China Policy

RRR cut as continuous effort to restore confidence

The RRR cut indicates Chinese policymakers' continuous effort to boost market confidence and growth momentum as the latest policy easing failed to ignite investor sentiment. The policy move will increase banking system liquidity and facilitate credit supply expansion as a continuous policy loosening signal. When market confidence slumped to a freezing point with investors expecting China to move towards Japanization, the policymakers need to make great efforts to reverse the sentiment. The RRR cut shows their stronger commitment to restoring confidence and growth as we expect continuous easing or supportive policies on the way. The PBOC may continue to expand credit supply with additional cuts on deposit rates & LPRs and municipal governments will further loosen property policies in next two quarters.

- **The RRR cut indicates continuous monetary policy easing to boost market confidence.** The PBOC cut the RRR by 25bps as the effective weighted average RRR is expected to decline from 7.6% to 7.4%. The RRR cut would increase liquidity supply in the banking system by over RMB500bn. The policy move indicates China's continuous effort to boost market confidence and growth momentum. The policy stance has become more active and pro-growth since July as the extremely pessimistic expectations about China's economy have created much pressure on the policymakers. The recent policy actions should have marked a significant change of the policy attitude from the top leaders, paving the way for stronger policy loosening ahead, which may be the strongest stimulus cycle since 2017.
- **We expect additional easing or supportive policies in the future.** To restore market confidence, China needs additional easing or supportive policies. The policymakers may: 1) further loosen property policies, with an acceleration of urban village renovation and affordable housing construction and loosening of home purchase restrictions in tier-one and tier-two cities; 2) maintain liquidity easing with further expansion of credit supply and reduction of the RRR, deposit interest and LPR; 3) actively resolve the local government contingent debt risks by supporting local governments to use special bond financing and state-owned assets to replace or repay some contingent debts and encouraging banks to rollover matured local government contingent debts; 4) accelerate the issuance of government bonds, employ part of the debt quota for next year in advance in 4Q, and increase broad fiscal deficit rate next year to facilitate fiscal expansion; 5) boost the retail sales of automobiles, electronic products, and home furnishing, and stimulate service consumption such as sports, leisure, and cultural tourism; 6) focus on industries such as digital economy, artificial intelligence, and advanced manufacturing and increase the intensity of industrial policy support; 7) establish and improve the normalized communication mechanism with entrepreneurs and enhance the confidence of private businesses.
- **The current policy easing cycle may last longer than the previous ones as the policy effectiveness on economic growth declines.** China launched two rounds of strong stimulus in the past two decades with one in 2008-2009 and the other in 2015-2016. After the stimulus, the economy experienced a recovery cycle for 1.5-2 years and then continued with the structural slowdown trend. Nowadays, the policy effectiveness on economic growth further

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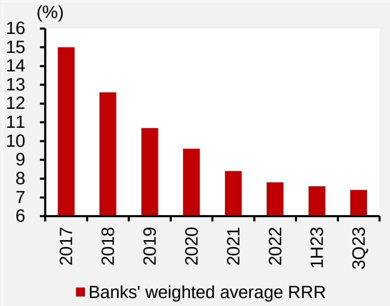

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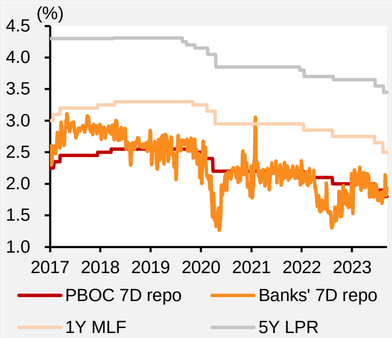

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declines with more aging population, less labor supply, weaker market-oriented incentive and greater geopolitical uncertainty. That means the current policy easing cycle may last longer than the previous ones if the policymakers continue to seek growth at around 5% in next two years.

Figure 1: RRR Cuts From 2021

Date	Effective date	RRR change	WA RRR	Incremental liquidity
9/14/2023	9/15/2023	0.25ppt for most banks	7.4%	Rmb500bn
3/17/2023	3/27/2023	0.25ppt for most banks	7.6%	Rmb500bn
11/25/2022	12/5/2022	0.25ppt for most banks	7.8%	Rmb500bn
4/15/2022	4/25/2022	0.25ppt for most banks and 0.5ppt for regional banks	8.1%	Rmb530bn
12/6/2021	12/15/2021	0.5ppt for almost all banks	8.4%	Rmb1.2trn
7/9/2021	7/15/2021	0.5ppt for almost all banks	8.9%	Rmb1trn
4/3/2021	4/15/2021 & 5/15/2021	1ppt for regional banks	9.4%	Rmb400bn

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Figure 2: Effective RRR & Excess Reserve Ratio

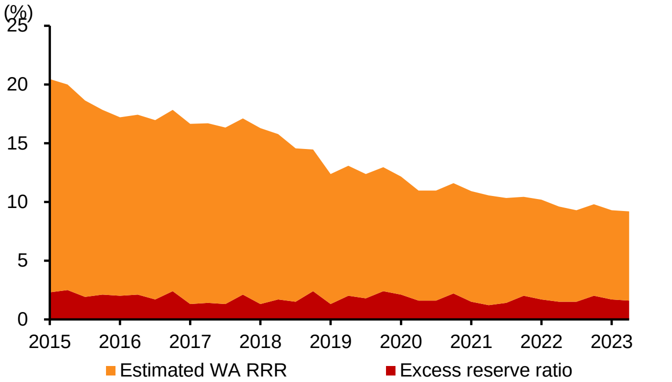

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Figure 3: PBOC Claims to Banks

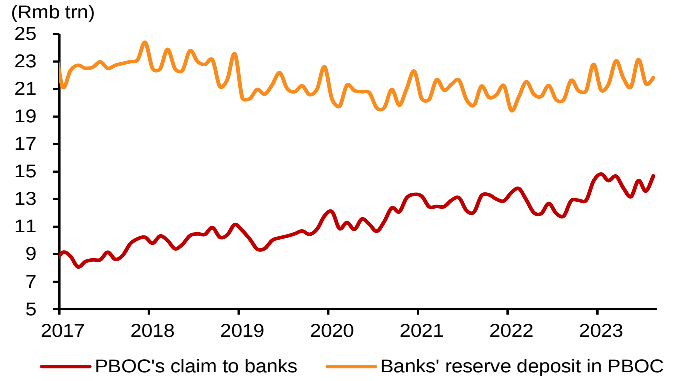

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Figure 4: Liquidity Condition & M2 Growth

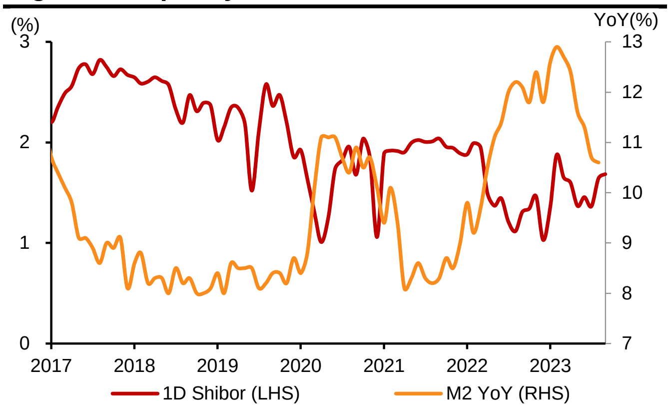

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Figure 5: Money Market Rates

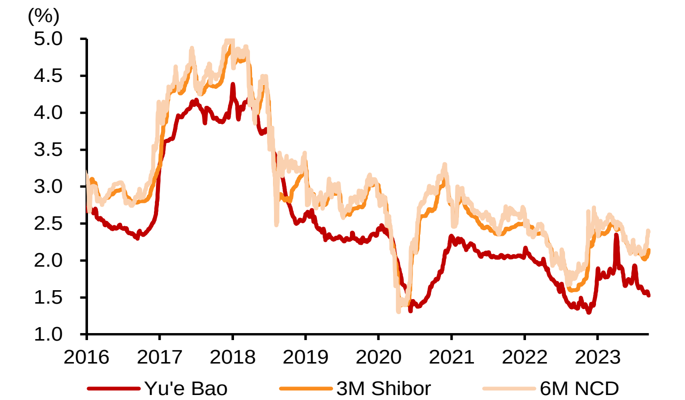

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Figure 6: Bond Yield Rates

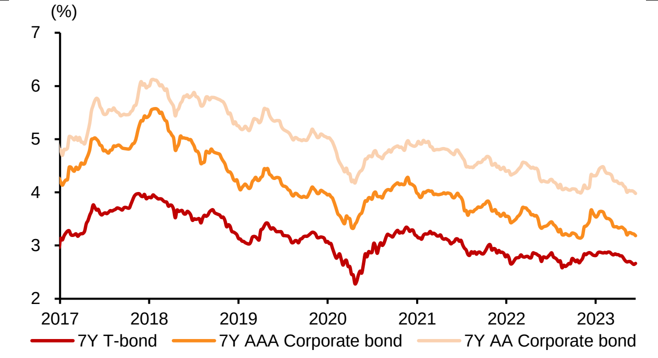

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Figure 7: Average Outstanding Loan Rates

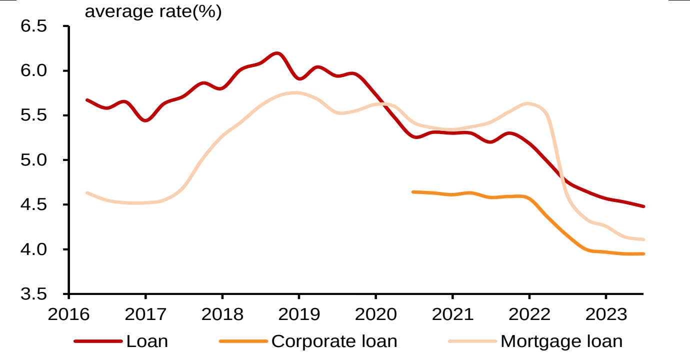

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Figure 8: Credit Growth

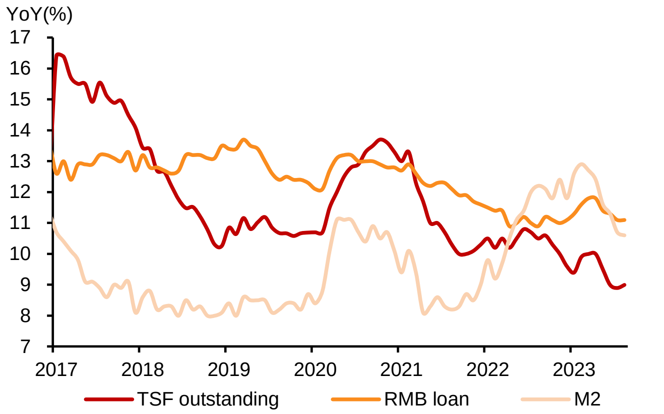

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Figure 9: Core CPI Growth & T-bond Rates

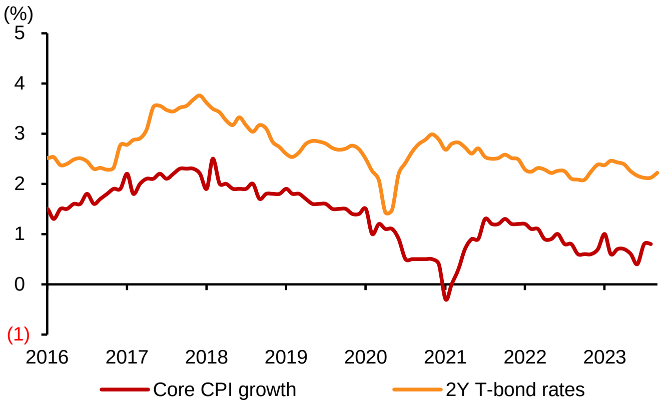

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Figure 10: Unemployment & House Rent Growth

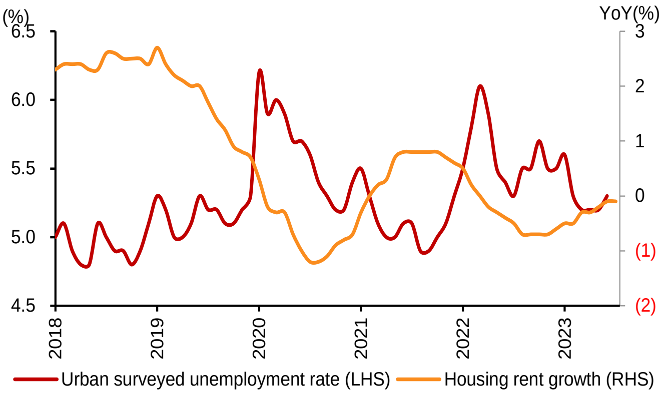

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Figure 11: Housing Sales Recovery Ratio to 2019

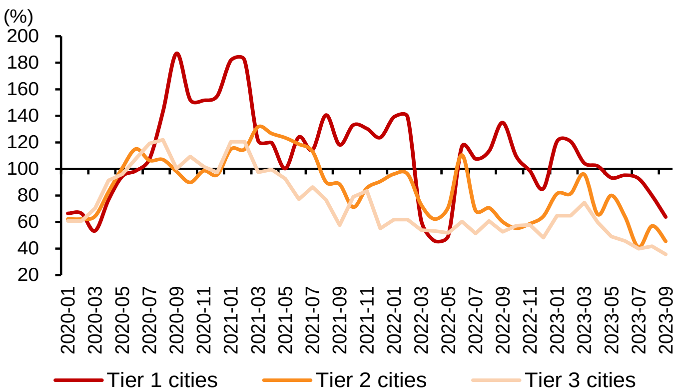

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Figure 12: EM Volatility & North Fund Flow

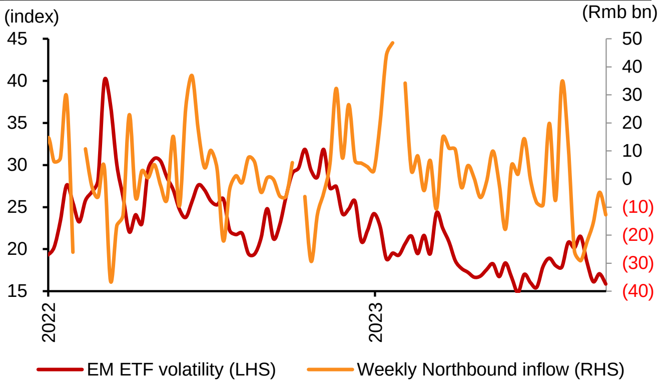

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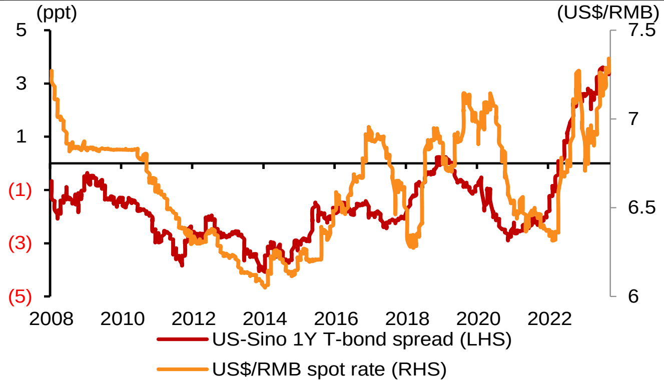
Figure 13: US/RMB Rates & Interest Spreads



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