2023: China's Weak Recovery And 2024: Supply Chain Adjustment

Asia-Pacific Chief Economist Louis Kuijs' Year-End Blog

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For the final 2023 edition of our Essential Economics Newsletter, we asked each S&P Global Ratings chief economist to share insights on following questions:

- What was the biggest surprise for you in 2023 and what are the takeaways?
- What will you be watching most closely in 2024, and why?

2023: China's Weak Post-COVID Recovery

The post-COVID recovery didn't last. The Chinese economy initially bounced back in early 2023 after Beijing relaxed its pandemic lockdowns and eased up on financial restrictions targeting developers at the end of 2022. But the property sector downturn remained a drag on confidence and consumption. And the shadow of the pandemic continued to hang over consumer spending with people worried about their jobs and the economy, and some were slow to return to their pre-pandemic lifestyles.

Weak business confidence also reflects worries about the stance of the government vis-à-vis the private sector and the impact of geopolitical friction. The situation was aggravated by an ill-timed reduction in government spending in the second quarter. Recent months have seen some improvement in economic momentum, especially for consumption. But prospects remain modest. We expect a moderate pick up in consumption growth in 2024 and overall GDP growth of 4.6%.

Takeaways: Lockdowns and restrictions can affect people's behavior and confidence in a major way, even after restrictions have been removed. That has been the case both with China's COVID restrictions and the financial tightening in the property sector.

2024: Will Supply-Chain Adjustment Speed Up?

Despite a lot of discussions and plans by companies, the actual shift of manufacturing activity from China to other Asian emerging markets has been modest so far. China's manufacturing sector is fundamentally quite competitive. Such shifts take time because conditions elsewhere are sometimes less conducive than expected and sophisticated supply chains require a landscape of suppliers and skilled employees.

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The Asian economies' share of total exports in the region did not change much through September (see chart 1). The most significant increase took place in Indonesia, but that reflects investment in green-transition commodity mining and processing, rather than manufacturing.

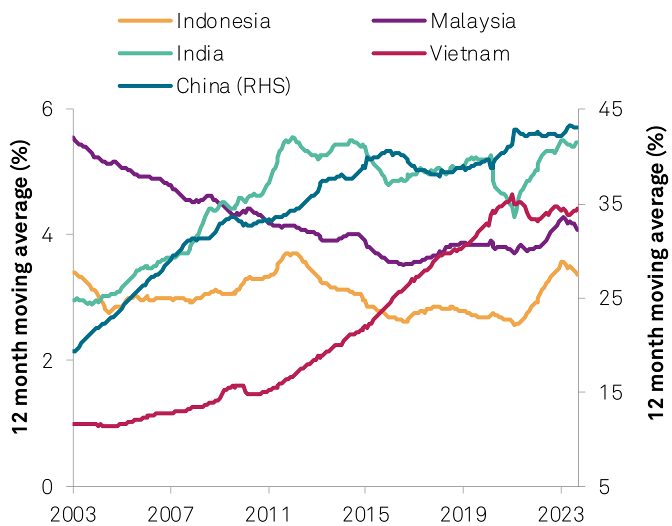
China's share of inward foreign direct investment (FDI) into Asia has declined fast in 2023, according to balance-of-payment data (see chart 2). Yet only the financial centers Hong Kong and Singapore have seen a substantial increase in their shares. That likely in part reflects temporary transfer of funds to benefit from higher interest rates than in China. It could also point to the first stage in a process to shift financial resources away from China.

What to watch: I will be closely watching the evolution of exports and FDI in Asia, since this trend will inform both our short- and long-term outlook for the Asian economies. My impression is that more supply-chain adjustments are likely, especially as regards production for exports to the U.S. But the manufacturing shift out of China will remain more modest than many observers expect.

Chart 1

Export market shares haven't changed much

Share of total Asian exports

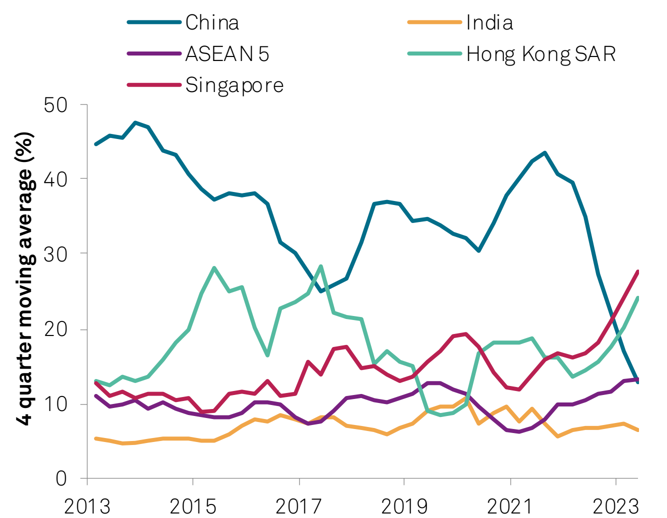


RHS--Righthand scale. Sources: CEIC. S&P Global Ratings.

Chart 2

Inward FDI share has not risen much in EMs

Share of total Asian inward foreign direct investment



EM--Emerging markets. FDI--Foreign direct investment. ASEAN 5--Indonesia, Malaysia, the Philippines, Vietnam, and Thailand. Sources: CEIC. S&P Global Ratings.