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Economic situation in China

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In 2021, China's GDP grew by 8.1 per cent. Due to the deteriorating economic situation, however, the growth rate in the second half of the year was much weaker. It reached only 4 per cent in the last quarter. The risk of the dynamic spread of the coronavirus pandemic has also increased. Due to these factors, leading global financial institutions, like the International Monetary Fund and the World Bank, have recently revised China's economic growth forecasts for 2022.

Value-added growth in Chinese industry slowed significantly in the last months. Since October, the share of loss-making enterprises in the secondary sector has increased and the indicator of the accumulated losses to accumulated income has deteriorated. As a result of the continuing liquidity problems and over-indebtedness of many Chinese property developers led by Evergrande, the situation in the Chinese property sector has deteriorated significantly. This also has significant negative impact on the situation in the construction, steel and non-ferrous metals manufacturing, construction equipment manufacturing and other related industries, as well as on the economy as a whole.

The growth of the added value of the service sector was even weaker than of industrial production. The share of services in GDP, despite growth in the last two quarters of last year, was still below the levels from 2019 and 2018. Poor results were recorded by retail sales, whose minimal positive growth was due to the relatively high dynamics of e-commerce sales.

With falling investments and weak consumption growth, net exports again became the component of GDP that supported overall economic growth. In the last quarter, as in many months of last year, export recorded double-digit growth. According to Natixis analysts, China has been recently exporting producer inflation to foreign markets. Examples include such industries as footwear, LCD panels, mobile phones and, to a lesser extent, electronic circuits. Chinese companies compensate for their limited ability to raise prices in the domestic market by raising prices to foreign customers. Increased transport costs have also played an important role in raising the cost of imports from China.

In recent weeks, the level of economic activity and the situation in supply chains have been significantly affected by the restrictions implemented by the authorities due to new outbreaks of the pandemic. In January, the Caixin PMI overall index stood at 50.1, with the manufacturing sector at 49.1 and the services sector at 51.4. Value of 50 marks the line between growth and contraction.

There is little sign that the situation will improve dramatically in the coming months. However, the CCP leadership still has a number of instruments in its hands that can be used to stimulate the economy to grow faster and to induce moderate improvement in the economic situation. In December and January, the Chinese authorities applied some tools of an expansionary monetary policy, including cuts in some interest rates. Credit growth accelerated. Private sector financing growth was above market expectations in January. So far, however, the rate cuts have been quite cautious and it seems that the Chinese authorities will introduce more in the coming months.

Since August, a fairly steady trend towards appreciation of the Chinese currency has been evident. The CCP leadership will attempt to incur the depreciation of RMB, as its further appreciation threatens the competitiveness of Chinese exports, which currently constitute the key element supporting economic growth. It therefore seems quite likely that the actual application of restrictions on the financing of foreign investment by Chinese companies may be relaxed. Adjustments in formal regulations can be also implemented.

In the coming months, the greatest threat to the economy is the dynamic spread of the epidemics and the enforcement of restrictive policies, which hamper economic activity.

Another threat is the drop in demand for Chinese exports in the foreign markets. So far, the Chinese authorities have indicated that the benefits of restrictive anti-Covid policies have outweighed the costs. There have been no signs yet that the CCP leadership has moved decisively away from its strategy, which increases the risk of disruption to supply chains. The additional risks are related to the impact of the war in Ukraine.

Critical to a return to healthy growth is a rebound in consumption. Neglecting the support of consumption growth can lead to further deterioration in demand and adversely impact the return on the path of stable, dynamic economic growth. Without the CCP leadership taking actions, even costly or risky ones, it will be difficult to stimulate healthy acceleration in economic activities in the coming months. Following the old path of increasing investments in infrastructural projects and supporting state-owned enterprises at the expense of private sector will only deepen the existing profound structural problems.