of end products. The implementation of RCEP will deepen the China-ASEAN cooperation at the industrial chain level, clearing the way for the "China - ASEAN - Americas and Europe" export path. **Second, China is a globally competitive exporter of electric vehicles, photovoltaic products and lithium batteries.** Proprietary technologies, huge production capacity and low kWh cost represent China's core competitiveness in green product exports. China will see its export growth driven by European energy security needs and emerging market countries' short supply of new energy products. Overall, China's exports contraction in Q2 will likely ease to around 4%.

**4. The supply side continues to recover, likely to return to the pre-pandemic level.**

**In the industrial sector, first, the supply chains are being repaired as earlier production constraints have been removed.** Since the Spring Festival, the flows of people and goods have been restored, businesses have accelerated reopening and the constraints on labor supply have been significantly eased. In the future, the industrial and supply chain self-reliance will be further strengthened to ensure smooth industrial production. **Second, the sustained recovery of domestic demand is expected to offset the contraction in foreign demand , becoming a major driver of production.** "Stabilizing growth" and "expanding domestic demand" are the top economic tasks in 2023. The fiscal policy will be more targeted and effective to expand effective investment, boost consumption growth and accelerate industrial growth. **Third, market expectations and confidence of micro market entities will be improved on restored confidence of micro market entities.** The improving corporate expectations will likely further speed up the investment spending and business activity to bolster industrial growth. Overall, the industrial value added is expected to grow by about 9% in 2023Q2 from a low base in 2022. **In the service sector,** offline activities will recover at a faster pace, improving employment and boost income. The confidence of market players will be further solidified. These factors, alongside policy measures and incentives to boost consumption, are likely to accelerate the recovery of close contact services. Overall, the service value added is estimated to grow by about 7.5% in 2023Q2.

**5. PPI-CPI divergence further widened amid moderate inflation**

**First, CPI will remain low.** On the one hand, food inflation is losing steam. On the other hand, non-food inflation is moderate. Taking into account the muted carry-over effect, the CPI growth in Q2 is projected to soften from Q1. **Second, PPI will continue to decline year-on-year.** The prices of crude oil and other commodities will remain strained by weaker demand from major economies. Although domestic infrastructure and real estate demand will provide some support for prices of producer goods, the year-on-year decline in PPI will be further widened due to carry-over effect. The PPI-CPI divergence will further expand. CPI and PPI are expected to rise 0.9% and fall 2.8% respectively in Q2.

## II. 2023Q1 Financial Review and Q2 Outlook

### II.1 2023Q1 financial review

2023Q1 still witnessed many uncertainties in either internal or external environment of China's financial sector. Externally, major economies saw continued price declines, with rate hike expectations moderated and liquidity conditions improved marginally. However, a series of risk incidents, such as the collapse of Silicon Valley Bank and Credit Suisse, roiled and panicked the global financial markets. Meanwhile, the high inflation and high interest rates led to weakened growth expectations and heightened recession risks in the US and Europe. Global equity markets were lackluster and commodity prices remained volatile. Internally, China's financial market steadily recovered on positive growth expectations. The magnitude of money and credit expansion hit a record high, with the market interest rates edging up slightly, the RMB exchange rate rising and then declining, the bond issuance still divided and the stock market ratcheting up. In addition, the financial regulatory system has undergone another overhaul by setting up the Central Financial Commission and the National Financial Regulatory Administration NFRA. A new regulatory framework consisting of the Financial Stability and Development Committee (FSDC), the People's Bank of China (PBOC), the National Financial Regulatory Administration (NFRA) and the China Securities Regulatory Commission (CSRC) has taken shape, streamlining the supervision of institutions and functions and helping enhance China's financial system stability.

**1. Money and credit supply expanded notably on stronger corporate willingness to borrow**

During January and February 2023, new aggregate financing to the real economy totaled RMB9.14 trillion, up RMB1.75 trillion year-on-year. New RMB loans hit a record high of RMB6.75 trillion, up RMB1.64 trillion year-on-year. Domestic equities financing of non-financial enterprises totaled RMB153.5 billion, down RMB48.9 billion year-on-year. The growth trend of government bonds and enterprises bonds were divergent, up RMB353 billion year-on-year and down RMB431.8 billion year-on-year, respectively. The increase in government bond issuance was mainly attributable to front-loaded special bond quota and accelerated issuance of government bonds. The decline in corporate bond issuance was due to rising costs of debt financing amid bond market turmoil that began in November 2022. Off-balance-sheet financing (trust loans, entrusted loans and undiscounted bank acceptances) added RMB340.4 billion, up RMB397.6 billion year-on-year. Off-balance-sheet financing has become increasingly regulated.

**The credit structure continued to improve with stronger support for key fields and weaker links of the economy. By credit structure,** the growth rate of outstanding credit to industrial, manufacturing, inclusive small and micro businesses, green and agriculture-related sectors was 26.5%, 36.7%, 23.8%, 38.5% and 14%, respectively, significantly higher than the growth (11.1%) of total outstanding loans. The growth of real estate loans further slowed to 1.5%. **By term structure,** medium- and long-term corporate loans took up a significantly larger share, while the proportion of medium- and long-term consumer loans shrank. In January and February 2023, new medium- and long-term corporate loans amounted to RMB4.61 trillion, accounting for 68.7% of total new loans, a surge of 18.7 pcts year-on-year. New medium- and long-term consumer loans stood at RMB309.4 billion, accounting for 4.61% of total new loans, down 8.75 pcts year-on-year. Since the beginning of the year, the share of medium- and long-term loans rose sharply, based on the steady pickup in corporate expectations for economic growth alongside pro-growth policies.

**2. Market interest rates were generally stable in a bottoming-out process, with mortgage rates still declining in many cities.**

The macro-economy has kept recovering since 2023 began, driving market interest rates to bottom out and stabilize. However, the recovery was not "synchronized" across the board. Specifically,

**first, main policy rates remained stable.** The seven-day reverse repo rate remained at 2.0% and the one-year MLF was still 2.75%, showing no changes since August 2022. The monetary policy stance has stayed unchanged in supporting the real economy and stabilizing economic growth. **Second, short-term money market rates bounced back.** The monthly average interest rate of China's interbank pledged repo, a gauge of the overall interest rate level in the money market, surged to 2.07% in February 2023 from 1.41% at the end of 2022, basically back to the pre-COVID-resurgence level in 2022 (the reading was 2.06% in February and 2.08% in March before plummeting to 1.61% in April in 2022 due to coronavirus resurgence). This may well indicate that the financing needs began to swell across the real economy. **Third, residential mortgage rates further declined in many cities.** Mortgage rates were generally lowered to near the policy floor in 2022 to bolster the property market. In January 2023, PBOC and the former China Banking and Insurance Regulatory Commission (CBIRC) issued policies allowing discretionary lowering of the mortgage rate floor for first-time homebuyers in cities that met certain conditions. Subsequently, many cities lowered the interest rate floor, further driving down mortgage rates.

**3. The China Government Bond (CDB) rose slightly in choppy trading, with bond issuance still divergent.**

The yield of the 10-year CDB moved higher in a choppy fashion in Q1 due to COVID-19 policy shift, positive economic outlook and money market rates in a bumpy upturn. The 10-year CGB yield closed at 2.86% on March 28, 2023, up 4 bps from the beginning of the year and up 3 bps year-on-year. Overall, the bond market has shown the following characteristics in Q1: **First, the total issuance was stable in size, with a continued structural divergence.** As of March 28, 2023, RMB15.78 trillion of bonds was issued in total, up 9.17% year-on-year. Specifically, the issuance of CGB and policy bank bonds expanded year-on-year. The CGB issuance totaled RMB2.15 trillion, up 34% year-on-year. Policy bank bond issues reached RMB1.72 trillion, up 33.9% year-on-year. **Second, term spread shrank and credit spread narrowed.** As of March 28, the term spread (between ten-year and one-year CGB yields) stood at 0.58%, down 13 bps from the beginning of the year, or down 5 bps year-on-year, partly due to the short-term yield pickup alongside the rise in money market rates. **Third, the bond market showed a credit risk convergence, the marginal default rate remaining stable.** As of March 28, a total of ten bonds had been defaulted, with the defaulted amount reaching RMB4,379 million, down 51.9% year-on-year. Sven property developers slipped into credit defaults in the real estate industry, with an actual default amount of RMB 2,538 million in aggregate. The marginal default rate[1] in the bond market was 0.18% at the end of February, down 0.09% year-on-year, suggesting a continued convergence of credit debt risk.

**4. RMB appreciated first and then depreciated in a V-shaped pattern of exchange rate movements**

In 2023Q1, the RMB exchange rate experienced two stages (rapid appreciation followed by a decline with two-way fluctuations), showing a V-shaped trend. The RMB exchange rate appreciated rapidly from 6.96 to around 6.7 in the first nine trading days of January, and moved with two-way fluctuations in February and March leading to a come-down to around 6.9.

The rapid RMB appreciation at the beginning of the year was driven by the following factors: First, market confidence was significantly boosted. The year began with a robust economic recovery spurred by the COVID-19 policy shift and pro-growth policies, which greatly buoyed investor confidence. Second, foreign institutions were generally optimistic about holding RMB financial

[1] Source: China Bond Rating's *Monthly Report on Default Monitoring*.

assets and kept increasing their exposure to domestic financial assets, pushing RMB higher in value. The stronger-than-expected recovery of Chinese economy attacked a large influx of the northbound capital at the beginning of the year.

The recent depreciation in RMB is mainly attributable to the following factors: First, the USD Dollar Index (DXY) has rebounded. Given the hotter-than-expected US inflation data (with CPI up 6.4% in January and 6% in February year-on-year) and persisting inflationary pressure, the Fed frequently voiced out its hawkish stance on rate hikes, leading to a transitory DXY rebound. Second, the China-US interest rate spread became more inverted. The average daily inverted spread between the China 10-year Government Bond yield and the US Treasury 10-year yield widened to -0.8451% from -0.6706% in January, triggering transitory capital outflows seen in February.

**5. The A-share index generally moved higher on restored confidence in the capital market**

The A-share market made a higher start at the beginning of the year and then remained range-bound amid a recovery of the real economy, restored investor confidence and changes in the Fed's rate hike expectations. SSE Composite Index closed at 3,245.38 on March 28, up 5.1% from the beginning of the year. The bullish factors include: **First, investor confidence was buoyed by improved economic and financial data.** Since 2023 began, corporate expectations for economic growth have been upbeat, with the manufacturing PMI rising to 52.6% and the non-manufacturing business activity index at 56.3% in February. The improved economic expectations and financial data have further boosted investor confidence, beefing up A-shares greatly. **Second, the capital market became more attractive, receiving a net influx of foreign capital.** 2023Q1 ended with a net foreign capital inflow due to the business cycle mismatch between China and the US. **Third, policy tailwinds fueled a valuation recovery as the capital market reform gained steam.** With the registration-based IPO reform implemented across the board, the market participants expected the resultant higher financing efficiency to create a tailwind for the stock market. The market expectations for pro-growth policies to be issued after the NPC and CPPCC annual sessions fueled an influx of additional capital and a recovery in valuations.

Negative factors were as follows: **First, the A-share technical correction made stock performance more divergent across sectors.** The sharp rise of A-shares in January added to the pressure of technical correction, making the market divergent in February. **Second, the Fed's pace of rate hikes remained uncertain.** The US non-farm payrolls rebounded in February, raising the Fed's rate-hike odds. The expectation that "the Fed would likely stop raising interest rates or even cut rates" was shaken.

**II.2 Financial Forecast for 2023Q2:**

**1. Main financial indicators will maintain a medium to high rate of growth to effectively feed the demand of finance the real economy**

Looking ahead to Q2, the financing environment in China will remain stable and slightly easy. **First, money supply and aggregate financing will maintain medium-to-high growth.** The monetary policy will remain prudent and slightly easy to meet funding needs in the real economy. M2 is projected to maintain a medium to high pace of growth in 2023Q2, with aggregate financing back to double-digit growth. **Second, support will continue to strengthen for key fields and weaker links.** Structural monetary policy tools will continue to give an impetus. Inclusive loans to micro and small businesses and green credit stand to maintain a growth rate of over 20%. **Third,**

**the growth of real estate credit is likely to stabilize.** While the economy is gaining steam, the property market is showing signs of stabilization. The real estate sector will enjoy continued policy tailwinds as supportive policies are still working.

**2. Mortgage rates are set to slow their pace of decline Policy, given a high probability of policy interest rates remaining unchanged**

Looking ahead to 2023Q2, **the first is that mortgage rates are set to slow their pace of decline, given a high probability of policy interest rates remaining unchanged.** On the one hand, the ongoing macroeconomic recovery has reduced the need for interest rate cuts. On the other hand, the recovery is still on shaky ground, with a low inflation showing no evident signs of going hotter, so monetary tightening is unlikely. **Second, money market rates will fluctuate around the policy rate.** Money market rates are expected to remain range-bound, driving financing costs to decline steadily. **Third, mortgage rates are set to decline at a slower pace.** Driven by policy support and economic recovery, more cities will likely see their property markets bottom out and stabilize, while a deceasing number of cities may further cut mortgage rates.

**3. Total bond issuance will remain stable with CGB yields likely to further creep up.**

Looking ahead to Q2, the bond market will likely remain stable. **First, the total bond issuance will remain stable, probably with a continued structural divergence.** The fiscal policy will be more proactive and effective, the interest rate bonds including CGB and local government bonds will be issued in larger volumes. **Second, the CGB yield stands to rise steadily.** The expectations for a solid economic recovery remain unchanged, coupled by the pro-growth policies continuing beyond the NPC and CPPCC annual sessions. The positive economic outlook will beef up the CGB yield. **Third, default risk in the bond market should be monitored continuously.** As the property market is still finding its bottom, close attention should be paid to the operating conditions and risk spillovers of leading property developers. Net proceeds from LGFV bonds shrank sharply, while the land transfer restrictions and swelling LGFV expenditure will further add to the fiscal strain of local governments. The default risk of LGFVs may rise.

**4. RMB exchange rate will rise steadily with two-way fluctuations.**

Looking ahead to Q2, external constraints will abate and more factors will appear in favor of RMB exchange rate. RMB will remain on course for steady rise amid two-way fluctuations. **First,** the failure of Silicon Valley Bank triggered a "butterfly effect", putting a damper on the Fed's rate hikes. The Fed announced a rate hike of 25 bps on March 22, signaling in its statement that the rate hike cycle is approaching its end. **Second,** China has sent a clear policy signal of stabilizing RMB value. After the Central Economic Work Conference proposed to "keep the RMB exchange rate stable", Governor Yi Gang of PBOC reaffirmed in March the importance of stabilizing the RMB value through 2023. **Third,** the Chinese economy will continue to improve, providing strong fundamentals for RMB money value. With China's economic fundamentals in steady recovery and its economic indicators turning more positive, foreign investors will remain bullish on domestic assets and the RMB exchange rate has the potential to appreciate.

**5. A-shares are expected to strengthen with swings on brightening economic outlook**

Looking ahead to Q2, A-shares are likely to further strengthen. **First, the expectations for sustained economic recovery have been solidified.** Driven by the optimization of COVID-19

policies, the real economy will continue to recover on both supply and demand sides, persistently boosting investors' expectations and bolstering A-shares. **Second, a raft of pro-growth policies implemented will likely unleash a bull run of A-shares in supported sectors.** Another round of policies to stabilize economic growth is expected to come one after another. These policy tailwinds will give a material boost to high-end manufacturing, traditional manufacturing, tech and high-quality "blue chip" stocks, thus driving up market activity. **Third, foreign investors are expected to increase their exposure to A-shares.** On the one hand, the business cycle mismatch between China and other countries may further widen. Driven by China's solid recovery, foreign investors are expected to increase their allocations to A-shares. On the other hand, the Shanghai/Shenzhen-Hong Kong Stock Connect program has expanded recently to include more stocks. The greater portfolio diversity and enhanced market openness will further attract foreign capital inflows.

**Table 1: China's Main Economic & Financial Indicators and Forecasts in 2023Q2 (%)**

| Indicator | 2019 (R) | 2020 (R) | 2021 (R) | 2022 (R) | 2023 (F) | | |
|---|---|---|---|---|---|---|---|
| | | | | | **Q1 (E)** | **Q2(F)** | **Full year** |
| GDP | 6.0 | 2.2 | 8.4 | 3.0 | **4.1** | **7.6** | **6.0** |
| Industrial value added of enterprises above designated size | 5.7 | 2.8 | 9.6 | 3.6 | **3.2** | **9.0** | **6.9** |
| Service value added | 7.2 | 1.9 | 8.5 | 2.3 | **4.5** | **7.5** | **5.8** |
| Fixed asset investments (cumulative) | 5.4 | 2.9 | 4.9 | 5.1 | **5.6** | **5.8** | **6.0** |
| Investment in real estate development (cumulative) | 9.9 | 7.0 | 4.4 | -10.0 | **-5.5** | **-4.0** | **-2.8** |
| Total retail sales of consumer goods | 8.0 | -3.9 | 12.5 | -0.2 | **4.8** | **13.0** | **9.0** |
| Exports (in USD) | 0.5 | 3.6 | 29.6 | 7.0 | **-6.0** | **-4.0** | **-1.0** |
| Imports (in USD) | -2.7 | -0.6 | 30.0 | 1.0 | **-5.0** | **2.0** | **2.5** |
| Consumer price index (CPI) | 2.9 | 2.5 | 0.9 | 2.0 | **1.4** | **0.9** | **1.5** |
| Producer price index (PPI) | -0.3 | -1.8 | 8.1 | 4.1 | **-1.5** | **-2.8** | **-1.0** |
| Broad money supply (M2, ending balance) | 8.7 | 10.1 | 9.0 | 11.8 | **12.6** | **12.3** | **12.0** |
| Aggregate financing to the real economy (stock, ending balance) | 10.7 | 13.3 | 10.3 | 9.6 | **10.0** | **10.3** | **10.5** |
| 1-year MLF (end-of-period) | 3.25 | 2.95 | 2.95 | 2.75 | **2.75** | **2.75** | **2.75** |
| 1-year LPR (end-of-period) | 4.15 | 3.85 | 3.80 | 3.65 | **3.65** | **3.65** | **3.65** |
| RMB/USD spot exchange rate (end-of-period) | 6.97 | 6.54 | 6.37 | 6.95 | **6.90** | **6.70** | **6.60** |

Sources: BOC Research Institute

## III. Macroeconomic Policy Orientations

### III.1 Flexibly adjusting policy priorities and improving the expectations of market entities

We should make flexible adjustments to policy priorities and keep boosting the expectations of

market entities. On the one hand, policies should facilitate the development of new enterprises through tax incentives, financial support and encouraging SOEs to grant rent deferral for new enterprises, the number of which may increase in Q2 as the economy continues to recover. On the other hand, the fiscal policy should take into account both advancing economic recovery and preventing overstretched fiscal capacity, gradually shifting the focus from "expanding tax and fee cuts" to "making support more targeted".

Reform policies should be prudently advanced, leaving room for economic recovery. Given the fragile rooting of recovery now, policies should hold to the underlying principle of bolstering the real economy. The real estate tax and other reform policies should be advanced with reasonable timing to avoid any material impact on the comeback of market confidence and economic recovery.

### III.2 Financial policies should ensure stable growth while guarding against risks to sustain economic growth

With the Chinese economy on course for steady recovery, financial policies should continue to play their part in sustaining economic growth. Outside China, risks such as the collapse of Silicon Valley Bank are still brewing. We should guard against their spillovers to China through expectations and capital flows and develop plans and policies for preparedness.

The monetary policy should continue to stabilize the economy by effectively adjusting both monetary aggregate and monetary structure. The monetary policy should, while remaining prudent, encourage financial institutions to rationalize their credit arrangements in light of the funding needs in pillar sectors for ensuring stable growth, such as infrastructure and manufacturing, so as to effectively meet their aggregate demand during the recovery with persistently strong financing support.

Adequate follow-up policies should be in place to help financial institutions manage their asset quality properly. Reliefs should be further provided for distressed sectors such as catering and cultural tourism, including making early arrangements for loan deferment according to the recovery status of enterprises, thus helping revitalize businesses in distressed sectors at a faster pace.

Financial risks should be forestalled and tackled effectively to maintain financial stability. Considering the close tie between LGFVs and local governments, on the basis of strictly stopping hidden debts, a thorough review of LGFVs is recommended under the guiding principle of strictly forestalling the hidden debt risk. The LGFVs with sound operations and stable cash flows should step up their market-oriented transformation. For those with significant operating risks and unable to make ends meet, it suggested to defuse their risks through market-oriented debt-for-equity swap, debt replacement, asset uploading and restructuring, and reasonably guide them toward transformation according to circumstances.

### III.3 Remaining focused on stabilizing employment and confidence and promoting a sustained recovery in consumption

We should stick to the employment-first policy, refine the soon-to-expire policies designed to lighten the burden of employers, help them keep their payrolls stable and create more jobs, and maintain support for stabilizing and expanding the service sectors, small and micro enterprises and self-employed individuals that have created the majority of jobs. The scope of comprehensive income for individual income tax assessment should be refined. Consideration should be given to raising the threshold for individual income tax on a differentiated basis according to local income level and improve the special additional deductions and standards.

As for the consumption of automobile, home furniture and other big-ticket items, a combination of government subsidies and producers' price cuts should be promoted in addition to the existing preferential policies such as green consumption subsidies, so as to create policy synergies and make profit concessions to consumers of big-ticket items.

A variety of creative and novel cultural tourism events should be held, seizing the golden time for spring outing and entertainment. Where conditions permit, tourist attractions and exhibitions should offer free and reduced admission. In addition, consumption vouchers should be issued from time to time.

### III.4 Strengthening funding for projects and boosting the confidence in private investment

Various funding sources and instruments should be coordinated for efficient use, including the central government budgetary investment, local government special bonds, development and policy-backed financial instruments and structural monetary policy instruments. Special bonds and development and policy-backed financial instruments should have a bigger weight in project capital, and adequate credit support should be provided for key projects. The infrastructure REITs development should be promoted in an orderly manner to put idle assets to good use.

The key to expanding effective investment lies in boosting the confidence in private investment. China will uphold the "two unswervingly" and "three unchanged" principles, (unswervingly consolidating and developing the public sector and unswervingly encouraging, supporting and guiding the development of the non-public sector and "1) the status and role of the non-public sector in China's economic and social development remain unchanged, 2) China's policy of encouraging, supporting and guiding the development of the non-public sector remains unchanged, and 3) China's commitment on creating an enabling environment and providing more opportunities for the development of the non-public sector remains unchanged", support the development and growth of private economies and private enterprises through policy and public opinion and create better institutional and social environment. The reforms to streamline administration, delegate powers, strengthen regulation and improve services should be deepened to boost the service efficiency and quality for nongovernmental investment projects. We should keep removing barriers to market access to create a fair playing field for investors. We should strengthen support for private investment in financing and improve the supporting system for direct financing and credit enhancement of private enterprises.

### III.5 Fostering a favorable environment for foreign trade, and strengthening the comprehensive service support for foreign traders

Stronger comprehensive service support should be provided for foreign trade enterprises strained amid subdued foreign demand. We should help enterprises better tap overseas markets through such platforms as the Canton Fair and the China Council for the Promotion of International Trade (CCPIT). Comprehensive information services should be provided for exporters. We should facilitate exporters of electric vehicles, photovoltaic products and lithium batteries in terms of technology exchanges and overseas exhibitions and help them get certified for international markets.

We should continue to sharpen the edge of exported products. We should strengthen brand compliance and protection, help the leading, innovative and demonstrative brands "go global", encourage exporters to adapt their production, supply chains and R&D strategies to the standards and preferences in import countries and regions by incorporating regional features, thereby enhancing the service experience and consumer stickiness.

### III.6 Cementing the groundwork for property market recovery through sustained policy support for both supply and demand sides

As the household sector expectations are unlikely to improve substantially in the short run, property developers still face liquidity strains. Financing support should be continued for property developers, and expanded to cover more eligible companies. Private enterprises and property developers should be included in the whitelist at controlled risks. Under the rule of law and the principle of commercial sustainability, we should give priority to qualified SMEs through innovating credit products, introducing expedited channels and reducing financing costs, in a bid to meet the reasonable financing needs of whitelisted enterprises.

City-specific measures should be further refined to support the reasonable housing demand in the household sector. Stronger support will be provided for the housing demand of first-time homebuyers homes, home upgraders, multi-child families and high-caliber talents. In the ongoing property market correction, the unreasonable policy restrictions on housing purchase, pricing and loans should be cancelled and instead more market-based measures should be taken. Support should be strengthened for affordable rental housing in big cities, with a focus on providing shelters for younger and needy people in metropolises.

**Disclaimer**

This report is prepared by BOC Research Institute. The information contained in this report is from publicly available sources.

The views or estimates contained in this report only represent the judgment of the author as of the date hereof. They don't necessarily reflect the views of BOC. BOC Research Institute may change the views or estimates without prior notice, and shall not be held liable for update, correction or revision of this report.

The contents and views in the report are for information purpose only and do not constitute any investment advice. No responsibility is held for any direct and indirect investment consequences as a result of the information provided in the report.

The copyright of this report is exclusively owned by BOC Research Institute. No individuals or institutions shall be allowed to copy, reproduce and publish the whole or part of the report without written consent. In case of quotation, reference to BOC Research Institute shall be given, and any quotation, abridgment and revision that deviate from the original meaning of the report shall be prohibited. BOC Research Institute reserves the right to take legal actions on any violation and any quotation that deviates the original meaning of the report.

**BOC Research Institute**
**1 Fuxingmen Nei Street, Beijing, 100818 China**
**Postal Code: 100818**
**Telephone: +86-10-66594264**
**Fax: +86-10-66594040**