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FOREIGN AFFAIRS & TRADE
Manatū Aorere

China: Economic Update - Return to Growth

Market Report

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Prepared by the New Zealand Embassy in Beijing

Summary

- China's economy grew by 4.9% in the third quarter, meaning the country has now recorded GDP growth (0.7%) over the first nine months of the year. China's economy is widely expected to achieve GDP growth for the full calendar year – the only major economy likely to achieve this in 2020.
- China's manufacturing sector again led Q3 growth; however all main sectors experienced growth.
- Consumer spending returned to growth this quarter for the first time, after having lagged behind other indicators until now (and remains down on a year to date basis given the sharp declines earlier in 2020). This return to (modest) growth was supported by increased consumer confidence and a continued increase in real household income.
- China's goods trade similarly returned to growth for the first time this quarter (up 7.5%) – pushing trade just into positive territory for the year to date (up 0.7%). Exports outperformed imports, which remained down slightly for the year to date (-0.6%). This has been supported by the appreciation of the Chinese currency against the US dollar since June (up almost 4%), reaching the highest level in over two years.
- China's headline fixed asset investment entered positive territory for the year to date for the first time (up by 0.8%), recovering from a sharp decline in Q1; however manufacturing investment remained weak and infrastructure investment growth slowed.
- China's recovery in the second half of 2020 is largely attributable to the country's ability to control COVID-19; however the government's fiscal stimulus and use of quantitative easing have also had a significant impact.
- The IMF is now predicting China's economy will grow by 1.9% in 2020, and 8.2% in 2021.

Report

1. China's National Bureau of Statistics reported this week that **China's GDP grew by 4.9% in the third quarter** (Q3). On the back of 3.2% GDP growth in Q2, this meant that China recorded GDP growth (of 0.7%) for the first nine months of 2020 and putting China on track to be one of the only global economies with GDP growth in 2020.

2. There is broad consensus among analysts that China's recovery in the second half of 2020 (after an historic GDP decline of -6.8% in Q1) is largely due to the country's handling of the COVID-19 pandemic; however the government's fiscal stimulus and the People's Bank of China (PBOC)'s prudent monetary policy settings - including cuts in lending rates and banks' reserve requirement ratios (RRR), without excessive quantitative easing - have also had a significant impact.

3. **Q3 growth was again led by the secondary (manufacturing) sector which grew by 6%**; however each of the three main sectors experienced growth: the primary sector expanding 3.9%, and the tertiary (services) sector up 4.3%.

4. Additional macroeconomic data released by the government supports the picture that China's economy has been recovering across the board in recent months. Of particular significance was the **return to growth in consumer spending** for the first quarter this year, up 0.9% in Q3. September data was particularly positive, with growth of 3.3% year-on-year, up from the first (marginal) growth of 0.5% in August. This is supported by **continued increases in real household income**, which grew by 4.5% Q3, and per capita disposable income which showed a nominal increase of 3.9 percent for the year to date.

5. **Industrial output continues to ramp up,** with China's official Manufacturing Purchasing Manufacturers' Index (PMI) – a composite indicator designed to provide a single-figure snapshot of operating conditions in the manufacturing economy – achieving the seventh straight month of growth in factory activity and the strongest growth since March (NB: a figure over 50 represents expansion in factory output; the figure for September was 51.5). China's official Non-Manufacturing PMI, which provides an equivalent snapshot of the services and construction sectors, increased 0.7 percentage points to 55.9 in September, the largest jump in this indicator since November 2013.

6. **Export growth eased in September, but still showed strong year-on-year growth of 8.7%** (down from 11.6% in August). In the first three quarters of 2020, the total value of imports and exports of goods was up by 0.7% year on year, shifting to positive for the first time in 2020. Analysts suggest the ongoing growth in exports (up every month for the last six months) is largely due to China's position as a key supplier of medical equipment, as well as pandemic-related disruptions faced by some of China's competitors. Exports linked to COVID, such as medical goods, electronics, and home furnishings, continued to show double digits growth in September.

7. **The Chinese currency has appreciated significantly over the last year**, strengthening 3.9% against the US dollar between July and October and since September building strength relative to the New Zealand dollar. The increased purchasing power of the RMB has been reflected in the fact that Chinese imports jumped 13.2% in September 2020 year on year, to an all-time high of NZ$305.8 billion. Commodities experiencing significant growth in imports included iron ore, semiconductors, and agricultural commodities.

8. China's **headline fixed asset investment grew by 0.8% in the first nine months of the year**, shifting from negative to positive for the first time in 2020. Highlights included investments in high-tech manufacturing (up 9.3%, within which pharmaceutical manufacturing was up 21.2%) and primary industry (up 14.5%). Real estate investment grew by 5.6% in the year to date – up 12% in September, the fastest pace in nearly 1.5 years, Reuters calculated, and continues to provide substantial support for the economy. Infrastructure investment eked-out 0.2% growth for the year to date, reaching positive territory for the first time. Manufacturing investment, despite showing some improvement in Q3, was still down by 6.5% in the year to date.

9. China's Consumer Price Index (CPI), a key gauge of retail **inflation increased 1.7% year-on-year in September**, down from 2.4% in August and a peak of 5.4% in January, while the Producer Price Index (PPI) declined by -2.1%, broadly flat with August and an improvement on the low in May of -3.7%.

10. In some sectors, such as tourism, not everything has yet returned to normal. While international travel is still heavily restricted, domestic tourism is recovering – but remains well below pre-COVID levels. While domestic tourism jumped over the Chinese National Day Golden Week holidays (1-8 October), data from China's Ministry of Culture and Tourism showed that **domestic tourism over the holiday period was down 21% (by number of trips) and 30% (by revenue) versus Golden Week in 2019.**

Assessment

11. There is now a broad consensus that China's economy will experience GDP growth in 2020. The IMF has increased its forecast for Chinese growth, predicting the country's economy will expand by 1.9% in 2020, while the global economy is predicted to shrink by 4.4%. Its forecast for Chinese growth in 2021 is even more bullish: an 8.2% increase in GDP.

12. Consumer spending remains one of the key indicators to watch as retail sales have so far lagged behind the trend of wider recovery. In addition to the positive signs in Q3 retail data, high-frequency data suggest that consumer spending is continuing to normalise; however consumption remains far from the driver of growth the government has been hoping for. Further relaxation of COVID restrictions, coupled with an improved labour market and growth in domestic tourism should further support the consumption recovery. Some analysts, however, view the deceleration in consumer prices as an ill omen for consumer confidence.

13. The government's fiscal and monetary policy settings are also key indicators to monitor. At present, analysts expect the government and PBOC to hold steady on the current stimulus plan, with the central bank signalling a shift in its focus to strike a balance between stabilising growth and preventing risks, such as the potential challenges caused by an increased national debt.

14. Chinese demand for imported agricultural products remains strong, and the growth in household incomes, an increase in consumer spending, and a strong Chinese yuan are all positive news for New Zealand exporters to China. While September data is not yet available, overall New Zealand goods exports to China have so far weathered a difficult 2020 well, up 0.75% in the first eight months of the year, reaching NZ$10.4 billion (although results across sectors vary).

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