Economic Watch

China | What could go wrong with China's new stimulus package?

Jinyue Dong / Le Xia

February 5, 2025

Amid ongoing economic slowdown, Chinese authorities pivoted their policy stance to pro-growth at two high-level internal meetings of the Communist Party of China (CPC) in Q4 2024: the CPC's Politburo meeting and the Central Economic Work Conference. The conclusions of these two meetings highlighted the authorities' pledge to employ a number of "extraordinary counter-cyclical policy tools" to bolster the economy amid growing domestic and international challenges. Notably, the authorities confirmed a shift to a "moderately loose" monetary policy, marking a significant change from the previously "prudent" stance that persisted between 2010 and 2024.

On the fiscal policy front, the authorities vowed to expand 2025's fiscal budget deficit to above 3% and to issue more ultra-long-term Treasury bonds and local government special bonds to rev up public expenditure. Additionally, the authorities have clarified that they will take special actions to boost domestic consumption and stabilize the property and stock markets. In November2024, the Central Committee of the National Congress also announced a plan to clean up local government debt, enabling local governments to better revitalize their economies.

In a nutshell, China's authorities appear well aware of the escalating headwinds to growth stemming from deteriorating domestic vulnerabilities and prospective protectionist measures to be implemented by the US President Trump. Policymakers' new strategy is to unveil a stimulus package to ensure that growth remains resilient to both internal and external adverse shocks. This approach echoes China's "Four-trillion" stimulus package implemented during 2008-2010, which, albeit contentious in policy and academic discussions, did effectively help the country overcome the economic downturn caused by the 2008-2009 Global Financial Crisis.

Nevertheless, China's prospective new stimulus package carries significant potential but also comes with a set of risks and challenges. In light of these, market investors have only given lukewarm reactions to the strong policy signals emanating from the CPC's Politburo meeting and the Central Economic Work Conference. For instance, in both onshore and offshore stock markets of China, the rallies caused by the policy shift didn't last long back to September 2024. (Figure 1 and 2)

People's doubt was also reflected in the housing market. The housing indicators including housing prices, new houses started and completed, housing investment etc., didn't give a knee-jerk reaction to the annoucement of stimulus policy initiatives, although some of them marginally improved recently. (Figure 3 and 4)

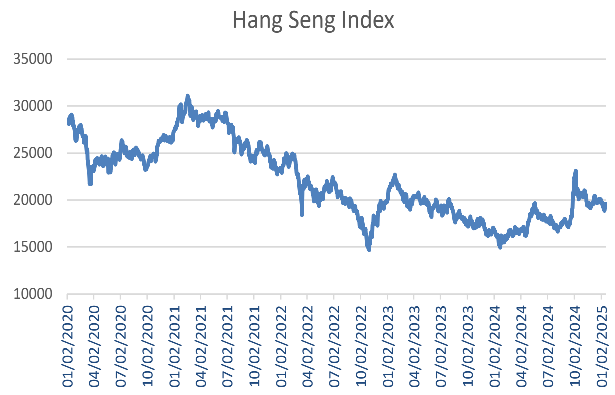
If history is of any guide, China's authorities should realize that deploying stimulus is not an easy task. At the current juncture, the authorities need to carefully avert various policy traps, ranging from designing policy package to its implementation, to maximizing the effectiveness of the new stimulus.

Below are our analysis of what could go wrong with China's stimulus package and how to avoid these traps:

Figure 1. **SHANGHAI SHENZHEN 300 INDEX RALLY ONLY LASTED FOR 2 WEEKS…**

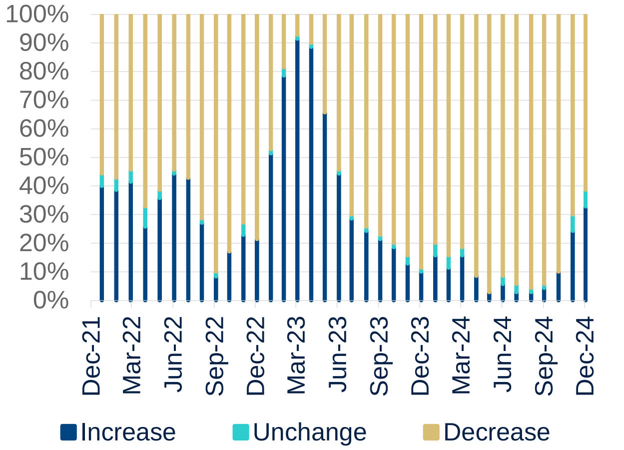
Source: Bloomberg and BBVA Research

Figure 2. **…WHILE HANG SENG INDEX IN HK WHICH ATTRACTS MORE FOREIGN INVESTORS EVEN WORSE**



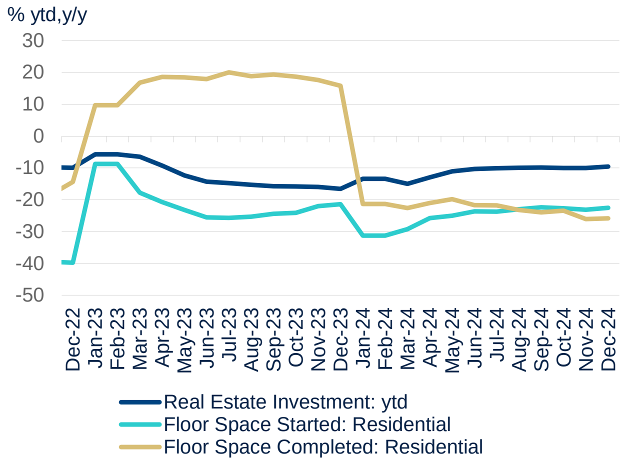
Source: Bloomberg and BBVA Research

Figure 3. **STILL MORE CITIES REPORT HOUSING PRICE DECLINE THAN INCREASE…**



Source: NBS and BBVA Research

Figure 4. **…MAIN HOUSING INDICATORS HAVE NOT BOTTOMED OUT, REMAINING NEGATIVE**



Source: NBS and BBVA Research

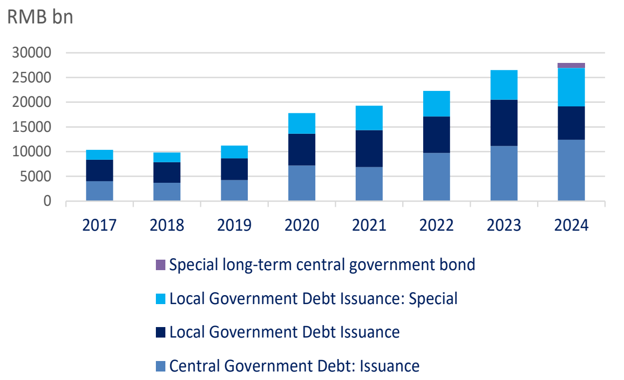
1. Insufficient Size of Fiscal Stimulus Measures

The authorities should deploy sufficient stimulus to counter aggravating growth headwinds, including Trump's possible 60% tariffs and domestic weak sentiments. If the measures are too conservative, they may fail to generate the necessary momentum to drive substantial economic growth and result in prolonged economic stagnation.

This is in particular relevant for fiscal stimulus measures given that the PBoC has already cut the interest rates to its historical low. The market is not satisfied with the scale of newly-issued central government bond, and complains that the fiscal measures only focus on local government debt swap program but not on newly issued central government bond. (Figure 5) The market is also concerned about the lack of direct cash injection to households in order to stimulate consumption as the US and Europe did during the Covid-19 pandemic time.

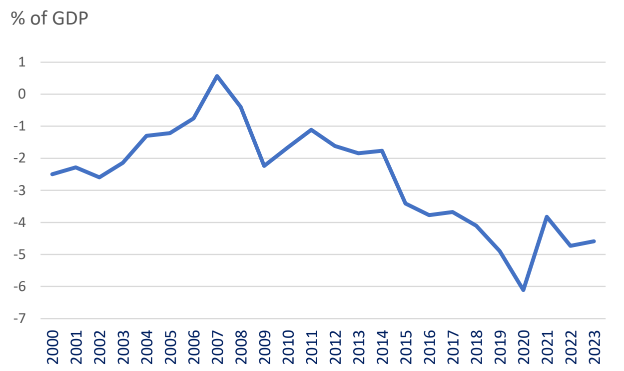
Market concerns can largely explain investors' lukewarm reactions to the stimulus package announcement. The authorities should pay due attention to this problem and tweak their stimulus package accordingly. On top of implementing the strucutrual reforms such as local government debt swap program, the authorities should show to the market how much additional financial resource is dedicated to boost the economy. In this respect, this year's figure of fiscal impulse, which is defined as the year-to-year difference in augmented aggregate fiscal deficit, is more relevant. (Figure 6)

Figure 5. **LOCAL GOVERNMENT BOND ISSUANCE IS RESTRICTED WHILE THE STIMULUS PACKAGE FOCUSES ON DEBT SWAP PROGRAM…**



Source: NBS and BBVA Research

Figure 6. **AUGMENTED GOVERNMENT DEFICIT TO GDP% IS EXPECTED TO INCREASE SIGNIFICANTLY THIS YEAR**



Source: NBS and BBVA Research

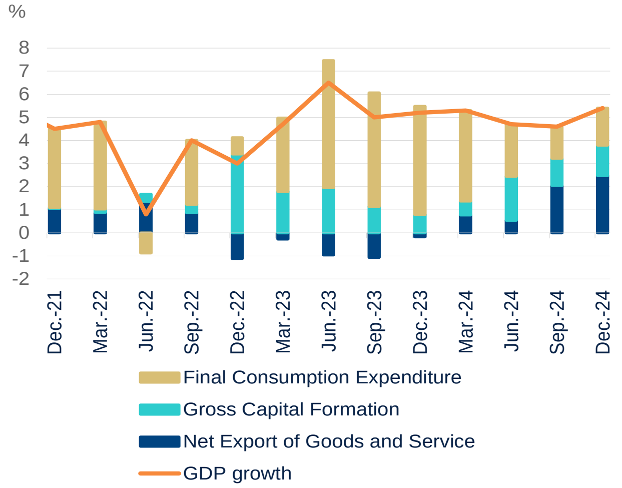
2. Inefficient Allocation of Stimulus Funds: Investment versus Consumption

Given a fixed size of stimulus package, the allocation of funds to different sectors could make a big difference in its utmost outcome. There is a risk that the stimulus might be directed towards areas that are not efficient in boosting the economy. For instance, excessive investment in infrastructure projects with low returns or in sectors that do not contribute significantly to economic growth could lead to wasted resources. It is crucial to ensure that the funds are allocated to sectors that can generate the highest economic impact.

In addition, Chinese authorities strongly favor high-end manufacturing, technology advancement and green economy transformation sectors but not on consumption. (Please refer to our previous internal notes: China | Do Chinese authorities not intent to prioritize consumption stimulus?) Over-emphasis of those policy-oriented sectors in fund allocation are set to aggravate overcapacity issues in them, such as the widely discussed overcapacity in China's "new trio" sectors-EV, lithium batteries, solar cells.

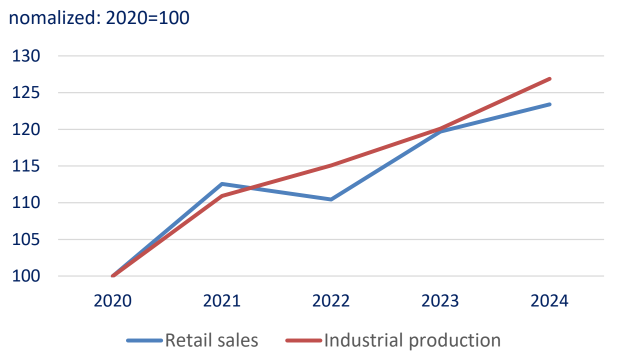
On the other hand, Chinese economy is long-lasting experiencing supply-demand mismatch, which means supply is significantly higher than demand. Under this circumstance, it is anticipated the stimulus funds should be relocated more to consumption stimulus, such as issuing consumption coupon and directly injecting money to low-income households. (Figure 7 and 8)

Figure 7. **CONSUMPTION'S CONTRIBUTION TO GDP GROWTH HAS BEEN DECLINING IN THE RECENT QUARTERS**



Source: NBS and BBVA Research

Figure 8. **RETAIL SALES GROWTH HAS BEEN LOWER THAN INDUSTRIAL PRODUCTION GROWTH FOR A LONG TIME**



Source: NBS and BBVA Research

3. Slow pace of Policy Implementations

On February 1, 2025, President Trump announced that he will impose 10% additional punitive tariffs on imports from China. Admittedly, the magnitude of this 10% tariff is much lower than the 60% he repeatedly discussed during his election campaign. However, we believe that it's just the first step. President Trump is very likely to escalate this tariff war against China, as well as other trade partners, in the near future.

In face with such high uncertainties, Chinese authorities might want to wait for President Trump to make his further moves first and then step up their policy stimulus. The policymakers might also attempt to solve the problem through high-level bilateral negotiations. In addition, the authorities may also want to wait until March 2025 "two sessions" to announce the exact figures of fisical stimulus.

The bottom line is that the efforts to solve trade problems with the US should not slow the pace of domestic stimulus implementation. In essence, the largest growth headwinds mainly stem from China's domestic vulnerabilities, including sluggish property market, local government debt overhang as well as weak market confidence. Slow implementation of necessary stimulus could only exacerbate economic situation and market sentiments. Moreover, a stabilized domestic economy will strengthen China's position in the trade negotiation with the US.

4. Lack of Incentives for Bureaucrats' Implementation

Pro-growth stimulus measures might encounter obstacles in implementation. Bureaucratic inefficiencies, regulatory hurdles, and local government resistance can delay or dilute the impact of the stimulus. Effective coordination and streamlined processes are imperative to ensure that the measures are implemented swiftly and effectively.

However, Chinese bureaucrats might have less appetite in implementing the stimulus measures for two reasons:

First, the indebtedness of local governments has substantially limited financial resources they can mobile to stimulate the economy. Compared to carrying out new investment projects or subsidizing household consumption, local government officials feel more urgent to meet their debt obligations and payrolls.

Second, the ever-increasing pressure of the Party's anti-corruption campaign have prompted many officials to shy away from making big decisions, in particular regarding relations between government and business. Even the authorities are well aware of this point and circulated policy guidance to encourage the can-do mindset among bureaucrats.

If the incentive problem cannot be solved well, the effectiveness of the stimulus package will be severely discounted. The authorities must find a better way to balance different requirements for government officials.

5. Counterproductive Communication Between the Authorities and the Market.

Poor communication skills could undermine the effectiveness of the stimulus package. If the authorities fail to clearly articulate the goals and benefits of the stimulus, it could lead to confusion and lack of confidence among businesses and consumers. Transparent and consistent communication is vital to build trust and ensure the success of the policy measures.

During the episode of the "4 trillion stimulus" in 2008-2010, it was the then Premier Wen Jiabao who took the lead to announce the stimulus package so as to show the authorities' determination. It had substancially reinforced people's confidence in the stimulus package. This time around, a number of governmental agencies including Ministry of Finance, Ministry of Housing and Urban-Rural Development, National Development and Reform Commission (NDRC) etc., held their own press conferences separately to announce specific measures in their domains separately. Such separated efforts might not be well accepted by the market due to the fact that people are now keen to see a comprehensive stimulus package with a strong commitment.

6. Premature Withdrawal of Stimulus

China's authorities might withdraw the policy stimulus too early after observing initial signs of recovery. A premature withdrawal could halt the recovery process and lead to a relapse into economic downturn. It is important to maintain the stimulus until the economy shows sustained signs of improvement and stability.

China should take lessons from Japan in this regard. Japan once made this policy mistake when the authorities, during the 1990s, tried hardly to get rid of the economic downturn. At that time the then Japanese policymakers tended to change their loosening stance too soon once they observed certain green shoots of economic recovery. In the end, the economy slipped into a deeper recession once the policy support disappeared.

To a great extent, today's woes in China's economy bears a great semblance to Japan in 1990s, for example, both of which experienced a bust of housing bubbles and a prolonged period of disinflation. In China a long haul is needed to boost growth and reverse people's sentiment in the ensuing years. If China's authorities withdraw the stimulus too early, the momentum might be reversed soon. It means that the authorities have to devote more resources to rev up the economy again.

Conclusion

In conclusion, the implementation of further simulative measures in China might not be as smoothly as we anticipated previously even though the pivotal change of policy stance in September 2024 has largely eliminated the tail risk of China's growth. The authorities must carefully tread a fine line to avert above-mentioned policy mistakes in deploying pro-growth policy initiatives.

BBVA Research

Creating Opportunities

DISCLAIMER

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Any estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

With regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA.

ENQUIRIES TO:
BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain).
Tel. +34 91 374 60 00 y +34 91 537 70 00 / Fax (+34) 91 374 30 25
bbvaresearch@bbva.com www.bbvaresearch.com