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China Policy

Fiscal policy framework for 2025

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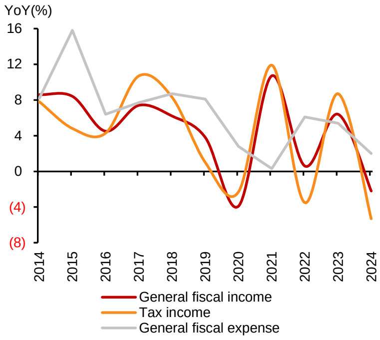
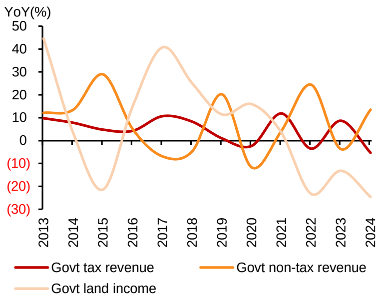
China's NPC Standing Committee has approved the LG debt swap program with a total quota of RMB6tn in 2024-2026. LGFVs, government contractors and state-owned banks are expected to gain from the scheme. This program reflects the policymakers' focus on relieving local fiscal stress after the housing bubble burst while the fiscal support to consumer remains limited. China's broad fiscal deficit ratio may moderately rise in 2025. Key fiscal policies include aiding local governments in reducing housing & land inventory, recapitalizing state-owned banks, enhancing fiscal transfers to local governments and increasing fiscal subsidies for upgrades in manufacturing equipment, autos and home appliances. However, these measures may prove insufficient to stimulate consumption or rejuvenate economic growth, particularly in light of the challenges posed by the Trump shock. China must gradually redirect its policy emphasis towards boosting consumption and defying deflation through additional liquidity & credit easing, more robust fiscal support with increased transfers to households and market-oriented reforms aimed at revitalizing the animal spirit within the private sector.

- **LG hidden debt resolution.** The central government only recognized one-fourth to one-third of local governments' off-balance-sheet borrowings as eligible LG hidden debt. It allowed local governments to issue special bonds to replace this recognised hidden debt. According to the MoF, LG hidden debt reached about RMB14.3tn at end-2023, significantly lower than the market's estimate of RMB40-60tn. The NPC Standing Committee approved a quota for LG debt swaps amounting to RMB6tn for the period from 2024 to 2026. This allows local governments to issue additional special bonds to replace their eligible hidden debt in the future. In addition, the central government allowed local governments to utilise RMB0.8tn from the special bond funds each year to settle their hidden debt from 2024 to 2028. The central government continues to prioritize the prevention of moral hazard among local governments by refraining from making any bailout commitments regarding their off-balance-sheet borrowings. For the majority of these borrowings, local governments have to engage in negotiations with financial institutions for rollovers. The primary beneficiaries of the LG debt swap program include LGFVs, government contractors and state-owned banks. In the absence of the debt swap policy, local governments may have to delay payments to civil servants or contractors as they work to address their hidden debt particularly in light of slumping land revenue. The debt swap policy is expected to mitigate the contractionary impact associated with the repayment of hidden debt.
- **Higher broad fiscal deficit ratio in 2025.** The MoF indicated that the general deficit and the quota for LG special bonds are expected to increase in the upcoming year, although specific details remain undisclosed. A significant discussion regarding about the GDP growth target, the general fiscal deficit and the LG special bond quota for 2025 is anticipated among official experts in November. The debate will precede the Central Economic Work Conference, where top leaders will in the second or third week of December to deliberate on development objectives and the policy framework for the following year. The finalised targets will be publicly announced in the cabinet's working report to the NPC in early March 2025. Some experts suggest that it may be prudent to lower the GDP growth target from around 5% in 2024 to a range of 4.5% to 5% in 2025, given that GDP growth has remained below 5% in the last two quarters. The recent easing of policies is unlikely to foster a sustainable economic recovery and potential external shocks such as a renewed trade war in Trump 2.0 era could exert additional downside pressure. Conversely, other experts argue



Source: Wind, CMBIGM



Source: Wind, CMBIGM

that China should maintain the GDP growth target for 2025 at around 5%, as this aligns with the long-term vision for 2035, especially since the pandemic has resulted in average GDP growth falling short of expectations from 2020 to 2023. Additionally, keeping the growth target stable could enhance market confidence by signalling China's commitment to economic stability. The reported GDP growth for 4Q24 could offer insights into the GDP growth target for 2025, depending on whether it exceeds or falls short of 5%. We maintain our forecast for China's GDP growth at 4.9% in 2024 and 4.6% in 2025. We expect the general fiscal deficit, local government special bond quota, and ultra-long Special Treasury Bond quota may increase from RMB4.06tn (3.1% of GDP), RMB3.9tn (3% of GDP), and RMB1tn (0.8% of GDP) in 2024 to RMB4.3tn (3.1% of GDP), RMB4tn (2.9% of GDP), and RMB2tn (1.4% of GDP) in 2025. The local government debt swap quota is set at RMB6tn for the period from 2024 to 2026, with an annual average of RMB2tn, compared to RMB1.5tn in 2024..

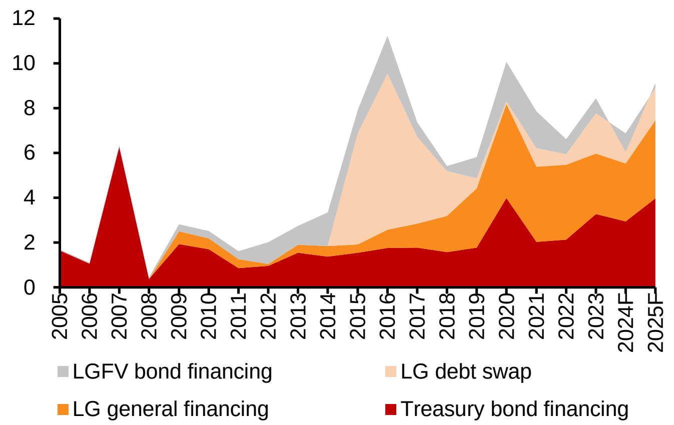
- **Additional fiscal policies in future.** Initially, the central government intends to motivate local governments to utilise special bond funds for the acquisition of unsold housing projects and undeveloped land from property developers. The MoF, along with other ministries, is currently engaged in formulating the specifics of this policy. However, it remains uncertain whether they will establish a definitive target in the future. A significant challenge lies in the strained fiscal conditions of local governments, making it difficult for them, property developers, and their creditors to reach an agreement on acquisition prices. It is comparatively simpler for local governments to procure housing projects or land from their financing vehicles or affiliated state-owned enterprises. Furthermore, the central government plans to allocate special bond funds to bolster the capital of the six largest state-owned banks, with an estimated total injection of around RMB0.6tn. Additionally, there is a possibility that the central government will increase fiscal subsidies to upgrades of manufacturing equipment, autos and home appliances. The MoF has earmarked RMB300bn in this year's budget for these initiatives, with potential increases in the following year to encompass a broader range of equipment and home appliances. Finally, the central government is expected to augment fiscal transfers to local governments to facilitate advancements in technology development and improve social welfare..
- **Additional policies are essential to rejuvenate consumer demand and defy deflation.** The recent meeting of the NPC Standing Committee may have left international investors underwhelmed, as the current policies primarily aim to alleviate local fiscal pressures following the housing market slump, with little emphasis on stimulating household consumption. In the near future, it is likely that policymakers will maintain their focus on stabilizing the housing sector and addressing local fiscal challenges, given that the former continues to hinder economic progress and the latter is crucial for the effective functioning of local governments. While these measures may have some positive effects on household consumption, their influence is largely indirect. We believe that they are insufficient to significantly boost consumption or spur economic growth, particularly in the event of the Trump shock. China must gradually redirect its policy priorities towards fostering consumption and combating deflation. This necessitates the implementation of additional measures, including increased liquidity and credit availability, enhanced fiscal support with greater transfers to households, and market-oriented reforms aimed at revitalizing the entrepreneurial spirit within the private sector.

Figure 1: China's broad fiscal system

(as % of GDP)	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024 plan
General fiscal revenue	22.1	21.4	20.7	19.9	19.3	18.0	17.6	16.9	17.2	17.0
General fiscal expenditure	25.5	25.2	24.4	24.0	24.2	24.2	21.4	21.6	21.8	21.6
expenditure-revenue	*3.4*	*3.8*	*3.7*	*4.1*	*4.9*	*6.2*	*3.8*	*4.7*	*4.6*	*4.7*
Government fund revenue (over 80% is land income)	6.1	6.2	7.4	8.2	8.6	9.2	8.5	6.5	5.6	5.4
Government fund expenditure	6.1	6.3	7.3	8.8	9.3	11.6	9.9	9.2	8.0	9.1
expenditure-revenue	*0.0*	*0.0*	*(0.1)*	*0.6*	*0.7*	*2.4*	*1.3*	*2.7*	*2.4*	*3.7*
State capital system revenue (e.g. SOE dividend)	0.4	0.3	0.3	0.3	0.4	0.5	0.4	0.5	0.5	0.4
State capital system expenditure	0.3	0.4	0.2	0.2	0.2	0.3	0.2	0.3	0.3	0.2
expenditure-revenue	*(0.1)*	*0.0*	*(0.1)*	*(0.1)*	*(0.2)*	*(0.2)*	*(0.2)*	*(0.2)*	*(0.3)*	*(0.2)*
Social insurance revenue (excluding fiscal subsidy)	5.2	5.2	5.5	6.7	6.5	5.5	6.5	6.6	7.0	7.1
Social insurance expenditure	5.7	5.8	5.8	7.3	7.6	7.7	7.5	7.5	7.9	8.1
expenditure-revenue	*0.4*	*0.6*	*0.3*	*0.7*	*1.1*	*2.3*	*1.1*	*0.9*	*0.9*	*1.0*
Broad fiscal revenue	33.9	33.2	34.0	35.1	34.8	33.2	33.1	30.4	30.3	29.8
Broad fiscal expenditure	37.7	37.6	37.8	40.4	41.3	43.9	39.0	38.6	38.0	39.0
Broad fiscal deficit	**3.8**	**4.4**	**3.8**	**5.2**	**6.5**	**10.7**	**5.9**	**8.2**	**7.7**	**9.2**

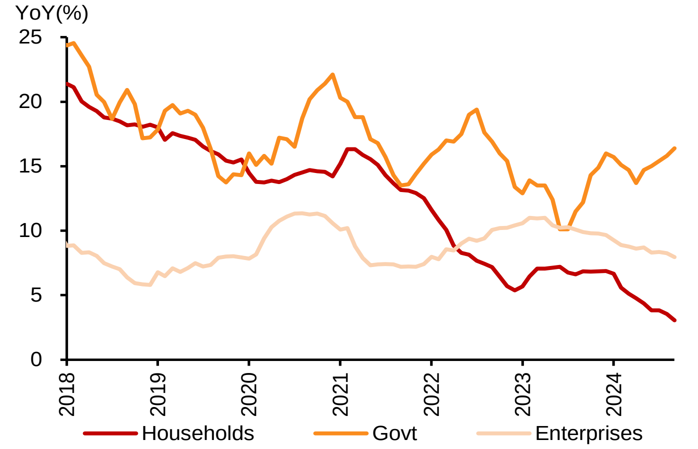
Source: Wind, CMBIGM

Figure 2: Broad government bond financing



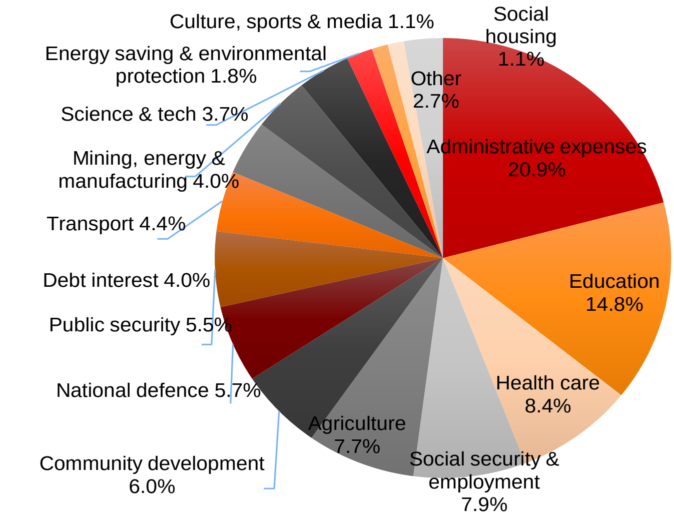
Source: Wind, CMBIGM

Figure 3: Growth of credit to real sectors



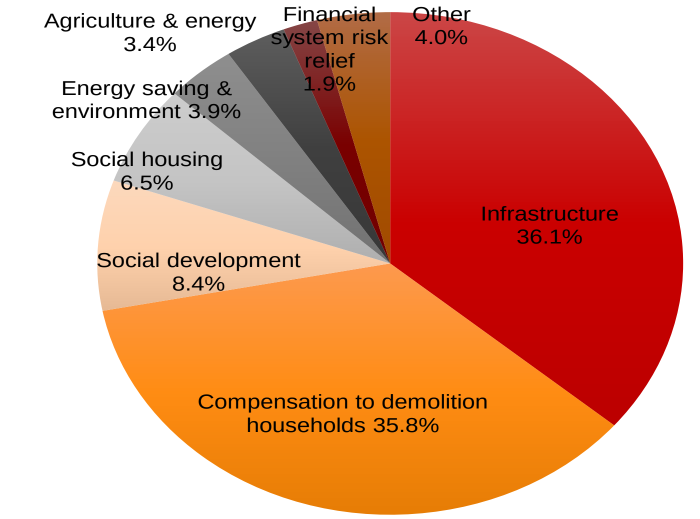
Source: Wind, CMBIGM

Figure 4: General fiscal expenditure mix



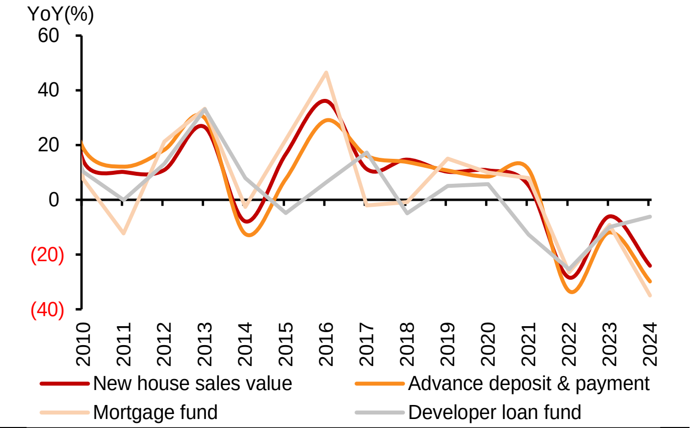
Source: Wind, CMBIGM

Figure 5: Government funds expenditure mix



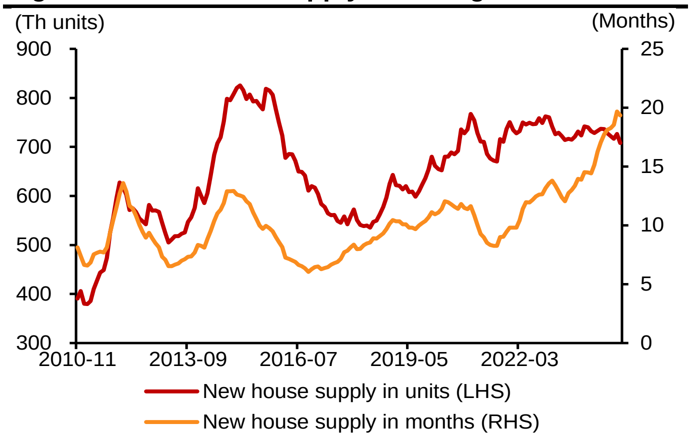
Source: Wind, CMBIGM

Figure 6: New house sales & development funds



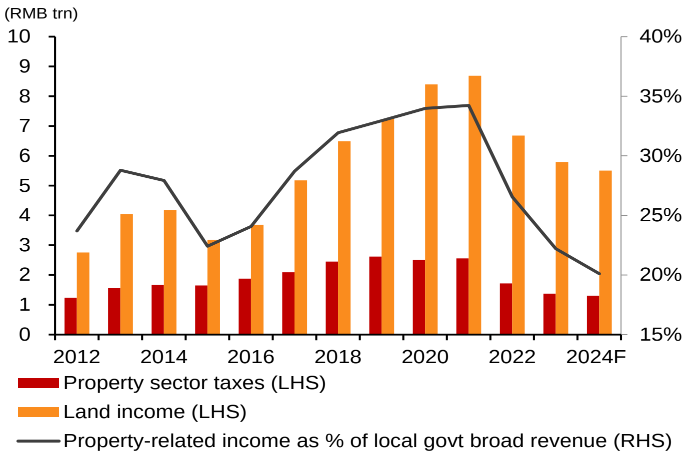
Source: Wind, CMBIGM

Figure 7: New house supply in 10 largest cities



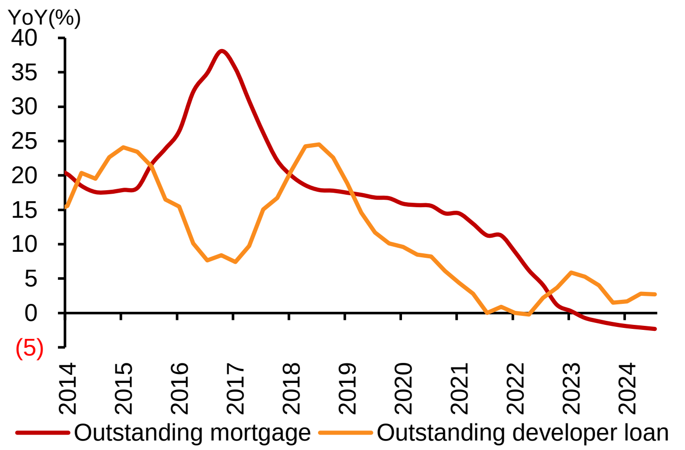
Source: Wind, CMBIGM

Figure 8: LG property related revenues



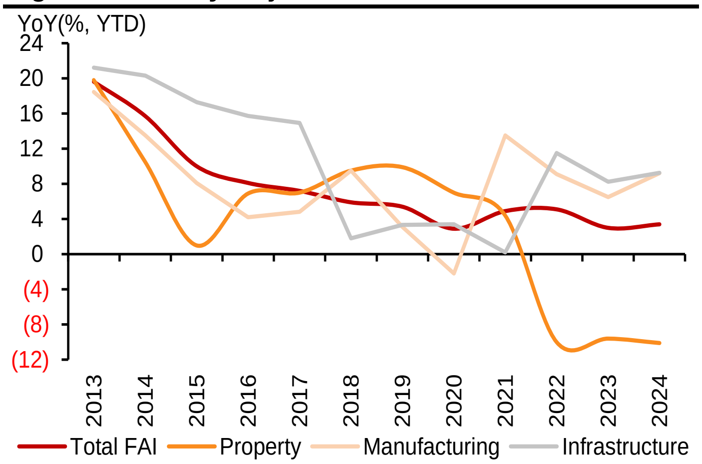
Source: Wind, CMBIGM

Figure 9: Growth of mortgages & developer loans



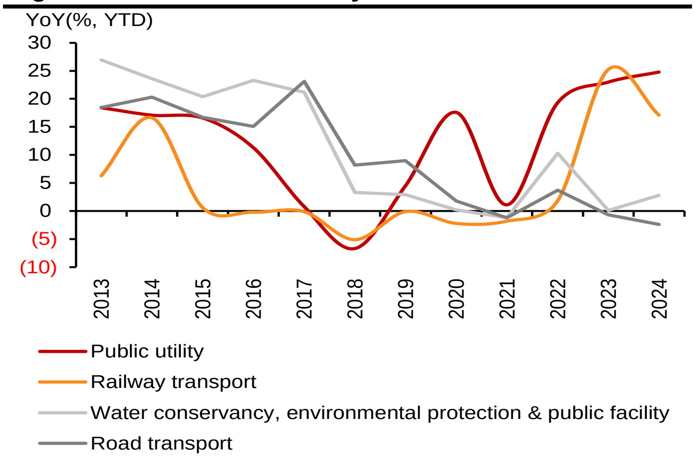
Source: Wind, CMBIGM

Figure 10: FAI by major sector



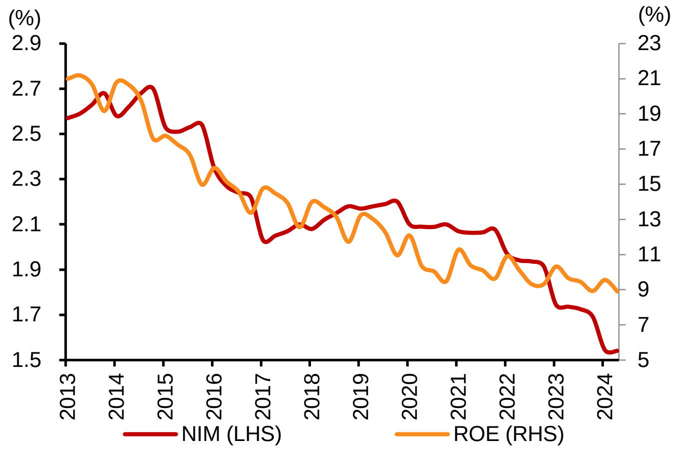
Source: Wind, CMBIGM

Figure 11: FAI dominated by central & local SOEs



Source: Wind, CMBIGM

Figure 12: Chinese banks' NIM & ROE



Source: Wind, CMBIGM

Figure 13: PBOC policy rates

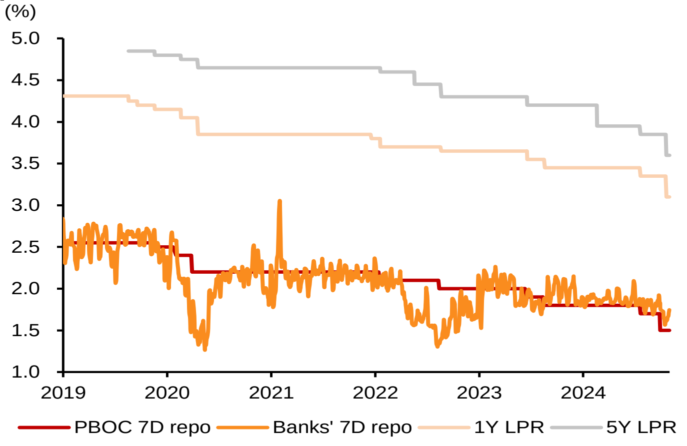
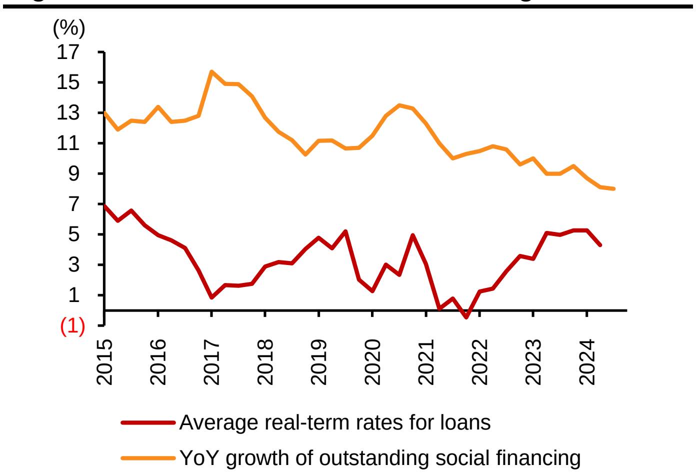
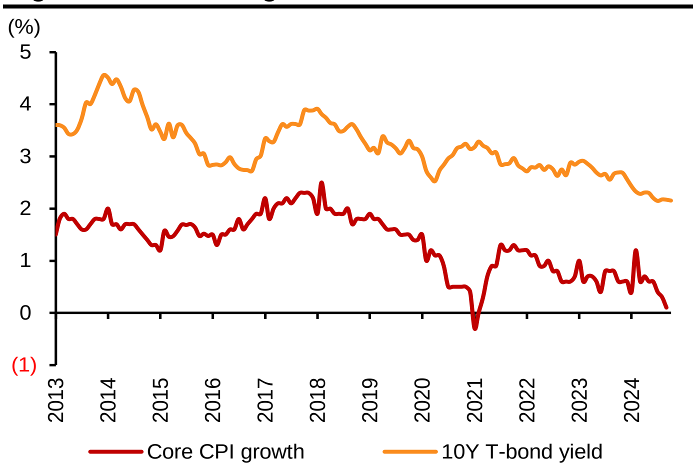


Figure 14: Real-term loan rates and TSF growth



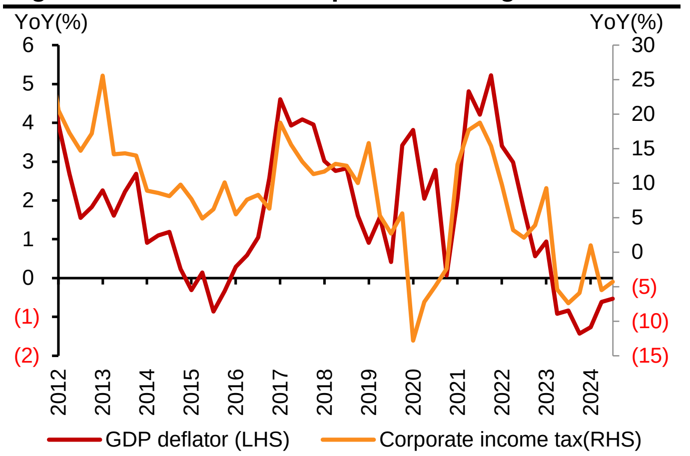
Source: Wind, CMBIGM

Figure 15: Core CPI growth and 2Y T-bond rates



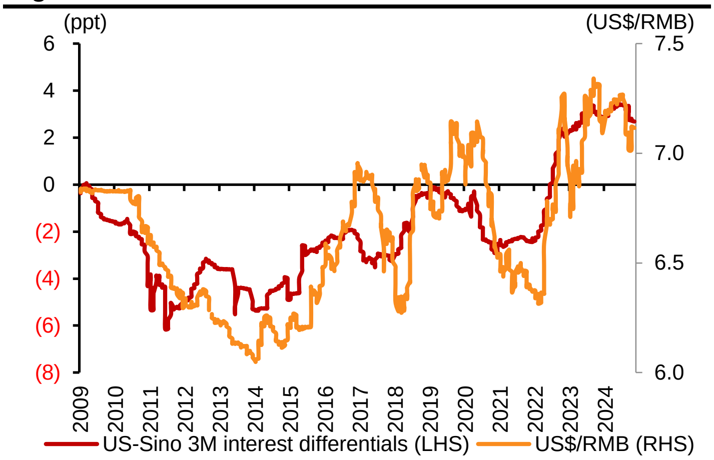
Source: Wind, CMBIGM

Figure 16: Deflation & corporate earnings



Source: Wind, CMBIGM

Figure 17: US$/RMB rates & interest differentials



Source: Wind, CMBIGM

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