

## The View

# “SINIFICATION” NOT JAPANIFICATION

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- China's property sector and growth rate more broadly are in structural decline. It is a slowdown driven by the three Ds: debt (property), decoupling and demographics
- “Sinification” as opposed to Japanification is the most likely development path
- We define “Sinification” as a grinding deceleration, led by falling property investment and consumption, only partially counteracted by rising fiscal spending on tech and welfare, and resilient exports ...
- ... but a hinge point is approaching: either more stimulus helps form a weak cyclical bottom or a balance-sheet recession begins in the next couple of quarters
- History rhymes as China echoes 1990s Japan and 2010s EU. Construction and demographics count against the PRC. Trade potential and bubble size are in its favour
- A narrow path to escape stagnation exists. Success will be determined by policy in Beijing, Brussels and Washington
- Fiscal and trade capacity is such that China should slow but not stagnate
- Globally the 2020s are the 2010s in reverse, with the PRC driving disinflation, weaker demand and trade competition
- The rise of populism – a key feature in DM in the 2010s – may well feature in the PRC

## Investment implications

“Sinification” is bearish RMB and property linked commodities

Stock pickers will beat index performance

China Government Bond bull market is likely, as is the success of a China 60/40 portfolio

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## Summary

China's property sector and growth rate more broadly are in structural decline. It is a slowdown driven by the three Ds: debt (property), decoupling and demographics. The only question is the pace of the deceleration. We think Sinification as opposed to Japanification is the most likely development path. We define Sinification as a grinding deceleration in activity led by falling property investment and weak consumption, only partially counteracted by rising government debt, fiscal spending on tech and welfare, and resilient exports, putting potential growth at 3-4% (official GDP is likely to be "adjusted" higher) in the next 3–5 years. A more classical Japanification scenario would see growth slowing much more sharply to ~1% over the next decade. The macro impact of Sinicizing or Japanifying will have significant global implications, including disinflation, trade competition and rising geopolitical friction. For markets, industrial commodity and RMB weakness is baked in, with a bull market in China Government Bonds (CGBs) and pockets of tech strength likely amidst overall poor equity index returns.

The prospect of a lost Chinese decade or decades is edging closer. Property sales are contracting at 24% yoy, investment at 19% yoy, and funding for developers at 26% yoy. A hinge point is approaching: either more stimulus helps form a weak cyclical bottom or a balance-sheet recession begins in the next couple of quarters. The former is still our base case.

While the post-Covid recovery in China is uniquely poor, its structural outlook has many similarities to 1990s Japan and Europe in the 2010s. China and Japan both experienced a rapid increase in household and corporate debt. Moreover, both property crises represent a structural break in supply and demand in the sector. The PRC, however, is substantially more exposed to a slowdown in construction activity and faces a steeper demographic cliff edge. On the plus side, Beijing has thus far managed to contain the pace of asset price correction and continues to benefit from a substantial external surplus, contrasting with the rapid popping of Japan's "everything bubble" and its external challenges (Plaza Accord, and East Asian competition), though China will face major trade problems once US and EU green manufacturing improve.

Whether China enters "Sinification" or "Japanification", the policy response required is similar. Once asset prices have collapsed and deflationary mentality becomes entrenched, there are only two ways to escape a balance-sheet recession: either the government can become the borrower of last resort or a country must rely on external demand. This means the PRC growth rate will be determined by policy in Beijing, Brussels and Washington.

In China, we think the political willpower and capacity exist to drive fiscal activity, targeted at favoured tech sectors and to a limited extent social services. We expect government debt to rise and state investment to become an ever more important driver of activity, but one that is incapable of replacing property's contribution to GDP. Meanwhile, both size and geopolitics limit the extent to which China can export its surplus savings to the rest of the world. Reduced imports and supply-chain dominance in key technology areas mean that net exports can still add to growth but not overcome a property slump. An escape route exists, but we are in the uncomfortable position of relying on rational decisions from a diverse group of political actors.

Globally the 2020s are the 2010s in reverse. Following the GFC, Europe and the US went through a prolonged period of balance-sheet repair and anaemic demand. China engaged in a robust fiscal response. Today it is the PRC that is recovering from a credit cycle. Weaker demand, disinflation and trade competition are the main macro spillovers. The rise of populism, a key feature in DM, may well be felt in the PRC with worldwide ripples. China growth rate has peaked its power certainly has not.

## Triple shock and a post covid hangover

China's property sector and growth rate more broadly are in structural decline. It is a slowdown driven by the three Ds: debt (property), decoupling and demographics. The only question is the pace of the deceleration. We think Sinification as opposed to Japanification is the most likely development path. We define Sinification as a grinding deceleration in activity led by falling property investment and weak consumption, only partially counteracted by increased government debt, fiscal spending on tech and welfare, and resilient exports, putting potential growth at 3-4% in the next 3–5 years. A more classical Japanification scenario would see growth slowing much more sharply to ~1% over the next decade, an outcome that is rising in probability. The macro impact of Sinicizing or Japanifying will have significant global implications, including disinflation, trade competition and rising geopolitical friction. For markets, industrial commodity and RMB weakness is baked in, with a bull market in China Government Bonds (CGBs) and pockets of tech strength likely amidst overall poor equity index returns.

The prospect of a lost Chinese decade or decades is edging closer. Last year we outlined a view that the real estate sector in the PRC was 30% too large and the rightsizing of supply and demand would knock 1–1.5 percentage points off the post-Covid potential growth rate for the next five years. One year on, the PRC is experiencing what we characterize as a cyclical balance-sheet recession – a phenomenon that could become structural if Beijing does not intervene more strongly in the next six months.

Property sales are contracting at 24% yoy, investment at 19% yoy, and funding for developers at 26% yoy. Declines in prices are much harder to assess: official data posit a modest decline of just 2.4% since 2020 in tier 3 cities. However, price controls are in place in almost all cities below tier 2, with developers offering various kickbacks including gold bars, white goods and parking spaces, to get around price controls. Anecdotally, prices in some tier 3 cities have dropped by 40–50%. Inventory awaiting sale has risen to 313 square kilometres, about two-thirds of the "ghost town" 2015 peak.

Our initial estimate of a 30% contraction in sales and construction from the 2021 peak now looks over-optimistic. Some of the more bullish state commentators suggest the rapid retrenchment is a positive sign that indicates an early finish to property-sector restructuring. We disagree, reprising our methodology which forecasts sustainable demand based on 1) urbanization rate; 2) upgrading of existing homes; and 3) rebuilding dilapidated homes (full details in China Property

Chart 1: No sign of a bottom

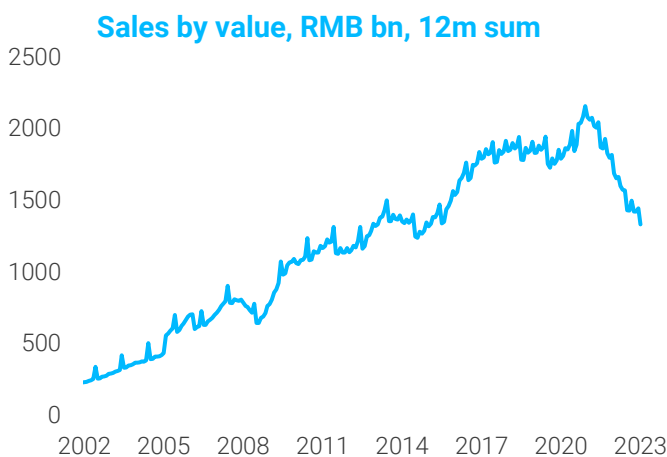
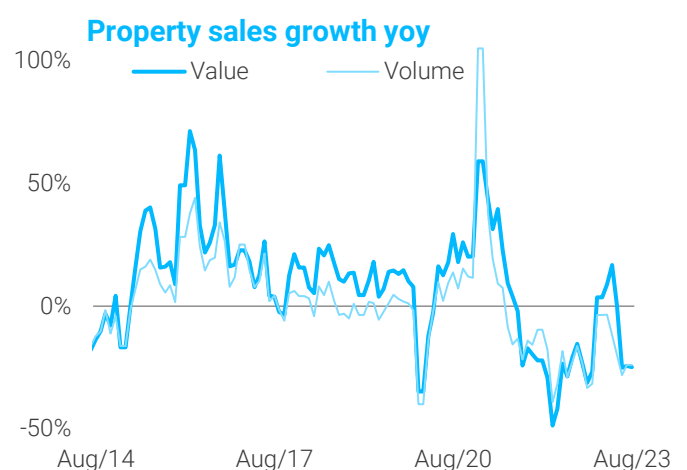


Chart 2: Post covid bounce proves fleeting



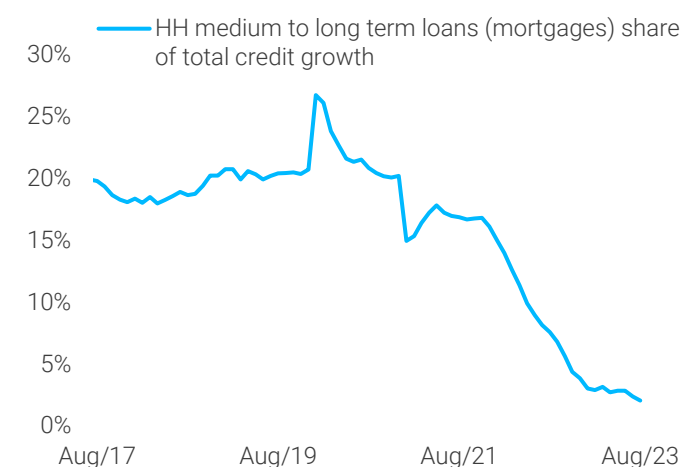
Dream Turns to Nightmare). The projection puts a new lower floor on sustainable demand at roughly 600–700 mn square metres per year, or 50–60% less than the 2021 peak. Sales in 2022 reached 1100 mn square metres. **In a pure hit to the real economy, without considering financial spillovers (much more on this below), China’s potential growth could be 2.5 ppts lower than pre-Covid levels, at least until property-sector restructuring is complete.**

Confidence trap or Japanification? As the data and charts outline, for any who have slept through the past 24 months, the PRC property sector is in serious trouble. We continue to characterize the economy as facing a cyclical balance-sheet recession and one that could become structural if poorly managed. A balance-sheet recession describes how a decline in the value of a sector’s assets that pushes it into some sort of insolvency then forces that sector to pay down its debt, leading to lower investment and growth. It typically occurs when high levels of private-sector debt cause individuals or companies to collectively focus on saving by paying down leverage rather than spending or investing, causing economic growth to slow or decline. Elements of this are certainly present in China, but it is not yet clear to what degree a pandemic hangover is smashing cyclical demand, as opposed to there being a permanent reduction in private-sector willingness to borrow, spend and invest.

China is undoubtedly heavily scarred from the triple shock of its zero-Covid policy, the internet regulatory crackdown and the property slump. Households (70% of wealth), banks (40% of loans) and local governments (30% of revenue) are the economic agents most impacted by falling property prices. Consumers have also been hit hard by employment and income shocks. The combination has caused households’ savings to average a 20% yoy growth rate in 2023, and household borrowing to slump to 3% yoy from a pre-Covid level of 17% yoy. The velocity of money has collapsed. Such behaviour is typical following an economic shock and tends to last about two quarters in China. Given the magnitude of the of the combined Covid/property hit, a recovery in household and business confidence will take longer, at least through 2023.

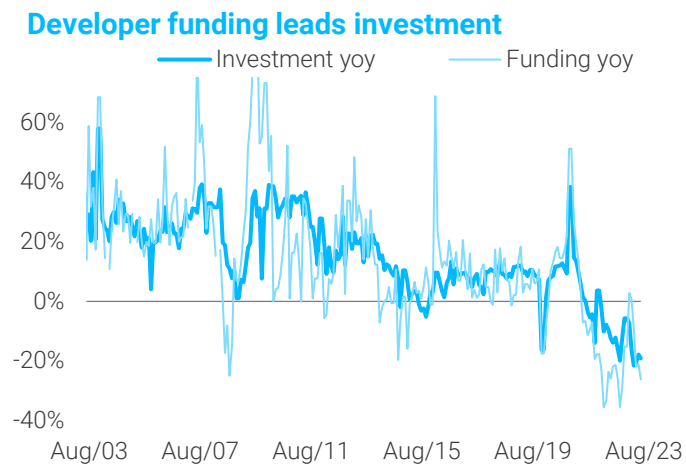
Households are clearly cutting back on major purchases, most prominently in real estate, but there are few indications that a collapse in asset prices is causing them to deleverage. For one thing, headline asset prices have not collapsed, at least officially, which helps limit forced and panic selling, even if it delays market correction and has frozen transactions. Looking at the headline data, China’s debt-to-GDP ratio has increased by 40 percentage points since Covid struck. In 2022, household debt to GDP rose 7 ppts, and corporate debt 15 ppts. Mortgage

**Chart 3: Cyclical or structural hit to loan demand?**



Sources: NBS, TS Lombard.

**Chart 4: Weak property investment baked-in**



Sources: NBS, TS Lombard.

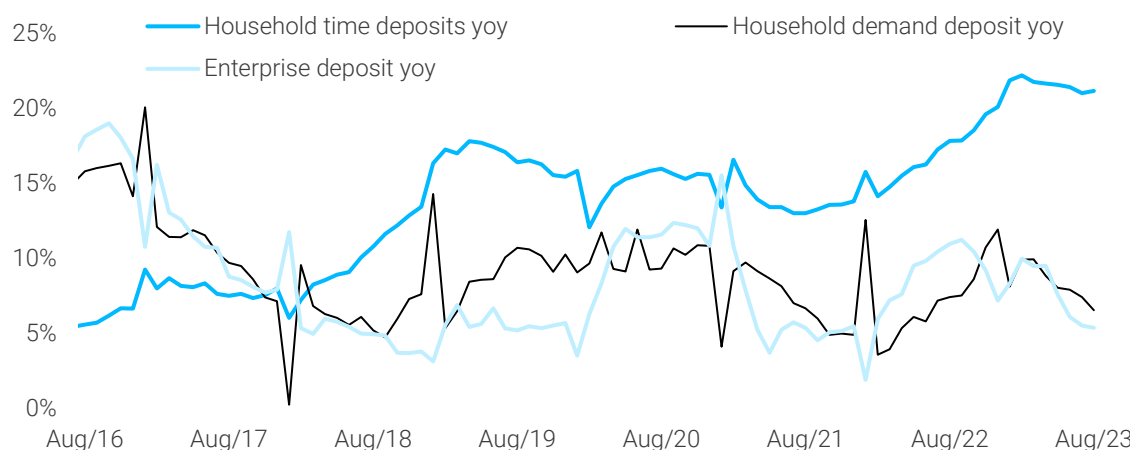
borrowing is increasing, just, at 1% yoy. It is not yet clear whether the masses have a lost faith in property investment or are simply suffering from post-Covid caution.

Separating a cyclical Covid hangover from a structural drive to deleverage is difficult at this stage. However, we can confidently assert that if current trends continue unchecked a more severe second leg of the property crisis will ensue – one that brings with it wider financial contagion and a Japan-style balance-sheet recession. Developers operated on a Ponzi-like financing model from 2015 onwards, relying on new presale funds to complete old projects. The pre-sale model only works when prospective buyers believe prices will rise and trust developers to deliver homes. Neither condition is present, leaving sales weak and an industry bereft of an irreplaceable source of money. Without improved confidence a second leg down in financial conditions is highly likely.

A hinge point is approaching: either a weak cyclical bottom or a balance-sheet recession begins in the next couple of quarters. Beijing is finally acknowledging property-sector difficulties. Famously, Xi Jinping believes “housing is for living in, not speculation” and real estate should not be used as a “short-term stimulus tool”. The longer-term direction is clear and policymakers have tolerated a great deal of property pain, attempting to take a structural view that near-term suffering is necessary to rebalance China’s economy. However, it appears even central authorities are acknowledging a need for greater easing. Neither of the aforementioned Xi aphorisms on housing was included in the July Politburo statement, and this paved the way for the broader easing measures announced earlier this week. Although these moves are positive, it is likely that policymakers are still underestimating the severity of the slowdown and related financial stress and overestimating their ability to manage more severe economic spillovers.

Alongside property easing, policymakers have increased intervention across a broad array of markets in the past couple of weeks. It is worth emphasizing that in line with Beijing’s hitherto rosy economic view, the coming infrastructure stimulus, property measures and rate cuts are the first round of meaningful stimulus this year; and they come after all three of our triggers – unemployment, financial contagion and growth-target risk – started to flash warning signs last month. Stimulus is ramping up but it is still not enough. More will be needed, and we think is coming in Q4, to prevent a more serious financial stress and a slide closer to a protracted balance-sheet recession. Our base case is weak bottoming out in Q4 and an L-shaped recovery.

**Chart 5: Cautious households increase savings even after zero covid was lifted**



Sources: PBoC, TS Lombard.

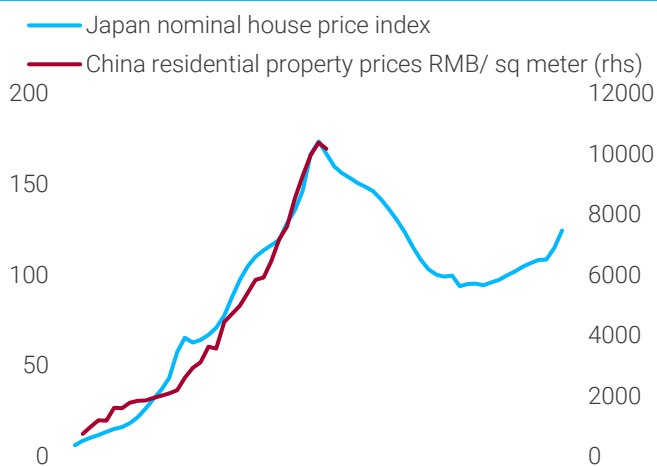
## Edging towards Japanification

While the post-Covid recovery in China is uniquely poor, its structural outlook has many similarities to Japan in the 1980s and to a lesser extent Korea in the late 1990s and Europe in the 2010s. China and Japan both experienced a rapid increase in household and corporate debt. That debt is mainly local and the domestic saving rate is high in both countries. Over the past decade household borrowing rose by 30 percentage points to 62% of GDP in China, with a similarly rapid increase in Japan, where it jumped by 24 percentage points to 68% of GDP in the run-up to 1990 (chart 11). Home prices also surged in the past decade, up 80% in China and 90% in Japan over the 1980s (chart 6). More broadly, Japan's property market correction was also a structural rather than cyclical issue, as is the case in China today. Finally, both countries face similar demographic challenges. The share of aged population (65 and above) was 12.7% in 1991 in Japan, comparable to China's 12.6% in 2019.

However, there are a number of important differences between the two countries. First, the share of construction in GDP has for some time remained significantly higher in China, by approximately 10 ppts. The PRC has a much greater reliance than Japan on property for growth, and the continued rightsizing of the sector will be the main drag on growth for the next five years ([see above and here for full details](#)). China is also ageing faster and faces a steeper demographic cliff edge. China's total population started to decline in 2022, while in Japan the decline began in 2008, nearly two decades after the start of the "lost decade". The post-Great Leap Forward baby boom means that the one-child generation will inherit a substantial amount of property in 10 years' time, potentially triggering a wave of selling.

An everything bubble. One point in China's relative favour is the breadth of asset price gains in Japan and the speed of their collapse. In addition to the stunning gains in home prices discussed above, almost all assets witnessed a rapid run-up in valuations. Throughout the 1980s the Tokyo Stock Exchange index increased by a staggering 800% compared to the S&P 500 rise of just 120%. In 1988–89 alone equities rose 80% (chart 7). Golf club memberships – an oft-cited bubble indicator – had their own index, with a market cap of US\$ 200bn [at the top]. Infamously, many of the assets including those prized club memberships were pledged as collateral for loans, often for speculation. It is difficult to gauge the extent of leverage tied to the rapid rise in financial assets. A breakdown of stock ownership reveals a high private-sector exposure; non-financial businesses owned 30% of the market in 1990 and households 20%.

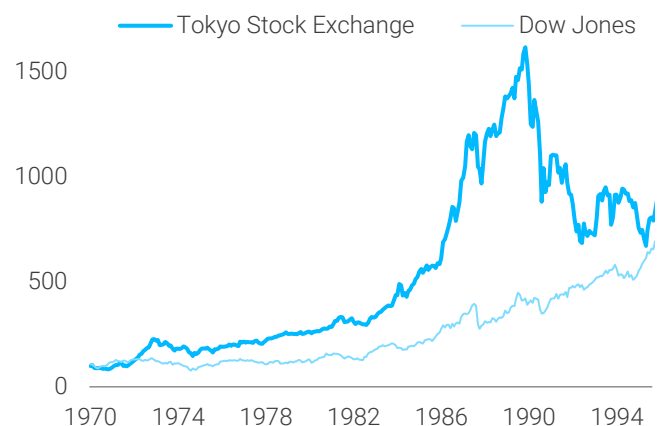
**Chart 6: Similar property dynamics in East Asia**



Sources: CEIC, TS Lombard.

**Chart 7: China's bubble is much narrower**

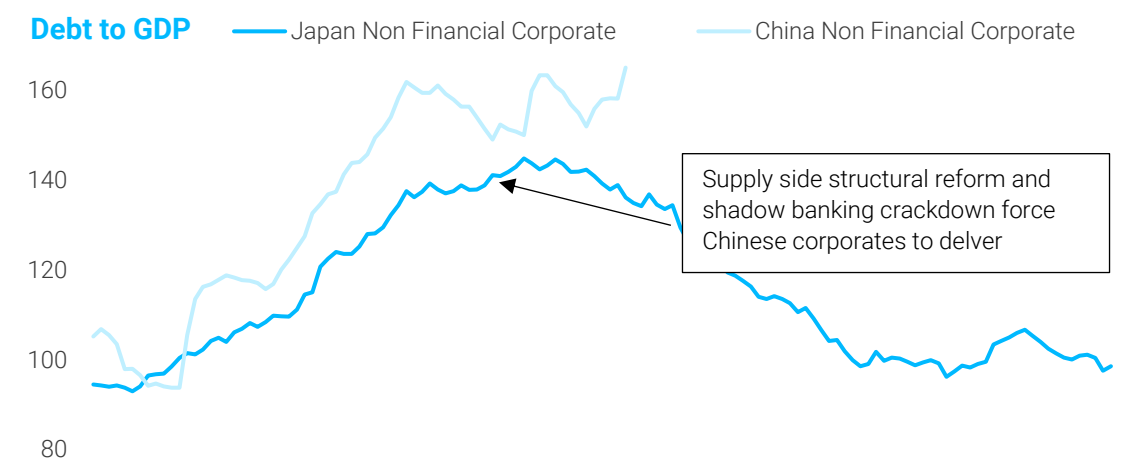
Jan 1970 = 100



Sources: BoJ, Bloomberg, TS Lombard.

The reversal was equally swift, with the Tokyo Stock Exchange halving in a nine-month period and national property prices dropping by 40% in a few years. Property, equities and club memberships have never regained their previous highs. Repaying nominal loans tied to assets that had halved in value was a key cause of Japan's balance-sheet recession. Needless to say, Chinese equity and WMP returns have not been stellar for many years. The country is more exposed to property as an asset class: 70% of household wealth is in real estate, along with 40% of banks' loan books. Beijing has adopted the strategy of protecting house prices but letting volumes correct dramatically. This is in sharp contrast to Japan, when prices and volumes fell simultaneously. And is perhaps the crucial difference thus far in preventing a typical balance-sheet recession, but one that has not protected the real economy.

**Chart 8: History rhymes if not repeats**



Sources: BIS, TS Lombard.

Beijing probably has less orthodox policy space than Tokyo. Interest rates are lower, central government's debt-to-GDP ratio is higher (including our recalculation of local government debt), and the loss of fiscal revenue from falling land sales greatly exceeds the tax hit felt by Japan. Balancing this is greater societal control (the house price floor being a prime example), a closed capital account, and with it more unorthodox policy levers, in addition to still large fiscal and monetary capacity. The crucial difference, as we discuss later, is our expectation of policy intervention compared to a degree of passivity from Japanese politicians.

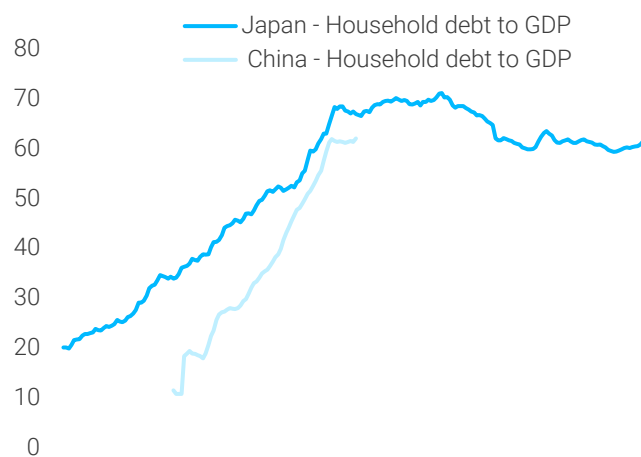


Chart 9: Trade slump big part of Japanification



Sources: CEIC, TS Lombard.

Chart 10: Comparable debt levels, assets differ



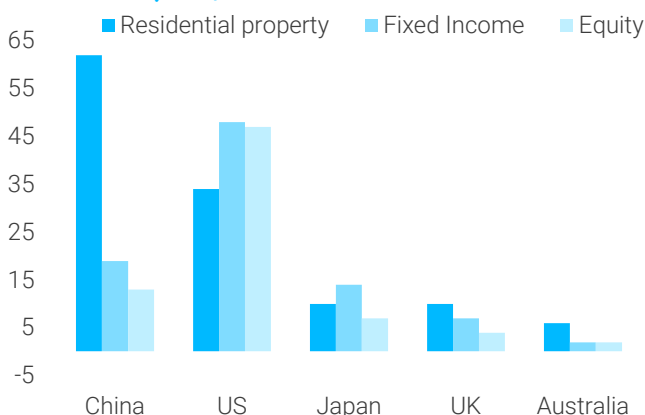
Sources: BIS, TS Lombard.

At the development level the situation provides mixed blessings. China is poorer and less urbanized than Japan at the peak of its bubble. China's GDP per capita was US\$12,800 in 2022, much lower than Japan's in 1991, at US\$29,470. While lower GDP per capita may imply higher growth potential, achieving developed market status is the exception not the norm, it also suggests that China is becoming old and highly indebted before it becomes rich. Urbanization does suggest some upside for the PRC. Its urbanization ratio was 65% in 2022; in Japan, the ratio exceeded 77% in 1988. This lower urbanization ratio points to a larger potential for productivity increases associated with labour migration from agricultural to non-agricultural sectors. It also implies some untapped housing demand, in particular tied to the hukou reform process which has actually accelerated in the past few years. As we discussed last year, this is unlikely to support demand in the next couple of years and will not help lower-tier cities, where the bulk of excess inventory is located.

China can look to trade for now. Japan Inc's global market share collapsed during the 1990s. The Plaza Accord gets a lot of the blame but the rise of export competition from the Asian Tigers and then China is the real culprit. Japanese trade's share of GDP shrunk from 25% in the mid 1980s to just 13% in 1993. For now, the PRC's manufacturing complex remains highly competitive, with its share of global trade increasing through the trade war and Covid. We think Chinese firms will be able to maintain market share for a number of years, but expect strengthening geopolitical headwinds to gradually erode this advantage.

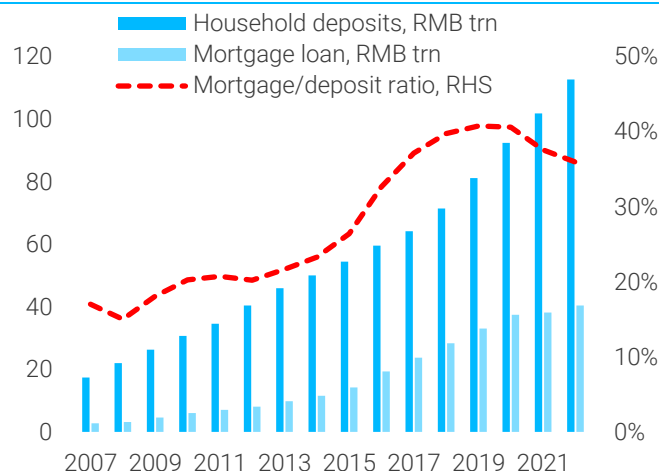
Chart 11: The most important asset in the world

Total value, US\$ trn



Sources: UBS, BBG, TS Lombard.

Chart 12: Households have a lot of equity



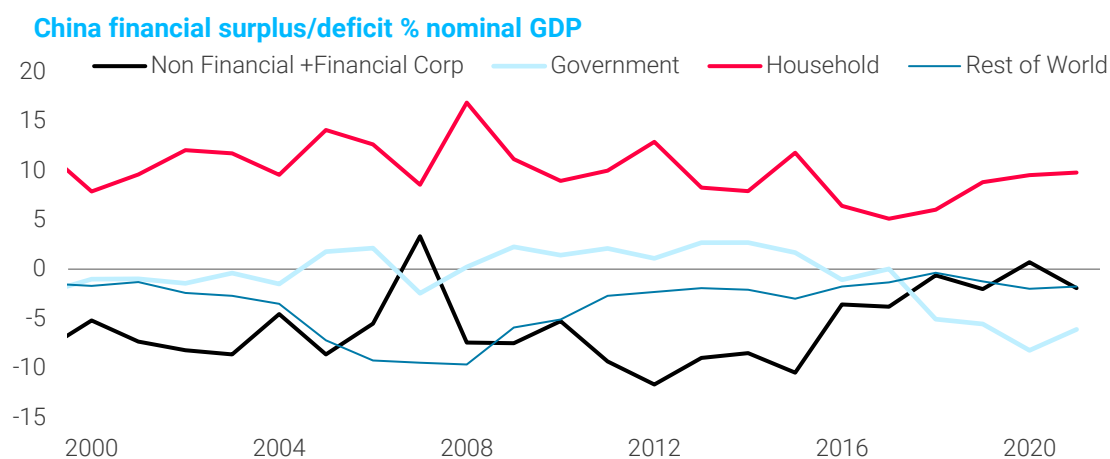
Sources: NBS, TS Lombard.

To sum up, there are many similarities between China today and Japan in the late 1980s, chiefly a rapid build-up in property prices and leverage, along with a structural break in supply and demand dynamics in real estate. The PRC is substantially more exposed to a slowdown in construction activity and faces a steeper demographic cliff. Thus far, Beijing has managed to contain the pace of asset price correction and benefit from a substantial trade surplus. Going forward, domestic stimulus and global trade are the major determinants of China's post covid growth rate.

### How to escape a balance-sheet recession?

Once asset prices have collapsed and deflationary mentality become entrenched, there are only two ways to escape a balance-sheet recession. If corporates and households are deleveraging, other balance sheets must borrow to create activity. Anaemic demand for credit means that a significant portion of the newly saved and deleveraged funds entrusted to the financial sector does not enter the real economy. This in turn means that those unborrowed savings become a break in the income stream and a deflationary gap for the economy, one that exacerbates balance-sheet difficulties. To combat these dynamics, either the government can become the borrower of first resort or a country must rely on external demand. China's economic fate hinges on decisions made in Beijing (fiscal policy and reform), Washington and Brussels (trade and industrial policy).

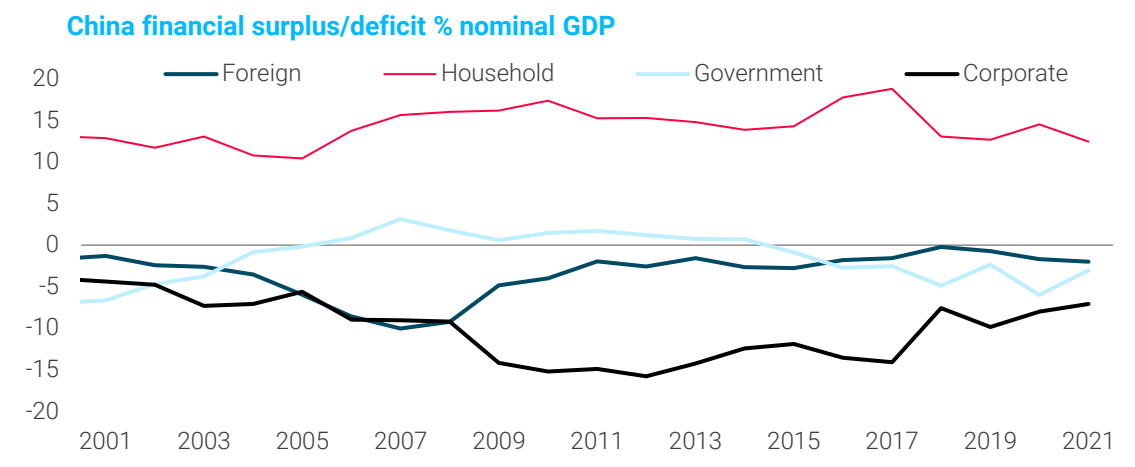
### Chart 13: Financial flow of funds says China is already in a balance sheet recession



Sources: CEIC, TS Lombard.

From 1984 to 1990 Japanese corporates' net financial position moved from -3% of GDP to -12% at the peak of the bubble. As companies rushed to pay back debt following the collapse of stock and property prices the sector's position flipped to positive 11% of GDP by 2005 and has stayed broadly unchanged since. As to the household sector, before 1990 net savings (gross savings less investment, mainly meaning house purchases) equalled about 10% of GDP. Those savings were then mostly intermediated into corporate investment in excess of their savings. Once firms started paying down their debts, a portion of household savings was no longer being intermediated into someone else's income or investment. That led to weaker household income growth, and then a fall in household savings rates in part due to increased retirements. Japanese households experienced a relative increase in leverage after 1990. However, the increased desire of corporates to deleverage (save) outweighed any decline in household aggregate desire to save.

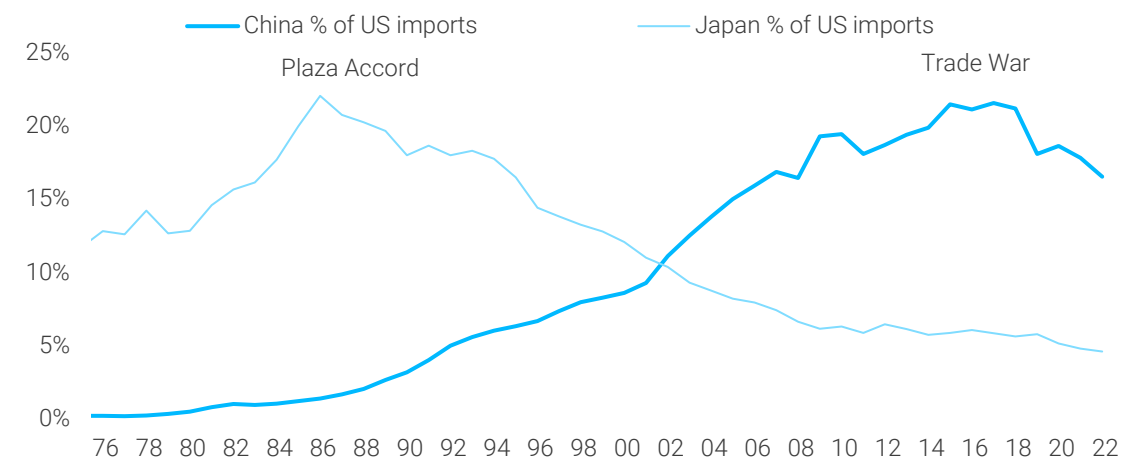
Chart 14: China physical flows data suggests otherwise



Sources: CEIC, TS Lombard.

The foreign balance stayed largely unchanged. As noted above, a combination of Plaza Accord trade restrictions and a loss of competitiveness limited the scope to increase exports (Charts 10 and 16). The current-account surplus fell to 2% of GDP and then remained stable, as did the foreign net financial position; both resulted from a drop in imports from 16% to 8% of GDP. Japan was able to export some of its corporate and relatively small household surplus to the rest of the world, but it did little to generate economic activity and income for investment, consumption or corporate balance-sheet repair.

Chart 15: History rhymes

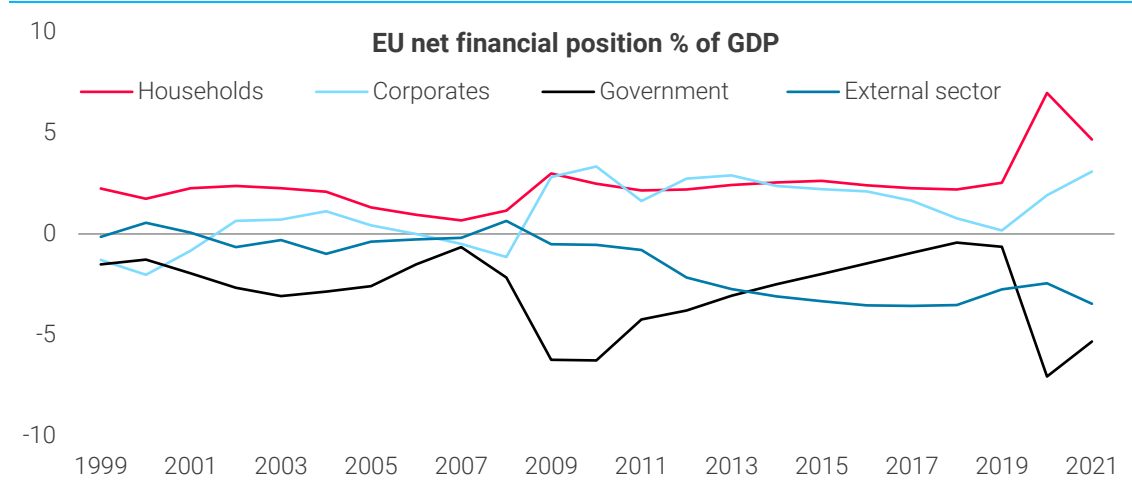


Sources: CEIC, TS Lombard.

Tokyo did increase borrowing to counter corporate miserliness. Government net financial position moved from positive 2% to -4% by 1995 and averaged -6% for the next decade. We can observe a similar dynamic in the US post GFC, when the government's net financial position moved from -4% of GDP in 2008 to -12% in 2010, and again in Europe through the 2010s (Chart 17). The response from the BoJ, the ECB or the Fed has not proved particularly effective. While government borrowing increased it did not translate into expenditure and demand creation to drive economic activity and income to enable debt repayment, which in turn would have supported asset prices. If authorities act promptly and spend unborrowed savings in the private

sector, the income stream and GDP level are maintained, providing the private sector with income to repair balance sheets. Moreover, this helps support asset prices, further limiting the downside risk of a balance-sheet recession. Ideally such stimulus should be maintained until debt has been repaid/asset prices recover/the private sector (households and businesses) begins spending. The risk of double-dip recessions is high should the government engage in fiscal consolidation before the aforementioned conditions are met. Japan in 1997 and the UK and Eurozone in 2010 are the

**Chart 16: EU stimulus too small and too short, sets up double dip recession**



Sources: AMECO, TS Lombard.

most recent examples of such events.

Turning to the present day, China data provide a mixed picture of the country's net financial position. The financial flows of funds series suggest that corporates have rapidly deleveraged since 2016, with Beijing stepping up to increase government borrowing. The change in net financial positions is stark, reminiscent of 1990s Japan (Chart 14). If we use data on the physical flow of funds (Chart 15), deleveraging still appears, as it should following major policy initiatives – namely, supply-side structural reform and the shadow banking crackdown – but the changes are less severe. Digging further into the differences between financial and physical funds data, the financial series suggests that much of the deleveraging of corporates occurred via the financial sector, which runs counter to the expansion of banks' balance sheets during that time. Moreover, the financial flows data indicate no change in corporate leverage during the 2000s and the post-GFC stimulus period. Given these discrepancies, we are inclined to give greater weight to the physical flow of funds data than to the financial flow of funds. China is not yet in a balance-sheet recession but could easily fall into one. Over the next five years it will experience a structural slowdown that will exhibit many of the same symptoms, if not the severity, of Japanification.

Beijing is likely to respond to any structural slowdown and Japanification via both fiscal and global demand channels. The former hinges on political willpower, the capacity to stimulate and its efficacy. We think Beijing is capable of all three, but should emphasize that this will not save China from slower post-Covid growth; it will merely prevent Japanification. There is much debate in markets and more importantly Zhongnanhai around the timing and size of any prospective Chinese stimulus. Domestically, the current policy discussion centres on the need for demand-creating stimulus vs structural reform. The reform-oriented camp argues that stimulus will only add to economic imbalances and cause greater pain when structural changes eventually do occur. The aggregate demand clique believes that stabilizing economic activity and structural changes are not mutually exclusive, and that growth will provide room for changes in the political

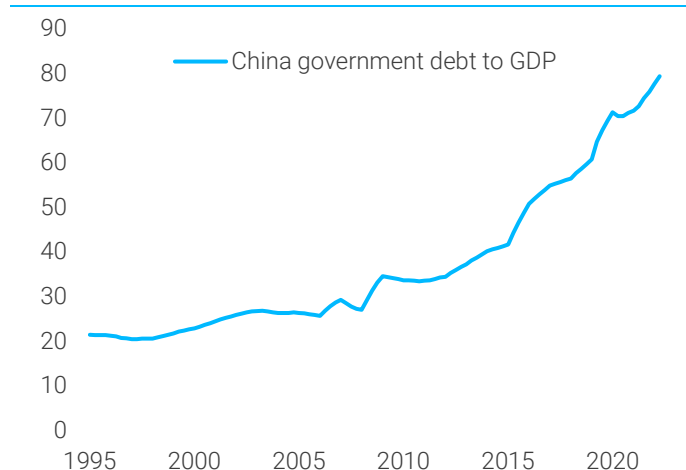
economy. Xi is certainly in the “reform” grouping. He has shown a high pain threshold and willingness to accept poor economic performance in order to pursue longer-term political-economic goals.

The stimulus reaction function of policymakers has been evolving since 2016, at the same time as cyclical and structural factors have been making traditional tools less effective. The Party patently favours more gradual targeted easing and has a much higher pain threshold, especially for real estate-related economic difficulties. The new policy outlook is a direct product of the most ideologically driven leadership in 20 years. President Xi is clearly attempting to reshape the political economy and growth model in an attempt to deliver “Chinese-style modernization”. National security and related technology innovation have joined growth – now more narrowly defined as “high-quality growth” – as core CCP objectives. Beijing is focusing on slower, more sustainable and more equal growth, coupled with structural reform and much greater state market intervention. In theory, new growth drivers of productive investment into technology and “new”-type infrastructure, together with increased domestic consumption, will offset the property slowdown and enable China to hit ambitious targets.

Although the relative importance of economic expansion has declined, it is still a major goal. Even to Xi, who is more steeped in Mao than Mises, it must be clear that a slowing China will struggle to compete with the US. Framing the economy as a national security or political stability question gets us closer to the logic in Beijing. The drive to deliver “Chinese-style modernization” comes from a security perspective: only by replacing a credit-fuelled property and export-driven growth model can China be placed on a sustainable and secure development path.

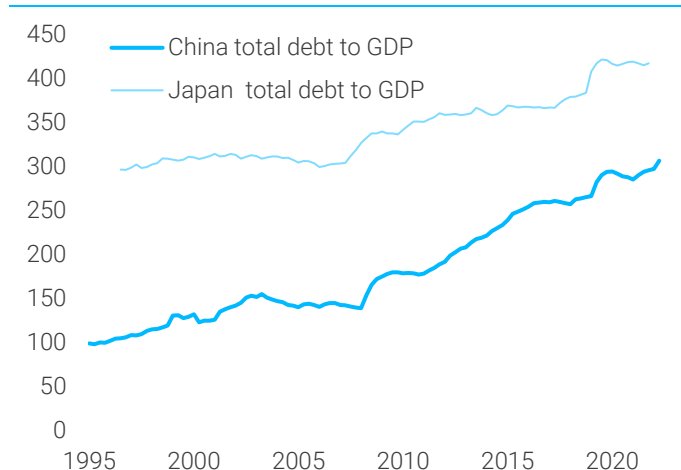
The stance of trading growth for “reform”, however, is only tenable for a relatively short period, several years at most. If China continues on the path to Japanification there must come a time when slower growth is detrimental to national security and political stability. The zero-Covid policy was maintained until suddenly it was scrapped almost overnight. And while we do not give much credence to rumours that party elders reprimanded Xi for poor economic management at the annual Beidaihe gathering this year, it is not unreasonable to suggest that slower growth is creating political pressure and will continue to do so. Officially, China still targets a doubling of 2020 GDP by 2035, implying an average annual growth rate of 5% over that period. Providing jobs, income, technological improvement and resource generation (primarily for government reallocation) and innovation are all central to Chinese style modernization. So too is the idea of catching up with the US. It is difficult to imagine that central authorities would remain passive in

**Chart 17: Plenty of space and China will need it**



Source: S

**Chart 18: Debt growth slows 2015-2020**



Source: o

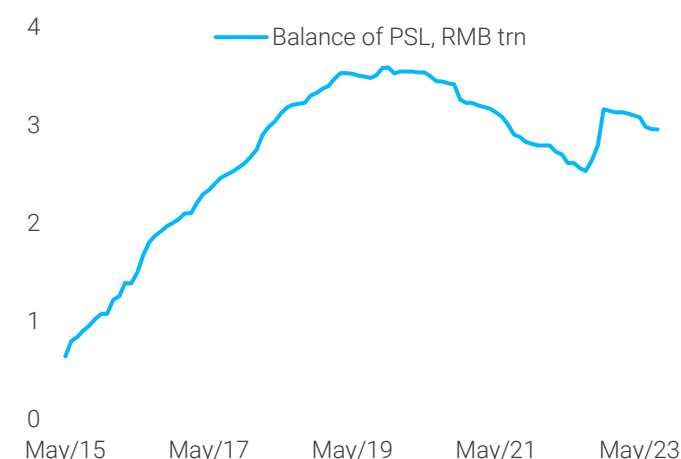
the face of a prolonged destabilizing growth shock. Framing stimulus as necessary to achieve Chinese-style modernization/maintain Party power/remain geopolitically secure, etc. etc. would align ideology with growth. Our main concern is that the authorities are too slow to react to current property risks, and end up slipping into asset price-driven stagnation, requiring a significant and prolonged stimulus to revive activity.

After establishing that Japanification would trigger a major fiscal response (one that may arrive too late), we must consider if China has any ammunition left. The conventional policy space is reasonably ample, central government debt to GDP ratio is 79% and is still low at 100-110%, even considering unclassified debt with implicit backing from Beijing. A recent IMF report calculates that the central government has the largest stock of financial assets in the world, at roughly US\$12.5 trn. The capital account is largely closed, and household savings are captive, as is the financial sector. BoJ-style QE is certainly feasible, if at odds with PBoC thinking.

Beijing has plenty of more unorthodox stimulus options. The shantytown renovation scheme that resolved the previous property crisis is one such example from the recent past. Government spent US\$150–200 bn a year on home construction from 2016 to 2018, and slightly less in 2019 (chart 20). Local governments destroyed millions of dilapidated homes, compensating the homeowners with cash provided by the PBoC. The new homeless took that money and leveraged up to buy property developers' excess inventory. Real-estate firms then bought land from the local governments which could thereby repay the policy banks. More than 100 million people moved into 54 million homes over the shantytown renovation period – an enormous property-sector stimulus that created some of the ills that beset the sector today.

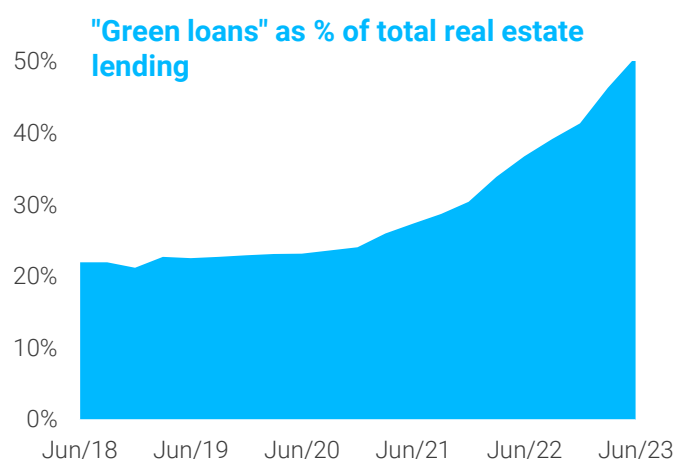
Shantytown renovation cannot be repeated, but it gives an indication of the policy levers available to Beijing. A number of novel plans are being floated in central government think-tanks, ranging from special bonds to recap local government coffers and a pre-sale guarantee fund, to the transfer of local government assets in exchange for debt and conversion of unsold homes to subsidized rental housing. To quantify some of these schemes, it would cost approximately RMB 23 trn to complete all projects under construction. Swapping out local government debt for assets could run to RMB 8 trn. It is unlikely we will see anything so spectacular in the near future; we expect Beijing to stick with drip-fed easing measures during this cycle. However, all of the aforementioned are within China's financial and administrative capabilities, as is more aggressive conventional easing. Current inaction is a political choice.

**Chart 19: Shantytown stimulus lending**



Sources: PBoC, TS Lombard.

**Chart 20: New growth model gets more resources**



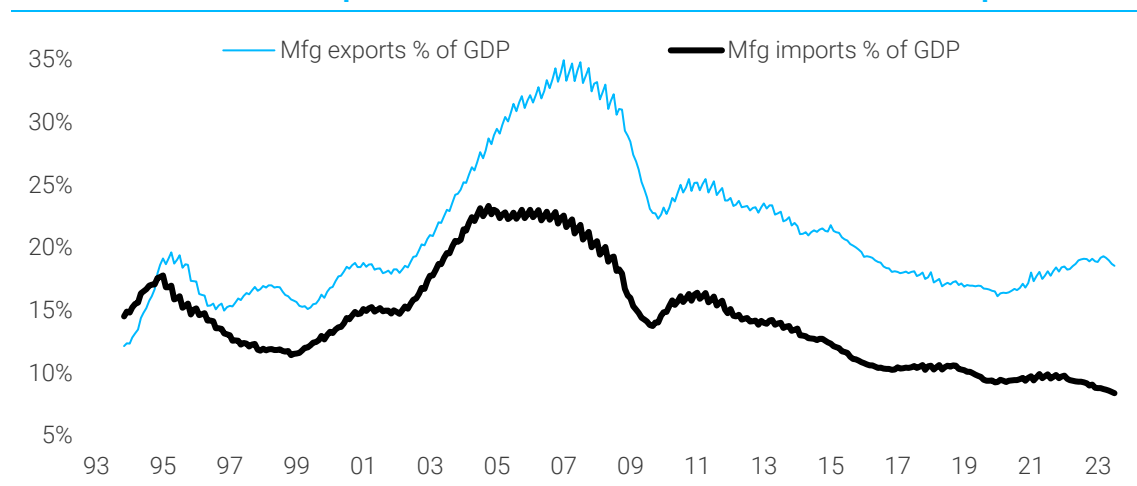
Sources: PBoC, TS Lombard.

While we cannot specify the precise policy response, some aspects of the inevitable stimulus are clear. Borrowing must almost certainly come via the central government balance sheet and will be funded via the banking system. Initially Beijing is likely to rely on captive institutions to purchase either special treasury bonds or expanded local government special purpose bonds. Should this approach run into bank funding constraints, the PBoC could increase provision to banks via MLF, TMLF or even a [QE-like programme](#) that has been on trial since 2020. Explicit QE will be avoided at all costs. Successive PBoC governors have blamed DM central bank policy for a host of ills from inequality to inflation, and will be loath to replicate perceived Fed mistakes. Government borrowing is certainly going to increase and will be funded by expansion of bank and monetary authority balance sheets.

Stimulus will be aimed squarely at areas aligned with longer-term policy objectives. From a sectoral perspective the focus is clear: policy favourites are largely concentrated in tech hardware and include clean energy, EVs, batteries, semiconductors, robotics, AI, biotech, 5G, etc. A substantial reallocation of resources from old economy to new has been under way for a number of years (Chart 21). Financing, land, infrastructure and human resources are flooding into tech. The funding channels are of most interest; they include new stock exchanges, traditional VC, “government guidance funds” and PBoC re-lending schemes. At around 15% of GDP, the sectors are too small to offset property contraction but provide an outlet for government borrowing that is consistent with political objectives. Over time China could spend US\$38 trn to meet its carbon-neutral targets by 2060 – a persistent demand pull that was absent in Japanese and European experiences of balance-sheet recessions. Beyond policy tech, we expect spending on welfare to gradually creep higher. Hukou reform has accelerated during the property crisis and is likely to continue as local government, desperate to increase population inflows, reduces residency requirements. Spending will focus on hospitals, education and childcare, rather than pension/employment benefits. Overall, China has the capacity and political alignment to engage in central government-led demand and income-creating stimulus to cushion a structural slowdown.

External demand can provide a partial escape route, but one that is limited by China’s size and geopolitical headwinds. China already runs a current account surplus of 2.2% of GDP, which is massive for an economy of its size. Its share of global trade surged through Covid and remains near an all-time high. It is difficult to envisage a larger share of world trade; however, the PRC surplus is unlikely to diminish significantly in the next five years. With household saving set to

**Chart 21: China active import substitution will continue and boost trade surplus**



Sources: NBC, CEIC, TS Lombard.



remain elevated for some time and investment (almost entirely property-related) declining, the simple accounting identity  $CA = S - I$  suggests China will continue to run a substantial trade surplus. Moreover, PRC firms, unlike those in 1990s Japan, remain highly competitive and are extremely well placed to profit from the green industrial transition. China dominates at almost every step of the battery/solar/EV/rare earth/legacy semiconductor supply chain. At present the world cannot “go green” without China.

On the import side, less investment will cut commodity imports, as will movement up the value chain and in tech self-sufficiency. China already imports far fewer manufactured goods as a percentage of GDP than it did a decade ago, thanks to passive import substitution, and US sanctions are accelerating this process in chips, planes and a host of other sectors. Meanwhile, surging EV adoption and grid upgrading could halve oil imports by 2035 and put a dent in gas demand.

Geopolitics is the main limit on Chinese exports. President Biden has maintained and expanded trade war restrictions. Europe is set to follow: we have long anticipated that with German and Chinese economic models moving from complementary to competing, EU trade policy will become more protectionist. When BYD is selling more cars than BMW, relations between Beijing and Berlin are in trouble.

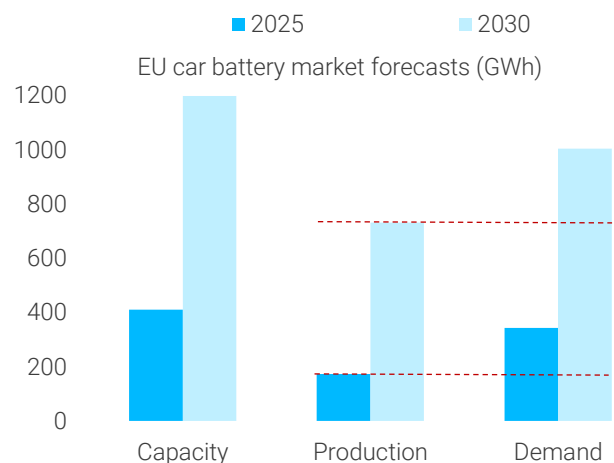
The EU has finally woken up to reality. As Davide Oneglia, our director of European research, writes, after years marked by sharp internal divisions on how to manage its relationship with an increasingly imposing China, amid growing pressures from the US, the EU has this summer ramped up diplomatic and regulatory activity, suggesting that China “de-risking” (albeit not the “de-coupling” advocated by Washington) is now a priority. While the consequences of irresponsible dependency on Russian energy were a massive wake-up call, the sudden rise of China as an EV producing and exporting superpower at the expenses of European car manufacturers has helped concentrate minds. In June, the EU Commission’s action plan on economic security, without ever mentioning China, made clear that “strategic dependencies, which may give rise to economic security risks, can be exacerbated by non-market policies and practices used by third countries that tilt the playing field” and that the EU Commission stood ready to use all its tools – such as the Trade Defence Instrument and the Foreign Subsidies Regulation – to protect the internal market from threats to supply-chain security, cybersecurity,

**Chart 22: EU cannot go green without China**



Sources: Eurostat, GlobalData TS Lombard.

**Chart 23: EU carmakers will need Chinese batteries**



Sources: Benchmark Mineral Intelligence, GlobalData TS Lombard.

technology leakage and “weaponisation of economic dependencies”. Germany’s China Strategy,



published recently, pointed explicitly to the same goals. This flurry of activity culminated in last week's State of the Union speech by EU Commission head Ursula von der Leyen, in which she announced a probe into Chinese subsidies to the EV sector that could lead to a tripling of EU import tariffs on Chinese EVs to around 27%.

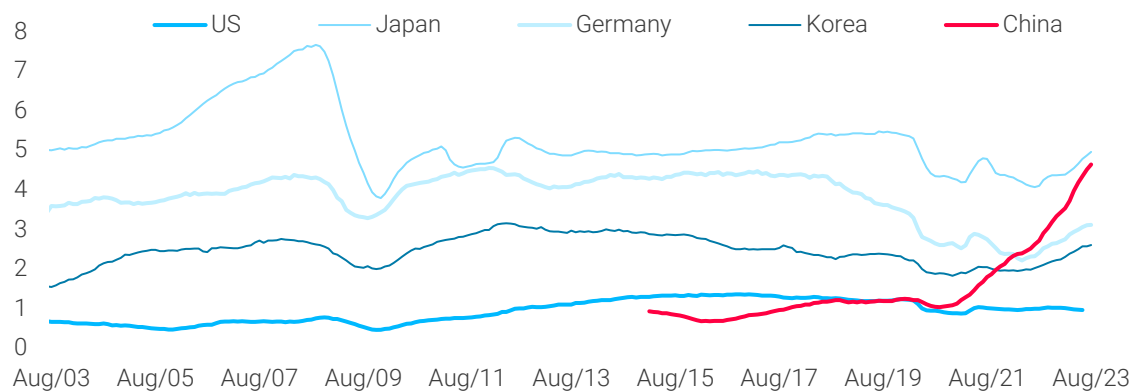
But what is next for EU–China relations? Inevitable protectionism, desirable “de-risking”, impossible “de-coupling”, for now. The risk that a flood of Chinese EVs into the European car market would trigger [a protectionist response from Europe was already clear back in April](#). EVs loaded with electronics and apps represent both a potential security hazard like that posed by Huawei's involvement in the German 5G network (soon to be history) and a direct challenge to European carmakers' bottom line. With the car manufacturing sector accounting for about 14% of Euro Area total manufacturing GVA and 12% of manufacturing employment, and a heightened sense of urgency posed by next year's EU general elections, more protectionism to prevent Chinese car brands from selling enough to establish their reputation is inevitable. That said, China's stranglehold on green technology supply chains makes any protectionist measure beyond final goods unthinkable.

To be sure, the EU is rushing to build up battery production capacity, but by 2030 demand is still expected to exceed output significantly, as time is needed to put nominal capacity to work. China's dominance over the entire supply chain for the extraction and processing of raw materials looks unassailable in the foreseeable future. What is more, China dominance extends beyond EV batteries to other critical inputs for EU green technologies, such as solar panels, which are among the major drivers of the shifts in EU–China trade flows since the post-Covid rebound. Finally, the EU's self-imposed fiscal constraints, such as a lack of a central fiscal capacity for green investment, put its domestic industry at a structural disadvantage vis-à-vis those of the US and China, while necessarily pushing it into the arms of cheap Chinese exporters.

China “de-risking” is a desirable goal for the EU to pursue with the help of the US, but actual “de-coupling” remains a chimera. If Europe is to stay on the path of mass EV and green technology adoption, China will still be needed for a long time. Italy's very careful and tactful withdrawal from China's Belt and Road Initiative may well be a sign of things to come. In other words, while EV protectionism runs its inevitable course and attempts at carrying out a “de-risking” agenda intensify in the run-up to next year's EU elections, there currently remain obvious limits to how closely the EU can align with the US.

#### Chart 24: China's EM GDP/capita plus DM tech capability is a unique trade challenge

##### Car exports by volume (12m sum, mn)



Source: CEIC, TS Lombard.

For America “de-risking” is much clearer. China’s share of US imports has slumped since the trade war and is set to continue falling. We expect tighter import and export restrictions and believe that Washington is moving from trade war to tech war to financial war, with investment into and from China the next area of focus alongside chips. That is not to say that decoupling is successful – like Europe, America is still heavily reliant on Chinese supply chains – but goods are transhipped through other destinations, primarily Vietnam and Mexico, and this is the reason why China’s share of global trade has risen despite a falling US market share. PRC firms still profit from American demand and US households still want cheap manufactured goods; however, the PRC economy benefits less and ever more production will be re-routed or re-shored.

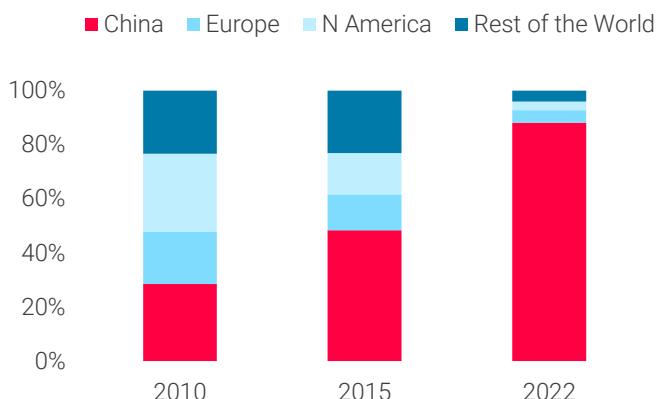
Non-DM economies do provide a growing market for Chinese goods. Exports to ASEAN are the largest single market for the PRC, while the OECD estimates that in the next 10–20 years, countries that did not sanction Russia will account for 50% of world GDP. However, both the amount of genuine final demand (as opposed to trade re-routing) generated by ASEAN and the true growth rate of the “unaligned” bloc, a good chunk of which comprises China and its trade unfriendly neighbour India, are questionable. Thus the bloc provides room to grow but is not a replacement for the US and Europe.

Policy in Beijing ,Brussels and Washington will determine China’s ability to escape a balance-sheet recession for a structural slowdown. Political willpower and capacity exist to drive fiscal activity, targeted at favoured tech sectors and to a limited extent social services. We expect government debt to rise and state investment to become an ever more important driver of activity, but one that is incapable of replacing property’s contribution to GDP. Meanwhile, both size and geopolitics limit the extent to which China can export its surplus savings to the rest of the world. Reduced imports and supply-chain dominance in key technology areas mean that net exports can still add to growth but not sufficiently to overcome a property slump.

An escape route from Japanification exists, but we are in the uncomfortable position of relying on rational decisions from a diverse group of political actors. Our base case remains a structural slowdown with the policies discussed above at least partially implemented. Needless to say, our confidence in politicians on both sides of the Pacific, especially in China, has been dented in the past few years, and with it increasing the chance of a deeper Chinese slowdown.

**Chart 25: China dominates solar panel inputs**

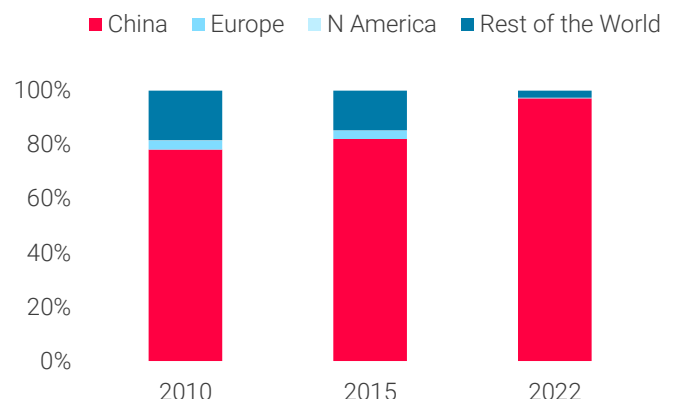
**Share of polysilicon market**



Sources: IEA, TS Lombard

**Chart 26: Green tech stranglehold**

**Share of silicon wafer production**



Sources: IEA, TS Lombard

## Stagnation with Chinese characteristics

Sinification – which signifies slower growth forced by property contraction, managed private-sector deleveraging and greater trade competition, partially offset by accelerated government investment and tech innovation – still appears more likely than Japanification. Our base case puts growth at 3-4% yoy for the next five years before further deceleration to 2–3% over the remainder of the decade. This projection is based primarily on prolonged property-sector rightsizing and its spillover impact. Reported growth rates are likely to diverge from the TSL measure of GDP. It is politically difficult for Xi to report growth less than 5% in 2023, and we expect a goal of >5% growth in 2024. Simply setting a GDP target with a four handle for next year would be immensely damaging to confidence. Our forecast of 2024 TSL GDP is 3.8% yoy.

The formula  $MV = PQ$  (money supply multiplied by velocity is equal to output times price level) helps to conceptualize the macro impact. In our Sinification outlook the rate at which money is spent continues to fall. Our estimate of “V” (chart below) has plummeted sharply during Covid and continues to decline. We expect a moderate cyclical pickup as confidence improves next year, but on a medium-term basis, with savings no longer intermediated into the real economy via property purchases, velocity should continue to fall – perhaps not as sharply as in Japan, but certainly moving in the same direction. This means money supply must increase to maintain the same level of prices and output. An increase in the debt-to-GDP ratio is almost inevitable (either debt will rise or GDP will contract), and a mix of both is likely, with the biggest move occurring on government balance sheets.

### Chart 27: Velocity of money still near pandemic lows



Sources: PBoC, TS Lombard.

Two other factors beyond the scope of the current report will influence potential growth in China: the degree of structural reform, and technological progress. We have a more positive view on the latter with some and think that areas of success on structural reform will be offset by ideologically led policymaking.

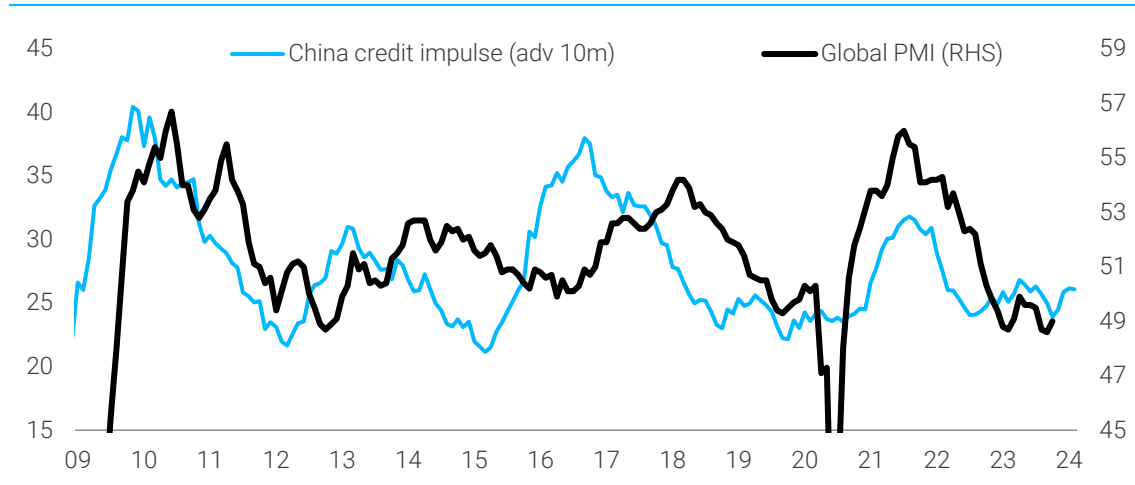
Finally, it is worth stressing that this is not the end of China. If the PRC grows at 3% and India at 6% for the next decade, the incremental GDP increase for China would be double that of its neighbour. Of course, we would still prefer to be long Indian equities over that period, but it is important to contextualize the coming China slowdown. The country's growth rate has peaked; its power certainly has not.

## What does Sinification mean for China and the world?

The 2020s are the 2010s in reverse. Following the GFC, Europe and the US went through a prolonged period of balance-sheet repair and anaemic demand. China engaged in a robust fiscal response which drove the global industrial cycle, with the credit impulse infamously leading world manufacturing by 9–12 months (chart below). Today it is the PRC that is recovering from an asset cycle (albeit with a much more supportive government stance) and Europe and the US that are finally engaged in meaningful fiscal policy.

China will mirror Europe in the 2010s in its impact on global demand and inflation. Investment, the primary factor in PRC imports of both industrial commodities and capital goods, will decline as the property sector undertakes a painful restructuring with a knock-on impact on global prices. Domestic deflation and wider demand weakness should also make for disinflation spillovers from China.

**Chart 28: China will not lead the industrial cycle in the 2020's**



Sources: Datastream, CEIC, TS Lombard.

On the trade front, the PRC presents a unique mercantilist challenge: it has the per capita GDP of a developing country but the technological prowess of a developed one. As Beijing increases tech investment to combat a structural slowdown and domestic demand remains weak, China will move further up the value chain, importing and consuming less with greater excesses production of greater quality available for export. Global trade competition will only increase.

The rise of populism, a key feature in DM, may be felt in the PRC. Xi Jinping completely dominated the 20th Party Congress, removing technocrats, promoting allies and quashing any hint of factionalism ([full details here](#)). However, Xi could already be approaching the peak of his power. The structural slowdown facing China and the necessary reorientation of its political economy will be very difficult indeed. Party performance legitimacy will need to change to something beyond growth, probably a national populist ideology. Growth and legitimacy challenges are profound and will occur as Xi reaches a natural retirement age. This is not to suggest a positive outlook for China's political fortunes – it is unclear whether another leader would or even could take a widely divergent path from that chosen by the current leadership. Succession struggles could hinder policy implementation, while a leader under pressure might fall back on a more jingoistic foreign policy. (More details in the "War" appendix)

## How to trade it?

The terminal decline in “the most important sector in the world” has broad macro, market and political consequences. To put it bluntly, China’s growth will be slower, less commodity-intensive and less dependent on private-sector debt. Cyclical bottoms are likely to be lower and harder to turn without a property stimulus trigger and amid lower demand for private-sector goods, services and credit. The greatest market mispricing today appears to be in projections of Chinese iron-ore demand, which need a sharp downward revision. There are some silver linings: China may be the last refuge of the 60/40 portfolio, with a secular bull market in CGBs likely.

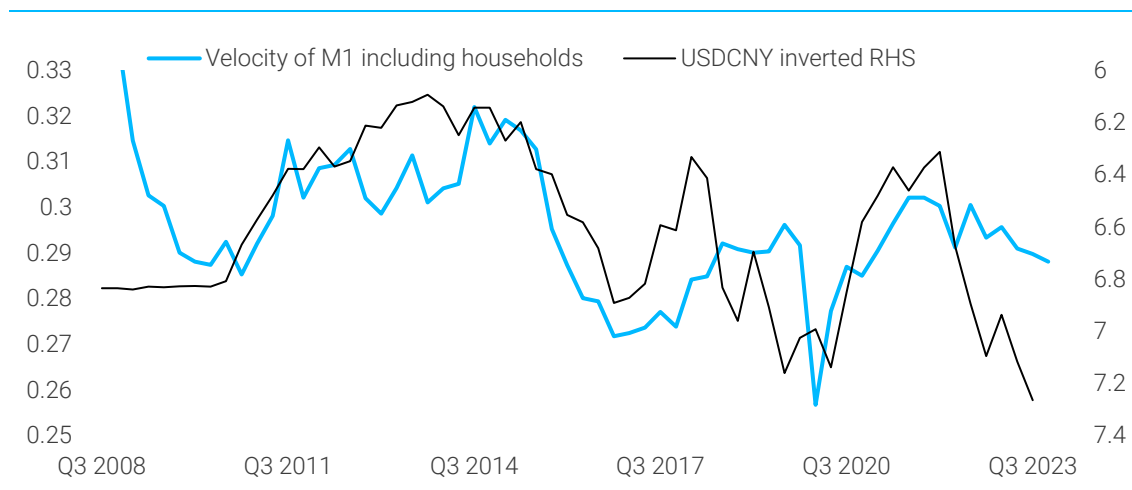
## FX – RMB depreciation

Savings minus investment equal net exports. This basic accounting identity suggests that China will run a large current-account surplus for some time as investment falls and households maintain high savings rates. To balance the equation, China will need either to run an internal deficit or to find a means to export excess savings. (Exports are essentially a form of saving. They are products that are not consumed at home, while saving is defined as what is not consumed out of income.) Extensive work by our [Chief Economist Freya Beamish shows both policy options lead to RMB depreciation.](#)

As we note above, government deficits are one solution that Beijing is likely to adopt, especially to facilitate tech “national mobilization” and green upgrading. [Freya notes that](#), as the government assumes the mantle of borrower of first resort, the drivers of liquidity switch from real economy demand for credit to policy-generated supply. When money is created to cater to demand growth in the real activity, it has a natural place in the economy, along with the investment or consumption of the borrower who took out the loan (a process that creates money). When it is created by the authorities expanding supply, it has to find its place and it often fails to do so; as a result, the ratio of GDP to money simply declines, as people and firms hold onto surplus liquidity. As economists we can think of this as a decline in velocity. There are more RMB compared with things that can be bought in the real economy, ultimately reducing the value of the currency, whether through nominal or real channels. (Chart below)

The other alternative is to allow nominal RMB weakness, thereby making Chinese goods more competitive. China’s unit labour cost-adjusted real effective exchange rate peaked in 2022, and global market share flatlined from 2015 to 2019. A weak RMB policy would sit well with Beijing’s

**Chart 29: RMB set for nominal and REER decline**



Sources: CEIC, TS Lombard.

interpretation of the importance of the Plaza Accord and a stronger yen in causing Japan's lost decade, via lost export market share and the resulting surge in domestic credit creation.

In practice, both greater state borrowing and deliberately weak RMB policies are likely to be pursued. We think depreciation will be greater in REER terms than in nominal ones, as the geopolitical and domestic political backdrop makes a larger nominal devaluation difficult to countenance. The implication is domestic demand compression.

### Equities – stock pickers over indexes

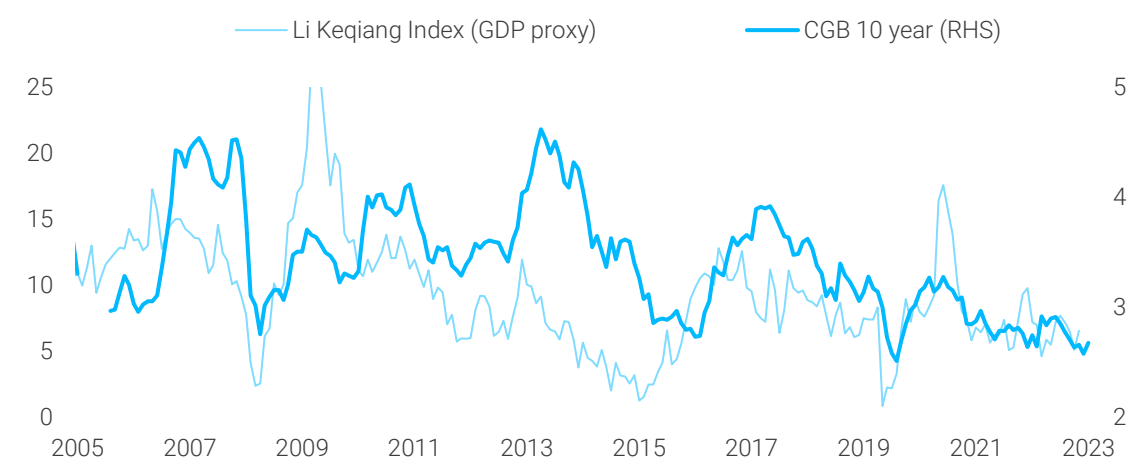
A backdrop of slowing nominal growth and greater state market intervention, not to mention significant geopolitical headwinds, suggests sector or single-stock allocation will outperform broad indexes.

The mantra for China equity investment should always be “don't fight the Party”, or indeed “invest with the Party”. In practice, this means picking policy favourites clearly highlighted by Five-Year Plans as well as other high-level documents and speeches. Areas with strong political and financial backing are electric vehicles, clean energy, 5G and advanced telecommunications, robotics, semiconductors and a host of other strategic emerging industries. Most of these combine domestic support with the broader shifts under way in the global economy, offering twin growth tailwinds. When growth slows and the policy pendulum swings, a different type of policy favourite – namely, infrastructure-related equities – tends to outperform.

While we think broad indexes are likely to underperform, the pockets of growth could deliver powerful returns. If China experiences a secular slowdown or a more pronounced balance-sheet recession, the resulting QE-like policy measures and sustained increase in money supply could support multiple expansion like that witnessed in Europe/US/Japan during the 2010s. There is also a massive stock of savings, hitherto destined for property investment, that will eventually be allocated elsewhere. Most will stay in the banks, some will flow offshore, but a portion is likely to go into stocks as part of a structurally higher allocation to equities from households. Increased flows should add to the tailwind behind the aforementioned policy favourites equities.

More broadly China markets are likely to decouple further from the global cycle providing some diversification benefits.

**Chart 30: Falling nominal growth and inflation plus QE like policy = bond bull market**



Sources: BBG, CEIC, TS Lombard.

### **Rates – multiyear bull market for China Government Bonds?**

Long-term yields are determined primarily by growth expectations and inflation. Given the property-sector headwind (as well as those of de-globalization and demographics), annual growth is likely never to surpass the reopening high. Barring outsized inflationary impact from the green energy transition, inflation too is likely to remain subdued as China digests decades of capital misallocation. With government debt set to rise, the PBoC will need to adopt a more expansionary monetary policy lowering rates, a setup for continued declines in CGB yields. Non-China participants will need to FX hedge (see above).

Beyond CGBs, the outlook is less clear. Risk repricing is coming across China, and we think anything beyond central government and policy bank debt is vulnerable. There are plenty of relative trades within this – for example, “green” provinces vs commodity producers, new private economy vs old economy – but a bull market is unlikely.

### **Commodities – demand destruction**

A smaller property sector means less commodity consumption, particularly of traditional industrial metals. Chinese real estate is the single largest user of copper, cement, glass and steel in the world. Its upstream and downstream linkages to white goods, construction equipment and furnishings make it a major user of minor industrial metals.

Iron ore and steel is where growth is likely to slow most sharply and have the most impact on macro and markets. Cement is largely domestically produced, while copper has a strong tailwind from “new” infrastructure investment and the global energy transition. China accounted for just over 70% of global iron-ore imports in 2021 and has done for the past decade. Real estate consumes about 30% of the total, compared with 20% for infrastructure. Property activity will likely shrink by a further 20-30%, implying a direct drop of 6–7% in global iron-ore demand. As we make clear above, the property-sector drag on China growth and iron-ore demand will continue well beyond the five-year horizon.

Renewed focus on tech manufacturing and infrastructure investment will provide a tailwind for green energy transition materials. China will remain the largest importer of lithium, cobalt, nickel, etc. for many years to come.

### **Conclusion**

China’s property sector and growth rate more broadly are in structural decline. It is a slowdown driven by the three Ds – debt (property), decoupling and demographics. The only question is the pace of the deceleration. We think Sinification as opposed to Japanification is the most likely development path. We define Sinification as a grinding deceleration in activity led by falling property investment and weak consumption, only partially counteracted by increased government debt, fiscal spending on tech and welfare and resilient exports, putting potential growth at 3-4% in the next 3–5 years. A more classical Japanification scenario would see growth slowing much more sharply to ~1% over the next decade, an outcome that is rising in probability. A “benign” Sinification outcome hinges on politics: decisions made in Beijing (fiscal policy and reform), Washington and Brussels (trade and industrial policy), will decide if China can escape a balance-sheet recession. The market impact of Sinicizing or Japanifying are broadly similar – industrial commodity and RMB weakness, a bull market in CGBs and pockets of tech strength amidst overall poor equity index returns.



## Appendix: War cure – with some Russian lessons

**With other exits from China's balance sheet squeeze variously discussed above, the outside prospect of military linked fiscal response is also worth considering.** Christopher Granville director of Geopolitical research notes that until recently, the standard debate about the chances of China deciding to invade Taiwan in the present decade has hinged on political arguments. Taking relative economic decline as a given, such risk assessments focus on the temptation of foreign military adventures as a way of reversing – through nationalist fervour – the damage caused by the ailing economy to the legitimacy of the Communist Party's rule. This kind of analysis is flipped around by the injection of economic reasoning. The idea here, runs that the attraction for China of going to war may not merely *distract* from economic setbacks but *cure* them.

**The model here is the positive effect of WW2 on the US economy.** Government-led demand triggered supply-side expansion and productivity gains going well beyond military-related manufacturing. As noted by Dario Perkins in his Macro Picture [note on this topic](#) in 2021, the supply-side response started with the ending of the until then stubborn Great Depression symptom of mass unemployment.

Against the backdrop of China's surging youth unemployment, gearing the economy to a war effort should, give everyone in China a job to do while offering a way forward from the present impasse of China reaching the limit of catch-up growth.

**The wartime US analogy is reinforced by another contemporary parallel which flips around another traditional line of argument on Chinese incentives.** This is the striking **growth rebound of the Russian economy** this year in conditions of wartime resource mobilization – despite sanctions and (more important, as highlighted in the chart below) lower oil prices and sales volumes.

**The explanation is simple and familiar: fiscal stimulus** (left-hand chart below); and, apart from the immediate goal of keeping the country's war effort adequately supplied, the most important broader socio-economic result may be the unprecedented acceleration of real wages (right-hand chart below) on the back of full employment – in fact an overheated labour market.

**Chart 31: Full wartime employment in the US**

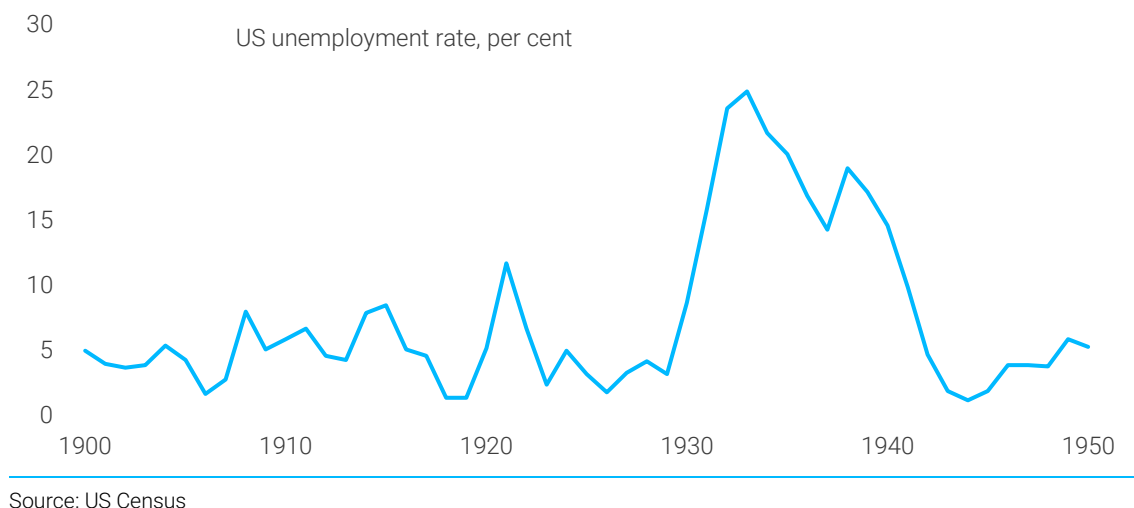
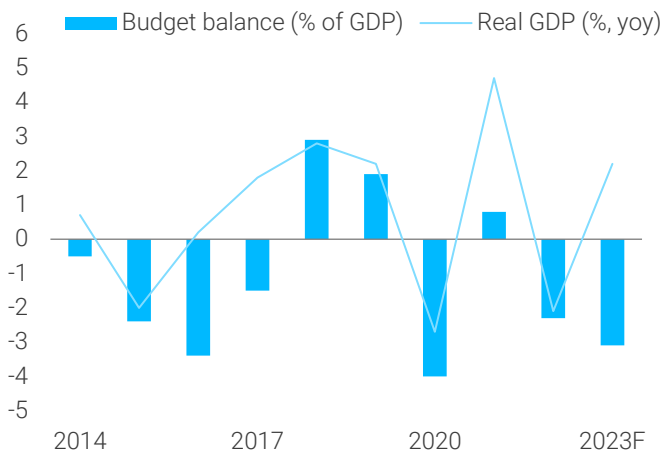




Chart 32: Russian growth and budget balance



Source: MinFin, Rosstat

Chart 33: Russia real wages (Index: Jan 2019=100)



Source: Rosstat, SberIndex, CBR

Speculation, fashionable since last year, that Russia's military setbacks in Ukraine might have had a sobering effect on the Chinese leadership as it weighs its options over Taiwan should now, therefore, be balanced by this demonstration of the war stimulus to the Russian economy.

**The thesis about the Ukraine war making China more risk-averse may be complacent for one other Russia-related reason.** Wartime conditions increase belligerents' vulnerabilities to external dependencies. China's residual dependencies on imported energy, metals and food should now be more sheltered from US naval power by imports across the secure continental land border with Russia which, as a result of its invasion of Ukraine, has become firmly locked into the Chinese orbit.

**This analysis does not alter our firm judgment that the huge dangers for China from a war of choice over Taiwan far exceed the leadership's risk tolerance,** but it may point to **increased defence spending** as a priority destination for fiscal stimulus designed to counter the effects of the real-estate bust. Such an outcome would be all the more visible and telling as military spending growth has slowed and declined as a share of GDP in the decade since Xi Jinping came to power. This points to additional underpinning from China of the 'global rearmament investment theme which, as we argue, has a long shelf life.

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