China's engineered economic recovery

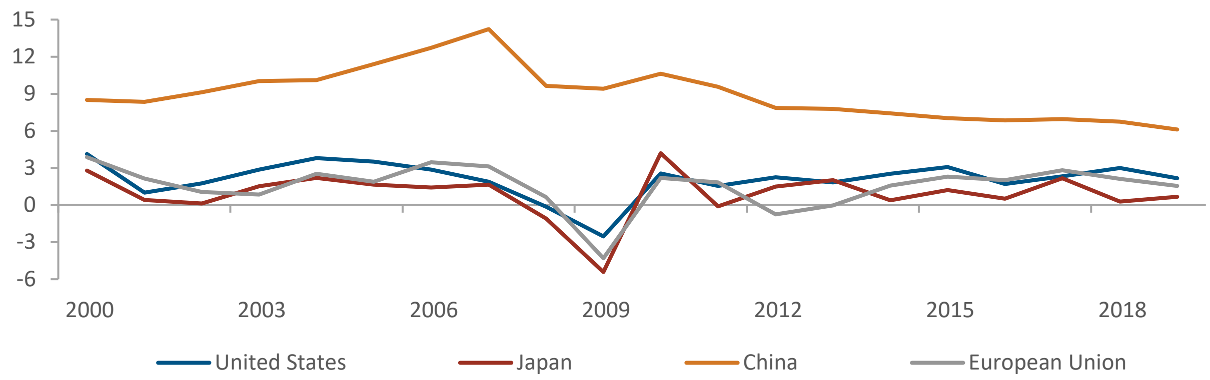
Blog post by Senior Associate Jens Presthus, 23 October 2020

The dust has now settled on China's latest GDP figures. As usual, even without going into questions about the reliability of official numbers, the data dump has led to some confusion. Strong headline GDP growth has been widely reported, both inside and outside of China – pointing to a strong recovery. However, while China without a doubt currently is doing better than most other economies, mainly due to its effective response to covid-19, the reality about its economic recovery is somewhat more nuanced.

The first thing that needs to be clarified is that China does not calculate GDP in the same way as most countries.[1] Any investment, good or bad, is for instance added to the value-added component of GDP and calculated as a growth contributor. Non-productive investments are not written down and do therefore not act as a drag on growth. This makes GDP comparison with other countries problematic, given that non-productive investment is a major issue in China.

Fig 1: Chinese GDP growth is incredibly smooth

Annual real GDP growth, %



Sources: CEIC, GC calculations

The second point to note is that China operates with politically determined GDP targets that are met through government borrowing and investment, but which are largely disconnected from real underlying growth and productive economic activity. The assumption is that if these targets are met, the Chinese leadership will be able to create enough jobs and lift enough citizens out of poverty – thus keeping their end of the social contract. While this, of course, can work in the short term, it is no guarantee for sustainable and equitable economic development. It also supports non-productive investment and creates significant amounts of debt that is challenging to service. Although Beijing did not reveal a 2020 growth target during the National People's Congress earlier this year, the leadership likely agreed on a number that would keep unemployment at a manageable level if the virus remains under control. In fact, a 2-2.5% growth estimate for the year has been widely circulated over the last few months, and

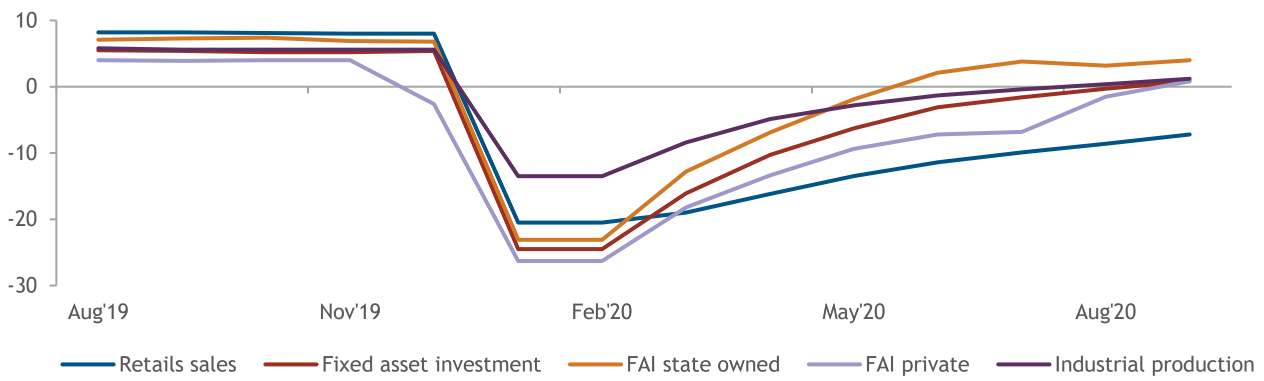
[1] https://carnegieendowment.org/chinafinancialmarkets/78138

was again reiterated by the PBOC's governor, Yi Gang, this week. Clearly Mr Gang cannot predict the future, but he knows that if Beijing and local governments borrow and spend enough on infrastructure and real estate, they will meet their growth targets.

Thirdly, and perhaps especially crucial in the case of China, it is important to look at what is actually driving growth. Besides industrial production and government investment, trade figures have also been highlighted as another sign of a strong recovery. However, rising imports have not been driven by real domestic demand, but rather a surge in food imports due to ruined crops and hoarding of technology components that Chinese firms no longer can buy due to US sanctions. Similarly, record exports should not immediately be attributed to Chinese manufacturers recovering quickly, but instead to strong demand from its trading partners – which again leaves Chinese exporters vulnerable to a faltering global economic recovery. Moreover, retail sales are still down 7.2% for the year. Golden Week in early October, China's most important annual holiday, saw tourist trips drop 21% and tourism revenue down 30% from last year. This is hardly data one would expect from an economy that is back on its feet, but not surprising given the meagre support China's consumers have been getting from the government.

Fig 2: A supply-side driven recovery

Retail sales, fixed asset investment and industrial production, yoy % change - ytd



Sources: National Bureau of Statistics, CEIC, GC calculations

Finally, China's recovery has been highly uneven. Any real uptick in activity has so far only taken place in Beijing, Shanghai and wealthy coastal provinces such as Guangdong and Zhejiang. Poorer provinces in central and western China are still suffering from weak labour markets and negative growth. This is, of course, troubling for the leadership, which has promised to raise rural livings standards and eradicate poverty by year end. Premier Li Keqiang acknowledged during the National People's Congress in May that over 600m Chinese still live on $140 per month and the pandemic has likely exacerbated income inequalities.

In conclusion, while it is clear that China has rebounded stronger from the pandemic than most other major economies, Beijing's investment and export-led strategy has not resulted in a comprehensive and sustainable recovery. Next week's fifth plenum will therefore be important as the Chinese leadership likely will provide details about how it intends to revive growth, make China self-reliant in the technology space and shift to a consumption-led economy. This, in turn, will reveal what will drive growth in the years ahead – and importantly, in a much more effective way than by reading the latest headline GDP data.