Round-up: Down, but not out? China's evolving economy

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When will China run out of workers?

Mounting pressure on Chinese government finances

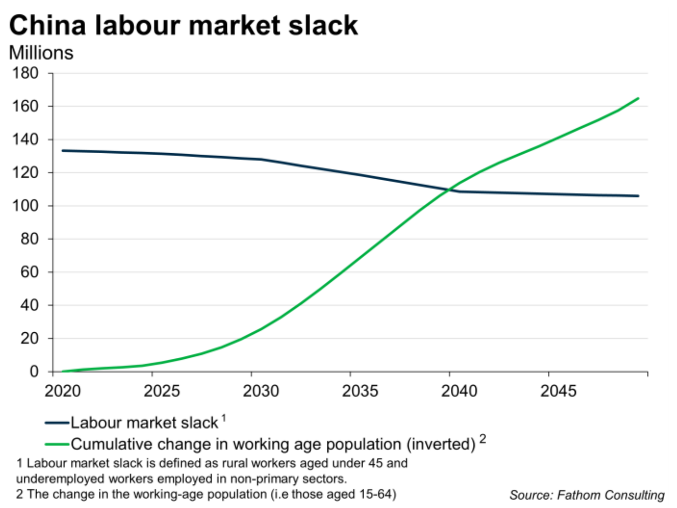
China doubles down double quick

China tech: a short-term revival or a longer-term theme?

When will China run out of workers? (08 June 2022)

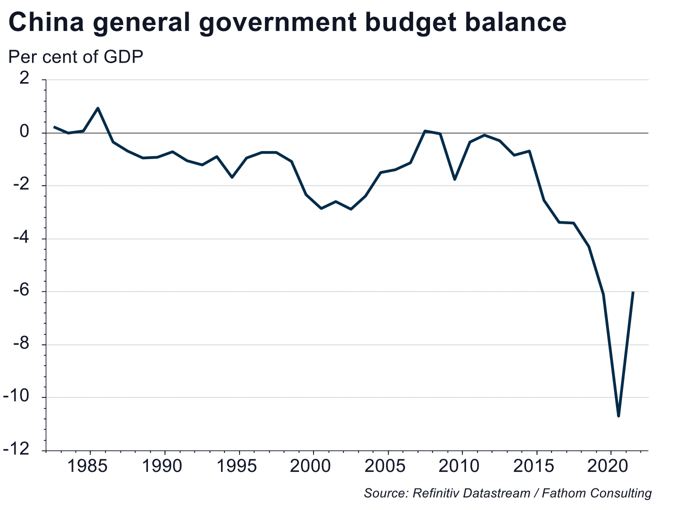
- We recently concluded that China is not about to drive up global inflation as it retains a substantial amount of labour market slack
- The slack comes from two sources: a pool of rural workers that can be pulled into urban areas, and underemployed urban workers[1]
- But this slack must be set against China's demographic headwinds —the working-age population is expected to shrink rapidly over the coming decades
- We estimate that these demographic headwinds could erode the remaining labour market slack within the next 15–20 years, and possibly sooner if there are rigidities that prevent those who contribute to labour market slack being reallocated
- Beyond this point, a dwindling labour supply could weigh increasingly on productive potential — unless China can find a way to decouple manufacturing output from human labour inputs (for example, through AI, robotics, and other forms of automation)

[1] Underemployment is calculated from the cumulative difference between the NBS's official GDP numbers and Fathom China Momentum Indicator, holding labour productivity in line with official numbers.



Mounting pressure on Chinese government finances (17 June 2022)

- The Chinese economy is in or close to recession, which raises the prospect of fiscal stimulus: but can China afford it?
- The fiscal position of China's central government has deteriorated steadily since the Global Financial Crisis of 2008/09, which was when its export-oriented growth model stopped working



- Since then, growth has been built on credit to support investment in industry, infrastructure and, above all, housing, but growth has slowed nevertheless

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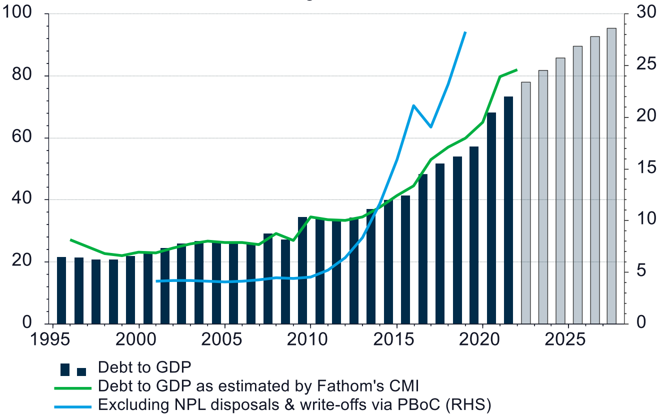
- The slowdown has put increasing pressure on government finances, peaking during the first COVID outbreak of 2020; the deficit is on track to exceed 10% of GDP within the next few years
- The worsening deficit has caused the government debt to GDP ratio to rise too, touching 70% of GDP on official measures
- Fathom's proprietary measure of Chinese GDP (the China Momentum Indicator, or CMI) suggests that the ratio of debt to GDP is even higher, at 80% - and that does not include the bad assets in the banking sector
- In Fathom's view, the Chinese government has implicitly underwritten those assets, so adding that implicit liability to the debt stock would take it to around 100% of GDP, or even higher – in the same area as the UK, the US and much of the euro area

China gross government debt and NPLs

Per cent of GDP, both axes, including IMF forecast



Source: Refinitiv Datastream / Fathom Consulting

China doubles down double quick (22 June 2022)

- While the global economy flirts with stagflation, China is facing additional economic headwinds: a real estate market knocked by past policy tightening, and Xi's still draconian zero-COVID policy; together, these challenges mean that China's economy will have contracted in the second quarter
- In response, policymakers in Beijing are doing what they do best, doubling down. And this time they are doing so at the double
- With the 20th Party Congress later this year, where major changes in leadership are announced, local authorities may be keen to curry favour by making extra efforts to meet or exceed targets, especially as Xi's tolerance for economic pain wanes

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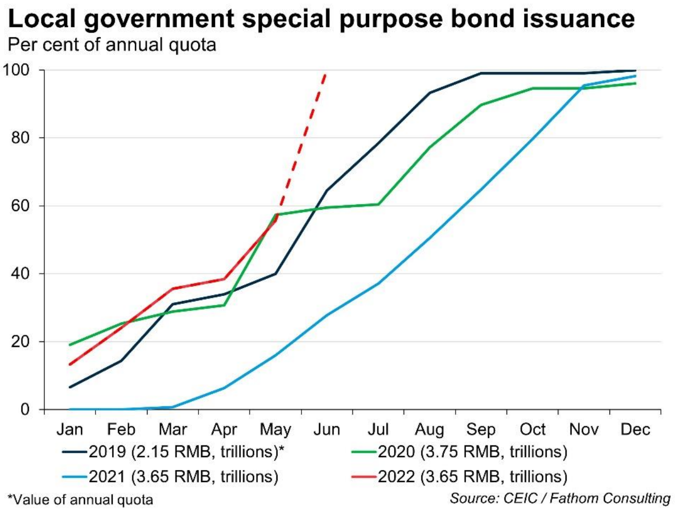

- As the chart shows, the issuance of local government special-purpose bonds has been expedited, with the full quota (around 3% of GDP) expected to have been issued by the end of June – much earlier than in previous years
- The funds raised will be used to frontload local authority infrastructure projects, boosting near-term economic growth
- Even this will not be enough to overcome China's economic headwinds, however, and growth will fall short of this year's 5.5% target; while in the longer term, this pursuit of credit-fuelled infrastructure spending merely ensures that China remains on the path to Japanification — low growth and low interest rates

China tech: a short-term revival or a longer-term theme? (29 June 2022)

- Chinese technology stocks have outperformed the broader Chinese domestic market (CSI 300) by 8% and their US peers (NASDAQ) by a significant 26% since a trough in late April
- This stronger performance has materialised as the Chinese authorities signal increased stimulus for the economy, and amid suggestions at a meeting of the Politburo that the worst of Beijing's regulatory oversight of tech companies might be over

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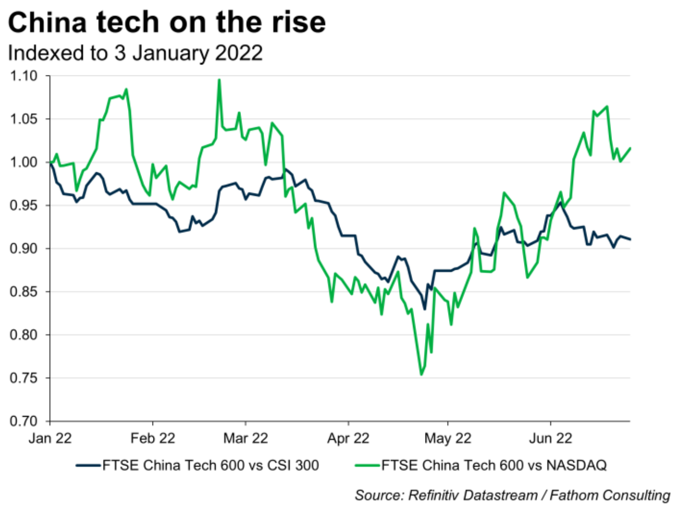

- Rising US interest rates help to explain the recent underperformance of the US tech sector, and recent COVID-related shutdowns in China have made Chinese tech relatively attractive compared to some other sectors of the economy
- But geopolitical considerations could provide additional tailwinds for Chinese tech stocks, as technology is increasingly seen by the CCP as a strategic means to maintain social cohesion, control over information and military advantage; for example, references to technology featured heavily in a transcript of a leaked (and unverified) meeting of the Guangdong Provincial Military Region, rehearsing how to mobilise in preparation for war
- As a recent update to Fathom's Global Outlook, Summer 2022 has highlighted, the slowdown in global economic activity is likely to provide a bigger story and surprise than inflation, resulting in a lower path for interest rates by year end than is currently priced in by investors. Technology stocks globally would be well positioned to take advantage of such a development

Chart authors: Andrew Harris, Erik Britton, Joanna Davies, Andrea Zazzarelli

Further reading:

Global Outlook, Spring 2022: Update

The Middle Kingdom is in the doldrums

In case you missed it, here's last month's round-up:

Inflation triggers rising rates

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