CHINA

ADAPTATION

After some hesitation, the Chinese authorities finally stepped up their stimulus measures over the summer. The recent slight upturn in economic growth is set to continue in Q4 2023. However, action by the central bank and the government remains constrained, cautious and measured, while internal and external obstacles to economic activity are still powerful. In the real estate sector, even if activity stabilises in the short term thanks to support measures, it is likely to remain hampered by the financial fragility of developers and weak buyer sentiment. In the export sector, enterprises are affected by the slowdown in global demand and US-China tensions, while multinationals are starting to rethink their production strategies.

MAJOR CONSTRAINTS ON ECONOMIC GROWTH

The downward trend in China's economic growth, which has been ongoing for around fifteen years, intensified in 2022 and 2023. Real GDP growth stood at 3% in 2022 and should barely exceed 5% in 2023, despite favourable base effects linked to the end of the health restrictions (economic growth averaged 6.7% per year during the 2012-2021 period).

Economic activity has been weakened for two years by an accumulation of powerful internal and external obstacles: unprecedented crisis in the real estate sector, wave of regulatory tightening in services, strict zero-Covid policy applied until December 2022, significant drop in household and investor confidence, lack of room for manoeuvre for monetary and fiscal policy makers, weakening global demand and tensions with the United States. These obstacles have added to the long-term structural factors of the Chinese economic slowdown: decline in the working-age population, moderation of productivity gains and exhaustion of the growth model driven by investment and debt.

Thus, the post-Covid rebound in Chinese growth, observed in Q1 2023, ran out of steam in the spring, and the authorities only provided a very cautious and gradual policy response (Chart 1). However, they have stepped up their stimulus measures since July, and there have been some signs of improvement. Already in August, activity in the services sector strengthened slightly (+6.8% y/y compared with +5.7% in July), supported by retail sales. Growth in industry also recovered slightly (+4.5% in August compared with +3.7% in July). The latest leading activity indicators and PMIs point to a further slight improvement in September.

The real estate sector is still in deep crisis. Property activity has contracted at unprecedented rates in the past two years : in January-August 2023, sales and housing starts represented 65% et 46% respectively of their levels in January-August 2021 (meanwhile, completed property projects recovered and represented 94% of their 2021 level). The average house price for China's main 70 cities declined by only 6% between August 2021 and August 2023, but there are large discrepancies between provinces.

ADDITIONAL MEASURES TO KICKSTART THE ECONOMY

In recent months, the central bank slightly lowered policy rates (between the end of May and the end of September, the 1-year MLF rate was cut from 2.75% to 2.5%; the 1-year and 5-year loan prime rates fell from 3.65% to 3.45% and from 4.3% to 4.2% respectively) as were the reserve requirement ratios (the average ratio fell from 7.6% to 7.4% in September). This monetary policy easing goes with support measures aimed at containing the real estate crisis and with the acceleration in bond issuance by local governments in H2 2023 in order to finance new public spending. The central government has also extended a number of tax incentives for SMEs and households.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	2.2	8.4	3.0	5.1	4.5
Inflation, CPI, year average, %	2.5	0.9	2.0	0.5	2.0
Official budget balance / GDP, %	-3.7	-3.1	-2.8	-3.0	-3.2
Official general government debt / GDP, %	45.9	46.8	50.4	53.0	54.9
Current account balance / GDP, %	1.7	2.0	2.2	1.8	1.4
External debt / GDP, %	16.3	15.4	13.7	13.0	12.5
Forex reserves, USD bn	3 217	3 250	3 128	3 080	3 030
Forex reserves, in months of imports	16.2	12.6	12.0	11.8	10.9

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CHINA: UNEVEN RECOVERY IN SERVICES ACTIVITY

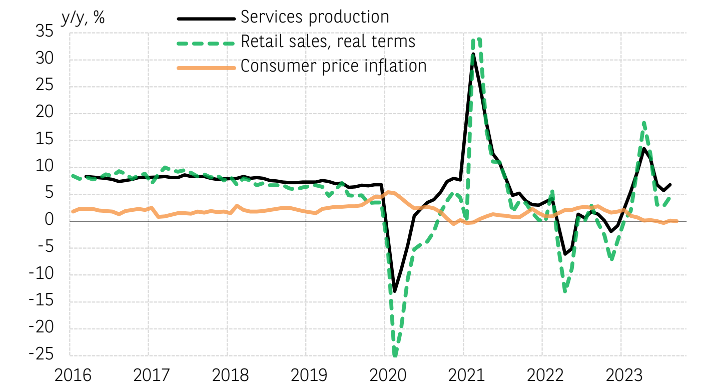

CHART 1 SOURCE: CEIC, BNP PARIBAS

In the property sector, the continued contraction in activity (and its spillover effects on the rest of the economy and household confidence), the increasing number of payment defaults by developers and the spread of risks in the financial sector have led the authorities to adjust their policy in recent months, while maintaining their objectives of making the market healthier (through the deleveraging of developers and the moderation of the cost of housing). Initially, the measures taken were mainly aimed at financing the completion of projects already underway. Since August, the authorities have stepped up their efforts to restore demand for housing. They have announced an easing of prudential rules relating to the purchase of housing and the granting of mortgage loans (including a reduction in down-payment ratios), as well as a reduction in interest rates on mortgage loans (for both new loans and existing loans). These changes are implemented differently by the government of each city depending on the local property market situation.

Thanks to these measures, real estate activity could bottom out and stabilise, or even recover slightly, by the end of the year. This should help the economic improvement seen since mid-summer to continue in Q4 2023.

However, the recovery in activity remains fragile, households are still wary, property developers remain faced with severe financial difficulties, and the authorities' room for manoeuvre to increase support for economic growth is narrow. While consumer price inflation remains very low (+0.3% y/y in August and 0% in September), the central bank's room for manoeuvre is limited by downward pressure on the yuan. The yuan has depreciated by 13% against the US dollar since April 2022 (of which 5% between end-March and end-September) due to the growing differential between US and Chinese interest rates and the large portfolio investment outflows .

Furthermore, economic policy remains heavily constrained by the excessive debt of the private sector and local governments. Total domestic debt reached 284% of GDP in mid-2023 compared with 247% at the end of 2019. This debt limits the central bank's ability to encourage new loans and discourages both bank lending supply and demand from households and enterprises. The fall in confidence is also weighing on credit growth. In fact, growth in total social financing did not strengthen in Q3 2023 (it stood at 9.3% y/y in September, as in June).

On the fiscal front, policy is constrained by the fragility of local governments resulting from their own debt (30% of GDP in mid-2023) and that of their financing vehicles (estimated at around 50% of GDP).

Finally, the authorities' action is dictated by long-term objectives. Beijing seeks to build a more balanced economic growth model, strengthen financial discipline, promote "Common prosperity" and stimulate innovation and the high-tech sectors. The priority is not to support growth in the short term, but to strengthen "national security" with measures aimed at reducing risks: both internal (in particular financial instability) and external (the tensions with the US explain China's efforts to achieve self-sufficiency in advanced technologies).

CHALLENGES IN THE MANUFACTURING SECTOR

After the strong rebound during the pandemic, growth in goods exports rapidly deteriorated in 2022 and 2023. Measured in current dollars, they contracted by 2% y/y in H1 2023, then by 10.8% in Q3 2023 (Chart 2). The very short term outlook remains poor.

The export industry is facing a slowdown in global demand (the IMF expects a slowdown in world trade volume in goods and services to +0.9% in 2023 compared to +5.1% in 2022 and +10.1% in 2021). It is also affected by trade tensions and the technology race with the US. Sales of Chinese goods on the US market fell by 16% y/y over the first nine months of 2023 (the US purchased 16% of total Chinese exports in 2022).

China's trade 'decoupling' with the US has become a reality, as evidenced by the drop in the Chinese share of total US imports from 22% in 2018 to 17% in 2022. By contrast, China has maintained its total global market share much better, notably because exporters have redirected certain products destined for the US to other countries with lower tariffs. China's share of total world exports fell to 14.4% in H1 2023 compared to 15.2% in 2021, but it is still well above its pre-Covid level (13.3% in 2019).

CHINA: DIFFICULTIES IN THE EXPORT SECTOR

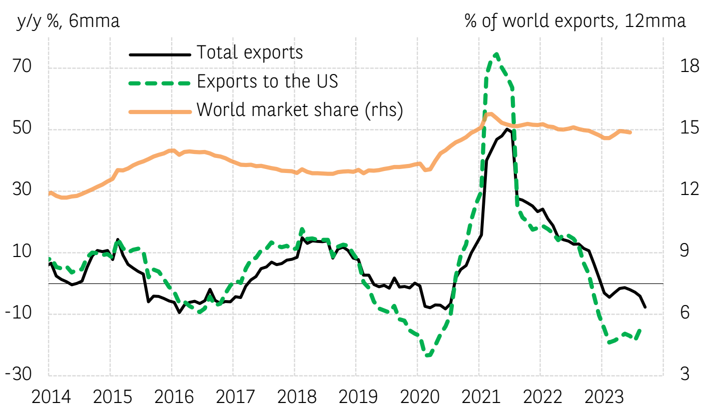

CHART 2 SOURCE: GENERAL ADMINISTRATION OF CUSTOMS, BNP PARIBAS

In the coming years, the Chinese manufacturing industry will remain affected by its lower cost competitiveness and the reorganisation of global value chains. Disruptions in value chains and the supply of essential goods caused by the Covid pandemic and then the war in Ukraine, the rise in geopolitical tensions and the increase in regulatory uncertainty in China, have led multinationals to rethink their production strategies. Some companies are moving towards a 'China for China' production strategy and/or towards a 'China+1' strategy, i.e. by relocating part of their production to Southeast Asia or India or to countries closer geographically to their country of origin, such as Mexico or Central Europe (nearshoring). Western governments are also encouraging the reshoring of certain strategic productions. In 2021, China had only received 5% of the total greenfield foreign direct investment (FDI) compared to 11% in 2018. In H1 2023, inflows of FDI recorded in the balance of payments fell significantly.

However, while changes in the organisation of global production and value chains have become evident and are expected to continue, they are unlikely to lead to a significant decline in China's role in world trade in the short and medium term. Firstly, because Chinese goods are mainly driven by Chinese firms. Secondly, because the Chinese manufacturing sector, supported by the government, keeps a solid capacity to adapt, continue its move up the value chain, and develop high-tech and green-tech products.

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