TAKING STOCK OF 2023

The post-Covid recovery in China's economic activity was not as strong as expected in 2023. The property sector crisis seemingly deepened further at the end of the year, the demand for housing did not pick up again despite support measures from the authorities, and weak household confidence weighs on private consumption. Conversely, the export-oriented manufacturing sector has performed better than expected over the past few months, in contrast with the performances of domestically oriented sectors.

Chinese economic growth stood at 5.2% in 2023, up from 3% in 2022. This recovery is largely due to the post-Covid normalisation of domestic demand and base effects. It has also been supported by cautious monetary and fiscal policy easing since last summer. However, the Chinese economy continues to deal with a large number of fragilities that are likely to persist in the short term.

These fragilities are concentrated in domestically oriented sectors and weigh on investment and private consumption. In particular, the property sector is still in the depths of a major crisis, which further intensified in late 2023. Property investment contracted by around 8% last year, just as it did in 2022. Property transaction volumes plummeted 23% y/y in December and 18% over 2023 as a whole, and the apparent recovery in housing starts seen in November (after falling for 31 consecutive months) was seemingly a false dawn. Only the number of completed projects has continued to improve (+16% in 2023, after a drop of 15% in 2022) thanks to the measures implemented by the authorities to finance the completion of unfinished projects. Conversely, the measures introduced to rekindle demand for housing have not made a difference. For the first time, total mortgages outstanding shrank in 2023 (-1.5% y/y at the end of September). Unsold housing stocks are still excessively high, while property developers continue to face enormous financial difficulties. However, access to loans for the healthiest developers has improved slightly over the last 18 months (total bank loans to developers were up +4% y/y in September 2023, compared to +1.5% in mid-2022).

Property prices have continued to fall. In December, the average drop in housing prices in China's 70 largest cities stood at 4.1% year-on-year and 0.8% month-on-month, which are the biggest falls since the correction in the property sector began in 2021. However, the overall fall in prices since the crisis began is relatively moderate: at the end of 2023, housing prices were estimated to be around 9% below their mid-2021 level on average.

The loss of confidence among households, private investors and lenders has significantly contributed to the property sector crisis not abating. Weak household confidence is also at the root of the weaker than expected recovery in private consumption in 2023, despite the effects resulting from the end of mobility restrictions. Retail sales volumes were up 7%, after contracting by around 2% in 2022.

At the same time, deflationary pressures emerged over the course of the year, as a result of not only weak domestic demand, but also falling food prices (-3% y/y on average in H2 2023, after rising 2.5% in H1), the correction in residential property prices and lower energy prices (fuel prices declined 5.1% in 2023). Consumer price inflation eased from +1.3% y/y in Q1 2023 to -0.3% in Q4. Core inflation stabilised at +0.6% y/y in the period from October to December, compared to +0.7% over the previous six months, which is low compared to the pre-Covid years (core inflation was 1.6% on average in 2019).

However, the increase in household purchasing power remained moderate in 2023 (disposable income per capita recovered +6.1% in real terms). Unemployment is still high among young people, and the employment prospects are uncertain, particularly in service sectors where the regulatory framework has become more stringent.

GROWTH & INFLATION

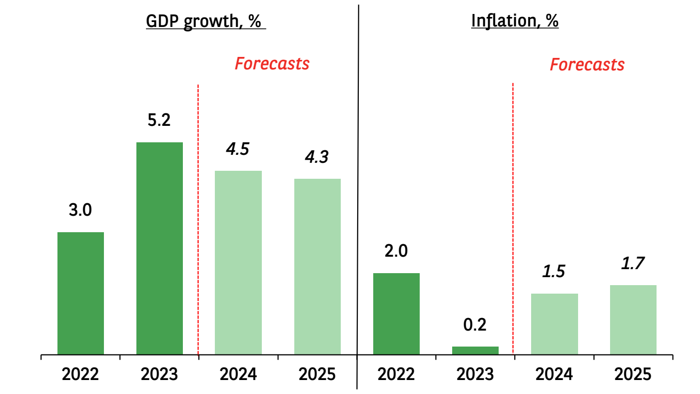

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

All of these factors adversely affect consumer confidence and spending. They are also compounded by the negative wealth effects of falling property and stock prices.

The recovery in service sector activity weakened in late 2023 given the weakness of household demand and lower base effects. Services growth stood at +8.5% y/y in December, bringing an end to four consecutive months where it accelerated gradually; it is estimated to be +8% over 2023 as a whole (vs. -0.1% in 2022).

By contrast, the performance of the manufacturing and export sectors has recently strengthened. Growth in industrial production further accelerated slightly in December (+6.8% y/y) and stood at +4.6% in 2023 (compared to +3.6% in 2022). Investment in the manufacturing sector recovered slightly in Q4 2023. Activity was largely driven by exports, which performed better than expected in 2023 despite a sluggish international environment. Goods exports stabilised in November and rose again in December (+2.3% y/y in current USD), following six months of decline. Most notably, export volumes have recovered in recent months, boosted by the reduced prices offered by Chinese companies in order to strengthen their market shares. As a matter of fact, China has managed to develop its product range (from low value-added consumer goods to green technology products), gain a foothold on the electric vehicle market, and diversify its markets in an attempt to offset the drop in sales in the United States and the European Union.

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