

China Policy

New stimulus package to revive economy

The latest policy moves indicate China's new stimulus package to revive the economy as top leaders start to recognize the severe challenges. The policy package includes monetary stimulus, fiscal loosening, pro-business measures, property support and stock market boost. The monetary stimulus as the first arrow beats expectations while the fiscal loosening as the second arrow is basically in line with expectations. The latest policy moves centre on boosting stock market, stabilising property market, relieving local fiscal distress and enhancing banking system stability, while support to households and consumption is limited. To revive and reflate the economy, China needs to gradually shift its policy focus to boosting consumption and defying deflation. Additional policies are needed including fiscal transfers to households and excessive capacity reduction. Meanwhile, the market-oriented reform should be the third arrow to restore animal spirit amid the trend of state domination in resource allocation and SOE rise in economic system.

■ **China is launching new stimulus package to revive economy.** After the NDRC's disappointing press conference last Tuesday (8 Oct), a WeChat public account named "Sanlihe" published an article trying to repair the damaged confidence¹. "Sanlihe" is a famous street in Beijing where the NDRC is located. The article is written by a former NDRC official and includes policy information the central planning agency wants to show to the market. The article indicates that top leaders decided at the politburo meeting on 26 October to launch a comprehensive package of policies to revive the economy. The policy package includes five key points: 1) to increase countercyclical loosening of monetary and fiscal policies; 2) to expand domestic effective demand; 3) to support enterprises and improve business environment; 4) to stop the property market decline for systematic risk relief; and 5) to boost stock market for confidence revival. Therefore, China's policy stance is shifting from conservative easing to strong loosening with the target to stabilize property market, boost stock market, expand domestic demand and restore business confidence. We do not know the specific trigger for the policy shift. It seems the top leaders start to recognize the severe challenges facing the economy as property market continued to slump, SOE earnings sharply declined, fiscal income fell short of budget, local governments faced difficulty in wage payment, former PBOC governor Yi Gang openly warned deflation risk and more experts seriously discussed how many years China's economy might lose like Japan.

■ **Monetary stimulus as the first arrow beats expectations.** The announced monetary stimulus policies at the PBOC's press conference on 24 September include: 1)RRR cut by 50bps; 2) 7D repo refinancing rate cut by 20bps and MLF rate cut by 30bps; 3)existing mortgage rate cut by 50bps; 4)second-home mortgage down-payment ratio reduction from 25% to 15%; 5)LPR and deposit rate cut by 20-25bps; 6)special refinancing loans to banks to support local SOEs to buy unsold homes;7)special refinancing loans to banks to support listed companies or their large shareholders to purchase stocks; and 8)a swap refinancing mechanism to support brokers, fund managers and insurance companies to buy stocks. By signalling an important policy shift towards strong loosening, the announced monetary policies have boosted investor confidence, caused a rally in Chinese stocks and lifted housing market sentiment in tier-1 cities. Looking forward, the PBOC might cut RRR and LPRs by another 50bps and 20bps respectively by end-2025 as China's economy continues to face slowdown and deflation pressure and the US Fed further lowers its policy rate into next year. Due to a moderate shrinkage of

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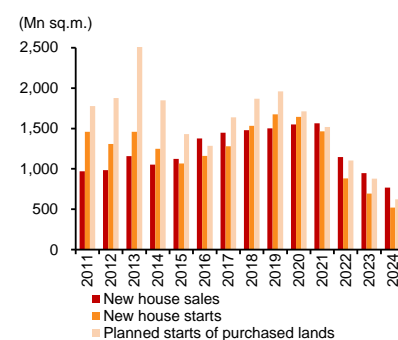
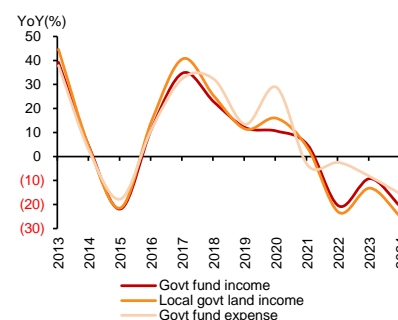
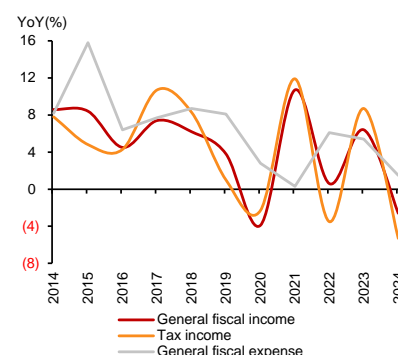
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¹ <https://m.chinanews.com/wap/detail/cht/zw/10299066.shtml>

US-Sino nominal GDP growth differentials and interest rate spreads, RMB might mildly rebound against US dollar in the next five quarters. We expect US\$/RMB to reach 7.05 at end-2024 and 7 at end-2025.

- **Fiscal loosening as the second arrow is in line with expectations.** At the press conference on 12 October, the MoF briefly introduced the framework of additional fiscal policies while kept most policy details in secret as most proposed policies still need the approval of the NPC Standing Committee at its meeting in late October. Firstly, local governments will be allowed to issue more bonds to replace their hidden debts. Local government hidden debts recognized by the MoF dropped by 50% from 2018 to 2023 mainly due to the MoF's strict identification standard. The MoF said the hidden debt replacement quota should be the highest in recent years. We expect total quota might reach RMB5-10tn, compared to RMB3.4tn in 2023-2024 and RMB12.2tn in 2015-2018. The debt replacement policy is stronger than expected as it will increase local government financing, reduce LGFV debt with additional borrowing capacity and support broad government expenditure. Local governments, LGFVs, local SOEs and government suppliers will benefit from this policy. Secondly, local governments can use money from special bonds to buy unsold homes or undeveloped lands and turn them into subsidized houses. This is not a new policy as local governments or SOEs have been reluctant to take risks to implement the program in the past. Unless the policymakers resolve the incentive problem, the impact of the policy would be limited. Thirdly, the MoF will inject capital into the six largest state-owned banks to strengthen banking system stability and improve banks' lending capacity. We estimate the injected capital might reach around RMB1tn or 7.7% of the six banks' total core tier-1 capital. The capital injection could help banks to clean toxic assets in their BS, improve investor confidence about China's banking system and increase banks' lending capacity to real sector. Fourthly, the MoF will increase subsidies to college students after giving one-off cash handouts to residents in extreme poverty. Those fiscal transfers to targeted individuals are quite limited as their total amount should be less than RMB50bn. Lastly, the MoF said central government still has large room to raise deficit and debt, but did not offer more specifics. The MoF's press conference indicates additional fiscal policies centre on resolving local fiscal distress and banking system instability after the property slump but new stimulus on consumption is quite limited. Local governments will have higher broad deficit quotas, but central government remains cautious on increasing its broad deficit.
- **China needs to gradually shift its policy focus to boosting consumption and defying deflation.** The latest policy moves centre on boosting stock market, stabilizing property market, relieving local fiscal distress and enhancing banking system stability, while support to households and consumption is limited. It is reasonable as property sector remains the major drag on economy while boosting stock market seems the easiest way to improve confidence. Property and stock markets as leading indicators for the business cycle are determined by economic prospect in future. Sluggish consumption and continued deflation is the weakness of China's economy. China needs to gradually shift its policy focus to boosting consumption and defying deflation. Additional policies are needed including fiscal transfers to households to boost consumer demand and excessive capacity reduction to reflate the economy.
- **Market-oriented reform is needed as the third arrow to restore animal spirit.** Chinese policymakers try to restore business confidence by showing pro-business stance, launching private sector promotion law, correcting local governments' misbehaviours against private business interests and managing tensions with the western countries. But China needs to do more in market-oriented reforms to invert the trend of state domination in resource allocation and SOE rise in economic system. Only in this way could China continue to improve its total factor productivity to offset the negative impact of aging population and deteriorating capital yield on the economy.

Figure 1: China's economic indicators

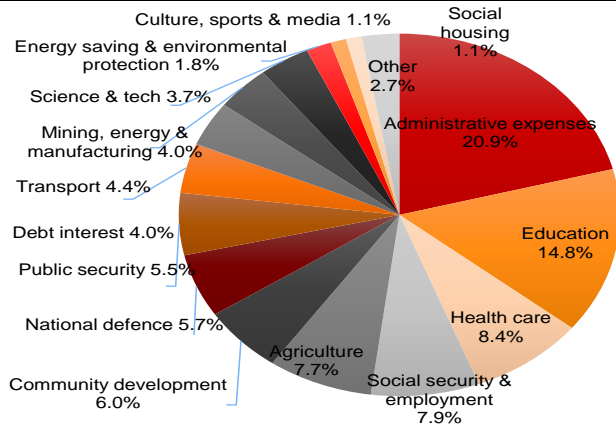
YoY(%)	2017-2019 CAGR	2020-2021 CAGR	2022-2023 CAGR	2024-2025 CAGR	2022	2023	2024F	2025F
Real GDP	6.5	5.3	4.1	4.8	3.0	5.2	5.0	4.6
GDP deflator	3.0	2.5	0.6	0.3	1.8	(0.5)	(0.3)	1.0
Nominal GDP	9.7	7.9	4.7	5.2	4.8	4.6	4.7	5.6
Urban employment	2.5	1.7	0.3	1.4	(1.8)	2.4	1.6	1.3
Non-farm employment	0.9	0.7	(0.4)	0.7	(3.3)	2.6	0.8	0.6
Freight transport volume	7.3	5.8	2.4	4.3	(3.1)	8.2	4.4	4.3
Passenger flow	(2.5)	(31.3)	5.8	10.5	(32.7)	66.5	12.0	9.0
Housing sales volume	2.9	2.2	(16.8)	(7.9)	(24.3)	(8.5)	(13.0)	(2.5)
Local govt land income	25.1	9.5	(18.4)	(10.1)	(23.3)	(13.2)	(15.0)	(5.0)
Corporate income tax	8.9	6.1	(1.1)	1.9	3.9	(5.9)	(2.0)	6.0
Total profit in manufacturing	6.8	19.0	(7.9)	6.0	(13.4)	(2.0)	5.0	7.0
SH-SZ 300 index EPS	10.3	(0.2)	(4.7)	5.4	(5.3)	(4.2)	1.0	10.0
Hang Seng Index EPS	9.9	(7.3)	(4.7)	5.2	(9.1)	(0.0)	4.0	6.5

Source: Wind, CMBIGM

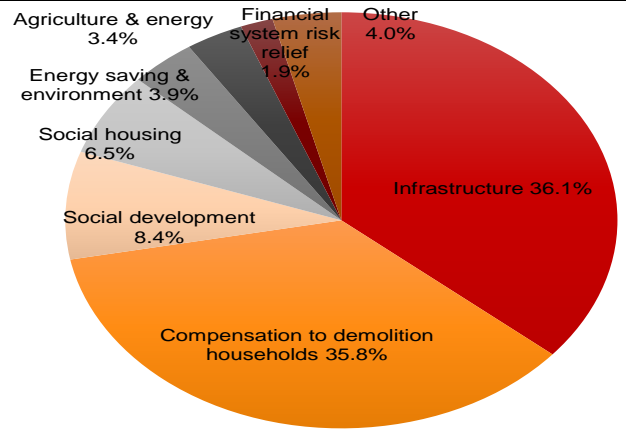
Figure 2: China's broad fiscal system

(as % of GDP)	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024 plan
General fiscal revenue	22.1	21.4	20.7	19.9	19.3	18.0	17.6	16.9	17.2	17.0
General fiscal expenditure	25.5	25.2	24.4	24.0	24.2	24.2	21.4	21.6	21.8	21.6
expenditure-revenue	3.4	3.8	3.7	4.1	4.9	6.2	3.8	4.7	4.6	4.7
Government fund revenue (ove	6.1	6.2	7.4	8.2	8.6	9.2	8.5	6.5	5.6	5.4
Government fund expenditure	6.1	6.3	7.3	8.8	9.3	11.6	9.9	9.2	8.0	9.1
expenditure-revenue	0.0	0.0	(0.1)	0.6	0.7	2.4	1.3	2.7	2.4	3.7
State capital system revenue	0.4	0.3	0.3	0.3	0.4	0.5	0.4	0.5	0.5	0.4
State capital system expendit	0.3	0.4	0.2	0.2	0.2	0.3	0.2	0.3	0.3	0.2
expenditure-revenue	(0.1)	0.0	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)	(0.3)	(0.2)
Social insurance revenue (exc	5.2	5.2	5.5	6.7	6.5	5.5	6.5	6.6	7.0	7.1
Social insurance expenditure	5.7	5.8	5.8	7.3	7.6	7.7	7.5	7.5	7.9	8.1
expenditure-revenue	0.4	0.6	0.3	0.7	1.1	2.3	1.1	0.9	0.9	1.0
Broad fiscal revenue	33.9	33.2	34.0	35.1	34.8	33.2	33.1	30.4	30.3	29.8
Broad fiscal expenditure	37.7	37.6	37.8	40.4	41.3	43.9	39.0	38.6	38.0	39.0
Broad fiscal deficit I	3.8	4.4	3.8	5.2	6.5	10.7	5.9	8.2	7.7	9.2
LG debt swap	4.6	6.5	3.3	1.4	0.2	0.1	0.4	0.4	1.1	1.0
LGFV bond financing	1.6	1.7	0.6	0.2	1.0	1.8	1.7	0.7	0.7	0.7
Broad fiscal deficit II	10.0	12.6	7.8	6.9	7.7	12.6	8.1	9.3	9.4	10.9

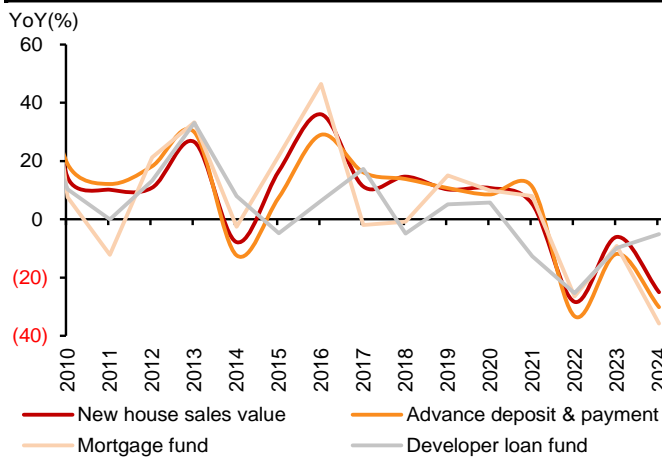
Source: Wind, CMBIGM

Figure 3: General fiscal expense mix

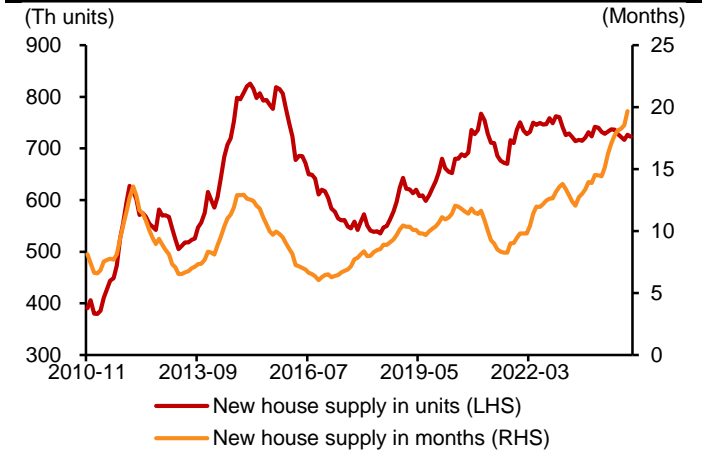
Source: Wind, CMBIGM

Figure 4: Government fund expense mix

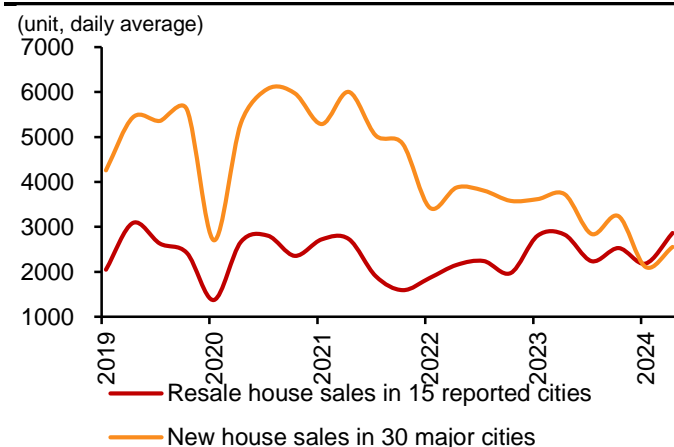
Source: Wind, CMBIGM

Figure 5: New house sales & development funds

Source: Wind, CMBIGM

Figure 6: New house supply in 10 largest cities

Source: Wind, CMBIGM

Figure 7: Daily average house sales in cities

Source: Wind, CMBIGM

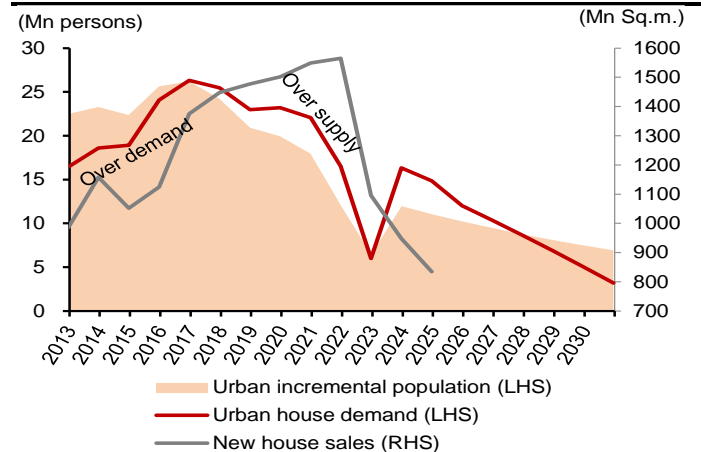
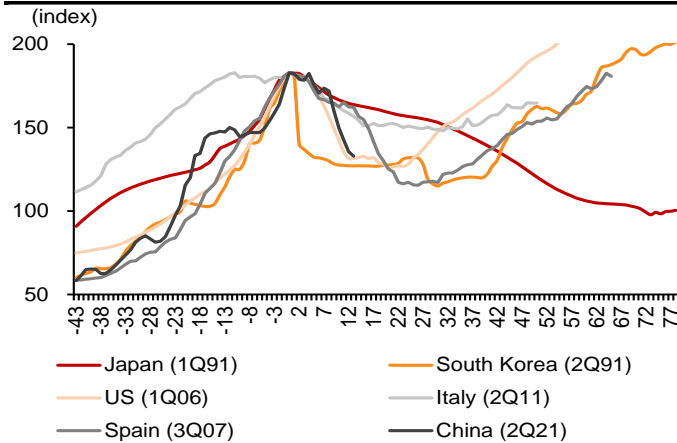
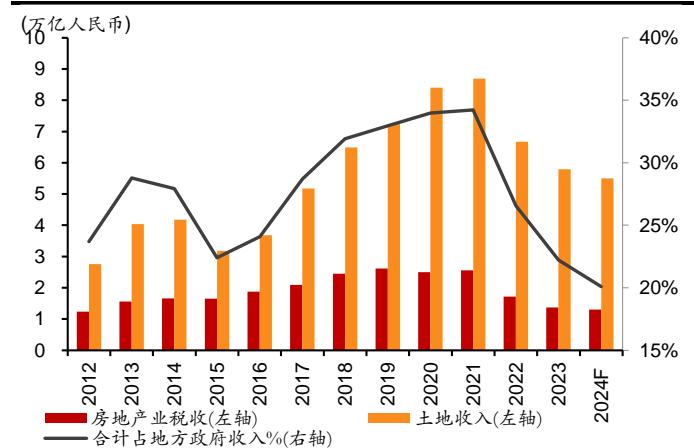
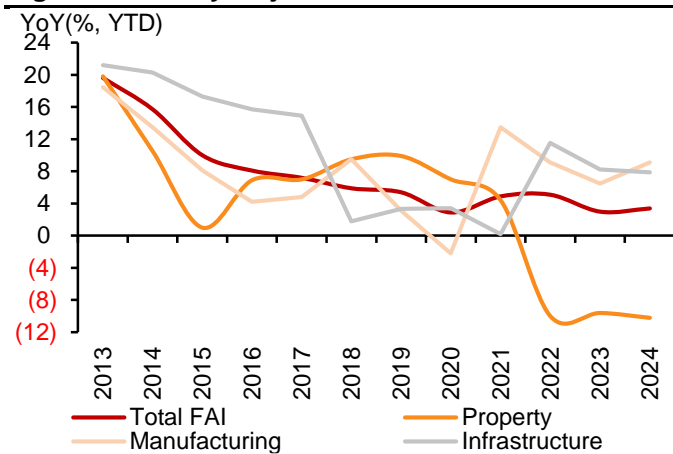
Figure 8: Urbanisation & incremental house demand

Figure 9: House prices around the peaks

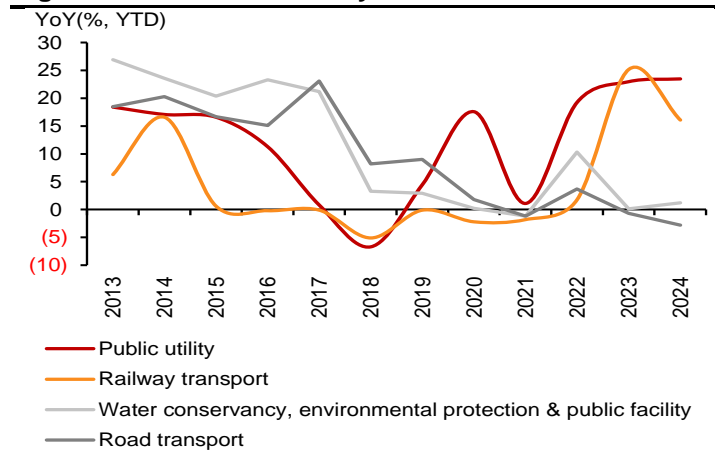
Source: Wind, CMBIGM

Figure 10: Property-related income for local govts

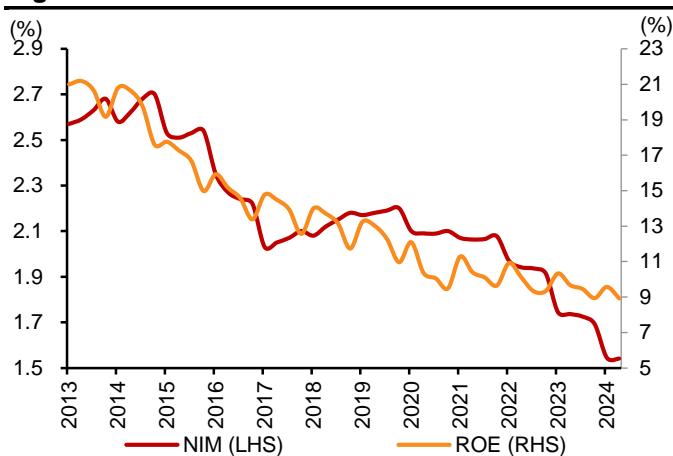
Source: Wind, CMBIGM

Figure 11: FAI by major sector

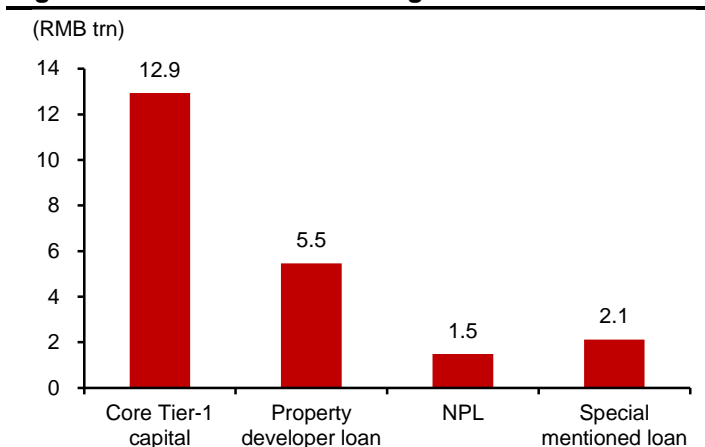
Source: Wind, CMBIGM

Figure 12: FAI dominated by central & local SOEs

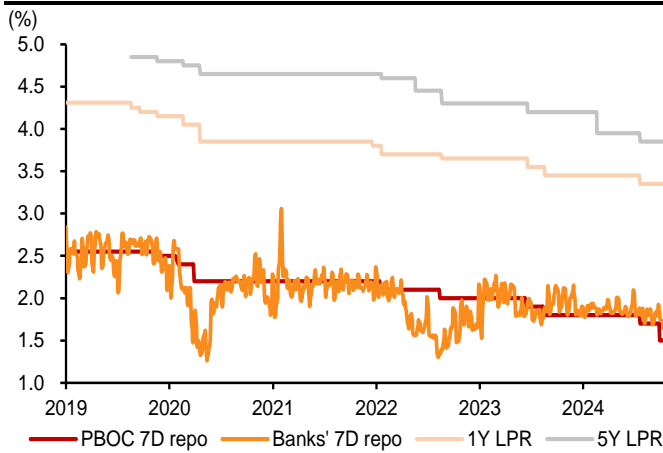
Source: Wind, CMBIGM

Figure 13: Chinese banks' NIM & ROE

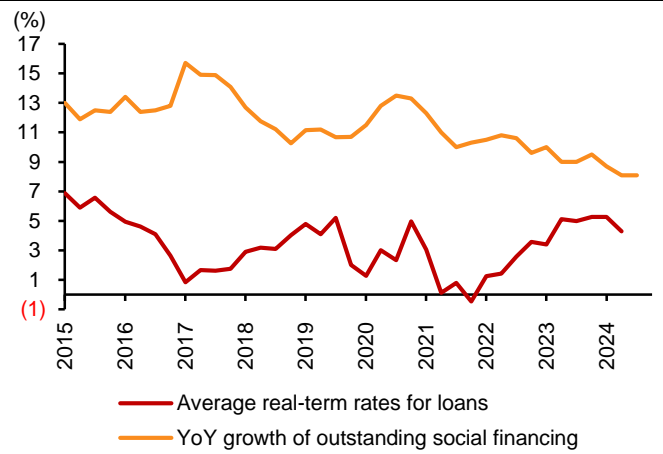
Source: Wind, CMBIGM

Figure 14: Indicators of the 6 largest state-owned banks

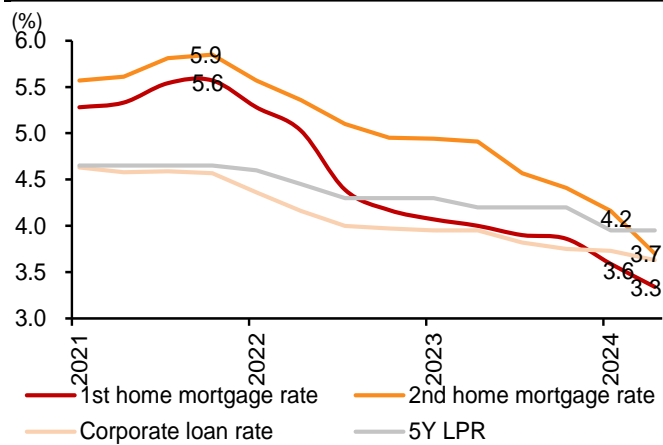
Source: Wind, CMBIGM

Figure 15: PBOC policy rates

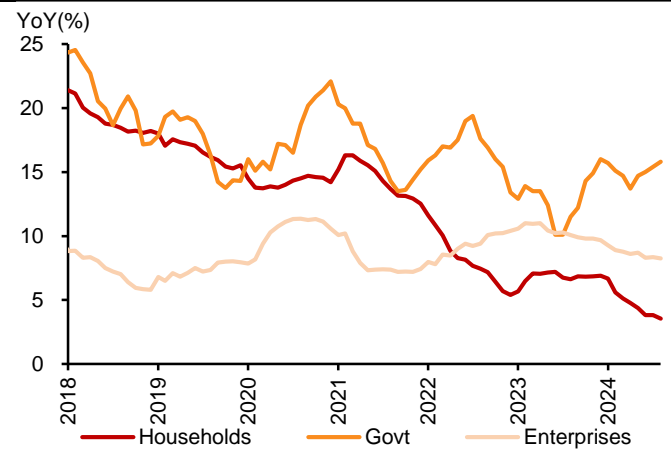
Source: Wind, CMBIGM

Figure 16: Real-term loan rate & social financing growth

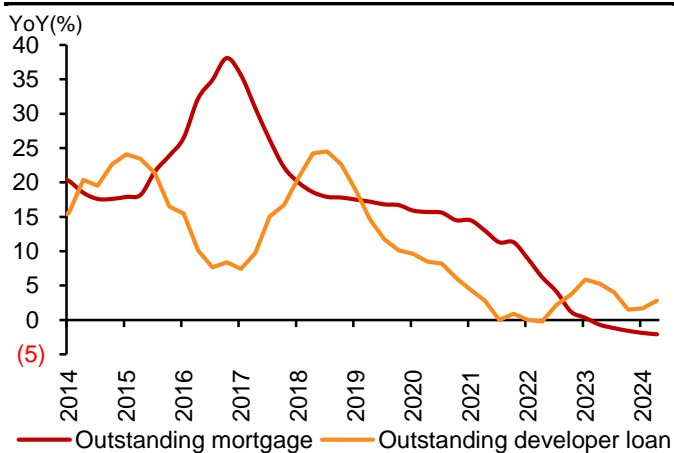
Source: Wind, CMBIGM

Figure 17: New mortgage rates & 5Y LPR

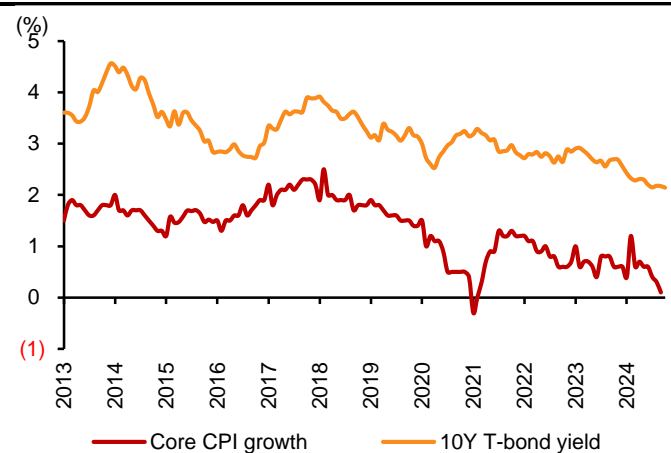
Source: Wind, CMBIGM

Figure 18: Real sector debt growth

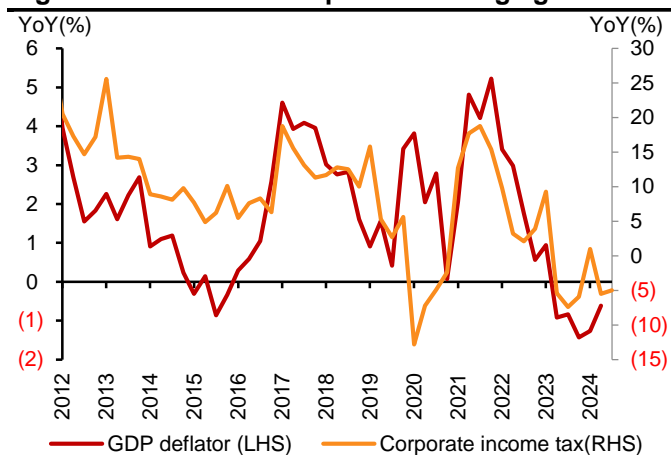
Source: Wind, CMBIGM

Figure 19: Property loan growth

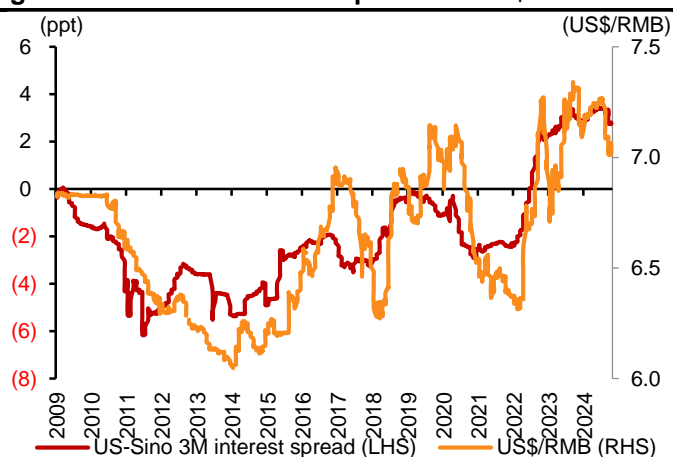
Source: Wind, CMBIGM

Figure 20: Core inflation & 10Y T-bond yield

Source: Wind, CMBIGM

Figure 21: Inflation & corporate earnings growth

Source: Wind, CMBIGM

Figure 22: US-Sino Interest Spreads & US\$/RMB

Source: Wind, CMBIGM

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