China's faster reopening fits with CIO's investment theme that more risk tolerant investors can 'anticipate the inflections.' (ddp)

China set to bounce back in 2023 after growth slows to 1970s levels

17 January 2023, 2:05 pm CET, written by UBS Editorial Team

China delivered one of its worst economic performances last year since the 1970s, as the impact of its prolonged zero-COVID policy stance took a toll on the world's second largest economy.

China's Gross domestic product expanded at just 3% y/y in 2022, missing the official target of 'around 5.5%' and well below the 8.4% growth seen in 2021. Apart from the 2.2% growth in 2020 following the initial COVID outbreak, last year's performance was the worst showing since 1976—the final year of the decade-long Cultural Revolution.

The economy took a further hit in the fourth quarter after the government rapidly dismantled its COVID-related curbs, leading to a surge of infections that disrupted businesses and daily activity. Fourth quarter GDP slowed to 2.9% y/y from 3.9% in the third quarter, although it was better than the Reuters' consensus estimate of 1.8% y/y.

But we think that the economic damage from the initial COVID shock following the reopening will be concentrated in 4Q22 and 1Q23, paving the way for a quicker rebound thereafter.

- **Faster reopening means faster, albeit bumpier, recovery.** We think that Beijing is now firmly prioritizing growth, as it opts for a "big bang" exit from zero-COVID, which is likely to lead to the peak infection rate being reached sooner rather than later.
- **The fourth quarter 2022 GDP 'beat' should not be overstated.** Market expectations set a very low bar and some outperformance came from zero-COVID exit factors like drug purchases and hoarding of household goods. But we expect the initial wave of infections in mainland China will have peaked in January, with some ripples through the Lunar New Year holidays and see a recovery in consumption and activity as early as February, picking up pace from 2Q onwards. We continue to expect GDP to recover to around 5% growth in 2023.

- **Continuing domestic policy support, pent-up savings to aid economic recovery.** China's top policymakers are emphasizing the need for monetary and fiscal support to aid domestic recovery. Notably, the property crisis is being tackled. While it may take some time for housing sales to recover, we think contagion risk from the property sector has been largely reduced, and the probability of defaults for large existing developers has also declined. We think Beijing's policy stance and pent-up savings should provide an additional boost—supporting consumption growth of 6.6% in 2023—while a faster return to social activities could lead to more upside in 1H23.

So, we recently lifted China to Most Preferred in our Asia strategy. We think select Chinese companies in the consumer, internet, pharmaceutical, medical equipment, transportation, capital goods, and materials sectors are likely to see more front-loaded returns. We recommend investors focus on these winners rather than the broader market, targeting a 15% outperformance against the wider MSCI China index over the next six to 12 months. China's faster reopening fits with our investment theme that more risk tolerant investors can 'anticipate the inflections.' As well as beneficiaries of China's reopening, we see select opportunities in early-cycle markets like Germany, "deep value" stocks, parts of the semiconductor sector, and currency structures that allow investors to navigate the turn in the US dollar.

Main contributors - Mark Haefele, Vincent Heaney, Patricia Lui, Yifan Hu, Jon Gordon

Content is a product of the Chief Investment Office (CIO).

Original report - China set to bounce back in 2023 after growth slows to 1970's levels, 17 January 2023.