23-34 | Dec 2023

中国金融四十人研究院
CHINA FINANCE 40 INSTITUTE

CF40 Policy Brief

China's Current Account Surplus May Further Narrow in 2024

Sun Zihan
CF40 Institute

Zhu He
CF40 Institute

Abstract: Against the backdrop of shrinking marginal demand overseas and the domestic economy converging towards potential growth, our projection for China's current account surplus in 2024 stands at $201.2 billion, marking a reduction of approximately $45 billion compared to 2023. On the one hand, exports are expected to persist in a strategy of 'quantity over price,' where the growth in export quantity is offset by deteriorating trade conditions, resulting in a decline in the goods trade surplus. On the other hand, there is a high probability of an increase in the service trade deficit, possibly approaching levels observed in 2019. Despite the inverted yield curve domestically and internationally, which usually leads to a reduction in the income deficit, it remains insufficient to fully offset the decline in the aforementioned surplus. However, in terms of exchange rate, more surplus does not necessarily imply less pressure, while a declining surplus does not necessarily exacerbate the pressure. In fact, a larger surplus may correspond to a greater level of exchange rate pressure.

The English version is post-edited machine translation. In case of any discrepancy or ambiguity between the English and Chinese versions, the Chinese version shall prevail.

From January to October 2023, China witnessed a significant reduction in its current account surplus compared to the same period in 2022. On one front, the tightening of monetary policies by central banks in developed countries resulted in a marginal contraction in external demand. Simultaneously, the domestic economic recovery spurred an increase in import demand. Meanwhile, there was also the deterioration of trade conditions. As a consequence, from January to October 2023, China's cumulative surplus in trade in goods decreased by $73.6 billion compared to the corresponding period in the previous year.

On the flip side, with the normalization of cross-border travel, the deficit in service trade saw a substantial increase, rapidly drawing close towards pre-2020 trends. Between January and October 2023, China's cumulative deficit in trade in services exceeded that of the same period in 2022 by $108.1 billion. When combining these factors together, the cumulative surplus in both goods and services trade in China decreased by $181.7 billion from January to October 2023, relative to the same period in the previous year. Considering the balance between primary and secondary income, China's projected current account surplus for 2023 was expected to decrease by $150-170 billion compared to 2022, falling within the approximate range of $235-255 billion.

Looking ahead to 2024, the restraining effect of a tightening monetary policy on overseas demand is likely to persist, while domestic demand will hinge on the intensity of policy measures. We conducted calculations based on a series of assumptions to estimate the balance of trade in goods and services in China to show the variances under different scenarios. Building upon these calculations, we discussed the macroeconomic policy implications.

I. ESTIMATING EXPORT GROWTH AND SCALE IN 2024

(I) Quantity of Exports

In terms of external demand, international organizations project a year-on-year growth rate of 3.2-3.4% for global commodity trade volume in

2024. The WTO predicts a potential 3.4% expansion, attributing this to the heightened sensitivity of capital and durable goods, pivotal components of trade that respond keenly to business cycles. Moreover, against the backdrop of the low base in 2023, there is notable potential for growth. Simultaneously, the IMF forecasts an actual growth rate of around 3.2% in commodity trade for the upcoming year. Despite an improvement from the current year, this growth rate remains historically subdued, reflecting the drag on global trade due to factors such as the contraction of global demand, the appreciation of the U.S. dollar, and uncertainties associated with fragmentation. **Based on these predictions, we anticipated a year-on-year growth rate of approximately 3.3% for global commodity trade volume in 2024.**

Concerning market share, data from the Netherlands Bureau for Economic Policy Analysis (CPB) for the latter half of 2022 indicates that, as overseas production orders gradually recover and global supply chain challenges ease, China's export substitution effect has weakened, resulting in an actual export share dipping below 13%. However, this year, due to the sustained lag in domestic demand growth, Chinese export enterprises have generally embraced a "quantity for price" strategy to secure overseas markets. This has led to a consistent uptick in export share, with China's actual export share rebounding to 14.1% as of August. The average export share from January to August stands at 13.8%, closely aligning with the 2021 level. In the baseline scenario, we anticipated the "quantity for price" strategy would persist in the next year, suggesting that China's actual export share would further rise in 2024. Drawing from the experience since 2020, we assumed that China's actual export share would increase from 13.8% to 14.0%. **Factoring in both total quantity and share, the estimated growth rate of China's export in 2024 under the baseline scenario would be 4.4%.**

(II) Export Prices

We classified goods for exports into two categories: those with notable price fluctuations, encompassing raw materials and intermediate goods such as energy commodities, basic raw materials, and agricultural products, constituting roughly 12.7% of China's export share. Prices for these goods can be referenced from international market futures prices. The second category predominantly includes capital goods and consumer goods, making up about 87.3% of China's export share. The export prices of these goods are intricately tied to the production costs and sales strategies of enterprises. Our forecast for China's export prices in the upcoming year involves a three-step approach.

First, export goods were categorized by national economic industries. Specifically, agricultural, forestry, animal husbandry, and fishery industries, petroleum, coal, and other fuel processing industries, mining, black metal smelting, and rolling processing industries, as well as non-ferrous metal smelting and rolling processing industries, correspond to agricultural products, petroleum, copper, aluminum, iron, and other energy and basic materials. Prices for these goods can be referenced from the price predictions of international organizations. For export goods from other industries, we placed greater emphasis on domestic production costs, aligning with the year-on-year growth rate of the producer price index (PPI) for the respective industries.

Moving to the second step, we used the Producer Price Index to forecast the export price growth of capital goods and consumer goods in 2024. Specifically, the PPI growth of each manufacturing subsector since 2021 was applied to do a regression on the export price growth rate so as to obtain the regression coefficients. Then assuming that the magnitude of price change for each industry next year would be equal to the mean level of this year, we predicted export prices for the corresponding industries based on the regression equation.

Third, taking into account of the average export share for each industry up to this point in the year, we calculated the overall price growth for export goods. **Our prediction indicated that China's export price growth in 2024 would be approximately -5.5%.**

(III) Forecast Results

Based on the above calculations, under the baseline scenario, China's exports are poised to continue the "quantity for price" trend next year,

characterized by an increase in quantity but a decrease in price. The growth rate of China's export value is about -1.0% in 2024. If China's total annual export in 2023 amounts to around $3.38 trillion, **then under the baseline scenario, the anticipated goods export in 2024 would amount to approximately $3.3458 trillion.**

II. ESTIMATION OF 2024 IMPORT GROWTH AND SCALE

(I) Import Quantity

The actual growth of imports is predominantly shaped by the pace of domestic demand. To project China's actual import growth for 2024, we looked into the growth rates of actual consumption and investment. We gauged domestic consumption using the growth rates of social retail sales of consumer goods and final consumption expenditure. Domestic investment was assessed with total fixed asset investment and total capital formation. Real growth rates of social retail and fixed asset investment were derived by the Consumer Price Index (CPI) and Producer Price Index (PPI) with adjustments for price fluctuations using . Similarly, the Import Price Index and the exchange rate were employed to adjust the import growth, yielding the actual import growth.

Taking 2012-2023 as the time frame, we performed a multiple linear regression of actual import growth against consumption and investment growth of various calculation standards, extracting coefficients reflective of domestic demand's impact on imports.

In the first ten months of 2023, China experienced actual growth rates of 6.5% for social retail and 5.5% for fixed asset investment, partly due to base effects. With these base effects no longer in play in 2024, we adopted conservative assumptions regarding domestic demand growth, recognizing that the validity of these assumptions was contingent on policy intensity. **Under the baseline scenario, China's actual import growth in 2024 was projected to be approximately 2.1%.**

(II) Import Prices

In contrast to export goods, the prices of import goods are primarily influenced by international market dynamics. In addition to previously mentioned international commodities, the IMF predicts a 2.3% year-on-year increase in prices for manufactured products and a 2.7% decrease in prices for other non-energy intermediates. Therefore, for major raw materials, intermediates, and capital goods which accounts for around 87.2% of China's total import value, we can rely on the IMF's price predictions.

For consumer goods sectors lack of international price predictions, we observed a strong correlation between import price growth rates and domestic PPI growth rates since 2021 in industries such as textiles, wood processing, paper, and paper products. Motivated by this, we adopted a similar approach, conducting a regression of import price growth on PPI growth to derive coefficients. These coefficients could then be applied to estimate changes in import prices of respective industries. Consequently, we calculated the import price growth rates for various industries in 2024. **Considering the average import share for each industry this year, China's import price growth in 2024 was estimated to be approximately -0.6%.**

(III) Forecast Results

Summarizing the above results, growth rate of China's import amount in 2024 was projected at approximately 1.5%. If China's total goods import in 2023 is around $2.55 trillion, then under the baseline scenario, **goods import in 2024 would be approximately $2.5956 trillion.** Considering the forecast for export amounts, **under the baseline scenario, China's goods trade surplus in 2024 was estimated to be approximately $750.2 billion, reflecting a decrease of about $72.9 billion compared to the trade surplus in 2023.** All discussions above are based on Customs statistics.

Table 1: Forecast of China's Goods Import and Export Growth Rates and Amounts in 2024

	Actual Growth Rate	Price Adjustment	Nominal Growth Rate	Amount (Billion USD)
Goods Export	4.4%	-5.5%	-1.0%	33458
Goods Import	2.1%	-0.6%	1.5%	25956
Goods Trade Surplus				7502

Data Source: WTO, IMF, General Administration of Customs of China

Due to disparities between the goods trade amounts in the balance of payments and the customs data, it is necessary to convert the above forecast results into the balance of payments framework. In the first ten months of 2023, the goods trade export in the balance of payments was $2.6098 trillion, and the import amount was $2.1107 trillion. In contrast, according to customs data, goods export and import amounts were $2.792 trillion and $2.108 trillion, respectively. **If we converted these amounts based on the ratios of export to export and import to import, the estimated goods trade export amount in China's balance of payments for 2024 would be approximately $3.1274 trillion, and the import amount would be around $2.5989 trillion. Consequently, goods trade surplus in the balance of payments would be approximately $528.5 billion.** Extrapolating further, if we applied the conversion ratios from 2021 or 2022, the goods trade surplus in China's balance of payments for 2024 would become $600.8 billion or $544.4 billion, respectively.

III. ESTIMATION OF CHINA'S SERVICES TRADE BALANCE IN 2024

Service trade includes 12 sub-accounts such as processing, maintenance and repair, transportation, and more. In terms of the scale of service trade, the portion related to goods trade accounts for over 50% of the total, and the import and export amounts of these items show a strong correlation with goods import and export. China's service trade deficit increased annually before 2020, reaching nearly $300 billion at one point. Tourism was the largest contributor to China's service trade deficit, constituting over 80% of the total deficit. After 2020, China's service trade deficit significantly reduced, primarily due to a substantial decrease in the deficit under the tourism category. Over the past three years, China's deficit in travel service trade decreased by approximately 50% compared to 2019. We categorized the 12 service trade items into three groups and estimated their balances for the upcoming year.

The first group includes service trade items related to goods trade, such as transportation, insurance and pension services, financial services, intellectual property usage fees, telecommunications, computer, and information services, as well as other business services. We used the amounts of goods import and export to regress the debit and credit amounts of these items separately and predicted the service trade balances for these items. As mentioned earlier, with the forecasted import and export growth rates of -1.0% and 1.5% in 2024, we predicted that the balance for this part of service trade items would be approximately -$87 billion.

The second group involves service trade items related to cross-border consumer spending by residents, mainly travel and cultural and recreational services. With economic activities returning to normal, the deficit in this category of service trade is expanding rapidly, and the annual deficit is expected to reach 90% of the 2019 level. Therefore, as international travel continues to recover, and residents' cross-border entertainment consumption is expected to remain high, the service trade deficit for travel and personal entertainment items in 2024 is anticipated to expand to approximately -$199.3 billion.

The third group encompasses other service trade items, including processing services, maintenance and repair services, construction, and government services not elsewhere mentioned. The service trade balances for these items do not show a clear trend, are less sensitive to external shocks, and account for a smaller share, around 10% of the total service trade amount. Thus, we assumed that the balance for other service trade items would slightly increase to $23.4 billion in 2024.

In summary, we predicted that China's service trade deficit in 2024 would be approximately $262.9 billion. Combining the above calculations, under the balance of payments framework, the forecasted trade surplus for both goods and services in China in 2024 was estimated to be approximately $265.6 billion.

IV. ESTIMATION OF CHINA'S BALANCE OF PRIMARY INCOME AND SECONDARY INCOME IN 2024

The current account also includes the accounts of primary income and secondary income. Primary income refers to the returns obtained from providing services, financial assets, and renting natural resources, including employee compensation, investment income, and other primary income. The majority of the primary income balance comes from investment income, namely profits, dividends, reinvestment income, and interest generated from financial asset investments. Over the past three years, we observed significant fluctuations in the credit and debit amounts under the investment income category, with varying impacts on funds related to employee compensation. Other primary income was less affected and accounted for a relatively low proportion. Considering the higher interest rates abroad, based on the current balance and changing trends in the domestic and international environments, we estimated that next year's deficit in investment income would continue to converge to $99 billion, while the surpluses in employee compensation and other primary income would slightly increase to $18.7 billion and $3.3 billion, respectively. This would result in a narrowing of the overall deficit in primary income to $77 billion next year.

In addition, the secondary income account also recorded routine transfers, including cash and goods, such as international cooperation between governments and remittances between residents. Transactions under this item exhibited more significant fluctuations, making it challenging to observe stable long-term trends. Considering recent changes in fund flows, we assumed that surplus in secondary income would slightly decrease to $12.5 billion next year.

Combining the above forecast results, the total deficit in primary income and secondary income for China in 2024 was estimated to be $64.4 billion. Adding this to the surplus in goods and service trade, China's overall current account surplus in 2024 was expected to be approximately $201.2 billion, a decrease of about $45 billion from 2023. The decrease could be attributed to a decline of $48.8 billion in goods, a fall of $34.6 billion in services, and an increase of $38.2 billion in income.

The baseline scenario assumes that China's economy will continue to converge towards potential output at the current pace, and overseas demand will continue to contract marginally due to the inhibiting effects of high interest rates. If the macroeconomic backdrop on which the forecast relies undergoes changes, it could disturb the forecast results. Here, we presented two scenarios worth considering.

Scenario One: If overseas demand remains strong next year, but there is increased contraction pressure from the domestic real estate and local government sectors, resulting in a noticeable drag on the domestic economy from real estate and infrastructure investments, trade conditions will significantly worsen. In this scenario, **China's export growth in 2024 may decline to -1.9%, import growth at -0.1%, and the service trade deficit at $249 billion. The corresponding trade surplus is estimated to be around $292 billion, a reduction of approximately $57.1 billion compared to 2023. Adding the deficits in primary income and secondary income, the current account surplus in this scenario is about $249.7 billion, roughly comparable to the 2023 current account surplus.**

Scenario Two: If overseas demand remains strong next year, and domestic macroeconomic policies show significant effectiveness, with the stabilization of the domestic real estate sector and a faster recovery in domestic demand driven by multiple factors, trade conditions are expected to improve. In this scenario, **China's export growth in 2024 may reach -0.5%, import growth at 2.6%, and the service trade deficit at $273.9 billion. The corresponding trade surplus is estimated to be around $242.9 billion, a reduction of approximately $106.2 billion compared to 2023. Adding the deficits in primary income and secondary income, the current account surplus in this scenario is about $148.4 billion, a significant reduction of approximately $98 billion compared to 2023.**

Table 2: Forecast of China's Current Account Surplus in Three Scenarios

	Baseline Scenario	Scenario 1	Scenario 2
Export Growth Rate	-1.0%	-1.9%	-0.5%
Import Growth Rate	1.5%	-0.1%	2.6%
Service Trade Deficit (Billion USD)	2629	2490	2739
Goods and Service Trade Surplus (Billion USD)	2656	2920	2429
Primary Income and Secondary Income Deficit (Billion USD)	644	423	945
Current Account Surplus (Billion USD)	2012	2497	1484

Data Source: WTO, IMF, General Administration of Customs of China, and State Administration of Foreign Exchange

V. CONCLUSION AND IMPLICATIONS

The above calculations may have three policy implications.

Firstly, even though China's goods trade surplus is decreasing in the baseline scenario, the net export of goods is still playing a role in driving

GDP growth as the actual growth of export is faster than import. The logic behind this is that the worsening trade conditions offset the actual changes in trade surplus, causing the nominal value of the trade surplus to decrease.

Secondly, there is a high probability that China's current account surplus will decrease in 2024. Two factors are at play here. First, as outbound tourism demand gradually recovers, the service trade deficit is likely to increase. Second, in both the baseline scenario and scenario one, trade conditions will continue to deteriorate, offsetting the improvement in actual export growth.

Finally, a higher surplus in 2024 may lead to increased exchange rate pressure. Scenario two implies a significant improvement in domestic macroeconomic conditions. Historically, China experiences less capital outflow pressure when the economic conditions are strong. In this scenario, China can maintain a trade surplus of over $200 billion in goods and services, providing support to the Renminbi exchange rate. However, people must the cautious with scenario one. In this case, although the current account surplus is the highest among the three scenarios considered, the recession-type surplus under conditions of sluggish domestic economy and worsening trade conditions may exert greater pressure on the Renminbi exchange rate.

中国金融四十人研究院
CHINA FINANCE 40 INSTITUTE

Disclaimer