# 2025 China Economic Outlook

## Sailing against all odds

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**China has shifted its top priority to boosting growth and is likely to keep its 2025 growth target at 5% to show its commitment to growth. Policymakers will focus on stabilizing the housing and stock markets, boosting consumption and promoting technological innovation. Macro policies are likely to be highly accommodative with higher broad fiscal deficit ratio, easing liquidity condition and stabilizing credit growth. China's economy will continue to recover with a more active stock market, less housing decline, continued consumption rebounding and moderate earnings improvement. However, the sustainability of the recovery may face a Trump shock, putting China's economic resilience and policy commitment to test.**

- China economy faces challenges like the Trump 2.0 shock, property slump, deflation risk and structural problems. Trump's 30% tariffs on China and 10% tariffs on others may cause China's constant-price GDP to lose 0.7%. China's property market needs more time to rebalance supply & demand as its weakness remains a drag on the economy. Deflation risk continues to cast a shadow on economy as it dampens consumption, adds debt burden and weakens earnings prospects. China also faces structural problems like an aging population, urban-rural dichotomy, and weakened market incentives.

- The policy has been shifted to strong easing to support growth. Fiscal policy will be more expansionary while the tone of monetary policy has shifted from prudent to moderately easing for the first time since the global financial crisis in 2009. Policies will focus on stabilising the housing & stock markets, boosting consumption, and promoting technological innovation. The progress of policy easing will depend on economic dynamics and the timing of the Trump shock.

- Fiscal policy will be more expansionary. General fiscal deficit, local government (LG) special bond quota, and special T-bond quota may respectively rise from 3.1%, 3% and 0.8% of GDP in 2024 to 3.7%, 3.2% and 1.5% of GDP in 2025. Incremental funds will be used to relieve local fiscal distress, inject capital to large banks, stabilize the housing market, improve livelihoods of the poor and renew the equipment & durables 'trade-in' subsidy program. The Trump shock may prompt China to focus on boosting consumption, but we think large-scale fiscal transfers to households are unlikely.

- Monetary policy will be more accommodative. Liquidity may be materially abundant with RRR, money market rate and LPR cuts by 100bps, 30bps & 20bps respectively in 2025. Government and household demand for credit may improve, yet corporate borrowings could remain weak. Outstanding social financing and loans may pick up 8% and 8.1% at end-2025 after rising 7.8% and 8% at end-2024. US$/RMB might rise from 7.30 at end-2024 to 7.50 at end-2025 with Trump's 30% and 10% tariffs on China and others in 2H25. US$/CNY might reach 7.80 at end-2025 under the scenario of 60% and 20% tariffs on China and other countries.

- China economy may continue to improve with GDP growth at 5.1% in 1H25 as the policy stimulus will boost domestic demand and exporters will front-load shipments in anticipation of higher tariffs. As the policy stimulus effect might diminish and trade conflicts may come, however, we expect GDP growth to slow to 4.3%-4.7% in 2H25. GDP growth might fall from 4.9% in 2024 to 4.7% in 2025 and 4% in 2026, with the contribution of net exports down from 1.2ppt to 0.6ppt and -0.4ppt. The contributions of consumption and fixed investment should rise.

- Deflation pressure might decline in 2025 yet rise again in 2026. CPI growth may rise from 0.3% in 2024 to 0.6% in 2025 and fall to 0.4% in 2026; PPI might continue to fall, with the decline narrowing from 2.1% in 2024 to 0.3% in 2025 and widening to 0.7% in 2026; and the GDP deflator may drop 0.7% in 2024 and rise 0.2% in 2025 before zero growth in 2026.

- Exports of goods might rise 4.5% in 1H25 as overseas interest rate cuts will boost capex and durables demand and tariff expectations will cause front-loading of trade shipments. However, export growth may fall to 2.2% in 2H25 as trade conflicts hit trade. For the full year, we expect exports and imports of goods to grow 3.3% and 2.2% in 2025 after rising 5.2% and 1.8% in 2024. Their growth rates might further decelerate to 0.2% and 0.4% in 2026.

- The property contraction is likely to moderate. Housing demand might see a short-term recovery thanks to continued policy stimulus and rebounding urban migrant population after economic reopening. However, most cities still face a state of oversupply and need more time and efforts to rebalance supply and demand. Property sales in terms of gross floor area and property development investment may drop 7% and 9.3% in 2025 after decreasing 14% and 10.4% in 2024. Market performance should vary by region, as tier-1 cities are likely to take the lead in possible stabilization. In the medium to long term, however, increments of both urban population and per capita living space could decline, putting additional downside pressure on incremental housing demand.

- Household consumption might moderately recover. We estimate the growth rates of retail sales and nominal service GDP to respectively rise from 3.7% and 4.6% in 2024 to 4.7% and 5.5% in 2025. Durables consumption may outperform thanks to the housing sales recovery and ‘trade in’ subsidies.

- Fixed asset investment growth may reach 3.4% in 2024 and 3.7% in 2025 thanks to narrower declines of property development investment. The drag of property development investment on GDP growth is likely to decline from 2.3ppt to 2.1ppt.  Manufacturing and infrastructure investment growth is likely to fall from 9.3% and 9.2% in 2024 to 8.5% and 8.7% in 2025.

# Contents

## Figure 1: China Economic Indicators

| | | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024F | 2025F | 2026F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP | Real GDP (YoY %) | 7.9 | 7.8 | 7.4 | 7.0 | 6.8 | 6.9 | 6.7 | 6.0 | 2.2 | 8.4 | 3.0 | 5.2 | 4.9 | 4.7 | 4.0 |
| | Nominal GDP (US$ tn) | 8.5 | 9.6 | 10.4 | 11.0 | 11.2 | 12.3 | 13.9 | 14.3 | 14.7 | 17.8 | 17.9 | 17.8 | 18.2 | 18.6 | 18.7 |
| | Per capita GDP (US$) | 6304 | 7078 | 7611 | 7943 | 8091 | 8822 | 9899 | 10141 | 10412 | 12617 | 12659 | 12609 | 12889 | 13198 | 13330 |
| Inflation (%) | GDP deflator | 2.3 | 2.2 | 1.0 | (0.0) | 1.4 | 4.2 | 3.5 | 1.3 | 0.5 | 4.6 | 1.8 | (0.6) | (0.7) | 0.2 | (0.0) |
| | CPI | 2.6 | 2.6 | 2.0 | 1.4 | 2.0 | 1.6 | 2.1 | 2.9 | 2.5 | 0.9 | 2.0 | 0.2 | 0.3 | 0.6 | 0.4 |
| | PPI | (1.7) | (1.9) | (1.9) | (5.2) | (1.4) | 6.3 | 3.5 | (0.3) | (1.8) | 8.1 | 4.1 | (3.0) | (2.1) | (0.3) | (0.7) |
| GDP by industry (YoY %) | Agriculture | 4.5 | 3.8 | 4.1 | 3.9 | 3.3 | 4.0 | 3.5 | 3.1 | 3.1 | 7.1 | 4.2 | 4.1 | 3.4 | 3.5 | 3.3 |
| | Industry & construction | 8.4 | 8.0 | 7.2 | 5.9 | 6.0 | 5.9 | 5.8 | 4.9 | 2.5 | 8.7 | 2.6 | 4.7 | 5.6 | 4.7 | 3.7 |
| | - VAIO | 10.0 | 9.7 | 8.3 | 6.1 | 6.0 | 6.6 | 6.2 | 5.7 | 2.8 | 9.6 | 3.6 | 4.6 | 5.7 | 4.9 | 3.8 |
| | Service | 8.0 | 8.3 | 8.3 | 8.8 | 8.1 | 8.3 | 8.0 | 7.2 | 1.9 | 8.5 | 3.0 | 5.8 | 4.7 | 4.9 | 4.5 |
| Contribution to GDP Growth(ppt) | Consumption | 4.4 | 3.9 | 4.2 | 4.9 | 4.5 | 3.9 | 4.3 | 3.5 | (0.2) | 4.9 | 1.2 | 4.3 | 2.4 | 2.7 | 2.8 |
| | Investment | 3.3 | 4.1 | 3.3 | 1.6 | 3.1 | 2.7 | 2.9 | 1.7 | 1.8 | 1.7 | 1.4 | 1.5 | 1.3 | 1.4 | 1.6 |
| | Net exports | 0.2 | (0.2) | (0.1) | 0.6 | (0.8) | 0.3 | (0.5) | 0.8 | 0.6 | 1.9 | 0.4 | (0.6) | 1.2 | 0.6 | (0.4) |
| Demand indicators (YoY %) | FAI | 20.6 | 19.6 | 15.7 | 10.0 | 8.1 | 7.2 | 5.9 | 5.4 | 2.9 | 4.9 | 5.1 | 3.0 | 3.4 | 3.3 | 4.0 |
| | - Manufacturing | 22.0 | 18.5 | 13.5 | 8.1 | 4.2 | 4.8 | 9.5 | 3.1 | (2.2) | 13.5 | 9.1 | 6.5 | 9.3 | 8.5 | 7.0 |
| | - Property development | 16.2 | 19.8 | 10.5 | 1.0 | 6.9 | 7.0 | 9.5 | 9.9 | 7.0 | 4.4 | (10.0) | (9.6) | (10.4) | (9.3) | (4.0) |
| | - Infrastructure | 13.7 | 21.2 | 20.3 | 17.3 | 15.7 | 14.9 | 1.8 | 3.3 | 3.4 | 0.2 | 11.5 | 8.2 | 9.2 | 8.7 | 8.0 |
| | Retail sales | 14.5 | 13.1 | 12.0 | 10.7 | 10.4 | 10.2 | 9.0 | 8.0 | (3.9) | 12.5 | (0.2) | 7.2 | 3.7 | 4.7 | 4.2 |
| | Exports of goods | 7.9 | 7.8 | 6.0 | (2.9) | (7.7) | 7.9 | 9.9 | 0.5 | 3.6 | 29.6 | 5.6 | (4.7) | 5.2 | 3.3 | 0.2 |
| | Imports of goods | 4.3 | 7.2 | 0.5 | (14.3) | (5.5) | 16.1 | 15.8 | (2.7) | (0.6) | 30.1 | 0.7 | (5.5) | 1.8 | 2.2 | 0.4 |
| Credit condition (%) | Outstanding social financing YoY | 19.1 | 17.5 | 14.3 | 12.4 | 12.8 | 14.1 | 10.3 | 10.7 | 13.3 | 10.3 | 9.6 | 9.5 | 7.8 | 8.0 | 7.7 |
| | Outstanding loan YoY | 15.0 | 14.1 | 13.6 | 14.3 | 13.5 | 12.7 | 13.5 | 12.3 | 12.8 | 11.6 | 11.1 | 10.6 | 8.0 | 8.1 | 7.8 |
| | RRR for large banks | 20.0 | 20.0 | 20.0 | 17.5 | 17.0 | 17.0 | 14.5 | 13.0 | 12.5 | 11.5 | 11.0 | 10.5 | 9.5 | 8.5 | 7.5 |
| | DR007 | | | 4.96 | 2.32 | 2.59 | 3.09 | 3.04 | 2.65 | 2.46 | 2.29 | 2.36 | 1.91 | 1.67 | 1.37 | 1.07 |
| | 10Y T-bond rates | 3.58 | 4.56 | 3.62 | 2.83 | 3.02 | 3.88 | 3.24 | 3.14 | 3.14 | 2.77 | 2.84 | 2.56 | 2.00 | 1.80 | 1.60 |
| | 1Y LPR | | 5.73 | 5.51 | 4.30 | 4.30 | 4.30 | 4.31 | 4.15 | 3.85 | 3.80 | 3.65 | 3.45 | 3.10 | 2.90 | 2.70 |
| | 5Y LPR | | | | | | | | 4.80 | 4.65 | 4.65 | 4.30 | 4.20 | 3.60 | 3.40 | 3.20 |
| | US$/RMB (offshore, year end) | 6.22 | 6.06 | 6.21 | 6.57 | 6.97 | 6.51 | 6.87 | 6.96 | 6.50 | 6.36 | 6.92 | 7.12 | 7.30 | 7.50 | 7.80 |
| Public finance (%) | General fiscal revenue YoY | 12.9 | 10.2 | 8.6 | 5.8 | 4.5 | 7.4 | 6.2 | 3.8 | (3.9) | 10.7 | 0.6 | 6.5 | 0.0 | 3.0 | 2.5 |
| | General fiscal expenditure YoY | 15.3 | 11.3 | 8.3 | 13.2 | 6.3 | 7.6 | 8.7 | 8.1 | 2.9 | 0.0 | 6.1 | 5.4 | 2.0 | 5.0 | 4.0 |
| | General deficit ratio | 1.5 | 2.0 | 2.1 | 2.4 | 2.9 | 2.9 | 2.6 | 2.8 | 3.7 | 3.1 | 2.8 | 3.1 | 3.1 | 3.7 | 3.7 |
| | Special fund revenue YoY | (9.3) | 39.2 | 3.5 | (21.8) | 11.9 | 34.8 | 22.6 | 12.0 | 10.6 | 4.8 | (20.6) | (9.2) | (18.0) | (7.0) | (2.5) |
| | Special fund expenditure YoY | (9.7) | 37.9 | 1.8 | (17.7) | 11.7 | 32.7 | 32.1 | 13.4 | 28.8 | (3.7) | (2.5) | (8.4) | (3.5) | 1.5 | 5.0 |
| | LG special bond quota as % of GDP | | | | | 0.5 | 1.0 | 1.5 | 2.2 | 3.7 | 3.2 | 3.0 | 3.0 | 3.0 | 3.2 | 3.3 |

Source: Bloomberg, Wind, CMBIGM estimates

## Main Challenges

### The Trump 2.0 Shock

The Trump 1.0 era witnessed a free fall in US-China relations, bringing about trade conflicts, investment restrictions and tech sanctions. China-US trade of goods was hit, but China's total merchandise trade was stable. Global supply chains have been restructured and evolved to adapt to high China-US tariffs. Some third-party connectors such as the ASEAN and Mexico have strengthened linkages to both China and the US and expanded trade with the two largest economies to avoid a complete decoupling. The significant growth in China's trade with non-US regions has offset the relative decline in trade with the US. The average tariff ratio between China and the US increased by 15ppts in 2018-2019 as their trade of goods in 2019 was 19% lower than the 2012-2017 trend line. However, China's overall merchandise trade in 2019 was 7.1% higher than the trend value. China's total merchandise trade expanded even faster in 2020-2022 when the pandemic disrupted global supply chains, the aggressive policy stimulus boosted demand for goods and China had a full range of stable supply chains. While the China-US trade of goods in 2020-2023 was 14.5% below the 2012-2017 trend line, China's overall merchandise trade in the past four years was 26.6% above the previous trend. China's share in US imports of goods fell from 21.6% in 2017 to 13.3% in 9M24, while the ASEAN, Mexico, Chinese Taiwan, South Korea and India saw their share rise noticeably in US imports. However, China's merchandise exports to those connectors increased significantly. China's market share in global merchandise exports mildly rose from 12.8% in 2017 to 14.2% in 2023.

The Trump 1.0 shock has affected China-US bilateral investment flows. China's direct and portfolio investment in the US declined sharply from 2018. While US direct investment in China declined, its portfolio investment in China increased thanks to the opening of China's securities market. China's overall cross-border investment flow outperformed US-China bilateral investment, with single-digit declines in foreign direct investment (FDI) and outward direct investment (ODI) and sharp increases of cross-border portfolio investment. During the Biden period, China-US bilateral investment and China's overall cross-border investment both sharply declined. On the one hand, China-US relations deteriorated instead of improving. The Russia-Ukraine war exacerbated the market's concern about uncertainties around the Taiwan Strait. Multinational companies accelerated their 'China + X' supply chain strategy while long-term investors reduced their investment exposure to China to hedge against geopolitical risks. On the other hand, high inflation in the US and deflation pressure in China widened the US-Sino interest rate differentials and attracted fund flows out of RMB assets and into US dollar assets. The US-China conflict triggered short-term turbulence in China's financial markets, with the Hang Seng Index, CSI 300 Index and RMB exchange rate falling sharply in Q2-Q4 2018. However, China's financial markets rebounded in 2019 thanks to the reversal of the market overshooting, the launch of US-China agreement negotiations and the Fed's shift to interest rate cuts.

The Trump 2.0 era might see an expanded scope of trade conflicts and enhanced investment restrictions and tech sanctions towards China. US trade imbalance has further increased in recent years as the investment and savings gap has widened due to higher federal fiscal deficits, lower household saving rates and continued business capex expansion. China's share in US merchandise imports has declined significantly, but Chinese goods can still bypass the US market by embedding themselves in third-party supply chains. Trump's insistence on protectionism to address the trade imbalance and rebuild domestic manufacturing indicates a possible expansion of tariff targets to more economies like Mexico, Canada, South Korea, the EU and Vietnam. However, lowering inflation and reducing illegal immigration appear to be a higher priority than addressing trade imbalance and imposing tariffs for Trump's first 100 days after taking office in late January. Tariff policies conflict with the disinflation goal because of their stagflation effect. Trump may lower energy prices by boosting energy production, slowing energy transition and ending the Russia-Ukraine war. However, there is uncertainty around the time lags of those policies. If tariffs are imposed only on China, Chinese goods can still enter the US through third-party connectors, which will not reduce the US's dependence on China's supply chains. If tariffs are imposed on all major trade partners, they could push up US inflation and supply chain costs for US firms.

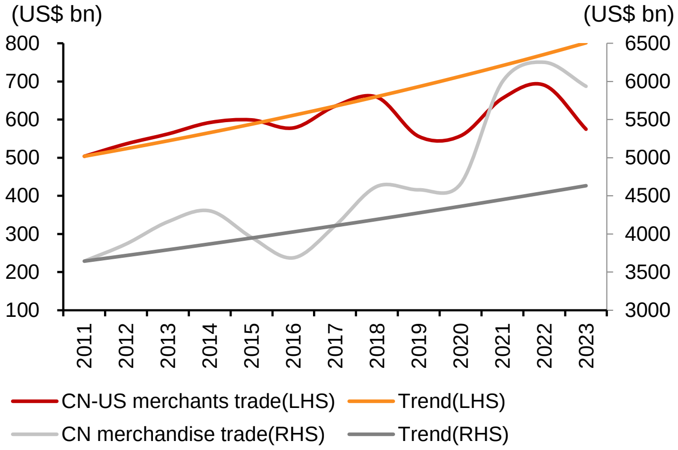
When inflation could remain high in 1H25, Trump might use a gradual approach to impose tariffs or use high tariffs as a bargaining chip to seek higher priority goals, such as pressuring Mexico, Canada and China to address issues such as illegal immigration or fentanyl. Massive tariff hikes are more likely to come in 2H25 or later when US inflation falls to lower levels. In the baseline scenario, Trump would impose a step-by-step increase of 30% tariffs on China and 10% tariffs on other countries with 5% retaliatory tariffs on the US by major countries in 2H25. China's merchandise exports and GDP at constant price in 2026 would be 2.7% and 0.7% lower than without the tariff hikes. In the pessimistic scenario, Trump would impose 60% tariffs on China and 20% tariffs on others. China's constant-price merchandise exports and GDP at constant price in 2026 would be reduced by 5.3% and 1.6%. In the optimistic scenario, China's merchandise exports and GDP would be less affected by only a minor trade conflict.

The Trump 2.0 shock will accelerate Chinese companies' efforts of going overseas to avoid tariffs or seek market diversification. China will continue to push forward the Belt and Road initiative to expand trade and investment with the ASEAN, Latin America and the Middle East. China will also strengthen economic, trade and investment ties with Europe, Japan, South Korea and Australia, as Trump's policies will weaken the US ally system. China's investment in the US might remain limited by Trump's restriction policies.

The Trump 2.0 shock may put China's financial markets under pressure. Trump's policies will push up US nominal GDP growth, slow the Fed's interest rate cuts and fuel a strong US dollar while hurting global trade, manufacturing activities and emerging market currencies. China's stock market and RMB exchange rates may face some downward pressure. As an unfavorable factor for China, US domestic demand seems stronger while China's domestic demand is weaker at present than in Trump 1.0 era. US personal consumption growth rose from 4.3% on average in 2017-2019 to 5.2% in 9M24, while China's retail sales growth over the same period fell sharply from 9% to 3.2%.

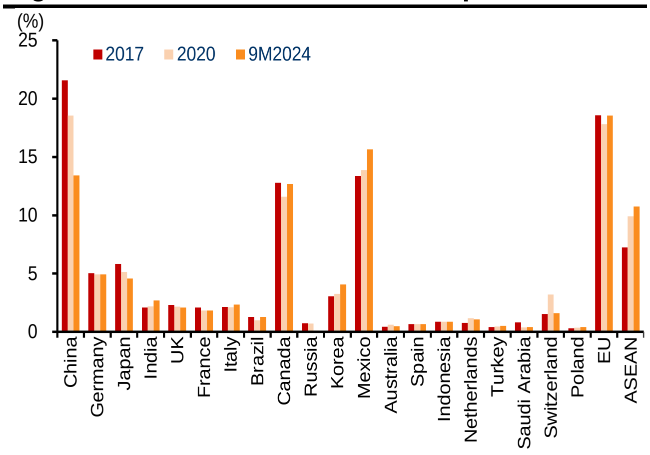
However, China's market reaction to the Trump 2.0 shock may be gentler than to the Trump 1.0 shock. There are more favorable factors for China. First, China is better prepared for further US-China conflicts as China's competitiveness in manufacturing and technology sectors have significantly improved and many large companies have already set up their operations overseas in recent several years. Second, the US dollar is currently in a cycle of interest rate cuts, whereas it was in a cycle of interest rate rises in the Trump 1.0 era. Third, China's liquidity condition is more relaxed than that of the US, with US interest rates at high levels and RMB interest rates at lower levels. Fourth, the US dollar index and stocks have high valuations after many years of gains while RMB asset valuations are low after a long decline. Last, the market is most afraid of uncertainty and unpredictability. Having already experienced the Trump 1.0 shock, the market may see the Trump 2.0 shock as relatively less uncertain and unpredictable.

### Figure 2: China's Merchandise Trade with US & World



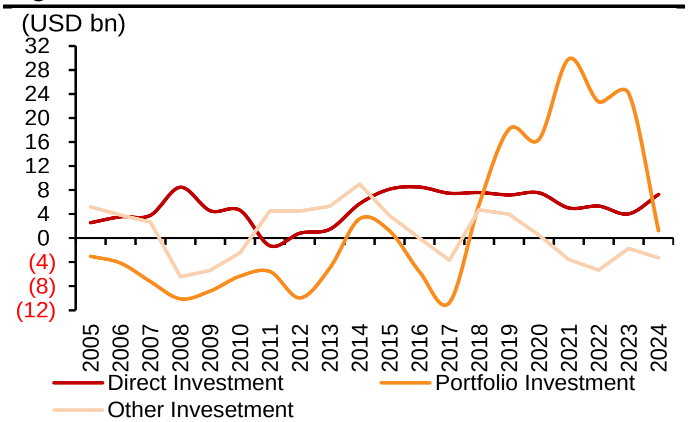

Source: Bloomberg, Wind, CMBIGM

### Figure 3: Share of Partners in US Imports



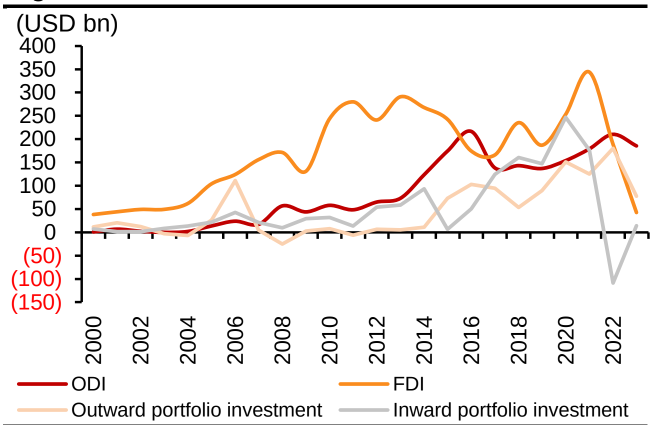

Source: Bloomberg, Wind, CMBIGM

### Figure 4: US Investment Flows to China



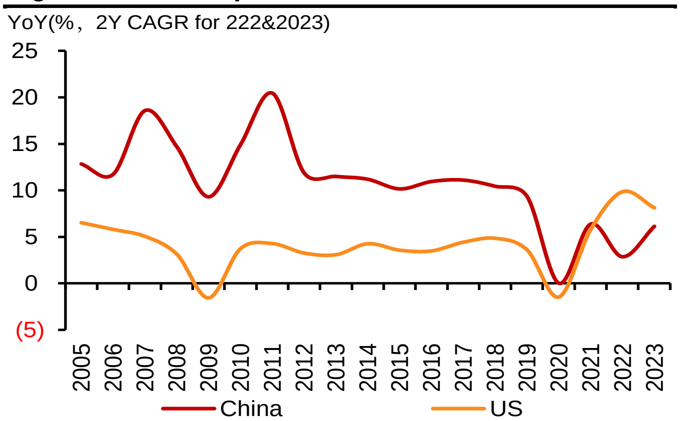

Source: Bloomberg, Wind, CMBIGM

### Figure 5: China Cross-border Investment Flows



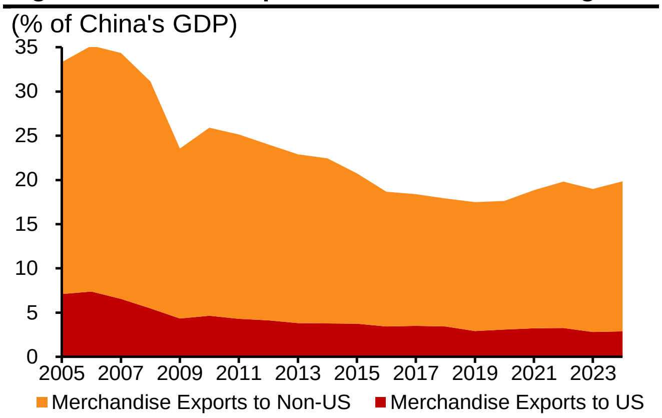

Source: Bloomberg, Wind, CMBIGM

### Figure 6: Consumption Growth in China & US



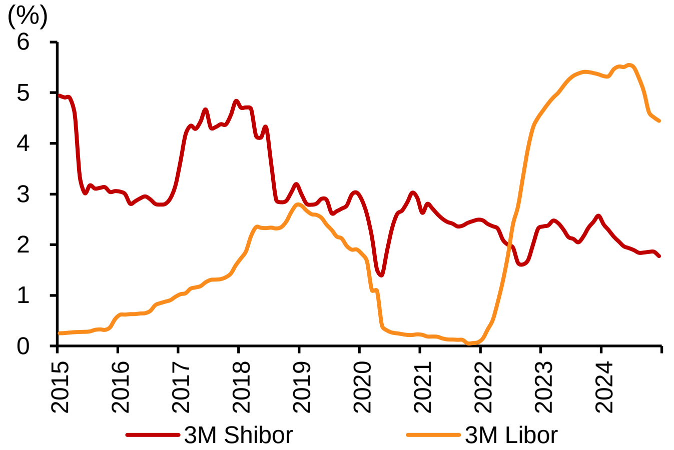

Source: Bloomberg, Wind, CMBIGM

### Figure 7: China's Exports to US & Non-US Regions



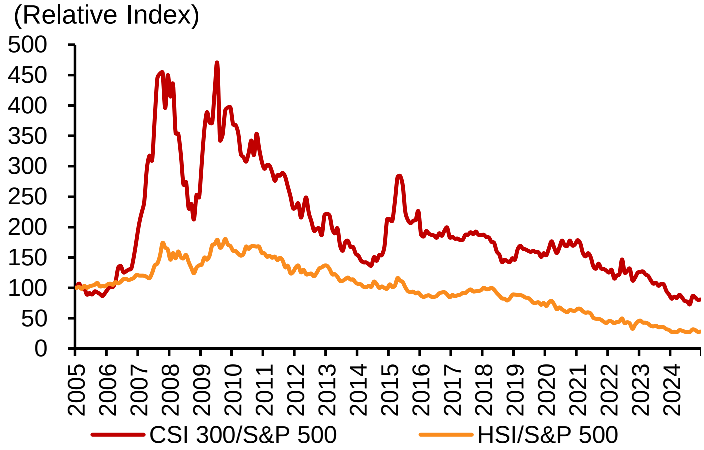

Source: Bloomberg, Wind, CMBIGM

**Figure 8: 3M Interest Rates in China and US**




Source: Bloomberg, Wind, CMBIGM

**Figure 9: Chinese Stocks Relative to US Stocks**




Source: Bloomberg, Wind, CMBIGM

## Aftermath of the Property Slump

China economy still needs more time and policies to absorb the aftereffects of the property slump and push forward the rebalancing of housing supply and demand. After a booming cycle and bubbling trend, the property market has entered the slump period in recent three years triggered by the aggressive deleveraging and reverse urbanization effects of the pandemic. New property sales, starts and land transactions in term of gross floor area respectively dropped 51%, 69% and 68% from the peak in 2021 to 10M24. Housing price in tier-one cities declined by around 28% from the peak in 2Q21 to 3Q24.

The property slump dragged China's economic growth. The annual average contribution of value added in the property sector to China's GDP growth declined from 0.35ppt in 2016-2019 to -0.22ppt in 2022-9M24. If we add up the impact of real estate construction, input-output effects, furniture and home furnishings-related consumption and the land-oriented fiscal system, the contribution of the broad property sector to China's GDP growth dropped from 1.4ppt in 2016-2019 to -0.18ppt in 2022-9M24.

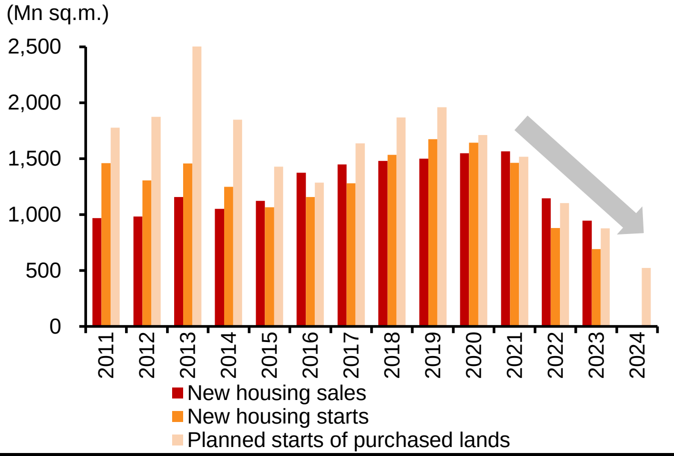
The property slump exacerbated local fiscal distress. Broad property-related fiscal revenues (property related taxes, land revenue & LGFV bond net financing) is likely to plummet from RMB13.1tn or 38.1% of local governments' total revenue to RMB5.6tn or 15.8% of local governments' total revenue in 2024. Local governments have been forced to dispose of assets, increase forfeiture, contract infrastructure projects or even postpone wage and supplier payments. The non-tax revenues and payables to suppliers have increased sharply, which hurts business confidence.

The property slump weakened household consumption by reducing employment, hurting wealth, restraining confidence and increasing deflation pressure. Based on NBS data, property service and related construction sectors accounted for 14% of total urban employment, while Chinese households allocated 60% of their total asset into the property market. The continued declines of property prices and housing rents would exacerbate deflation pressure as housing related items accounted for over 20% in China's CPI basket.

The property slump exerted pressure on the financial system. The large-scale defaults of property developers affected financial market confidence and increased bad debts of banks. The index of US dollar bonds of Chinese real estate enterprises fallen by over 70% from the peak level to date. The NPL ratio of property developer loans has increased noticeably in the past few years. However, the default rate on mortgages remained very low.

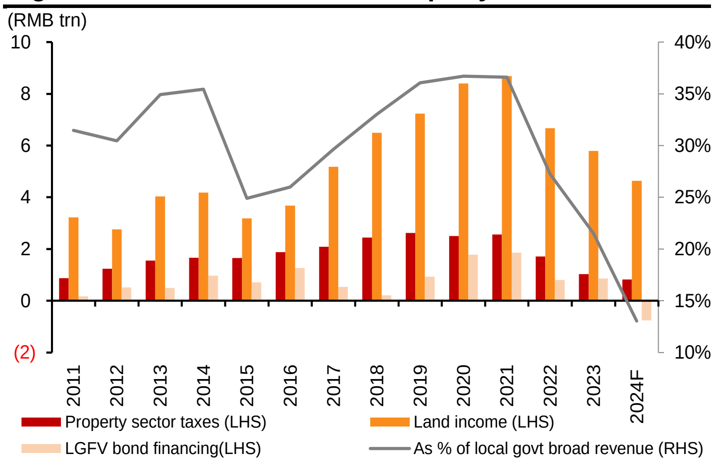
The policymakers have gradually loosened policies after the property slump, but they moved too slowly until this September when they eventually decided to launch strong stimulus. Property sales have rebounded sharply from this October with tier-one cities performing much better than lower-tier cities. Most cities still face an oversupply and downward pressure on house prices. It still needs more time and policy efforts to rebalance the supply and demand. Property might remain a drag on China economy next year, but we believe the magnitude of the drag will be moderately reduced.

**Figure 10: Sharp Decline in Housing Sales and Starts**




Source: Bloomberg, Wind, CMBIGM

**Figure 11: Local Government Property-Related Income**




Source: Bloomberg, Wind, CMBIGM estimates

**Figure 12: Real Estate Impact on China's Economy**

| (% or ppt) | 2016-2019 | 2020 | 2021 | 2022 | 2023 | 2024F | 2025F |
|---|---|---|---|---|---|---|---|
| GDP growth | 6.6 | 2.2 | 8.4 | 3.0 | 5.2 | 4.9 | 4.7 |
| Contribution from property | 1.4 | 0.7 | 0.5 | (0.4) | 0.1 | (0.3) | 0.1 |
| -Property service | 0.36 | 0.10 | 0.25 | (0.26) | (0.08) | (0.30) | (0.10) |
| -Property construction | 0.25 | 0.13 | 0.05 | 0.12 | 0.19 | 0.10 | 0.10 |
| -Input-output effect | 0.49 | 0.22 | 0.15 | 0.10 | 0.26 | 0.06 | 0.10 |
| -Land fiscal system | 0.24 | 0.29 | 0.05 | (0.32) | (0.25) | (0.13) | (0.07) |
| -Furniture & decoration consumption | 0.05 | (0.01) | 0.03 | (0.01) | (0.01) | 0.02 | 0.03 |
| Related taxes as % of govt revenue | 9.0 | 8.9 | 8.1 | 5.9 | 4.8 | 4.1 | 3.8 |
| Land income as % of govt revenue | 19.0 | 25.0 | 22.9 | 18.2 | 15.1 | 13.1 | 12.1 |
| Property loan as % of total loan | 27.3 | 28.7 | 27.1 | 24.8 | 22.2 | 20.3 | 19.3 |
| -Mortgage | 18.7 | 19.9 | 19.9 | 18.1 | 16.1 | 14.5 | 13.8 |
| -Developer loan | 8.6 | 8.8 | 7.2 | 6.7 | 6.1 | 5.8 | 5.5 |

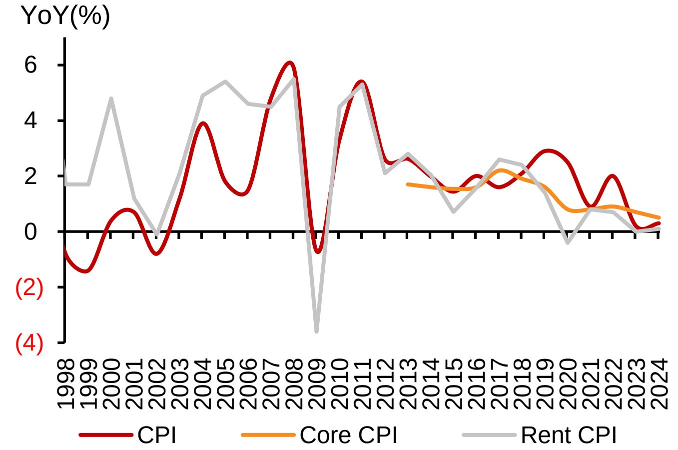
Source: Bloomberg, Wind, CMBIGM estimates

## Deflation Pressure

China economy is facing deflation pressure. The GDP deflator and PPI fell while CPI growth remained below 0.5% for two consecutive years. The causes for deflation pressure included consumer demand weakness, overcapacity and policies that stimulated investment rather than consumption. After the economic reopening in November 2022, consumer demand recovered especially for services. However, the recovery lasted only four months, then demand slowed again and remained weak. Consumer demand weakness was due to the property slump, sluggish private business capex and sharp declines in stocks which hurt household employment, income and confidence. The youth unemployment rate remained high and individual & corporate income taxes continued to decline. Consumer confidence index was low while household savings rate was high. Overcapacity problem existed in most sectors as fixed investment continued to grow faster than consumption after the economic reopening in November 2022. The optimistic expectations of a strong recovery spurred a rapid expansion of capex in the service sector in 2023 while manufacturing investment growth even exceeded the 2017-2019 level. As consumer demand recovery was short-lived after the economic reopening, oversupply and price wars ensued. China’s policies after the economic reopening focused on supporting businesses and boosting investment, with relatively limited support for households and consumption. China's social security system remains imperfect, with very low protection for the unemployed, low-income families and rural households, leaving those people in a situation where they have no money to consume. The imperfect social safety net has also increased Chinese households’ precautionary savings significantly.

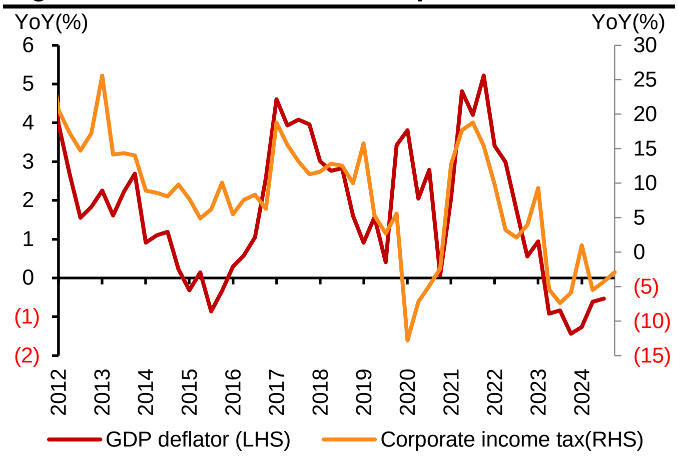
Japan's lost decades show that deflation has both cyclical and structural causes. Deflation has a self-reinforcing mechanism through deflation expectations. Deflation is very harmful for the economy as it suppresses consumer demand, increases debt burdens and weakens earnings prospects. Breaking the deflation spiral requires the decisive introduction of a comprehensive policy package. There were many reasons why Japan faced long-term deflation pressure in 1991-2010: 1) the housing and stock market bubble burst in 1991 caused a ‘balance sheet recession’ in the private sector as both households and corporates cut their expenditures to repay their debt or increase savings; 2) the large increase in toxic assets of financial institutions lowered their ability and willingness to supply credit while the Japanese government was hesitant to inject public funds for bailouts; 3) the aging of the population reduced the potential growth of domestic demand and the economy; 4) the US trade protection limited Japan's export growth, technological progress and industrial upgrading; 5) the large-scale fixed investment in the booming era became excessive capacity; 6) the BOJ’s response after the bubble burst was too slow and conservative; 7) the Japanese government allocated a large amount of public funds into inefficient investment, which had a limited boost on consumer demand; 8) technological innovation and globalization increased productivity and international competition; and 9) the savings rate in Japan was high as people in the East Asian nations are generally more aware of the future uncertainty. The bubble burst caused Japanese households to become more risk-averse with an increase in savings rate.

**Figure 13: CPI Growth**



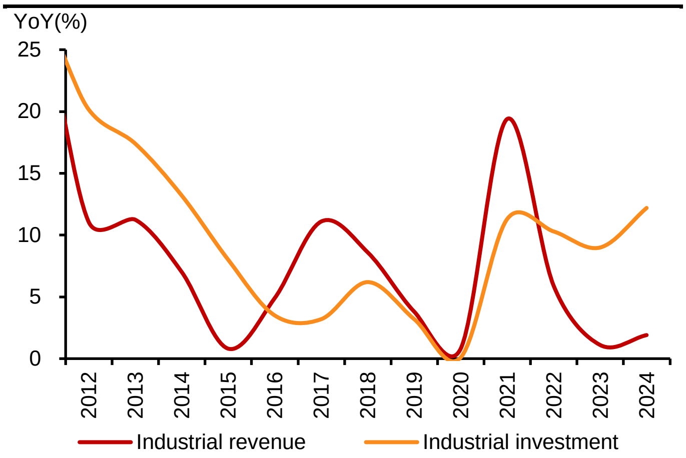

Source: Bloomberg, Wind, CMBIGM

**Figure 14: GDP Deflator and Corporate Tax Growth**



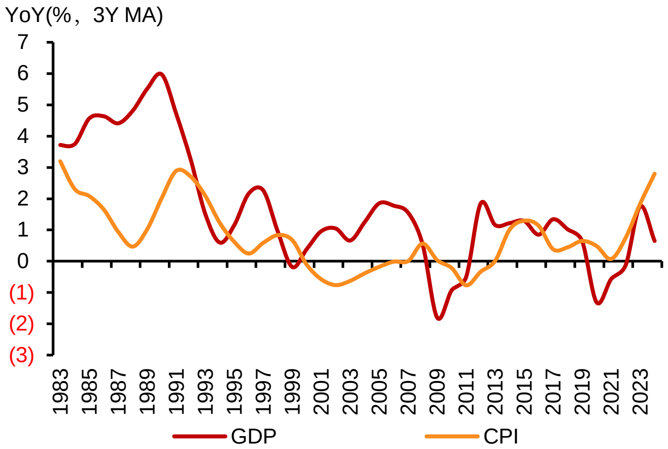

Source: Bloomberg, Wind, CMBIGM

**Figure 15: Industrial Investment and Revenue Growth**




Source: Bloomberg, Wind, CMBIGM

**Figure 16: Japan GDP and CPI Growth**




Source: Bloomberg, Wind, CMBIGM

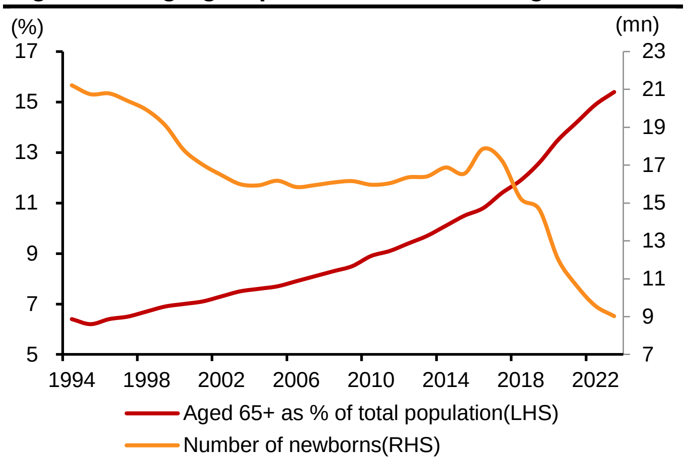
## Structural Problems

First is aging population and declining births. The impacts on the economy include reducing labour supply, weakening innovation dynamics, lowering potential growth, increasing social security deficits, pushing up government debt, and changing the structure of consumption. China's population aged 60 or older and its share of the population respectively rose from 202mn and 14.8% in 2013 to 296mn and 21.1% in 2023, and may reach 370mn and 26% in 2030 based on our estimates. The number of births dropped from 17.23mn in 2017 to 9.02mn in 2023 and may fall to 7mn in 2030. The working-age population peaked in 2013 and declined 0.6% on annual average in 2013-2023. We expect the annual average decline might widen to 0.7% in 2024-2030. After taking delayed retirement into account, the decline might narrow to 0.5%. The contributors/recipients ratio of urban workers' pension insurance declined from 3 times in 2013 to 2.67 times in 2023, and is expected to fall to 2.45 times in 2030. The social security fund, excluding fiscal subsidies, has already shifted from a surplus to a deficit in 2013, with the deficit rising to RMB1tn in 2023. Fiscal subsidies to the social security fund rose to RMB2.4tn or 1.9% of GDP in 2024 and might continue to increase in the future. Population aging and childlessness will raise consumer demand for healthcare, retirement, and nursing care, and lower consumer demand for education services and children's goods.

Second is the institutional inequality for different groups of people. For example, the household registration system is divided into the agricultural and the non-agricultural. There is a wide gap between the two groups in employment opportunities, education, social security and other public services. The wide gap constitutes an obstacle to the free flow of labors, economic efficiency, social fairness and common prosperity. The land system also harms rural households. China’s incremental construction land in cities and towns mainly comes from occupying rural land. However, local governments receive the huge value-added gains from converting rural land to urban construction land to support infrastructure construction, industrial investment and public service improvement in cities. Farmers or rural households as the collective owners of rural land only receive little compensation calculated on the basis of the agricultural output value. We estimate total land transfer revenue reached RMB56.2trn in 2013-2022, equivalent to 11% of households disposable income.

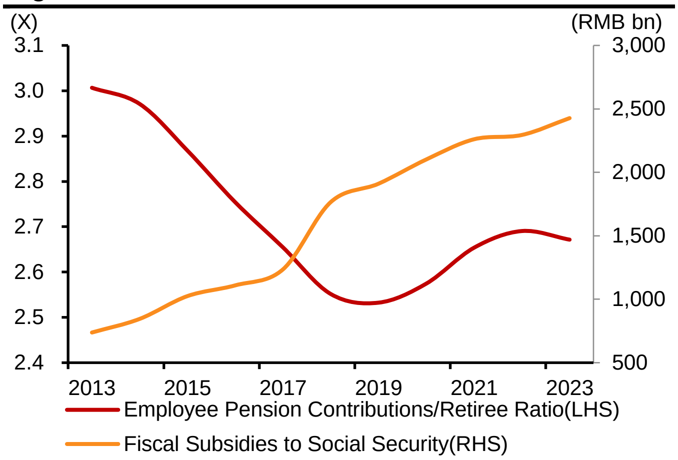
Third is a weakening of market incentives. In the face of the China-US Cold War risk, China has placed greater emphasis on national security, with a more centralised decision-making system, a stronger role for the government in resource allocation, and a rising share of the state-owned sector in the economy. In 2022-10M24, the average annual growth rates of investment by SOEs, private enterprises and foreign enterprises respectively reached 7.6%, 0.1% and -8.2%. The history of China's central-planned economy suggests that over-reliance on government planning and the state sector can lead to inefficient resource allocation, insufficient market incentives, soft budget constraints, distorted information transmission, increased decision-making errors, decreased innovation dynamism, structural imbalances in the economy, and a rise in international conflicts.

**Figure 17: Aging Population and Declining Births**



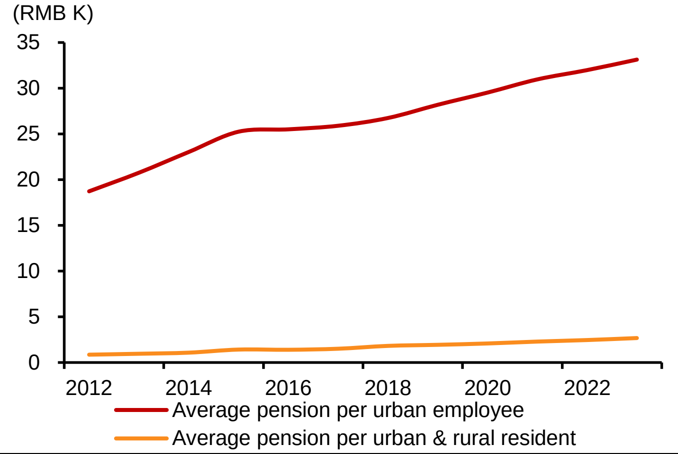

Source: Bloomberg, Wind, CMBIGM

**Figure 18: Pension Deficit Pressure**



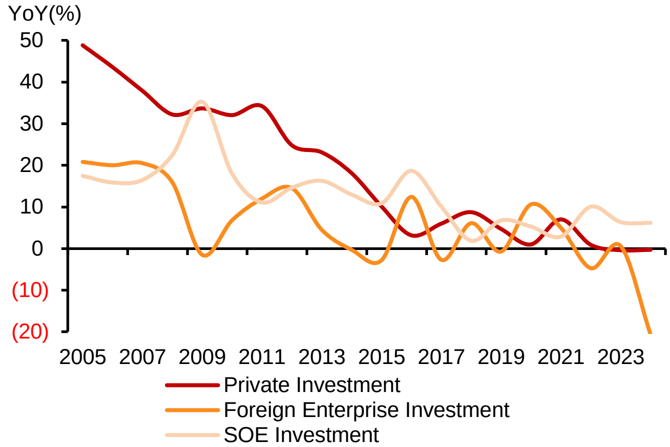

Source: Bloomberg, Wind, CMBIGM

**Figure 19: Pension Benefit Differential**




Source: Bloomberg, Wind, CMBIGM

**Figure 20: FAI Growth Rates by Enterprises**




Source: Bloomberg, Wind, CMBIGM

# Key Policies

## Policy framework

China's policy has shifted to strong easing. The top leaders became more acutely aware of the severe challenges facing the economy in September 2024 as the GDP growth dropped far below the target in 2-3Q24 with continued deterioration in the property market, fiscal revenue and employment conditions. Central ministries were required to introduce effective policies to support the economy. The central bank and financial market regulators took the lead in sending the policy-shift signals in the press conference on 24 September with the announcement of large cuts in RRR, policy rates & existing mortgage rates, more credit supply to whitelisted real estate companies, and the creation of a stock-swap refinancing mechanism to non-bank financial institutions and a refinancing mechanism for stock buybacks or key shareholders' stock purchase. China's market sentiment sharply improved. On 26 September, the Politburo confirmed the policy shift by calling for stronger policies to push the economy into a sustainable rebound. China's stock market entered into a frenzied mode with investor expectations for the policy outlook rising to a high level. Perhaps out of concern that market sentiment was overheating, an official from the central bank said on 7 October that banks are forbidden from supplying loans to individuals for stock purchase. At the same day, the NDRC held a press conference containing no news on the policy side. Investor sentiment turned bad. The Ministry of Finance held a press conference on 12 October to reiterate that there is a relatively large-scale fiscal policy, but did not give specific numbers, which is basically in line with the expectations. We believe China's policy has seen the pro-growth shift, which was similar to the removal of the Covid Zero policy in November 2022. The two policy shifts were both sudden top-down changes, triggering large swings in market expectations.

China is likely to keep its GDP growth target unchanged at 5% for 2025, in our view. The Politburo meeting and the Central Economic Work Conference this week will set key economic targets and policy tone for next year. The state council will make the information public in its work report during the NPC meeting in early March next year. The 2025 GDP growth target is likely to remain at around 5% as the policymakers try to show their pro-growth commitment. The 5% target is very challenging considering the Trump 2.0 shock and other uncertainties. Some experts suggested a more pragmatic and flexible target at 4.5%-5%, but policymakers' eagerness to show their determination to boost growth makes a target of 5% more likely.

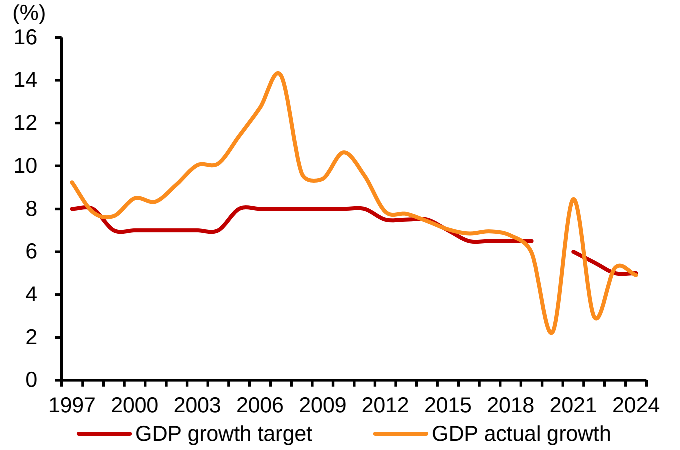
The CPI growth target may be also unchanged at 3% for 2025. The real meaning of China's inflation target seems to be no more than 3% as the target is not binding on policy. In the past 10 years, CPI growth has never exceeded 3%. After the economic reopening, China has faced deflation instead of reflation pressure. The central bank seems to have a clear mind on deflation pressure as it has repeatedly mentioned to push for a moderate price pick-up in future and its former governor Yi Gang said in September that China should focus on fending off deflation pressures and seeking positive GDP deflator growth in the next few quarters. However, China's central bank has multiple targets and the monetary policy is not anchored to a single target for inflation. In addition, higher-level policymakers and other ministries have never openly mentioned deflation pressure. Therefore, the priority of defying deflation pressure in China's policy reaction function is not clear. The central bank cannot prospectively fight deflation by effectively guiding expectations. The good thing is that China's pro-growth goal is in line with the direction of resisting deflation.

The target for urban surveyed unemployment rate is likely to remain at 5.5% for 2025. Despite high unemployment pressure, it is not difficult to achieve this target, in our view. From the statistical perspective, as long as one is engaged in a remunerated activity for up to one hour in the past week, he or she is considered to be employed. The definition of employment is a uniform international standard, but its applicability in China deserves to be studied. Chinese people are hardworking and family oriented, as most workers are willing to engage in temporary work after being unemployed. Therefore, China's urban surveyed unemployment rate has already fallen to pre-pandemic levels. However, the unemployment rate remains high for young people born in an era of abundance, as they demand higher quality jobs.

Macro policy will be more accommodative in 2025. Policymakers will focus on stabilising property and stock markets, boosting consumption and encouraging technological innovation. Fiscal policy will be more expansionary with the broad fiscal deficit ratio likely to rise by almost 2ppts to relieve local fiscal pressures, inject capital into large state-owned banks, stabilise the property market, extend the ‘trade-in’ subsidies for equipment & durables, and cut taxes for SMEs. Monetary policy will be more accommodative with the stance shifting from prudent to moderately easing, the first change since the global financial crisis in 2009. We expect the RRR, money market rates and LPRs could decline by 1ppt, 30bps and 20bps respectively in 2025. Liquidity conditions should ease significantly, credit growth could stabilize with slight pick-up and RMB could weaken further against the USD. Policymakers aim to stabilise the property market. New mortgage contract rates may decline further by 20-30bps along with the LPR cuts and removal of second-mortgage policy restrictions. Tier-one cities might further ease or remove their restrictions on home purchases. Local governments will be encouraged to expand the renovation of urban villages and acquire unsold commercial properties and vacant land to accelerate the rebalancing of housing supply and demand. Policymakers attract long-term funds, promote dividend payout, support M&As and improve corporate governance to boost the stock market. Policymakers will strengthen social safety net and increase transfers for the unemployed, low-income households and families with multiple births to boost domestic consumption. Policymakers will also promote technological innovation and business confidence by improving business environment and accelerating market opening.

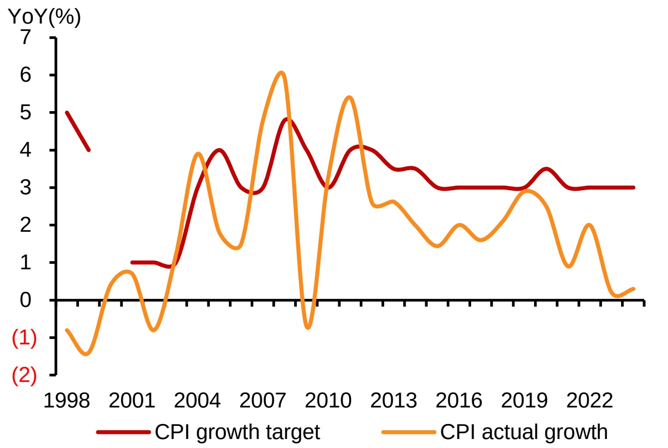
We believe China’s policy progress in 2025 depends on its economic dynamics and when the Trump 2.0 shock will come. China’s policy may remain accommodative and stable in 1H25 when the economy is likely to continue to recover. The latest round of policy stimulus could support property sales and durables consumption for 2-3 quarters. Exporters will front-load shipments in anticipation of higher tariffs in future. However, the economy may slow again in 2H25 as the policy stimulus effect might diminish and the Trump 2.0 shock might come. Then China may launch another round of stimulus policies to stabilize economic growth. China may prepare for the Trump 2.0 shock, but may not introduce countermeasures in advance before the shock arrives, in our view.

**Figure 21: GDP Growth Target vs. Actual Growth**



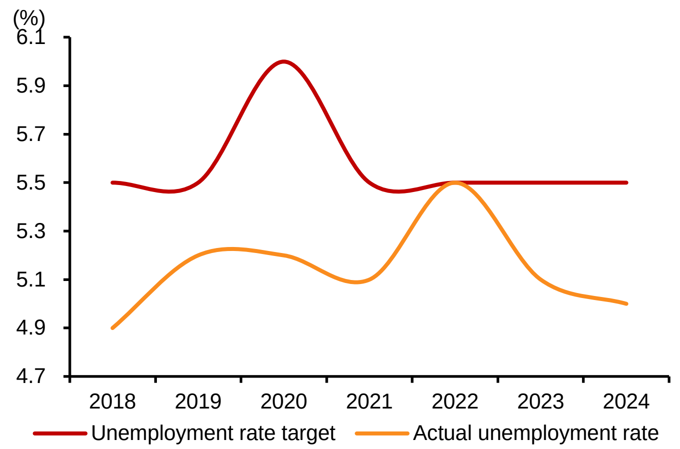

Source: Bloomberg, Wind, CMBIGM

**Figure 22: CPI Growth Target vs. Actual Growth**



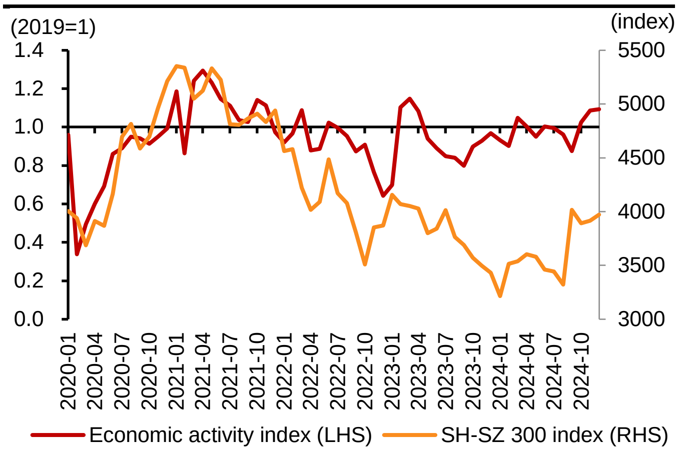

Source: Bloomberg, Wind, CMBIGM

**Figure 23: Unemployment Rate Target vs. Actual Rate**




Source: Bloomberg, Wind, CMBIGM

**Figure 24: Economic Activity and Stock Performance**




Source: Bloomberg, Wind, CMBIGM

## Fiscal Policy

Fiscal policy could be more expansionary. Broad fiscal deficit ratio may increase. We expect general budget deficit, local government special bond quota and special Treasury bond quota to rise from RMB4.06tn (3.1% of GDP), RMB3.9bn (3% of GDP) and RMB1tn (0.8% of GDP) in 2024 to RMB5.06tn (3.7% of GDP), RMB4.4tn (3.2% of GDP) and RMB2tn (1.5% of GDP) in 2025. Based on the revenue-expenditure gaps of the four fiscal budget systems (i.e., general budget system, government fund system, state capital system and social insurance system), broad fiscal deficit may rise from 8.7% of GDP in 2024 to 9.7% of GDP in 2025 and 10.4% of GDP in 2026. Based on the net issuance of government bonds and municipal bonds, broad fiscal deficit may rise from 8% of GDP in 2024 to 9.8% of GDP in 2025 and 10% of GDP in 2026.

Fiscal policy will focus on relieving local fiscal woes, injecting capital into large state-owned banks, stabilizing the property market, safeguarding people's livelihoods and extending the 'trade-in' subsidy in 2025. First, the central government allows local governments to use RMB6tn debt swap for 2024-2026 and RMB4tn special bond funds for 2024-2028 to repay their hidden debts. The central government's transfers to local governments might rise from

RMB10tn in 2024 to RMB11tn in 2025. Those policies will alleviate debt repayment pressure and improve cash flow in the broad government sector, which is positive for LGFVs and government suppliers. Second, the central government's capital injection for six large state-owned banks may reach at least RMB600bn to alleviate their pressure in net interest margins (NIMs) and non-performing loans (NPLs) and boost their capacity in rolling over local government hidden debt and expanding credit supply to targeted sectors. Thirdly, the central government will encourage municipal governments to renovate urban villages and acquire unsold properties and idle land. The proposed urban village renovation and property acquisition could accelerate the rebalancing of housing supply and demand, but the actual progress is still facing pain points, such as the local fiscal distress, the difficulty in achieving break-even for those projects given the property downturn cycle, and the difficulty in reaching consensus on the deal price among municipal governments, project owners and existing creditors. Fourth, the central government might strengthen social livelihood safeguarding with higher urban & rural resident pension benefits, lower the threshold for receiving unemployment insurance benefits and additional transfers to low-income households. Total amount of the incremental allocation might reach RMB200bn in 2025. Last, the central government might extend the 'trade-in' subsidy policy for business equipment and consumer durables upgrading. The subsidy budget for 2024 was RMB300bn with central government bearing 90% of the burden and enterprises & households each sharing half of the subsidies. The subsidy policy may be extended into next year with possibly more consumer durables covered by the subsidy scheme.

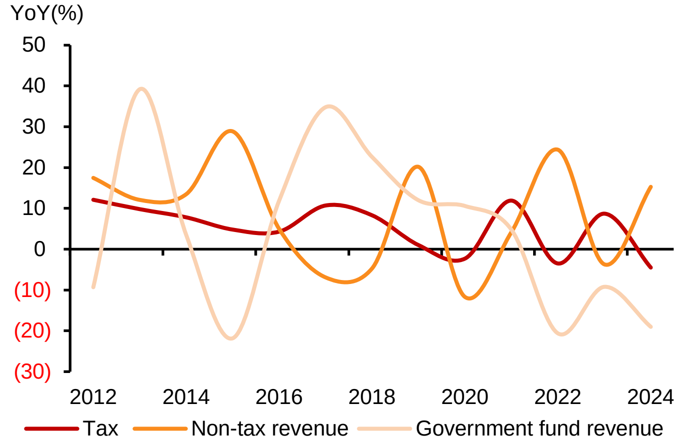
Fiscal transfers to households could be limited. By reliving local fiscal distress and boosting the property market, fiscal policy could also boost consumer confidence and alleviate deflation pressure in a gradual manner. The Trump 2.0 shock may push China's fiscal policy to place more emphasis on boosting domestic consumption, but the likelihood of large-scale fiscal transfers to households should be low, in our view. China's fiscal system has the doctrine of keeping expenditure within the limits of revenues. The current broad fiscal deficit ratio is not low and the policymakers are reluctant to further increase the deficit ratio significantly. The existing allocation pattern of fiscal funds may have solidified, with government operations, social livelihoods and infrastructural & industrial development respectively accounting for 25%, 40% and 35% of broad government expenditure. The first two expenditures are very rigid. A significant increase in transfer payments to households means a reduction in infrastructure and industrial development expenditures, which constitutes a change in the resource allocation mechanism and benefit distribution pattern. Fiscal transfers to households mean returning public funds to the private sector to let the market to decide the resource allocation. The policymakers want to leverage public funds to support supply-side technological innovation and high-end manufacturing development amid the China-US strategic competition. Local government officials also favor expenditures on infrastructure and industrial development, which creates both achievements for political promotion as well as private benefits.

## Figure 25: Broad Fiscal Revenue, Expenditure & Deficit

| (as % of GDP) | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024F | 2025F | 2026F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| General fiscal revenue | 22.1 | 21.4 | 20.7 | 19.9 | 19.3 | 18.0 | 17.6 | 16.9 | 17.2 | 16.5 | 16.2 | 15.8 |
| General fiscal expenditure | 25.5 | 25.2 | 24.4 | 24.0 | 24.2 | 24.2 | 21.4 | 21.6 | 21.8 | 21.3 | 21.4 | 21.2 |
| *expenditure-revenue* | 3.4 | 3.8 | 3.7 | 4.1 | 4.9 | 6.2 | 3.8 | 4.7 | 4.6 | 4.8 | 5.1 | 5.3 |
| Government fund revenue (over 80% is land income) | 6.1 | 6.2 | 7.4 | 8.2 | 8.6 | 9.2 | 8.5 | 6.5 | 5.6 | 4.4 | 3.9 | 3.6 |
| Government fund expenditure | 6.1 | 6.3 | 7.3 | 8.8 | 9.3 | 11.6 | 9.9 | 9.2 | 8.0 | 7.4 | 7.2 | 7.2 |
| *expenditure-revenue* | 0.0 | 0.0 | (0.1) | 0.6 | 0.7 | 2.4 | 1.3 | 2.7 | 2.4 | 3.0 | 3.3 | 3.6 |
| State capital system revenue (e.g. SOE dividend) | 0.4 | 0.3 | 0.3 | 0.3 | 0.4 | 0.5 | 0.4 | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 |
| State capital system expenditure | 0.3 | 0.3 | 0.3 | 0.2 | 0.2 | 0.3 | 0.2 | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 |
| *expenditure-revenue* | (0.1) | (0.1) | (0.1) | (0.1) | (0.2) | (0.2) | (0.2) | (0.2) | (0.3) | (0.2) | (0.2) | (0.2) |
| Social insurance revenue (excluding fiscal subsidy) | 5.2 | 5.2 | 5.5 | 6.7 | 6.5 | 5.4 | 6.5 | 6.6 | 7.0 | 7.1 | 7.1 | 7.1 |
| Social insurance expenditure | 5.7 | 5.8 | 5.8 | 7.3 | 7.6 | 7.7 | 7.5 | 7.5 | 7.9 | 8.2 | 8.4 | 8.6 |
| *expenditure-revenue* | 0.4 | 0.6 | 0.3 | 0.7 | 1.1 | 2.3 | 1.1 | 0.9 | 0.8 | 1.0 | 1.3 | 1.5 |
| Broad fiscal revenue | 33.9 | 33.2 | 34.0 | 35.1 | 34.8 | 33.2 | 33.1 | 30.4 | 30.4 | 28.5 | 27.7 | 27.0 |
| Broad fiscal expenditure | 37.7 | 37.6 | 37.8 | 40.4 | 41.3 | 43.9 | 39.0 | 38.6 | 37.9 | 37.2 | 37.2 | 37.2 |
| **Broad fiscal deficit I** | **3.8** | **4.4** | **3.9** | **5.2** | **6.5** | **10.7** | **5.9** | **8.2** | **7.6** | **8.7** | **9.5** | **10.2** |
| + LG debt swap | 4.6 | 6.5 | 3.3 | 1.4 | 0.2 | 0.1 | 0.4 | 0.4 | 1.1 | 1.5 | 1.5 | 1.4 |
| + LGFV bond financing | 1.6 | 1.7 | 0.6 | 0.2 | 1.0 | 1.8 | 1.7 | 0.7 | 0.7 | (1.0) | (0.6) | (0.3) |
| **Broad fiscal deficit II** | **10.0** | **12.6** | **7.8** | **6.9** | **7.7** | **12.6** | **8.1** | **9.3** | **9.3** | **9.2** | **10.4** | **11.3** |
| General fiscal deficit | 2.4 | 2.9 | 2.9 | 2.6 | 2.8 | 3.7 | 3.1 | 2.8 | 3.1 | 3.1 | 3.7 | 3.7 |
| Special treasury bond quota | | | | | | 1.0 | | | | 0.8 | 1.5 | 1.4 |
| LG special bond quota | 0.1 | 0.5 | 1.0 | 1.5 | 2.2 | 3.7 | 3.2 | 3.0 | 3.0 | 3.0 | 3.2 | 3.3 |
| **Broad fiscal deficit III** | **2.5** | **3.5** | **3.8** | **4.1** | **5.0** | **7.4** | **6.3** | **5.8** | **6.1** | **6.1** | **6.9** | **7.0** |
| **Broad fiscal deficit IV (Government & LGFV bond financing)** | **8.5** | **11.2** | **7.4** | **5.4** | **5.8** | **10.1** | **7.9** | **6.6** | **8.5** | **8.0** | **9.8** | **10.0** |

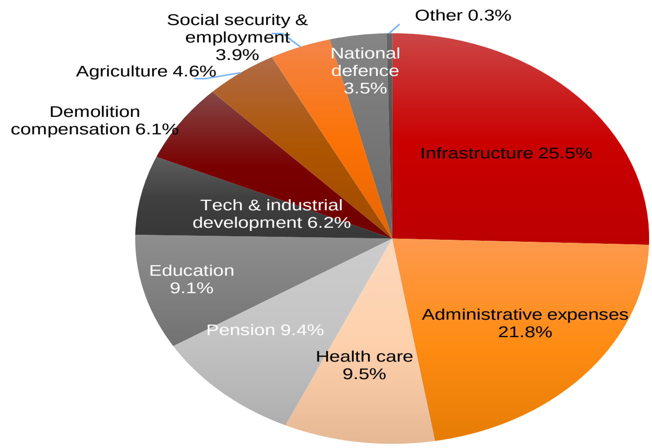
Source: Bloomberg, Wind, CMBIGM estimates

## Figure 26: Government Revenue Growth




Source: Bloomberg, Wind, CMBIGM

## Figure 27: Broad Fiscal Expenditure Structure (2023)




Source: Bloomberg, Wind, CMBIGM

## Monetary Policy

Liquidity condition could be more easing in 2025. The PBOC might cut RRR by 1ppt and open market refinancing rates by 30bps. Interbank 7D reverse repo rate (DR007) may fall from 1.7% at end-2024 to 1.4% at end-2025. By highlighting the role of interest rate transmission mechanism in monetary policy, the central bank may rely more heavily on money market rate as the policy rate. This implies substantial easing of money market liquidity. Central banks in developed countries generally use overnight or 7D money market rates as their operation targets to influence the securities market, credit market, FX market and expectations to achieve the final target of price stability or employment maximization. Money market as the starting point of monetary policy transmission has a fundamental role to play. The securities market is more responsive to money market changes than the credit market.

The PBOC has long relied on deposit and lending rates as the policy rates, bypassing the money market and securities market transmission to directly change the financing costs for the real sector. Such practice has four major drawbacks, in our view. First, deposit and loan rates are sticky while the central bank needs flexibility in policy rate due to economic uncertainty. Second, it inhibits the development of financial markets and lowers the efficiency of financial resource allocation. Third, it strengthens the dominant role of banks in the financial system and slows the development of the securities market. Last, it weakens the feedback mechanism of financial markets to the central bank, increasing the risk of policy error.

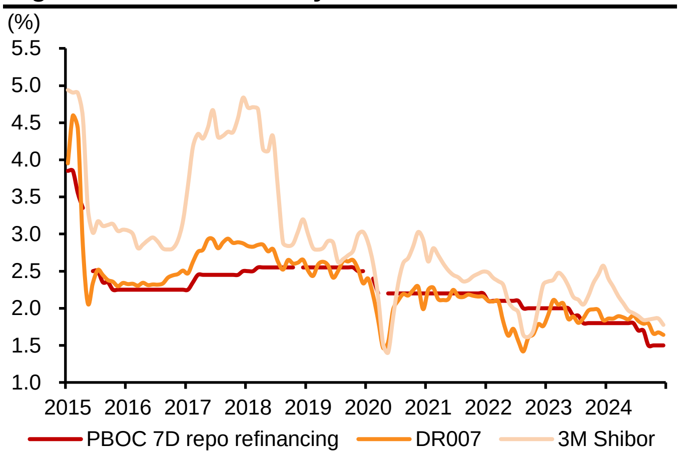
The PBOC has lowered open market operating rates and RRR in recent two years, yet with a limited impact on China's money market rates. The annual average level of DR007 rose from 1.8% in 2022 to 2% in 2023 and 1.9% in 8M24. Meanwhile, market expectations on economic outlook significantly deteriorated as annual average 10Y T-bond yields fell sharply from 2.77% in 2022 to 2.73% in 2023 and 2.2% in 8M24. The sharp narrowing of bond-money interest rate spreads sounded an alarm for the financial system. The central bank initially chose to alert the market to the risk of bond yields being too low. Unlike the A-share market with many noise traders, the bond market is dominated by large financial institutions and is very efficient. It actually sends a signal to the central bank that it should reduce money market rates rather than trying to pushing up bond yields. After the policy shift in September, DR007 dropped noticeably to 1.67%. The 1Y T-bond yields declined to 1.37% recently, indicating additional cuts in money market rates in the next four quarters.

China may further loosen credit policy and we expect a slight rebound in credit growth in 2025. The PBOC might cut LPRs by 20bps with 1Y and 5Y LPRs respectively down from 3.1% and 3.6% at end-2024 to 2.9% and 3.4% at end-2025. Outstanding social financing and RMB loans might slightly pick up 8% and 8.1% at end-2025 after rising 7.8% and 8% at end-2024. The trend of LPRs is strongly correlated with medium-term T-bond yields with some time lag between changes. Both 1Y and 5Y T-bond yields have declined by around 90bps since 2022 while 1Y and 5Y LPRs have declined by 70bps and 105 bps during the same period. The PBOC indicated in its recent monetary policy report to facilitate a mild decline in financing costs for the real sector. In order to alleviate banks' pressure in NIMs, deposit rates may be cut by about 20bps. As deposit repricing is significantly slower than lending, banks' NIMs might still face downward pressure.

Credit demand from governments and households might improve in 2025. Higher broad fiscal deficit ratio implies an increase in government financing. We estimate the growth of outstanding government bonds to rise from 15.5% at end-2024 to 17.5% at end-2025, pushing up outstanding social financing growth by 0.4ppt. Loans to households might pick up 4.3% at end-2025 after rising 3.5% at end-2024, with its contribution to outstanding social financing growth up by 0.2ppt. Major catalysts include an improvement in housing sales, durables consumption and stock market sentiment. However, corporate credit demand might remain weak due to overcapacity, deflation pressure and the shift of some capex from domestic to overseas. We expect the growth of outstanding business loans and corporate bonds to fall from 8% at end-2024 to 7.6% at end-2025, pulling down outstanding social financing growth by 0.2ppt. Outstanding social financing growth has a close negative correlation with real-term loan rates. Real-term loan rates should decline next year with a moderate decrease in nominal interest rates and a gradual alleviation in deflation. By sector, credit supply to high-end manufacturing, technology, digital economy, modern services and green development should maintain higher growth rates than total loan growth, in our view.

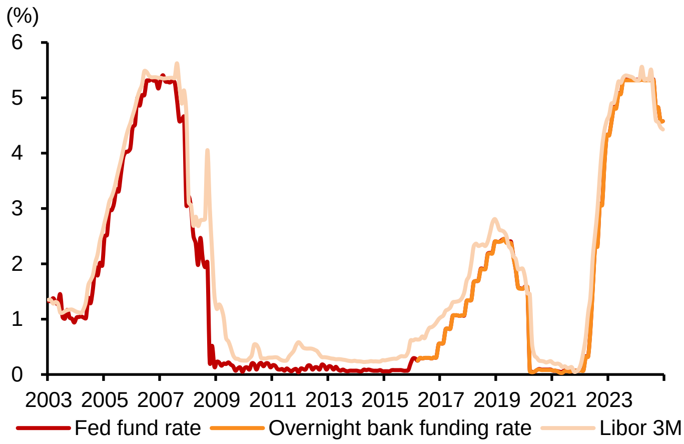
RMB exchange rates could be more flexible to absorb the Trump 2.0 shock in 2025. The PBOC said the market should play a decisive role in FX rates as flexible exchange rates are an automatic stabilizer to absorb external shocks. The central bank also said to strengthen the guidance of expectations to prevent disorderly movements or overshooting risks of RMB exchange rates. In other words, market supply and demand determines the medium- and long-term trend of RMB exchange rates while the PBOC has some influence in the short term by managing market expectations. Since 2017, the FX position at historical price on the PBOC's balance sheet has remained stable. The central bank has abandoned direct exchange rate interventions through the sale and purchase of FX. The central bank has used indirect ways including verbal intervention, fixing rate signals and window guidance on large state-owned banks to influence RMB exchange rates. In face of the Trump 2.0 shock, the PBOC will let RMB exchange rates to go down and to further cut RMB interest rates. In our baseline scenario (30% US tariffs on China, 10% tariffs on others and 5% tariffs on the US by major partner countries), US$/RMB could rise to 7.50 at end-2025. In our pessimistic scenario (60% US tariffs on China, 20% tariffs on others and 10% tariffs on the US by major partner countries), US$ /RMB could reach 7.80.

**Figure 28: China's Money Market Rates**



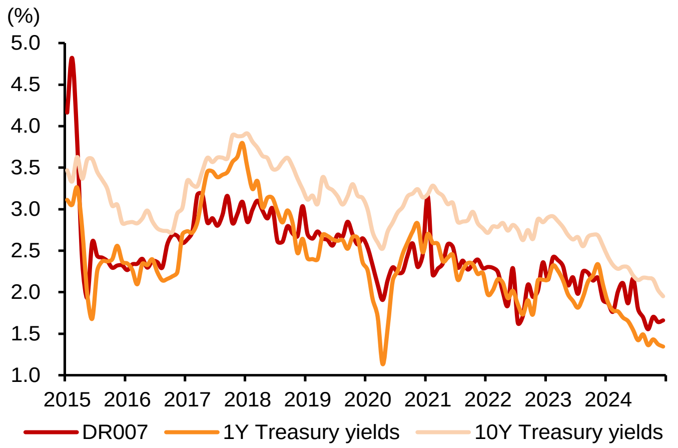

Source: Bloomberg, Wind, CMBIGM

**Figure 29: US Money Market Rates**



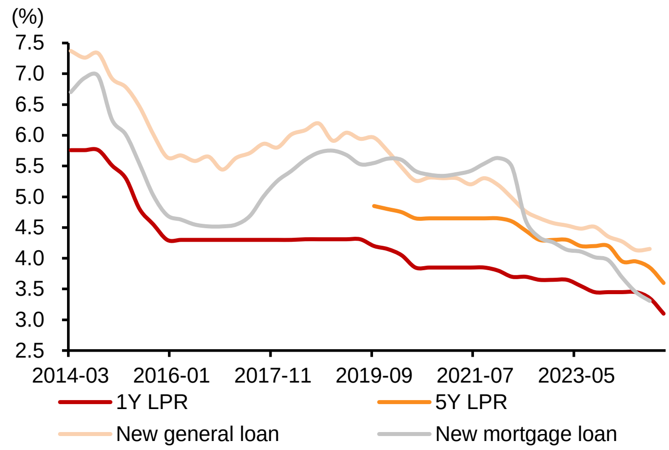

Source: Bloomberg, Wind, CMBIGM

### Figure 30: China Treasury Yields



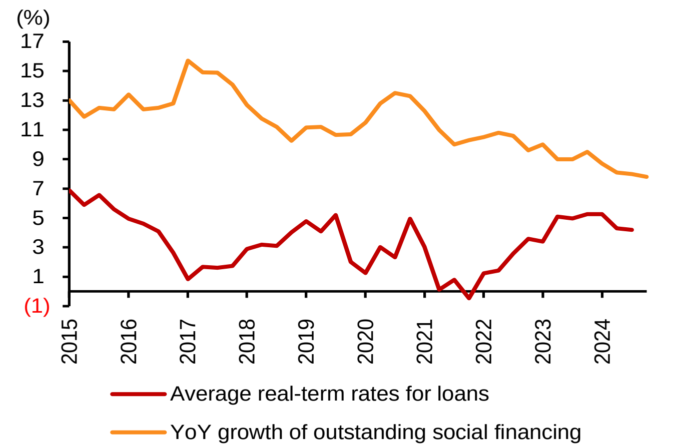

Source: Bloomberg, Wind, CMBIGM

### Figure 31: LPRs and New Loan Contract Rates



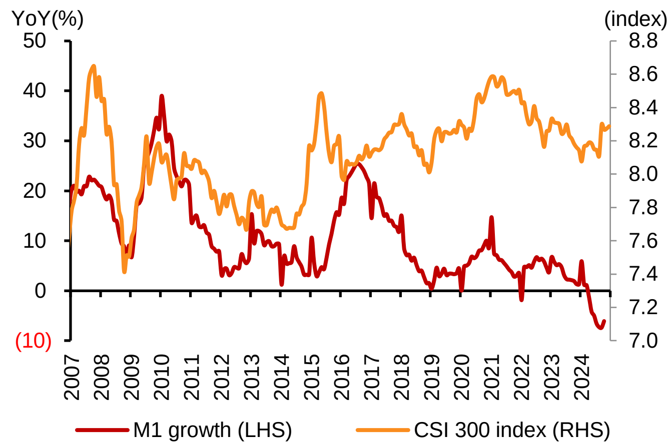

Source: Bloomberg, Wind, CMBIGM

### Figure 32: Real-term Loan Rates & Credit Growth



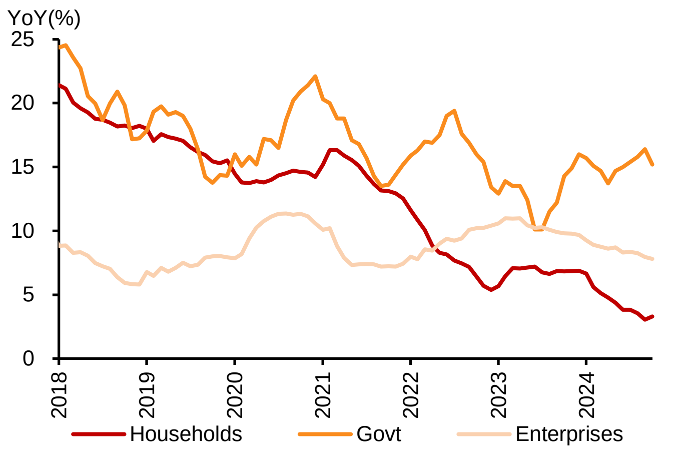

Source: Bloomberg, Wind, CMBIGM

### Figure 33: M1 Growth and CSI 300 Index



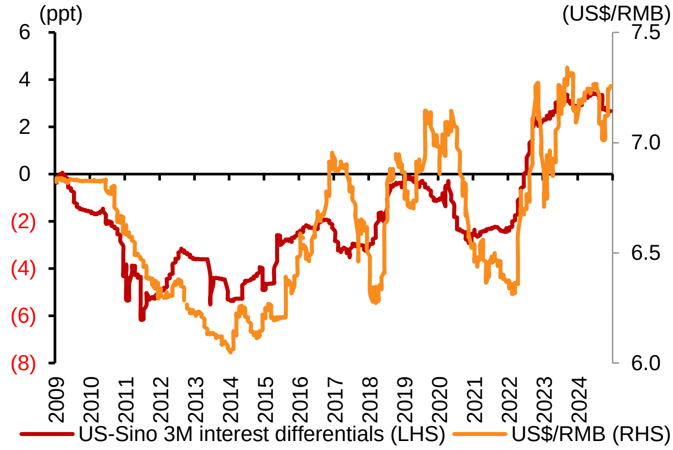

Source: Bloomberg, Wind, CMBIGM

### Figure 34: Growth of Credit to Real Sectors



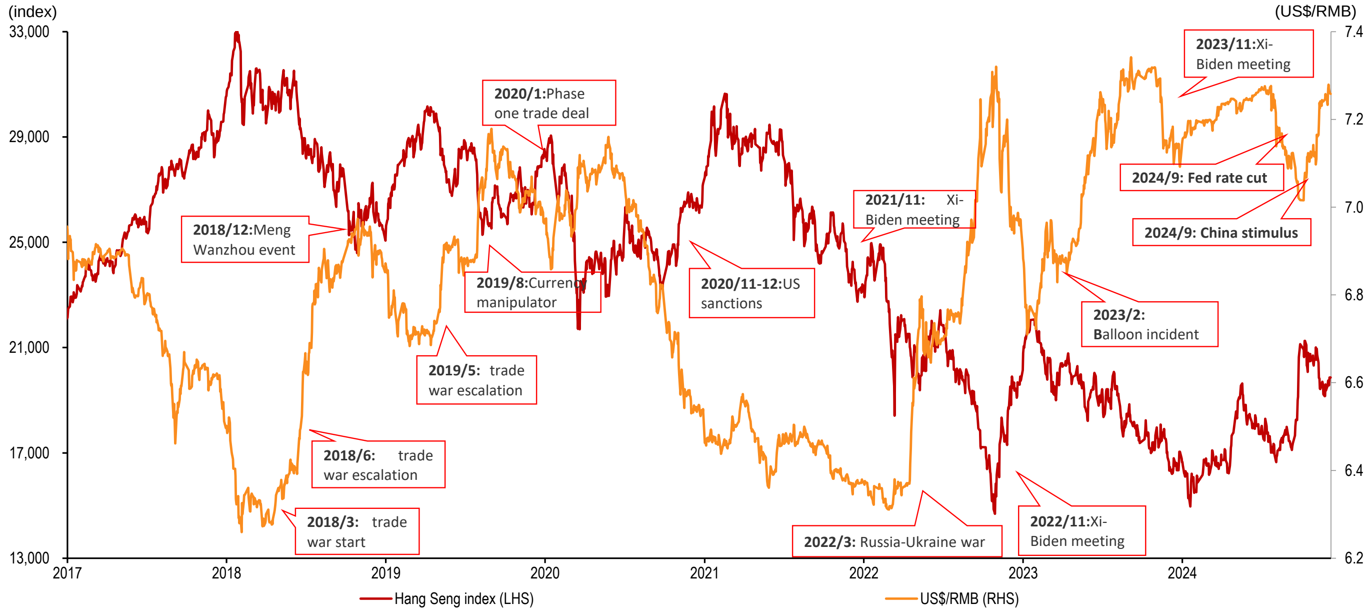

Source: Bloomberg, Wind, CMBIGM

### Figure 35: USD/CNY & Interest Rate Differentials




Source: Bloomberg, Wind, CMBIGM

## Figure 36: HSI and USD/CNY Exchange Rate as U.S.-China Relations Barometer




Source: Bloomberg, Wind, CMBIGM

# Economic Trends

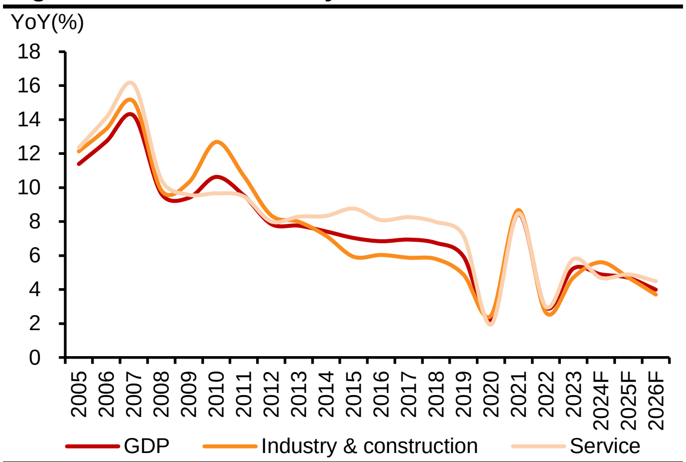
## Growth and Inflation

China economy has seen recovery signs recently. The economy entered a bottom in 2022 due to the pandemic shock, aggressive property deleveraging and regulatory crackdown over capitalism. As a result, the stock market crashed, the property market started to slump and deflation pressure appeared. After economic reopening in late 2022, the service economy rebounded yet the recovery only lasted for four months. From 2Q23, the economy weakened again with a continued property slump, consumer demand weakness, export deterioration and deflation pressure. In 9M24, the economy remained weak with exports picking up yet domestic demand still sluggish. The economy has seen recovery signs in 4Q24 as the latest policy stimulus has boosted stock market confidence, housing sales and durables consumption while the tariff expectations have stimulated a front-loading of trade shipments. We expect China’s GDP growth to rise from 4.7% in 2Q24 and 4.6% in 3Q24 to 5.1% in 4Q24.

China economy may continue to improve in the short term, but may face the Trump 2.0 shock in the medium term. GDP growth might reach 5% in 1Q25 and 5.1% in 2Q25 as the policy stimulus continues to boost domestic demand and overseas interest rate cuts and tariff expectations stimulate China’s exports. However, GDP growth may fall to 4.7% in 3Q25 and 4.3% in 4Q25 as the policy stimulus effect diminishes and the trade war comes. For the whole year, we expect GDP growth to slow from 4.9% in 2024 to 4.7% in 2025 and 4% in 2026, with the contribution from net exports down from 1.2ppt in 2024 to 0.6ppt in 2025 and -0.4ppt in 2026. Meanwhile, the contribution of consumption and investment to GDP growth might rise from 2.4ppts and 1.3ppt to 2.7ppts and 1.4ppt, and then to 2.8ppts and 1.6ppt, respectively.

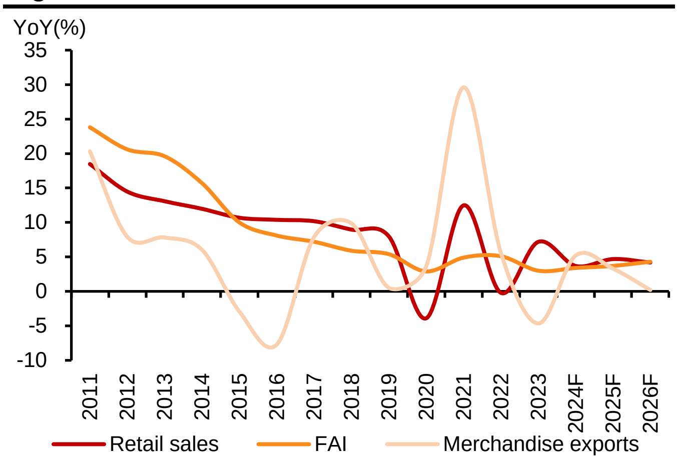
Deflation pressure is likely to fall in 2025 before rising again in 2026. CPI growth may rise from 0.3% in 2024 to 0.6% in 2025 with the peak at around 1% in 1Q25, thanks to property and durables consumption recovery. As domestic demand recovery softens and trade conflict starts to slow exports, CPI growth might fall again to 0.4% in 2026. PPI may continue to fall with the decline likely to narrow from 2.1% in 2024 to 0.3% in 2025 and widen to 0.7% in 2026. GDP deflator might pick up 0.2% in 2025 after dropping 0.7% in 2024. Its growth might decline to 0% in 2026 as the economy is expected to slow again. Deflation pressure is likely to persist, as most sectors would continue to see supply exceeding demand significantly and the Trump 2.0 shock might dampen global economic prospects.

**Figure 37: GDP Growth by Sector**



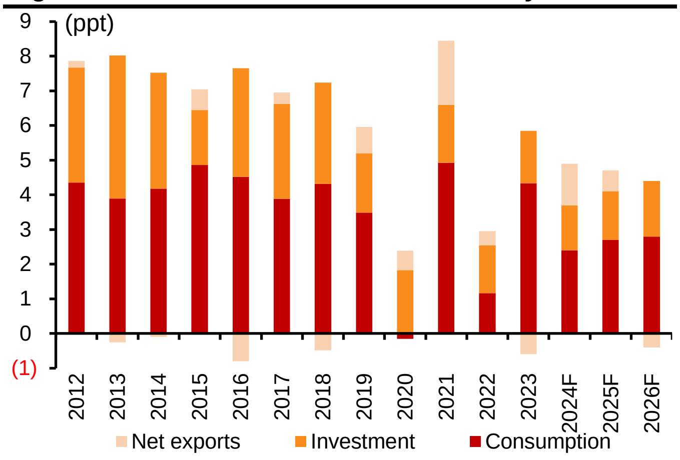

Source: Bloomberg, Wind, CMBIGM estimates

**Figure 38: Demand Growth**



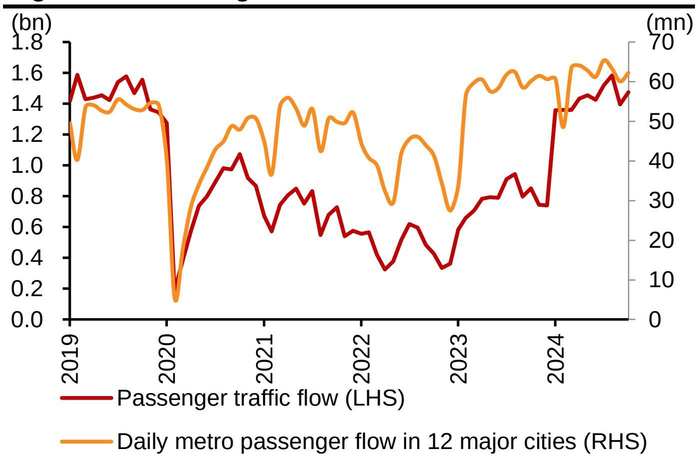

Source: Bloomberg, Wind, CMBIGM estimates

**Figure 39: Contribution to GDP Growth by Demand**



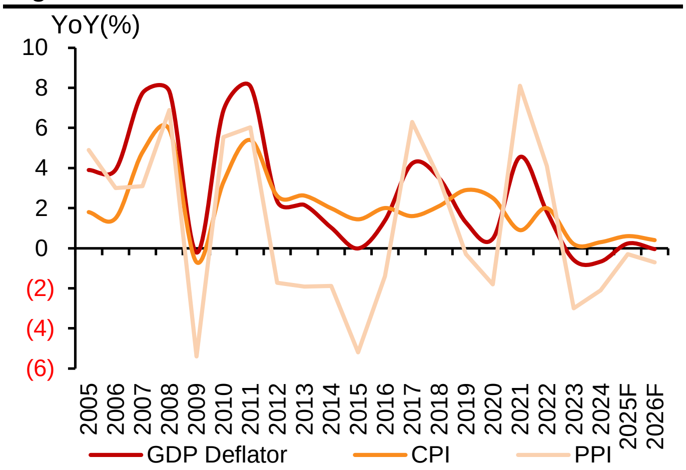

Source: Bloomberg, Wind, CMBIGM estimates

**Figure 40: Passenger Traffic Flow**



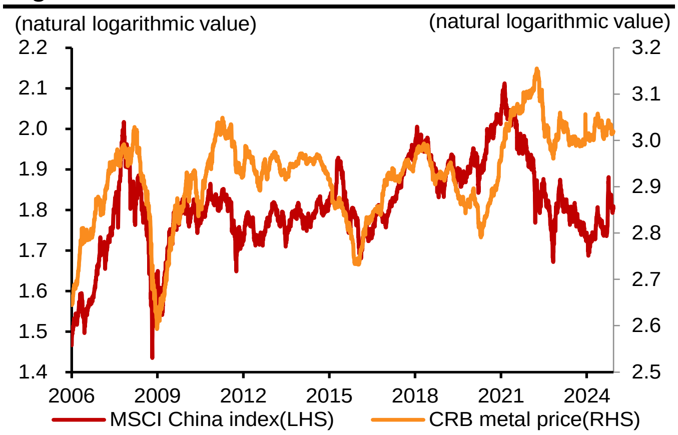

Source: Bloomberg, Wind, CMBIGM

**Figure 41: Deflation Pressure in China**




Source: Bloomberg, Wind, CMBIGM estimates

**Figure 42: China Stock Index & Global Metal Price**




Source: Bloomberg, Wind, CMBIGM

## Merchandise Exports

China's merchandise exports could maintain moderate growth in 2025 despite a slowdown after the Trump 2.0 shock. Merchandise export growth might reach 4.5% in 1H25 and slow to 2.2% in 2H25. For the full year, we expect the growth to slow down from 5.2% in 2024 to 3.3% in 2025 and 0.2% in 2026. China's merchandise exports has been in an expansionary cycle since late 2023 as overseas demand for durables and capital goods has started to improve with inventory replenishment. Overseas demand might further improve in 1H25 thanks to continued interest rate cuts, European supply chain recovery and the front-loading of foreign trade shipments amid tariff expectations. However, downside pressure might increase sharply in 2H25 if Trump launches a new round of trade war. Foreign trade performance might be even worse in 2026 especially in the first half year with a higher base.

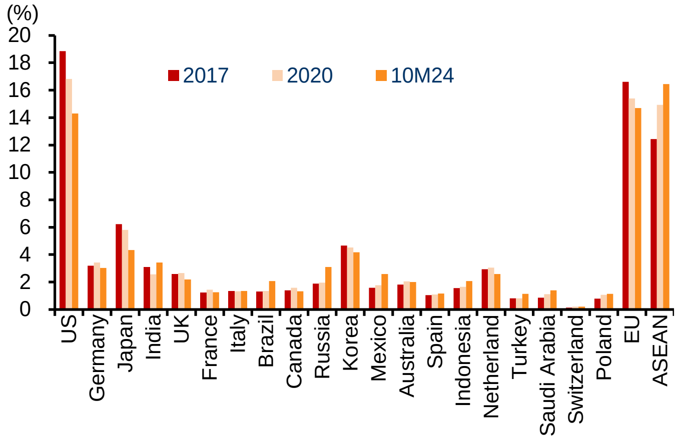
China's exports of consumer durables should maintain relatively faster growth in 2025. Benefiting from demand improvement amid interest rate cuts, mild inventory replenishment and front-loading effects, export growth in home appliances, furniture, medical equipment, computers, mobile phones, consumer electronics and integrated circuits might be higher than in other products. Auto exports might maintain moderate growth with the growth rate slowing down because of high base and rising trade barriers. China's exports to Southeast Asia, Latin America and the Middle East may continue to outperform as the country continues to enhance ties with those economies. In recent years, both multinational corporations and large Chinese companies have built production bases in those economies to overcome tariffs against China and hedge possible geopolitical risks. China has been an important supplier of components, intermediate products, equipment and production technologies to those economies.

**Figure 43: China's Exports Growth & Structure by Destination**

| | YoY (%) | | | | | | | Proportion (%) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2023 | 2023 | 2023 | 2023 | 2023 | 2023 | 10M24 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 10M24 |
| World | 9.9 | 0.5 | 3.6 | 29.6 | 5.6 | (4.7) | 5.1 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| ASEAN | 14.2 | 12.7 | 6.7 | 26.1 | 17.7 | (5.0) | 10.8 | 12.8 | 14.4 | 14.8 | 14.4 | 16.0 | 15.5 | 16.1 |
| US | 11.3 | (12.5) | 7.9 | 27.5 | 1.2 | (13.1) | 3.3 | 19.2 | 16.8 | 17.4 | 17.2 | 16.4 | 14.8 | 14.6 |
| EU | 9.8 | 4.9 | 6.7 | 32.6 | 8.6 | (10.2) | 1.9 | 16.4 | 17.2 | 15.1 | 15.4 | 15.9 | 14.8 | 14.6 |
| Latin America | 13.7 | 2.1 | (0.8) | 52.0 | 10.6 | (2.4) | 12.8 | 6.0 | 6.1 | 5.8 | 6.8 | 7.1 | 7.3 | 7.9 |
| Africa | 10.8 | 7.9 | 0.9 | 29.9 | 11.2 | 7.5 | 0.5 | 4.2 | 4.5 | 4.4 | 4.4 | 4.6 | 5.1 | 4.9 |
| Japan | 7.2 | (2.6) | (0.4) | 16.3 | 4.4 | (8.4) | (4.4) | 5.9 | 5.7 | 5.5 | 4.9 | 4.9 | 4.7 | 4.3 |
| Korea | 5.9 | 2.1 | 1.4 | 32.4 | 9.5 | (7.2) | (2.4) | 4.4 | 4.4 | 4.3 | 4.4 | 4.6 | 4.4 | 4.1 |
| India | 12.7 | (2.4) | (10.8) | 46.2 | 21.7 | 0.8 | 2.7 | 3.1 | 3.0 | 2.6 | 2.9 | 3.3 | 3.5 | 3.4 |
| Russia | 12.0 | 3.7 | 1.7 | 33.8 | 12.8 | 46.9 | 4.7 | 1.9 | 2.0 | 2.0 | 2.0 | 2.1 | 3.3 | 3.2 |
| UK | (0.3) | 10.4 | 16.3 | 19.9 | (6.1) | (3.4) | 1.0 | 2.3 | 2.5 | 2.8 | 2.6 | 2.3 | 2.3 | 2.2 |
| Australia | 14.2 | 1.8 | 10.9 | 24.2 | 19.0 | (5.3) | (3.8) | 1.9 | 1.9 | 2.1 | 2.0 | 2.2 | 2.2 | 2.0 |
| Canada | 12.1 | 5.0 | 14.0 | 22.4 | 4.5 | (14.9) | 3.9 | 1.4 | 1.5 | 1.6 | 1.5 | 1.5 | 1.3 | 1.3 |
| Saudi Arabia | (5.1) | 36.9 | 17.7 | 7.9 | 25.7 | 14.5 | 15.3 | 0.7 | 1.0 | 1.1 | 0.9 | 1.1 | 1.3 | 1.4 |
| China Hong Kong | 8.2 | (7.6) | (2.3) | 28.6 | (15.0) | (6.3) | 9.1 | 12.1 | 11.2 | 10.5 | 10.4 | 8.4 | 8.1 | 8.1 |
| China Taiwan | 10.6 | 13.2 | 9.1 | 30.4 | 4.2 | (16.0) | 9.8 | 2.0 | 2.2 | 2.3 | 2.3 | 2.3 | 2.0 | 2.1 |

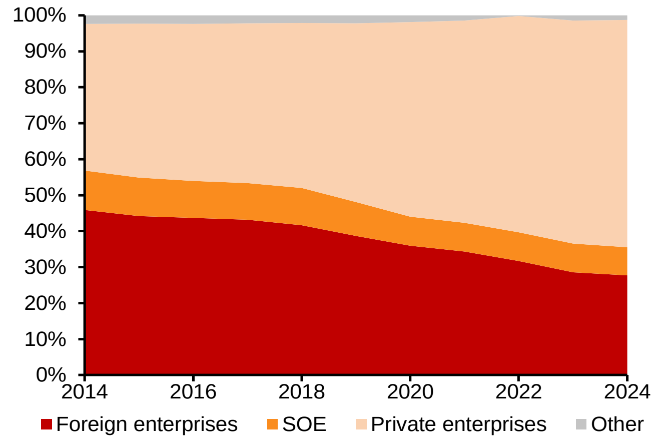
Source: Bloomberg, Wind, CMBIGM

Figure 44: Shares of Partners in China's Exports




Source: Bloomberg, Wind, CMBIGM

Figure 45: China Export Growth by Enterprise




Source: Bloomberg, Wind, CMBIGM

## Property

Property demand is likely to see cyclical recovery in 2025. Second-hand home sales as a leading indicator recovered in 2023, flattened in 2024 and might return to growth in 2025. New housing sales may significantly narrow its declines in 2025 after continued slump in 2022-2024. We expect property sales in term of gross floor area to decline 4% in 2025 after dropping 13.5% in 2024. The recovery cycle of housing demand is supported by three main factors. First is a cyclical rebound in urban migrant inflow. The urban incremental population plummeted from 17.9mn in 2020 to 6.5mn in 2022 due to the pandemic. It sharply rebounded to 12mn in 2023 after the economic reopening. Urban footfall recovered better but employment condition and individual income recovered more slowly, leading to a lagging recovery in housing and consumption demand. Second is a significant increase of home affordability. As mortgage rates and house prices have fallen sharply, home affordability has risen significantly. From 4Q21 to 3Q24, average rates for new mortgages fell by 230bps while home prices in most cities dropped by 30%. We estimate the monthly payments for 30-year mortgages might have declined by over 40%. Third, there were strict home purchase and mortgage restriction policies in higher cities in the previous years, which suppressed much demand. After the removal of policy restrictions in recent quarters, pent-up demand may gradually be released, boosting short-term home sales.

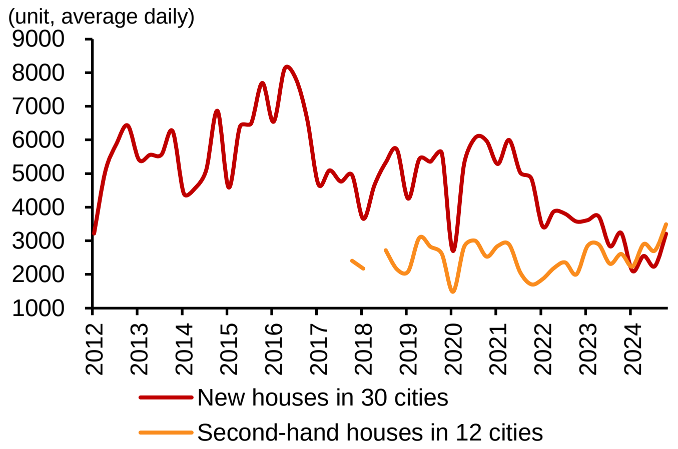
Property supply may still outstrip demand with weak development investment activity in 2025. The rebalancing of supply and demand will continue and home prices might see less declines. The unsold area to sold area ratio of commodity buildings as an indicator for current supply-demand condition rose from the average of 36% in 2015-2021 to 76% at end-10M24 and 60% at end-2023. The days of new home supply for sales in the top 10 cities started to decline from 601 days at end-3Q24 to 580 days at end-10M24, yet still much higher than the 2012-2021 average of 284 days. However, started area to sold area ratio as an indicator of future supply-demand condition declined from the 2012-2021 average of 122% to 89% in 2023 and 85% in 10M24. Development investment activity could remain weak in 2025 as land purchases and housing starts may continue to see double-digit declines. We expect property development investment to fall by 7% in 2025 after dropping 10.5% in 2024. Excessive supply might last next year, with additional room for home prices to fall. But the price decline is likely to narrow thanks to demand improvement and continued rebalancing of supply and demand. In typical cycles of house bubble bursting or financial crisis in six selective economies [1], house prices often experienced a first round of sharp declines followed by a second round of gentle declines. The decline cycle lasted for 5 years or longer and home price cumulatively dropped by 39% on average. The current cycle of home price declines in China's first-tier cities has lasted for 3.2 years, with a cumulative decline of 30%. The prices might enter a second round of gentle decline in the future.

The property market will likely continue to be regionally differentiated. First-tier cities have better economic prospects, more land supply constraints and less oversupply pressure as their home prices may bottom out first. Shenzhen's housing market can be seen as a leading indicator. According to Wind data, Its average daily sales of second-hand homes bottomed out in 2022 and rebounded by 49.3% in 2023 and 56.6% in 11M24. The average daily sales of new homes have rebounded sharply since October 2024, supporting the full-year sales to be almost close to that of last year. The number of new homes available for sale continued to fall from 95,000 units at end-3Q23 to 68,000 units at end-11M24. The days of supply may fall to the 2012-2021 average level in 4Q25. The recovery of the housing market in lower-tier cities could be slower and the downward cycle of home prices may last longer.

New home demand may continue to see downward pressure in the long term. The long-term prospect depends on urban incremental population, per capita living space and demolition & renovation. Urban incremental population is expected to gradually decline in the long term after the latest round of cyclical recovery. Continued declines in births imply a shrinkage of home-buying population in the future. Based on the births in 1983-2005, the population aged 25-40 is expected to be 12% lower than in 2023. Meanwhile, the urbanisation process is likely to slow down due to reduced employment opportunities in cities, unfriendly public service system to rural migrants and skills mismatch of the remaining rural population. In addition, per capita living space might increase more slowly as it has already reached to 38.6 square metres in 2020, based on the data of Ministry of Housing. If urban incremental population drops from 8.5mn in 2024 to 5mn in 2030 and the annual growth of per capita living space drops from 2.5% in 2010-2020 to 1.6% in 2020-2030, urban incremental housing demand would decline from 950mn square metres in 2023 to 600mn square metres in 2030. In the future, existing home transactions, property management and other services, retirement property and tourism property may become new growth drivers for the property sector, in our view.

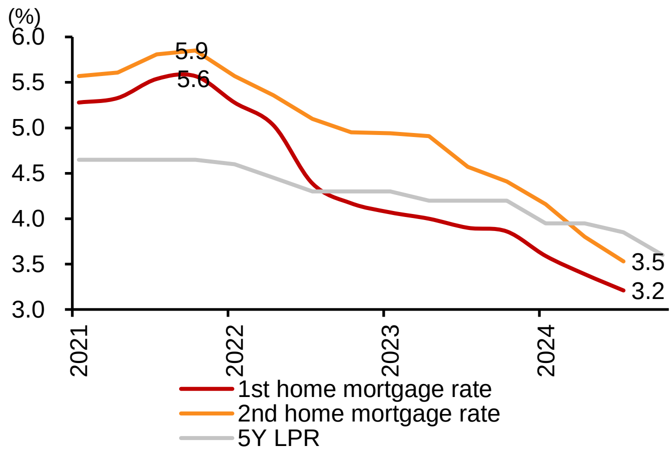
[1] The six selective economies are Japan, South Korea, Hong Kong, US, Spain and Italy.

### Figure 46: New and Second-hand Home Sales



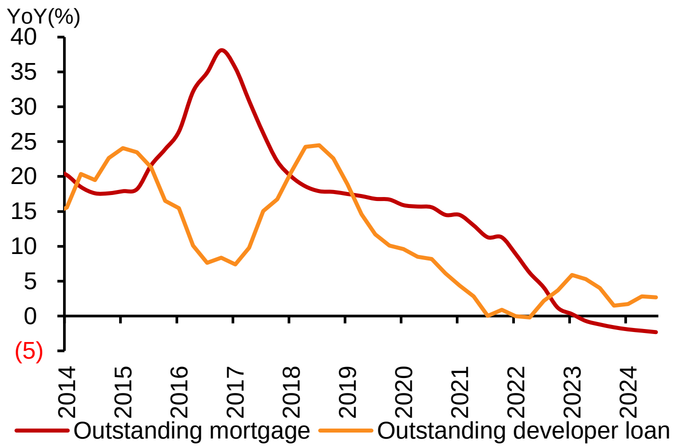

Source: Bloomberg, Wind, CMBIGM

### Figure 47: New Mortgage Contract Rates



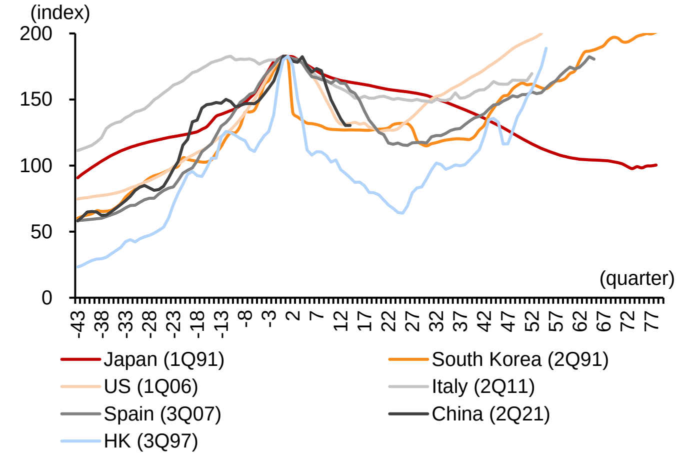

Source: Bloomberg, Wind, CMBIGM

### Figure 48: Growth Rates of Property Loans



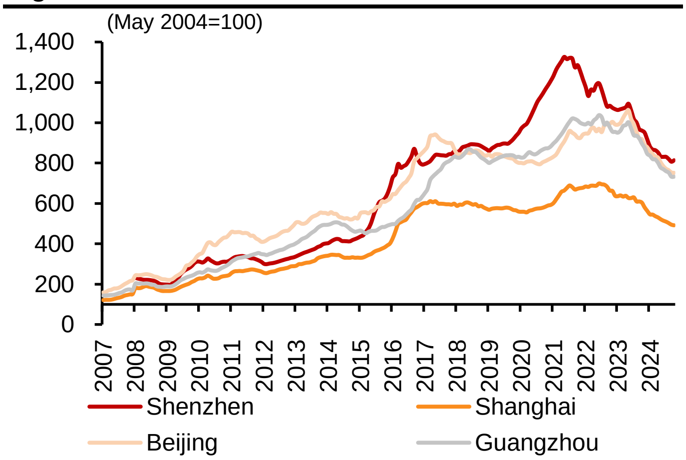

Source: Bloomberg, Wind, CMBIGM

### Figure 49: House Prices Around the Peaks



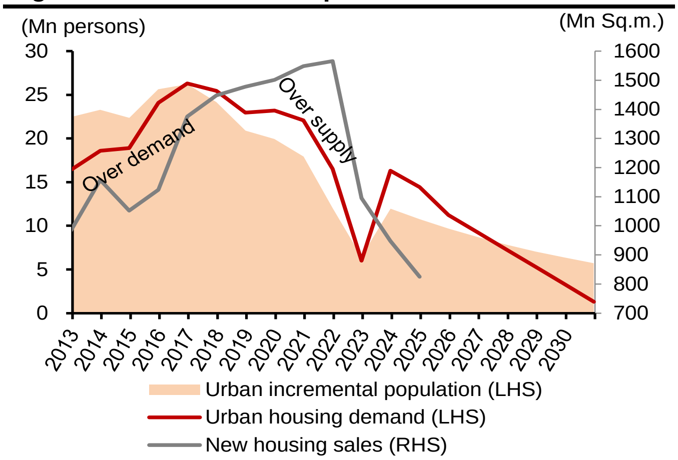

Source: Bloomberg, Wind, CMBIGM

### Figure 50: House Prices in Tier-one Cities




Source: Bloomberg, Wind, CMBIGM

### Figure 51: Urban New Population & House Demand




Source: Bloomberg, Wind, CMBIGM

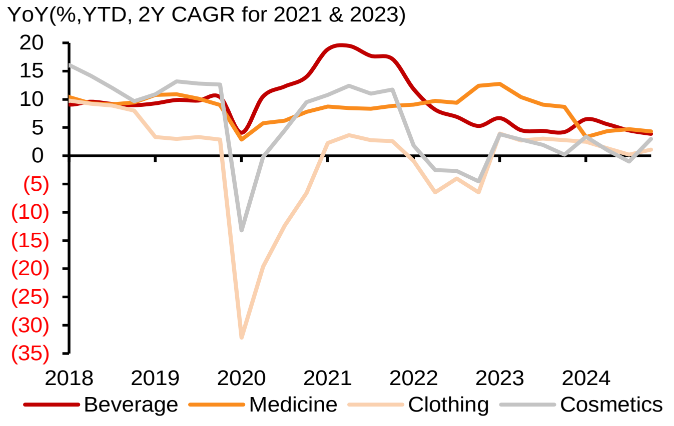
## Household Consumption

Household consumption growth remained weak in 9M24. Retail sales grew 3.3% YoY in 9M24, similar to the 2Y CAGR in 2022-2023. Real GDP growth in services grew 4.7% YoY in 9M24, slightly above the 2Y CAGR in 2022-2023. Due to a slight deflation, however, nominal GDP growth in services fell to 4.6% in 9M24 from the average of 5.9% in 2022-2023. Breaking down items, cultural & office products, construction & decoration materials, autos, gold, silver & jewelry and cosmetics extended their YoY declines, while furniture, clothing and daily used goods saw low growth rates below 3%, and only food, tobacco & alcohol, and telecom equipment maintained growth rates above 5%. Reasons for weak consumption include individual income declines, unemployment pressure, the property slump and deflation expectations. In 9M24, China's individual income tax and corporate income tax respectively declined by 4.9% and 4.3% YoY while consumer confidence was subdued with high saving ratio and low consumer credit growth.

Household consumption growth might improve in 2025. We estimate the growth rates of retail sales and nominal GDP in services to respectively rise from 3.7% and 4.6% in 2024 to 4.7% and 5.5% in 2025. China’s latest policy stimulus has boosted the stock market confidence, property market sentiment and consumers’ willingness to spend. The YoY growth of retail sales rebounded from 3.3% in 9M24 to 4.8% in October. Not only did consumer durables such as home appliances, furniture and automobiles, which benefited from the trade-in policy, rebounded sharply, but other consumer goods like cosmetics and apparels also recovered markedly. The recovery in household consumption might be even broader in scope in the future especially during the Chinese New Year holiday. 2025 will see a marked improvement in home sales and the ‘trade-in’ subsidy policy is likely to continue with possible more durables on the list, with consumer durables likely to maintain stable growth, based on our estimates.

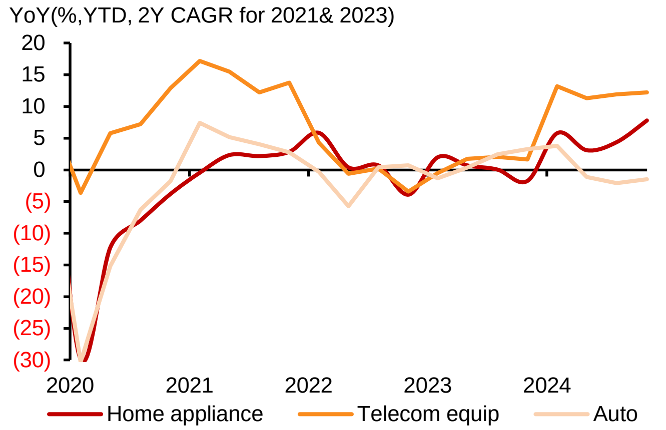
A sustained recovery in household consumption in the medium term will require a better household income outlook and a stronger social safety net. To improve household income, China has to increase both the quantity and quality of employment. As private businesses account for 80% of employment, China needs to restore entrepreneurial confidence and animal spirit to create more high-quality jobs for individuals. A stronger social safety net could increase the spending power of those with no or low incomes as well as lowering the excessive savings rate for most Chinese households. Building a stronger social security net requires a transformation of the fiscal system, compressing spending on infrastructure and industrial development and expanding spending on basic livelihoods.

### Figure 52: Staples and Discretionary Retail Sales Growth



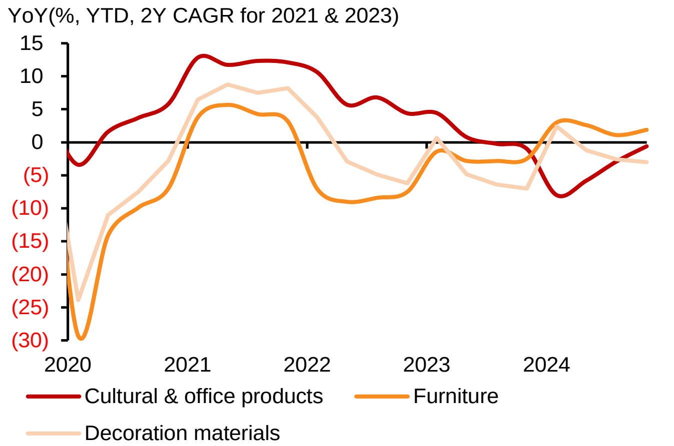

Source: Bloomberg, Wind, CMBIGM

### Figure 53: Appliance, Telecom Equip and Auto Retail Sales Growth



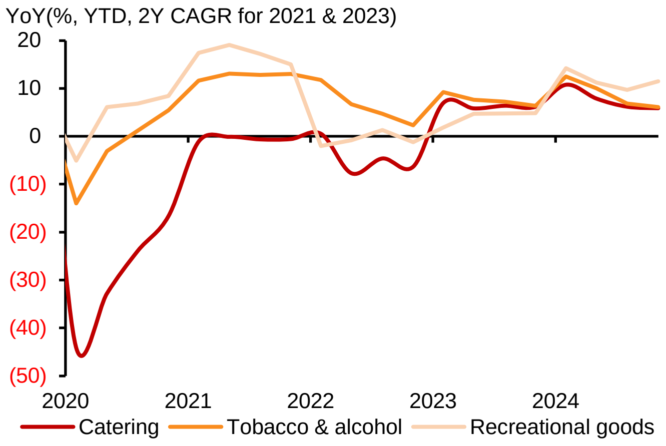

Source: Bloomberg, Wind, CMBIGM

### Figure 54: Office Goods, Furniture & Decoration Materials Retail Sales Growth



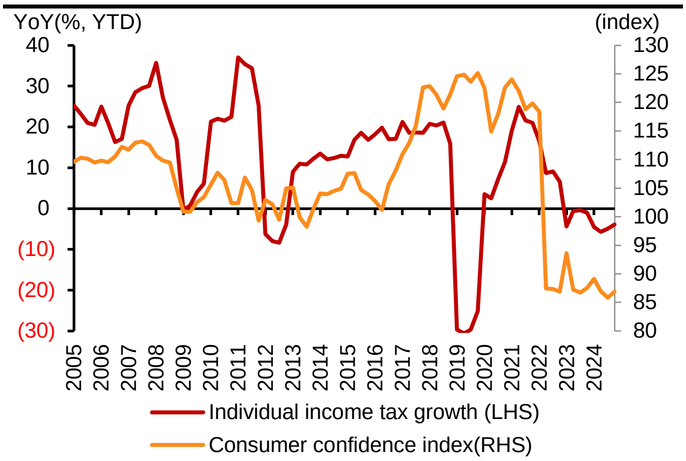

Source: Bloomberg, Wind, CMBIGM

### Figure 55: Catering, Tobacco & Alcohol, and Recreational Goods Retail Sales Growth



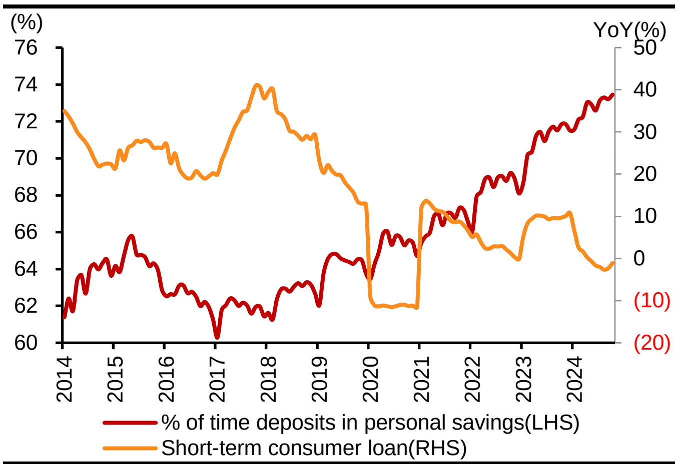

Source: Bloomberg, Wind, CMBIGM

### Figure 56: Individual Income Tax Growth & Consumer Confidence




Source: Bloomberg, Wind, CMBIGM

### Figure 57: % of Time Deposits in Personal Savings and Consumer Loan Growth




Source: Bloomberg, Wind, CMBIGM

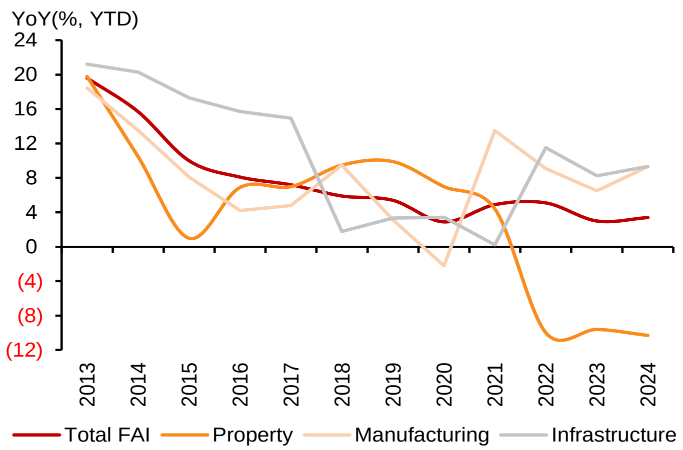
## Fixed Investment

Fixed asset investment (FAI) growth is likely to rise from 3.4% in 2024 to 3.7% in 2025. The decline in property development investment will narrow from 10.5% in 2024 to 7% in 2025, with its drag on total FAI down from 2.3ppts to 1.5ppts. Manufacturing investment growth is likely to fall from 9.3% in 2024 to 8.1% in 2025 because of overcapacity pressure and trade conflict uncertainty. Infrastructure investment growth may fall from 9.2% in 2024 to 8.4% in 2025. Local government-led infrastructure investment may pick up slightly, but the growth is likely to remain low, as the land market and hidden debt financing might continue to decline. Fiscal policy focuses on relieving local government hidden debt problem and fiscal distress, which may have limited direct pull on infrastructure investment. Thanks to the 'trade-in' subsidy policy stimulus, we expect business equipment investment to grow over 15% in 2024 with the contribution ratio to total FAI growth at 60%. As the 'trade in' subsidy policy might continue, business equipment investment is likely to maintain strong growth in 1H25. However, its growth might slow down in 2H25 due to a higher base and continued overdraft on future demand.

FAI growth in manufacturing has varied across different industries. Investment growth in railway, ship & aerospace equipment has exceeded 30% in 2024 thanks to a boom in the low altitude economy and drone industry. Investment growth rates in non-ferrous metals, metal products, food manufacturing and textile products have been above 15% while those in general equipment, special equipment, chemical products, computers, telecom equipment & other electronic equipment have reached over 10%. Due to overcapacity pressure, however, investment in electrical equipment & materials and automobile manufacturing has remained weak in 2024.

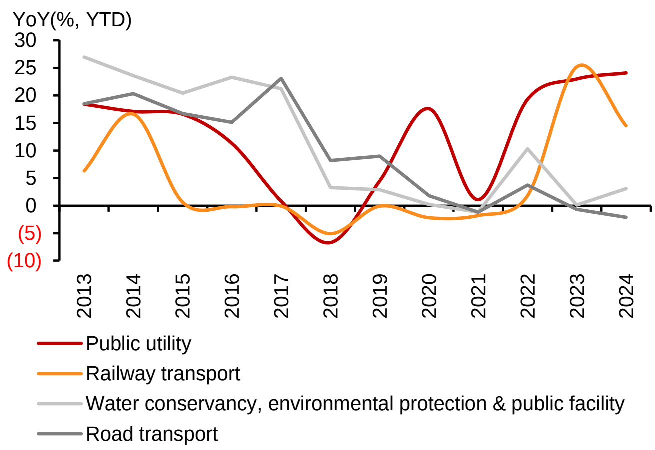
Infrastructure investment growth has also seen divergence. Investments led by LGFVs and local SOEs have slowed down sharply, such as those in road transport and public facility management. The local fiscal woes and strict restrictions on hidden debt financing have restrained investments by LGFVs and local SOEs. However, investments led by central SOEs have maintained rapid growth, with double-digit growth rates in both utilities and railway transport.

**Figure 58: FAI Growth by Sector**



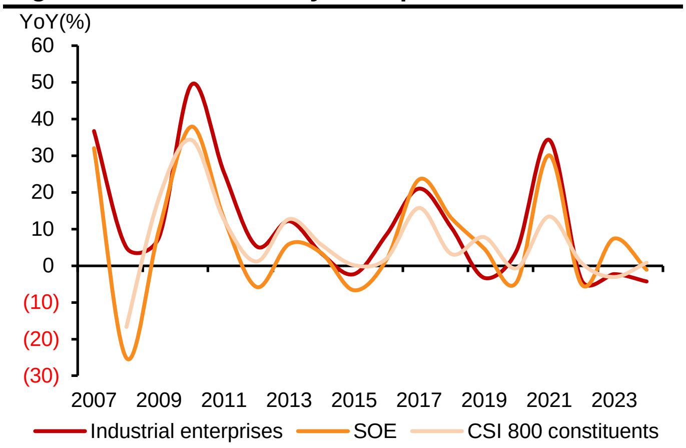

Source: Bloomberg, Wind, CMBIGM

**Figure 59: FAI Growth in Infrastructure Sector**



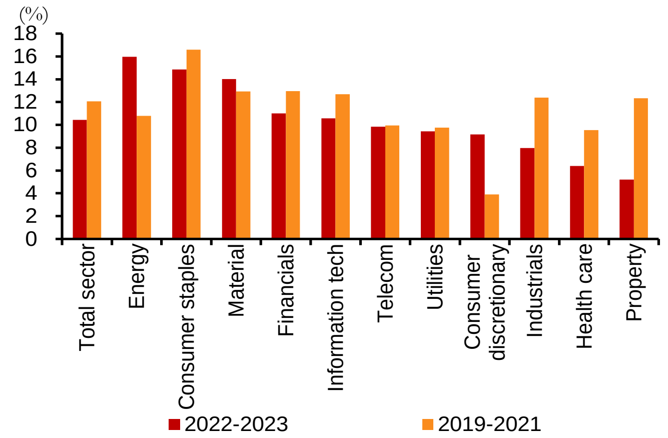

Source: Bloomberg, Wind, CMBIGM

**Figure 60: FAI Growth by Enterprise**



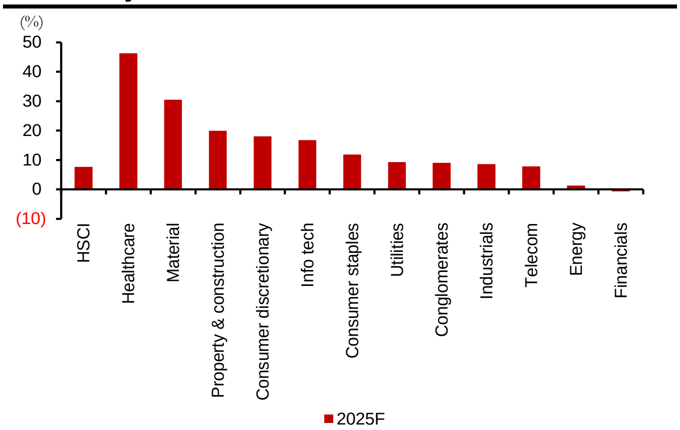

Source: Bloomberg, Wind, CMBIGM

**Figure 61: Hang Seng Composite Index Sector ROE**



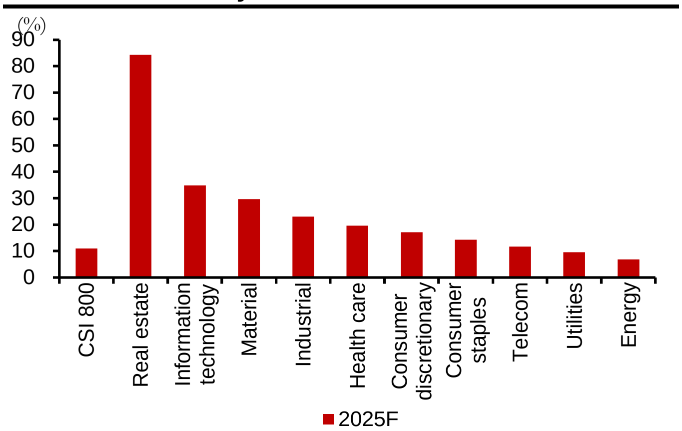

Source: Bloomberg, Wind, CMBIGM

**Figure 62: Bloomberg Consensus of 2025 HSCI EPS Growth by Sector**




Source: Bloomberg, Wind, CMBIGM

**Figure 63: Wind Consensus of 2025 China A Share 800 EPS Growth by Sector**




Source: Bloomberg, Wind, CMBIGM

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