Marketing Communication

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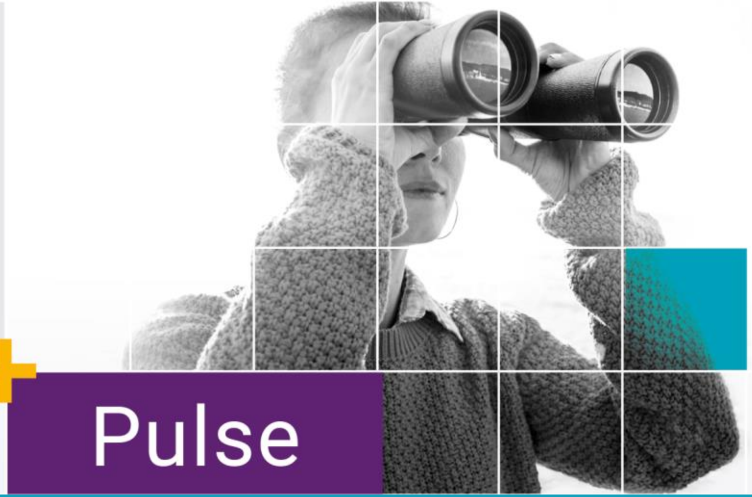


Pulse

Global Market Strategy, NIM Solutions | **March 2024**

China: a long way to go

China recently held its 2024 National People's Congress, where policy makers announced a 2024 GDP growth target of around 5%, along with their set of new economic targets. Achieving these targets will be challenging in a context where China's structural growth is slowing (see Table 1).

Table 1: China's NPC Key Economic Targets
(Source: Bloomberg & NIM Solutions)

Year	Growth	CPI	Fiscal Deficit	Local Gov. Bond Quota (RMB tn)
2021	Above 6.0%	3.0%	3.2%	3.65
2022	Above 5.5%	3.0%	2.8%	3.65
2023	Above 5.0%	3.0%	3.8%	3.80
2024	**Above 5.0%**	**3.0%**	**3.0%**	**3.90**

While the central government have pledged to address both insufficient domestic demand and overcapacity in certain industries, the new fiscal deficit target of 3.0% is significantly lower than the target of 3.8% in 2023. In addition, given that the GDP growth target is the same as last year, this equals to a fiscal contraction in terms of GDP. Somewhat encouraging however was to see Prime Minister Li Qiang announcing the issuance of RMB 1 trillion (USD 139 billion) of ultra-long special central government bonds this year. But still, the overall size of fiscal deficit remains below market expectations. This prudent fiscal stance reflects an effort to contain local government debt risks at a time when local governments keep struggling with their debt burden (see our 1123 Pulse – Unravelling China's Structural Challenges).

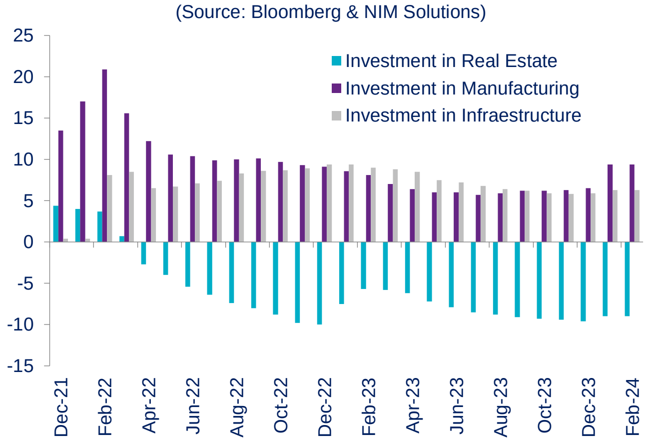
Overall, in a way, it was encouraging that policymakers set another ambitious growth target since lowering the target would have further weakened an already weak economic confidence. But we do not expect major changes in the larger economic policy agenda given that stability remains the key priority amidst major structural and cyclical challenges.

China's two-pace recovery and its consequences

China's economy has been experiencing a two-pace recovery since the end of last year. One is relatively strong, driven by manufacturing, infrastructure investment, and robust exports. While the other one is weaker, consisting of consumer related sectors like retail sales and property investment (see Figure 1). Industrial output in January-February came in at the fastest in two years and significantly exceeding estimates, the biggest driver being exports as they benefit from price reductions. On this note, however, we do have reservations about the sustainability of this strength, as exporters should have limited room left to continue lowering prices.

But still, external demand has been much stronger than domestic demand, which is a departure from previous cycle downturns and the recovery seen in other major economies like the US. As a result, the industrial sector has been replacing property as the main growth driver of China. This strong industrial demand coupled with the reluctance of the central government to use excessive leverage, has led to overall policy stimulus to be slower than in previous cycles, which in turn has exacerbated the downturns in the consumption and property sectors.

Figure 1: China's Fixed Asset Investment Breakdown – YoY
(Source: Bloomberg & NIM Solutions)



This two-pace recovery has created various problems. Stronger production than consumption has accentuated oversupply and deflation, in stark contrast to the situation in other major economies. As China tries to export its excess capacity, these exports are becoming a growing global disinflationary force, increasing the risk of trade tensions, especially with Europe and the US. Moreover, weak income prospects continue to weigh on Chinese consumers' confidence and in turn to reduce their risk appetite among, leading to a flight to safety in the form of bonds and bank deposits (+36% in two years according to IMF figures), rather than investing in real estate as in the past.

Chinese policymakers have been reluctant to increase central government leverage, relying instead on enterprises, local governments, households, and banks to drive growth. However, this time it will be more difficult for these economic agents to play the same role as in the past, given existing debt burdens and tighter regulations on local government financing vehicles (LGFVs). Therefore, as last year, when the final fiscal deficit was around 4.6% (against a target of 3.8%), it is likely that the central government will have to take on a greater role through fiscal stimulus to reach the 5% growth target.

While the government's market stabilization measures have helped to lift investor confidence since early February, we remain negative on China. We believe there is still a long way to go before both investors' confidence and overall fundamentals are restored in any sustainable manner.

Sources: Bloomberg & NIM Solutions. Data as of March 19, 2024.