

China Policy

5Y LPR cut to boost housing demand

The PBOC cut 5Y LPR by 25bps to support the property market while 1Y LPR remained unchanged to alleviate the pressure on RMB exchange rates and banks' NIMs. The asymmetric rate cut is positive for property, public utility, infrastructure construction and capital goods by reducing long-term debt financing costs. But the positive impact may be limited given weak economic prospects, declining housing prices and continued deflation expectation. Looking forward, the PBOC may further loosen monetary policy with additional moderate cuts in RRR, LPRs and deposit rates. But concerns about RMB depreciation, banks' NIM shrinkage and market arbitrage may continue to restrain the room of interest rate policy. We expect two more RRR cuts by 50bps in total and one more LPR cut by 10bps in the remainder of this year. Meanwhile, core cities will accelerate the construction of affordable housing and further relax or even eliminate housing purchase restrictions ahead. China's broad fiscal deficit is expected to reach at least 7.1% of GDP in 2024, which is not low compared to other economies. But China's fiscal expenditures are mainly on public sector operation, infrastructure investment and supply-side subsidy as the transfer support to households and boost effect on consumption is limited.

- **Asymmetric LPR cut to support property market.** The PBOC cut 5Y LPR by 25bps from 4.2% to 3.95%, while 1Y LPR remained unchanged at 3.45%. 5Y LPR is the key reference rate for mortgages and other long-term loans. The rate cut sends a signal that China will further ramp up support to property sector, which has continued to slump since 2022. The policy move is positive for property, public utility, infrastructure construction and capital goods by lowering long-term financing costs for the real sector. For instance, with a 2 million & 30 year mortgage loan, the LPR cut reduces the monthly payment for homebuyers by approximately 3%. The LPR cut is expected to reduce the annual interest cost of the outstanding RMB38.2trn mortgage loans in the next repricing window (either beginning of 2025 or the corresponding loan issuance date) by nearly 0.2% of household disposable income.
- **The actual boost effect may be limited by weak fundamental factors.** 1) Weak economic prospects and declining housing prices may continue to restrain households' willingness to buy homes. 2) Deflation may last longer than expected as real-term interest rates are still high. Deflation will increase real debt burden, postpone durables consumption and hurt business earnings. 3) Domestic policy uncertainty and geopolitical risk may continue to dampen business confidence, which is negative for capex and employment recovery.
- **More aggressive policy response is needed yet its possibility is still low.** In theory, China needs aggressive interest rate cuts and substantial fiscal transfer to households to boost demand and defy deflation. In reality, however, three factors continue to limit the downside room for policy rates as we expect two more reserve requirement ratio cuts each by 25bps and one additional LPR cut by only 10bps in the remainder of this year. Firstly, the policymakers are concerned about RMB depreciation pressure amid high US-China interest spreads. Secondly, they are concerned about banks' NIMs, which is related to banking system stability and MoF's dividend income from state-owned banks. Thirdly, the policymakers have some other targets like economic restructuring and arbitrage control as restraints on interest rate policy. For fiscal policy, broad deficit ratio should reach at least 7.1% of GDP in 2024 based on our estimates, which is not low compared to other economies. However, China's fiscal expenditures are mainly on public sector operation, infrastructure investment and supply-side subsidy as the support to households and boost effect on consumption is limited.

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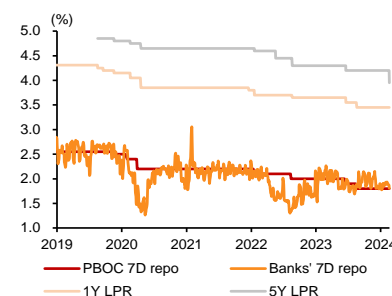
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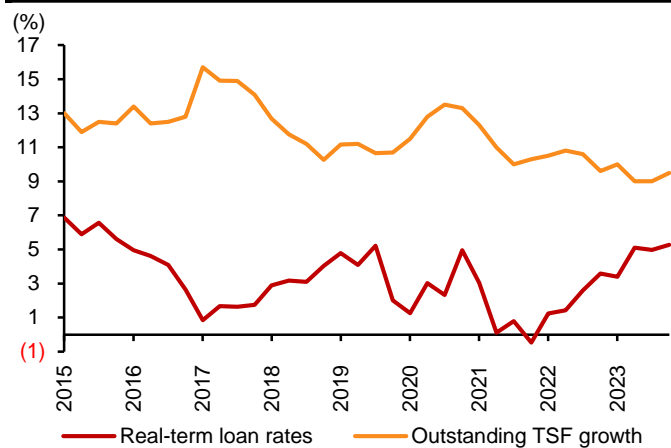
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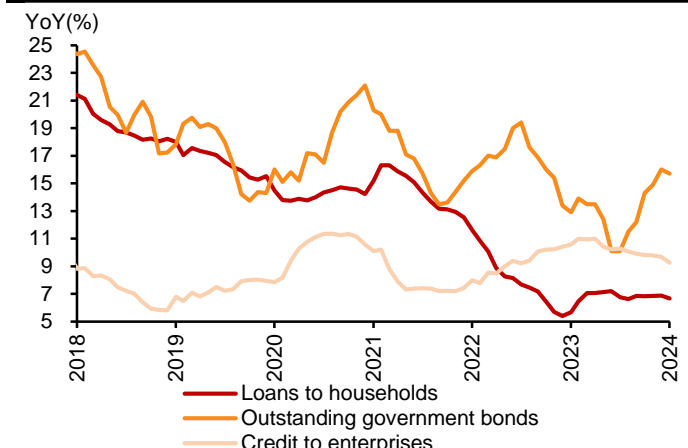
Source: Wind, CMBIGM

Figure 1: Real-term loan rates and TSF growth



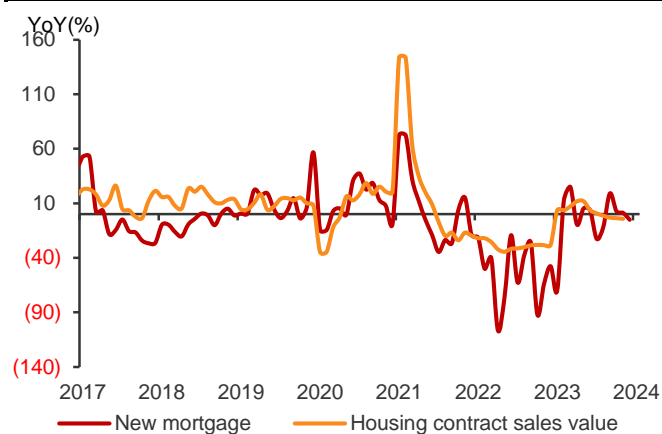
Source: Wind, CMBIGM

Figure 2: Growth of credit to real sector



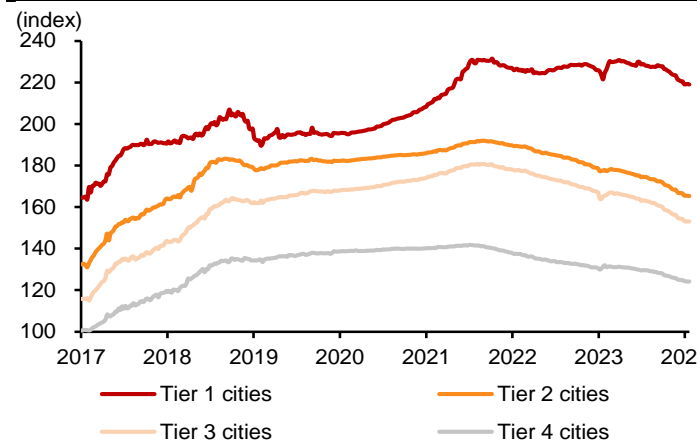
Source: Wind, CMBIGM

Figure 3: Growth of new mortgage & housing sales



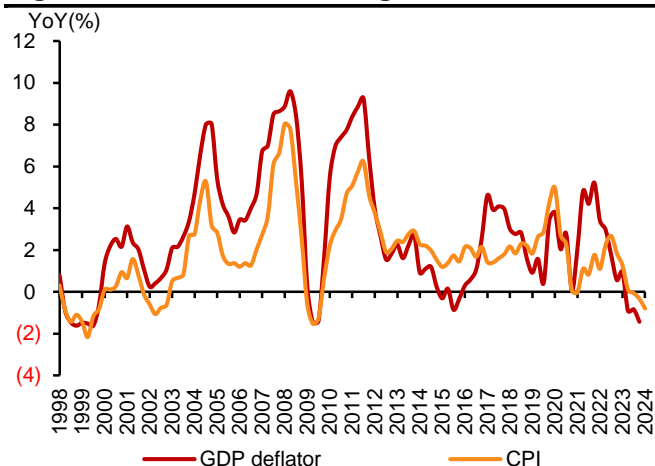
Source: Wind, CMBIGM

Figure 4: Housing price indexes



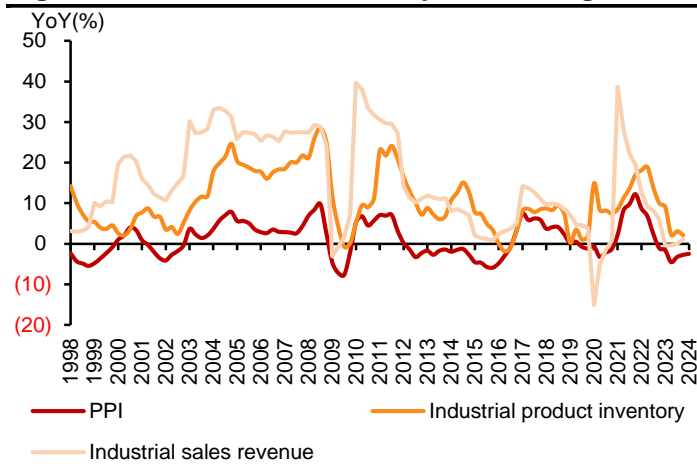
Source: Wind, CMBIGM

Figure 5: GDP deflator & CPI growth



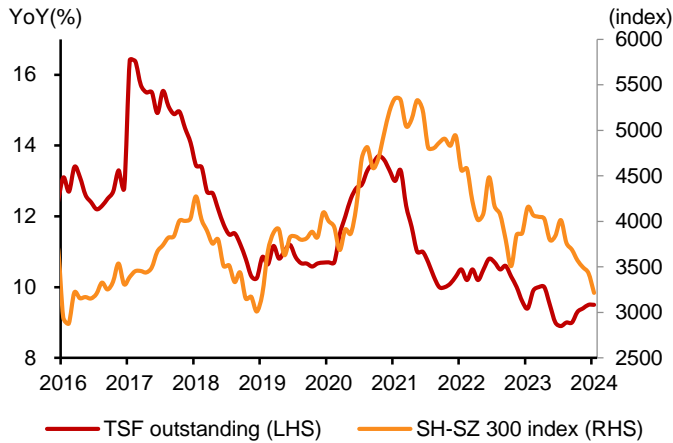
Source: Wind, CMBIGM

Figure 6: PPI, industrial inventory & revenue growth



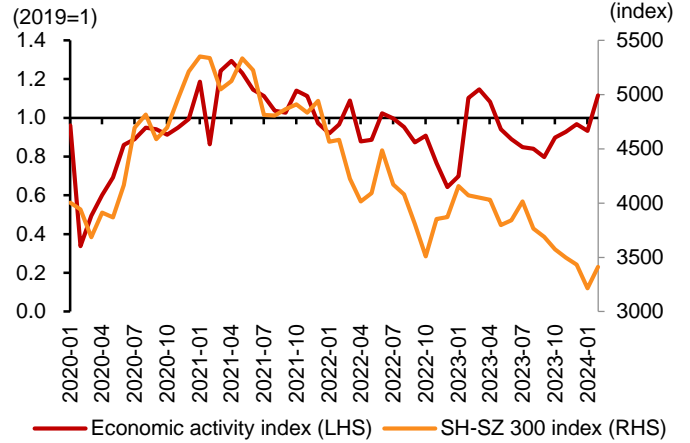
Source: Wind, CMBIGM

Figure 7: TSF growth & A share index



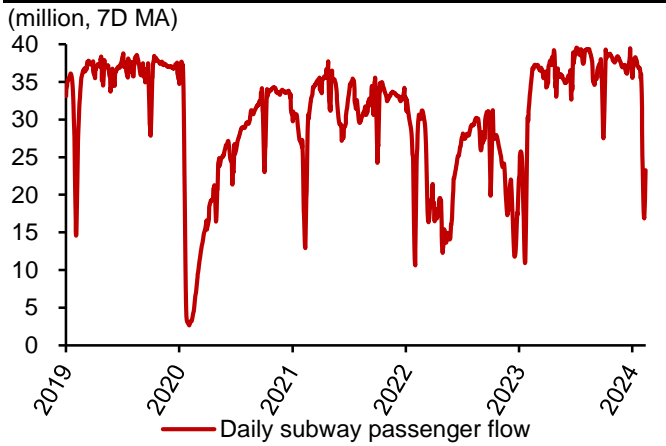
Source: Wind, CMBIGM

Figure 8: Economic activity & A share index



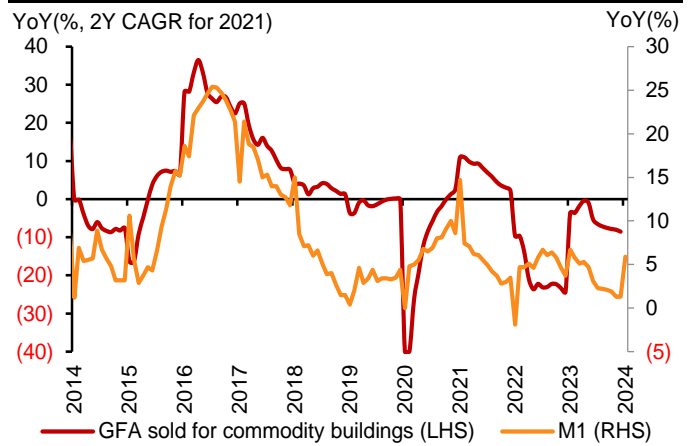
Source: Wind, CMBIGM

Figure 9: Subway passenger flow in tier-1 cities



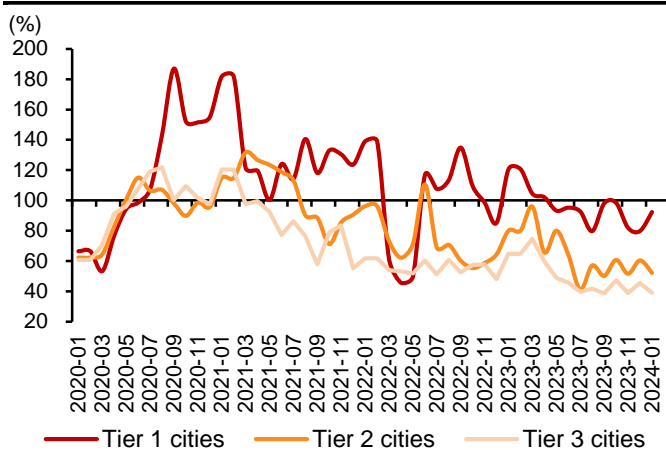
Source: Wind, CMBIGM

Figure 10: Housing sales and M1 growth



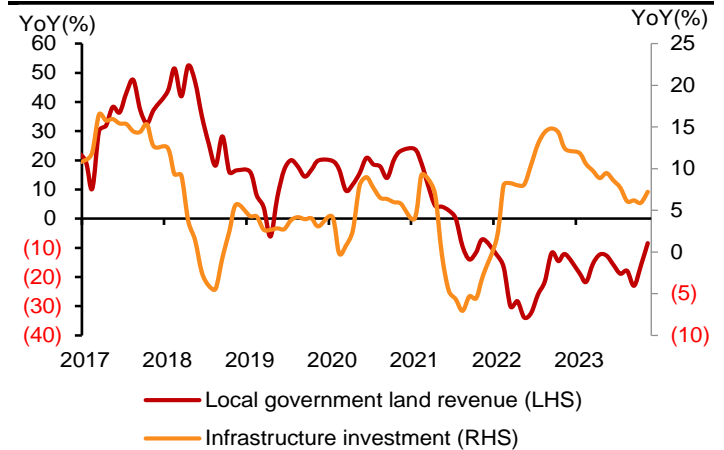
Source: Wind, CMBIGM

Figure 11: Housing sales recovery rates vs 2019



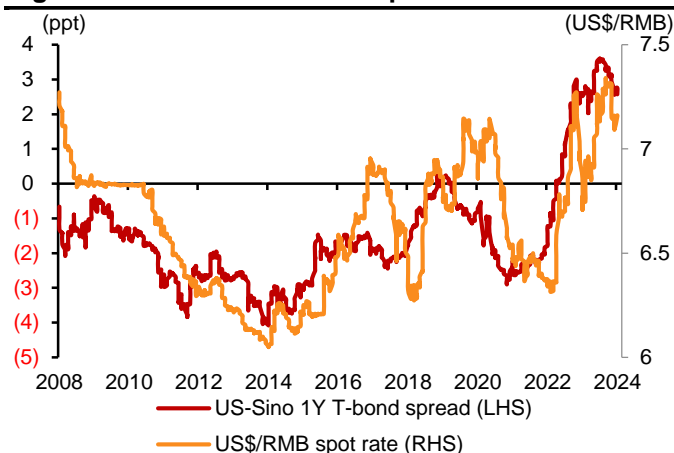
Source: Wind, CMBIGM

Figure 12: Land market & infrastructure investment



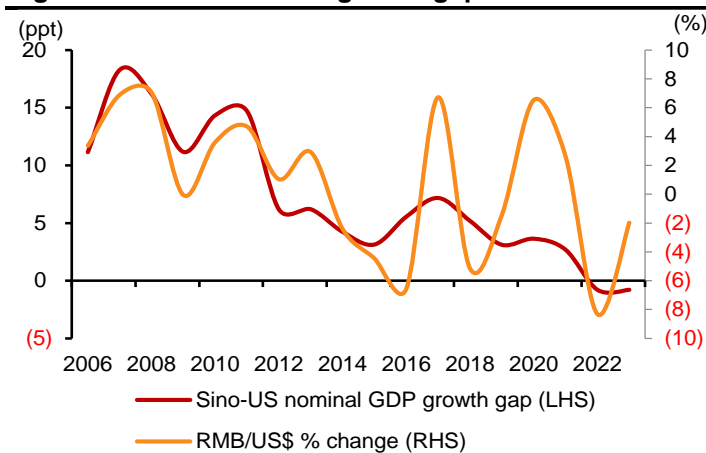
Source: Wind, CMBIGM

Figure 13: US-China interest spreads & RMB



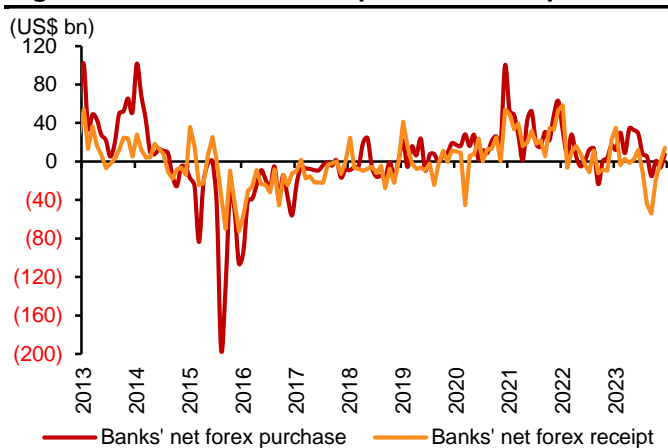
Source: Wind, CMBIGM

Figure 14: US-China GDP growth gap & RMB



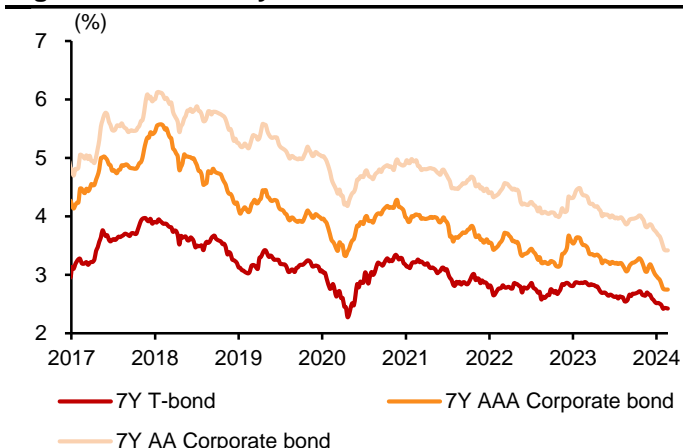
Source: Wind, CMBIGM

Figure 15: Bank's net forex purchase/receipt



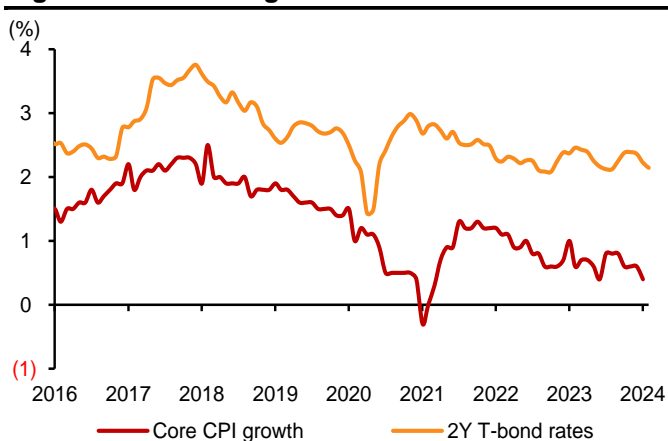
Source: Wind, CMBIGM

Figure 16: 7Y bond yield



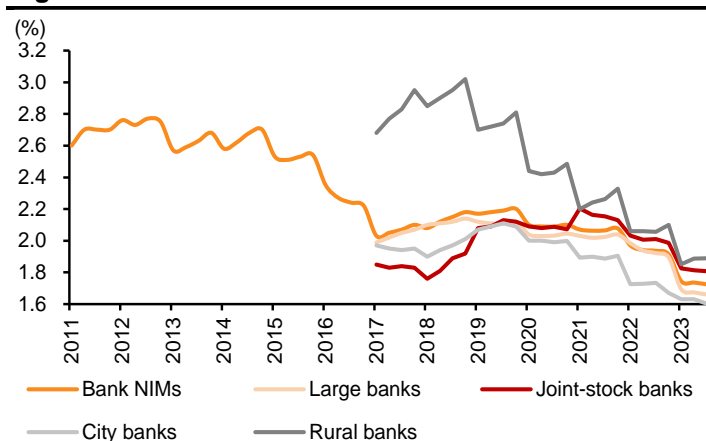
Source: Wind, CMBIGM

Figure 17: Core CPI growth and 2Y T-bond rates



Source: Wind, CMBIGM

Figure 18: Banks' NIMs



Source: Wind, CMBIGM

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