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China in 2023: A year of two halves

A seemingly mundane announcement on 7 December 2022[1] effectively signalled the end of China's strict zero-COVID policy. The policy reversal has come as a surprise to many, especially given that the government seems to have made few preparations for it, such as rolling out vaccinations for the elderly or preparing intensive care units. And with limited data, the severity of the impact remains unclear. Since early December, the virus has been spreading in China's large cities - with estimates pegging the number of infected at around 250 million in the first twenty days of December[2] - alongside anecdotal reports of a spike in deaths. But the official death toll reported on 4 January 2023 was 5,253 since the start of the pandemic.

Meanwhile, the economy continued to slow, with factory activity in December China shrinking for the third consecutive month as COVID infections sweeps through production lines. This deceleration will likely continue through early 2023 as infections continue, although China's National Health Commission reportedly expects outbreaks to peak in January.[3] What is clear, then, is that China is learning to live with COVID and that much of the economic fallout will be felt in the first quarter of 2023, with some lingering effects in the first half. Whether infections peak in January, as the government expects, or later in the winter, remains to be seen. This, in turn, will be critical for China's economic outlook as well as for its energy demand. But the longer the economic deceleration, the sharper the rebound is likely to be as the government seems to be switching to a pro-growth mind-set.

The Central Economic Work Conference (CEWC) - the most important Party-led annual economic meeting - which convened on 15-16 December, focused on the real estate sector and efforts to ensure that stalled construction projects are completed and that developers have sufficient credit to execute them. Bank funding and credit lines have since been made available to developers. The CEWC also gave a nod to a more proactive fiscal policy and indicated potential support for the tech sector. Put simply, announcements in December seem to be hinting at the unravelling of almost three years of macroeconomic policies that squeezed the real estate sector and private entrepreneurs alongside the strict COVID controls. The extent to which these are short term measures to support growth or a deeper U-turn in government priorities, will be a key question for 2023.

The steepness of the recovery, after the initial hit, is also an open question. The Chinese government did not set a GDP growth target at the CEWC (it might still issue one during the Parliamentary sessions in March), but the IMF now expects China's GDP to grow by 4.4 per cent year-on-year in 2023, after a weaker expansion of

[1] National Health Commission, "Notice on Further Optimising and Implementing the Prevention and Control Measures of COVID-19", 7 December 2022, http://www.nhc.gov.cn/xcs/gzzcwj/202212/8278e7a7aee34e5bb378f0e0fc94e0f0.shtml
[2] Qianer Liu, Cheng Leng, Sun Yu, Ryan McMorrow, "China estimates 250mn people have caught Covid in 20 days", Financial Times, 25 December 2022, https://www.ft.com/content/1fb6044a-3050-44d8-b715-80c18ca5c9ab
[3] "Chinese Cities See Covid Peaking in January as Official Data Gets Obscured," Bloomberg, 26 December 2022, https://www.bloomberg.com/news/articles/2022-12-26/china-cities-covid-estimates-suggest-infections-may-peak-in-january?leadSource=uverify%20wall

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3.2 per cent in 2022.[4] To be sure, views of China's growth potential vary widely, with estimates ranging from 3 per cent to 5 per cent for 2023. Proponents of lower growth rates highlight structural macroeconomic factors that will impede a return to the heyday of rapid growth, such as high levels of local debt and a long-term slowdown in housing demand which will hold back expansion in infrastructure that had served as a main growth lever for over a decade.

But the domestic structural issues may not manifest themselves in 2023. The reopening of the country will likely result in a rebound in consumption and travel - with travel already beginning to recover in large cities - as well as fewer supply chain disruptions. As China's supply chains return to normal, business sentiment within China as well as international confidence in China as a manufacturing base could improve, leading not only to a catch-up in production, but potentially to a further boost in demand for manufacturing, even though the recession in Europe could dampen appetite for exports. The low growth forecasts may prove overly pessimistic, but equally, there are headwinds buffeting a very strong economic expansion.

In light of this, energy demand is likely to remain subdued initially, and see a strong recovery in the second half of 2023. Both oil and gas demand are set to grow as economic activity rebounds. Oil product demand will see growth across the barrel: from industrial fuels for construction activity through to transport fuels as domestic and international travel resume. At the same time, crude imports and product exports depend on quotas and licences. And in a pro-growth environment, the government may issue additional allowances for independents to import crude and for the majors to export products as a means of boosting growth. Nonetheless, in the first half of the year, in the context of weak domestic demand, crude import growth could be muted even as product exports rise. What is more, it will be important to watch if environmental control policies and tax crackdowns will be softened, allowing the Shandong independents as well as new refineries to thrive. If environmental protection takes a backseat to growth, crude imports and refinery throughputs will rise strongly this year, but domestic demand increases will moderate product exports in the second half of the year.

Gas demand may only pick up later in the year, although spot LNG purchases are slowly resuming. Even though an uptick in industrial activity will support gas demand, it will only lead to more spot LNG purchases if prices do not spike. Indeed, with additional flows on the Power of Siberia and a strong policy mandate to focus on domestic production, most of the incremental gas demand will be met by pipelines and domestic supply. That said, with new LNG terminals and SPAs starting up, LNG flows will pick up from their 2022 levels, rising by 6-8 bcm, after a close to 20 bcm drop in 2022. The potential, at least for the second half of the year, is likely skewed to the upside.

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[4] Based on Xi Jinping's New Year's speech, however, the economy grew in 2022 at over 4 per cent, Laura He, "Xi Jinping estimates China's 2022 GDP grew at least 4.4%. But Covid misery looms", CNN, 2 January 2023, https://edition.cnn.com/2023/01/02/economy/xi-jinping-china-gdp-estimate-covid-intl-hnk/index.html