Asia Report #2

An Assessment of the Current Chinese Economy

The recent rally in Chinese stocks, driven by the government's latest stimulus measures, has temporarily boosted investor sentiment and raised the CSI 300 Index, which tracks major companies listed on the Shanghai and Shenzhen stock exchanges, by 25.1%, making Chinese stocks one of the best-performing investments globally in 2024. These measures, which include large-scale stock market interventions and commitments to reduce interest rates, reflect Beijing's aggressive approach to stabilizing financial markets. However, significant challenges remain, especially in the broader economy.

Key Economic Challenges

Property Market Slump: The Chinese real estate sector, an important pillar of the economy, continues to struggle despite government efforts to stabilize it. While there are early signs of improvement in certain cities, the high volume of unsold homes and weakening demand continue to weigh on the market. The real estate sector represents a significant portion of household wealth, so a prolonged slump could further erode consumer confidence and spending. Additionally, local authorities may need incentives, such as funding or tax benefits, to buy back unsold properties and help stabilize the market.

Consumer Confidence: There are tentative signs of recovery in consumer spending, such as increased movie ticket sales and home purchases during the recent holiday period. However, the overall outlook remains fragile. Analysts warn that without further fiscal measures, such as subsidies, tax cuts, or increased social welfare spending, it is unlikely that consumer demand will strongly rebound. The lack of robust domestic consumption continues to be a drag on economic growth. A more sustainable solution could involve targeted consumer support measures, including subsidies for specific consumer goods or direct financial aid to low-income households.

Deflationary Pressures: China faces growing risks of deflation, with weak consumer demand, falling property prices, and declining industrial profits. These deflationary trends could become entrenched, limiting the effectiveness of stimulus measures and stalling economic recovery. A broader social safety net, along with higher household disposable income, could help combat these pressures by boosting consumer spending and reversing deflationary trends.

Youth Unemployment and Industrial Decline: High youth unemployment (18.8% in August 2024) and declining industrial profits (down 17.8%) reflect underlying structural issues. Both indicators highlight weakness in key sectors of the economy and pose risks to long-term stability.

Without addressing the mismatch between labor market needs and the skills of young workers, youth unemployment may remain high, potentially exacerbating social unrest and further dampening consumer confidence. Increased investment in education and reskilling programs would be crucial to tackling this issue.

Government Revenues and Fiscal Space: Government revenues have been underperforming, putting pressure on Beijing’s ability to fund additional stimulus measures without further borrowing. While analysts expect more fiscal interventions, the government’s fiscal space is becoming increasingly limited. Successful management of this fiscal space will require prioritizing growth-enhancing spending, such as innovation-driven sectors, over broader but less efficient stimulus measures.

A Projection for the Chinese Economy

While the government’s stimulus measures have temporarily lifted stock markets, the broader economy still faces deeply rooted challenges. In the short term, the stock rally may continue, especially as the People's Bank of China has indicated its continued support for the financial sector. However, without more aggressive fiscal policies targeting consumer demand and the property market, the economic recovery is likely to remain weak. Long-term growth will require addressing core structural issues such as the imbalance in the property market and the shrinking labor force caused by an aging population.

GDP Growth: International analysts and Chinese economists predict that GDP growth will fall below the official 5% target, with estimates close to 4.7%-4.8% for 2024. Looking ahead to 2025, growth may decelerate further, potentially reaching around 4.2%, reflecting long-term structural issues such as an aging population, declining investment, and shrinking global demand for Chinese exports. The GDP is also being impacted by trade tensions with key partners like the U.S. and the European Union, which are imposing restrictions and tariffs on Chinese products such as electric vehicles, batteries, and solar panels, claiming that China is flooding the global market with cheap, government-subsidized products. These trade tensions are reshaping China's role in the global economy, pushing it to seek new markets in Asia, Africa, and Latin America, or to focus more on its domestic market.

Policy Outlook: To sustain recovery and prevent further declines, Beijing may need to consider more targeted consumer support measures, such as subsidies for homebuyers, tax incentives, and broader social safety nets. Additionally, the government may need to focus on restructuring the real estate sector, particularly by encouraging local authorities to buy back unsold properties, which would help stabilize prices and improve household finances. In parallel, deeper structural reforms, such as reducing the economy's reliance on real estate and investing more in high-tech sectors, are critical for long-term stability.

Conclusion

While the stock market is experiencing a rally, China's broader economic outlook remains uncertain. Without a larger and more sustained boost to domestic demand and deeper structural reforms, the country may struggle to meet its growth targets and fully recover from current deflationary pressures. In the coming months, Beijing's ability to implement and expand fiscal measures, as well as manage international trade relationships, will be critical to determining the trajectory of the Chinese economy.

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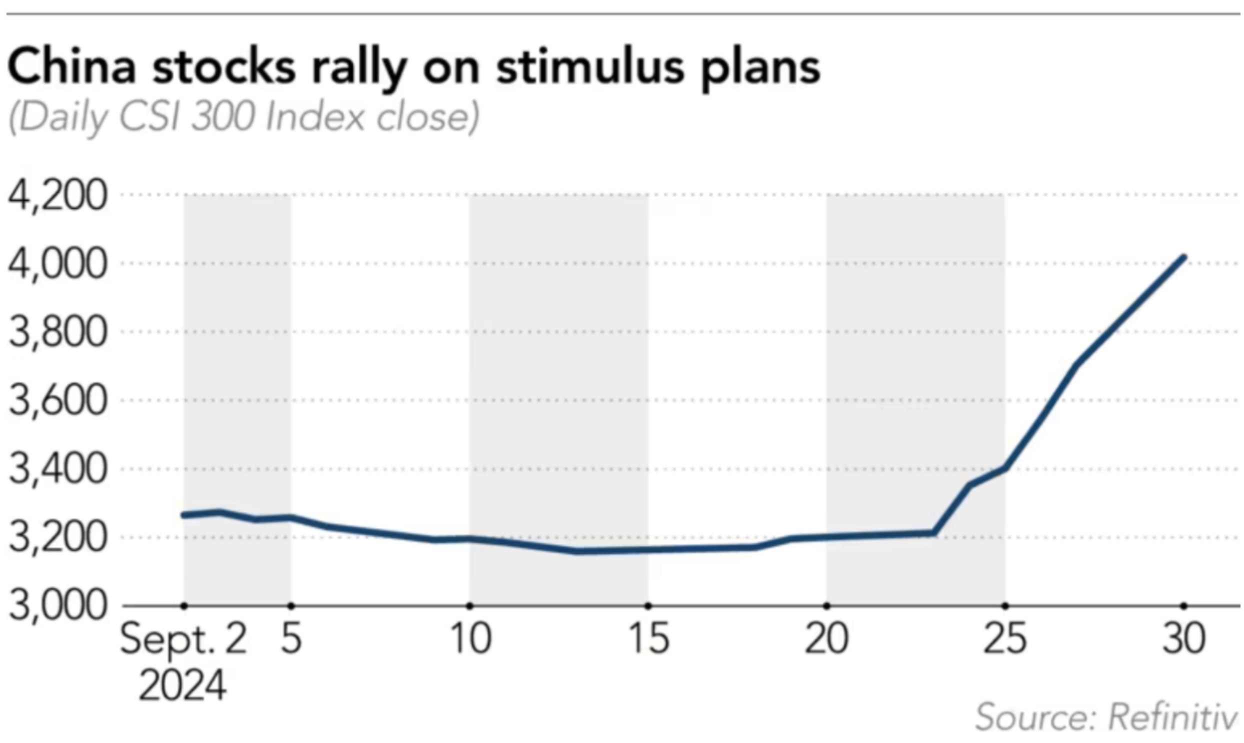
Tokyo, October 7, 2024

Annexes

Chinese stocks rally driven by the government's latest stimulus measures



Stimulus Measures Announced by the People's Bank of China

September 24: The Governor of the People's Bank of China, Pan Gongsheng, announces cuts in interest rates, mortgage rates, and bank reserve requirements, along with an injection of **800 billion yuan (US$114.30 billion)** in financing for stock purchases and other monetary stimulus measures.

September 25: The Ministry of Civil Affairs announces a one-time cash payment for those in need.

September 26: The Politburo of the Communist Party concludes an "unusual" meeting with calls to "strengthen countercyclical adjustments of fiscal and monetary policies" and to "halt the decline of the real estate market and encourage stabilization."

September 29: The People's Bank of China announces a plan for mortgage readjustment and extends support to real estate developers; major cities ease property purchase restrictions.

Source: People's Bank of China, Information Office of the State Council.

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