

The sick dragon of Asia? The spluttered reopening of the Chinese economy

July 2023

Introduction

The ending of restrictive COVID-19 policies and the fading away of pandemic-related health impacts propelled the Chinese economy to a rapid rebound in the first quarter of 2023. But there are signs that the recovery is faltering, with headwinds facing the property market, high youth unemployment, and weak exports threatening the recovery before it's even begun. This note explores what has happened to the Chinese economy since it exited COVID restrictions in December 2022 and what this may mean for the UK.

China since 2020

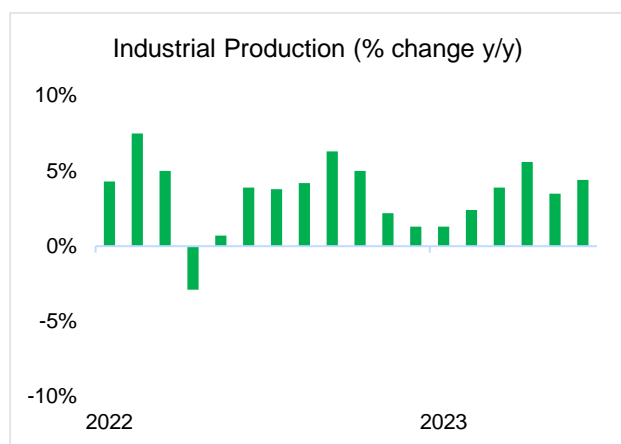
The epicentre of the COVID pandemic, China saw harsh measures to control the spread of the virus. From the beginning of the crisis, China adopted a “zero-COVID” policy involving targeted lockdowns that disrupted manufacturing, limited domestic consumption and banned intra- and international travel. As a result of these measures, the growth of the Chinese economy averaged just 2.9% in 2021, and 3% in 2022, compared to an annual average of 7.4% in the ten years to 2019.

While extremely successful at controlling the virus in the earlier periods of the outbreak, the last quarter of 2022 saw a large outbreak of COVID-19 in China which led to further declines in mobility and economic activity. With leadership committed to stamping out any presence of the virus, it seemed as if the zero-COVID policy would continue indefinitely. However, on 8th December 2022, the Government unexpectedly lifted restrictions. While this set the stage for a reopening economic boom as seen in other countries, it also allowed the virus to spread unchecked through a vulnerable population, with some officials estimating that around 250 million people (18% of the population) caught COVID in the first 20 days in December, with a death-toll much higher than officially reported.¹

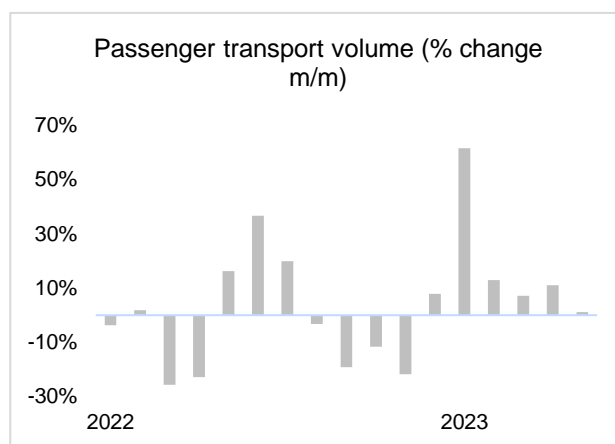
As the health impacts of the reopening wave faded, China seemed poised to make a comeback, with positive spillover effects for the global economy.

China rebounded in the first quarter

China's economy rebounded in the first quarter (4.5% in the year to Q1²) as pandemic related restrictions and health effects dissipated, driven primarily by domestic services activity, particularly hospitality, leisure and transport as consumers began spending. Industrial production recovered following anaemic growth in late 2022, and mobility increased sharply following the ending of restrictions.



Source: China National Bureau of Statistics



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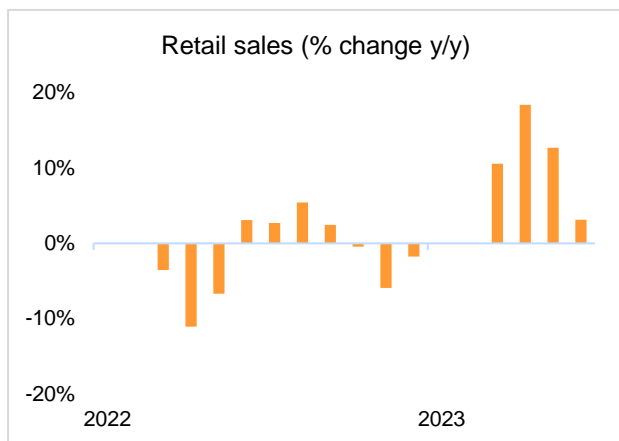
Increased tourism is a core aspect of China's recovery. Domestic passenger volumes jumped 61% between December and January, and Spring Festival passenger volumes rose sharply by 52% in 2023 compared to the previous year.³

The rest of the world, especially neighbouring countries in Asia, will benefit from an influx of inbound tourists. Chinese tourists accounted for almost 20% of all global spending on tourism in 2019, with the Asia-Pacific region attracting 56% of China's 155 million tourists in 2019. It's estimated that 2023 will see 110 million outbound tourists,⁴ which should help drive growth in their destination countries. Early numbers for international tourism are strong as outbound flight and hotel bookings rose by more than 400% during Chinese New Year compared to 2022, and the number of international passenger flights rose 173% year-on-year between January 1st and March 5th.⁵ A normalisation of tourist numbers will also benefit European and US GDP, particularly countries with a high tourism share of GDP like Spain (12.4%) and France (7.5%), with the UK at 3.7% in 2019.⁶

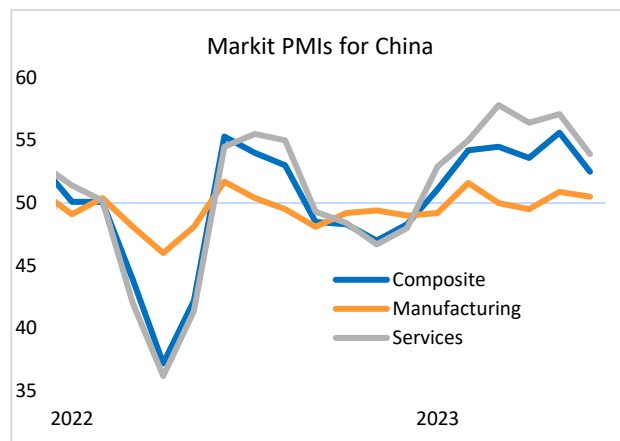
But there are signs the recovery is faltering

However, spillover effects from China's reopening may be limited as the signs point to an uneven recovery led by primarily by domestic consumption of services, in contrast to previous recoveries which were led by investment and exports. This comes amid signs the recovery is already losing steam with China posting 6.3% year-on-year growth in Q2 – below market expectations (of 7.3%⁷) and an expansion of just 0.8% through the quarter.

This triggered an immediate reaction from forecasters, who collectively downgraded their expectations for Chinese growth in 2023, with the median forecast being cut from 5.7% in May to 5.5% in July.⁸ The weaker than expected outturn has already been reflected in the PMIs, which show softer growth in both manufacturing and services.



Source: China National Bureau of Statistics



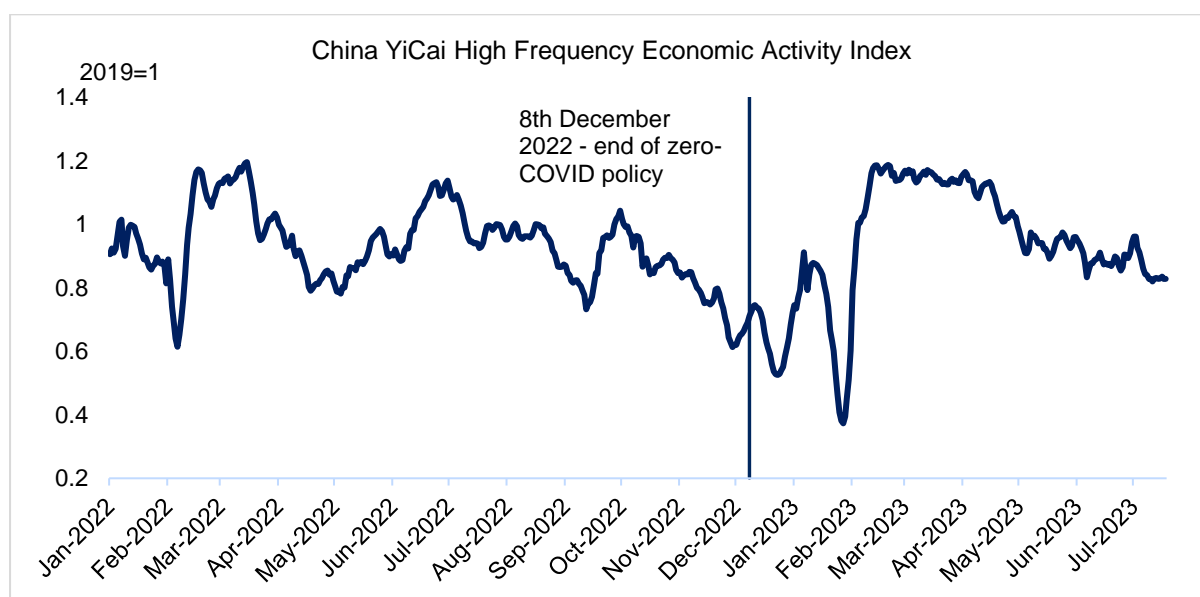
Source: S&P Global

The slowdown can be seen in a variety of indicators. Despite a small recovery in exports in the year to March and April, annual trade growth turned negative in May and June saw exports and imports fall 13% and 7%, respectively. US trade fell 5.5% during the first five months of the year.⁹ With signs that major developed markets are slowing, exports may deteriorate further.

Consumer confidence, which dropped in 2022, has yet to recover.¹⁰ The property market is faltering, with sales falling to 64% of their 2019 levels in April, down from 95% in March,¹¹ and transaction volume by floor space contracted by 19.2% in the year to June.¹²

Structural headwinds are also on the horizon, unemployment is above 5%, 5.5% in major urban areas, and stands over 20% for those aged 16 to 24 as another 11.6 million new graduates are expected to enter the saturated labour market.¹³

The faltering recovery is illustrated by the YiCai Index,¹⁴ which shows a steady weakening to below 2019 levels amid tepid consumer confidence, following a jump in activity in February following the conclusion of the COVID-19 outbreak. Weaker momentum has also dented some commodity markets with prices for copper and iron ore dropping, Chinese equity markets falling and the renminbi weakening against the US dollar.



Source: YiCai Research Institute

All of this points to an uneven recovery that, while seeing a burst of activity in the first quarter, is already starting to slow with deteriorating trade figures, weak consumer confidence, and high unemployment weighing on the economy. These difficulties, short and long term, suggest that the Chinese economy faces troubles ahead, with the IMF expecting annual growth to fall to an average of 3.9% over the next five years.¹⁵

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- ¹ China estimates 250mn people have caught COVID in 20 days, Financial Times, 25th December 2022, at <https://www.ft.com/content/1fb6044a-3050-44d8-b715-80c18ca5c9ab> [accessed 21st June 2023]
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- ³ China's National Bureau of Statistics, Macrobond
- ⁴ Asian Development Outlook: April 2023, Asian Development Bank, April 2023, at <https://www.adb.org/sites/default/files/publication/863591/asian-development-outlook-april-2023.pdf> [accessed 16th June 2023]
- ⁵ Asian Development Outlook: April 2023
- ⁶ China's reopening spillovers may be more ripples than waves, Swiss Re Institute, 13th February 2023, at <https://www.swissre.com/institute/research/sigma-research/Economic-Insights/china-reopening-spillovers.html> [accessed 19th June 2023]
- ⁷ China's Q2 GDP seen rising 7.3% year over year but on low base, recovery fades: Reuters poll, Reuters, 13th July 2023, at <https://www.reuters.com/markets/asia/chinas-q2-gdp-seen-rising-73-yy-low-base-recovery-fades-2023-07-13/> [accessed 17th July 2023]
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- ¹⁰ 'Confidence is a big problem': China's economic recovery loses steam', Financial Times, 29th May 2023, at <https://www-ft-com.ezp.lib.cam.ac.uk/content/e2aaaa56-5dee-41be-9ed4-181496de6bf3> [accessed 8th June 2023]
- ¹¹ 'Confidence is a big problem': China's economic recovery loses steam'
- ¹² Why China is flirting with deflation as the west battles raising prices, Financial Times, 13th July 2023, at <https://www.ft.com/content/cf4dc73c-1164-42df-83b1-083be279c6fc> [accessed 25th July 2023]
- ¹³ China National Bureau of Statistics, Macrobond
- ¹⁴ A high frequency index of China's economic activity
- ¹⁵ China's Economy is Rebounding, But Reforms Are Still Needed, International Monetary Fund, 3rd February 2023, at <https://www.imf.org/en/News/Articles/2023/02/02/cf-chinas-economy-is-rebounding-but-reforms-are-still-needed> [accessed 12th June 2023]