Trend Analysis and Assessment Report

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CMC Director: Scott Boster
Report Author(s): Scott Boster

China seeks to improve domestic market as economy stabilizes

Key Takeaway
During 2021, China experienced significant export growth due to increased demand for home electronic appliances, which it was able to fulfill. Despite the significant trade surplus [1], the domestic market was stagnant. This was evident when looking at the Singles' Day retail sale (China's highest retail sales event), and the decision by the People's Bank of China (PBOC) to cut interest rates [2] to stimulate property sales, which were also down in 2021. The lack of consumer spending likely due to the increased lockdowns, a method used to achieve China's zero-COVID policy.

Trend Pattern
A series of recent events indicate China is attempting to augment its domestic market, as economic growth stabilizes.

- On February 5, Argentinian President Alberto Fernandez visited Beijing to sign an agreement for Argentina to join China's Belt and Road Initiative (BRI) [3]. China's presence in Latin America is likely to help strengthen its shortage of resources, by allowing it to taking advantage of the continent's richness in oil and agricultural products. This project is likely an effort to fulfill China's goal of creating more green energy and to compete with US influence in Latin America. Producing more green energy, such as coastal nuclear plants, is part of China's 14th five-year plan.

- On February 17, officials from the European Union (EU) met with 40 African leaders to draw up plans for investment in Africa, totaling about US $340 billion [4]. The US $170 billion seven-year infrastructure plan is a large commitment to African infrastructure compared to China's US $21.7B investment over its most recent five-year plan (2015-2020). Competitive EU foreign direct investment may curtail China's ability to expand the BRI in Africa, which could lead to a higher cost in raw materials imported by China.

- Online sales on Singles' Day, China's largest online shopping day, displayed a decreasing growth rate in sales. Chinese online sales giant Alibaba, the largest online sales platform in China, displayed a mere 8.5% growth rate in sales, compared to the 26% growth rate from 2019-2020 [5].

- China's real-estate investment is dropping. Cumulative growth for real-estate investment fell from 15% to 4.4% in Q4 2021 [6]. To attempt to correct this trend, the PBOC cut interest rates on loans.

- China's Sinopharm and CoronaVac vaccines are only about 51% effective against COVID-19 [7]. This has led to lockdowns, which damage retail sales as seen during Singles' Day in 2021, which occurred shortly after a wave of the Delta variant swept through China.

- China's Gross Domestic Product (GDP) grew 8.1% in 2021 [8], which was more than the government's stated goal of 6%, and higher than its 2.2% growth in 2019 and 5.95% growth in 2019. This growth is largely due to China's larger trade surplus of US $676.43 billion in 2021. For reference, trade surplus in 2020 was US $523.99 billion [9].

- Inflation is expected to reach 2.2% in 2022, compared to 0.9% in 2021, and is expected to stabilize at 2.1% in 2023 [10].

Assessment
China is very likely to continue to take measures to improve the domestic market and maintain a positive trade surplus, such as outsourcing for labor and raw materials via the BRI, adjust interest rates on loans, and continue to invest in e-CNY.

We assess with high confidence that the Chinese government is trying to improve overall economic performance by keeping the same success it has with exports, while promoting consumer spending inside the country, so that the economy is more stable and less dependent on the demands of the global market. China is likely continuing to outsource for labor and raw materials due to its ageing population [11] and lack of rare earth metals. The government is likely adjusting interest rates to assist small businesses, which have struggled to survive during the waves of lockdowns [12]. We estimate that an expansion of the e-CNY will take place within China in the next 4 years, so that electronic commerce is less reliant on private companies and therefore more stable and manageable by the Chinese government.

Broader Implications
A stronger domestic market would make China less susceptible to being affected by fluctuating global demand. A more balanced economy would also enable China to be less affected by sanctions and tariffs, due to an ability to offset external factors by increased domestic tax revenue. A more independent Chinese economy would decrease the ability of the US to use sanctions or tariffs as a negotiating tool.

China's decision to continue to use lockdowns, despite the evident negative effect these have on its economic performance, will likely continue to produce supply chain disruptions, which will in turn continue to affect the US, just as they have been in recent months.

Additionally, a nationalized digital currency may decrease China's reliance on SWIFT for international trading. This would decrease China's reliance on Europe and the US to maintain the ability to trade with other countries.

Indicators
We will be watching for the following actions to determine changes in China's economic performance: changes in yuan inflation; future investment and expansion of the BRI; retail sales; export trends; and the performance of the e-CYN. Yuan inflation will indicate the strength of China's currency compared to the US dollar. Activity in relation to BRI will allow us to monitor China's influence on participating partners and will allow us to monitor changes in labor and raw material cost which, will affect export costs. Performance of the e-CYN will allow us to watch China's ability to control electronic commerce and collect consumer data within its borders.

Sources

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