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China outlook 2024

Fiscal expansion will underpin economic growth

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China outlook 2024

- EIU expects China's leaders to set the annual real growth target for 2024 at about 5% again, supported by strong central government spending. Top leaders will probably consider a high growth target to be necessary to foster economic opportunities, restore public confidence and quell sporadic social discontent.
- Capital inflows will rebound, but these flows will largely be concentrated in short-term portfolio capital. Foreign direct investors will remain cautious amid challenging US-China relations and mistrust over China's operating environment.
- Youth unemployment will stay elevated in 2024, as skill mismatch issues become pronounced following a series of crackdowns in recent years. We expect this problem to ease in 2025-28, but corresponding social and economic issues will have enduring implications.
- Some "wild cards" could have an outsized impact on China's political and economic trajectory. These include technological advances, a refocus on decarbonisation, and worse than expected volatility in foreign relations.

EIU forecasts that China's real economic growth will slow to 4.9% in 2024, from 5.2% in 2023. The country's economic performance was mixed in 2023. Although the country exceeded its 5% official GDP growth target, aided by a robust expansion in private consumption, the course of recovery was bumpy, characterised by a worse than expected deterioration in the property market. China is likely to experience more challenges in 2024, when the post-reopening momentum fades, but will also benefit from greater government policy support.

China could aim for 5% growth again, emboldened by widened fiscal deficits

The Chinese government could set the growth target for 2024 at about 5% again next March, at the annual plenary sessions of the National People's Congress and the Chinese People's Political Consultative Conference. Our current growth forecast, at 4.9%, is close to that target. This will be harder to achieve than in 2023, when stronger economic momentum helped to shepherd China through its (sometimes bumpy) post-pandemic reopening. There will also be headwinds from the chronic slowdown in China's potential growth, meaning that it will require more stimulus or reform to maintain the elevated rates of headline expansion.

Although leaders have increasingly emphasised alternative goals—such as energy efficiency, decarbonisation and technology advancement—headline growth rates still matter at times. For 2024, **they will deem a high growth target as necessary to foster economic opportunities, restore public confidence and quell sporadic social discontent.**

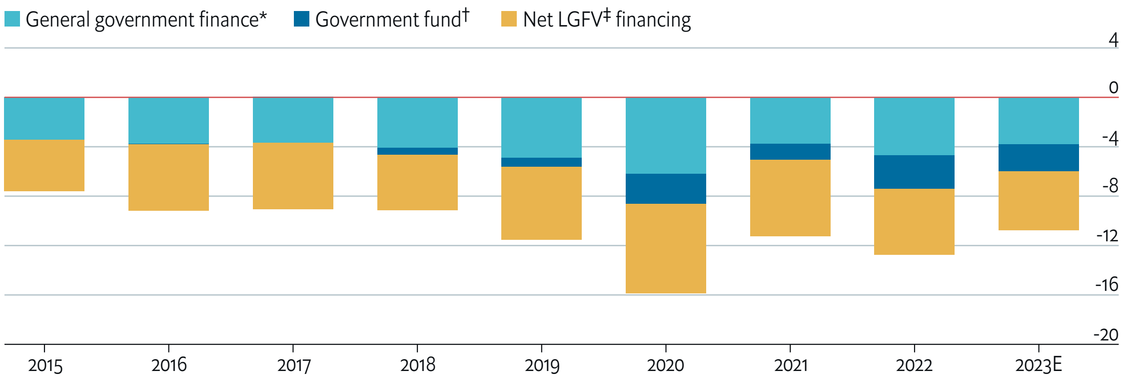
Consequently, we view fiscal expansion as an important pillar of growth, with the major lever being wider deficits assumed by the central government. Although the Rmb1trn (US$136.8bn) ad hoc government bond issuance approved in October 2023 will be subsumed into the fiscal deficit for that year, most of the resulting capital formation will take place in 2024. A similar magnitude of general government deficit is likely to be maintained in 2024, as the central government steps up spending at a time when some local governments are overwhelmed by China's debt clean-up programme. This expansionary stance will, among other things, play a more prominent role in supporting public investment and providing fiscal transfers to lower levels of governments.

Expected upturns in trade, resilient private consumption and greater policy support to the housing sector will also work in the favour of the economy. The contribution of private consumption will remain sizeable, as the services sector boom boosts employment and income growth. The external sector will benefit from a rebound in demand as Western economies restock.

The risk of a financial contagion in the property sector has drawn increasing attention from policymakers, which will aim to prevent further deterioration in 2024. The possibility of government-brokered bailout of large developers such as Country Garden will help restore homebuyer confidence and stabilise the market. Recent central government directive for banks to step up financing support to developers will also play a secondary role. Although fixed-asset investment (FAI) in the property sector will continue to contract in 2024 (representing the third consecutive year of decline, owing to plummeting land sales in 2022-23), the construction of affordable housing will place a floor under overall activity, positioning the wider sector to begin recovering from late 2024/early 2025.

That said, vulnerabilities related to property, local government finance and international relations pose key risks to the economy. In particular, while a deeper crisis may be averted, the housing market will remain fragile—particularly in smaller cities—and susceptible to the government's mishandling of the crisis (a long delay in bailouts for example, which is not our baseline assumption). Moreover, high levels of central government expenditure could be insufficient to compensate for the retrenchment of local governments and its affiliated entities. Local government spending has been driving the economy since the early 2010s and pushed China's broader deficit (including both on- and off-the-books items) to an estimated average of 12.4% of GDP in 2019-23.

China has maintained high broader deficit
(balance as a percentage of GDP; %)



*Involving general budget revenue and expenditure at central and local levels. †Mostly incurred by local governments, supported by land revenue and local government special bond issuance. ‡Local government financing vehicles, which are off-budget financing and investment platforms of local governments.
Sources: Wind Info; EIU.

China's upcoming fiscal reform

At the annual Central Economic Working Conference held in December 2023, Chinese leaders called for a "fresh round" of fiscal reform, the details of which could be expounded on at the third plenary session of the Chinese Communist Party's central committee. The session is likely to take place in early 2024.

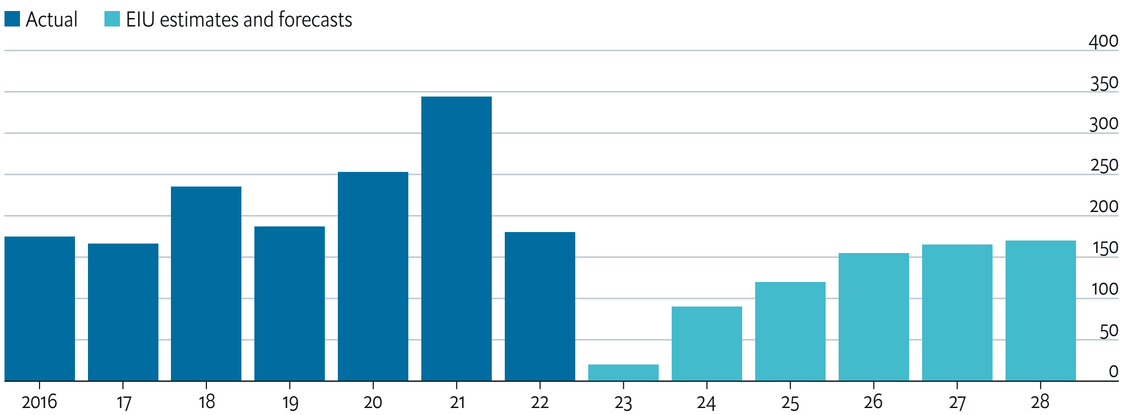
China's centralised fiscal system, in place since 1994, was instrumental in fostering the country's economic success in the decades that followed, but also acted as a catalyst for the ballooning of off-balance-sheet local government debts. We do not expect forthcoming reforms to result in fiscal decentralisation; instead, we anticipate an increased role for the central government in fiscal expenditure and co-ordination of fiscal resources nationwide. This may involve the transfer of certain spending burdens from local authorities to the central government, aimed at alleviating local fiscal strains and curbing a resurgence in local borrowing during the ongoing debt clean-up.

Capital inflows will rebound, but long-term investors will need some convincing

The expected resilience of the Chinese economy will prompt global investors to recalibrate their capital allocation in 2024, after they aggressively shed their China exposure in 2023. Investment decisions will be further shaped by a softer global outlook, particularly in the US, where growth is expected to slow to 0.8% in 2024, from estimated 2% this year. Resulting policy rate cuts by the Federal Reserve (the US central bank) in the second quarter of 2024, as well as possible declines in long-term US Treasury yields, will narrow the interest-rate differential between the US and China. This will reduce arbitrage opportunities for foreign companies repatriating their China-derived profits, creating more favourable conditions for capital inflows to China.

The shifting landscape of capital flows will primarily benefit foreign portfolio investors with short-term and flexible mandates, but foreign companies engaged in direct investment will maintain a wait-and-see stance. Although we forecast a rebound in FDI inflows in 2024, as divestment pressures ease, the absolute level will be muted by historical standards. We believe that

FDI inflows will struggle to recover to pre-pandemic levels
(US$ bn)



Source: EIU.

China's operating environment facing foreign enterprises will improve slightly, amid more enthusiastic government efforts to woo back businesses, but they will be overshadowed by a lack of meaningful improvement in US-China relations and China's continued obsession with national security, which has eroded market opportunities for foreign enterprises. A lack of sustained source of inflows will make China's capital account more volatile.

Wooing back foreign investors

Policymakers will step up efforts to boost confidence outside state sectors, having failed to pacify both private and foreign businesses in 2023. At the December 2023 Central Economic Work Conference, they vowed to further open up China's telecommunications and healthcare industries—two sectors that remain largely closed to foreign investors.

We interpret these moves as signalling a rhetorical commitment to addressing market-access concerns raised by trade partners such as the EU. However, our optimism regarding a substantial near-term improvement in opportunities for foreign firms in these sectors is not high. Despite the expansion of market access to financial services, foreign financial institutions have yet to gain a strong foothold owing to regulatory complexities and geopolitical strains.

The government will also seek to address the hurdles experienced by foreigners visiting China, by liberalising visa arrangements, bridging the gap between China's idiosyncratic payment system and its international counterparts, and easing the language barrier (for example, by enhancing the visibility of English signs).

Rebuilding confidence will be a gradual process. It will require the government to ensure a consistent business environment, offer predictable regulatory guidance, and refrain from conducting sudden and unexplained investigations into businesses.

Youth unemployment will remain a problem in 2024, but less so thereafter

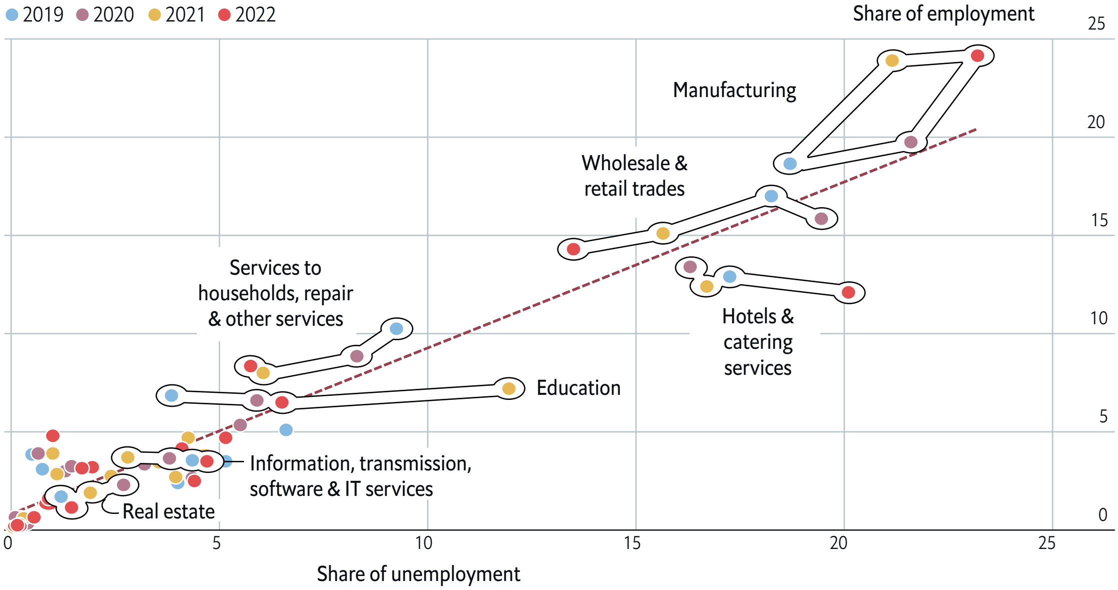
Despite the upturn in China's labour market as a whole, the biggest improvements are concentrated in middle-aged groups and migrant workers. **In contrast, the post-covid recovery has not eased the slack in the youth labour market.** The surge in fresh graduates has not been met by a commensurate increase in new job opportunities. New hires are still being offered lower wages amid the labour oversupply.

Youth unemployment will stay elevated owing to the persistence of skill mismatch. Under China's industry-driven strategy, more top talents are migrating towards China's emerging manufacturing sectors, such as electric vehicles and integrated circuits, a trend that will help to improve productivity in those industries. However, the bulk of jobs created are low- or medium- skilled ones that have little appeal to university graduates, many of whom now possess even higher-level degrees following an expansion of postgraduate enrolment during the pandemic. The rapid adoption of automation poses another threat to the number of jobs. As a result, China has struggled to absorb the labour force who left tutoring and property, two sectors which were battered by government crackdowns.

The hiring outlook remains as dim as in 2022
(CKGSB BCI Recruitment Index)*

*Respondents are asked to indicate whether recruitment is expected to increase (>50), remain unchanged (=50), or decrease (<50) over the coming six months as compared with the same time period last year.
Sources: Wind; EIU.

Pandemic and tech crackdown worsens youth labour market
(%)



Sources: China Population & Employment Statistical Yearbook; EIU.

We do not believe that youth unemployment will stay elevated in the long run. The persistence of that phenomenon is usually rooted in a years-long "youth bulge" resulting from falling infant mortality and high fertility rates in the past. The current glut of youth labour will gradually be mitigated later in our forecast period (2026-28) amid a sustained decline in the working-age population.

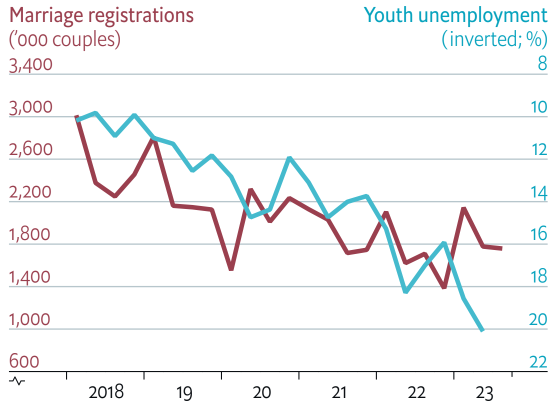
However, before that happens, the unemployment-induced economic plight facing the young generation will still carry lasting consequences. These include lower lifetime earnings and purchasing power; delayed marriage and childbirth, with negative long-term implications for demographics; and greater fiscal costs stemming from lost revenue and additional welfare spending. However, the risk of social instability is low.

Wild cards: advancing technologies, recentering climate policies

Other domestic and international developments in 2024 could have an outsized impact on China's political and economic trajectory. Below are several "wild cards" to monitor.

Accelerated progress in advanced technologies will have implications for long-term productivity gains, an item highlighted by policymakers at the Central Economic Work Conference. In 2024 we expect China to advance in making "lagging-edge" chips despite being several generations behind the global cutting edge. Mature chips could be enough for many consumer electronics and artificial intelligence (AI) applications. Investments in digital technologies will continue to increase, although regulatory uncertainty will probably remain a major bottleneck for the technology sector. For multinationals, cross-border data transfer rules will probably see better clarity, with Hong Kong's policy address hinting at the territory's potential role as an offshore data hub. On a global level, debates over global AI governance are heating up and China is set to roll out a designated AI legislation in 2024-25. We expect safe development and deployment of AI technologies enshrined in the new AI law.

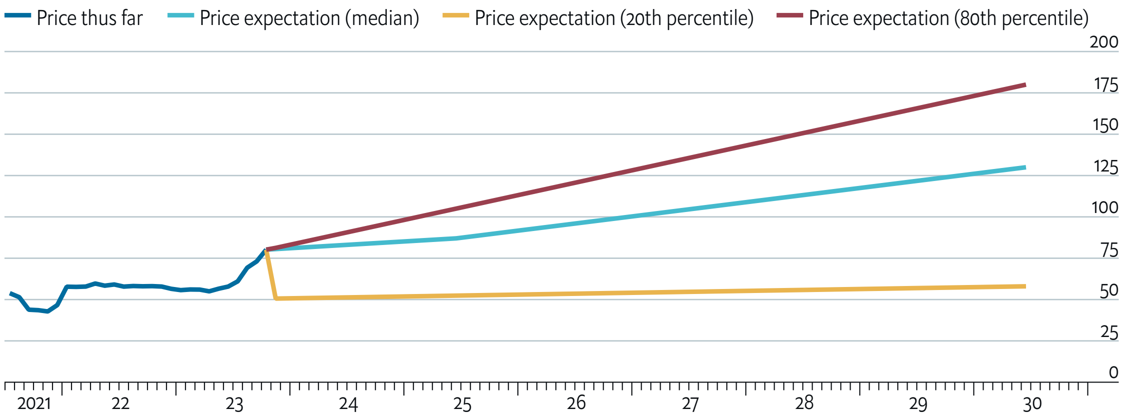
Youth unemployment appears inversely correlated with marriage registrations



Sources: National Bureau of Statistics; EIU.

Mitigating and adapting to climate change will slowly come back on the agenda as the economy stands on a better footing. El Niño, likely extending into 2024, will probably have a moderate impact on China, but the government will continue to invest in natural disaster infrastructure. Room for further improvement exists particularly for bureaucracy readiness. In energy transition, the pivot away from coal is likely to have some progress: the role of coal power plants will begin to shift from an integral part of the power grid to back-up options (that is, serving peak load). The prolonged weakness in the property market is also leading to a structural decline of coal-dependent heavy industries. Although the carbon market will still develop slowly, paying for emissions in the future has become a consensus among businesses.

Businesses have begun to take into account carbon pricing policies
(expectation of China's carbon market stakeholders of the country's future carbon price; Rmb)



Sources: China Carbon Pricing Survey; EIU.

The geopolitical environment looks challenging for China in 2024. Ties with the West will face more tests amid aggressive rhetoric during the US election campaign season, and the EU's increasing trade protectionism. The tension could be aggravated by the Taiwanese election, with the China-sceptic Democratic Progressive Party to retain the presidency. Relations with emerging economies will come under further strain, especially over security issues in the South China Sea. Meanwhile, the BRICS expansion is likely to hit a roadblock with Argentina's new president, Javier Milei.

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