China Viewpoint

Unpacking the potential fiscal stimulus package amid tariff shock

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GEM Economics
Asia | China

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Offsetting tariff headwinds: stimulus after retaliation

External headwinds loom large, especially after the US decided to levy another 84% tariffs on China. We believe China's strategy is to follow a "retaliate, stimulate, negotiate" tactics. Given China has already retaliated with a "reciprocal" blanket 84% tariffs on all US imports, the next question lies in how China may stimulate to neutralize the elevated risk. Earlier at the NPC in March, policy makers adopted the rare phrase "dynamically adjusting policies according to the changing situation" to signal a higher level of policy flexibility amid rising uncertainties. Apart from monetary easing including rate cuts and RRR cuts, we believe fiscal stimulus will take the heavy lifting, and policy makers are likely to roll out part of the grand plans as early as this month.

Pathway to follow: from fiscal expansion to fiscal stimulus

China has significantly eased its fiscal policy since 4Q24, and increased its on-balance sheet deficit to 4.0% this year. Fiscal expenditure growth has in turn improved and contributed in stabilizing domestic demand. That said, notwithstanding this nearly 10% GDP-equivalent fiscal package, most fiscal expansion this year so far is only towards risk containment (targeting local fiscal shortfall and property market turmoil), instead of directing towards areas with higher fiscal multipliers such as investment and consumption stimulus. Currently, the immediate impact of this fiscal composition is less visible elsewhere, other than the credit growth rebound supported by government sector financings. We see more room for a further step-up in fiscal stimulus, by as much as another RMB2tn (equivalent to 1.5% GDP) more of borrowing.

Stimulus phase I: to households, to consumption

The stimulus, in our view, may come in two phases, firstly on consumption, then on investment. With the top-priority goal being to boost consumption, we expect as much as RMB600bn stimulus towards households to roll out first, in two new areas:

(1) The long-waited childbirth subsidies could be the next to watch. We expect a coordinated policy framework to be introduced at both national and local level as early as this month, with annual subsidies reaching as much as RMB300bn to boost newborns.

(2) Separately, other than further broadening the categories within the consumer goods trade-in policies and to inject with more subsidies (RMB100-200bn), promoting services consumption at a national level is also likely. Catering, accommodation, tourism and sports are likely to be included, but at a relatively small size (RMB50-100bn) initially.

Stimulus phase II: investment to lift the aggregate demand

Consumption stimulus alone may still be insufficient. If past cycles can be any reference, the most effective Chinese-style stimulus is always towards investment. In our view, stimulus towards investment will be put on the table, to achieve the goal of "property market stabilization" as well as facilitating investment in strategic areas. With the preparation of 15th Five-Year Plan (2026-30), more feasible projects are in the pipeline, and funded with additional Special CGB issuance (about RMB1.4tn) likely from mid-year.

Abbreviations

GWR: Government Work Report

NPC: National People's Congress

CGB: China government bond

B/S: balance sheet

LGSB: local government special-purposed bond

LG: local government

LGFV: local government financial vehicle

GDP: gross domestic product

RRR: Required reserve ratio

Current fiscal support insufficient to absorb the shock

A 10% GDP-equivalent fiscal expansion in place…

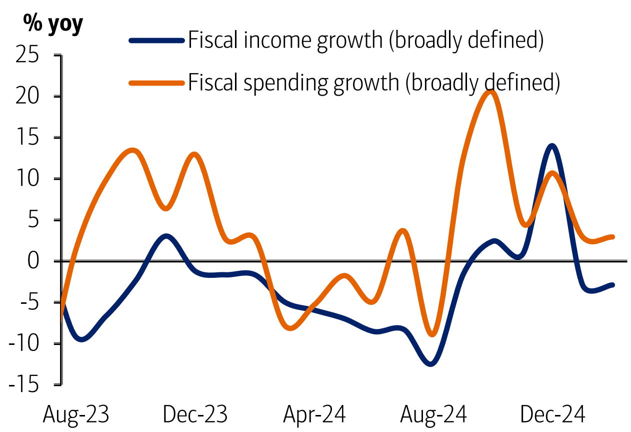
The annual fiscal budget plan for 2025 was released after the final approval from the NPC, and fiscal policy stance turned "more proactive" this year from a "proactive" stance in 2024. It comes with a notable increase in fiscal deficit to 4% (from 3% last year) and more issuance of special CGBs. The total fiscal tools are equivalent to as much as 10% of GDP, highlighting step-up in fiscal expansion this time around.

That said, many have argued that the current seemingly higher fiscal deficit is not sufficient for a growth turnaround, and we see three reasons behind that: 1) less off-B/S financing limited the increase in augmented fiscal balance; 2) reasonable fiscal income projection capped the expenditure growth; 3) current direction of use mostly towards risk containment, instead of areas with higher fiscal multipliers such as investment and consumption stimulus. (*See more in the Appendix*).

… yet, unlikely to offset the external shock

So far, there has been an improvement in expenditure growth since 4Q24, suggesting the accelerating pace has been sustained (Exhibit 1). We also note that the latest fiscal policy step-ups have moved in the right direction. The focus on promoting science & technology, education, and strategic investment in the budget plan will likely help enhance productivity growth in China over the medium term, while the new focus on boosting consumption could also contribute to demand stabilization. However, the growth shortfall looms large, as in 2024, total growth contribution from net exports was equivalent to 1.5ppt (Exhibit 2). In other words, only to modest stabilize, rather than stimulate domestic demand will not be sufficient in meeting this year's growth target.

Exhibit 1: Fiscal spending and income growth
We see notable improvement in fiscal spending since 4Q24



Source: CEIC, BofA Global Research

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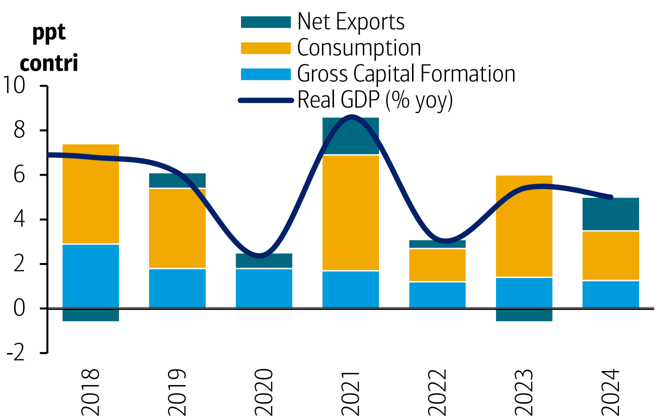
Exhibit 2: GDP by expenditure
In 2024, of the 5% GDP growth, 1.5ppt came from net exports



Source: CEIC, BofA Global Research

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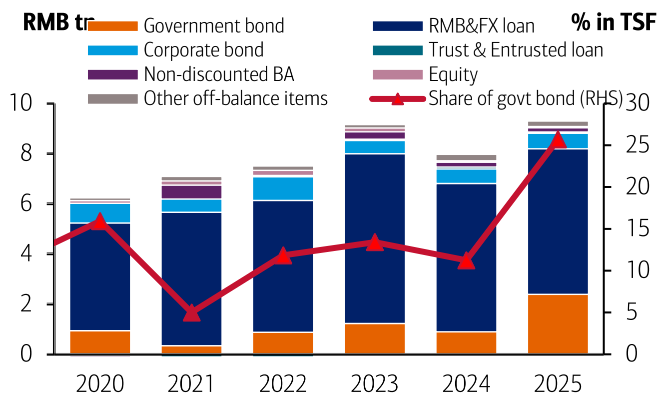
Facilitated credit expansion, while more are expected

Currently, owing to the fast issuance of local government refinancing bond (already exceeded 60% of last year's issuance), and the on-track LGSB issuance, total social financing growth stabilized in the year-start (Exhibit 3). In turn, our BofA FCI (financial condition index) has also eased to 96.3 in Feb from 97.2 in Dec'24, despite the recent rebound in money market rates and treasury bond yields. But, due to a lack of immediate stimulus, the economic impact seems less visible elsewhere, other than the credit expansion from government sectors. The improvement in government bond issuance has also failed to fully lift credit demand from both corporate and household sectors.

After all, fiscal expansion revealed in 2025 budget plan looked less exciting than what the headline suggests. Will it still serve as a cornerstone for growth stabilization? Before the trade conflict escalation, we may see a modest stabilization amid these announced fiscal expansions. However, given US decided to impose a total of 125% tariffs on China, more policy stimulus appears to be needed.

Exhibit 3: New TSF breakdown in Jan-Feb (2020-2025)
Of the record-high new TSF in Jan-Feb, the share of government bond issuance rose sharply to over 25%



Source: Wind, BofA Global Research

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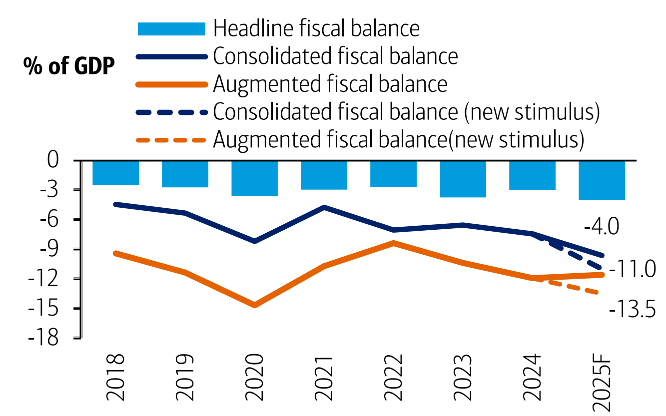
Pathway to follow: from fiscal expansion to fiscal stimulus

As highlighted in our earlier report (see: China Viewpoint), we believe China's strategy is to follow a "retaliate, stimulate, negotiate" tactics. Given China has already retaliated with a "reciprocal" blanket 84% tariffs on all US imports, next question is how China may stimulate to hedge the elevated risk. Earlier at the NPC in March, policy makers adopted the rare phrase "dynamically adjusting policies according to the changing situation" to signal a higher level of policy flexibility amid rising uncertainties. Apart from monetary easing including rate cuts and RRR cuts, we believe fiscal stimulus will take the heavy lifting, and policy makers are likely to roll out part of the grand plans as early as this month.

Exhibit 4: Fiscal deficit estimate
We expect government to allow further widening in both consolidated and augmented deficit this year



Source: CEIC, BofA Global Research estimates; Note the dotted line is based on projection with potential announced stimulus packages

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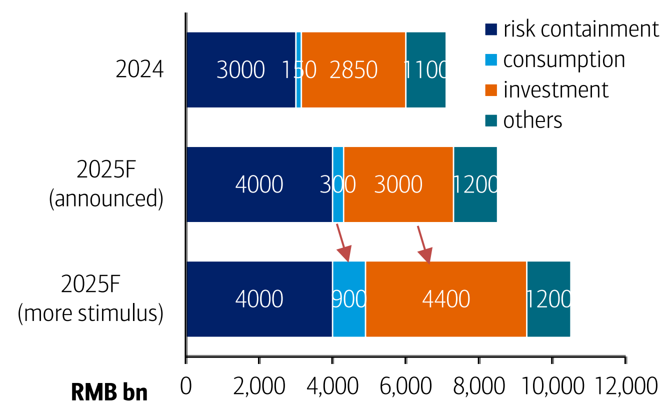
Exhibit 5: Expect govt bond-funded fiscal support to key areas (ex-fiscal deficit
See a step-up in fiscal expansion with more directed towards consumption and investment



Source: CEIC, BofA Global Research estimates Note: risk containment includes local govt debt swaps, bank capital injections, idle-land buy backs etc., investment includes both infrastructure investment & manufacturing investment

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We expect the following consumption-stimulus measures to be firstly considered to partially hedge with the elevated external risks, while the effort towards boosting investment is also warranted in the coming months. We see more room for further step-up, likely another RMB2tn or 1.5% GDP-equivalent stimulus are on the table (Exhibit 5). Such measures will help to hedge about 0.7-1ppt of GDP growth shock and may help with the growth stabilization, especially in 2H25. The consolidated and augmented fiscal deficits are also likely to widen by 2ppt or more versus the budget-implied numbers (Exhibit 4).

Stimulus phase I: To households, to consumption

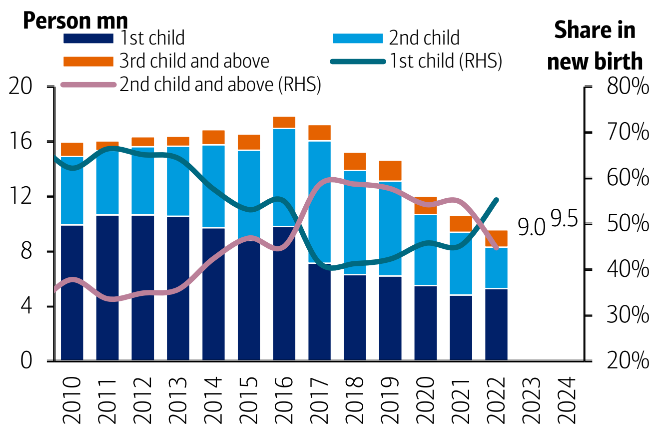
What's new we can expect in the near term? One clear answer is working on the top-priority goal highlighted in the GWR, i.e., boosting consumption. And the next window is seen near term, especially for the long-waited childbirth subsidy program, in our view. In total, we may expect another RMB600bn-worth package towards consumption, according to our estimate.

More local gov't efforts showcase childbirth nation-wide subsidies on the way

Among all areas towards consumption, one key aspect to look at is the potential policies on boosting birth rates. This is one of the few areas that still lacks further clarity in terms of policy magnitude, and see a size as much as RMB300bn (0.2% GDP) per year.

Exhibit 6: China's newborn breakdown

In 2024, total newborns rebounded to 9.5mn, while in 2022, 2nd or above child's newborn share came in at about 45%, with 4.3mn in total



Source: CEIC, BofA Global Research

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Exhibit 7: Local government child subsidy plans

Select regions have already introduced subsidy policies to pro-birth

	City	Child subsidies policies
One-off subsidy	Shenzhen	Childcare subsidies: RMB3,000 for the first child, RMB5,000 for a second child, RMB10,000 for a third child (or more); Additional annual subsidy of RMB1,500/2,000/3,000 for 3 years
	Hangzhou	Maternity subsidies: RMB2,000 for a second child, RMB5,000 for a third child (or more); Childcare subsidies: RMB5,000 for a second child, RMB20,000 for a third child (or more).
	Nanjing	Maternity subsidies: RMB28,889 for the first child, and more for the 2nd or more children; Unemployed women could get 3 months jobless claims at once
	Hohhot	Childcare subsidies: RMB10,000 for the first child, RMB50,000 for a second child, RMB100,000 for a third child (or more);
Monthly subsidy	Jinan	RMB600 per month for families to have a second child (or more); and additional RMB200 per month for mother unemployed or in poverty for 3 years
	Harbin	RMB500 per month for families to have a second child, and RMB1,000 per month to have a third child (or more) for 3 years

Source: Local governments, BofA Global Research

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The current practice varies from city to city, with either one-off subsidies or monthly ones (Exhibit 7). In our earlier estimate (see also: Interpreting fiscal package), a rough calculation of subsidies provided to '2nd or above children' family with about RMB10,000 per year per child for the first three years (with 4.3mn newborns included for the first three years) suggests an annual fiscal support of RMB150bn. If we include all families with newborns (including first child as well), as evident from cities such as Hohhot, the size could at least double (to annual subsidy of about RMB300bn, if considering multi-year support). Also, with a high propensity to consume such subsidy (as this is for child caring), its fiscal multiplier would be relatively meaningful.

In terms of timelines, we may expect a more detailed nationwide guideline to be rolled out soon. The discussion on such mechanism has started six months ago, and we believe the timing is more certain after taking into consideration both national and local level coordination.

More can be included in the consumer goods trade-in program

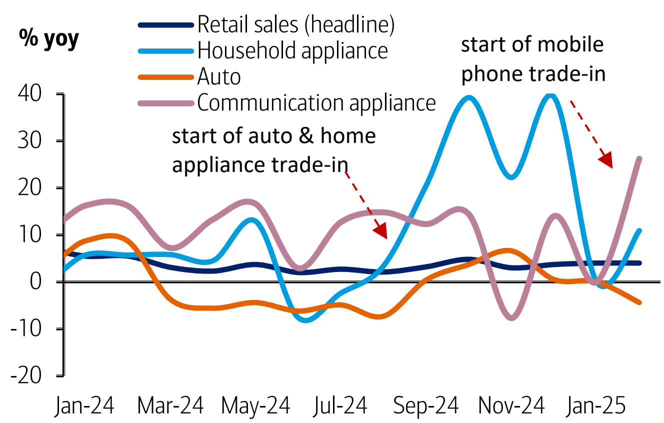
Fiscal supports on goods consumption have shown to be effective last year, especially for large-ticket items (Exhibit 8). According to the Ministry of Commerce, RMB150bn-worth subsidy (0.1% of GDP) facilitated auto sales of RMB920bn in 2024, as well as home appliances sales of RMB240bn. This year, consumer-subsidy programs have been expanded to include small consumer electronics, such as phones and tablets, while the eligibility for auto trade-ins has also been loosened.

With the doubling of the subsidy (RMB300bn, or 0.2% of GDP), we expect it to continue support retail sales growth this year. E.g., the inclusion of mobile phones into the consumer goods trade-in program has helped the rebound in communication appliance sales in Feb (26.2%), and the sales of household appliances remained resilient. However, after some front-loading, sales of autos have normalized, along with selected home appliances recently.

Although the current trade-in policies have already included most of the large-ticket items, fine-tuning still has room, in our view. Currently, the trade-in program covers eight major categories at the national level, while some local governments included more, including home decoration materials, aging-friendly renovation products, smart home devices. Policy makers can marginally include such categories, and/or to further increase the subsidy amount for high-value purchases. An additional subsidy of RMB100-200bn is likely, in our view.

Exhibit 8: Retail sales growth by key supported categories

Consumer goods trade-in policies helped to support key large-ticket item sales since 2H24



Source: CEIC, BofA Global Research

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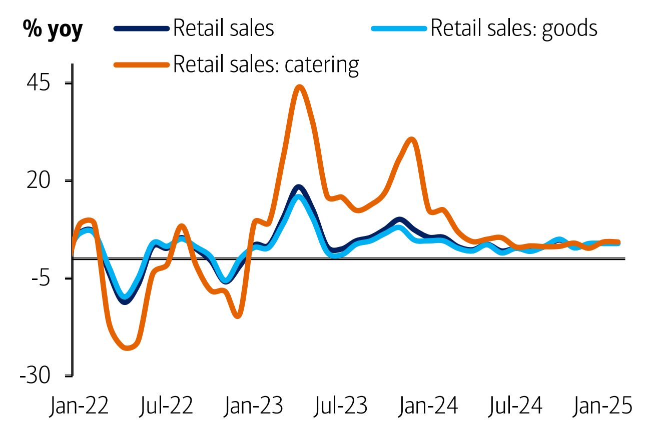
Exhibit 9: Retail sales (goods & catering)

Catering retail sales continued to remain muted after the initial spike post-reopening



Source: CEIC, BofA Global Research

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Potentially from goods consumption to services

Separately, promoting services consumption at the national level may also be another new area to focus.

The GWR emphasized the need to expand services supply in areas like health, elderly care, childcare, and home services. In addition, there was also language around the promotion for new consumption scenarios related to culture, tourism, and sports. With the promising box-office revenue contributed by Nezha 2 earlier this year, as well as the still-muted catering sales growth (Exhibit 9), we expect policy makers to gradually shift their focus to services consumption as well and start introducing fiscal subsidies toward catering and cultural & tourism if additional consumption boosts are needed. Note that local governments have already introduced similar measures over the past few years. For example, Shanghai recently launched another round of consumer coupons toward catering and tourism (Exhibit 10).

Exhibit 10: Consumption coupons in Shanghai

Shanghai provided multiple consumption coupons covering services over the past years, mostly focused on catering and tourism

Date	Size	Area	Method and coupon type
Aug 22 – Nov 22	RMB1.1bn	Goods, catering and accommodation	Consumers registered online for coupons were selected randomly; Coupon type ranged from RMB25 (available with over RMB50 expense) to RMB100 (available with over RMB300 expense). Coupon will be valid for next 20 days after issuance
Sep 24 – Nov 24	RMB360mn	Catering	Consumers first came were first served Coupon type: RMB50-90 (available with over RMB300 expense), RMB100-150 (available with over RMB500 expense), RMB200-240 (available with over RMB800 expense) and RMB300 (available with over RMB1,000 expense). Coupon will be valid for next 7 days after issuance
Feb 25 – Jun 25	RMB500mn	Catering (RMB360mn), tourism (RMB90mn), movie (RMB30mn) and sports (RMB20mn)	Consumers registered online for coupons will be selected randomly, only one coupon could be used per day Coupon type: 1. **Catering**: RMB90 (available with over RMB300 expense), RMB180 (available with over RMB500 expense), and RMB400 (available with over RMB1,000 expense). 2. **Tourism**: 1) accommodation coupons: RMB90-360 (available with over RMB300-1,200 expense) 2) sightseeing coupons: RMB15-75 (available with over RMB30-150 expense) 3. **Movie**: Varied by ticket type with max RMB30 reduction per ticket; 4. **Sports**: RMB5-8 (available with over RMB10-120 expense)

Source: Shanghai government, BofA Global Research

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However, such measures still lack national-level implementation experiences, and cultural & tourism resources vary from place to place. Hence, regional pilots rather than at universal level are more likely if such measures were to be further implemented soon, in our view. If there is a possible national-level subsidy, in terms of sizes, current Shanghai's subsidy program covers a period from end-Feb to June at RMB500mn. Thus, if we borrow its experience and simply divide by its share of national retail sales (3.68% in 2024), the annualized subsidy size for services consumption could reach nearly RMB50bn, or even RMB100bn if the coupon discount turns more generous. Such services consumption related coupons also told to have a high multiplier (4x, according to government measures); hence it will help to improve services consumption and the respective tertiary sector employment.

Stimulus phase II: investment to lift the aggregate demand

Consumption stimulus alone may still be insufficient. If past cycles can be any reference, the most effective Chinese-style stimulus is always towards investment. In our view, stimulus towards property investment is on the table, in achieving the goal of "property market stabilization" and facilitating investment in strategy sectors. With preparation of 15th Five-Year Plan (2026-30), more feasible investment projects are in the pipeline, and funded with additional Special CGB issuance (of about RMB1.4tn) likely from mid-year.

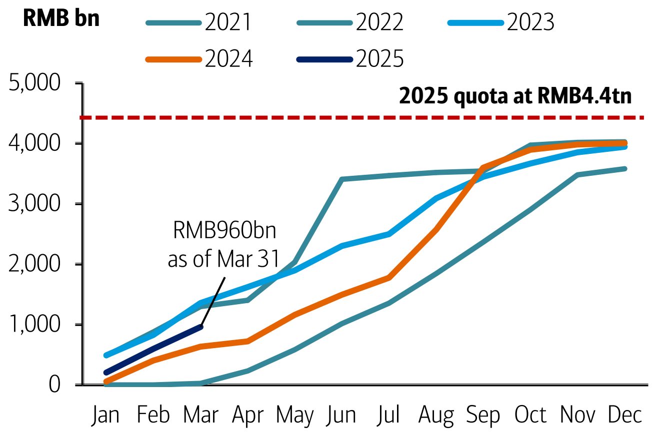
Accelerating planned bond issuance and calls for fast implementation

This year, policy makers have added another RMB500bn quota and relaxed the issuance approval progress of LGSBs, providing more autonomy at the local level by allowing a number of major provinces to approve LGSB usage by themselves. So far, the issuance pace has been on track, with RMB960bn-worth LGSB issued in 1Q (Exhibit 11), and most of the funding were directed towards infrastructure investment (Exhibit 12). The new usage idle-land buyback has also been included and issued by Guangzhou and Lanzhou governments earlier this year to enhance developers' financial conditions.

Near-term, with increasing necessity of policy boost, a fast issuance and implementation is warranted, and we may see a much faster LGSB issuance pace similar to 2022 amid the increasing autonomy in issuance at the local level. Separately, we see the fast issuance and implementation of this year's RMB1.3tn special CGB, before any new quota that will be approved by the authority later in the year.

Exhibit 11: LGSB issuance pace

2025 LGSB issuance is largely on track, as of end-March



Source: Wind, BofA Global Research

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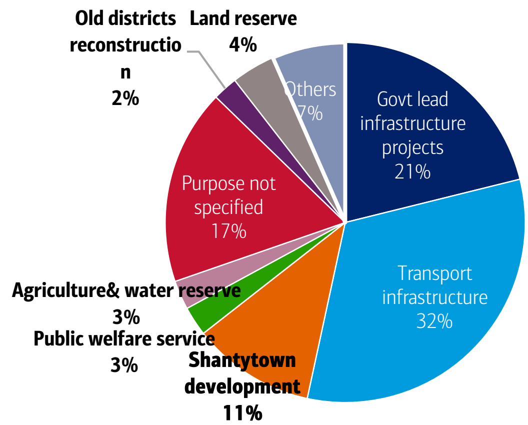
Exhibit 12: Usage breakdown for the 2025 ytd newly issued LGSB

Year-to-date, we see most of the LGSB funding were directed towards infrastructure projects



Source: Wind, BofA Global Research

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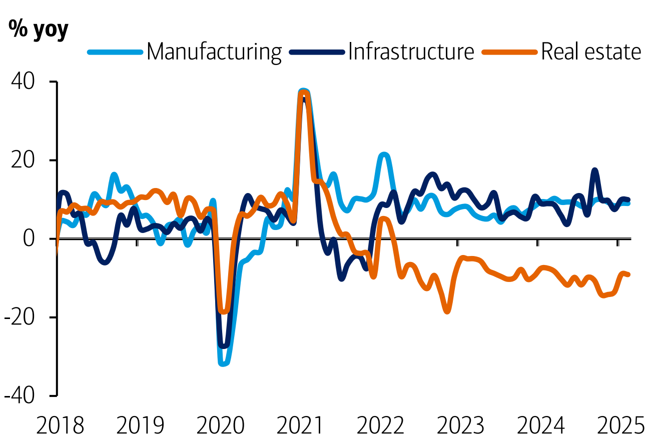
Property & strategic areas; 1% GDP-worth fiscal package in sight

In addition to the acceleration and implementation of earlier in-plan projects, a basket of new investment projects is also in sight towards demand-boosting stimulus. In our view, additional resources are likely to be allocated into two areas later this year, as much as RMB1.4tn or more, towards property investment and investment in strategic areas.

Policy makers have called for “property market stabilization” in the GWR, after a multi-year correction. Despite some improvement in the housing prices and sales, property investment is still in a deep contraction, and await further policy support. In our view, by accelerating the pace of urban renewal programs, including the relaxation requirement in urban village redevelopment, it could create new investment demand. Although the overall impact looks much smaller than the shantytown redevelopment from a decade ago (Exhibit 14), it could still play an important role in investment stimulus, and we expect special CGB or LGSB to be utilized as an additional funding source this time.

Exhibit 13: China FAI (fixed asset investment) growth

Real estate investment growth in a deep contraction in Jan-Feb



Source: CEIC, BofA Global Research

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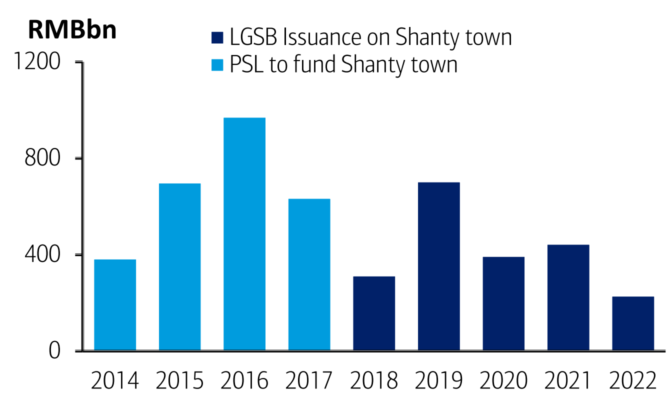
Exhibit 14: PSL and LGSB for shantytown

During 2014-2017, notable PSL (pledged supplement lending facility) has been injected to support shanty town renovation, while LGSB also played a role afterwards



Source: Wind, BofA Global Research

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In terms of investment in strategic areas, with the preparation of 15th Five-Year Plan (2026-30), more major projects can be added to the pipeline, especially in the second half of this year. Additional public investment towards facilitating new urban citizens is one important direction. We believe more investment will be committed to improving social-welfare facilities, such as upgrading and reconstruction of underground pipe network, as well as other public facilities toward healthcare, entertainment, etc.

AI facility investment a viable option, but private firms may take lead

Separately, some expectations on additional fiscal support to tech investment are also building up after the rise of DeepSeek. Multiple large Chinese tech companies have already announced more aggressive capex plans over the coming years to invest in AI-related infrastructure, including Alibaba (RMB130bn) and Tencent (RMB100bn). The government is likely to increase its participation in the AI-related investment in the medium term but, currently private companies are taking the lead. Further, investment is also less likely to have a strong impact on domestic economy even with notable capex plans. Chinese tech companies are mostly utilizing their investment for advanced chip purchases, which are more imports related, rather than domestically produced.

Appendix: All you need to know about the 2025 budget plan

Progress so far: from “proactive” to “more proactive”

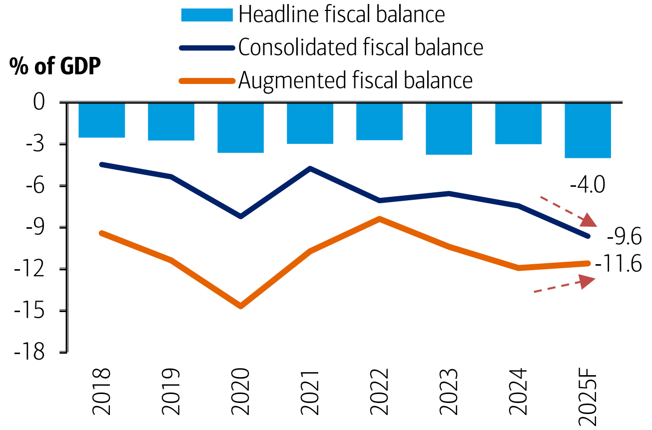
The annual fiscal budget plan for 2025 was released after the final approval from the NPC, and fiscal policy stance turned “more proactive” this year from a “proactive” stance in 2024. It comes with a notable increase in fiscal deficit to 4% (from 3% last year) and more issuance of special CGBs. The total fiscal tools are equivalent to as much as 10% of GDP.

The underlying fiscal policy direction has also been evolved over the past quarters, from “curbing bond issuance in debt overhang regions” in 1Q24, to “swapping local government hidden debt” in 4Q24, then to “allowing selected provinces to self-approve and issue LGSB” in 1Q25. We see continued finetuning of fiscal policy implementations along with the step-up in fiscal expansion this time around. That said, many have argued that the current seemingly higher fiscal deficit is not sufficient for a growth turnaround, and we see three reasons behind that: 1) less off-B/S financing limited the increase in augmented fiscal balance; 2) reasonable fiscal income projection capped the expenditure growth; 3) current direction of use towards areas with low fiscal multipliers.

(1) Record-high on-B/S fiscal expansion, but less off-B/S financing

It is important to measure the overall size of the fiscal expansion in the first place. Doing so through a fiscal-budget-balance perspective would be the most-straight-forward method. Overall, more financing through “front door” (government bond issuance) is well anchored this year, while off-balance sheet fundings will likely narrow from previous years. This could be a paradigm shift, and we need to always look at the broader definition of fiscal deficit to assess the size of fiscal packages going forward. For 2025, this number (augmented fiscal deficit) is likely to be slightly lower than that of 2024 if without further stimulus, marking a modest fiscal expansion than what the headline suggests (Exhibit 15).

Exhibit 15: China fiscal deficit
According to the budget plan, fiscal deficit will widen for both headline and consolidated balance, while that of augmented is likely to narrow on debt control for hidden debts



Source: Wind, CEIC, BofA Global Research estimates; Note: Forecast in 2025 without the potential stimulus package

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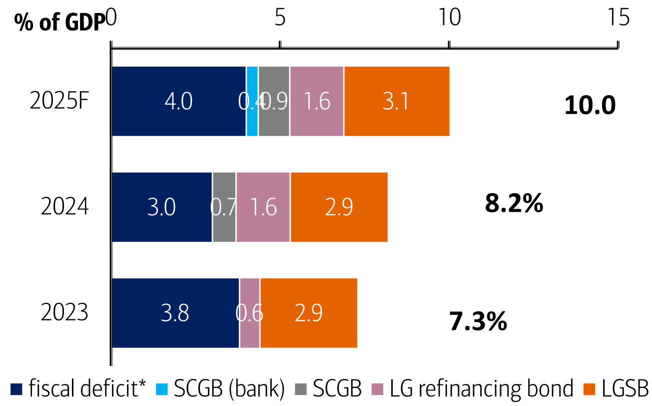
Exhibit 16: Fiscal expansion (by types of government bonds)
In 2025, the budget plan suggested the additional fiscal expansion is likely to be 1.8% of GDP, or RMB2.9tn, compared with 2024



Source: Wind, BofA Global Research; Note: fiscal deficit includes the issuance of LGGB and CGB; Forecast in 2025 without the potential stimulus package

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From "back door" to "front door": government bond issuance takes lion's share

According to the budget plan, total government bond net new issuance could reach RMB14tn, or 10% of GDP this year, significantly higher than 7.3% and 8.2% witnessed in 2023 and 2024, respectively (Exhibit 16). If we break down the new issuances, we see more issuances of conventional government bonds, special treasury bonds, LGSBs, as well as continued issuances of local government special refinancing bonds.

Exhibit 17: China fiscal balance
The consolidated fiscal balance is likely to increase to 9.6% of GDP this year, but the local government off-balance sheet borrowings may see lesser expansion

(% of GDP)	2018	2019	2020	2021	2022	2023	2024	2025F
Headline fiscal balance	-2.5	-2.7	-3.6	-3.0	-2.7	-3.8	-3.0	-4.0
On-balance sheet deficit (cash basis)								
General public fiscal account	-4.0	-4.8	-6.1	-3.7	-4.6	-4.5	-4.8	-5.5
National government-managed fund account	-0.5	-0.7	-2.4	-1.3	-2.7	-2.4	-2.9	-4.4
State-administered SOE fund account	0.1	0.2	0.2	0.2	0.2	0.3	0.3	0.2
Consolidated fiscal balance	-4.5	-5.4	-8.2	-4.8	-7.1	-6.6	-7.5	-9.6
Off-balance sheet deficit								
Central government borrowings †	-0.4	-0.2	0.0	-0.3	0.0	0.0	-0.3	0.0
Local government borrowings								
Special refinancing bonds							-1.6	-1.6
LGFV bonds	-0.3	-1.0	-1.7	-1.5	-0.7	-0.7	0.4	-0.4
Others ‡	-4.3	-4.8	-4.7	-4.2	-0.7	-3.2	-2.9	0.0
Augmented fiscal balance	-9.4	-11.4	-14.7	-10.7	-8.4	-10.4	-11.9	-11.6

Source: Wind, CEIC, BofA Global Research estimates; Note: † Including policy bank special bonds, China Railway Corp.'s borrowings and etc..; ‡ Including PPPs and LGFV's total interest-bearing debts other than bonds; Forecast in 2025 without the potential stimulus package

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Consolidated deficit to reach multi-year high of 9.6% in 2025…

As a result, the consolidated fiscal deficit could reach 9.6% in 2025, marking the highest on-balance sheet deficit in years (even higher than that in 2020, at 8.2%, Exhibit 17). The consolidated deficit takes into account the entire government fiscal books. In detail, the expansion is mostly supported by the widened deficit in general public fiscal account (-5.5%), as well as the national government-management fund account (-4.4%), while contribution from the state-administered SOE fund account is budgeted to remain in surplus and looks flat from last year (+0.2%).

... while fiscal package could be capped by tighter off-B/S financing

On the other hand, although the top-line figures look exciting, if we consider the overall fiscal boost, one would note that this could be capped by the recent local government debt-swap programs. The augmented fiscal balance, which takes into account quasi-government financing activities, is likely to narrow from last year (to -11.9% from -11.6% in 2024), according to our estimate. In our view, the continued issuance of local government special refinancing bonds is likely to swap a part of the hidden debt from LGFVs, and hence reduce the overall fiscal expansion through off-balance sheet channels. Such a measure will not only help consolidate the local fiscal condition but may also in turn curb the "over-leverage" phenomenon for the broader entities compared with previous years.

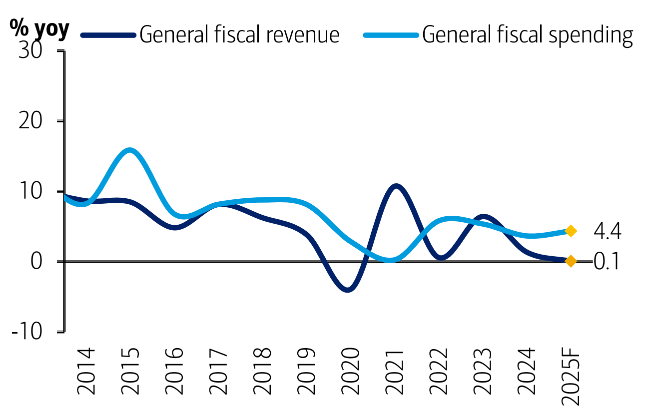
After all, if the current budget plan can be any reference, we see the augmented fiscal balance expansion not deviating much from the past five years' average (of -11.3%), if a less expansion in LGFV debt to remain in place. So, we may not overstate the fiscal impulse coming from the current fiscal deficit figures.

(2) Achievable fiscal revenue target, spending growth to improve to par level

In addition, a record-level fiscal deficit also does not warrant a much higher fiscal expenditure growth, as the overall income will also be considered separately. The good news is this year's income projection is more realistic, meaning we may not undershoot the target for another year. However, the relatively cautious income projections also suggest only a modest improvement in fiscal spending this year.

Exhibit 18: General fiscal revenue and spending growth

Budget plan suggests 4.4% fiscal expenditure growth and 0.1% growth in fiscal revenue



Source: Wind, Budget Plan, BofA Global Research

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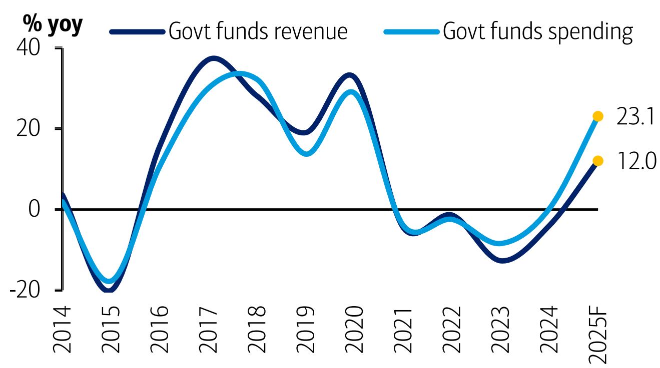
Exhibit 19: government managed fund revenue and spending growth

Budget plan suggests 23.1% growth in government-managed fund expenditure growth and 12% growth in revenue



Source: Wind, Budget Plan, BofA Global Research

Note: the government funds revenue taking into account of the government bond issuance that included under this category

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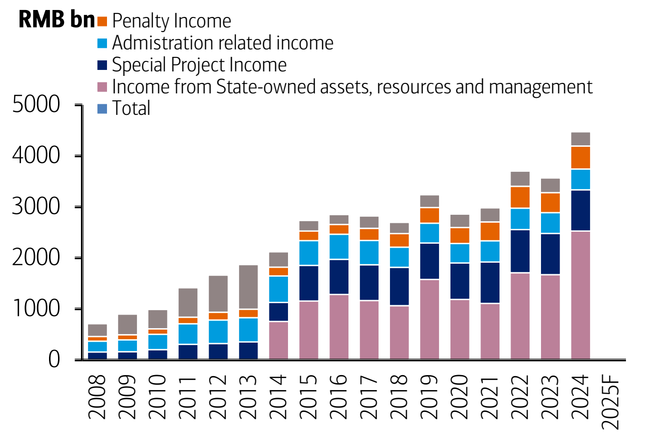
Accountable fiscal revenue targets, especially from local level

According to the budget plan, the general government budget revenue growth is estimated at 0.1%, compared with 2024 budget and actual fiscal revenue of 3.3% and 1.3%, respectively (Exhibit 18). Specifically, the budget expects tax revenue to grow 3.7% (vs -3.4% in 2024) and non-tax income to drop 14.2% (vs +25.4% last year, on notable revenue collection from SOE assets and managements).

On the tax front, given the tax-collection target is set below the economic growth target, it looks achievable, especially if no major tax cuts are rolled out this year (except for the property-related tax easing-measures announced in late-2024). For non-tax revenue, which accounted for about 20% of the annual general fiscal income, we also see a notable downward revision target (of -14.2% yoy). Last year's spike was mostly due to higher income collection from SOE assets, resources, and management (grew by over 50% in 2024), most of them through one-off utilization (sale or lease) of SOE assets/resources. Hence, this year's lower target would be more rational, and bring back the income close to 2022 level (Exhibit 20).

Exhibit 20: Breakdown of non-tax revenue

Non-tax revenue grew by 25.4% in 2024, driven by higher income from state-owned assets and managements



Source: Wind, NBS, Budget Plan, BofA Global Research

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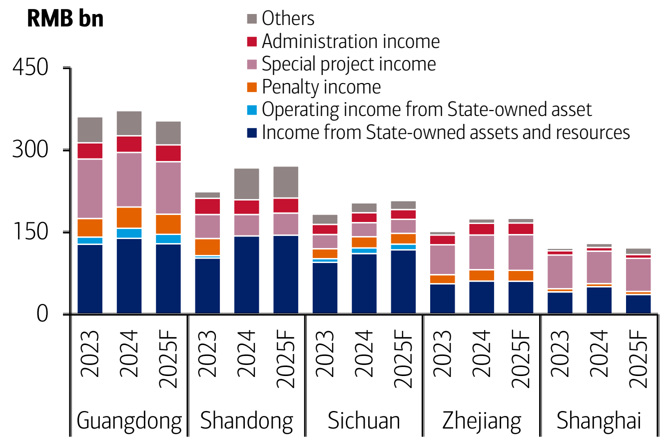
Exhibit 21: Breakdown of non-tax revenue for key regions

At provincial level, the target for income collection from SOEs is also largely consistent with 2023-24 trend



Source: Wind, NBS, Local government budget plan, BofA Global Research

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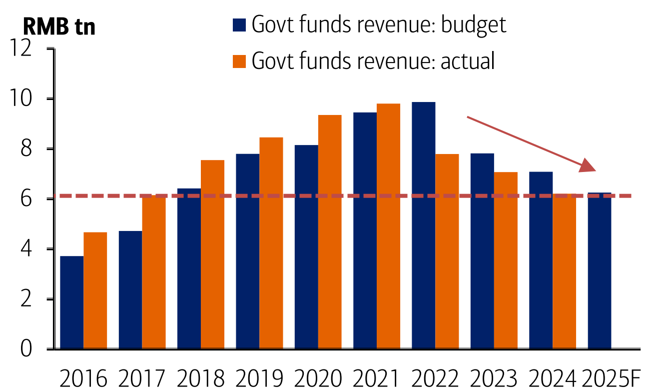
Gov't-managed fund revenue (ex-bond) projection set at only 2017 level

For government-managed fund accounts, the budget plan expects the total revenue (ex. government bond issuance) to grow 0.7%. After missing its target for three consecutive years, the revenue projection has been more realistic and set at a level similar to 2017 (Exhibit 22).

Exhibit 22: Govt managed funds revenue (budget vs. actual, ex-bond)

The government-managed funds revenue (ex-bond) has fallen short over the past three years. This year's target has returned only to the 2017 level



Source: Wind, Budget Plan, BofA Global Research

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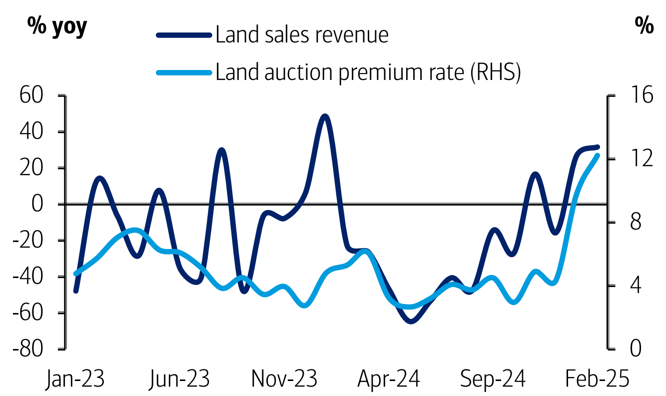
Exhibit 23: Land sales revenue vs. land sales premium in 300 cities

Land sales revenue growth improving since late-4Q, along with improvement in land auction premium rate



Source: Wind, BofA Global Research

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In our view, if the property market, especially the land market, were to stabilize as evident from 4Q24 (Exhibit 23), the target would also be more realistic, as land sales revenue accounted for the majority of the local government-managed fund revenue. That said, we acknowledge the wide discrepancy in land market performance. There is a strong imbalance in the recovery of land auction market lately, with most of the sales improvement concentrated in key cities such as Hangzhou, Shanghai, and Beijing. Thus, the recovery in land sales revenue could overstate the situation at national level, making the sustainability uncertain.

Expenditure acceleration, but not deviating from pre-Covid levels

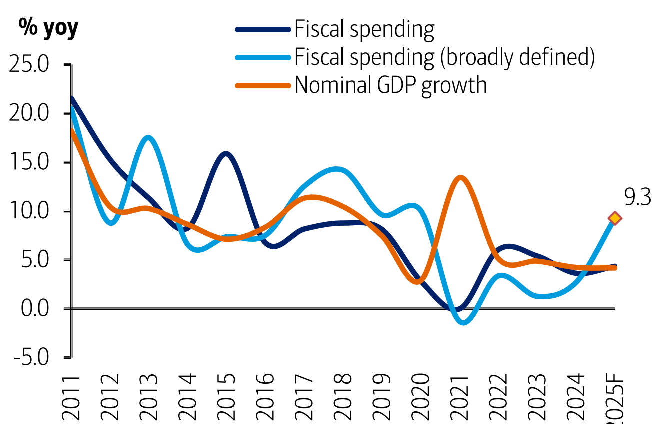
As a result of this accountable fiscal income targets, the budget plan sets the fiscal general government expenditure growth at a reasonable level of 4.4% (vs 3.7% in 2024), an improvement but still lower than the real GDP growth target this year. Separately, government-managed account spending is likely to increase notably (23.1%), after taking into account the widened usage of LGSBs, as well as special CGBs (see later sections), Combined, we expect this broadly defined fiscal spending growth to pick up to 9.3% yoy, and to play its counter-cyclical role similar to 2018-2020 (Exhibit 24). However, even with such projected growth rate, it is still not deviating much from the pre-Covid expenditure growth path, and we may also face much higher interest repayment burdens more than before.

In terms of area of spending, of the 4% headline deficit-funded general fiscal spending, we see more towards targeted areas. By category, fiscal spending on science & tech (8.3%), cultural & tourism (7.3%), defense (7.2%), and education (6.1%) is expected to grow at a faster pace (Exhibit 25), consistent with the 2025 policy priorities toward technology innovation, education, as well as consumption.

On the other hand, we see slower budget expenditure growth in agri & water (0.2%) and community affairs (2.4%). It is worth noting that the interest payment for debt will maintain high growth (7.7%), with the recent year's higher issuance of gov't bonds.

On the positive front, although the headline figure looks less exciting, it is worth highlighting that we will continue to see more fiscal transfers from the central to local governments. The size is likely to increase to RMB10tn, or +8.4% yoy from a year ago, and could help increase the autonomy at the local level. We do expect such arrangement to enhance the efficiency of fiscal spending, and the budget plan also calls for an acceleration in fund allocation and disbursement.

Exhibit 24: Fiscal spending vs. nominal GDP growth
Broad fiscal spending may pick up, but only to pre-Covid level average level



Source: CEIC, BofA Global Research

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Exhibit 25: Budget fiscal general spending in major areas
Fiscal spending on science & tech, defense, education grows at a faster pace

RMBbn	2024 actual	2025 budget	2024 growth rate(%)	2025 budget growth rate (%)
Education	4207.6	4464.7	2.0	6.1
Social Security	4211.4	4409.1	5.6	4.7
Agriculture& Water	2704.5	2709.5	12.7	0.2
Community Affairs	2174.2	2225.3	5.9	2.4
General Public Service	2067.5	2150.1	-2.7	4.0
Health	2034.8	2137.2	-9.1	5.0
National Defense & Diplomacy	1750.7	1876.8	6.9	7.2
Culture & Tourism	1452.7	1559	-	7.3
Public Security	1480	1545	-0.4	4.4
Interest Payment for Debt	1287.7	1387.3	8.9	7.7
Science & Tech	1150.5	1246.4	5.7	8.3
Transportation	1207.6	1237	-1.2	2.4
Resources Prospecting	872.6	907.4	5.7	4.0
Housing Security	835.1	872.1	1.4	4.4
Environment	548.9	558.2	-2.6	1.7
Disaster &Emergency	475.4	415.4	-	-12.6

Source: MoF fiscal budget report, BofA Global Research

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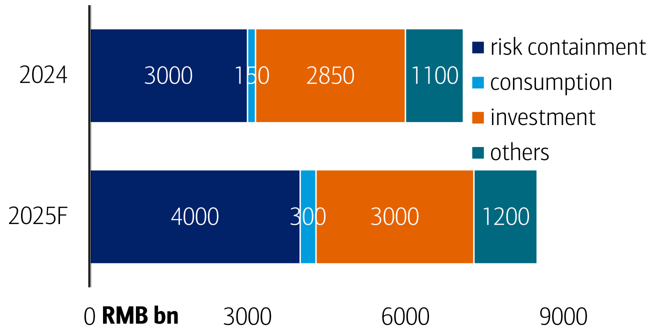
(3) Targets risk containment, rather than demand boost

Another reason for the insufficient fiscal boost is that the current budget plan has features more of fiscal accountability, rather than consisting of stimulus directed towards areas with high fiscal multipliers.

Exhibit 26: Govt bond-funded fiscal support to key areas (ex-fiscal deficit)

Most of the net increase in government fiscal support focus towards risk containment, rather than in other areas, according to the budget plan



Source: CEIC, BofA Global Research estimates Note: risk containment includes local govt debt swaps, bank capital injections, idle-land buy backs etc., investment includes both infrastructure investment & manufacturing investment; Forecast in 2025 without the potential stimulus package

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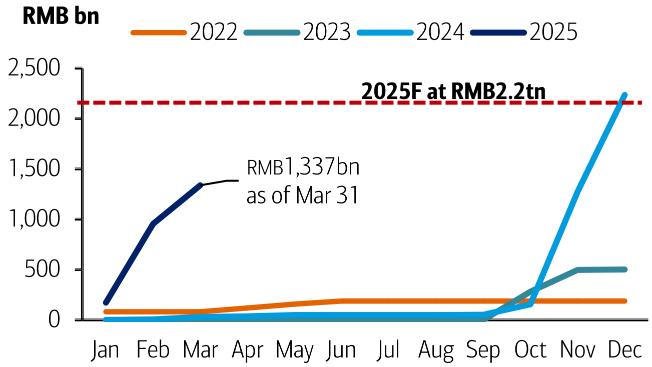
Exhibit 27: Local government special refinancing bond issuance pace

2025 local government special refinancing bond issuance pace accelerated notably to swap "hidden debt" at local level



Source: Wind, BofA Global Research

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According to our analysis, the additional fundings (of RMB1.4tn, or about 1% GDP) are mostly directed to risk-containment uses, rather than towards investment and consumption stimulus (Exhibit 26). Specifically, the new tools, including the special CGB for bank capitalization (RMB500bn), as well as the new use of LGSB towards idle-land buybacks (estimated RMB500bn) will come with little spill-over effect near-term. The continued issuance of refinancing bond for debt swaps accelerated notably from the year beginning, but is mostly replacing the existing debt (Exhibit 27). In addition, the expected new funds directed to both infra and manufacturing investment (via special CGB and LGSB) are estimated only to be at close to trend growth of infra and manufacturing FAI, while those to the consumption took a small share in the whole package. After all, the fiscal expansion revealed in 2025 budget plan looks less exciting than what the headline suggests.

Not worried about policy determination for fiscal expansion medium-term

Fiscal reform on consumption tax to kick-start this year

Medium-term, another area to look at in the budget plan is the fiscal reform progress. During the Third Plenum held in July'24, policy makers highlighted deepening reforms to fiscal and tax systems. In the budget plan this year, it has been mentioned that the government will accelerate efforts to shift the collection link of consumption tax for some product categories to later stages and devolve it to local governments.

We see this as a major step in initiating the restructure of central and local governments' fiscal revenue collection. Although the near-term macro impact looks limited, its medium-term implication will be key to watch. We expect the gradual but progressing reform steps to help balancing the fiscal power between the central and local governments. More autonomy at the local level could also help boost incentives for local officials to provide a competitive and friendly business environment, in our view.

Robust on-balance sheet fiscal expansion likely from 2025 onwards

We also note that we are just entering the new era of on-balance sheet fiscal expansion. We expect the trend of a multi-year robust fiscal expansion to kick-start from 2025.

Three pieces of evidence to support this observation: 1) official budget deficit to break above the 3%-handle; 2) the issuance of ultra-long special CGB for the second straight year; and 3) the increase in local government debt ceiling last year.

In particular, the 4% fiscal budget deficit ratio is set at a multi-decade-high level, with a clear signaling effect. In previous years, when the government faced stiff headwinds on growth, it has either set a budget deficit higher than 3% or issued a standalone special treasury bond (separate of the budget deficit), or allow more quasi-government financing (via policy banks, local government financing vehicles, etc.). This time around, policy makers are willing to adopt both the on-balance sheet measures, marking a whole new fiscal regime, in our view.

In addition, the increase in debt ceiling for local governments in late-December 2024 was another significant measure, where the central government approved new quotas for local governments to issue special refinancing bonds to swap their "hidden debts". In our view, if we face new local government fiscal shortfall in coming years, further lifting of the ceiling is also possible. The central government will also be willing to bear more local government liabilities going forward.

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