China Economic Update November 2023

Searching for some signal in the noise – digging deeper into China's Q3 GDP data

NAB Group Economics

There were some notable inconsistencies in China's national accounts data in Q3, adding to the uncertainty around the direction of China's economy. The volatility triggered by COVID-19 and China's policy responses to the pandemic has made the analysis of the country's economy more challenging in recent times. While it appears that China's growth recovered in Q3, it is not apparent that this momentum will be maintained, and we continue to expect a softer growth profile in 2024.

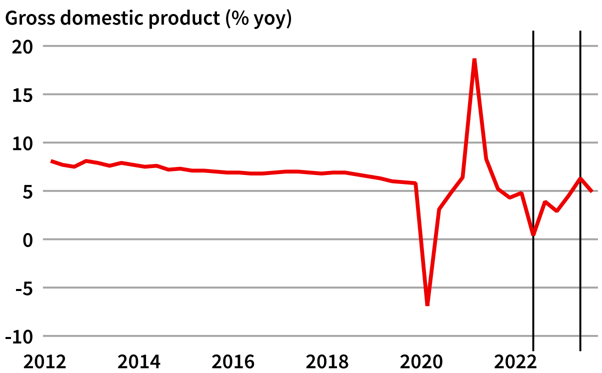
Limited data makes tracking China's economic path difficult

Compared with most major economies, China's National Bureau of Statistics (NBS) provides a much more limited range of national accounts data. Typically, growth in these measures is expressed in year-on-year terms, which makes tracking the changes between individual quarters more difficult (particularly give large scale base effects during the pandemic).

According to China's headline national accounts data, China's economic growth slowed in Q3 to 4.9% yoy (from 6.3% yoy in Q2). That said, this apparent slowdown largely reflected the impact of base effects – the severe lockdown in Shanghai and COVID measures in other cities negatively impacted China's economy in Q2 2022, which led to an inflated growth rate in Q2 2023. This boost had faded by Q3.

China economic growth

Fading base effects explain much of the slowing trend in Q3



The NBS produces a single seasonally adjusted quarter-on-quarter growth series which painted a slightly different picture, suggesting that Q2 2023 was comparatively weak. According to this measure, growth slowed from 2.3% qoq in Q1 (as China's economy was boosted by the removal of the zero-COVID policy restrictions) to just 0.5% in Q2. This loss of momentum was attributed to ongoing consumer caution, combined with the headwinds of property sector weakness and softer demand for exports. However, quarterly growth recovered in Q3 – increasing by 1.3% qoq.

It is worth noting that there are a range of issues with this quarterly measure. First, it is the only seasonally adjusted quarterly data series released by the NBS, meaning that there is no disaggregation to demonstrate how different sectors of the economy have performed over time. Second, the NBS do not provide any details of its seasonal adjustment methodology, meaning that it often differs from independent estimates of quarterly growth. Third, this series is frequently inconsistent with the headline year-on-year growth rate. For example, while the headline series states that China's economy grew by 6.3% yoy in Q2, the seasonally adjusted quarterly series implies a much stronger rate of 7.5% yoy.

In an effort to determine the underlying drivers of growth in the economy, we constructed a long run seasonally adjusted series for China's economic growth. This was done by using a short-running non-seasonally adjusted quarterly constant price (2020 prices) time series from the NBS and then deriving historical data back to 1992 by applying published annual growth rates. We then seasonally adjusted these data for the period 1992 to the end of 2019. The reason for excluding data from 2020 onwards in calculating the seasonal factors is to avoid possible distortions from the COVID-19 pandemic. If this period was included, the resulting adjusted series resulted in comparatively strong growth in Q2 and a weaker outcome in Q3 – something inconsistent with partial indicators and anecdotal evidence.

The resulting time series is consistent with the headline year-on-year growth rates and provides a similar pattern

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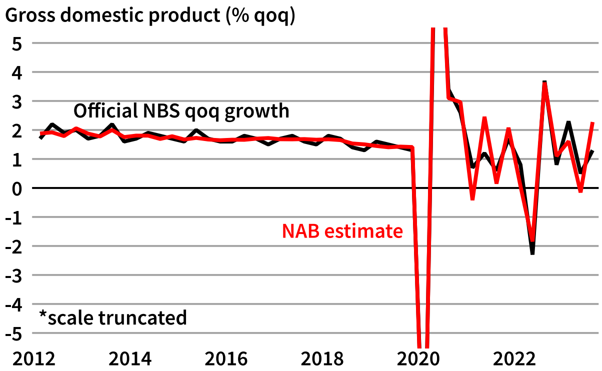
Data sources: Macrobond, NAB Economics

to the NBS's quarter-on-quarter growth series – albeit our measure shows greater volatility in recent quarters – contracting by 0.2% qoq in Q2 before increasing by 2.3% qoq in Q3.

Quarterly economic growth

Our seasonally adjusted profile is similar but more volatile

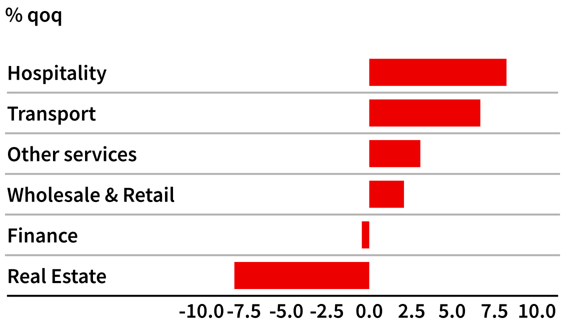


We took the same approach to the disaggregated data for the primary, secondary (which includes manufacturing and construction) and tertiary (services). Our seasonally adjusted estimates suggest that services were the key driver of growth in Q3 – increasing by 2.9% qoq – while the secondary sector increased by 2.3% qoq. In contrast, the primary sector, which under China's national accounts system comprises agriculture, forestry and fishing (but excludes mining), increased by just 0.3% qoq.

Further disaggregation of the services sector is more difficult, as the NBS does not produce inflation adjusted values for each segment. However, we can approximate these using nominal values, scaled using real growth rates and seasonally adjusted. This approach suggests that the wholesale and retail sector grew at a similar pace to the overall services sector in Q3, however there was much more rapid growth in transport and hospitality sectors. Unsurprisingly given the deterioration the property sector, the real estate sector continued to shrink in Q3. Our estimates suggest that another substantial driver of growth was the "other services" category – which comprises a broad range of services including healthcare, education and arts, culture and entertainment (among others). Again a lack of transparency around this sector, and its comparatively strong growth, adds some uncertainty around the direction of China's economy.

Estimated services growth

Hospitality, transport and "other" services appear to drive growth in Q3

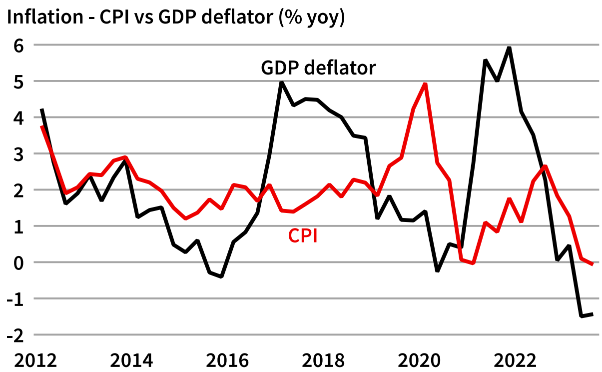


Data highlights deflation in China's economy

China's national accounts data also give a broader indication of deflationary pressures across China's economy than the basket of goods in the consumer price index (where growth hovered close to zero in Q3). China's real GDP growth outpaced nominal growth in both Q2 and Q3, with the implicit price deflator contracting by around 1.4% yoy in Q3.

Deflationary pressure in China

GDP deflator demonstrates broader deflationary pressures in Q3



At a high level, this deflation was driven by falling prices in the secondary sector – down by 3.5% yoy in Q3 – and to a lesser extent the agricultural sector (-3.1% yoy), with the former consistent with falling producer prices. In contrast, services prices rose by 0.4% yoy, albeit there were sizeable differences between individual sectors. Real estate service prices fell by almost 2.0% yoy, IT services were down by 1.1% yoy and wholesale & retail prices fell 1.0% yoy. In contrast, prices for transport services rose by 4.5% yoy.

In recent months, producer prices have been less deflationary, primarily as energy prices have trended higher since mid-year. It is currently unclear whether production discipline from OPEC+ can support oil prices during a deterioration in global demand (in line with weaker economic activity in 2024).

Conclusions

The volatility resulting from the COVID-19 pandemic highlights the poor range of data produced by the NBS, including detailed disaggregated national accounts data, along with the lack of long running and high-quality partial indicators of activity in the services sector.

We will continue to use and refine the approaches outlined in this report to provide greater clarity around underlying conditions in China's economy.

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