MEKETA

China's Latest Stimulus May Not Be Enough

CONNECTIVES
OCTOBER 2024

On August 19th a key daily indicator capturing daily foreign investor flows in China's Stock Connect was inexplicitly switched to a quarterly indicator. In China, various economic and financial indicators have been canceled over the past few years – often associated with official attempts to mask unfavorable data.[1] Between June 2024 and mid-August, foreign investors pulled over $12 billion out of Chinese stocks more than offsetting the national teams' efforts to purchase Chinese stocks this year.[2] In August, Chinese government bond yields hit record lows as authorities tried to cool investor flows into sovereign debt. The unresponsive Chinese Communist Party's (CCP) piecemeal policy attempts to stabilize asset prices appeared doomed to fail.

But on September 24, China' policy makers announced a significant stimulus package designed to lift stock prices, improve bank liquidity, and support mortgage holders. Perhaps the CCP was moved to boost share prices and investor sentiment just days ahead of the 75th anniversary of the People's Republic of China or perhaps it was the prospect of continued investor outflows, but the multi-pronged stimulus appears to have done much to boost domestic and foreign investor sentiment.[3] By the end of September, the MSCI China Index returned 23.9% enough to boost the index year-to-date return to 29.3% handily beating the S&P500 (22.1%) for the same period.[4]

[1] Source: Financial Times, A. Alim, "Beijing Retracts Trading Data as Foreign Investors Flee Chinese Stocks," August 19, 2024. For example, China canceled a key measure of labor market health to mask record high youth unemployment. New York Times, "China Suspends Report on Youth Unemployment, Which Was at Record High," August 15, 2023.

[2] Source: Financial Times, A. Alim, "Beijing Retracts Trading Data as Foreign Investors Flee Chinese Stocks," August 19, 2024.

[3] Source: The Economist, "At Last, China Pulls the Trigger on Bold Stimulus Package," September 27th, 2024.

[4] Source: Bloomberg and MSCI as of September 30, 2024.

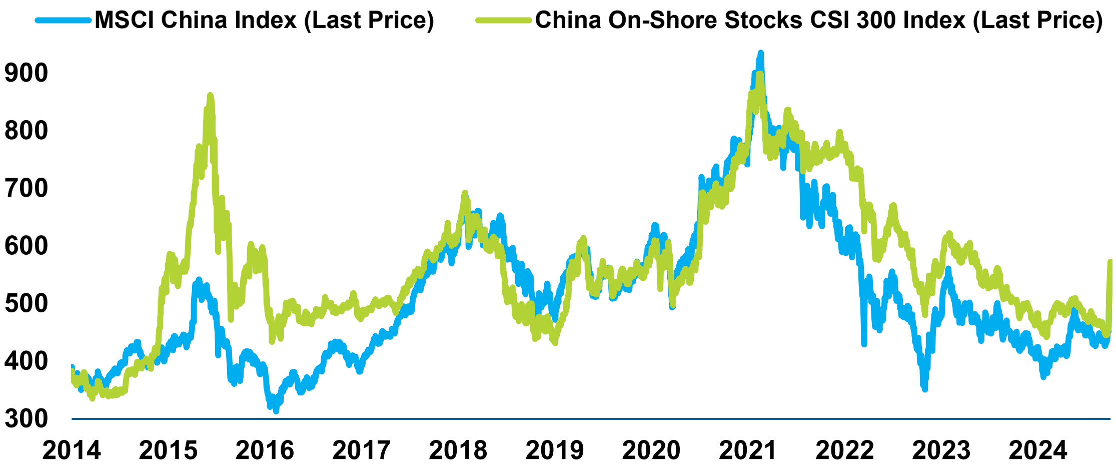

FIGURE 1
China's CSI 300 and MSCI China Indices (Daily Last Price)
Source: Bloomberg as of September 30, 2024.

What is the stimulus package?

As a part of the stimulus package, the Peoples Bank of China (PBoC) unveiled several programs designed to address points of weakness in the economy which in total may be worth at least $114 billion USD (800 B CNY).[5] The stimulus is largely an expansion of credit channels rather than fiscal stimulus with an eye of supporting equity prices and providing mortgage holders and future home buyers with lower borrowing costs. Likewise, the stimulus will lower the minimum downpayment for a first time or second home purchase from 25% to 15%. Banks will have more liquidity with a cut in their RRR (Bank Reserve Requirement Ratio) but will also be expected to provide loans to listed companies for share buybacks and/or purchases. The cut in the reverse repo rate and lower 1-year medium term policy rate could support bank margins (Figure 2). Morgan Stanley has estimated that the policy support may be equal to 3.9% of the free-float market value of the on-shore A-market.[6] Markets have interpreted remarks from PBoC Governor Pang Gongsheng as especially encouraging for future support and willingness to continue interventions to support asset prices.[7]

[5] Source: Financial Times, "Will China's $100 B War Chest for Shares Lift the Economy?" September 27, 2024.

[6] Ibid.

[7] Source: The Economist, "At Last, China Pulls the Trigger on Bold Stimulus Package," September 27th, 2024.

General Economy	Policy Interest Rate	Lowered 7-Day reverse repo rate to 1.5% reduction of 1-Year medium term lending facility
	Bank Reserve Requirement Ratio (RRR)	Cut Bank RRR by 50 bps to average of 6.6% for 1 T CNY in bank liquidity; further RRR cuts may come by year end
Housing Sector	Mortgage Rate (Current and Future Borrowers)	Cut current mortgage interest rates by 50 bps
	Second Home Down Payment Ratio	Cut down payment for first & second home from 25% to 15%
Capital Markets	Asset Swap Facility	500 B CNY liquidity facility for financial & insurance companies for purchasing stocks via a swap line while pledging assets for high quality govt securities
	Relending Facility	300 B CNY Relending Bank Facility with interest rate of 1.75% to re-underwrite or finance listed companies for buybacks & stock purchases

FIGURE 2
Stimulus Overview
Source: Oxford Economics September 2024.

While the PBoC policy stimulus and new quantitative easing measures are welcome, so far the official policy stimulus is only a fraction of the 2008 two-year fiscal and policy stimulus which was equal to 27% of China's total GDP.[8] China's economy still faces considerable deflationary pressures and its debt to GDP level is over 300%[9] leaving much less assurance that new debt issuance expected later this year will do little to stimulate new investment and growth but will be used to pay off existing debts.[10] Local and municipal governments continue to struggle since land sales have largely halted leaving them with little revenue. Moreover, PIMCO estimates that these cash strapped local governments have overextended their financing vehicles (LGFVs) so that they may have another $6.5 trillion USD in undeclared debts which are interlaced with local and national bank balance sheets.[11]

There have been expectations of another 2 T CNY ($284 B) in new debt issuance by the end of 2024. And while details are yet to be made clear, approximately half are expected to be allocated to support local governments and the rest will be applied to an existing cash for clunkers program to upgrade equipment, cars and trucks and major household appliances.[12] Asset managers, banks, and listed companies can borrow funds to buy stocks, but they will be on the hook if share prices fall further. Banks will have lower reserves to cover bad loans and are being asked to extend loans for stocks and home mortgages. But economists note that so far, the problems with falling retail sales, investment, and real estate prices remain. And political tensions between the US and China have failed to reset. China's asset price stimulus is positive, but questions remain if they will be sufficient to re-ignite growth and investment.

[8] Source: The Economist, "At Last, China Pulls the Trigger on Bold Stimulus Package," September 27th, 2024.

[9] Source: Bank for International Settlements as of September 30, 2024.

[10] Source: Financial Times, S. Roach, "Why China Needs a Three-Arrow's Strategy," September 30, 2024.

[11] Source: PIMCO, A. Zhou et al., "Local Government Financing Vehicles: A Growing Risk for China's Economy," January 9, 2024.

[12] Source: The Economist, "At Last, China Pulls the Trigger on Bold Stimulus Package," September 27th, 2024. The Economist article relied heavily on a Reuters article "China to Issue $284 B of Sovereign Debt This This Year to Help Revive the Economy," September 26, 2024. It is not clear is this is the same debt issuance expected in August or will be additional debt issuance.

Please visit the **Thought Leadership** section of our **website** or click the links here to learn more.

US Trade War with China Escalates
https://meketa.com/news/meketa-connectives-us-trade-war-with-china-escalates/

Emerging Market Equities without China
https://meketa.com/leadership/emerging-market-equities-without-china/

The Art of Patient Investing
https://meketa.com/leadership/the-art-of-patient-investing/

Disclaimers

This document is for general information and educational purposes only, and must not be considered investment advice or a recommendation that the reader is to engage in, or refrain from taking, a particular investment-related course of action. Any such advice or recommendation must be tailored to your situation and objectives. You should consult all available information, investment, legal, tax and accounting professionals, before making or executing any investment strategy. You must exercise your own independent judgment when making any investment decision.

All information contained in this document is provided "as is," without any representations or warranties of any kind. We disclaim all express and implied warranties including those with respect to accuracy, completeness, timeliness, or fitness for a particular purpose. We assume no responsibility for any losses, whether direct, indirect, special or consequential, which arise out of the use of this presentation.

All investments involve risk. There can be no guarantee that the strategies, tactics, and methods discussed in this document will be successful.

Data contained in this document may be obtained from a variety of sources and may be subject to change. We disclaim any and all liability for such data, including without limitation, any express or implied representations or warranties for information or errors contained in, or omissions from, the information. We shall not be liable for any loss or liability suffered by you resulting from the provision to you of such data or your use or reliance in any way thereon.

Nothing in this document should be interpreted to state or imply that past results are an indication of future performance. Investing involves substantial risk. It is highly unlikely that the past will repeat itself. Selecting an advisor, fund, or strategy based solely on past returns is a poor investment strategy. Past performance does not guarantee future results.