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FOREIGN AFFAIRS & TRADE
Manatū Aorere

China market update: out with the Tiger and in with the Rabbit – prospects for China's economy in 2023

MARKET REPORT

January 2023

Summary

- China recorded 3% GDP growth in 2022, falling short of the growth target of 5.5% set by the Chinese Central Government. The result was a consequence of a year beset by large-scale COVID-related disruptions.

- While 2022 saw weaker than forecasted economic performance, the year of the Rabbit is predicted to bring economy recovery. Analysts estimate GDP growth for 2023 of between 4-6% which would be consistent with China’s pre-pandemic trend lines. On 31 January the IMF released an updated 2023 GDP growth prediction for China of 5.2% (up from an earlier prediction of 4.4%).

- In December at China's Central Economic Work Conference (CEWC), China’s highest-level discussion on its economic outlook, Party leaders identified economic recovery as their key focus in 2023. Outgoing Vice Premier Liu He subsequently reiterated this message at the World Economic Forum in Davos. The themes of leaders speeches have been openness, micro reform - especially in real estate, banking and employment.

- Analysts consider the IPO of Jack Ma’s Ant Group and the resumption of new user registrations to ride-sharing behemoth Didi (both previously suspended by Beijing) as signals Beijing is relaxing its ‘tech crackdown’ and is willing to work to restore business confidence in e-commerce and tech.

- Travel data from the recent Lunar New Year period showed a significant improvement on domestic tourism compared with the last few years. This year 308 million tourists took trips domestically during the festive season, (89% of 2019 levels), driving consumer spending in catering and tourism in particular. However the uptick in consumption was not consistent across sectors, and there was continued weakness in some sectors such as manufacturing and automobile.

- China's post-COVID economy still faces significant economic challenges including: a depressed and highly indebted property sector, low export growth, and high youth unemployment. Further COVID waves or sub-variants are also expected. Consumer confidence and improved domestic consumption– seen as a key pillar for economic growth – will take some time to rebound.

- In 2022 China's population contracted for the first time in 60 years to 1.4118 billion – falling by 850,000 on the previous year. Only 10 million babies were born in China in 2021, compared to over 17 million in 2016. China will increasingly face the issue of supporting an ageing population with a shrinking workforce.

- These long-term economic challenges, however, while real, are unlikely to markedly affect demand for New Zealand products and services driven by China's reopening in 2023.

Report

Turning a page on a difficult Year of the Tiger

The Year of the Tiger, 2022, was a challenging year. China recorded 3% growth in GDP, falling short of the 2022 growth target of 5.5% and 2021's growth rate of 8.4%. Strict implementation of Zero-COVID policies saw manufacturing halted and restarted, supply chains disrupted and consumption dampened by city-wide lockdowns, most notably Shanghai's two-month lockdown in Q2. Economic activity was also impacted by internal travel restrictions. Domestic growth was also dampened by a depressed property market, lower consumer confidence and subdued consumption, and a challenging international environment (the war in Ukraine and high inflation in China's major markets).

Beijing has consistently deployed fiscal and monetary stimulus to support the economy. Most notable in 2022 was the disbursement of central funds to local governments to invest in infrastructure. China's GDP growth nonetheless remained sluggish, particularly in the second half of 2022. Many small and medium sized businesses closed, consumer demand from Chinese households slumped as COVID-risk averse consumers stayed home, and house prices fell, aggravating the debt issues affecting property developers. The bright spot in 2022 was strong trade and export growth, with high demand for Chinese goods buttressing economic growth. However, as inflation has risen in many of China's markets, export growth slowed through December and January.

The Q4 GDP growth result was reported as 2.9%. While low compared to pre-pandemic times, it exceeded average market forecasts of 1.6%. The result came despite strict restrictions in the first two months of Q4 and the large COVID wave as China's exited from its Zero-COVID settings. Despite the resilient Q4 GDP growth rate, there were some weaker economic indicators: household consumption dropped by 2.4% yoy, indicators of industrial activity were static or slowing and net exports also shrank.

Bullish outlook for the Year of the Rabbit

Notwithstanding a choppy Q4 the Year of the Rabbit has started quickly with considerable optimism. Economists are predicting a GDP growth rate for China in 2023 in a range of 4% to 6%. On January 31, the IMF released an updated GDP growth forecast for China in 2023 5.2% (up from its 4.4% forecast October of last year). During the pandemic, China's annual GDP growth has been volatile: from a pre-pandemic 5.9% in 2019; to 2.2% in 2020; a high 8.4% in 2021 (when global lockdowns saw online purchases of Chinese goods soar) to last year's result of 3%. A return to 4-6% GDP growth would bring China's growth rate more into line with its pre-pandemic trends.

The relaxation of Zero-COVID and the promise of a return to economic normalcy has many commentators relatively bullish on China's outlook for 2023. More optimistic forecasters pin their hopes on 'revenge spending' to drive household consumption (as occurred in the West following the relaxation of lockdown measures). More conservative commentators suggest unemployment needs to fall and consumer confidence to rise before households will be willing to spend more of their savings. A new 'urban push' – where Chinese from rural backgrounds migrate to urban centres for better economic prospects – is also anticipated to drive up consumption. Taken together, small-scale discretionary service spending could rise first, to be then followed by a more significant surge in consumption when Chinese consumers feel more confident about their longer-term economic position (employment and property in particular).

A number of New Zealand businesses operating in China who spoke with MFAT staff expressed optimism for China's economy in 2023. They expected demand for premium food and beverage products to pick up quickly, driven by the recovery of China's hospitality sector, rebounds in household income and consumption habits; "revenge spending"; continued trends towards buying healthy products from COVID-conscious consumers; and a return to traditional ways of celebrating Lunar New Year (e.g. the ability to gather and travel).

Companies also pointed out the removal of cold chain COVID restrictions/screening would simplify and lower the compliance cost of trade. Business travel was back on the agenda for many companies as a result of China ending on-arrival quarantine. However, the remaining pre-departure PCR test requirement was cited by companies as a potential obstacle for staff with historic COVID-19.

Political focus on economic recovery and restoring confidence

On December 16, China concluded the Central Economic Work Conference (CEWC), often referred to as the country's highest-level discussion on the economic outlook. With the relaxation of Zero-COVID, the focus for 2023 was on driving economic growth and restoring confidence. The priority areas identified included: lifting domestic consumption, continued deleveraging of the property market, and ensuring financial sustainability.

The CEWC did not focus on "reining in capital" as previous years had done (short-hand for regulating tech platform companies and risky speculative lending). Observers have taken this as Beijing softening its antagonist stance towards large private Chinese tech companies and signalling its intention to restore confidence in the high growth e-commerce and tech sectors.

In his speech at the World Economic Forum in Davos on 17 January, outgoing Vice Premier Liu He signalled China was committed to its economic engagement with the international community "We must open up wider and make it work better," Liu said. He also commented on the role of the state and the market in the Chinese economy: "We must let the market play a decisive role in resources allocation, let the government play a better role. We will deepen SOE reform, support the private sector, and promote fair competition, anti-monopoly and entrepreneurship".

A politburo study session held at the start of February reportedly focused on boosting consumption and developing technology as important drivers of economic development in 2023.

Easing of tech measures

In January there were two significant developments in the tech sector indicating a relaxation of Beijing's regulatory tightening: announcement of Ant Group's Initial Public offering (IPO) (Ant Group owns Alipay, the world's largest mobile payment platform, and is an affiliate group to Alibaba); and the resumption of new user registrations for ridesharing behemoth Didi. In 2020, Ant Group's IPO was suspended by Beijing 48 hours before trading was due to begin and was required to undergo a restructure. In 2021, Didi was reprimanded with a ban on new users and the launch of a corruption probe following its own IPO on the New York Stock Exchange, with Beijing citing a need to "prevent an expansion of risk".

Analysts have taken the easing of these measures as a signal that Beijing is stepping back from its 'tech crackdown' to support sector confidence. One Chinese official was quoted declaring that Beijing's measures on tech platforms was "largely complete". Analysts consider these moves to shore up sector confidence will likely have a broader positive effect on facilitating greater domestic and foreign private investment.

Relaxation of 'Three Red Lines' to reduce pressure on property market

Chinese regulators are relaxing the 'Three Red Lines' policy, originally introduced by Beijing in 2020 to reduce the level of debt and financial risk in China's property market. Facing a sector saturated with highly leveraged property developers, Beijing from 2020 imposed strict debt and cash-flow targets on real estate firms, and limited liquidity for the most-leveraged developers.

Three years on, the Three Red Lines policy has reduced the debt level in the property market. However it has also left many developers lacking sufficient funding to complete project construction. When consumers saw their deposits tied to half-completed apartments, demand for property plummeted. Prices in a depressed housing market shrank by 5.1% year on year through 2022. Given the output value of real estate-related industries accounts for around 25% of China's GDP and contributes more than half of local governments' revenues, some economists warn that without a meaningful recovery in the housing market, consumption will remain sluggish and limit prospects of an economic recovery.

Moving into 2023, in a bid to stabilise this critical sector, Beijing has again relaxed lending restrictions on property developers to release liquidity for property completion. China's financial regulators have raised lending caps on developers and extended the deadline for companies to meet loan repayments, and reduced barriers for consumers to apply for mortgages. Deleveraging of the property market remains important, but the moderation of the Three Red Lines policy allows Beijing to support a troubled – and essential – sector of the economy without entirely backtracking on long-term real estate reforms.

Lunar New Year travel and January economic data promising

China's services activity in January expanded for the first time in five months, as consumer travel and spending rose over the Lunar New Year period. Official and independent survey of services activity showed a rebound in January, with the latter showing a stronger increase and the latter a more moderate result. Travel data from the holiday period showed a significant improvement on the last few years, with 308 million tourists taking trips domestically during the festive season (89% of 2019 levels). Data from one of China's largest online travel booking platforms, Ctrip, showed bookings on the platform were four times higher compared than 2022, with overseas bookings increasing more than 640% yoy. Catering, tourism and other leisure activities also saw jumps in consumer spending, a notable example being box office revenue reaching 1.54 billion NZD over the holiday period (a 13% increase on pre-COVID 2019 levels).

However the Lunar New Year surge in consumption was not shared across all sectors, with manufacturing data suggesting a patchy economic performance in January. While official measures of manufacturing business activity pointed to a return to expansion in activity, an independent measure (which surveyed a smaller sample of businesses) suggested sector activity contracted, although by a lesser margin than December. Sitting behind this, manufacturing supply, demand and employment all shrank in January, however, supplier delivery times did improve. Automobile sales were also weak in January, with major carmakers reporting a 3.6% increase over the holiday period compared 2022 (versus a 6.8% increase in catering and retail). Analysts view the January data as a positive start to 2023, but also as evidence that the economic recovery is likely to be bumpy and inconsistent across the board.

A slow lift off for household consumption; economic headwinds remain

To drive the economic recovery in 2023, market analysts are anticipating a rallying of household consumption as the primary driver of growth. However, the rebound in household consumption – which accounts for close to 38% of the economy – may not be immediate and is likely to be patchy. While reopening has spurred an initial surge in travel booking over the Lunar New Year, consumer confidence remains low. Surveys of Chinese households in December and January showed a strong preference for saving over spending and lingering concerns around the health impact of COVID-19. Analysts suggest it may not be until the second half of 2023 that consumer confidence lifts sufficiently for more sustainable consumption-led growth. High youth unemployment is also seen as a likely dampener on a fast return to consumption growth. China's labour market has not fully recovered from the sharp deterioration earlier in the year and there remains record numbers of university graduates looking for jobs.

At a provincial level, there is a strong focus on revitalising household consumption. Provinces in Eastern China, including Shanghai, Hangzhou, Ningbo, have implemented a range of measures to stimulate consumer spending and tourism, such as through the provisions of coupons/vouchers. In Guangdong province, anecdotal evidence suggests a strong bounce back in retail and dining spending (a sector hard-hit by stringent lockdowns in Q4 last year), and the province is benefitting from resumed connections with Hong Kong. However key sectors of industrial manufacturing, transport and cargo service, and fixed asset investment, will likely observe a more gradual recovery.

With subdued prospects in Europe and the US, export growth is unlikely to drive economic growth as it did in 2022. December trade data showed a drop in China's export growth by 10% year on year. This challenging external environment is expected to persist for at least the first half of 2023.

COVID-19 remains a significant disruption risk as future waves threaten to drive worker absences, impacting manufacturing and logistics, as well as overall confidence. This may be moderated by the extreme speed with which COVID spread in China in December and January; the first wave may already have peaked. There could be a honeymoon period in H1 before immunity wanes and a second wave arrives.

A shrinking and aging population to have long-term implications for economy

In 2022 China's population contracted for the first time in 60 years to 1.4118 billion – falling by 850,000 on the previous year. While the fall has been expected for some time, it shows the limited success of policies to incentivise more births. In 2021 births only just exceeded 10 million, compared to 17 million as recently as 2017. A longer term decline in population could see demand for goods and new houses slow, and with it, China's domestic growth potential.

China’s population is not only shrinking, but it is also ageing. In 2022, 209.78 million people were aged 65 and above (up from 200 million in 2021) now accounting for 14.85% of the population. China faces the issue of supporting an ageing population with a smaller workforce. This presents a looming fiscal challenge for local governments who are required to finance a growing pension burden as their tax base is trimmed.

Optimism for the year ahead

Given the disruptions of 2022, analysts are comparatively bullish on China’s economic prospects for 2023. Beijing has signalled the importance it places on an economic recovery. A consumption-based recovery in China would help to buoy the international economic environment, given projections that many Western countries are facing recessionary conditions.

China’s various longer term economic challenges are unlikely to perceptibly offset growth in demand for New Zealand products and services driven by China’s reopening in 2023. With Zero-COVID relaxed and China’s economic activity normalising, including as travel and hospitality recovers, Aotearoa New Zealand business trading into China should suffer fewer shocks than the last few years. It is likely that demand for New Zealand goods will increase as consumer confidence picks up; a positive trend is also anticipated for Chinese tourist and students arrivals into New Zealand as air connectivity improves.

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