China Economic Update September 2024

Monetary easing, on its own, is unlikely to stimulate China's economy

NAB Group Economics

Financial markets and foreign observers have been anticipating some form of Chinese stimulus plan for much of 2024, reflecting the prolonged weakness in the country's domestic demand and the history of such policy responses – such as those in response to the Global Financial Crisis and the downturn in 2015. In late September, the People's Bank of China announced a range of measures to provide additional support, however in the current environment these monetary measures, on their own, are unlikely to be enough to stimulate domestic growth.

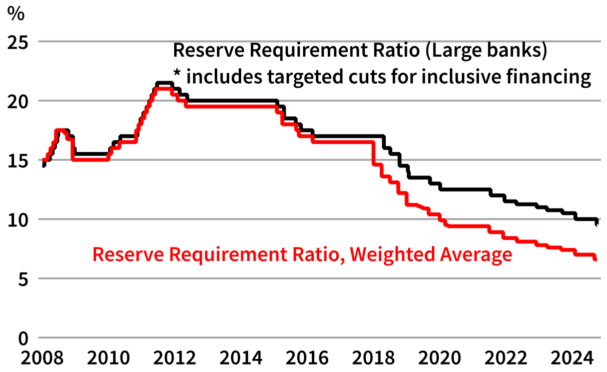
Monetary measures at a glance

The measures announced by the People's Bank of China (PBoC) can be grouped into broad monetary easing and policies targeted at the property and equity markets.

In the case of the former, these measures consist of a 50 basis point cut to the Reserve Requirement Ratio (RRR) – the share of deposits that commercial banks are required to hold at the central bank. It is estimated that this should free up around RMB 1 trillion for additional lending. The PBoC also indicated that further cuts to the RRR, in the range of 25 to 50 basis points, could be made this year, depending on conditions in the market at the time.

Reserve requirement ratio

PBoC has steadily freed up bank lending since 2017



In addition, the PBoC cut the seven day reverse repo rate by 20 basis points to 1.5%. Since reforms introduced in July, the PBoC has started to transition its monetary policy management towards using the seven day reverse repo as its primary policy rate, and this should guide other rates lower.

Measures specifically targeted to the property sector include a 50 basis point cut to existing mortgage rates, a reduction in the minimum downpayment for second home buyers nationwide to 15% (from 25% previously) – bringing it in line with first homes – and changes to the relending program introduced mid-year to support the sale of unsold houses for conversion into affordable housing. Previously the PBoC provided 60% of the total lending by commercial banks under the program, but this will be lifted to 100%.

Equity markets are also targeted through two programs. The first is a swap facility (worth around RMB 500 billion) for non-bank financial institutions (such as brokers, insurance companies and securities funds) to exchange assets with the central bank to access funds that would be used to purchase equities. The second is a relending program (worth RMB 300 billion) to allow commercial banks to lend to publicly listed companies and major shareholders to fund share buybacks.

How effective are these measures likely to be?

At a high level, there have been increasing doubts around the effectiveness of changes to China's monetary policy settings in recent times, in a large part due to the weakness in loan demand. The steep downturn in the residential property sector, since the implementation of the Three Red Lines policy in 2020, has impacted demand for mortgages, while regulatory crackdowns on various industries (most notably technology) has restricted private sector loan demand. Earlier cuts to the RRR and policy rates have had little impact on this weak demand, and as such, it is difficult to see why these changes would be any different.

Similarly, the downturn in the residential property sector substantially impacted confidence in the sector, with

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sales plunging and house prices falling. If there is little expectation of capital growth, it is likely that second (or more) home purchasers would still be reluctant to purchase, even with a reduced downpayment requirement.

The cut to mortgage rates appears to be the most likely policy change that could benefit China's economy. According to the PBoC, this change will benefit 50 million households, reducing their interest payments by around RMB 150 billion a year. However, it remains to be seen how households will utilise this additional windfall. While authorities would hope this boosts consumption, households may choose to increase savings or pay down debt faster.

Similarly, it is unclear whether the proposed measure to support equity purchases can sustainably drive equity prices higher, and with it, boost consumer confidence and wealth.

Will China's government implement fiscal stimulus?

China's Politburo met in late September, following the monetary easing by the PBoC. Typically economic matters are only discussed at the April, July and October monthly meetings. That it was a key focus of this meeting highlights the greater concern around the current economic conditions. The statement following the meeting stated their intention to "increase the intensity of countercyclical adjustment of fiscal and monetary policies", "promote the stabilisation of the real estate market" and increase consumption by expanding the "income of middle- and low-income groups."

There have been rumours that this monetary easing will be accompanied by a sizeable fiscal stimulus as well – albeit there have been rumours of such policies for much of 2024, with little to show for it so far. However, expectations were boosted in mid-September following a speech by Liu Shijin, the former deputy director of the State Council's Development Research Centre, at a conference at Renmin University. He suggested a RMB 10 trillion stimulus plan (funded by ultra long term special bonds), focussed on improving public services such as affordable housing, education, healthcare, social security and elderly care, with a particular focus on migrant workers in cities. In reducing the needs of households to fund retirement or key services, this could lower savings rates and boost consumption.

It seems likely that the probable fiscal package will be far more modest. According to a report by Reuters – which cites two unnamed sources with knowledge of the plan – the Ministry of Finance will issue around RMB 2 trillion (equivalent to around 1.6% of GDP) in special sovereign bonds to fund two programs. The first RMB 1 trillion will fund a continuation (and possibly increase) of the existing consumer good trade-in and business equipment upgrade program (which had been scheduled to finish at the end of this year and anecdotally is suffering from a poor take up rate). Funds from this issuance will also be used to provide a monthly allowance to families with two or more children of RMB 800 per child (excluding the first child). The second RMB 1 trillion will reportedly be used to assist local governments to address their debt problems.

Conclusions

In isolation, we argue that the monetary measures do not appear to be sufficient to stimulate significant growth in China's economy, reflecting the headwinds of the property downturn – which we expect will continue for some time – and weak domestic demand. As we have previously noted, the consumption share of China's economy remains weak, and fiscal policies should be implemented to reduce the need for households to save such a large share of their incomes. Should these policies fail to boost demand, while further expanding supply, this could further worsen existing imbalances in China's economy and further build trade tensions with other countries.

If the fiscal package outlined by Reuters proves to be correct, and should this be the full extent of fiscal stimulus, it is somewhat underwhelming and certainly not the so-called "bazooka" many commentators have called for. The trade-in and upgrade program appears (so far) to have been only a modest success and may only bring forward some amount of consumption, rather than sustainably building longer term demand.

The monthly allowance to larger families could have a material impact on household incomes, and could potentially result in stronger consumption from this population. However, it is not clear as to whether this would be an ongoing payment, or represent a limited program, given it is estimated that there are enough eligible households that this program would cost RMB 1 trillion for a full year (the total funds available for both the trade-in and upgrade program and this funding). Were this to be a short term package, it would only provide a limited boost to the overall economy.

The funds allocated to addressing local government debt seem to be unlikely to either boost economic activity, nor have a material impact on the debts of these authorities. Local government debt is highly opaque, estimated to be in the order of 76% of GDP at the end of 2022 – equivalent to around RMB 91 trillion, meaning the RMB 1 trillion package is a drop in the ocean. The modest amount to address this debt means that it will not allow local governments to boost spending, nor put it on a more stable footing.

At this stage, there is nothing that forces us to change our forecasts. We see China growing by 4.7% in 2024 –

Data sources: Macrobond, NAB Economics

below the “around 5% target” – although it is possible that these measures could bring growth closer to this target. In this regard, the most significant measures are the cuts to mortgage rates and the rumoured payments to larger households, as these will directly boost disposable income which, with sufficient confidence, could translate into stronger consumption.

That said, should these measures (both implemented and rumoured) prove ineffective this year, the stronger focus from authorities on economic conditions means there could be a ramp up in stimulus programs in 2025.

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