CHINA IN 2025: TEMPORARY ADJUSTMENT OR STRUCTURAL REBALANCING OF ECONOMIC GROWTH DRIVERS?

The message delivered by Beijing at the annual meeting of the National People's Congress at the beginning of March was clear: whatever the difficulties linked to trade and technological rivalries with the United States, the Chinese economy must achieve growth of close to 5% in 2025. The target has remained unchanged since 2023. It seems particularly ambitious this year, given that external demand, the driving force behind Chinese growth in 2024, is set to weaken significantly due to the rise in protectionist measures against China. The authorities are counting on domestic demand to pick up the slack, but this is still coming up against powerful obstacles. The authorities have announced further monetary and fiscal policy easing, as well as various initiatives to stimulate private consumption in the short term. However, the measures envisaged may not be sufficient to rebalance lastingly the sources of Chinese growth.

The export engine is likely to stall soon. Exports, which drove economic growth in 2024, are likely to be quickly penalised by increases in US customs tariffs. Of course, China will continue to apply its defence strategy, which has been successfully implemented since Trump's first term in office. This strategy involves redirecting goods flows and diversifying trade partners (see *chart 1*), relocating part of production to connector countries in order to circumvent tariffs, and government support for the manufacturing sector. However, the protectionist shock under Trump 2.0 will be greater than the first: the tariff hikes aimed at China will be higher (+20 pp already applied to all goods since 20 January) and the US is likely to start targeting some of the connector countries soon. The European Union and other third countries could also step up measures to protect their markets from Chinese competition, which is affecting an increasingly wide range of goods.

In addition, the central bank has less room for manoeuvre to depreciate the yuan, and thus offset the effects of the new tariffs, than it did in 2018-2019. Moreover, Chinese exporters may be increasingly reluctant to reduce their sale prices after already two years of decline (export prices for manufactured goods fell 15% cumulatively over 2023-2024). Chinese export growth already slowed in January-February.

Private consumption is struggling to recover. Private consumption measured as a percentage of GDP, which fell during 2020-2022, is struggling to recover (it is estimated at 39.4% in 2024, the same level as in 2019). Since September, the measures introduced by the authorities to boost household demand have had very mixed success. Growth in retail sales accelerated slightly, mainly thanks to the government-subsidised consumer goods trade-in programme. Growth in outstanding bank loans to households reached an all-time low in January-February and housing sales, which had stabilised in Q4 2024, have fallen again since the start of the year, despite interest rate cuts and measures to encourage housing demand.

Chinese consumers remain cautious, after more than three years of property crisis that have eroded their wealth (the average price of second-hand homes has fallen by 17% since mid-2021) and because of relatively weak labour market conditions. These conditions have not returned to their pre-Covid situation with, in particular, a higher youth unemployment rate (16.9% in February) and slower growth in wages and incomes. Although consumer confidence indices have improved very slightly since October, they remain at historically very low levels.

CHINA: EXPORTS BY DESTINATION

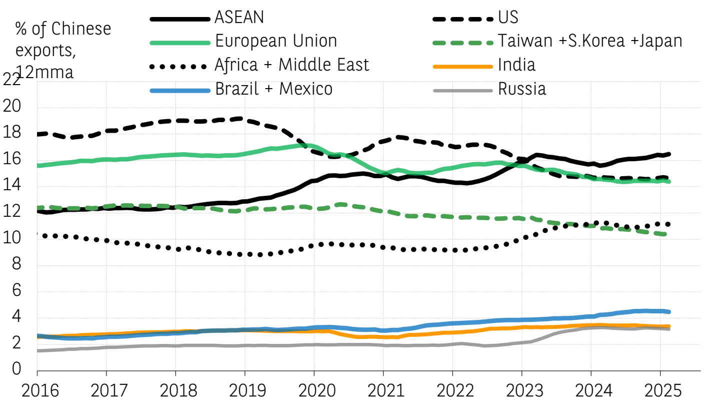

CHART 1

SOURCE: GENERAL ADM. OF CUSTOMS, BNP PARIBAS

Restoring confidence will be difficult in property, but possible in tech. In order to stimulate private consumption, the authorities must first reverse the trends observed since 2020. Firstly, by stabilising the property market. This has been a policy objective since spring 2024 (gradual easing of conditions for access to housing and mortgage credit, increased purchases of unsold homes by local governments to convert them into social housing) and will be maintained in 2025. However, success is uncertain. The continuing correction in house prices could continue to weigh on household sentiment and spending in the short term.

Secondly, by reassuring private players in the service sectors to encourage investment and job creation. In particular, this means stabilising and securing the legal environment. In fact, the President's recent speech in support of private entrepreneurship and the promise of strategic support for tech companies mark a policy change compared with the last five years and the regulatory tightening in 2020-2022. If confirmed, this change will boost innovation and investment, as well as job creation, particularly well-paid jobs and jobs for young graduates.

The root cause of the problem has yet to be addressed, namely the structural causes of weak private consumption. Chinese households consume little because they save a very high proportion of their income: in 2024, their gross savings rate is estimated at 22% of GDP and 36% of disposable income (compared, for example, with 15% of disposable income in the euro zone). A large proportion of these savings are precautionary, due to the high cost of education, housing, pensions and healthcare. The authorities must therefore act on the levers that can support incomes and reduce households' high propensity to save. In particular, this will involve improving the social welfare system, by extending medical cover, increasing retirement pensions, improving redistribution and increasing transfers to the poorest, and continuing to reform the *hukou* system. Urban residents have much better access to public services and a better social welfare provision than rural residents and migrants. A profound change aimed at reducing these inequalities could significantly increase the propensity to consume of more than half the population.

The necessary reforms have been identified and incorporated into the authorities' strategy for several years, but the process of change has remained slow and was interrupted during the COVID years. The household savings rate, which had fallen slowly during the 2010s, has risen again since 2020 (see *chart 2*).

The new "special action plan" to support consumption is falling short of expectations. Beijing has made boosting private consumption one of its priorities for 2025, and has just announced a new action plan. However, on the one hand, this plan contains measures that are already in place and are aimed primarily at increasing household spending on a temporary basis. The subsidies for the consumer goods trade-in program is expected to be doubled in 2025 compared with 2024, financed by the central government to the tune of CNY 300 billion, or 0.2% of GDP.

On the other hand, the new measures announced to increase household income and improve social protection have yet to be specified. The authorities are planning to increase wages and incomes for low- and middle-income households in «various" ways, as well as improve social benefits (health, elderly care, childcare and education). However, the amounts of public spending committed could remain modest, with little lasting impact on household confidence and propensity to consume. This fear can be explained, in particular, by Beijing's long-standing reluctance to prioritise households in its policy to support economic activity, and by the deteriorating finances of local governments. The latter are responsible for over 80% of general budget expenditure, but their revenue has collapsed as a result of the property crisis, which severely restricts their scope for increasing social spending. Finally, the government's special plan includes measures to increase leisure-service activities; this could encourage consumption by wealthier, urban households, but does not solve the problem of weak demand from the rest of the population.

CHINA: HOUSEHOLD CONSUMPTION AND SAVINGS

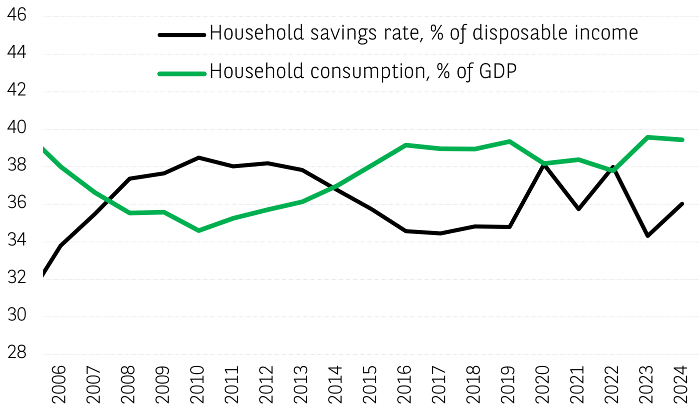

CHART 2 SOURCE: NBS, BNP PARIBAS

While the external environment is deteriorating and exports are beginning to slow, the government is not really changing its strategy to support economic growth. For now, it remains reluctant to increase substantially public spending on households or to propose extensive reforms to the social protection system. The authorities are insisting on the need to strengthen private consumption, but the latest proposed measures could have only a modest effect, without leading to a lasting rebalancing of growth drivers. Beijing needs to present a more precise and more ambitious support plan to convince of a deep change in its economic policy. For the time being, the authorities are continuing to focus on investment, supporting manufacturing production and strengthening innovation to generate productivity gains and guarantee "national security". As a result, on the one hand, the imbalance between increased production capacity and constrained domestic demand could persist, fuelling deflationary pressures. On the other hand, China may remain dependent on its export markets to sustain its growth, with implications for the rest of the world.

Christine Peltier