China Economic Update February 2024

Tougher target: China faces a more challenging outlook in 2024

NAB Group Economics

China exceeded its growth target in 2023, albeit only narrowly, with growth boosted by positive base effects following the end of economically restrictive COVID-19 policies. The lack of these base effects combined with various headwinds to growth in 2024 will make an expected unchanged target much more difficult to achieve – indeed we expect China to miss this mark this year.

China's growth target likely to be unchanged in 2024

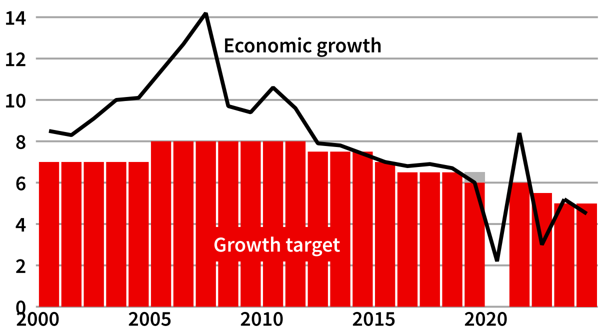
China sets its annual growth target at the Central Economic Work Conference in December, however this target is not officially announced until the National People's Congress the following March. Reports from the 2023 work conference suggest that China's growth target for 2024 will be unchanged at "around 5%". This was a relatively unambitious target for 2023, given that a substantial boost was expected from a reopening dividend following the end of zero-COVID policies and positive base effects (related to severe lockdowns in 2022). Ultimately the reopening dividend proved limited when compared with advanced economies and the weakness in domestic consumption meant growth barely beat the target – at 5.2%.

The unchanged target for 2024 is likely to be more challenging – particularly if weak domestic consumption persists – given the lack of positive base effects this year, and ongoing headwinds for growth. We forecast China's growth to fall below target this year, increasing by 4.5%.

China growth target

Unchanged target more challenging in 2024

China economic growth and target (%)



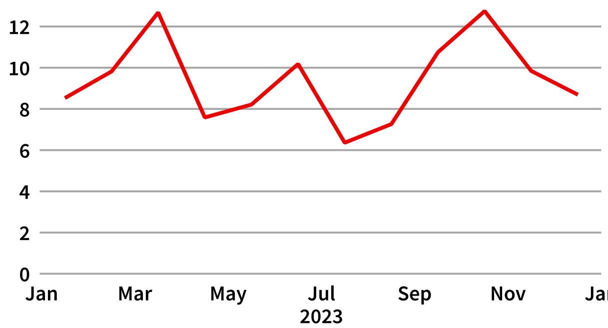
China's economy faces various headwinds in 2024

First and foremost, weakness in China's domestic economy reflects the softness in consumption. This has been a long-term trend – with China's economic growth model long favouring investment over consumption – however during the COVID-19 pandemic, China's public health policies further depressed consumption and encouraged households to increase savings. We are yet to see a clear rebound in household spending in its retail sales data (which is a far from perfect measure of consumption) – looking through the pandemic period to smooth out the volatility over time, real retail sales in December were around 8.7% higher than the same period in 2019, compared with a peak of 12.7% in October 2023.

Retail sales

Lack of clear direction

China real retail sales (relative to same month in 2019) (%)



Consumption is unlikely to be impacted by the downturn in China's equity markets in early 2024. The Shanghai and Shenzhen composite indices have trended lower since April 2023, but dropped steeply in January – down 7.8% and 18.8% respectively since the start of the year, with efforts by Chinese authorities to stabilise the market so far having had minimal effect. That said, various studies have suggested a weaker relationship

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Data sources: Macrobond, NAB Economics

between wealth and consumption in China than advanced economies – in part due to the sizeable share of equity ownership by the government – which the Stanford Center on China's Economy and Institutions estimates at around 60%.

Equity markets weaker…

…but likely limited wealth effect impact on consumption

China equity market composite indices

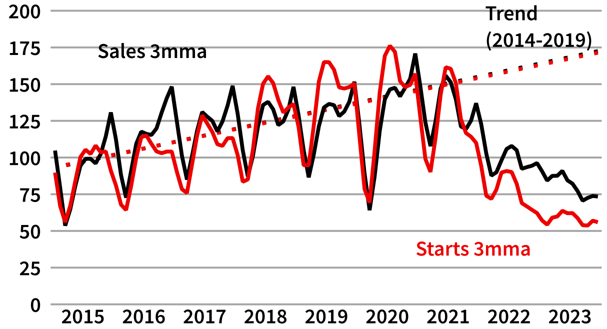
In contrast, weakness in the labour market could limit income growth, a more pressing constraint on spending. A recent survey by online recruiting platform Zhaopin suggested that one-third of professional workers in China saw their salaries fall in 2023. A record number of graduates will enter China's workforce this year, at a time where firms (particularly in the private sector) have been reducing hiring. Widespread youth unemployment – for which data is no longer released – could constrain wages growth at the lower income levels of the labour market.

The property sector has been another constraint on economic growth in recent times. In brief, the introduction of the Three Red Lines policy in mid-2020 (which restricted lending to the industry) and the mortgage strike in 2022 had a significant impact on the sector from both a supply and demand perspective – with steep falls in both new construction starts and new home sales. While these data are highly volatile due to seasonality, new construction starts in December were almost 70% below their 2020 peaks, while sales were almost 50% lower.

Property sector downturn

Starts and sales well off peaks, and downturn could be prolonged

Residential property indicators (million sqm)



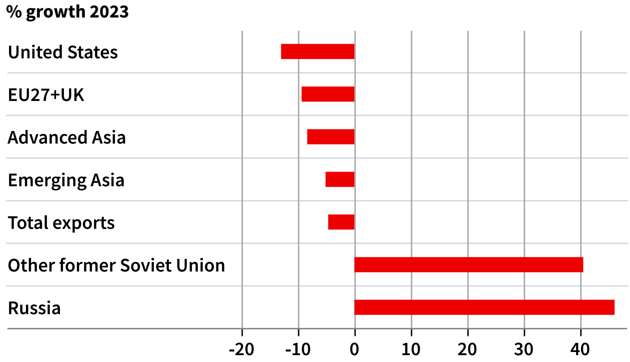
The downturn in the property sector could be a prolonged one. According to the People's Bank of China (PBoC), 96% of Chinese households own at least one property, while other studies suggest that over 20% of households own multiple properties. Estimates, based on property completions, sales and average property sizes, suggest that the urban vacancy rate of residential properties could also be over 20% (although this would vary considerably between different cities). The sharp downturn has lowered land sales (which fell by 13% in 2023), restricting revenues for already cash-strapped local governments, pressuring their ability to spend and repay existing debts.

Exports offer a limited avenue for growth in 2024. The weaker outlook for the global economy – at 2.7% in 2024, which outside the outliers of the Global Financial Crisis and the initial wave of COVID-19 in 2020, would be the slowest rate of growth since 2001 – means weaker demand for China's consumer and producer goods, particularly in advanced economies. While there has been a massive ramp up in exports to the Russian Federation and the former Soviet Union, there is a limit to the degree this can offset weakness elsewhere, particularly if political pressures continue to mount. India imposed an anti-dumping tariff on Chinese steel exports in September 2023, and US Presidential candidate Donald Trump has proposed a 60% tariff on all Chinese exports if he is elected in November.

Data sources: Macrobond, NAB Economics

China exports

Value of exports fell in 2023, despite surge to Russia and former USSR



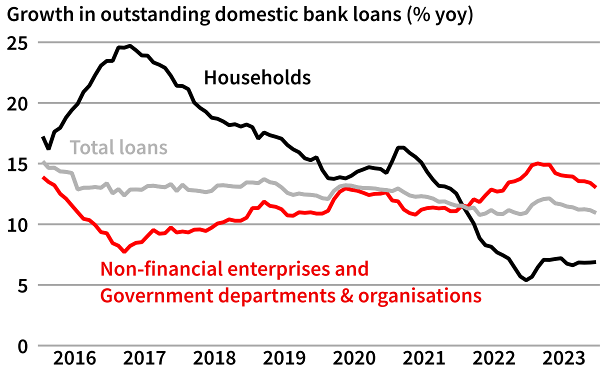
Monetary easing unlikely to boost loan demand

Recent easing of monetary policy – which boosted liquidity in financial markets, rather than directly reducing the costs of lending – is unlikely to turn around weak loan demand. The PBoC cut Reserve Requirement Ratio (RRR) in January, reducing the share of deposits that commercial banks must keep at the central bank, and increasing the supply of funds available for lending. However, there has been no shortage of liquidity in China's financial markets in recent times – instead loan demand has been constrained by the weakness in the property sector and low consumer and business confidence.

Loan demand in the PBoC Banker Survey plunged in Q2 2023, and the central bank has not published any subsequent data – despite two further quarters of results being due. Growth in outstanding domestic bank loans peaked in February 2023, and steadily declined across the rest of the year, driven by weakness in corporate demand.

Outstanding bank loans

Slowing growth in outstanding loans across 2023 points to weak demand



Conclusions

A key uncertainty in the near and medium-term outlook for China is the role of fiscal policy. Beijing has identified the need to boost spending, with the Ministry of Finance announcing in February that it would maintain spending at a "necessary intensity" in 2024, without providing specific details around it plans. In part, expanded central government spending may be necessary to offset weakness in the local government sector.

We have previously noted, large scale reforms to fiscal spending – particularly the establishment of a broad social safety net that would reduce the need for households to save – may be necessary to sustainably underpin consumption in coming years (particularly given the declining working age population and growing old age dependency ratio). That said, there appears to be a clear ideological opposition to such reform, with President Xi's speeches frequently warning of the dangers of "welfarism". Failure to address these issues will place China on a slower growth path over the longer term.

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