NAB Group Economics

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China's economy at a glance
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Key points

Transition away from zero-COVID could boost growth in 2023, however needs to rebalance towards consumption

- The sudden reversal of public health policy in December – abandoning zero-COVID policies – resulted in considerable disruption, as the rapid spread of the virus led to labour shortages (both due to new infections and self-isolation) across the economy. The mass movement of people during the Chinese new year holidays risks further COVID-19 cases in the near term. That said, the end of economically-restrictive zero-COVID policies should provide a boost to growth once China is through this volatile transition period. It remains to be seen whether fiscal and monetary policies will be effective in supporting growth in consumption. We have revised our forecast for 2023 higher – to 5.4% (5.2% previously) – as authorities eased zero-COVID policies more rapidly than expected. Our forecast for 2024 is unchanged at 4.5%.

- China's economy grew more slowly in Q4, reflecting the impact of the latest COVID-19 wave, disruptions related to the end of zero-COVID public health policies and reduced base effects (compared with Q3). Headline GDP increased by 2.9% yoy but recorded no growth in quarter-on-quarter terms. For the full year, China's economy grew by 3.0% – marginally weaker than our forecast (3.1%). This was the second weakest rate of growth (after the 2.2% increase in 2020) since the end of the Cultural Revolution in 1976. Growth remained imbalanced – driven by the old model of industrial output and exports, rather than domestic consumption (which was constrained by the impact of zero-COVID policies).

- China's industrial production grew more slowly in December – reflecting the impact of the recent COVID-19 trends (both in terms of spread and policy) on producers. Output rose by 1.3% yoy (down from 2.2% yoy previously).

- There remains a sizeable divergence in nominal investment trends between state-owned enterprises (SOEs) and the private sector. Investment by SOEs rose by 9.0% yoy in December, compared with a modest 0.1% yoy increase from private firms.

- China's trade surplus was marginally higher in December, reflecting a modest month-on-month rise in the value of exports. The trade surplus totalled US$78.0 billion (up from US$69.2 billion in November). Although this surplus was below the peaks seen in mid-2022, it remained high by historical standards.

- The fall in real retail sales was comparatively modest in December – 3.7% yoy (compared with a 7.6% yoy decline previously) – a somewhat surprising outcome given the impact of the COVID-19 wave.

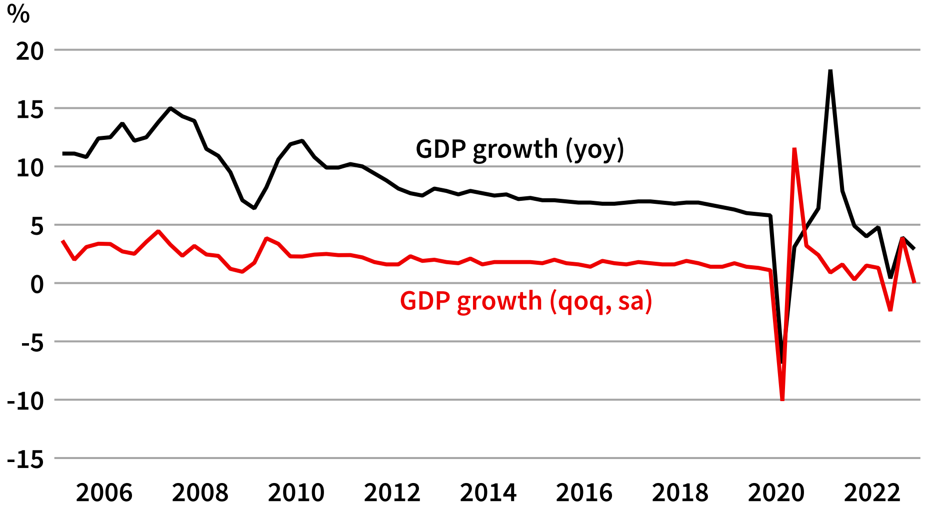
- New credit issuance increased by 1.4% to RMB 31.8 trillion in 2022. Overall, credit growth was rapid in the first half, before contracting for the bulk of the second half of the year.

- The PBoC has held its main policy rate – the Loan Prime Rate – unchanged since August 2022. There remain substantial risks around monetary stimulus – given the apparent weakness in credit demand (which may improve once China moves through its transition away from zero-COVID) and the imbalance with tighter monetary policy in advanced economies – which risks capital flight that could destabilise China's financial sector.

Gross domestic product

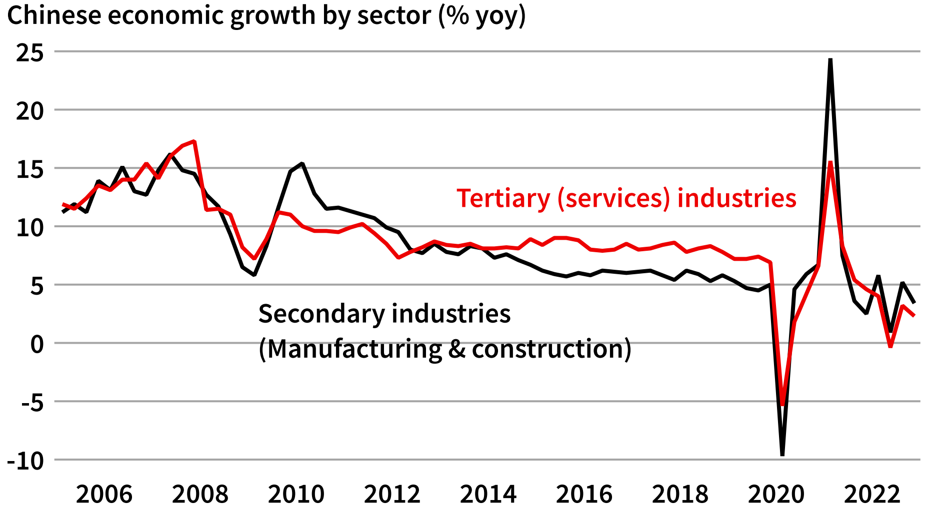
China's economic growth

Latest COVID-19 wave contributed to zero qoq growth in Q4



Economic growth by industry

Services growth remains weak



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- For the full year, China's economy grew by 3.0% – marginally weaker than our forecast (3.1%). This was the second weakest rate of growth (after the 2.2% increase in 2020) since the end of the Cultural Revolution in 1976. Growth remained imbalanced – driven by the old model of industrial output and exports, rather than domestic consumption (which was constrained by the impact of zero-COVID policies).

- By industry, growth remained comparatively weaker in the services sectors – the key driver of China's overall growth from 2013 onwards, but harder hit during the pandemic. Services expanded by 2.3% yoy. In contrast, the secondary sector increased by 3.4% yoy.

- There is considerable uncertainty around the outlook for China's growth in 2023 – primarily related to the duration of China's disruptive transition away from zero-COVID policies (which have constrained growth since the start of the pandemic). In addition, it remains to be seen whether fiscal and monetary policies will be effective in supporting growth in consumption. We have revised our forecast for 2023 higher – to 5.4% (5.2% previously) – as authorities eased zero-COVID policies more rapidly than expected. Our forecast for 2024 is unchanged at 4.5%.

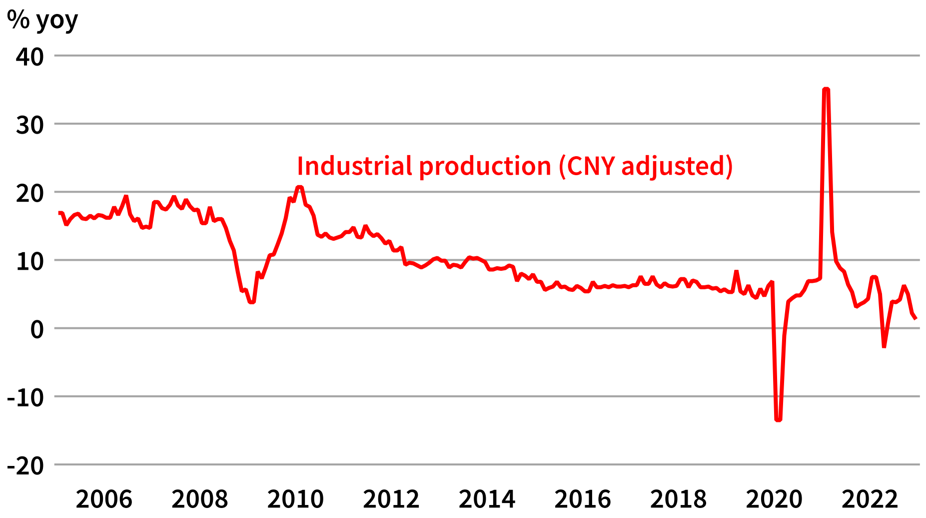
NAB China GDP forecasts

%	2021	2022	2023	2024
GDP	8.1	3.0	5.4	4.5

Industrial production

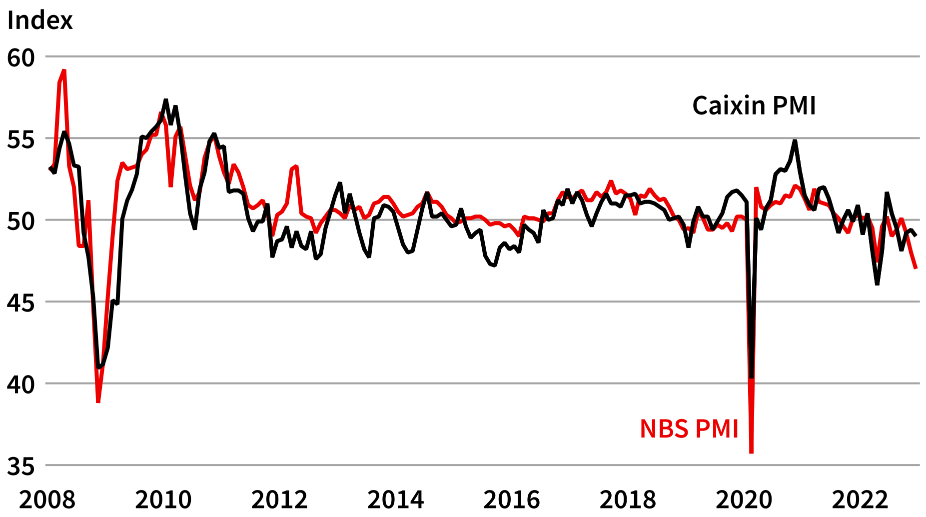
Industrial production

Slower output in December as COVID-19 impacted labour supply



Manufacturing surveys remain weak

Domestic demand and export orders remain negative



Sources: Macrobond, NAB Economics

- China's industrial production grew more slowly in December – reflecting the impact of the recent COVID-19 trends (both in terms of spread and policy) on producers. Output rose by 1.3% yoy (down from 2.2% yoy previously).

- A range of major industries saw sizeable falls in production in December. Construction related industries – such as crude steel and cement – saw output fall by 9.8% yoy and 12.3% yoy. Similarly, motor vehicle production fell by 16.7% yoy. In contrast, production of electronics rose by 1.1% yoy and electricity output was 3.0% yoy higher.

- There was a stark difference in trends in China's major manufacturing surveys in December – albeit both measures were in negative territory. The official NBS PMI survey deteriorated – down to 47.0 points (from 48.0 points previously). The private sector Caixin PMI was less negative, easing to 49.0 points (from 49.4 points in November).

- Both surveys reported sharp deteriorations in new orders – with both domestic demand and exports continuing to weaken.

Investment

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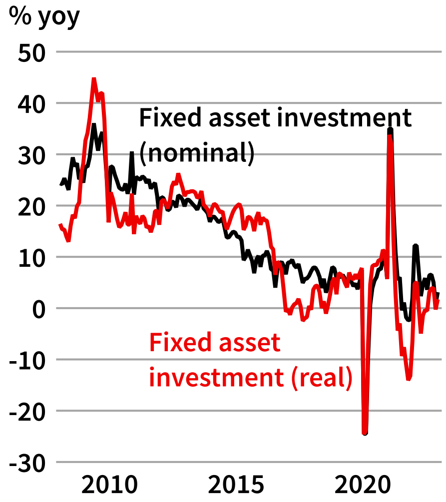
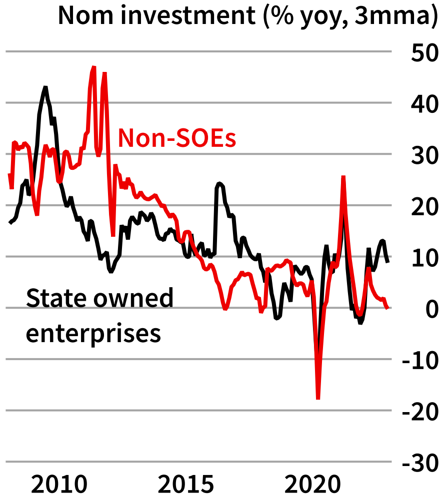
Fixed asset investment growth stronger in December

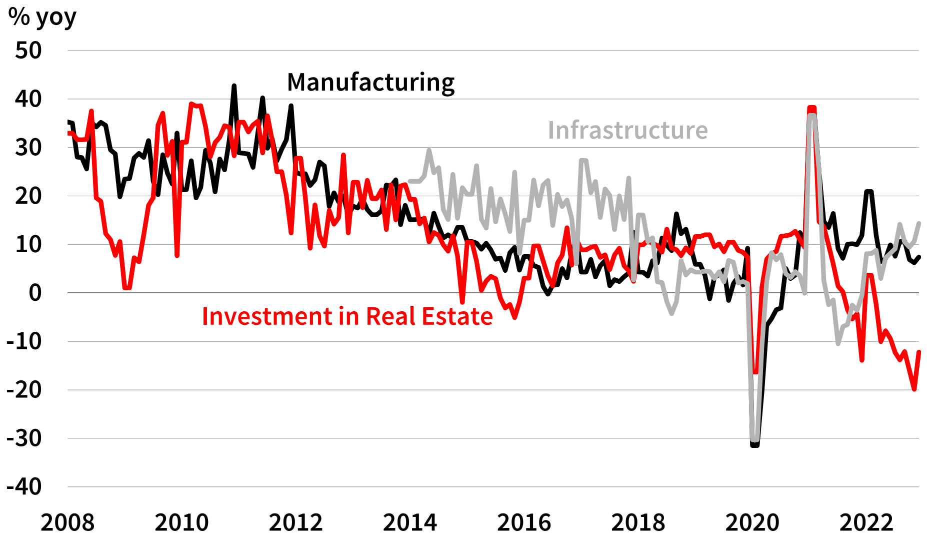
SOEs remain the key driver





Fixed asset investment by industry

Sizeable divergence between sectors, with real estate weak



Sources: Macrobond, NAB Economics

- China's nominal fixed asset investment accelerated in December – increasing by 3.1% yoy (up from 0.8% yoy in November). The recent softening in producer prices has lowered the cost of investment goods. As a result, we estimate that real investment rose by 1.7% yoy (compared with a 0.3% fall in November.

- There remains a sizeable divergence in nominal investment trends between state-owned enterprises (SOEs) and the private sector. Investment by SOEs rose by 9.0% yoy in December, compared with a marginal 0.1% yoy increase from private firms. The deteriorating conditions in the property sector may explain some of the divergence between these firms.

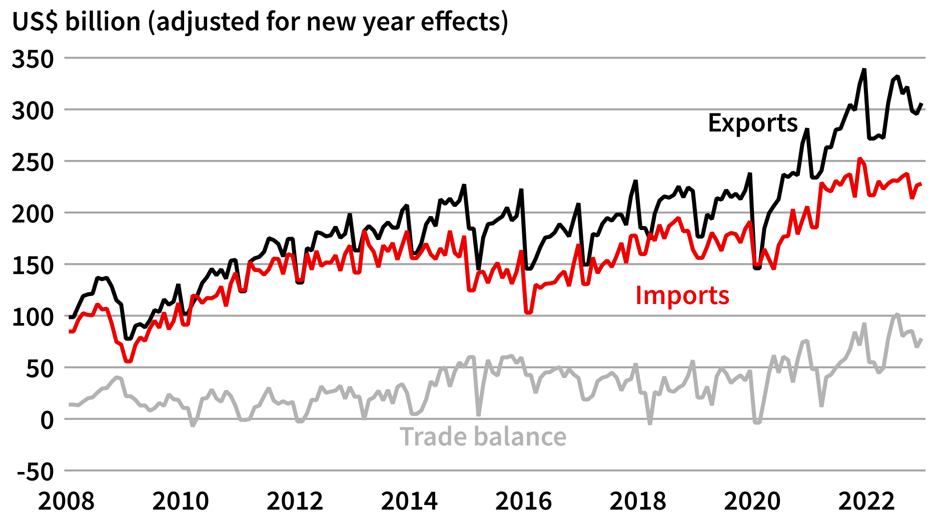
- The weak conditions in China's property sector are clearly evident in investment trends by industry. Investment in real estate continues to fall – down by 12.2% yoy in December (albeit this was less negative than in November). The collapse of several major property developers (due in part to the Three Red Lines policy), a broad mortgage strike and zero-COVID policies all impacted the sector. While Chinese authorities have sought to stabilise activity, it remains to be seen whether confidence will recover in 2023.

- In contrast, investment in infrastructure rose strongly – up by 14.3% yoy – while manufacturing investment rose by 7.4% yoy in December.

International trade – trade balance and imports

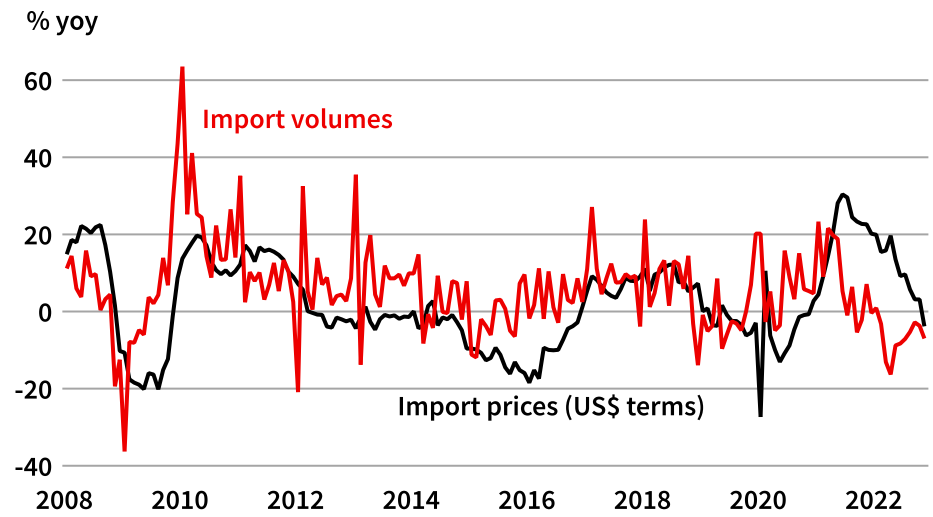
China's trade balance

Trade surplus remains near historic highs



Import volumes and prices

China's import volumes fell from February 2022 onwards



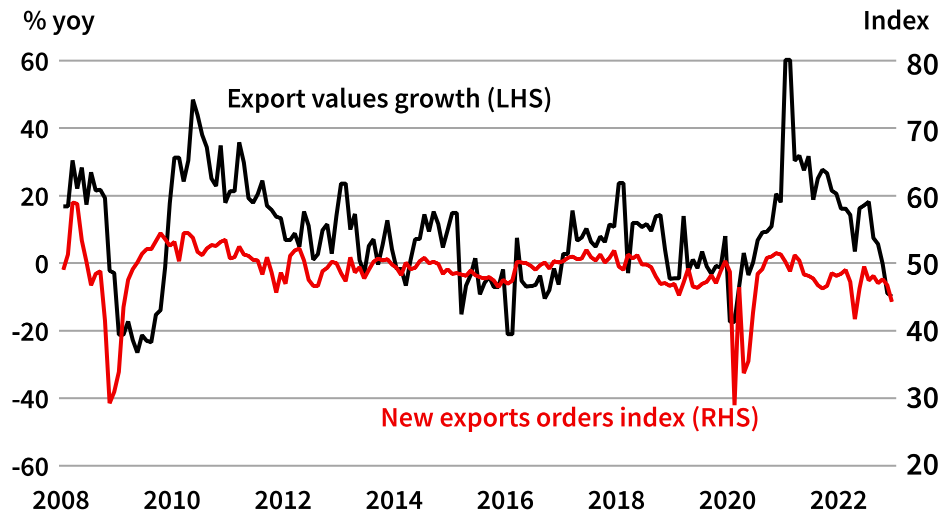
Sources: Macrobond, NAB Economics

- China's trade surplus was marginally higher in December, reflecting a modest month-on-month rise in the value of exports. The trade surplus totalled US$78.0 billion (up from US$69.2 billion in November). Although this surplus was below the peaks seen in mid-2022, it remained high by historical standards.
- Slowing demand in the United States has seen China's trade surplus with the US ease somewhat in recent months. As a result, the twelve month rolling surplus has gradually fallen from its peak in July 2022 (US$439.7 billion) to US$403.9 billion in December 2022.
- The value of China's imports totalled US$228.1 billion in December (up from US$226.3 billion previously). However, the value of imports fell in year-on-year terms, down by 7.5% – the third straight month of declines.
- Import prices increased strongly across the early months of 2022, where they rose at double digit rates, driving much of the increase in overall import values. However import prices (in US dollar terms) fell in November. Official data shows that China's import volumes fell by 7% yoy in November, with the sharp decline in import values in December point to this trend continuing.
- Import prices of individual commodities have differed considerably across 2022. In particular, surging energy prices – in part related to Russia's invasion of Ukraine – have impacted the prices of crude oil and fertilisers during the year.

International trade – exports

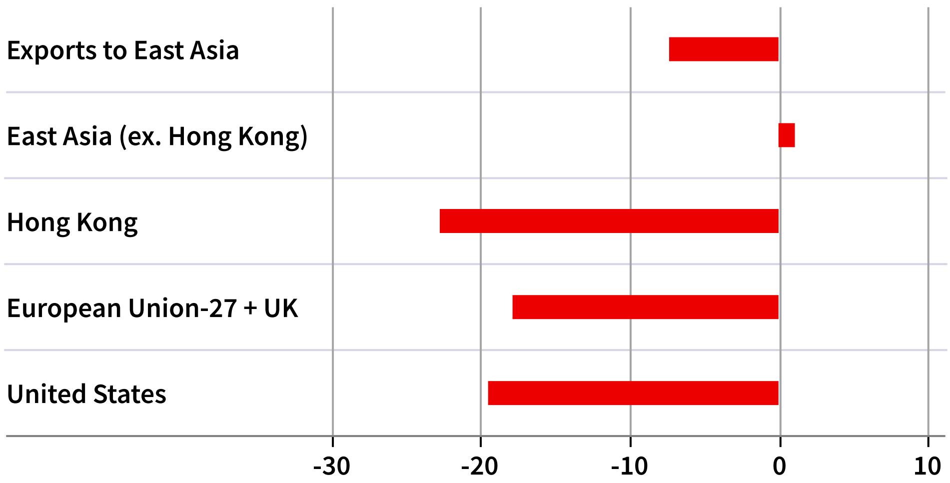
Export value and new export orders

Export growth falling, with new orders negative



Exports to major trading partners

Marginal increase to non-HK East Asia, steep falls to other majors



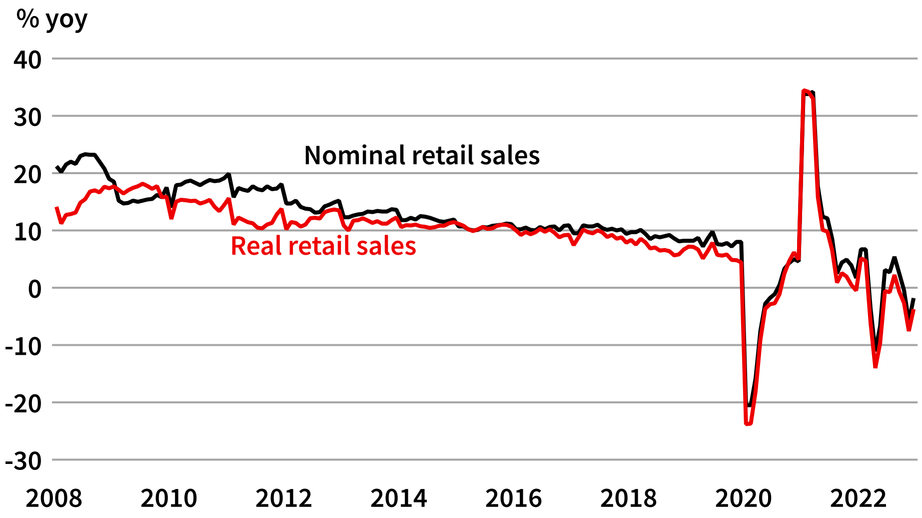
Sources: Macrobond, NAB Economics

- China's exports rose month-on-month in December – up to US$306.1 billion (from US$295.5 billion previously). However, this represented a substantial fall in year-on-year terms – down by 9.9% yoy. In part this reflects the impact of tightening monetary policy across 2022 on demand in most major advanced economies. This is reflected in the new export orders measure in the NBS PMI survey, which fell to 44.2 points in December (from 46.7 points in November).
- In a similar trend to that of imports, export prices for China's goods increased significantly across 2022 – albeit this price growth has slowed rapidly in recent months, up by 2.3% in November (in US dollar terms), compared with double digit growth between mid-2021 and mid-2022. China's trade index shows that export volumes have fallen year-on-year since August, and the sharp fall in export values implies another fall in December.
- Trends in exports to China's major trading partners differed somewhat in December. There were significant falls in exports to both the United States (down 19.5% yoy) and European Union-27 + the United Kingdom (down 17.9% yoy). In contrast, exports to East Asia fell by just 7.3% yoy.
- That said, the key driver of declines in exports to East Asia was Hong Kong – where exports fell by 22.7% yoy. There have long been issues regarding the accuracy of China's reported exports to Hong Kong – in part related to capital flows being disguised as trade activity. Excluding Hong Kong, exports to East Asia rose by 1.1% yoy – lead by increased deliveries to Singapore and (to a lesser extent) Vietnam.

Retail sales and inflation

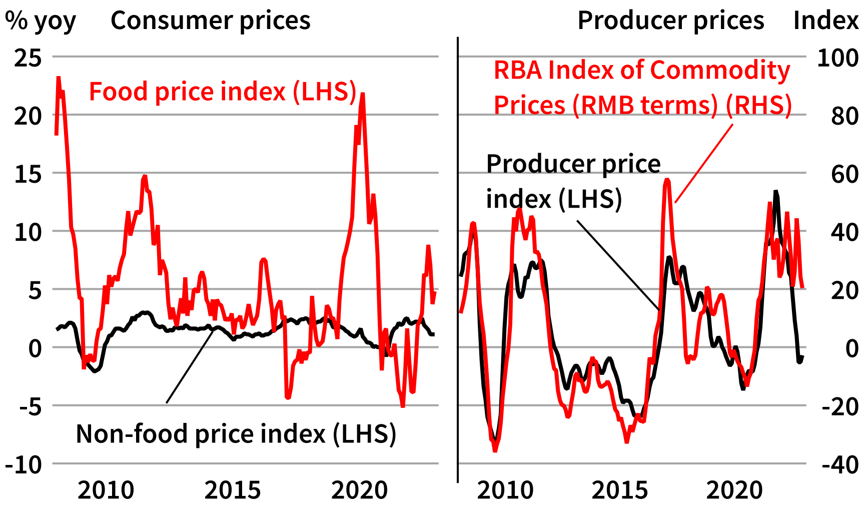
Retail sales growth

Sales less negative in December despite the COVID-19 wave



Consumer and producer prices

Consumer prices subdued as producer prices continue to fall



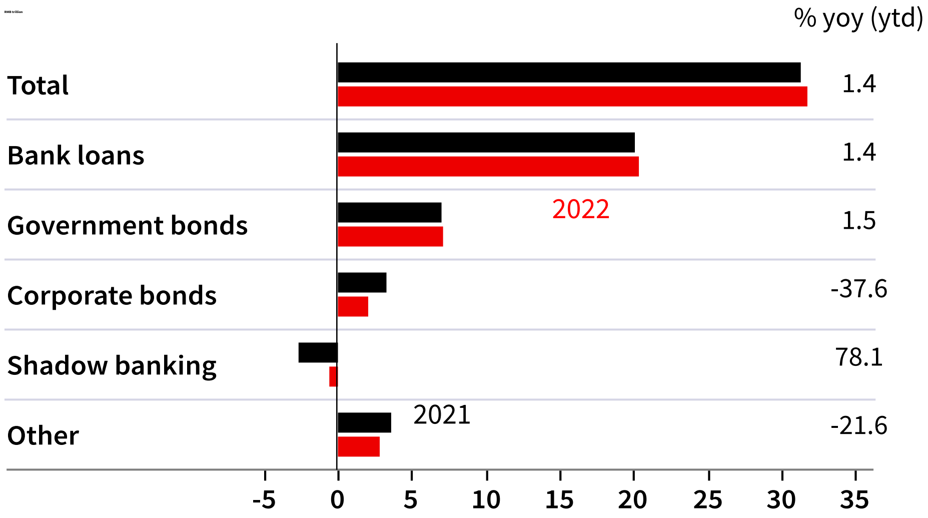
Sources: Macrobond, NAB Economics

- The fall in nominal retail sales was comparatively modest in December – down by 1.8% yoy (compared with a 5.9% yoy drop in November) – a somewhat surprising outcome given the impact of the COVID-19 wave.
- Retail prices saw a modest acceleration in December, meaning a smaller recovery in real retail sales – which fell by 3.7% yoy (compared with a 7.6% yoy decline previously).
- China's consumer price index rose marginally more rapidly in December, increasing by 1.8% yoy (up from 1.6% yoy previously). China's inflation across 2022 remained well below the global trends – where average prices rose to multi-decade highs – indicative of the weakness in domestic demand.
- Food price growth was marginally faster in December – increasing by 4.8% yoy (compared with 3.7% yoy previously). This acceleration came despite a slowing trend for pork prices – which have had a major influence on overall food prices in recent years – which rose by 22.3% yoy (down from 34.4% yoy in November). Instead, fresh fruit prices rose more rapidly, while fresh vegetable prices fell more modestly than was the case in November.
- Growth in non-food prices remained stable – increasing by 1.1% yoy – the same increase recorded in October and November. Slower growth in vehicle fuels (up by 10.4% yoy from 11.3% yoy in November) was offset by stronger growth elsewhere.
- Producer prices continued to contract in December – down by 0.7% yoy (compared with 1.3% yoy previously). Recent declines in factory gate prices appear at odds with trends in global commodity markets – with the RBA Index of Commodity Prices (when adjusted for RMB terms) increasing by 20.3% yoy. This may indicate that firms are cutting prices given the weakness in domestic and export markets.

Credit conditions

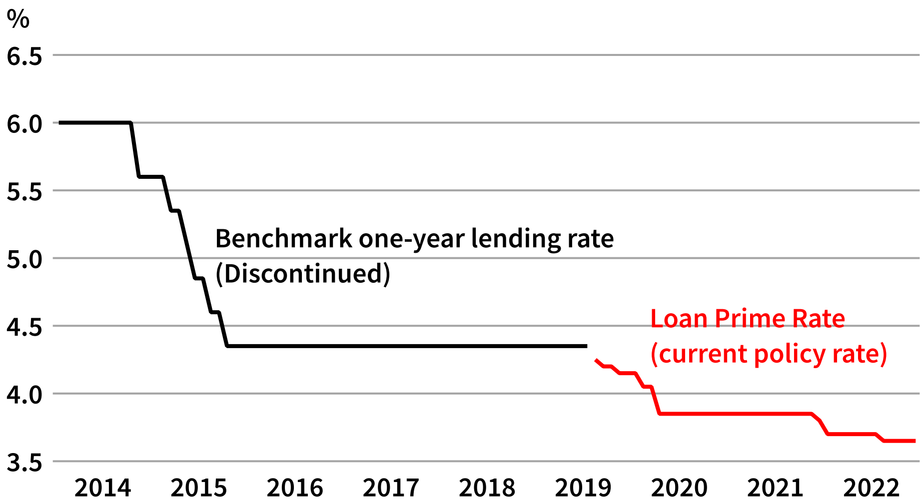
New credit issuance

Modest growth in 2022 after rapid slowing in H2



Monetary policy

PBoC has held rates low, counter to advanced economy trends



Sources: Macrobond, NAB Economics

- New credit issuance remained weak in December, with the total declining by almost 45% yoy. Trends were highly mixed between lending categories – with a sizeable year-on-year increase in bank lending, while government and corporate bond issuance was significantly weaker.

- For the full year of 2022, new credit issuance increased by 1.4% to RMB 31.8 trillion. Overall, credit growth was rapid in the first half of 2022, before contracting for the bulk of the second half of the year.

- Bank lending accounted for the largest share of new credit issuance, increasing by 1.4% yoy to RMB 20.4 trillion. Non-bank lending rose marginally faster – up by 1.6% yoy. The main contributor to this increase was shadow banking – where the stock of lending contracted less rapidly in 2022 than 2021. In contrast, government bond issuance – which rose rapidly earlier in the year – rose by just 1.5% yoy for the full year.

- Recent commentary from the People's Bank of China (PBoC) has indicated that it intends to step up monetary support in 2023 – allied with fiscal policy – to provide stimulus for the private sector as well as easing the crackdown on the tech sector. The combined policy approach will also seek to improve incomes for low and middle-income groups as well as COVID-19 impacted groups.

- The PBoC has held its main policy rate – the Loan Prime Rate – unchanged since August 2022. There remain substantial risks around monetary stimulus – given the apparent weakness in credit demand (which may improve once China moves through its transition away from zero-COVID) and the imbalance with tighter monetary policy in advanced economies – which risks capital flight that could destabilise China's financial sector.

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