China, running out of steam

The country was the first to publish its GDP figures, which show that economic growth in China slowed in the 2nd quarter of 2023 (+0.8% quarter-on-quarter). In the 1st quarter, activity rebounded following the lifting of Zero-COVID measures at the end of last year. This rebound served to mask the signs of weakness in China’s economy but only temporarily; momentum is now waning.

The country is currently facing structural challenges. Firstly, population growth entered negative territory in 2022, despite the fact that the country’s labour pool has helped to accelerate its economic development for many decades. Secondly, despite the authorities’ stated desire to rebalance national wealth from exports to domestic demand and from industry to services, the economy remains dependent on purchases from its trading partners and is still largely dominated by manufacturing (with a massive weighting of unprofitable state-owned companies). What’s more, the construction sector (and its offshoots), which accounts for almost a third of GDP, is struggling to recover from the property crisis, the result of private individuals’ distrust of property developers because so many of them have defaulted on their debts and put projects on hold. As a result, some individuals have found themselves owners of unfinished flats but forced to honour their mortgages. The government has intervened to try to restore confidence and help the sector recover, but debt remains a thorny issue. According to the IMF, in 2022 corporate debt represented 158% of GDP and total public debt (including all funds directed by the government and local authority financing vehicles) exceeded 110% of GDP. The government must therefore balance implementing support measures and debt reduction.

The weak employment situation, counter to what is being seen in other countries, is further fuelling gloom among Chinese households. The youth unemployment rate is rising steadily and now stands at 21.3%. Admittedly, consumer spending and retail sales have rebounded following the lifting of mobility restrictions, but individuals are still worried, and massively rising bank deposits are limiting the rebound in demand.

For businesses, too, the situation is complicated. On one hand, the global slowdown in activity and trade is holding back Chinese exports, while productivity in state-owned enterprises is low and industrial confidence is fragile. On the other hand, industrial production is showing signs of acceleration, imports of raw materials are rising (in terms of volume) and China is well positioned in the renewable energy and electronics value chains. It is also a critical supplier of the metals needed for the energy transition and the production of semi-conductors; China worked to secure supplies long before the United States and Europe did. Admittedly, tensions with the United States and regulatory changes are complicating the task of investors, who are taking a cautious approach. However, in 2022, China was still the second-largest recipient of foreign direct investment, behind the United States and well ahead of India (8th place). Inflows have even risen by 5% compared to 2021. According to the United Nations Conference on Trade and Development, the increase, mainly from European multinationals, has been concentrated in the manufacturing and high-tech sectors.

Nevertheless, domestic demand is lacklustre. So, unlike in other countries, the environment is deflationary. Producer prices are falling, both monthly and year-on-year, and monthly consumer price inflation is also in negative territory. This deflation is widespread, with six of the seven price categories recording a decline in June.

In addition to its structural problems, China is dealing with cyclical drags. The post-COVID reopening is facing major challenges. The crisis of confidence is profound, and China is suffering from the polarisation of its relations with the United States and its demographic transition. Nevertheless, China is experiencing a dominant position in electronics, renewable energies and critical metals. This is borne out by the high levels of foreign investment, despite the geopolitical context and domestic difficulties. The Chinese stock market is not immune to the prevailing volatility – quite the opposite, in fact – but it does provide an opportunity to position oneself on the digital, energy and demographic transitions, while maintaining a principle of prudence and selectivity.