China: 2024 macro outlook

Moderate recovery on continued policy support

07 DECEMBER 2023, CIO OFFICE & MACRO RESEARCH

SUMMARY

- We expect a moderate recovery in the Chinese economy to extend into 2024 as recently beefed-up government policy support will likely continue.
- The property sector will likely remain a drag on growth, although to a lesser extent than before. More financial support to developers is needed to stabilise the sector, but some recently announced measures seem to point in the right direction.
- Fiscal stimulus will likely play a key role in supporting growth in 2024. In addition to maintaining a relatively large fiscal deficit target, addressing the financial stress facing many local governments is another important task for policy makers.
- With continued policy stimulus and a possible moderate improvement in the property sector, China may pull itself out of deflation in 2024. Reflation in the industrial sector will be key.
- There are three risks to our central scenario: policy that remains behind the curve, a severe global deceleration and a resurgence in US-China tensions.

MODERATE RECOVERY TO CONTINUE

China’s post-covid recovery in 2023 turned out to be a disappointment, as the property sector’s hard landing not only threw many developers into distress, but also hurt employment and greatly damaged consumer confidence.

The authorities’ policy support has only started to pick up strength in earnest since the end of August. A series of measures aimed at boosting property demand was first introduced, followed by much stronger fiscal stimulus to support infrastructure growth. For example, the pace of local government bond issuance has risen sharply since August and has surpassed the level reached in 2022 (see chart 1). In addition,
the Chinese government has taken the rare decision to increase its fiscal deficit by Rmb1 trn through the issuance of special Chinese government bonds. The step-up in policy support led to a notable improvement in growth momentum in Q3, when annual GDP (4.9%) exceeded consensus forecasts.

We expect a moderate recovery to extend into 2024, but it could be bumpy. Our full-year GDP forecast for 2024 stands at 4.7%, down from the expected 5.2% in 2023 (see chart 2).

**PROPERTY SECTOR TO BE LESS OF A DRAG**

The property sector will likely remain a drag on growth in 2024, but to a less extent than this year. In our view, the downturn in the housing sector is structural, reflecting the shifting balance between demand and supply as the Chinese population peaks and the pace of urbanisation slows. But the lack of confidence among
potential home buyers has exacerbated the current downturn, with home sales in 2023 falling significantly below real underlying demand, according to our estimate (see chart 3). Hence, more policy measures aimed at boosting confidence are still needed. A move to encourage banks to provide more credit support to selected developers points in the right direction on this score.

Chart 3: Housing sales and estimated underlying demand in China

Source: Pictet Wealth Management, National Bureau of Statistics of China, 7 December 2023

In our base-case scenario, we expect a small rebound in housing sales in 2024. New project starts may not increase but might at least stop declining further. Total property investment could improve moderately as more stalled projects resume thanks to policy-induced financial support.

As we elaborated in an earlier publication (China: fear of systemic risks and equity outlook), we still do not expect the housing crisis to cause systemic risks in the financial sector, although it surely dampens the earnings outlook of many related corporates, including banks.

**FISCAL SUPPORT IS THE KEY**

We expect fiscal stimulus to continue to play an important role in supporting growth in 2024. At the central government level, the fiscal deficit target will likely stay at around the same high level as in 2023, about 3.8% of GDP. However, to address the on-going debt problem at the local government level arguably is more important to boost growth outlook in the near term than the headline deficit level.

The pandemic hit Chinese local governments’ revenue hard. Land sales and home sales again plummeted in 2023, putting local governments under tremendous financial pressure. They have had to cut back on their traditional responsibility for infrastructure investment, and in some extreme cases day-to-day spending has had to be reduced.

This effective tightening of fiscal conditions contributed to the weakness of the Chinese economy in the first half of 2023. But starting in Q3, the central government started to address financial stress at local governments seriously. For example,
about Rmb1.5 trn of special refinancing local government bonds were issued to swap out the “hidden debt” borne by some local government financing vehicles (LGFVs). The debt swap reduces their funding costs by half and extends the maturity of their debt by three to five years on average.

Following the call to establish a long-term mechanism for controlling local government debt risk during the Central Financial Work Conference at the end of October, efforts to deal with the local government debt problem will likely continue in 2024. We could see various forms of debt restructuring, including more debt swaps, asset sales by local governments or outright loan extensions. While fully addressing this problem will take years, alleviating local governments’ financial stress could enable them to play a role in promoting growth again in 2024.

To accommodate the increase in government bond issuance, the People’s Bank of China (PBoC) will likely maintain an accommodative policy stance by providing ample supplies of liquidity. We expect at least one 25bps cut in banks’ required reserve ratio (RRR) in 2024, possibly in the first half of the year, and we cannot rule out the possibility of rate cuts as well.

**A MODERATE REFATON TO UNFOLD**

In sharp contrast to the fight against inflation that has occupied much of the rest of the world, China suffered deflation in 2023 due to weak domestic demand. China’s GDP deflator sank into negative territory in Q2 2023 and continued to contract in Q3, despite some minor improvement. Deflation was most serious in the industrial sector, where prices dropped by 4.7% y-o-y in Q2 before improving slightly to -3.3% in Q3. Price changes in the services sector have been positive, but insufficient to offset negative momentum in the industrial and the agricultural sectors (see chart 4A).

---

**Chart 4A: Chinese GDP deflator by sector**

- GDP deflator: total
- GDP deflator: agriculture
- GDP deflator: industry
- GDP deflator: service

Source: Pictet Wealth Management, National Bureau of Statistics of China, 7 December 2023

**Chart 4B: Changes in Chinese PPI**

- PPI m-o-m (rhs)
- Chinese PPI % m-o-m

Source: Pictet Wealth Management, National Bureau of Statistics of China, 7 December 2023

---

*For illustrative purposes. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations. There can be no assurance that these projections, forecasts or expected returns will be achieved. The projection is not based on simulated past performance.*
There are signs that industrial prices may have troughed, as indicated by the producer price index (PPI, see chart 4B). The government’s continued policy support is essential to boost industrial demand through sustained infrastructure investment. A moderate improvement in housing construction could also add demand on the industrial front.

Chinese exports declined sharply in 2023 as consumers in the developed world shifted their spending from goods to services. While the global economy may decelerate further, the worst may be over for Chinese exports, which have shown some signs of stabilisation in recent months (see chart 5A and chart 5B). Hence, in 2024 we expect net exports to cease being a drag on growth and a contributor to deflation.

**WHAT ARE THE RISKS?**

In our view, the biggest risk to our benign scenario of a moderate recovery in 2024 is that policy making remains behind the curve. Partly due to intensifying US-China strategic competition, national security issues have been elevated in China to a level unseen in the past three decades. So-called ‘common prosperity’, green development and curbing financial risks are other top priorities for the government. The era of a single-minded pursuit of economic growth has gone. Given the multiple, and sometimes conflicting, objectives, policy making may slow and become less effective.

A global deceleration that turns out to be more severe than we currently expect is another risk. For the time being, we expect only a mild recession in the US in H1 and we think the euro zone will skirt one in 2024. But an unexpectedly weak global economy could add more pressure on China’s export sector and hurt the reflationary process.
Last but not least, geopolitical risks cannot be ignored. Although US-China tensions seem to have subsided somewhat since the meeting between President Biden and President Xi in November, there are plenty of flash points. Taiwan’s presidential election in early 2024 and the US presidential election at the end of next year could both be disruptive. Such risks will likely limit foreign investors’ interest in China, both in terms of direct investment and portfolio inflows.
This marketing communication is not intended for persons who are citizens of, domiciled in, or entities registered in a country or a jurisdiction in which its distribution, publication, provision or use would violate current laws and regulations.

The information, data and analysis furnished in this document are disclosed for information purposes only. They do not amount to any type of recommendation, either general or tailored to the personal circumstances of any person. Unless specifically stated otherwise, all price information is indicative only. No entity of the Pictet Group may be held liable for them, nor do they constitute an offer or an invitation to buy, sell or subscribe to securities or other financial instruments. The information contained herein is the result neither of financial analysis within the meaning of the Swiss Bankers Association’s Directives on the Independence of Financial Research, nor of investment research for the purpose of the relevant EU MiFID provisions. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness.

Except for any obligations that any entity of the Pictet Group might have towards the addressee, the addressee should consider the suitability of the transaction to individual objectives and independently assess, with a professional advisor, the specific financial risks as well as legal, regulatory, credit, tax and accounting consequences.

Furthermore, the information, opinions and estimates in this document reflect an evaluation as of the date of initial publication and may be changed without notice. The Pictet Group is not under any obligation to update or keep current the information contained herein. In case this document refers to the value and income of one or more securities or financial instruments, it is based on rates from the customary sources of financial information that may fluctuate. The market value of financial instruments may vary on the basis of economic, financial or political changes, currency fluctuations, the remaining term, market conditions, the volatility and solvency of the issuer or the benchmark issuer. Some investments may not be readily realizable since the market in the securities can be illiquid. Moreover, exchange rates may have a positive or negative effect on the value, the price or the income of the securities or the related investments mentioned in this document. When investing in emerging countries, please note that the political and economic situation in those countries is significantly less stable than in industrialized countries. They are much more exposed to the risks of rapid political change and economic setbacks.

Past performance must not be considered an indicator or guarantee of future performance, and the addressees of this document are fully responsible for any investments they make. No express or implied warranty is given as to future performance. Moreover, forecasts are not a reliable indicator of future performance. The content of this document can only be read and/or used by its addressee. The Pictet Group is not liable for the use, transmission or exploitation of the content of this document. Therefore, any form of reproduction, copying, disclosure, modification and/or publication of the content is under the sole liability of the addressee of this document, and no liability whatsoever will be incurred by the Pictet Group. The addressee of this document agrees to comply with the applicable laws and regulations in the jurisdictions where they use the information reproduced in this document. This marketing publication is issued by Banque Pictet & Cie SA. This marketing publication and its content may be cited provided that the source is indicated. All rights reserved. Copyright 2023.

This is a marketing communication distributed by Pictet London Branch.

This document sets forth neither a personal recommendation tailored to the needs, objectives and financial situation of any individual or company (investment advice as defined in the Financial Conduct Authority’s Handbook of rules and guidance (the “FCA Handbook”)), nor the results of investment research within the meaning of the FCA Handbook. Moreover, it does not constitute an offer, or an invitation to buy, sell or subscribe to securities or other financial instruments, nor is it meant as a proposal for the conclusion of any type of agreement. Furthermore, this document should not be considered a suitability report as Pictet London Branch has not received all the necessary information on the recipient to complete its suitability assessment that covers the recipient’s knowledge and experience, tolerance to risk, sustainability preferences, if any, investment needs and the recipient’s ability to absorb financial risk. Should its addressee decide to proceed to any transaction in relation to a financial product referred to herein, this will be in his sole responsibility, and the suitability/appropriateness of the transaction and other financial, legal and tax aspects should be assessed by an expert.

Any information contained in this document is disclosed for information purposes only, and neither the producer nor the distributor can be held liable for any fluctuation of the price of the securities. No express or implied warranty is given as to future performance. The opinions expressed reflect the subjective and prospective evaluation of information available to the general public, such as rates from customary sources of financial information. The market value of the securities mentioned may vary on the basis of economic, financial or political changes, the remaining term, market conditions, the volatility and solvency of the issuer or the benchmark issuer. Moreover, exchange rates may have a positive or negative effect on the value, the price or the income of the securities or the related investments mentioned in this document. It is also expressly noted that forecasts are not a reliable indicator of future performance, while past performance is not a reliable indicator of future results.

You should only take investment decisions when you fully understand the financial product and the involved risks. In particular, the relevant product documentation (such as the issuance program, final terms, prospectus, simplified prospectus and key (investor) information document), as well as Appendix 4: Risk Warnings Relating to Trading in Financial Instruments of the Terms and Conditions of Pictet London Branch, shall be read. Structured products are complex financial products and involve a high degree of risk. The value of structured products depends not only on the performance of the underlying asset(s), but also on the credit rating of the issuer. Furthermore, the investor is exposed to the risk of default of the issuer/guarantor.

In respect of any product documentation, including key information documents of Packaged Retail and Insurance-based Investment Products ("KiDs"), please note that these may change without notice. You should ensure that you review the latest version of them prior to confirming to Pictet London your decision to invest. If you have been provided with a link to access the relevant KiD/other product document, you should therefore click on
the specific investment objectives, financial situation and/or the particular needs of any recipient of this document. Investors should seek independent financial advice regarding the appropriateness of investing in any Investments or adopting any strategies discussed in this document, taking into account the specific investment objectives, financial situation or particular needs of the investor, before making a commitment to invest.

BPCAL/Pictet HK Branch has not taken any steps to ensure that the Investments referred to in this document are suitable for any particular investor, and accepts no fiduciary duties to any investor in this regard, except as required by applicable laws and regulations. Furthermore, BPCAL/Pictet HK branch makes no representations and gives no advice concerning the appropriate accounting treatment or possible tax consequences of any Investment. Any investor interested in buying or making any Investment should conduct its own investigation and analysis of the Investment and consult with its own professional adviser(s) as to any Investment including the risks involved.

This document is not to be relied upon in substitution for the exercise of independent judgment. The value and income of any Investment mentioned in this document may fall as well rise. The market value of any Investment may or may not have relation to the originally invested.