

ECONOMIC VIEWPOINT

Will China's Latest Stimulus Measures Make a Difference?

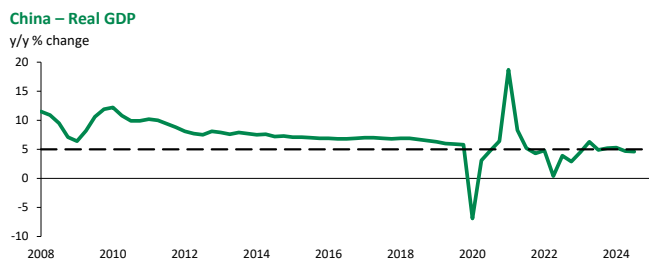
By Hendrix Vachon, Principal Economist, and Marc-Antoine Dumont, Senior Economist

Beijing went big last month, unveiling more aggressive stimulus aimed at reviving China's struggling economy. Many of the fresh measures are focused on shoring up the property sector. These include cutting interest rates and reserve requirement ratios for financial institutions, two moves that could facilitate access to credit. The central government also announced plans to recapitalize financial institutions and support local governments. So far the markets have responded favourably to these decisions, but this optimism is fragile. Some people would like to see more government intervention in the economy and a significant increase in spending. While this could provide a boost in the short term, it's less clear what the effects would be over the long term. In our view, China's problems run deep and structural changes are needed to sustainably lift the economy.

A Flagging Economy

Aside from a post-pandemic bounce, China's real GDP growth has been decelerating for more than a decade (graph 1). Based on the most recent data, the country's growth rate has dipped below 5%, which is low for China and below the government's target.

Graph 1
Economic Growth Has Fallen Below 5% in China

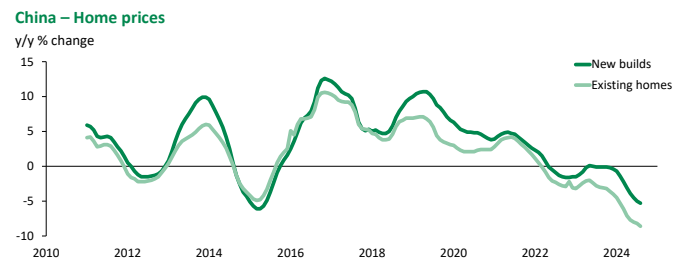


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The accuracy of Chinese economic data is often called into question. In reality, the situation could be even worse than reported—but that's a subject for another note. It's clear, however, that some areas of the economy are struggling, especially those linked to the housing market. Following a sustained period of investment, supply eventually outstripped demand, which sent property prices tumbling (graph 2). At the

same time, concerns about credit growth and credit quality prompted authorities to take action to address the glut. But clearly the Chinese government wasn't able to engineer a soft landing for its property sector. Many real estate developers ran into serious financial trouble, leading to a proliferation of unfinished homes. All of this has hobbled a large swath of China's economy as well as its financial sector.

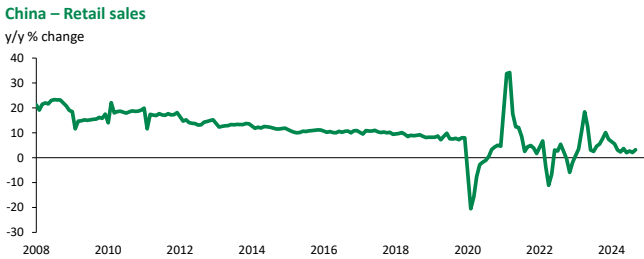
Graph 2
Home Prices Have Been Sliding Since 2022



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Consumer spending is also in the doldrums. Before the pandemic, retail sales were advancing at a respectable pace of 8% per year, but now they're struggling to push past 3% (graph 3 on page 2). Chinese households didn't get much financial support during the pandemic years, despite strict public health measures, and this hindered their ability to start spending again once the economy reopened. The country's current

Graph 3
Consumption Growth Has Slowed Considerably



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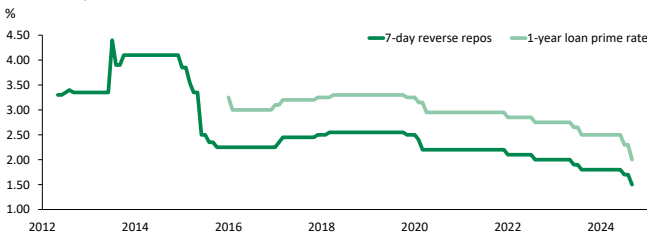
economic woes, which are undermining consumer confidence and driving up unemployment, are only making things worse, along with the fact that banks are more reluctant to grant loans.

Recent Monetary Easing Measures Probably Aren't Aggressive Enough

Chinese policymakers recently announced cuts to interest rates and bank reserve requirement ratios. The goal is to make it easier for financial institutions to issue loans. But will these cuts be enough?

The People's Bank of China has already lowered interest rates several times in recent years, but these moves didn't prevent the slump in the credit and property markets. While the latest interest rate cut is bigger than past reductions (graph 4), there's no guarantee that it will do the trick. They may need to make additional bold cuts.

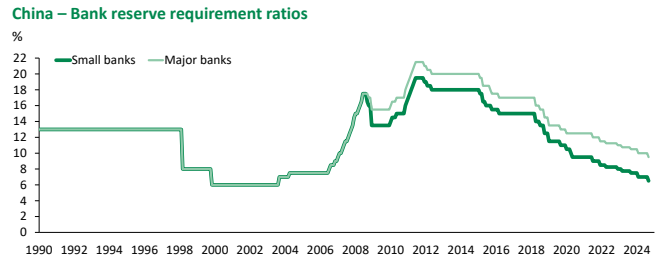
Graph 4
The People's Bank of China Announced Fresh Interest Rate Cuts in September
China – Key interest rates



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The same critique applies to bank reserve requirement ratios, which have been trimmed several times in recent years (graph 5). Theoretically, lowering ratios allows financial institutions to grant more loans, but the impact of such measures is limited if there isn't much demand for credit.

Graph 5
Monetary Authorities Keep Cutting Bank Reserve Requirement Ratios

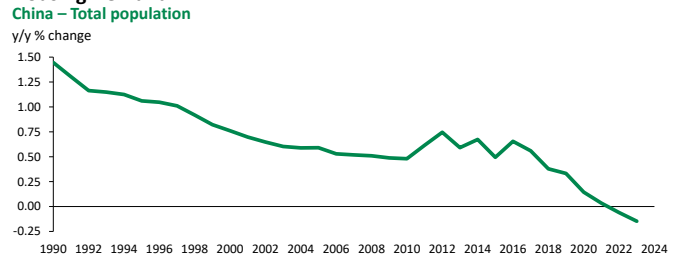


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It's Hard to Revive Housing When the Population Is Declining

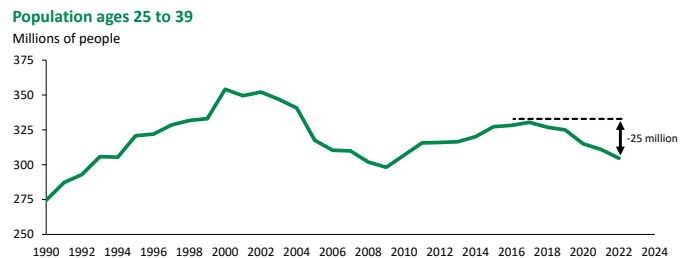
One reason why credit demand may not increase significantly is structural. China's population is starting to shrink—and the implications of this shift are huge (graph 6). Demand for housing and mortgages is unlikely to rebound in the next few years. A similar situation played out in [Japan](#) in the 1990s. It's equally unlikely that property values will start trending sustainably upward again. The decline is even more alarming when you look at the population between 25 and 39 years of age (graph 7). This

Graph 6
China's Population Is Shrinking, Which Naturally Leads to Reduced Housing Demand



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Graph 7
The 25 to 39 Age Group Is Shrinking Faster



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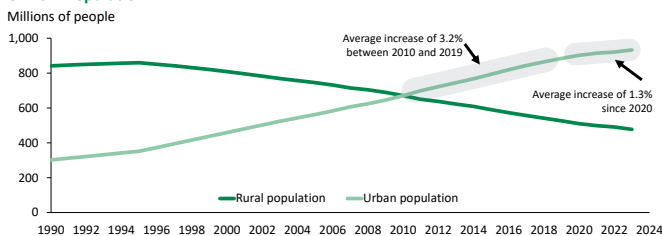
segment, which includes the bulk of first-time homebuyers, has fallen by 25 million people in the past few years.

One thing that could help is China’s urbanization. With cities continually absorbing an influx of new residents, ongoing residential development is needed, but at a slower pace than before. Annual urban population growth has slowed in recent years. The urban population grew by more than 3% per year between 2010 and 2019, but the pace eased to an average of 1.3% between 2020 and 2023 (graph 8). The deceleration may be partially due to the COVID-19 pandemic and the related public health measures. The 2024 and 2025 numbers will help give us a better sense of the trend. But expectations should nonetheless be scaled back since, sooner or later, China’s overall population decline will stem the growth of its urban population.

GDP) and the eurozone (236% of GDP). However, China still trails Japan, which leads with debt in the order of 400% of GDP.

China already ranks among the world’s most heavily indebted countries. So does it make sense to rely on credit expansion once again to pull up the economy? Corporate debt is particularly high (graph 10), but this data obscures the fact that a portion of local government debt has been recorded as business debt, especially through costly industrial policies. In reality, the situation is probably more optimistic for private companies, but less so for governments. In addition, many people are also calling for the different levels of government to modernize how they work. Currently, local governments and their financing vehicles are being forced to increase nonproductive investment to meet central government targets that simply aren’t compatible with maintaining healthy public finances. A better division of responsibilities and tax reforms would make a lot of sense, but these types of changes can take several years to implement. In the meantime, the central government may have to continually rescue local governments, as it recently did.

Graph 8
Urbanization Supports the Need for Real Estate Investments, but It May Also Be Waning
China – Population

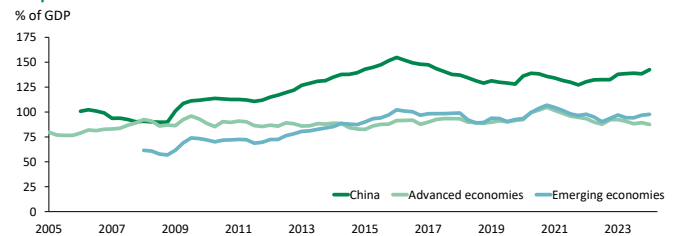


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China’s Debt Levels Are Already Sky High

Even though there’s potential for China’s property and credit sectors to rebound somewhat, the country’s debt levels may not be sustainable over the long term. Its combined government, corporate and household debt is equivalent to 290% of GDP. That’s more than the average for advanced economies (graph 9). According to data from the Bank for International Settlements, China has racked up more debt than the United States (255% of

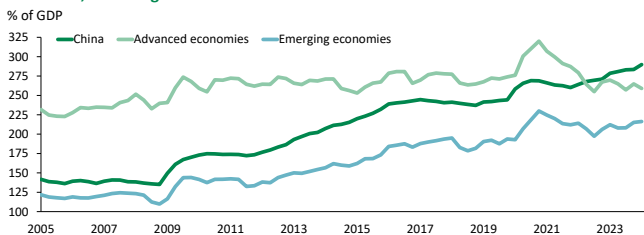
Graph 10
Chinese Corporate Debt Is Substantially Higher Than the Average for Other Countries
Corporate debt



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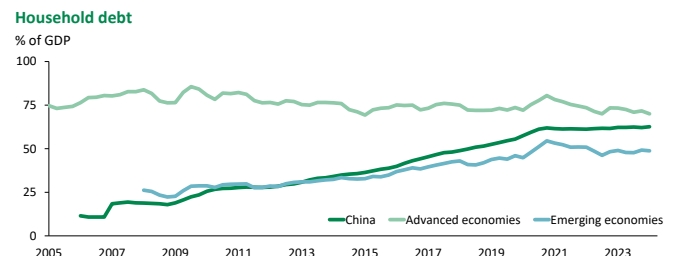
Chinese household debt is higher than the average for emerging economies, but lower than the average for advanced economies (graph 11). This means that household debt levels won’t necessarily hold back Chinese domestic demand, but in order for consumers to start spending more, they need to be reasonably

Graph 9
China’s Total Debt Is Already High and Exceeds the Average for Advanced Economies
Total debt, excluding the financial sector*



* Consumer, corporate and government debt.
Bank for International Settlements and Desjardins Economic Studies

Graph 11
China’s Household Debt Burden Has Been Stable for Several Years



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confident about the economy and job market. The unfavorable demographic outlook will also probably hinder domestic demand expansion.

China Can't Rely on Investment Indefinitely

For years, China's economic success was driven mainly by strong growth in investment (property, industry and infrastructure). Since the 2000s, investment has accounted for a greater share of GDP than consumption (graph 12).

Increased personal freedom could also whet consumers' appetite for consumption, but this seems unlikely in the foreseeable future.

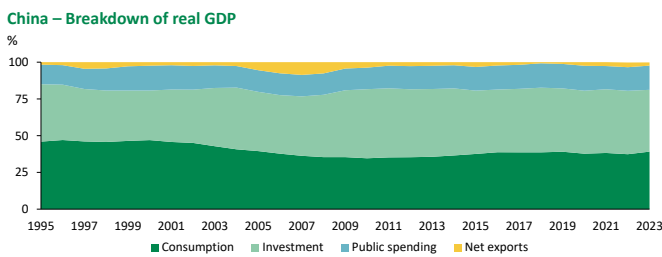
If China decides to stick to its investment-driven model, it could find itself faced with deteriorating return on capital. With each new factory or major infrastructure project that gets built, the economic returns on these investments diminish relative to previous ones. This means that interest rates need to keep coming down to make further large-scale investments viable. And eventually you end up with capacity surpluses that are impossible to ignore.

Several Industrial Sectors Now Have a Production Surplus

China is the world's factory. It accounts for 30% of global industrial production, followed by the US with 15%. However, the same factor that drives China's economic growth also seems to be creating headaches for Chinese policymakers.

Several industries, including those for low-end electronic chips, solar panels, batteries and steel, are already overproducing. Consequently, the prices of these components have tumbled while the percentage of companies reporting financial losses has soared from 12.9% in 2011 to 31% in 2024 (interim data) (graph 14).

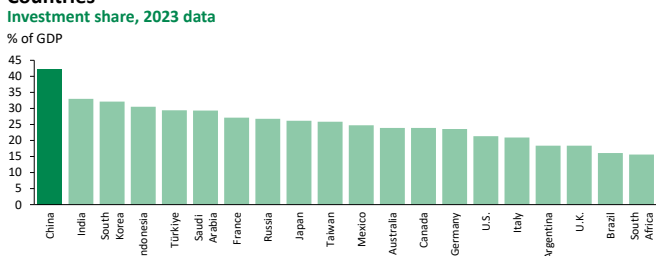
Graph 12
China's Economy Remains Heavily Dependent on Investment



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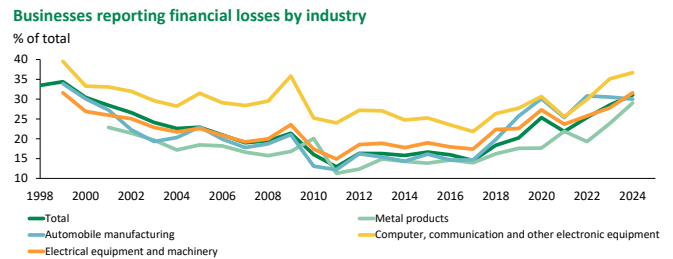
This is starkly different from other major economies. Even in 2023, despite the problems plaguing China's property sector, investment still accounted for 42% of the country's GDP (graph 13). That's 10% more than in India and South Korea. In Canada, the United States and many European countries, investment rarely accounts for more than 25% of GDP. In these mature economies, consumption is the largest component of GDP and government spending also generally tends to be larger. China would be wise to shift away from its decades-old policy and embrace an economic growth model that relies more heavily on consumption and public spending. However, this type of change would take years to implement, not just a few quarters. It would also require a number of reforms. A better social safety net could help convince households to save less and spend more.

Graph 13
China's Investment Share in GDP is Higher Than in All Other G20 Countries



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Graph 14
Financial Losses Are Rising in China's Industrial Sector



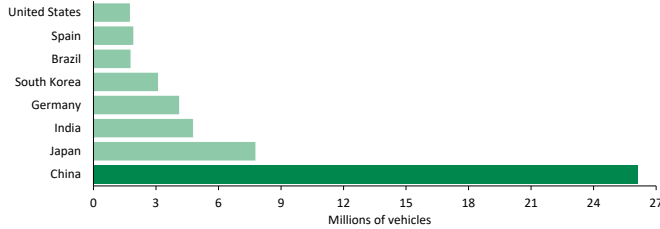
NOTE: Partial data for 2024, average for January to August. National Bureau of Statistics of China, Datastream and Desjardins Economic Studies

But this is nothing compared to what's happened in the automotive sector. In a sense, China has been hugely successful. It's the world's largest producer of passenger vehicles, having made more than 25 million units in 2023 (graph 15 on page 5). But the country actually has the capacity to produce twice as many vehicles, despite the fact that domestic sales of new vehicles is just 30 million.

Simply put, the domestic market is too small or underdeveloped to support its own manufacturing capacity. This is also a symptom of Chinese industrial policies, which are very effective at developing new industries, but unable to bring them to

Graph 15
China Is Now the World's Largest Motor Vehicle Producer

Passenger vehicle production by country, 2023



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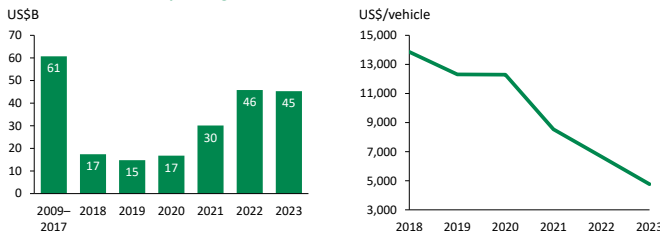
maturity because of a misalignment with actual demand from Chinese consumers. Too many businesses and sectors are subsidized for too long. This ends up costing the government a lot and undermining public confidence in the economy. It would be in China's best interest to further liberalize its economy and leave investment decisions in the hands of business leaders. In the short term, a government withdrawal could lead to a drop-off in investments and a spate of business consolidations in various sectors. However, in the longer term, having resource allocation more closely aligned with domestic demand is more likely to lead to strong, sustainable growth. This in turn would boost household confidence toward the economy and encourage spending.

Western Protectionism Is Complicating Matters

Another reason why China should focus on its domestic market is that exporting goods is becoming increasingly challenging. For instance, the US, Canada and the European Union have all applied new tariffs on Chinese-made electric vehicles, despite the climate crisis. That's because Chinese industrial policies, which include extensive government subsidies, are rightly perceived as creating unfair competition (graph 16). In 2023, government spending on the electric vehicle industry amounted to approximately US\$5,000 per car. New tariffs could also be

Graph 16
China's Support for Its Industries Is Perceived as Unfair Competition

China – Government spending on electric vehicles



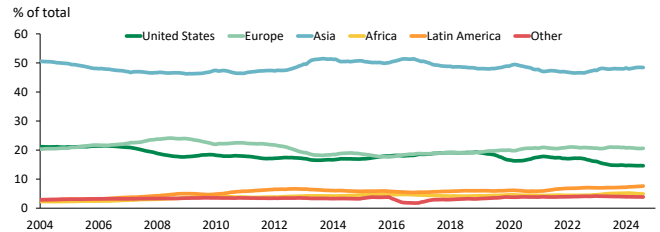
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imposed on other Chinese products. The situation could become even more complicated if Donald Trump is re-elected, as he's threatening to slap a 60% tariff on imports from China.

In light of these challenges, should China look to diversify its export markets? Right now, about 15% of Chinese exports go to the US. This share has been declining since US tariffs were imposed during Trump's first mandate (graph 17). Meanwhile, the share destined for other regions, like Europe and Latin America, has slowly edged up. But the expansion in Europe could slow because of newly introduced tariffs on electric vehicles and the potential for more. As for the other markets, how much demand for imports do they really have? With lower consumer purchasing power and under-developed electrical networks, these countries are unlikely to have a large appetite for electric vehicles. And on a more basic level, will these countries be willing to absorb China's excess production? Probably not. Every country wants to develop its own industries in one way or another. All things considered, it simply doesn't make sense for China to rely on export growth to resolve its production surplus.

Graph 17
The Share of US-Bound Exports Is Declining

Share of Chinese exports by destination



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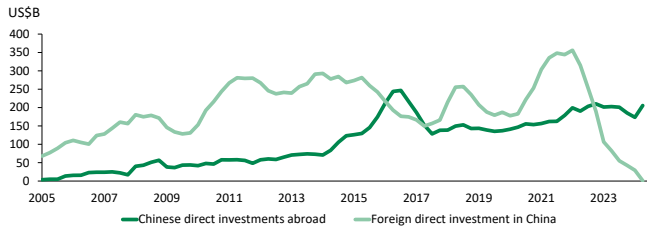
Both Foreign and Chinese Investors Are Feeling More Cautious

If Chinese policymakers don't reform the economy, investors may do it for them. An analysis of international financial statistics shows a rise in China's net capital outflow from direct investment. Foreigners have significantly reduced their direct investment in China, but the Chinese are continually increasing their direct investment abroad (graph 18 on page 6).

While this unfavourable trend in foreign direct investment could be offset by other sources of financing, they are more volatile. Foreign direct investment is considered a high-quality source of funds backed by a longer-term vision and commitment.

Graph 18
Foreign Investors Are More Hesitant and Chinese Investors Continue to Take Their Capital Abroad

Direct investment flow, 4-quarter total



State Administration of Foreign Exchange and Desjardins Economic Studies

Why are foreign investors turning away from China? The answer may go beyond the recent years of overinvestment, protectionist risks, poor government management and the sluggish property sector. The country also seems riskier from a geopolitical standpoint due to its support for Russia and threats against Taiwan, among other things.

We Still Expect China's Economy to Gradually Decline

Beijing's recent announcements have had little effect on our forecast. While the new measures may yield some short-term benefits, we expect Chinese growth to continue trending downward over the long term unless major structural reforms are introduced. That's because China's economic development model, which is based on large-scale investment and pro-industry policies, is now running on fumes. Production capacity surpluses are becoming increasingly apparent, and the excess will be hard to sell domestically or as exports. The returns on these investments will steadily diminish, which could make investors more anxious. China's shrinking population is another major challenge, as the demographic change will significantly hinder the property market's chances of revival.

China's bleak economic outlook is one of the reasons why we expect moderate growth in [commodity prices](#). From an investment standpoint, China should be approached with caution. Even though the Chinese stock market recently rebounded, the improvement was mainly based on hopes that Chinese authorities will be able to lift the economy. Going forward, it will also be important to keep an eye on the Chinese yuan. Increasing export challenges, due in part to protectionism in Western countries, could be offset by a falling yuan. Less favourable foreign investment flows could also cause the yuan to depreciate, unless China sells some of its international reserves, which is unlikely.