# Insufficient Demand Remains the Main Challenge: Macroeconomic Policies Need to Be Intensified

CF40 Research Department

**Abstract:** *Recently, the China Finance 40 Forum and the China Center for International Economic Exchanges jointly held the 6th Bund Summit, during which a closed-door seminar was convened on the topic of China's Macroeconomic Outlook for the Second Half of 2024.*

*Experts at the seminar unanimously agreed that the most prominent issue facing China's economy remains the insufficient effective demand. The lingering impacts of the pandemic, ongoing contraction in the real estate market, and weaker-than-expected macroeconomic policy efforts are cited as the main reasons for this shortfall.*

*Experts highlighted the secondary harms of inadequate overall demand, such as the deterioration of the business environment in some regions. In an environment of insufficient demand, young people and newly established small and micro businesses are the most vulnerable. Stabilizing spending and credit, which requires a leading role from the government, is key to addressing this issue.*

*Therefore, the majority of experts recommended that increasing fiscal efforts is the most crucial measure to tackle insufficient demand at this stage. Fiscal expenditures should aim to meet the budget targets set at the beginning of the year, and, if necessary, increase the general public budget deficit. It is also suggested to continue reducing policy interest rates and, if necessary, utilize the central bank's balance sheet management capabilities. Additionally, efforts should be made from both supply and demand sides to stabilize the real estate market as soon as possible.*

## I. Insufficient Effective Demand Remains the Primary Problem in the Current Economic Performance

Experts unanimously believe that although China's economy remained generally stable in the first half of the year, the most prominent issue is still the insufficient effective demand, and the structural contradiction of "strong supply, weak demand" is very prominent. There are three main reasons for this issue.

Firstly, the impact of the pandemic has not fully subsided, and the consumption habits of the young and middle-aged population have not returned to normal, directly suppressing consumer demand. Experts point out that the pandemic and related industry policies have had a huge impact on the income and work status of the young and middle-aged working population, thereby changing their consumption behavior patterns. Therefore, before the pandemic, regions with a high proportion of young people and high population inflow showed stronger consumption growth; however, after the pandemic, this pattern reversed, with regions having a high proportion of young people and high population inflow showing weaker consumption growth.

Secondly, the real estate market continues to decline, residents are more cautious about buying houses, and real estate companies still face significant debt pressure. In 2021, when the real estate market reached its peak, sales amounted to 18.2 trillion yuan, but in 2023 it was only 11.6 trillion yuan, a contraction of 6.6 trillion yuan. In the first half of 2024, sales of new commercial housing in China fell by another 25%, potentially falling below 9 trillion yuan for the whole year. Experts believe that currently no dynamics have been found that can completely offset the demand gap formed by real estate. The "New Three" are difficult to fill the demand gap caused by real estate in terms of volume and scale. In addition, the continuous decline in real estate prices has also led to asset losses and a contraction in residents' balance sheets, which continues to affect residents' willingness to consume.

Lastly, macroeconomic policies not being as forceful as expected is an important reason for the insufficient effective demand. Several experts pointed out that in recent years China has indeed intensified its macroeconomic policies, including temporary measures such as interest rate cuts and reductions in the reserve requirement ratio, issuing one trillion yuan in ultra-long-term special government bonds, implementing large-scale equipment upgrades, and promoting consumer goods replacement. However, overall, the implementation strength, progress, and pace of macroeconomic policies have not met expectations, with the issuance and utilization of local bonds progressing significantly slowly. Especially given the current challenges facing China's economy, the intensity of current macroeconomic policies is clearly insufficient and has not fully played a role in stabilizing overall demand.

## II. Addressing Secondary Harms of Insufficient Aggregate Demand and Automatic Contraction Mechanisms

Experts point out that the academic community generally considers insufficient aggregate demand as a cyclical problem in the medium and short term. However, historical experience suggests that viewing insufficient demand as a cyclical issue requires prerequisite, specifically that the government can improve demand within a short period. Otherwise, the damage caused by insufficient demand to the economy can last for a long time, even evolving into a medium-to-long-term problem. The most classic example is the Great Depression that began in the United States in 1929. Initially, it was a very typical problem of demand shortage, but during the process of addressing the issue, U.S. government policies were markedly inconsistent, resulting in the country taking more than a decade to truly recover from the effects of the Depression.

In addition to causing issues such as a decline in corporate profits, difficulties in new job creation, a contraction of wealth, and an increase in financial risks, insufficient demand can also lead to various "secondary disasters". For example, some local governments seek non-tax revenues to compensate for fiscal revenue shortfalls, and some increase debts to enterprises when revenues fall short of expectations, all of which negatively impact the business environment. More importantly, in an environment of insufficient demand, the most affected are young people and newly established small and micro enterprises, because the least competitive in the labor market are often those just entering the workplace, and in the goods market, newly established small and micro enterprises are the least capable of withstanding market shocks. If these groups of young people and newly established small and micro enterprises continue to endure unemployment and bankruptcy, it is extremely detrimental to increasing productivity in the country and transitioning to an innovation-driven economy.

There are many initial causes of insufficient demand, but once it arises, insufficient demand itself becomes an independent market failure, leading to a vicious cycle of automatic contraction in the economic cycle. International historical experience shows that almost all instances of insufficient demand are accompanied by significant credit contraction, i.e., a substantial reduction in purchasing power, resulting in a vicious cycle of "income-expenses-credit," with credit contraction being the largest force of contraction. Therefore, the key to addressing insufficient demand lies in timely interrupting the above vicious cycle, and the crucial step in breaking the cycle is to stabilize spending and credit, which requires a leading role from the government.

## III. Policy Recommendations

First, fiscal policy should aim to meet the full-year targets for the general public budget and government fund budgets. If necessary, the size of the fiscal deficit should be increased. In the first half of the year, the growth rates of general public budget expenditures and government fund expenditures in China were significantly lower than the nominal GDP growth rate, primarily because both general public budget revenue and government fund budget revenue fell short of expectations. If the situation with fiscal revenues does not significantly improve in the second half of the year, then to meet the annual financial budget expenditure targets, it may be necessary to appropriately increase the fiscal deficit. Fiscal funds could be focused more on transferring payments to areas in difficulty, settling government arrears to enterprises, and supporting housing completion guarantees.

Second, continue to reduce policy interest rates, and if necessary, utilize the central bank's asset-liability management capabilities. By lowering policy rates, which would lead to a decrease in market interest rates and financing rates, this can stimulate effective demand from residents and businesses, help economic agents repair their balance sheets, and also reduce the cost of new government financing, thereby enhancing the efficacy of fiscal policy. An important mechanism for monetary policy to complement fiscal efforts is balance sheet management, i.e., a large-scale asset purchase program, which can release liquidity more directly to the market and also send a very clear signal for stable growth, helping to reverse the market's pessimistic expectations.

Third, be committed to simultaneous efforts on supply and demand to stabilize the real estate market.On the supply side, there needs to be a concerted effort to ensure housing deliveries, quickly issue guidelines for whitelisted project loans and due diligence exemptions to alleviate commercial banks' financing concerns, provide targeted guidance, and effectively alleviate corporate and project risks. On the demand side, there should be increased policy support for the acquisition of existing homes, and improvements to the refinancing policies for subsidized housing. These optimizations should further reduce loan interest rates, extend the duration of debt, and gradually address the interest rate differential between existing and incremental housing loans.