

ASIA MONTHLY

December 2023

<i>Asia: Lack of Momentum in Asia's Economic Recovery</i>	1
<i>NIEs</i>	5
<i>ASEAN5</i>	6
<i>India</i>	7
<i>China</i>	9



株式
会社

日本総合研究所

<http://www.jri.co.jp/english/periodical/asia/>

This report is the revised English version of the December 2023 issue of the original Japanese version (published 30th Nov.).

This report is intended solely for informational purposes and should not be interpreted as an inducement to trade in any way. All information in this report is provided "as is", with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, express or implied, including, but not limited to warranties of performance, merchantability and fitness for a particular purpose. In no event will JRI, its officers or employees and its interviewee be liable to you or anyone else for any decision made or action taken in reliance on the information in this report or for any damages, even if we are advised of the possibility of such damages. JRI reserves the right to suspend operation of, or change the contents of, the report at any time without prior notification. JRI is not obliged to alter or update the information in the report, including without limitation any projection or other forward looking statement contained therein.

Asia: Lack of Momentum in Asia's Economic Recovery

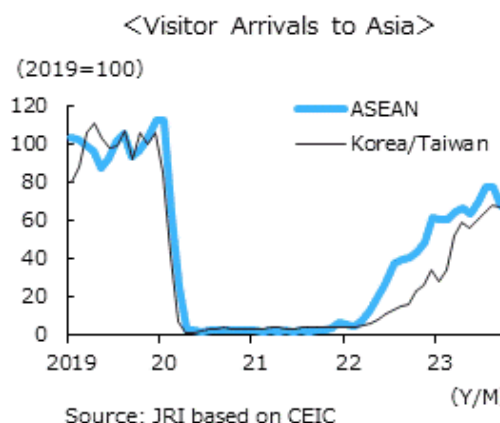
Asian economies will continue to recover in 2024, but the recovery will lose momentum due to headwinds from the slowdown of the Chinese economy, high interest rates, and soaring inflation. The recovery could even stall if the China's real estate crisis deepens and supply chain disruptions reemerge.

1. Economic recovery continues, but the Chinese economy's slowdown, high interest rates, and soaring inflation create headwinds.

(1) The economy of each Asian country/region in 2023 differs depending on export dependence

In 2023, the economies of Asian countries and regions generally rebounded, but the pace of recovery varied widely across countries and regions. Economies heavily reliant on exports continued to face challenges due to the global downturn in demand for goods. Recently, there have been positive signs in the exports of South Korea, Taiwan, and Vietnam, driven by increasing demand for new technologies like AI and progress in inventory adjustments for IT-related products. However, the strength to fully recover from the previous declines is not evident.

In contrast to goods, demand for services remained firm, and the number of tourists from abroad, which began to increase last year, maintained its upward trend in 2023. The resulting increase in employment contributed significantly to the recovery of domestic demand in Asian countries and regions.



The growth rate for Asia as a whole is likely be +5.1% YoY, up from +4.3% YoY in 2022, but revised slightly downward from the previous forecast (forecast as of July 2023: +5.3% YoY). The growth rates for Taiwan and Vietnam, both highly dependent on goods exports, likely stand at +1.1% YoY (+1.8% YoY) and +5.1% YoY (+6.2% YoY), respectively, revised downward from the July 2023 forecast. Despite expectations of a significant rebound following the lifting of the zero-COVID policy at the end of last year, China has experienced sluggish growth, with the forecast for the country remaining at +5.3% YoY (+5.6% YoY). Meanwhile, Indonesia and India are recovering robustly, as expected, with growth rates of +5.0% YoY (+4.9% YoY) and +6.3% YoY (+6.3% YoY), supported by the recovery of domestic demand, respectively.

<Asia Economic Forecasts>

		(%)			
	2022	2023 F	2024 F	2025 F	
Asia	4.3	5.1	4.8	4.8	
Northeast Asia	2.8	4.7	4.1	4.1	
China	3.0	5.3	4.4	4.4	
Korea	2.6	1.3	2.0	2.3	
Taiwan	2.4	1.1	2.2	2.4	
Hong Kong	-3.5	3.3	2.7	2.7	
ASEAN 5	6.0	4.6	4.9	5.2	
Indonesia	5.3	5.0	4.8	5.2	
Malaysia	8.7	4.2	4.4	4.6	
Philippines	7.6	5.4	5.6	6.1	
Thailand	2.6	2.5	3.6	3.2	
Vietnam	8.0	5.1	6.7	6.8	
India (FY)	7.2	6.3	6.7	6.5	

Source: JRI based on various statistics

(2) Three factors will weigh on the economy in 2024

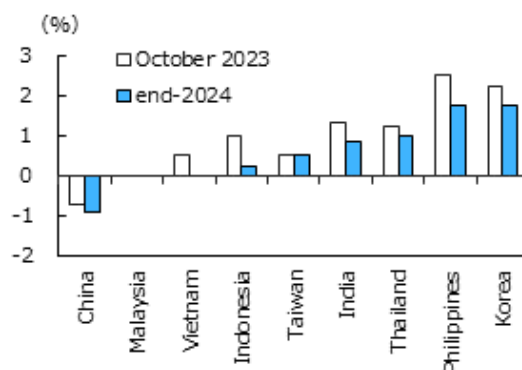
We expect the growth rate of the Asian economy as a whole to be +4.8% YoY in 2024, a slowdown from 2023 reflecting the sluggish growth rate of China (+4.4% YoY in 2024). While the NIEs and ASEAN-5 growth is expected to accelerate from the previous year to +2.1% YoY and +4.9% YoY, respectively, they will remain below their pre-COVID average (2017-19 average: +2.7% YoY and +5.3% YoY, respectively). On the other hand, India will likely grow at a stable rate of +6.7% YoY, exceeding the pre-COVID growth rate (+5.7% YoY). Overall growth in Asia will remain sluggish, with the following three factors contributing to the downward pressure on the economy.

First, the Chinese economy is facing a slowdown. While goods exports have managed to recover from its worst phase, a broad-based economic recovery appears elusive. Moreover, the worsening real estate downturn in China could dampen domestic demand, potentially putting downward pressure on the export of goods and services in Asia. Although global demand for IT-related products is expected to contribute to export growth, notably in South Korea, Taiwan, and Vietnam, these regions rely heavily on China, which is likely to offset the positive impact of such a recovery. Additionally, although the number of Chinese tourists visiting Asian countries and regions is gradually increasing, approaching pre-pandemic levels, the weaker RMB and deteriorating income conditions are unlikely to support robust local spending, as seen in the past. Consequently, the inbound tourism demand, driving the economy in 2023, will likely plateau.

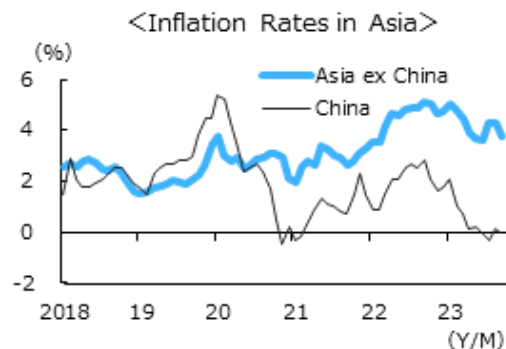
Second, interest rates will remain high. In Asia, many central banks have continuously followed the U.S. in raising policy rates. While we expect the U.S. to cut rates by 0.75% during 2024 and Asian countries will likely follow suit, the degree of interest rate cuts will vary by country and region, and policy rates may not return to their pre-COVID levels in many countries and regions. In particular, South Korea and the Philippines will keep policy rates at high levels amid concerns about inflation, and the tight financial conditions will likely weigh down their economies.

Third, inflation rates will remain elevated. While deflation poses a concern in China, other Asian countries and regions remain wary of inflation. Since the beginning of 2023, inflation has declined but has gradually plateaued, and is rising again in some countries. Currently, resource prices, especially energy, are rising, and the deteriorating situation in Israel and Palestine following the Russia-Ukraine crisis could further push up resource prices. In addition, climate problems, such as the onset of the El Niño phenomenon, could cause food market prices to soar.

<Forecasts for Policy Rates>
(Differences from the levels of end-2019)



Source: JRI based on CEIC



Source: JRI based on CEIC

Note: Asia ex China is a simple average of Taiwan, Korea, ASEAN5 and India.

2. Risks include China's real estate crisis and the recurrence of supply chain disruptions

In contrast to the main scenario of a moderate economic recovery in 2024, the risks include a significant deterioration in China's financial and economic situation triggered by worsening conditions in the real estate market, and a disruption in global supply chains resulting from an escalation of the U.S.-China confrontation.

(1) The deterioration of China's real estate market is a concern

China's real estate market, overheated for a long time due to aggressive housing construction, has

recently cooled off sharply, and housing inventories have accumulated significantly, especially in rural areas. With a declining population, demand for real estate, primarily residential housing, is unlikely to turn around autonomously. Reportedly, the government is planning to allocate RMB 1 trillion of funds at a low interest rate to urban redevelopment projects, and the People's Bank of China (PBoC) plans to use its pledged supplementary lending (PSL), also known as China's version of quantitative easing, to stimulate demand. In the past, measures to stimulate housing demand repeatedly took place, and the PSL's measures to support the redevelopment of poor neighborhoods from 2015 to 2018 enormously boosted the real estate market. This time, however, the scale of the policy will be smaller because the area covered by the support is limited, and the policy will likely be less effective than before. Government measures to stimulate demand appear to have reached their limits, and there is no practical way to deal with the deteriorating real estate market.

If the real estate market deteriorates for a prolonged period, the management of financial institutions and the finances of local governments may suffer, potentially sparking instability in the financial system. The non-performing loan (NPL) ratio of banks remained low at 1.6% as of September 2023, but this is because banks dispose of RMB 3 trillion of NPLs (selling loans to asset management companies (AMCs)) every year. The actual situation for banks appears challenging. The Chinese government seems keen to avert financial turmoil over NPLs by allowing large banks to take over small and medium-sized banks, thereby preventing the NPLs from escalating into a social problem such as a run on bank deposits. That said, the number of NPLs, particularly loans to the real estate industry, is increasing rapidly. If this situation continues, more financial institutions may face financial crises due to their losses, making it difficult to prevent turmoil.

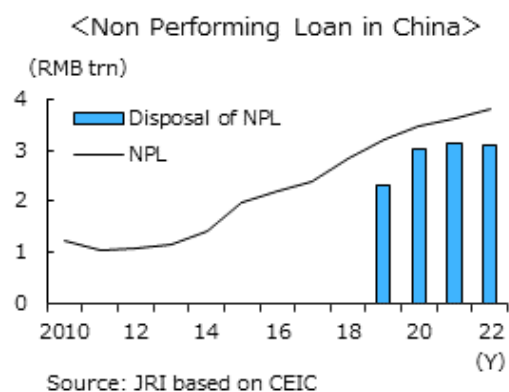
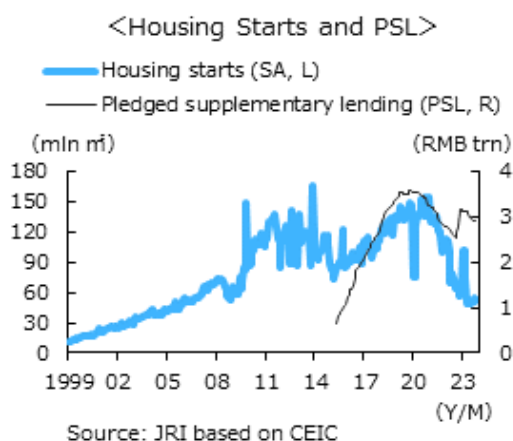
In addition, local governments have been using the sale of land as an essential source of income but have suffered declining revenues against the backdrop of the deteriorating real estate market. Investment companies established by local governments, "Local Government Financing Vehicles (LGFVs)," also carry a large amount of debt, raising concerns about the risk of bankruptcy. The debt of LGFVs stands as a "hidden debt" of local governments, and there are concerns that a simultaneous decline in land revenues and a funding impasse for LGFVs could put significant pressure on local government finances.

If the management of corporations and financial institutions closely linked to the real estate market or the finances of local governments deteriorate, the Chinese economy could suffer a severe blow from the deterioration of financial intermediation functions and financial market turmoil.

(2) Risk of disruptions in the supply chain fueling inflation

Since 2020, global supply chains for various goods have stagnated due to disruptions in trade on the back of lockdowns in the wake of the COVID pandemic and Russia's invasion of Ukraine. Such dysfunction of supply chains has made people worldwide aware of the importance of economic security. In particular, Western countries have become keenly aware of the need to "decouple" and to "de-risk" from the Chinese economy. Both governments and businesses are working together to reconstruct supply chains. However, the momentum for restructuring has caused friction between Western countries and China, and certain developments could reignite turmoil in supply chains that had recently settled down.

In fact, the U.S. and other Western countries are restricting trade in products, such as semiconductors,



with China. China has tightened export controls on gallium and germanium, critical minerals indispensable for manufacturing electronic components, including semiconductors, in response since August 2023. In addition, China tightened export controls on rare earths used in motor magnets in October and graphite used in batteries in December. Currently, the Chinese government is confining its countermeasures against Western countries only to export controls. Still, if the conflict intensifies further, China may strategically use its overwhelming share of the world's critical minerals by imposing embargoes, which could significantly harm the world's manufacturing industry.

Demand for critical minerals used in digitalization and the transition to clean energy is growing worldwide. Western countries recognize the danger of their heavy dependence on China, aiming to restructure their supply chains for critical minerals by providing strong policy support to mitigate their dependence on China.

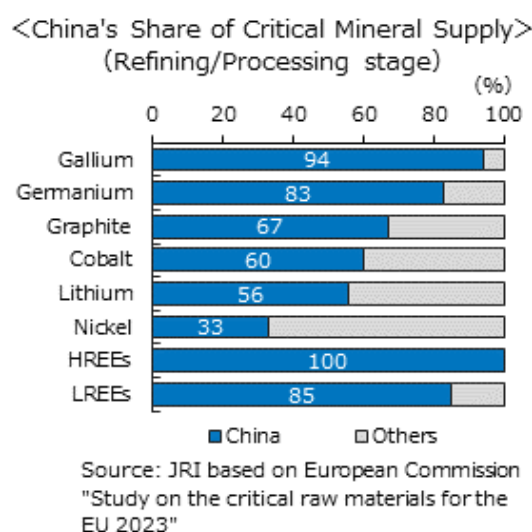
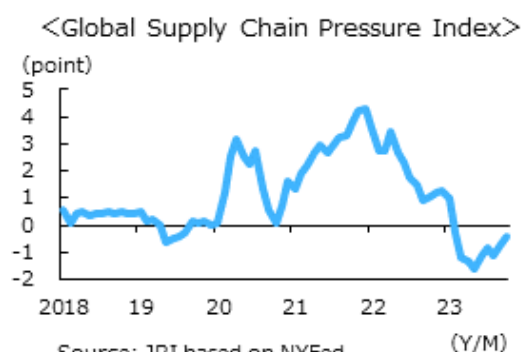
Japan launched its "policy for initiatives to ensure stable supplies of critical minerals" in January 2023, outlining specific initiatives, including financial support for development in this field. Based on this policy, a total of 215.8 billion yen was allocated in this financial year's budget for (1) investment projects by the Japan Organization for Metals and Energy Security (JOGMEC) and (2) mineral resource-related subsidy projects based on the Economic Security Promotion Act.

The U.S. granted funding to projects to increase domestic battery production for EVs under the "Infrastructure Investment and Jobs Act," enacted in November 2021. In addition, in April 2022, the U.S. government launched an initiative to increase domestic production of critical minerals based on the "Defense Production Act." Furthermore, the "Inflation Reduction Act" passed in August 2022 removed EVs with batteries including critical minerals of Chinese origin from the subsidy list and provided tax breaks for producing critical minerals in the U.S.

In March 2023, the EU released the "European Critical Raw Materials Act" with the goal of processing at least 40% of the annual consumption of critical minerals in the region and mining 10% of them by 2030. Specific actions to achieve the goal include simplifying business licensing procedures, with the possibility of contributing subsidies as well.

That said, China's dominance in the critical minerals sector, in which it maintains an overwhelming share, could easily remain unchanged. Western countries will have to provide substantial financial support to move away from China. Even if a rebuilding were to take place, the cost sourcing from non-Chinese supply sources would be high and could structurally raise prices. If global high inflation persists, Asian countries and regions will find it more difficult to cut interest rates, while pressure to depreciate currencies will increase. It is important to note that a resurgence of disruptions in the supply chain could lead to imported inflation and derail the recovery scenario for the Asian economy.

(Minoru Nogimori)



NIEs Semiconductor market recovers, yet the economy is still limping

■ South Korea's and Taiwan's growth to decelerate in 2023, Hong Kong to gain ground

The real GDP growth rate of the NIEs (South Korea, Taiwan, and Hong Kong) in 2023 will be +1.5% YoY, slowing from +1.9% YoY in 2022. While Hong Kong experiences a rebound from negative growth, South Korea and Taiwan will see their growth rates decline. Hong Kong's recovery reflects a sharp rebound in consumption and inbound tourism demand in the first half of the year thanks to the termination of Mainland China's zero-COVID policy and the Hong Kong government's travel support measures. The lackluster economies in South Korea and Taiwan owed much to the sluggish semiconductor market in the first half of the year, along with a slowdown in the Chinese economy, the largest trade partner for the NIEs.

<NIEs Growth Rate Forecasts>

	2020	2021	2022	2023 F	2024 F	2025 F
NIEs	-0.0	5.3	1.9	1.5	2.1	2.4
South Korea	-0.7	4.3	2.6	1.3	2.0	2.3
Taiwan	3.4	6.5	2.4	1.1	2.2	2.4
Hong Kong	-6.5	6.4	-3.5	3.3	2.7	2.7

Sources: Prepared by JRI based on data from national statistical bureaus, central banks, and the IMF

■ Economy to pick up in 2024

The real GDP growth rate for the NIEs in 2024 is expected to increase from the previous year to +2.1% YoY. Still, this is below the average growth rate before the COVID pandemic, and the economy will not fully recover until 2025 or later.

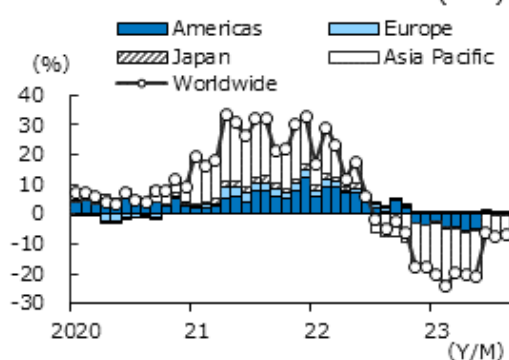
Goods exports, which have been a drag on the economy, will likely bottom out in the future. A recovery in exports of IT-related products will be the main factor as the semiconductor industry enters a recovery phase. Global semiconductor sales bottomed out at the beginning of 2023, with the year-on-year drop in sales narrowing. Sales will likely turn upward from the beginning of the new year amid the global electrification of automobiles and rising demand for generative AI and data centers.

Meanwhile, the following two aspects will weigh down the economy in the coming year. The first is the sluggish growth of inbound tourism demand. South Korea and Taiwan have experienced a recovery in the number of tourists from regions other than China, but Chinese tourist numbers will remain subdued for the foreseeable future. Second, continued high interest rates will depress domestic demand. In South Korea and Taiwan, inflation is accelerating again due to high resource prices and a weak currency. In addition to a decline in the real purchasing power of households, which will suppress personal consumption, the central banks will continue to tighten monetary policy for the time being, curbing capital and housing investment.

Heightened geopolitical risks in the countries and regions of the NIEs also require close monitoring. South Korea is increasingly at odds with North Korea, which is rapidly drawing closer to Russia politically and has made clear its aggressive stance toward the Western powers. Taiwan stands between the Chinese government, aiming for unification, and the U.S., seeking to draw Taiwan into the Western camp. Meanwhile, Hong Kong faces concerns that the Chinese government will tighten regulations, and foreign-owned companies and financial institutions continue exiting the territory. None of these moves is likely to have serious consequences immediately. Still, the risks remain that companies and investors may become less interested in investing in the NIEs amid concerns over lingering problems in the region.

(Wu Zijing)

<Total Semiconductor Revenues (YoY)>



Sources: Prepared by JRI based on data from WSTS

ASEAN-5 *Economic recovery to continue, yet to lack momentum*

■ Growth rate to remain more or less flat in 2024

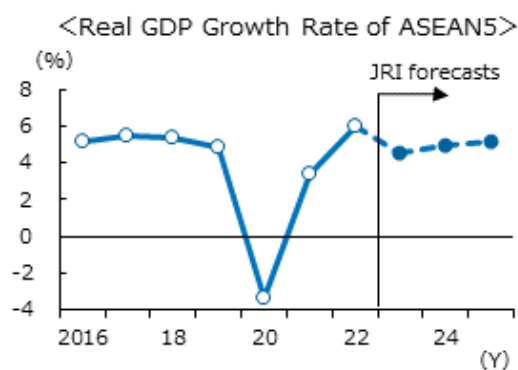
The real GDP growth rate of the ASEAN-5 (Indonesia, Malaysia, the Philippines, Thailand, and Vietnam) in 2023 will decelerate to +4.6% YoY from +6.0% YoY in 2022. The majority of this deceleration reflects the global slump in demand for goods, especially for Vietnam and Malaysia, countries that rely heavily on exports of goods.

Meanwhile, loosening COVID-19-related entry restrictions has led to a recovery in services exports in these countries. In ASEAN, the service sector represents a large share of employment, and the recovery of inbound tourism demand contributed to an improvement in the employment environment and boosted domestic demand. The Indonesian economy benefited particularly from the enormous weight of domestic demand, reaching a growth rate comparable to the pre-COVID days.

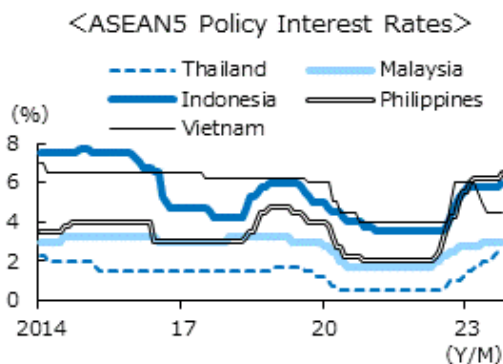
The ASEAN economy in 2024 is expected to be lackluster overall due to the downward pressure on domestic and foreign demand, even though it will be still in the recovery phase. The real GDP of the ASEAN-5 will likely grow +4.9% YoY in 2024, falling below the pre-COVID average growth rate of +5.3% YoY (2017-2019). Regarding foreign demand, a lull in the recovery of services exports seems likely and the pace of export recovery will be moderate due to the slowdown of the global economy, although goods exports have bottomed out due to progress in inventory adjustment of IT-related products. More individually, the sluggish Chinese economy may significantly impact the Vietnamese economy, as it is highly dependent on its trade with China. At the same time, a slowdown in mineral fuel exports resulting from the global economic slowdown is likely to put downward pressure on Indonesian and Malaysian exports.

Regarding domestic demand, rising inflation and high interest rates will put downward pressure on consumption and investment. Inflation will remain high due to upward pressure on food prices caused by irregular climate conditions resulting from the El Niño phenomenon and surging energy prices caused by the deterioration of the situation in the Middle East. Furthermore, many central banks in Asia have sequentially raised their policy rates following the U.S. In 2024, the U.S. will turn to monetary easing, with Asian central banks likely to follow suit. Still, the pace of interest rate cuts will probably be slow amid fears that inflation will re-accelerate, and then the financial environment will remain relatively tight for a prolonged period.

Moreover, a lingering tight monetary policy in the U.S. could pose a downside risk to the economy. If the U.S. does not lower its policy rate and interest rates stay high, ASEAN countries will likely see a resurgence of imported inflation through currency depreciation. In such a case, the central banks of each country face the possibility of needing further interest rate hikes to defend their currencies, putting significant downward pressure on domestic demand.



Source: Prepared by JRI based on statistics from each country



Source: Prepared by JRI based on data from CEIC

Note: As of October 31, 2023. Figures for Vietnam are refinancing rates.

(Tomoki Kumazawa)

India Stable growth continues, yet at risk of rekindling inflation

■ Economy to remain firm in FY2023 following the suspension of interest rate hikes

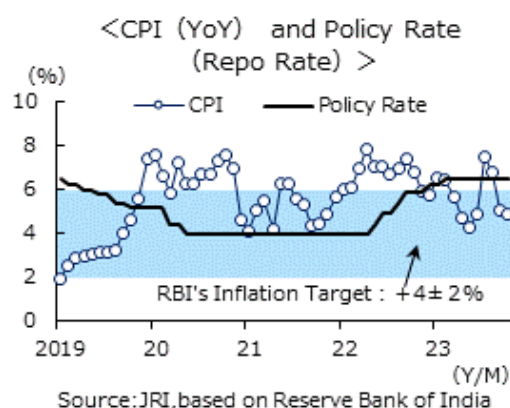
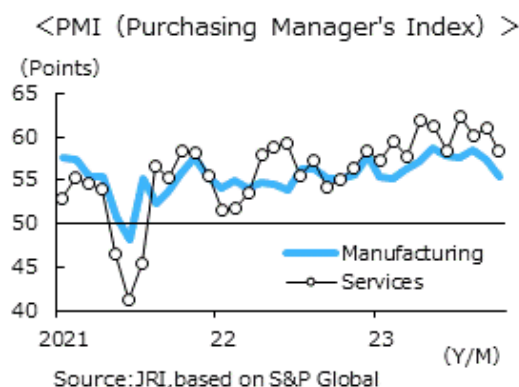
India has emerged from the turmoil of the COVID pandemic to normalize economic activity, and its economy in FY2023 (April 2023 to March 2024) has been solid, with the country's PMI (Purchasing Managers' Index) consistently staying above the 50-point mark, the threshold for economic confidence, and the SENSEX index, a leading stock index, reaching record highs several times in the early autumn of 2023.

The reasons for the resilience of the Indian economy despite the slowdown of the global economy include that the Indian economy is primarily domestic demand-driven and that the government has taken various measures to curb inflation.

The Indian government, in response to rising energy prices triggered by the ongoing Ukraine crisis, has expanded imports of inexpensive Russian crude oil and cut fuel taxes. Consequently, the import ratio of crude oil from Russia has risen from 2% in 2021 to just under 40% at the current time. In addition, responding to soaring food prices in the wake of extreme weather, the government sought to stabilize domestic supply by (1) banning the export of white rice (non-basmati rice), (2) introducing a 40% export tariff on onions, and (3) releasing government stockpiles. Such government initiatives proved successful, and the inflation rate broadly remains within the Reserve Bank of India's target range.

In addition, the suspension of interest rate hikes by the Reserve Bank of India also contributed to supporting the economy. Since May 2022, the Reserve Bank of India has implemented interest rate increases at six consecutive meetings to stabilize the exchange rate and prices. However, in the face of the collapse of medium-sized U.S. banks and concerns about financial instability among major European banks, the Reserve Bank of India, wary of the adverse effects of rapid financial tightening on the financial system, has kept its policy rate unchanged since February 2023.

The outlook for the second half of FY2023 shows that economic expansion may gradually wane as pent-up demand accumulated from the COVID pandemic gradually diminishes. At the same time, consumption will continue to drive firm growth. Real GDP growth in FY2023 will be +6.3% YoY, slightly lower than the previous fiscal year but still the highest among the major Asian emerging economies. An increase in fiscal spending ahead of the general election of the lower house scheduled for the first half of 2024 may further boost the growth rate.



■ Stable growth will continue in FY2024

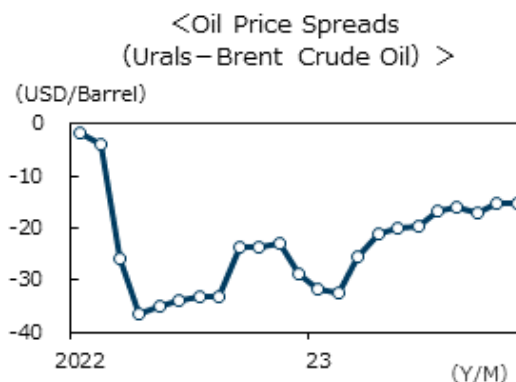
In FY2024, the U.S. will likely start cutting interest rates, reducing inflationary pressures driven by a weakening rupee. In response, the Reserve Bank of India is also expected to implement interest rate cuts, with real GDP growth projected to rise to +6.7% YoY, driven by the increasing consumption of durable goods and capital and housing investment. However, caution is needed regarding the risk of a resurgence in inflation, particularly in the energy and food sectors, which could exert downward pressure on the economy.

Regarding energy prices, heightened geopolitical risks in Ukraine and the Middle East raise concerns about potential supply disruptions and price spikes in mineral fuels, including crude oil. Additionally, the price difference between the U.K.'s Brent crude oil and Russia's Urals oil has narrowed to less than \$20 per barrel, diminishing the inflation-suppressing benefits of crude oil imports from Russia. Furthermore, the possibility of the El Niño phenomenon persisting into FY2024 has been suggested, potentially leading to a surge in food prices due to crop failures. In the event of an inflation resurgence, the Reserve Bank of India may implement further monetary tightening, increasing the risk of an economic downturn.

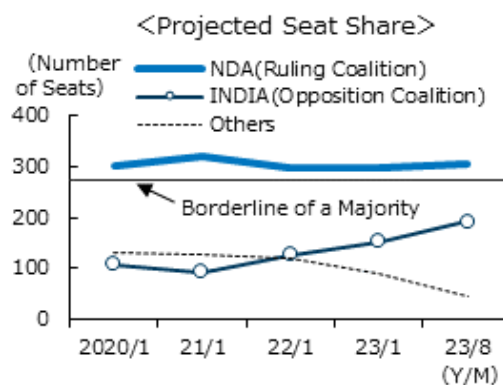
Moreover, the outcome of the general elections to the lower house scheduled for around April or May could also factor into the economy in FY2024. Up to now, most observers believe that the current ruling coalition led by the Bharatiya Janata Party will retain a majority of seats in the lower house due to factors such as the robust economy and the absence of strong opposition candidates and that the Modi administration may enter its third term as a result. Suppose the current government, which emphasizes business-friendly policies, remains in office. In that case, the government will likely expand subsidies for businesses and increase fiscal spending to improve energy and logistics infrastructure toward further improving the business environment. Progress on reforms related to controversial issues such as land expropriation and restrictions on layoffs depends primarily on whether the Bharatiya Janata Party gains a majority of seats in the lower house of parliament by itself or whether the "twisted parliament" ends.

However, considering that Indian elections tend to be "anti-incumbent" and that there are often significant differences between the results and the predictions, regime change may also be possible. There is also the potential for an economic slowdown before the elections, catalyzing expressions of dissatisfaction with the negative aspects of the Modi administration, such as repressive policies towards minority groups and democratic backsliding. In such a scenario, contrary to prevailing expectations, a shift in power to the current opposition coalition, primarily led by the Indian National Congress, that emphasizes policies favorable to households, becomes increasingly likely. This change in government would significantly impact the economy, prompting a revision of the FY2024 budget plan with a focus on (1) expanding subsidies to support the livelihoods of low-income citizens and (2) directing budget allocations toward enhancing public education, vocational training programs, and improvements in the healthcare system. Given considerations for leftist parties within the coalition, the government will likely approach large-scale structural reforms cautiously, mindful of the potential for significant economic and social disruptions.

(Shotaro Kumagai)



Source: JRI, based on NESTE
Note: Spread on the 15 day of each month
(or closest day to that)



Source: JRI, Based on India Today "Mood of the Nation" (2023 August 24th)

China Pace of growth to slow down

■ Growth to slightly exceed the government's target in 2023

China's economy halted its decline that started in the spring of 2023, averting a further downturn. The real GDP growth rate for the July-September quarter accelerated to an annualized rate of +5.3% from the previous quarter, an increase from +2.0% in the April-June quarter.

This growth is mainly due to a recovery in domestic demand, which was boosted successfully by the economic stimulus measures implemented by both the public and private sectors since the middle of the year, including measures to stimulate consumption and monetary easing.

The recovery of consumption stands out among domestic demand. In late July, the government announced measures that include: (1) Tax exemptions for purchasing new energy vehicles, including EVs, (2) Incentives to replace old appliances with smart ones, and (3) The introduction of packages to promote tourism by encouraging off-peak vacations. In August, it also expanded the income tax credit.

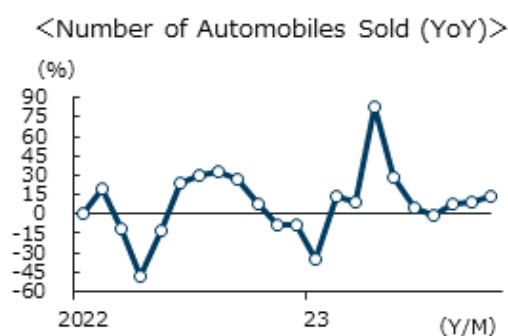
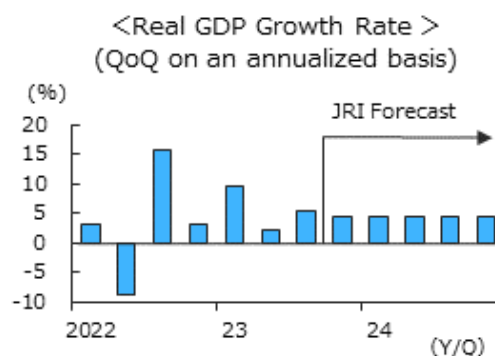
Automobile sales saw the most significant boost from these measures to stimulate consumption. Sales of automobiles have increased YoY for the third consecutive month since August, driven by a series of price cuts by manufacturers and augmented by subsidies provided by local governments. In addition to automobiles, the consumption of home appliances and domestic travel has also seen an uptick.

In the October-December quarter, the economy will likely continue to grow at a higher rate, supported by such measures to stimulate consumption. In addition to boosting consumption, on the fiscal policy front, the government has decided to issue additional government bonds and accelerate issuing local government bonds from the 2024 issuance quota, while on the monetary policy front, the central bank continues to take an accommodative stance. All of these measures should help boost the growth momentum.

However, there are still many uncertainties. In particular, the real estate slump continues to exert downward pressure on the economy. Home sales remain sluggish despite the government's efforts to boost demand in the real estate sector since the end of August, such as lowering mortgage rates and down payment ratios. Real estate developers are also grappling with completing reserved properties and managing existing inventories, leaving them with limited capacity for new developments. As a result, real estate development investment has failed to halt its decline, putting intense downward pressure on the economic growth rate.

In terms of foreign demand, exports have been sluggish since spring, reflecting a global downturn in demand for goods, mainly due to the waning of stay-at-home needs. A breakdown of exports by country and region reveals a significant decline of exports to developed nations such as the U.S., Japan, and the EU. Products, including IT-related devices (such as cell phones and PCs), accounting for 10% of total exports, have experienced widespread declines. Such export weakness will likely continue for the time being.

While the Chinese economy has emerged from its worst phase, persistent economic pressures endure, and the real GDP growth rate for 2023 will be +5.3% YoY, barely exceeding the government's target of "around 5% YoY."



■ Domestic demand losing momentum, leading to an economic slowdown in 2024

The economy will decelerate again from the beginning of the year, with growth expected to remain in the +4% QoQ range on an annualized basis (see the upper right-hand chart on the previous page). The real GDP growth rate for the entire year of 2024 will likely be +4.4% YoY, lower than that of 2023. The following two factors could account for declining growth.

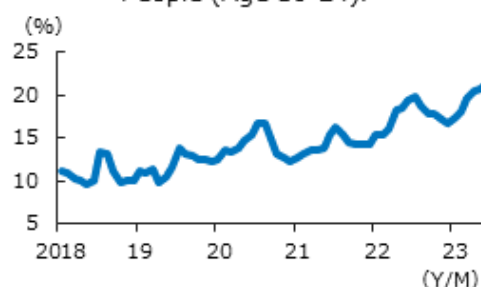
First, the growth-boosting effects of the economic stimulus packages will have worn off. For instance, the government has explained, among other things, the purpose of the additional issuance of government bonds approved in October 2023 that after completing the procurement of RMB 1 trillion by the end of the year, RMB 500 billion out of the amount will finance disaster recovery and related objectives within the year, while the remaining RMB 500 billion will cover expenditures in 2024. In light of this, the current economic stimulus package merely advances government spending for the next year, and there is no assurance that the aggressive policy stance will persist into the following year. Considering that the additional issuance of government bonds is small and that the government has decided to forego an expansion of the municipal bond issuance cap for the current fiscal year, the government seems cautious about aggressive fiscal spending. In November, Pan Gongsheng, governor of the central bank, stated that "China's economy needs to grow at a moderate pace, but high-quality and sustainable development is more important than growth" and that the government will shift from its traditional approach of boosting growth by force by stimulating investment demand with little urgency through excessive monetary easing. Unless the government explicitly emphasizes its commitment to the economy and takes further steps to ease fiscal and monetary policy, the growth rate will likely slow down next year due to a drop in policy factors.

Second, a self-sustaining recovery in domestic and foreign demand has little hope. Weak consumer spending is likely to continue in the first instance. China's employment and income environment has become increasingly challenging since the outbreak of COVID-19. Above all, the youth unemployment rate has risen conspicuously. Growth in per-capita disposable income has also remained at a lower level compared to the pre-pandemic days. As a result, households' propensity to purchase is declining, leaving little prospect for a full-fledged recovery in personal consumption. Indeed, a local research firm (Syntun) reported that transaction volume on "Singles' Day," China's largest online shopping sale, grew at a sluggish 2.1% YoY as consumers remained intensely frugal.

The appetite for capital investment in the private sector continues to wane as well. The government has tightened business regulations since 2021 to prevent IT firms from pursuing excessive profits. It has also promoted industrial policies favoring state-owned enterprises, all of which have led to a retreat in the investment stance of private firms. In July 2023, the government reversed course on its policies with a call for investment in research and development of high-end products through initiatives to (1) correct unfair treatment with state-owned enterprises, (2) eliminate barriers to market entry, and (3) protect the interests of private enterprises and managers. However, companies remain skeptical about these policy changes by the government, and private investment growth remains sluggish.

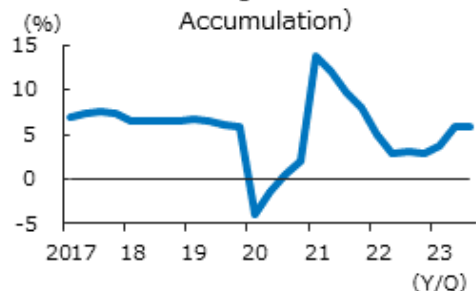
Furthermore, overseas economies will remain lackluster in the foreseeable future, making exports likely to remain sluggish. Indeed, the new export orders index of the manufacturing PMI for October stood at 46.8, falling below the milestone of 50 for the seventh consecutive month.

<Unemployment Rate among Young People (Age 16-24)>



Source: Prepared by JRI based on the National Bureau of Statistics and CEIC

<Disposable Income per Capita>
(YoY Changes, Year-to-date Accumulation)



Source: Prepared by JRI based on the National Bureau of Statistics and CEIC

■ Piles of downside risks to the economy

Moreover, many risks could lead to a downturn in the Chinese economy, three of which deserve particular attention.

First, the real estate recession has turned serious. The government has taken a series of policies to stimulate housing investment, yet there is no sign of a halt to the downward trend in home sales. Sluggish sales have also caused home prices to decline, with prices in 56 out of the 70 major cities falling in October 2023 compared to the previous month. The expectation that the price declines could last longer is causing buyers to hold off, leading to a further contraction in demand - a typical vicious cycle.

The financial situation of real estate developers has already deteriorated, where several, including major companies such as Evergrande Group and Country Garden, are experiencing delays in debt repayments and requesting payment deferrals to creditors. Should this trend spread, NPLs to real estate developers will likely increase. If the financial intermediary function were to weaken due to the deterioration of financial institutions' management, the Chinese economy could plunge into a severe recession.

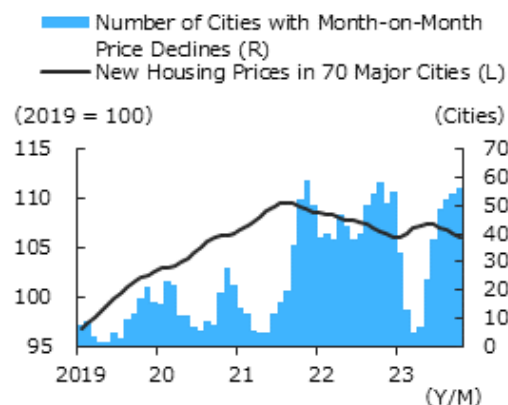
Second, exports are falling. The U.S. government may take a hard stance toward China in the run-up to the 2024 presidential election. If the U.S. government intensifies export restrictions on China, especially on cutting-edge semiconductor manufacturing equipment, China's production and exports could face a significant setback. Simultaneously, the China-plus-one trend of increasing production outside of China will accelerate, thereby diminishing the international standing of the Chinese economy.

There are also signs of growing trade friction with countries other than the U.S. China's EV exports have surged in response to the growing global demand for EVs, but there is growing opposition to the rapid growth in exports of Chinese EVs. In effect, the EU has investigated whether the Chinese government is providing unfair subsidies for EVs. China's EV exports could stall if such a move becomes widespread.

Third, there is an acceleration of capital outflows to foreign countries. China has experienced a rise in capital outflows to foreign countries in response to the widening interest rate differential between domestic and foreign interest rates and the sluggish domestic economy. According to the State Administration of Foreign Exchange (SAFE), capital outflows linked to securities investment and other activities reached \$53.9 billion in September 2023, the highest level since January 2016. Concerns about the future of the domestic economy and real estate market will likely continue to smolder next year, fueling further depreciation of the RMB. Suppose foreign exchange reserves decline significantly to support the government's local currency purchases. In that case, the depreciation of the RMB and capital outflows may synergistically progress into a vicious cycle, leading to a cascade of adverse effects, such as a decline in Chinese stock prices and a downturn in consumer spending and capital investment through the negative wealth effect.

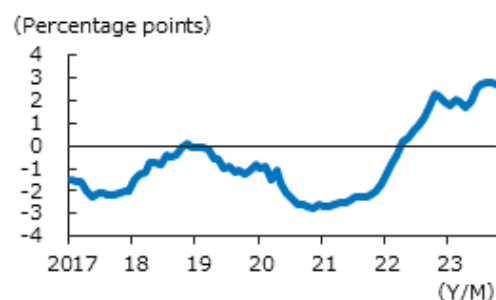
(Junya Sano)

<Housing Prices and Number of Cities with Price Declines>



Source: Prepared by JRI based on the National Bureau of Statistics and CEIC

<US-China Interest Rate Differential>
(2-year Government Bond Yield)



Source: Prepared by JRI based on FRB, National Interbank Funding Center, and CEIC
Note: Calculated as U.S. interest rate minus Chinese interest rate