China Economic Update November 2024

No "bazooka", not even real stimulus

NAB Group Economics

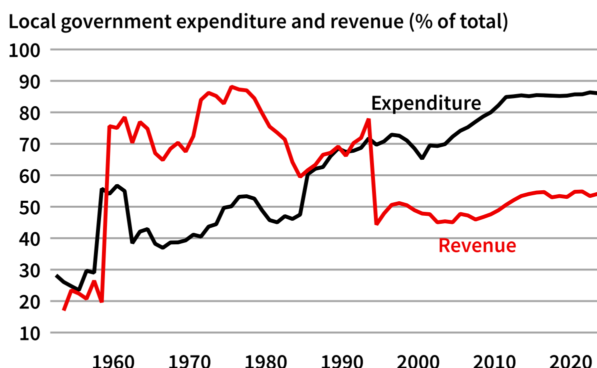
China's National People's Congress held a week long session that concluded on 8 November. Financial markets had been anticipating a major fiscal stimulus announcement at its conclusion, but what Chinese authorities delivered instead was more akin to a risk mitigation package that is unlikely to provide a meaningful boost to growth.

Authorities focused on local government debt

There have been long running concerns around the scale and sustainability of local government debts in China, in a large part due to the uneven balance of expenditures and revenues split between local governments and Beijing. Local governments have long been responsible for bulk of total public spending (particularly on infrastructure) – with this share at around 86% in 2023 – while their share of revenue was just 54% last year. Local governments were prohibited from issuing their own debt following the 1994 Budget Law until reforms implemented by the Ministry of Finance in 2014, which allowed issuance under a strict quota. The Budget Law also barred direct from borrowing from banks.

Local government finances

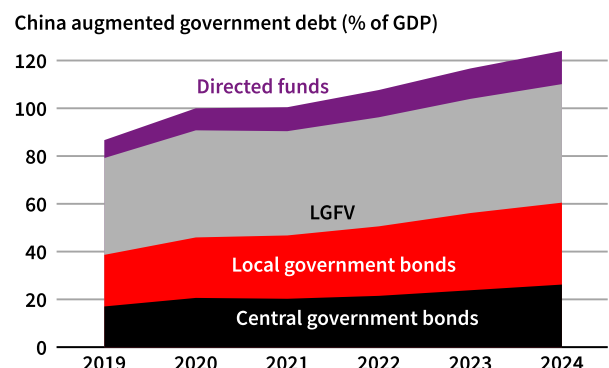
Finances are strained by spending obligations and lack of revenue



To fill this gap, local governments established state-owned enterprises known as local government financing vehicles (LGFVs), which were able to issue their own bonds and borrow from financial institutions (including off-balance sheet lending by institutions such as shadow banks). By its nature, LGFV debt is somewhat opaque, with the IMF estimating LGFV debt will total around RMB 65 trillion (or 50% of GDP) in 2024, with this LGFV debt being around 1.4 times larger than the value of local government bonds.

Augmented government debt

IMF estimates suggest LGFV debt exceeds that of local gov't bonds



It is worth noting that these estimates differ somewhat from China's own assessment of the scale of this debt. The Finance Minister described the "hidden debt" of local governments as totalling RMB 14.3 trillion at the end of 2023 (around one-quarter of the IMF total) – albeit it is not apparent that this measure has the same scope as the IMF's estimate. The Ministry of Finance aim to reduce this hidden debt to RMB 2.3 trillion by the end of 2028.

Fiscal plan adds some debt transparency and lower cost, but little else

Various headlines described the plan announced following the congress as a RMB 10 trillion package, however this is somewhat misleading. The first part of this total comprises RMB 6 trillion of additional local government "special bond" issuance over three years

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(RMB 2 trillion each year, including the remainder of 2024 as the first year) to bring hidden off-balance sheet debt onto their books.

The remaining RMB 4 trillion of special bonds are set for issuance over five years and are committed to the same purpose. However, the difference is that these bonds will be counted towards existing special bond issuance quotas.

According to the Ministry of Finance, the combined impact of this debt swap would be an interest saving of around RMB 600 billion over the next five years. While this will ease some pressure on local government balance sheets, it will not provide a substantial boost to their capacity to spend.

It is worth noting that there has been no significant change to how local governments raise revenue. While debts are likely to be more transparent given the fiscal plan, there is no improvement in the capacity of local governments to service their debts.

Local government revenues have been highly dependent on land sales over the past decade (albeit to differing degrees in different locations), which means that the downturn in the property sector following the implementation of the Three Red Lines policy in 2020 has placed greater strain on local government balance sheets – something we expect to continue for some time.

Conclusions – are we still waiting for something more?

Nothing in this fiscal announcement is likely to boost domestic demand – the key source of weakness in China's economy at present. In this sense, the announced fiscal package fell short of market expectations, given that there were widespread rumours that the plan would incorporate an expansion of the consumer goods trade-in and business equipment upgrade programs that are currently scheduled to finish at the end of this year. Similarly, the plan lacked fiscal support for low income groups in China's economy that had similarly been mooted.

The Ministry of Finance has suggested that more fiscal support is coming in 2025, however as we have noted, it is not only the size of any program that matters but also how and where funds are directed, with measures targeted at supporting demand needed to materially lift China's growth.

Overall, we see no need to lift our growth forecasts at this time – 4.7% in 2024 and 4.6% in 2025 – with risk beyond this period increasingly weighted to the downside following the US Presidential Election and the likelihood of sizeable tariffs on Chinese exports to the US. The timing of implementation and the ultimate scale of trade barriers are uncertain, particularly if retaliatory measures trigger another trade war between the two countries.

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