Rising Contingent Liabilities Risk? China Retains Policy Spaces to Navigate Challenges

After the pandemic, the economy of China (AA/stable) is steadily recovering, with per capita GDP reaching USD12,751 in 2022, higher than the upper point of the range (USD6,000 to USD12,000) that corresponds to Stage Three of economic development out of a five-stage classification system under our sovereign rating criteria. Compared to global peers, China's current government debt burden remains at a moderate level. Over the past few years, China's current account balance has consistently remained in surplus, and its net international investment position remains strong. Additionally, China's external debt burden has long been extremely low, with abundant foreign exchange reserves providing a buffer against external risks. We believe that China's economy is entering a crucial transition from 'high-speed growth' to 'high-quality growth'. During this transition phase, despite challenges such as a real estate downturn, high local government debt, and tension in Sino-U.S. relations, we believe that China's institutions and policies continue to demonstrate adaptability and effectiveness, which help to avoid any systemic risks in the short to medium term. Given its ample room and track record of effective policy responses, we have great confidence in China's long-term sustainable growth, expecting its fiscal strength and external position to remain robust.

China's economy has strong resilience and continues to recover steadily. In the first three quarters of 2023, China's real GDP grew by 5.2% year-on-year, and we anticipate a full-year growth of 5.4%, higher than the official economic growth target of 5%. We observe a continuous rise in the contribution of consumption to economic growth, with ongoing consumption recovery expected to offset the negative impacts of the real estate downturn and temporarily weak exports. In terms of investment, from January to October, fixed asset investment in manufacturing increased by 6.2% year-on-year, and manufacturing private fixed asset investment, excluding real estate development investment, grew by 9.1% year-on-year. Moreover, high-tech industry investment also continued to grow rapidly. We believe that China's economic endogenous momentum will become more apparent, presenting a trend characterized by "consumption-oriented, stabilized investment, and recovering exports" in the short term. We estimate that China's economic growth rate in 2024 will be 4.7%, and average 4.6% through 2026, reflecting our view that China can sustain relatively robust growth in the face of challenges compared to global peers.

Government debt burden is controllable and at a moderate level. As of the end of 2022, China's general government net debt-to-GDP ratio was 46.2%, which is not high on a global scale, indicating that China's government debt burden remains at a moderate level. Although China's fiscal strength has been eroded to some extent over the past three years, mainly caused by the increase in the fiscal deficit and government debt level due to the massive public spending and fiscal stimulus to offset tax rebates, the current overall government debt level is still within a controllable range. Recently, the central government has firmly stated its commitment to strengthen local government debt management, effectively prevent and resolve local debt risks, and formulate and implement 'a package of debt resolving schemes'. As can be seen from the recent policies closely implemented by the government, there is a strong determination and effort to control the broadly-defined government debt (including contingent liabilities), which is expected to restrain the continued rise of local government debt, optimize the debt structure, and reduce the financing cost of local governments. In the long term, this is favorable for the entire Chinese fiscal system. With the gradual recovery of the economy, we expect the Chinese government to implement timely fiscal consolidation measures in the coming years, which are likely to gradually improve government fiscal strength.

China has low external debt burden and strong external position. As a major net external creditor and the largest holder of foreign exchange reserves in the world, China's external debt burden is exceptionally low. We believe that China's substantial foreign exchange reserves are sufficient to help the country resist external financial risks. In recent years, despite negative impacts from the pandemic and soft overseas demand, China's international balance of payments has remained robust, with a consistent surplus in the current account balance. Meanwhile, China's net international investment position remained strong, accounting for 71.3% of current account payments in 2022. The increasing use of the Renminbi in the international market further consolidates China's external financing strength as well. Given China's unchanged key role in global trade and manufacturing, we expect China's exports to gradually improve with the recovery of external demand, and we believe that China's current account will maintain a moderate surplus in the future.

Institutions and policies are highly adaptable and effective. China's political and social stability, coupled with its effective general institutions and policies, has long supported the country's robust economic growth and foreign economic performance. Since the pandemic, compared to the aggressive monetary policies adopted by most countries internationally, China's monetary expansion system has been relatively restrained, helping to control inflation at a moderate level. Currently, China's Consumer Price Index (CPI) is gradually bottoming out and rebounding, and we expect the CPI to be between 1.5% and 2.0% in 2024-2025. We believe that moderate inflation creates greater monetary policy space for China, and China will continue to implement prudent monetary policies to support economic growth. On the fiscal side, China's fiscal reforms have been steadily advanced, with a focus on increasing efficiency, resolving local government debt risks, and further strengthening financial discipline. Recently, there have been some positive signals from the government in dealing with domestic and international challenges, such as multiple agreements reached in the meeting between the leaders of China and the United States, the release of policies loosening real estate regulations, and the gradual implementation of policies supporting the development of the private economy. We believe that China's institutions and policies could demonstrate strong adaptability during the critical period of economic transition, which could avoid any systemic risks in the short to medium term.

Note: The ratings mentioned above are unsolicited.

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