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China's economy in 2023

How far will the shift from politics to pragmatism go?

The end of the zero-Covid policy will be key to China's economic fortunes this year. Signs of a reining in of political control over the private sector will also have a bearing.

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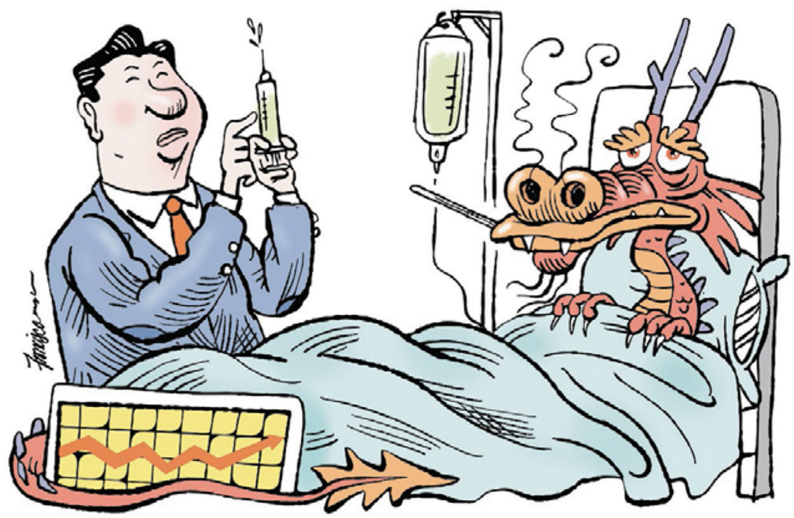

The pictures Chinese President Xi Jinping puts up on his bookshelf during his traditional New Year's speech provide rich food for thought for China watchers. This year, the most prominent new pictures were that of President Xi with his two predecessors Hu Jintao and Jiang Zemin – perhaps to assuage rumours that the unceremonious removal of Mr Hu at the closing session of the 20th Party Congress in October signalled a split in the party.

Also featured was Mr Xi Zhongxun, Mr Xi's father, with then President Jiang. Xi the elder was a prominent reformer under Deng Xiaoping, who piloted China's most successful special economic zone, Shenzhen. In his speech, President Xi also lauded Mr Jiang, who died on Nov 30, for the "great legacy" he left behind, perhaps referring to the Three Represents, the notion that entrepreneurs and intellectuals can also be part of the party alongside farmers, workers and soldiers.

Mr Xi for the first time acknowledged that life under China's Covid-19 policies for the past three years had been tough, saying: "It has not been an easy journey for anyone."

He even seemed to have some reconciliatory words for the protesters against the policies. "Ours is a big country. It is only natural for different people to have different concerns or hold different views on the same issue," he said, but also stressing that China is a country that draws strength from unity.

Mr Xi was rather optimistic on the economy. "The Chinese economy has remained the second largest in the world and enjoyed sound development," he said in his speech, and added: "The Chinese economy enjoys strong resilience, tremendous potential and great vitality."

This optimism contrasted with the assessment made by the Central Economic Work Conference (CEWC) on Dec 15 and 16, 2022. This conference, which brings together economic policy managers and experts from government and party, is important towards understanding the policy direction the government will take in the coming year and beyond. While party documents of the Communist Party of China are not known for their introspection of late, the readout of the meeting recognised that not all is well.

"The current basis for China's economic recovery is not yet solid, the triple pressure of demand contraction, supply shock and weakening expectations is still relatively large, and the external environment is turbulent, which has deepened the impact on China's economy." The "triple pressures" had also been mentioned last year, and the situation has hardly improved since. The main task for 2023 is to "seek progress while maintaining stability".

The 2021 conference declared 2022 to be one of stability and stable growth. But that has been upended by the repeated flare-ups of Covid-19 and subsequent lockdowns, the protracted real estate slump and Russia's invasion of Ukraine. All played havoc with the 5.5 per cent growth target set at the March 2022 National People's Congress.

With Covid-19 spiking in the past two months, and the world economy cooling off, China should be happy with 3 per cent growth in gross domestic product for the year.

WHAT HAPPENS AFTER ZERO COVID?

The dramatic about-turn in China's Covid-19 policies will likely be the most decisive event for China's economy in 2023.

The dire state of China's economy in the last quarter of 2022 was no doubt a major factor in the decision to change the policy, along with the protests of people frustrated with the "20 measures" of Nov 11, a guide to the easing of the zero-tolerance policy. Of course, as the all-important 20th Party Congress was out of the way, gone too was the political reason to stick to the zero-Covid policy.

No doubt, the abrupt change in policy is causing more casualties, and enormous strains on the medical system, as "China's Dr Fauci" Zhang Wenhong said.

Some of this could have been prevented by better planning, such as a vaccination campaign, boosting the intensive care unit capacity and conducting a more gradual process of opening. But all this seems water under the bridge, or, as someone put it: "China went from a zero-Covid policy to zero Covid policy."

The tsunami of infections currently engulfing China further depressed economic activity in the final months of 2022, alongside much human suffering. People stayed at home, and many are too sick to work, causing the simultaneous demand and supply shock that many other countries went through in 2020.

China's December official Purchasing Managers' Index – an indicator for economic prospects – was in deep contraction territory, and showed its second-lowest reading in history, beaten only by the lows registered during the height of the global financial crisis of 2007-2008.

The situation is fluid, though. Monitoring the Covid-19 situation has become more challenging with the shelving of regular tests and unusual reporting on the number of deaths, which remains miraculously low.

However, data on traffic congestion and metro ridership in the largest cities suggests that the worst of the infection wave is over. This could mean an impending rebound in household consumption, which had dragged down growth last year. Indeed, household savings deposits are overflowing, and some of this will likely be spent once the Covid-19 situation improves.

SUPPORTING THE PROPERTY SECTOR

After the 20th Party Congress, the Chinese government also moved more aggressively in addressing the property downturn. The supportive measures from the banks have de facto reversed the Chinese regulators' "three-red line" policy to limit borrowing of real estate firms, and it will take time for buyers' confidence to return.

Moreover, structural factors such as demographics and slower urbanisation may mean that it is indeed different for the sector this time, and that China will end up with a smaller property sector and a very different one than that now.

The read-out from the CEWC recognises the importance of stabilising the property sector. The "housing is for living in" mantra is repeated, but the need to stabilise the current market and ensure housing for those who pre-paid for their homes is recognised, as is the need for a rental market.

Nevertheless, the most recent numbers show a levelling off in the decline in sales: In December, housing sales in the 30 biggest markets were 27 per cent lower than a year before, a slight improvement from the 30 per cent decline registered in November.

The CEWC promises a continuation of "proactive fiscal policies" and "prudent monetary policies" for 2023 – the same as for 2022. Though the dust on 2022 has not yet settled, fiscal policies were again a bottleneck in delivering on domestic demand. The impact of the real estate decline, tax reductions and weak consumption on local government revenues constrained spending, despite an increase in central government transfers.

There was also only lukewarm uptake of the bonds quota by local governments. Thus, to make fiscal policies truly proactive, major fiscal system reforms are needed, which for now are not on the books.

PRIORITIES ON REFORM

As for reform priorities, the 2022 CEWC mentions five: expand domestic demand; accelerate the construction of a modern industrial system; earnestly implement the "two unwavering" (that is, support for public and private sectors); make greater efforts to attract and utilise foreign capital; and effectively prevent and defuse major economic and financial risks. Not numbered in the document is a sixth priority – to comprehensively promote rural revitalisation and prevent a large-scale return to poverty.

These priorities have a distinctly different tone from the one set for last year. First, there is no mention of common prosperity, which was one of the priorities for 2021.

Second, the tone towards the private sector seems very different from the previous report. The emphasis on state-owned enterprise reforms and the encouragement of foreign direct

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investment by further reducing the negative list are a departure from the previous CEWC report, which derided the "barbaric expansion of capital" and spoke of a traffic light system for capital investment, in which the state decided what private enterprises could invest in.

The latest CEWC statement now advocates support for "the development and growth of private economy and private enterprises in terms of policy and public opinion".

"Protect the property rights of private enterprises and the rights and interests of entrepreneurs in accordance with the law. Leading cadres at all levels should solve problems for private enterprises, do practical things and build transparent political and business relations," it adds.

Even the online platform companies, the bogeymen of the "common prosperity" crowd, are getting a better press: "It is necessary to vigorously develop the digital economy, improve the level of normalised supervision and support platform companies in leading development, creating jobs, and showing their talents in international competition." Perhaps it is still too early for technopreneur Jack Ma to move back from Tokyo where he had retreated to after his run-ins with the Chinese government, but the politics seems to have changed.

Indeed, the politics has changed with the 20th Party Congress. Perhaps politics is no longer in command of economic policy, and the practical approach that China's success was built on is seeing a comeback. As the CEWC puts it: "Use practice as the standard for testing the effectiveness of various policies and work."

The CEWC may just be "sweet talking the private sector", as former editor of the South China Morning Post Wang Xiangwei wrote in his Substack post. The decisions on Covid-19 policy, the real estate market and the language in the CEWC read-out suggest something more. The proof of the pudding will be in the eating.

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