NEW ZEALAND
FOREIGN AFFAIRS & TRADE
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China's Economic Scorecard ahead of the 20th Party Congress

Market Report

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Rāpopoto - Summary

- China's recent economic data showed an improvement from Q2, with increased industrial and retail activity. However, the challenges of lower consumption, reduced industrial and services output, a depressed property market, and a weakening international economic environment continue to weigh on China's economy.
- In late September, the World Bank revised down its forecast for China's annual economic growth to 2.8%. This is the first time in 30 years that China is expected to be outperformed by the rest of Asia.
- China's property downturn has deepened over the past couple of months. Property sales fell by 50% yoy in August, and early indicators suggest a continuation into September. Economic commentators highlight the continued financial distress of real estate developers as a significant risk to medium-term economic growth.
- Decelerating export growth and a depreciating Chinese Renminbi have emerged as new (contrary) headwinds, challenging Beijing's efforts to grow the economy. Business confidence of foreign firms in China is low, based on survey results from major chambers of commerce.
- The Chinese Government has expressed confidence in Q3's economic performance. Premier Li has stated that "the negative trend [of the second quarter] was reversed and the economy has generally recovered in the third quarter."
- As analysts have pointed out, China's economic situation remains challenging, especially when viewed against the target growth rate of 5.5% set seven months ago.

Pūrongo - Report

August data turning a page on Q2's weak performance

Some sectors of the Chinese economy recovered ground lost in Q2 according to the most recent macroeconomic data released by China's National Bureau of Statistics. The headline growth improved in August from July, with measures of industrial activity rising 4.2% yoy, faster than July's 3.8% and total retail sales of consumer goods increasing by 5.4% yoy, 2.7% higher than the previous month (automobile tax cuts drove up purchases). Both indicators surpassed market expectations. The utility sector also grew in August, which was partly a result of the record-breaking heatwave and drought that saw energy demands spike. China's state index on manufacturing and services notched a small improvement in the month of September. However, a similar index of private business showed a contraction over the same period (with the lowest in the past five months).

Despite the areas of improvement from Q2, headwinds are still impacting China's economic outlook. Domestic consumption (outside of automobile purchases) remains weak, export growth has decelerated and the prolonged financial distress of the property market all present risks to H2 economic growth. The unprecedented heatwave and drought that impacted large swathes of Southern China over July-August, and the Covid-lockdowns in the economic hubs of Chengdu and Shenzhen in early September, disrupted supply chains, industrial production and services, and domestic consumption. It is possible that these events will yet show a drag on Q3 data when it is released later in October

Chinese Government projects confidence in Q3 outlook

The Chinese Government's outlook on the economy remains positive. At a meeting of economic policy makers on 27 September, Premier Li expressed confidence that in Q3 China's economy was now recovering, stating that: "the negative trend was reversed and the economy has generally recovered in the third quarter." Looking ahead to Q4, Premier Li also outlined a number of priorities, namely increasing confidence, stabilising market expectations and the implementation of policies from central government (including more special purpose bonds for infrastructure spending).

Beijing has repeatedly signalled the implementation of stimulus (through a combination of infrastructure spending and tax cuts) to be a key focus of it economic programme. However, commentators argue that the stimulus has been too supply-side focused, with not enough emphasis on boosting domestic demand. Commentators point out that, without specific policy intervention – such as the relaxation of COVID restrictions – demand is likely to remain depressed.

World Bank's downward revision of annual GDP growth forecast; business sentiment among foreign firms remain low

The World Bank, in its most recent East Asia and Pacific Economic Update, forecasts that China's GDP will grow 2.8% in 2022, significantly below the growth rate for the rest of the region (and far below the original GDP growth target of 5.5% set by Chinese leadership). This is the first time in 30 years that China looks likely to be outperformed by the rest of Asia. (cf. China's economy grew 8.1% in 2021 after COVID-affected growth of only 2.2% in 2020).

This report follows a trend of downward revisions of growth forecasts for China issued by other multilateral development banks and private banks. For example, the Asian Development Bank, the International Monetary Fund, and major private banks, including Goldman Sachs, Morgan Stanley and UBS, have now forecast growth for China at around 3% or lower. These banks have cited the numerous headwinds buffeting the Chinese economy, and the dampening effect of China's zero-COVID policy as major factors in the downward revisions of the annual growth forecast.

Levels of pessimism amongst the foreign business community in China has also increased, according to surveys from the American and European Union's Chambers of Commerce in China. Respondents pointed to the impact of China's COVID-control measures on their business activity and future planning. The restrictive nature of entry into China is a considerable source of frustration, contributing to a 'gap of understanding' between foreign executives in HQ and their China operations.

The real estate crunch continues

The property market has continued its downward trend, with property sales falling 50% yoy in August. Market expectations are that this trend will continue into September. Property prices and construction activity have fallen too. There is evidence of a lack of consumer confidence as some developers continue to wrestle with heavy debts (estimated NZD 8.9 trillion) and unfinished projects.

To ease the pressure on financing in the sector, in September China's financial regulators advised large state-owned banks to provide financing worth at least NZD 152 billion to the property sector. At a local level, city governments have been instructed to relax mortgage loan requirements for first-home buyers, and some cities will be allowed to lower or scrap the floor on mortgage rates for first-home buyers. Analysts have commented that the potential success of this policy depends on whether banks will cut rates sufficiently to stimulate housing demand given the grim environment.

Chinese external trade growth decelerating

Chinese exports grew by 7.1% in August, a far lower rate than previous months and falling short of market expectations. Shipping rates have been falling for weeks, suggesting that demand has faded. The Shanghai Containerized Freight Index has fallen to its lowest level since 2021, and the cost of sea freight from Shanghai port (China's largest port) has also dropped. Taken together, the fall in export growth may signal foreign demand for Chinese products falling to their pre-pandemic levels from COVID-induced heights.

Exports had been a bright spot in Q2 for China. While a depreciating RMB may temporarily buoy Chinese exports, commentators worry that the deceleration in export growth is not a temporary blip and could limit the longer-term ability of exports to drive GDP growth.

In response to slowing exports, on 27 September the Chinese Ministry for Commerce announced a suite of policies to support external trade, including: expanding the scale of the China Import and Export Fair, supporting further cross-border e-commerce, and improving the operational efficiency of trade ports and inland transport.

Chinese Renminbi depreciating

Against the US Dollar, the Renminbi (RMB) has hit a 14-year low, caught-up in the global strength of the USD. The RMB/USD exchange rate breached the 7 RMB threshold in mid-September, falling to the lowest rate for the RMB since 2008. Despite this, analysts do not expect the People' Bank of China (PBoC, China's central bank) to take drastic action, preferring to prevent large swings in either direction. To date, the PBoC has employed some tools to slow the pace of the RMB's depreciation, and has publically warned against speculating on the RMB as it depreciates.

Analysts have pointed out the RMB's depreciation against the US Dollar has been moderate in comparison to other currencies. Moreover, the depreciation has not triggered a sudden surge of capital outflow, and domestic inflation is relatively low.

Looking ahead to the Party Congress: economic headwinds front of mind

The Communist Party of China is set to host its 20th National Party Congress from 16 October. The five-yearly meeting will set out China's high-level priorities for the coming period, and analysts anticipate reaffirmation of current policy priorities such as 'common prosperity' and 'dual circulation'. It is not yet clear whether any new economic directives will be announced. However, we expect China's leadership to reiterate its awareness of the economic headwinds that need to be navigated and managed.

Based on August data, Q3 is likely to tell a more positive story than Q2; the challenge will be maintaining momentum into Q4 when China's central pillars of growth may slow again because of underlying challenges: low consumption, the depressed property market, and now decelerating export growth all present risks to China's ability to generate growth.

There are no clear signals yet when China might relax its zero-COVID policies, although there are some signs that international air connectivity could start to (slowly) increase from November.

Our next China market intelligence report will address how these recent economic trends have impacted New Zealand trade with China.

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