2 October 2024

Research China

Lift to GDP forecast after leaders draw line in the sand

- Following the big stimulus and clear growth message from Chinese leaders, we revise up our China growth forecast in 2025 from 4.8% to 5.2%. For 2024 we keep our 4.8% forecast.
- The stimulus is the strongest coordinated push to lift the economy since the global financial crisis in 2008. We expect China to follow up with fiscal stimulus measures on the other side of the National Day holiday.
- The key to turning the Chinese slump is to put a stop to the housing crisis, which we see as the epicentre of current challenges. We now look for a gradual improvement in housing over the next year but not a fast rebound.
- China is set to change from a disinflationary force to a more neutral force. Since we look for the recovery to be gradual we do not expect China to become an inflationary force within the next 6-12 months.

All clear to go for growth

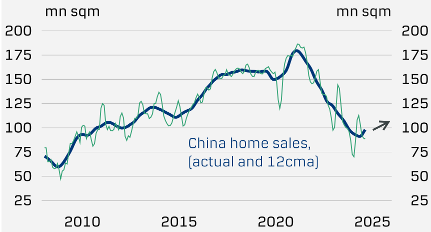
On Tuesday last week, Chinese policy makers drew a line in the sand and surprised with the most sizeable stimulus measures since the Global Financial Crisis in 2008/09, see box on page 3. The growth signal was underlined by the monthly meeting in the Politburo (China's top leadership) on Thursday, which focused solely on the economy. The agenda was a break with the usual schedule as the economic situation is normally only the agenda of Politburo meetings in April, July and October. The readout from the meeting also left no doubt that growth has moved to the top of the agenda with leaders saying that the decline in the housing market should stop and the counter-cyclical stimulus will be intensified. They also sent a clear signal to local policy makers to experiment to lift the economy specifically stating that errors would not be punished. This an all clear from China's government to go for growth.

Stimulus to drive gradual recovery in domestic demand

We have lifted our growth forecast on the back of the stimulus and the follow-up fiscal actions we expect to see over the coming months. We now look for 5.2% growth in 2025 revised from 4.8%. This year we keep our forecast at 4.8% (without the stimulus we would have lowered it following the recent weak data, but we now keep it unchanged).

A key assumption is that China keeps the foot on the gas pedal - and push it down further if needed - until they see visible signs that the housing market is bottoming out and consumer confidence improves. If they ease the foot from the gas too early, there is a risk the current lift to sentiment fades again quickly – as was the case after the re-opening from the pandemic in 2022.

China's housing crisis expected to bottom gradually after stimulus



Source: Macrobond Financial, NBS, Danske Bank

Stimulus set to lift consumer spending and employment in 2025

Source: Macrobond Financial, NBS, Danske Bank

New China GDP forecast

GDP forecast	Danske Bank	Prior
2023	**5.2**	
2024	**4.8**	4.8
2025	**5.2**	4.8

Source: NBS, Danske Bank

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More important than the specific growth rate, is what engines drive the recovery. In the first half, we expect the stimulus to be the main engine but in the second half, we look for more 'organic' growth coming from a gradual lift to housing and household consumption from state led investments. If China succeeds in turning the negative confidence around, they will be able to withdraw stimulus and the growth will be able to stand on its' own feet with real domestic demand being a stronger force during 2025.

Given the extent of the confidence crisis, we believe it will take time for households to open up their wallets again and not put as much into savings accounts. We thus don't see a rapid rebound in growth. Policy makers are also not aiming for a strong rebound in the housing market, as it would be counterproductive to the long-term goal of being less dependent on housing and allocate more resources to high-tech manufacturing, AI, and other types of technology.

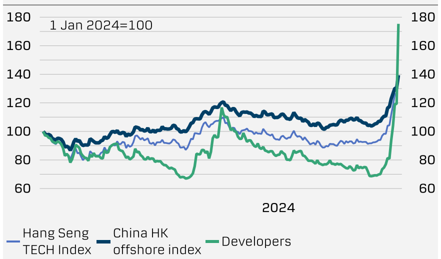
Why now – and why not before?

The extend of the stimulus took markets (and ourselves) by surprise as witnessed by the strongest equity rally since 2008. China has launched many stimulus packages before, but they have tended to be smaller and the expectation was they would again do only what was necessary to keep the economy floating - but nothing more than that. One may therefore ask, why now? Why did policy makers decide that it was time to pull out the big stimulus? And why not before?

We see a couple of reasons. The first reason is Chinese leaders believed that the first part of the crisis has been necessary. China's housing bubble needed to be deflated and the pain it caused was an unfortunate but unavoidable side-effect. China is in a transition to a new growth model as illustrated by the quote in the margin by China's central bank governor Pan Gonsheng from December 2023, where he highlights that China is on a long and difficult journey to transition to a new growth model. Pulling out the big guns too early could have stopped the necessary adjustment and pushed the problems down the road. However, the deflating of the bubble has come far now, and without decisive action, China could enter a second phase of the crisis where the country slides into 'a lost decade' because confidence fails to recover once the necessary adjustment of the housing market has been achieved. Avoiding this scenario requires much larger-scale stimulus.

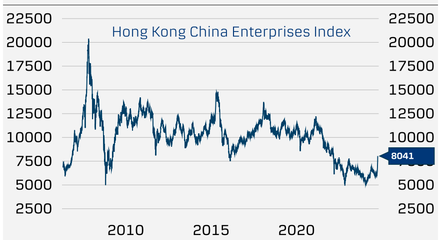
A second reason why leaders take action now, is probably that the pain keeps growing among Chinese people. Consumer confidence and expectations of future employment have continued to slide this year to even more extreme lows (see top chart). Retail sales growth has also fallen back to just 2% growth from around 7-8% in the beginning of 2024 and inflation is again flirting with deflation levels as core inflation has fallen to 0.3% y/y. Finally, youth unemployment continues to rise and reached 18.8% in August, a new high after they changed the methodology in late 2023. If this pain goes on for much longer, it may at some point trigger rising protests and social instability.

Very sharp turn in Chinese stocks…



Source: Macrobond Financial, Bloomberg
Note: Past performance is not a reliable indicator of current or future results.

… but coming from very low levels

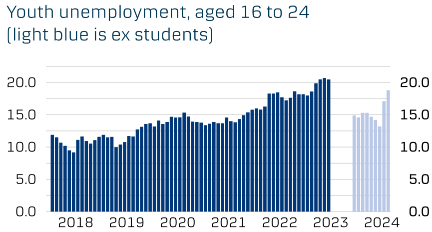


Source: Macrobond Financial, Bloomberg
Note: Past performance is not a reliable indicator of current or future results.

Consumer confidence record low – and employment expectations keep worsening

Source: Macrobond Financial, PBOC

Youth unemployment keeps rising



Source: Macrobond Financial, NBC

Central bank governor Pan Gonsheng on the need for China's painful transformation

*"China is experiencing a transition of economic growth model. **The traditional model of relying heavily on infrastructure and real estate might generate higher growth, but would also delay structural adjustment** and undermine growth sustainability. High-quality and sustainable growth is far more important. So right now we should focus more on improving economic structure, and forming new growth drivers. **The ongoing economic transformation will be a long and difficult journey, but it is a journey we must take.**"*

Source: BIS (link to speech), December 2023

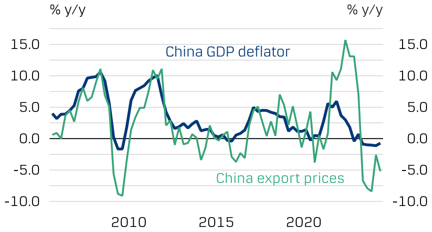
These factors are also the reason we believe, Chinese leaders will keep pushing for growth until they achieve the turnaround.

From disinflationary to neutral force

During the three-year long crisis, China has served as a global disinflationary factory through both weaker commodity demand as well as falling export prices related to domestic overcapacity. **Looking ahead, we expect China to gradually become less of a disinflationary factor and more a neutral force for global inflation**. As housing stabilizes and slowly recovers commodity demand should increase and a lift to domestic household demand will also work to reduce overcapacity. However, as argued above, we do not look for a rapid rebound but rather a gradual bottoming, and despite a rise in demand it will take time to reduce overcapacity. Thus we don't see China suddenly becoming a strong inflationary force at least within the next 6-12 months.

For oil markets, more important factors in the short term will likely be what happens on the supply side; hence how much escalation we get in the Middle East (upside risk) and how much Saudi Arabia will increase oil output.

China a global disinflationary force – set to become more neutral



Source: Macrobond Financial, NBS

Box: Overview of stimulus measures announced last week

Monetary policy:

- Seven-day repo cut from 1.7% to 1.5% (normally only cut by 5-10bp)
- 1-Year Medium Lending Facility rate cut by 0.3 percentage points to 2.0%. It was the biggest size cut since the rate was introduced in 2016.
- Reserve Requirement Ratio for banks lowered to 0.5 percentage points. Normally it is not lowered simultaneously with interest rate reductions.

Housing:

- Requirement for minimum down payment for second time buyers lowered from 25% to 15%
- The major cities Shanghai, Shenzhen and Guangzhou announced all home purchase restrictions would be removed.

Consumer:

- Mortgage rates on existing loans to be reduced by 0.5 percentage points freeing up disposable income.
- One-off handouts given to people facing hardships.
- Shanghai providing vouchers for service-related spending.

Banking:

- Reports indicate that China's big state banks will get a capital injection of CNY1 trn (USD142 bn).

Stock market:

- A swap program at initially 500 billion CNY allows funds, insurers and brokers easier access to funding to buy stocks.
- Another program provides up to 300 billion CNY in cheap loans to commercial banks that fund share purchases and buy-backs.
- China also weighs plans for a stock stabilization fund.

On 25 September the State Council (China's cabinet) presented *24-point guidelines* to support future employment.

Source: Bloomberg, Reuters, China Daily

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Date of first publication

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