



FOR PROFESSIONAL INVESTORS – 6 February 2024

# Chi Time

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## Still bearish on China? Indicators for gauging changes

*Put your heart, mind, and soul into even your smallest acts. This is the secret of success.*

*Swami Sivananda*

Since the New Year, Beijing – having apparently hit the economic ‘pain point’ – seems to have stepped up its easing measures ([See “Chi Flash: Beijing Mulls Aggressive Easing as ‘Pain Point’ Hits” 15 November 2023](#)). Within a few days after the State Council meeting on 22 January, it announced three major measures to help boost market sentiment:

- RMB2 trillion to support the stock market (both offshore and onshore)
- Cutting the bank reserve requirement ratio (RRR) by 50 bp, releasing RMB1 trillion (~USD 140 billion) into the system, and cutting the re-lending and re-discounting rates applied to loans for rural and small firms by 25 bp
- Allowing property developers more leeway to use of their property-backed loans for repaying other loans or bonds, not just for property investment

This latest effort comes on the heels of [a slew of easing measures](#) since the second half of 2023. The key questions are:

- 1) Is it enough to turn things around?
- 2) Does this finally mark a policy shift to more aggressive easing?
- 3) What are the indicators for gauging changes in the economic and market dynamics?

### Is this enough?

Probably not yet. This is because China has only eliminated one of the three confidence dampeners that have been stymieing growth: scrapping the Zero Covid Policy in December 2022. The other two – the deeply distressed property market and insufficiency policy easing – are still hurting public confidence and remain to be addressed decisively.

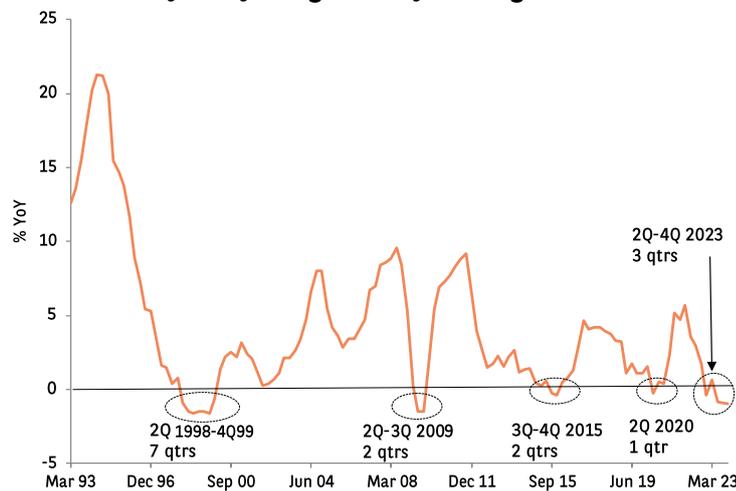


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The property market has yet to stabilise after two years of ‘incremental easing’, with transaction volume still contracting although at a slower rate recently. The property woes reflect insufficient easing and have raised the risk of deflation, with the GDP deflator contracting since 2Q 2023 (Exhibit 1).

**Exhibit 1**  
**China's GDP deflator flirting with deflation again**



sources: CEIC, BNP Paribas Asset Management 5 Feb 2024

### Aggressive easing needed

From a macroeconomic policy perspective, to counter the deflation risk so that structural reforms and debt reduction can proceed, Beijing needs to pump-prime the system by aggressive easing to protect economic growth with determination during China's structural transformation, or 'creative destruction', process (see ['Chi on China: China's Structural Growth \(II\) – Thinking Outside the Growth Box', 14 February 2023](#)) in which old industries are being destroyed while new industries are being created. This process is inherently deflationary as the rate of destruction is faster than the rate of creation. Hence, monetary and fiscal policies need to expand aggressively if necessary to soothe the economic pains from the structural transformation.

The PBoC seems to have finally started to ease policy more aggressively by sharply injecting net liquidity in the system recently (Exhibit 2). However, this is only a job half done. China's economy has liquidity, but no one is taking it up due to a loss of private sector confidence.

## Exhibit 2

### PBoC total net liquidity injection (RMB bn)\*



\* net injection via lending facilities and open market operations, 3-mth moving average

sources: CEIC, BNP Paribas Asset Management 5 Feb 2024

So the public sector has to pick up the slack and deploy the idle liquidity through more government bond issuance; and this is what Beijing is planning to do. So far, Beijing has announced at least RMB2 trillion (~USD 280 billion) of special government bond and local government bond issuance for 2024 in addition to the RMB3.8 trillion (~USD 531 billion) issuance plan in the fiscal budget.<sup>1</sup>

However, the market has seen many 'false' promises. Public confidence will only improve when these easing measures come through. Since the monetary transmission in China is impaired, the authorities have to ease policy by more and for longer than in the previous cycles (see ['Chi on China: Implications of China's Impaired Monetary Transmission Mechanism', 5 February 2024](#)).

If Beijing can sustain its assertive easing in the coming months, there is a fair chance of a sustained rebound in Chinese economic growth and stock market this year. If not, we could see Chinese growth stuck in low gears, further weakening China's asset prices.

In the grand scheme of things, a Chinese economic recovery would help global growth, commodity demand and market sentiment as the developed world slows down.

## Indicators to watch

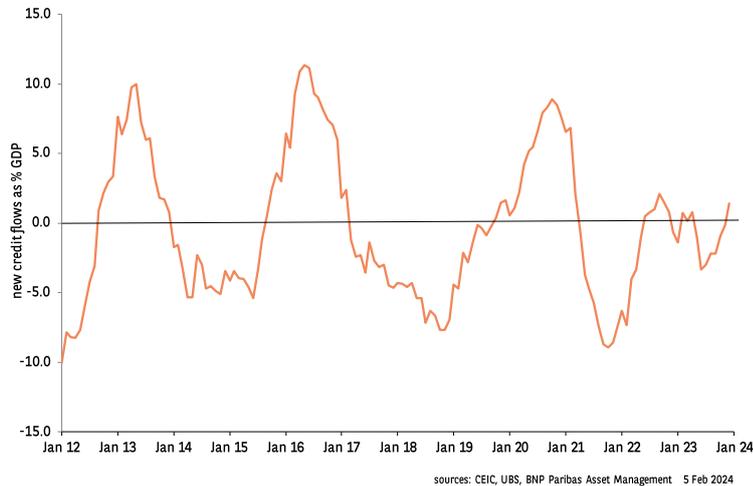
The following are some suggestions:

For high frequency indicators, when the Caixin manufacturing PMI (which focuses on SMEs and private sector companies) and the NBS manufacturing PMI (which focuses on large and state manufacturers) move in the same direction and surpass the 50 boom-bust line on a sustained basis, it would be a sign of recovery. The two PMIs moved in opposite directions in November and December 2023 – the Caixin PMI rose above 50 and the NBS PMI fell below 50. In January 2024, they moved in the same direction, but the NBS PMI was still below 50 while the Caixin PMI stayed above 50.

<sup>1</sup> The National People's Congress in March will confirm the final amount of government bond issuance (excluding the special bond issuances) for 2024.

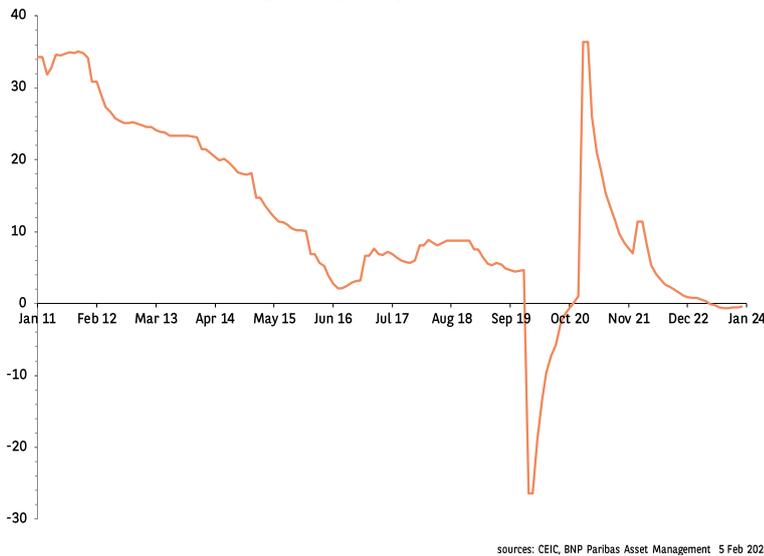
As a leading economic indicator, the credit impulse needs to see a sustained recovery. Despite two years of incremental easing, the credit impulse did not recover (Exhibit 3). However, in December 2023, it turned positive. To sustain it, the PBoC needs to continue injecting net liquidity in the system (see Exhibit 2) to monetise government borrowing, kickstart spending and turn around public confidence.

**Exhibit 3**  
**China credit impulse**



On the real side of the economy, private-sector investment needs to grow again after two years of contraction (Exhibit 4). Renewed private-sector investment would signal a return of 'animal spirits'. The property market needs to stabilise first, with transaction volume growth rather than contraction. This would go a long way to boost public confidence and consumer spending (Exhibit 5).

**Exhibit 4**  
**Private sector investment growth (%YoY)**



**Exhibit 5**  
**China consumer confidence index**



It is simply a Keynesian policy prescription: When the private sector is not spending, the public sector must come in to spend and pull the economy out of the liquidity trap.

From a market perspective, minimising regulatory shocks and policy flipflop helps improve confidence to invest in Chinese assets. The most recent example of regulatory risk is the imposition of [a law on 22 December 2023](#) restricting people playing online games and curbing spending and rewards that encourage video game-playing. The move sparked panic selling, wiping off nearly USD80 billion in market value from China's two biggest gaming companies<sup>2</sup> as investors feared a major hit to these companies' earnings. However, the proposed law was removed after four weeks due to the damaging impact it had on the financial market.

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<sup>2</sup> These two companies are Tencent Holdings, which fell by 16% at one point in the trading day when the draft law was announced, and NetEase, which plunged by as much as 25%.

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