

## Field Notes from China, October 18, 2024

---

### The Tearsheet

---

1. The Chinese leadership is concerned about the state of the economy, but is trying to address the issue using supply-side measures.
2. They are being forced to act by a Chinese polycrisis: the combination of a local debt crisis, a youth jobs crisis, and a general confidence crisis.
3. Even after the recent announcements and press conferences, we have not seen the full panoply of government actions.

*“You can’t really jump down if you’re already in the basement.”*

- That private comment from an economic advisor to Chinese policymakers stuck with me as I reflected on my recent two-week China trip. It revealed two things to me: 1) those adjacent to policymakers and the leadership understand the severity of the economic downturn; 2) the Chinese economy is nearing the bottom of the cycle.
- This was of course before the recent announcements of monetary and fiscal stimulus to juice the Chinese economy, which have validated that the pervasive concerns about the economy are being taken seriously.
- Taking the economy more seriously is one thing, but will the follow-through reflect that sense of gravity? To have a better sense of what the Chinese government is trying to achieve on the economy, it is important to first begin with some context on its diagnosis of the problem.
- I’ll approach it by posing three questions:

---

### 1. How concerned are Beijing mandarins about the state of the economy?

---

- I believe they are more concerned than at any time since the global financial crisis, except the genesis and impact of the current challenges are primarily endogenous rather than exogenous. For instance, the immediate impact of the GFC was the collapse of Chinese exports, whereas Chinese exports are holding up today.
- The challenges today are mainly a result of Beijing’s approach to structural reforms amid a secular slowdown. To be sure, the Chinese government had long priced in a secular slowdown, having concluded since about 2010 that China would enter a structurally slower rate of growth of 5-6%. The top-level consensus was that China would be able to average ~5% growth throughout the 2020s.
- What was not priced in was “structural reforms with Xi Jinping characteristics.” While the Xi administration inherited the secular slowdown, it believes it also inherited an economic model it didn’t like very much.
- In simple terms, the Xi leadership believes China needs to move from an economy that is prone to producing excesses to one that is focused on efficiency—hence its latest fixation on “total factor productivity” instead of GDP growth (TFP contribution to GDP is down from 5.5 during 1978-2007 to 2.7 in 2022).
- So structural reforms, which began in earnest around 2017, were about taming the excesses and redirecting capital and resources toward segments that, in the leadership’s view, enhance productivity and efficiency of the “real economy.”

- I believe much of the government's willful negligence and/or draconian measures on the economy can be explained by the leadership's view of what is in excess. Property, for instance, was one of the excess sectors that Beijing was loath to support, leaving it to its own devices instead of bailing it out. The crackdown on big tech, too, was in the context of those companies having excessive market share and excessive profits.
- Both of these actions, or the lack thereof, were departures from expectations of Chinese government behavior. In short, the Chinese government can no longer be counted on as a reliable backstop to shore up troubled sectors, injecting much more uncertainty around policy expectations.
- But of course, shifting an \$18 trillion economy from excess to efficiency requires a long-time horizon and deploying capital into new engines of growth, such as cleantech and advanced manufacturing, to compensate for the decline of old growth engines like property and infrastructure. It is also important to note that this is a supply-side oriented approach, not one that is focused on raising demand and consumption.

---

## 2. Why is the government taking action now?

---

- Such an approach to structural economic adjustment, more or less by fiat, necessarily prioritizes the long game at the expense of the near-term, paradoxically exacerbating cyclical problems instead of addressing them.
- The pursuit of this approach has led to what I think could be aptly described as a “polycrisis moment” for the Chinese economy. It is now facing a local debt crisis (the downstream effect of the property collapse), a youth jobs crisis (the government has stopped publishing this data), and a general confidence crisis (private sector/stock market malaise).
- The recognition of this convergence of cyclical crises has prompted the leadership to address the economy more forcefully in recent weeks. But each piece on its own is quite complex, and it is nearly impossible for Beijing to properly deal with them in equal measure.
- For instance, at MacroPolo we [conservatively estimated](#) that local government liabilities are at least \$10 trillion, or more than 50% of GDP. It would be unrealistic to simply bail out local governments given the scope of the problem.
- The low-hanging fruit to tackle is the confidence crisis, and the latest spate of monetary actions and fiscal pledges are aimed at bringing back more animal spirits and confidence in the markets. That has been partially achieved, though how long it endures depends on how much more firepower Beijing is willing to unleash.

---

## 3. Where does it go from here?

---

- We do not yet have as much information as we need to fully digest this stimulus cycle, but our informed view is that we have yet to see the full panoply of actions.
- More details and official press conferences are forthcoming, but we quickly outline the contours of potential outcomes here as placeholders to be assessed in coming months:
  - **The Good** – Before end of year, Beijing announces bazooka stimulus (potentially up to 10 trillion yuan) to be spent over the next two years to reflate the economy while also tackling structural challenges.
  - **The Meh** – Beijing will dribble out a slew of “just enough” stimulus to more or less achieve 5% growth for 2024 and revert to its supply-side structural adjustment approach in 2025.

- **The Ugly** – Beijing is unable to rise to the occasion, gets more trapped in the “polycrisis moment”, which will exacerbate deflation and all the associated challenges. As such, the economy could face structurally slower growth of perhaps 2-3% going forward.

## Disclaimer

This newsletter is a general communication being provided for informational and educational purposes only. It is not designed to be a recommendation for any specific investment product, strategy, plan feature or other purposes. By receiving this communication, you agree with the intended purpose described above. Any examples used in this material are generic, hypothetical and for illustration purposes only. Opinions and statements of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice. We believe the information provided here is reliable but should not be assumed to be accurate or complete. The views and strategies described may not be suitable for all investors.

None of Aurora Macro Strategies, LLC, its affiliates, or representatives is suggesting that the recipient or any other person take a specific course of action or any action at all. Prior to making any investment or financial decisions, an investor should seek individualized advice from personal financial, legal, tax and other professionals that consider all of the particular facts and circumstances of an investor's own situation. Neither Aurora Macro Strategies or any third party involved in or related to the computing or compiling of the data makes any express or implied warranties, representations or guarantees concerning information or perspectives included in written research. In no event will Aurora Macro Strategies or any third party have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) relating to any use of this information.

This report has been created without regard to the specific investment objectives, financial situation, or particular needs of any specific recipient and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Past performance is not necessarily a guide to future results. Company fundamentals and earnings may be mentioned occasionally but should not be construed as a recommendation to buy, sell, or hold the company's stock. Predictions, forecasts, and estimates for any and all markets should not be construed as recommendations to buy, sell, or hold any security--including mutual funds, futures contracts, and exchange traded funds, or any similar instruments.

The text, images, and other materials contained or displayed on any Aurora Macro Strategies, LLC product, service, report, email, or website are proprietary to Aurora Macro Strategies, LLC and constitute valuable intellectual property. No material from any part of [www.auroramacro.com](http://www.auroramacro.com) may be downloaded, transmitted, broadcast, transferred, assigned, reproduced or in any other way used or otherwise disseminated in any form to any person or entity, without the explicit written consent of Aurora Macro Strategies, LLC. All unauthorized reproduction or other use of material from Aurora Macro Strategies, LLC shall be deemed willful infringement(s) of this copyright and other proprietary and intellectual property rights, including but not limited to, rights of privacy. Aurora Macro Strategies, LLC expressly reserves all rights in connection with its intellectual property, including without limitation the right to block the transfer of its products and services and/or to track usage thereof, through electronic tracking technology, and all other lawful means, now known or hereafter devised. Aurora Macro Strategies, LLC reserves the right, without further notice, to pursue to the fullest extent allowed by the law any and all criminal and civil remedies for the violation of its rights.

The recipient should check any email and any attachments for the presence of viruses. Aurora Macro Strategies, LLC accepts no liability for any damage caused by any virus transmitted by this company's electronic communications.