

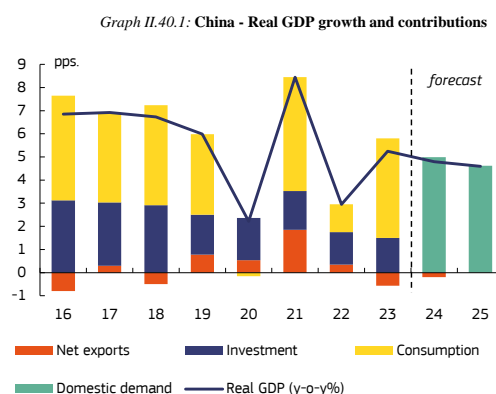
40. CHINA

China's economy remains burdened by both cyclical and structural factors. The impact of the pandemic, tighter government control of the economy, and the crisis in the real-estate sector continue to undermine consumer, business, and investor confidence. Investment is enjoying the traditional strong policy support. Aside from boosting infrastructure investment, the authorities are supporting a massive increase in manufacturing capacity investment to offset the drop in construction activity. Fiscal policy is expected to continue focusing on supporting especially infrastructure investment. However, burdened by the already high and rising debt imbalances and decreasing returns on investment, its contribution to growth is set to weaken. Monetary policy remains constrained by a stubbornly low credit demand and an already high interest rate differential. Growth is expected to gradually slow in 2024 and 2025.

Growth surprises in the second half of 2023 and early 2024

The Chinese economy rebounded in 2023, following weak growth in 2022, on the back of the post-COVID-19 reopening and a limited fiscal impulse in the second half of the year. Annual GDP growth reached 5.2%, above the government target of 5%, driven by recovering consumption and investments by both SOEs and local governments. Still, a prolonged scarring effect from the pandemic together with the ongoing real estate crisis continued to weigh on domestic demand. High policy uncertainty and worsening economic outlook held back consumer and private business confidence. The household's spending rate increased but remained below its pre-pandemic level. Furthermore, worsening external environment and higher imports turned the growth contribution of net exports negative in 2023.

Real GDP growth exceeded expectations in the first quarter of 2024 and reached 5.3% y-o-y (1.6% q-o-q), on the back of stronger-than-expected consumption. Nonetheless, retail sales increased by only 4.7% y-o-y in the first quarter, despite the 6.2% growth in household incomes. Investment growth remained weak, underpinned by a relatively limited fiscal impulse from local government bonds issued in the fourth quarter of 2023. Net exports contribution turned positive on the back of stronger real export growth and subdued real imports.



Difficult growth going forward

Growth in 2024 is expected to be driven both by domestic demand and net exports. Consumption is projected to provide the largest contribution to growth, supported by stable income growth, which however remains significantly lower than in the pre-pandemic period. Labour market conditions are slowly improving although youth unemployment remains high. Despite some improvements, the household saving rate remains around 2 pps. above its pre-pandemic level. Its reduction is expected to only be gradual over the coming years as households continue to rebuild and strengthen their buffers to offset a high uncertainty and negative wealth effects surrounding the ongoing real estate crisis.

Investment is expected to remain subdued in both 2024 and 2025. Private sector investment is projected to continue stagnating under the weight of the real estate crisis. The volume of real estate under construction contracted only 12% since the peak in early 2022. At the same time, new construction starts contracted more than 60% with no signs of stabilising. Real estate sector is thus expected to continue weighing on investment growth over the forecast horizon. Private investment in other sectors is showing more dynamism, supported by policy initiatives to boost, in particular, high-end and green manufacturing. However, the less efficient SOEs are expected to be

the main beneficiaries of this policy support and to thus drive manufacturing investment growth. Furthermore, policy insistence on new investment in sectors that are already exhibiting structural overcapacities and falling capacity utilisation is projected to lead to falling returns and rising corporate debt burden. Infrastructure investment is expected to remain strong, benefiting from the continuous fiscal support.

Net exports are forecast to provide a neutral contribution to growth in both 2024 and 2025. Notwithstanding the strong policy support for manufacturing, weakening external demand and rising geopolitical and trade tensions are expected to continue burdening Chinese exports. At the same time, import growth is set to remain subdued due to relatively sluggish domestic demand and the strong policy push for import substitution and self-sustainability. The current account balance is expected to narrow only marginally over the next two years, to 1.3% of GDP in 2024 and 1.2% of GDP in 2025. Overall, economic growth in 2024 is expected at 4.8%, broadly in line with the government target of 'around 5%'. A further slowdown is expected in 2025, to 4.6%, as the ongoing real estate crisis and high uncertainty continue to weigh on economic activity.

Policy support to remain constrained

The National People's Congress in March left the official growth target for 2024 unchanged at "around 5%". However, growth in 2023 benefited from a large positive base effect due to the weak 2022 that has now dissipated making the new growth target more 'ambitious'. The announced government spending and borrowing plans do not foresee a major fiscal impulse in 2024, however, as both the general government deficit target and the local government special purpose bond quota remain broadly unchanged. Weak credit demand has rendered recent monetary policy loosening ineffective, while both the large interest rate differential between China and the US and the persistent pressure on the renminbi exchange rate constrain further policy action.

Short term downside risks to China's growth stem from the ongoing real estate crisis and the volatile external environment. Consumer and investor confidence remains weak while mounting global trade restrictions directed at China may undermine its still sizeable trade surplus. Over the medium term, China's structural imbalances are forecast to continue weighing on growth. High debt burden, weak productivity growth, falling return on investment and the weak demographics are all weighing on China's potential growth and increasing the urgency to rebalance the growth model away from state led investment and towards private sector and consumption.

Table II.40.1:

Main features of country forecast - CHINA

	2022			Annual percentage change						
	bn CNY	Curr. prices	% GDP	04-19	2020	2021	2022	2023	2024	2025
GDP	120472.4		100.0	9.0	2.2	8.5	3.0	5.2	4.8	4.6
Private consumption	45046.8		37.4	-	-	-	-	-	-	-
Public consumption	19336.0		16.1	-	-	-	-	-	-	-
Gross fixed capital formation	50483.5		41.9	-	-	-	-	-	-	-
Exports (goods and services)	25041.3		20.8	10.5	-3.2	18.5	-0.2	-0.3	3.0	2.8
Imports (goods and services)	21092.0		17.5	9.6	-6.7	10.5	-2.6	3.0	4.6	3.3
GNI (GDP deflator)	-		-	-	-	-	-	-	-	-
Contribution to GDP growth:		Domestic demand		-	-	-	-	-	-	-
		Inventories		-	-	-	-	-	-	-
		Net exports		-	-	-	-	-	-	-
Employment				-	-	-	-	-	-	-
Unemployment rate (a)				4.3	5.2	5.1	5.5	5.2	-	-
Compensation of employees/head				-	-	-	-	-	-	-
Unit labour costs whole economy				-	-	-	-	-	-	-
Saving rate of households				-	-	-	-	-	-	-
GDP deflator				3.8	0.5	4.5	1.8	-0.6	-2.0	0.3
Consumer price index (c)				2.7	2.5	0.9	2.0	0.2	-	-
Terms of trade goods (b)				-	-	-	-	-	-	-
Trade balance (goods) (b)				4.1	3.5	3.2	3.7	3.3	2.7	2.6
Current-account balance (b)				3.8	1.7	2.0	2.5	1.4	1.3	1.2
General government balance (b)				-	-	-	-	-	-	-
Structural budget balance				-	-	-	-	-	-	-
General government gross debt (b)				-	-	-	-	-	-	-

(a) urban unemployment, as % of labour force. (b) as a percentage of GDP. (c) national indicator.