CIO View
CIO Flash

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Marketing material

China's rescue mission

Can the recent policy measures save China's growth target?

IN A NUTSHELL

— The Chinese government announced a body of measures to stimulate growth, putting the 5% GDP growth back in picture.
— The stimulus package includes monetary easing consisting of interest rate cuts and a reduction in the reserve requirement ratio, potential fiscal support and targeted measures for the real estate sector.
— While the stimulus has sparked a market rally, its long-term effectiveness is uncertain. The property market downturn and sluggish consumption pose significant challenges, and the full impact of the measures may not be evident until later in the year.

The Politburo unveils significant economic stimuli

In a bold move to counteract economic deceleration and rejuvenate market confidence, a coordinated effort by China's central bank unveiled a robust series of stimulus measures. A following pivotal Politburo meeting surprised with a strong commitment to the economic growth targets and, for the first time, aims to halt the decline and reach stabilization in the property market. These targets encompass substantial monetary and fiscal interventions to reach the target of the desired 5% in gross domestic product (GDP) growth. These announcements have led to the strongest rally in the blue-chip CSI300 index, which is now almost 30% above its February low. A lot of investors fearing to miss out on the impending rebound ahead of a week-long holiday, lifted the CSI300 index 8.5% at the close, taking its five-day gain to over 25% – the strongest on record.[1]

Among the key measures that helped the markets to gain such a pace is the People's Bank of China's (PBOC) implemented 50-basis point (bps) cut in the reserve requirement ratio for banks. This reduces the portion of reservable liabilities that commercial banks are required to hold rather than lend or invest. This cut is paired with a 20-basis point reduction in the 7-day reverse repo rate to 1.50%, both aimed at increasing liquidity and boosting demand to combat deflationary tendencies and spur economic growth.
While we have seen similar measures before, what is unprecedented in this attempt to increase liquidity is the newly introduced equity facility by the Chinese central bank. This facility allows non-banking entities to use high-quality equity holdings as collateral for loans from the central bank, with an initial quota of 500 billion (bn) Renminbi (RMB). Furthermore, listed companies can apply for refinancing loans for share buybacks, under a preliminary quota of 300 billion RMB. Its primary aim is to bolster market confidence, stimulate investments and alleviate liquidity constraints faced by businesses.[2]

The real estate sector has also seen significant interventions, with a 50-basis point reduction in mortgage rates for existing loans, expected to lower household interest expenses by RMB 150 billion annually. Thus the measure could not only help the property market but also increase scope private households capacity to consume, as the decrease in interest expenses would translate into 2.5% more annual disposable income for eligible households. More easing of home buying impediments were announced. While home purchase

[1] Source: See "China stocks set best month nearly decade stimulus cheer", as of 30th September, 2024, reuters.com
[2] Data is taken from Bloomberg Finance L.P. as of 9/30/2024 if not otherwise stated

restrictions in some of the tier-2 cities have been lifted, the difference this time is the easing measures in some tier-1 cities. Over the weekend, three tier-1 cities announced further easing measures: Guangzhou became the first tier-1 city to totally eliminate home purchase restrictions (HPRs), while for Shanghai and Shenzhen, the HPR easing was partial. The "powerful" message on the real estate space was the Politburo's call to "stop falling & stabilize" and not "stop falling & rise," which has created room for imagination for investors.

On the fiscal front, the stimulus package is expected to introduce targeted support to ease financial pressures on households and stimulate consumer spending. So far, extent and detail of planned fiscal stimulus is not known. Most likely, at least RMB 1-2 bn is expected to be spent to expand the consumer trade-in program ('old for new'), increase social spending and restructure local government debt [3] Size and specifics of the fiscal package have not been officially confirmed, with further details anticipated to be revealed later in October, as the proposed financing with ultralong Central Government special bonds needs budget changes. The consumer boost is likely aimed at supporting disposable income via reducing households spending on elder care, retirement, health, education, and affordable housing. Dealing with unemployment also has a high priority and there are respective measures to be expected. There might be additional direct payments to consumers to get a short-term lift. All in all, the absolute size of the fiscal program could be much larger. Additionally, new infrastructure projects might be announced, if urgency is felt to get a lift in Q4.

What to make out of this intervention?

Despite the myriad of monetary policies introduced, such as policy rate and down payment cuts, their effectiveness remains questionable. While these measures theoretically enable households to borrow at lower costs, the prevailing property market downturn curbs their willingness to increase leverage. Consequently, it's uncertain whether these initiatives will substantially revitalize economic activity.

This dampened outlook might be confirmed with the release of consumption and travel data in the future as minimal optimism exists for upbeat figures. The mid-October National People's Congress (NPC) meeting, however, is expected to shine a spotlight on potential fiscal deficit expansion, possibly lifting market sentiment. Alongside this, third-quarter earnings reports will be unveiled, possibly indicating a quarter-on-quarter decline for most companies. Yet, if overall market sentiment remains stable, investors could remain relatively undeterred, which would limit downside possibilities going forward.

To support domestic demand, enhanced financing for social welfare reforms could provide a sustainable boost to household financial stability. Given China's GDP growth target of around 5%, the recent policy implementations might yield positive demand effects, potentially starting to become evident by end of the year. Initially, the execution of earlier measures, such as the RMB 500 billion re-lending program for state-owned enterprises (SOEs) and local governments turning excess housing supply into social housing, alongside the July RMB 300 billion financing initiative for consumer subsidies, was sluggish. However, momentum for these initiatives has since increased, signaling a more promising economic outlook.

The pressing question is whether the potential fiscal program will significantly enhance market confidence beyond short-term effects. Additionally, the likely RMB 1 trillion. bank recapitalization and support to local government debt relief remain key areas of focus. If a fiscal pivot occurs, better coordination between fiscal and monetary policies may emerge. Given that the property downturn has reduced annual government income by around RMB 8.6 trillion and that personal and corporate income tax revenues have fallen more than 5% year-to-date, a fiscal stimulus exceeding those efforts might be necessary to compensate for the shortfall and stabilize the economy. Even with anticipated fiscal stimulus in the coming months, local governments will require time to identify viable investment projects.

[3] Source: See "Chinas central bank cuts banks reserve requirement ratio by 50 bps", as of 27th September, 2024, reuters.com

In summary, while the newly announced stimulus measures present a multifaceted approach to revitalize the economy, their success will depend on timely and effective implementation, alongside addressing the existing structural challenges within the housing market and broader economic landscape.

Asset-class implications

Equities:

It has to be noted that previous market rallies on the back of significant stimuli plans have yielded equally abrupt market movements, even if considering just the last three years. In all cases, market excitement soon lost momentum as stimuli programs lacked follow-on programs. If the current measures fail to wake up the domestic consumer's interest in spending savings again, the effect of the reforms might be short-lived. Though initially impressive due to the wide range of measures enacted, the results might still be insufficient in order to rekindle the consumer as essential parts of the domestic problems, like the strong decline in real estate prices, remain largely untackled. We consider the Chinese equity market to be optically cheap at a price-to-earnings ratio (P/E) of just 9.5x for 2025 which leaves positive re-rating potential on the table as long as market optimism about additional reforms does not fade away. Once initial optimism has been digested and no further structural reforms have been announced, Chinese equities might again prove to be a value trap with the current rally being short lived.

Credit:

Over the next three months, significant measures to stabilize the property market are expected to boost real estate-related credit instruments. Continued rate cuts across financial sectors—particularly in mortgages and deposits—suggest a trajectory toward "zero" monetary policy, benefiting credit markets by lowering borrowing costs. Additionally, managing the RMB exchange rate firmly against the USD aims to foster positive sentiment and attract foreign credit flows. Massive debt issuance by state-owned enterprises (SOEs) and corporations in local and off-shore markets should provide investment opportunities within fixed-income assets, as these entities seek to replenish their balance sheets and stimulate economic activity.

In the medium to long term, the performance of credit instruments will largely depend on domestic demand. The forthcoming data will be crucial; encouraging property sales and consumption figures could validate the government's measures and stabilize the credit market. Conversely, disappointing figures may lead to a significant unwinding of recent investments, mirroring the downturn observed in early 2023. Investors are likely to remain cautiously optimistic but highly reactive to economic indicators, underlining the importance of strategic positioning in credit markets to navigate potential volatility effectively.

Listed Real Estate:

The Chinese government has nearly exhausted most demand-side easing measures in an effort to support the real estate market. While removing home purchase restrictions has typically led to only short-term boosts in sales volume, sustained recovery in property sales will be key for sector performance. Recent data from the top 100 developers shows a deteriorating market, with a substantial decline in September. Though recent measures, including the easing of housing restrictions in tier-1 cities, may lead to a sales uptick in October, consistent improvement in the coming months is necessary to confirm a market bottom.

Challenges remain, especially with some dead inventory unlikely to see significant turnover due to location and quality issues. Additionally, it's not practical to expect the government to purchase all excess inventory. A silver lining is that Chinese banks have already recognized a significant portion of this dead inventory in their non-performing loans, mitigating some financial risk. Land acquisitions by listed state-owned-enterprises will be a critical indicator of market stabilization. Despite overall sales declines, state-owned-enterprises have performed better than private developers and may lead in land banking if a sustainable sales recovery occurs, signaling a potential market rebound.

Glossary

One basis point equals 1/100 of a percentage point.

Collateral refers to an asset that a lender accepts as a security for a loan.

The CSI 300 Index includes the 300 largest companies of the Chinese mainland, that is companies listed on the Shanghai and Shenzhen Stock Exchange (so called A-shares).

Deflation is a sustained decrease in the general price level of goods and services.

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

The gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

People's bank of China (PBoC) is the central bank of China.

Renminbi (RMB) is the currency of the People's Republic of China.

Reverse repo operation describes the purchase of securities with the agreement to sell them at a higher price at a specific future date.

A state-owned enterprise is a legal entity that executes commercial activities on behalf of an owner government.

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