China Economic Quarterly Q4 2023

Pivot to high tech and policy levers to revive demand

March 2024

Content

In brief

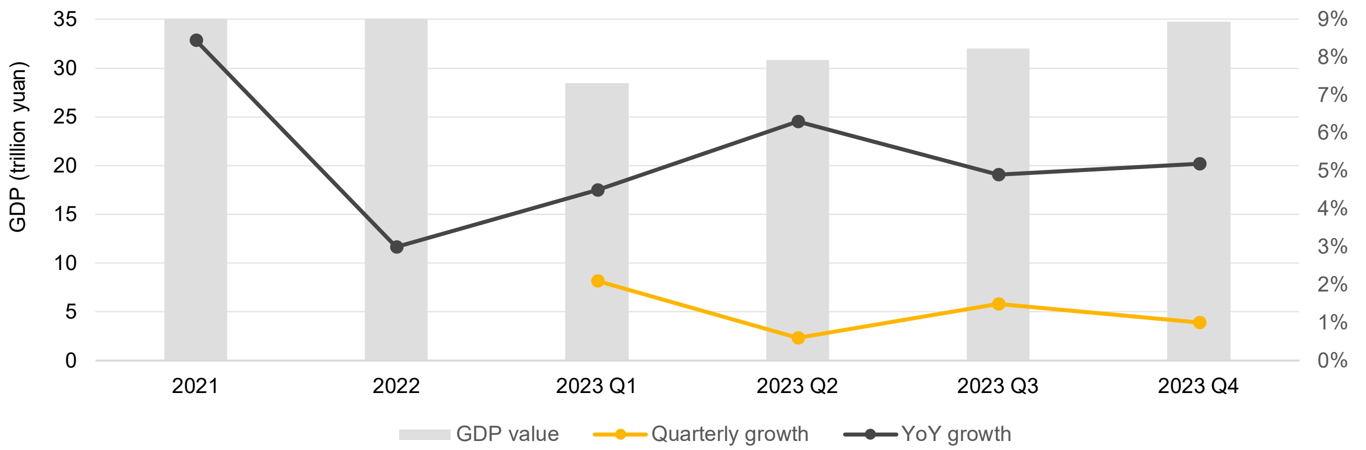
- China's GDP grew 5.2% in 2023, surpassing the official target.
- Economic recovery was uneven in the fourth quarter, with industrial output and fixed asset investment accelerating but retail sales slowing in December.
- High-tech sectors continued to shine, with related industrial production, fixed asset investments, bank lending, foreign direct investment and exports growing at a faster pace than the broader economy.
- Anaemic consumer spending, sluggish consumer prices, and slowing imports consistently underscore the imperative for boosting domestic demand.
- In terms of investment, China's pivot towards the high-tech sector is expected to continue, with recent policy highlighting the green energy sector.
- Policymakers will likely up their game to put a floor under the real estate sector by rolling out further supportive measures.
- With global demand unlikely to bounce back sharply, policymakers will need to step up economic stimulus to prop up growth.
- Domestic demand will pick up steam in 2024 if policymakers roll out larger-scale, more coordinated policy measures to shore up household and business confidence.

Main economic indicators

GDP rose by 5.2% in the fourth quarter compared to a year ago, a quicker pace than the third quarter's 4.9%. On a quarter-by-quarter basis, the fourth quarter's growth came to 1%, slowing from the 1.5% in the third quarter.

For the full year in 2023, GDP grew 5.2%, surpassing the official target of "around 5%". The annual growth data is in part flattered by a low base from 2022, when the economy eked out a mere 3% growth. The value added of the tertiary industry rose 5.8%, outpacing the primary industry's growth of 4.1% and the secondary industry's growth of 4.7%.

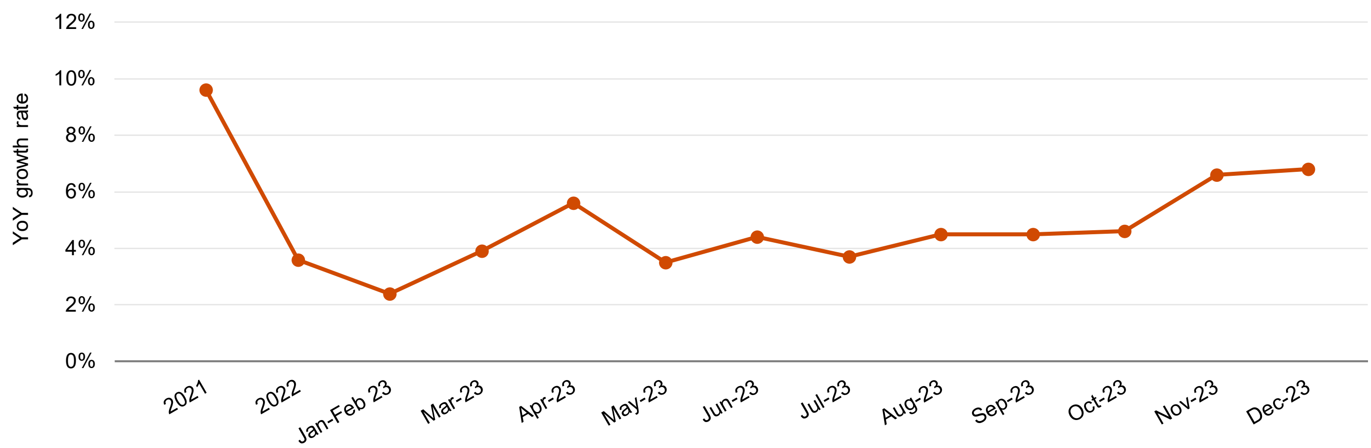
Quarterly GDP values and quarterly and annual GDP growth rate



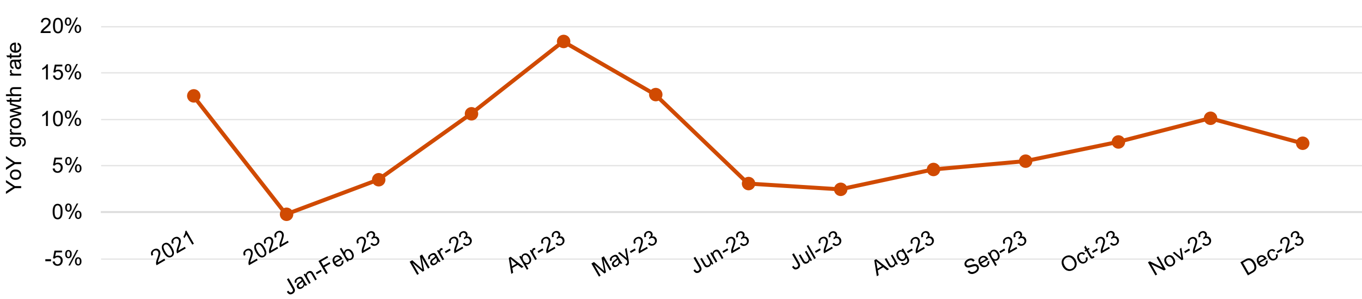
Source of data: Unless otherwise stated, economic data are from the National Bureau of Statistics, Wind and financial data from the People's Bank of China.

On the supply side, **industrial production** gained momentum in the last three months of 2023, logging an annual growth of 4.6%, 6.6%, and 6.8% in October, November, and December respectively. The December data marked the fastest growth pace since February 2022. In particular, production of solar cells, new energy vehicles and power-generating devices surged 54%, 30.3% and 28.5% respectively.

Industrial added values



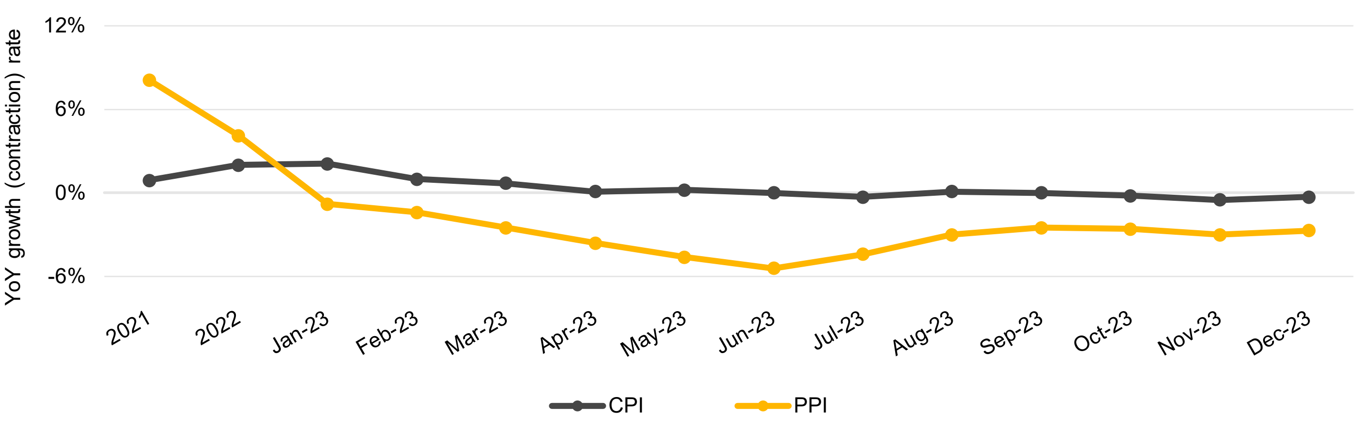
Retail sales of consumer goods



On the demand side, **retail sales** increased by 7.2% in the fourth quarter from a year earlier. In December 2023, retail sales posted a 7.4% increase, marking the slowest pace since September, showing signs of lagging momentum. The catering sector is one of the bright spots, marked by a surge of 30% in December. The data reflects the combined effect of a low base in 2022 and various pro-consumption measures rolled out by local governments. However, the government has so far stopped short of offering cash handouts to households.

Through 2023, retail sales grew by 7.2%. The growth has remained underwhelming except for a few sectors such as catering, tourism, and entertainment. Consumer spending bounced back sharply in the earlier months of 2023 after COVID restrictions were removed. But the rebound failed to sustain, and the hoped-for consumption boom driven by pent-up demand has not materialised in the second half of the year. The latest retail sales figures reaffirmed the concern that domestic demand remains the weak spot in the economy, and it is yet to be seen whether the recovery in services spending will broaden across other sectors. Further policy measures are needed to rebalance the economy towards domestic consumption.

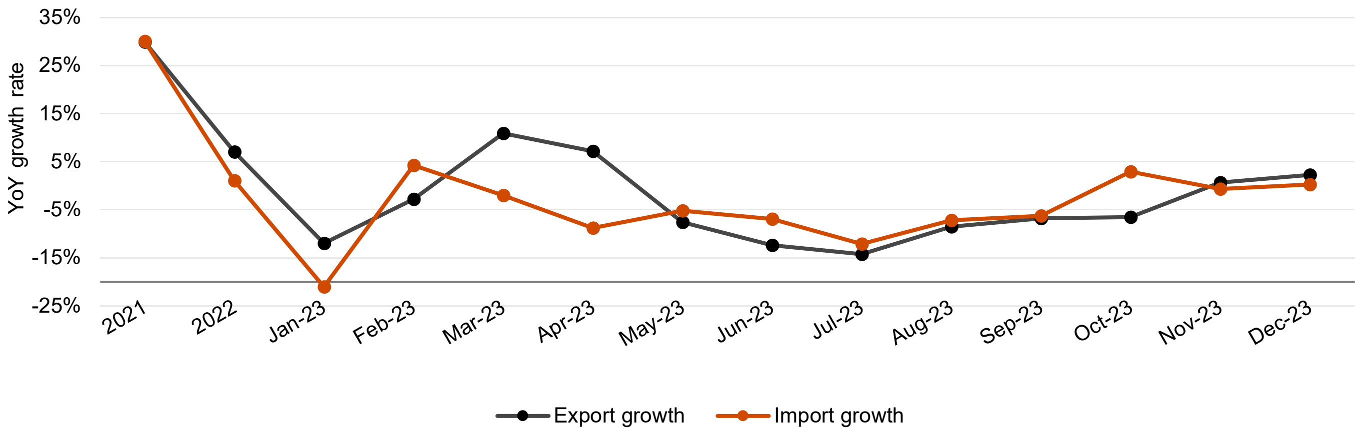
Producer price index and consumer price index



Consumer Price Index (CPI) fell for three straight months during the last quarter, dropping 0.2%, 0.5%, and 0.3% in October, November, and December respectively. The latest core CPI reading, after stripping out volatile food and energy prices, was at 0.6% in December. Consistent with the lacklustre retail sales growth, the weak price inflation data underscores insufficient domestic demand.

Meanwhile, the decline in **Producer Price Index (PPI)** extended into the fourth quarter, falling by 2.6%, 3%, and 2.7% in October, November, and December respectively. The gauge has remained in deflationary territory for 15 months in a row.

Exports and imports

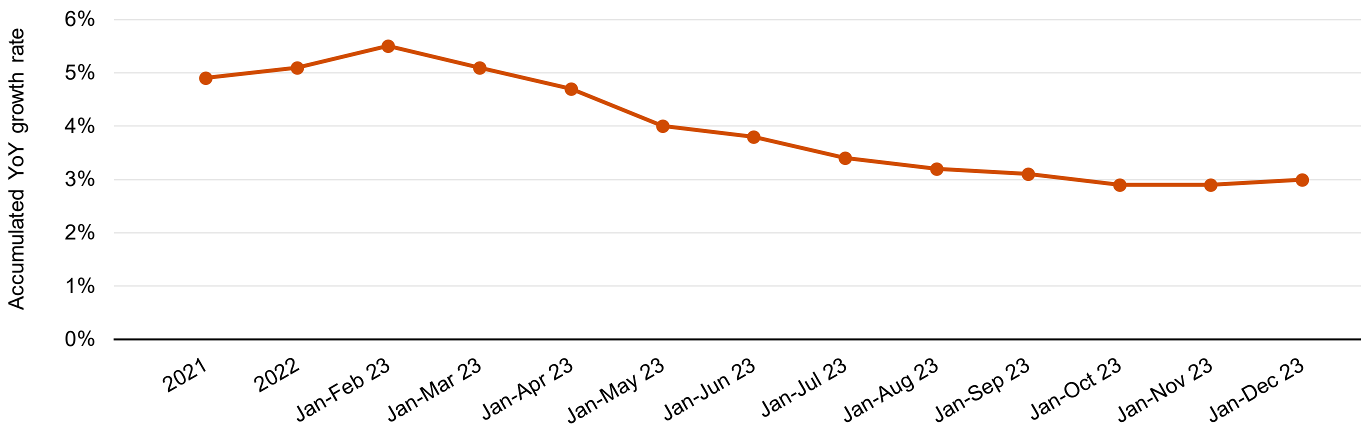


Despite high interest rates and inflation continuing to weigh on global consumer demand, China's **export** data in the last quarter began to show signs of stabilising. Through the three-month period, export dropped by 1.19% from a year earlier. In December 2023, exports edged up 2.3% from a year earlier, marking the second straight month of growth and helping to narrow the full-year decline to 4.6%.

Aligned with the industrial production data, the "New Three" (electric vehicles, lithium batteries, and solar cells) have become the new engines powering China's export growth, indicating that China's pivot towards high-tech manufacturing sectors have begun to yield results. By region, ASEAN remains China's largest trading partner in 2023, followed by the EU and the U.S. Meanwhile, imports rose by 0.2% year on year in December 2023, bringing the full-year decline to 5.5%.

Imports rose by 0.76% through October to December 2023 from a year ago, with imports rising 0.2% in December. Through 2023, China's imports dropped by 5.5%. Consistent with the retail sales figures and consumer prices, the sluggish import data points to weak domestic demand.

Fixed asset investment

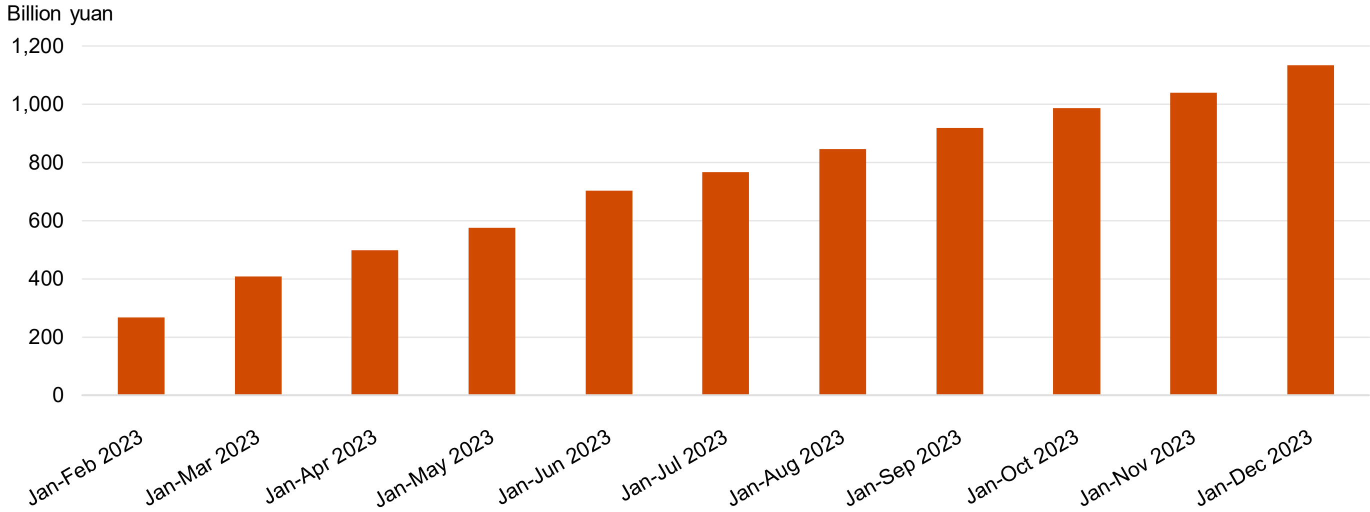


In a sign of stabilisation, **Fixed asset** investment grew at a 3% annual rate through 2023, after logging a 2.9% growth rate for both the January-October and January-November periods. The growth seemed to be partially driven by accelerating infrastructure activities, after the top legislative body approved the issuance of RMB1 trillion in special government bond to support the rebuilding of disaster-hit areas in late October.

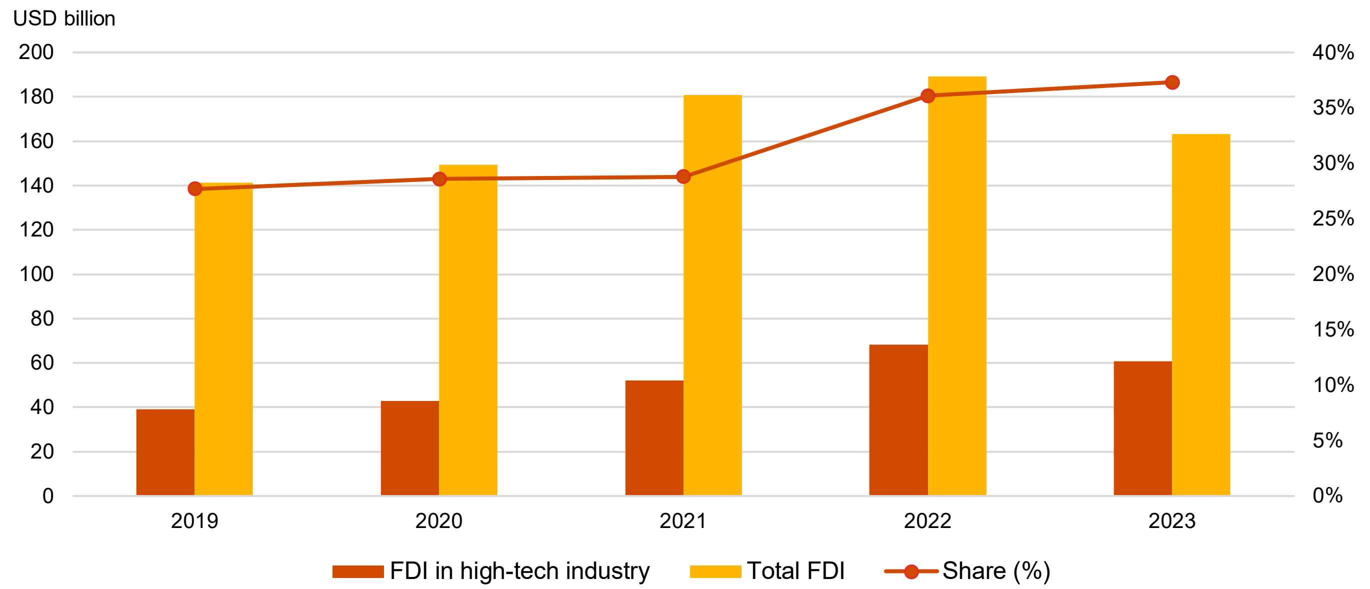
Aligned with the industrial production data, there has also been a clear shift in fixed asset investment towards high-tech sectors. Through 2023, investment in high-tech manufacturing and services sectors rose by 9.9% and 11.4% respectively from a year earlier. In contrast, investment in the real estate sector shrank by 9.6%.

However, the overall growth has concealed the challenges faced by the private sector, as private fixed asset investment fell 0.4% through 2023. Recognising this weakness, in November, China's central bank joined force with seven ministries in releasing 25 specific measures in a bid to bolster the private sector. The authorities pledged to increase lending to micro, small, and medium-sized enterprises and reducing their financing costs. The release of the policy measures followed an earlier decision by the government in September 2023 to create a bureau responsible for coordinating policies to better support private businesses.

Foreign direct investment



High-tech FDI (2019-2023)



Note: FDI data for 2023 is based on press release statistics
Source: Ministry of Commerce, PwC analysis

Through January to December, **foreign direct investment (FDI)** into China hit RMB1.13 trillion, falling 8% from a year earlier but remaining at a historically elevated level, according to China's Ministry of Commerce (MOFCOM). During the same period, 53,766 foreign-invested companies were established, marking a 39.7% increase from a year earlier. This is also higher than the 40,910 companies established in 2019 but lower than the 60,560 established in 2018.

It is noteworthy that MOFCOM measures FDI on a directional basis, which tracks gross FDI inflows, while the State Administration of Foreign Exchange (SAFE) estimates FDI on a net basis, taking into account reinvested and repatriated earnings by foreign companies. As such, SAFE's balance of payments data has shown a larger decline throughout 2023.

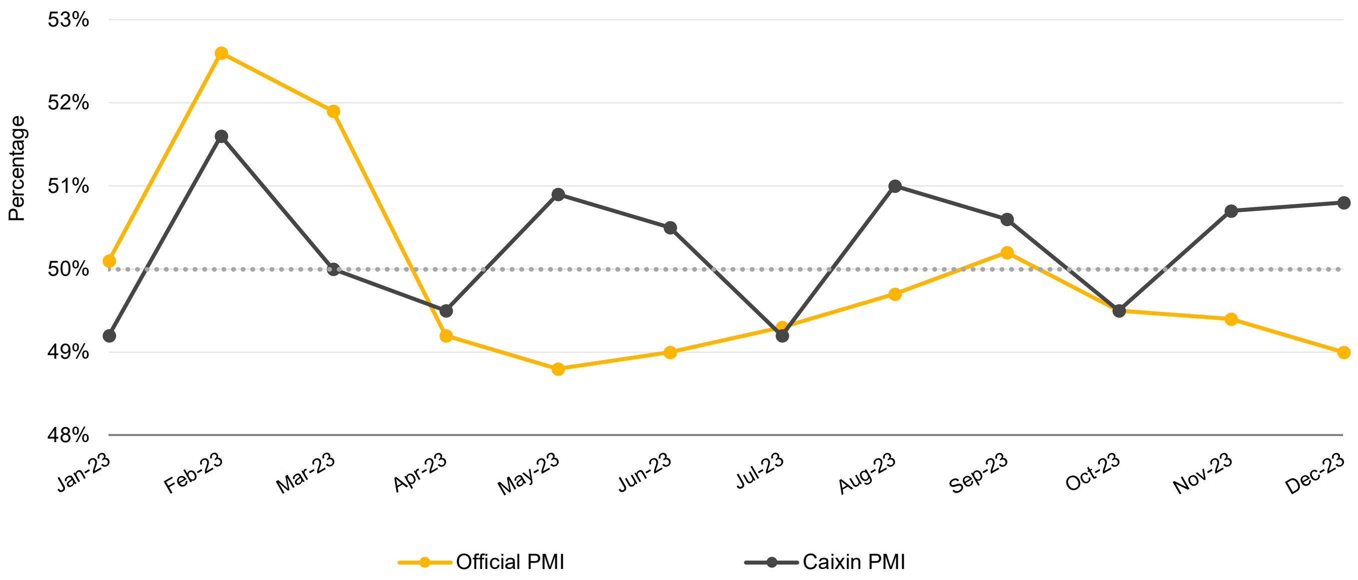
China's high-tech industries remained a bright spot, accounting for 37.3% of China's total FDI in 2023, an increase of 1.2 percentage points from the previous year. As a sign of the country's shifting investment landscape, FDI into high-tech manufacturing sectors grew by 6.5% from a year earlier, defying the broader decline of 1.8% in total manufacturing FDI.

The Chinese government has pledged to roll out additional policy measures in 2024 to attract and retain foreign investments. These measures, as stated by the National Development and Reform Commission, include lifting restrictions on foreign investment in the manufacturing sector and further opening up the service sector. These measures are expected to help stabilise and reverse the decline in FDI.

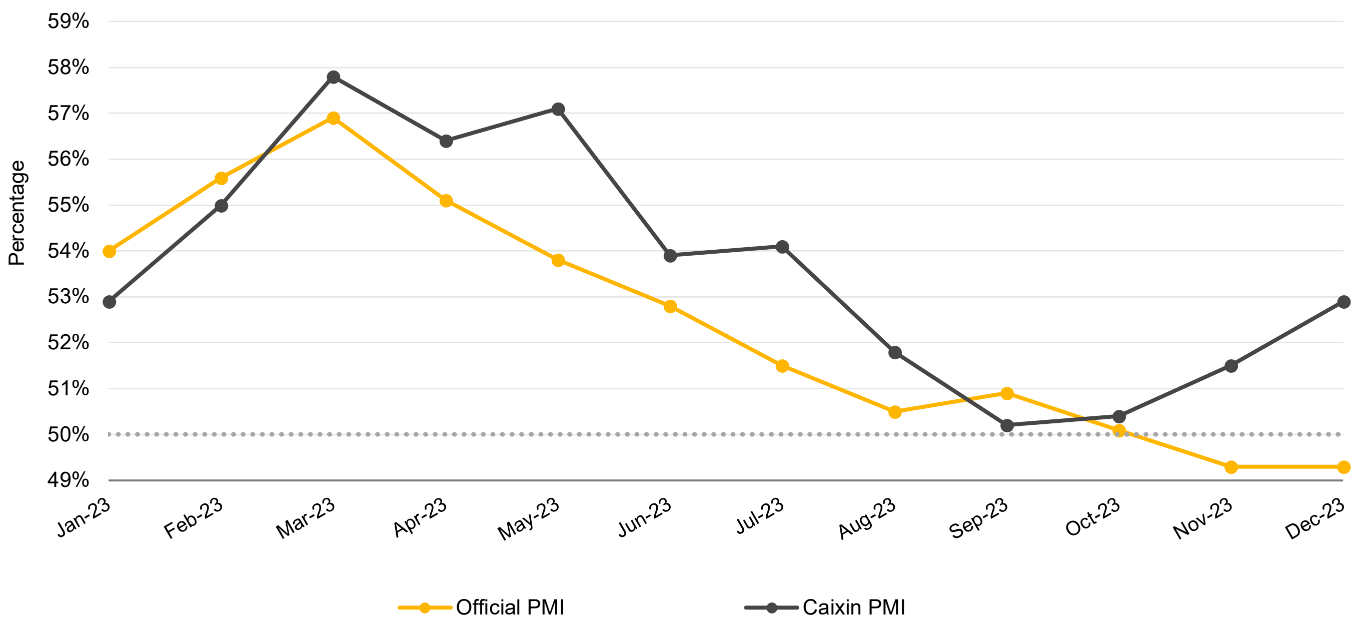
In the last quarter, the **official manufacturing Purchasing Managers' Index (PMI)** slipped below the 50-point mark that separates expansion from contraction. After reaching 49.5 and 49.4 in October and November 2023, the gauge edged down further to 49 in December, marking the worst drop in six months. In contrast to the official PMI, the Caixin Manufacturing PMI edged up to 50.8 in December. The divergence between the official PMI readings and the Caixin PMI readings likely points to an uneven pace of recovery in economic activities, with export- and consumption-oriented businesses covered by the private gauge bouncing back faster than industrial producers covered by the official index.

Through the quarter, the **official non-manufacturing PMI** remained in the expansion territory, reaching 50.4 and 50.2 in October and November respectively before rising back to 50.4 in December. The improvement was mainly fuelled by accelerating construction activity on the back of government-led infrastructure investment. Services activity, however, remained in contraction with an underlying measure falling from 50.1 in October to 49.3 in November and December. The Caixin services PMI rose to 52.9 in December.

Manufacturing PMI



Services PMI

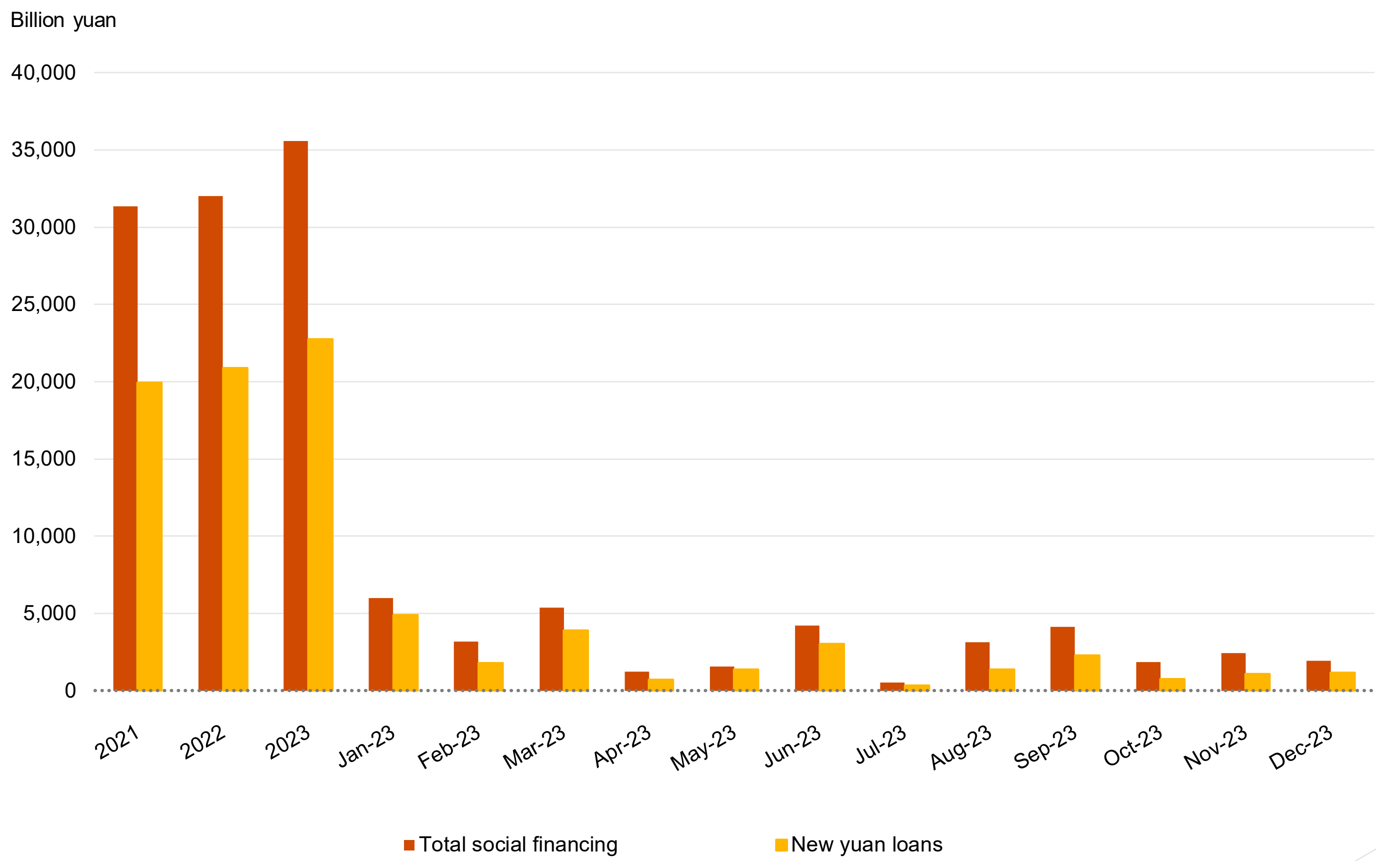


Total social financing, which is a broad measure of credit and liquidity in the economy and includes nonbank financing, increased by RMB35.59 trillion through 2023, up RMB3.41 trillion from the previous year. That brought the country's outstanding total social financing by the end of 2023 to RMB378.09 trillion, 9.5% higher than a year earlier. Broad **M2 money supply** also rose 9.7% in 2023 from a year earlier to RMB292.27 trillion. In particular, banks extended a record of RMB22.75 trillion in **new yuan loans** to the economy throughout the year, marking a RMB1.31 trillion increase from the previous year.

The overall credit growth is driven by both accelerated government bond issuance and the central bank's accommodative monetary policies to support the economy. On the one hand, net financing from government bonds rose by RMB2.48 trillion from a year earlier to RMB9.6 trillion, an increase of RMB2.48 trillion over the previous year. On the other hand, the central bank eased its monetary policy to spur lending through liquidity injection and rate cuts. However, loan demand from households and businesses has remained soft. The sustainability of future credit growth will hinge on the effectiveness of policy initiatives to boost the borrowing needs of households and corporations.

Mirroring the pattern in the fixed investment data, banks are also directing funds towards China's high-tech manufacturing sector. Outstanding loans to the high-tech manufacturing industries soared by 34%, outpacing the 31.9% growth for the manufacturing sector as a whole and the total loan growth of 10.6%.

Credit growth



Key takeaways from China's Q4 economic data

China's GDP expanded by 5.2% in the fourth quarter from a year earlier, bringing the full-year growth to 5.2% which exceeded the official growth target. However, the overall growth numbers have masked an uneven economic recovery, characterised by emerging bright spots in the high-tech sector and weakness in domestic demand. Besides, the numbers were also flattered by a low base in 2022.

Among the positive developments, indicators such as industrial production, fixed asset investment, bank lending, FDI and exports consistently point to China's pivot towards a high-tech economy. Through 2023, industrial production of new solar cells and new energy vehicles surged 54% and 30.3% respectively, while exports of electronic vehicles, lithium batteries and solar cells also grew significantly by 29.9%. Fixed asset investment in China's high-tech manufacturing sector rose 9.9%, outpacing overall investment growth and helping to offset the impacts from the ailing property sector. Chinese banks are also funnelling loans into the sector to finance the investment in advanced manufacturing, resulting in a surge of 34% in outstanding loans to the high-tech manufacturing industries. Aligned with this trend, foreign investment into the country's high-tech manufacturing sectors grew by 6.5%, defying the broader downtrend seen in other sectors.

Domestic demand remained sluggish. Through the year, retail sales rebounded from a low base in 2022 but remained anaemic, with the exception of the catering, tourism, and entertainment sectors. Annual retail growth slowed to 7.4% in December 2023, versus November's 10.1%. Sluggish imports and falling consumer prices are echoing signs of slowing momentum. Consistent with this pattern, growth in total social financing and bank loans remained underwhelming.

The divergence between the official PMIs and Caixin's PMIs towards the end of 2023 likely suggests that small, export-oriented businesses covered by the private gauge rebounded faster than their industrial peers covered by the official index. The official manufacturing PMI came in below 50 through the last quarter of 2023, reflecting a slowdown in factory activities, while a pickup in construction activity helped lift the official service PMI. In comparison, the Caixin PMIs point to improvement in both the manufacturing and services sectors.

Topic in focus: 2024 economic outlook

Looking ahead, we expect China's economic recovery to continue in 2024, driven by stabilising exports and a continuing pivot towards high-tech investments. This year will also mark China's transition into a new normal – a slower but more balanced trajectory of economic growth. To further accelerate the economic recovery, it will be crucial for the government to roll out larger-scale support measures to stimulate domestic demand. Below, we highlight six key areas to watch in 2024.

GDP – Shifting gears towards more sustainable and balanced growth

China's economic performance surpassed its official target in 2023, growing 5.2% from a low base in 2022. Yet the economic recovery has remained uneven since the relaxation of COVID restrictions, with industrial production gaining momentum, fixed asset investment levelling off, and retail sales growth moderating towards the end of 2023.

Moving forward, it is expected that the Chinese government will set an annual economic growth target of around 5% for 2024, signalling that the economy is entering a stage of more balanced, albeit slower, growth. In the absence of a low base effect, achieving such target would likely require the government to implement stronger policy stimulus to bolster economic activities.

China's economy is also undergoing a profound transformation that places increased emphasis on technological innovation and green transition. Beneath the surface, the overall GDP figures mask the underlying factors – both positive and negative - that herald important trends shaping the country's economic landscape.

China's property sector: Less of a drag on economic growth

The property sector has cast a shadow over China's broader economic recovery through 2023. In the long run, a consolidating property sector will help steer the Chinese economy towards a more balanced, sustainable growth path. Consumers are likely left with more disposable income to spend on other goods and services and investment will be redirected towards more productive sectors. Yet in the short run, weak property sales and investment have continued to strain local government finances. The negative wealth effect stemming from falling home prices has also prompted consumers to tighten their spending.

Policymakers have scrambled a flurry of policy measures to shore up the property sector, including cutting mortgage rates, lowering the down payment ratios, and easing home-buying restrictions. The rescue efforts kicked into higher gear with the government's launch of the whitelist financing programme to ease liquidity issues faced by property developers. Banks have started extending loan support to both state-owned and private home builders to complete unfinished projects on the whitelist.

Through 2023, property sales by floor area dropped 8.5%, while property investment fell 9.6%. The recent policy initiatives signal the government's determination to up their game and introduce further supportive measures in 2024.

Pivot towards high-tech and green sectors

China's economy will continue to forge ahead against long-term and near-term headwinds. In the medium to long run, China needs to raise productivity to address its structural challenges including an aging population, diminishing returns to investment in real estate, and rising debt. A key manoeuvre in this regard is China's ongoing pivot towards and investment in high-tech sectors, which are expected to offer a boost to the country's productivity growth and technological prowess, thereby propelling future growth despite the drag from the property sector.

Through 2023, China's investment in the real estate sector fell by 9.6%, but its impact was largely offset by investment in high-tech manufacturing and high-tech services sectors that surged by 9.9% and 11.4% respectively. Mirroring this trend, FDI inflows into China's high-tech manufacturing sector rose by 6.5%, defying the broader decline of 8% in total FDI, as suggested by data from the Ministry of Commerce.

China's high-tech investment has also helped accelerate its transition towards a low-carbon economy. In particular, as part of its commitment to high-quality development, China's efforts to move up the value chain have borne fruits in sectors including the "New Three" (electric vehicles, lithium batteries, and solar cells). The focus on electronic vehicles and renewable energy technologies dovetails with China's response to climate change. According to the International Energy Agency, China's carbon emissions are set to peak ahead of schedule, as the country's newly installed renewable energy capacity for the first time matched the annual increase in domestic demand for electricity in 2023. The authorities recently pledged to promote the "Beautiful China" initiative, which includes detailed targets for carbon peak and neutrality. This is a clear signal that China will likely continue to channel investment into the clean energy sector and decarbonisation projects.

Consumer spending: Weak confidence still clouds the horizon

In the near term, insufficient aggregate demand is a more imminent concern for the Chinese economy. In the last quarter of 2023, consumer spending has remained a weak spot of the economy, with a drawn-out property market downturn denting consumer confidence through the negative wealth effect. Tepid growth in consumer spending translated into further deflationary pressure on the broader economy, as evidenced by falling consumer prices and sluggish imports.

In recent months, policymakers have rolled out a patchwork of support measures to halt the slide in the property market, including loosening restrictions for buyers and easing liquidity for developers. Chinese authorities also convened during the Central Economic Work Conference in December on ways to tackle lacklustre social expectations and weak demand. We expect policy support to continue to trickle down and help stabilise the property market. While consumer spending will likely stay soft in the near term, it remains to be seen whether the support measures are sufficient, in both scale and scope, to revive consumer confidence and boost domestic demand.

Light at the end of the export tunnel?

China's export data in December 2023 showed signs of improvement as cyclical headwinds continued to recede. Going forward, we expect China's exports to stabilise in 2024 after falling 4.6% in the previous year, but unlikely to mount a strong recovery as global demand continues to wane amid persistent inflation and high interest rates.

In particular, China's trade with ASEAN is expected to be a bright spot in 2024, as ASEAN has remained China's largest trading partner in the last four years. Adding to the momentum, China is expected to conclude the negotiations for version 3.0 of the China-ASEAN Free Trade Area (FTA) this year while creating conditions for participating in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the Digital Economy Partnership Agreement (DEPA). Expanded trade linkages, as facilitated by these trade pacts, will provide tailwinds for the growing trade of intermediate goods and cross-border e-commerce between China and ASEAN.

However, geopolitical tensions remain a significant risk factor that threatens the outlook for global trade. Potential escalation of conflicts in both the Russia-Ukraine front and the Middle East could send shockwaves across the global economy and hinder central banks' efforts in combating inflation. The Red Sea disruption dealt another blow to the fragile global supply chain, causing spike in delay and shipping rates for routes between China and Europe. The impact of these events on China's exports is yet to be reflected in the trade data as Chinese factories tend to ship their goods overseas ahead of the Chinese New Year.

Heightened trade frictions could also further impede China's export growth, after the EU expressed concerns about its widening trade deficit with China and opened an anti-subsidy investigation into Chinese electric vehicle makers. Massive investment into the electronic vehicle and renewable energy sectors has also raised fresh concerns in the US and the EU about China's fast-growing capacity in these sectors.

Economic stimulus – From a piecemeal approach to bringing out the big guns

That leaves the central government to do the heavy lifting to shore up economic growth.

On one hand, China's central bank will likely continue to maintain an accommodative monetary policy stance, especially with the recent announcement by the PBOC in January 2024 to cut reserve ratio requirements for banks to free up RMB1 trillion in liquidity. On the other hand, policymakers are expected to roll out larger-scale fiscal stimulus throughout the course of 2024. Until recently, China has kept its fiscal powders dry by refraining from a massive stimulus, except for the issuance of an additional RMB1 trillion of special government bond last October. With a robust balance sheet and a low debt ratio of slightly over 20%, the central government has ample fiscal space to ramp up spending as needed in the months ahead.

Better coordination between fiscal and monetary policies is required to further enhance policy effectiveness - fiscal stimulus will help revive household and business confidence to spend and invest, fuelling greater appetite for loans. While China has adopted a piecemeal approach towards stimulus so far, the government may need to bring out the big guns to supercharge domestic demand in 2024.

Author

Jackie Yan
Economist
PwC China
+852 2289 5460
jackie.z.yan@hk.pwc.com

www.pwccn.com/ceq