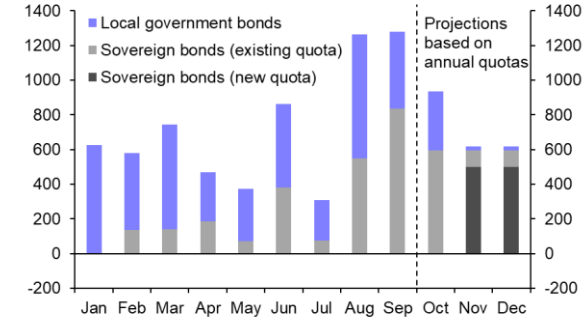
CHINA ECONOMICS UPDATE

New fiscal support needed to prevent end-year slump

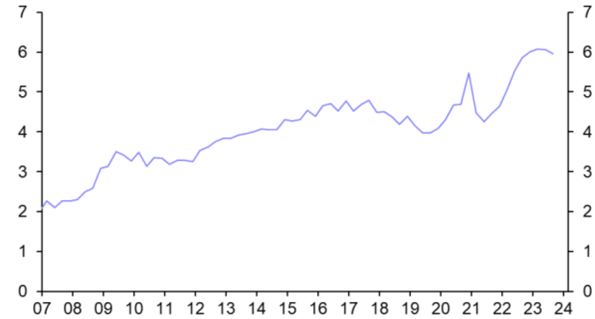
- **The additional fiscal support approved today is the intervention we had been expecting and that was needed to prevent an abrupt fiscal tightening in China in the closing weeks of the year. Fiscal policy has been a prop to growth in China over the last few quarters. These new steps will keep it supportive but not deliver any additional boost.**
- The standing committee of the National People's Congress has signed off on a revision to the annual budget that allows issuance of slightly over RMB1trn of additional central government bonds, worth 0.8% of GDP.
- **It is rare for the central government's fiscal plans to be revised outside the usual budget cycle, so this move signals clear concern about near-term growth**. (The last budget revision was in 2008 to raise funds for reconstruction after the Sichuan earthquake.) The proceeds are therefore likely to be spent rapidly. Local governments have also been given the go-ahead – as they have in previous years – to start issuing some portion of their 2024 bond quotas before the budget is formally approved in March.
- **The added fiscal support from the central government will be directed to investment rather consumption as some had been hoping**. That reflects the leadership's belief that the proper role of government spending is to boost the supply side of the economy. The areas chosen are presumably those able to deploy new funds quickly. According to Reuters, much of the proceeds will go towards water conservancy and flood prevention projects, and to reconstruction after recent flooding. "Farmland construction" is the other area mentioned – the bolstering of food security has emerged as a pre-occupation of the leadership over the past couple of years.
- The scale of the new funding confirms rumours that Bloomberg first reported two weeks ago. **Our forecasts for China's growth had assumed fiscal loosening of roughly this size. Without it, aggregate bond funding for local and central governments was set to drop off a cliff at the end of this month**. (See Chart 1.) Accordingly, the new financing should sustain fiscal activity, but it won't give it much of a boost. **If all the new central government bonds are issued by the end of December, total government bond issuance in Q4 will still be lower than it was in Q3**.
- **That raises a question of why the new injection isn't any bigger. The answer is that the finance ministry already feels it is doing a lot.** Government investment is running close to an all-time high. (See Chart 2.) In its *Fiscal Monitor* this month, the IMF estimated that China's fiscal deficit this year will be 7.1% of GDP. The IMF's and our own estimate of the augmented deficit, including off-budget spending, is even larger.

Chart 1: New Government Bond Issuance (RMBbn)



Sources: CEIC, WIND, Capital Economics

Chart 2: Investment Funded by State Budget (% of trend GDP, seas. adj.)



Sources: CEIC, Capital Economics

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- **Today's move is the latest in a series that look like a concerted effort to boost confidence**. Bloomberg is reporting that Xi Jinping visited the PBOC and SAFE today, the first known visit since he became leader. That will be read as a signal of his belief in their ability to provide appropriate monetary support and exchange rate stability.
- On Monday, state investment fund Central Huijin confirmed that it had been buying ETFs. And senior leaders will convene the national financial work conference next week, again according to Bloomberg. This typically happens only every five years. The focus is likely to be on the property crisis and local government debt strains with a focus on the medium-term rather than immediate support. But restructuring of local government debt could provide a little more fiscal space for cash-strapped local authorities.
- **The hope will be that this flurry of activity puts a floor under sentiment and activity. But it would be unwise to expect a large or sustained rebound**. Efforts to shore up the stock market in the past have had only a short-lived impact unless they coincided with improvements in the economic situation. And the new fiscal resources will only keep spending stable.
- That's probably enough for the government to hit its "around 5.0%" 2023 GDP growth target. But the bigger picture is that this year's growth rate is being flattered by the weakness of activity a year ago. We believe that growth of 5% is faster than China's economy can sustainably generate.
- **We expect growth to drop back to around 4.5% on the official GDP figures in 2024 and be near 4.0% in reality. Once output recovers to trend, growth is likely to average around 3% over the coming years.**

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