BOC Research Institute

China's Economic and Financial Outlook

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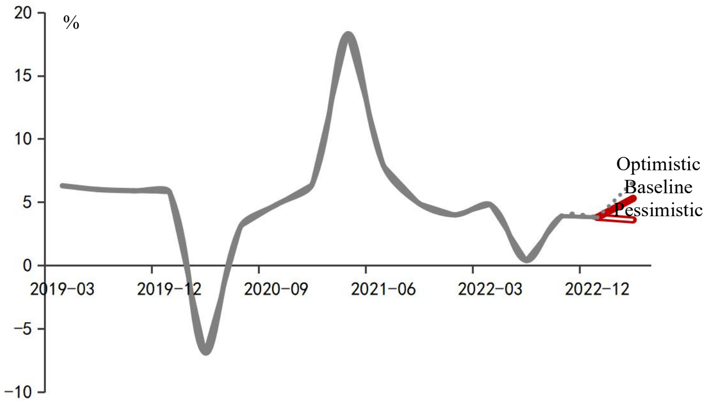
Highlights

- In 2022, the Chinese government efficiently coordinated COVID-19 containment with economic and social development amid shocks inflicted by unexpected factors, including the Ukraine crisis, recurrent and sporadic coronavirus outbreaks and housing market decline. Thanks to strengthening policy efforts to stabilize the economy, China's economy bottomed out to stage a V-shaped pattern, yet on a weak footing, in the year. GDP growth hit 3% for the first three quarters accumulatively, projected to be about 3.8% for Q4 alone and approximately 3.2% for the year.
- Looking forward to 2023, China' growth drivers will be shifting from foreign demand to domestic demand and macro-economic indicators will recover from the prior year. But the recovery level depends on continued optimization of COVID-19 prevention and control measures and restoration of domestic market demand and confidence. The annual GDP growth for 2023 is projected to be around 3.6%, 5.3% and 6.6% under the pessimistic, baseline and optimistic scenarios, respectively.
- The year 2023 will be the first year of implementing strategic plans laid down by the 20th CPC National Congress, and usher in the change of government. It is critical to ensure the continuity and stability of policies. Macro policies should endeavor to "stabilize growth, promote recovery, prevent risk and ensure safety", in particular, improve the confidence and expectations of market entities and keep restoring and boosting the internal drives of economic growth.

China's Economic Growth in a V-shaped Pattern



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Policy Stability and Continuity need to be Maintained amid Growth Drivers Shifting from Foreign to Domestic Demand

– China’s Economic and Financial Outlook (2023)

In 2022, the Chinese government has stepped up policy efforts to stabilize the economy amid the Ukraine crisis, recurrent and sporadic COVID-19 outbreaks and housing market decline. China’s economic growth showed a V-shaped pattern in the year, representing a weak recovery in general. GDP growth hit 3% for the first three quarters accumulatively, projected to be about 3.8% for Q4 alone and approximately 3.2% for the year. Looking forward to 2023, China’ growth drivers will be shifting from foreign demand to domestic demand, with the domestic and overseas environment expected to improve. Major economies will slow their pace of monetary policy tightening. As China’s COVID-19 regulation will likely be further optimized, the real estate market will gradually recover, and the production and investment in high-tech manufacturing and service sectors will maintain rapid growth. China’s macroeconomic indicators will recover from the low base of 2022. But the economy recovery depends on the continued optimization of COVID-19 regulation and restoration of domestic market demand and confidence. The annual GDP growth for 2023 is projected to be around 3.6%, 5.3% and 6.6% under the pessimistic, baseline and optimistic scenarios, respectively. The year 2023 will be the first year of implementing strategic plans laid down by the 20th CPC National Congress. It is critical to ensure the continuity and stability of policies. Macro policies should endeavor to “stabilize growth, promote recovery, prevent risk and ensure safety” and boost the confidence and expectations of market entities. The fiscal policy should maintain continuity and the monetary policy should remain prudent and slightly easy, so as to keep investment serving as a ballast stone, vigorously boost consumption and ensure stability of the real estate market.

I. 2022 Economic Review and 2023 Outlook

I.1 2022 Economic review

Domestic and foreign environmental developments became grimmer and more complex in 2022. Domestic market demand, confidence and expectations were persistently subdued. But the economy has improved since Q3 on optimized COVID-19 response measures and stronger policy efforts to stabilize growth. From the perspective of the four objectives of macro control: **First, economic growth showed a V-shaped pattern.** Year-on-year GDP growth hit 3% for the first three quarters of 2022 accumulatively, registering a year low of 0.4% in Q2. GDP growth is projected to be about 3.8% for Q4 alone and approximately 3.2% for the year. **Second, inflation was mild and controlled.** In the first 10 months of 2022, PPI and CPI increased by 2% and 5.2% respectively, in sharp contrast to the scorching global inflation. **Third, the employment pressure mounted.** Surveyed urban unemployment rate has shown a year-on-year increase since March 2022, with the surveyed jobless rate of the population aged 16 to 24 averaging 17.7%, above the annual average for 2020 and 2021. **Fourth, the balance of payments remained in equilibrium.** In the first three quarters, the ratio of current account surplus to GDP was 2.4%, which was within a reasonable range.

In terms of economic performance in 2022, there are four major changes that should be noted:

First, it became more difficult to contain imported and local COVID-19 cases, which had a

greater impact on economic activity. The pandemic has resurged across China since March 2022. On one hand, Omicron is more transmissible and stealth. On the other hand, overseas COVID-19 measures have been gradually relaxed, making it more difficult to prevent imported cases. Based on the growth rate for the same period in 2019, the pandemic is estimated to lower the cumulative GDP growth in 2022 by about 2.8 pcts year-on-year. The epidemic has disrupted the normal production and life, leading to higher jobless rate, slower income growth and depressed spending power. Consumers were less willing to spend, showing a notable trend of consumption downgrade. Offline consumer scenarios were persistently restricted and online shopping growth was sluggish. Supply-side industries with high exposure to the pandemic have generally seen a moderated pace of value added growth. The value added of consumer goods manufacturing grew at a slower pace due to stricter regularized coronavirus regulation that led to lower efficiency of the industry chain and supply chain. Transport, hotels, restaurants and other in-person services remained depressed, far below the pre-pandemic level of activity.

Second, the real estate market cooled sharply, waiting for the market stabilization policies to unleash their full effects. In 2022, the real estate industry underwent a simultaneous decline in land trading, development investment and sales. But the market has not improved notably despite the persistent easing of property curbs. Credit risk has not yet been eliminated from the real estate market in 2022, with the risk level and impact even more severe than the worst days of the industry in the past. The root cause lies in fundamental changes in the logic of property market. First, on the demand side, the residents' expectations of property market have reversed. Residents are unwilling and unable to take on too much of mortgages. Second, on the supply side, developers are suffering pains of weaning themselves off the high-leverage business mode. Developers have to break away from the high-leverage, high-turnover mode of development.

Third, exports continued to grow rapidly, but a reversal for weakening is taking hold. The contribution of net exports to economic growth rose. The growth of exports to major destinations was divided, with the exports to the US and Europe slowing down and the exports to ASEAN in a steady upturn. Price factors[1] had a bigger effect on export growth. The elevated commodity prices pushed export prices higher, while the weakening foreign demand resulted in sluggish growth in export volume. The export growth showed fresh changes for various types of products. The export growth of labor-intensive products slowed down while the exports of automobiles grew fast, with the exports of new energy vehicles increased by 96.7% year-on-year.

Fourth, the pro-growth policies provided a strong underpinning. Fiscal, financial and industrial policies were fully implemented in 2022. The fiscal policy has played a particularly prominent role in counter-cyclical regulation. First, the rapid implementation of funding and projects translated into fast growth in infrastructure investment. The issuance of special-purpose government bonds and the project approval were expedited, and projects were implemented at a faster pace by delegating powers, strengthening regulation and improving services. Second, the policy support for troubled enterprises bolstered fast growth in manufacturing investment. Third, policies were adjusted to stabilize market expectations. The policy to ensure supply and stabilize price worked to keep inflation within a moderate and controlled range. Pace and intensity of policies designed to conserve energy and reduce emissions were fine-tuned to ensure energy supply for industrial

[1]According to the volume-price decomposition formula, the year-on-year growth rate of total amount = year-on-year growth rate of price + year-on-year growth rate of volume + comprehensive year-on-year growth rate of price and volume. Price contribution = YoY growth rate of price /year-on-year growth rate of total amount; so is the volume contribution. The comprehensive year-on-year growth rate of price and volume is the quadratic term, which is usually ignored in analysis. However, due to the different weights of commodities in the index construction, the quadratic term occasionally has an impact on the overall result.

production.

I.2 2023 Economic outlook

2023 will be the first year of implementing strategic plans laid down by the 20th CPC National Congress. The year will see improvements in the internal and external environment for China's economy. As major economies are slowing their pace of monetary tightening and the COVID-19 regulation will likely be further optimized, which are in favor of a gradual recovery of producer and consumer activities. Given the low base in 2022, the annual GDP growth for 2023 is projected to be around 3.6%, 5.3% and 6.6% under the pessimistic, baseline and optimistic scenarios, respectively.

First, the fallout from COVID-19 will be mitigated and consumption will gradually recover. Firstly, the COVID-19 regulation will likely be further optimized to set the stage for service consumption and offline consumption to recover in 2023. **Secondly,** household income is poised to improve on the pro-growth policy support and optimized coronavirus regulation, helping improve expectations for future economic and income growth. **Thirdly,** the property market will bottom out to drive a comeback in housing-related consumer spending, such as home furniture and building decoration. The annual consumption growth for 2023 is projected to be around 4%, 5.5% and 7% under the pessimistic, baseline and optimistic scenarios, respectively.

Second, investment growth may slow down, with infrastructure investment remaining a major pillar. Firstly, the infrastructure investment, as the important growth driver, will remain the focus of policy and keep growing fast. **Secondly, the investment in manufacturing will slow down.** Manufacturers have limited internal sources of funding and are under-motivated to invest. With the capacity utilization rate still at a five-year low, manufacturers will be reluctant to embark on new or expansion projects until running at full capacity. **Thirdly, real estate investment will stage a rally.** The 16-point set of financial measures will further help mitigate the property market risk, boost homebuyers' confidence and unleash the reasonable housing demand. However, it will take some time to defuse the property market risks, including cutting the large real estate inventory and reviving stalled projects, which will impede the recovery of real estate investment. The annual growth of fixed asset investment for 2023 is projected to be around 3.5%, 5.5% and 6.8%, with the real estate investment down 6%, 3% and 1% cumulatively, under the pessimistic, baseline and optimistic scenarios, respectively.

Third, export growth will weaken under pressure from sluggish foreign demand alongside ebbing price increase. Slowing US and European economies weigh on foreign demand. Commodity prices will move lower with fluctuations in 2023 as the world economy weakens with a slow recovery in supply. As a result, the prices of exported products will drop to undermine the nominal growth rate of exports. **Exports to ASEAN are likely to maintain fast growth.** The ASEAN economy boasts robust internal drivers of growth, showing a bright future of domestic demand expansion. ASEAN's share in global exports is expected to further increase. The deepening RCEP cooperation and the stronger synergies between China and ASEAN in the industrial chain will help increase China's export of intermediate goods to ASEAN. The annual growth of China's exports for 2023 is projected to be around 2.5%, 4.5% and 6% under the pessimistic, baseline and optimistic scenarios, respectively.

Fourth, industrial production will continue to recover, and the eased COVID-19 restrictions are expected to spark a steady recovery of the service sector. Firstly, the pro-growth policies will effectively work to fortify the groundwork for producer activity recovery. **Secondly, the normalization of production is expected to continue.** As the 20 new measures on further optimizing the COVID-19 regulation are implemented, the logistics and transport activity will likely further improve to warrant a recovery on the producer side. **Thirdly, the marginal improvement in domestic demand will cement the foundation for supply-side recovery.** The optimized policy measures are set to unleash the potential for consumer spending and fuel a "mild recovery" of the real estate industry. In 2023, the annual industrial value added is projected to grow by around 4%, 6% and 7% and the annual services value added to grow by 3.4%, 5% and 6.8% under the pessimistic, baseline and optimistic scenarios, respectively.

Fifth, CPI inflation will cool from high and PPI deflation will bottom out, with the PPI-CPI gap remaining negative. First, the pork price will retreat from high. Second, core CPI will rise from a low base amid improving employment, income and consumption in the household sector. Third, the carryover effect will be initially high and then move lower. PPI deflation will bottom out. First, commodity prices will generally pull back as the global demand softens and the Fed slows its pace of monetary tightening. Second, domestic demand will gradually recover as the pro-growth policy package continues to work. Third, the carryover effect will be initially low and then move higher. PPI deflation is expected to gradually return to the low range after hitting its bottom in Q2, with an annual contraction of about 0.5%. The negative PPI-CPI gap will help midstream and downstream enterprises to improve profits, while the pressure of imported inflation should be closely monitored.

II. 2022 Financial Review and 2023 Outlook

II.1 2022 Financial review

The COVID-19 pandemic and the world's political and economic turmoil have not only sent shock waves to China's economy, but also disrupted the Chinese financial market. Stabilizing the macro-economy, keeping the market stable and promoting the financial system reform were the major tasks in China's financial sector. Overall, 2022 saw stronger financial-sector support for the real economy. The financial market remained generally stable amid steady progress in the financial system reform and higher-standard opening-up.

1. Liquidity supply was sufficient but effective demand was depressed, with medium- and long-term credit growth moderated

From January through October 2022, new aggregate financing to the real economy totaled RMB28.68 trillion, up RMB2.29 trillion year-on-year. New RMB loans totaled RMB18.33 trillion, up RMB726.5 billion year-on-year. Domestic equities financing of non-financial enterprises totaled RMB952.7 billion, up RMB53.9 billion year-on-year. The growth of government bonds and enterprise bonds were divergent, up RMB1.15 trillion year-on-year and down RMB234.9 billion year-on-year, respectively. The increase in government bonds was mainly attributable to the accelerated pace of bond issuance in 2022, while the decrease in enterprise bonds was due to lack of corporate demand for funding amid COVID-19 resurgences and relatively ample supply of credit funds. Off-balance-sheet financing (trust loans, entrusted loans and undiscounted bank acceptances) fell by RMB415.5 billion, down RMB1.36 trillion year-on-year, partly due to the crackdown on shadow banking under the new regulation on asset management.

The credit structure continued to improve to increase support for key fields and weaker links of the economy. By lending structure, the balance of inclusive loans to micro and small businesses, industrial loans and lending to other key sectors kept growing fast. By the end of 2022Q3, the growth rate of outstanding loans to industrial, inclusive small and micro business, green and agriculture-related sectors was 23.3%, 24.6%, 41.4% and 13.7%, respectively, significantly higher than the growth (11.1%) of total outstanding loans. The structural monetary policy was a major contributor to their faster-than-average growth. Outstanding inclusive loans to micro and small businesses kept growing at a pace of above 20% for more than 40 consecutive months. The balance of green loans refreshed record highs. The growth of real estate loans decelerated to 3.2%, the lowest on record. **By term structure,** medium- and long-term corporate loans took up a stable share, while the proportion of medium- and long-term consumer loans declined significantly. From January through October 2022, new medium- and long-term corporate loans amounted to RMB9.11 trillion, accounting for 48.72% of total new loans, basically flat with 2021. New medium- and long-term consumer loans stood at RMB2.35 trillion, accounting for 12.58% of total new loans, sharply down 16.72 pcts year-on-year.

2. Market liquidity remained easy throughout the year, and the real economy saw financing costs staying low

Main interest rates all declined in 2022 due to policy guidance, economic downturn and weak financing demand. **First, main policy rates were lowered twice.** PBOC cut key policy rates including one-year MLF and seven-day reverse repo rate in January and August. The one-year MLF and seven-day reverse repo rate fell to 2.75% and 2.0% in November, respectively. **Second, short-term money market rates kept moving lower.** Since April when another COVID-19 wave began, the weighted monthly average rate of pledge-style repos and the weighted monthly average rate of inter-bank lending have dropped continuously, hitting 1.41% and 1.46% in October, down 61 bps and 63 bps from the end of 2021, respectively. **Third, medium- and long-term lending rates dropped.** Financial institutions' weighted average RMB lending rate fell to 4.34% in 2022Q3, down 66 bps YoY, pointing to significantly lower costs of corporate financing.

Three phenomena in the interest rate market in 2022 deserve particular attention. **First, as the property market hit a freezing point, residential mortgage rates fell at an unusually fast pace.** As of 2022Q3, the weighted average interest rate of residential mortgages stood at 4.34%, a sharp fall of 120 bps from a year ago. **Second, the interest rate of bills financing fell to the lowest on record, highlighting the practice of "replacing loans with bills financing" again.** By the end of Q3, the weighted average interest rate of bills financing dropped to 1.92%, and the balance of bills financing rose steeply. The share of new bills financing in total new loans exceeded 30% for several months after April. **Third, deposit rates quoted by a number of commercial banks fell for the first time in seven years.** Since September 2022, a number of commercial banks represented by the four major state-owned banks have successively announced to lower their quoted deposit rates, helping ease the pressure from the narrowing net interest margin (NIM) of commercial banks.

3. The China-US interest rate spread became further inverted, RMB exchange rate moving lower

2022 saw RMB depreciating against the US dollar with fluctuations before staging a gradual pickup toward the end of the year. Since March 2022, the RMB exchange rate has shown a gradual decline due to the spillover effect of the Fed policy, depreciating to around 6.8 by mid-May. After mid-August, the RMB exchange rate became volatile again and fell below the 7 marks, and further fell below 7.3 in October. As at November 25, 2022, the spot exchange rate of RMB against USD was quoted at 7.1615, a slight pickup.

The main contributors to the temporary RMB depreciation were as follows: **First, DXY was persistently strong, sending non-USD currencies falling in value.** The Fed stepped up its monetary tightening in 2022, hiking interest rates by 75 bps in June, July, September and November in a row. These frequent, big hikes led to a soaring DXY that even hit a 20-year high of 114. Risk aversion continued to rise in the market. Most major non-USD currencies, including the pound, euro and yen, depreciated against the US dollar. **Second, the China-US interest rate**

spread became more inverted. Due to the divergence of monetary policies between China and the US, the yield spread of 10-year government bonds between the two countries showed an inversion, adding to the pressure of short-term capital outflows and weighing on the RMB exchange rate. That inversion once hit -1.54% in late October, which was a major cause for the fast RMB depreciation to below 7.3. **Third, forex settlement and sales by banks on behalf of customers under securities investment recorded a deficit.** According to the agency forex settlement and sales data of banks, there was a deficit of net forex sales under capital and financial accounts in H2. FDI maintained a surplus (net forex settlement of USD1.7 billion), but a deficit occurred under securities investment (net forex sales of USD3.2 billion). Short-term capital outflows eroded the current account surplus. In addition, under the Bond Connect program, foreign institutions reduced their RMB bond holdings by USD70.7 billion in September on a net basis, representing an increase from USD35.4 billion in August.

4. CDB yield fell in choppy trading with bond issuance markedly divided

The yield on the 10-year CDB fluctuated downward in 2022 due to sporadic COVID-19 resurgences, continuing monetary easing and weaker-than-expected recovery of the real economy. The 10-year CGB yield closed at 2.82% on November 25, 2022, down 3 bps from the end of 2021. Overall, the bond market mainly showed the following characteristics: **First, the total issuance was stable in size, with a continued structural divergence.** As of November 25, RMB55.9 trillion of bonds were issued in total, representing a year-on-year increase of RMB127.2 billion. Specifically, the CGB issuance reached RMB8.18 trillion, up 36.8% year-on-year. The local government bond issuance was RMB7.24 trillion, up 4.4% year-on-year. The issuance of commercial bank bonds reached RMB1.03 trillion, up 54.7% year-on-year. The issuance of enterprise bonds and corporate bonds was RMB347 billion and RMB2.84 trillion, down 12.6% and 8.1% year-on-year, respectively. **Second, term spread rose amid swings, while credit spread widened slightly.** As of November 25, the CGB term spread (between 10-year and 1-year CGB yields) stood at 0.76%, up 23 bps from the beginning of the year. The credit spread (between the yield on 3-year AA+ commercial papers and mid-term notes and the yield on 3-year CDB bonds) was 0.68%, up 14 bps from the beginning of the year, mainly due to wider swings in the bond market in November. **Third, the share of foreign institutions' bond holdings declined.** By the end of October 2022, the domestic bonds held by foreign investors totaled RMB3.14 trillion, representing a share of 3.28%, down RMB545.8 billion and 0.94 pct from the end of 2021, respectively. **Fourth, the credit risk of bonds continued to recede.** As of November 25, 2022, accumulative defaults on credit bonds amounted to RMB35.56 billion, representing a year-on-year decrease of 75%. However, debt extensions in the real estate industry reached RMB132.35 billion, threatening a still-high credit risk in the sector.

5. A-shares were in a bumpy downturn under combined effects of various factors

A-shares showed weak performance in 2022. SSE Composite Index closed at 3,101.69 on November 25, down 14.6% from the beginning of the year. Overall, negative factors for A-shares were as follows: **First, the domestic sporadic COVID-19 outbreaks disrupted economic recovery and undermined market confidence.** The recurrent and sporadic coronavirus outbreaks in China have frustrated economic recovery in 2022, adding to the market sell-off pressure amid investors' dim expectations of economic activity. **Second, external disruptive factors aggravated market panic.** A-shares declined markedly in H1 due to escalating Russia-Ukraine conflict and the Fed's monetary policy shift. The China-US interest rate spread became further inverted, triggering capital flows that increased the downward pressure on A-shares. On November 25, foreign investors' A-share holdings had a market cap of RMB2.30 trillion, representing 3.50% of total, down RMB442 billion and 0.49% respectively from the beginning of the year. **Third, the profitability of listed companies weakened YoY.** As disclosed by Q3 reports of listed companies, the return on equity (ROE) of most industries declined year on year. The ROE of the real estate, materials and information technology industries fell by 3.06%, 2.7% and 1.5% year-on-year respectively in the first three quarters, leading the decline. But there were also many positive factors for A-shares: **First, a raft of pro-growth policies was launched to shore up market evidence.** The State Council launched 19 follow-up policy measures at its August executive meeting and PBOC announced stronger-than-expected interest rate cuts in August, which both further boosted market confidence. **Second, targeted policies were issued to spur a rebound in industry valuations.** For example, regulators have actively promoted private enterprises' debt financing instruments to support private-sector business financing, which has underpinned the recovering valuations of listed companies in such sectors as real estate and improved market expectations. **Third, a stable and slightly easy monetary policy will keep liquidity reasonably sufficient and bolster A-shares.**

II.2 2023 Financial outlook

Looking forward to 2023, the financial market will likely remain steady. From the perspective of economic fundamentals, such factors as mitigated impact of COVID-19, continued economic recovery and market confidence restoration will help stabilize financial markets. From the policy point of view, PBOC is expected to flexibly use open market operations and various lending facilities to ensure reasonably sufficient liquidity. On the whole, new credit supply is expected to further ratchet up in 2023, corporate financing costs will remain low, capital markets will remain volatile and RMB will appreciate slightly.

1. Main financial indicators will remain stable to meet the funding demand of the real economy

Looking forward to 2023, the expected that the financing environment will remain stable and slightly easy. **First, money supply and aggregate financing will maintain medium-to-high growth.** Considering that stabilizing growth remains the focus of economic work in the short term, the monetary policy is expected to keep the financing environment prudent and slightly loose in 2023, and the incremental aggregate financing to the real economy and credit supply will keep growing steadily. M2 and aggregate financing are projected to maintain double-digit growth in 2023. **Second, credit support will continue to strengthen for key fields and weaker links.** Inclusive loans to micro and small businesses and green credit stand to maintain a growth rate of over 15%. In addition, various re-lending facilities launched in 2022, such as targeted re-lending for elder care services and targeted re-lending for upgrading, will continue to play a leading role. Elder care, education, public health and new infrastructure are expected to receive more credit support. **Third, a notable rebound in the growth of real estate loans will be a low probability.** Given the profoundly changing logic of the property market, it is still difficult for the industry to stabilize in the short term, and it is unlikely to see a significant rebound in the growth of real estate loans.

2. Market rates will stay low to keep corporate financing costs also low

The monetary policy is expected to remain easy in 2023 and keep financing costs low for the real economy. **First, policy rates will stay low.** Even if the economy recovers somewhat, the policy rates still need to remain low to bolster the recovery. It is expected that the 7-day reverse repo, MLF and other policy rates will remain low. Further small cuts in policy rates are still possible. **Second, money market rates will find a solid floor.** Economic recovery will restore corporate demand for financing and thus stabilize interest rates in the short-term money market. However, an easy monetary policy will keep market rates low. **Third, lending rates will stay low.** The recovering demand for corporate financing will push lending rates higher. In 2023, lending rates may discontinue the rapid decline seen in 2022 but are still likely to stay low.

3. RMB has the potential for pullback and will gradually pick up amid swings

Looking forward to 2023, the forex market will see unfavorable factors moderating to lay a foundation for gradual stabilization. Main stabilizing factors are as follows: **First, the market expectations of the Fed policy have started to reverse.** Though the Fed will continue to hike rates to fight inflation, the Fed may slow its pace of tightening as the US inflation shows signs of abating (with CPI inflation down to 7.7% in October). Thus, the depreciation pressure on RMB will marginally ease. Major non-USD currencies gain in value slightly against the US dollar in November 2022, with RMB also showing signs of rebound. **Second, the recovery of China's economic fundamentals will be central to a stronger RMB.** Since 2022Q4, the pro-growth policy package launched by the State Council at its executive meeting and the COVID-19 policy improvements will shore up a solid recovery of China's economic fundamentals. In addition, given the persistently hot inflation in the US and Europe, the world economy will come under greater downward pressure in 2023. According to IMF estimates, the global economy will slow to 2.7% in 2023. The pattern of "domestic recovery and overseas slowdown" will underpin a gradual pickup in RMB exchange rate. **Third, China's capital markets will see orderly reshoring of cross-border capital.** PBOC and SAFE jointly published the *Rules on Funds Invested by Overseas Institutional Investors in China's Bond Market* in November 2022. The policy will provide more convenience for foreign institutional investors to invest in the Chinese bond market, increase the appeal of RMB assets to foreign investors and attract an influx of short-term cross-border capital.

4. Total bond issuance will remain stable with yields kept low

Looking forward to 2023, the bond market is expected to show the following characteristics: **First, the bond issue size will remain stable with a structural shift.** Government bonds will further work to support aggregate financing and drive effective investment. The issuance of interest rate bonds is expected to keep expanding. Driven by a solid recovery of the real economy, the issuance of enterprise bonds and corporate bonds stands to increase. **Second, bond yields will remain low.** The pandemic will likely ease as China is refining its COVID-19 policy. The economic recovery is expected to remain on track to bolster bond yields. In terms of policy, liquidity will remain reasonably sufficient amid dim expectations of the real economy, which will keep bond yields low. **Third, credit risk in the bond market should be closely monitored.** In terms of credit bonds, property developers will be relieved from liquidity stress as a package of policies launched in support of property developers continue to work. However, property developers still threaten a credit risk due to no significant improvements in their profitability. Close attention should be paid to operating conditions of property developers in the future. In addition, micro, small and medium-sized businesses remain strained, posing a credit risk that deserves particular attention. As for local government bonds, the local government debts will become a bigger burden as local public finance is under heavier pressure on both revenue and spending sides. We should watch out for the problem of additional hidden debts.

5. A-shares are still exposed to disruptive factors, yet with structural opportunities emerging

Looking forward to 2023, A-shares will still face a number of influencing factors. Overall, there are still some positive factors for A-shares: **First, institutional investors will likely account for a larger percentage of the investor base, serving as a bigger source of medium- and long-term funds for A-shares.** The private pension scheme launched recently will help bring additional medium- and long-term capital to the market, increasing the share of institutional investors. The policy-directed further opening-up also will attract more international investors to A-shares and continue with the trend of long-term A-share investment. **Second, industry upgrading creates structural investment opportunities.** It is expected that new energy vehicle industry chain, the photovoltaic industry chain and other booming manufacturing sectors will still have relatively strong profitability, and key technology-related fields will still present good growth opportunities. **Third, an easy monetary policy will keep liquidity reasonably sufficient and bolster the strength of A-shares.** Negative factors were as follows: **First, external factors may continue to disrupt A-shares.** The Fed and other central banks have signaled a slowing pace of rate hikes since Q4. Given the still-hot inflation, however, the scale and pace of rate hikes in major developed economies will remain uncertain in 2023. Their spillover effect will continue to roil global financial markets and send greater shock waves to A-shares. **Second, the COVID-19 uncertainties will remain a drag on economic recovery.** The resurging COVID-19 wave will impair investors' confidence and risk appetite, thus putting the stock market under greater downward pressure.

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

Indicator	**2020 (R)**	**2021 (R)**	**2022** Q1 (R)	Q2 (R)	Q3 (R)	**Q4 (E)**	**Full year (E)**	**2023 (Baseline) (F)**
GDP	2.2	8.1	4.8	0.4	3.9	**3.8**	**3.2**	**5.3**
Industrial value added of enterprises above designated size	2.8	9.6	6.5	0.6	4.8	**4.3**	**4.0**	**6.0**
Value added of the services sector	1.9	8.2	4.0	-0.4	3.2	**3.0**	**2.4**	**5.0**
Fixed asset investments (cumulative)	2.9	4.9	9.3	6.1	5.9	**5.8**	**5.8**	**5.5**
Investment in real estate development (cumulative)	7.0	4.4	0.7	-5.4	-8.0	**-8.4**	**-8.4**	**-3.0**
Total retail sales of consumer goods	-3.9	12.5	3.3	-4.6	3.5	**0.9**	**0.8**	**5.5**
Exports (in USD)	3.6	29.9	15.5	12.5	10.1	**-0.6**	**8.7**	**4.5**
Imports (in USD)	-0.6	30.1	10.6	1.6	0.9	**-0.2**	**2.9**	**5.0**
Consumer Price index (CPI)	2.5	0.9	1.1	2.2	2.7	**2.2**	**2.0**	**2.2**
Producer price index (PPI)	-1.8	8.1	8.7	6.8	2.5	**-1.0**	**4.2**	**-0.5**
Broad money supply (M2, ending balance)	10.1	9.0	9.7	11.4	12.1	**12.0**	**12.0**	**11.5**
Aggregate financing to the real economy (stock, ending balance)	13.3	10.3	10.5	10.8	10.6	**10.5**	**10.5**	**10.3**
1-year MLF	2.95	2.95	2.85	2.85	2.75	**2.75**	**2.75**	**2.70**
1-year LPR	3.85	3.80	3.70	3.70	3.65	**3.65**	**3.65**	**3.60**
RMB/USD spot exchange rate (mean)	6.54	6.37	6.35	6.66	6.85	**7.09**	**6.90**	**6.70**

Note: According to different scenarios of pandemic developments and containment measures, the annual GDP growth in 2023 is estimated to be about 3.6%, 5.3% and 6.6%, under the pessimistic, baseline and optimistic scenarios. This table only shows the baseline scenarios. For projected indicators under all scenarios, please refer to the analysis above.

Source: BOC Research Institute

III. Macroeconomic Policy Orientations

III.1 Actively expanding sources of funding to ensure continuity of fiscal policy

The structure of fiscal expenditure in 2023 should be based on both immediate and long-term considerations. On the one hand, policy should ensure employment, appropriately extend tax rebates and fee cuts and continue to promote the recovery of the real economy, especially micro and small businesses. On the other hand, efforts should be step up in science, education, culture and health care, rural vitalization, development of a modern industrial system and major infrastructure projects to serve the 14th Five-Year Plan and Vision 2035. In terms of funding sources and efficiency, forward-looking planning for funding should be strengthened, and a higher deficit to GDP ratio of 3% or above is recommended. Structural fiscal policies, such as the mechanism for direct allocation of fiscal funds, should be further implemented and more precise.

III.2 Maintaining a prudent and slightly easy monetary policy while closely monitoring the impact of evolving external risks

Taking into account the economic recovery still on a fragile footing, the monetary policy should remain prudent and slightly easy to keep the overall financing environment stable. Financial institutions should be guided to fully implement all incremental policy tools, continue to increase credit support for key areas, keep helping industries to tide over difficulties and continue to stabilize the expectations of economic entities and boost market confidence. In addition, we should pay close attention to the spillover effect of the Fed's policy shift and keep the domestic financial market and RMB value basically stable.

III.3 Continuing to leverage the role of investment as a ballast and intensifying efforts to restore consumption

The pipeline of high-quality projects should be created at a faster pace. Sources of funding for infrastructure investment should be early planned. The policy and development finance toolkits should be further enriched. Policy should maintain the support for enterprises, expand the scope of lending support for manufacturing upgrading, keep industrial adjustment basically stable, actively restore downstream demand and improve business expectations for enterprises. Persistent efforts should be made to ensure stable employment, ensure adequate policy support for low-income groups and raise the threshold for individual income tax depending on the fiscal situation. Promotional events such as cultural tourism festivals and shopping festivals should be held in due course through government subsidies and merchant concessions to promote recovery of the tourist and consumer markets.

III.4 Effectively implementing the real estate policy to stabilize the housing market

Demand-side policy should further extend to first-tier cities and demand for home upgrades, thus fully unleashing the potential housing demand. Five-year LPR should be further cut to bring down mortgage rates and reverse the expectations for property market. On the supply side, efforts should be stepped up to mitigate the property developer risks. Financial institutions should be encouraged to increase support for high-quality projects and high-quality private property developers. For developers already in trouble, the bankruptcy reorganization process should be accelerated to clean up the industry and avoid risk spreading. The policy support for reviving stalled property projects, which consists of "earmarked lending, matching loans from commercial banks and government intervention" should be fully utilized. Commercial banks should be further encouraged to expand supporting scale of corresponding loans. More flexibility to the establishment and operation should be given to local bailout funds.

III.5 Fortifying the foundation for recovery of the real economy and stabilizing the expectations of market players

The resilience and security of industry chains and supply chains should be enhanced. The inter-departmental logistics coordination mechanism with neighboring provinces or regions should be launched in line with China's 20 new measures on further optimizing the COVID-19 response. Enterprises should be encouraged to cooperate in building a supply chain coordination platform to allocate resources more efficiently. The industry chains and supply chains should be more self-sufficient, with tax breaks and funding support offered to encourage in-house research and development among enterprises. The package of "targeted fiscal support, interest subsidies and tax exemption" should be strengthened to support the upgrading of foundational industrial infrastructure. **The capacity building in energy security should be stepped up.** Efforts should continue to build capacity for monitoring and early warning of traditional energy security, establish and improve early warning mechanisms for supply and demand of coal, oil and gas, and electricity and strengthen infrastructure construction for emergency power supply. The planning and construction of a new energy system should be accelerated, optimizing trans-provincial energy allocation and exploring the integration of wind-solar-hydrogen energy storage. **Private enterprises' confidence and expectations should be revived.** State-owned enterprises should serve as leaders and helpers. Private enterprises should be encouraged to participate in government purchasing and take an in-depth part in state-owned capital and enterprise reform. **New drivers of industrial development should be unleashed.** Industrial policy should foster and expand innovative industrial clusters and speed up breakthroughs in core technologies on the industrial chain. Measures should be taken to support the upgrading of traditional enterprises and provide them with professional technical support based on research institutes and other technological innovation platforms.

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