CHINA: "3 major projects" to underpin economic stimulus this year

- China's premier may announce a GDP growth target of "around 5%" for 2024 and a fiscal deficit target near 3.4% of GDP when the annual parliament convenes on 5 March.
- Given economic headwinds from housing, consumption, and exports, combined with constraints on monetary easing, fiscal policy will be Beijing's primary tool for supporting growth.
- "Urban village" redevelopment, affordable housing, and disaster infrastructure will be the focus of fiscal stimulus designed to boost construction volumes, commodity demand, and employment.

China's premier is likely to announce a GDP growth target of "around 5%" for 2024 and a fiscal deficit target near 3.4% of GDP when the National People's Congress (NPC) convenes on 5 March. Recent data show housing, consumption, and exports all with weak momentum, making fiscal stimulus essential for achieving the growth target. Monetary stimulus will play a supporting role, but high US interest rates have generating capital outflow and currency depreciation pressures, forcing policymakers to proceed cautiously on interest rate cuts.

Beijing's traditional fiscal stimulus toolkit is also ill-suited to current conditions. Returns on investment in traditional infrastructure have declined, since the most highly productive projects have already been completed over the last two decades. One response is the shift to so-called "new infrastructure" — 5G networks, data centers, and integrations of technology into traditional infrastructure — but such projects are too few and too small to fill the investment hole left by traditional infrastructure.

The solution that Chinese policymakers have formulated is the "3 major projects" designated receive special fiscal support this year: affordable housing, renewal of "urban villages," and disaster resilience projects. Key details about their size and scope remain uncertain, but this note summarizes what is known, and the NPC will likely reveal new information.

Urban villages

In terms of the scale of fiscal expenditure, the renewal of so-called "urban villages" will be the most important of the three projects. Urban villages are pockets of nominally-rural land within cities. As China's cities expanded outwards, the government reclassified rural land as urban, auctioned it to housing developers, and compensated the previous rural occupants. But for various reasons — often because property rights to collectively owned land were ill-defined — some tracts were never reclassified. Instead, expanding cities simply engulfed these areas. Because their ownership status remained unsettled, however, urban villages often subsist as slums.

Renovation of urban villages has progressed slowly for years, but progress is poised to accelerate after the State Council, China's cabinet, issued new policy guidance in July. That guidance initially called for focusing on the 21 Chinese cities with populations above 5mn, but as the growth picture worsened, media reports say the scope has expanded to cover cities with population above 3mn, of which there are 35.

The resulting investment in construction will be macro-economically significant. With perhaps 15% of residents in these cities living in urban villages, the program could involve around 15mn households and renovation or construction of around 1.3bn square meters (sq m) of floor space over the next 5 to 10 years, with annual investment of RMB 700bn to 1.3tn (USD 97bn to 181bn). This investment will be financed with a mixture of local government bonds and bank loans, mainly from China Development Bank (CDB), the state-owned "policy bank." As a tool of fiscal stimulus, the urban villages program has the advantage of stimulating construction activity — and with it, demand for workers and physical commodities — without exacerbating oversupply in the housing market.

Affordable housing

The second of the three major projects, affordable housing, has a similar benefit. At least in theory, affordable housing construction will not worsen the oversupply of commercial housing, since the program targets low-income residents who are not served by that market.

An earlier incarnation of the affordable housing program focused on providing subsidized rental units, but policymakers have apparently discarded that approach. Around 3mn rental units remain to be completed under the 14th Five Year Plan's implied target of building 8.7mn such units in 2021-25, but the next evolution of the program will apparently focus on subsidizing home purchases by low-income families.

The scale of the program remains uncertain, but the program may target creation of 6-10mn affordable housing units through a combination of new construction and the purchase of unsold or partially built units from developers, implying annual investment of RMB 240-400bn. In a best-case scenario, the program will reduce commercial housing inventory in cities beset by oversupply, while using public funds to enable completion of projects where construction has stalled due to the financing woes afflicting developers.

As with renovation of urban village, a mix of fiscal borrowing and bank lending will finance the affordable housing program. As previously discussed, the People's Bank of China (PBoC) is deploying a form of quantitative easing to support housing construction. Through its Pledged Supplementary Lending facility, the PBoC lends to CDB, which on-lends to developers for construction. The two projects will also overlap, since some cities are redeveloping urban villages as affordable housing. The 6-10mn target might also overlap with the 3mn units of rental housing still targeted by the 14th Five Year Plan.

Disaster infrastructure

Disaster reconstruction and infrastructure is the smallest of the three big projects. In October, the State Council approved a special RMB 1tn bond sale to finance reconstruction of areas harmed by natural disasters and to build infrastructure to withstand future disasters. As previously discussed, that bond sale marked a rare instance of fiscal authorities expanding the deficit target midyear — from the 3% of GDP target approved at last year's NPC to 3.8% after the special bond issue. Much of that funding will be spent this year on flood control projects and emergency facilities.

This project is the most dubious in terms of its effect on economic growth. Spending on disaster infrastructure is probably less stimulative on a per-renminbi basis than other forms of fiscal spending, but the program may represent a political compromise. Approving the special bond in response to devastating floods last summer in Beijing, Tianjin, and Hebei probably reassured fiscal conservatives that the bond sale would entrench expectations for unscheduled deficit spending in response to every future economic downturn.

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