

## Chinese economy dragged down by external demand

Domestic demand in China has been strong since the start of the year; the recovery story is on track. But weakening external demand is dragging on economic growth, potentially putting pressure on the labour market



While domestic demand in China is holding up well, weakening external demand has dragged on economic growth

### Domestic economic recovery is on track

Retail sales grew 3.5% year-on-year in the first two months of the year, above the -0.2% growth seen for all of 2022. While this figure did not match market expectations, we believe it is a reasonable pace of recovery. Manufacturing PMI was worse than expected in March due to weaker external demand, but non-manufacturing PMI jumped with signs of recovery in the real estate sector.

Strong loan growth in January and February also suggests that companies are actively laying out business expansions domestically after three quiet years due to Covid-19. Loan growth is likely to remain very strong in March, implying that business expansion and infrastructure growth should exceed 5% in 2023.

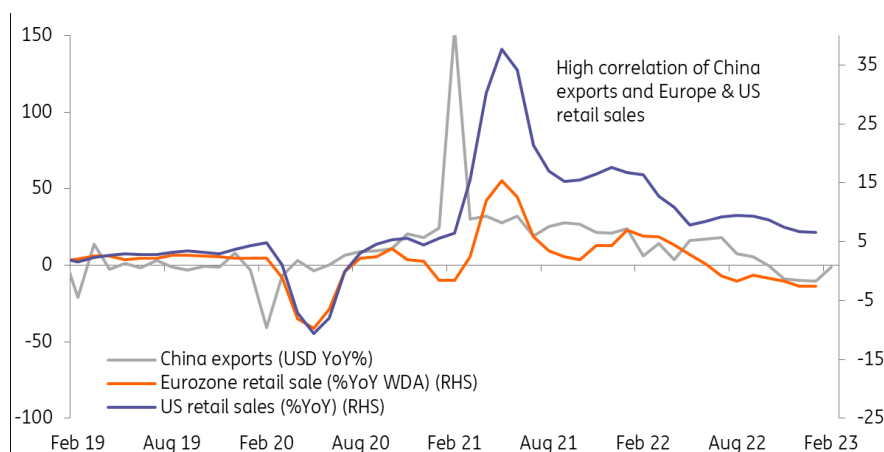
## Weakness in external markets may be a factor inhibiting the path to recovery

The bad news is that exports and imports in the first two months of 2023 contracted by 6.8% year-on-year and 10.2% YoY, respectively. The implication is that external demand is dragging down China's economic growth, which was also shown in PMI data. This should become more pronounced in the second half of the year. This could affect the manufacturing labour market, and therefore possibly consumption.

## We do not expect the central bank to ease policy further

The People's Bank of China (PBoC) cut the reserve requirement ratio by 0.25 percentage points at the end of the first quarter and injected a large amount of liquidity into the financial system to smooth out the seasonal interest rate spike. The moderately accommodative monetary policy also serves as a buffer against the possible transmission of global market turmoil to China's financial markets. However, as the local economy is recovering, further easing is unlikely and aggressive easing could fuel unnecessary asset price inflation, which would then trigger the risk of rising consumer prices.

## Exports could be a risk to China recovery



Source: CEIC, ING

## Revising GDP growth profile

Though we expect the overall GDP growth rate for China in 2023 to be 5%, we are revising lower the GDP growth to 3.8%YoY for the first quarter from 4.5% due to slower external demand reflected in PMI and trade data. As we believe the government could increase fiscal stimulus after the weak GDP report for the first quarter, GDP growth from the second quarter could be faster. As such, we revise GDP growth upward for the second quarter to 6.0%YoY from 5.2%.

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