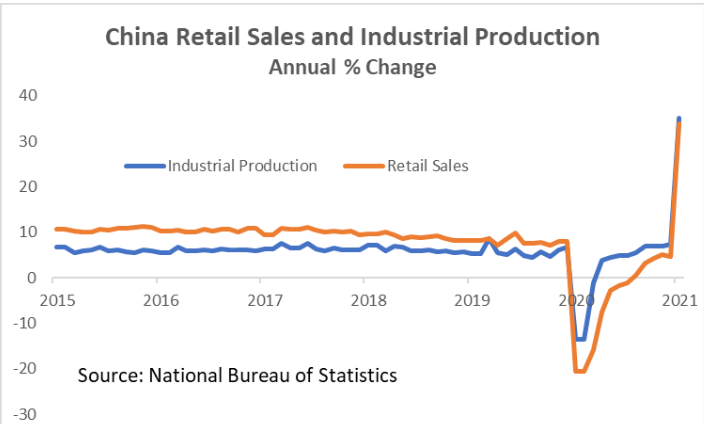
China rebounding strongly, but challenges remain

Data this week saw a strong rebound in Chinese activity indicators in early 2021 – though off the low base of early 2020 when the country was in the grip of the COVID-19 outbreak.

Growth in industrial production came in at an annual rate of 35.1% in February with retail sales not far behind at 33.8%. Both outcomes were ahead of expectations. Fixed Asset Investment came in at 35%, just below expectations of 40%, suggesting the manufacturing sector is not yet convinced of the durability of the recovery.



Factory output was no doubt boosted by the Lunar New Year travel ban (the "stay-in-place" policy). This allowed many factories that would normally close for up to two weeks over the holiday to remain open. Many others that did close were able to reopen earlier than normal.

Such is the strength of the data that private sector GDP growth forecasts for Q1 2021 are narrowing in on a range of 15-20%, though this is off a base of a 6.4% contraction in GDP in the March quarter of 2020.

March quarter will likely represent the highest annual growth of calendar 2021. Growth rates can be expected to move lower over the course of the year reflecting the gradual withdrawal of policy support and a likely decline in foreign demand for Chinese goods as vaccines roll out around the world and more normal consumption and production patters emerge.

Full-year 2021 GDP growth is projected to be around 9.0%, up from 2.3% in 2020, the only major economy to post positive growth last year.

This data comes hot on the heels of last week's 14th National People's Congress, the so-called "rubber stamping" process of the Chinese Communist Party's policy agenda.

The congress endorsed the latest 5-year development plan that focusses on boosting consumption and reducing economic reliance on exports of lower quality goods. A goal of 11-million new urban jobs has also been set.

Premier Li Keqiang also announced a GDP growth target of "above 6%" for the year, a goal that looks to be easily achieved based on the numbers outlined above.

The other targets look a little more challenging in our view. While consumption looks to be recovering in spectacular fashion, it is proving to be the least resilient part of the recovery. Looking over a two-year period to remove the COVID distortions, industrial production is up 17% (8.5% per annum) while consumption is up 6.4% (3.2% per annum). Policies to boost consumption will need to be a key focus in the period ahead.

Further strengthening of consumption growth will be hampered by rising unemployment. The urban unemployment rate hit 5.5% in February, up from 5.2% in December. The authorities' job-creation target is welcome and indeed necessary if the unemployment rate is to end the year below the 5.5% cap.

Finally, it is often forgotten that while China is still an emerging economy, it is facing the predominantly developed world problem of an ageing and declining population. The United Nations projects that China's current estimated population of 1.44 billion will decline to 1.37 billion by 2050, with a rising dependency ratio indicating a declining working age population will have to provide for an ever-increasing proportion of children and elderly.

So despite the at times spectacular rates of growth in China, the policy challenges in creating a more prosperous society remain confronting.

From a New Zealand perspective, policies to reorient the Chinese economy towards greater consumption is good news. China is our largest trading partner and is particularly important for trade in dairy products, education services and tourism. This bodes well for the reopening of borders when that occurs.