January round-up: China economics

7 February 2023

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Last month Fathom's economists focused their attention on China, discussing how much of a boost China's reopening will give to the global economy, the structural headwinds to Chinese growth, the quality of official Chinese GDP statistics and how China's high-tech sector compares with the US's FAANG titans. Read on for a round-up of some of the economic insights Fathom sent to clients in January.

Will China drive a global rebound? (11 January 2023)

- China's recent U-turn on its zero-COVID strategy implies that a rebound in growth is likely, but how big will it be, and what impact is it likely to have on the global economy?
- The answer is perhaps not as large as many think — while China's official GDP remains some 6% below its pre-pandemic trend, Fathom's China Momentum Indicator suggests that this gap could in reality be less than 2%, due to a weaker trend rate of growth
- Moreover, our analysis suggests that China's consumers lack the substantial savings pots that supported the rebound in activity in Europe and the US, as fiscal policy in China has been less generous

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Pandemic savings pots*

Per cent of GDP

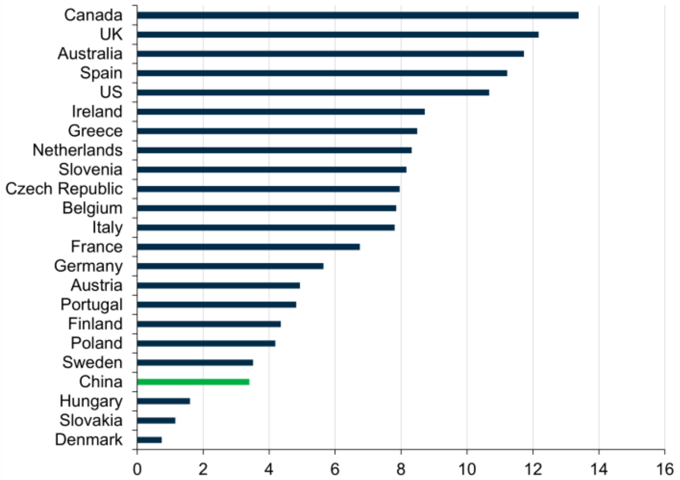


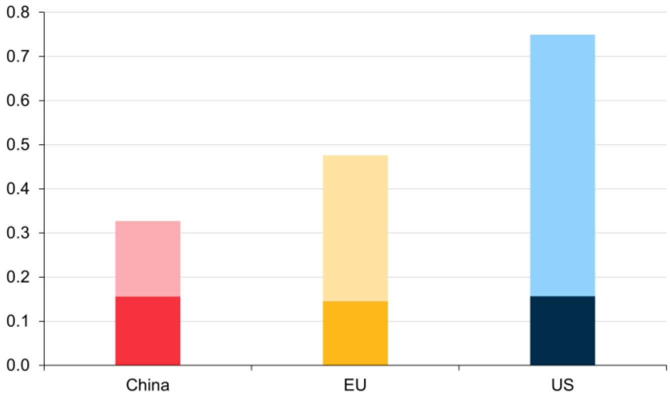
*Chart shows the maximum amount of excess savings built up through the pandemic as a share of nominal GDP at that time

Source: Refinitiv Datastream / Fathom Consulting

- Fathom's proprietary Centrality Tracker suggests that each additional percentage point of Chinese growth typically boosts global growth by around 0.3 percentage points, with commodity exporters and tourist destinations likely to benefit the most
- This effect is split roughly equally between the direct impact of Chinese growth (i.e., the PRC's share of global GDP multiplied by the size of the shock) and the spillover effects to the rest of the world
- These spillover effects may sound large, but they are about half the magnitude of those yielded by shocks to EU growth — and only roughly one quarter of the magnitude generated by shocks to the US economy
- Of course, the re-opening of the Chinese economy is not a 'typical' shock and the ripples it creates around the world may be equally unusual — we will explore this topic in further detail in our next quarterly outlook

Spillover effects from shocks to hub growth

Percentage point impacts on global growth



Darker colour denotes direct impact
Lighter colour denotes spillover effects

Source: Fathom Consulting

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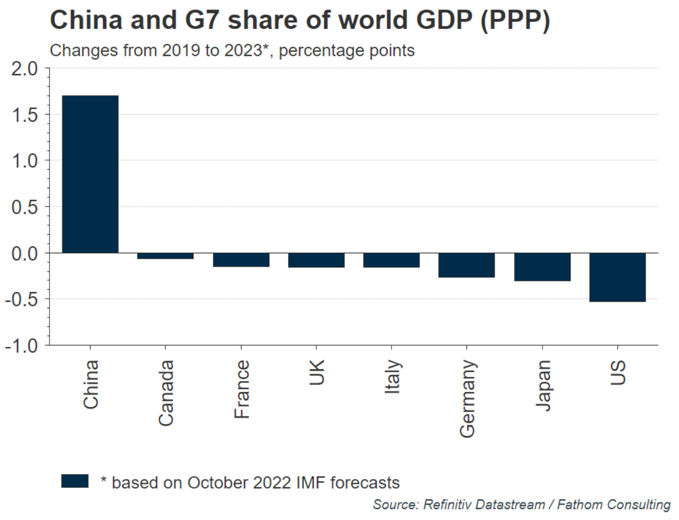
A changing China consensus (18 January 2023)

- After a series of policy missteps by Beijing, the narrative on China has flipped from optimistic to pessimistic
- Yet IMF forecasts suggest that China will have increased its share of world GDP by 1.6 percentage points over the period 2019–23, which compares to a combined 1.8 percentage point decline for the G7, at purchasing power parity (PPP) exchange rates



- Fathom was ahead of the curve in warning about China's secular headwinds, which have since become well-known:
    - Demographics: China's ageing workforce and falling birth-rate, highlighted this week by news that its population has started to fall, will limit economic growth and impact other economies
    - Unbalanced growth: historically China's economy has over-relied on investment and debt to drive economic activity, leaving its domestic market underdeveloped
    - Politics: history suggests that China's authoritarian set-up and heavy state influence in the economy are likely to stifle innovation and prevent it from escaping the Middle Income Trap
- All factors remain for now, but as Fathom has also pointed out, they can all be addressed (at least in theory) by policy. Shrinking demographics can be tackled by automation or immigration; the dangers of unbalanced growth can be mitigated by rebalancing towards household consumption; and the restrictive influence of politics can be lessened by liberalisation of the economy
- If Beijing showed some signs of policy flexibility towards addressing these structural headwinds, it could flip the narrative back the other way from negative to positive

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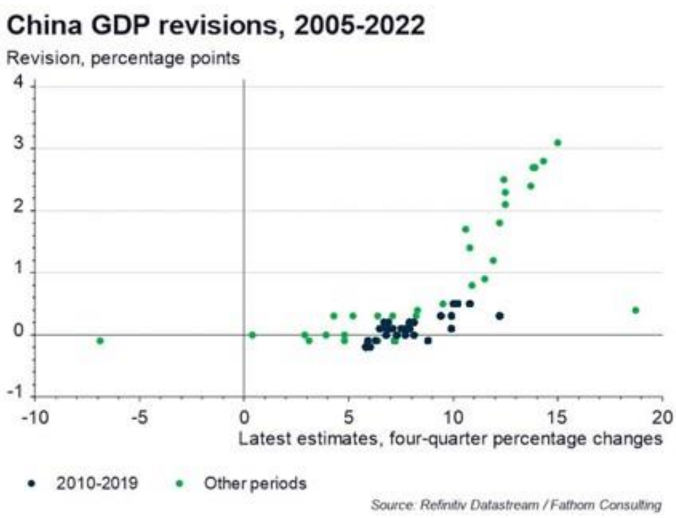
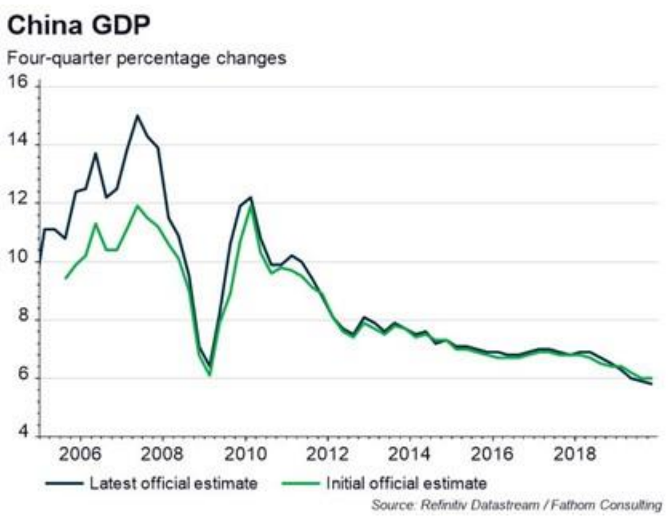
China's incredibly accurate GDP statistics (25 January 2023)

- Fathom has long been sceptical of China's GDP statistics, and that is why in 2014 we launched our own alternative measure – the China Momentum Indicator (CMI)
- Although China is an emerging market, it is one of the first countries to publish its GDP data — yet despite this rapid turnaround, revisions have been small in recent years
- If we focus just on the decade leading up to the pandemic, the mean absolute revision to the initial estimate of four-quarter growth has been just 0.2 percentage points
- By comparison, despite taking more than twice as long to put together its own GDP statistics, revisions to the initial estimate of four-quarter UK GDP growth have been more than twice as large, on average, over that same ten-year period
- There will be much attention on measures of economic activity in China as it reopens, but we continue to advise our clients to focus on indirect measures that are less subject to political influence





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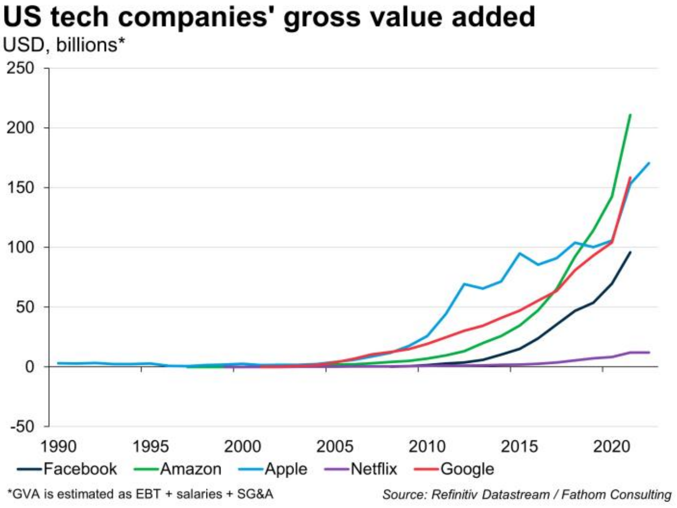
FAANG ache — will China bite back? (1 February 2023)

- An industry or company's contribution to GDP is determined by the value it adds to the inputs it uses (its gross value added, or GVA); from an income perspective, this should be equal to the sum of a company's profits and its expenditure on wages
- Using data from financial statements, we have created proxies for the GVA of leading US and Chinese tech companies[1]
- Our estimates suggest that the GVA of the FAANG companies (Facebook, Amazon, Apple, Netflix and Google) far exceeds that of their Chinese counterparts
- When judged by this metric, the gap between the leading Chinese tech companies and their American counterparts is closing more slowly than many think
- Whether the PRC can bite back will ultimately depend on the innovative capacity of its high-tech sector and the extent to which companies in that sector can harness the huge pool of customer data they possess



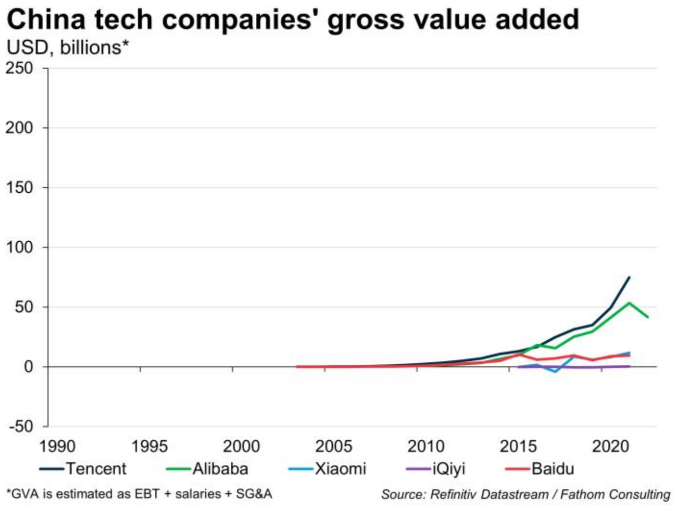


Chart authors: Andrew Harris, Kevin Loane, Andrew Brigden

1. Our proxies are created by summing pre-tax earnings, wages, and selling, general and administrative expenses (SG&A). We include SG&A since 'wages' in corporate income statements includes only the salaries of workers involved in production (those involved in activities such as marketing and sales are included in the SG&A entry). Of course, not all SG&A expenses reflect a labour expenses, but we think the inclusion of other SG&A in our estimate of GVA is the lesser evil.

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Further reading:

Leading questions on Chinese growth

Why China must automate

The impact of a slowing Chinese economy

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

November round-up: Global outlook

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