ADJUSTMENT OF ECONOMIC GROWTH DRIVERS

After a good start to the year, Chinese economic growth will slow down in 2025 due to still weak domestic demand and the effects of the upcoming protectionist shock on exports. China has tools at its disposal to respond to President Trump's new tariff plans, even though its room for manoeuvre to offset the effects of rising tariff barriers with a depreciation of the yuan and a drop in export prices has narrowed compared to 2018. The authorities will continue to ease their monetary and fiscal policies in the short term to stimulate activity and boost private consumption, and try to support a rebalancing of China's economic growth model.

ECONOMIC GROWTH: TEMPORARY STRENGTHENING

Economic growth continued to accelerate in Q4 2024. It reached +1.6% q/q, after +1.3% in Q3 and +0.9% in Q2, and stood at +5% over the year as a whole, exactly in line with the target set by the authorities in March 2024. Growth is expected to remain sustained in Q1 2025, driven, as in the previous quarter, by the good performance of exports and the strengthening of private consumption.

In fact, exports posted strong growth in Q4 2024, both in value (+10% y/y in USD, after +6% in Q3) and in volume (estimated at +12% y/y, after +10% in Q3). This is due to the still aggressive strategy of Chinese companies to gain market share and the fact that US importers have anticipated the hike in tariffs by inflating their orders pre-emptively. This phenomenon is expected to continue in early 2025.

In addition, household demand growth has finally recovered slightly thanks to the stimulus measures implemented since the end of September. Firstly, retail sales growth accelerated (to a modest rate of +3.6% y/y in volume in Q4 2024, compared to +2.2% in Q3), particularly encouraged by the consumer goods trade-in program subsidised by the government. In the short term, this program is expected to remain an essential policy instrument to support consumption; the total amount of subsidies granted amounted to 0.1% of GDP in 2024 and is expected to increase in 2025, and the list of subsidised goods (household appliances, home decoration products, cars, etc.) is expected to be extended to include electronic goods. Secondly, housing sales have increased very slightly y/y since November, after more than three years of contraction (-17% over the first nine months of 2024). This recovery is the result of the continued easing of policies to support housing demand in recent months. However, it does not signal the end of the property crisis. Construction activity continued to fall in Q4, and the average house price continued to decrease (-8.1% y/y at the end of 2024).

Even with a good start to the year, economic growth is expected to resume its downward trajectory in 2025. In our central scenario, it will reach 4.5% this year as a whole. The manufacturing export sector is expected to suffer from the effects of new tariff barriers. In the domestic market, activity will be supported by the accommodative economic policy mix, but it will also continue to face strong constraints (continued property market correction, deflationary pressures, weak confidence in the private sector). As a result, the contribution of net exports to real GDP growth is expected to decline significantly in 2025, while the contribution of total consumption is expected to increase moderately and that of investment is expected to stabilise (*chart 1*). In terms of sectors, the trends observed last year are expected to reverse in 2025, with a slowdown in industrial growth (+5.8% in 2024) and an improvement in services growth (+5.2% in 2024).

Deflationary pressures will continue, fuelled in particular by excess industrial production capacities and the continued fall in housing prices. However, consumer price inflation is expected to pick up somewhat in 2025 (to +0.8% on average, after +0.2% in 2024), thanks to the recovery in household demand and the rebound in food prices.

FORECASTS

	2022	2023	2024f	2025f	2026f
Real GDP growth, %	3.0	5.2	5.0	4.5	4.3
Inflation, CPI, year average, %	2.0	0.2	0.2	0.8	1.0
Official budget balance / GDP, %	-2.8	-3.9	-3.9	-4.0	-3.8
Official general government debt / GDP, %	50.6	54.7	61.0	66.4	70.0
Current account balance / GDP, %	2.5	1.4	1.9	1.6	1.3
External debt / GDP, %	13.7	13.8	14.0	14.2	14.0
Forex reserves, USD bn	3 307	3 450	3 456	3 450	3 450
Forex reserves, in months of imports	12.6	13.2	12.8	12.2	11.8

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CHINA: CONTRIBUTIONS TO ECONOMIC GROWTH

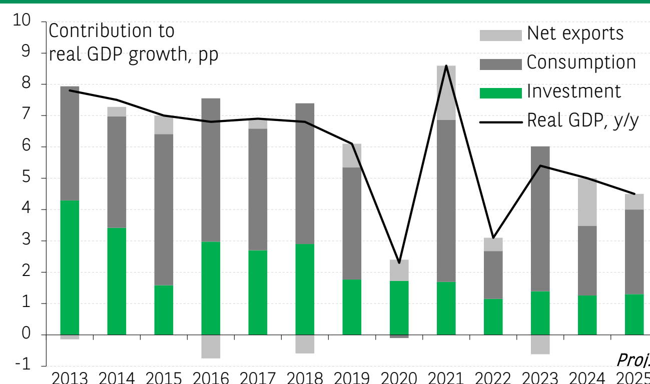

CHART 1 SOURCE: NBS, CEIC, BNP PARIBAS

FISCAL POLICY: PRIORITY GIVEN TO PRIVATE CONSUMPTION?

Since late September, fiscal policy has taken a firmly expansionary turn, which the authorities will maintain in the short term. The main objectives will be to offset the effects of the deterioration in global conditions on economic activity and to strengthen domestic consumption. Policy easing is expected to remain moderate, at least initially, and could be adjusted during the year in response to external shocks.

The budget for 2025 will not be announced until March next year. On the one hand, the authorities have kept some room for manoeuvre to increase deficits thanks to financing at low rates on the local bond markets. The official fiscal deficit in the strict sense is expected to be 4% of GDP (compared to the 3% announced in the 2024 budget), and the general government deficit in the broad sense, as measured by the IMF,

is expected to be close to 8% of GDP (compared to 6.9% in 2023). On the other hand, local government (LG) finances are fragile (notably due to the drop in land sales proceeds for three years and the excessively high level of debt of their financing vehicles). This restricts their room for manoeuvre and will force the central government (CG) to increase its direct role in stimulus measures, as it did in 2024. The official general government debt is expected to rise to 61% of GDP at the end of 2024 (CG debt: 26% of GDP + direct debt of LGs: 35%) and to 66% at the end of 2025. To this direct debt we should add the indirect debt contracted by LG financing vehicles, estimated at nearly 50% of GDP by the IMF (a small proportion of which is being gradually refinanced by LG bond issues).

Regarding fiscal policy tools, the government will continue to place the usual emphasis on public investment, particularly in strategic manufacturing sectors and infrastructure projects. But the authorities also indicated at the Central Economic Work Conference last December that strengthening private consumption would be a priority for 2025. The measures introduced so far have been mainly aimed at stimulating household spending temporarily. Meanwhile, a revaluation of pensions and medical coverage has been announced but has yet to be specified; this will need to be significant so as not to dash expectations. Substantial strengthening of the social safety system would in fact be necessary to improve household confidence, reduce savings rates (estimated at 37% of disposable income in 2024) and durably increase their consumption (which has remained close to 38% of GDP since 2020). This would help change China's economic growth model, which the authorities want to make more balanced and of "better quality", less dependent on property and debt, and contributing to "Common Prosperity".

MONETARY POLICY: EASING UNDER CONSTRAINTS

Since 2020, the central bank has conducted an accommodative monetary policy, officially described as a "prudent" policy. Interest rates have been lowered very gradually (the 7-day reverse repo rate fell to 1.5% at the end of 2024, compared to 1.8% at the end of 2023 and 2.5% at the end of 2019), as have the reserve requirement ratios (to 9.5% for large banks at the end of 2024, vs. 10.5% at the end of 2023 and 13% at the end of 2019). However, growth in total social financing has gradually slowed for two years (to reach 7.9% y/y in Q4 2024, an all-time low), a consequence of the cautiousness of banks and the weak credit demand.

In December, the authorities announced further loosening in monetary policy, which should be "appropriately loose" in 2025. The wording is changing, but the pace of easing is expected to remain gradual, as the central bank's room for manoeuvre is constrained by several factors. The first is the effect of lower interest rates on bank profitability. It has deteriorated over the past five years, due to the slowdown in lending activity, the deterioration in asset quality and the narrowing of net interest margins (which fell to a low of 1.5% on average in mid-2024, compared to 2.2% in 2019). Monetary policy is also constrained by the decline in long-term bond rates and currency depreciation. Treasury bond yields reached historically low levels (1.65% on average in January 2025 for 10-year securities, compared to 2.17% in October and 2.51% in January 2024), reflecting investors' concerns about China's economic prospects and the effects of US tariff hikes.

The RMB depreciated 3.5% against the USD between mid-October and mid-January (spot rate), as a result of the general strengthening of the dollar, the widening of the spread between US and Chinese rates and capital outflows. After intensifying at the beginning of the year, pressures on the yuan have eased since 20 January, and the spot exchange rate against the dollar (7.24 on 24 January) has moved away from the upper limit of the permitted trading band. The central bank has stepped

CHINA: EXTERNAL TRADE PERFORMANCE

CHART 2 SOURCE: GENERAL ADMINISTRATION OF CUSTOMS, CEIC, BNP PARIBAS

up its measures to defend the yuan since the autumn, in order to reduce financial market instability and leave some leeway to respond to future US tariff hikes through further yuan depreciation.

TRUMP 2.0: A NEW SHOCK FOR EXPORTS

How China-US trade relations will evolve in 2025 is very uncertain. Will the new US President implement his programme of sharp tariff hikes in the short term, or will he first seek to establish a new balance of power and then move forward in trade negotiations? Our central scenario to date includes a preliminary hike in tariffs of 10% in Q1 2025, followed by further increases from Q3 onwards (+15% over a year).

The overall performance of Chinese exports has not been weakened by the first round of the trade war that began in 2018-2019 and by the resulting trade decoupling between the US and China. Over the past few years, the effects of tariff barriers on Chinese companies have been offset by the decline in export prices (strongly supported by yuan depreciation and public subsidies) and by the re-routing of trade flows. China's goods exports (in USD) have grown by an average of 7% per year since 2018 and their global market share has increased, from 12.8% to 14.7% over the first nine months of 2024 (chart 2). China posted a record trade surplus of USD 992 billion in 2024 (5% of GDP) and a current account surplus estimated at 1.9% of GDP – which was offset however, by net capital outflows in the balance of payments.

The onset of a new round of the trade war could have more painful effects on Chinese exports and economic growth. Admittedly, China's direct exposure to the US market decreased from 19% of its total exports in 2017 to 14.6% in 2024 (i.e. 2.6% of GDP). In addition, China will continue to reorganise its supply chains and trade flows to circumvent tariffs and continue to offset losses of US market share. However, on the one hand, the protectionist threat has spread, and new tariff barriers will not only come from the US. On the other hand, the central bank's room for manoeuvre to depreciate the yuan has narrowed compared to 2018-2019 (depreciation of 3% to 4% is expected by the end of 2025 in our central scenario) and corporate profits have deteriorated, reducing their ability to lower their export prices to offset tariff hikes. China could see its global market share get smaller in 2025.

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