Global Macro Research - Insight

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China's lacklustre performance set to Drag-on

Q4 GDP and December's monthly data still imply activity has firmed from the summer trough. But real estate continues to pose a major challenge to 2024 growth. Markets may also be sensitive to the upcoming US election, implying a high bar for the return of animal spirits.

Key Takeaways

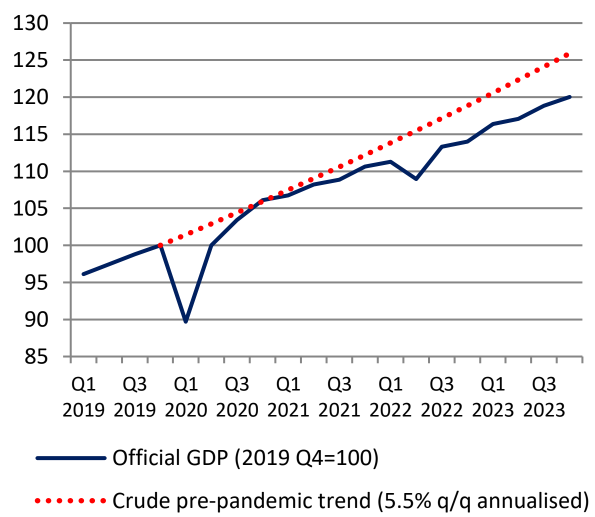
- 2023 GDP growth was marginally below consensus expectations, but, at 5.2%, it expanded slightly above the government's growth target (5%).
- That said, the reopening boost at the start of the year – combined with base effects from the lockdown-induced stress in 2022 – meant that this was an exceptionally low bar.
- China's December data releases at least provided further evidence that policy easing to date is gaining traction, even if activity remains shaky in parts.
- The property sector remains a major concern. Key metrics now point to a continued slide, rather than the tentative stabilisation indicated a couple of months ago. A faster pace of price falls also implies that households are staying on the sidelines.
- Policy continues to ease, as illustrated by robust government debt issuance and strengthening infrastructure investment. And the rumoured 'ultra-long' debt issuance could further loosen financial conditions.
- But the desire to hold the line on de-risking is still resulting in a targeted and incremental approach.
- The Taiwanese election at least has passed without incident (thus far anyway). The potential for the US election to usher in greater US-China risk is however another reason for investors to stay away.
- We remain somewhat cautious about the Year of the Dragon and our 2024 growth forecast stays at 4.4%.

GDP growth cleared a low bar

2023 GDP growth of 5.2% may have been marginally below consensus expectations, but there was little doubt that the authorities' growth target of 'around 5%' would be easily met, if not surpassed by a wide margin.

Lockdowns, and the slightly chaotic pivot away from zero-Covid in 2022, had severely depressed output. Removing restrictions was therefore always going to make it easy for annual growth in 2023 to recover strongly.

Figure 1: An unimpressive reopening recovery



Source: Haver, abrdn (January 2024)

Taking a step back, one can see that the economy has failed to return anywhere close to its pre-pandemic trend (see Figure 1).

And we actually estimate that GDP has suffered a 6% hit since the pandemic began, which can be largely attributed to a stalling in total factor productivity growth since the end of 2020.

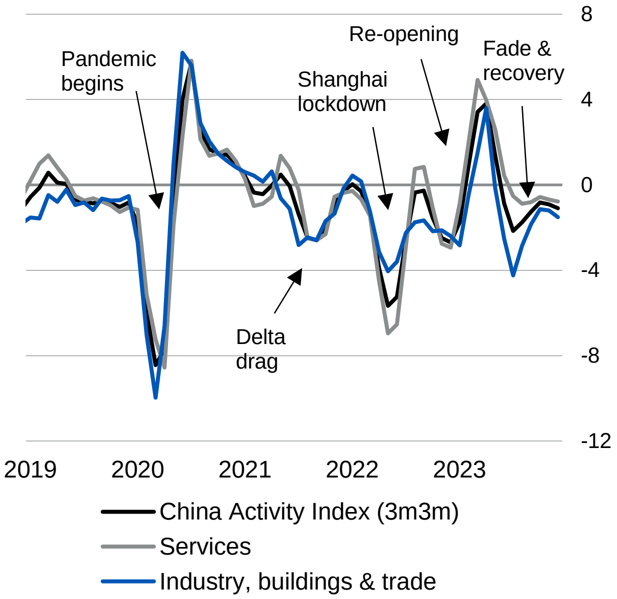
Activity has firmed since the early summer lull

December's data generally still imply that the economy has regained momentum, at least compared to the notable soft patch in the spring and early summer.

December data for industrial production and fixed asset investment were a bit better than expected – as was the previously released trade data – but retail sales were weaker. The National Bureau of Statistics (NBS) estimates that industry expanded 0.5% month over month, similar to the implied expansion of the service sector, while we estimate that retail sales volumes posted a small fall on the month (-0.2%).

Smoothing through some of the volatility, our China Activity Index (CAI) continues to imply policy has gained some traction. But momentum has eased off slightly in the latest estimates, with services broadly stable, but industry, buildings & trade now weighing on the CAI (Figure 2).

Figure 2: Our China Activity Index implies the economy has improved, but is not roaring



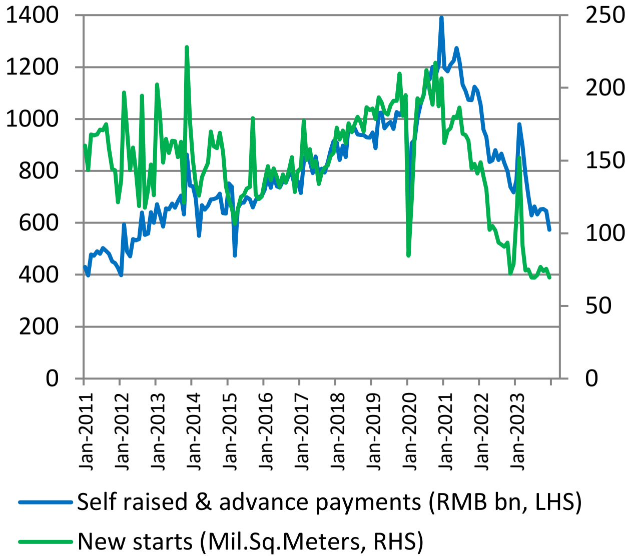
Source: Haver, Refinitiv, abrdn (January 2024)

As big question remains over the state of real estate and what this means for the growth outlook heading into 2024 and beyond.

Property prices fell again in December, with the proportion of cities recording price rises in existing builds dropping to zero.

The value and volume of buildings sold, and real estate developer funding have also continued to slide. Within funding there was a sharp drop in advance payments, which casts some doubt about whether new starts can maintain their recent stability (see Figure 3).

Figure 3: Real estate is still sliding across most metrics



Source: Haver, abrdn (January 2024)

The authorities have at least been somewhat successful at countering the drag from the real estate adjustment by leaning on infrastructure spending. But, since the drag from property still has some way to go even if the pipeline of new builds remains stable, further stimulus is warranted.

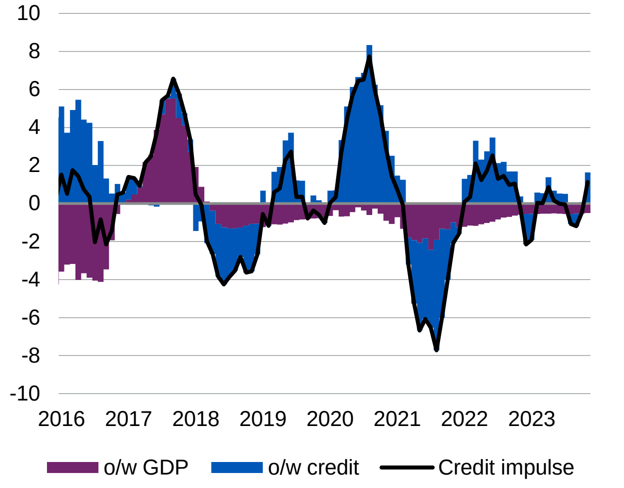
Policy makers are not feeling the heat

We expect policy makers to maintain their incremental approach to providing support for the economy, likely dashing hopes for a more forceful approach.

Speaking at the World Economic Forum in Davos, Chinese Premier Li Qiang lauded the economy's ability to hit the government's 2023 growth target without "massive stimulus". The somewhat better macro backdrop since the summer therefore will likely temper authorities' desire to further dial up the stimulus.

Indeed, policy easing is already in train: government bond issuance has ramped up in recent months and will continue to filter through to activity in 2024. Our estimate of the credit impulse has turned back up sharply, moving further into positive territory in December (see Figure 5).

Figure 5: Strong government debt issuance is helping boost credit flows and reduce downside risks



Source: Bloomberg, Haver, abrdn (January 2024)

Moreover, we estimate that the authorities have managed to push policy further into a modestly accommodative position overall and the China Financial Conditions Index (CFCI) rose very slightly in December (see Figure 6).

The CFCI should loosen more as we venture further into 2024. While the 1-year medium-term lending facility rate was left unchanged at 2.5% in January, further liquidity was provided in addition to the larger-than-expected injection in December.

There is also the possibility that the People's Bank of China (PBOC) further lowers the reserve requirement rate over the coming months. Overall, the liquidity injections imply that the PBOC is still loosening at the margin and is cognisant of the need to help markets digest government debt issuance.

Further fiscal support also looks likely. Bloomberg reported that policymakers were considering issuing RMB 1 trillion ($139bn) in special 'ultra-long sovereign' bonds, with the aim of encouraging local governments to spend on infrastructure and other national security related policies, such as food, supply chains and energy security.

While this amounts to less than 1% of GDP, it could be a sign that authorities are aware of the challenges facing the economy in 2024. Policymakers have only resorted to such issuance on three occasions in the past 26 years: the Asian Financial Crisis, the Global Financial Crisis and the onset of the pandemic.

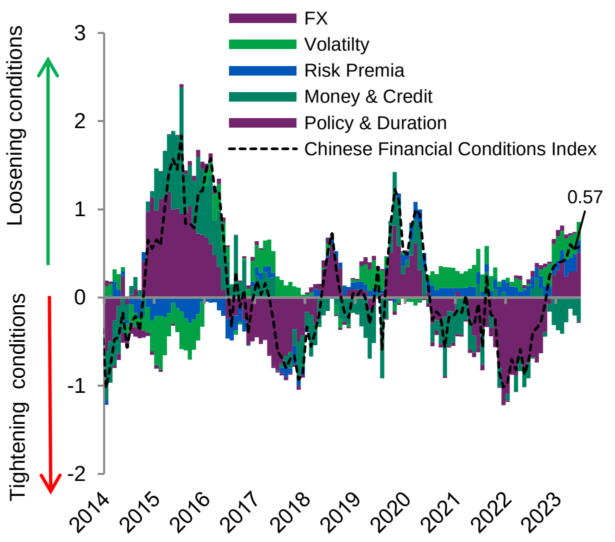
That said, the initiative could also be part of an increased focus on local government debt risks rather than pure stimulus. Authorities have flagged the need to put in place a more robust fiscal framework and there is a risk that government debt becomes the new phase of the de-risking campaign.

For now, that seems unlikely. The authorities appear to be aware of the risks of austerity and must appreciate the interplay between a still weak property sector and local government finances. It has been reported that local governments with strong balance sheets will be asked to do more to help mitigate the economic drag caused by consolidation to those provinces in difficulty. We will need to wait to see what proposals for fiscal reform are drawn up to have a clearer view.

Further surprises on the regulatory front could emerge as President Xi has vowed further scrutiny on corruption across industries such as finance, energy and pharmaceuticals, as well as state-owned enterprises.

Much will depend on whether growth or de-risking have moved up the priority list and we have little to no sight on this given the opacity of Chinese decision making. If addressing government debt is set to become the next phase of de-risking, then the near-term outlook could be significantly worse than our already below consensus 4.4% 2024 GDP forecast. We judge that the authorities have already shifted towards the former but recognise the risk of the latter.

Figure 6: Financial conditions show policy has gained moderate traction, but still risks being insufficient



Source: Bloomberg, Haver, abrdn (January 2024)

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