CHINA ECONOMIC UPDATE AUGUST 2022

Walking away? China's ambitious growth target has moved too far out of reach

NAB Group Economics

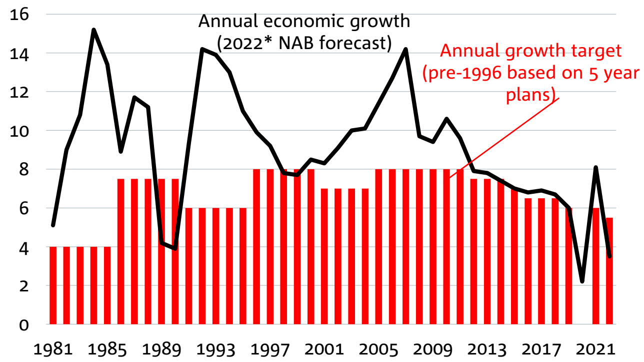
China's economic growth stalled in the second quarter of 2022, due to the negative impacts of the country's public health policy response to COVID-19. The question now is how do Chinese policy makers respond to this outcome? Until recently, public statements from China's leaders continued to endorse the annual growth target of 5.5% – a highly ambitious target even when it was initially announced in March and virtually impossible after the Q2 national accounts. That said, some support to boost the economy appears likely, although it may raise debt levels, increasing long-term risks.

HISTORICALLY WEAK TARGET FOR 2020 WAS A STRETCH IN MARCH

At the National People's Congress in March 2022, Premier Li Keqiang unveiled the China's official growth target of 5.5%. Despite this being the lowest target set in over three decades, we argued at the time that this growth target appeared to be a challenging one (setting our 2022 forecast at this time below this mark) – particularly given the weakness in household consumption indicators. In large part, this reflected the nature of China's fiscal stimulus in response to the initial COVID-19 wave – which supported businesses and offered little-to-no support for consumers. In addition, the economy continues to face headwinds from negative conditions in the property sector and the fallout from the Russia-Ukraine conflict.

ECONOMIC GROWTH VS TARGET

China's growth in 2022 set to fall well below lowest target in decades



This ambitious target for 2022 reflects the strictly regimented nature of China's economic planning. Economic targets are determined at the Central Economic Working Conference in the middle of December, but not publicly announced until the Congress almost four months later. What may have seemed possible in late 2021 (despite the slowing trend in the economy that was emerging during this period), appeared much more challenging in early 2022, however there appeared to be no urgency to amend the target to suit the emerging reality of the situation.

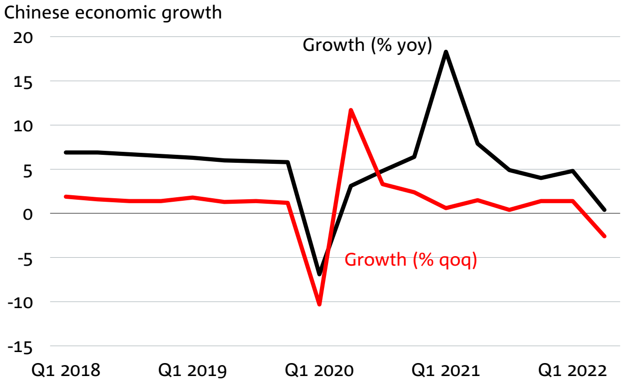
Revisions to the growth target are not completely unprecedented. The 2019 conference reportedly set a target of 6% for 2020, however the target was completely abandoned once the economic impact of the initial COVID-19 outbreak, and the strict public health response, became apparent. That said, it is worth noting that China's first outbreak came prior to the National People's Congress (which was deferred until May 2020 due to COVID-19).

ECONOMIC REALITY MAY HAVE TEMPERED AMBITION

China's headline gross domestic product grew by 0.4% year-on-year in the June quarter, albeit this represented a 2.5% quarter-on-quarter decline. Key to this outcome was a strict lockdown in Shanghai, which lasted for more than two months, nominally ending at the start of June, albeit with a recovery that high frequency data suggests was somewhat subdued. While public health measures in Beijing were not as severe as Shanghai, they also restricted economic activity over a similar period. It is worth noting that some observers have cast doubt about the accuracy of these official figures – given the contractions in both real retail sales and real fixed asset investment over the second quarter.

CHINA'S ECONOMY WEAKER IN Q2

Worst quarterly outcome since the start of the pandemic



Taking the official growth data as a given, China's economy expanded by 2.5% yoy over the first half of 2022. Reaching the growth target of 5.5% would require growth of 8.5% yoy in the second half. Excluding the volatility triggered by the COVID-19 pandemic, the last time China consistently grew at these rates was in late 2011.

Until recently, Chinese authorities continued to argue that the country could meet this year's target. During a keynote speech to the BRICS Business Forum in late June, President Xi suggested that China's government would implement sufficient policy support that would allow the country's economy to strive to meet its growth target. While the support measures were not articulated in this speech, it is thought that this referred to tax cuts intended to boost consumption and expanded special local government bond issuance – used to support infrastructure development.

Reports in early July suggested that the Ministry of Finance was seeking to bring forward around RMB 1.5 trillion worth of special bonds from next year's annual quota, in an effort to accelerate infrastructure spending. It is thought that such a move would require approval from the State Council and possibly the National People's Congress as well. The 2022 quota – totalling RMB 3.65 trillion – was almost completely sold by the end of June.

However, it is possible that this position has shifted following the weak growth outcome for Q2. Premier Li addressed the World Economic Forum in late July and suggested that the growth target was flexible, that employment and price stability were more important, and that China would not use excessive stimulus to meet an overly high target.

CONCLUSIONS

There is always a lack of clarity regarding policy debates within China's government as they occur behind closed doors. While it appears probable that authorities have moved away from the 2022 target as a strict goal, it is still likely that they will seek to stimulate the economy via infrastructure development, given the ongoing downside risks from the property sector, weak consumption growth and potential lockdowns due to zero-COVID public health policies.

Given the downside risks, and the poor outcome in Q2, we cut our full year forecast for China's growth to 3.5% in July.

The potential infrastructure spending also presents medium-to-longer term risk to China's economy. Local governments are responsible for infrastructure projects and many provinces already have high debt levels (including the obscured debts of Local Government Funding Vehicles, which lack considerable transparency and regulatory oversight), while revenues have been impacted by the downturn in the property sector (with many governments highly dependent on land sales). This increases the risk of default in coming years.

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