

China Policy

Tentative signs of policy shift to demand side

China has shown tentative signs of policy shift towards demand-side stimulus from supply-side upgrading, which is positive for the market. After the PBOC cut 5Y LPR more than expected to boost housing market, President Xi announced to launch large-scale renewal in producer equipment and consumer durables on a meeting last Friday (23 Feb). We see positive changes on the policy side as the policymakers may have realised the major challenge for China's economy is not in the supply side but in the demand side, in terms of slumping property sales, weak consumer demand and continuous deflation. We maintain our forecast on the policy side (additional RRR cuts by 50bps in total, LPR cut by 10bps in remainder of the year and broad fiscal deficit at 7.1% of GDP in 2024), yet see possible upside surprise on the policy side.

- **Producer equipment upgrading plan.** During the meeting last Friday, it was indicated that China would start a new round of producer equipment upgrading. Possible policies include tax credit, fiscal subsidy and low-cost special loans to manufacturers and businesses to replace or upgrade their plant and equipment. Capital goods like ordinary equipment, special equipment, NC machine tools and industrial robots may benefit from the policies.
- **Consumer durable replace program.** China would launch large scale of consumer goods replacement program. Policies may include fiscal subsidy to consumers to replace their used autos and home appliances. The top leader required at the meeting that the MoF and local governments should coordinate efforts to ensure the replacement can benefit consumers in a more extensive way. Although the detail is still unknown, major progress has been made as the central government will join in funding the program. As local fiscal condition remains challenging, the MoF's participation will improve the stimulus effect of the program. Autos and home appliances should benefit from the replacement program.
- **Three approaches to reduce logistics costs.** Firstly, to adjust transportation structure by improving the utilization of railways and waterways beside roadways. Secondly, to accelerate the development of new logistics models involving the platform economy, low-altitude economy and unmanned driving. Thirdly, to support the development of airport and port economies. Sectors related to new logistics models should benefit from the policies. The policy risk for logistics prices should be low as the top leader emphasized the market-oriented principle in related policies.
- **Major challenge for China's economy.** The recent policy moves may mark a possible change in the policymakers' focus as they may have realised the major challenge for the economy is in the demand side. Property market continued to slump, household consumption remained weak while deflation pressure increased. If these trends persist, the concern of possible Japanesization would continue to erode business and consumer confidence. Meanwhile, China faces increasing diplomatic pressure from western countries to boost its domestic demand as those countries continue to make progress in disinflation. China's excess capacity and continuous deflation is a strong stimulus for its exports to global market, which is a hot topic in the US and EU. According to Financial Times, a US delegation addressed its concerns on China's excess manufacturing capacity in a recent visit to China. Last Friday, the Appliance for American Manufacturing said in a report that the US government should block the import of low-cost Chinese autos and parts from Mexico.
- **Policy outlook.** Reasonable policy options for China should be aggressive mortgage rate cuts to stabilize housing market, substantial fiscal transfers to

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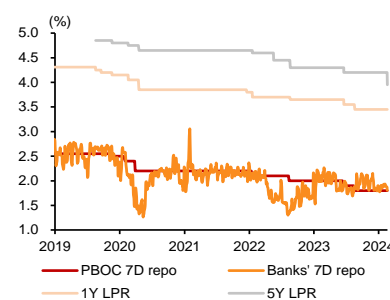
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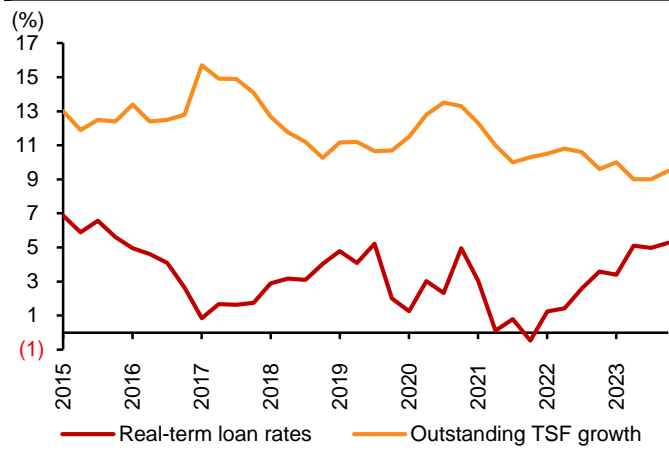
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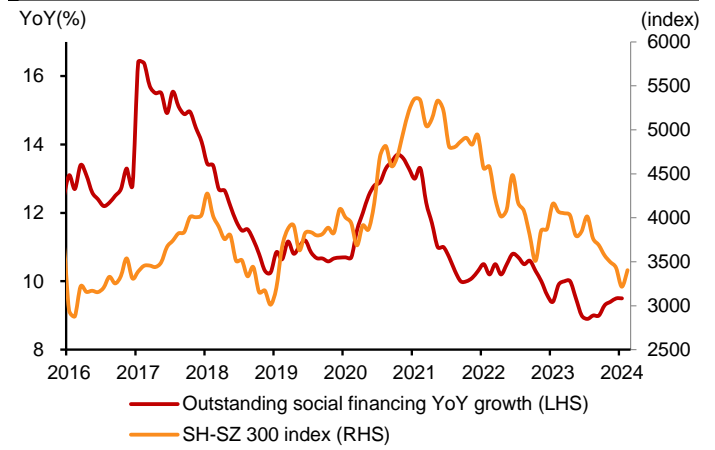
households to boost consumption, strong market-oriented structural reforms to revive animal spirits and continuous market opening & diplomatic efforts to lower geological tensions. Capital market dynamics and economic prospect will highly depend on the progress in the above policies. For interest rate policy, the policymakers must overcome the fear of floating exchange rates and reduce deposit rates more aggressively. For fiscal policy, the policymakers should change the conservative mind or significantly restructure fiscal expenditure. We maintain our forecast (additional RRR cuts by 50bps in total and LPR cut by 10bps in the remaining of the year and broad fiscal deficit at 7.1% of GDP), yet see possible upside surprise on the policy side.

Figure 1: Real-term loan rates and TSF growth



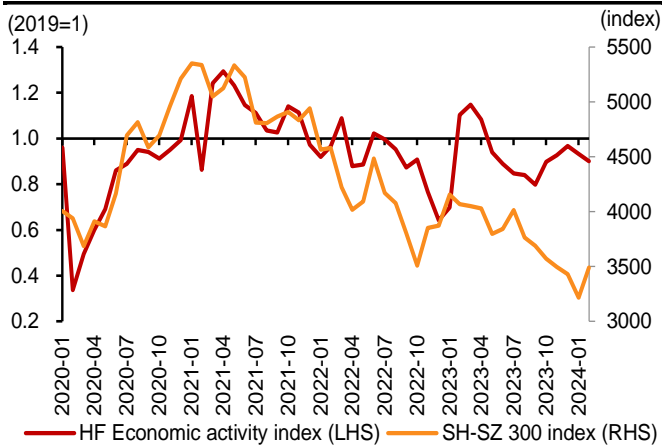
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Figure 2: TSF growth and A share index



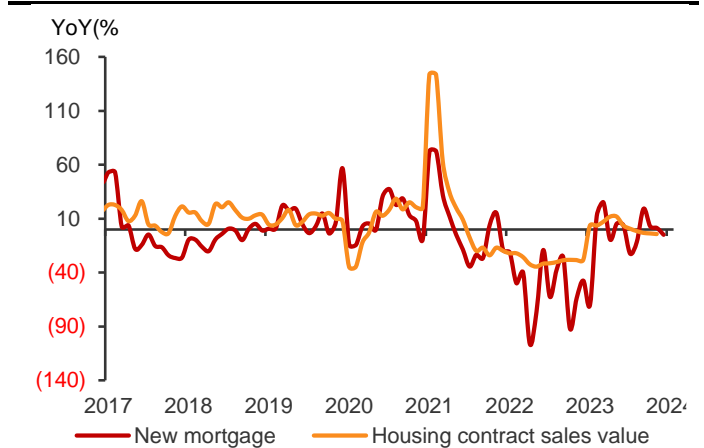
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Figure 3: Economic activity & A share index



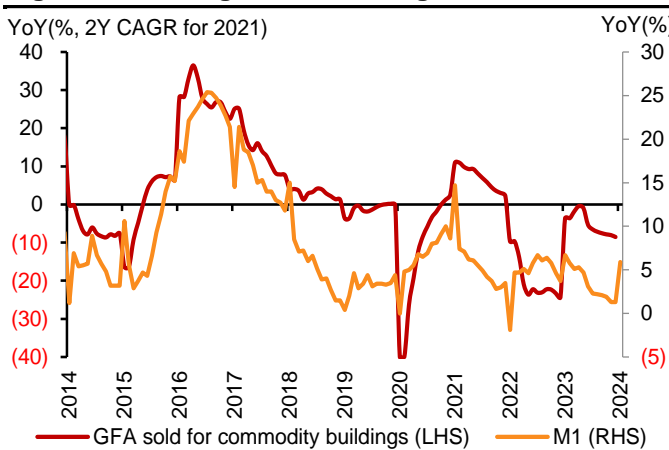
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Figure 4: New mortgage and housing sales value



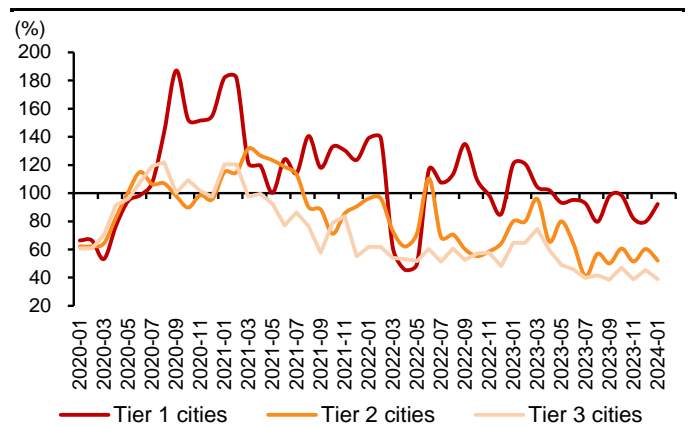
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Figure 5: Housing sales and M1 growth



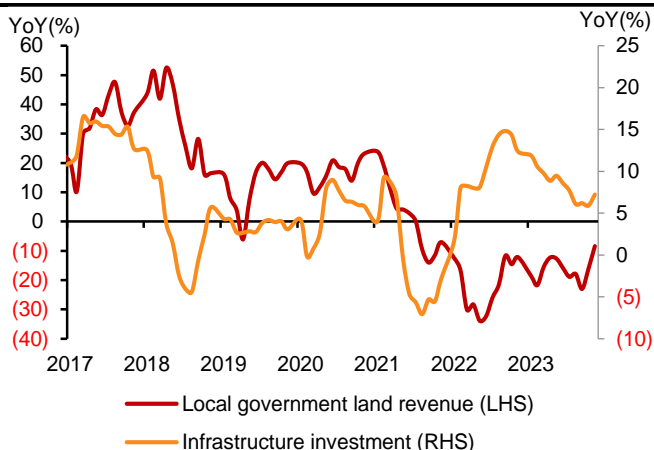
Source: Wind, CMBIGM

Figure 6: Housing sales recovery ratio compared to 2019



Source: Wind, CMBIGM

Figure 7: Land market & infrastructure investment



Source: Wind, CMBIGM

Figure 8: GDP deflator & CPI growth

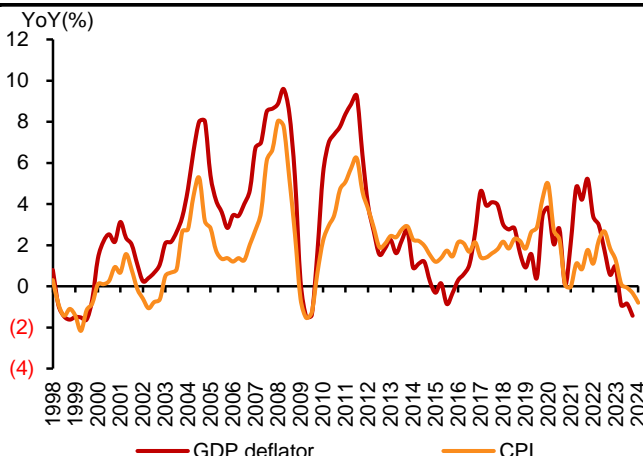
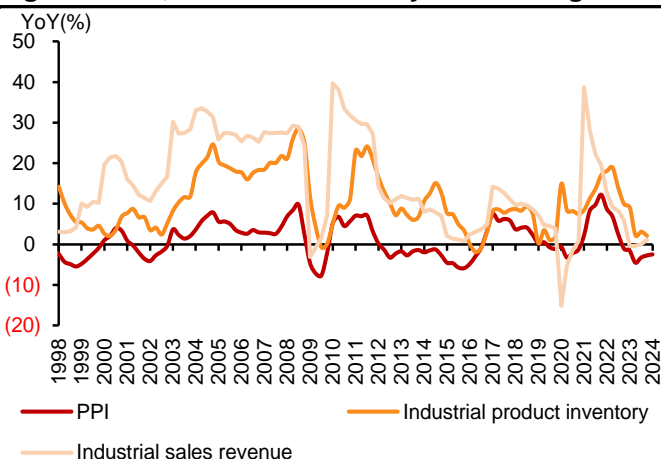
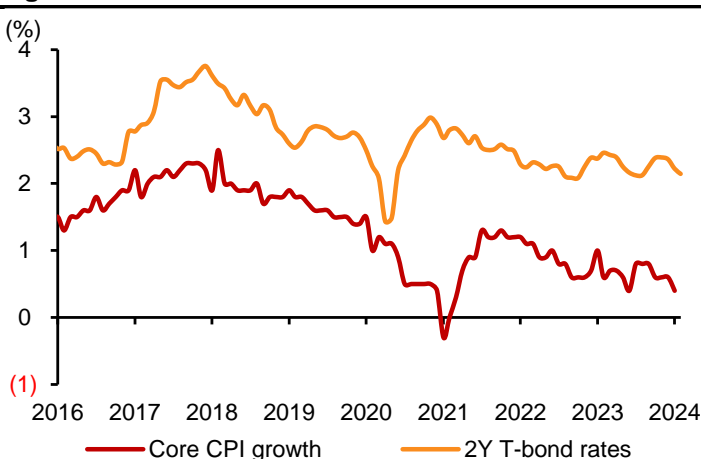


Figure 9: PPI, industrial inventory & revenue growth



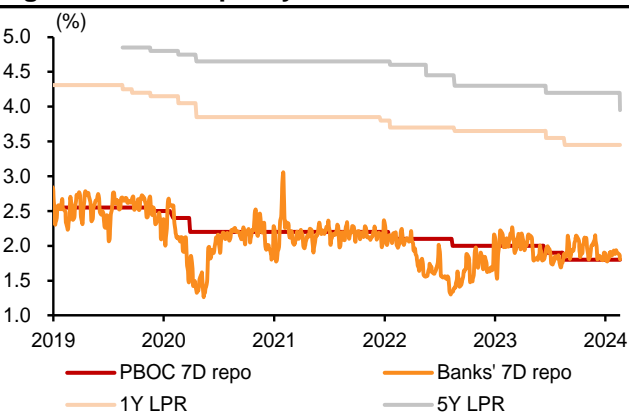
Source: Wind, CMBIGM

Figure 10: Core CPI Growth and 2Y T-bond Yield



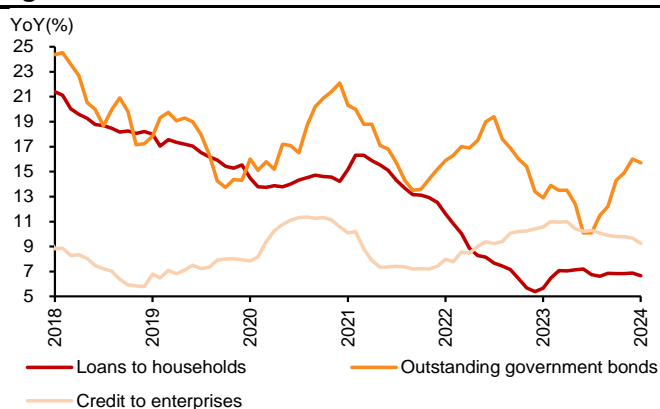
Source: Wind, CMBIGM

Figure 11: PBOC policy rates



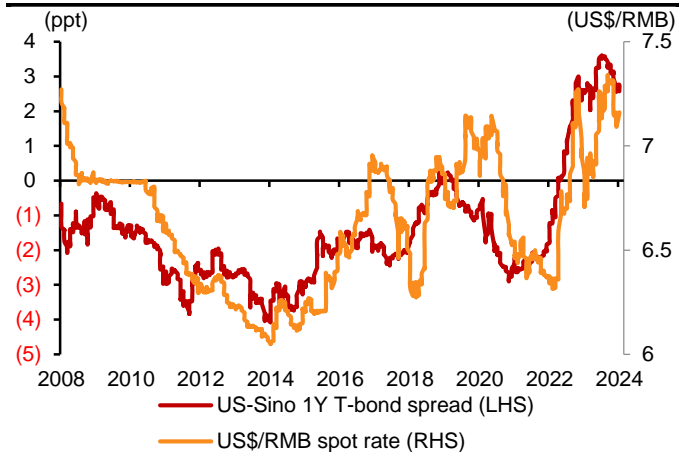
Source: Wind, CMBIGM

Figure 12: Growth of credit to real sector



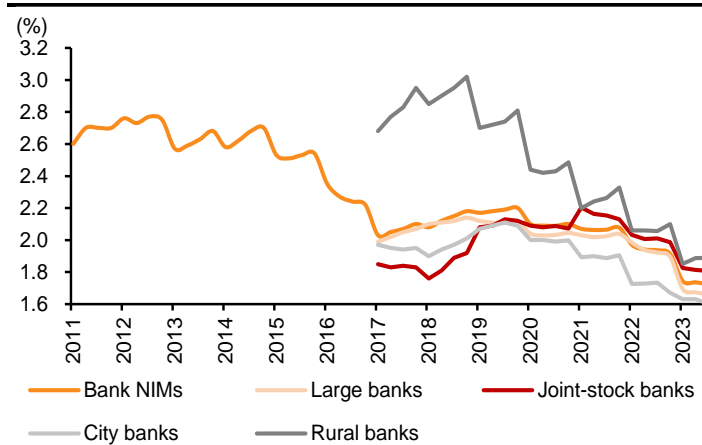
Source: Wind, CMBIGM

Figure 13: US-Sino interest spread & exchange rate



Source: Wind, CMBIGM

Figure 14: Banks' NIMs



Source: Wind, CMBIGM

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