February 6, 2025

Can China boom with challenges looming?

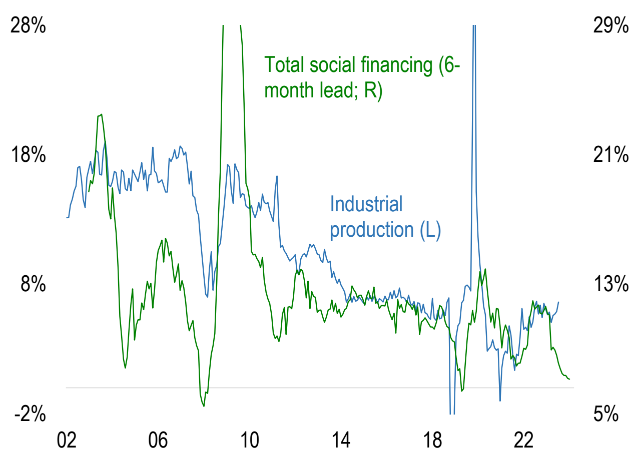
A tale of two Chinas – China's economy ended 2024 on a high note, growing 6.5% annualized in Q4, the strongest quarterly read since Q1/23. This strong finish enabled Beijing to hit its 5% growth target for 2024. One question is whether the pick-up in activity already reflects the impact of the array of policy measures announced last September.

We estimate that this mix of monetary and fiscal moves improves this year's growth prospects by 0.5%. Policy changes can quickly affect financial markets but take longer to impact activity. Since broad liquidity shifts lead industrial production by about six months, weaker liquidity by mid-2024 meant the policy shift had little effect on growth (F1).

So what then explains the recent gains? With property construction under pressure and consumer confidence at rock-bottom levels, China's industrial sector did all the heavy lifting. One source of support was CNY depreciation, as 'higher-for-longer' Fed expectations and continued CN growth worries narrowed CN-US spreads (F2).

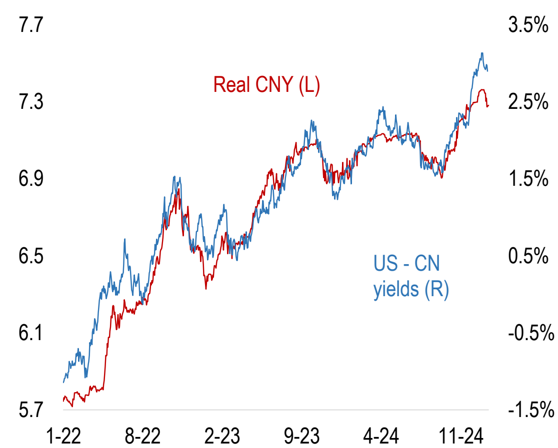
This competitiveness boost allowed manufacturers to ramp up export volumes, a dynamic particularly evident in the auto sector. China is now a global leader in EV manufacturing, which now makes up over 40% of car output, versus 5% pre-COVID. Exports have largely benefitted, with EVs now accounting for nearly a quarter of CN exports by value.

F1: Stimulus hasn't kicked in yet
CN industrial prod. and liquidity (YoY %)



Note: Chart compares year-over-year changes in Chinese industrial production to 6M prior changes in real total social financing, a proxy for total liquidity in the Chinese economy. Source: China NBS, Numera calculations.

F2: A weaker yuan supporting CN exports
Real USDCNY vs. US - CN 10Y yields



Note: Chart compares the CPI-adjusted USDCNY exchange rate against the spread between 10Y US and CN sovereign yields. Source: Macrobond.

T1: Baseline	Quarterly					Annual				
	Q2/24	Q3/24	Q4/24	Q1/25	Q2/25	2022	2023	2024[e]	2025f	2026f
World GDP	2.6%	2.9%	2.0%	2.4%	2.7%	3.2%	2.6%	2.5%	2.4%	2.2%
Developed	1.9%	1.9%	1.5%	1.3%	1.6%	2.9%	1.7%	1.6%	1.5%	1.1%
Emerging	3.6%	4.6%	2.8%	4.1%	4.5%	3.7%	4.3%	4.0%	3.9%	3.8%

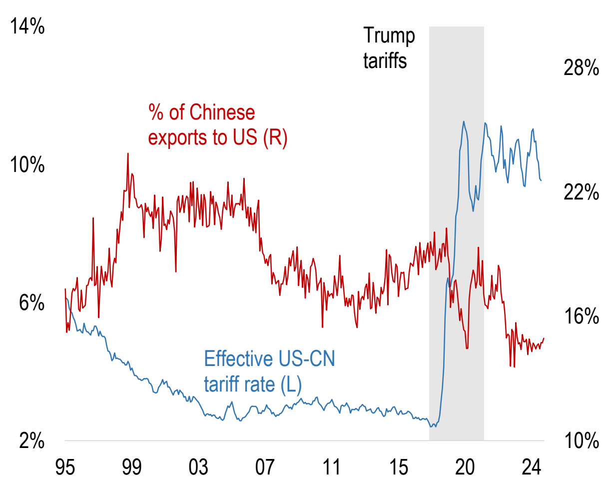
Note: Quarterly figures are QoQ SAAR (%). Source: History: World Bank; Forecast: Numera Analytics

In addition, the prospects of elevated US tariffs this year encouraged CN producers to front-load shipments, with export volumes into the US growing 18% YoY in December, versus 10% growth to other destinations. This, however, raises a question around growth sustainability: Will exports compensate for a lack of domestic demand in 2025?

The CN/US Trade War offers a useful blueprint in assessing the impact of protectionist measures on China's economy. When the Trump administration levied section 301 tariffs, the US was China's largest foreign market at 20% of exports. The duties raised the effective tariff rate on CN imports four-fold to around 10%, and the impact on CN export volumes was highly adverse (F3): By late 2019, exports to the US had fallen 20% versus trend, lowering total volumes by 8%.

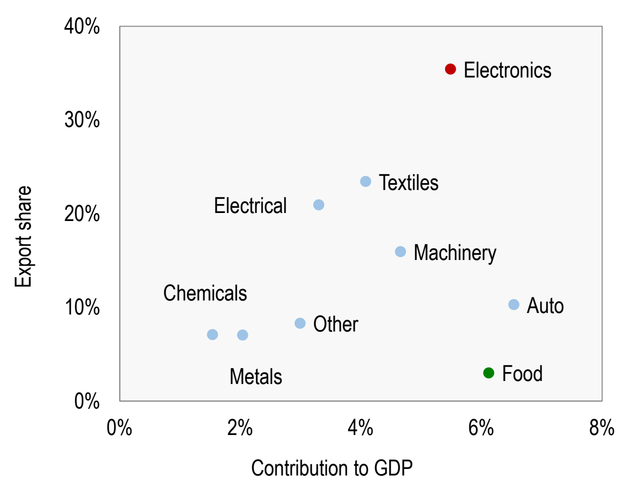
China today has a lower exposure to the US, as it diversified its export base. Still, at 15% of export volumes, a blanket tariff on all CN goods will pose a significant headwind. Even the 10% tariff announced last week (toned-down from the 60% proposed during the campaign) would double the current effective rate. Large trade barriers would prove especially detrimental to electronics, a sector with a high export reliance and a large contribution to GDP (F4).

F3: Tariffs seriously affected CN exports
CN export share to US vs effective tariff



Note: China's export volumes to the US (% total exports) vs the effective tariff rate imposed by the U.S. on Chinese goods. Shaded area highlights the period of tariff implementation during Trump's first term. Source: China NBS & Numera Analytics.

F4: Export-focused sectors most exposed
China GDP and export share by industry (%)



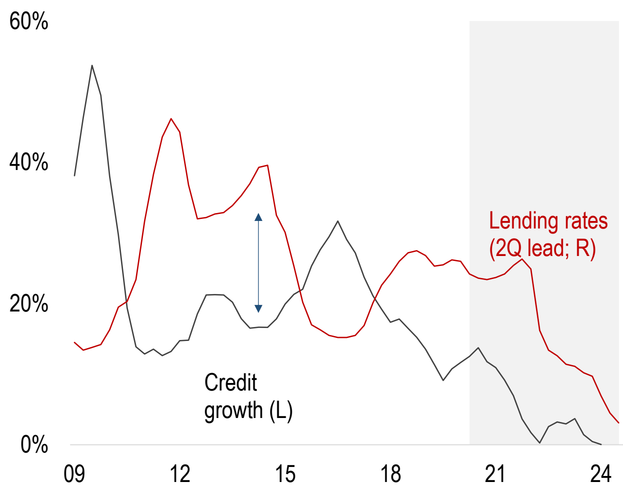
Note: Chart compares the contribution to GDP of select industries in China to their export share in 2016. Source: World Input-Output Database, Numera calculations.

Besides the direct hit to exports, expanded tariffs also fuel economic policy uncertainty, hurting growth by discouraging investment spending. In our US Macro Strategist earlier this week, we presented findings from a rigorous global model we have built to assess the impact of tariffs on the US and major trading partners. Absent a policy response by Beijing, a similar hike in tariffs as that experienced in 2018/19 would lower CN GDP by about 0.7% in 2025.

These headwinds imply that for China to again hit its growth target, this will require stronger domestic demand. By far the main challenge, in this regard, is continued pressure on the property market. A lack of demand has caused housing inventories to sky-rocket, weighing on prices. Since real estate is the primary store of value for Chinese families, this is keeping consumer confidence at zero-COVID lows, in turn discouraging spending.

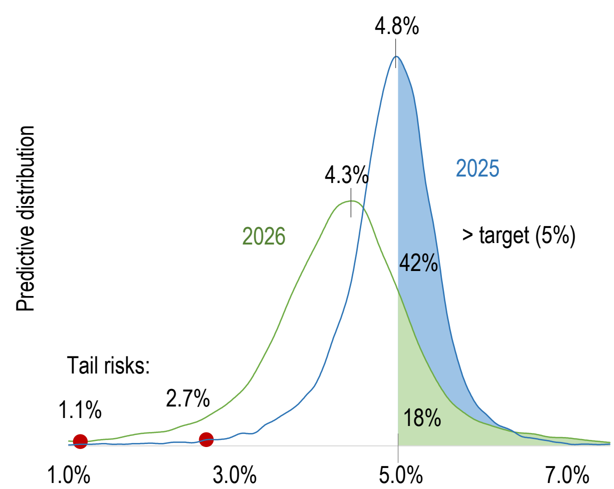
This also weakens the potency of Beijing's policy measures. The government has introduced a number of measures to revive the sector, like cutting mortgage rates on existing loans or reducing down payments for second homes. But the lack of confidence is preventing a pick-up in credit demand, a textbook case of a 'liquidity trap' (F5).

F5: Clear signs of a liquidity trap
China credit growth and lending rates



Note: Chart compares YoY growth in overall Chinese credit volumes to the 6M prior average mortgage lending rates. Source: China NBS, Numera calculations.

F6: Growth target increasingly unlikely
CN real GDP growth outlook - 2025/6 (%)



Note: There is a 42% chance of above target growth in 2025 and 18% probability in 2026. Should the economy decelerate, the worst potential outcome is a 2.7% growth in 2025 and 1.1% in 2026. Source: Numera Analytics.

So what can we expect from China's economy in 2025? Since consumption and residential investment make up over half of GDP, to the extent that Beijing's policy changes are unable to fuel construction, it will be challenging for China to again hit its growth target. Still, a likely expansion in fiscal spending should keep activity at a striking distance: Our base scenario currently points to growth of 4.8% this year, with a 42% chance that growth exceeds 5%.

Yet the likelihood falls sharply by 2026, with our models signaling only a one-in-five chance of 5%+ growth (F6). As the policy boost fades, structural challenges like falling FDI and population declines come at the forefront. One potential tailwind for productivity is the rapid progress made by CN software firms in developing cost-efficient AI models. It is far too early to assess the macro implications, but efficiency gains could help mitigate these headwinds.

Growth Outlook:

- **All DM** – *Below trend*. Developed market (DM) economies are estimated to have grown by 1.6% last year, a below-trend pace primarily due to weak performance outside the US. This year, however, we expect the US economy to lose steam while growth in other DMs improves, as lower interest rates, easing inflation and higher real wages drive increases in consumption. Our baseline is now for overall DMs to grow at a 1.5% pace in 2025.

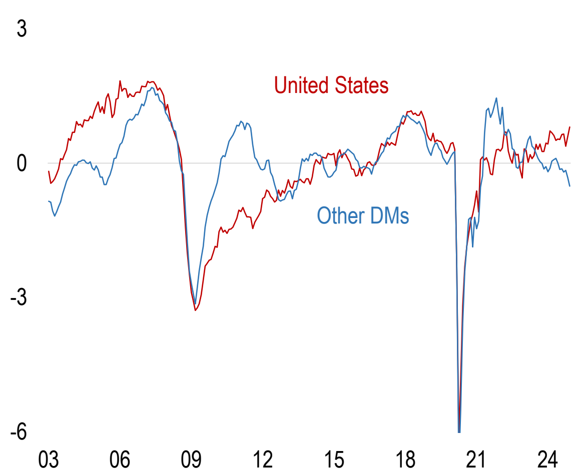
- **Eurozone** – *Recovery*. Despite a weaker-than-expected Q4, Eurozone growth improved slightly in 2024, with GDP ending the year up 0.7%. The recovery should continue but remain subdued as Germany grapples with still-high interest rates and weak exports. Rising inflation also poses a risk, as higher-than-expected ECB rates could delay the recovery. Our baseline projects Eurozone growth to accelerate to 1% this year.

- **United States** – *Slowdown*. The US economy finished 2024 strong, registering a 2.8% gain in the year as a whole, far stronger than other DMs. However, we expect this "exceptionalism" to fade in 2025 as labor market weakness becomes more evident. Trump's announced tariffs add uncertainty, likely fueling higher inflation. We forecast growth to slow to 1.9% next year, with only a one-in-three chance of reaching the 2.2% consensus forecast.

- **All EM** – *Below trend*. Emerging markets likely grew 4% in 2024, a slightly below-trend pace despite Brazil's strength and China's Q4 rebound. Looking ahead, China will likely miss its growth target due to a weak housing sector and the drag form tariffs. Meanwhile, we expect Brazil to cool from its overheating and India to remain below potential due to restrictive policy rates. We project EM GDP will rise 3.9% in 2025 and 3.8% in 2026.

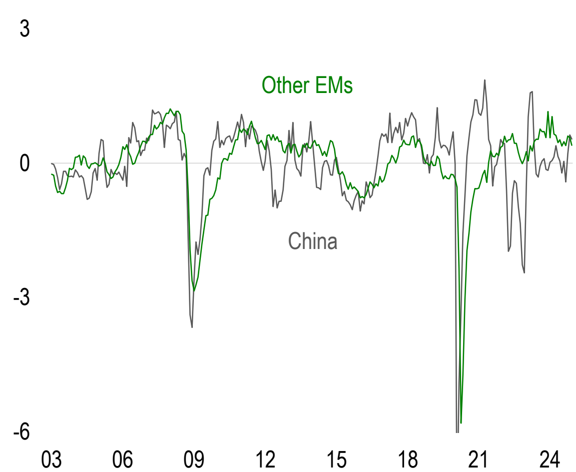
- **China** – *Near target*. China surprised on the upside in Q4 2024, allowing Beijing to meet its 5% target. The economy benefited from a weaker yuan, which boosted export competitiveness. Additionally, we estimate that the policy stimulus package launched last September will add 0.5% to GDP growth in 2025. However, downbeat consumers and a potential trade war will make reaching the 5% target especially challenging this year.

F7: Numera DM real activity indices
Deviations from slow-moving trend (Z-scores)



Note: The real activity indices capture common fluctuations in a large panel of country or region-specific economic indicators. Source: Numera Analytics.

F8: Numera EM real activity indices
Deviations from slow-moving trend (Z-scores)



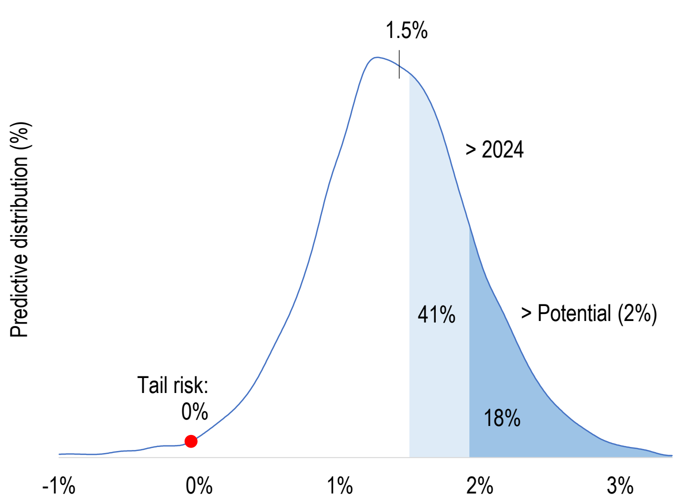
Note: The real activity indices capture common fluctuations in a large panel of country or region-specific economic indicators. Source: Numera Analytics.

T2: DM GDP	Baseline outlook			2025 probabilities (%) Downside risk[1]		Upside		Potential[2]
	2024e	2025f	2026f	Growth-at-risk	Recession	> 2024	> potential	
All DM	1.6%	1.5%	1.1%	0.0%	11%	41%	18%	2.0%
Australia	1.1%	2.2%	1.9%	0.0%	15%	87%	43%	2.4%
Canada	1.2%	1.8%	2.0%	-1.7%	21%	66%	38%	2.1%
Eurozone	0.7%	1.0%	1.2%	-1.5%	31%	62%	24%	1.6%
France	1.1%	1.1%	1.2%	-2.9%	33%	46%	36%	1.4%
Germany	0.0%	0.6%	1.0%	-2.6%	50%	69%	19%	1.6%
Italy	0.4%	0.3%	0.4%	-4.9%	59%	45%	43%	0.5%
Japan	-0.2%	0.8%	0.6%	-1.2%	44%	83%	43%	0.9%
South Korea	2.1%	1.1%	2.5%	-1.4%	17%	15%	5%	2.9%
United Kingdom	0.5%	0.9%	1.8%	-0.7%	9%	75%	2%	2.2%
United States	2.8%	1.9%	0.8%	-0.6%	19%	11%	28%	2.3%

1. Growth-at-risk refers to expected GDP growth below the 5% quantile, indicating maximum potential output losses. Recession defined as 2+ quarters of contraction.

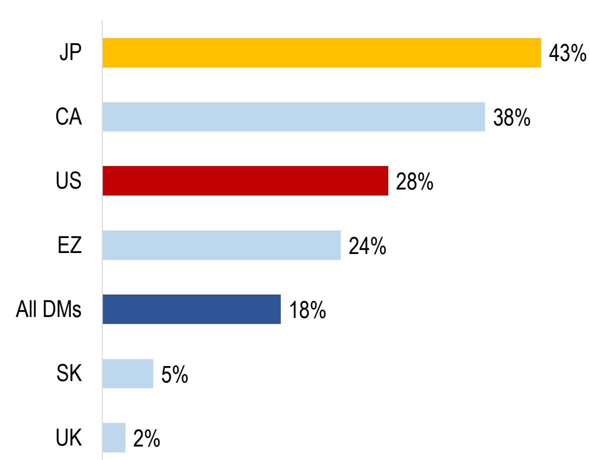
2. Potential growth refers to an economy's sustainable growth path. For the EZ and US, Numera estimates, for other DMs, 2012-19 CAGR.

F9: DM GDP outlook
Real GDP growth (%) - 2025



Note: Baseline scenarios are the mean of each predictive distribution.Shaded area denotes likelihood of growth below potential (2%) in 2025. Source: Numera Analytics.

F10: Likelihood of above potential growth
Probabilities by DM region - 2025 (%)



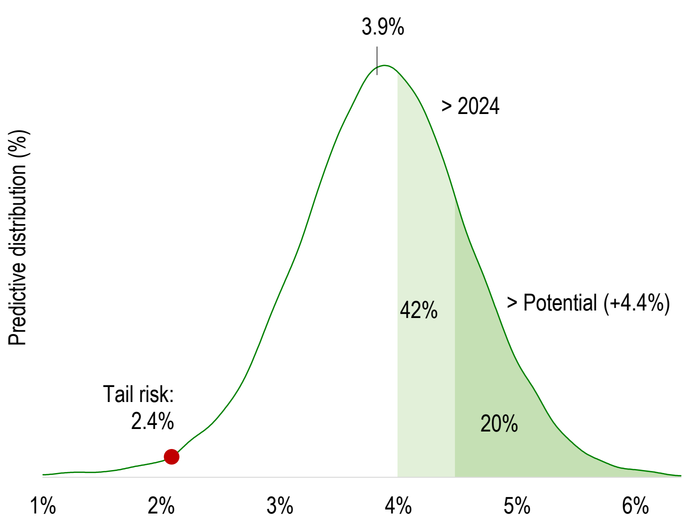
Note: Chart compares the likelihood that real GDP grows faster than potential (2012-19 CAGR) in full-year 2025. Source: Numera Analytics.

T3: EM GDP	Baseline outlook			2025 probabilities (%) Downside risk[1]		Upside		Potential[2]
	2024[e]	2025f	2026f	Growth-at-risk	Recession	> 2024	> potential	
All EM	4.0%	3.9%	3.8%	2.4%	1%	42%	20%	4.4%
EM Asia	5.0%	5.0%	4.8%	3.1%	1%	48%	15%	5.7%
China	5.0%	4.8%	4.3%	2.7%	1%	38%	2%	6.2%
India	5.9%	6.3%	6.7%	-0.3%	14%	60%	44%	6.8%
Indonesia	5.0%	4.9%	5.1%	0.8%	3%	49%	46%	5.1%
EMEA	3.1%	2.5%	3.0%	-1.6%	26%	37%	54%	2.3%
Russia	3.9%	2.0%	2.0%	-1.6%	24%	8%	79%	0.9%
Turkey	2.8%	2.7%	4.3%	-4.6%	35%	48%	26%	4.9%
Latin America	2.1%	2.1%	1.8%	0.1%	20%	48%	73%	1.6%
Brazil	3.2%	2.3%	1.8%	0.8%	12%	12%	94%	1.2%
Mexico	1.3%	1.4%	1.5%	-0.6%	31%	51%	21%	2.1%

1. Growth-at-risk refers to expected GDP growth below the 5% quantile, indicating maximum potential output losses. Recession defined as 2+ quarters of contraction.

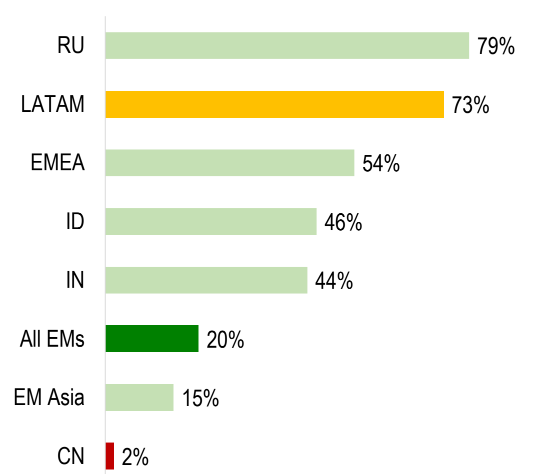
2. Potential growth refers to an economy's sustainable growth path. For all EMs, 2012-19 CAGR.

F11: EM GDP outlook
Real GDP growth (%) - 2025



Note: Baseline scenarios are the mean of each predictive distribution. Shaded area denotes likelihood of growth above potential (+4.4%) in 2025. Source: Numera Analytics.

F12: Likelihood of above potential growth
Probabilities by EM region - 2025 (%)



Note: Chart compares the likelihood that real GDP grows faster than potential (2012-19 CAGR) in full-year 2025. Source: Numera Analytics.

Inflation Outlook:

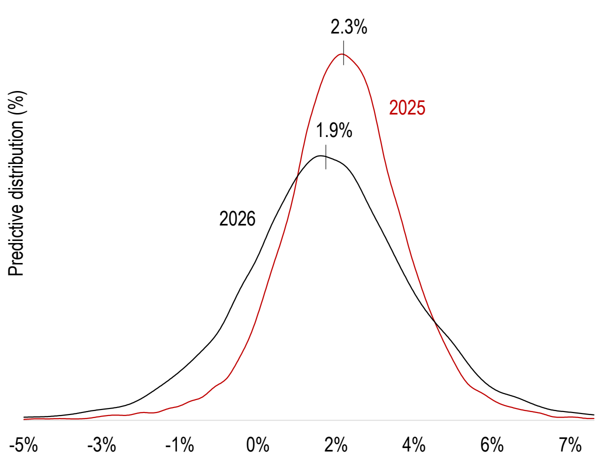
- **Producer prices** – *Upside risk*. Producer inflation has eased since early 2024 as commodity prices fell and freight rates normalized. Our baseline scenario is for this trend to continue, and we project PPI inflation of 2.3% in 2025. However, a lengthy trade conflict between the US and its largest trading partners a major upside risk.

- **Consumer prices** – *Above target*. CPI inflation in developed markets (DMs) was on a downward trajectory for most of 2024 thanks to elevated rates and cooling energy prices. In recent months, however, inflation has inched up due to higher energy costs and sticky core inflation. Recent momentum and the risk posed by tariffs have led us to upgrade our baseline scenario for 2025 to 2.5%, with risks skewing to the upside.

				2025 probabilities (%)			
T4: Inflation	Baseline outlook			Deflationary risk		Inflationary risk	
	2024[e]	2025f	2026f	5% quantile	Deflation	> 2024	> target (2%)
DM CPI	2.6%	2.5%	2.1%	1.9%	0%	37%	-
Canada	2.4%	1.9%	1.8%	0.9%	0%	22%	45%
Eurozone	2.4%	2.4%	1.9%	1.5%	0%	50%	74%
Japan	2.7%	3.3%	2.2%	2.0%	0%	77%	94%
United Kingdom	2.6%	2.4%	2.0%	1.6%	0%	33%	79%
United States (PCE)	2.5%	2.2%	2.1%	1.3%	0%	29%	64%

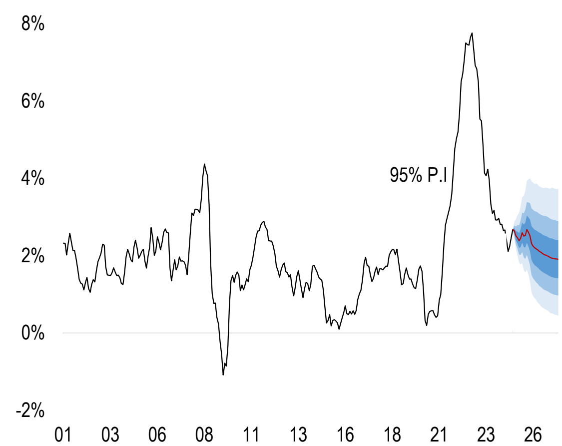
Source: History: Numera Analytics, government agencies; Forecast: Numera Analytics

F13: World PPI inflation
Probability forecasts - 2024/25



Note: Baseline scenarios are the mean of the predictive distribution for 2025 and 2026.
Source: Numera Analytics.

F14: DM CPI inflation
Year-on-year (%)



Note: Fan chart denotes 95 / 80 / 50% prediction intervals.Source: History: World Bank; Forecast: Numera Analytics.

Currency Outlook:

- **CAD per USD** – *Neutral*. After falling 6% in Q4, the CAD is down another 1.5% YTD, dragged by the uncertainty created by tariffs. While our baseline is for Canadian growth to rebound, a prolonged trade war cannot be discarded. The balance of risks points to a flat CAD as the most likely outcome 12M out.

- **EUR per USD** – *Neutral*. The euro has weakened by 7% since September, driven by market expectations of aggressive ECB rate cuts amid sluggish growth and near-target inflation. Looking ahead, the prospect of tariffs is a significant drag, but improving regional growth in 2025 should contain the downside on the EUR this year.

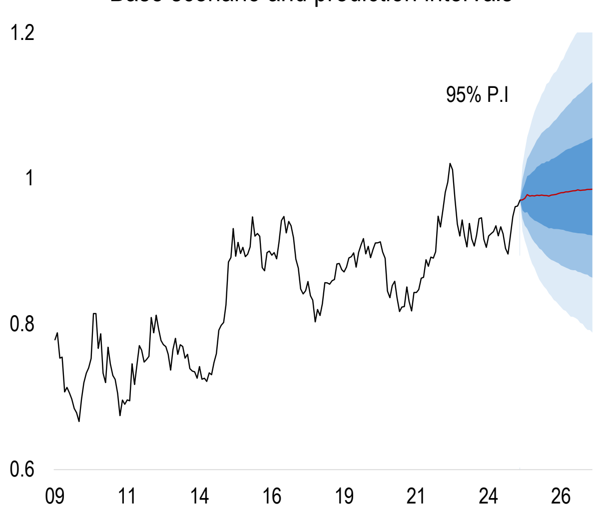
- **GBP per USD** – *Neutral*. The pound is down 8% since September amid rising trade uncertainty. Looking ahead, improved post-election sentiment should provide support, but the BoE should continue cautiously cutting rates in a context of weak growth. We expect the GBP to remain flat at 0.8 per USD over the next 12M.

- **JPY per USD** – *Overweight*. The yen depreciated nearly 13% since September, making it the weakest-performing major DM currency. However, this trend is expected to reverse as the Bank of Japan (BOJ) continues normalizing interest rate policy. We forecast the JPY to strengthen modestly, reaching 152 per USD 12M out.

- **BRL per USD** – *Neutral*. The Brazilian real depreciated over 30% in 2024, pushing it below 'fair' value. It has gained 5% YTD amid aggressive BCB hiking. Even if we expect the BCB to remain hawkish, our models suggest this will be offset by weaker growth, and we project that the BRL will trade near 6 per USD 12M out.

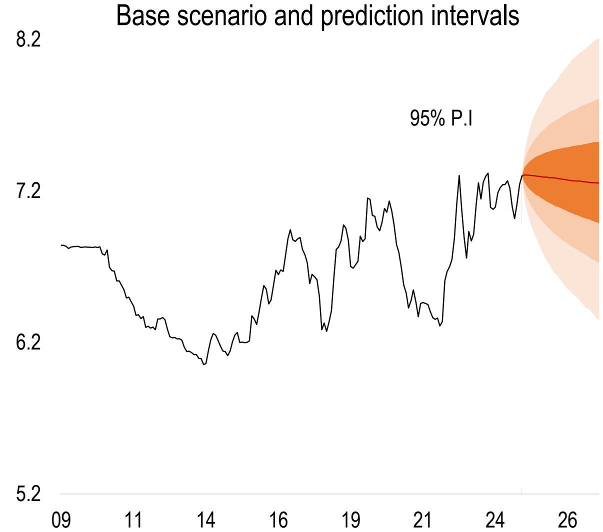
- **CNY per USD** – *Neutral*. The Chinese yuan is down roughly 3% since September, as concerns over tariffs have overshadowed stronger activity in Q4. With Beijing implementing an aggressive policy mix to stimulate growth, this limits downside risks on the CNY, which we expect to remain largely stable over the coming year.

F15: EUR per USD outlook
Base scenario and prediction intervals



Note: Fan chart denotes 95 / 80 / 50% prediction intervals.Source: History: World Bank; Forecast: Numera Analytics.

F16: CNY per USD outlook
Base scenario and prediction intervals

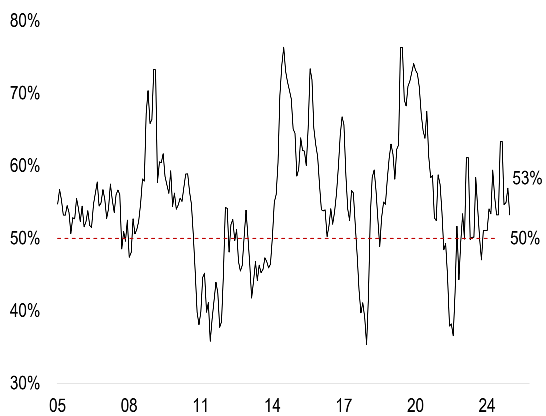


Note: Fan chart denotes 95 / 80 / 50% prediction intervals.Source: History: World Bank; Forecast: Numera Analytics.

T5: DM currencies Currency per USD	Baseline outlook 02/25	3M	12M	12M probabilities (%) > 5% Dep.	Currency appreciation	> 5% App.
Canadian dollar	1.46	1.45	1.46	19%	53%	24%
Euro	0.97	0.98	0.98	27%	47%	21%
UK pound	0.80	0.80	0.80	25%	53%	29%
Japanese yen	155	154	152	21%	57%	33%

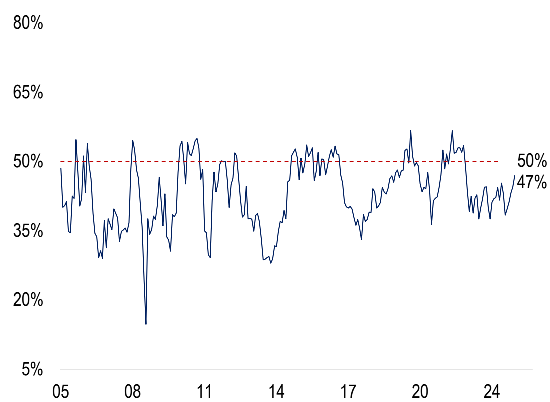
Note: Probability of individual DM currencies appreciating against the US dollar over a 12M horizon. Source: Numera Analytics

F17: CAD appreciation (vs. USD)
12M ahead probability (%)



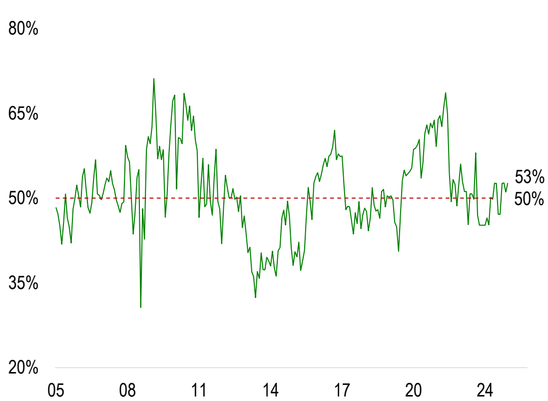
Note: Likelihood of CAD strengthening against the USD 12M out. Probabilities above 50% indicate CAD appreciation is the most likely outcome. Source: Numera Analytics.

F18: EUR appreciation (vs. USD)
12M ahead probability (%)



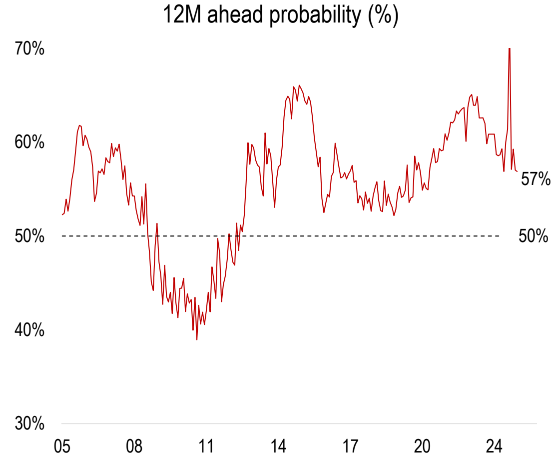
Note: Likelihood of EUR strengthening against the USD 12M out. Probabilities above 50% indicate EUR appreciation is the most likely outcome. Source: Numera Analytics.

F19: GBP appreciation (vs. USD)
12M ahead probability (%)



Note: Likelihood of GBP strengthening against the USD 12M out. Probabilities above 50% indicate GBP appreciation is the most likely outcome. Source: Numera Analytics.

F20: JPY appreciation (vs. USD)
12M ahead probability (%)

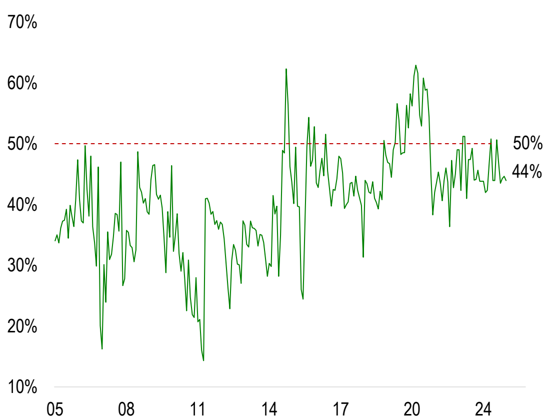


Note: Likelihood of JPY strengthening against the USD 12M out. Probabilities above 50% indicate JPY appreciation is the most likely outcome. Source: Numera Analytics.

T6: EM currencies	Baseline outlook			12M probabilities (%)		
Currency per USD	02/25	3M	12M	> 5% Dep.	Currency appreciation	> 5% App.
Brazilian real	5.88	5.92	6.03	35%	44%	25%
Chinese yuan	7.30	7.30	7.29	9%	52%	10%
Mexican peso	21.0	21.0	21.4	25%	38%	9%
Indian rupee	87.0	87.2	88.1	16%	38%	9%

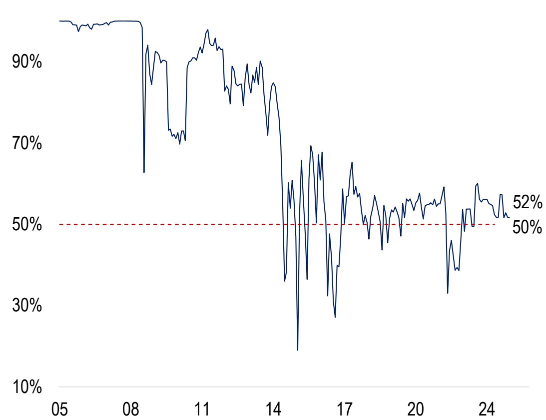
Note: Probability of a given EM currency appreciating against the US dollar over a 12M horizon. Source: Numera Analytics

F21: BRL appreciation (vs. USD)
12M ahead probability (%)



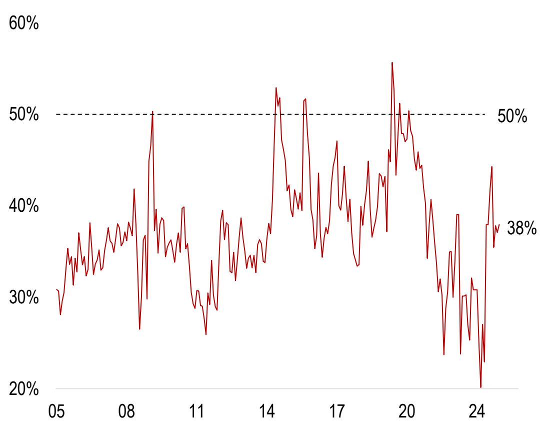
Note: Likelihood of BRL strengthening against the USD 12M out. Probabilities above 50% indicate BRL appreciation is the most likely outcome. Source: Numera Analytics.

F22: CNY appreciation (vs. USD)
12M ahead probability (%)



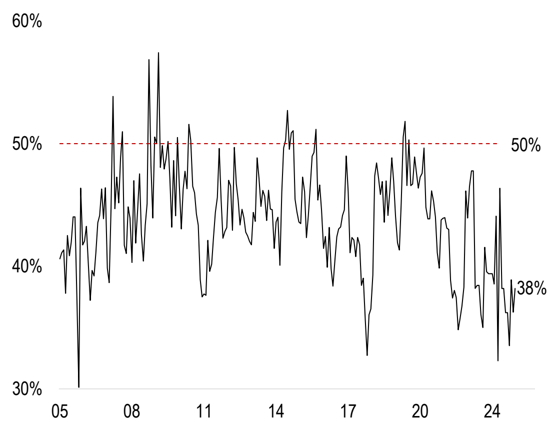
Note: Likelihood of CNY strengthening against the USD 12M out. Probabilities above 50% indicate CNY appreciation is the most likely outcome. Source: Numera Analytics.

F23: MXN appreciation (vs. USD)
12M ahead probability (%)



Note: Likelihood of MXN strengthening against the USD 12M out. Probabilities above 50% indicate MXN appreciation is the most likely outcome. Source: Numera Analytics.

F24: INR appreciation (vs. USD)
12M ahead probability (%)



Note: Likelihood of INR strengthening against the USD 12M out. Probabilities above 50% indicate INR appreciation is the most likely outcome. Source: Numera Analytics.