China Economic Update February 2023

COVID's rapid spread may allow a faster economic rebound in 2023

NAB Group Economics

China's sudden abandonment of its zero-COVID policies in December led the country into a disruptive transition period before what is likely to be an economic rebound across 2023. A faster-than-expected spread of the virus may reduce the length of the transition period, providing upside risk to our growth forecasts. That said, the strength of the rebound may depend on consumer confidence – particularly the willingness to spend the savings built up during zero-COVID.

Sudden policy shift unleashes massive COVID-19 wave…

In early December, China's government unexpectedly shifted away from its long running zero-COVID public health policies. When compared with most other countries in recent years, China had remained an outlier with respect to COVID-19, continuing to implement mass testing regimes and respond to outbreaks of the virus with strict lockdowns and domestic movement restrictions while keeping international borders effectively closed.

Public statements continued to provide support for zero-COVID policies past the National Congress in October – which reappointed Xi Jinping as President – and through November. Statements from the Politburo Standing Committee at this time expressed concerns around the low rate of vaccinations among the elderly and pointed to policy relaxation around mid-2023. However, these policies changed rapidly in the wake of mass protests that commenced in late November – the scale of which had not been seen in China in over three decades.

In early December, Beijing announced a relaxation of quarantine measures (to allow asymptomatic and mild cases to isolate at home), the end of widespread, high frequency PCR testing and the elimination of proof of negative tests to enter public spaces. It is worth noting that from around August 2021, responsibility for implementing COVID-19 policies shifted from the central government to local authorities. Some policy observers have suggested that Beijing may have intended this policy relaxation to be a gradual process, but implementation at the local level was immediate.

Reflecting the removal of COVID-19 restrictions, the virus spread rapidly across the country in December and January. In late January, China's Center for Disease Control and Prevention announced that 80% of the population had been infected during this wave – although the reduced testing that was part of the policy change adds a degree of uncertainty around this estimate.

…but this could result in a faster recovery

Anecdotal evidence suggests that the initial phase of the transition was highly disruptive – with the rapid spread of COVID-19 leading to labour shortages – due to both new infections and self-isolation by individuals to avoid the virus. Similarly, there were reports of shortages of medical treatments, hospitals becoming overwhelmed and deaths exceeding initial reports. Our expectation was that the disruptions on both the production and consumption sides of the economy would negatively impact economic activity in Q1, but allow for a rapid rebound starting in Q2, as new infections started to fall away.

However, some data and further anecdotal evidence are suggesting that the recovery may come sooner, in part due to the faster-than-anticipated spread of the virus. That said, it is worth noting that trends during the early stages of each year can be hard to interpret, given that the Chinese New Year holidays add considerable volatility to various data series.

China's PMI surveys suggest a substantial improvement in conditions in January, when compared with December (when the policy change and the start of the latest wave occurred). In particular, services PMIs rebounded sharply. The NBS non-manufacturing PMI rose to 54.4 points in January, from 41.6 points in December – the latter being the second weakest reading on record, following the initial wave of COVID-19. In contrast, the recovery in manufacturing PMIs was more muted – reflecting the comparatively modest impact of recent COVID-19 waves and zero-COVID policies on manufacturing output.

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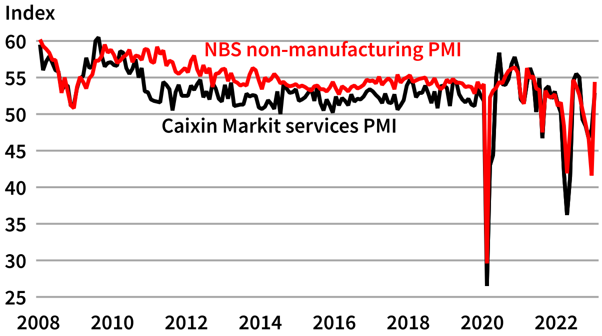
China services PMIs

Rapid rebound from December weakness

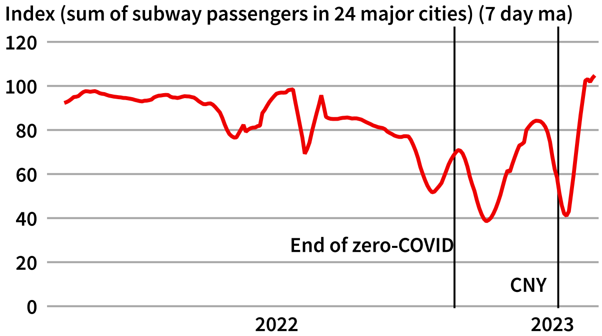


Source: Macrobond, NAB Economics

Other activity measures – such as subway traffic – also point to improvement in individual mobility, which is typically associated with stronger economic activity. Passenger numbers fell sharply in mid-to-late December – during the apparent peak of the COVID-19 wave – before starting to recover in early January and then rapidly rising following the Chinese New Year holidays.

China subway usage

Passenger numbers rising from late December lows



Source: Macrobond, NAB Economics

Economic activity could be further boosted in Q1 by lower-than-normal disruption related to long distance travel associated with Chinese New Year. Traditionally, large numbers of Chinese residents return to their hometowns for the holidays – historically one of the largest mass movements of people worldwide. Travel restrictions minimised movements during 2021 and 2022 and caution around the spread of COVID-19 (particularly to elderly relatives in rural areas with less developed healthcare systems) has kept many residents at home this year as well. This may allow for a more rapid resumption of normal operation for Chinese businesses post holidays than compared with pre-pandemic trends.

Conclusions – much will depend on the confidence of consumers

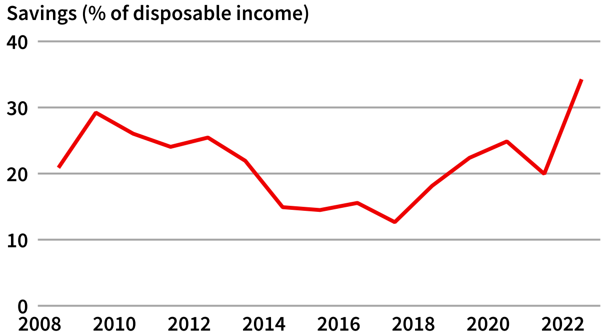
In January, following the release of China's economic data for Q4 2022, we revised our forecast for growth in 2023 to 5.4% (compared with 3.0% in 2022). In a large part, the acceleration in growth anticipated this year reflects base effects – given the weakness in China's economy in both Q2 and Q4 2022, year-on-year growth in those quarters will be comparatively strong.

However, this forecast was predicated on a more gradual reopening, that prolonged the economic disruption across Q1. This means there is potential upside risk to our forecast.

The overall outlook, not just the upside risk, is ultimately dependent on the confidence of consumers and their willingness to spend. Consumption was muted during the era of zero-COVID, due to a lack of fiscal support and the uncertainty around sudden strict lockdowns. This led to a surge in savings – particularly in 2023, when savings totalled around one-third of disposable income, compared with around 20% in the decade leading up to the pandemic (a level that is high by international standards and in part reflects the weak nature of social safety nets).

China household savings

Savings surged in 2022 but uncertainty could keep rates higher in near term



Source: Macrobond, NAB Economics

How consumers respond in 2023 will have a major impact on overall growth. While some observers have suggested that the high level of savings could support a wave of "revenge spending" as exhibited in many advanced economies following reopening, others note that the level of savings is somewhat inflated, as Chinese residents moved towards cash and away from investments in real estate and equities last year due to the poor performance of these sectors. This could suggest that near-term "normal" savings rates could be higher than pre-pandemic levels.

A consumption-led rebound may also be dependent on confidence among Chinese residents that the worst of the pandemic has passed due to herd immunity.

Experience from other countries has shown that protection from having recovered from COVID-19 could be limited – with natural immunity from earlier sub-variants of Omicron providing minimal protection against other Omicron sub-variants. Additional COVID-19 waves could keep constrain consumer confidence.

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