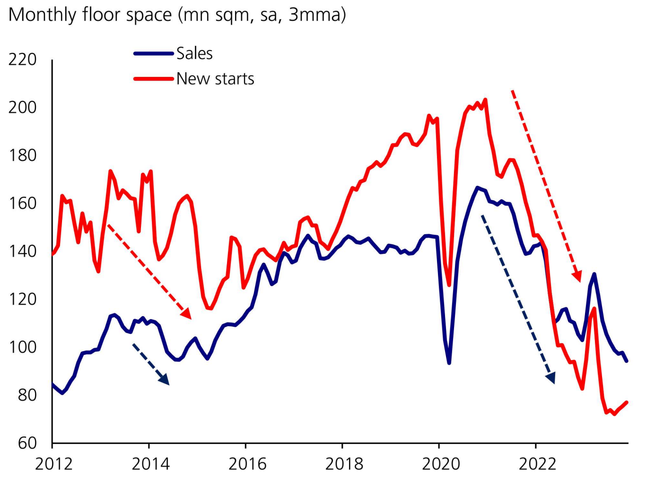
What surprised in 2023?

A year ago, we and the market expected China's growth to rebound by about 5% in 2023, led by domestic consumption and helped by property stabilization. We also expected inflation to rebound as Covid-related disruptions and rise in services costs push up the overall prices. While 2023 GDP growth will likely come in above 5%, prices declined and many parts of the economy and the market felt worse than expected a year earlier. What went wrong?

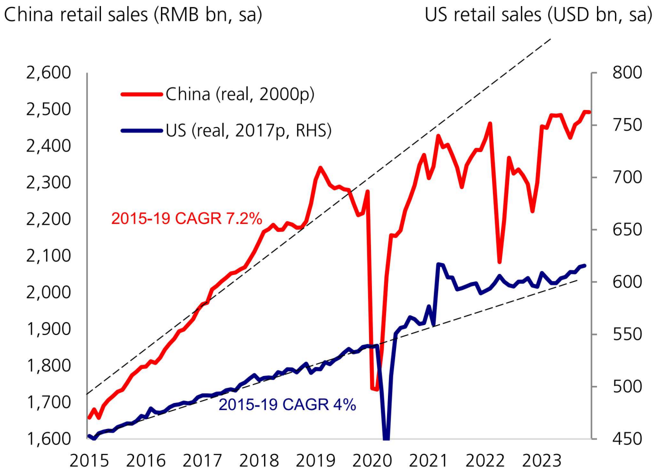
Property market did not stabilize in 2023 as expected. After a notable rebound in February and March, new property sales and starts fell sharply subsequently while expected easing did not materialize until later in the year. Property activities and sentiment have yet to bottom, and prices have fallen more visibly in H2 2023. The weak property market led to local government financing issues and fiscal tightening until the end of summer, while fiscal support came more slowly and modestly. Both then contributed to weaker-than-expected consumption recovery. Inflation failed to pick up but fell into deflation in 2023, as weak labor market limited services price rebound, pork prices unexpectedly fell sharply and stayed low, and domestic demand stayed weak.

Figure 2: Property downturn deepened since Q2 2023



Source: CEIC, UBS estimates

Figure 3: Consumption recovery has been weak



Source: CEIC, UBS estimates

Key themes and baseline forecast for 2024

Our baseline forecast projects China's GDP to grow by 4.4% in 2024, as the base effect of post-Covid recovery fades and property downturn continues to be a drag. Meanwhile, we expect exports to improve despite a global slowdown due to the upswing in the tech cycle, and infrastructure investment to slow modestly even with more explicit central government fiscal support. We foresee CPI inflation rebounding to 0.8% in 2024, as pork and energy prices stabilizes while core inflation remains low.

Specifically, our key macro themes for 2024 are the following:

Property starts and sales to stop falling in H1 and rebound somewhat sequentially in H2. The government has eased property policy notably since late August, but property activities have yet to stabilize and market sentiment remains fragile. We expect the government to ease property policy further, including providing credit support to developers and make concrete progress in "urban village renovation" and social housing. As such and given the deep contraction already happened, we expect property new starts and sales to stop falling in H1 2024 and subsequently rebound modestly on a seasonally adjusted sequential basis. We foresee 2024 annual sales to decline by 5%, new starts by 10%, and property investment by 5%, and property's drag on GDP growth should drop from 1.5-2ppts in 2023 to 1-1.5ppts in 2024.