BBVA Research

China Economic Outlook

October 2024

Creating Opportunities

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01

Global Economic Outlook 3Q24

Creating Opportunities

Main messages

Recent developments

Monetary easing cycles are now in place in the US and Eurozone as inflation has fallen due to demand moderation and supply gains. Labor markets are slowing, manufacturing remains weak, but services and consumption remain relatively strong. Financial volatility has risen, but markets continue to see a soft-landing ahead.

Growth outlook

Global growth is likely to converge to moderate levels. In the US, growth was revised up again, as incoming data surprised to the upside, but is still expected to gradually weaken ahead. In the Eurozone, forecasts remain unchanged; lower inflation and interest rates will support a cyclical recovery. In China, increasing policy stimulus will help to sustain growth, but a structural deceleration is still likely.

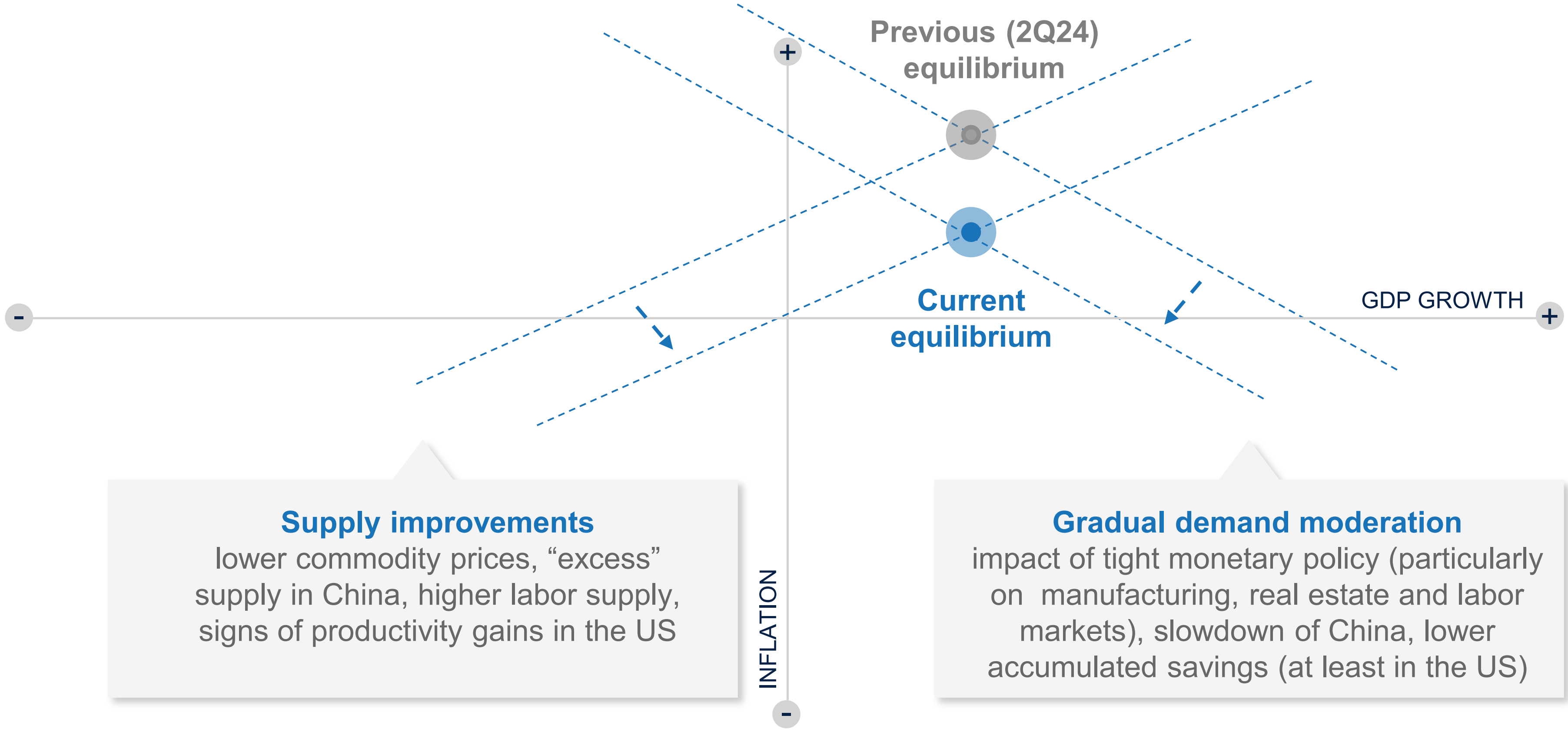
Inflation and rates outlook

Monetary conditions are set to gradually become less restrictive given more controlled inflation and easing labor pressures. The Fed's rate cuts are likely to be more aggressive than anticipated, but interest rates are forecast to remain relatively high. The monetary easing cycle is also expected to continue in the Eurozone and China.

Risks

Risks to growth and inflation are now more balanced. The recent labor market slowdown and China's structural problems raise concerns about a hard landing. However, strong demand, fiscal policy, and geopolitical tensions, among other factors, keep upward inflation risks alive.

Recent developments: lower inflation and interest rates as well as resilient growth in a context of demand moderation and improvements in supply



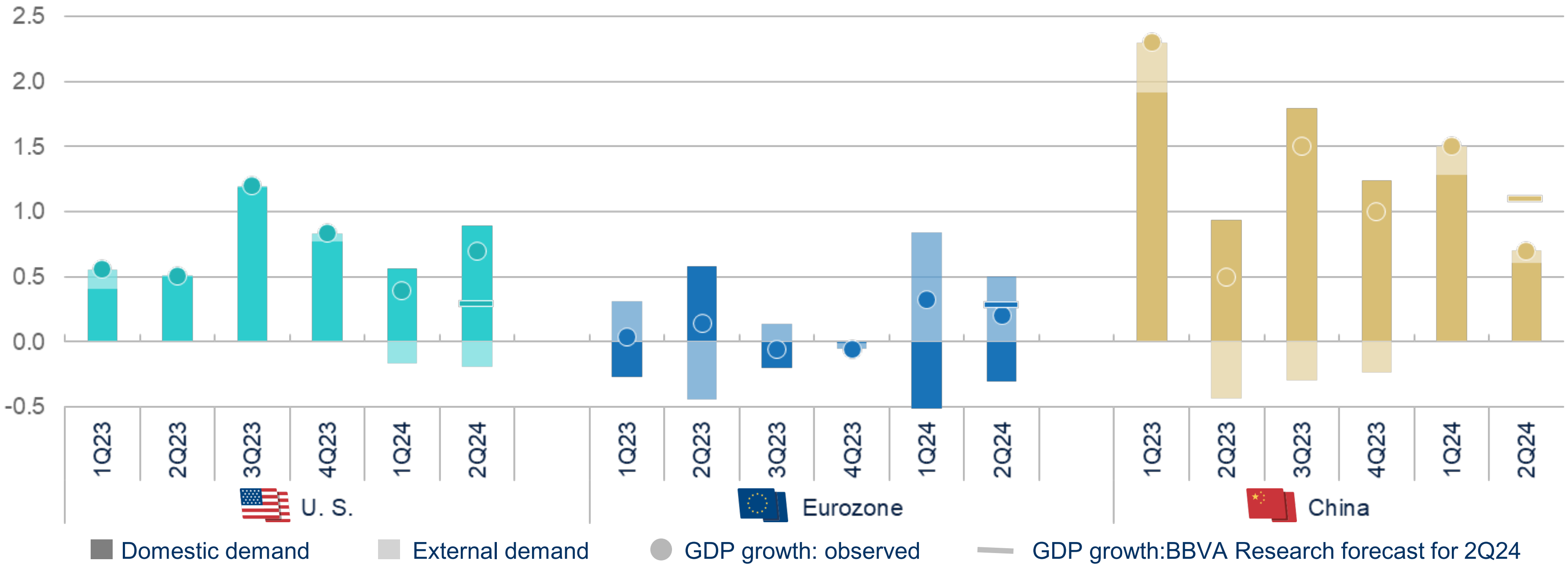
Supply improvements
lower commodity prices, “excess” supply in China, higher labor supply, signs of productivity gains in the US

Gradual demand moderation
impact of tight monetary policy (particularly on manufacturing, real estate and labor markets), slowdown of China, lower accumulated savings (at least in the US)

Growth remains strong in the US, slightly positive in the Eurozone, and relatively weak in China despite policy support

GDP: CONTRIBUTION OF DOMESTIC AND EXTERNAL DEMANDS TO GDP GROWTH

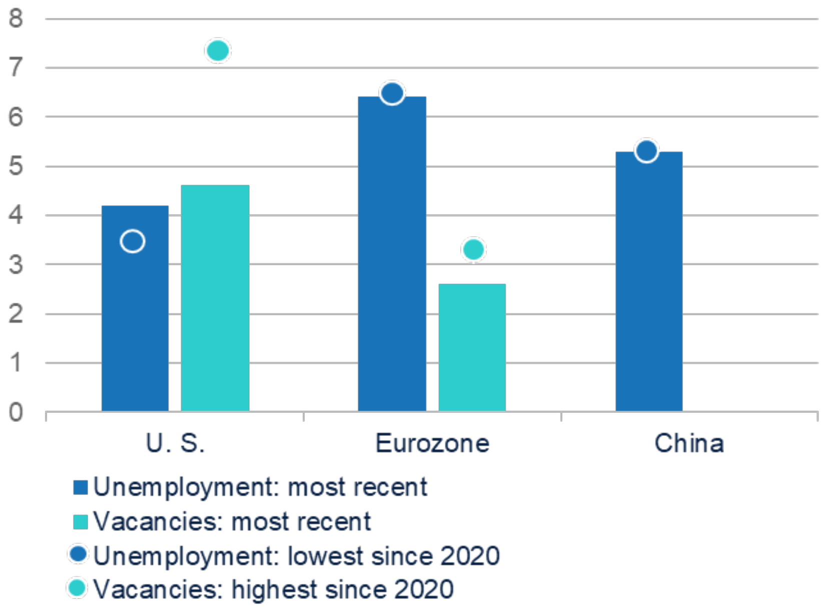
(GDP GROWTH: Q/Q%; CONTRIBUTIONS TO GDP GROWTH: PERCENTAGE POINTS)



Source: BBVA Research based on data from Haver and China's NBS.

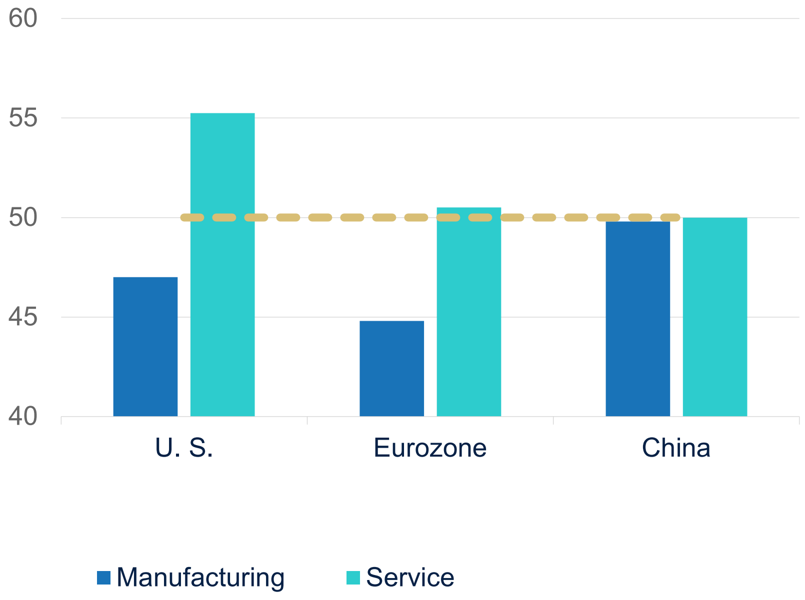
Hard-landing fears have risen following labor market deceleration, but services remain relatively strong; weakness in manufactures persist

UNEMPLOYMENT AND VACANCY RATES (*)
(%)



(*) Unemployment rate: unemployment as share of the labor force. Vacancy rate: job vacancies as share of the sum of total employment and job vacancies. Vacancies data not available for China.
Source: BBVA Research based on data from BLS , Eurostat and Haver.

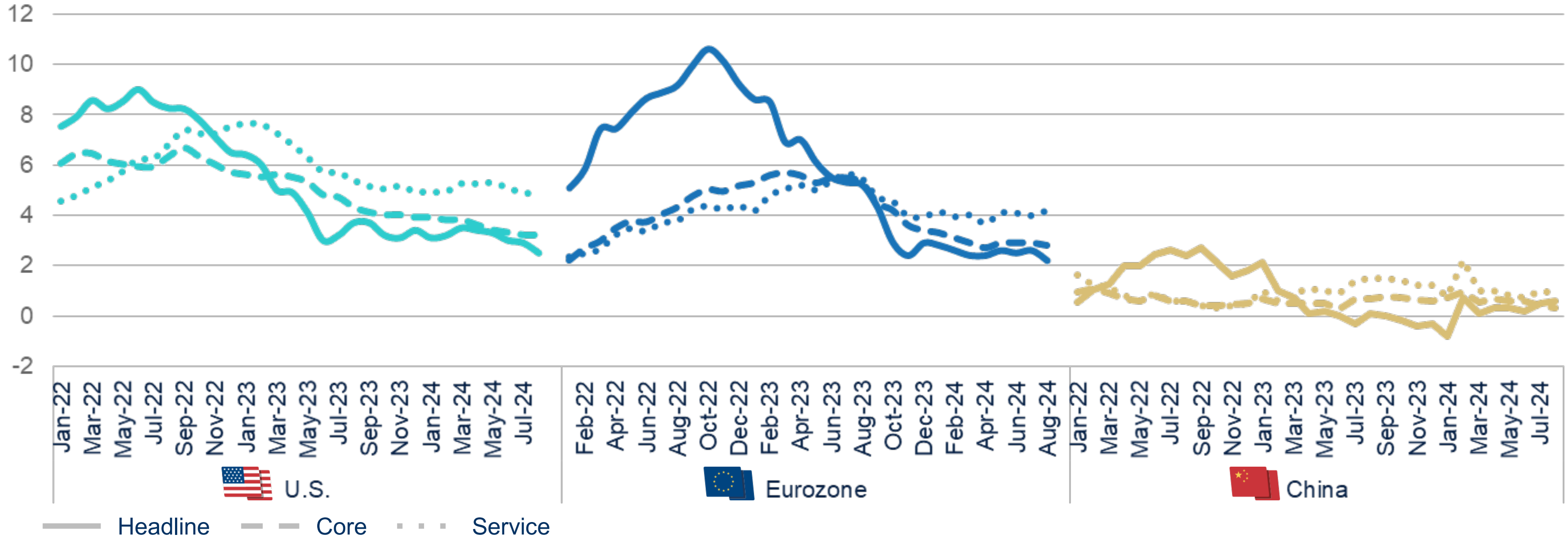
PMI INDICATORS: MOST RECENT DATA (*)
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)



(*) September 2024.
Source: BBVA Research based on data from Haver.

Inflation has eased more than expected in the US, and has been broadly in line with forecasts in the Eurozone, but services inflation remains high

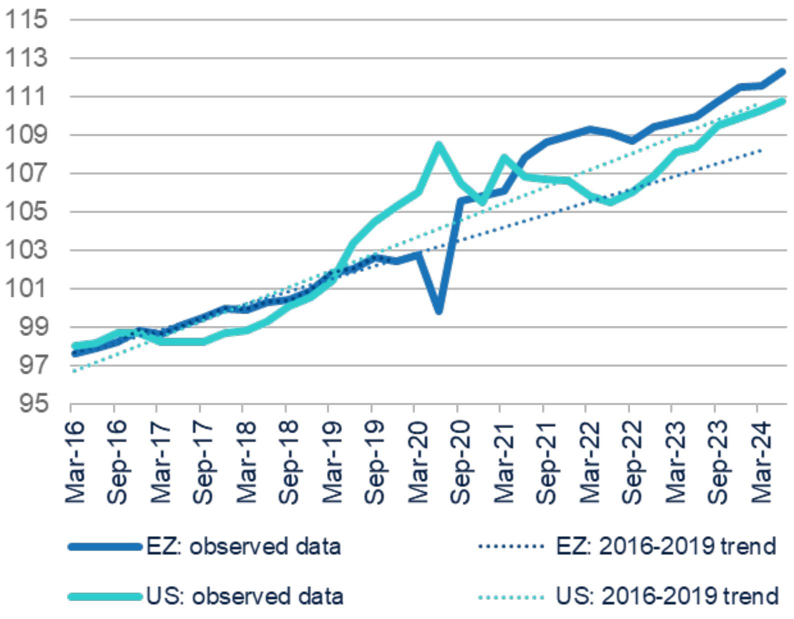
CPI INFLATION: HEADLINE, CORE AND SERVICE
(Y/Y %)



Source: BBVA Research based on data from Haver.

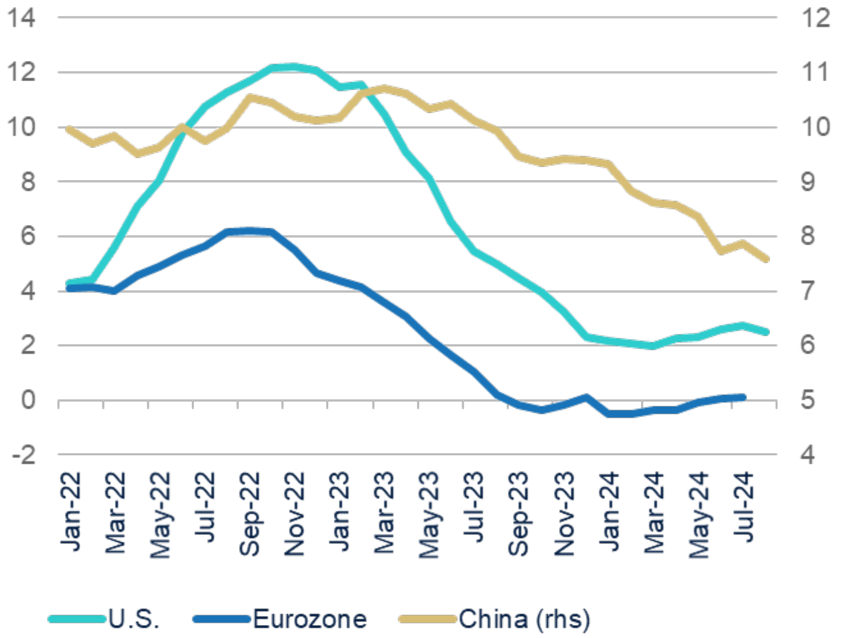
Despite still supportive fiscal policy, demand continues to weaken gradually amid still tight monetary conditions and weakness in China

GOVERNMENT CONSUMPTION
(INDEX: 2016-2019 AVERAGE = 100, CHAINED VOLUMES)



Source: BBVA Research based on BEA and ECB data.

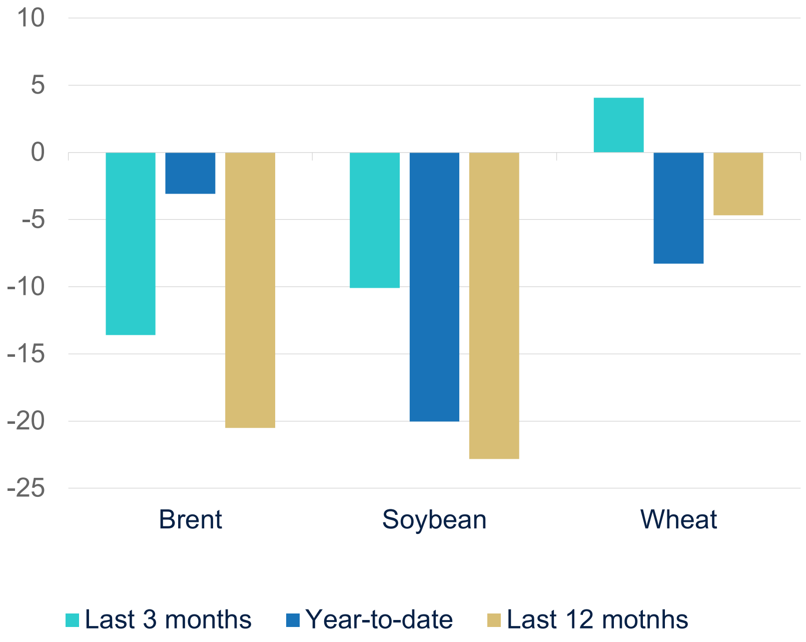
BANKING LENDING
(YOY %)



Source: BBVA Research based on data from Haver.

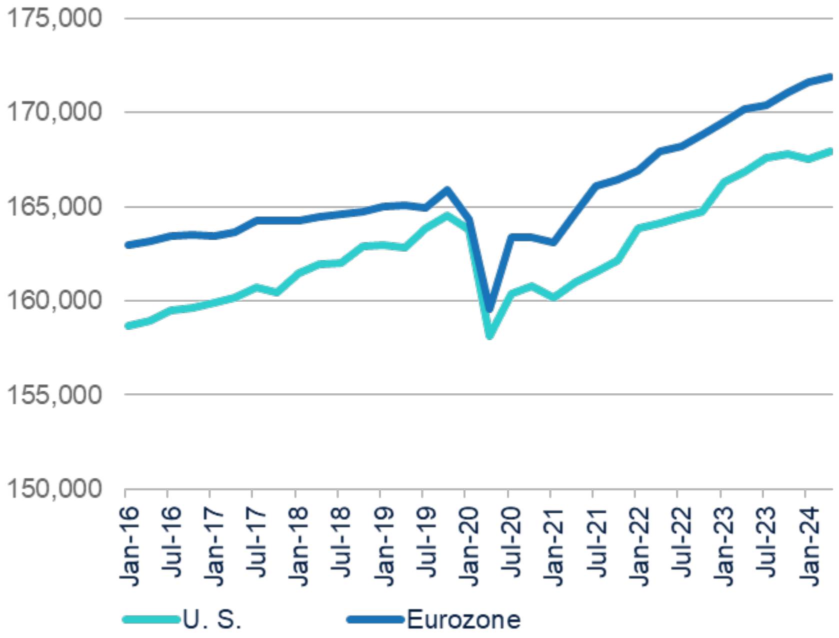
A fall in commodity prices, the expansion of the labor force and incipient productivity gains in the US have helped to improve supply conditions

COMMODITY PRICES (*)
(% CHANGE DURING SELECTED PERIODS)



(*) Last available data: September 25th, 2024.
Source: BBVA Research based on data from Haver.

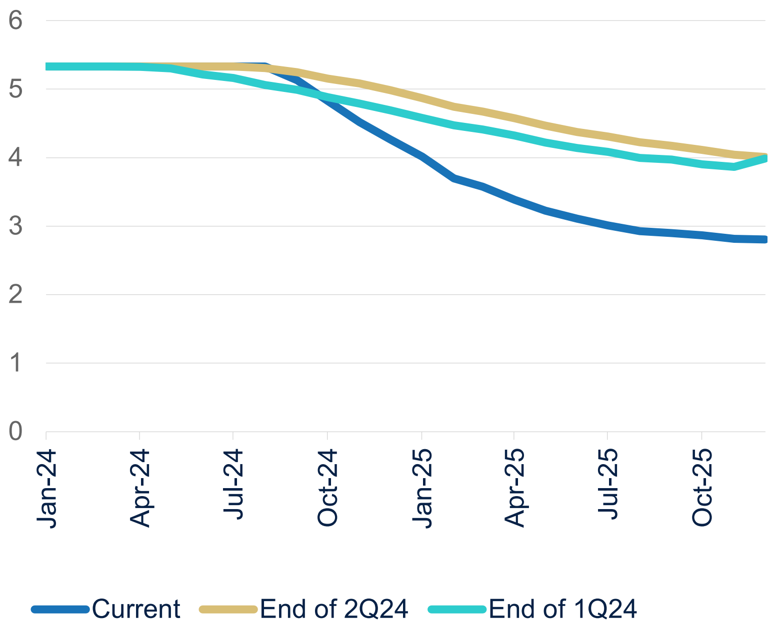
LABOR SUPPLY: LABOR FORCE LEVEL (*)
(THOUSANDS, QUARTERLY DATA)



(*) U. S.: 16 years or older. Eurozone: 25 to 74 years old.
Source: BBVA Research based on data from the Fred and Eurostat.

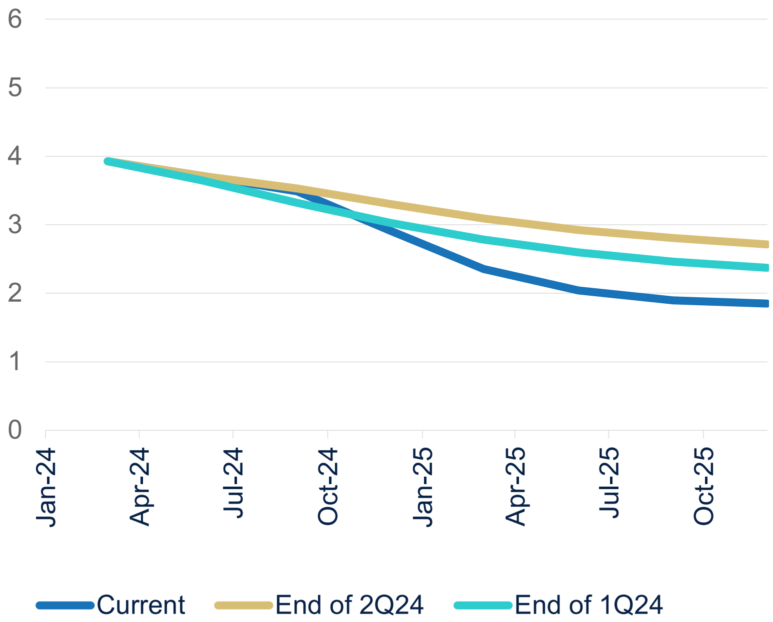
Monetary easing has begun in the US (with a 50 bps cut) and has continued in the EZ (with a second 25 bps cut); markets see larger room for further cuts

US: IMPLICIT RATE IN FED FUND FUTURES (*) (%)



(*) Last available data: September 25th, 2024.
Source: BBVA Research based on data from Haver.

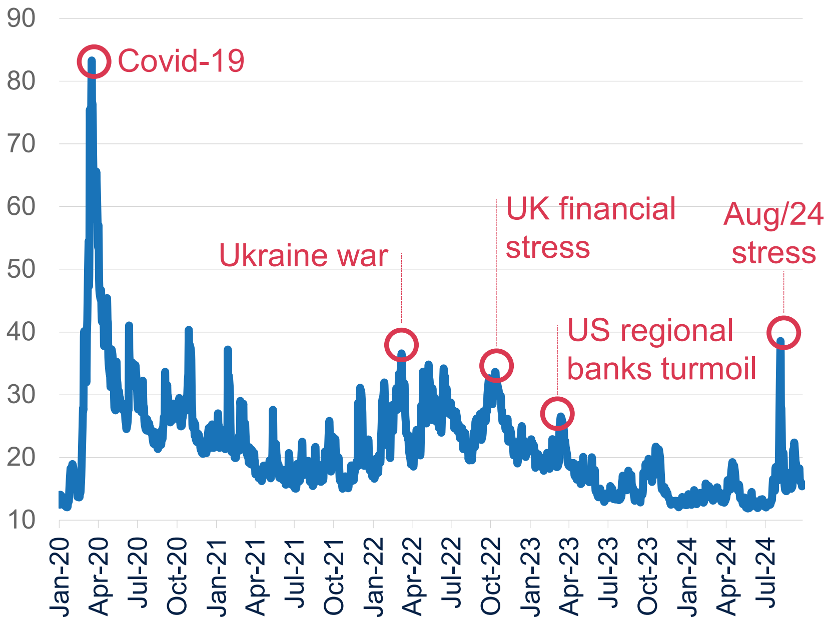
EZ: IMPLICIT RATE IN 3-MONTH EURIBOR FUTURES (*) (%)



(*) Depo interest rates. Last available data: September 25th, 2024.
Source: BBVA Research based on data from Haver.

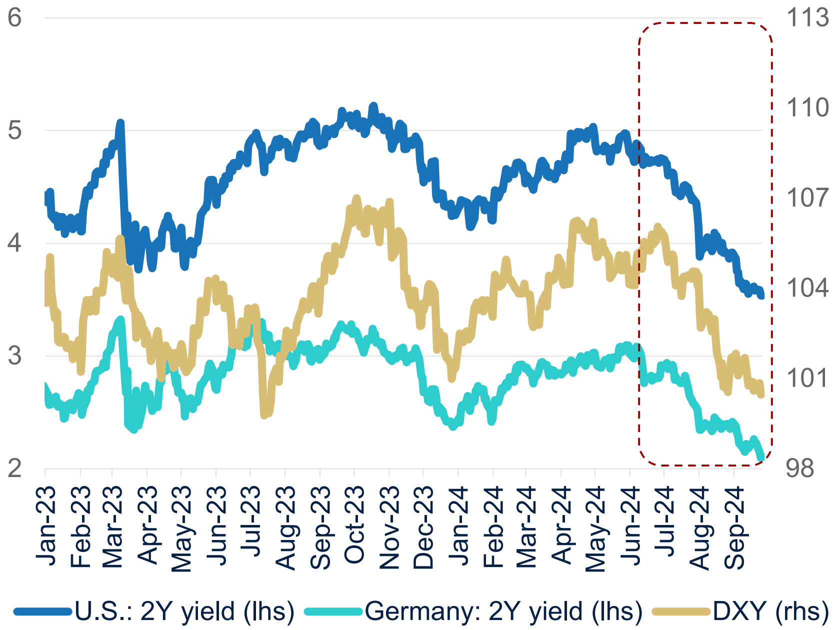
Financial volatility has risen on growth deceleration concerns but soft-landing view continues to prevail; sovereign yields and the USD have trended down

VIX (*)
(INDEX)



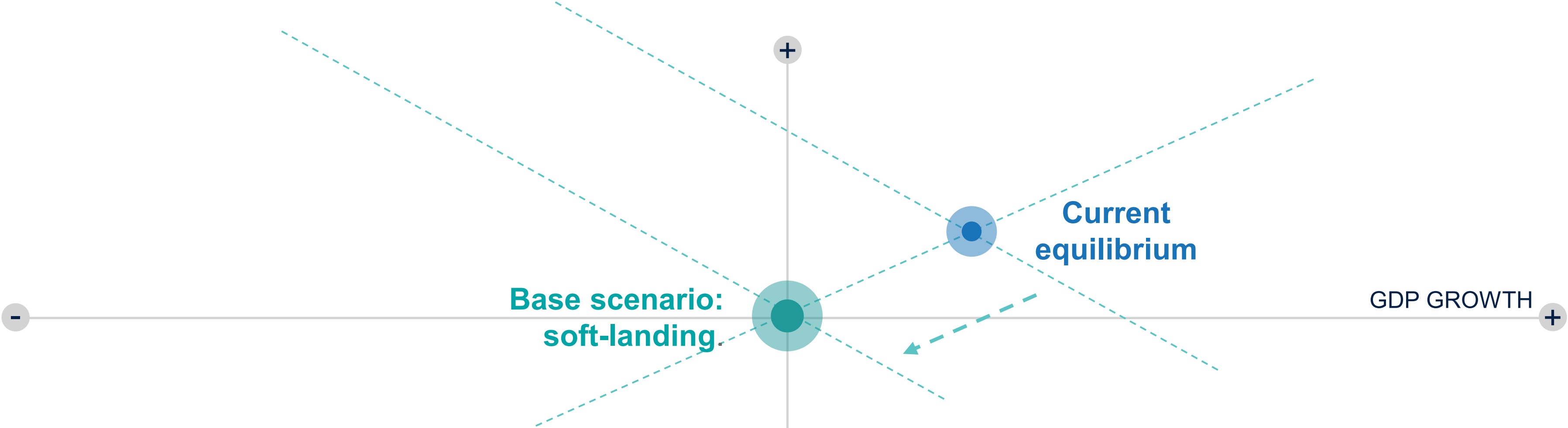
(*) Last available data: September 25th, 2024.
Source: BBVA Research based on data from Haver

SOVEREIGN YIELDS AND USD INDEX (DXY) (*)
(SOVEREIGN YIELDS: %; DXY: INDEX)



(*) A lower DXY index represents a weaker US dollar. Last available data: September 25th, 2024.
Source: BBVA Research based on data from Haver

Base scenario: controlled inflation and demand slowdown will pave the way for more aggressive rate cuts; growth is likely to converge to moderate levels



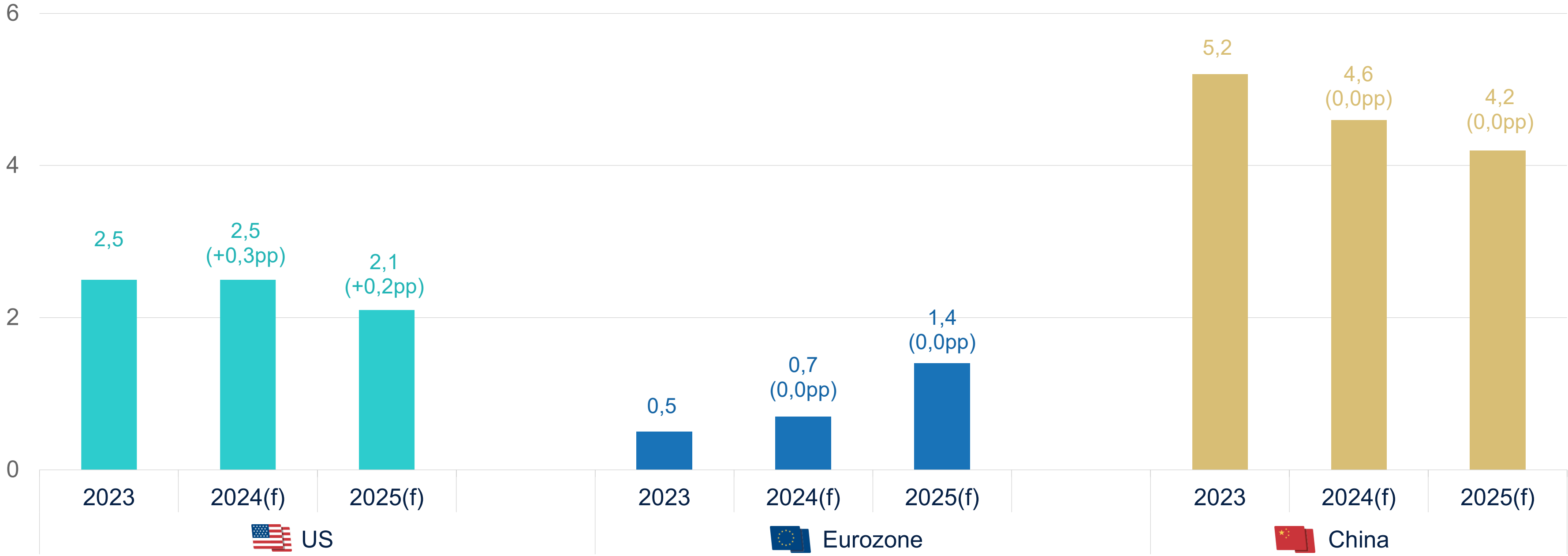
No supply shocks assumed
supply conditions to remain broadly unchanged, despite risks (commodity prices, geopolitics, labor supply...)

Further demand moderation
on still tight monetary policy and weak growth in China despite increasing policy support; expansive fiscal policy will help to sustain demand and prevent a recession

GDP forecasts: growth revised up on resilient demand in the US; cyclical recovery in Eurozone; policy stimulus will help to sustain growth in China

GDP GROWTH (*)

(%, CHANGE WITH RESPECT TO PREVIOUS FORECAST IN PARENTHESES)



(*) Global GDP growth: 3.1%in 2023, 3.1% (unchanged in comparison to the previous forecast) in 2024 and 3.3% (unchanged in comparison to the previous forecast) in 2025.

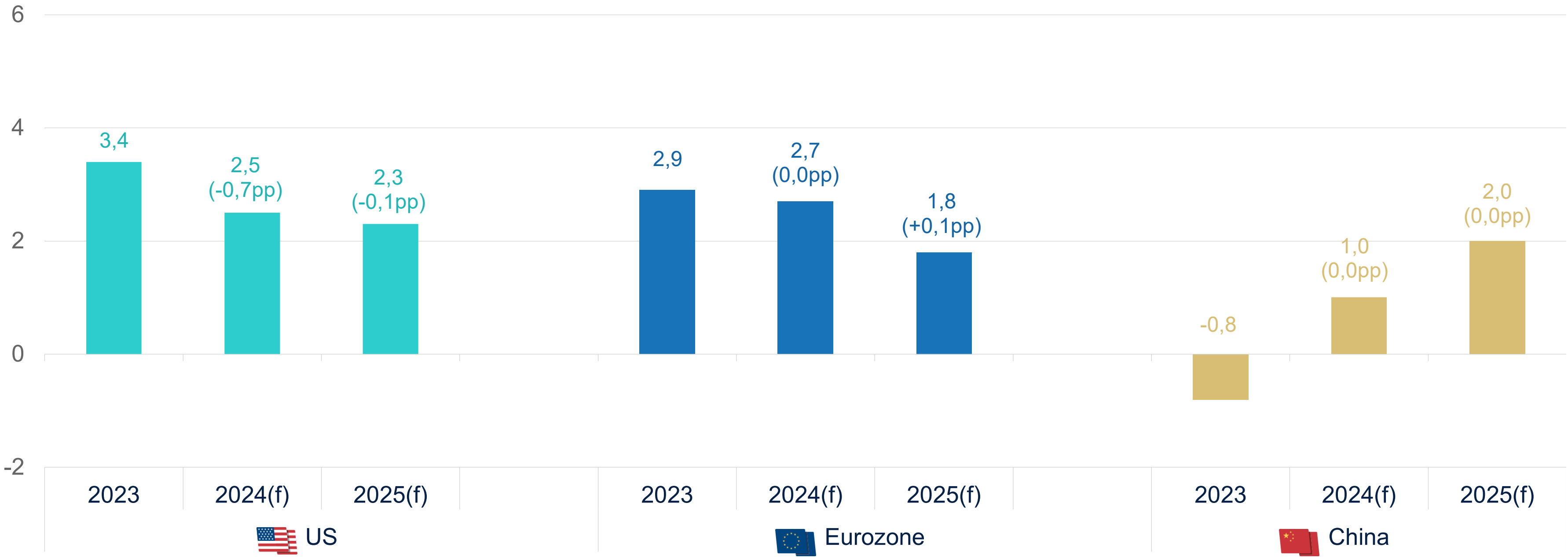
(f): forecast.

Source: BBVA Research.

Inflation forecasts: downward revision in the US on clearer labor market easing and favorable incoming data; no significant changes in Eurozone and China

HEADLINE CPI INFLATION

(Y/Y %, END OF PERIOD, CHANGE WITH RESPECT TO PREVIOUS FORECAST IN PARENTHESES)



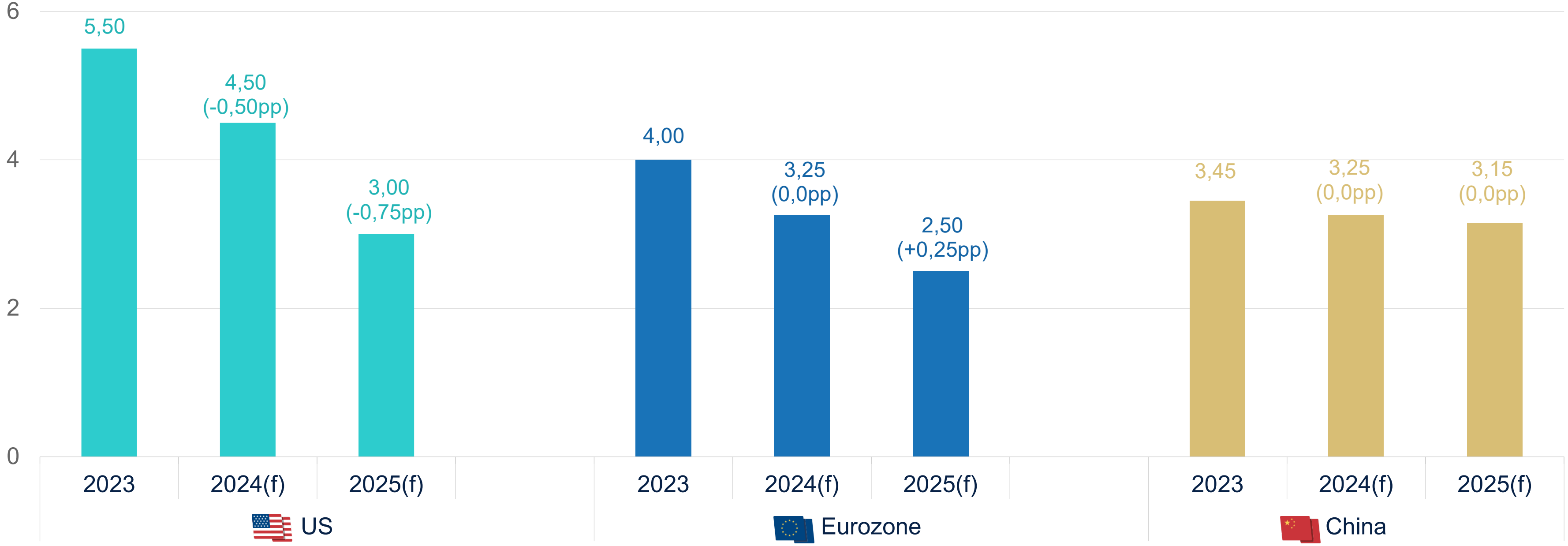
(f): forecast.

Source: BBVA Research.

Rate forecasts: further monetary easing is expected; the Fed is likely to cut rates at a 25bps pace till mid-2025; slightly higher long-term ECB rates

POLICY INTEREST RATES (*)

(%, END OF PERIOD, CHANGE WITH RESPECT TO PREVIOUS FORECAST IN PARENTHESES)

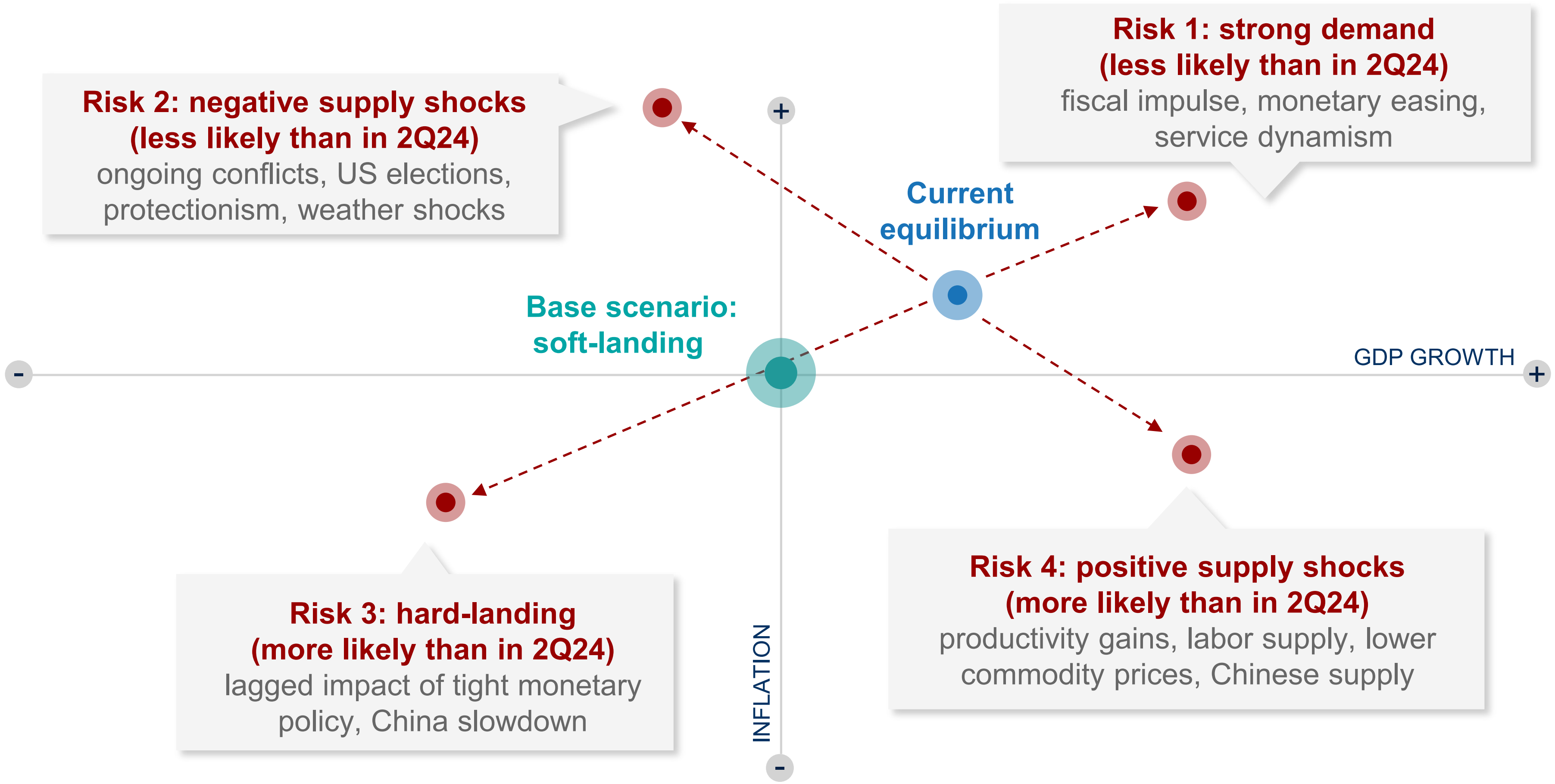


(f): forecast.

(*) In the case of the Eurozone, interest rates of the deposit facility.

Source: BBVA Research.

Risks: still sizeable, but more balanced than before



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02

China: Here comes China's Draghi moment

Summary

Growth

Chinese authorities on September 24 promulgated a jumbo size stimulus package to support growth, housing market and stock markets etc, that the market views it as Chinese QE or "China's Draghi Moment".

Chinese economy is experiencing structural rebalancing amid deep real estate adjustment. 2024 Q2 GDP decelerated to 4.7% from 5.3% in Q1, with unbalanced economic structure that supply side is stronger than the demand side persisting. Strong industrial production is supported by national strategy to prioritize high-end manufacturing, green economy and national security, particularly on the "New Trio"- EV, lithium-ion batteries and photovoltaic products; but domestic investment and consumption lag behind.

Look ahead, the large-scale stimulus package and the US and Europe's rate cut cycle provide room for China's economic rebound. As the historical large China-US rate reversion gradually normalizes together with surging Chinese stock markets, there will be more capital inflows and stronger RMB. However, the recovery has not got a solid foundation as the deep adjustment of real estate and unbalanced economic structure remain; Deflationary environment and geopolitics risks also persist with weak market sentiments of households and enterprises not reversed.

Risks

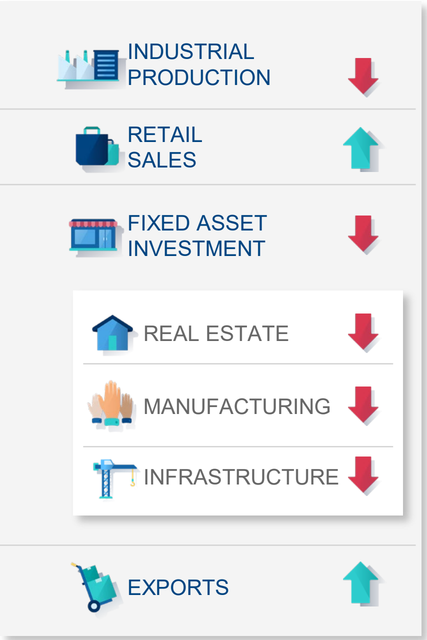
Growth pressure comes from: (i) sluggish consumption coming from wealth effect, weak sentiments; (ii) the deceleration of profits in "New Trio" products with over-investment; (iii) local government revenue dragged significantly by land sales dipping; (iv) deep adjustment of housing market. However, we do not think the systemic financial risks exist, given the prudent monetary policy and precautionary financial regulation measures.

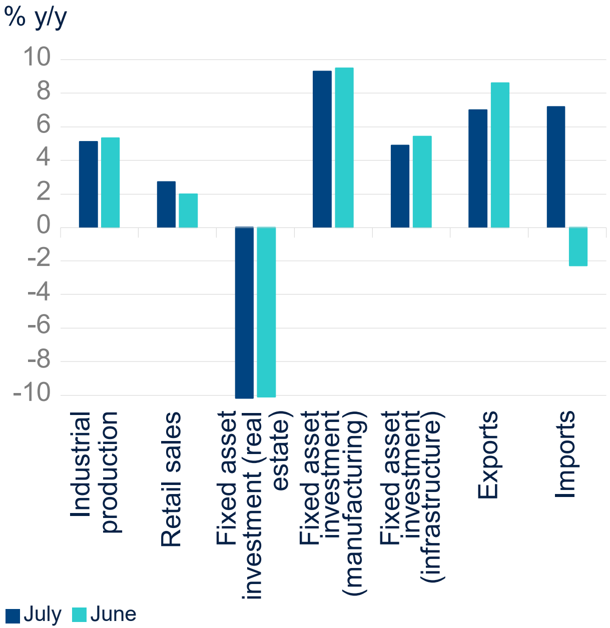
Geopolitics

China-US confrontations have achieved some marginal improvement amid the high-level communications. The US president election becomes the game-changer for the bilateral relation. Taiwan Strait situation remaims unchanged with limited risk. President Xi's high-profile European visit shows China's foreign affairs' focus might be transferring from the US to the Europe, although trade disputes will remain.

A summary of China's recent economic situation; risks and opportunities

THE ECONOMY





Source : BBVA Research and NBS

RISKS & PRESSURE

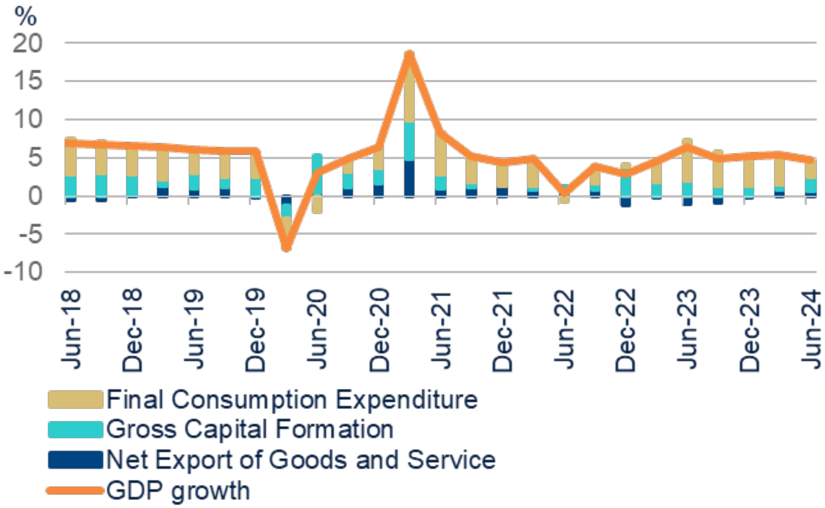
1. Unbalanced economic structure;
2. Deflation;
3. Weak sentiments for enterprises and households;
4. Real estate crash;
5. High unemployment rate at young age.
6. Profit deceleration and over-investment in "New Trio".
7. Local government revenue dragged by land sales dipping.

OPPORTUNITIES

1. Large scale comprehensive stimulus package paves the way to recovery.
2. US and Europe's rate cut cycle provides policy room for monetary easing measures;
3. China-US rate reversion normalization, more capital inflows and strong RMB.
4. The leading role in the world in green transformation sector.
5. US soft-landing story, tech advancement "New Trio" and deflation support exports.

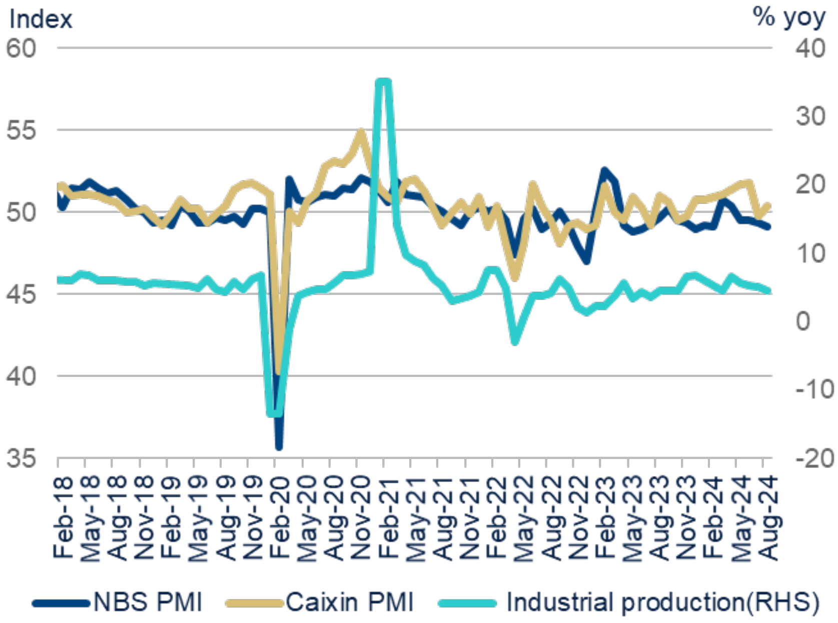
2024 Q2 GDP decelerated to 4.7% y/y from 5.3% in Q1 with an unbalanced structure persists

Q2 GDP DECELERATED TO 4.7% FROM 5.3% IN Q1



Forecast	2024Q1	2024Q2	2024Q3F	2024Q4F
Y/Y%	5.3	4.7	4.3	4.3
Q/Q% (HAVER SA)	3	-0.5	1.2	1.3

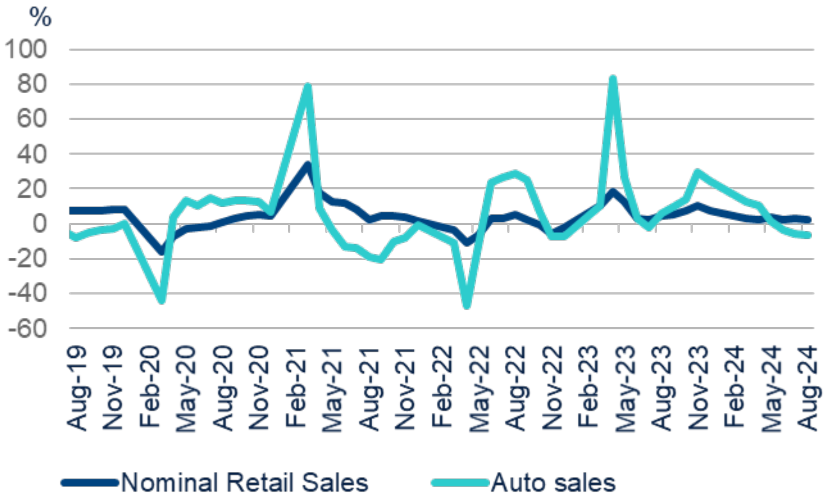
NBS PMI DECLINED TO 49.4 IN JULY; INDUSTRIAL PRODUCTION DECREASED TO 5.1% FROM 5.3%



Source：BBVA Research and NBS

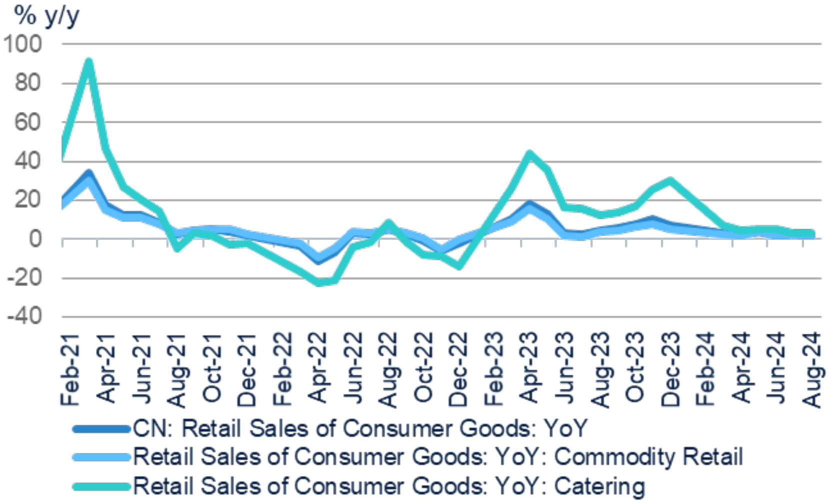
Retail sales still at low level, despite of the authorities' "large-scale equipment renewal and trade-in old consumer goods"; but will rebound after stimulus package

RETAIL SALES MARGINALLY PICKED UP BUT STILL REMAINED WEAK IN JULY



Source : BBVA Research and NBS

RETAIL SALES SLOWDOWN IS COMPREHENSIVE FOR ALL SECTORS, DIFFERENT FROM PREVIOUS DIVERGING PATTERN

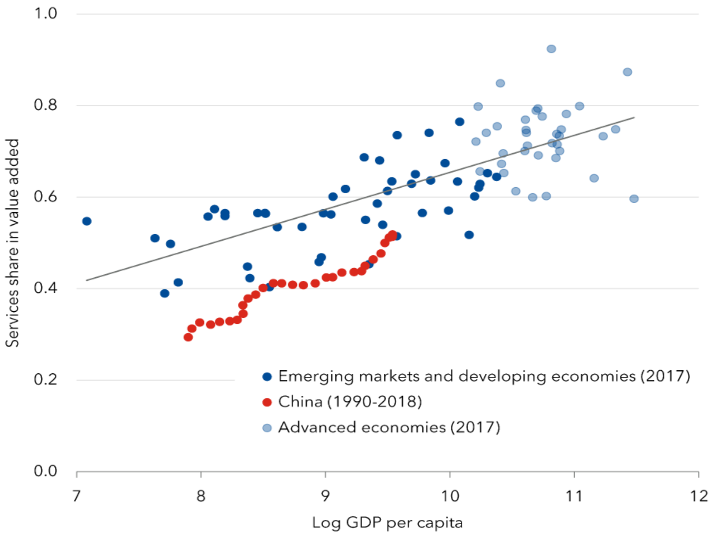


The authorities issued RMB 300 billion long-term government bond to support consumption by "large-scale equipment renewal and trade-in old consumer goods"; however, we still see low possibility of issuing "consumption coupon" to stimulate retail sales.

Stimulating consumption in China is a comprehensive long-term issue: high saving rate is a long-lasting cultural and historical tradition;

China saves and produces while the US consumes pattern since 2001 China joined WTO

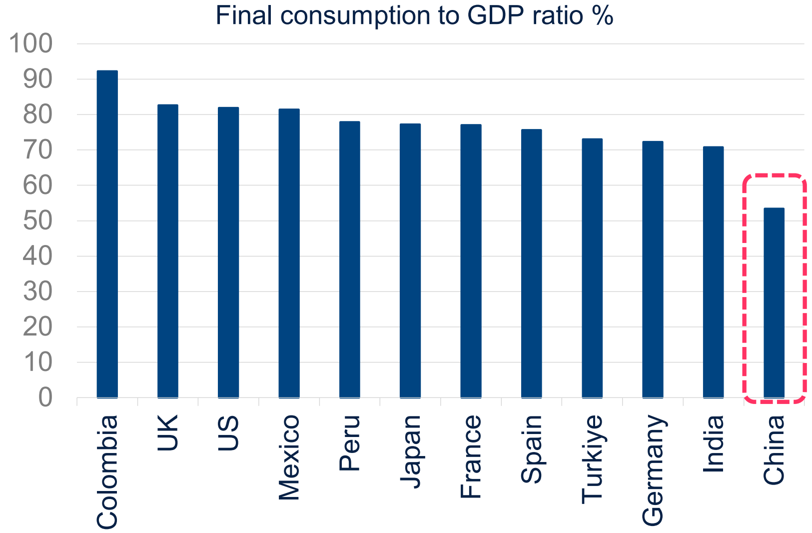
CHINA´S SERVICE SECTOR IS SMALLER THAN COMPORABLE ECONOMIES



Source：IMF staff calculations.

IMF

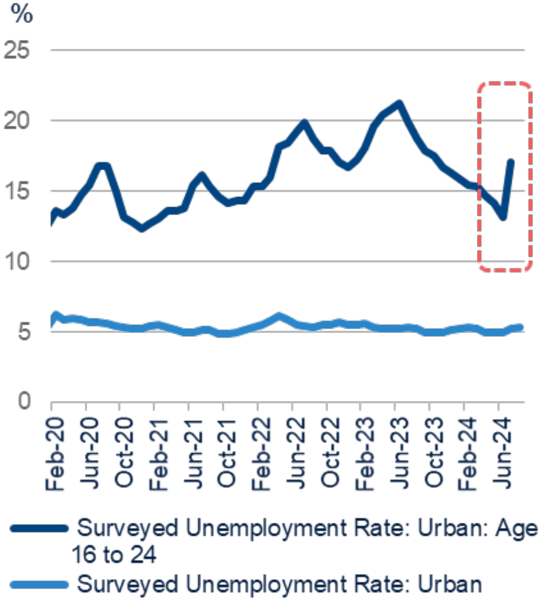
CONSUMPTION TO GDP RATIO IN SELECTED COUNTRIES: CHINA IS THE LOWEST



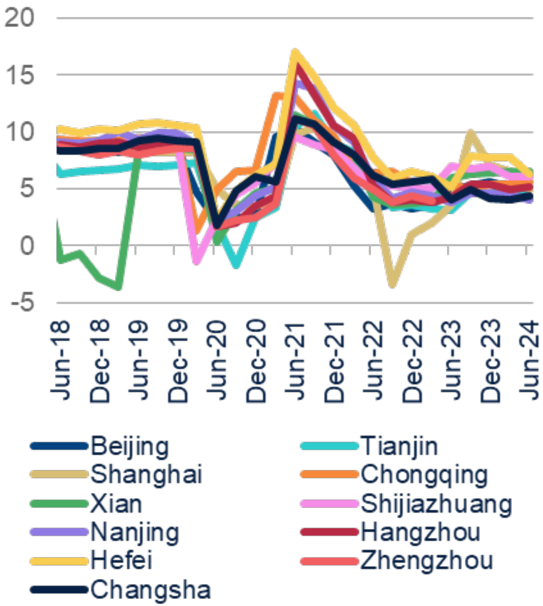
Stimulating consumption in China needs comprehensive long-term reforms to change people’s saving habits and tradition which is difficult: (i) medical insurance; (ii) social security/welfare reform; (iii) expectation of lifelong income growth (growth and job security); (iv) retirement plan, (v) education, etc.

In short term, retail sales is still constrained by: (i) high unemployment rate in young group (ii) "salary cap campaign" in finance and gov. sectors; (iii) wealth effect: sliding housing Price, but will have opportunities to rebound due to the large scale stimulus

REVISED 16-24 UNEMPLOYMENT RATE IS 13.2% STILL HIGHER THAN HEADLINE UNEMPLOYMENT 5%



INCOME GROWTH IN BIG CITIES LOWER THAN PRE-PANDEMIC LEVEL



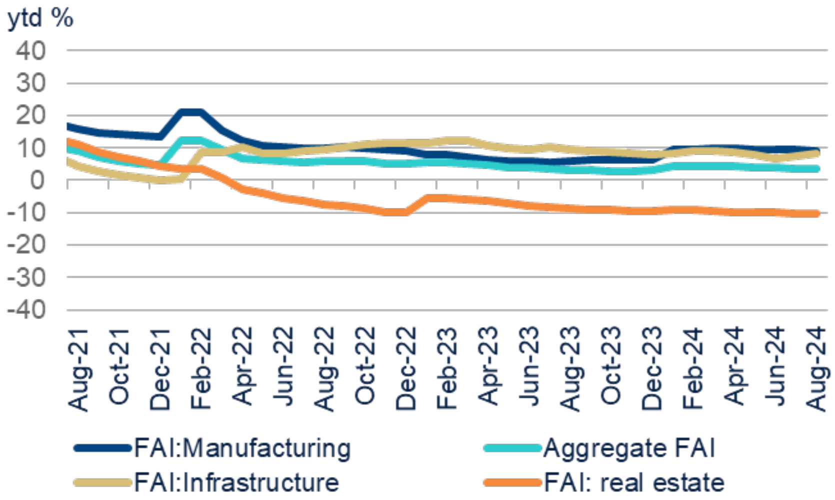
WEALTH EFFECT : STOCK MARKET LACKLUSTER

Source : NBS and BBVA Research;
NOTES: The revised statistic method of 16-24 unemployment rate excludes the survey on final year students at school

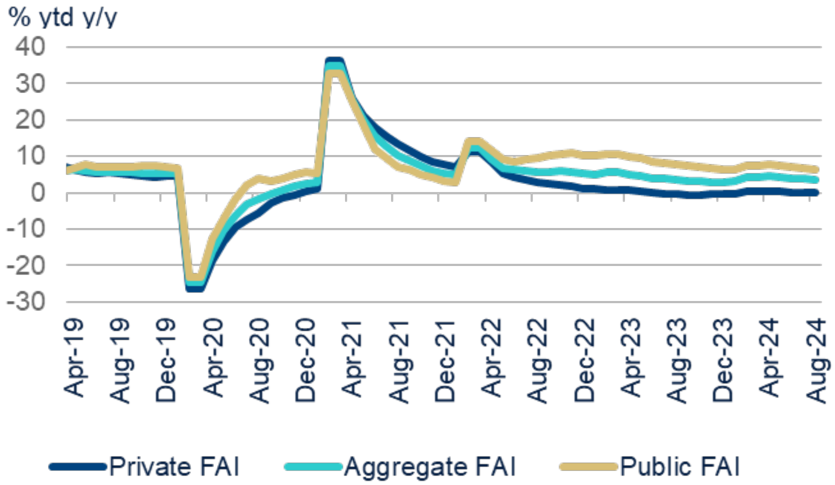
Investment further slowed to 3.6% ytd y/y from 3.9% with very diverging pattern: housing FAI remains the main lag (-10.2%);

manufacturing FAI remained strong (9.3%) surpasses infrastructure FAI (4.9%)

HOUSING INVESTMENT EXPANDED ITS DECLINE TO -9.8% YTD Y/Y FROM -9.5%



THE MULTIPLIER EFFECT OF PUBLIC FAI TO PRIVATE FAI REMAINS WEAK

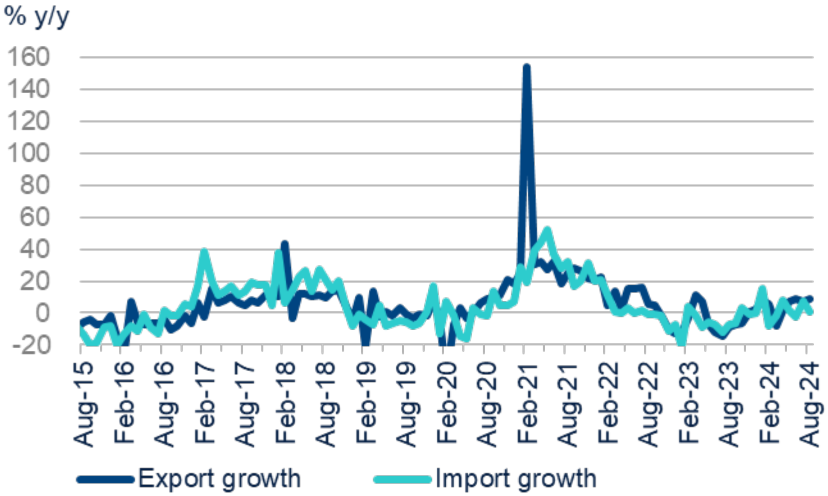


Source：BBVA Research and NBS

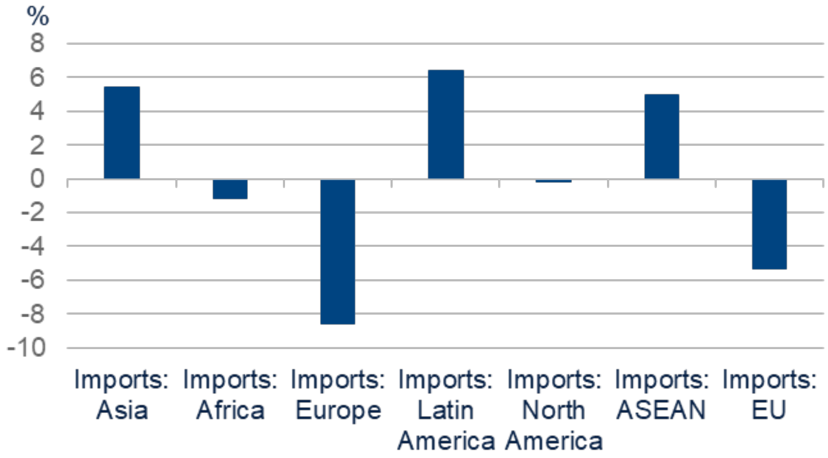
(1) Manufacturing FAI is supported by high-end manufacturing, digital economy, modern service industry, national security projects etc.; (2) Infrastructure FAI issupported by the extra RMB 1 trillion govenment bond issuance at end-2023 and the anual issuance of RMB 1 trillion government bond in 2024.

Exports remained resilient

EXPORTS DECLINED FROM 8.6% TO 7% BUT REMAINS RESILIENT; IMPORTS IMPROVED TO 7.2% FROM -2.3%



CHINA'S IMPORTS PICKED UP MOSTLY FROM NORTH AMERICA AND ASIA

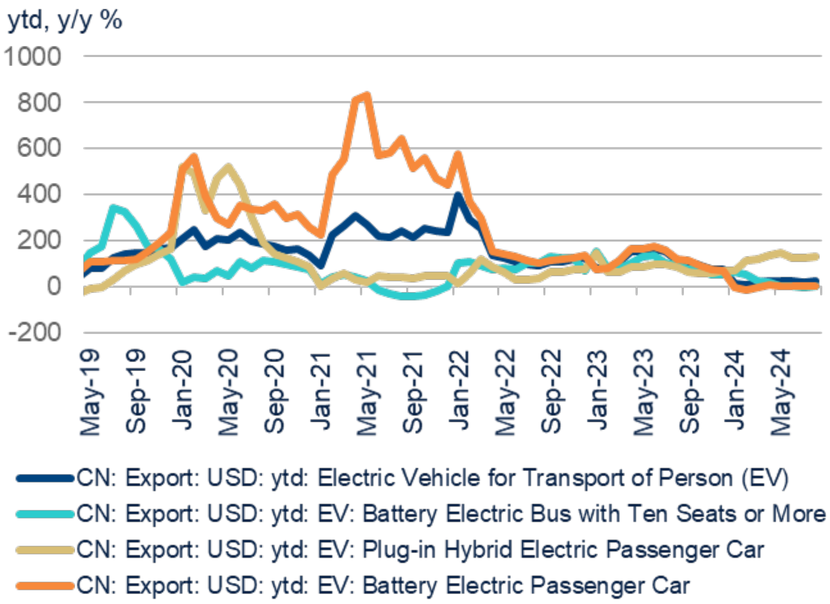


Source : NBS and BBVA Research.

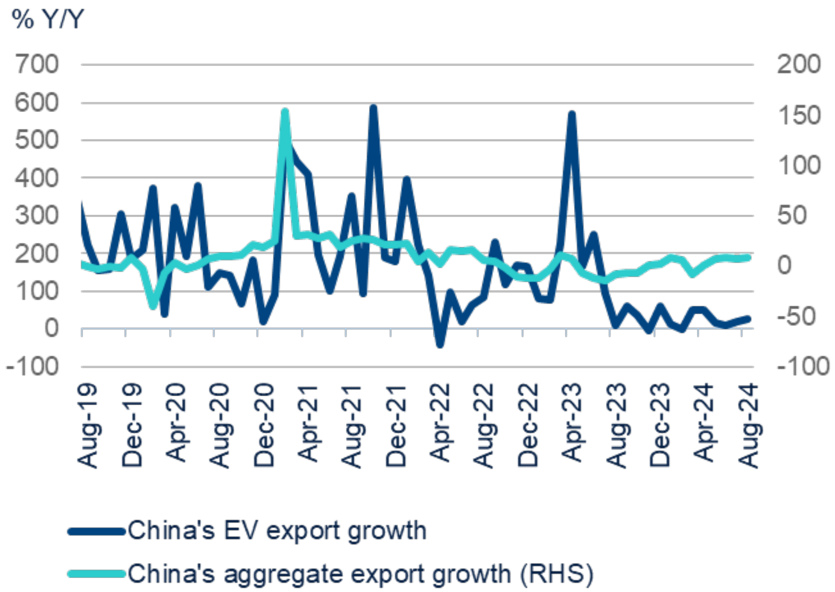
China recently expanded the commodity imports from Latam, due to (i) expanding its strategic reserve amid rising geopolitical uncertainties; (ii) "buy low" before the US cut the rate. (iii) Strong supply side particularly in green economy and high-end manufacturing.

China's "New Trio" exports face trade restrictions in advanced economies, leading to their exports slowdown

EV EXPORTS: FROM HIGH GROWTH TO LOW GROWTH DUE TO TRADE FRICTIONS



EV EXPORTS GROWTH CONVERGED TO AGGREGATE EXPORTS GROWTH IN RECENT MONTHS

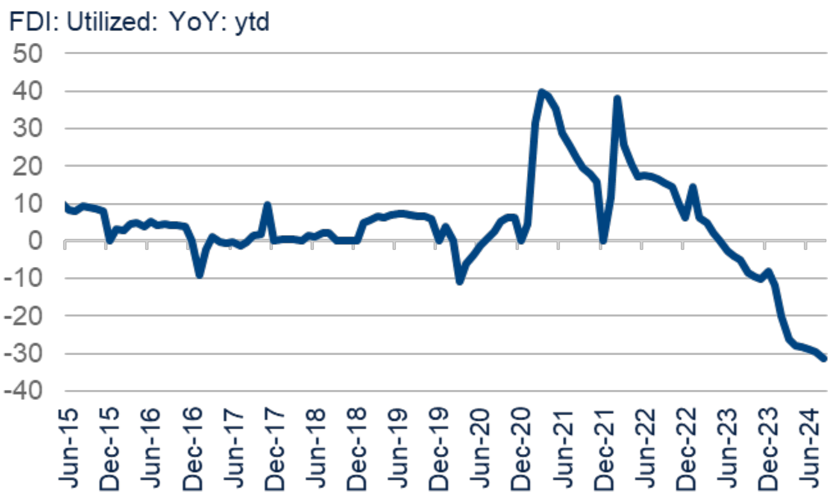


Source：BBVA Research and NBS

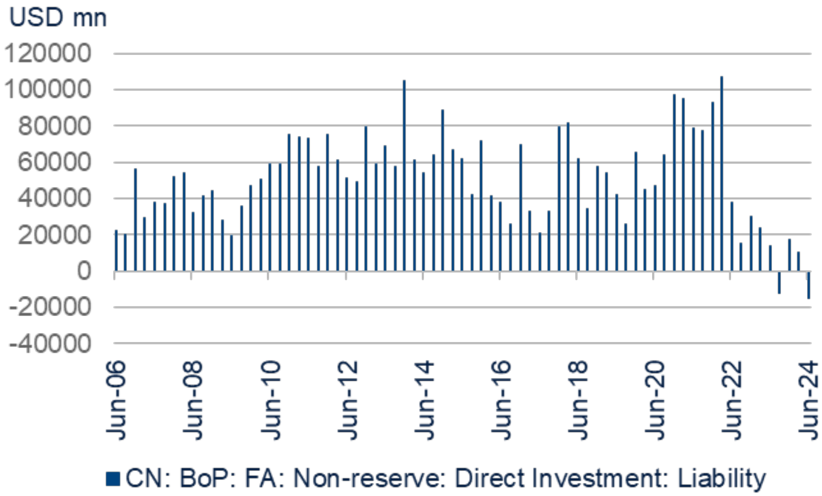
China's FDI negative net inflows remained, but it is expected to reverse after US-China rate reversion nomalized;

but EU's FDI inflows to China in 2024 surged, mainly contributed by Germany

MOFCOM: THE NET FDI INFLOW DROP IS CONTINUING



BoP LEVEL (SAFE): FDI NET INFLOW TURNED TO POSITIVE IN RECENT MONTHS

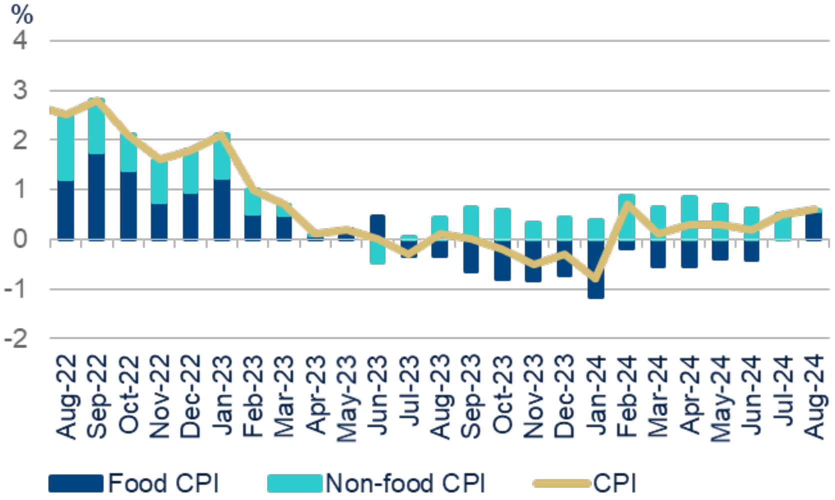


Source：BBVA Research and NBS

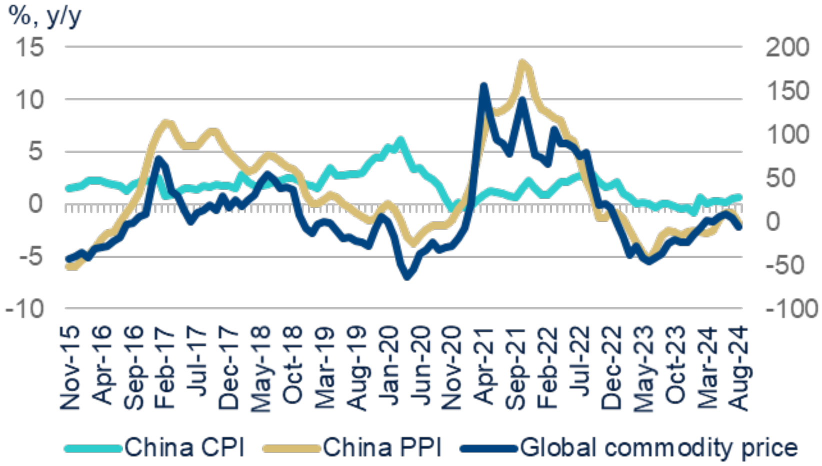
German FDI in China for the first half of 2024 stood at €7.3bn, compared with €6.5bn for the whole of 2023. German investments have consistently accounted for more than 50% of EU investments in China, mostly contributed from German carmakers. That means, although the politicians call for "de-risk" and decoupling from China, auto makers in Germany still stick to "in China, for China" principle and expand FDI in China.

Deflationary environment is not easy to reverse amid deep real estate adjustment and unbalanced economic structure

CPI WENT MARGINALLY UP TO 0.3% SUPPORTED BY NON-FOOD CPI



BOTH CPI AND PPI IMPROVED MARGINALLY IN JULY, BUT THIS DOES NOT MEAN DEFLATION ENVIRONMENT REVERSED

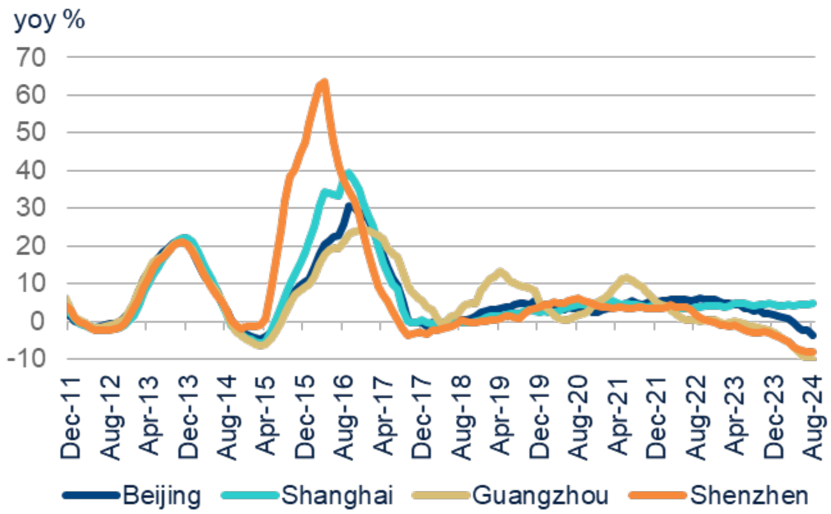


Source：BBVA Research and NBS

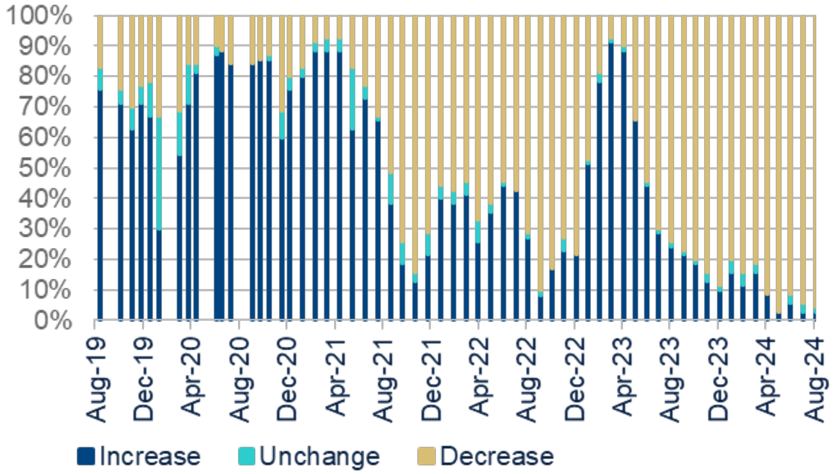
Deflation in China: 1. Weak domestic demand and weak sentiments VS. strong supply. 2. Price decelerated due to the "salary cap campaign" in financial and gov. sector etc., together with high unemployment in young age group; 3. Pork cycle is outside the swine flu period, pork supply expanded significantly leading to overcapacity. 4. Conservative central banks indicates limited liquidity in the market.

China's real estate market remains the primary risk of the economy, and we anticípate a significant rebound amid the current jumbo size stimulus

IN TIER-1 CITIES, THE PRICE PERCENTAGE CHANGE RANGE IS WITHIN -10% TO 5%



90% CITIES REPORTED HOUSING PRICE DECREASE IN 70-CITY SURVEY

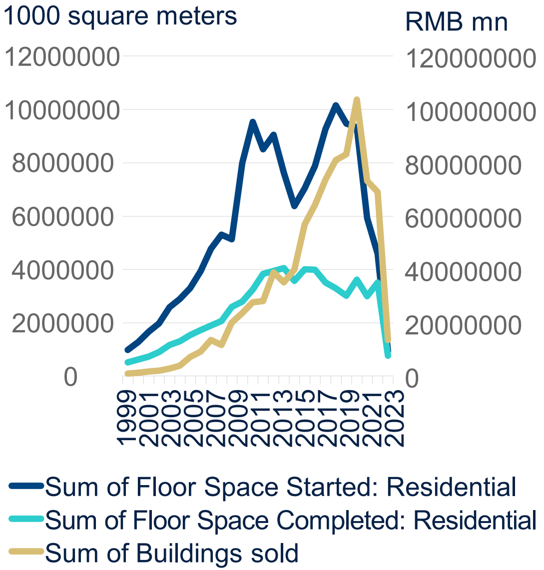


Source: NBS and BBVA Research.

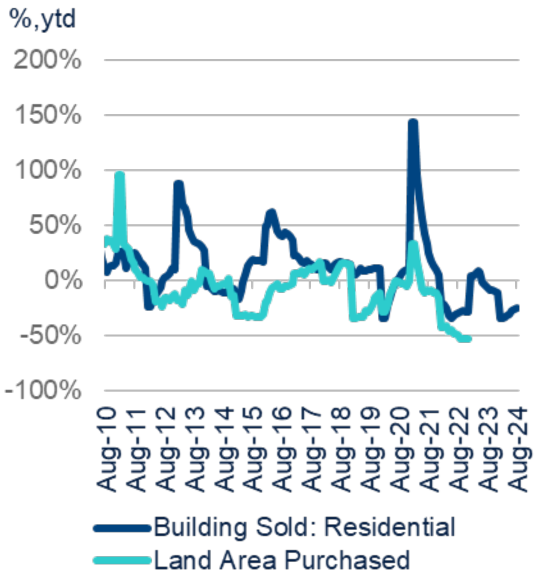
The recent housing stimulus: (i) Lower the first and second house purchase's downpayment ratio to 15% (ii) To move the lower bound of mortgage rate for home buyers. (iii) PBoC set RMB 300 billion re-lending pool to encourage local SOEs and government to purchase unsold houses as low-income housing. (iv) The four large cities continuously promulgated easing measures for home purchase. (v) Gov could get back the land that sold to real estate developers to increase the cash flows to those developers.

We have not yet observed bottom-up of the main housing indicators such as housing sales, floor space started and real estate investment etc.

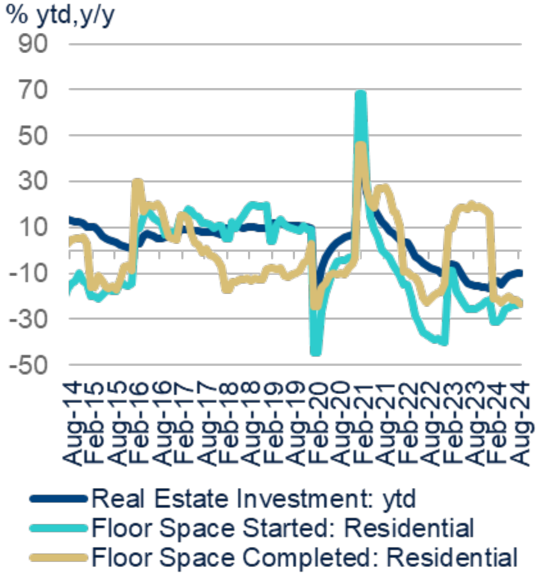
THE LEVEL OF HOUSING INDICATORS DIPPED TO HISTORICAL LOW



BUILDING SOLD REMAINS NEGATIVE GROWTH



FLOOR SPACE COMPLETED & STARTED REMAINED NEGATIVE, HOUSE INVESTMENT NEGATIVE 20 MONTHS



Source : BBVA Research and NBS

Compared with other real estate cycles, why real estate recovery is so difficult in this downward cycle?

- This round of real estate deep adjustment is fully policy-driven. The authorities on purpose want to break the long-lasting expectation that "China's housing price is one-way increasing" amid "common prosperity" advocation in the 2021 regulatory storms.

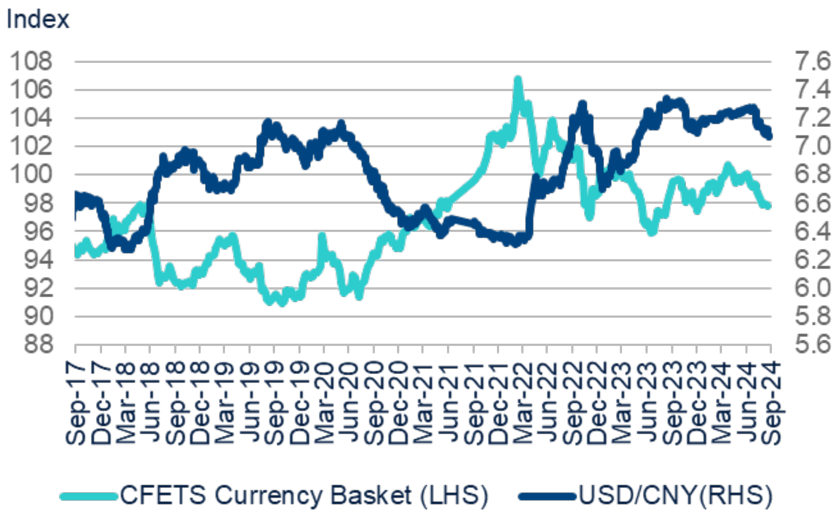
- Long-term structural factors also matters: potential growth slowdown, aging, urbanization deceleration, population growth deceleration.

- Cyclical factors:
  (i) 2015-2018 China experienced "shantetown redevelopment" (intrinsically Chinese versión of QE) greatly supported real estate recovery outside the downward cycle;
  (ii) regulation failure on "pre-sale" scheme and house-buyers' fear on default risk of developers;
  (iii) high-leverage business mode.

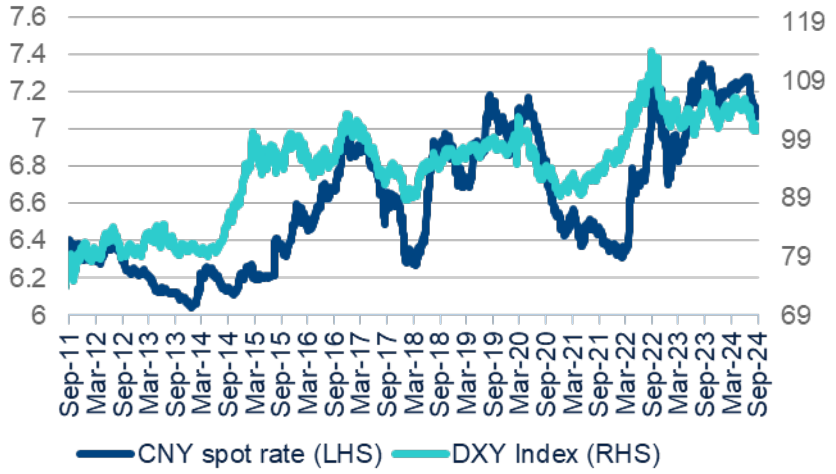
- Three housing market negative spirals:
  (i) investment---wea lower housing prices—lower willingness for purchasing with investment or arbitrage purpose.
  (ii) people's fear of default risks of developers in "pre-sale"---no cash flows for developers.
  (iii) lower housing price expectations---lower housing investment---lower land sales ---local government revenue dipping---lower local gov drivenker income growth and higher unemployment.

RMB to USD Exchange rate appreciated recently due to FED's rate cut in September and the large-scale stimulus package

RMB EXCHANGE RATE APPRECIATED TO 7.1 RECENTLY DUE TO US FED CUT EXPECTATION IN SEP



THE MIRROR EFFECT OF RMB EXCHANGE RATE AND USD DXY PERSISTS

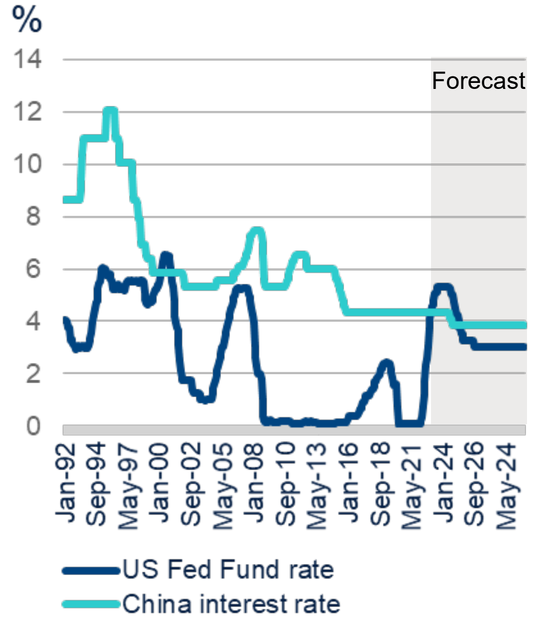


Source：BBVA Research and NBS

FED rate cut cycle will lead to **RMB/USD appreciate to around 7 at end-2024 and end-2025 forecast at 6.8** (**Bloomberg: consensus: 2024: 6.97, 2025: 6.8**).

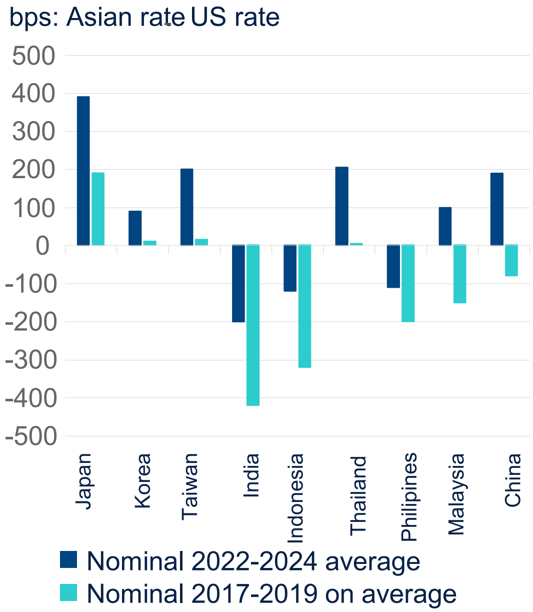
Historical large China-US rate reversion significantly impacted our bank's China corporate lending business (1)

THE HISTORICAL LARGE REVERSION OF CHINA-US POLICY RATE



POLICY RATE REVERSION ALSO TRIGGERRED VARIOUS RATE REVERSIONS, eg. BOND YIELD

SIMILAR REVERSION IN SELECTED ASIAN COUNTRIES



Source : BBVA Research and NBS

Historical large China-US rate reversion significantly impacts our bank's China corporate lending business (2):

corporates transfer their previously USD financing to RMB financing

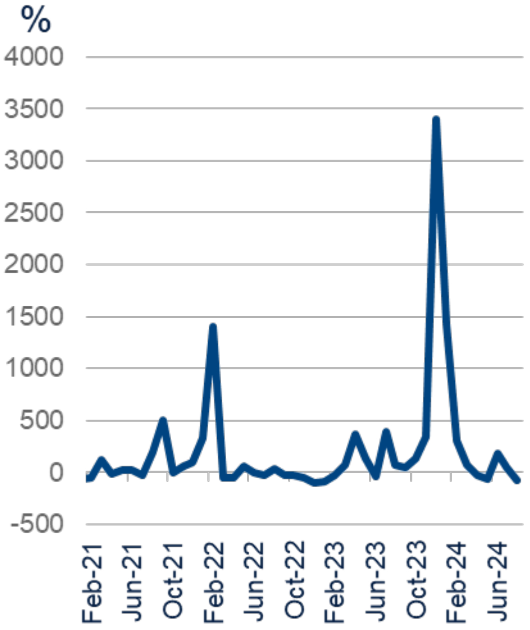
1. For foreign banks' asset side of balance sheet, their claims on Chinese corporates significantly dropped since 2023. Usually, foreign banks provides USD funding for them as the USD cost has been traditionally lower than the RMB. But amid rate reversion, due to lack of RMB liquidity, these foreign banks' asset shrank.
2. Foreign currency loans experienced a significant drop to negative since 2022.
3. On bond financing, Panda bond, which is the RMB denominated bond issued by foreign institutions in China sees a significant jump since 2023.
4. Regarding the offshore RMB financing in HK, dim-sum bond which is the offshore RMB bond issuance also sees a significantly expansion in 2023.
5. RMB loans in HK expanded. In 2023, its size of RMB loan outstanding in HK almost doubled from 2022, reaching RMB 450 billion.
6. China's syndicated loan volume in the offshore markets dipped since 2023. The volume even shrank more in 2024 as the USD (and its pegged HKD) funding cost goes up. Many firms would rather scale down their USD borrowings and defer their financing plan to a later stage.

Historical large China-US rate reversion significantly impacts our bank's China corporate lending business (3):

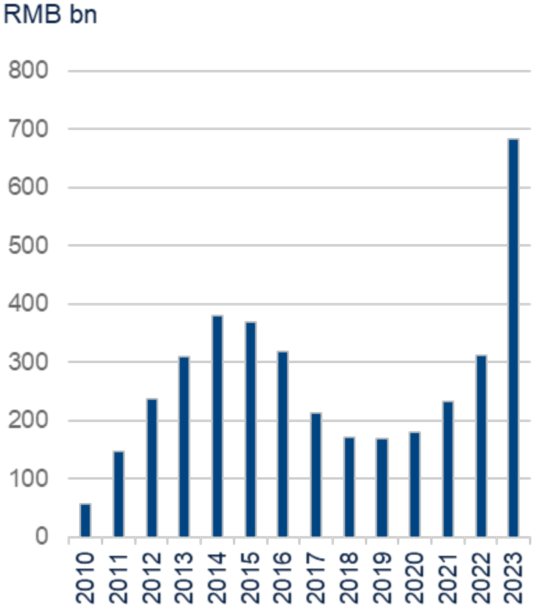
corporates transfer their previously USD financing to RMB financing

FOREIGN CURRENCY LOAN GROWTH DIPPED TO NEGATIVE

PANDA BOND ISSUANCE REACHED HISTORICAL HIGH RECENTLY



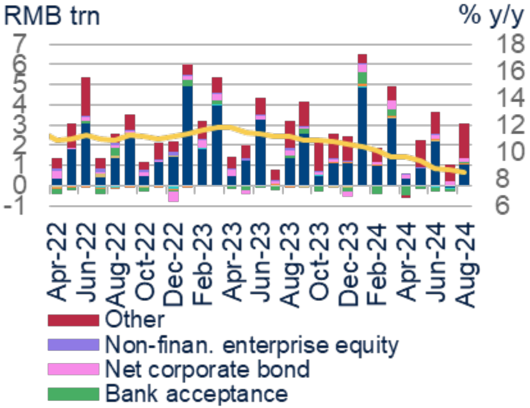
DIM SUN BOND ISSUANCE IN HK SEES A SIGNIFICANT JUMP IN 2023



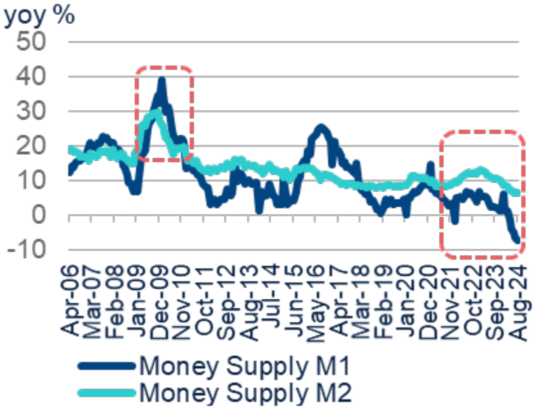
Source：BBVA Research and NBS

China's total credit growth significantly slowed amid lackluster demand; no substitution effect in credit market observed

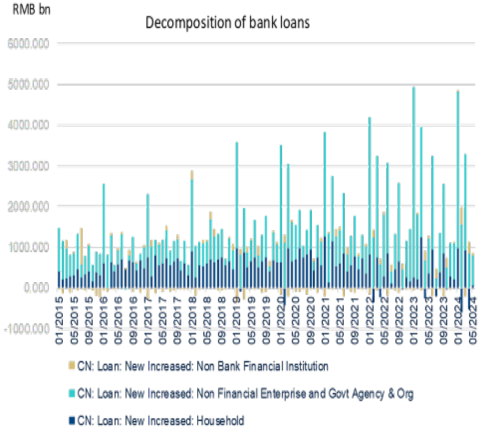
TOTAL SOCIAL FINANCING AND NEW RMB LOANS DECELERATED



M2 AND M1 DIPPED TO HISTORICAL LOW; M1 HAS REMAINED NEGATIVE



DECOMPOSITION OF BANK LOANS: ALL KINDS OF LOANS DECELERATED, NO SUBSTITUTION EFFECT



Source : BBVA Research and NBS

- Behind negative M1 growth: sluggish economic activities, weak market sentiments, weak enterprises' liquidity condition.
- No substitution effect among corporate loans, household loans, non-financial institutions loans and other kinds of loans, they all declined to a large extent.

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03

Policy: The Chinese style QE

Main messages

Monetary policy

The market views the authorities' September 24's jumbo size stimulus package as Chinese QE or "China's Draghi Moment". The stimulus package announced by the PBoC's governor Pan Gongsheng in the media conference include several aggressive elements, including aggressively cut rate and RRR, using central bank's balance sheet to inject money into stock market etc.

Fiscal policy

The authorities have announced expansionary fiscal policy together with the monetary stimulus package in the Politburo meeting which emphasised the counter-cyclical adjustment role of fiscal policy, and focused particularly on the role of fiscal easing on stimulating consumption.

Housing policy

The authorities also promulgated a series of aggressive real estate easing measures to revert the housing market crash.

Understanding the jumbo size stimulus package (1)

The September 24's jumbo size stimulus package announced by the PBoC's governor Pan Gongsheng in the media conference include the following elements:

(i) The PBoC will cut the RRR by 50 bps, releasing RMB 1 trillion of long-term liquidity to the market. In the rest of the year, the PBoC will adopt data-dependent approach to cut RRR again by 25 to 50 bps.

(ii) The PBoC will also cut 7-day repo by 20 bps from 1.7% to 1.5%, guiding banks' lending rate and deposit rate decline.

(iii) To cut the rate for the existed residential mortgage by 50 bps expected.

(iv) To cut the down payment for second house purchase to 15% from 25%.

(v) The government announced RMB800 billion of liquidity support for the stock market, with a RMB500 billion swap facility for brokers and funds and a RMB300 billion refinancing facility for companies and shareholders for stock buybacks.

(vi) The PBoC also cut the Medium-lending facility rate (MLF) by 30 bps, from previously 2.3% to 2%.

Understanding the jumbo size stimulus package (2)

Following the September 24 announcement of aggressive monetary stimulus, the authorities also further elaborated the comprehensive stimulus plan beyond monetary easing in the recently held Politburo meeting. The main take-aways of the Politburo meeting include:

(1) Fiscal policy: the meeting emphasised the counter-cyclical adjustment role of fiscal policy, and focuses particularly on the role of fiscal easing on stimulating consumption. Although we do not think China will conduct the direct money injection to households like what US and EU did during pandemic time, we indeed expect China will continue to push forward Chinese-style fiscal easing by issuing central government bond in a larger scale, not only to stimulate infrastructure but also to swap part of the local government debt to ease local government's burden.

(2) The meeting also very clearly requires the housing price stabilization and to stop the previous one-way dipping. Unlike the previous easing measures on housing which focused more on "quantity", this time focuses more on "price".

(3) Consumption stimulus: unlike the previous Politburo or other high-level meetings of CCP that emphasized more on supply-side: high-end manufacturing, green economy and technology advancement, this Politburo is focusing more on consumption stimulus. No matter it is stock market and housing stabilization, or employment protection, POE support policies etc, the ultimate goal is to stimulate consumption by increasing income expectations, wealth effect and employment rate etc.

Our comments on the jumbo size stimulus package:

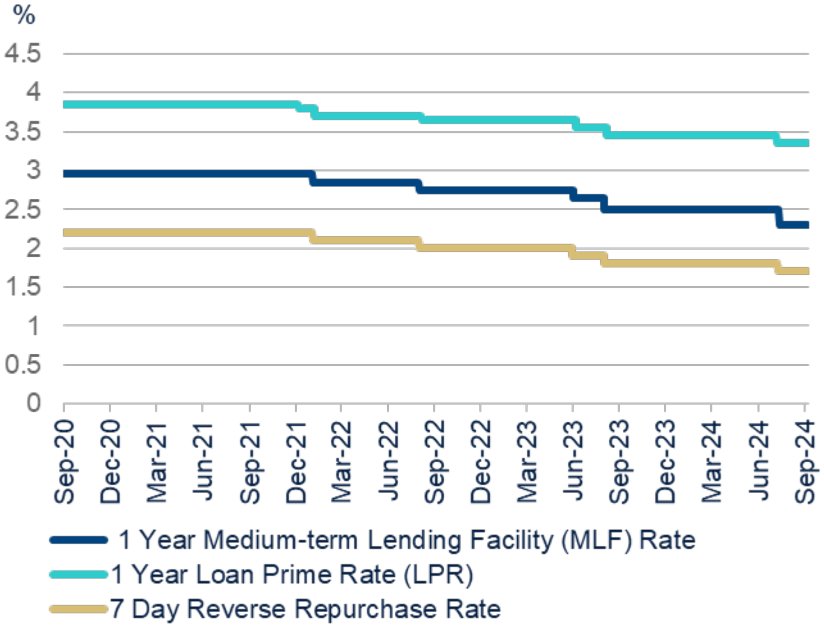
When we comment the above jumbo size monetary stimulus package together with stimulus measures in Politburo, we have to first of all identify the impact to the stock market and the real economy, as the stock market might not necessarily be the real time reflections of the real economic activities.

On stock market, indeed, the (v) measures on stimulating stock market by issuing RMB 500 billion swap facilities for securities, mutual funds and insurance firms to make their stock assets as the collateral to swap the high-liquidity assets from the central bank such as government bond or notes; and by issuing RMB 300 billion special re-lending tool to lead commercial banks to lend to listed companies' shareholders to re-purchase or increase the holding of their stocks, are definitely equivalent to the PBOC using the central bank's own balance sheet to inject liquidity into the stock market, which makes it not difficult to understand the recent rallies of A-share and HSI. We believe the stock market carnival will last for a while as China's stock market has already been at the historical low evaluation after 2021's regulatory storms and housing market crash.

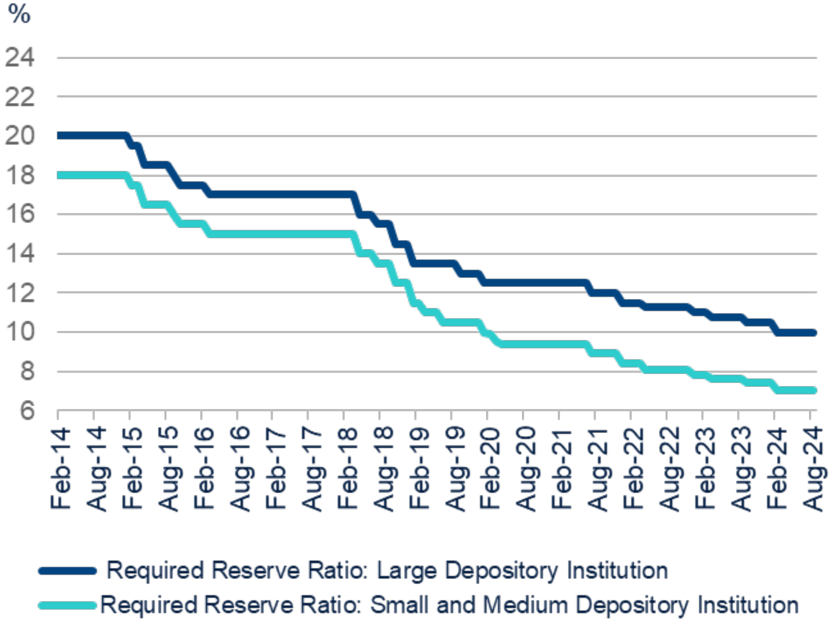
On the stimulus package's impact on the real economy, we believe that the main issue of lacklustre growth outlook in China is due to weak market sentiments of households and enterprises, it indeed needs a large-scale comprehensive stimulus or policy support including not only monetary policy, fiscal policy, housing stimulus, employment support to reverse the market expectations. That means, the transmission mechanism from lower policy rates to real economy might not be as fast or effective as the market anticipates. And it takes time to implement all these measures to rebuild market sentiments, to recover households and enterprises' balance sheets and to reverse the real estate crash. We'd better view it as a gradual process.

Monetary policy: keeps expansionary amid FED's rate cut cycle and the stimulus package, but the central bank will not cut the rate to 0 as what US and Europe did during pandemic and GFC

THE PBOC CUT A SERIES OF POLICY RATES IN THE STIMULUS PACKAGE



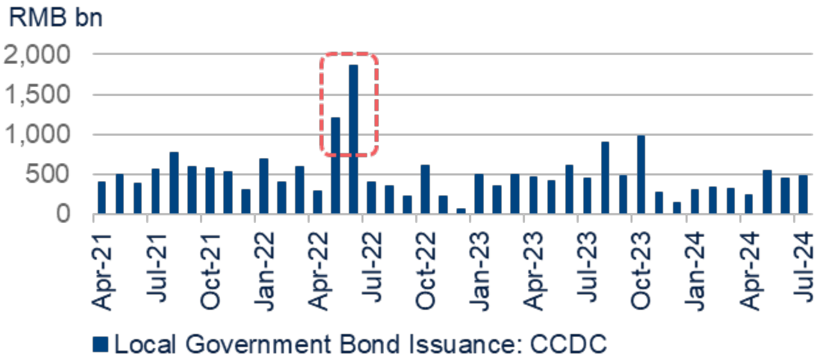
ON TOP OF THE RECENT 50 BPS CUT, WE EXPECT TO CUT ANOTHER RRR 1-2 TIMES IN 2024, PROVIDING LIQUIDITY FOR RECOVERY



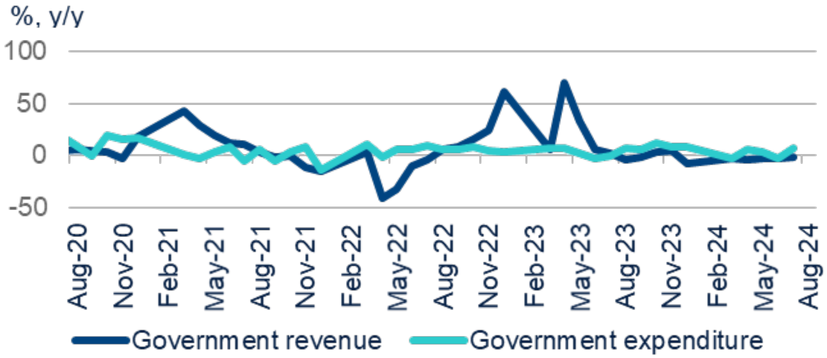
Source : BBVA Research and NBS

Fiscal easing focuses on central gov. bond issuance instead of tax cut

LOCAL GOV BOND ISSUANCE IS AT A STEADY BUT CONSERVATIVE PROGRESS TO AVOID DEBT OVERHANG



GOV EXPENDITURE IS HIGHER THAN THE REVENUE WHICH WAS DRAGGED BY LAND SALES DIPPING



- 2024 fiscal Budget is set to be at 3% announced in “two sessions”, but the actual fiscal déficit may reach 3.5-3.8%.
- Starting from 2024, Chinese government will issue long-term government bond every year (2024: RMB 1 trn). PBoC could purchase gov bond in the secondary market.
- The expansionary fiscal policy will expand central government debt (21% of GDP, still low in international comparison; 1/5 for China’s total gov debt) but contain local government debt, as the central gov balance sheet is more healthy. Central government debt will swap part of local government debt to settle the local government debt problem.

Forecast: China's main economic indicators: Baseline scenario

	Baseline scenario						
	2019	2020	2021	2022	2023	2024(F)	2025(F)
GDP (%)	6.1	2.3	8.1	3	5.2	4.6 (with upside bias)**	4.2(with upside bias)**
CPI (%)	2.9	2.6	0.9	2	0.2	0.6	1.5
PPI (%)	-0.3	-1.8	8.1	4.2	-3	-1.2 ↓	1
Interest rate (LPR, %)	4.1	3.85	3.8	3.6	3.45	3.05 ↓	3.05 ↓
RMB/USD exchange rate	7	6.5	6.36	6.9	7.1	7.0 ↓	6.8 ↓

** the forecasting is made before the September 24 jumbo size stimulus package, thus is subject to upside bias. We will raise GDP forecast in the next QRES.

China's forecasting: decomposing GDP growth

	Baseline scenario						
	2019	2020	2021	2022	2023	2024(F)	2025(F)
GDP (%)	6.2	2.3	8.1	3.0	5.2	4.6 **	4.2 **
Personal consumption	6.27	1.70	7.90	1.50	6.50	4.80	4.00
Government consumption	8.50	1.60	10.00	1.00	7.00	4.50	4.00
GCFC	5.00	1.40	6.20	2.80	4.00	4.00	5.00
Inventory Change	-0.80	-12.30	2.50	5.80	2.20	2.20	5.00
Export	-0.10	3.60	30.00	12.00	-1.50	2.70	2.21
Imports	-1.00	-1.05	29.00	8.00	-1.50	2.00	3.20

** the forecasting is made before the September 24 jumbo size stimulus package, thus is subject to upside bias. We will raise GDP forecast in the next QRES.

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China Economic Outlook

October 2024

Creating Opportunities