Chinese economic growth slowed sharply in 2022 amid strict COVID-related lockdowns, headwinds from a housing downturn and a fading boost from exports. At the recently concluded 14th National People’s Congress (NPC) in Beijing, the government set a modest 5% target for year-over-year GDP growth in 2023. This marked the lowest growth target in over thirty years and followed the 5.5% target in 2022. In addition to the modest target, Premier Li Keqiang listed eight policy priorities for this year, with the expansion of domestic demand at the top of the list. After moderate economic growth in the first quarter of 2023, PNC expects strong domestic consumption and a stabilization in the real estate sector to drive stronger growth through the rest of the year. PNC’s baseline forecast is for year-over-year GDP growth of 4.5% in 2023 and 5% in 2024.

Gross capital formation has played a more significant part in China’s economy while household consumption has played a smaller role (Chart 1) since the 1960s. As China’s economy grew in recent decades, a big share of real estate investments was largely leverage driven, which was unsustainable. The Chinese government took steps to reduce leverage in the real estate sector in its “three red lines” financial regulatory guidelines released in August 2020. However, many real estate developers were late to implement the government guidelines, leading to failures of real estate developers like Evergrande Group last year. The People’s Bank of China (PBoC) responded to the housing crisis by reducing mortgage rates which boosted consumer and business sentiment. Several economic indicators suggest an improvement in the real estate market in early 2023. The China Real Estate Climate Index fell to the lowest level on record in December 2022 but rose in January and February. Also, investment in real estate development fell 5.7% in February from a year ago, the smallest decline since June 2022.

Meanwhile, the labor market has struggled during the pandemic era because of strict lockdowns and the Chinese government’s regulatory crackdown on tech companies. The youth (ages 16 to 24) unemployment rate rose to 19.9% in July 2022 but declined to a still high 18.0% in February. Even

---

**CHART 1: INVESTMENT HAS BEEN A BIGGER DRIVER OF ECONOMIC GROWTH IN CHINA IN RECENT DECADES**

---

Source: National Bureau of Statistics of China
CHINA UPDATE

Improved Chinese demand will likely prop up global commodity prices later this year

Before the pandemic started in China, there was considerable slack in the labor market with the youth unemployment rate at 13.6% in February 2020.

As the country reopens and the real estate sector stabilizes (Chart 2), the youth unemployment rate should decline, although weak external demand will weigh on employment in the Chinese industrial sector this year. A declining population—China’s population declined last year for the first time in six decades—and an aging workforce pose downside risks to China’s economic potential in the medium-to-long term. In the near term, however, labor market weakness could suppress consumer discretionary spending.

Given China’s substantial footprint in the global economy, a resurgence in China’s economy will be a boost to world economic growth. So far, China’s reopening has not resulted in higher oil prices in 2023. The price for Brent crude oil, the international benchmark, was down 7.1% in the first quarter. Notwithstanding, improved Chinese demand will likely prop up global commodity prices as the reopening picks up steam in the second half of the year. The International Energy Agency (IEA) sees global oil demand rising by 2 million barrels per day (bpd) in 2023, with China making up 900,000 bpd. The big question is if optimism from China’s reopening outweighs recession fears.

To meet the government’s “around 5%” GDP growth target this year, the PBoC will likely increase monetary stimulus moderately through this year by cutting the one-year medium-term lending facility rate and reducing the reserve requirement ratio. The one-year medium-term lending facility rate will likely be reduced by 10 bps to 2.65% before the end of the second quarter. With low headline and core inflation in China, the PBoC has additional room to increase monetary stimulus through 2023. However, a rapid increase in consumer demand could lead to hotter inflationary pressures, which would limit the PBoC’s ability to implement additional expansionary monetary policies this year.

China’s yuan will appreciate against the dollar as the Federal Reserve pauses its hiking cycle, the reopening gains momentum and the real estate sector stabilizes. PNC forecasts for the yuan to appreciate to ¥6.70 per U.S. dollar by year-end from ¥6.87 per U.S. dollar in late March, and average around ¥6.80 per U.S. dollar in 2023. An improved real estate sector will also support capital inflows into China's equity market, which should support the yuan.

PNC’s GDP growth expectation is subject to balanced risks. Major economies outside China may very well avoid a recession, which would result in stronger growth than expected. On the other hand, trade tensions or political tensions would constrain domestic economic activity and slow global trade flows.

Risks to the forecast are balanced

CHART 2: CHINA’S PROPERTY SECTOR EXPECTED TO IMPROVE THIS YEAR AFTER SLUMP IN 2022

Floor spaces started

Floor spaces sold

Quarterly real estate indicators, year-ago percent change

Source: National Bureau of Statistics of China

Disclaimer: The material presented is of a general nature and does not constitute the provision of investment or economic advice to any person, or a recommendation to buy or sell any security or adopt any investment strategy. Opinions and forecasts expressed herein are subject to change without notice. Relevant information was obtained from sources deemed reliable. Such information is not guaranteed as to its accuracy. You should seek the advice of an investment professional to tailor a financial plan to your needs.

Forward-looking statements are necessarily subject to numerous assumptions, risks and uncertainties, which change over time. Future events or circumstances may change our outlook and may also affect the nature of the assumptions, risks and uncertainties to which our forward-looking statements are subject. Forward-looking statements speak only as of the date made. We do not assume any duty and do not undertake any obligation to update forward-looking statements. Actual results or future events could differ, possibly materially, from those anticipated in forward-looking statements, as well as from historical performance. As a result, we caution against placing undue reliance on any forward-looking statements. © 2023 The PNC Financial Services Group, Inc. All rights reserved. Visit pnc.com/economicreports for more information from PNC Economics.