China pivots to economic growth as top priority in 2023

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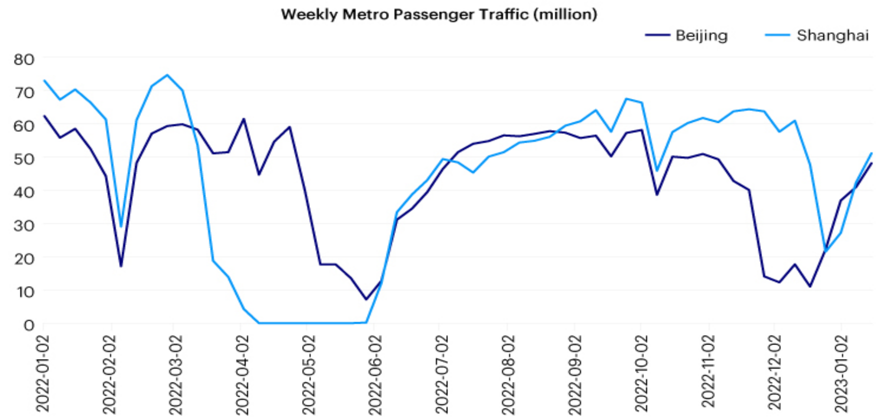
After a year of slowing economic growth, China took decisive steps to exit from its COVID zero policy following the 20th Party Congress. Although the resulting spike in COVID-19 cases may have caused disruptions to domestic economic activities, as reflected in the dip in December's official non-manufacturing PMI to 41.6 from 46.7 the prior month[i] , the effect is likely to be transient based on the swift post-Omicron recovery experience of other Asian economies. Furthermore, the latest uptrend in local traffic data suggests that the current wave of COVID infections has already peaked in most populous tier-1 cities, paving way for a sooner than expected recovery.

Figure 1: Metro passenger volume in Beijing and Shanghai rebounded strongly in recent weeks after the Omicron wave peaked

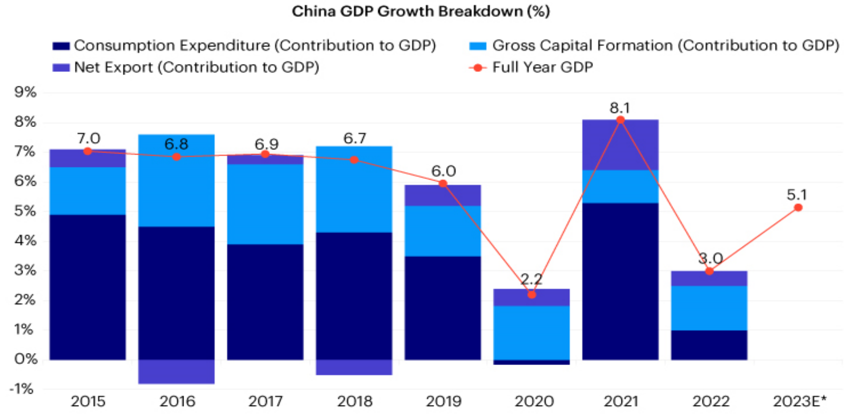


Source: China's Ministry of Transport, Wind as of 15 January 2023

As border restrictions have also been fully lifted in January 2023, we expect a strong rebound in consumer activities during the Lunar New Year festival as pent-up inbound travel demand is likely to outweigh outbound travel. Consumption-driven industries such as consumer discretionary, retail, catering, entertainment, hotels, and airlines stand to benefit the most during the initial reopening phase before a broader consumption recovery takes place. The healthcare sector, especially medical service and medical device subsectors could also benefit from recovering patients' visits to hospitals and the rising number of surgeries as zero-COVID policies have now been dropped.

i National Bureau of Statistics of China, data as of December 2022.

Figure 2: Consumption in China is expected to contribute to a strong economic recovery in 2023

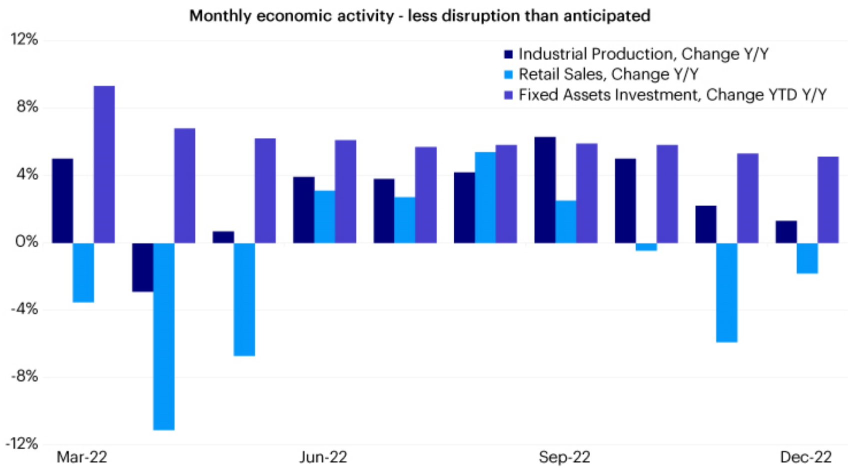


Source: National Bureau of Statistics of China, *Wind Estimates (2023E)

In December, the Central Economic Work Conference affirmed economic growth as the government's top priority in 2023 while emphasizing "unwavering support" for both state-owned and private enterprises. More supportive policies aimed at small and medium private enterprises may be expected in the lead up to the upcoming National People's Congress in March given their significant role in local job creation.

We expect a robust recovery in China's industrial production in 2023 led by solar- and wind- power industries. China's solar industry already holds a dominant market share in the global supply chain, and we may see further expansion in the downstream segment as raw material prices fall on increasing supply. The wind power industry may also experience a growth acceleration from 2023 to 2025 on the increasing uptake of offshore installations, according to targets set in the 14th 5-year-plan.

Figure 3: Slowdown in economic activity in 4Q2022 was less severe than expected



Source: National Bureau of Statistics of China. Data as of December 2022.

China's regulatory crackdowns on fintech and property companies, which have weakened investor sentiment in the past couple years, also appear to be coming to an end. While the property market still faces significant downward pressure, the 16-point policy package delivered by the People's Bank of China (PBOC) and the China Banking and Insurance Regulatory Commission (CBIRC) last November may help the sector reach a soft landing this year if demand stabilizes.

At the same time, we expect China's export growth to face greater risks this year due to the impact of a slowing global economy. Although there is optimism that the Fed's rate hike cycle may be peaking soon, market volatility may spike again this year if US inflation does not decline as expected. Geopolitical risk remains another source of uncertainty for the A-share market. On this note, we believe China's reemergence on the global diplomatic stage is a positive development that may help improve foreign relations amid increasing competition.

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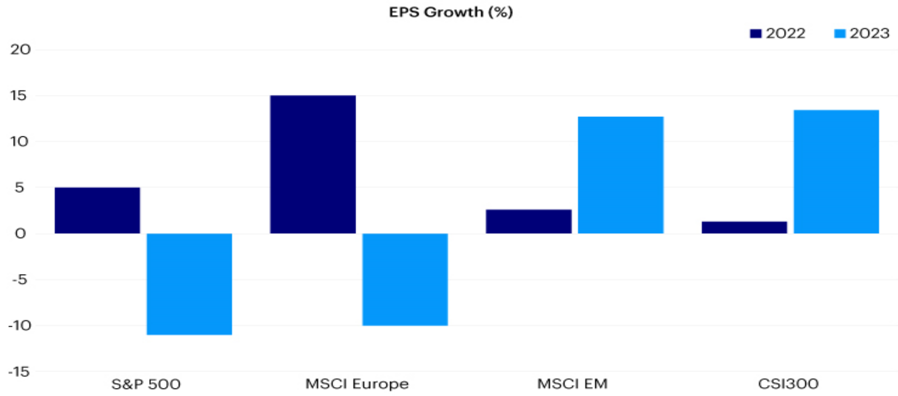
Figure 4: China is expected to drive emerging markets' strong earnings growth momentum in 2023



Source: Morgan Stanley Research. Data as of 10 Jan 2023. Past performance does not guarantee future results.

Looking forward, we believe China's exit from zero-COVID and the government's pivot to growth will raise the outlook for a strong corporate earnings recovery in 2023. In fact, the year-to-date net purchase of China A-shares via the Stock Connect has already exceeded the amount in 2022[ii], suggesting a fast turnaround in investor sentiment towards China equities. With US interest rates expected to peak in 2023, a weakening dollar may start to channel liquidity back to emerging markets (EM), further amplifying the need for EM investors to cover their underweight positions in China equities.

ii Northbound Stock Connect, data as of January 19, 2023.

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