WHATEVER IT TAKES? ECONOMIC POLICYMAKING IN CHINA IN THE CONTEXT OF A POSSIBLE DEFLATIONARY SPIRAL

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Abstract

This paper discusses the challenges the Chinese economy has been facing and assesses the policy measures taken to mitigate them. The analysis starts in September 2024, when Chinese policymakers announced the largest package of stimulus measures in years, reflecting their concerns about the situation of the Chinese economy. This situation is indeed concerning, with a multitude of problems needing to be addressed. Economic growth has been declining, China is in mild deflation which could turn into a deflationary spiral, it has a severe property crisis and a concerning debt situation (with a large fiscal deficit according to IMF estimates). Moreover, the structure of its economy is unbalanced, with very low domestic demand, especially private consumption, and considerable industrial overproduction contributing to deflationary pressures. Furthermore, China has considerable demographic pressures, its banks – especially the smaller ones – have high non-performing loan ratios, partly due to loans to the property sector, and external risks have been growing, in particular those related to import tariffs and other trade restrictions imposed by the United States and the threat of even higher tariffs.

The paper discusses in detail the policy measures taken during September-December 2024 by a large number of policy bodies. The Chinese economic policy regime is very complex, with many political, administrative and government organizations involved and with many policy conferences. These, and their policy measures, are all explained carefully. Monetary policy measures adopted by the People's Bank of China are discussed and assessed in particular. Next, given that several of China's economic challenges are rather similar to those that Japan faced during its "three lost decades", an increasingly common question is whether China will be the next Japan, or whether China will face a "Japanification" of its economy. My assessment is that the differences between China and Japan are larger than the similarities, and that China has a relatively large number of advantages compared with Japan during its crisis period. Nevertheless, China is certainly not yet out of the woods and much will depend on its policy response and economic developments in 2025.

Keywords: China, economic policy, monetary policy, fiscal policy, economic slowdown, deflation, property crisis, demographics, "japanification".

JEL classification: E00, E58, E60, E62.

Resumen

Este documento analiza los desafíos que ha enfrentado la economía china y evalúa las medidas políticas adoptadas para mitigarlos. El análisis comienza en septiembre de 2024, cuando las autoridades chinas anunciaron el mayor paquete de medidas de estímulo en años, lo que refleja su preocupación por la situación de la economía del país. Esta situación es ciertamente preocupante, con numerosos problemas que deben abordarse. El crecimiento económico ha disminuido, China se enfrenta a una leve deflación que podría convertirse en una espiral deflacionaria, y sufre una grave crisis inmobiliaria y una preocupante situación de deuda, con un déficit fiscal que, según las estimaciones del FMI, es elevado. Además, la estructura de su economía está desequilibrada, con una demanda interna muy baja, especialmente el consumo privado, y una considerable sobreproducción en su industria, lo que contribuye a las presiones deflacionarias. Además, China tiene presiones demográficas considerables, sus bancos —especialmente los más pequeños— tienen altos índices de préstamos incobrables, en parte debido a los préstamos al sector inmobiliario, y los riesgos externos han ido creciendo, en particular los relacionados con los aranceles de importación y otras restricciones comerciales impuestas por Estados Unidos y la amenaza de aranceles aún más altos.

El documento analiza en detalle las medidas políticas adoptadas entre septiembre y diciembre de 2024 por un gran número de organismos. El régimen de política económica chino es muy complejo, con la participación de multitud de organizaciones políticas, administrativas y gubernamentales, así como numerosas conferencias y congresos sobre políticas. Estas medidas, así como sus respectivas políticas, se explican detalladamente. Se analizan y evalúan, en particular, las medidas de política monetaria del Banco Popular de China. A continuación, dado que varios de los desafíos económicos de China son bastante similares a los de Japón durante sus «tres décadas perdidas», surge cada vez más la pregunta de si China será el próximo Japón o si se enfrentará a una «japonización» de su economía. Nuestra evaluación es que las diferencias entre ambos países son mayores que las similitudes, y que China cuenta con numerosas ventajas en comparación con Japón durante su período de crisis. Sin embargo, China aún no está fuera de peligro y mucho dependerá de su reacción política y de la evolución económica en 2025.

Palabras clave: China, política económica, política monetaria, política fiscal, desaceleración económica, deflación, crisis inmobiliaria, demografía, «japonización».

Códigos JEL: E00, E58, E60, E62.

Contents

1 Introduction[1]

The growth of the Chinese economy over the past decades has been a tremendous success story, supported by market-oriented reforms and trade liberalization, lifting millions of Chinese out of poverty and establishing an expanding middle class. The Chinese economic model was based on export-investment driven growth, with a more marginal role of consumption. Yet in recent periods this model has shown cracks, with China now experiencing a housing crisis, deflation, economic growth below the target set for the year and other weaker parts in the economy. Increasingly, discussions focus whether China will become another Japan, and end up in a deflationary spiral. Analysis focuses also on whether the policy reaction of the Chinese authorities so far has been enough, and whether they are prepared to do "whatever it takes" to avoid a deflationary trap.

Our analysis aims to contribute to the ongoing discourse how the Chinese economy can be turned around and a deflationary spiral can be avoided. This is especially important given the role and size of the Chinese economy, being the second largest economy in the world. It is also important because the policy reaction in China offers valuable lessons for other countries which may face similar problems.

This paper investigates the economic challenges of China, the policy measures taken and announced by the various policy bodies in China during September-December 2024 and their impact on the Chinese economy, the threat of a "Japanification" of China. It looks in detail at these policy measures during this specific time interval, and hence de-facto is providing a micro analysis of macro-economic developments. The micro-analysis involves the analysis of the measures taken by a large body of policymakers, including the People's Bank of China (PBoC), ministries and numerous political committees and bodies, and starts with the large set and historically unique set of policy measures announced and taken on 24 September . Especially the involvement of so many political agents is a relatively Chinese-unique phenomenon, which makes the processes of policy making and policy implementation quite challenging to understand, and supports our choice for a micro analysis (see Appendices I and II for overviews of the political and policy bodies and conferences).

Our main source of references will be the research of large number of investment and commercial banks on China, augmented by newspaper, rating agencies, academic papers and international organizations' publications, and an elaborate set of charts. As this research follows the Chinese economy and policymaking and -implementation on a day-to-day basis during September-December 2024, it gives a unique insight in economic

1 This paper is the first of a project on policy and financial developments in China. While the first paper provides an overview of the policy measures taken during September-December 2024, with an explicit focus on monetary policy issues, the second paper will discuss the policy outlook for 2025, analyse structural reforms and provide an overview of economic and policy developments during January-May 2025 in the context of a tariff war. The third paper will analyse the impact of the policy measures on Chinese financial markets, banks and portfolio flows from September 2024 onwards.

and policy developments in China on a high frequency basis, allowing again for a micro analysis of macro developments. September 2024 marked a real policy shift from the past, representing the most comprehensive, coordinated policy easing in many years, combining fiscal, monetary, housing, equity market and banking measures (JP Morgan, 2024o, p. 4). To our knowledge, this is the first paper on China that uses this research as major source of information.[2]

This paper is structured as follows. Section 2 presents the key characteristics of the economic backdrop of China's policy measures, discussing the various economic and financial problems that China is facing now. Section 3 explores in detail the policy measures taken and announced during September-December 2024, starting with the "Big Bang" of measures on September 24th[3]. This section will not only look at the traditional policymakers, such as the central bank and ministry of finance, but will expand the analysis into the measures taken and proposed by the various administrative political actors relevant in China, which requires a detailed micro analysis. Section 4 concludes and investigates if China could fall into a deflationary spiral similar to that of Japan. In this context, firstly, an extensive analysis of Japan's deflationary spiral is presented and secondly, the Chinese policy reaction is assessed if the country has done "whatever it takes" to avoid following Japan. Various and often contrasting views are presented to judge if a "Japanification" of China has occurred or may occur. Our main conclusion is that the differences between China and Japan on their economic and policy challenges are bigger than their similarities. But, as Chinese policy for the time being has not been "whatever it takes" yet, China is definitely not on the safe side yet.

2 In order not to give prevalence to the research of one bank or just a couple of banks and to avoid bias, the publications used as the main references of this paper are from a wide range of banks.

3 It is generally agreed that policy support picked up pace since September 24, 2024 (for a concise summary see, among others, BBVA (2024), pp. 27-28; the various China Handbooks of JP Morgan; Morgan Stanley (2024o); Société Générale (2024e), p. 23; UBS (2024j), p. 9.

2 Economic and financial backdrop

In recent periods, China has been facing numerous cyclical and structural headwinds. Most have been analyzed in depth in the IMF 2024 Article IV Consultation Report for China published in August, just before the September-December 2024 period, of which we will analyze the policy response and its consequences in greater detail. Section 2 will allow the reader to understand why the policy response in China has been so important and necessary, resulting in policy measures in September that were the most significant in many years.

First, economic growth has declined from the high levels achieved in earlier years, with the yearly target set by the Chinese authorities for 2024 of "around 5% GDP growth" being significantly lower from the high targets set for example during the period 2015-2019 and which were achieved, resulting in significant higher economic growth than in recent years (Chart 1, Panel A). From a structural perspective, China has the challenge of addressing an uneven composition of its economy: there is too much investment and too little consumption, with an underexploited service sector. In short, the old model of export-investment-led economic growth is showing its limitations and reforms are unequivocally necessary, which should give a much larger weight to consumption to achieve a more balanced economic structure.[4] Although the household savings rate declined post reopening of the economy, it remained above pre-pandemic levels amid weak consumer confidence (IMF, 2024b, p. 6). China's consumption at around 39% of GDP is very low when compared with its EM peers (Mexico 70% of GDP, Brazil 63%, India 60%) (Chart 1, Panel B). A headwind to consumption also has been declining consumer confidence in recent years, driven by the housing crisis and worsening other macro-economic variables (Chart 1, Panel B). The increase of consumption as a share of GDP is not an easy task (The Economist, 2024a). First, the property crisis has diminished the income, assets and confidence of ordinary Chinese. Second, for rebalance its economy successfully, Chinese consumption would have to increase by about 10% of GDP. The Economist found that only in 11% of 181 countries consumption did rise by more than 10% in the space of a decade. Third, China's policymakers have talked about rebalancing the economy towards consumption for almost 20 years and are still doing so.

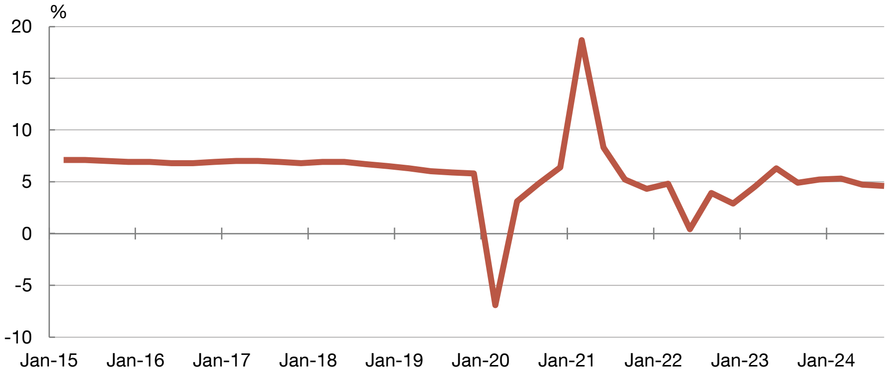
The need to restructure its economy has been advocated for years by international policy organizations and Western observers, and Chinese scholars as well.[5] According to

4 Muir, Novta and Oeking (2024) show that China's potential growth over the medium to long-term could slow to around an average of 3.8% between 2025-2030 and to around 2.8% over 2031-2040 in the absence of major reforms. By contrast, a serious reform program could raise potential growth to an average of 4.3% between 2025-2040.

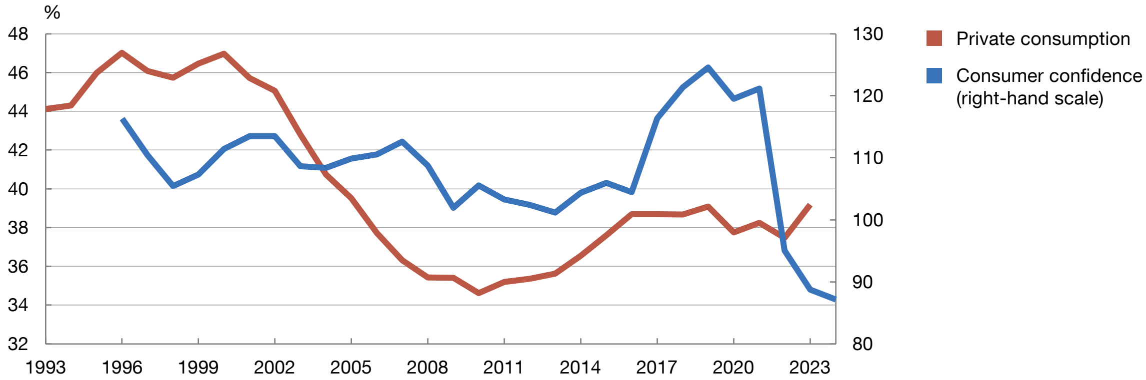
5 Some market analysis has emphasized more the positive aspects of the necessary restructuring. For example, ING believes that China is in a necessary transition in a direction which will allow for sustained long-term development rather than in any long-term decline (ING, 2024b). In its view, China's transition toward high-quality growth can be exemplified by four factors: Transition toward a consumption-driven growth model, transition up the value-added ladder (driven by the use of industrial policy, having the world's most complete manufacturing and logistics infrastructure and a massive domestic market), transition toward greener economic growth (policy changes and initiatives have led to much lower pollution levels and carbon intensity of growth over the past decade) and transition toward a digitalised economy (China has now the second largest "digital economy", with globally leading tech firms (e.g. DeepSeek). By contrast, UBS sees a "tricky" transition, with shifting supply chains (need of going global) and US tariff hikes, with the property market adjustment being key that will take time (UBS, 2024k).

Chart 1
Macroeconomic developments

1.a Quarterly Real GDP, YoY %



1.b Annual Private Consumption (% GDP) and Consumer Confidence Index (Annual Average)



SOURCES: LSEG Workspace, Bloomberg and World Bank

Liu (2024), the over-reliance on investment and limited contribution of consumption in the Chinese economy does not stem from ignorance or miscalculation but reflects the Chinese Communist Party's long-standing economic vision: "consumption is an individualistic distraction that threatens to divert resources away from China's core economic strength: its industrial base" (Liu, 2024, p. 162). This policy view emphasizes that the low rate of consumption and high rate of savings generate capital that the state-controlled banking system can divert to industrial enterprises. And even more importantly: "This system also reinforces political stability by embedding the party hierarchy into every economic sector" (Liu, 2024, p. 162). Hence, the uneven economic structure allows the Party to safeguard its political power and dominance in China's society and its control of the economy and political system. It's no surprise that this system of overinvestment has generated structural overproduction and wrongly sided incentives.

As Liu (2024) in her analysis goes to the heart of China's current economic problems, we shall focus more in detail on her arguments. She argues further as follows: "Top-down industrial plans are designed to reward the cities and regions that can deliver the most GDP growth, by providing incentives to local officials to allocate capital and subsidies to prioritized sectors. […] These planning directives and campaigns put enormous pressures on local party chiefs to achieve rapid results, which they may see as crucial for promotion within the party. Consequently, these officials have strong incentives to make highly leveraged investments in priority sectors, irrespective of whether these moves are likely to be profitable. […] In order to encourage local initiative, Beijing often does not provide financing: instead, it gives local officials broad discretion to arrange off-balance-sheet investment vehicles (AvR- the so-called local government financing vehicles or LGFVs)[6] with the help of regional banks to fund projects in priority sectors […]. About 30 percent of China's infrastructure spending comes from these vehicles" (Liu, 2024, p. 166).

This policy led to the two main structural problems: first, a huge industrial overcapacity[7] and second, enormous levels of local government debt. Liu (2024) cites figures from the Wall Street Journal that in July 2024 the total amount of off-the-book debts by local governments across China was between $7 trillion and $11 trillion, with possibly $800 billion at risk of default. Moreover, another consequence of the Party's policy has been that local governments all concentrated on the politically prioritized economic sectors and products, hence duplicating investments in state-designed priority sectors. In the end, China has been burdened by more debt and more industrial overcapacity.

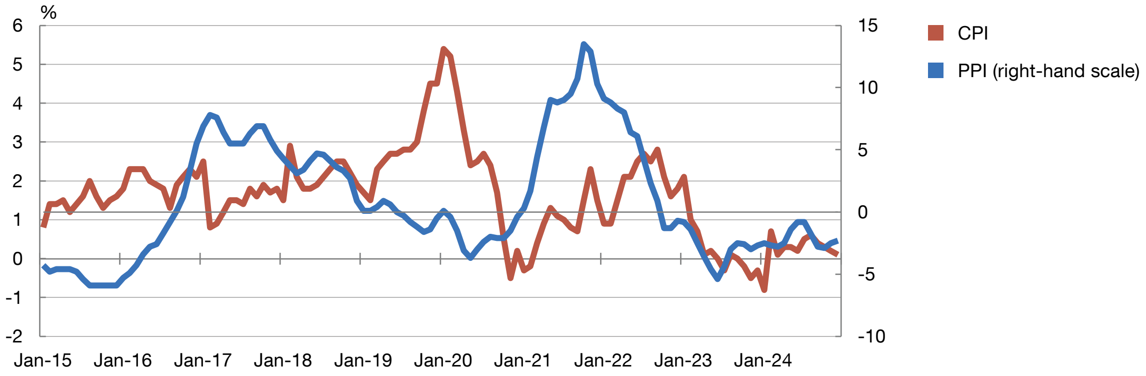
The IMF in its 2024 Article IV Consultation Report published in August noted that China's economy remained resilient despite the property market correction, supported by public consumption and investment, which contributed significantly to domestic demand growth in 2023 and 2024Q1, while net exports contributed strongly to growth in the first quarter of 2024. Retail sales indicated relatively subdued domestic demand for goods and services. Despite this relatively positive assessment, the IMF acknowledged that uncertainty surrounding its outlook remained high and that risks were skewed to the downside: "The key domestic risk is a deeper – or longer than expected – contraction in the property sector, which, combined with high debt levels, could result in a sustained period of disinflationary pressures, adverse macro-financial feedback loops, and risks of deflation" (IMF, 2024b, p. 1). Clearly, these risks largely materialized in the remainder of the year.

6 In China, a local government financing vehicle (LGFV) is a funding mechanism for local governments. An LGFV is usually an investment company that borrows money to finance real estate development and other local infrastructure projects. LGFVs can borrow money from banks, or they can borrow on the open market by selling bonds known as "municipal investment bonds" or "municipal corporate bonds", which are repackaged as "wealth management products" and sold to individuals. Since local governments in China are not allowed to issue municipal bonds, LGFVs have played a unique role in securing funding for local governments to develop their economies. However, the vehicles rarely make enough returns to pay back their debts, often requiring local governments to raise more money to pay back their creditors. Both the number and the indebtedness of LGFVs have soared in recent years, sparking fears about their inability to repay debts as well as subsequent defaults. Although LGFVs are operated by local governments, who investors assume will remain accountable for them, the often-unsecured debt is classified as "corporate debt", and the central government has indicated it would not bail out a bankrupt LGFV. Since land has traditionally been owned by the local governments, LGFVs have also turned to earning revenue by through land sales or leases, which can help to repay its creditors. Land can also be used as collateral to secure the bonds.

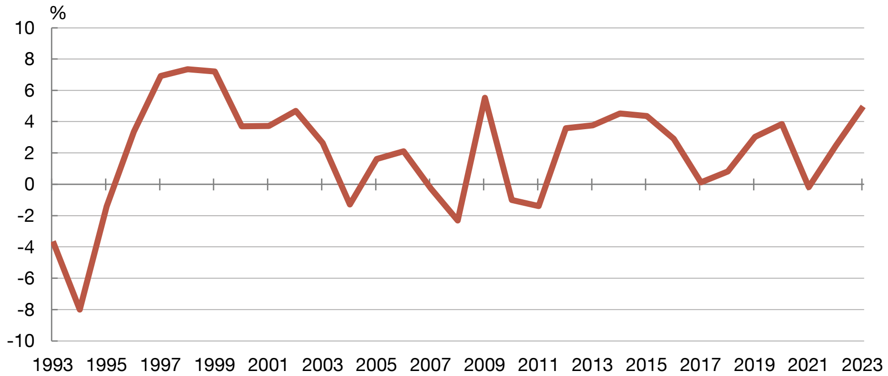
7 Structural overproduction in China has made it the industrial powerhouse of the world and actually it is now the world's sole manufacturing giant (Baldwin, 2024), which is expected to increase further with unchanged industrial policy. According to figures published by the United Nations, China accounted for almost 30% of global industrial production in 2024 and may reach 45% in 2030, if investments are not replaced by consumption.

Chart 1
Macroeconomic developments (cont'd)

1.c CPI and PPI, YoY %



1.d Real Interest Rate (a)



SOURCES: LSEG Workspace, Bloomberg and World Bank.

a Defined by the World Bank as the lending interest rate adjusted for inflation as measured by the GDP deflator. It is the bank rate that usually meets the short- and medium-term financing needs of the private sector.

Second, China is facing a situation of deflation (or near-deflation), especially in producer prices, with the danger of a deflationary spiral and being close to a situation of the yearly change in consumer price inflation (CPI) falling into negative territory. The CPI is still above zero – but only barely (WSJ, 2024j). Yearly changes in producer price inflation (PPI) have been negative already for some years and deflationary pressures in producer prices persisted into 2024 (Chart 1, Panel C; World Bank Group, 2024, p. 10). The cost of deflation is well-understood and is clearly summarized in Morgan Stanley (2024a), pp. 4-6: 1) Deflation raises real interest rates which increase the burden on debtors; 2) Deflation leads to weaker returns on new investments and softer nominal GDP growth which are hurting corporate sector profits and wage growth; 3) Lower income households and the youth are bearing the brunt of deflation; 4) Debt ratios will only keep rising because of deflation.

The IMF emphasized that persistent disinflationary pressures had emerged amid continued economic slack (or overproduction) with a negative output gap, low industrial capacity utilization and lower food and commodity prices, and that trade restrictions could further exacerbate deflationary pressures (IMF, 2024b, pp. 7-8 and p. 45). More specific, JP Morgan mentions that the threat of deflation in China's reflects "unique" problems such as lagging and weaker recovery in domestic demand, high unemployment and lack of wage inflation pressure, weak rental cost, and unexpected large drops in auto and pork prices (JP Morgan, 2023). In fact, deflation in China may become more entrenched, certainly if the authorities would pursuit the yearly GDP target by more massive investment, which would worsen deflationary pressures (Morgan Stanley, 2024r). Throughout 2024, deflation continued to accelerate, especially in food prices, with food inflation remaining the biggest contributor to inflation especially in the latter part of the year (Morgan Stanley, 2024k; Citi, 2024h). The two sectors in the economy contributing the most to deflationary pressures in 2024 have been first industry and second the property sector. The year-on-year change in September was 0.4% for the CPI index, while registering -2.8% for the PPI index in the same month (Chart 1, Panel C).[8] This situation seems quite persistent, especially in the PPI, and has required considerable attention from Chinese policymakers, also because it is a symptom of deeper structural issues (Zhang, 2024): In the view of market analysts, the economy's general deflation pressure remains concerning, as demand-supply imbalances and excess industry capacity remain significant and have been structural (JP Morgan, 2025). This situation could worsen further in case of the implementation of US tariffs on Chinese imports in the US: this would lead to a decline in Chinese aggregate demand and possibly lower prices, as according to a survey conducted by UBS, 42% of Chinese firms plan to cut export prices when that scenario materializes (UBS, 2024i). As a result of declining inflation, real interest rates have been rising during the past few years, posing another drag to economic growth (Chart 1, Panel D). All in all, deflationary pressures and the threat of a deflationary spiral have become key challenges for policymakers.[9] According to some, these challenges are rather easy ones to address: the Economist wrote that the policy response to the threat of deflation (and weak growth) is a "textbook" one, i.e. implement more policy stimulus (The Economist, 2024b). Former PBoC Governor Yi Gang made a rare admission at a conference early in September 2024 that "rooting out deflation has to take priority for policymakers" and he called for "proactive fiscal policy and accommodative monetary policy" (Bloomberg, 2024a).

If industrial supply is too high to be absorbed by domestic demand, the easiest strategy is to go abroad. This is exactly what China has been doing and its trade balance has been showing increasing surpluses, reach a historic record high of almost one trillion US dollar in 2024. In the same year, China surpassed Japan as the biggest car exporter in the world.

8 Morgan Stanley (2024a) reported in September that the GDP deflator had been negative for the past five quarters, suggesting the persistence of deflation in China.

9 Regarding the existence of a deflationary spiral in China, the views are divided between those who have concluded that China was already in such a situation in 2024 and those arguing that China might be in a deflationary spiral in the near future: the former are also more convinced of a possible Japanification of China (for more discussion on deflation in China see: Asia Financial, 2024; Bloomberg, 2024a and 2025a; Business Insider, 2024; Drut and Heissat, 2024; Financial Times, 2023a, 2024i and 2024a; The Economist, 2023, 2024b, 2024c and 2024g; Morgan Stanley, 2024a and 2025a; Reuters, 2024f; Wall Street Journal, 2024b and 2024i.)

The IMF has developed an inflation vulnerability index (DVI) to assess the likelihood of deflation in China, which is based on five categories of variables that can predict downside risks to inflation, including commodity prices, output gaps, financial asset prices, exchange rates and inflation expectations (IMF, 2024b, p. 44; IMF, 2024c). The information content of these variables is summarized in a single variable – the DVI – using principal component analysis. As of August 2024, the IMF report concludes that the "calculated DVI, which shows persistent negative values in recent years, suggests that China is currently experiencing its longest recorded period of deflationary pressure" (IMF, 2024b, p. 44). In the baseline analysis, the IMF estimated in August 2024 the probability of deflation in China at 7%, but a one and two standard deviation negative shock to the DVI could increase this chance to respectively 27% and 54%.

On challenges one and two, the Fund recommended that "If significant downside risks to growth and inflation materialize, more accommodative macro policies and early financial sector intervention will be essential. Expansionary fiscal policy and more aggressive monetary easing would be warranted to cushion the impact on activity. Fiscal policy should focus on expediting funding for unfinished housing and support for households" (IMF, 2024b, p. 22).

Third, a key structural factor is that China has been facing a severe housing crisis, with demand for housing collapsed, resulting in an oversupply of dwellings. Most analysts agree that China's economy cannot be fixed without first rescuing the housing market (The Economist, 2024e). The Chinese authorities have been following the policy line that the easiest way to do this is to target unsold homes, as with so many properties on the market, developers are hesitant to start new projects, which also means that they stop leasing government land, which is a major burden for local governments – especially those which are heavily indebted – whose main source of revenue is the leasing of land.

Two indicators are important to assess the property downturn in China, which are the prices of secondary homes and new home sales; both have been signaling a severe downturn in the housing market (UBS, 2024l).[10] For the distribution of private wealth, the

10 Assessment of the Chinese property crisis is rather complicated, because in China a city tier unofficial hierarchical classifications of cities is used, of which various editions exist. We use the 2020 classification of the financial magazine Yicai Global, which consists of six tiers; the number of cities per tier are used as reported by Investor Insights Asia. Ranking is based on concentration of commercial resources, the extent to which a city serves as a commercial hub, the vitality of urban residents, diversity of lifestyle and future dynamism. The following presentation is based on reporting by Investor Insights Asia. The Tier 1 cities are the four most important ones: Beijing, Shanghai, Guangzhou and Shenzen (with around 75 million inhabitants, 2021 number). A new in-between tier that has emerged in recent years is the New Tier 1, which comprises of 15 cities. These cities serve as regional hubs, report directly to the central government instead of to the provincial government and are relatively wealthy provincial capitals or economically developed cities. Tier 2 cities number 30 (around 218 million inhabitants, 2021 number) and are provincial capitals as well as cities that are relatively economically developed. Tier 3 cities include 70 cities which are poorer provincial capitals and cities with large populations that have somewhat developed infrastructure but no economic or political significance. Tier 4 cities number 90 and are still in the developing and urbanizing stage. Lastly, Tier 5 cities are 128 cities which are the poorest in China. The analysis of the property crisis is further complicated by important divergences among the cities within a specific Tier group. For example, in some key Tier 2 cities but not in all, progress was achieved with handling the crisis: Land bank auctions were active and local governments were able to plan the supply of new dwellings, while housing demand in these cities was also buoyed by talent inflow (UBS, 2024l). Stabilization of the real estate crisis in these more developed cities will have a positive ripple effect to surrounding Tier 3/4 cities.

property sector is key: Chinese households hold around 60% of their wealth in housing assets and only 5% in equity, hence the property overhang has severe negative effects on private wealth and hence on private consumption, leading to an important drag on the Chinese economy. Developers have been highly leveraged, issuing offshore and onshore bonds to finance their mainland activity. As a result of high indebtedness, several large real estate developers have defaulted, worsening the debt burden in the sector. Estimates of the IMF suggest that about 50% of developers have been grappling with solvency and viability concerns, while an additional 15% or so are facing liquidity problems (IMF, 2024b, p. 7). As of October 2023, more than half of the biggest 50 developers in 2020 had gone into default.

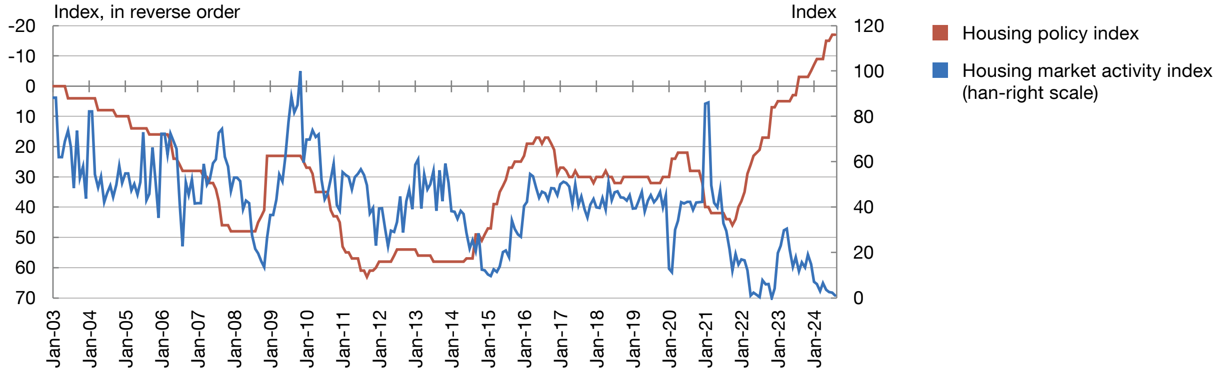
The most famous collapse among China's real estate developers was that of the China Evergrande Group. With more than $300 billion in liabilities, it was the world's most indebted developer. On 9 December 2021, Fitch Ratings downgraded to default the long-term foreign-currency issuer default ratings (IDR) of Evergrande, when it defaulted on its debt payments (Fitch Ratings, 2021). The decision by Fitch to declare that Evergrande was in default stemmed from its assumption that two interest payments of $131 million, that were due on December 6, 2021, were not made. More specifically, Fitch downgraded its rating of Evergrande to "restricted default", which means that the Hong Kong-based property development company neither ceased operations nor commenced formal legal procedures such as filing for bankruptcy (Investopedia, 2021). In January 2024, a Hong Kong court ordered Evergrande to liquidate assets tied to its Hong Kong unit after a failed restructuring deal among mainland banks and foreign creditors (Congressional Research Service, 2024). Hong Kong's court ruling did not govern the firm's People's Republic of China's subsidiaries, which constitute 90% of its business. Since 2021, the firm's PRC assets have been mostly redistributed to domestic creditors, particularly local governments. In 2021, Hong Kong and PRC authorities agreed to mutually recognize liquidation orders. According to Bloomberg, as of 2024, the firm owed $300 billion in debt (including $20 billion in offshore debt) and held about $240 billion in assets (Congressional Research Service, 2024). The collapse of Evergrande affected roughly 1.5 million people who put deposits on Evergrande homes that have yet to be built.

As of October 2023, market assessments estimate that the property crunch since 2021 has wiped out some $18 trillion in household wealth, equivalent to around $60,000 per family as published by the Wall Street Journal. Goldman Sachs analysts expected that the Chinese property market would not be stabilized until 2027. Furthermore, the contribution of residential property investment to Chinese GDP is high from an international perspective: it was 12% in 2021, what compared to 6.7% during the US housing bubble in 2005 and 6% during the Japanese housing bubble in 1990 (UBS, 2025a). Oversupply has been high with a vacancy rate of almost 20% in 2021, which was much higher than during the real estate bubbles in the US, Japan and Hong Kong in 2005, 1990 and 1997, respectively.

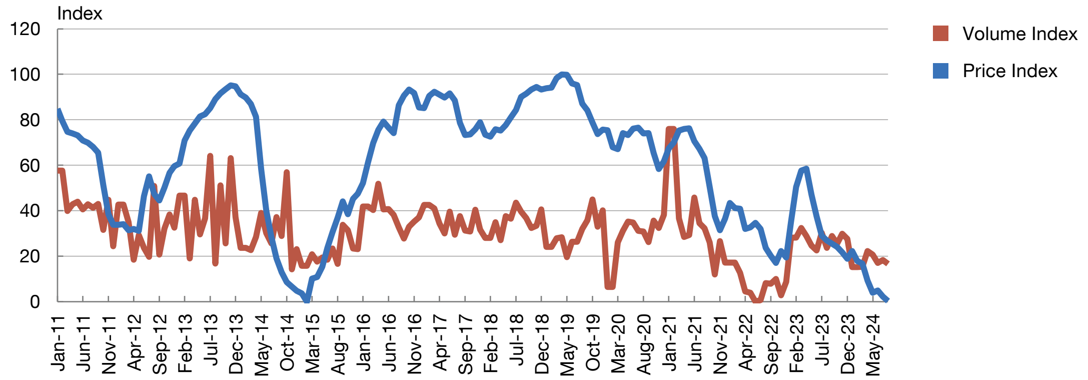
At this juncture, the downturn in Chinese property has been a relatively recent phenomenon and of (for the time being) short duration: while it started around mid-2021

Chart 2
Housing crisis and fiscal situation

2.a Housing policy and housing market activity



2.b China housing activity index



SOURCES: Bloomberg, LSEG Workspace and JP Morgan.

in China, the property downcycles in the US (2005), Japan (1990) and Hong Kong (1997) lasted around 6, 14 and 6 years, respectively (UBS, 2025b). In China, housing market activity continued to decline strongly in 2024, while housing market policy measures increased markedly from 2022 onwards (Chart 2, Panel A).[11] Both housing prices and volumes have been on a declining trend for several years now (Chart 2, Panel B). To stabilize the market for primary homes of Chinese households, progress in the implementation of the plan to

11 The JP Morgan index of the housing policy index is based on recording each policy announcement in each month with a positive sign for housing market tightening and a negative sign for housing policy easing. It incorporates the information from volume indicators, transaction-value indicators and house prices (JP Morgan, 2022b). The construction of the index distinguishes between central government initiatives and city-level policy announcements (JP Morgan, 2022a). Then the monthly changes are aggregated in policy indicators. The index explains the housing policy regime shift in 2017. First, since 2017 housing policy adjustments have been mainly city-specific. This may also explain that the positive correlation between the policy rate and reserve requirements on the one hand and the housing policy index on the other hand before 2017 turned negative after 2017. The components of the index also show that in recent years housing policy relied more on administrative measures. Local governments have little decision-making power on most housing policy instruments , hence city-level policy changes increasingly relied on variation in the implementation of administrative measures (JP Morgan, 2022a, p. 3). The housing policy shift since 2017 reduced the volatility in the property sector (JP Morgan, 2022b), but for the rest has not been very successful

renovate one million housing units in urban villages,[12] the program to buy-back unsold housing inventories and potential subsidies to help support housing demand is needed (UBS, 2024l, p. 1). But severe obstacles need to be overcome: insufficient supply of primary dwellings with many property developers facing substantial financial headwinds, the weak income expectations of consumers (i.e. potential buyers), and short-term losses on secondary home sales.

The origin of the property crisis has been described aptly by the IMF in its 2024 Article IV Consultation for China: "Excessive investment in infrastructure and housing in the 2010s has resulted in elevated debt of property developers and local governments and the build-up of vulnerabilities" (IMF, 2024b, p. 5).

The IMF recommended that the ongoing housing market correction is needed to bring the sector back to sustainable size and that fiscal support should be used to address the property sector problems. Its view can be summarized as follows: "The policy priority should now be the timely resolution of unviable developers and the deployment of central government financing to accelerate completion of unfinished, presold housing, which would help restore homebuyer confidence" (IMF, 2024b, p. 1). Furthermore, greater housing price flexibility would support housing demand and the clearing of the inventory overhang. The Fund suggested that "Fiscal policy should accommodate one-off central government fiscal support for the real estate sector to complete unfinished housing and protect homebuyers" (IMF, 2024b, p. 1). The IMF would accept that this policy measure would lead to higher fiscal deficits in 2024 and 2025. It acknowledged that the necessary property market correction also has its risks: "it is weighing on economic activity and local government's finances, given their heavy reliance on property as a source of revenue, while also worsening asset quality of banks and increasing macro financial risks" (IMF, 2024b, p. 5). However, the step-by-step approach to tackle the property sector and local government debt problems has not resolved underlying asset quality problems, weak consumer confidence and left the related risks of deflation unaddressed.

Chinese policymakers sought to restrict new borrowing by real estate developers with a strict so-called "three red lines" policy in 2020. As a result, the developers' old fundraising model collapsed (Financial Times, 2023c). Not surprisingly, it contributed to the turmoil in the property sector: the housing policy tightening from late 2020 to Q32021 created funding stresses for real estate developers and eroded market confidence (JP Morgan, 2022a). The rule regulated the leverage taken on by developers, limiting their borrowing based on the following metrics: 1) A 70% ceiling on liability to asset ratios; 2) A 100% cap on net debt to equity ratio; and 3) A cash requirement to cover short-term liabilities (Congressional Research Service, 2024). Evergrande crossed all three red lines, resulting in a liquidity crisis and its later insolvency. The property sector crisis also reflected structural

12 Residents in these properties started to receive compensation to relocate towards the end of 2024, either in the form of cash or vouchers (Autonomous, 2024h). The program got underway in December, intending to move one million households out of urban villages into new housing units and renovate their existing homes.

factors in the slowdown of housing demand, as population growth, household formation and urbanization all slowed (JP Morgan, 2022a). The general assessment among market has been that the Chinese authorities' policy measures regarding the property crisis were well-intended but ineffective.

The property market has showed some tentative signs of recovery since October 2024, supported by new government support measures (see next section), further cuts in mortgage rates (result of policy measures, see next section) and seasonal effects (Autonomous, 2024h, p. 1; Morgan Stanley, 2024p; Goldman Sachs, 2024na). Another positive sign was the tightening of Chinese high-yield property bonds with almost 2,000 basis points in 2024. A China Housing Survey conducted by UBS over the period 9 August – 4 September and published in October 2024 showed that the intention to buy property over the next two years had increased since the previous survey in April 2024; however, in order to boost household confidence to buy properties three top factors were mentioned: 1) Job promotion and/or salary increase; 2) Lower mortgage rates; 3) Faster economic growth so property values will appreciate (UBS, 2024g). In the course of 2024, the Chinese authorities seem to have embarked more profoundly on a comprehensive housing strategy, while using other policies to mitigate the collateral damage, something where market observers had been asking for some years (JP Morgan, 2024a).

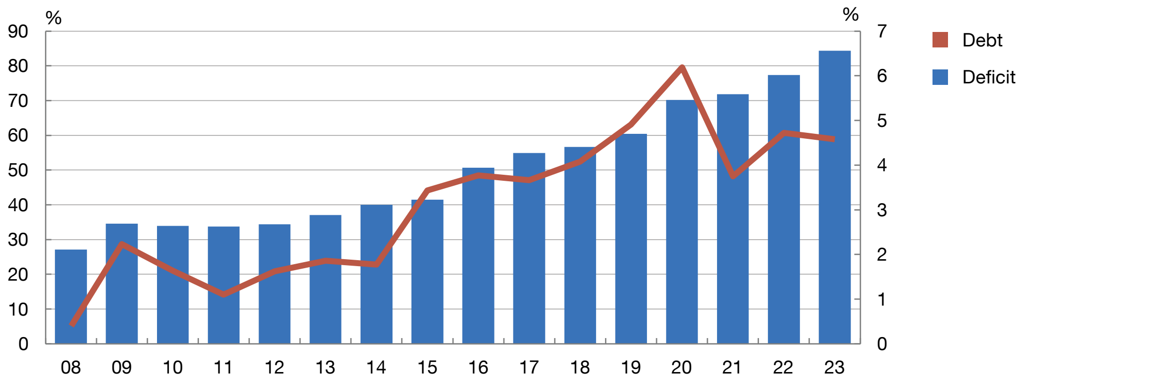
Fourth, this brings us to the fiscal situation. According to various observers, the most important cyclical factor regarding China's economy and policy response is the lack of sufficient fiscal support for households, including a better pension system and healthcare, whereas – as mentioned before – fiscal space is also required to address the real estate sector problems, and ultimately to achieve the "around 5%" 2024 target for GDP growth.[13] According to official numbers, China has a fiscal deficit of close to 5% of GDP, and fiscal debt in the order of just over 80% of GDP (Chart 2, Panel C). The official on-budget fiscal deficit target for 2024 was set at 3% of GDP, plus local government special bond issuance[14] and the issuance of ultra-long-term central government special bonds (Goldman Sachs, 2024a). The fiscal deficit and debt according to Chinese policymakers put some pressure – however somewhat limited – on the size of the fiscal package that the Chinese authorities could allocate to fiscal stimulus measures, especially aimed at stimulating consumption and mitigating the problems in the housing sector. The IMF recommended using the available fiscal space for the restructuring of the "debt of unsustainable local government financing vehicles (LGFV) through greater use of insolvency frameworks" which "will reduce local government fiscal strains".

13 See for example IMF (2024b) and Goldman Sachs (2024c). According to the latter, statements by Chinese policymakers indicated that the central government has relatively large space for debt expansion and deficit increases. But probably it will not be enough, according to Goldman Sachs, to completely offset the headwinds from the property sector and local government deleveraging as well as the headwinds from increased trade tensions with the US. Morgan Stanley (2024i) argues that forceful fiscal easing to support consumption is needed, but that the already wide fiscal deficits and high levels of public debt mean policy makers will be hesitant.

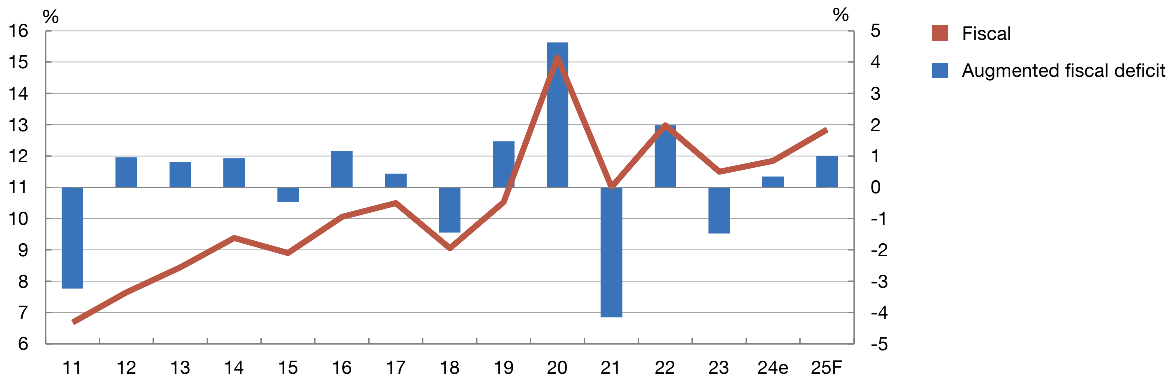
14 Special bonds were once reserved for infrastructure projects that could earn some revenue, but the proceeds from special purpose bonds issued by local governments – usually associated with state-led infrastructure projects – can now be used to buy unsold homes from developers and convert them to affordable housing and to buy idle land from property developers. Source: CEIC (2024).

Chart 2
Housing crisis and fiscal situation (cont'd)

2.c Fiscal Deficit and Debt (%GDP)



2.d Augmented fiscal deficit and fiscal thrust



SOURCES: Bloomberg, LSEG Workspace and JP Morgan.

The situation looks completely different when one looks at the so-called augmented fiscal deficit, a concept that the Fund uses to analyze the fiscal deficit situation in China, and which includes both official and off-budget debt (IMF, 2024a and 2024b) (Chart 2, Panel D). Official debt includes central government debt and "on-budget" local government debt. Off-budget debt involves other types of local government borrowing, including debt from LGFVs, government-guided funds and special construction funds. The estimated value of the augmented fiscal deficit for 2024 is at close to 13% of GDP around 2.5 times larger than the official fiscal deficit. The fiscal thrust is the year-on-year absolute change in the augmented fiscal deficit (Chart 2, Panel D). The augmented fiscal deficit was set to widen in 2024 on expansionary targets. Based on this concept, significant fiscal consolidation will be required to achieve public debt sustainability in the medium term, supported by fiscal framework reforms and the restructuring of unsustainable LGFV debt (IMF, 2024b, p. 42).[15]

15 On a positive note, observers believe that the fiscal budget will become more transparent, moving away from less transparent off-budgetary items (Zhu, 2024). Further on fiscal reform, see IMF (2024b) and Qiao et al. (2022).

From a policy perspective, the large augmented fiscal deficit seems to leave little fiscal "ammunition" for a significant fiscal stimulus policy.

The concept of the augmented fiscal deficit seems to make sense when looking at the fiscal situation of local governments. The gap between the local revenues and expenditures of these governments has been on an increasing trend during the last two decades before the COVID-19 pandemic (Han, Li and Zhou, 2024, p. 2). It mainly reflects the long-standing misalignment between the local government's limited revenue sources and high expenditure responsibilities. As a result, "local governments in most provinces had been relying heavily on funding resources other than local tax and non-tax revenues to cover their own expenditures […] In particular, transfers from the central government are one of the major sources of such funding, particularly for provinces with relatively large fiscal gaps" (Han, Li and Zhou, 2024, p. 2).

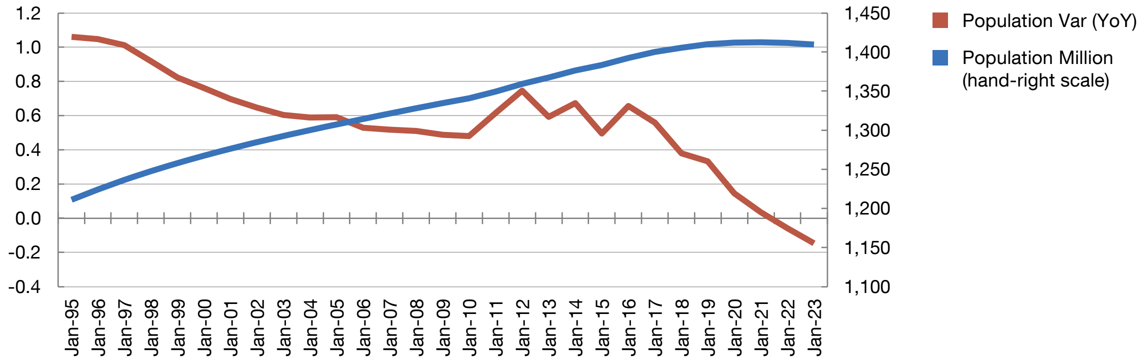
Which deficit and debt definition one considers more appropriate or not, of course has important consequences for the size of the fiscal stimulus that the Chinese government can use to stimulate economic growth. In contrast to the IMF's view that China has only a small amount of fiscal space left, Brad Setser of the Council of International Relations dismisses the concept of augmented fiscal deficit and debt as flawed (Setser, 2024). He argues that China has sufficient fiscal space because: 1) The central government has a low level of debt outstanding, as seen from an international perspective; 2) The concept of augmented fiscal deficit was an analytic tool developed to capture China's unique post-global crisis stimulus, which was more of a credit easing in a state-guided economy; it is much less relevant today; 3) One also has to look at State assets and by that metric China is in a much better position than the IMF suggests. Hence, China's central government still has a lot of fiscal space.

Despite this positive note on the size of fiscal deficit and debt, it is a fact that China's total debt figure (government and private) of around 300% of GDP for the total debt of Chinese households, government and non-financial corporations is concerning (IMF, 2024b, p. 5). A favorable development in this respect is that the People's Bank of China (PBoC) has been officially buying bonds in the secondary market on a net basis since August 2024. It also facilitated larger government bond issuances through liquidity injections. The main objective of the buying of government bonds is according the PBoC "to be a channel for the injection of base money and as a liquidity management tool" (PBoC, 2024j).

Fifth, in more recent periods, the danger of "Japanification" has been emphasized by numerous observers as a major risk for the Chinese economy. With this, it is alleged that China may face a long period of economic slowdown and a deflationary spiral, comparable to the around 30 years of deflation and sluggish economic growth that Japan experienced from around 1990 to around 2020. The threat of Japanification will be discussed in more detail in section 4.

Chart 3
Population growth

3.a Population



SOURCE: LSEG Workspace.

Sixth, the Chinese population has been declining for at least 25 years, contributing to the housing crisis, as many Chinese parents buy apartments for their children, but less so at this juncture (Chart 3, Panel A). A combination of the "One Child Policy" of 1979-2015, as well as socioeconomic and cultural shifts, led to lower birth rates and an ageing population, resulting in a decline of China's working age population (ING, 2024b). Lower birth rates have been driven by the rising costs of raising a child. Life expectancy in China rose from 60.2 years in 1974 to 78.2 years in 2021 (World Bank Group, 2024, p. 24). Without policy measures, population aging could contribute to a deceleration in potential economic growth, by its impact on labor, human capital, physical capital and productivity channels, according to the World Bank.[16] Aging could further shrink the size of the labor force, reduce household savings which are available to finance investment and economic restructuring (i.e. the capital channel), put pressure on government financing and adversely affect productivity (World Bank Group, 2024, p. 26). The average labor force growth could fall from 0.3% during 2000-2020 to -1.1% to -1.4% in 2025-2045, unless labor participation increases. The General office of the State Council issued in January 2024 "Opinions on Developing the Silver Economy to improve the Well-Being of the Elderly" (World Bank Group, 2024, p. 32). This initiative aims to support the welfare and quality of life of China's elderly, while leveraging their economic potential. Research put the size of China's Silver Economy at about RMB 7.0 trillion in 2024 (6% of GDP). It is expected to rise to RMB 30 trillion by 2035 and to one-third of GDP by 2050 (The Economist, 2024h). The ageing of China's population is also fueling

16 Eberstadt and Verdery (2021) focus on a demographic trend that has attracted far less attention: the coming transformation of the Chinese family structure. Families in China are not only aging, but shrinking as well, and many people will no longer have close blood relatives, as for example the number of one's cousins and siblings will decline; this development "will impose financial burdens on individuals and limit their ability to move and pursue risky entrepreneurial careers" (Eberstadt and Verdery, 2021). As the family remains China's primary social security system for supporting the elderly, this development, if unaddressed, also may have major repercussions for its social and economic systems.

demand for insurance products tailored to health and retirement, with both life and health insurers benefiting from this demographic trend (Financial Times, 2025b). The insurance industry in China has emerged as “one of the earliest and most significant beneficiaries of the artificial intelligence revolution”.[17]

Seventh, the banking sector, especially the smaller banks, have higher non-performing loan (NPLs) ratios and lower provisions and capital buffers than larger banks, exacerbated by the housing crisis and the bankruptcy of housing lending companies. IMF estimates indicate that property sector NPLs increased from around 5% in 2022 to 6% in 2024. At the same juncture, the growth of Total Social Financing (TSF) declined to historic low levels, whereas bank loan growth also fell.[18] China has around 4,000 of small and medium-sized commercial and rural banks, accounting for around 25% of total banking system assets, which are the weak link in the large banking system (IMF, 2024b, p. 11). Especially in fiscally weaker regions, these banks remain vulnerable. The Fund concludes that financial stability risks remain elevated, amid significant debt over-hang. High credit risks to the financial system remain a challenge, “at a time when profitability pressures limit financial institutions’ ability to build buffers” (IMF, 2004b, p. 27).[19]

Eight, the goal of “common prosperity”, promoted by president Xi (Ang, 2021), has de-facto developed in “common wealth”, with huge wealth differences between the extremely wealthy and the extremely poor. These differences in wealth affect the social fabric of China and put pressure on the government to try to mitigate these differences. It will not be easy to balance the inequalities in private wealth in order to achieve a more balanced “common wealth” situation, as these are very substantial. Morgan Stanley (2024a) stated that one of the overarching policy objectives is to lift per capita incomes and maximize the welfare of the population, particularly of lower income groups, for which the key is to defeat inflation and exit the debt-deflation loop. Fiscal easing should be used to stimulate consumption via social security spending.

17 The PBoC issued on 10 December 2024, together with the NFRA and seven other ministries, the “Guidelines on financial support for China’s elderly care initiatives and high-quality development of the Silver Economy” (PBoC, 2025b). Among other issues, the guidelines “The Guidelines highlight the need to provide diversified financial services tailored to different elderly groups, support individuals in preparing for retirement through pension savings and financial planning, and channel more financial resources to rural areas based on their demand. The document also advocates for improving the service and management systems of financial support for the silver economy, increasing credit supply for silver economy enterprises and industry clusters, intensifying support for direct financing, and diversifying funding sources” (PBoC, 2024ba). The PBoC had already been providing financial support to the elderly, as stated in its Monetary Policy Report for the third quarter of 2024: “The PBoC implemented special central bank lending for inclusive elderly care on a continuous basis […] At end-September (2024), the outstanding amount of the instrument posted RMB 2.1 billion, supporting financial institutions to grant preferential loans worth a cumulative RMB 3 trillion, up 13% from Q2. The instrument benefited 87 inclusive elderly care institutions and 4 enterprises manufacturing products for the elderly” (PBoC, 2024b, pp. 15-16).

18 TSF is the volume of financing provided by the financial system to the real economy (domestic non-financial enterprises and households) during a certain period of time. It is an economic barometer that sums up total fundraising by Chinese non-state entities, including individuals and non-financial corporates. It includes RMB loans, foreign currency loans, entrusted loans, undiscounted bankers’ bills of acceptance, corporate bonds, government bonds, domestic equity financing by non-financial enterprises, etc. See PBoC (2024a), p. 78. China’s bond and stock markets have developed rapidly, resulting in a steady increase in the proportion of direct financing. By the end of September 2023, the proportion of direct financing to TSF reached 29.2% (PBoC, 2024a, p. 83).

19 The banking sector will be discussed in more detail in the third Occasional Paper.

Finally, external risks would largely be concentrated on the effect of possible trade restrictions on Chinese exports, in particular from the US. The trade policy of the Trump administration, which became clearer in the course of 2025, including tariffs imposed on Chinese imports in the US, will be discussed in the Epilogue. Trump threatened repeatedly during the election campaign that he would impose tariffs of 60% on Chinese exports to the US.

3 The policy measures of the Chinese authorities during September-December 2024

Give the challenges facing Chinese policymakers, they became convinced that more structural and substantial policy measures were needed. To provide policy support, the People's Bank of China (PBoC), ministries, central (Prime Minister's Office), regional and city governments, political authorities and advisory councils enacted or announced at press conferences during September-December 2024 a multitude of policy measures of historical magnitude to break the deflationary spiral, increase consumption, mitigate the housing crisis and strengthen banks. The most important ones were taken in September, followed by more in October, November and December, so the analysis will concentrate on these months. The number of measures has been breathtaking: concentrating on the most important and/or most discussed ones, there were in total more than 50 measures taken or announced during these four months (around 18 in September, 12 in both October and November, and 11 in December) (JP Morgan, 2024k, 2024b, 2024e, 2024l, 2024q and 2025a; BOFIT, 2024; Citi, 2024e; Xinhua, 2024a).

Early September, the PBoC overhauled the monetary policy framework and traded in government bonds, the latter which it had restarted in August (BOFIT, 2024; PBoC, 2024j; Nomura, 2025). Zou Lan, head of the bank's monetary policy department, said at a press conference on September 5th that the central bank would guide market interest rates closer to the new main policy rate – the seven-day reverse repo rate – as it shifted its focus in its operation of monetary policy from quantitative targets to price-based tools such as interest rates (Reuters, 2024a).

The adoption of the new operational procedures of monetary policy was announced by Governor Gongsheng Pan in mid-2024, who gave a very important policy speech on 19 June 2024 at the 15th Lujiazui Forum, where he discussed the evolution of the monetary policy framework of the PBoC in the future (Pan, 2024a). First, he noted that the PBoC would optimize the use of intermediate target variables for monetary policy and gradually weaken its focus on quantitative targets such as M2 and aggregate financing. In his view, financial aggregates are to be viewed more as indicators for monitoring, reference and projection, and the role of interest rates in economic regulation should be more highlighted. Second, Pan proposed the seven-day reverse repo rate as the main short-term policy rate. With this focus on a short-term rate as the main policy target, the PBoC follows in the steps of many other central banks. Third, the PBoC would gradually include the purchase and sale of China government bonds on the secondary market in its set of instruments. It should be noted that including China government bond buying and selling in the monetary policy toolkit does not mean quantitative easing, but predominantly it is meant to be a channel for base money injection. Pan also remarked that the loan prime rate (LPR), which is the reference rate for bank loans, needed to be reformed to better reflect market rates (Bofit, 2024). The banks submit their quotes for the LPR to the PBoC based on its medium-term lending facility (MLF) rate,[20] which should become a less important policy rate, with greater emphasis placed on the seven-day reverse repo rate.

Another important policy message that Governor Pan gave on 19 June was that the official interest rate corridor was too wide and a narrower corridor should be implemented to signal a clearer target to assure the market (Nomura, 2025). The PBoC wanted to exercise more precise control over short-term interest rates by narrowing the corridor. This official corridor was the range between the seven-day Standing Loan Facility (SLF) rate[21] and the interest rate on excess reserves (IOER).[22] As explained by Nomura (2025, p. 9), the PBoC aimed "to guide short-term market rates, particularly the seven-day repo rate for depository institutions (DR007), to move around the policy rate of the seven-day reverse repo rate – through open market operations – within the corridor". The policy problem was that this corridor appeared to be too wide to be meaningful; moreover, while the lower bound was effective, the PBoC did not explicitly commit unlimited lending at the upper bound. This all led the PBoC to introduce a new, narrower corridor in July-2024, with the overnight reverse repo rate (lending) as the ceiling (50bps above the seven-day reverse repo rate) and the overnight repo rate (borrowing) as the bottom (20bps below the seven-day reverse repo rate), with both the overnight repos and reverse repos conducted on a temporary basis (Fitch Ratings, 2024a, Central Banking, 2024). In this narrower corridor, "the DR001 (interbank bond collateral repo rate for depository institutions – AvR) appears to have become the new targeted short-term market interest rate, subject to the new interest rate corridor" (Nomura, 2025, p. 9). The new interest rate corridor narrowed from around 230bps to around 70 basis points (Central Banking, 2024).

The remarks by Zou Lan early September 2024 aimed to explain that the PBoC's objectives were to strengthen the seven-day reverse repo rate as the main policy interest rate to smooth the transmission mechanism, to conduct temporary repo/reverse repo operations to enhance the precision and efficiency of open market operations. Lu Lei, deputy-central bank governor, told the same press conference that the PBoC would continue to adhere to a supportive monetary policy stance (Reuters, 2024a).

20 The Medium-term Lending Facility (MLF) was the PBoC's main policy rate and is the rate at which banks can borrow from the PBoC for a one-year term utilizing qualified collateral (ING, 2024a, p. 2). The PBoC sets this rate, which typically then has a direct impact on commercial banks' loan prime rates, adjusted several days later. ING emphasized that the PBoC sets the MLF rate, but it is up to the banks to take the initiative to utilize the MLF. Even taking into account the changes announced by Governor Pan, the MLF remains quite an important tool for medium-term financing: At the end of the first half of 2024, there was RMB 7.07 trillion of MLF outstanding. Hence, it is to be expected that the MLF will remain a relevant monetary policy instrument and any phasing out would only be gradual (ING, 2024a, p. 5). A schematic overview of the monetary policy framework in China is shown in Appendix III.

21 The seven-day SLF facility provides loans to commercial banks against collateral with a seven day maturity and represented the ceiling for the "old" interest rate corridor (ING, 2024a). Use of the SLF is low relative to the MLF. The PBoC set the seven-day SLF rate at the seven-day reverse repo rate plus 100bps.

22 The IOER is the rate at which the central bank makes interest payments on the excess reserves deposited by financial institutions (Nomura, 2025, p. 9).

The bank included again in its monetary policy toolbox government bond operations.[23] This move was intended to serve as a channel for base currency issuance and a tool for liquidity management (Xinhua, 2024a; PBoC, 2024b). It was designed to work in conjunction with other instruments to make short-, medium- and long-term liquidity management more precise. The face value of net government bond purchases in September was RMB 200 billion (PBoC, 2024f, p. 12).

On September 24, the Peoples' Bank of China (PBoC), the China Securities Regulatory Commission (CSRC, the securities market regulator) and the NFRA (National Financial Regulatory Administration, which conducts unified supervision and regulation of the financial industry except the securities sector) unveiled a comprehensive and coordinated set of easing policies at a joint press conference (Autonomous, 2024a; Bloomberg, 2024b; Citi, 2024b and 2024e; Société Générale, 2024a and 2024b; The Economist, 2024d; Goldman Sachs, 2024e; KraneShares, 2024a and 2024b; Nomura, 2024a; PBoC, 2024b; UBS, 2024c and 2024e). This package has been typified as a policy "Bazooka" or a "Big Bang" and undoubtedly was the most important policy package and policy shift announced in many years[24], and included monetary, fiscal, housing and equity market policy measures (JP Morgan, 2024k and 2024x). In fact, it was the first very large, coordinated policy initiative in recent years, a comprehensive package rather than the more usual piecemeal policy measures, and was larger than many observers expected and surprised many by both the timing and scope of the measures (Morgan Stanley, 2024h and 2024e). David Tepper, of the hedge fund Appaloosa Management, was so impressed by the size and comprehensiveness of the package that he concluded that "This is incredible stuff for that place. […] Buy Everything. Every. Thing" (The Economist, 2024d). According to many analysts, the package indicated policymaker's growing concerns over downside risks to domestic economic activity (Goldman Sachs, 2024d). Morgan Stanley called it a "policy pivot" and concluded that reflation was now a serious target (Morgan Stanley, 2024g).

23 As reported by media outlets early July 2024, the PBoC had set up central government bond (CGB) borrowing arrangements with major financial institutions on an open-ended unsecured basis (Goldman Sachs, 2024b; italics GS). The PBoC hinted at potential short selling of CGBs to stem the bond rally in the near term. In the view of Goldman Sachs, the PBoC was trying to set a floor for long-term CGB yields via a reverse operation twist, i.e. sell long-term bonds and provide front-end liquidity simultaneously to steepen the yield curve. This suggests that the PBoC would like to maintain an upward-sloping yield curve and contain the rising exposures to interest rate risks in financial institutions (Goldman Sachs, 2024b, p. 1).

24 JP Morgan called it "the most comprehensive easing since 2015" (JP Morgan, 2024b, p. 1). Morgan Stanley asserted that it reflected a shifting approach on deflation (Morgan Stanley, 2024d). The Economist (2024f) wrote that "The measures represent a long overdue change in the style and urgency of China's policymaking.[…] Compared with past stimulus efforts, the latest measures have been better communicated and coordinated, and more targeted at consumers". Goldman Sachs (2024j, p. 6) concluded that the stimulus announcements appeared "distinct from prior announcements: they appear more coordinated, with greater buy-in from the highest echelons of government, and appear to be specifically aimed at putting a floor under equity prices". It also wrote on 29 September that "After more than two years of slow and reluctant easing, last week's easing measures announced by the PBoC and the surprise economy-focused September Politburo meeting seemed to break away from the previous piecemeal-style of policy easing and provide a sizable dose of policy stimulus that the market had long been hoping for" (Goldman Sachs, 2024gk, p. 1). Citi (2024e, p. 3) was inclined to think that "this time was different". ING appreciated the package and also emphasized the departure from the conventional step-by-step policy convention, as multiple measures were "announced together rather than spacing out individual piecemeal measures to a more limited effect" (ING, 2024c, p. 2).

The actions taken consisted of three areas in particular: Actions by the central bank (e.g. monetary easing), forward-looking discussions and possible actions by the fiscal authorities (e.g. fiscal stimulus), and debate on structural economic reforms (e.g. structural rebalancing): this policy has also been typified the “three-arrow policy” (JP Morgan, 2024k, 2024g and 2024x).

First, PBoC Governor Pan announced at the briefing organized by the State Council Information Office (SCIO) on 24 September, that since the course of September, following the decisions and arrangements of the CPC Central Committee[25] and the State Council,[26] the PBoC had strengthened monetary policy adjustments, introduced a series of incremental financial policies, and provided support for the stable growth of the real economy. In summary, the bank unveiled a package of policy measures, including further easing of the policy stance by lowering the reserve requirement ratios (RRRs) and policy rates, reducing the interest rates on existing mortgages and unifying the minimum down payment ratios for mortgages, and creating new monetary policy tools to support the stable development of the capital market (e.g. stock market) (Citi, 2024a; ING, 2024c; Pan, 2024b, p. 4; Wall Street Journal, 2024a; SCIO, 2024). In line with the further easing of monetary policy, the size of the balance sheet of the PBoC continued to increase (Chart 4, Panel A). Pan said that the measures aimed to support the stable growth of the economy and promote a moderate rebound in prices (Financial Times, 2024b). The package exceeded market expectations and market analysts generally assessed it as a step in the right direction. With all these policy measures, one has to keep in mind that according to the PBoC Law, the bank is not independent from a legal and most likely also not from an operational perspective.[27]

More specifically, the PBoC implemented three important main groups of measures, of which the first one amounted to an important round of monetary easing (i.e. lower interest rates) (Chart 4, Panel B and C) and lower reserve requirement ratios (RRRs) (Chart 4, Panel D and E) and providing market liquidity, with cuts in policy rates that were

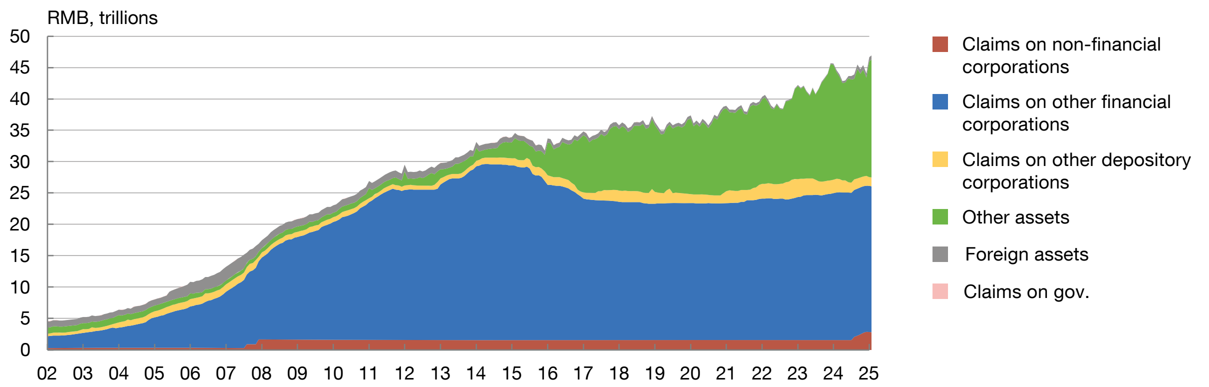
25 The Central Committee of the Communist Party of China (CPC) is the highest organ when the National Congress is not in session and is tasked with carrying out congress resolutions, directing all party work, and representing the CPC externally. According to the CPC’s constitution, the Central Committee is vested with the power to elect the General Secretary and the members of the Politburo and its Standing Committee, as well as the Central Military Commission. It consists of some 200-odd delegates and meets at least once per year. The Standing Committee of the Politburo is according to Bloomberg (2025c) the “highest ranking body in China, and the ultimate decision maker on the part committees in the government, judiciary and parliament that carry out its orders”. It has seven members and may meet as many as three or four times a month.

26 The State Council of the People’s Republic of China, also known as the Central People’s Government, is the chief administrative authority and akin to the National Cabinet of China. It is constitutionally the highest administrative organ of the country and the executive organ of the National People’s Congress (NPC), the highest organ of state power. It is composed of a premier, vice-premiers, state councilors, ministers, chairpersons of commissions, an auditor-general, the governor of the PBoC, and a secretary-general. See also Bloomberg (2025c).

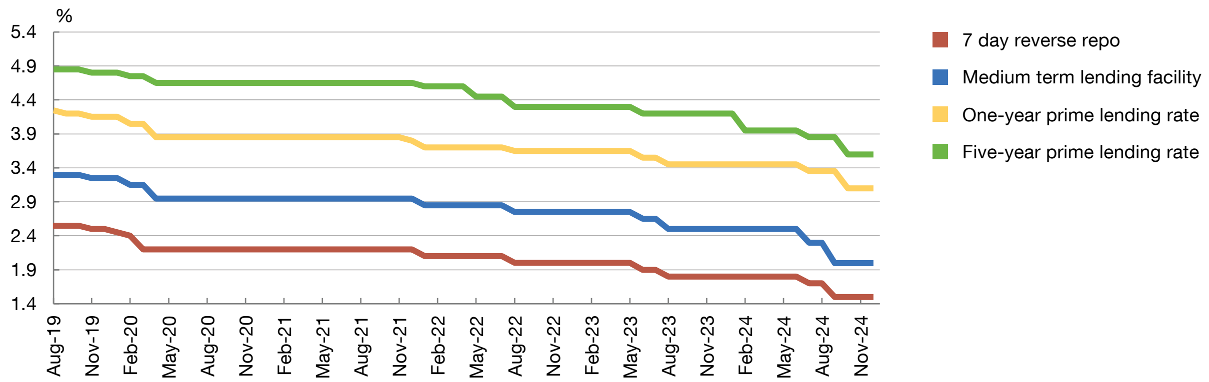
27 The Law of the People’s Republic of China on the People’s Bank of China states in Article 2: “The People’s Bank of China shall, under the leadership of the State Council (bold added – AvR), formulate and implement monetary policies, guard against and eliminate financial risks, and maintain financial stability” (PBoC, 2003; amended version original 1995 Law). Bloomberg (2025c) states unequivocally that the PBoC is not independent: It needs to get approval from the State Council before making any major decisions. See also Bofit (2024). The PBoC’s Monetary Policy Committee meets once a quarter. The bank publishes the one-year and five-year Loan Prime Rates (LPRs).

Chart 4
Central bank

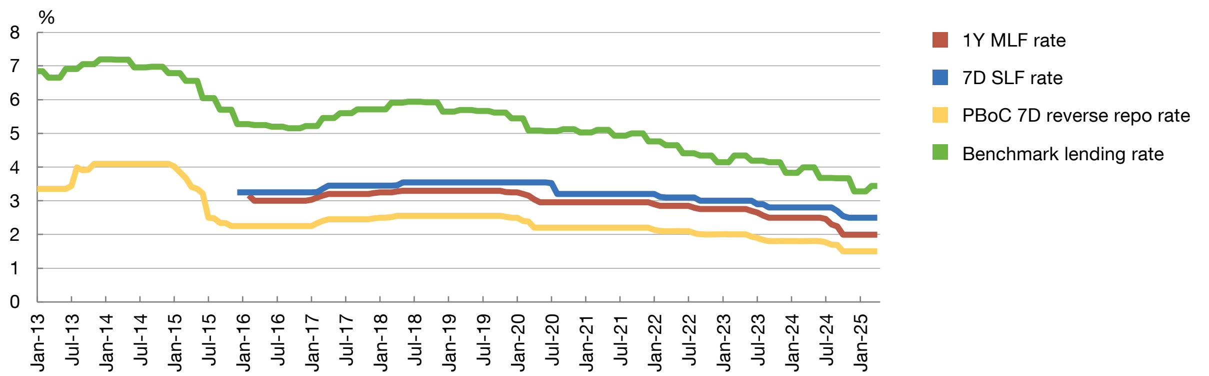
4.a PBoC total assets (RMB trillions)



4.b China main lending rates



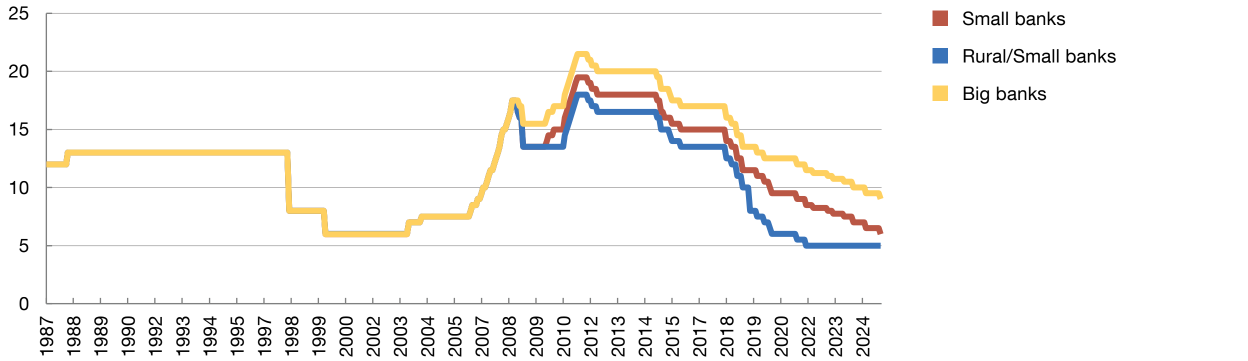
4.c China lending rates



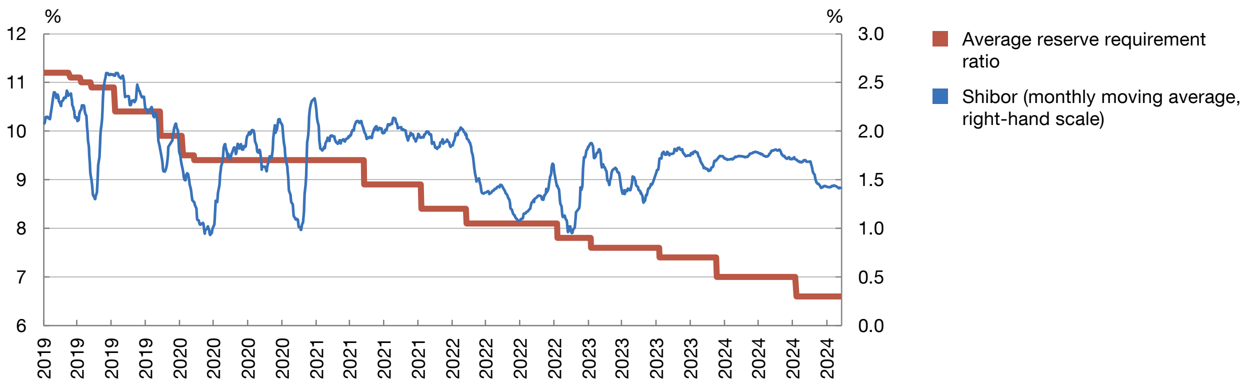
SOURCES: LSEG Workspace, Bloomberg, CEIC, JP Morgan and Goldman Sachs.

Chart 4
Central bank (cont'd)

4.d China reserve requirement ratios different bank types



4.e Weighted average effective reserve requirement ratio Chinese banks and Shibor interbank rate



SOURCE: LSEG Workspace, Bloomberg, CEIC, JP Morgan and Goldman Sachs.

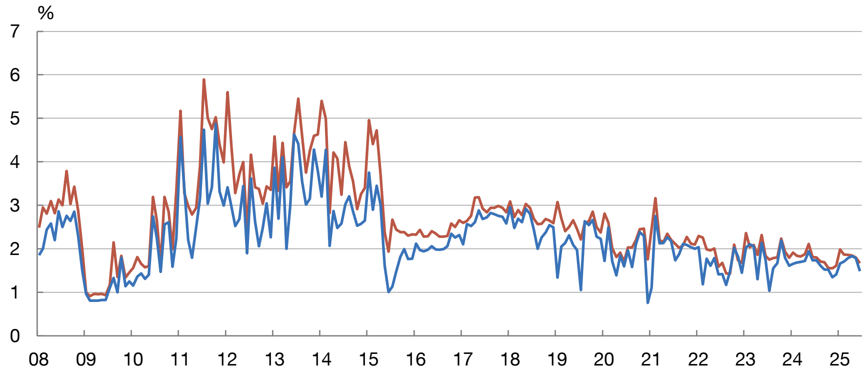
larger and more encompassing than expected (Wall Street Journal, 2024d).[28] In this line, on September 27th the target for the 7-day reverse repo rate (e.g. the policy rate) was lowered by 20 bps to 1.5% from 1.7%, which was the largest decrease in four years and arguably the most important measure in the package.[29] The decline in the policy rate contributed to the continuation of the decline in repo rates that has been observed during the past years (Chart 5, Panel A), which was accompanied by an increase in net open market operations, with a considerable injection of net liquidity towards the end of 2024 (Chart 5, Panel B).

28 The 7 day SLF rate in Chart 4, Panel C, provides loans to commercial banks with a seven day maturity and represents the ceiling for the interest rate corridor (ING, 2024a). Use of the SLF is low relative to the MLF. The SLF rate is the upper bound of the interest rate corridor, while the interest rate on excess reserves is the lower bound. As explained by ING (2024a, pp. 2-3), "the interest rate corridor represents the upper and lower bound for market interest rates; the ceiling and floor represent the rates at which banks could borrow from and lend to the central bank. The seven day reverse repo rate is the policy rate, while the one week Shanghai Interbank Offered Rate (Shibor) is the market rate which both fall within this corridor".

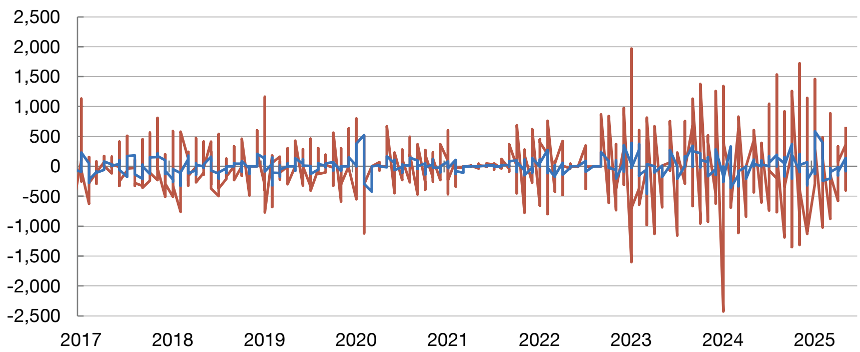
29 The PBoC conducts open-market operations (OMOs) in the form of repos and reverse repos in order to influence interest rates and liquidity in markets (ING, 2024a, p. 3). These are primarily short-term operations, where the 7-day reverse repo rate is the main rate. As observed by ING, the PBoC has signaled it wishes to expand its OMOs to trading of longer-term securities as well.

Chart 5
Money market developments

5.a Repo rates



5.b China net open market operations



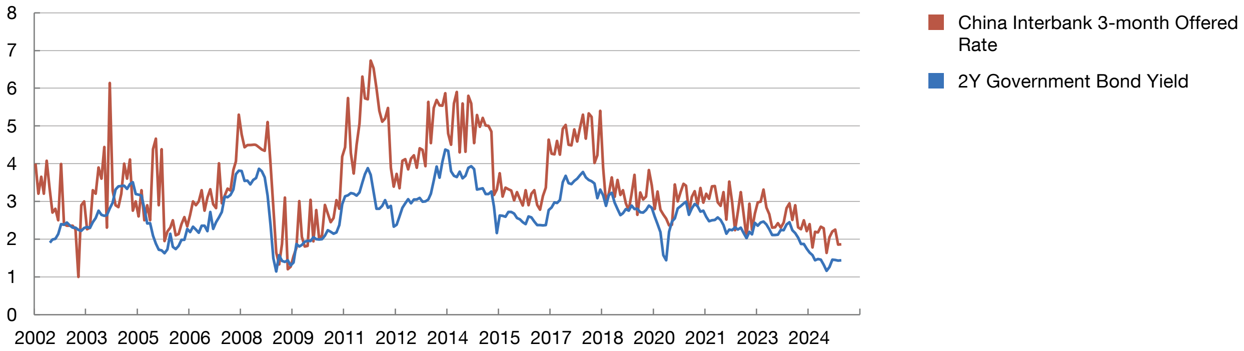
SOURCE: LSEG Workspace.

The MLF rate was cut by 30bps (from 2.3% to 2%) and a follow-up adjustment of the Loan Prime Rate (LPR) charged by commercial banks would follow soon, while Governor Pan mentioned that deposit rates would move down at the same time (around 20-25bps) to keep banks' net interest margins (NIM) stable (Goldman Sachs, 2024d; Wall Street Journal, 2024h and 2024c). However, market analysts assessed their impact as modest.

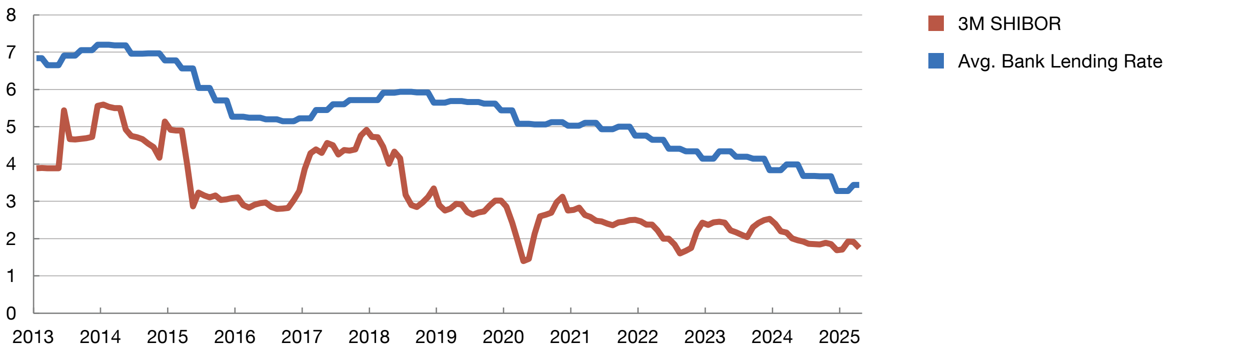
What was new was that for the first time since 2015 a reduction in RRRs was combined with interest rate reductions. The bank reduced the RRR for financial institutions by 0.5 percentage points on September 27th, especially the RRRs of big and small banks, while those of rural/small banks stabilized at a historic low (Chart 4, Panel D). This resulted in a lower weighted average effective RRR and in a lower Shanghai Interbank Offered Rate (Shibor) (Chart 4, Panel E). This was to support the banking sector: the lower RRR freed up liquidity for banks, so they could extend more loans (higher volume), but at a lower interest rate (lower price). The reduction of the RRR resulted in injecting about RMB 1 trillion of medium- and long-term liquidity in financial markets (PBoC, 2024f).

Chart 6
Financial market developments

6.a China interbank rate (Shibor) and government bond yield



6.b China interbank rate (Shibor) and average bank lending rate



SOURCES: LSEG Workspace, CEIC and JP Morgan.

Governor Pan provided forward guidance that the RRR could be lowered by another 25-50 bps before the end of the year, depending on the macro developments (JP Morgan, 2024b). The PBoC optimized the mechanism for open market operation and conducted 14-day reverse repos to inject cross-quarter funds in advance – from September 23rd to September 30th, it injected RMB 1.7 trillion, ensuring a smooth operation of market institutions at quarter-end (PBoC, 2024f, p. 12). It also gradually increased the purchases and sales of government bonds in its open market operations. The purchases should not be seen as a form of Quantitative Easing, but as a tool to provide the economy with sufficient base money. The PBoC announced the start of outright reverse repo operations on 28 October with a maturity of no longer than one year; at the end of the month, RMB 500 billion of these operations had been conducted (JP Morgan, 2024l).

The transmission of lower policy rates to other interest rates was smooth, as they resulted in lower interbank rates (for example a lower three-month Shibor rate), which were accompanied by a lower two-year government bond yield (Chart 6, Panel A) and a lower average bank lending rate (Chart 6, Panel B).

Moreover, secondly, the PBoC launched new policies to bolster the real estate market, including a relaxation of mortgage loan policy. The PBoC lowered existing mortgage interest rates, unified the minimum down payment ratio for first- and second-home buyers, and it improved central bank lending for government-subsidized housing. Numerous specific measures were implemented, both on the supply and demand side.

On the supply side, the PBoC provided support to the de-stocking of real estate, basically supporting the purchase of empty apartments. The PBOC advanced implementation of the central bank lending facility for government-subsidized housing, incentivizing and guiding financial institutions to support local state-owned enterprises in their purchase of completed but unsold commercial housing, with the aim of accommodating rental and sales needs (PBoC, 2024f, p. 16). After the launch of the facility, the loan support scheme for rental housing was merged into the central bank lending facility for government-subsidized housing. The PBoC also modified the re-lending facility to support the purchase of housing inventory by increasing the share of this facility in such operations from 60% to 100% (JP Morgan, 2024k and 2024b).[30] The pledged supplementary lending (PSL) facility was utilized effectively in supporting financial institutions to grant loans for the development of government-subsidized housing, the renovation of urban villages and the construction of public infrastructure. At end-September, the outstanding amount of the PSL posted RMB 2.6 trillion (PBoC, 2024f).

On the demand side, the minimum downpayment ratio for mortgages would no longer distinguish between first-home and second-home loans and was reduced and set uniformly at no less than to 15% (PBoC, 2024c). The PBoC would guide banks to lower interest rates of existing mortgages towards the rates of new mortgages, which according to Governor Pan would lower existing mortgage rates by around 50bps on average (Goldman Sachs, 2024d). The latter measure was especially seen as providing a boost to consumption, as it could minimize mortgage interest payments by around RMB 150 billion. The PBoC announced on September 29th an improved pricing mechanism for rates on existing mortgages used to finance commercial personal housing (PBoC, 2024f, p. 22). The spread on mortgage rates was now replaced by a new pricing method in order to reduce the rates of existing mortgages: these were now priced at the latest 5-year loan prime rate with a spread, which could be positive or negative (JP Morgan, 2024k). The new pricing mechanism of mortgages also offered many more possibilities for households to engage in renegotiation talks with the banks: 1) Existing fixed rate mortgages could now be renegotiated info floating rates; i.e. refinance mortgages from fixed to variable rates (Natixis, 2024c). Before this, many Chinese home buyers with existing mortgages had been unable to immediately benefit from interest-rate cuts (Wall Street Journal, 2024f and 2024d); 2) Effective from November 1st, existing mortgage borrowers could renegotiate the

30 The re-lending facility of RMB 300 billion to support the purchase of housing inventory was created in May 2024 (JP Morgan, 2024b). The PBoC created this facility to support affordable housing, providing 60% of the principal of bank loans extended to regional state-owned enterprises (SOEs) to purchase unsold homes.

repricing process with banks; 3) When existing mortgage rates deviate to some extent from new mortgage rates, mortgage borrowers could negotiate with banks to refinance their existing mortgages (JPM, 2024k, p. 127). On the same day, a “self-regulatory” initiative was issued, with active response from commercial banks, to adjust (i.e. lower) the rates of existing mortgages, starting on October 25th (PBoC, 2024f, p. 22). All in all, as the PBoC concluded, “The market mechanism played a more effective role in encouraging banks and clients to independently negotiate and dynamically adjust mortgage rates for existing housing loans based on market principles so as to mitigate conflicts in an orderly manner and to safeguard the integrity of contracts” (PBoC, 2024f, p. 22).

However, what was missed in these housing sector-oriented policy measures was the implementation of improved incentives to get rid of unsold stocks of housing, by adopting fiscal subsidies, which according to many observers could play a more pronounced role in the economic situation at that juncture in mitigating the property crisis. However, fiscal policy was still not conducted at the central level, despite several small moves in some cities. There were some short-term positive effects (see below), but they did not amount to a fundamental and structural solution to the property crisis. Analysts did not see a quick fix to the property challenges, and a step-up of existing measures was perhaps not enough; the game changer, if taken, should be large-scale public funds to make housing buybacks really work, which would perhaps be the only way to restore the supply-demand balance quickly (Citi, 2024e, p. 7). It has to be said that formulating and implementing a fiscal stimulus package is also not easy in China, given that it would require joint efforts by many ministries and other state actors (Goldman Sachs, 2024k, p. 2).

The PBoC also increased financial support for all-round rural revitalization, specifying special actions focusing on rural industry, rural construction, and rural governance to further support this revitalization. The PBOC does not extend loans, but it has structural monetary policy instruments (e.g. re-lending facilities) to encourage lending to targeted areas, such as agriculture, small-and medium-sized enterprises, innovation and the environment. For example, agriculture-related loans are supported by the PBoC’s agriculture re-lending facility. Financial institutions were guided to provide financial services in key areas related to rural revitalization, such as safeguarding food security, securing stable production and the supply of important agricultural products, promoting industry revitalization, consolidating and expanding the achievements made in poverty alleviation and improving the effectiveness of financial assistance (PBoC, 2024f, p. 21). At end-September, outstanding agriculture-related bank loans amounted to RMB 51.1 trillion with a year-on-year increase of 10.8 percent, while the balance of bank loans for rural infrastructure construction registered a year-on-year increase of 12.7 percent, reaching RMB 10.2 trillion. These are very large amounts of bank loans and impressive growth figures: With an RMB/$ exchange rate of 7.85 on 30 September 2024, these loans were in USD terms equal to $6.5 trillion and $1.3 trillion, respectively.

Finally, the PBoC announced two new instruments to support the stock market: according to JP Morgan (2024x), the PBoC’s direct support to the equity market was the biggest surprise of the package. It introduced RMB 500b billion in swap arrangements with market parties, which will significantly enhance the ability of eligible institutions to acquire funds and make (stock market) investments (Pan, 2024b). This Securities, Funds and Insurance companies Swap Facility (SFISF) was launched on 10 October to support eligible securities firms, mutual funds and insurance companies to use their assets, including bonds, stock ETFs and holdings of CSI 300 constituent stocks, as collateral in exchange for highly liquid assets, such as government bonds and central bank bills from the PBoC (PBoC, 2024f, p. 12-13). This facility improves the participating institutions' ability to raise funds and to increase stock holdings: government bonds have a higher collateral value than stocks, allowing investors to raise more funds by purchasing additional stocks using government bonds as collateral (S&P Capital IQ, 2024). Governor Pan said the swap facility would "significantly enhance these institutions' ability to raise funds and increase stock holdings" (Wall Street Journal, 2024f). The bank conducted the SFISF operations for the first time on 18 October, with an allotment amount of RMB50 billion and 20 institutions participating (which applied for RMB 200 billion), with eligible collateral being bonds, stock ETFs, REITs and constituents of the CSI300 stock index (Morgan Stanley, 2024n).

Furthermore, the other new monetary policy tool consisted of providing RMB 300 billion in a new re-lending facility to help listed companies and major shareholders to buy back shares and to provide loans to these companies' major shareholders (increase shareholdings), which was kicked off on October 18th, offering funds at 1.75%, with a maturity of one year and liquidity granted on a quarterly basis, to 21 eligible banks (JP Morgan, 2024k; PBoC, 2024d and 2024e). The expectation is that this new instrument will guide banks to provide loans to listed companies and major shareholders for share buybacks (Pan, 2024b, p. 4). The first operation in the SFISF was conducted on 18 October. On the same date, the PBoC started its re-lending facility to help listed companies and major shareholders to buy back shares, for which 21 commercial banks were eligible (JP Morgan, 2024l). Market observers overall assessed these two new instruments for stock market support as positive.[31]

Never before the PBoC had taken such measures in support of the equity market. If necessary, the governor said, these measures could be scaled up three times, making ultimately available RMB 2.4 trillion (about USD 336 billion).[32] It has to be emphasized that under the programs, the PBoC does not directly buy stocks.

In the context of the PBoC's measures, supervisory authorities were concerned that lower rates and a flatter yield curve undermined the profitability potential of banks. Hence, to alleviate concerns of financial stress, plans were announced by Li Yunze, director

31 Morgan Stanley (2024c, p. 2) assessed the stock market support measures as "an absolute positive move given their unprecedented nature, and the unlimited funding promised". It put the caveat that implementation remained key and that macro recovery and corporate earnings growth bottoming out are crucial for long-term sustainability of market sentiment improvements and rebound rally.

32 1 $ = RMB 7.14 (25 October 2024).

of the NFRA[33], to increase core tier one capital in the biggest six commercial banks, whose margins and profits had been eroded by fee reductions and lower interest rates, without giving further details of the bank recapitalization (Financial Times, 2024a).

Second, fiscal easing was discussed, although no specific amount of fiscal support was announced. In the markets, the wildest expectations regarding the amount of a fiscal stimulus circulated, ranging from RMB 2 trillion to RMB 10 trillion. Market estimations of more respected analysts were between RMB 1 and RMB 2 trillion.

Third, structural rebalancing of the economy was mostly discussed, and no important policy measures were taken. It was reiterated that China should move from an ((over)investment and supply economy, dominated by heavy industries and government-owned enterprises, to a demand and consumption society, with a well-developed services industry (e.g. services versus manufacturing, consumption versus investment (JP Morgan, 2024x).

Finally, the CSRC,[34] one of the three policy bodies participating in the September 24th press conference, announced a couple of financial market friendly measures (UBS, 2024c; KraneShares, 2024a and 2024b). First, it would publish a consultation paper to solicit public opinion on market cap management guidelines aiming to boost listed companies' value. Second, the CSRC would look to reform the mergers and acquisitions rules of listed companies. Third, it intended to enhance profitability and governance of listed companies to attract long-term capital. Fourth, it would study the establishment of a market stabilization fund. Finally, the intentions were announced supporting private equity and encouraging venture capital.

The total "Bazooka" policy package was indeed impressive, but according to many analysts not impressive enough, as concrete larger fiscal stimulus measures were not included (see for example: Natixis, 2024c; Wall Street Journal, 2024a). Many held the view that the package could offer important temporary support and short-term improvement of the economy, but that

33 The National Administration of Financial Regulation (NAFR) was officially established on 18 May 2023 (Clifford Chance, 2023). The new regulator replaced the former China Banking and Insurance Regulatory Commission (CBIRC) and also took over certain financial consumer/investor protection responsibilities from other regulators. The NFRA is responsible for implementing the policies and decisions of the CPC Central Committee on financial work. The five top main responsibilities (out of 15 tasks mentioned, see NAFR, 2025) of the NAFR can be summarized as follows (NAFR, 2025): 1) To conduct supervision and regulation of the financial industry except the securities sector; 2) To carry out systematic research on issues concerning the reform and opening up as well as effective supervision of the financial industry; 3) To conduct and coordinate work concerning the protection of financial consumers' rights and interests; 4) To conduct authorization of banking institutions, insurance institutions, financial holding companies and others in accordance with law, and carry out supervision and regulation of these institutions; 5) To conduct on-site examination and off-site surveillance of banking institutions, insurance institutions, financial holding companies and others.

34 The China Securities Regulatory Commission (CSRC) is under the direct administration of the State Council and implements the policies, principles, decisions, and plans of the CPC Central Committee on financial work. The CSRC's top four main responsibilities (out of 16 mentioned, see CSRC (2025) include: 1) Performing unified regulation and supervision of the securities industry, with strengthened oversight of the capital markets in accordance to laws and regulations; 2) With regard to the securities, futures and fund markets, formulating principles, policies and development plans and drafting relevant laws and regulations; 3) Regulating and supervising the issuance, listing, trading, custody and settlement of stocks, convertible bonds, depository receipts and other equity securities subject to CSRC's oversight as assigned by the State Council; 4) Regulating and supervising the issuance, listing, admission, trading, custody and settlement of corporate (enterprise) bonds, asset-backed securities and other fixed-income securities on the exchange-traded market subject to CSRC's oversight as assigned by the State Council; regulating and supervising the listing and trading of government bonds in the exchange-traded market.

it was not yet "the whatever it takes" action.[35] As is usual with economic policy announcements, and certainly in China, given past experiences, the key was definitely in the implementation of the policy measures. It was also unclear to some analysts what the policy objectives of the Chinese government regarding the package were. Some believed that the government intended to address the structural problems in the economy, while others held the view that Chinese policymakers just wanted to make sure to reach the "around 5%" of GDP target for 2024 (Financial Times, 2024c).

Nevertheless, some measures had short-term positive effects, for example regarding the property sector: the positive effects from the stimulative policies announced in late September on housing lasted longer than was the case with post-May supportive policies (UBS, 2024l). Some green shoots were notable in the property sector: the September measures boosted buyers' confidence more as evidenced by the rebound in new home sales in October, while major cities' new home sales increased by almost 20% in November (e.g. the first increase in 1.5 years) whereas "upgrade" demand for high-end projects remained intact; secondary home sales jumped at the end of October as VAT and deed tax cuts took effect (JP Morgan, 2024r). Goldman Sachs reported in October that on the back of the comprehensive and coordinated easing package finally an inflection point of the ongoing downward spiral in the housing market was achieved; it was "the first-time since this downturn (of the housing market – AvR) that the government has indicated its inventory reduction efforts will go beyond minimizing completion risk for pre-sold units and reducing saleable inventory. The government also plans to address idle construction-in-progress and raw land through potential issue of local government special bonds" (Goldman Sachs, 2024n).[36] As reported by UBS, so-called "rigid" demand (i.e. buying homes to live in, rather than for investment purposes) has also been active since October. The stock prices of real estate developers surged after the policy package was announced, with the stock prices of distressed developers increasing by 50% to 400% (JP Morgan, 2024d). Since the through in developer's stock prices, they had increased by 94% early October, after a drop of 78% from their peak in 2021. Following the easing measures, new home sales staged a strong rebound, led by the first-tier cities, while the downward momentum in house prices softened slightly (Société Générale, 2024d).[37]

35 Among the many assessments, see for example Bloomberg (2024b); Citi (2024a); UBS (2024a). UBS (2024b), p. 2 stated that "more policy easing is needed to counter property downturn and stabilize the economy in the coming months. On the property side, we believe a meaningful property destocking would need significantly more funding support from the government and the PBoC, and with lower interest costs, among other things. We also believe the whitelist scheme needs to be expanded further to support home delivery of stalled projects". The "white list" is a register of real estate projects or developers that have been ruled compliant with regulations and thereby eligible for financial support from policy organizations; under this list published in late January 2024, local authorities are recommending real estate projects eligible for financial support to financial institutions, which are required to timely disburse loans to eligible property projects and meet their reasonable financing needs (Xinhua, 2024b). Natixis (2024a, p. 2) concluded that "it will take considerable time for these policies to translate into a full recovery. Furthermore, the geopolitical tension surrounding China has also been uncertain". Goldman Sachs called the package "Better late than never", and that it was "not enough to turn things around fundamentally", but that was "enough to catalyze another policy-induced rally" in stock markets (Goldman Sachs, 2024e). Morgan Stanley (2024h) focused on three issues that remained after the "Bazooka" package: 1) A shortfall in demand; 2) A challenging situation around the outlook for public finances; 3) An unsolved debate over whether to invest or consume.

36 End November 2024, Goldman Sachs (2024r) reported: "top tier cities are more likely to reach a price bottom sooner, driven by stronger migration flows, lower inventory levels and the recent easing of housing purchase restrictions, while the house price recovery in lower-tier cities is likely to be prolonged".

37 The Economist (2024i) published that sales of new residential properties rose a little year on year in November, "the first increase in over three years excluding a surge in early 2023 after covid controls were abandoned", while prices also seemed to be flattening out.

Local initiatives tried to contribute to mitigating the property crisis. Late in September, the four Tier-one cities implemented their own policies to support the property sector by a variety of city-specific measures, such as tax exemptions and lowering VAT (i.e. exempted VAT (5%) for secondary house with buying record over 2-year in Shanghai and Shenzen), the relaxation of home purchase and resale restrictions, lowering the downpayment ratios for first home and second home purchases and for second-home purchases in core and non-core districts, in Guangzhou eliminating all home purchase restrictions in all districts of the city, removing the distinction between ordinary and non-ordinary housing in Shanghai and Beijing (which could exempt VAT tax for housing units of 144 square meters+ if held for 2+ years) and removing home-selling restrictions in Shenzhen (JP Morgan, 2024k; Goldman Sachs, 2024i). Huang, Gan and Song (2024) found that relaxing housing purchase restrictions, which some Chinese cities had adopted as of March 2022 to boost the real estate market and stabilize housing prices, had a positive effect on the existing housing market, contributing to its stabilization, while the impact on new house prices was unclear.

The Monetary Policy Committee of the PBoC held its third quarterly meeting of 2024 on September 25th. The report of the meeting included the PBoC's measures announced one day earlier, and portrayed a remarkable optimistic picture, with very little attention for the challenges facing the Chinese economy (PBoC, 2024f). In the view of analysts, the report confirmed a supportive policy stance, did not reveal any new concerns on deflation risks[38] and elaborated on the new monetary policy framework focused on interest rates, replacing the previous quantity-based system (Citi, 2024l, pp. 1-2). The optimistic tone in the report was set from the beginning: "Since the beginning of 2004, […] China has strengthened macro regulation and control while focusing on deepening reform and opening-up, expanding domestic demand, and optimizing the economic structure. As a result, overall economic performance has been stable". The report also acknowledged the subservient position of the PBoC in monetary policy decision making: "the PBoC earnestly implemented the decisions and arrangements of the CPC Central Committee and the State Council". It concluded that "external uncertainties are on the rise" and that the "domestic economy still faces challenges, such as insufficient effective demand and weak social expectations" (PBoC, 2024f, p. II). But, nevertheless, it continues: "China's economic fundamentals remain solid, and favorable conditions for development, including its big market, resilient economy, and great potential, remain unchanged. Therefore, we should face the challenges, remaining confident and responding proactively". The PBoC announced to deepen institutional reform in the financial sector, fasten the pace of improving the central banking system, and further optimize the monetary policy framework, including studying a plan to update money supply criteria.[39] On the outlook for China's economy, the report concludes that

38 The words "deflation" or "deflationary pressures" do not appear in the report. On inflation, the Committee stated rather positively that "consumer prices rebounded moderately, while the decline in producer prices generally narrowed" and "prices are expected to continue a moderate rebound" (PBoC, 2024f, p. 44 and p. 50). On the announced further policy easing, Citi (2024l) expected that the PBoC's forward guidance on a 25-50 reserve requirements' cut within 2024 should follow through soon, while exchange rate policy could return to the focus with the inauguration of the second Trump administration.

39 In China's money supply statistics, there are three different aggregates: M0 (currency in circulation), M1 (includes M0 plus demand deposits by enterprises and public institutions) and M2 (M1 plus time deposits by enterprises and public institutions, personal deposits, deposits of non-depository financial institutions, and fund shares held by non-depository institutions in the money market) (definitions PBoC, 2024f, p. 7).

"China's economic development enjoys strong resilience, tremendous potential, and vigorous support" (PBoC, 2024f, p. 49). It acknowledges that the foundation for economic recovery still requires strengthening, with both the internal and external environments being complex and changing: external uncertainties, risks and challenges are rising, while domestically the economy is at "a pivotal stage of structural adjustments and transformation, facing intertwined cyclical and structural challenges"; but all in all, "China's economic fundamentals remain robust with favorable conditions" (PBoC, 2024f, pp. 49-50).

The report of the Monetary Policy Committee devotes considerable attention to the monetary policy transmission process, starting from 7-day reverse repo rate, its new main policy interest rate. It explains that by adjusting this rate, the PBoC is able to affect money market rates, government bond yields, and deposit and loan rates. The Committee concluded that the transmission of policy rates is effective, but there are differences in transmission across different markets: "The money market and bond market rates generally move in the same direction as does the policy rate of a similar magnitude. However, […] the movement of deposit and loan rates diverged from that of the policy rate during the same period" (PBoC, 2024f, p. 24). According to the PBoC, this was mainly due to intense market competition and inertia in bank policies: while loan interest rates fall quickly, with rates on loans to large enterprises being substantially lower than government bond yield with the same maturity, deposit rates showed a 'reluctance to decline'". The PBoC attributed this policy to the "obsession" of banks with the expansion of scale, with some banks making up for the lower deposit rates through manual interest subsidies to their clients, thereby raising actual rates, while explicit rates are declining (PBoC, 2024f, p. 24). Interestingly, the PBoC will continue its efforts to build China into a "financial powerhouse" (PBoC, 2024f, p. 50).

Further in September, and following up to the "Bazooka" package of 24 September, the Politburo meeting[40] on September 26th – which was chaired by President Xi[41] – called for strengthened counter-cyclical policy measures, which was seen as an unusual move to focus on economic issues outside the normal meeting agenda (i.e. unprecedented) (JP Morgan, 2024k, p. 127; KraneShares, 2024d; Nomura, 2024b), and was an indication of the seriousness of the economic downturn, housing crisis and deflationary pressures, as top leadership showed an increased sense of urgency (Morgan Stanley, 2024f and 2024g): the Politburo

40 The Politburo of the Chinese Communist Party, officially the Political Bureau of the Central Committee of the Communist Party of China, is the executive committee of the Central Committee of the Chinese Communist Party. Currently, the bureau is a group of 24-25 top officials who oversee the party and central government. The Politburo is headed by the general secretary. The meetings of the Politburo are monthly, mostly near the end of each month, but usually only three meetings per year (April, July and December) are focused on economic issues, while the September meeting mostly has been focused on party discipline or other less economic related issues. The meeting was interpreted by JP Morgan as preparing the groundwork for economic stimulus entering a new phase, possibly lifting the official fiscal deficit target and higher quota for special central government bond issuance. See also Bloomberg (2025c).

41 President Xi created, resurrected or put his own stamp on a number of party bodies that "have a narrower focus and that allow him to absorb some functions from the government and assert the party's control" (Bloomberg, 2025c). On economic and financial matters, there are the Central Commission for Financial and Economic Affairs (led by Xi, deals with economic issues in broad aspirational language; does not disclose all of its meetings), Central Commission on Deepening Reforms (led by Xi; deals also with economic questions), Central Financial Commission (created in 2023; responsible for top-level policy making and supervision of the country's vast financial sector) and Central Work Commission (revived after 20 years; overseas the ideological and political role of the party in the financial sector) (Bloomberg, 2025c).

sent clear (and louder) easing signals (Goldman Sachs, 2024f; UBS, 2024d). The policy tone turned more pragmatic, and hence narrowed the discrepancy with market assessments of the Chinese economic situation (JP Morgan, 2024c). In detail, the meeting called for strengthening counter-cyclical fiscal and monetary policy, striving to achieve the 5% yearly growth target, focusing on housing, social welfare & employment, and restoring confidence among private entrepreneurs and foreign direct investors (Goldman Sachs, 2024f). It was also observed that the Politburo meeting sent out unprecedented signals to prioritize and stabilize the property sector by emphasizing a number of key policy messages (Citi, 2024d; see also Goldman Sachs, 2024i): 1) Stabilize the property market from further decline; 2) Strictly control the new supply, optimize existing properties (destocking) and enhance housing quality; 3) Expand loan facilities for eligible ("white list") projects and support revitalizing idle lands; 4) Adjust purchase restrictions and lower mortgage rates on public needs; 5) Optimize land, tax and financing policies to promote a new development mode.

Some observers emphasized that the meeting emphasized fiscal policy measures, i.e. "to increase the countercyclical adjustment of fiscal and monetary policies, ensure necessary fiscal expenditures" (KraneShares, 2024c; UBS, 2024e); the "unusual" meeting signaled according to Citi a "policy shift", with the Politburo confirming that "fiscal stimulus, with a focus on spending", would follow the earlier "Bazooka" package (Citi, 2024c), but however without concrete fiscal measures. The pledging of more active fiscal stimulus was a positive, but some market analysts warned for becoming too excited, as Chinese policymakers have a track record of underwhelming in actual concrete policy measures (Autonomous, 2024b).

The State Council met on 29 September, and called for faster implementation of easing measures and reiterated to "strive for the full-year growth targets", echoing President Xi's call in the September Politburo meeting (Goldman Sachs, 2024h). Premier Li Qiang "pledged to accelerate 'the pace for rolling out and implementing policy easing measures'", required more forceful collaboration across different ministries and more synergy between various policy measures, and vowed to 'speed up the progress of 102 key investment projects under China's 14th Five Year Plan'" (Goldman Sachs, 2024h, p. 1).

After all the policy measures taken or announced in September, some economic data releases for the month contained some positive surprises, with fixed-asset investment, industrial production and retail sales all beating consensus estimates by a strong margin of 0.7-0.8pp each (Autonomous, 2024f). Autonomous expected the uplift to be "short-lived", given "the absence of any consumption or domestic demand measures in the face of worsening CPI deflationary pressure, the still difficult path ahead for the property sector, and growing overcapacity issues in a number of industrial sectors".

The next policy action was a press conference by the National Development and Reform Commission (NDRC), which is in charge of long-term strategic developments and structural reform issues, on 8 October. The topic of the meeting was "implementing a package of incremental policies to promote economic growth, improve economic structure and maintain positive momentum" (JP Morgan, 2024f, p. 1). NDRC Head Zheng Shanjie pledged to strengthen the countercyclical adjustment to macro policy and highlighted that the ongoing stimulus measures should focus more on improving people's livelihoods, boosting consumption, and enhancing the multiplier effects of investment on economic growth, but did not provide details on the size of a possible fiscal stimulus (Goldman Sachs, 2024k, p. 1). He also called for improving consistency among macro policies and highlighted that any inconsistencies should be corrected in a timely manner.

The measures discussed related mostly to bringing forward policy initiatives already taken, such as RMB 100 billion of government investment projects scheduled for the 2025 budget and the remaining RMB 290 billion in new special local government bonds (LGBs) of already approved LGB issuance (JP Morgan, 2024f). Moreover, at the press conference, NDRC Head Zheng Shanjie mentioned that China would continue to issue ultra-long-term central government special bonds in 2025 to "implement major national strategies and build up security capacity in key areas" (Goldman Sachs, 2024k). Overall, the press conference disappointed with a lack of concrete stimulus measures, and new important initiatives – especially on the fiscal side – were not taken, leading some analysts to conclude that the NDRC press conference "underwhelmed" (Autonomous, 2024c, p. 1) and "did not address filling the fiscal gap despite accumulating market expectations" (Citi, 2024f, p. 1). Some even concluded that the press conference "should never have been held" (KraneShares, 2024d).

On 12 October, the with high market expectations anticipated press conference by the Ministry of Finance (MoF) was held. However, it fell short in announcing a sizeable multi-trillion fiscal stimulus that the market was hoping for and the presentation focused more on risk mitigation than offering structural solutions.[42] The Minister of Finance Lan Fo'an discussed four areas to develop a comprehensive fiscal policy package, as summarized in JP Morgan (2024h) and (2024k), pp. 1-2, as follows: 1) Additional fiscal support for local government debt resolution, consisting of a lift in the government debt ceiling to support local government hidden[43] debt swap program. Reuters reported that the authorities had allocated RMB 1.2 trillion in local bond quotas in 2024 to help resolve existing debt and settle government arrears to firms (Reuters, 2024c); 2) Special central government bond issuance to replenish the core Tier-1 capital of the six big state-owned banks', which was the first recapitalization of these banks in more than a decade, in order to help them weather low margins, declining profits and increasing bad loans (Bloomberg, 2024d); UBS estimated that this would likely require at least RMB 1 trillion over the 2025 or so (UBS, 2024f); 3) Further measures to support the housing market, by expanding special LGB issuance to support

42 Autonomous (2024d) concluded that the Ministry of Finance's "latest fiscal measures disappoint as deflation deepens". Its assessment of the measures was that they offered "little to bolster consumption or expand domestic demand and hence does not represent the fundamental pivot in policy many have been hoping for, in our view". It also saw some positive elements: "Nevertheless, we do expect it to boost activity in Q4 and close some of the gap with this year's 5% real GDP growth target". The Wall Street Journal reported that the Minister of Finance laid out spending plans, but left investors hanging on scale and scope of rescue efforts (Wall Street Journal, 2024g).

43 The Chinese authorities use the term "hidden" debt to describe the loans, bonds and shadow credits of local government financing vehicles (LGFVs) (Reuters, 2024b).

housing de-stocking and the purchase of undeveloped land; 4) Targeted cash support for people in extreme poverty and students.

The Minister of Finance mentioned that RMB 400 billion from not yet used local government debt space could be used to mitigate local government funding stress and pay fiscal arrears. It was estimated that the few concrete fiscal measures announced would increase the augmented fiscal deficit with just 0.2% of GDP, but that the measures brought forward would offer larger than expected fiscal support for Q4 2024 (JP Morgan, 2024i). Forward guidance by the Ministry indicated that it was willing to lift the budget deficit and increase the issuance quota of special local government and ultra-long government bonds, and that the central government had relatively large room for debt expansion and deficit increases, suggesting that growth friendly fiscal measures would extend well into 2025; hence, as a positive sign, the Ministry of Finance showed clear forward guidance on multi-year fiscal expansion and stated that more policy tools were under study, raising expectations that the official fiscal deficit for 2025 would be raised from the official fiscal deficit of 3% of GDP for 2024 (JP Morgan, 2024o; Goldman Sachs, 2024l; UBS, 2024f). Citi (2024g) called the press conference “solid forward guidance without details”. Overall, customarily for Chinese policymakers’ press conferences and policy briefings, it did not provide details of the amount of fiscal stimulus. It has to be acknowledged that the Ministry is institutionally also not very equipped to announce more details of possible fiscal measures, as it can only announce them until these are approved by China’s parliament, the National People’s Congress (NPC) (i.e. reviewed by the Standing Committee of the NPC) (Financial Times, 2024p; Autonomous, 2024d): the NPC is in charge of approving the fiscal budget, hence more details could become public when the NPC meets, which was expected at the end of October (KraneShares, 2024e).[44]

The Ministry of Housing and Urban-Rural Development (MOHURD) held a press conference on 17 October where it was announced that the renovation of urban villages and homes with safety risks would be expanded with one million units, compensated with cash (JP Morgan, 2024k, p. 127). Furthermore, the so-called “white list”[45] would cover all qualified projects with expanded credit support to RMB 4 trillion before end-2024 (JP Morgan, 2024o, p. 4). In sum, the measures included four removals of administrative regulations (i.e. removal of purchase restrictions, resale restrictions, price limits and the distinguishment between ordinary and non-ordinary home definitions) and four reductions of housing related variables (reduction of housing provident fund mortgage rates, downpayments, existing mortgage rates and taxes for replacement purchases) (Citi, 2024i). Goldman Sachs (2024m) believed that “the announced measures could improve to some degree the supply-demand dynamic of the property market in the near term, yet they haven’t fully addressed how the lumpy backlog of construction in progress (not-yet-saleable) and its associated liabilities will be resolved, beyond the government’s

44 The Minister of Finance actually acknowledged that much, saying that he could not specify the size of the fiscal stimulus, citing the need for due legal process, such as approval by the NPC (UBS, 2024f).

45 The “white list” is a register of real estate projects or developers that have been ruled compliant with regulations and thereby eligible for financial support (South China Morning Post, 2024).

land buyback initiatives". Some analysts were disappointed by the press conference of the Housing Ministry, similar as to the recent NDRC and MoF press conferences, for the lack of concrete steps and policy details (Autonomous, 2024e).[46]

The six state-owned banks and the China Merchants Bank (a joint-stock commercial bank, see: Xu, van Rixtel and van Leuvensteijn, 2016) lowered demand deposit rates and time deposit rates by 5bps and 25bps, respectively, on 18 October, which was followed by a cut in their Loan Prime Rates (LPRs) – both the one and five years, the biggest symmetric cut for LPRs – by 25bps on 21 October, with mortgage repricing also be largely effective from 25 October (Citi, 2024j). The cut in the LPRs by the PBoC was more aggressively than expected (KraneShares, 2024f). Early November rules for foreign investors to invest in listed companies were softened and the Vice Minister of Commerce announced that new policies would be launched to boost consumption starting in five of the biggest cities, which could be supported by local initiatives (such as the opening of new stores and the issuance of consumer vouchers) (JP Morgan, 2024l).

Governor Pan discussed in a speech on 18 October (at the 2024 Financial Street Forum) the need to stimulate consumption to ease deflationary pressures. He stated that (Pan, 2024c): "To achieve the right balance in the economy, we need to deal with the following priorities. First, macro-economic policies should pivot from over-emphasis on investment to both consumption and investment, with more focus on consumption"; if policy would indeed move into this direction, according to several analysts this would represent a real move forward to mitigate the relationship between debt and deflation. "Second, the relationship between government and market should be handled in a more appropriate a manner […]; Third, reform and opening-up will be further deepened to foster a favorable economic development ". Pan emphasized on various occasions in his speech additionally the importance of stimulating consumption to fight the deflationary spiral: "given the current economic performance, we need to implement strong macro aggregate policies. Major problems in the current economic operation, as reflected at the macro level, are insufficient effective demand, weak social expectations and low prices. A common market view is that we need to launch strong macro policies. […] We need to strike the right balance between investment and consumption. […] We will […] promote consumption growth, thus giving rise to a virtuous cycle in which government encourages consumption, consumption activates markets, markets lead businesses, and businesses expand investment". The speech was one of the strongest worded communications by Chinese policymakers about the need to stimulate consumption to have a much better balanced economic structure which could mitigate the deflationary spiral.

To promote consumption, China's policymakers were confronted with various challenges. Arguably the most important one was to stabilize the housing market, as

46 Autonomous (2024e) concluded that "The housing authority failed to outline how the central government and/or central bank would aid local governments in absorbing new home inventory, which effectively leaves the mammoth task still in the hands of overstretched local authorities to solve".

housing assets account for two-thirds of Chinese households' wealth, and hence promoting consumption would require a stabilization in housing prices first (Société Générale, 2024c). The SC analysts concluded that the Chinese government understands this, as President Xi himself pledged explicitly to stabilize the housing sector.

Huang (2024) reported that Governor Pan stated at least twice in late October that an important goal of the PBoC was to restore inflation, in an attempt to anchor inflation expectations. However, he questioned the ability of the PBoC and Pan's public statements to credibly achieve this policy objective, given that the PBoC does not have operational independence, and that ultimately it is the top leaders who decide on major economic policies in China.[47]

Later in the month, also Vice Finance Minister Liao Min reiterated that the stimulus measures aimed to boost consumption, and consequently should contribute to lift domestic demand and achieving the "around 5%" GDP growth target for (2024) (Bloomberg, 2024e).[48]

Then, from 4 to 8 November, the long-awaited meeting of the important Standing Committee of the National People's Congress (NPC) took place. The NPC is the highest organ of state power of the People's Republic of China. It is the only branch of government in China and all state organs are subservient to it. Due to the temporary nature of its plenary sessions, most of the NPC's power is delegated to its Standing Committee (NPCSC), which meets in continuous bi-monthly sessions, when its parent NPC is not in session. The meeting announced a multi-year RMB 12 trillion implicit local debt resolution package, which for the most part (i.e. RMB 10 trillion) consisted of multi-year "implicit" local debt resolution measures (i.e. local government "hidden"[49] debt swaps), consisting basically in changing bad "hidden" (implicit) local debt for "good" LGB (explicit official) debt. Hence, it needs to be emphasized that the swaps were completely local policy measures: "Bad", non-transparent debt of LGFVs at an average estimated interest rate of 4.8% during the first half of 2024 would be swapped into "better", official transparent debt issued at lower costs, i.e. (special) local government bonds issued at an average yield of 2.34% in the first nine months of 2024 (UBS, 2024h). The central government would not be involved in the debt swaps. They would not actually increase the government's overall debt, but merely reconfiguring the components within the existing government debt (Natixis, 2024d).

47 In October, China's GDP deflator had been negative for six consecutive quarters, showing the need for much more stimulus to stimulate effective demand and consumption in order to revive inflation (Huang, 2024). Société Générale concluded that the deflation momentum was still "entrenched", with the October CPI figure declining to 0.3% from 0.4% in September (Société Générale, 2024d, p. 5). In November, CPI inflation declined again marginally to 0.2%, moving closer to negative territory, while PPI surprised to the upside, improving from -2.8% in October to -2.5% in November (Société Générale, 2024h, p. 5).

48 The need for stronger macro policies to stimulate effective demand and consumption was underpinned by the publication of China's Q3 2024 GDP data, which illustrated why policymakers felt the urgency to ease significantly in late September (Goldman Sachs, 2024o): "The headline real GDP growth of 4.6% was probably deemed by policymakers as too low relative to the full-year target of 'around 5%'. More worryingly, final consumption expenditure growth slowed substantially from an already soft Q2 print".

49 We reiterate: the Chinese authorities use the term "hidden" debt to describe the loans, bonds and shadow credits of local government financing vehicles (LGFVs) (Reuters, 2024b).

The local government "hidden" debt swap program consisted of two parts, totaling RMB 10 trillion (Citi-Chua, 2024; JP Morgan, 2024n and 2024q; Morgan Stanley, 2024s, p. 5): 1) The NPCSC approved a one-off increase of the special LGB issuance limit by RMB 6 trillion to swap implicit local government debt into explicit LGB debt, the latter which will be issued during three years (e.g. 2024-2026) at a pace of RMB 2 trillion per year; 2) The Ministry of Finance would allocate RMB 0.8 trillion from new annual special LGB quota for debt swaps during five years from 2024, for a total of RMB 4 trillion. In addition, the Ministry of Finance explicitly announced to repay the RMB 2 trillion of poor village redevelopment-related "hidden" debt after 2029 as scheduled, essentially making RMB 2 trillion of "implicit" debt "explicit". According to the MoF, the three measures together would reduce total implicit local government debt from RMB 14.3 trillion to RMB 2.3 trillion by 2028 (Citi-Chua, 2024).[50] The package did not include the possibility that the Ministry would offer to take over any local government debt.

MoF estimates suggested that the direct economic growth impact of these measures would be quite small, i.e. basically the swapping of "hidden" for official debt was expected to save only RMB 600 billion in interest payments for local governments over five years. Nevertheless, positive aspects need to be highlighted: In addition to lower financing cost, the swap program should help local governments to move forward on the resolution of local debt and avoid taking extreme revenue-enhancing measures such as cutting the salaries of local government workers, strengthening consumption. Société Générale (2024e) expected that the local debt swap would ease deleveraging pressures. Furthermore, to be fair to Chinese policymakers, Minister of Finance Lan Foam provided forward guidance on more stimulus, saying that more policies were to follow, to support the purchase of unsold flats and buybacks of undeveloped land, replenish the capital of large state-owned banks and future policy support for consumption (UBS, 2024h, p. 1; Goldman Sachs, 2024p).[51]

UBS analysis considered the positives of the debt swap program to outweigh the negatives: 1) The package could be of great help to resolve the recognized implicit LGFV debt outstanding, helping to meet the original deadline of an end-2028 adopted 10-year debt resolution plan for this debt; 2) Local governments continued over the years to grow new implicit debt, which the debt swap program could help to address; 3) The relief of the imminent debt repayment burden from the debt swaps could free up local government's resources, freeing up resources for tasks they are typically supposed to do, such as project

50 It has to be said that the International Monetary Fund, however, estimated in its Article IV Consultation on China that so-called "hidden" debts of LGVFs amounted to RMB 60 trillion at the end of 2023, or 48% of GDP, and could increase to RMB 66 trillion for 2024, or 50% of GDP (IMF, 2024b, p. 64).

51 JP Morgan emphasized that what was missing this time did not mean that it would not happen, especially against the background of Ministry of Finance forward guidance: 1) The MoF mentioned that some special local government bonds would be issued to support local governments' purchase of housing inventory and unsold land; 2) Minister Lan confirmed ongoing accelerated efforts on the issuance of special central government bonds to support the recapitalization of major banks; 3) Forward guidance was given on increased efforts to support equipment upgrade and consumption "trade-ins" (i.e. buying new home appliances, cars, etc. with government subsidy), as well as efforts to improve social welfare; 4) The minister reiterated the policy room to increase the fiscal deficit and increase the ultra-long Treasury bond and special local government bond quota (JP Morgan, 2024m, pp. 1-2).

investments and salary payments. UBS actually estimated that the debt swaps could save interest payments of around RMB 900 billion, instead of the RMB 600 billion projected by the Ministry of Finance; 4) Reducing arrears to corporates using part of the local bond issuance proceeds could be a stronger boost to confidence than merely swapping interest-bearing debt (UBS, 2024h, p. 1).

Also Citi analysts concluded that on a standalone basis, the debt swap package deserved some credit (Citi, 2024k). Moreover, by alleviating the debt burdens of local governments, it would allow them to be better incentivized to implement the central government's plans to stabilize the economy: In essence, the measure was a rescue package for local governments (rather than a genuine fiscal expansion) (Natixis, 2024d). Estimates by Goldman Sachs suggested that the debt swap program could potentially boost China's real GDP with around 55bps, with 50bps from salary payments and arrears settlements and 5bps from interest savings (Goldman Sachs, 2024q, p. 1).[52] Shan (2024) called the RMB 10 trillion debt swap plan the most important easing measure announced so far and arguably the most underappreciated: "The plan increases the amount of debt local governments are allowed to raise, with the additional debt to be swapped for 'hidden debt' held by LGFVs. […] The new debt is to be issued over five years – RMB 2.8 trillion annually from 2024 to 2026 and RMB 800 billion annually in 2027 and 2028. […] RMB 2.8 trillion is roughly enough to cover local governments' fiscal shortfall this year. […] the central government has essentially ensured that local governments don't use fiscal revenues to pay off their debts, but rather to conduct regular operations vital for their citizens' wellbeing" (Shan, 2024, p. 4).

But overall, the measures announced by this important committee generally disappointed analysts and markets (Autonomous, 2024g), as they had hoped for a more comprehensive fiscal package, also against the background of the election of President Trump: Chinese policymakers were not taking the big "whatever it takes" measures (yet), i.e. not shifting from their own policymaking norms (Citi, 2024k). Generally, the few fiscal details appeared to fall short of market expectations: As aptly summarized by the Financial Times, "The package itself, following the pattern of recent stimulus measures, is underwhelming" (Financial Times, 2024f). Some suggested that Chinese policymakers were planning to save their fiscal ammunition for the possible battle they would face if the Trump administration would follow through with its threat to start a second trade war, much fiercer than the one under the first Trump administration (The Economist, 2024f).

With the absence of concrete fiscal stimulus measures, issues such as bank recapitalization, consumption support and buybacks of undeveloped land and unsold houses could not be implemented. Moreover, the size of the local "hidden" debt of LGFVs remained unclear, with the official MoF number of RMB 14.3 trillion versus the number estimated by the IMF and market analysts of RMB 60 trillion. The measures disappointed also, as they

52 For a very positive assessment, see the rebuttal of five misperceptions prevailing in markets about the package according to Jianguang Shen in the Financial Times (Financial Times, 2024sa). Fitch Ratings assessed that even without new explicit fiscal stimulus, China retained room to accelerate public spending in 4Q2024 under the March 2024 budget (Fitch Ratings, 2024c).

did not coincide with measures outlined in the media prior to the meeting which suggested that much stronger policy support would be announced, such as direct fiscal stimulus.[53] All in all, the NPC put more emphasis on financial stability through debt restructuring than on stimulus and its measures taken were unlikely to immediately boost economic growth (Natixis, 2024d; Fitch Ratings, 2024b); they essentially aimed to address the problems of the local and regional government debt held off balance sheet by LGFVs (the often mentioned “hidden” debt) by bring it onto the local and regional balance sheets and by doing so laying the foundation for sustainable growth (Financial Times, 2024g).

On 13 November, the Ministry of Finance (MoF), the Ministry of Housing and Urban-Rural Development (MOHURD) and the State Taxation Administration (STA)[54] announced to reduce certain taxes in the housing markets (deed tax and VAT), effective from 1 December. This was followed by announcements and actions regarding the so-called consumer “goods trade-in” program that was implemented to boost consumption. This program (the “Action Plan for Promoting Large-scale Equipment Renewal and Consumer Goods Trade-in”) was announced by the State Council in March 2024 and involved the “trade-in” of automobiles and household appliances and encouraged other home renovations.[55] Basically, Chinese households could replace their old cars and appliances by new ones partly financed with government subsidy. In August 2024, Chinese authorities had increased measures to encourage consumers to participate in the “trade-in” plan offering subsidies of up to RMB 2,000 for each item, with subsidies being 15% of the final sale price, to expand domestic demand (Global Times, 2024). The Ministry of Commerce announced around mid-November that it had received over four million subsidy applications for “trade-ins” of passenger cars (JP Morgan, 2024q). Later in the same month, JP Morgan reported that the State Council announced that it would intensify efforts to promote consumer goods “trade-ins” and large-scale equipment renewals.[56]

53 Reuters had reported on 29 October in an exclusive report that the NPCSC would approve more than RMB 10 trillion ($1.4 trillion) in additional fiscal support in the next few years, with RMB 6 trillion to address local government debt risks and RMB 4 trillion for idle land and property purchases (Reuters, 2024d; JP Morgan, 2024j). The package could increase in case of a Trump-win. But clearly this additional direct fiscal support did not materialize, the NPCSC only offered indirect support through debt swaps and there was no revision of the central government fiscal deficit, nor pro-growth measures on consumption, property and bank recapitalization (Citi-Chua, 2024). For more discussion of an outcome that disappointed overall, see for example Citi (2024m) and JP Morgan (2024m).

54 The State Taxation Administration (STA) is a ministerial-level department within the government of the People’s Republic of China. It is under the direction of the State Council, and is responsible for the collection of taxes and enforces the state revenue laws.

55 The program covers eight major categories of appliances: refrigerators, washing machines, televisions, air conditioners, computers, water heaters, household stoves and range hoods. In addition, there are “trade in” programs for automobiles and even real estate. The “Golden Week” holiday (1-7 October 2024) was an important period to assess China’s domestic demand and the success of the “trade-in” program: for example, in the automotive sector, as of 7 October, the Ministry of Commerce had received more than 1.27 million subsidy applications, resulting in more than RMB 160 billion from new vehicle sales (He, 2024). The Ministry reported that sales revenues of home appliances under the program reached almost RMB 202 billion early December (Xinhua, 2024d).

56 KraneShares (2024g) reported towards the end of November about possible news that major cities would be issuing consumer vouchers and the potential expansion of the “trade-in” policy beyond autos and home appliances. Reports circulated that major city governments issued consumer vouchers on Sunday November 24th to promote consumption, with the focus of the vouchers varying by city (Shanghai’s vouchers were geared towards restaurants, hotels and tourism sites, while Hangzhou and Guangzhou’s vouchers were for restaurants; Beijing issued vouchers for winter sports and tourism).

On November 21st, the PBoC, together with eight other policy bodies and committees, held a meeting on advancing the issuance of loans for sci-tech innovation and technological transformation (PBoC, 2025f). The meeting noted that the program thus far had functioned well, with the scale of loans signed and issued had continued to expand, with as of mid-November 1,737 enterprises and projects had benefited (PBoC, 2024g).

Among property sector stabilizing measures taken late November was the joint announcement by the Ministry of Housing and Urban-Rural Development (MOHURD) and Ministry of Finance (MoF) to expand the urban village redevelopment program from 35 cities to 300 (Goldman Sachs, 2024s). Goldman Sachs met with 80+ investors in November, whose assessments are interesting to report, as they represent expert market views on the state of the property sector crisis. These investors noticed some early signs of property price sequential improvement and shared the view of GS that price stabilization in key cities will be seen in late 2025. However, most agreed with GS that further contraction regarding new starts of housing projects and property fixed asset investment would be inevitable, given the inventory overhang and worsening industry liquidity situation. They also expected "the housing completion outlook to remain challenging if the government could not push banks to accelerate lending to projects on the 'white list' as well as address the funding shortage for presold projects that are already in negative equity" (and hence unlikely to be eligible for government support under the "white list" program) (Goldman Sachs, 2024s, p. 1).

In a retaliatory move to the US decision to add 140 Chinese companies to the list of Chinese firms subjected to strict export controls on semiconductor-making equipment and advanced chip technology, the Ministry of Commerce announced early December to ban exports to the US of critical minerals that have widespread military applications (JP Morgan, 2024q, p. 6).

On Chinese monetary policy, Governor Pan announced on a press conference on 2 December to utilize a variety of monetary policy tools and increase countercyclical regulation to maintain reasonable and ample liquidity and to reduce the overall financing costs for enterprises and households: he guaranteed that the PBoC would maintain a supportive monetary policy stance and policy orientation in 2025 (JP Morgan, 2024q, p. 6; PBoC, 2024h; Xinhua, 2024c). The PBoC also announced to broaden the coverage of the monetary aggregate M1, including also households' demand deposits and non-bank payment institutions' reserves (JP Morgan, 2025, p. 6).

The December Communist Party of China (CPC) Politburo meeting was held on 9 December, chaired by President Xi to analyze and plan for the economic work of 2025 and provide high-level policy guidance (JP Morgan 2025 and 2024s). The Politburo concluded that major social and economic development goals in 2024 will be achieved. For 2025, the Politburo used stronger wording on macro policies: 1) To implement more proactive and effective macro policies, to strengthen extraordinary counter-cyclical adjustments; 2) To implement more proactive fiscal policy (vs standard 'proactive fiscal policy') and moderately loose monetary policy (vs standard ‘prudent monetary policy’) (JP Morgan, 2024s; bold and italics in reference).

The Politburo meeting concentrated on five central areas of policy attention (JP Morgan, 2024s, p. 1): 1) Boosting domestic demand. The JP Morgan note emphasizes that in China’s policy language, domestic demand refers to both consumption and investment, rather than primarily consumption; nevertheless, consumption support topped the priority list, with a direct reference to “greatly boost consumption” (Citi, 2024o; Société Générale, 2024f); 2) Promoting innovation and productivity growth; 3) Opening-up of the economy, stabilizing foreign trade and foreign direct investment (FDI); 4) Preventing major risks, stabilizing the housing and stock markets: the stock market was mentioned in the same line as housing market, which was an indication of the high-level recognition of the importance of wealth effects (Société Générale, 2024f); 5) Supporting other social development objectives, such as rural, regional coordinative and green development, and enhancing social welfare. The “around 5%” growth target was maintained. According to Morgan Stanley economists, the wording “moderately loose” for monetary policy and “more proactive” for fiscal policy “… sent the most aggressive stimulus tone in a decade” (GFMA, 2024a). Also other market analysts stressed as a positive outcome the strong policy wording – interpreted by Bloomberg (2024g) as the most direct language on stimulus in years – and viewed the outcome as an upside surprise due to stronger easing rhetoric, especially against the background of the low market expectations prior to the meeting (JP Morgan, 2024u; Goldman Sachs, 2024t), with implementation being the most important issue (Citi, 2024n). Several analysts saw the strong wording as a policy signal preparing China for possible much tougher trade restrictions under the newly elected Trump administration.

The strong wordings in the communication of the Politburo reached the headlines in China and abroad, with some emphasizing that “moderately loose” monetary policy signaled the first change in the monetary policy stance 14 years, i.e. since the monetary policy stimulus after the Global Financial Crisis (Financial Times, 2024l). Market analysts did not expect that the “moderately loose” monetary policy stance would imply a policy move to a “zero interest rate policy” or Quantitative Easing (JP Morgan, 2024v, p. 1). It was left to the upcoming annual Central Economic Work Conference (CEWC) to provide more policy details, only qualitatively, not quantitatively, of these qualifications of the stances of monetary and fiscal policy for 2025. Hence, as had been the case with other high-policy level meetings, hard and concrete stimulus policy decisions were not announced (yet).

The important CEWC of China’s top policymakers was held during 11-12 December in Beijing, chaired by President Xi. This annual meeting consists usually of two parts, one backward-looking, the other forward-looking: in this case, assessing the economic work of 2024 and defining the economic policy challenges for 2025, largely echoing the tone of the December Politburo meeting (JP Morgan, 2024p; Goldman Sachs, 2024u; Bloomberg, 2025c). As in previous years, the CEWC offered critical insights into the Chinese authorities’ multifaceted approach to balancing short-term recovery with long-term economic transformation, with the 2024 CEWC outlining China’s economic priorities and strategies for 2025 (China Briefing, 2024). Among other areas, the government identified weak domestic demand as the primary challenge facing the nation's economy and signaled plans to intensify fiscal and monetary measures in 2025 to address this issue. Literally, the Conference prioritized "vigorously boosting consumption, improving investment efficiency and fully expanding domestic demand" for 2025, indicating a heightened focus on reviving consumer spending compared to previous years' statements (Autonomous, 2024i, p. 3).

President Xi held a speech, in which he provided a critical assessment of 2024's economic performance, while setting the tone for the coming year (China Briefing, 2024). The discussion placed significant focus on bolstering domestic demand, stabilizing the property sector, and leveraging innovation to drive sustainable growth. According to JP Morgan (2025a), the CEWC emphasized that for 2025, economic policy needs to balance five relationships: 1) Between effective market and well-functioning government; 2) Between supply and demand: 3) Between new economy sectors and old economy sectors; 4) Between incremental growth and revitalizing existing stock to improve resource allocation; 5) Between quality improvement and volume expansion.

Boosting domestic demand was moved up as the top priority task of nine key policy areas for 2025,[57] with focus on both consumption and investment (Citi, 2024o, p. 3; Morgan Stanley, 2024s, p. 6), with measures to support consumption receiving greater attention, while price stability was also mentioned briefly. The Conference showed increased concerns on external challenges, although potential tariffs imposed by the Trump administration were not mentioned explicitly. To counteract the declining population in China, the CEWC advocated measures to improve childbirth, which could imply the establishment of a subsidy scheme for families with young children (UBS, 2024n, p. 1). In addition to highlighting the need to stabilize the housing market, the conference also mentioned the need to stabilize financial markets in the same policy recommendation, echoing the statement of the Politburo meeting in December.

The CEWC provided more specific details for the "moderately loose" direction for monetary policy and "more proactive" fiscal policy stance, such as mentioned by the December Politburo meeting. To quote JP Morgan (2024u), p. 1: "Monetary policy will be moderately loose, to cut rates and reserve requirements (RRRs) at the proper time, maintain ample liquidity, match the TSF[58] growth and money supply growth with target economic growth and inflation, maintain basic stability of RMB exchange rate at reasonable equilibrium levels, and the central bank will expand its macro-prudential and financial stability functions". According to Société Générale (2024g), it was rare for the CEWC to be so specific about monetary policy tools, which it interpreted that the change made in the

57 These nine policy priority areas mentioned were (JP Morgan, 2024u): 1) Boost domestic demand by supporting consumption and improving investment efficiency; 2) Develop new quality productivity via technology innovations; 3) Promote structural reform; 4) Expand high-level opening up of the economy; 5) Prevent risk in key areas, ensure the housing market to stop falling and stabilize and managing the risks of regional small and medium-sized financial institutions; 6) Promote rural revitalization and urban-rural integrated development; 7) Enhance regional coordinate development; 8) Promote green development; 9) Protect and improve people's livelihood.

58 Total Social Financing, see footnote 19.

tone of the appropriate monetary policy stance at the December meeting of the Politburo was the “real deal”.

Regarding fiscal policy, the Conference concluded: “Fiscal policy will be more proactive, by increasing budget fiscal deficit, increasing ultra-long Treasury bond and special local government bond quotas, and improving the structure of fiscal expenditure”. The latter measure related to support social welfare and consumption. Overall, the wording on fiscal policy suggested a broadly stronger fiscal expansion in 2025 (UBS, 2024n).

Despite financial markets hoping for specific numerical targets for specific instruments of monetary and fiscal policy, this did (again) not happen (JP Morgan, 2024w). There was no clear actionable strategy to stabilize the property sector and normalize inflation (Goldman Sachs, 2024u), and the Conference’s statement did not provide concrete indications of how much authorities would step up support for the economy in 2025 (Autonomous, 2024i); while the wording was deemed stronger and more positive than in previous years, Autonomous emphasized that markets had been disappointed by optimistic rhetoric in the past.[59] Citi (2024o) mentioned a number of concerns related to the CEWC’s statement: 1) Coexistence of too many targets could remain an issue, meaning that policymakers remained in a reactive mode; 2) Highlighted consumption support so far was very targeted and unlikely to reflate the economy; 3) There was no mentioning of a reaction plan if tariff risks would materialize; 4) Despite the policy intentions, policy delivery and implementation as well as policy effectiveness were yet to be seen.

Some market analysts had not expected specific policy targets in the Conference’s final statement, as numerical growth and fiscal targets historically and typically had been announced at the highly important so-called “Two Sessions” meeting, as usually in 2025 also set for March (Société Générale, 2024h; UBS, 2024n and 2024m). This meeting relates to the annual plenary sessions of the National People’s Congress (NPC) and of the Chinese People’s Political Consultative Conference (CPPCC), which are typically both held every March at the “Great Hall of the People” in Beijing around the same dates.[60] The “Two Sessions” last for about ten days. Media announcements suggested that China would reportedly plan to increase its budget deficit from 3% of GDP in 2024 to 4% of GDP in 2025, which would be the highest on record (GFMA, 2024b).

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59 Autonomous (2024i, p. 1) clearly showed its scepticism about the CEWC statement: “it remains unclear whether Beijing is truly willing to go to the extent necessary to pull the economy out of the doldrums, particularly given the growing constraints on some levers and the need to preserve firepower to address any challenges that may arise from Trump’s policies over the next four years, not just 2025”.

60 During the “Two Sessions”, the National People’s Congress (NPC) and the Chinese People’s Political Consultative Conference (CPPCC) hear and discuss reports from the premier of the State Council, the president of the Supreme People’s Court, and the procurator-general. The NPC is the one-house legislature, “It acts on directions passed down from above but also represents an important forum that brings a wide range of officials together” (Bloomberg, 2025c); it has around 3,000 deputies. The CPPCC is a political advisory body in the People’s Republic of China and a central part of the Communist Party of China (CPC). Its members advise and put proposals for political and social issues to government bodies. However, the CPPCC is a body without real legislative power, and while consultation does take place, it is supervised and directed by the CPC. The meeting of the “Two Sessions” is arguably the most important political, administrative and policy meeting in the People’s Republic of China.

Regarding the property sector, the CEWC advocated four policy measures (UBS, 2024o): 1) Push for property market stabilization; 2) Accelerate urban village renovation; 3) Control new land supply and revitalize the existing land resources and commercial properties; 4) Handle the existing housing inventory. Of these measures, UBS took the view that urban village renovation was probably the only way to stimulate housing demand, but the risk was in execution, as it could take multiple years to negotiate with villagers. Overall, stabilizing the housing market was definitely regarded a top task, but, as with previous announced policy measures, policy execution was the "key" (UBS, 2024n, p. 2). With respect to the property sector, Société Générale (2024h) reported mid-December that housing activity continued to improve, albeit mostly only in large cities. In line with other analysts' assessments, it concluded that the policy measures taken so far were not convincing enough to sustain the housing recovery. Improvement of the housing sector was also highlighted by Autonomous (2024h), especially since October 2024, driven by recent government support measures and further mortgage rate cuts. They mentioned that "We are incrementally more positive on the sector as Tier 1 and 2 markets show early signs of reheating and the program to move 1 million families out of urban villages into new units and renovate their homes gets underway". This program to redevelop 1 million urban-village housing units had started as residents in these units were starting to receive compensation to relocate, either in the form of cash or vouchers. But overall, in the view of Autonomous, the property market continued to grapple with persistent issues related to weak confidence, job insecurity and slowing income growth.

During the second half of December, the PBoC took some additional policy measures (JP Morgan, 2025a, p. 6). As reported by JP Morgan, the central bank held discussion with financial institutions against the background of declining government bond yields, in order to safeguard the stability of their bond investments. Moreover, the bank published its Financial Stability Report for 2024, emphasizing a number of policy areas and measures for 2025: 1) Implement appropriately accommodative monetary policies (i.e. a "moderately loose" stance of monetary policy) to keep liquidity at an adequate level; 2) Enhance the resilience of the foreign exchange market and keep the RMB exchange rate basically stable; 3) Intensify support for key areas (technology finance, green finance, inclusive finance, old-age finance and digital finance); 4) Improve the system upholding financial stability by strengthening prevention, monitoring and early warning of financial risks, basically improving risk management; 5) Establish a mechanism of risk resolution; 6) Expand the Deposit Insurance Fund and the Financial Stability Fund; 7) Forestall and defuse financial risks so that no systemic risks will occur (PBoC, 2024j, p. 4).

On 12 December, the Ministry of Human Resources and Social Security, together with four other ministries, announced that a 36-city private pension scheme trial would go national on 15 December (JP Morgan, 2024t). Eligible account owners could contribute up to RMB 12,000 per year with tax reductions depending on different tiers of taxable income. Promoting pension schemes was important, as these could reduce Chinese households' precautionary savings made for retirement and hence potentially encourage consumption.

Late in December, the State Council (SC) issued guidelines regarding the management of local government special bonds (LGSBs) (JP Morgan, 2025a, p. 6). It was decided that the proceeds from the issuance of these bonds would be available for the funding of more eligible projects, while a “negative list” was introduced for non-eligible projects. The guidelines also promoted faster issuance of these bonds and the use of their proceeds, strengthened oversight and accountability, and encouraged a more effective implementation of major projects by local governments that are financed by LGSBs.

The Ministry of Finance (MoF) held a National Fiscal Work Conference during 23-24 December, which served as a comprehensive implementation of the conclusions of the CEWC and to arrange the key financial tasks for 2025 (Abound, 2024). The Minister of Finance Lan Fo’an stated that the ministry would step up fiscal spending and government bond issuance in 2025, adopting a more proactive fiscal policy (Xinhua, 2024e). Reuters reported that Chinese authorities had agreed to issue RMB 3 trillion in special government bonds for 2025, from RMB 1 trillion in 2024, which would be the highest annual issuance on record, and was partly motivated to soften the impact from expected increases in US tariffs on Chinese imports under the Trump administration (Reuters, 2024g). The conference concluded that fiscal policy would concentrate on six key areas (Unbound, 2024; KraneShares, 2024h): 1) Support the expansion of domestic demand, focusing on both investment and consumption; 2) Support the protection and improvement of people’s livelihoods; 3) Preventing and resolving major risks, especially those related to local government debt and the real estate market; 4) Promote the construction of a modern industrial system; 5) Support the integrated development of urban and rural areas; 6) Strengthening the opening-up and ecological development of the economy.

The National Housing and Urban Development work meeting underscored major tasks for 2025 and listed promoting housing market stabilization as a top priority (Goldman Sachs, 2024v). This two-day meeting (24-25 December) was organized by the Ministry of Housing and Urban-Rural Development (MOHURD), which pledged to continue efforts to stabilize the real estate market and to reverse its downtown in 2025 (Xinhua, 2024f). The property market showed some positive momentum of stabilizing in 2024, with home transactions in October and November seeing year-on-year and month-on-month growth for two consecutive months; China’s housing prices fell at the slowest pace in 17 months in November, attributed to government policy measures to revive the sector (i.e. summarized as lower mortgage rates, lower down payment requirements, relaxed purchase restrictions and improvements in land use, fiscal and tax policies: see this section for specifics) (Reuters, 2024h; Xinhua, 2024f). The meeting proposed the following measures: 1) To unlock housing demand by fully implementing a mix of policies to support people’s needs for buying their first homes or improving their housing conditions; 2) To optimize housing supply by strictly controlling the expansion of new commercial housing while improving the quality of homes; 3) To make greater efforts to expand the supply of affordable housing, offering more support to new urban residents, young people and migrant workers to meet their housing needs; 4) To support urban village and shabby housing renovation projects in 2025, further expanding the scale of such projects beyond the approved one million units; 5) The Ministry aimed to establish a new development model for the real estate markets, including the increase of supply of improved housing, particularly high-quality homes (Xinhua, 2024f).

The Monetary Policy Committee (MPC) of the PBoC held its fourth quarterly meeting of 2024 on December 27th. Its Monetary Policy Report concluded: “In 2024, in the face of complex and severe situations of external pressures and difficulties in domestic economic development[61]”, the PBoC “implemented the strategic arrangements of the CPC Central Committee and the State Council”(PBoC, 2025b, p. 43), with the economy being generally stable and progress being made in high-quality development. GDP increased by 5% year-on-year, meeting the official target of “around 5% GDP” growth, surpassing RMB 130 trillion, and “prices were generally stable” (PBoC, 2025b, p. I). The monetary policy stance was accommodative throughout 2024: “Notably, since late September 2024, the PBoC has implemented a package of incremental financial policies and redoubled efforts to implement these policies according to the arrangements of the CPC Central Committee” (PBoC, 2025b, p. 1). The report provided a positive assessment of the two new facilities announced on September 24th to support the capital market (i.e. the Securities, Funds and Insurance companies Swap Facility (SFISF) and the re-lending facility to help listed companies and major shareholders to buy back shares): “Within one month from their announcement to implementation, the two instruments effectively boosted market confidence both at home and abroad and established a preliminary mechanism featuring inherent stability and equilibrium in the capital market” (PBoC, 2025b, p. 13). In the course of 2024, the PBoC gradually increased the purchases of government bonds (which it started in August), as a tool for base money supply and liquidity management; net cumulative purchases by the PBoC in 2024 were RMB 1 trillion, which kept liquidity adequate, in combination with other tools. The Committee concluded that the reform of the loan prime rate (LPR) achieved remarkable results, and the mechanism for market-oriented adjustments of deposit rates has played its due role (PBoC, 2025a). It also announced to expedite “central bank lending for sci-tech innovation and technological transformation, and step up financial support for large-scale equipment renewal and ‘trade-in’ of consumer goods” (PBoC, 2025a). The MPC paid considerable attention to the RMB exchange rate, acknowledging some volatility: “As global geopolitical tensions intensified and the U.S. Dollar Index oscillated at a high level, the RMB exchange rate moved in both directions”, but remained generally stable and was one of the strongest exchange rates among the major international currencies.

The report explicitly warns for the challenges facing the growth of international trade, i.e. the negative implications of external changes have intensified, not surprisingly as the meeting was held after the victory of Donald Trump in the U.S. presidential elections: “On the one hand, rising unilateralism and protectionism, major shifts in global industrial chains, and post-election trade policy uncertainties in the major economies may have implications for the recovery of global trade. On the other hand, the still-high geopolitical

61 Regarding domestic economic challenges, the report mentions insufficient domestic demand, production and operational difficulties for some enterprises, pressures on employment and income growth, and a range of potential risks (PBoC, 2025b, p. 50, and PBoC, 2025a).

risks may bring uncertainties to global trade and investment growth, and the global economic recovery will face greater challenges" (PBoC, 2025b, p. 42, and PBoC, 2025a). The MPC concludes with a positive outlook for 2025, with China's economy expected to maintain stable growth: First, the conditions for economic recovery continue to improve with more positive factors, largely due to the series of policy measures taken since the fourth quarter of 2024 (after the "Big Policy Bazooka" of September 24th), which led to positive changes in major indicators, "such as production, demand, prices, income and expectations" (PBoC, 2025b, p. 50); Second, domestic demand has significant potential for further growth, as in 2024 programs such as the consumer good 'trade-ins' and the large-scale equipment renewal significantly stimulated consumer spending and investment; Third, more policy stimulus measures are expected in 2025, in line with the directives of the CEWC, including a more proactive fiscal policy (i.e. higher fiscal deficit and increased government spending), and an accommodative monetary policy, ensuring a coordinated policy mix that can underpin the economy's continued recovery; the MPC expects the overall effectiveness of these measures to improve further; Fourth, prices are expected to continue "a moderate rebound" (PBoC, 2025b, p. 50). Interestingly, the Committee made some explicit references to structural reforms: "the PBoC will solidly promote Chinese modernization, […] and speed up building a new development paradigm. It will pursue the strategy of expanding domestic demand while concurrently deepening supply-side structural reform, and it will enhance macroeconomic policy coordination" (PBoC, 2025a).

President Xi held a televised new year address December 31st and stressed support for the country's vulnerable elderly and youth, and that issues of employment, income growth, elderly care, childcare, education and healthcare "are always on my mind"; he signaled that growth "is top priority", while acknowledging China's challenges (Financial Times, 2024o).

Finally, the PBoC, in collaboration with the CSRC, held its second SFISF operation amounting to RMB 55 billion, involving 20 institutions, on January 2nd (JP Morgan, 2025a, p. 6).

To conclude, the large number of measures taken during the period September–December 2024 showed the conviction of Chinese policymakers that the economic situation was very serious indeed and needed to be addressed firmly, with often new and unconventional policies. At the same time, they did not follow yet a "whatever it takes" policy stance, with no important fiscal stimulus package announced, which was the one measure financial markets were hoping for. Market analysts expected that some of the measures that were announced, but not specified yet would be concretized at the important March meeting of the National People's Congress (NPC) of the People's Republic of China.[62]

Taking into account the signs of a deflationary spiral, the continuous sluggish demand and over-production, the high degree of indebtedness of both the private and public sectors

62 Among the large number of administrative, bureaucratic and political bodies in the economic-financial policy sphere is finally the Central Financial Work Conference, which is normally held once every five years (Bloomberg, 2025c). It was first held in 1997 amid the Asian financial crisis; the last meeting was in 2023 (delayed from 2022 due to the Covid outbreak). It sets broad priorities for the financial sector and may discuss structural reforms needed in the financial system.

and consequently a lack of ample fiscal stimulus space, the property crisis and the threat of trade restrictions imposed by the Trump administration increased the comparisons made of the economic situation during 2024 with the Japanese financial and banking crisis of 1990-2020. In other words, would China be a second Japan? This so-called possible “Japanification” of China will be discussed in the next section as the conclusions of this paper.

4 Conclusions: Possible Japanification – will China be a second Japan?

Japan experienced almost three decades of a severe deflationary trap, from the collapse of its equity bubble in 1990 to the outbreak of the Covid pandemic in 2020 and significant wage hikes. It was not a period of constant decline, but the episodes of some economic improvement lasted generally very short and hence the literature typifies this period as "Japan's three lost decades" (Nomura, 2023). The crisis in Japan led to the terminology of "Japanification", which is typically defined as a combination of slow growth, low inflation or actually deflation, and a low policy rate, accompanied by deteriorating demographic trends (Financial Times, 2023b and 2024c). Furthermore, the long duration of Japan's economic and financial crisis was characterized by both policy mistakes, such as downward pressures on wages and the increase in the consumption tax in April 2014, and the (late) introduction of unconventional economic policies, especially of unconventional monetary policy, which enlarged the size of the Bank of Japan's balance sheet strongly.

As Japan's financial and economic crisis lasted so long, its causes have been investigated thoroughly in the academic literature. The crisis started with the collapse of bubbles in real estate and stock markets, which resulted in the rapid accumulation of bad debts, with various types of loans turning non-performing, such as loans which had been used directly for stock market activity and to finance real estate investments, and industrial loans which had been granted on the basis of real estate collateral; total bad debts were estimated to amount to 25% of GDP in 1998 (Lincoln, 1998). On the back of encompassing financial liberalization and deregulation, banks had entered rapidly into real estate and international lending markets, without having the adequate business models and experience. Not surprisingly, a severe banking crisis was the result, which was not adequately dealt with mainly because of strong informal networks and long-term personal relationships between bankers, their supervisors and politicians, which resulted in even larger debts (see Van Rixtel, 2002).

Moreover, the financial crisis worsened because of huge losses of Japanese insurance companies and securities houses, the former through losses on investments in the US Treasury market when exchange rate conditions deteriorated, the latter through losses on investments in the stock market on their own accounts and on lending to other speculators through non-bank subsidiaries (Lincoln, p. 358). In light of the financial crisis, the Ministry of Finance could have used an expansionary fiscal policy, but it chose not to do so, deliberately opposing any departure from its long-term goal of eliminating the large fiscal deficit that had emerged in the 1970s (Lincoln, p. 335). The banking crisis culminated in the bankruptcies of several major and many smaller Japanese banks and a reorganization of the Japanese banking sector through mergers and acquisitions, often orchestrated by the Ministry of Finance.

It was finally halted by the infusion of large amounts of public money and regulatory reforms, approximately ending in 2005 when the non-performing loan ratio of major banks fell below the government's official target. By cleaning up the banking sector and forcing banks to write off bad loans, unprofitable firms had to close down, which created the situation for monetary and fiscal policy implementation to revive the economy (The Economist, 2002). Japan had been very reluctant to let unproductive firms fail, which resulted in the phenomenon of the "zombie" firms (Caballero, Hoshi and Kashyap, 2008). Japan also experienced challenges from its custom of lifetime employment, which tended to delay the necessary reallocation of workers from declining companies and industries to rising ones (Shirakawa, 2023). Overall, it is generally accepted that Japan's financial and banking crisis lasted unnecessary long because of slow government intervention and resolution.

Hayashi and Prescott (2002) sought the causes of the 1990s as a "lost decade" in real economy factors. First and most important was the fall in the growth rate of total factor productivity. Second, the reduction of the workweek length between 1988 and 1993 contributed to the economic slowdown. Hoshi and Kashyap (2004) concentrated on the contribution of the financial crisis to the economic stagnation. They presented estimated losses from the financial crisis of at least 20% of GDP at the beginning of the 20th century. These authors concluded that "the financial crisis has left Japan with a dysfunctional banking system that misallocates funds and a perverted industrial structure in which subsidized inefficient firms are crowding out potentially profitable ones" (Hoshi and Kashyap, 2004, p. 24).

Koo (2013 and 2014) introduced the concept of the "balance sheet recession", which occurs after the bursting of a debt-financed asset bubble, in Japan both of real estate and stock market bubbles, which leads to significant deleveraging of the private sector, as both lenders and borrowers have balance sheet problems. Hence, savings are not being borrowed, do not enter the real economy and become a deflationary gap for the economy, which will push the economy ever deeper into balance sheet recession. In this situation, the government has to offset the deflationary forces coming from private sector deleveraging by crucial fiscal stimulus (Koo, 2014). Indeed, in response, the Japanese government ran fiscal deficits and government debt as a percentage of GDP increased strongly, reaching 167% in 2007 (Abe, 2010). This author mentioned as the two chronic concerns of the Japanese economy deflation and the fiscal deficit. In his view, the Japanese economy was unable to get out of the economic slump created by the burst of the real estate and stock market bubbles because of two factors: the financial crisis and "three excesses" that plagued the economy – excess equipment, excess employment and excess debt.

Hoshi and Kashyap (2015) concentrated on two aspects of economic policy in Japan after the bursting of the bubbles: the delay in bank recapitalization and the lack of structural reforms, which were responsible for the slow recovery from the crisis caused by the bursting of the bubbles and the stagnant postcrisis growth. Ito (2016) analyzed the so-called "Japanization" of Japan's economy, which he characterized by a negative output gap, deflation, a negative natural real interest rate and a zero (nominal) policy rate. This situation was caused by various factors, including not dealing with non-performing loan problems promptly and decisively, resulting in a severe banking crisis, the lack of quantitative easing policies when deflation first occurred, the absence of an inflation target and of timely, large scale fiscal stimulus measures. He argued that this "Japanization" of the economy could be prevented or solved by a mix of aggressive monetary policy, an (2%) inflation target and fiscal stimulus. Ito proposed a so-called “Japanization” index, which is the sum of the GDP gap, inflation rate and the nominal interest rate.

With the collapse of economic growth and effective demand, and a profound financial crisis, deflation became a structural characteristic of the Japanese economy. Measured by the GDP deflator, the Japanese economy was in deflation every quarter since the third quarter of 1994,[63] while CPI inflation was negative consistently since late 1999 (Hoshi and Kashyap, 2004, p. 4). Nishizaki, Sekine, Ueno and Kawai (2013) investigated in more detail the causes of deflation in Japan, which they find have been a decline in inflation expectations, a negative output gap- where oversupply reduces the prices of goods and services -, a decline in import prices and a stronger exchange rate, and a supply shock from emerging economies, most importantly China.[64] On the contribution of the strong yen, Japan faced the consequences of the 1985 Plaza Accord, when the yen appreciated by around 20% in just a few months after its enactment. Furthermore, and most importantly, Japan faced important demographic challenges.

Comparing the Chinese economy with that of Japan during the lost decades show that there are similarities but also important differences. Overall, the dominant opinion is that the differences between the current Chinese and past Japanese economies are more pronounced than the similarities, suggesting that Japanification is far from the only path forward for China (Goldman Sachs, 2023).[65] At the same time, if not for the change in its policy stance with the “Big Bazooka” on 24 September 2024 and the subsequent policy measures during September-December 2024, China may have been risking a deflationary spiral like Japan (Wall Street Journal, 2024b).

Regarding the similarities, Chart 7, Panel A, shows that based on the GDP deflator and the PPI inflation index, China was in the September-December 2024 period – which is the central focus of our analysis in this paper – in a situation of deflation, largely caused by insufficient domestic demand.[66] Both Japan and China faced similar macroeconomic imbalances, such as excessively high savings rates and very low consumption relative to GDP, leading to over-investment and persistent current account surpluses (Natixis, 2025b). Moreover, Chinese bond yields declined sharply, at some maturities falling even

63 Except for four quarters starting with the second quarter of 1997, when the consumption tax increase of two percentage points led to a mild increase in the GDP deflator (Hoshi and Kashyap, 2004, p. 4).

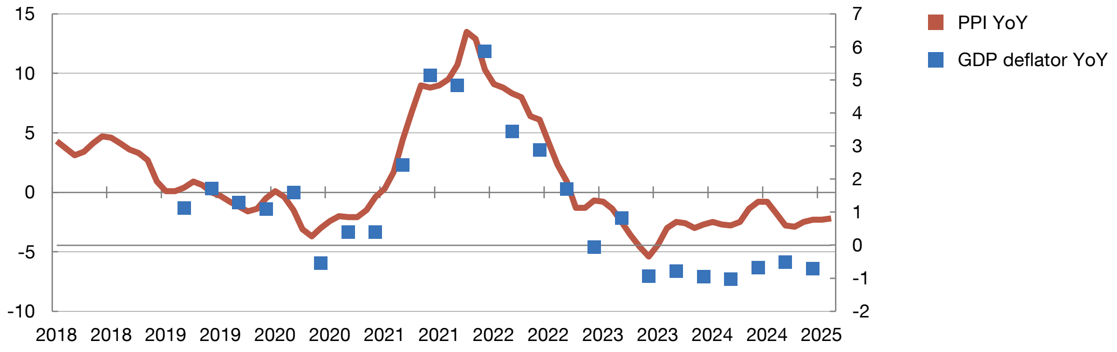
64 Deflation can be very persistent: The Japanese government announced only in August 2023 that Japan may be at an “inflection” point in its 25-year battle with deflation, as price and wage rises showed signs of becoming more pronounced (Kihara, 2023). Furthermore, in an interview with the Financial Times in March 2025, Japan’s Minister of Finance Kato warned that Japan had not yet conquered deflation, as rising prices were still being driven by a weak yen and high commodity prices (Financial Times, 2025a). Nevertheless, Goldman Sachs (2025a) expected that Japan’s reflation could be sustained, with both CPI and core CPI inflation at 2.2% YoY for 2025 as a whole, above the Bank of Japan’s policy target, while wage growth and key service price measures could be in the 2-3% range.

65 State Street (2024) concluded that “government authorities in China have the resources to launch a credible proactive policy response to lift near-term growth expectations, as well as the ability to institute structural reforms to balance the demographic transition and property sector drag. Investors will be watching for those signals to be assured that Japanification will be averted”.

66 China experienced two periods of deflation: first in 2015 and again starting in 2022. The deflationary pressures in the first period were mitigated through fiscal stimulus, but China became more hesitant to use stimulus again in the second one (Natixis, 2024e, p. 7).

Chart 7
Inflation

7.a China PPI and GDP deflator (both YoY%)



SOURCE: LSEG Workspace.

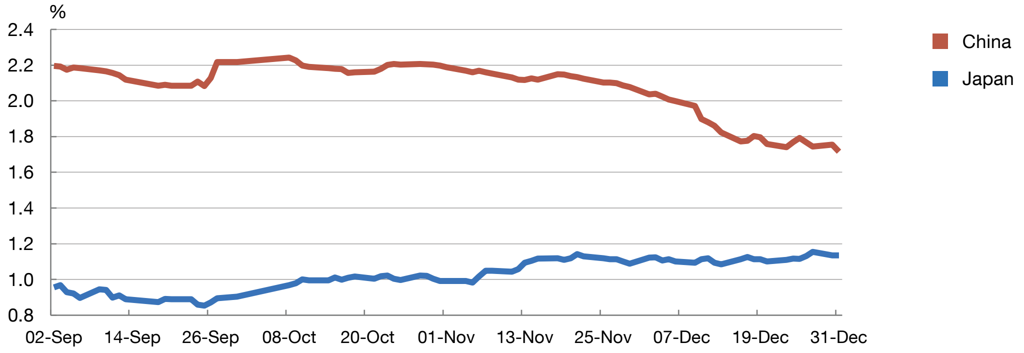
below Japanese yields of similar maturities, such as those at 30 years, which suggested declining inflationary expectations (Chart 8, panels A and B).[67] China also has experienced high levels of debt, a property sector crisis and unfavorable demographic trends (Vontobel Asset Management, 2024). China's overall indebtedness has been rising in 2024, and the IMF's concepts of augmented fiscal deficit and debt are much higher than China's official figures: the pace of increase and level of the debt problem of China now is similar to that in Japan in the 1990s, according to BIS data (JP Morgan, 2023). JP Morgan also argued that China's housing market correction is not only cyclical, but is also structural, reflecting major changes in demand versus supply in the housing markets, which is similar to Japan's housing market correction in the 1990s. The problematic demographic situation of China is mentioned by many analysts, such as for example Wise and Loeys (2025), p. 4, who conclude that China has a very weak demographic outlook, facing rapid population aging and working-age depopulation, and JP Morgan (2023), whose concern is that China is actually ageing more rapidly than Japan, resulting in the prediction that China will "grow old before it grows rich" (Financial Times, 2023b).[68] Moreover, an amended version of Ito's "Japanization" index showed that China's economy has become more "Japanized" than

67 The decline in the Chinese 30-year bond yield below the Japanese one for the first time has been interpreted in various analyses that China was "grappling" with "Japanification", as deflationary pressures fueled a slide in China's long-term sovereign bond yields below Japan's (Financial Times, 2024u). See also Bloomberg (2024ba), Financial Times (2024k), (2024c), (2024j), (2024m) and (2024n). The decline of interest rates in China also reflected expectations of further rate cuts by the PBoC (Bloomberg, 2024ka).

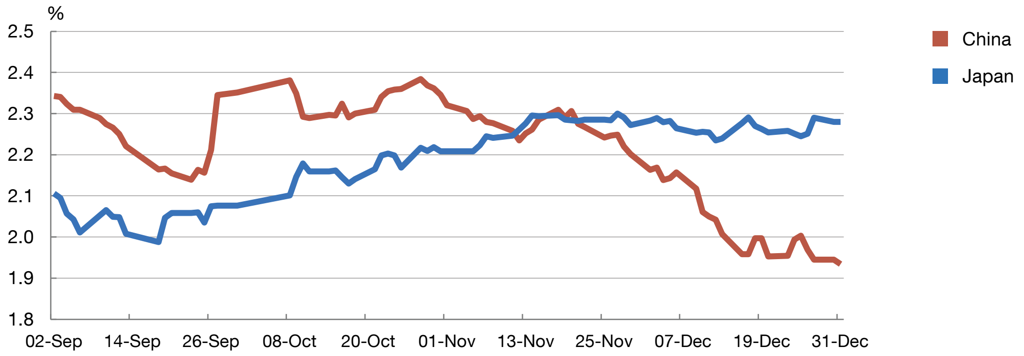
68 Wise and Loeys (2025), p. 4, concluded: "Growth in the elderly share of its population over the next decade is expected to be close to, if not the fastest ever observed in any country over a ten-year period. At the same time, China's working-age population is expected to shrink quite quickly, ultimately contracting by an expected ~70% by 2100. Natural demographic change is likely to be exacerbated slightly by net emigration over the coming decade, and there is a risk that this will be concentrated among the highly educated and skilled due to their greater mobility. The pension system appears to be vulnerable to the resulting substantial increase in old-age dependency, posing a serious challenge to be managed by the government". Fuxian (2025) concluded that regarding demographics, China is more Japanese than Japan: "China's trajectory has been similar to Japan's, except that its fertility rate is even lower. […] 30 years after peaking, Japan's prime-age labor force has shrunk by 19%, while China's will have declined by 31% after its peak".

Chart 8
China and Japan government bond yields

8.a Chinese and Japanese 10Y government bond yields



8.b Chinese and Japanese 30Y government bond yields



SOURCE: Bloomberg Data License.

Japan's recently (Financial Times, 2024e).[69] Other similarities are that both countries used industrial policy in response to the economic challenges, increasing expenditures in R&D and support high-technology sectors (Natixis, 2024e). They also used both export markets to channel abroad excessive manufacturing capacity and experienced excessively high savings rates that led to over-investment and persistent current account surpluses. This "investment-heavy" economic model had two important consequences: "the rapid accumulation of public debt and deflationary pressures from overcapacity" (Natixis, 2024f, p. 12). Finally, both countries experienced trade conflicts with the US on the size of trade surpluses, resulting in the Plaza Accord in 1985 between the US and Japan, and the US-China tariff war that started in 2018 under the first Trump administration (JP Morgan, 2003). A critical assessment of China's situation and closeness to a possible Japanification as of end-February 2025 is given in Bloomberg (2025b): "China's fiscal stimulus has been lacking so far. […] In 2024 the government even missed its own spending targets. […] Whether China can adequately

69 The Financial Times replaced the GDP gap with working-age population growth, as "the estimation methods of GDP gaps differ across nations and working-age population is by far the most fundamental determinant for long-term growth".

step up spending despite its fiscal position is the question for 2025 and beyond. Insufficient stimulus and premature fiscal tightening can prolong a slump or even make it worse, as Japan found out when each hike in the sales tax pushed the economy in contraction". It quotes Richard Koo who concludes that for China to avoid falling into Japanification, it must keep large stimulus flowing for five or seven years until the nation's balance sheet is repaired. What was also similar between Japan's and China's experience was that wage growth continued to slow through "mini" growth cycles, with the lower-income earners taking the biggest hit and lower wage growth spilling over to household consumption (Morgan Stanley, 2024s).

But the differences between Japan's economic crisis and the current Chinese economic and financial challenges seem more pronounced, suggesting that China is no 1990's Japan yet, which is the dominating view across analysts (Goldman Sachs, 2023; ING, 2023; JP Morgan, 2023; PineBridge Investments, 2023; Crédit Agricole, 2024; Morgan Stanley, 2024m; Robeco, 2024; Xiaojing, 2024).[70] Morgan Stanley (2024s) concluded that China is better positioned than Japan after the property/land Bubble burst, but that reflation needs the stimulus of consumption.

First, China has not experienced a severe banking crisis which was not addressed properly, resulting in the collapse of some of its main banking institutions, as in the case of Japan. The real estate crisis had a much more severe impact on the Japanese banking sector than it currently has on the Chinese one, as Chinese banks have been much less exposed to real estate developers as their Japanese counterparts, due to regulations in China that limited banks' ability to provide lending to real estate ventures (Natixis, 2024e).

Second, China has not experienced a collapse of a stock market bubble. The Nikkei 225 was trading at a price-earnings ratio of around 70 at the height of the Japanese bubble in 1989, while the China MSCI was trading at a price-earnings ratio of 13.5 in September to 11.4 in December 2024. Moreover, the overall decrease in asset prices in China has been relatively contained (Xiaojing, 2024), while Japan's trend profit growth was much lower in the late 1980s than Chinese growth at present; moreover, the exposure of Chinese households to the equity market is much lower than it was in Japan (Goldman Sachs, 2023).

Third, China also has not experienced a rapid appreciation of its exchange rate, but has been maintaining a managed exchange rate system that should avoid such a situation. It has avoided so far any push from the US Treasury to appreciate its currency and generally kept the RMB relatively weak to foster external competitiveness (Natixis, 2024e, p. 9). This may be an understandable policy stance, given the poor experience of Japan with US pressure (such as the Plaza Accord in 1985) in the 1980s and 1990s to limit the flexibility of the yen, as yen appreciation was seen by the market as a means to accommodate US trade concerns. The yen basically doubled in value after the Plaza Accord and stayed

70 As the key differences in favor of China relative to Japan, Morgan Stanley (2024m), p. 43, summarized: underlying potential growth, the size of the property and stock market bubbles, FX management, real rates well below real GDP growth and more favorable demographics.

strong after it peaked, while it can be argued that the RMB is undervalued now (Goldman Sachs, 2023). Moreover, China's capital account is not fully liberalized and largely closed, which protects it from capital movements as well as foreign exchange pressures (Crédit Agricole, 2024), shields its banking system and economy from capital flight (Magnus, 2003) and reduces the risk of fire sales of domestic assets (mainly housing) to invest overseas (JP Morgan, 2023).

Fourth, China has taken measures such as the RMB 10 trillion swap program to address the high leverage and indebtedness in its economy, especially of the local governments and their LGFVs. Prasad (2003), p. 57, argued that debt accumulation in China has been financed mostly by domestic savings and the state owns many of the key creditors and debtors; hence, the Chinese government has stronger control of both asset and liability sides of the debt problem (JP Morgan, 2023), which means a financial shock is unlikely to set off a financial crisis or a collapse in growth.

Fifth, deflation in China seems relatively modest, as the development of the GDP deflator is relatively mild and does not seem to be deteriorating strongly and has stabilized at a modest negative level, which possibly could avoid a deflationary spiral. Shirakawa (2023) argued that mild deflation is just a symptom of underlying demographic challenges, and should not cause severe alarm. Most research follows the line that China is not yet on the brink of a deep deflationary situation (ING, 2023). But an increase in domestic demand, especially consumption, is key to avoid a deflationary trap.

Moreover, according to various analysts, China has not been experiencing a "balance sheet recession", such as proposed by Richard Koo, which is characterized by asset decline, debt contraction and economic decline: the crucial mechanism of debt contraction triggering economic recession has not taken place, as debt across various sectors still has been expanding, while the economy – according to official figures – still has been growing (Xiaojing, 2024). JP Morgan (2023) concluded that there are "enough differences to suggest the 'balance sheet recession' diagnosis, and policy recommendations that flow from it, is/are not correct". In their view, it is critical to stabilize the housing market as a near-term policy priority in order to avoid such a scenario, as emphasized in various Politburo meetings, by taking measures such as lowering down-payment requirements, relaxing the definition of first home mortgages and relaxing home purchase restrictions. As was discussed in Section 3, Chinese authorities took various of such measures during the September-December 2024 period.

Sixth, China is still a developing economy, with many years of increasing urbanization, while Japanification is associated with an economy already in a high state of development (Vontobel Asset Management, 2025). According to JP Morgan (2023), a lower urbanization ratio "points at larger potential for productivity increase associated with labor migration from agricultural to non-agricultural sectors". In this line, China has more growth potential than Japan had: per capita income of Japan at the end of its economic miracle "was 120% that of the US, while in China it stands at 16% now. Economic growth at about 5% in China driven by productivity gains means the country can grow out of its problems far more easily" (Robeco, 2024).[71]

Seventh, China's property crisis is showing signs of stabilization and even recovery in some areas. Moreover, residential property prices in China (such as for example in Beijing) did not show the sort of exponential growth that typically characterizes a bubble, and which was observed in the development in Tokyo's residential property prices: China's housing price overvaluation seems less severe than Japan's in the 1990s (ING, 2023; JP Morgan, 2023). Furthermore, Chinese policymakers acted already in 2017 to prevent the occurrence of a bubble similar to the one in Japan, and policy measures ensured that residential property in China has been financed much more conservatively than in Japan, with downpayments of at least 30% on first homes and often up to 50% on second homes; as a consequence, there is much less leverage in China's property market than there was in Japan's (Robeco, 2024).

Eight, China has largely closed the technological gap with the more advanced economies, and is even leading in certain areas of renewable and electric automobile technologies, robotics and artificial intelligence, such as the Deep Seek event showed in early 2025. The Australian Strategic Policy Institute analyzed the lead of individual countries in critical technologies and found a remarkable shift in research leadership over the past two decades towards large economies in the Indo-Pacific region, led by China's exceptional gains (ASPI, 2024). It reported that "the US led in 60 of 64 technologies in the five years from 2003 to 2007, but in the most recent five years (2019–2023) it was leading in only seven. In contrast, China led in just three of 64 technologies in 2003–2004, but is now the leading country in 57 of 64 technologies in 2019–2023, increasing its lead from the ranking last year (2018–2022), where it was leading in 52 technologies". These developments counterbalance a continued deterioration in longer-term growth expectations, which was a key contributor to Japan's economic malaise (Goldman Sachs, 2023). China is a leading country in humanoid robotics,[72] with also having a significant cost advantage: "non-China supply chain prices are almost 3x China prices, indicating that China supply will be highly significant for making humanoid robots affordable. We see this as an opportunity for China to further upgrade its manufacturing capabilities and reach a higher level of precision and automation" (Morgan Stanley, 2025b). Moreover, "China continues to benefit from a wide range of national support with government-backed robotics funds, innovation centers, and policies to support critical parts of the supply chain. […] the gap in national support between the US and China appears to be steadily widening" (Morgan Stanley, 2025d). Expectations are that by 2050, China alone will account for 30% of global humanoid robots. Moreover, China is also leading in Robotaxis: Goldman Sachs (2025b), p. 1, mentioned that 500,000 Robotaxis are expected to be operating across 10+ cities in China by 2030, "… with growing consumer acceptance across large 'Tier-one' cities, a tightening supply of human drivers as the fleets mature and

71 On the downside, JP Morgan (2023) also mentioned that a lower GDP per capita means that China is becoming old and highly-indebted before it becomes rich.

72 Humanoid robots are general-purpose robots modeled after the human form factor and designed to work alongside humans to augment productivity. They're capable of learning and performing a variety of tasks, such as grasping an object, moving a container, loading or unloading boxes, and more.

drivers retire, and with Government and insurance industry as enablers to support growth". It forecasted that the market for Robotaxis in China will grow from USD 54 million in 2025 to USD 47 billion in 2035. Finally, Morgan Stanley (2025c), p. 4, highlighted the scientific advancements of China "Recent advances in AI and technology have renewed confidence in China's scientific prowess. As of April 2025, the future of China's manufacturing sector hinges on integrating technology with supply chains amid domestic and geopolitical challenges".[73]

Innovation and new technological developments were aided by support from the PBoC, which launched in 2024 a lending facility for sci-tech and technological transformation "to guide financial institutions to provide credit support to technology-based small and medium-sized enterprises (SMEs) and for technological transformation and equipment renewal projects" (PBoC, 2025b, p. 19). By the end of 2024, financial institutions had signed loan contracts worth over RMB 900 billion with enterprises (projects), "strongly supporting first-time loans of technology-based SMEs as well as financing for technological transformation and equipment renewal projects in key areas" (PBoC, 2025b, p. 20).

Furthermore, Chinese corporations do not seem as risk averse as Japan's. The latter were hit by severe balance sheet constraints: "Japanese corporations were forced to take big write-downs on their balance sheets and de-lever very quickly, depressing return of equity" (Robeco, 2024, p. 73). Chinese corporations have not been hit by a similar process of forced fast deleveraging.

Finally, China has a much larger domestic market, a larger pool of graduates in science, technology, engineering and mathematics, and comprehensive manufacturing sectors (JP Morgan, 2023).

There are also some differences to the disadvantage of China. For example, its very low share of consumption in GDP is much lower than it ever was in Japan (Natixis, 2025b). Moreover, it does not have a welfare state and is characterized by underdeveloped private insurance markets, which force Chinese households to maintain large levels of precautionary savings. Moreover, the US containment of China is much stronger than it was of Japan, as it sees China as a competing military and economic superpower, which was not the case with Japan. Magnus (2023) concludes that China's chronic over-investment and misallocation of capital, particularly in the property sector, pose a potentially bigger economic problem than Japan's banking crisis in the 1990s. Another characteristic which causes more challenges for China to some extent are its capital controls, which are much more severe than in Japan's case, which means that its savings cannot be deployed externally (Natixis, 2025b, p. 2). Also in respect with the degree of openness of the economy, Japan was a global creditor which provided it with capital account income, while China has much less outbound foreign direct investment and has to forego mostly these revenues. Furthermore, the external environment

73 The Economist (2025a) opened an article on robots with the sub-heading "Why China may win the great automation race", arguing that Chinese robot-makers have two major advantages vis-à-vis their US competitors, namely substantial state support and a well-developed supply chain, with China also catching up fast in machine thinking.

is more challenging for China nowadays, and the country may have less room for macro policy stimulus measures than Japan in the early 1990s (JP Morgan, 2023).

But overall, China enjoys a number of advantages compared with Japan's three lost decades, which makes a "Japanification" of China far from certain.

First, and most importantly, it can learn from the lessons of Japan's experience, from the policies that worked and those that didn't, and from past deleveraging experiences (see for example Shirakawa, 2023; Morgan Stanley, 2024l).[74] The Japanese crisis had been analyzed in depth by many and policy recommendations are clear, such as implementing an accommodative monetary policy and fiscal stimulus measures, a timely recapitalization of banks saddled with bad loans and a resolution of high levels of indebtedness. For example, China has not made the policy mistake of Japan of keeping monetary policy too tight (Robeco. 2024). China has announced or implemented already most of the aforementioned policies,[75] while it also has been taking measures and is planning more to address the important demographic challenges it is facing. Koo (2023) emphasized that China, unlike post-Bubble Japan and the West, understands a balance sheet recession and how to respond to it: Chinese companies had been reducing borrowings long before the Property Bubble burst, and forced the Chinese government to borrow more. Of course, as we discussed before, the opinions are divided if China is in a balance-sheet recession at all.

Second, China's policymakers seem to move faster in taking and announcing policy measures than their Japanese counterparts during Japan's lost decades, for example avoiding full financial forbearance.

Third, as mentioned before, China did not experience some of the developments that promoted Japan's crisis, such as a long-lasting banking crisis and the collapse of a stock market bubble.

Fourth, some green shoots can be observed in China's economy, such as a stabilization and partly recovery of the property sector, as described in Section 3.

Fifth, China has a one-party government instead of a multi-party democracy in Japan, which should be beneficial to policymaking during crisis situations and support long-term strategic economic objectives. The ultimate goal of China's communist party is to stay in power, and for that it knows it has to deliver prosperity and economic growth for all of its citizens.

Given the number of similarities and differences between the current Chinese economy and Japan's lost decades, it is too early to tell if the Chinese economy will turn

74 Shirakawa (2023) argued that the Chinese authorities had intensively studied Japan's experience with demographic change as well as its asset bubble and collapse.

75 Ito (2016) also recommended adopting an inflation target. China's government sets an inflation target of around 3% for 2024, but this target does not seem to be binding. In any case, the PBoC does not have an inflation target monetary policy framework.

Japanese. However, China can take the adequate steps to prevent this and has the benefit of the doubt, as it enjoys numerous advantages compared to Japan's policymakers during the Japanese crisis, as mentioned before. Chinese policymakers have definitely learned from Japan's economic and financial developments and policies taken (and not taken) during its lost decades. As a matter of fact, on the basis of the wave of policy measures announced and taken during September-December 2024, Chinese policymakers certainly are aware of the danger of Japanification and seem determined to avoid this scenario. Moreover, the government seems to have understood the need for financial sector reforms and liberalization to promote better resource allocation (Prasad, 2023).[76] Supply reforms may help to improve productivity in China, avoiding the fall in total factor productivity that Hayashi and Prescott (2002) emphasized in their analysis of the causes of Japan's lost decades.

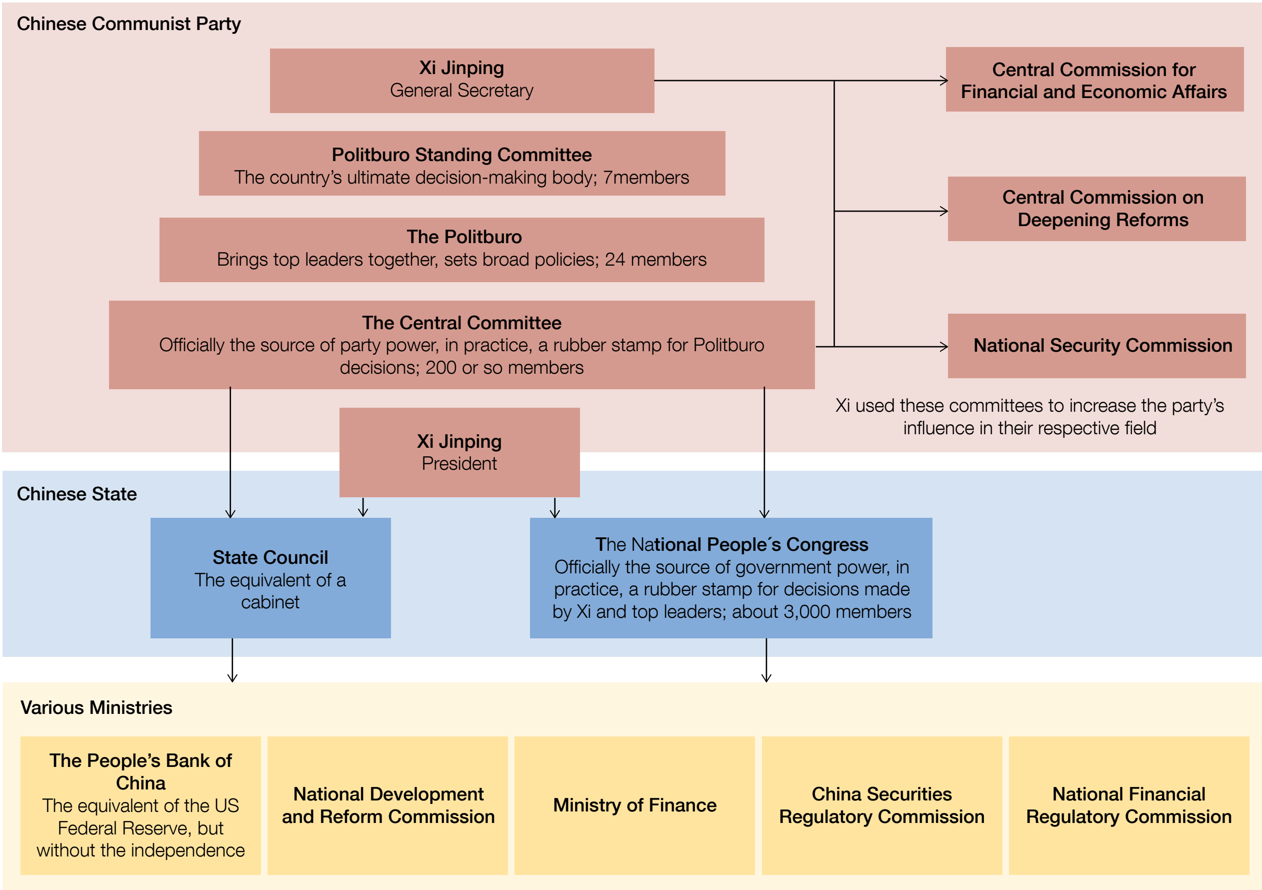
In other words, the policy intentions in China are in the right direction. All will determine on the speedy implementation of the right measures, which should largely take place in 2025. Among the right decisions are further structural reforms, such as addressing the imbalanced structure of the Chinese economy characterized by structural overcapacity in its industries and very low levels of consumption: promoting effective demand and addressing worsening demographics are the best remedies against a possible deflationary spiral. If not, China might turn into a second Japan, experiencing a Japanification of its economy.

76 JP Morgan (2023) emphasized that Chinese financing flows have been dominated by debt – bank loans and bonds – which have been growing faster than equity financing, which also leads to continuous debt increase. Structural reforms are needed which promote the development of capital markets, such as equity markets, private equity and venture capital, and the transformation of the economic structure from high credit-intensify to low credit-intensify sectors.

Appendix I Who Runs China?

Scheme A1.1

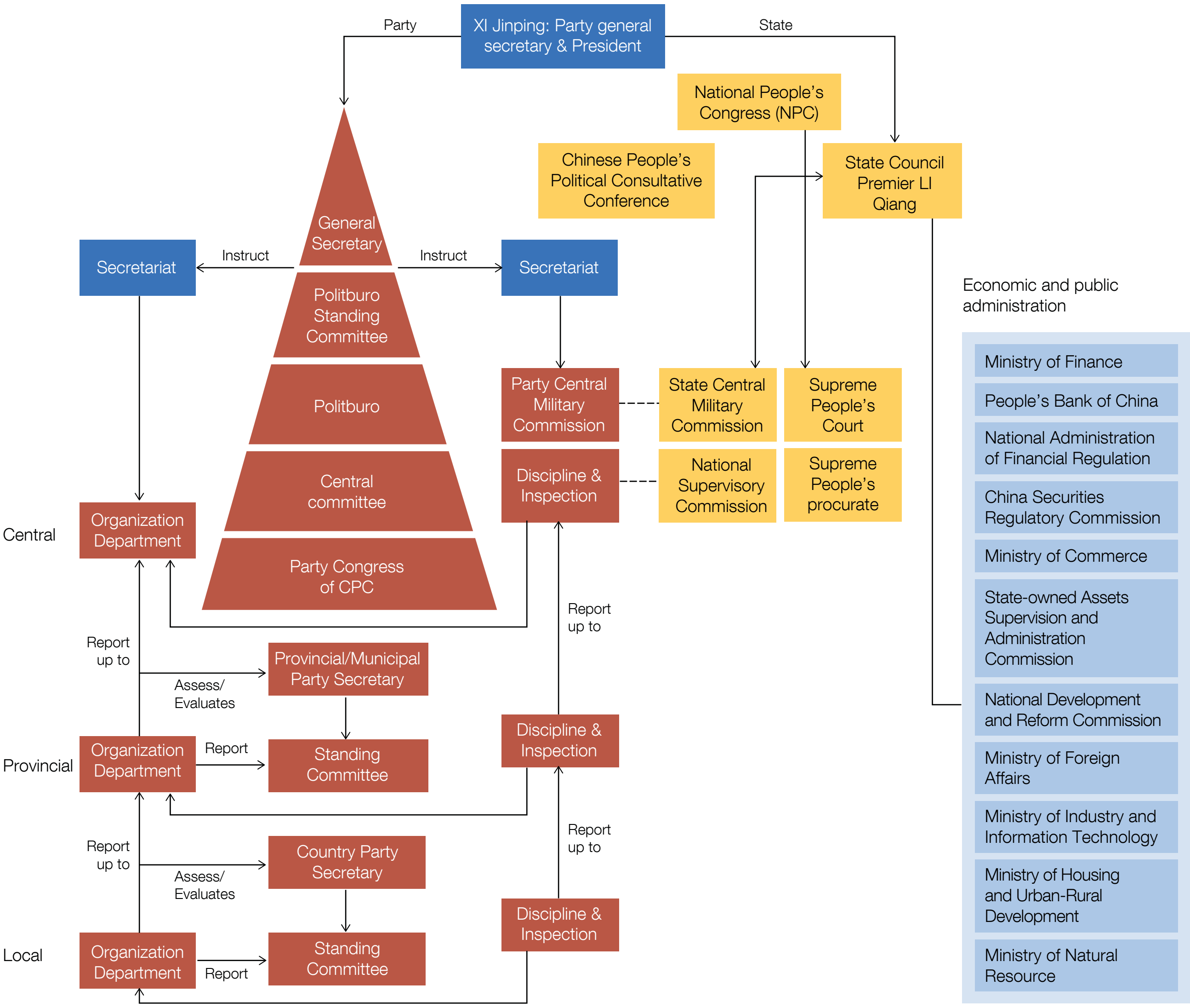
Policymaking in China



SOURCE: Bloomberg (2025c).

Appendix II China's Political Structure

Scheme A2.1
Policymaking bodies in China

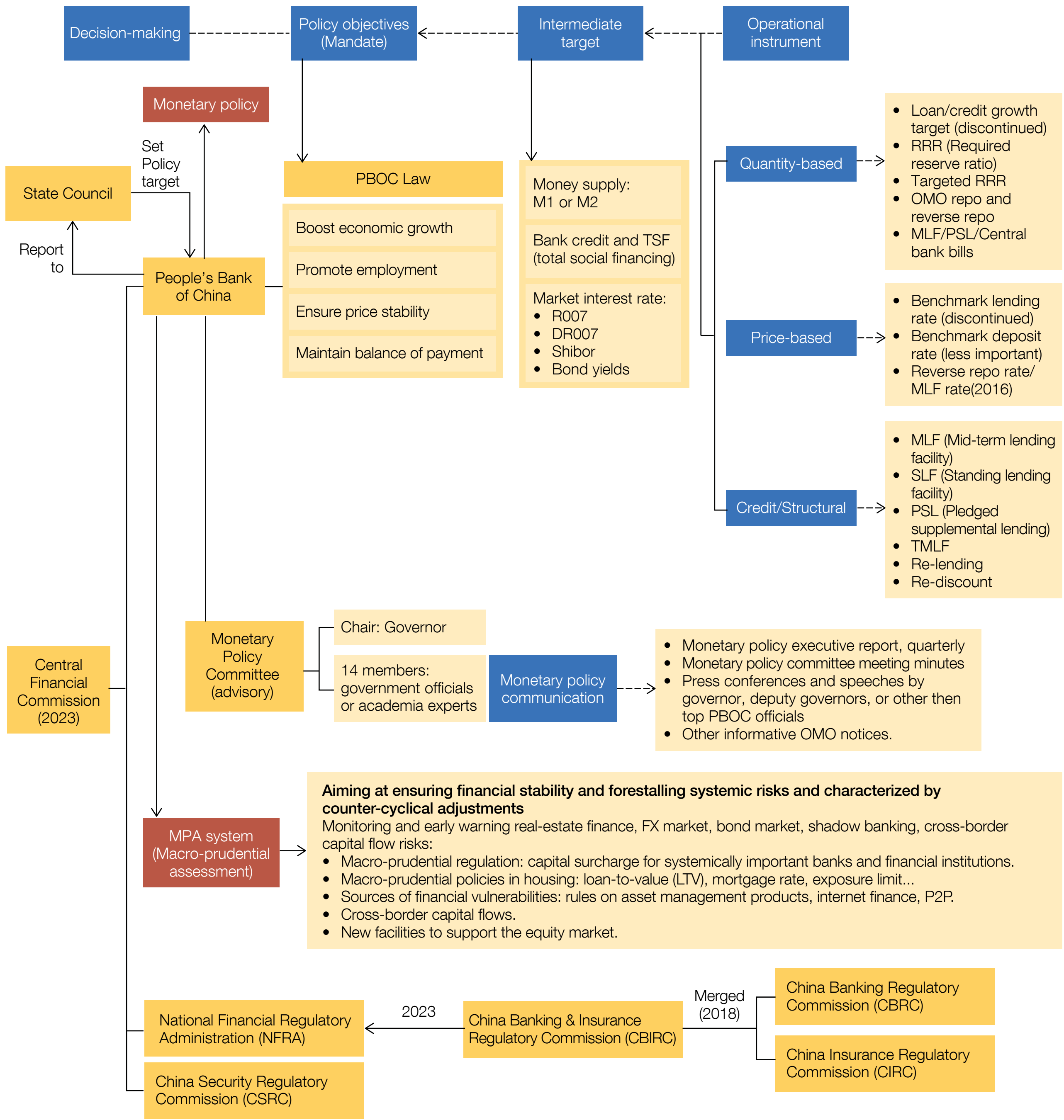


SOURCES: Government websites and media news, compiled by JP Morgan.

Appendix III China's Monetary Policy Framework

Scheme A3.1

Monetary policy process in China



SOURCE: Government websites and media news, compiled by JP Morgan.

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