

CHINA

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A WORRYING LOSS OF MOMENTUM

China's economic growth recovered rapidly following the abandonment of the zero-Covid policy, but it is also running out of steam faster than expected. Domestic demand is held back by a significant loss of consumer and investor confidence, and export momentum is stalling. The authorities are cautiously easing monetary policy, and additional stimulus measures are expected in the short term. They should, among other things, aim to encourage youth employment.

Household consumption and activity in the service sectors recovered rapidly following the abandonment of the zero-Covid policy in December 2022 and after a few weeks of disruption caused by an upsurge of the epidemic. However, this recovery already lost momentum in Q2 2023.

Growth in the services sector accelerated to +9.1% year-on-year in the first five months of 2023, after a slight contraction in 2022. However, on the one hand, this figure is inflated by favourable base effects resulting from the very strict lockdowns imposed in the Shanghai region in spring 2022; on the other hand, activity in services showed first signs of weakening in May. The same applies to retail sales volumes, which rebounded by almost 9% y/y over the first five months of 2023, but whose growth slowed in May. Households are limiting their spending. They remain cautious in the face of the severe crisis in the real estate sector and the uncertainties weighing on their income and employment prospects.

The labour market situation is still weak. In particular, while the unemployment rate in all urban areas fell to 5.2% in May (compared to 5.5% at the end of 2022) and is approaching its pre-Covid level, unemployment among young people aged 16-24 has increased since the beginning of the year. It reached a record high of 20.8% in May, compared to 16.7% at the end of 2022 and 12% in 2019. This development can be notably explained by a mismatch between supply and demand that has appeared on the labour market since the regulatory tightening imposed in 2021 in various service sectors.

On the supply side, the number of young graduates entering the labour market has increased gradually over the past few years, and their level of education has risen. The number of young graduates leaving university reached 10.5 mn in 2022, up from 7.9 mn in 2017. Meanwhile, the total number of migrant workers from rural areas increased by only 3.1 mn in 2022 (to 295.6 mn), down from 4.8 mn in 2017. On the demand side, total employment in the services sector stabilised in 2021 and then contracted in 2022 for the first time. Total employment in industry also decreased in 2022 (resuming the trend followed from 2015 to 2019) while employment in the primary sector rose for the first time in twenty years.

In the tertiary sector, job losses last year concerned services affected by health restrictions (retail, leisure, etc.), real estate, and high-end services that have been targeted by regulatory tightening (education, Internet and tech in particular). The former have benefited from the post-Covid rebound since the beginning of 2023, which should translate into new job creation. On the other hand, the regulatory framework remains uncertain for all sectors considered sensitive by Beijing, which weighs on their investment and employment. However, these sectors specifically recruit young graduates and the most qualified workers.

The ongoing crisis in the real estate and construction sectors and the slowdown in the manufacturing sector could also lead to further job losses. Admittedly, the number of completed construction sites has recovered since the beginning of the year thanks to support measures of the authorities. Nevertheless, potential buyers' sentiment still appears depressed and many developers continue to face significant financial difficulties. Housing sales have continued to fall and the contraction in property investment worsened in May. The manufacturing sector is heavily penalised by the slowdown in global demand and tensions with the United States. Industrial production only increased by +3.6% y/y over the first five months of 2023, which is unchanged compared to growth in 2022. Goods exports have barely increased since the beginning of the year (+1.1% y/y), and the decline in imports has continued (-4.4%).

GROWTH & INFLATION

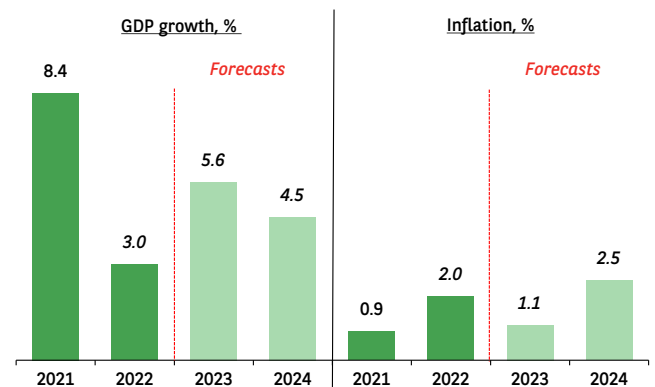


CHART 1

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CHINA: EMPLOYMENT

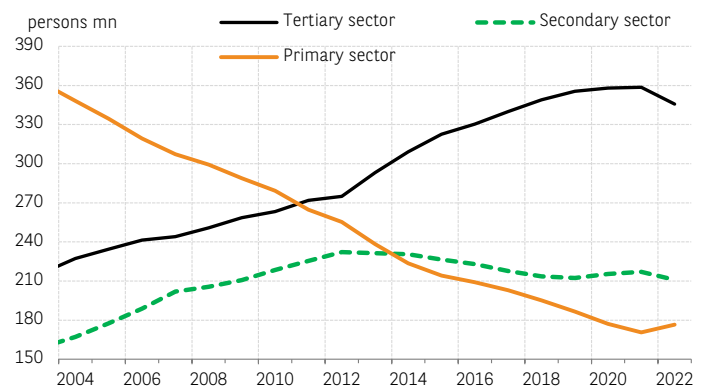


CHART 2

SOURCE: MINISTRY OF HUMAN RESOURCES AND SOCIAL SECURITY, BNP PARIBAS

The central bank cut its policy rates in mid-June (for example, the MLF rate went from 2.75% to 2.65%). The impact on credit growth could be limited, but monetary policy easing is likely to precede other stimulus measures. Given the fragility of local government finances, further fiscal support could come from the central government. Moreover, more actions to reduce youth unemployment are expected (some programmes of modest scope have been launched since last year, aimed at creating jobs in the public sector and supporting companies hiring young graduates). It is indeed urgent to strengthen Chinese household confidence.

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