NAB Group Economics

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China's economy at a glance

December 2022

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Key points

Latest COVID-19 wave impacting activity in Q4; COVID policy pivot could provide boost in 2023 (after transition period)

- Reflecting the impact of the latest COVID-19 wave on activity across October and November, we have lowered our full year forecast for China's economic growth to 3.1% (from 3.4% previously). Stronger base effects lead to a small upgrade to 2023 – to 5.2% (from 5.0% previously). The easing of public health policies (see page 3) could provide a boost (once China is through a volatile transition period) however the downturn in the property sector continues to present downside risk.

- Growth in China's industrial production slowed significantly in November, as various major industrial centres were impacted by the latest major COVID-19 wave. Industrial production increased by 2.2% yoy (compared with 5.0% yoy in October).

- China's fixed asset investment slowed substantially in November – we estimate that real investment rose by 0.4% yoy in November (down from 4.6% yoy previously). There remains a significant difference between investment by private sector firms and State-owned enterprises (SOEs), with the latter the key driver of growth. That said, growth in investment by SOEs slowed in November – down to 4.7% yoy (from 12.3% yoy previously).

- China's trade surplus narrowed in November – reflecting a month-on-month fall in the value of exports, while imports trended modestly higher. The trade surplus totalled US$69.8 billion (compared with US$85.2 billion previously).

- The impact of the latest COVID-19 wave was clearly evident in retail sales data – with real sales falling by 7.6% yoy in November (compared with a 2.7% yoy decline in October). That said, this downturn was less significant than those associated either of the previous two large waves.

- In the first eleven months of 2022, new credit issuance increased by 5.9% yoy to RMB 30.7 trillion – with the rate of growth slowing since June. Overall, bank loans accounted for the largest share of new credit, however new bank loans contracted over this period – down by 0.2% yoy. In contrast, non-bank lending increased by 17.6% yoy over the first eleven months of the year, with government bonds issuance the key driver.

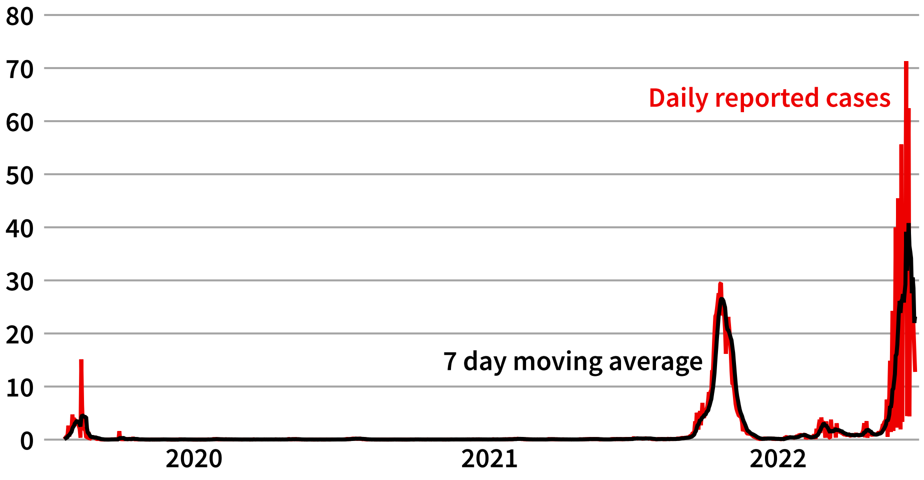
- Monetary policy effectiveness has been limited in recent times, with comparatively strong increases in liquidity (as measured by growth in M2 money supply) and slower growth in lending. This suggests weak demand for credit (particularly from the household sector), and it remains to be seen whether easing of COVID-19 public health policies will support a rebound, particularly given the weakness in the property sector.

COVID-19 policy

Daily COVID-19 cases

Third wave considerably larger than earlier ones

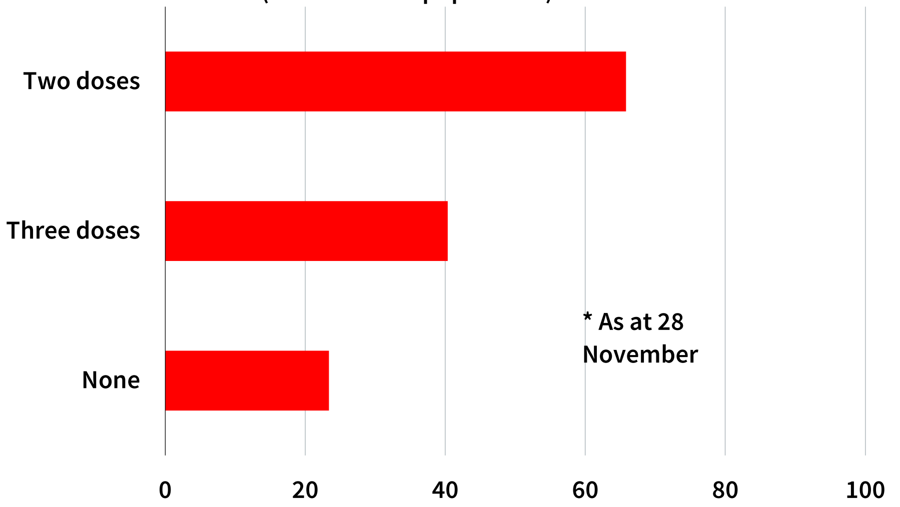
Daily confirmed cases of COVID-19 (000s)



Vaccination rates

China's elderly population has limited protection

China vaccination rate (% of over 80s population)*



* As at 28 November

Sources: Macrobond, China National Health Commission, NAB Economics

- Despite being in the midst of its third major COVID-19 wave – with case numbers far exceeding the previous two – Chinese authorities started to unwind a range of strict zero-COVID public health measures in early December. These changes came in the wake of mass protests across the country, on a scale not seen for decades.

- Policy changes include relaxing quarantine measures (allowing asymptomatic and mild cases to isolate at home), reducing widespread, high frequency PCR testing, ending closed loop requirements for industry (which forced workers to sleep onsite at factories) and eliminating proof of negative tests to enter public spaces. Public messaging around COVID-19 by health officials has also shifted, noting the reduced severity of the Omicron variant (compared with earlier strains).

- Although lockdowns may continue to occur, guidance from the central government is that they should be more targeted – such as the individual floors of apartment buildings, rather than entire neighbourhoods (or indeed cities). For now, international borders remain effectively closed, however this is expected to change at some point in 2023.

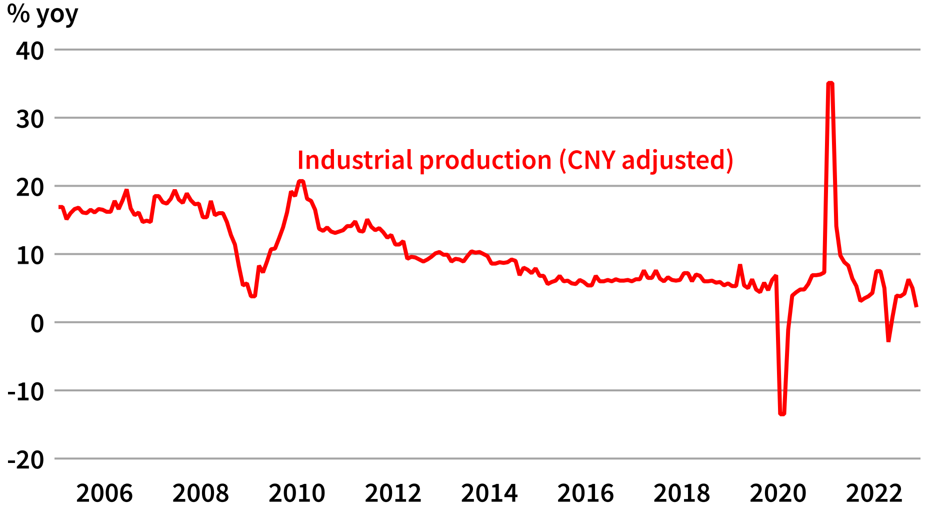
- A key risk regarding this policy pivot is the low rate of vaccination among China's elderly population. Just over 40% of over 80s have had at least three doses of domestically produced vaccines (which may be less effective and shorter lasting than global mRNA alternatives).

- Experience from other countries has shown that infections tend to increase as COVID-19 restrictions are reduced. Key factors to watch for China's economy are how its health system is able to cope with the likely increase in hospitalisations and how residents respond to a wider spread of the virus (with the potential for weak activity due to self isolation – something that anecdotally appears to be happening in Beijing at present). While there is little doubt that the zero-COVID policies have constrained China's economy in recent times, the potential for a disruptive period as case numbers increase means that there will not necessarily be an immediate bounce in activity.

Industrial production

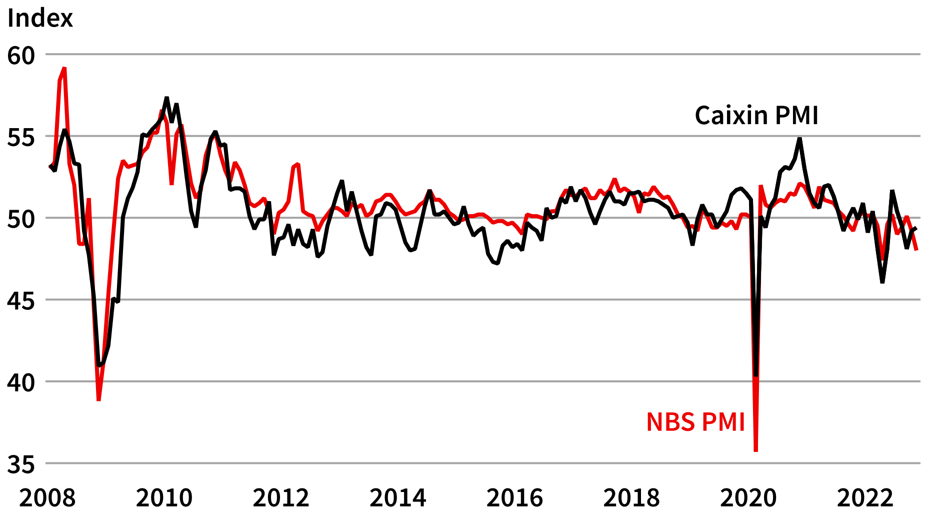
Industrial production

COVID-19 restrictions impacted industrial output in November



Manufacturing survey trends diverged in November…

…but both surveys remained negative, with new orders weak



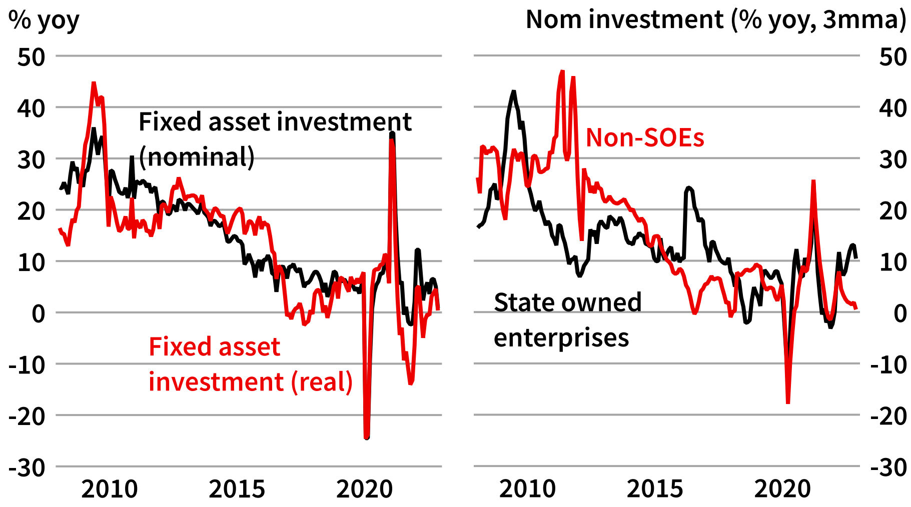
Sources: Macrobond, NAB Economics

- Growth in China's industrial production slowed significantly in November, as various major industrial centres were impacted by the latest major COVID-19 wave. Industrial production increased by 2.2% yoy (compared with 5.0% yoy in October).
- Production trends in individual industries were highly mixed. For example, crude steel output rose by 7.3% yoy, however this growth largely reflected base effects (given that steel output in November 2021 was particularly weak). In month-on-month terms, steel production has fallen since September.
- In contrast, production of electronics fell by 1.1% yoy (with major producer Foxconn's Zhengzhou plant one of the major centres of recent protests), cement manufacturing was down by 4.7% yoy and motor vehicle output fell by 9.9% yoy.
- Trends in China's major manufacturing surveys diverged somewhat in November, albeit both measures remained in negative territory. The official NBS PMI fell further in November – down to 48.0 points (from 49.2 points previously). In contrast, the private sector Caixin PMI was marginally less negative – moving up to 49.4 points (from 49.2 points in October).
- Forward looking measures – such as new orders – remain very weak in both surveys, pointing to the ongoing weakness in domestic demand and the deterioration in export demand in recent months (due to tightening financial conditions in most advanced economies).

Investment

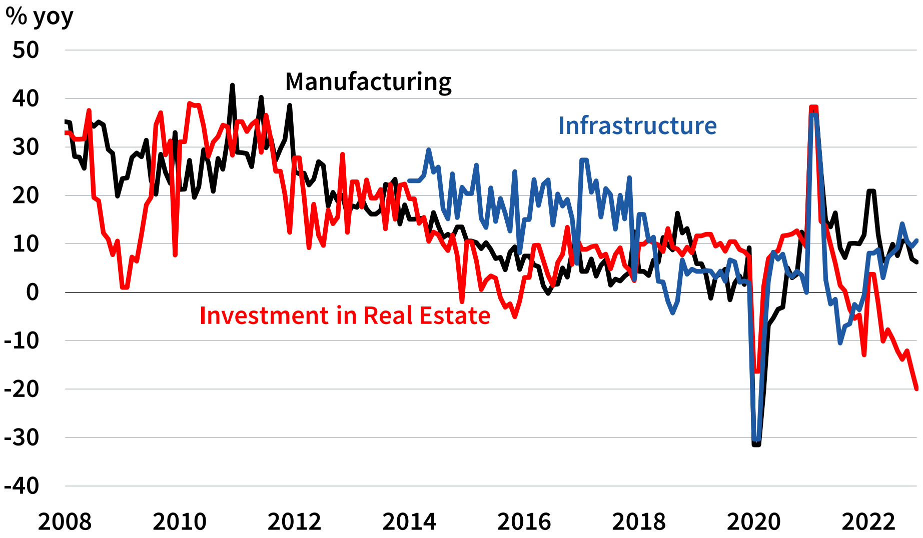
Fixed asset investment growth slowed in November

Private investment contracted while SOEs softened



Fixed asset investment by industry

Property downturn has seen real estate investment plunge



Sources: Macrobond, NAB Economics

- China's fixed asset investment slowed substantially in November – increasing by 0.8% yoy (down from 5.0% yoy previously) in nominal terms. That said, the steep slowdown in producer prices (from double digit growth to modest declines) lowers the cost of investment goods. As a result, we estimate that real investment rose by 0.4% yoy in November (down from 4.6% yoy previously).

- There remains a significant difference between investment by private sector firms and State-owned enterprises (SOEs), with the latter the key driver of growth. That said, growth in investment by SOEs slowed in November – down to 4.7% yoy (from 12.3% yoy previously). Private sector investment declined – down by 1.3% yoy (compared with a 0.5% yoy increase in October). Negative conditions in the property sector may explain some of the divergence between SOEs and private firms.

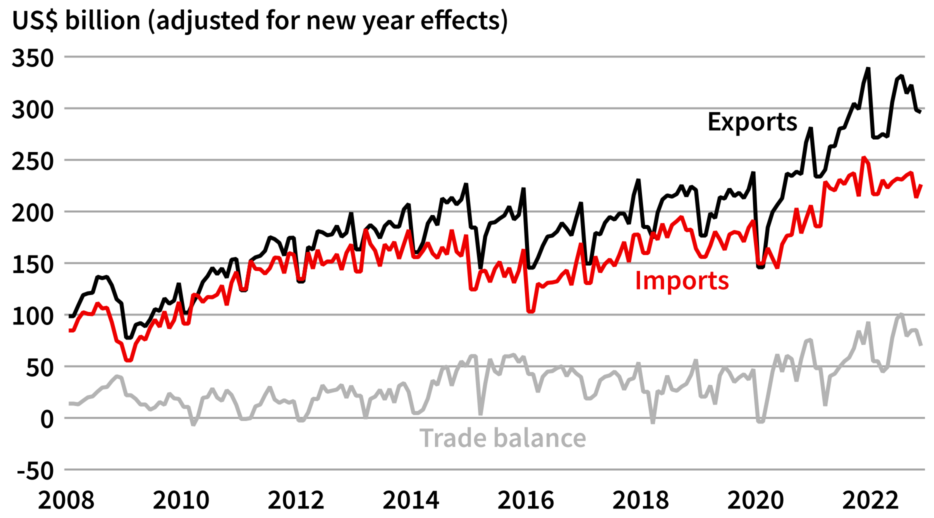
- Weak conditions in the property sector are evident in the investment trends by industry. The collapse of several major property developers – with Evergrande the most high profile – along with a mortgage strike and zero-COVID measures have negatively impacted confidence in the sector, with residential property sales and new construction starts continuing to fall. As a result, investment in real estate has continued to plunge – down by 19.9% yoy in November.

- In contrast, investment in infrastructure and manufacturing has remained relatively strong – up by 10.6% yoy and 6.2% yoy respectively in November.

International trade – trade balance and imports

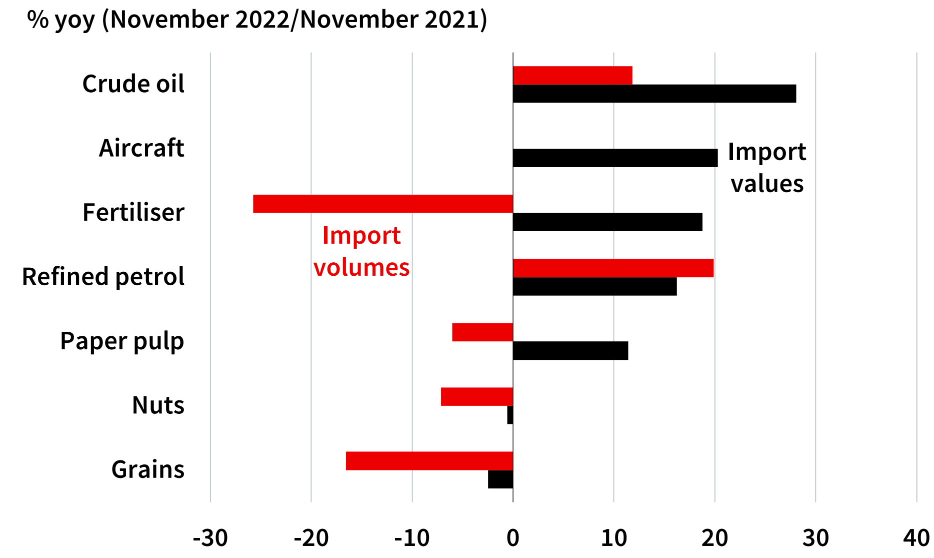
China's trade balance

Decline in exports drove China's trade surplus lower in November



Import values and volumes

Sizeable price effects impacting import data



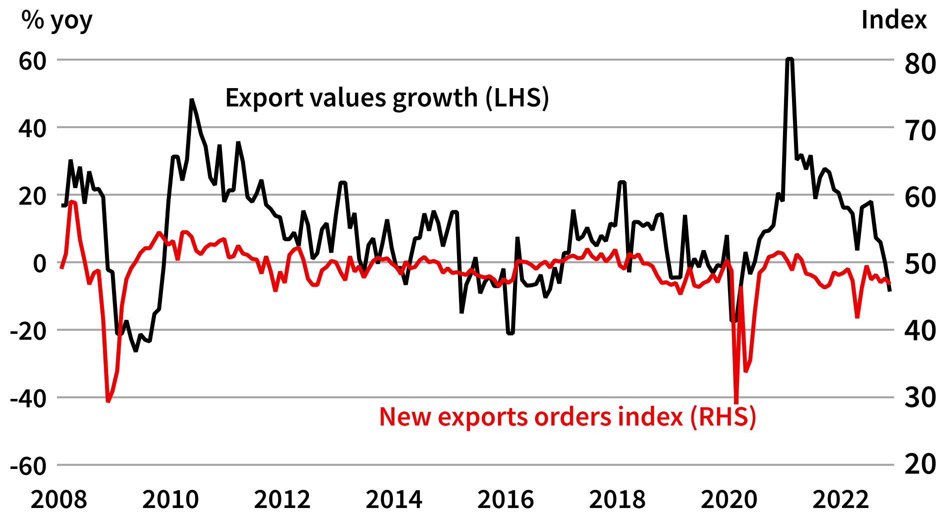
Sources: Macrobond, NAB Economics

- China's trade surplus narrowed in November – reflecting a month-on-month fall in the value of exports, while imports trended modestly higher. The trade surplus totalled US$69.8 billion (compared with US$85.2 billion previously).
- Slowing US demand (due in part to rapidly tightening monetary policy) has seen China's trade surplus with the United States start to contract. On a twelve month rolling basis, the surplus totalled US$413.7 billion – down from a peak of US$439.7 billion in July 2022. That said, it remains well above the levels prior to the US-China trade war.
- China's imports totalled US$226.3 billion in November (up from US$213.2 billion previously). It is worth noting that this monthly increase is highly seasonal – with weakness in October due to the Golden Week holidays at the start of the month. In year-on-year terms, imports plunged by 10.6%.
- Recent growth (until November) in US dollar denominated imports has largely been driven by rising import prices, with China's trade index showing that import volumes fell year-on-year each month between February and October. Given that global commodity prices rose year-on-year in November (which can be used as a proxy for import prices), and the total value of imports fell steeply, another decline in volumes is almost certain.
- The impact of price volatility is evident when breaking down imports by individual products. This is clear in energy related commodities – with large increases in crude oil and fertiliser values in contrast to the trend in volumes (with fertiliser volumes falling sharply year-on-year). However there are also sizeable impacts in a range of agricultural products – such as nuts and grains – and aircraft.

International trade – exports

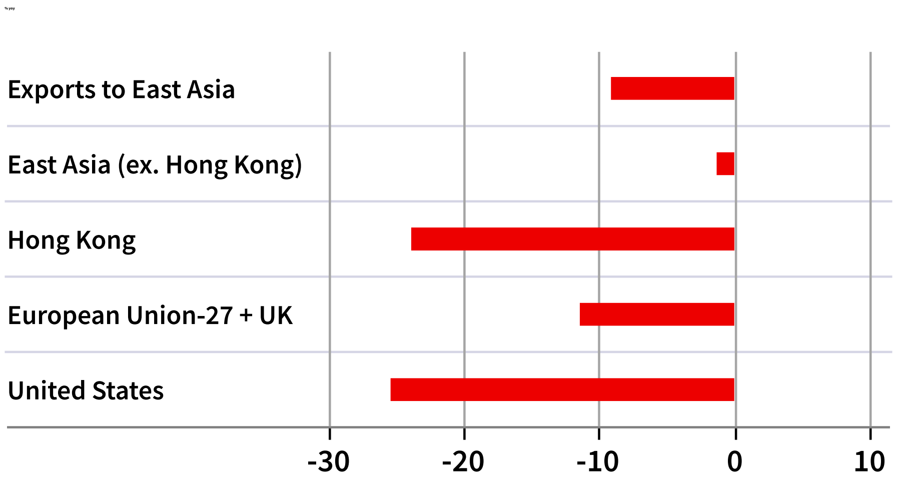
Export value and new export orders

Weaker global demand starting to bite on China's exports



Exports to major trading partners

Steep fall in exports to the United States



Sources: Macrobond, NAB Economics

- China's US dollar denominated exports fell in November – down to US$296.0 billion (from US$298.4 billion in October). In year-on-year terms, exports fell by 8.7% yoy – the steepest contraction in export values since February 2020. In part this reflects the impact of rapidly tightening monetary policy on consumption in advanced economies. New export orders in the NBS PMI survey fell to 46.7 points (from 47.6 points in October).

- As is the case with imports, export prices have risen strongly in 2022 – up by 15.3% yoy in October. The strength of export price growth implies that China's export volumes have been falling since August (albeit it is worth noting that the recent price trends are somewhat at odds with producer prices and import prices from China reported by US authorities).

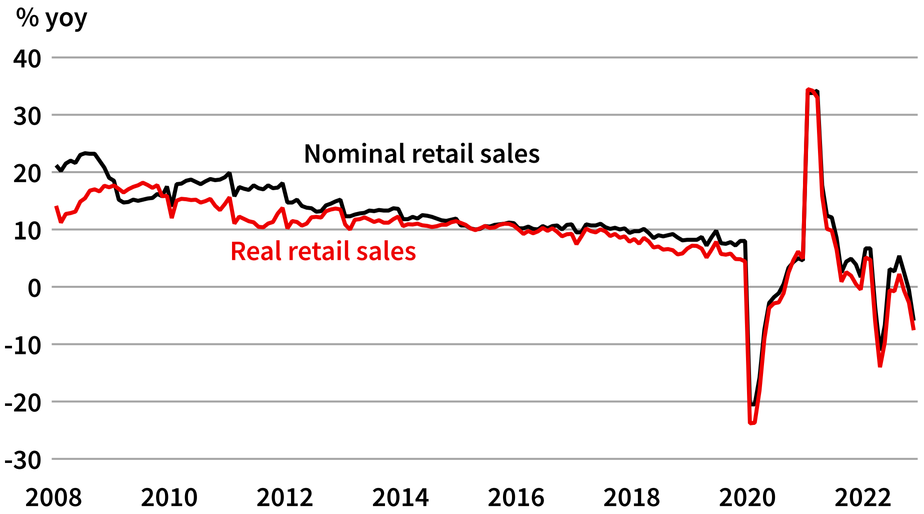
- Exports fell to all major trading partners in November – with particularly steep declines in exports to the United States (-25.4% yoy). In contrast, exports to the European Union-27 + the United Kingdom and East Asia fell more modestly – down by 11.4% yoy and 9.1% yoy respectively.

- That said, a plunge in exports to Hong Kong was the key driver of the East Asia slowdown – with exports down by 23.9% yoy. While COVID-19 and public health policies may have influenced this outcome, trade data with Hong Kong has long been distorted, with frequent disparity between Hong Kong and China Customs data due to capital flows being disguised as trade activity. Excluding Hong Kong, exports to East Asia fell by just 1.3% yoy.

Retail sales and inflation

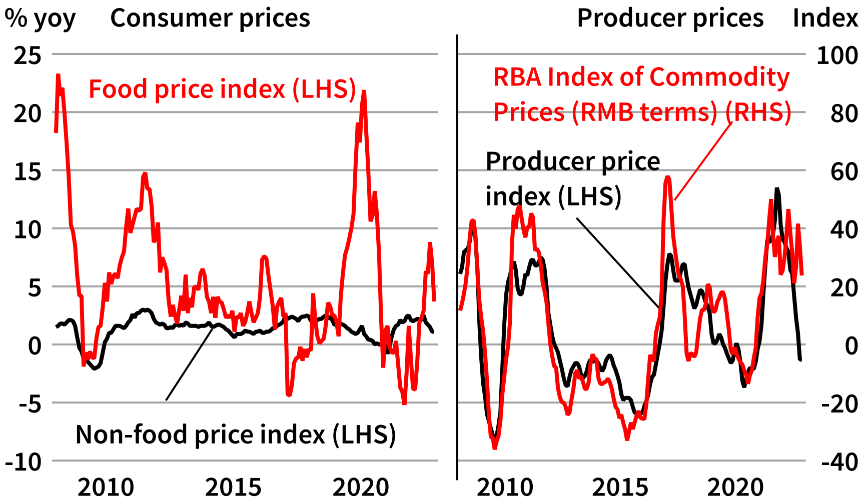
Retail sales growth

China's third major COVID-19 wave hit retail sales in November



Consumer and producer prices

Soft consumer price growth indicative of weak domestic demand



Sources: Macrobond, NAB Economics

- The impact of the latest COVID-19 wave was clearly evident in retail sales data – with nominal sales falling by 5.9% yoy in November (compared with a 0.5% yoy decline in October). That said, this downturn was less significant than those associated either of the previous two large waves.

- China's retail price growth was slower in November – in line with consumer price trends below – meaning that the fall in real retail sales growth was marginally smaller than the nominal one. Real retail sales decreased by 7.6% yoy in November (compared with a 2.7% decline previously).

- China's consumer prices grew more modestly in November – with the headline consumer price index rising by 1.6% yoy (compared with 2.1% yoy previously). This weakness – particularly in comparison to soaring rates in most advanced economies – points to subdued domestic demand.

- Food price growth slowed considerably in November – down to 3.7% yoy (from 7.0% yoy in October). Pork prices have had a major influence on food prices in recent years, and pork price growth slowed to 34.4% yoy in November (from 51.8% yoy in October). Fresh vegetable prices also fell sharply – down 21.2% yoy.

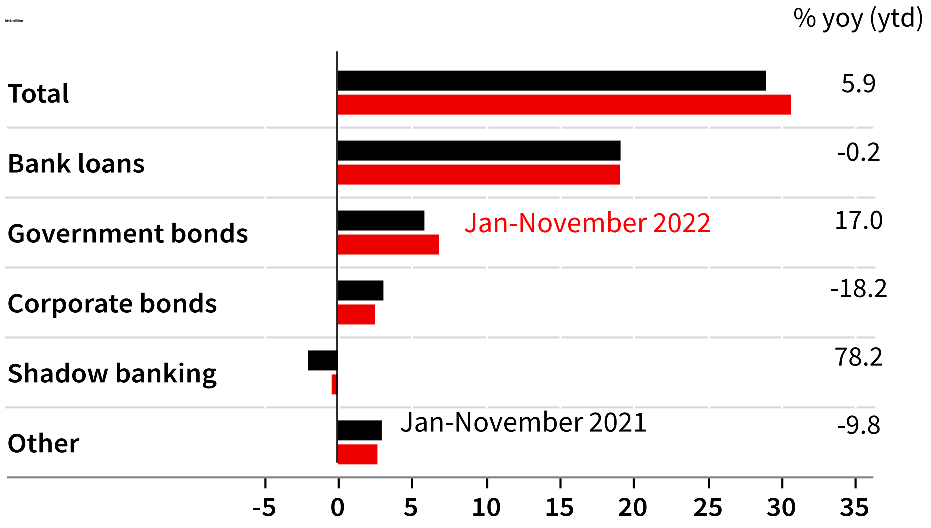
- Non-food price growth was stable – increasing by 1.1% yoy in November. Vehicle fuel price growth eased in November – rising by 11.3% yoy in November (down from 12.4% yoy previously).

- Producer prices fell at an unchanged rate in November – down 1.3% yoy. This decrease came despite global commodity prices (the RBA Index of Commodity Prices adjusted for RMB terms) continuing to increase strongly – up by 23.7% yoy. This may indicate that Chinese manufacturers have been cutting prices to support output – given the weak conditions in both domestic and global markets (albeit export prices have remained comparatively high up to October).

Credit conditions

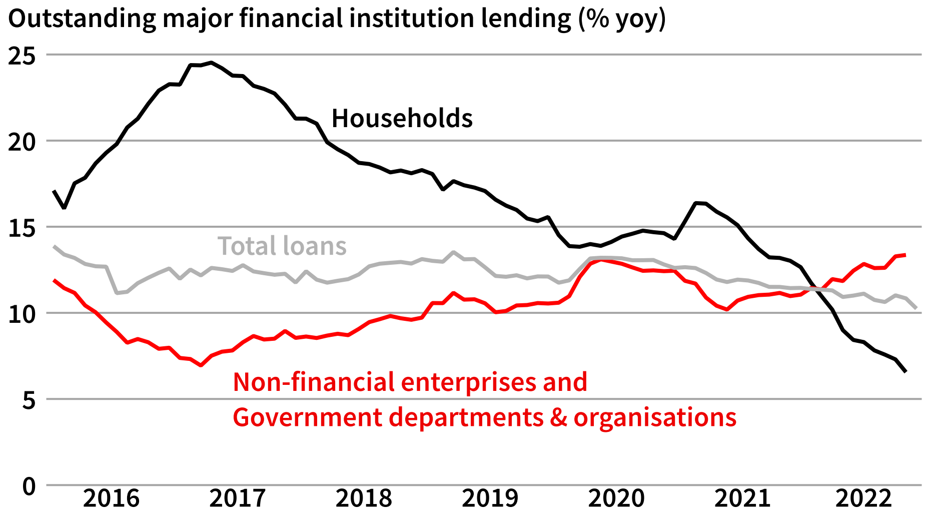
New credit issuance

Lending growth in 2022 driven largely by government bonds



Lending growth has been weak

Household lending growth has slowed substantially in 2022



Sources: Macrobond, NAB Economics

- Although new credit issuance rose month-on-month in November, it fell in year-on-year terms, with corporate and government bond issuance and bank lending all declining.
- In the first eleven months of 2022, new credit issuance increased by 5.9% yoy to RMB 30.7 trillion – with the rate of growth slowing since June. Overall, bank loans accounted for the largest share of new credit, however new bank loans contracted over this period – down by 0.2% yoy.
- In contrast, non-bank lending increased by 17.6% yoy over the first eleven months of the year. The key driver was government bonds issuance – which rose by 17.0% yoy to RMB 6.8 trillion. The outstanding stock of shadow bank lending declined at a slower pace over the first eleven months of 2022 than the same period in 2021 – boosting the growth rate for non-bank lending.
- Recent commentary from the Politburo state that they intend to support China's economic recovery in 2023 via "active fiscal policy" and "prudent monetary policy that is targeted and forceful". The People's Bank of China (PBoC) has held the Medium Term Lending Facility (MTF) rate stable since July – with this rate directly influencing the primary policy rate. This stability is in stark contrast with the steep hikes that major central banks have implemented since early 2022.
- Monetary policy effectiveness has been limited in recent times, with comparatively strong increases in liquidity (as measured by growth in M2 money supply) and slower growth in lending. This suggests weak demand for credit (particularly from the household sector), and it remains to be seen whether easing of COVID-19 public health policies will support a rebound, particularly given the weakness in the property sector.

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