China Strategy Focus STILL ON AUTHORITIES' SHOULDERS

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Chinese authorities have rolled out a series of easing measures in the previous quarters (and more are on the pipeline), which helped stabilizing growth and induced early signs of domestic demand consolidation: overall, downside risks in the short term appear now under control.

It's still too early, though, to turn constructive, in our view. Structural issues related to the housing sector, weak domestic demand and a persistent lack of confidence remain unresolved. Furthermore, fresh deflationary risks cast a shadow on China's ability to outperform its 2024 growth target, which we expect to be set at 5.0%. Anyway, we are ready to upgrade our stance should signs that authorities may intervene with a stronger hand mount (yet not our baseline).

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Tactical view - Downside risks under control, room for upside still limited.

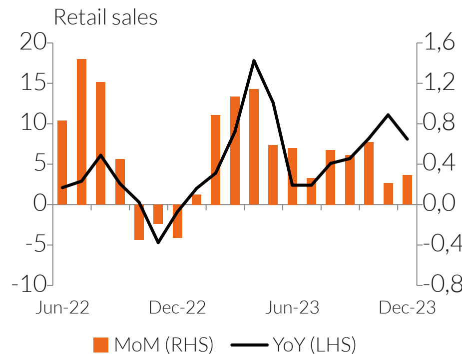
The macro backdrop has remained broadly steady, as Chinese authorities seemingly succeeded in stabilizing growth. Signs of reacceleration are not in sight yet, though. Following the economic rebound in Q2 last year (GDP up 6.3% y/y), the Chinese economy slipped into a downturn due to 1) weak domestic demand amid cautious households' sentiment, 2) ongoing housing sector correction, 3) persistent deflationary pressures and 4) global economic slowdown.

Since then, all these factors have only marginally eased, if any. In detail:

1. **Domestic demand remains below trend despite authorities' efforts to encourage spending.** Retail sales slowed down going into Q4 in y/y terms (**Figure 1**), burdened by negative base effect; meanwhile, in sequentially households' spending shows early signs of reacceleration, mainly driven by sales of good (**Figure 2**). Overall, high frequency data suggest economic momentum has improved during the New Year break (**Figure 3**). In any case, we continue to think households' sentiment remain way too weak to suggest a self-sustainable spending uptrend is around the corner (**Figure 4**).

FIGURE 1.

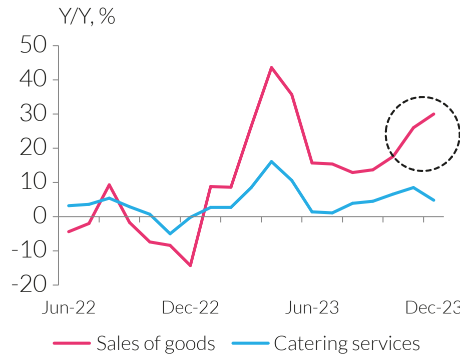
Retail sales slowed down in Q4...



Source: Haver Analytics, Anima Research

FIGURE 2.

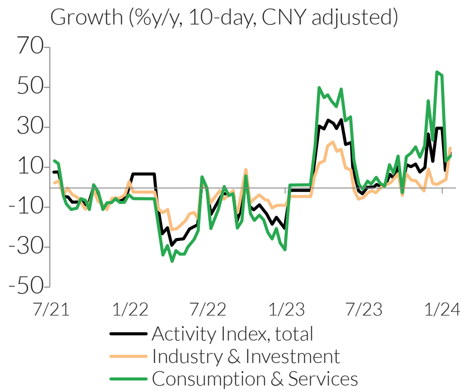
...but sales of goods picked up a little



Source: Haver Analytics, Anima Research

FIGURE 3.

HF data suggest activity went up in January



Source: Haver Analytics, Anima Research

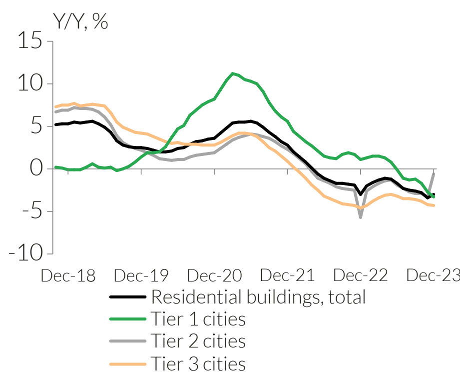
FIGURE 4.

Consumer confidence still weak though

2. **Housing sector not out of the wood yet.** House prices dropped by -3.0% y/y in December from -3.4% y/y in November (**Figure 5**); meanwhile, housing activity continued to prioritize buildings completion vis à vis new housing starts (**Figures 6**), which on the one hand helped limiting house prices drop, on the other suggest activity momentum is set to remain subdued for longer. Furthermore, high frequency data on top 100 developers' contract sales volume for January suggest property sales narrowed contraction at the start of 2024: even though the worst phase of the housing market correction is behind us, demand/supply imbalances remain too large, though (**Figure 7**).

FIGURE 5.

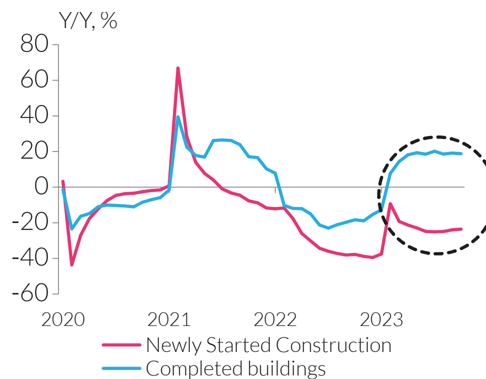
House prices down



Source: Haver Analytics, Anima Research

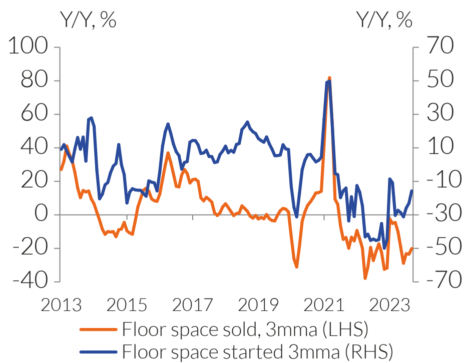
FIGURE 6

Developers prioritize building completion



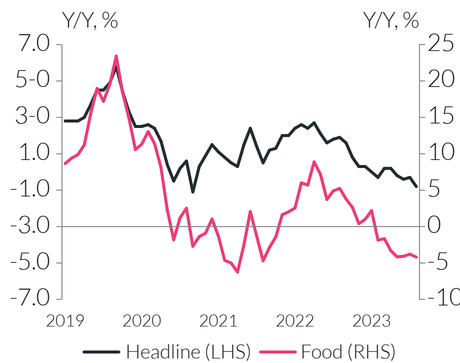
Source: Haver Analytics, Anima Research

FIGURE 7.
Demand/supply imbalances still large



Source: Haver Analytics, Anima Research

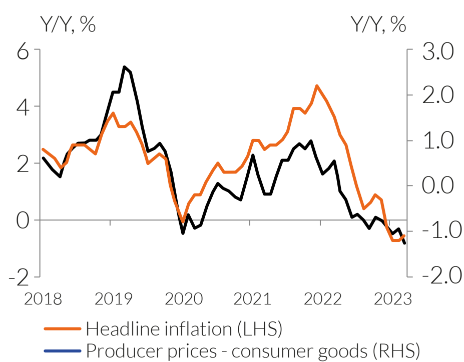
FIGURE 8.
Food prices still deflationary



Source: Haver Analytics, Anima Research

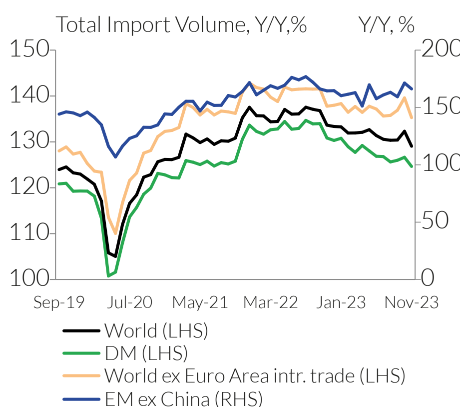
3. **Deflationary pressures widened in January, but should ease by the summer; nonetheless, we expect inflation to remain weak in tandem with sluggish domestic demand.** Consumer prices fell more than expected in January, to -0.8% y/y from -0.3% y/y driven by non-core items (especially food prices, Figure 8) and non-food inflation edged down to 0.4% y/y from 0.5% y/y on weak services inflation and flat energy prices. As a result, core prices were stable to 0.6% y/y from 0.7% y/y previously. Meanwhile, producer prices remain on a deflationary path, largely on a low base (**Figure 9**). Overall, we continue to think very weak domestic demand reflects into the deflationary environment China has been experiencing since late Q2-23, and we expect it to gradually improve in H1, albeit at a very slow pace.

FIGURE 9.
Consumer goods deflation persists



Source: Haver Analytics, Anima Research

FIGURE 10.
Flatting global imports won't help China



Source: Haver Analytics, Anima Research

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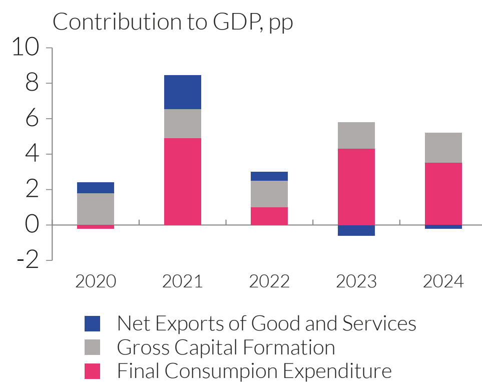
4. **Although better than 2023, net export might do little to push GDP up in 2024.** We expect the global slowdown, especially among DMs, to translate into anemic exports momentum for China (**Figure 10**) and, as a consequence, a broadly flat external trade contribution to Chinese GDP in 2024 from -0.6% contribution last year (**Figure 11**). Furthermore, going into the US presidential election, we think geopolitical risk will add volatility, further capping US-China international trade flows.

FIGURE 11.

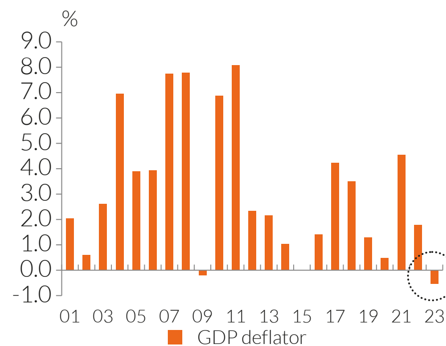
Net export expected to be flat this year



Source: Haver Analytics, Anima Research

FIGURE 12.

2023 GDP deflator turned negative



Source: Haver Analytics, Anima Research

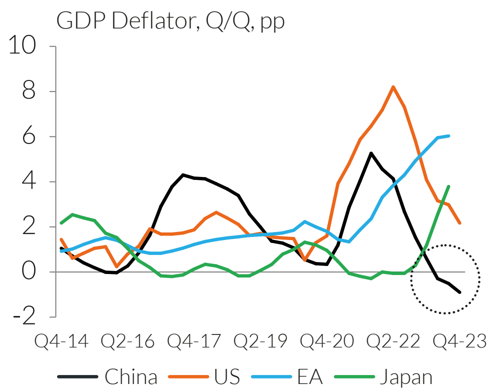
Strategic view - We reiterate our cautious stance as 2024 looks like a year of transition.

We stick to our view that China is facing structural hurdles difficult to fix in the short term. Even though policymakers' efforts proved successful in limiting growth downsides so far, we continue to think above-potential growth is not easy to achieve and might not be the #1 priority in their political agenda.

5) **The low inflation environment is a new threat for 2024, which can cap extra-loose fiscal policies due to the mechanical lifting of budget deficit ratios vis à vis a deflated nominal growth.** China fell into a deflationary environment last summer: as a consequence, the GDP deflator posted a negative reading for the whole year of 2023 for the first time since 2009 (**Figures 12, 13**). When GDP deflator goes negative, expansionary fiscal policies come at a higher cost: in 2009 the General Government Deficit rose to -2.2% y/y from -0.4% y/y previously, while in 2015 - when GDP deflator came in flat - it rose to -3,4% y/y from -1,7% y/y. Thus, as we expect GDP deflator to remain weak (if not negative) in 2024 as well, we think this could mechanically represent a new constraint for policymakers to deliver fiscal easing as China's government and local deficits are under market participants' radar.

FIGURE 13.

China is exception among its main partners



Source: Haver Analytics, Anima Research

TABLE 1.

Fiscal consolidation in sight for 2024

Fiscal stance (RMB trn, % of GDP)			
Year	**Budget deficit**	**Special LGB**	**Special CGB**
16	2.18 (3.0)	0.4 (0.6)	
17	2.38 (3.0)	0.8 (1.0)	
18	2.38 (2.6)	1.35 (1.5)	
19	2.76 (2.8)	2.15 (2.2)	
20	3.76 (3.6)	3.75 (3.6)	1.0 (1.0)
21	3.57 (3.2)	3.65 (3.3)	
22	3.37 (2.8)	4.15 (3.5)	
23	4.88 (3.8)	3.8 (3.0)	
24e	**4,10 (3.0)**	**3.8 (2.8)**	**1.0 (0.7)**

Source: Haver Analytics, Anima Research

6) **On the fiscal side, we expect policymakers to curb the budget deficit, while maintaining piecemeal approach.** We continue to think 2024 will be a year of an investment-led growth stabilization at around 5%, driven by fiscal and quasi-fiscal policies; anyway, we continue not to expect a "bazooka" stimulus. We think authorities will turn less expansionary in fiscal terms (Budget deficit expected at 4.1% from 4.9% in 2023, **Table 1**) and roll out piecemeal counter-cyclical measures, such as further relaxing funding usage for developer loans borrowed against commercial properties and further removing purchase restrictions for properties. Furthermore, with local governments troubled by debt (the budget deficit hit an all-time high at 3.8% of GDP last year), we expect the central government to step in this year with around RMB 1trn of off-budget special CGB issuance, meanwhile, we expect an almost flat LGBs quota of RMB 3.8trn, as per 2023 (**Table 1**).

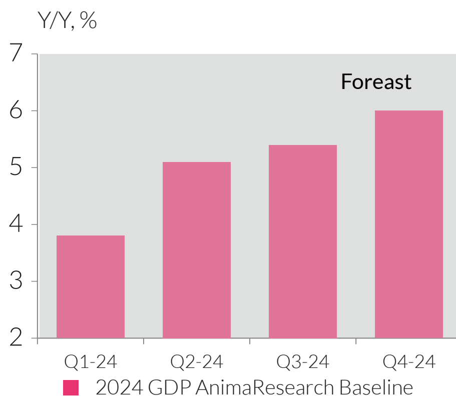
7) **Finally, on monetary policy, odds are the PBoC could end up delivering slightly more than expected.** Over the past few weeks pressure mounted on policymakers to restore investors' confidence, which prompted the PBoC to sound more pro-growth than previously thought. Overall, we expect 20bp policy rate (LPR) cuts by year-end (10bp in H1, 10bp in H2, as before) and 60bp RRR cuts (vs 20bp before); anyway, we continue not to expect a major monetary easing as financial risks are closely monitored by the PBoC.

Bottom line

Against this backdrop, we acknowledge downside risks in the short term appear now broadly under control. Nonetheless, we remain of the view that the macroeconomic momentum would remain sluggish and growth would remain at potential (GDP at 5%) as the structural hurdles the country faces have not dis-sipated yet (Figures 14-15). We remain strategically cautious, then.

FIGURE 14.

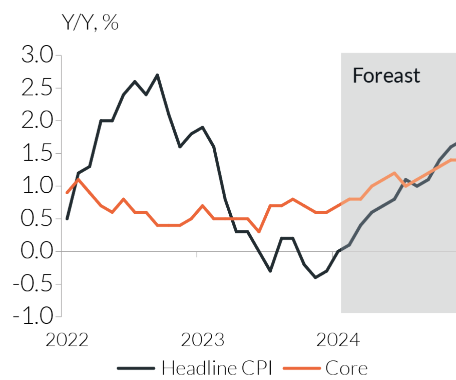
2024 GDP seen at potential



Source: Haver Analytics, Anima Research

FIGURE 15.

Core inflation set to remain subdued



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