China Economic Update March 2023

Step down: China's cut its growth target to a multi-decade low

NAB Group Economics

Following the abandonment of its economically constraining zero-COVID policies, China's economy is widely expected to rebound in 2023. To that end, there was some degree of surprise that China's government cut its official growth target in 2023 to a multi-decade low. A broad range of factors could explain this modest target – from a faster than expected recovery or a desire to re-establish credibility to a greater appreciation of longer-term challenges.

China's growth set to rebound from 2022's weakness

China's economy underperformed in 2022, reflecting the impacts of severe lockdowns in various locations (most notably Shanghai) along with the general uncertainty associated with the zero-COVID policies. A lack of financial assistance for households meant that Chinese residents cut discretionary consumption, building up a savings buffer to withstand the loss of income associated with sudden lockdowns. As a result, the economy expanded by just 3.0% for the full year – the second weakest outcome (following 2020) since 1976.

This growth fell well short of China's official growth target for the year – at 5.5%. Following the target's announcement in March 2022, we noted that it appeared highly ambitious – given the already apparent weakness in domestic consumption and the deteriorating outlook for export demand. In part this reflected the sizeable lag between when the target was set – at the Central Economic Work Conference in December – and the announcement around three months later, by which time the economic picture had deteriorated.

The weakness in China's economic growth was particularly evident in Q2 2022 – when official data showed a 2.4% quarter-on-quarter decline – and (to a lesser extent) Q4 2022, where officially the economy recorded no growth when compared with Q3 (albeit a range of alternative measures suggested another contraction). Given the relatively rapid recovery exhibited in Q1 2023, even modest quarterly growth across the rest of the year will see large year-on-year increases in Q2 and Q4 due to base effects.

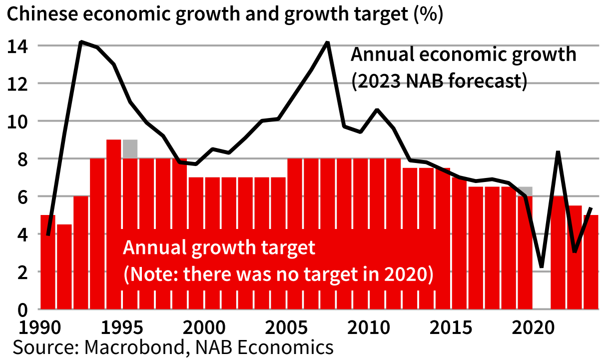
We forecast China's economy to grow by 5.4% in 2023 – albeit this forecast anticipated a longer and more disruptive transition period following the end of zero-COVID. This suggests that there is some upside risk to this forecast – albeit much will depend on how willing consumers are to spend accumulated savings, and how quickly this occurs, as well as the degree to which the property sector and export markets remain drags on growth.

Is cutting the target a sign of the longer-term reality?

China's official growth target was highly anticipated this year, as a signal of the government's economic priorities. There were various rumours circulating ahead of the National People's Congress regarding the direction of China's growth target – including some that suggested it could be lifted from last year's target of 5.5% (possibly a range from 5.5% to 6%) – or that it could remain unchanged from 2022. Instead, outgoing Premier Li Keqiang revealed a lower target – "around 5%" – which, reflecting the upside risk to our forecast, suggests that it is not an overly challenging goal. This was the weakest target growth rate since 1991 (when it was 4.5%).

China cuts growth target for 2023

Lowest target since 1991



Source: Macrobond, NAB Economics

It is worth noting that Premier Li's report was relatively brief and largely backwards looking (when compared

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with previous versions). Various news reports suggest that there was little-to-no involvement from the likely incoming Premier – Li Qiang – and his team, meaning that there is the potential for policy to change once the latter is in office – particularly if conditions prove to be weaker than anticipated across 2023.

This downgrade was consistent with provincial growth targets that had already been released – of China's 31 provinces, 23 of them cut their targets and just four of them increased them, with the weighted average falling significantly.

What then can we make of the cut to the target? First, it could once again reflect the lag between the decision and the announcement. The Central Economic Work Conference concluded around a week after the decision to abandon zero-COVID, meaning it was far too early to see the impacts of this policy change. Ultimately COVID-19 spread more rapidly than anticipated, which allowed for a more rapid recovery.

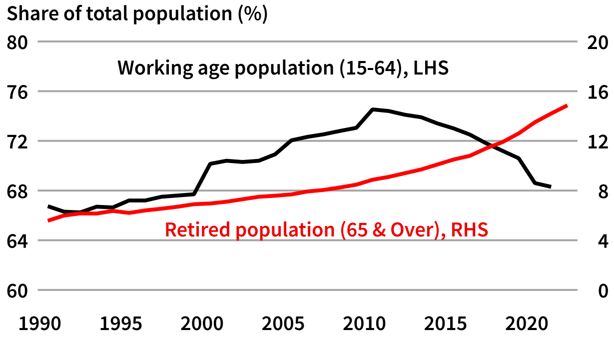
Second, the Communist Party may have sought a more easily manageable target in an effort to restore credibility that was damaged by last year's sizeable miss.

Third, the relatively modest – and apparently easy to achieve – target may reflect a desire within the government to avoid stimulus. The National Development and Reform Commission has noted that domestic consumption will be the key driver of growth in 2023, however the majority of policy measures outlined are designed to improve goods supply (once again avoiding providing direct fiscal support to households). Similarly Premier Li's report explicitly noted concerns around local government debt and seeking to avoid building up new debts.

Finally, the reduction in the target could reflect a degree of acceptance that China's longer term growth prospects are weaker than the trend exhibited in the past two decades. In a large part this reflects the growing demographic headwinds. China's working age population (as a share of the total) peaked in 2010 and its total population declined in 2022. Despite easing its population policy – moving away from the long running One Child Policy – this has not had a meaningful impact on birth rates. This contributes a lower (and likely slowing) potential rate of growth going forward.

Demographic headwinds

Falling population and working aged share restrains potential growth



Source: Macrobond, NAB Economics

Conclusions

Overall, this year's target should provide Chinese authorities with a relatively easily achievable goal with little need for intervention – a positive given existing debt concerns, particularly among local governments (who are responsible for the majority of infrastructure investment). Household consumption remains the key uncertainty for China's growth in 2023. Despite this being identified as the key driver of growth, policy makers remain unwilling to provide any direct support.

Contact the author

Gerard Burg

Senior Economist – International

Gerard.Burg@nab.com.au

+61 477 723 768

Group Economics

Alan Oster
Group Chief Economist
+(61 0) 414 444 652

Jacqui Brand
Executive Assistant
+(61 0) 477 716 540

Dean Pearson
Head of Behavioural & Industry Economics
+(61 0) 457 517 342

Australian Economics and Commodities

Gareth Spence
Senior Economist
+(61 0) 436 606 175

Brody Viney
Senior Economist
+(61 0) 452 673 400

Phin Ziebell
Senior Economist
+(61 0) 475 940 662

Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 0) 477 723 769

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 0) 455 052 520

Steven Wu
Senior Economist – Behavioural & Industry Economics
+(61 0) 472 808 952

International Economics

Tony Kelly
Senior Economist
+(61 0) 477 746 237

Gerard Burg
Senior Economist – International
+(61 0) 477 723 768

Global Markets Research

Ivan Colhoun
Chief Economist
Corporate & Institutional Banking
+(61 2) 9293 7168

Skye Masters
Head of Markets Strategy
Markets, Corporate & Institutional Banking
+(61 2) 9295 1196

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