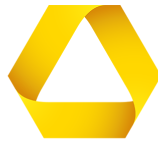

Economic Research

Economic Briefing

China – Better budget implementation may create short-term boost

14 October 2024

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Chinese policymakers have in recent weeks announced a mix of fiscal and monetary policies to support the economy, the property sector, and to boost local government spending. Much of the fiscal announcements focus on the usage of available resources, and more new funding may be announced in the coming weeks. However, the measures so far are not addressing the problem of demand weakness. While the improvement in the delivery of fiscal budget and new stimulus may help from a cyclical perspective, China's growth will remain under pressure due to the ongoing structural headwinds such as the real estate troubles. It will likely require a change in policy thinking to address these structural problems.

Before the week-long National Day holiday, the PBoC announced a policy mix to support the economy. The package included reductions in the reserve requirement ratios (RRRs) for banks and the 7-day reverse repo rate (now the main policy rate). The central bank also lowered the interest rates on outstanding mortgage loans, provided more support for state-owned enterprises (SOEs) to acquire unsold homes from property developers to support the housing market, and set up stock stabilization funds. We wrote about these in an earlier **Economic Briefing**.

China's Politburo, which consists of the top 24 leaders of the country, also announced a number of pledges to support the economy and the property sector before the holiday. The Chinese leadership gave the strongest vow thus far since the property downturn and some unusual but forceful languages about fiscal and monetary implementations. This suggests that the leadership senses the urgency and at the same time wants to improve its communication to the markets.

Focus on the implementation of current budget

Following the holiday, the government promised more support for the property sector and indebted local government. The finance ministry said China has CNY2.3 trillion (USD325 or 1.8% of China's annual GDP) in local government special bonds funds available for the rest of this year. This is not new money but idle cash waiting to be used. Local governments have been falling behind on budgeted spending due to the fall in tax revenues, and also the fact that it is getting harder to find projects that are profitable which is currently required

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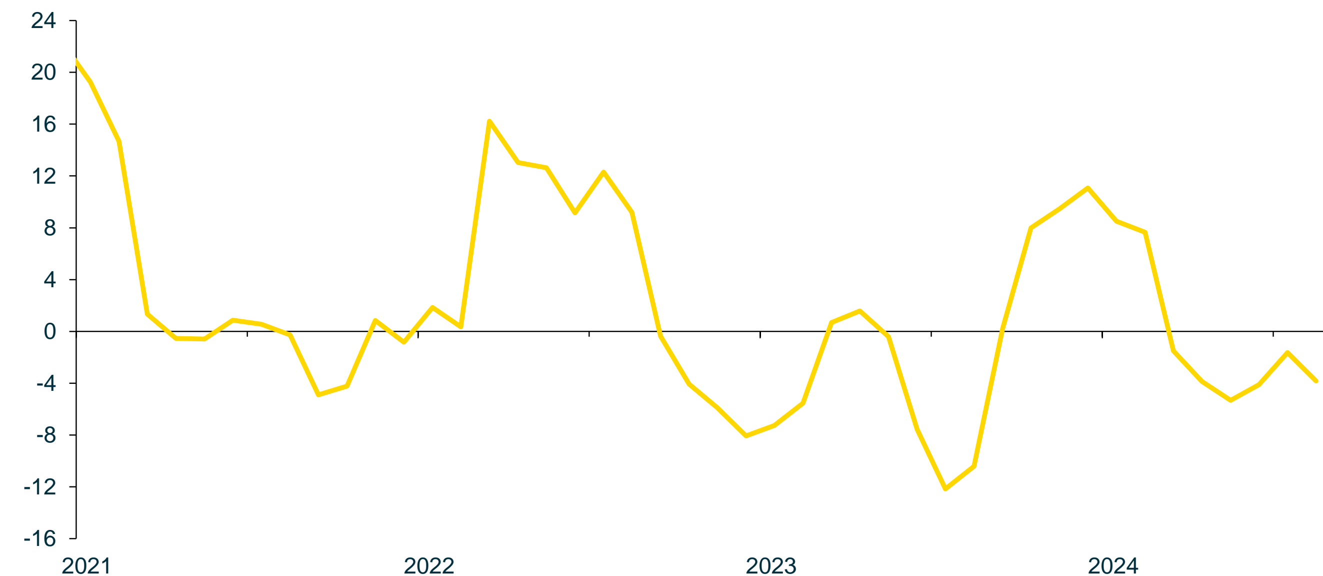
by the central government (Chart 1). That is, despite a **larger budget deficit** that has been announced earlier this year.

Chart 1 - China: On-budget government spending is lagging behind despite having an expansionary fiscal stance
Percent change from a year ago on a 3-month moving average basis



Source: NBS, CEIC, Commerzbank Research

Expanding the usage of special funding

Local governments will be allowed to utilize the existing funds from the special bonds to purchase unsold homes to stabilize the property sector. Additionally, sectors eligible for support through these special local bonds will be expanded. This could trickle down to bigger infrastructure investment because it makes it easier to find new investment projects.

To alleviate local authorities' debt burden and encourage spending, the local governments will have the option to swap hidden debts with cheaper bond issuance to increase liquidity. The ministry noted that this will be the largest support in recent years to relieve debt burdens of local authorities.

The central government also plans to issue special sovereign bonds to boost capital at largest state-owned banks. The top six banks have capital levels far exceeding regulatory requirements. However, this policy move would provide the banks with even larger capital buffer so that they could take on more credit risk when being asked to offer cheaper loans to risky borrowers, including distressed property developers and local government financing vehicles. This can be seen as an alternative type of policy stimulus.

The government also provided some forward guidance on next year's policy. For instance, the government will continue to issue ultra-long sovereign bonds next year that can be used for supporting real estate, local government financing, infrastructure spending, and providing additional capital to commercial banks.

However, the government is still not emphasizing support for the demand side, even as deflationary pressure is building up.

New stimulus may still come

The press briefing by the finance ministry last weekend fell short of providing the size of new funding for stimulus and didn't announce additional plans to support consumption. However, the ministry suggested that more details could be released in the coming weeks. This likely means more funding will be committed to new stimulus in Q4.

Having said that, we maintain our GDP forecast for 2024 at 4.7%. Any additional stimulus may unlikely have a sizable impact on Q4 GDP, though they will likely boost growth in 2025.

However, we still maintain our growth forecast of 4% for 2025 for now. This is because while new stimulus may boost growth, the biggest problem is weakness in demand. The policies announced so far are not addressing this problem. What's more. Structural issues including

the real estate troubles, local government debt problems, overinvestment, and the secular fall in private investment share will persist. To be fair, the government has been trying to address these issues. The measures announced will buy some time and are designed to cushion the effects of the unavoidable structural changes. In particular, the outsized share of the real estate market will – and must – decline. As the experience of other countries show, this tends to be a risky process. In any case, the correction phase will likely take a much longer time and will likely require out-of-the-box policy thinking.

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