Reasons for cautious optimism about China

March was a busy month for China, featuring the Two Sessions setting the policy direction for 2024 and key data releases for the first two months of the year

Chinese President Xi Jinping helps children plant trees near Beijing

Steady growth target at Two Sessions indicates policy support will continue

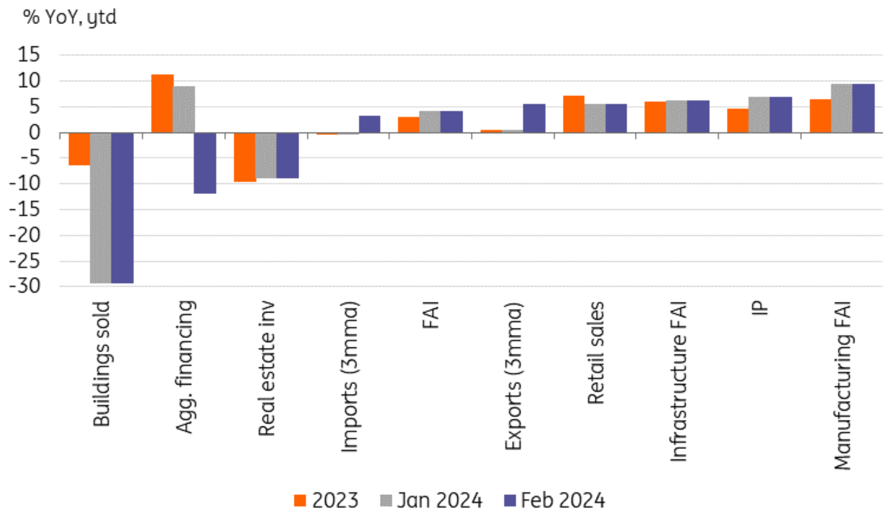
Policymakers set the key economic goals and strategic directions at the Two Sessions meetings. The GDP growth target was maintained at 5%, indicating a commitment toward growth stabilisation.

The fiscal deficit target was left unchanged at 3%, but there was a higher special government bond issuance target and an additional RMB1tn ultra-long duration bond issuance, which indicates that fiscal policy will remain supportive this year.

The language on monetary policy and the RMB was left largely unchanged, indicating monetary policy would remain prudent and hinting at further Reserve Requirement Ratio cuts to come and an intention to maintain the basic stability of the RMB exchange rate at a “reasonable and balanced level." The RMB has come under increased attention over the past month; after a small move to relax the fixing spurred speculation on depreciation, the PBOC pushed back against rapid depreciation. The top-level policy tone suggests that this resistance will continue, and last year's 7.34 level is not likely to be broached in the baseline scenario.

In the near term, efforts will likely be focused on infrastructure investment, bolstering consumption via a 'trade-in' programme, and continued support of the property sector. In the longer term, much attention was placed on unlocking 'new productive forces' for the economic transition toward higher-quality growth.

China activity showed changing growth drivers in early 2024



Source: CEIC, ING

Key activity data mostly came in stronger than expected

Data published over the past month has been mixed but mostly came in stronger than expected, given downbeat forecasts. Most of the data supports our thesis for 2024, which is that we will see growth drivers shifting and a more challenging road to achieving the 5% growth target.

Consumption was the main driver of growth in 2023, with over 80% share of GDP growth. However, retail sales growth slowed from 7.3% YoY in 2023 to 5.4% YoY through the first two months of the year. Weak consumer confidence and a negative wealth effect are headwinds for consumption, and a relatively strong base effect will limit growth.

However, most other data beat expectations to start the year, raising hopes for other growth drivers to pick up the slack. Fixed asset investment beat forecasts to start the year, up 4.2% YoY year-to-date, largely due to strong infrastructure (6.3% YoY YTD) and government & SOE (7.3% YoY YTD) investment. This was in spite of real estate causing an even larger-than-expected drag, with property investment down -9.0% YoY YTD.

Industrials also picked up in a positive sign that things may be bottoming out for the sector. We saw upside surprises to the value-added of industry (7.0% YoY YTD) and industrial profits (10.2% YoY YTD). March manufacturing PMI data also returned to expansion for the first time in six months, indicating that the first quarter of this year could finish strongly.

Trade was also off to a stronger-than-expected start to the year. However, we remain cautious on this front, as the potential for additional trade barriers remains a notable risk for 2024 and because global trade growth is expected to remain below historical averages.

Forecast revisions

After upside surprises to early economic data but more cautious than expected policy guidance from the Two Sessions, we've adjusted China's first quarter 2024 GDP growth higher to 4.7% YoY and tweaked subsequent quarters' growth a little lower. The full-year growth forecast remains unchanged at 4.8% YoY.

Amid hawkish developments overseas leading to fewer expected rate cuts and an indication policymakers may prefer to use RRR cuts first amid Chinese bank struggles, we've pared back our expectations for Loan Prime Rate (LPR) cuts as well to two more 10bp reductions for 2024, both in the second half of the year. Recent data suggests odds are currently balanced toward fewer than expected rate cuts. We've also adjusted our FX forecasts accordingly to account for a stronger-than-expected US dollar backdrop.

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