Economic Research View

China: No Bazooka in Politburo's Hand

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Tomohiro Eguchi, CFA

Economist

On July 24, the Political Bureau of the Communist Party of China Central Committee (Politburo) held a meeting to analyze the current economic situation and set tone for macro policies in H2. The statement unveiled by Xinhua was broadly in line with the April version, but there were meaningful changes in the rhetoric and policy priorities. The July statement suggests that the policy focus has shifted from structural factors to countercyclical ones, which was the opposite of the April statement released after the significant upturn in GDP during Q1. The Politburo signaled further supports to the property sector as well as durable goods consumption, but distanced itself from bazooka-type stimulus. The overall tone of the statement was almost in line with or slightly more dovish than (low) market expectations including our own. They also focused on local government debt and other structural problems that are essentially incompatible with countercyclical macro policies. Considering the leadership still committed to "quality of growth", bazooka-type stimulus is unlikely to arrive in the foreseeable future.

Fiscal Policy: The Politburo stays away from bazooka-type stimulus which significantly increases public debt

- The Politburo mentioned "it is necessary to stick to a proactive fiscal policy" and "extend, optimize, improve and ensure the implementation of tax and fee reductions". In June, the government announced that NEV tax breaks would be extended to 2027. The Politburo also mentioned that government investment should better play the role of driving overall investment, with faster issuance and use of local government special-purpose bonds, which reduces the probability of an expanded annual quota for local government special-purpose bonds and the issuance of special-purpose treasury bonds in my view. Considering the government also focuses on the risk of local government debts, a significant expansion of fiscal deficits is still unlikely. Given that the statement touched upon support of consumption of major items including automobiles, electronic products and household items and spending on services such as sports, leisure and cultural and tourist services, limited tax reductions or similar measures could potentially be implemented.

Monetary policy: Structural monetary policy tools will play more important role

- The Politburo committed to continue prudent monetary policy and "give full play to the role of quantitative and structural monetary tools". In my understanding, "quantitative monetary tools" mean traditional ones, such as cuts in policy rates and the reserve requirement ratio, while "structural monetary tools" mean targeted liquidity provision tools such as PSL or re-lending. With regard to the former, I expect a 10bp rate cut and one-time RRR cut to partially offset MLF redemption in H2. Given the limited room for rate cuts and the potential impact on RMB, structural policy tools will play a more active role in H2.

Real estate policy: omitting the tightening slogan to give more support

- The biggest change in their rhetoric was observed in real estate policy. For the first time since 2019, the statement omitted Xi's tightening slogan "housing is for living, not for speculation". Instead, the statement stressed the need for "adapting to the new situation where major changes have taken place in the relationship between supply and demand", which is a meaningful change in policy stance. Under "one city, one policy", the change in rhetoric will make it easier for local governments to decide further policy adjustments. That said, given the various shocks that have occurred since 2021, the slight easing of housing policy may not be sufficient to change homebuyer sentiment. Considering the trend decline in housing demand, the recovery of the real estate sector will be L-shaped. When households choose to reduce their debt, it is necessary for the government to create demand for housing, and policy such as "expanding the supply of government-subsidized housing" or "increasing public facility constructions in mega cities" will be the key going forward. That said, due to a decrease in land-sale revenues, local governments don't have room to increase such projects, so this kind of public demand is unlikely to be a game-changer.

Local government debt policy: planning a comprehensive resolution package

- The Politburo listed local government debt risk as one of the important reform areas. The July statement says "effectively prevent and resolve local debt risks, make a package of plans to resolve the debt", contrasting with "strengthen local government debt management, strictly curb new hidden debt" in April. Concerns regarding LGFV and other local government debt are rising as local government land sales decline and the economy slows. While there has not yet been a default on LGFV's debt, the last-minute repayment of the debt has raised concerns about LGFV's ability to repay. In June, Bloomberg reported, citing an anonymous source, that the leadership launched a nationwide investigation into "hidden debt" in local governments. The central government will take further measures after identifying off-balance sheet debts. Concern on local government debt stems from structural problems such as land-dependent revenue, and unbalanced central-local revenue/expenditure distribution, so addressing these problems is desirable. However, stimulating the economy through counter-cyclical macro policies and resolving debt problems are incompatible in nature. The focus on these structural problems implies that the leadership is committed to "quality of growth", accepting lower growth itself.

Other important points from the statement

- Efforts should be made to promote the well-regulated, healthy and sustained development of platform enterprises.
- It is necessary to promote the in-depth integration of the digital economy with advanced manufacturing and modern services and to advance the safe and sound development of artificial intelligence.
- The meeting pledged efforts to invigorate the capital market and boost investor confidence.
- Authorities should establish and improve regular communication and exchange mechanisms with enterprises, which will be encouraged to venture, invest and take risks to actively explore new markets.

*This commentary is based on personal views of the author and does not necessarily represent Nomura Asset Management house view.

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