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Economic Insight

China – Is the 5% growth target achievable?

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The "around 5%" growth target set for this year is once again an ambitious one. Despite the heavy investment to boost the high-tech "new economy", it has not yet been contributing to growth and employment the way people would expect. Chinese companies will try to increase exports at competitive prices. But this may not be easy as trading partners may impose more countermeasures.

A growth target of around 5% is being set, again

At the annual meeting of **National People's Congress** (NPC) which took place in early March, Chinese policymakers set a growth target of "around 5%" for this year, the third year in a row. However, weak consumption and private sector investment have been under pressure because of the property sector downturn and the lack of private business confidence. Whether the 5% target is achievable boils down to whether domestic demand can turn around this year.

Property sector is still in a downcycle...

China's real estate troubles have entered the fourth year. China's property sector, which at its peak accounted for 25% of the economy, has been reduced to around 19.5% of GDP, after factored in both direct (construction and real estate services) and indirect (upstream and downstream) effects.

Encouragingly, thanks to the central and local governments' property easing measures on mortgages and home purchases, there are emerging signs that property transactions and land sales in major cities are stabilization. Nevertheless, international comparison based on house prices suggests that China's housing downturn may last for another 4 to 10 quarters (Chart 1). This means the property sector will remain a drag on growth for this year.

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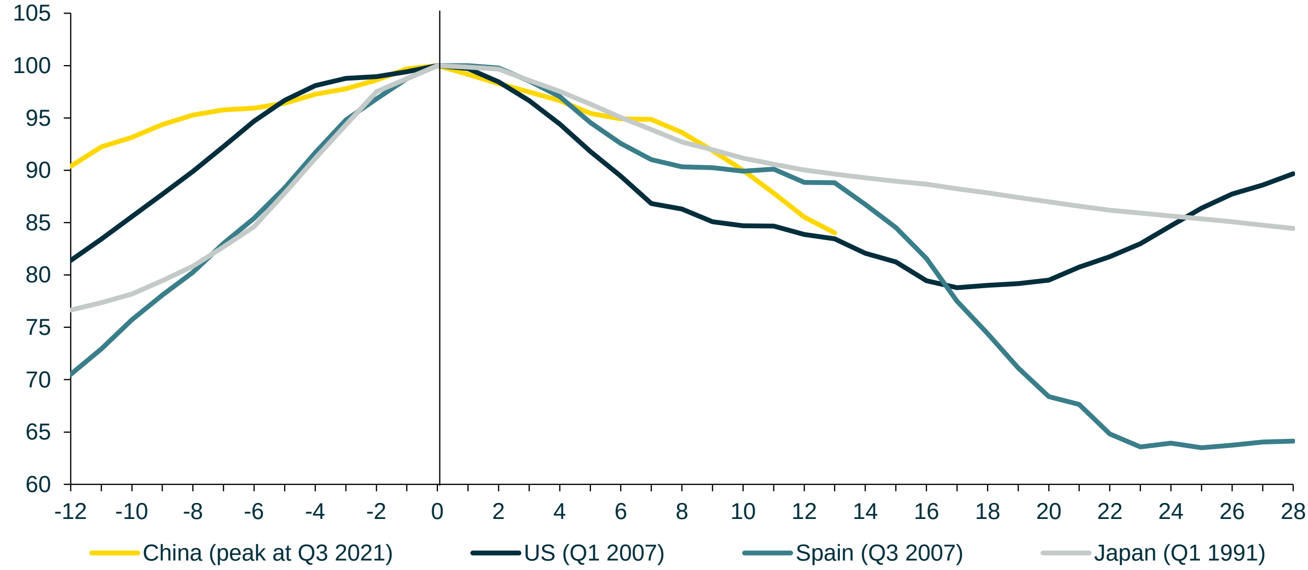
Chart 1 - China's downcycle may still last for another 4-10 quarters based on US and Spain's experience

House price index, peak before crisis = 100, peak quarter = 0; x-axis denotes quarter relative to peak



Source: OECD, China NBS, Bloomberg, CEIC, Commerzbank Research

...and private confidence has yet to recover

While the regulatory crackdown on private tech companies since late-2020 has paused in the past couple of years, the overhang is still affecting confidence and investment today. There was zero growth in private investment in the past two years. Excluding investment in real estate development, private investment grew 6% in 2024 in yuan terms, down from 9.2% growth in 2023.

Positively, there has been a change in the government's stance toward private enterprises. The clearest signal came in February when President Xi Jinping met with private sector entrepreneurs, acknowledging their contribution to innovation and growth. The success story of a homegrown generative artificial intelligence (AI) company also injected fresh momentum into the tech industry and the Chinese stock market. During the NPC meeting in March, the government pledged to roll out new policies and a new law to restore private business confidence and encourage investment.

It is unlikely that Beijing will completely change its belief in the state-led growth model. But Beijing will likely follow words with actions given the recent success stories from private tech companies, notably in AI, robotics, and electric vehicles (EVs) and batteries, especially that these successes are very much in line with China's industrial policies. Beijing has likely recognized that the private sector could play a major role in helping China to achieve self-reliance and tech innovation, and this would be complementary to the state-led effort. Still, the lack of confidence has been around for a few years, and it will unlikely completely turnaround overnight.

But the new economy...

With rising US tariffs and tech restrictions on China, Beijing sees the best strategy to counter the decoupling with the US is to increase self-reliance. At the same time, due to the decline in the traditional growth engines, notably real estate and low-value-added manufacturing, China needs to find a new growth engine.

As such, Beijing focuses on the development of the "new economy" in China. There is no standard definition of "new economy" in the textbook or across the economics profession. But it is generally defined as industries which involve the application of new scientific and technologies and their related services.

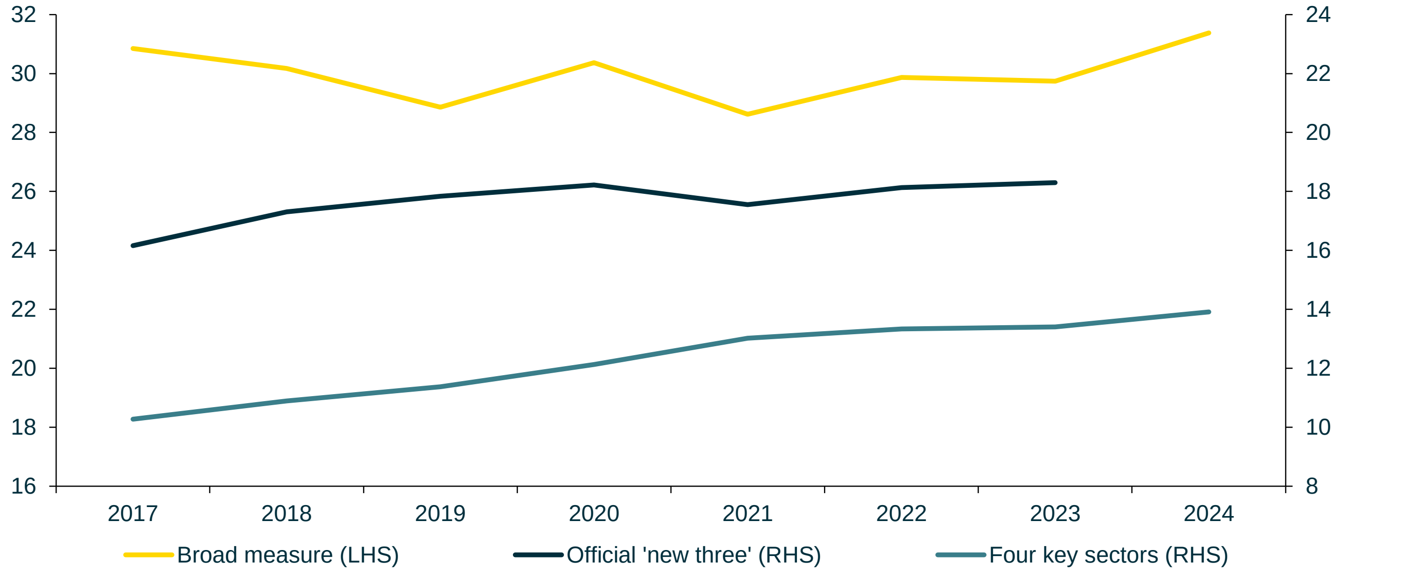
This is at the heart of the "Made in China 2025" policy. It is a 10-year master plan to drive self-reliance and innovation across 10 key industries such information technology (IT), robotics, new energy, biomedical, and new materials. Even though the Chinese government has downplayed the rhetoric since 2018 when US-China trade tensions first escalated, the initiative was largely in place.

...is not growing fast enough...

Based on a broad definition, the size of the new economy increased to 31.4% of China's whole economy in 2024 from about 30% in 2022-23 (Chart 2). But overall, it does not show a clear upward trend. The broad definition is based on the measure from Caixin's "new economy index". It covers 145 industries at China industry code 4-digit in 10 categories – new energy, energy conservation, IT, biomedical, high-end equipment, new material, EV and batteries, and related research and development (R&D) and other service industries.

Chart 2 - New economy's growth stagnated before a pick-up in 2024

% of China's economy; Broad measure is Caixin new economy index, official 'new three' came directly from NBS's measure, four key sectors is based on NBS data and author's calculations



Source: NBS, Caixin, Bloomberg, CEIC, Commerzbank Research

Similarly, the official data using the so-called "three new" economy also show its share in the whole economy has stagnated. "Three new" here means new industry, new business format, and new business model, all related to tech development and their applications.

A third alternative, but narrower, measure shows a somewhat different picture. We use GDP and value-added data on IT, pharmaceutical, special equipment, and R&D services as a proxy of the new economy. Accounting for the direct contribution of these sectors to the economy and their indirect linkages through other industries, these industries combined trended upward from 10% of GDP in 2017 to about 14% by 2024.

Overall, these trends suggest that among the emerging industries classified under the "new economy", only some are contributing to GDP growth. Also, broadly speaking, the "new economy" is far from offsetting the decline in real estate, which reduced to 19.5% of GDP in 2024 from 24% at its peak before 2021.

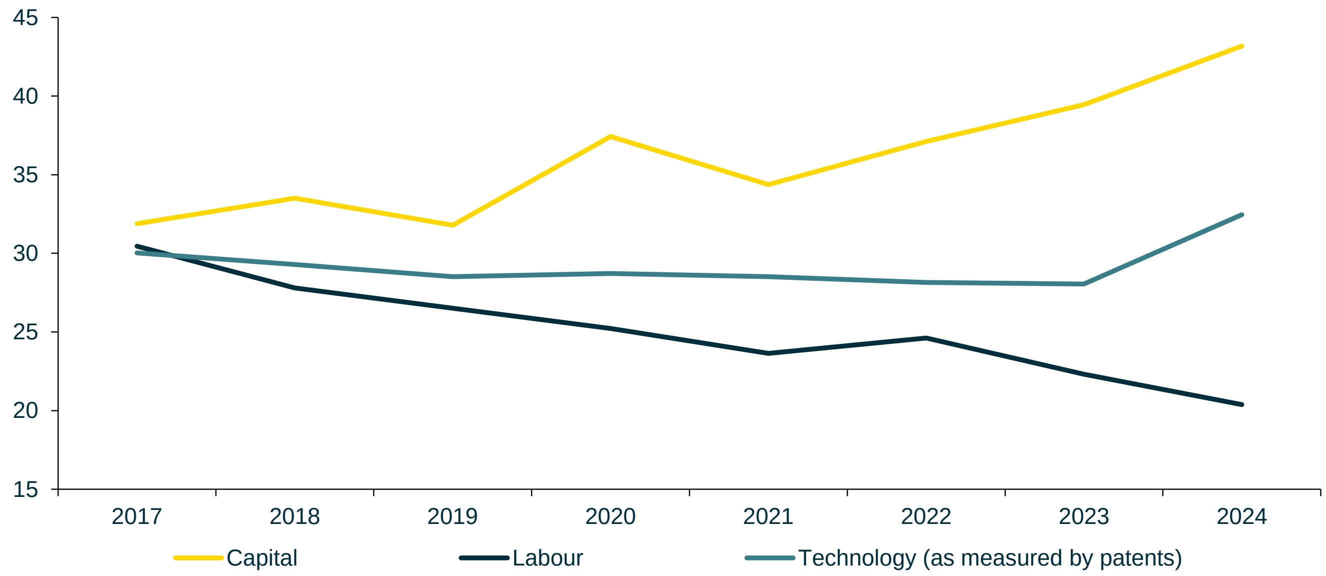
...as huge investment has not yet translated into strong growth...

Based on the broad measure from Caixin, capital investment into the new economy displayed a dramatic uptrend, accounted for 43% of capital in the whole economy in 2024, up from 32% in 2017 (Chart 3). But this is in sharp contrast to the stagnating share of new economy's output. Why is this the case?

1. It could be that innovation requires huge investment upfront. For example, the R&D spending as a percent of sales for EV, solar panel, batteries, computer and electronics, instrument and meter, and pharmaceutical are all at the range of 3-4% or even above. This is compared to 1.7% average for the manufacturing sector. Also, these industries have higher capital depreciation rates, meaning that capital becomes obsolete much faster and hence need large investment to maintain the capital stock. For instance, the depreciation rates (as a percent of fixed assets) for IT and biomedical are between 7-9%, and above 10% for EV manufacturing, compared to 6% for overall manufacturing.
2. But it could also be that huge investment is contributing to further **overcapacity in China**. Based on past experience, China tends to lower costs by scaling up production, and that requires massive investment or even overinvestment.

There is no clear verdict as to which one of the two is correct. It could also be that both are correct at the same time.

Chart 3 - More capital has been invested into the new economy, but this sector has been hiring less over time
% of total in China's economy; from Caixin new economy index



Source: Caixin, CEIC, Commerzbank Research

...and overcapacity may lead to more trade tensions...

Without a sustained boost in domestic demand, a "new economy" with overcapacity means Chinese companies will try to export their way out of the current economic woes. For instance, thanks to the development in the EV and battery industries, China is now one of the top three largest car exporters in the world, competing against Germany and Japan.

Exports have been an important growth engine in the past two years. In 2024, net exports contributed 1.5%-point of the 5% growth. This is the second highest since 2006. But this will be no easy task in 2025 and such export growth will unlikely be repeated, given the escalating tit-for-tat trade war with the US and rising protectionism against Chinese products globally. China's trading partners have been complaining about China's overcapacity and unfair trade practices, not just in the US and Europe but also in emerging countries. This might lead to more countermeasures from trading partners.

The Chinese government may actually roll out measures to reduce capacity in industries such as EVs this year. But even if the government is serious about addressing the overproduction problem, the process will likely take a few years and without much immediate impact.

...while the new economy is less labor intensive

Meanwhile, the new economy is hiring less workers than in the past, accounted for just 20% of all employment, down from 30% back in 2017 (Chart 3). One could argue that the new industries are tech- and capital-heavy so they don't need as many labor as a mean of production.

From a long-term perspective, this actually bodes well for a shrinking Chinese population in which labor supply is expected to fall over the next few decades. But in the short term, the development of the new economy is not contributing to employment the way most people would have expected. What's more, there are actually fewer workplaces to employ the workers shed in the problematic sectors, notably real estate.

Fiscal policy will do the heavy lifting

The development of the "new economy" is not translating to enough growth and employment for the Chinese economy to reach a 5% growth target. This means China will rely on fiscal policy to bridge the gap. As discussed in our recent Economic Briefing on "**China – More spending to meet the 5% target**", China will increase its budget deficit for this year to stimulate the economy. The number one priority is stimulating consumer spending. This will come in the form of consumption subsidies and transfers to the youth, low-income individuals, migrant workers, and the elderly.

However, given the sluggish revenue growth and land sales, bigger spending would be financed by rising debt. There isn't much room for local governments to increase debt. Official local government debt (35.2% of GDP) plus a broad definition of hidden debt (63.5% of GDP) has already reached 98.7% of GDP. While the debt-swap program of CNY10 trillion (USD1.4 trillion or 7.4% of GDP) rolled out last November will help reduce the risk from hidden debt and save interest costs to some extent, the size is small compared to the outstanding hidden debt, based on the IMF estimates. This means the central government should shoulder more of the financing burden, given that its debt is currently at 25.6% of GDP which is low by international comparison. But overall, a broad measure of total government debt is already at 124% of GDP, compared to around 110% for the US and 105% across advanced economies, though this is still below around 215% for Japan.

Reaching the growth target remains difficult

Given all the domestic challenges and a much more volatile global environment, it would be another challenging year for China to achieve the ambitious 5% growth target. We are less optimistic and only forecast GDP growth at 4.3% for this year.

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