Key Considerations for China's Growth in 2024

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In line with our forecast, China's GDP expanded by 5.2 percent in 2023. This is certainly positive news. It reinforces our thinking that the Chinese economy is neither shrinking nor at risk of an impending 'Lehman moment,' as suggested by some media headlines. In fact, in nominal terms, the Chinese economy is more than 25 percent larger than pre-COVID (i.e., 2023 vs 2019).

But it is necessary to stress that this headline growth figure is not indicative of a recovery in confidence levels, which is crucial for a reversal to China's current economic weakness and to strengthen growth in a sustainable manner. Not only does the official consumer confidence index remain deeply in negative territory, but even if it were to jump above the 100 mark, there would still be a lot of room to cover before reaching pre-COVID levels. And while sentiment amongst MNCs remains cautiously optimistic, it did deteriorate throughout 2023, as suggested by our latest survey to China CEOs.

Four key drivers helped China achieve its official growth target for 2023. Firstly, robust growth in Q1 thanks to the government's decision to lift zero-COVID restrictions in December 2022, which led to an improvement in business conditions and to a release of pent-up demand. Secondly, an unexpected, but short-lived release of pent-up demand during the holidays in Q3. Thirdly, the low base of comparison of 2022. Finally, stimulus measures did have a positive effect in partially offsetting headwinds and maintaining a degree of growth stability, especially during the second half of the year.

Looking ahead at 2024, there are four main factors to consider when assessing what growth will look like for China.

First: the low base effect is gone. The calculation of China's 2023 GDP growth rate benefitted from its weak economic performance in 2022, when zero-COVID was pursued aggressively by authorities. Conversely, the calculation of the 2024 GDP growth rate will not only ***not*** benefit from a low base; but will in fact be affected by what could be considered a high base – i.e., the 5.2 percent growth of 2023. Now, calculating growth rates is purely about mathematics, which is why headline figures should be taken with a grain of salt: they can make the economy look deceptively strong or deceptively weak.

Second: the headwinds to growth that China is facing have not receded, on the contrary they are intensifying. Chief among them is the downturn of the property sector, which has left a hole in aggregate demand that will be difficult to fill. This sector was estimated to contribute up to 30 percent of China's growth given its importance as a driver of demand, from upstream industrial activity to downstream household consumption; and to generate around a third of local government revenue because of land sales to developers. Housing assets have also been estimated to account for around 70 percent of Chinese households' wealth. It is hard to think what will compensate for the loss in growth in property. More investment into manufacturing would only increase deflationary pressures and generate excess capacity – and this is already spilling over into geopolitics, as several governments are concerned about this excess capacity being exported and displacing home industries. Moreover, consumer confidence levels have remained persistently weak because of the impact of the property downturn, as well as because of deep-rooted structural imbalances, such as the lack of a robust social safety net. As a result, we expect spending to remain on the softer side, and increasingly directed at similar but less expensive goods and services than before. And, as if this were not enough, external demand is likely to continue moderating because of the global growth slowdown, thus exacerbating downward pressures on China's industrial production, prices, and profit margins.

Third: government stimulus is likely to remain moderate. This is despite the Central Government having considerable room to leverage up and engineer a growth rebound in the short term. Based on data from the Bank of International Settlements, China's public debt-to-GDP ratio stood at 79.4 percent in Q2 2023, well below the global average of 90.7 percent and the average for developed economies of 107.6 percent in that same quarter. Let's say that the government were to release a stimulus package of similar magnitude to the one that it released during the Global Financial Crisis, which was worth RMB 4 trillion or 12.5 percent of nominal GDP in 2008. China's nominal GDP in 2023 reached slightly over RMB 126 trillion, of which 12.5 percent is about RMB 15.7 trillion. A stimulus package of this size would increase its public debt-to-GDP ratio to around 89 percent, which is still below global average levels. Even then, China's massive forex reserves of USD 3.22 trillion provide significant financial cushion.

Authorities have certainly been stepping up monetary and fiscal stimulus measures in

recent months, but these have been highly targeted and restrained. This is likely to remain the case this year, as per the readout of the 2023 Central Economic Work Conference (CEWC; see our analysis here). This is because the Chinese top leadership understands the risks that a large, broad-based stimulus package poses for the country. While this could lead to some years of good growth, the tradeoff would be the exacerbation of the systemic risks and structural imbalances that underpin the current economic weakness. This would not only constrain the transition of the Chinese economy to a more sustainable, consumption-led growth model; but it would also likely lead to a severe deterioration of household, corporate, and government balance sheets. Once the effect of the stimulus dissipates, China would be left with a bigger debt problem, and then we would really have to consider the risk of an imminent Chinese 'Lehman' moment.

Fourth, despite the need for structural reforms, national security considerations may take precedence in an environment of growing geopolitical tensions. The 2023 CEWC made it clear that, at the very least, the government will try to maintain a balance between economic and security priorities – both of which are seen as interdependent. Still, building self-reliance in core technologies to counter Western 'containment' efforts seems to be a higher priority than enabling a sustainable increase in consumption and fostering the development of the private sector. Granted, technological self-reliance is more 'palpable;' especially compared to demand-side structural reforms which need time to take effect.

Unfortunately, the geopolitical environment has only grown more volatile during the early part of 2024, with the newest flare point being the spreading conflict in the Middle East. China and the US are involved to varying degrees. While considerable progress has been made to establish a floor in US-China relations to avoid escalation, it is clear that both have fundamental differences and clashing interests. I certainly do not expect this to lead to kinetic action, but tensions are likely to continue.

Having said all this, there are three key implications for China's growth in 2024:

- First is that the size of the Chinese economy will continue expanding (albeit relatively slowly), and thereby presenting business opportunities. However, because of the rising downside risks and structural changes, winning in China will demand more rigor in planning and execution than ever before. We explore some of that here.
- Second is that it will be difficult for China's GDP in 2024 to expand by 5.0 percent or above. Achieving this would require the government to backtrack on its intention to keep stimulus moderate and targeted. Growth is likely to remain between 4.0 percent and 4.5 percent.
- Third, national security considerations will remain at the top of China's policy agenda, in great part due to rising geopolitical tensions. While this will not necessarily affect growth this year, it will exacerbate operational uncertainty for MNCs. It might also constrain China's long-term growth potential by preventing the pursuit of structural reforms.

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