BOC Research Institute

China's Economic and Financial Outlook

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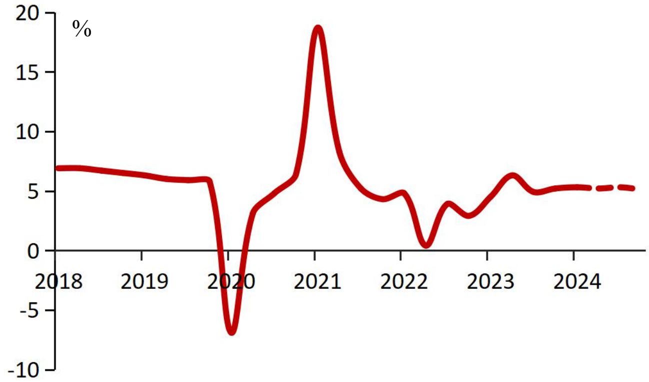
Highlights

- China's economy was off to a good start in 2024Q1. Globally, international trade picked up as market demand recovered, leading to a quick rebound in China's export growth. Domestically, economic policy support were further increased, strengthening the internal momentum of economic growth. The GDP growth in 2024Q1 is 5.3% year on year..
- In 2024Q2, the internal momentum of economic growth will continue to recover. With foreign demand to be boosted as the world enters a restocking cycle and economic policies to further unleash their supporting role, China's economic climate index is expected to pick up. Estimates put GDP growth in Q2 at around 5.2%.
- The *2024 Report on the Work of the Government* set the economic growth target at around 5%, which is not only intended to promote short-term employment, increase residential income and prevent and defuse risks, but also needed to achieve medium and long-term goals. Redoubled efforts from various sides are required to deliver on the growth target. Economic policies should be devised to further bolster the foundation of economic recovery.

China's Economic Growth Shows a Wavy Trajectory after the Pandemic



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More Efforts Required to Achieve the 5% Growth Target

— China's Economic and Financial Outlook (2024Q2)

China's economy was off to a good start in 2024Q1. Externally, global market demand recovered, leading to a quick rebound in China's export growth. Domestically, macro-economic policy support were further increased, strengthening the internal momentum of economic growth. The GDP growth in 2024Q1 is 5.3% year on year. In 2024Q2, the internal momentum of economic growth will continue to recover. With foreign demand to be boosted as the world enters a restocking cycle and economic policies to further unleash their supporting role, China's economic climate index is expected to pick up. Estimates put GDP growth in Q2 at around 5.2%. Currently, China's economy still faces challenges including insufficient effective demand, overcapacity in some industries, weak social expectation, and hidden risks. The *2024 Report on the Work of the Government* set the economic growth target at around 5%. To achieve the growth target, more efforts are required to strengthen the foundations for economic growth. Economic policies should be designed to further strengthen the foundation of economic recovery.

I. 2024Q1 Economic Review and Q2 Outlook

China's economy achieved a good start in 2024Q1. The internal momentum of economic growth grew, with consumption performing better than expected, investment in manufacturing expanding faster, production steadily recovering, and industrial transformation and upgrade gathering stronger momentum. Economic policies were further intensified. In 2023, all of the one trillion yuan in additional China Government Bonds (CGBs) were issued, and one trillion yuan in super-long-term special CGBs is to be issued in 2024. As part of the monetary policies, the deposit reserve ratio was cut by 0.5 percentage point, and 5-year LPR was lowered by 25 bps. In 2024Q2, the recovery of China's economy will be subject to the internal momentum of growth, changes in the international environment and the intensity and effects of economic policies. Consumption will remain the "cornerstone" of China's economic growth, and the potential of service consumption is expected to be further unlocked. Industrial transformation and upgrade will be a stronger trend, while new quality productive forces will be further nurtured. With the foreign demand to be boosted as the world enters a restocking cycle, plus a lower base in the previous year, export recovery is expected to continue. However, the international environment will remain tight, and the uncertainties resulted from the changing political and economic landscape worldwide require continued attention. According to the *2024 Report on the Work of the Government*, fiscal policies will be further optimized and combined with the use of diverse policy tools like deficits, special bonds and super-long-term CGB, which will help infrastructure investment maintain a relatively high growth. The new round of "large-scale equipment renewals and trade-ins of consumer goods" will contribute to the expansion of domestic demand.

I.1 The internal momentum of economic growth continued to recover, supported mainly by service consumption and manufacturing investment

1. Consumption grew faster and diverged in structure, with the potential expected to be further unlocked in the future.

2024Q1 saw continued pickup of consumption. In the first quarter of 2024, the total retail sales of consumer goods grew by 4.7%, and the growth rate was 0.2 percentage higher the same period of 2022-2023. **The consumption structure diverged significantly.** Service consumption still outperformed commodity consumption. In the first quarter of 2024, the retail sales of services recorded a growth 6 percentage points higher than the retail sales of commodities, with the latter growing by 4%. During the Spring Festival, the number of domestic tourists and the income from domestic tourism respectively increased by 34.3% and 47.3% year-on-year, about 119% and 107.7% the levels in 2019 on a comparable basis. Auto consumption expanded fast, and real-estate-related consumption picked up a little. In the first quarter of 2024, the total retail sales of auto-related consumer goods surged by 3.8% year-on-year, and the consumption of house decoration, furniture and home appliances grew by 2.4%, 3% and 5.8%, respectively. Consumption in lower-tier markets was even more robust. Consumption in rural areas was stronger than that in urban areas, with the consumption tendency of rural residents higher than the pre-pandemic level and that of urban residents still far below the pre-pandemic level.

In 2024Q2, consumption is expected to further recover. Service consumption will remain the major driver of consumption growth. International comparison indicates service consumption in China is still promising in the future. In Q2, the Tomb-Sweeping Day, May Day and Dragon Boat Festival holidays will create more opportunities for the recovery of tourism, accommodation and other services, while the new round of trade-in of old consumer goods is likely to boost commodity consumption. According to our estimate, the ongoing round of trade-in of old consumer goods is expected to expand the demand for automobiles and home appliances by about 210.9 billion-629.3 billion yuan, and drive GDP growth by about 0.16-0.5 percentage point. The trade-in policy, when combined with preferential policies to promote new energy vehicles and new-type home appliances in rural areas, will unleash greater potential for boosting consumption. Comprehensive estimates put the growth of the total retail sales of consumer goods in Q2 at around 5.5%.

2. The momentum of manufacturing investment recovered significantly, underpinning the internal drivers of growth.

Since the start of 2024, industrial production and investment continue to pick up. In the first quarter of 2024, industrial enterprises above the designated size recorded a year-on-year increase of 6.1% in added values. With the gradual recovery of the economy, industrial enterprises saw continued improvements of profits. Some industries entered the active restocking cycle, and the internal momentum of investment in manufacturing further gathered pace. In the first quarter of 2024, investment in manufacturing grew by 9.9% year-on-year, driving the growth of investment in fixed assets up by about 2.4 percentage points. **Investment in high-tech manufacturing maintained fast growth,** which was 0.9 percentage point higher than that of investment in manufacturing in the first quarter months of 2024. **Private investment in manufacturing was as dynamic as ever,** with the focus shifted to midstream machinery and equipment manufacturing in recent years, and maintained a good momentum of growth amid the equipment renewal at home and the expanding demand for motors abroad. In the first quarter of 2024, private investment in manufacturing increased by 11.9% year-on-year.

In Q2, **backed by the new round of large-scale equipment renewal and trade-in of old consumer goods, investment in manufacturing will sustain fast growth.** The *2024 Report on the Work of the Government* called for efforts to "encourage and promote consumer goods trade-in programs" and "encourage upgrading and technological transformation of production and service equipment". The ongoing round of trade-in of old consumer goods focuses on areas like automobiles, home appliances and house decoration, expected to unlock residential demand for commodity consumption. Centering around energy conservation and carbon reduction, ultra-low emissions, safe production, digital transformation and intelligent upgrade, the equipment renewal program will accelerate the upgrading of production equipment and energy-consuming equipment in key industries like iron & steel, petrochemical, machinery and aviation. According to our estimate, the ongoing large-scale equipment renewal is expected to drive the overall investment in fixed assets up by 1.2-1.5 percentage points, and GDP growth by 0.4 percentage point[1].

[1]Please refer to *How Much Investment Potential Will the New Round of "Large-Scale Equipment Renewal" Unlock* published in

In China, manufacturing investment is currently in the latter half of the ongoing investment cycle. Upstream industries like chemical fiber, rubber and plastics, midstream industries like general equipment and electrical machinery and downstream industries like food and beverages have entered the restocking phase. Going ahead, equipment renewal and the trade-in of old consumer goods are expected to further advance the restocking process and take manufacturing investment into the next investment cycle. According to estimates, investment in manufacturing and investment in fixed assets will grow by about 10% and 4.7% respectively year-on-year in Q2.

I. 2 China's export achieved a good start thanks to the recovering foreign demand, but the uncertainties arising from the evolving political and economic landscape worldwide require continued attention.

In Q1 2024, China's export amount was USD807.5 billion, with a year-on-year increase of 1.5%, and **the better-than-expected result was mainly due to the recovering foreign demand. China's exports to main trade partners and of main products were all improved.** In Q1, China's exports to ASEAN grew by 4.1% year-on-year; China's exports to the US and EU contracted by 1.3% and 5.7% respectively. Exports of bags & cases, textiles, apparels and plastics increased by 5.6%, 2.6%, 1.4% and 10.2% respectively year-on-year. The growth of exports of mechanical and electrical products changed from negative to positive. Given a higher base, the growth of auto exports fell by 63.4 percentage points year-on-year to 18.2% in Q1.

In Q2, **exports will maintain the momentum of growth. First,** the US may kickstart an active restocking cycle, propelling the recovery of global trade. Industries like petroleum, technical hardware and equipment and durable consumer goods will enter the active restocking stage, driving China's exports of relevant

BOC's *Macroeconomic Observation* (2024, Issue 16) https://www.boc.cn/fimarkets/summarize/202403/t20240308_24707359.html products upward. **Second,** trade of intermediate goods is expected to provide new impetus to China's exports. The *2024 Report on the Work of the Government* proposed to tap the trade of intermediate goods as a new growth point. Export-oriented emerging economies are increasingly relying on the intermediate goods made in China. Going forward, the continued recovery of international demand will boost the growth of exports from emerging economies, and China's exports of intermediate goods are expected to maintain fast growth. **Third,** the drag from export prices will be eased. Since the start of 2024, amid the recovering international trade and tightening international shipping situation, the price factor is expected to support China's nominal export growth. Given the lower base in the same period of last year, exports in Q2 are estimated to grow at about 3% year-on-year.

Despite the expansion of exports, the complexity, severity and uncertainty of the foreign environment are still growing, with expected impacts on China's FDI and foreign trade. **First,** the monetary policies of major economies remain uncertain, and the persistent high interest rates curb international investment. **Second,** driven by the manufacturing reshoring and friend-shoring strategies adopted by developed countries, global value chains are increasingly fragmented and shorter. **Amid the evolving political and economic landscape across the globe, the size and structure of China's FDI may be somewhat impacted.** Trade protectionism in emerging areas is increasingly intense, likely to challenge the exports of emerging products.

I. 3 Economic policies offered a stronger support for the economy, but real estate remained a drag on economic performance

1. Fiscal policies further took effect to fuel the growth of infrastructure investment

In the first quarter of 2024, investment in infrastructures (excluding power infrastructures) grew by 6.5%. **Given the high debt pressure and weak expectation for fiscal income, issuance of special local government bonds slowed significantly.** In the first two months of 2024, the actual issuance of new special bonds was only 48.8% of the level in the same period of 2023. Due to the still-weak real estate market, intensified fiscal policies for counter-cyclical adjustment, the fading base effect of VAT credit refunds and the negative year-on-year growth of PPI, the expectation of local governments for tax income was further lowered. **Project progress was slow.** The huge number of migrant workers returning home before the Spring Festival was in stark contrast with the much smaller number of migrant workers coming back to work after the Spring Festival. The commencement rate of construction projects was generally low after the holiday.

In Q2, infrastructure investment is expected to grow faster and become a major force stabilizing economic growth. Fiscal investment will expand significantly, providing sufficient funds for project construction. The additional funds from intensified fiscal policies are estimated to drive the GDP growth up by about 1.6 percentage points in 2024. While boosting the development of new quality productive forces, infrastructure investment is experiencing a structural change. In key provinces (autonomous regions and municipalities directly under the State Council) where debts are to be eased, the growth of infrastructure investment has remarkedly slowed down in recent years, expected to bottom out and stabilize in 2024 given a low base for comparison. Developing new-type infrastructures aligned with the development of new quality productive forces will also be a source of increase.

2. The downward trend of the real estate market is expected to moderate, but the restoration of market confidence will take time

In Q1, despite increased policy support on both supply and demand sides, the real estate market continued the downward trend. First, market sales declined

faster, resulting in mounting destocking pressure. In the first three months of 2024, new home sales areas and amounts fell by 19.4% and 27.6% respectively year-on-year. Market expectation and confidence remained weak, combined with insufficient purchasing power, leading to a strong wait-and-see sentiment in the market. Commercial housing areas for sale expanded significantly, hitting a new high in history. The downward sales trend is gradually spreading from central and western cities to eastern cities, further weighing on the real estate market on the sales side.

Second, most indicators on the supply side moved further downward as they were dampened by confidence and fund supply. In the first three months of 2024, real estate developers reported a year-on-year drop of 26%, 27.8% and 20.7% in the funds in place, areas of newly commenced housing projects and areas of completed housing projects, and the drop was respectively 17, 8.6 and 35.4 percentage points bigger year-on-year. But thanks to the fund support from the "three major projects" (construction of government-subsidized housing, renovation of urban villages, and building of public infrastructure for both normal and emergency use), investment in real estate development slightly outperformed other indicators. In the first three months of 2024, investment in real estate development fell by 9.5% year-on-year, and the decline was 3.7 percentage points bigger year-on-year, but significantly smaller than the other indicators in the real estate sector.

In Q2, policy support for real estate will be ramped up, likely to ease the sliding trend in the market. First, the mechanism for coordinating real estate financing will further unleash its role, boosting industrial liquidity and confidence. The *2024 Report on the Work of the Government* once again called for "equal support for the reasonable financing demand of real estate developers of different ownerships". Going forward, the mechanism for coordinating real estate financing will be further implemented, while the projects on the "white list" will be financed at a faster pace, expected to help real estate developers improve liquidity. Second, the "three major projects" will be sped up, likely to boost the investment in real estate development. Third, the demand-side policies will be further relaxed, pushing market demand to stabilize. It's estimated that housing purchase restrictions will be further loosened across the country, expected to ease the slide in market demand. But we should be aware that the restoration of market confidence and expectation and industrial stabilization will take time, and the adjustment of the real estate industry will persist for some time.

I.4 Unlocked consumption potential and intensified pro-growth policies will keep commodity prices stable

Since the start of 2024, **commodity prices have been kept at a low level.** In the first quarter of 2024, CPI and PPI rose by 0% and fell by 2.7%, respectively, both at relatively low levels in history. New Year's Day and Spring Festival holidays spurred consumer demand, driving food and service prices upward and pushing year-on-year CPI change from -0.8% in January up to 0.7% in February. Noteworthily, the year-on-year rise of CPI in February was somewhat a result of the low base in the same period of last year, when the Spring Festival was over. The recovery of consumer prices was not sustained. After the Spring Festival of 2024, prices of pork, tourist services, among others, declined significantly.

In Q2, China's commodity prices will pick up gradually. First, the pressure on pork destocking will persist, but the drag of pork prices on CPI will weaken year-on-year given the lower base for comparison. In the short run, China's pork production capacity will still be higher than demanded, and pork prices are expected to be kept at the current low level. In the long run, China has established the mechanism for adjusting pork production capacity, which will lead to milder cyclic fluctuations of pork prices in the future. It's estimated that the year-on-year decline of pork prices in Q2 will gradually narrow, playing a weaker role in lowering CPI. **Second, the potential of consumer demand for services will be further unlocked,**

and the trade-in of old consumer goods will spur traditional consumption, likely leading to a continued recovery in core CPI. In 2023, the per capita spending of Chinese residents on education, culture and entertainment was still about 6.2% lower than the pre-pandemic level. Going ahead, improvements in residential income and expectation will drive the further pickup of service consumption, thus elevating service prices. The trade-in policy is expected to release the consumer demand for traditional items like automobiles and home appliances, pushing up the prices of transport means and home appliances. **Third, properly intensified fiscal policies will boost demand for manufactured goods.** As more fiscal funds are in place, the implementation of construction projects and the expansion of manufacturing capacity will fuel demand across industries, and the year-on-year PPI decline is expected to narrow. **Fourth, the price rise of crude oil and other commodities will see limited upside.** With the increase of crude oil production in non-OPEC+ countries, global supply of crude oil will be relatively loose. Given the slowed momentum of economic growth worldwide, the demand for crude oil is not likely to expand significantly. Global geopolitical tension will persist, leading to soaring international transport costs. So, attention should be paid to the imported inflation factors like rising prices of commodities like energy and grain caused by increasing transport cost. It's estimated that CPI and PPI will respectively fall by 0.1% and 1.1% year-on-year in Q2.

II. 2024Q1 Financial Review and Q2 Outlook

2024 is a crucial year for the realization of the objectives set in the 14th Five-Year Plan, as well as the first year when China starts to build itself into a financial powerhouse. In 2024Q1, the financial industry stepped up efforts to consolidate the good momentum of economic recovery, with financial regulation further enhanced and the financial market operating as solidly as ever. Monetary policies put equal emphasis on economic aggregate and structure, with the deposit reserve ratio and interest rate cut successively to increase support for real economy. Measures targeting real estate developers were rolled out to meet their reasonable demands for funds. Operating property-backed loans were well managed and payment service was more accessible for foreigners visiting China. Cross-Border Wealth Management Connect 2.0 was officially launched, while over-the-counter bond trading was further relaxed, indicating the further acceleration of financial reform and opening-up. Regulators effectively guided expectation to boost market confidence. RMB exchange rates move reasonably and stock prices stop falling and recover. In 2024Q2, as required by the *2024 Report on the Work of the Government*, the financial industry will make continued efforts to support real economy. According to estimates, major financial indicators will maintain a medium-to-high growth rate; corporate financing costs will decline steadily; RMB exchange rates will stabilize and pick up; issuance of major types of securities will maintain fast growth, and A-shares will see more structural opportunities.

II.1 Due to the financing demand recovery from real economy and policy tailwinds, major financial indicators will maintain a medium-to-high growth rate

In 2024Q1, China's economy was off to a good start, and financial support kept steady. In the first two months of 2024, aggregate financing to the real economy increased by RMB8.06 trillion, and the growth fell by RMB1.1 trillion year-on-year. **First, the increase of RMB loans was smaller year-on-year.** In the first two months of 2024, the growth of RMB loans decreased by RMB929.8 billion year-on-year, including RMB838.5 billion decrease in February. **Second, bond financing diverged to some extent.** In the first two months of 2024, net financing through corporate bonds totaled RMB659.2 billion, and the increase was RMB129.3 billion more than that of the same period of last year. Increasing issuance of corporate bonds is mainly due to improved corporate willingness to issue bonds as the celebration of the Spring Festival at a time later than last year and the liquidity released from the cuts in the deposit reserve ratio. Net financing through government bonds totaled RMB895.8 billion, and the increase contracted by RMB332 billion year-on-year. The contraction was mainly due to the high base of the previous year. **Third, equity financing grew at a slower pace.** In the first two months of 2024, through the issuance of stocks rasied RMB53.6 billion, and the increase was RMB99.9 billion less year-on-year. Since the start of 2024, to boost the stock market, IPO has slowed down, resulting in decreasing amounts of funds raised through corporate stocks. **Fourth, the increase of off-balance sheet financing dropped year-on-year.** In the first two months of 2024, off-balance sheet financing (trust loans, entrusted loans and undiscounted banker's acceptance bills) recorded a year-on-year decrease of RMB68.4 billion in the growth, but trust loans saw a year-on-year increase of RMB129.9 billion in the growth. Recently, trust loans have maintained the momentum of faster growth, providing a stronger support for real economy.

The credit granting structure continued to optimize. **First, the expansion of credit in main areas maintained fast growth.** As at the end of 2023, the growth of outstanding loans to micro and small-sized businesses, green, industrial and agriculture-related sectors was 23.5%, 36.5%, 28% and 14.9%, respectively, remarkedly higher than the growth of all outstanding loans (10.6%). In particular, the growth of outstanding inclusive loans to micro and small-sized businesses has been kept above 20% for several years in a row. **Second, the increase of medium and long-term enterprise loans no longer declined.** In February, the growth of medium and long-term enterprise loans increased by RMB180 billion, ending the momentum of continuous year-on-year decreases in growth since 2023Q3.

In Q2, driven by tailwinds like enhanced economic policies and recovering expectation, the internal momentum of economic growth is poised for further restoration, which will boost corporate and residential confidence and help improve financial data. **First, aggregate financing will steadily grow.** The *Report on the*

Work of the Government underscored efforts to align the aggregate financing to the real economy and money supply with the expected targets of economic growth and price levels. On one hand, funding support will be needed to accelerate the issuance of super-long-term special CGBs and local government bonds. On the other hand, the intensity of fund supply should be based on the demand of real economy and changes in commodity prices, to effectively meet the expected targets. It's estimated that money and credit supply will maintain fast growth in Q2. **Second, the financial support for key areas and weak links of the economy will be kept at a high level.** The *Report on the Work of the Government* called for greater support for major strategies, key areas and weak links of the economy. With the further implementation of key strategies like scientific and technological innovation, green development and rural revitalization, technology finance, green finance, inclusive finance, pension finance and digital finance will remain the focuses of policy support and financial institutions, and credit growth is expected to maintain a two-digit growth or above. **Third, the pace of credit granting will be more steady.** The *Monetary Policy Execution Report in 2023Q4* noted, financial institutions should be guided to properly smoothen the fluctuations of credit supply across months, and maintain the proper aggregate and steady pace of credit supply. It's expected that the pace of credit granting will be smoother in Q2, with a stronger focus on the efficiency of fund utilization, and phenomena like increasing loans at critical times to fulfill tasks will be reduced to some extent.

II.2 Liquidity will remain reasonably sufficient, and corporate financing cost will decline steadily

In Q1, interest rates showed the following characteristics. First, policy rates remained unchanged. The 7-day reverse repo rate was kept at 1.8%, and the 1-year MLF rate 2.5%, both the same as the levels in 2023Q4. Second, money market rates converged to policy rates. In 2023Q4, the short-term money market experienced tighter liquidity. For example, DR007, a major market rate, was about 15 bps higher than the 7-day reverse repo rate of the same term per day on average. In 2024Q1, liquidity was reasonably sufficient, and market rates moved towards policy rates. Third, LPR was lowered asymmetrically. In 2024Q1, One-year LPR was 3.45%, unchanged quarter-on-quarter. Five-year LPR was lowered from 4.2% to 3.95%. Keeping One-year LPR unchanged while cutting five-year LPR is rare in history and beyond market expectation, possibly related to the further bottoming-out of the real estate market since the start of 2024.

In Q2, China's interest rates will present the following characteristics. **First, the cost of aggregate financing to real economy will move slightly downward.** According to the *2024 Report on the Work of the Government*, "we should work for a steady decline in overall financing costs", and "improve city-specific policies on real estate regulation, lower housing mortgage costs, and ensure the delivery of housing projects". Currently, as CPI and PPI growths are still at low levels, commodity prices will have weaker impact on monetary policies. Driven by flexible, moderate, precise and effective monetary policies, corporate financing cost will be kept at a historically low level, and the weighted average interest rates on corporate loans and the interest rates on individual housing loans are both likely to be reduced. **Second, bank deposit rates will be lower.** Due to the fast slide of loan rates and the rigidness of deposit rates in recent years, the net interest margin of the banking industry has dropped to the lowest point in history. Given the recent efforts of financial regulators to urge cuts in bank deposit rates and rectify the behavior of attracting deposits through high interest rates, some banks may lower deposit rates in Q2.

II.3 The RMB exchange rate will stabilize and recover on a more solid footing

In 2024Q1, the RMB exchange rate against USD was basically steady, moving narrowly within the reasonable range of 7.1-7.2. So far, the RMB exchange rate against USD hasn't shown any notable sign of appreciation, mainly due to the rebound of the US Dollar Index (DXY) amid the changing expectation for rate cuts by the US Federal Reserve and the widening China-US interest rate spread. Non-US currencies, such as EUR, GBP and JPY, all depreciated against USD. The RMB exchange rate against USD is equally strained, but hasn't shown major depreciation similar to that in October 2023, suggesting the fluctuations of the RMB exchange rate are less subject to the movements of USD and China-US interest rate spread. In addition, in 2024Q1, the CFETS Index rose from 97.42 points at the beginning of the year to 99.44 points at the highest, indicating an upward trend of the RMB exchange rate against the basket of currencies.

In Q2, the RMB exchange rate against USD will be basically steady within a reasonable range. Tailwinds for a recovery is building up. **First, the reshoring of foreign investment will be a strong trend.** As China's stock market further picks up and bond market stays bullish, overseas investors will have growing demands for the financial assets in China, and short-term cross-border funds will maintain the momentum of reshoring. **Second, favorable policies will continue working.** The "Two Sessions" held in March 2024 and the *2024 Report on the Work of the Government* highlighted the need to "expand high-level opening-up" several times, signaling that China will create a better environment to attract foreign investment, and the foreign investment introduced and utilized will be improved in both quantity and quality. The launch of the "Three Connects and Three Facilitations" and Cross-Border Wealth Management Connect 2.0, among other initiatives, will further deepen the connectivity between mainland China's financial market and that of Hong Kong SAR and facilitate cross-border investment, fueling demand of more global investors for RMB-denominated assets. But the recovery of RMB exchange rate against USD still meets headwinds, which particularly include the uncertain pace of monetary policy adjustment by developed economies. Amid the rising energy prices worldwide and the rebounding inflation in the US, market expectation about whether the US Federal Reserve can kickstart rate cuts in June 2024 has been fluctuating.

II.4 CGB yields dipped slightly, and issuance of interest rate bonds is poised for acceleration

In 2024Q1, the bond market showed the following characteristics. **First, CGB yields declined further.** Due to headwinds like loose liquidity, 10-year CGB yields continued the steady downward trend since 2023Q4. **Second, major types of securities varied in issuance.** As of March 27, bond issuance totaled RMB17.01 trillion, up by 7.98% year-on-year. Specifically, boosted by tailwinds like the accelerated issuance of CGBs and the recovering willingness of real economy to raise funds, issuance of CGBs, NCD, commercial bank bonds and corporate bonds totaled RMB2.45 trillion, RMB7.28 trillion, RMB238.3 billion and RMB917.39 billion, respectively, up by 13.9%, 24.3%, 64.9% and 14.9% respectively year-on-year. RMB1.5 trillion of local government bonds were issued, down by 21.1% year-on-year, mainly due to the high base of last year and the stabilizing pace of issuance. **Third, term spreads increased slightly, while credit spreads declined steadily.** Affected by factors like cuts in the deposit reserve ratio, 1-year CGB yield fell fast, and its gap with 10-year CGB yield widened slightly. Boosted by steady economic recovery, market expectation picked up, while credit risks contracted, with the credit spread between the yield on 3-year AAA mid and short-term notes and the yield on the policy financial bonds of the same term narrowing slightly. **Fourth, credit risks continued to moderate.** As of March 27, eight bonds were in default, associated with RMB11.985 billion unpaid, which was less than that of last year (18 bonds in default, associated with RMB15.08 billion). Specifically, seven of these eight bonds were issued by real estate developers, with a total of RMB11.187 billion unpaid.

In Q2, the bond market is expected to show the following characteristics. **First, CGB yields may dip further.** During the Two Sessions, regulators said there was still room for more cuts in the deposit reserve ratio, and liquidity may remain loose. Due to the lack of high-yield assets, investment institutions in the market generally make CGBs a major target of investment. Affected by both factors, CGB yields may see slight declines. **Second, issuance of major types of securities will maintain fast growth.** In Q2, the issuance of super-long-term special CGBs, accelerated issuance of local government bonds and faster implementation of various projects need to be supported by bank funds, which will boost bank demand for supplementing capital. The issuance of CGBs, local government bonds and financial bonds are estimated to fast growth. **Third, term spreads and credit spreads will continue to narrow.** Driven by reasonably sufficient liquidity, the CGB yield curve will go further downward, but the decline of short-term CGB yields will likely slow down, term spreads will narrow slightly and the CGB yield curve will be flatter. **Fourth, bond default in key areas still deserves attention.** In the short run, real estate may not stabilize, and there may be bond defaults in related sectors in Q2.

II.5 As A-shares bottom out and stabilize, green and silver economy related sectors are to see more structural opportunities

In 2024Q1, A-shares slightly recovered after bottoming out at a low level. Shanghai Composite Index showed a V-shaped trajectory, regaining the 3,000-point mark since the end of February. Fueled by tailwinds, both the daily trading volume and amount of A-shares hit new highs in a year, exceeding 100 billion shares and RMB1 trillion, respectively. By March 27, 2024Q1 saw six days with the net purchase amounts of northbound funds surpassing RMB10 billion.

In Q2, A-shares are poised for bumpy recovery, with several sectors to embrace structural opportunities. But the wavy course of economic development, lower-than-expected recovery of the profitability of listed companies and the inverted interest rate spread between China and the US will affect the trends of A-shares to some extent.

First, industries representing new quality productive forces may deliver remarkable performance. The recent release of Sora, a text-to-video generative AI model, has unleashed a new wave of growth across AI-related sectors. In active response to the transforming landscape of the global tech industry, China has planned ahead and rolled out a package of initiatives including the *3-Year Action Plan for "Data Element X (2024-2026)*"; the Two Sessions recently proposed to take "AI +" actions and build digital industry clusters with international competitiveness, boosting expectation for the growth of related sectors like data and computing power.

Second, industries related to technology finance, green finance, inclusive finance, pension finance and digital finance will see structural opportunities. Since the start of 2024, a chain of policies have been implemented, including the first policy about "silver economy" and the *Opinions on Comprehensively Driving the Building of Beautiful China* aimed to promote green development. According to Bloomberg data, worldwide installed PV capacity will grow by 47.5% year-on-year in 2024, and China's newly installed PV capacity will account for 54.7% of the global total. Driven by policy tailwinds and high-speed industrial development, related sectors are expected to perform well.

Third, policy portfolios will help create a better environment and boost investor confidence. Regulators have intensively unveiled policies like the *Opinions about Strictly Controlling Listing Access to Improve the Quality of Listed Companies from the Source (For Trial Implementation)*, which regulate the A-share market from all dimensions including investors, financers, intermediaries and regulators, and underscore the protection of investors' legitimate rights as a major task. Relevant policies further define the responsibilities of intermediaries, such as securities companies and PE institutions, to improve the quality of listed companies. Amid the policy and market adjustments, the industries with high dividends will gain the upper hand.

Fourth, technological innovation will continue to power the pharmaceutical sector. The launch of GLP-1, a diet pill, in 2023 marks polypeptide drugs entered a fast lane, and data-based estimates put the annual growth of the global polypeptide drug market at 6.4% in the coming five years. In February, the National Healthcare Security Administration issued the *Notice on Establishing the Mechanism for the Formation of Initial Prices of Newly Launched Chemical Drugs to Encourage High-Quality Innovation (Draft for Comments)*, aiming to open the pricing rights to innovative drugs and encourage the values of innovative drugs to be reflected through market competition, which is likely motivates innovation by pharmaceutical enterprises.

Table 1: China's Main Economic & Financial Indicators and Forecasts in 2024Q2 (%)

Indicator	2021 (R)	2022 (R)	2023 (R)	2024(F)		
				Q1 (R)	Q2 (F)	Full year (F)
GDP	8.5	3.0	5.2	**5.3**	**5.2**	**5.2**
Industrial value added of enterprises above designated size	9.6	3.6	4.6	**6.1**	**5.5**	**5.7**
Service industry added value	8.5	3.0	5.8	**5.0**	**5.1**	**5.1**
Fixed asset investments (cumulative)	4.9	5.1	3.0	**4.5**	**4.7**	**5.3**
Investment in real estate development (cumulative)	4.4	-10	-9.6	**-9.5**	**-9.7**	**-9.5**
Total retail sales of consumer goods	12.5	-0.2	7.2	**4.7**	**5.5**	**5.5**
Exports (in USD)	29.6	5.6	-4.7	**1.5**	**3.0**	**3.0**
Imports (in USD)	30.1	0.7	-5.5	**1.5**	**2.5**	**2.0**
Consumer price index (CPI)	0.9	2.0	0.2	**0**	**-0.1**	**0.2**
Producer price index (PPI)	8.1	4.1	-3.0	**-2.7**	**-1.1**	**-0.7**
Broad money supply (M2, ending balance)	9.0	11.8	9.7	**8.3**	**8.5**	**8.7**
Aggregate financing to the real economy (stock, ending balance)	10.3	9.6	9.5	**8.7**	**9.0**	**9.2**
1-year MLF (end-of-period)	2.95	2.75	2.5	**2.5**	**2.5**	**2.5**
1-year LPR (end-of-period)	3.80	3.65	3.45	**3.45**	**3.45**	**3.45**
RMB/USD spot exchange rate (end-of-period)	6.37	6.95	7.09	**7.22**	**7.10**	**7.0**

Source: BOC Research Institute

III. Macroeconomic Policy Orientations

III.1 Accelerating the implementation of fiscal policies and improving the quality and efficiency of fund utilization

The fiscal policies should be implemented at a faster pace, to unleash their role in supporting the economy. Issuance of various government bonds should be planned ahead, and relevant policies or guidelines should be released in a timely manner. Approval procedures should be streamlined to improve the efficiency of insurance. **Pre-project examination and post-project assessment and management systems should be in place, to boost the quality and efficiency of fund utilization.** Institutional, standardized and transparent pre-project review and approval standards should be established, while post-project assessment and management measures should be developed and improved, and public participation should be highlighted in the assessment of projects related to people's livelihood. The results of post-project assessment should be made a major reference to the decision-making for future investment projects. **The fiscal income and expenditure structure should be optimized to improve fiscal sustainability.** The fiscal income structure should be optimized by improving the tax system and cancelling unreasonable fees. The tax and fees reduction mechanism should be refined to support the steady recovery of real economy. Budget performance management should be implemented in an all-round way, to unlock the synergetic effects and boost the efficiency of fiscal expenditure.

III.2 Introducing a combination of financial policies and balancing the relationship among stabilizing growth, promoting reform and preventing risks

The growth of the aggregate amount of funds should be kept at a reasonable level to support continued economic recovery. Monetary policy instruments such as reducing the deposit reserve ratio and open market operations should be combined to inject liquidity, keep liquidity reasonably sufficient and provide financial institutions with effective support in the input of funds. **Efforts should be made to fully leverage incremental funds and activate stock funds, and to scale up support for key areas.** The renewal of structural monetary policy instruments should be ensured, and the incentive mechanism should be improved to boost the desire of financial institutions to increase support for technology finance, green finance, inclusive finance, pension finance and digital finance, especially for new quality productive forces, so as to promote the construction of modern industrial systems. **Reserve policies should be formulated to avoid disturbance from the outside world.** Although China will see less external policy pressure, unexpected fluctuations are still likely. The pace of policy adjustment by major overseas central banks should be closely monitored, while macro prudent counter-cyclical management should be intensified, and corresponding instruments should be used as appropriate to respond in advance.

III.3 Further tapping the potential of consumption and investment and stepping up efforts to expand domestic demand

The plan for the new round of trade-in of old consumer goods should be detailed to tap the consumption potential in lower-tier markets. The market environment for services like traveling, concerts and sports events should be further optimized. **Efforts should focus on releasing effective demand for investment** and advancing large-scale equipment renewal projects. Special relending programs can be considered again, to support financial leasing, insurance and other financial institutions in providing diverse financing channels for enterprises. The reserve of infrastructure projects should be vigorously expanded, with the focus on infrastructures like rural charging piles and power grids, public services like healthcare and education, and the renovation of old residential compounds in cities.

III.4 Properly managing the impact of the evolving international economic and trade landscape and promoting the sound operation of foreign trade enterprises

Efforts should be made to assist relevant enterprises in effectively navigating unreasonable trade restrictions overseas. This entails providing forward-looking warnings, tracking, reporting, and publicizing the potential trade barrier risks facing competitive Chinese products, as well as assisting them in addressing the looming trade barriers in an active and appropriate manner. **Efforts should also be made to mitigate the impact of geopolitical risks on China's economy, foreign investment, and foreign trade.** It is crucial to establish an early warning system for global supply chain risks and industrial damages to important resources and products. Furthermore, it is essential to diversify industrial chains and supply chains and to enrich trade adjustment and assistance instruments. **Foreign trade enterprises should be guided to adopt a risk-neutral mindset with regard to exchange rate risks.** The coverage of the policies to facilitate foreign exchange receipt and payment involved in trade should be expanded as fast as possible, while the cycle for confirming cross-border receipt and payment should be shortened, to alleviate the operating pressure on micro, small and medium-sized enterprises, which are major participants in foreign trade.

III.5 Increasing policy support for real estate on both supply and demand sides to mitigate industrial risks at a faster pace

Demand-side policies should be relaxed in an all-round way, to fully unlock the reasonable demand for housing. House purchase incentives, such as subsidies and raising the limits of housing provident fund loans for multi-child families, should be launched faster, to provide certain support for the real estate market. Emerging demand for housing should be seized, while diverse means should be introduced to reduce stock housing. **The "three major projects" should be sped up by ramping up financial support.** The laws, regulations and regulations on the restructuring of property rights, definition of public interests, construction standards and design specifications involved in urban village renovation should be improved. Policy banks should give full play to their leading role in driving the construction of the "three major projects". The mechanism for coordinating real estate financing should be further implemented, and the projects on the "white list" should be financed at a faster pace. Efforts should also be made to defuse the risks associated with real estate. Furthermore, asset management companies should be engaged to dispose of the medium and long-term stock assets of real estate developers.

III.6 Reinforcing the foundation for nurturing new quality productive forces, and accelerating the improvement of the infrastructure, talents, factors and industrial systems to facilitate the development of new quality productive forces

In order to ensure the development of new quality productive forces, infrastructure construction and talent cultivation should be planned in advance to nurture new edges for development. The digital ecosystem adaptive to new quality productive forces should be developed. Efforts should also be made to accelerate the removal of the pain points restricting the integration between digital economy and real economy, and support enterprises in upgrading processes for R&D, production, management, marketing and services through digital and intelligent empowerment. The industrial systems aligned with new quality productive forces should be refined. Traditional industries should be further upgraded through profound restructuring of industrial foundations. "Digital factories" and "lighthouse factories" should be built to facilitate the transition of the manufacturing industry to flexible manufacturing, personalized production, and other emerging industrial paradigms.

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