CHINA

PREPARING FOR BATTLE

In China, economic policy has taken a firmly expansionary turn since late September. This has given a boost to activity, which is expected to strengthen further in the very short term. However, over 2025 as a whole, economic growth will continue to slow. The constraints weighing on domestic demand persist, as the adjustments in the property sector are not yet complete, private sector confidence remains fragile and households are waiting for conditions in the labour market to improve. In addition, the risks to growth have increased with the election of Donald Trump. China will be able to respond to new US customs barriers in various ways, ranging from retaliatory measures to depreciating its currency and continuing to re-route its trade flows. Moreover, the authorities are ready to continue to ease their monetary and fiscal policies.

A SLIGHT GROWTH ACCELERATION IS UNDERWAY

In Q3 2024, Chinese economic growth accelerated to +0.9% quarter-on-quarter (q/q), after its poor performance in the previous quarter (+0.5% q/q). It stood at +4.8% year-on-year (y/y) in the first three quarters of 2024, and it is expected to reach the target of "around 5%" set by the authorities for this year. This scenario assumes that the series of stimulus measures announced since the final week of September will successfully revitalise activity in services in Q4, thanks to the property market beginning to stabilise and consumer confidence starting to improve. It will not be easy. Yet, over the last two months, the authorities have demonstrated a new resolve to reinvigorate domestic demand, and activity has in fact begun to strengthen.

In services, growth accelerated to +5.1% y/y in September and +6.3% in October, compared with +4.7% on average over the previous four months. This improvement came together with improving retail sales, which were boosted by the launch of sales campaigns and the continuation of government-subsidised "durable consumer goods trade-in" programmes (sales of household appliances leapt up by 39% y/y in October). However, retail sales growth was only +4.5% y/y in real terms in October (after +2.8% y/y on average over the first nine months of 2024), compared with average growth of +7% in the three years prior to the health crisis. In the very short term, the more favourable momentum of private consumption should continue, especially as activity in the property market showed encouraging signs in October. The contraction in sales volumes has almost come to a halt (-1.6% y/y after -12% in Q3 2024 and -20% in H1 2024), pointing to a slight improvement in household sentiment and finally a positive effect from the loosening of prudential rules governing mortgage loans. On the other hand, construction activity (starts and completions) continued to fall in October (by -27% and -20% y/y, respectively).

In the industrial sector, growth accelerated to +5.4% y/y in September after four months of slowdown and stabilised in October (+5.3%). In the very short term, industrial growth could benefit from an improvement in domestic demand, as well as from an increase in export orders in anticipation of the US tariff hikes, expected in 2025. Chinese goods exports rebounded in October, in both volume and value (+12.7% y/y in current USD, after +4.6% y/y on average over the first nine months of 2024), with the average export price still falling (estimated at -4% y/y in Q3).

Investment growth has fallen slightly since the summer compared with H1, standing at +3.4% y/y in value terms over the first ten months of 2024. It was logically driven by investment in manufacturing (+9.3%) and public infrastructure (+4.3%). Meanwhile, the contraction in property investment continued (-10.3%).

FORECASTS

	2021	2022	2023	2024f	2025f
Real GDP growth, %	8.4	3.0	5.2	4.9	4.5
Inflation, CPI, year average, %	0.9	2.0	0.2	0.4	1.3
Official budget balance / GDP, %	-3.1	-2.8	-3.9	-3.8	-4.0
Official general government debt / GDP, %	46.8	50.6	56.1	59.6	62.7
Current account balance / GDP, %	2.0	2.5	1.4	1.5	1.4
External debt / GDP, %	15.4	13.7	13.8	13.6	13.3
Forex reserves, USD bn	3 427	3 307	3 450	3 500	3 540
Forex reserves, in months of imports	13.3	12.6	13.2	12.8	12.4

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CHINA: LABOR MARKET CONDITIONS ARE STILL DEGRADED

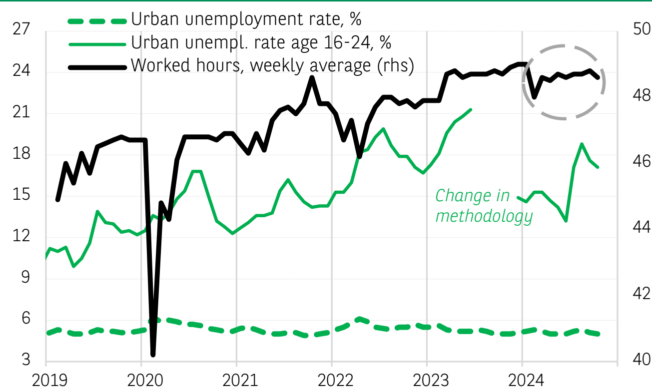

CHART 1 SOURCE: NBS, BNP PARIBAS

INTERNAL CONSTRAINTS REMAIN

After an acceleration in Q4 2024 and early 2025, economic growth will return to a downward trend. It is expected to stand at +4.5% in 2025 as a whole. The risks to this scenario are high. Domestically, these risks mainly stem from the property crisis and the lasting decline in confidence of households and private investors.

The correction in the property sector is likely to continue, even if the authorities successfully mitigate the crisis by reviving housing demand

and reducing stocks of unsold homes through purchases by local governments. The property market adjustments are far from over, with prices continuing to fall (-8.9% y/y in October for second-hand homes), large stocks of unsold and unfinished homes, and developers still facing serious financial difficulties (the IMF estimates that by mid-2024, around half of them were facing solvency or viability issues).

Private consumption could therefore continue to be depressed by the negative wealth effects linked to the fall in house prices and the impact of the property crisis on household morale and the willingness of households to save. In addition, labour market conditions are still worse than in the pre-Covid years. The average unemployment rate has returned to its 2019 level (it fell to 5% in October), but youth unemployment is still higher. Moreover, the average number of hours worked remains below its long-term trend (*chart 1*), and incomes are growing at a slower pace. Over the first three quarters of 2024, disposable income per capita increased by 4.9% y/y in real terms, compared with the average increase of +6.5% per year recorded in 2017-2019. Against this backdrop, the consumer confidence index has declined since April (standing at 85.7 in September, compared with over 110 before the lockdowns in spring 2022), and its "employment" sub-component hit an all-time low in September (71.3). The household savings rate remains very high; it is estimated to be close to 37% of disposable income, and has not returned to its pre-Covid level (it rose from 34.8% in 2019 to 38.1% in 2020).

Finally, the factors that have adversely affected private-sector confidence and investment since 2020 are likely to persist (private investment was virtually stagnant y/y in the first ten months of 2024). On the one hand, corporate profits have deteriorated due to weak domestic demand and deflationary pressures – producer prices continued to fall (-2.9% y/y in October) and consumer price inflation remained low (+0.3% y/y in October and +0.5% in Q3). On the other hand, political risk and regulatory uncertainties in services remain, while geopolitical risks and trade tensions with the United States are set to intensify.

EXTERNAL RISKS ARE ON THE RISE

Externally, the main risk to Chinese growth is the rise of protectionism once Trump is inaugurated as President of the United States in January.

Beijing's industrial policy, which has been stepped up in the post-Covid era in order to stimulate economic activity and strengthen national security, has supported the expansion of the manufacturing sector. Helped by public subsidies and a competitive yuan, Chinese exporters have slashed their prices and gained global market share in a wide range of sectors. In recent months, this strategy has already led a growing number of countries to introduce tariff barriers against China. This protectionist drift could worsen considerably in 2025, as Trump has threatened to impose a tariff across-the-board of 10% on imports from all countries and of 60% on imports from China. Since early 2020, the US has been taxing 66% of goods imported from China, with an average tariff rate of 19.3% (compared with 3.1% in early 2018 before the "first trade war" between China and the US).

The direct impact of higher tariffs on Chinese exports, investment and growth will be significant. However, it is difficult to predict what it will be for the time being, as it hinges on the timetable for implementing the new tariffs, their exact scale and the retaliatory measures taken by China and other trading partners. Moreover, the European Union might also increase its trade barriers.

Beijing appears to be preparing for negotiations with Washington to avoid another trade war. However, it is also preparing its response should there be an increase in US tariffs and a slowdown in its exports. China is likely to react in a number of ways: i/ with tariff retaliatory measures

CHINA: THE YUAN IS ALREADY RELATIVELY WEAK

CHART 2 SOURCE: BIS, PBOC, BNP PARIBAS

(its tariff rate on imports of US goods rose from 8% to 21.1% between early 2018 and early 2020, closely following the tariff increase imposed by the US), non-tariff retaliation measures, and new controls on its exports of critical materials; ii/ by allowing the yuan to depreciate, even though the central bank's scope to resort to exchange rate depreciation is more limited than in 2018-2019 (*chart 2*); iii/ by continuing to re-route its trade flows and relocate its production in order to circumvent trade tariffs, offset market losses in the United States and expand its trade relations with political allies; and iv/ by further easing monetary and fiscal policies in order to support domestic demand.

SUPPORT POLICIES CAN BE FURTHER STRENGTHENED

Since the final week of September, the authorities have stepped up their measures to ease monetary conditions, support the property sector and support equity markets. While the first measures align with the policy easing that had been underway for several months, the support for the stock markets is different and aims to boost the confidence of resident savers and investors.

On the other hand, disappointingly, the authorities have not accompanied their monetary and financial measures with significant direct support for household incomes. However, on 8 November, the central government did confirm the budgetary component of its support program. It is a plan aimed at strengthening local government finances, which will reduce credit risks in the financial sector and improve the ability of local governments to stimulate activity. Beijing is therefore once again increasing the quota of "special bond" issues allocated to local governments, by a total of RMB 10,000 billion, or 7.5% of estimated 2024 GDP, to be spread over the next five years. With these new resources, local governments will have to refinance some of their "hidden" debt, incurred through their financing vehicles. The debt swap should reduce the default risks of these financing vehicles in the short term and alleviate the interest burden for local governments, as they benefit from lower rates on their bond debt. However, refinancing hidden debt of local government financing vehicles with on-balance sheet debt of local governments improves only very partially their overall solvency.

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