KIEL INSTITUTE FOR THE WORLD ECONOMY

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Global China Conversations

Prospects of the Chinese economy: Short malady or fundamental slow-down?

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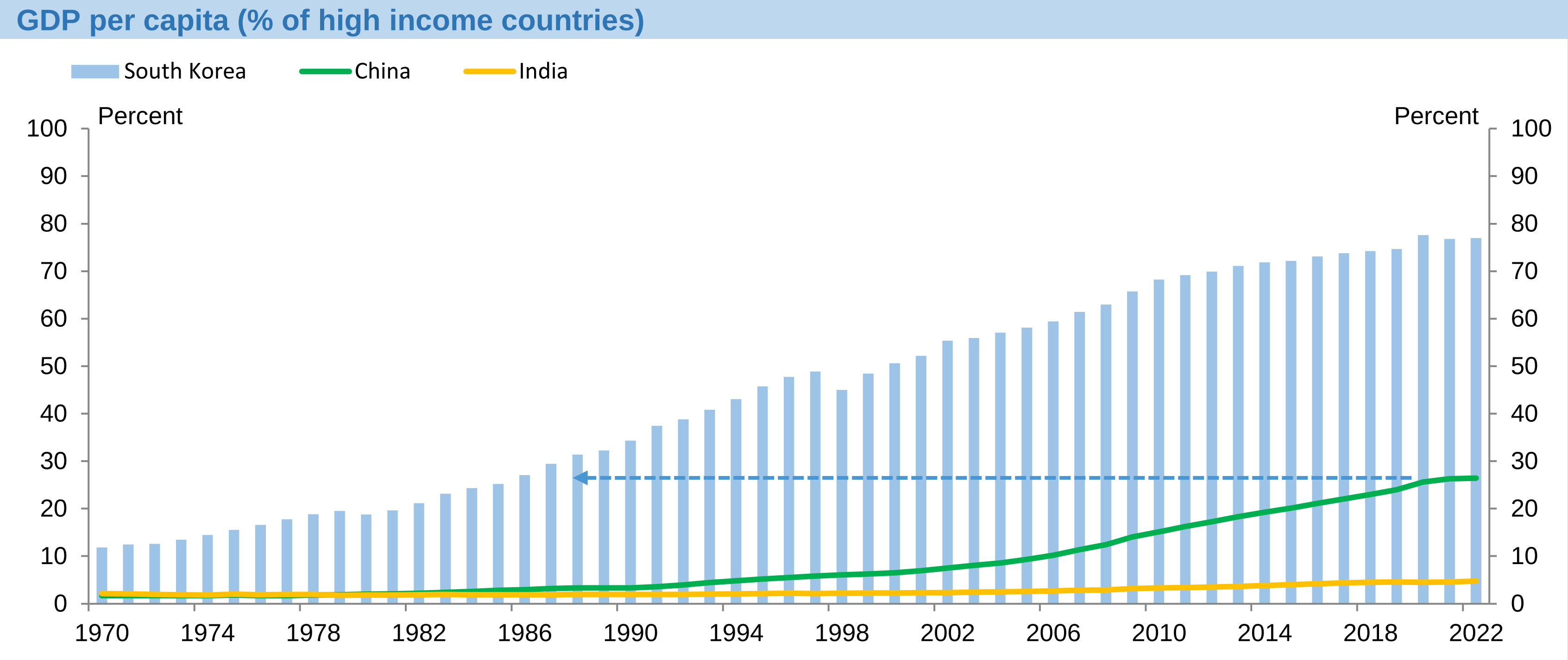
Narratives matter

End of China's economic miracle?

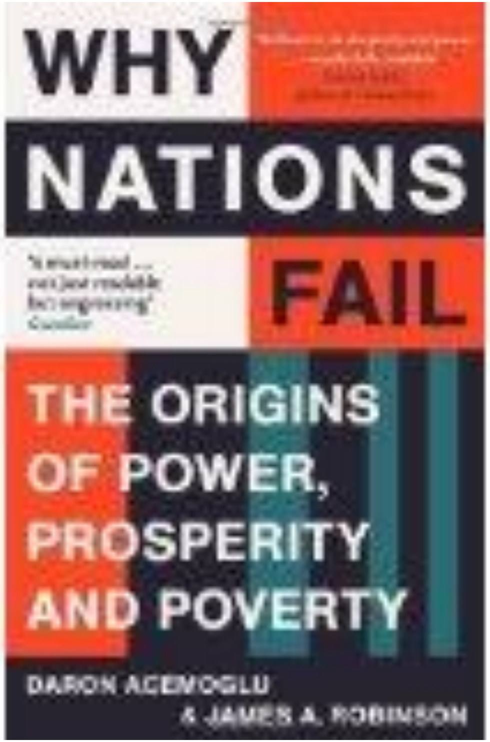
What miracle?

GDP per capita relative to HIC (1970 – 2022)



Annual data, GDP per capita: constant 2015 USD.
Source: World Bank, World Economic Indicators; IfW calculations.

Institutions matter



China in the world economy: Size matters

But:
It’s not Chinas fault to be large.

Is China different?

Political system: Obviously.

However: Economic laws still apply.

Lesson for China (not yet learnt)

The more sophisticated an economy becomes,

the less interventionism works.

(Including GDP targeting)

Political and social stability

Transfers to people rather than subsidies to firms.

(More efficient and less trade-conflict provoking)

Lesson for the Western world

You are stronger than you think
(when following your own principles).

2023 in retrospect

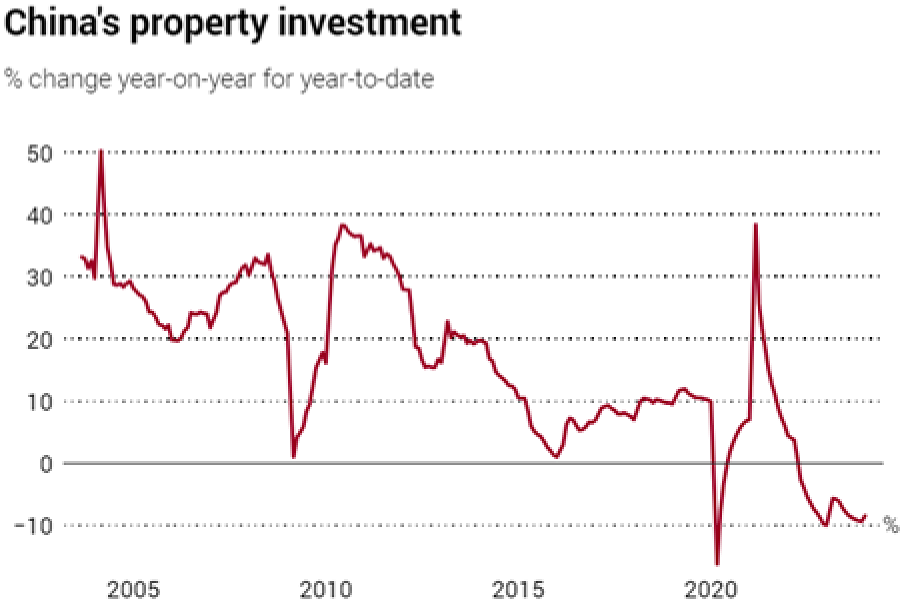
- In 2023, Chinas **economy grew at one of the lowest rates in decades**, pointing to persistent challenges.
- Given the positive base effects resulting from various COVID-19 lockdowns in 2022, the growth rate of 5.2% was a **relatively weak outcome**.
- Problems in China's **property sector**, slower export activity and subdued domestic consumer demand are all factors contributing to slower growth.
- **Consumer confidence** has not really recovered from the lows of the 2022 lockdowns (at 87.1 on average between April and November 2023, after 93.6 in Q1 2023 and 87.2 over April-December 2022), while business confidence and hiring intentions are also not sufficiently buoyant.
- **Property investment** in China, which has been a major drag on the nation's post-Covid recovery, fell by 9.6% for all of 2023
- **Fixed-asset investment** in China, which includes spending on factory equipment, construction and infrastructure projects grew by 3%, year on year, in 2023.
- **Industrial production** grew by 4.6% last year.
- Despite many weaknesses, 2023 was also the year when China became the **largest auto exporter** in the world, driven by booming global demand for electric vehicles. Other strategic sectors such as batteries, solar panels and industrial robots also performed very well. While growing rapidly, **for now these emerging industries are not sufficient to make up for the real estate slump**.

Short-term outlook

- Slowdown in 2024 and beyond amid **structural problems** such as high levels of debt and a low birth rate.
- Ongoing recovery has not got a solid foundation yet as the **deep adjustment of real estate market** and **local government debt overhang** remain major risks. The property market downturn in China will hence also continue to weigh on investment and consumption
- The wide disparity between China's two **major manufacturing surveys** persisted in December. The private sector Caixin PMI remained in positive territory – at 50.8 points. In contrast, the official PMI softened further, down to 49.0 points. However, both surveys pointed to weakness in new export orders.
- **Emerging industries and advanced manufacturing** (new energy vehicles, renewable energy, batteries, industrial robots etc.) could become more sustainable growth drivers in the long run, but they are not large enough for now and further development will likely face challenges.
- We expect **fiscal policy to ease modestly** in 2024, particularly by the central government.
- **Slower pace of expansion** expected for 2024 and beyond: **4.7% (2024), 4.6% (2025)**

Real estate crisis

- Chinas real estate is estimated to account for around **30% of GDP and nearly 70% of household wealth**.
- Crisis continued as more developers teetered on the brink of default and **home sales remained at half their December 2020 levels**.
- New **home prices in December declined 0.4%** on the previous month, the sharpest fall since February 2015
- An estimated **60 to 80 million apartments across China remain empty**, and another 20 million are reportedly unfinished, according to Nomura.



Fiscal/monetary policies

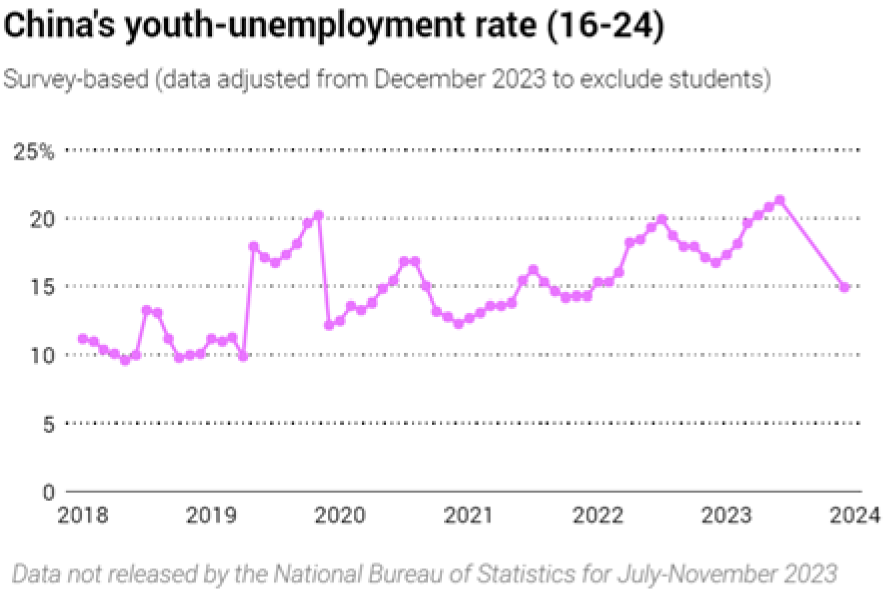
- In October, Beijing made the rare decision to **increase the official fiscal deficit** with the issuance of an additional 1 tr RMB treasury bond. Local government special bonds quota have also stepped up.
- Moody recently **downgraded Beijing's credit rating** from stable to negative, citing its bailout of indebted local governments, the real estate crisis and the country's shrinking population as reasons.
- The **monetary stance has turned to easing** in the second half of 2023 (positive credit impulse). One and five-year Loan Price Rates (LPR) have been decreased as have reserve requirements.
- However, **household loan demand has remained weak**. This is likely to continue for as long as conditions in the real estate sector remain negative and domestic demand remains constrained.

Consumer and producer prices

- **Consumer prices continued to contract in December**, with the headline consumer price index down by 0.3% yoy (compared with 0.5% yoy previously).
- **Food prices have been the key driver of recent deflationary pressures** – falling by 3.7% yoy (from 4.2% yoy in November). Pork has an outsized influence on the food price index, with pork prices down by 26.1% yoy in December. In contrast, fresh fruit prices fell by just 0.3% yoy, while fresh vegetables rose by 0.5% yoy
- Compared to the volatility in food prices, **non-food price movements have been relatively subdued**, increasing by 0.5% yoy (from 0.4% yoy in November). Vehicle fuel prices have been a major contributor to the overall trend – falling by 1.4% yoy in December
- **Producer price deflation was a little softer in December** – with prices down by 2.7% yoy (compared with 3.0% yoy in November). This was the fifteenth month in a row that prices fell.
- **Deflation pressure will likely fade in 2024**, with assumed turnaround in global commodity prices and domestic pork prices, but low inflation will stay along with subdued domestic demand

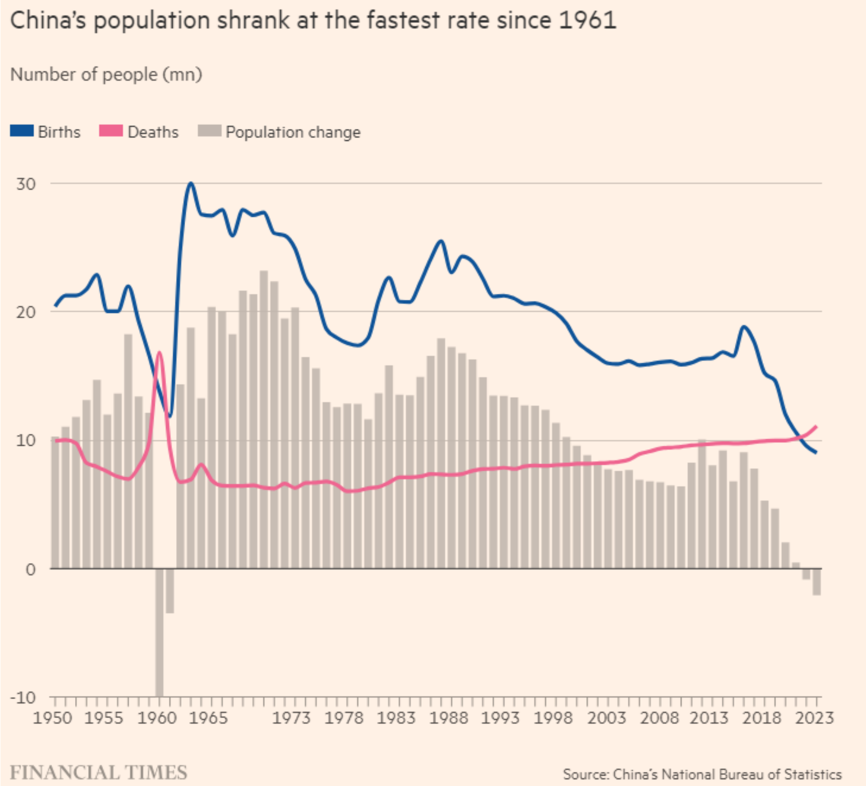
Unemployment

- Urban surveyed unemployment rate stood at 5.1% in December.
- Record of 21.3% of people aged 16 to 24 in China were unemployed in June 2023.
  - » Release of unemployment figures has been stopped until December 2023.
  - » After this nearly half-year suspension, a newly adjusted monthly rate for the 16-to-24 age group stood at 14.9% in December 2023.



Aging population

- 2022 and 2023 represent the first decline in population since 1961 (great famine)
- Population fell to 1.4bn or 0.15% in 2023 and forecast point to further falls as the population rapidly ages.
- Decline comes on the back of lifting the Covid restrictions. The number of deaths last year was almost 600,000 more than in 2022, exceeding the increase of more than 200,000 between 2021 and 2022.
- Births continued their rapid post-2016 decline, now down by more than 50% in just eight years. A birth number of about 9 million translates roughly into a total fertility rate (TFR) of about 1.0. This decline is virtually unheard of in peacetime (and raises questions about the underlying data).
- A marginal rebound in fertility rates may occur because some marriages postponed by now lifted COVID restrictions may take place.



Decoupling/derisking

- FDI inflow:
  Global firms appear to be pursuing a **“China+1” strategy**, investing in other countries in addition to – but not instead of – China.

- FDI outflow:
  Chinese companies, for their part, have increased their foreign direct investment in recent years and deployed their own production chains far beyond China’s borders, especially to **countries that can avoid punitive US tariffs/sanctions**.

Diskussion

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