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Markets will have to wait for Chinese stimulus

Chinese policymakers announced a RMB 10 trillion debt swap, providing some breathing room for cash-strapped local governments. Additional support for consumers and businesses should eventually arrive, not least because stimulus will be necessary to offset another trade war under President Trump. But the focus on derisking and shoring up balance sheets may continue to disappoint market expectations for big stimulus.

Key Takeaways

- China's top legislative body, the National People's Congress Standing Committee, concluded its week-long session by announcing a substantial debt swap, which will help avoid a more austere fiscal backdrop.
- Finance minister Lan Foan outlined a plan to reduce 'hidden' debt by RMB 10 trillion, with local governments benefiting from a RMB 600 billion (~0.5% of GDP) reduction in interest payments over the next five years.
- While this is welcome and authorities indicated that further measures to support the economy – such as fiscal spending for consumption – were still under consideration, a pattern of announcements coming more slowly, and in underwhelming size, appears to be setting in.
- Admittedly, Trump's win suggests Chinese authorities will ramp up easing in 2025. While trade threats against other countries may be aimed at extracting concessions, such as reducing flows of migrants from Latin America, it's unlikely that China can avoid another tariff shock.
- However, additional stimulus and currency depreciation can only offset some, but not all, of the immediate economic hit from higher tariffs.
- For now, we assume that the average bilateral tariff rate will be roughly doubled from 16% to 35-40%, pushing our growth forecasts down to 4.4% and 4.2% for 2025 and 2026 respectively (-0.2ppts each). A more aggressive stimulus package could mitigate more of the near-term damage, but a long-run drag will still be hard to avoid.

China's abrupt policy pivot loses momentum

Markets were shocked in late September by Chinese policymakers suddenly shifting gear, announcing a raft of new support measures, and breaking from a long period of incremental and piecemeal policy easing.

However, while there have been many easing measures announced – spanning monetary policy and real estate – these have started to come more slowly and in somewhat underwhelming size relative to market expectations.

Indeed, while market expectations were not particularly high for the National People's Congress, the prioritisation of steps to shore up local government balance sheets, rather than announcing direct fiscal stimulus for households and corporates, was disappointing. This is especially the case given Donald Trump's presidential win, which is all but certain to unleash another trade war.

No sign of the policy bazooka

The National People's Congress Standing Committee press conference grabbed news headlines on Friday 8 November, announcing a RMB 10 trillion debt swap.

The local government debt ceiling is to be raised by RMB 6 trillion by the end of 2026, while a further RMB 4 trillion will be swapped using the special bond quota through to the end of 2028.

Local governments will still need to find RMB 2 trillion to deal with maturing debt related to 'shantytown' redevelopment in 2029 and beyond.

But this is too far in the future to affect current plans and in practice further expansions of local government debt issuance will most likely be condoned.

Finance minister Lan Foan said that these steps are expected to cut the stock of 'hidden' debts from RMB 14.3 trillion to 2.3 trillion. That said, there is disagreement about the scale of off-balance sheet and 'hidden' debt. The International Monetary Fund (IMF) estimates that local government financing vehicle (LGFV) debt stands at RMB 66 trillion, suggesting that more 'hidden' debt could be found at a later date.

The debt swap is certainly welcome from a financial stability perspective and is unambiguously good for local government finances. Put simply, it swaps one relatively costly form of borrowing for another cheaper form. Indeed, the Ministry of Finance estimates that this should save local governments RMB 600 billion (~0.5% GDP) by reducing interest rate costs over the next five years.

It is not however what markets were really hoping for.

The economy still faces significant challenges from its beleaguered property sector, a weak nominal growth environment and reticent consumers.

The debt swap reduces the risk of a more austere fiscal backdrop, but direct fiscal support for households and businesses is needed to unlock potential synergies across the policy levers, raising the chances that the economy can overcome multiple headwinds.

The authorities did at least provide some guidance that consumption support measures are still on their way. But markets may need to wait for December's Politburo meeting or the Central Economic Work Conference (CEWC) for more details.

A Trump 2.0 trade war will lead to more easing, but we are downgrading our growth forecasts anyway

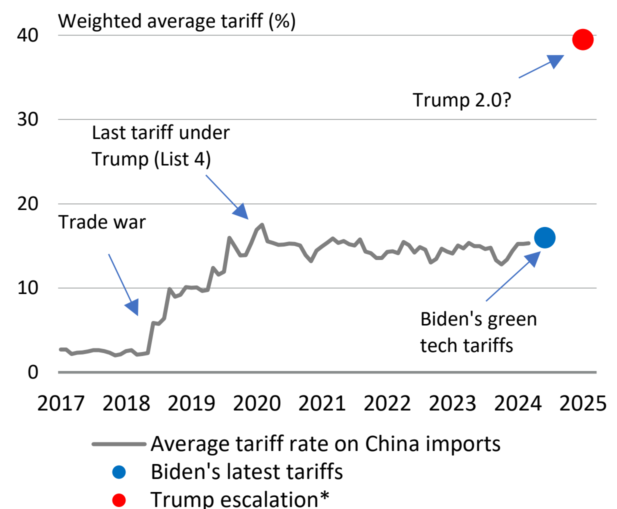
Trump's win in the US election suggests that the authorities will be forced to ramp up policy easing.

Noise will likely be high and multiple countries will likely come under pressure due to their high bilateral deficits with the US. But, while threats against other countries are plausibly aimed at extracting concessions – such as increasing European defence spending or reducing the flows of migrants from Latin America – it seems unlikely that China will be able to avoid another trade war.

The Chinese authorities may still opt to reserve policy optionality until US trade policy is revealed in 2025, partly because it is unclear when Trump will turn his attention to China. But tariffs are more a question of *when* and *how high* rather than *if*. For now, we assume that the average bilateral tariff rate will be roughly doubled from 16% to 35-40% (see Figure 1).

It is difficult to calibrate the size of the economic shock that a second trade war could unleash, not least because of the uncertainty of its scale and key features.

Figure 1: Tariffs are likely to double



Source: US Census Bureau, USTR, WITS, abrdn, November 2024

Chinese GDP growth did slow from an average of 6.9% year over year in 2016/2017 to 6.4% in 2018/2019 once the first trade war began, but it is difficult to be sure what role tariffs played.

'Shanty town' redevelopment was a major driver of growth in 2016/2017 and global trade also picked up notably following a period of particular weakness in 2015; hence, some moderation was likely.

In addition, the start of the authorities' 'de-risking' campaign was a key policy shift that began to weigh on trend growth over 2018/2019.

So, while the authorities allowed the currency to release some of the pressure from tariffs, and policy shifted to a more neutral setting, cyclical and structural drivers outside of the first trade war may have actually been the largest contributors to China's 0.5ppt growth slowdown.

We assume that the authorities will allow a currency depreciation to take some of the strain this time too. Combined with more decisive additional policy easing, this should be enough to absorb much, but not all, of the immediate economic hit from higher tariffs.

Our latest forecasts assume that GDP growth in 2025 and 2026 will be reduced by 0.2 percentage points in each year (4.4% and 4.2% respectively) as a result of Trump's tougher trade actions.

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