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CHINA'S 'POLITBURO PUT' – AN OUT-OF-CONSENSUS THOUGHT

We cannot solve our problems with the same thinking we used when we created them.

Albert Einstein

Market consensus for China's economic and market outlook was, and still is, based on Beijing's incremental easing. However, recent economic data shows that the incremental easing approach had not been effective on sustaining GDP growth momentum.

Beijing wants to balance structural reform and debt reduction with GDP growth. It does not want to return to the old debt-fuelled supply-expansion growth model, and hence is willing to tolerate a lower growth rate between 5% and 6% a year for the medium term, in my view. However, the cycle risk is that the incremental easing approach might be insufficient to sustain the growth momentum and risk GDP growth undershooting the 5.0% official target this year.

China's growth and market outlook are indeed contingent upon Beijing acting quickly and decisively to shore up activities and confidence before the current pessimism becomes entrenched and hurt growth further. Hence, the growth-supportive messages from the Politburo meeting on 24 July created market expectations that a 'Politburo put' option might be 'exercised' to ensure GDP growth will not weaken further.

The Politburo meeting's supportive policy tone, especially the removal of the statement of "housing is for living, not for speculation", is important and indeed positive.

Why is the housing statement important?

The PBoC and the Politburo have made references to significant changes in the supply-demand balance of the property market and called for adjustment/optimisation of controls. This could be a signal that more property market stimulus is on the cards.

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If this change in the policy tone helps to revive confidence, it could spark a rebound in property, and hence the economy and asset markets. But confidence is a wild card. Only time will tell how confidence will react to the Politburo's announcement. So the Politburo's policy announcement should be seen as mildly positive, in my view.

Nevertheless, this policy tone change may give local governments more space to relax home purchase restrictions, lower down payment requirements for second mortgages, and ease other related measures. It may also put more pressure on banks to increase credit support for developers.

A possible liquidity-push re-rating, and a caveat

In case if this policy-tone change catalyses a turnaround in confidence and boosts the property market in the short term, we could see Chinese stocks being re-rated under Beijing's liquidity push. The market's reaction since the Politburo meeting has been quite positive.

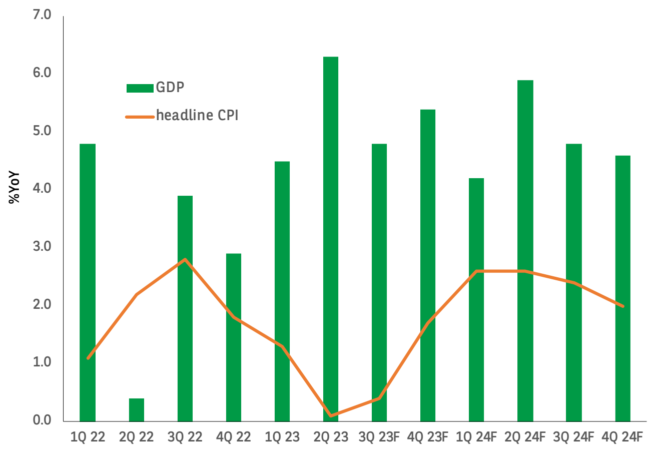
The risk is that if growth momentum remains sluggish but does not deteriorate to threaten the official 5.0% target, then incremental easing could continue, disappointing the market and depriving it of any liquidity push re-rating. The market could even go into another round of sell-off.

The biggest uncertainly is the timing and magnitude of the Politburo put, which does not come with an unlimited expiry. If the put is not implemented forceful enough to turn around confidence and the property market woes, inventors' sentiment could turn sour again quickly, disregarding the amount of liquidity in the system.

Our base case is for GDP to grow 5.3% this year and 5.0% in 2024, with inflation remaining well below 3% a year (Exhibit 1).

Exhibit 1

China's GDP growth and inflation forecasts



sources: CEIC, BNP Paribas Asset Management 31 July 2023

An out-of-consensus thought

However, as I have repeated argued, weak confidence and the property woes are the two biggest drags on growth and earnings outlook. Given these, the risk of Beijing missing the 5.0% growth target is not negligible. If that risk has risen to a 'pain point', Beijing may have to ease more aggressively than consensus expects.

The recent policy actions and statements seem to show that Beijing might be approaching that pain point. In that case, there is a fair chance for more aggressive easing boosting growth and a sustained rebound in Chinese stocks in the coming months. This is an alternative scenario to our base case.

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