China Limps Into The Year Of the Dragon

Beijing hasn't hit on the right mix of policies to reawaken the animal spirits

Edited by
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As China heads into the lunar Year of the Dragon, traditionally seen as one of the most auspicious creatures on the zodiac, the country's leaders are struggling to restore confidence at home and abroad.

The economy is besieged by deflation, a persistent housing market slump and a stock selloff. And Beijing's piecemeal stimulus policies—such as lowering bank reserve requirements to encourage more lending and issuing more government bonds to fund construction projects—don't seem to be improving sentiment.

A key issue is the government's focus on promoting what President Xi Jinping calls "high-quality development," an umbrella term for a variety of policy goals, from boosting China's high-tech capabilities to combating social inequality. That's a more complex ambition than officials' earlier single-minded fixation on achieving high levels of economic expansion. "The biggest challenge is Beijing's inattention to deteriorating growth, which exacerbates all the structural and secular problems China faces," says Houze Song, an economist at the Paulson Institute, a think tank focused on US-China relations. "And the solution is to assign a bigger weight to growth in government policy."

Here are five charts that zero in on China's pain points in 2024.

❶ DEFLATION NOW TOPS LIST OF WORRIES

The term "deflation" describes a situation in which prices for goods and services fall across a large swath of the economy. (Not to be confused with disinflation, which signifies prices are still rising, though more slowly. That's what's happening in the US.)

Adjusted for inflation, China's gross domestic product expanded 5.2% in 2023. But in nominal terms the world's No. 2 economy grew 4.6%, the slowest pace in almost four decades, not counting the years when pandemic restrictions were in place.

The GDP deflator, the widest measure of prices in the economy, has fallen for the last three quarters, the longest streak since 1999. Manufacturing is leading the price drops—a side effect of Beijing's approach to economic stimulus. Officials are channeling credit to manufacturers to boost output. But with growth in consumer spending on goods weak at home and demand for Chinese exports also flagging overseas, businesses are left with little choice but to mark down their products.

❷ WHILE OLD PROBLEMS PERSIST

China's economy grew faster than the US's last year, but relative to expectations at the start of 2023, the former underperformed, while the latter consistently beat estimates.

Blame it on China's property market crisis. It's an old story by now—the slump began in 2021—but it's making headlines again thanks to a Hong Kong judge's ruling ordering the liquidation of China Evergrande Group, one of the many distressed developers.

Despite Beijing's efforts to deter real estate speculation, construction still represents a huge chunk of the economy, driving demand for goods and services worth around 20% of GDP, according to Bloomberg Economics. Related sectors such as household furnishings and cement are also being dragged down. And there's a spillover effect to other areas, as falling home prices make many households reluctant to spend on everything from electronics to luxury goods.

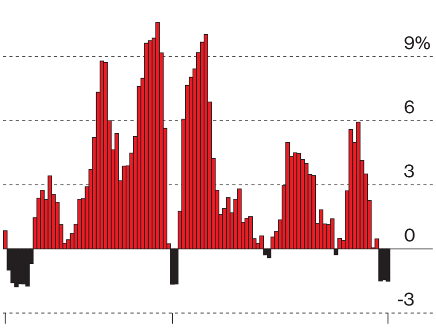
After a few mistaken calls of a turn in the property market, Wall Street analysts have arrived at the consensus that conditions won't stabilize until 2025.

❸ NEED MORE, BETTER STIMULUS

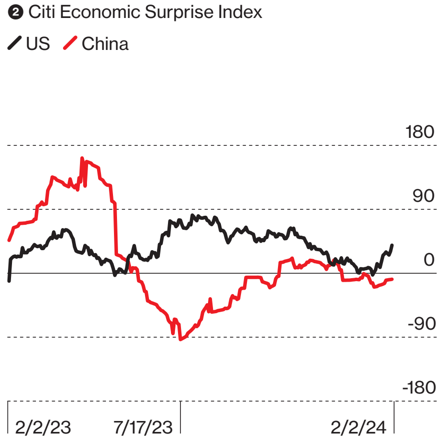
Chinese government advisers' calls for more stimulus reached a fever pitch last summer, and Beijing responded with an unusual midyear dose ▶

"The biggest challenge is Beijing's inattention to deteriorating growth"

❶ China GDP deflator, year-over-year change



❷ Citi Economic Surprise Index



❸ China's monetary and fiscal stimulus as a share of GDP

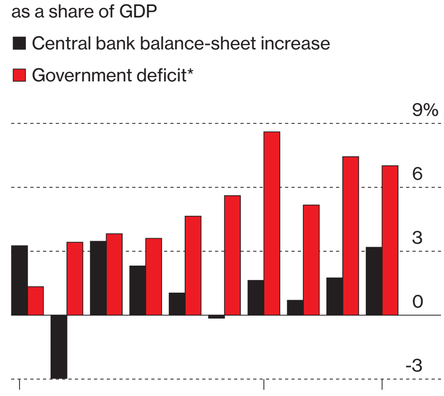


PHOTO ILLUSTRATION BY 731; PHOTOS: GETTY IMAGES (2). *EXCLUDES OFF-BALANCE-SHEET SPENDING. DATA: NATIONAL BUREAU OF STATISTICS COMPILED BY BLOOMBERG AND BLOOMBERG CALCULATIONS; CITIGROUP DATA COMPILED BY BLOOMBERG; PEOPLE'S BANK OF CHINA AND CHINESE MINISTRY OF FINANCE FIGURES COMPILED BY BLOOMBERG

◀ of deficit spending. While the timing signaled a welcome flexibility, the scale of the effort, at 1 trillion yuan ($13.9 billion), paled compared with past interventions. Government officials channeled funds into construction, a tried-but-less-true method of spurring the economy, ignoring recommendations that directing assistance to households might yield better results.

The Communist Party's Politburo unveiled two slogans in December that hinted at more support for the housing market and a greater focus on economic growth. But neither should be interpreted as a return to the past.

Perhaps it's time investors take Beijing at its word when it says it will never again unleash "floodlike" stimulus (a reference to the government's response during the global financial crisis) or massively increase demand for housing (as it did after a downturn in 2015). Policymakers will instead prioritize industries such as high-tech manufacturing that are central to Xi's revamp of China's economic model.

❹ FEELING LOW

Stubbornly low confidence among households and businesses is blunting the impact of stimulus. That may be a hangover from the past few years, which along with the housing slump have been marked by unpredictable pandemic restrictions, sudden crackdowns on sectors including education and tech, and rising US-China tensions.

One sign Chinese families are feeling less secure: Rather than investing in housing or stocks, they're socking money away in savings accounts at banks. Companies are being showered with credit, but outside of growth sectors such as electric vehicles and cleantech, business owners appear to be reluctant to expand amid weak demand and falling prices.

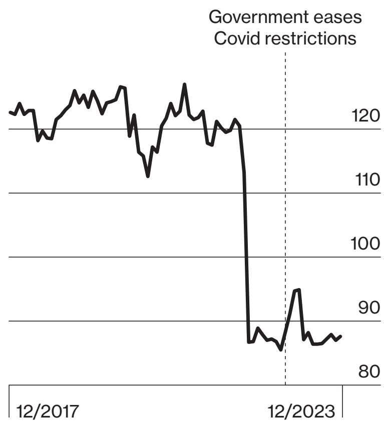
The optimistic view is that confidence will recover as recent traumas recede further into the past and China's relations with the US and other key markets improve. The pessimists see the property slump continuing to drag on confidence. The prospect of a Donald Trump reelection won't ease nerves either.

❺ FINDING THE FLOOR

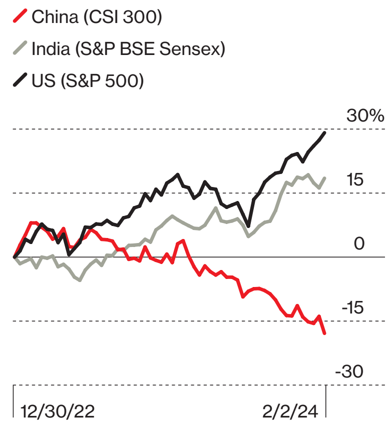
Worries about China's future are reflected in prices of stocks traded at exchanges on the mainland and in Hong Kong. A yearlong rout has wiped away about $6 trillion in market value, from a peak in 2021.

Although the stock market isn't a reliable tracker of China's economy over the long term, in the medium term it's sensitive to trends in nominal growth because they affect profits. So Beijing's efforts to boost valuations by tweaking market rules, such as restricting short selling, and possibly using

❹ China consumer confidence index



❺ Change in benchmark stock index since Dec. 30, 2022



DATA: NATIONAL BUREAU OF STATISTICS DATA COMPILED BY BLOOMBERG, BLOOMBERG

government funds to buy stocks at scale—an idea that was floated last month—are unlikely to produce a lasting upswing. "Without a growth rebound, I see little chance policy can sustainably boost the stock market," says Song of the Paulson Institute. —*Tom Hancock*

THE BOTTOM LINE China's economy is battling an assortment of ills, some chronic and others new. Sporadic doses of government stimulus have proved an ineffective treatment so far.

Politics and the Fed

● Powell hopes to stay out of the crosshairs of the US presidential election. It won't be possible

Federal Reserve Chair Jerome Powell would no doubt prefer that the central bank not be dragged into the middle of what's likely to be a highly contentious presidential election campaign. But he's finding that may be near impossible.

In a rare interview, on CBS's *60 Minutes*, which aired on Feb. 4, Powell insisted the Fed wouldn't take politics into account in deciding when to reduce interest rates as inflation ebbs. "It just doesn't come up in our thinking," he said.

But such assertions didn't stop former President Donald Trump from accusing him of doing just that. "I think he's political," the likely Republican presidential nominee said in an interview that aired on Fox Business' *Sunday Morning Futures*, also on Feb. 4. "I think he's going to do something to probably help the Democrats, I think, if he lowers interest rates."