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China Stimulus: Fourth Time a Charm?

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An impressive rally, but this is nothing that hasn't been tried (and failed) many times now.

Chinese authorities "finally get it" and have "capitulated" with the long-awaited stimulus to turn everything around. Here's the *Financial Times*:

> "China's top economic official intervened to reassure investors, saying Beijing would take measures to support the economy and financial markets after a sharp sell-off that has accelerated.
>
> "President Xi Jinping's closest economic adviser said the government would take measures to 'boost the economy', as well as introduce 'policies that are favorable to the market'.
>
> "He made the comments after convening a special meeting of the State Council's Financial Stability and Development Committee…
>
> "Chinese shares rallied on Wednesday, with Hong Kong's benchmark Hang Seng index, rising more than 9.1%. The Hang Seng Tech index jumped 22.2% following the meeting, with shares of Alibaba and Tencent, China's two biggest internet groups, rising 27.3% and 23.2%
>
> "Larry Hu, chief China economist at Macquarie, said Liu had sent a

Shanghai Shenzhen CSI 300 Index

Source: Bloomberg, Macrolens calculations

Brian McCarthy
Our guest analyst for this report is a long-time friend: Brian McCarthy, Chief Strategist at Macrolens, a Massachusetts-based research firm specializing in China. Previously, Brian was Chief Strategist and Portfolio Manager at Emerging Sovereign Group, where he managed the Nexus Fund, a China-focused macro hedge fund.

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Update to strategic view

ASIA MACRO, ASIA STOCKS: The Peoples Bank of China and the Politburo have announced monetary and fiscal stimulus, and equity markets have responded with a large rally. But the measures announced are almost literally the same things that have already been tried over the last four years of a relentless bear market. Why should they work this time? Throwing more debt at an already debt-heavy economy won't help, and its usual transmission channel – housing speculation – is moribund. Demand-side measures will fail, when the issue …

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strong message, 'suggesting that policymakers are deeply concerned about the recent market rout.'"

Keen observers – as TrendMacro and Macrolens readers tend to be – will realize *that gushing story was not published this week, but in March 2022*. It's *déjà vu* all over again, right down to the characterization of events as a "special meeting." The China bulls tell us, "it's highly unusual for the September Politburo meeting to address the economy!" It's also highly unusual to head into October without being able to sniff the annual growth target.

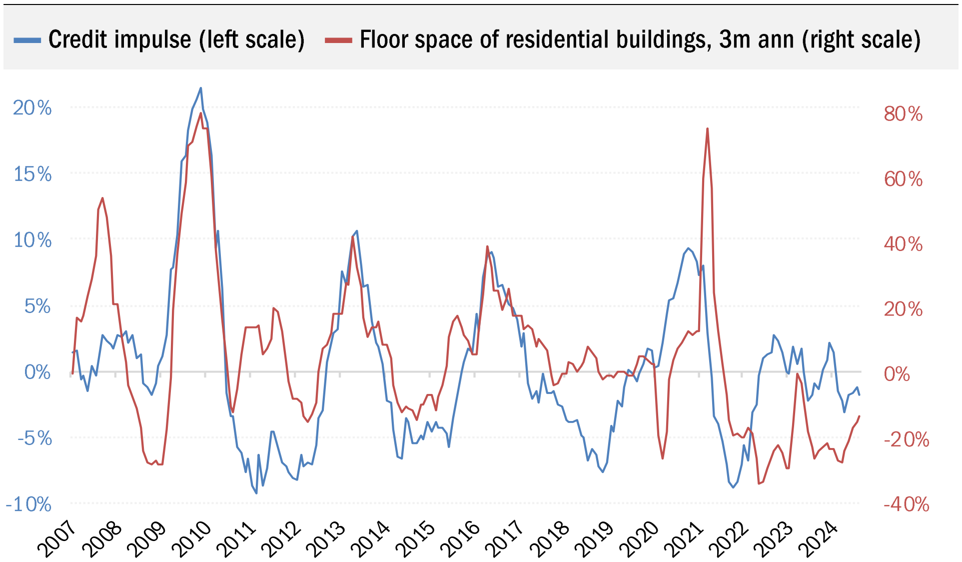
This isn't the second time in this bear market we've been here (please see the chart on the previous page) – *it's the fourth*. And for all the excitement of a 27% rally in equities over about the last two weeks, they're no higher than they were a little more than a year ago.

- The first defense, predicated upon the end of the outright assault on tech and pledges to prop up the property market came in the Spring of 2022. The end of 2022 and early 2023 witnessed the famous but ultimately doomed "reopening rally" (see "The Myth of China's Lockdown" May 26, 2022). Then earlier this year we had a sharp squeeze in Chinese stocks as the new securities regulator muscularly pledged to put a floor under the market with purchases by state-owned funds and a crackdown on shorts.

DIFFERENT THIS TIME?

To those who expect this round of stimulus to sustainably turn the tide in China's moribund economy, we would ask: "what exactly is it that you're expecting them to stimulate?"

- Production in China is a function of central planning and export



Source: Bloomberg. Macrolens calculations

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… is China's supply-side inefficiency, worsened by a an increasingly repressive regime of central planning. The authorities cannot buy their way to a prosperous totalitarianism by pushing the string of credit.

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prospects, so it's not likely they're going to create a self-reinforcing up-cycle in production.
- Infrastructure is primarily funded by local governments who remain financially strapped. Nothing announced this week appears focused on stimulating investment.
- So, what are we stimulating here? Is goosing restaurant sales by a few hundred billion Yuan really going to turn things around?

Chinese stimulus used to work by pumping credit into the housing sector (please see the chart on the previous page).

But we can forget about that channel remaining functional for two reasons:

- This package isn't going to generate a meaningful credit impulse.
- Property speculation isn't reviving any time soon, anyway.

Here was Peoples Bank of China Governor Pan Gongsheng at Tuesday's press conference patting himself on the back for maintaining credit growth at 8%+ (generational lows) this year:

> "The effects of monetary policy are becoming increasingly evident. By the end of August, the year-on-year growth of total social financing was 8.1%, and RMB loans increased by 8.5% year-on-year, about 4 percentage points higher than nominal GDP growth. Financing costs are also at historical lows."

We can forget about this week's package of measures generating the kind of response investors became used to in the 2007-2020 period. Those days are over.

What we've got here is an incremental easing of both fiscal and monetary policy that is perhaps slightly bigger than expectations – and which, we must admit, was expertly packaged and presented to achieve maximum market impact in the lead-up to next week's National Day holiday celebrating the 75th anniversary of the founding of the People's Republic. Let's dig in.

MONETARY MEASURES:

- The 20 bp cut to the 7-day repo rate is marginally helpful.
- Reserve requirement ratio cuts are meaningless – best thought of as regularly scheduled system maintenance to allow banks to continually expand balance sheets in the absence of growth in reserves.
- The cut from 25% to 15% down-payment on second home purchases is unlikely to have a noticeable effect, as speculative property purchases are unlikely to revive any time soon.
- The cut to outstanding mortgage rates was already announced. This is of minor cash-flow help to households saddled with underwater mortgages and large paper losses on property. This won't move the dial on moribund retail sales.

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- The increase from 60% to 100% in the portion of PBoC funding for local government purchase of excess inventory for transition to rental housing will moderately reduce funding costs, but the hold-up here has been local governments wanting only to buy excess inventory at discounts as deep as 50% in some cases. Developers can't do that and survive, so not much is likely to change here.
- 800 billion RMB in liquidity support: 500 billion in PBoC loans against financial asset collateral for equity purchases by funds, insurance companies and a 300 billion relending facility for corporations and major shareholders to buy back stock (we're not sure banks will have a lot of enthusiasm for this). We don't think liquidity has been a meaningful constraint on equity purchases, so we would question the efficacy of this one, too.
- That said, the introduction of PBoC lending facilities for the purchase of equity by insurance companies, funds, and corporations (for buyback), while not terribly meaningful as a stand-alone, does present an intriguing possibility when combined with the China Security Regulatory Commission's pledge to "further support Central Huijin Investment's arrangements to increase its holdings and expand its investment scope."
- Marry the two policies – PBoC funding and sovereign wealth fund buying – and the offspring looks like "equity QE."

They might get there eventually, but not in this policy iteration.

FISCAL MEASURES:

There was widespread chatter that Thursday's Politburo was going to follow up the Tuesday announcement with something on fiscal policy, and perhaps we got a bit more than expected. But the market once again seems to be reading signals into the Politburo statement that aren't really there.

For instance, the statement itself said nothing about the magnitude of any stimulus. All we have on that is this Reuters article quoting "sources," suggesting that the central government will issue Y2t in special government bonds into year-end.

> "**Exclusive: China to issue $284 billion of sovereign debt this year to help revive economy**
>
> "China plans to issue special sovereign bonds worth about 2 trillion yuan ($284.43 billion) this year as part of a fresh fiscal stimulus, said two sources with knowledge of the matter.
>
> "Part of the MOF proceeds raised via special bonds, which are floated for a specific purpose, will be used to increase subsidies for the trade-in and renewal of consumer goods and for the upgrade of large-scale business equipment, said the two sources.

> “The proceeds will also be used to provide a monthly allowance of about 800 yuan, or $114, per child to all households with two or more children, excluding the first child, the first source said.
>
> “China also aims to raise another 1 trillion yuan via a separate special sovereign debt issuance and plans to use the proceeds to help local governments tackle their debt problems, the source added.”

Let’s get the macro out of the way first. The central government budget deficit has been set at 3% of GDP the past two years. Last year, they issued a Y1t special bond in Q4 to pump the deficit up to 3.8% of GDP. So, we all knew they had to issue at least Y1t in special bonds just to tread water.

But that wouldn’t actually be treading water, because local government spending has continued to contract amidst a severe fiscal squeeze. To tread water – that is, prevent the fiscal impulse from going negative – they needed to up this year’s special bond issuance. Will a Y2t make up for local government retrenchment to prevent a contractionary fiscal impulse? Maybe, maybe not.

So, it is wildly premature to be suggesting that Xi Jinping has signaled a sea change in policy. He is merely fighting a rearguard fiscal action to prevent further contraction.

With that, let’s dive into what the Politburo actually said. It’s all far less exciting that the breathless commentary might suggest.

> The meeting pointed out that the fundamentals of China's economy and favorable conditions such as a vast market, strong economic resilience, and great potential have not changed. At the same time, some new situations and problems have emerged in the current economic operation. It is necessary to comprehensively, objectively, and calmly view the current economic situation, face difficulties, maintain confidence, and effectively enhance the sense of responsibility and urgency in doing economic work well. We should focus on key areas, take initiative, effectively implement existing policies, introduce additional policies with greater effort, further improve the targeting and effectiveness of policy measures, and strive to complete the annual economic and social development goals and tasks.

OK, nothing new so far. On to the specifics…

> “The meeting emphasized the need to increase counter-cyclical adjustment of fiscal and monetary policies, ensure necessary fiscal expenditures, and effectively carry out the ‘three guarantees’ (ensure wages, ensure operation, ensure basic livelihood) at the grassroots level.”

Note the reference to a “counter-cyclical adjustment.” This is not being presented as a shift in strategy.

> “It called for issuing and using ultra-long-term special treasury bonds and local government special bonds well, to better leverage the role of government investment.”

We already knew there was a special bond coming. Bumping it from Y1t to Y2t can be viewed as a marginal incremental easing.

> “The meeting also called for reducing the reserve requirement ratio and implementing significant interest rate cuts.”

People got excited about the call for “significant interest rate cuts,” but this is merely describing what PBoC had announced two days before.

> “It stressed the need to promote the stabilization of the real estate market, strictly control new construction of commercial housing, optimize existing stock, improve quality, increase loan issuance for "whitelist" projects, and support the revitalization of idle land stock. In response to public concerns, the meeting called for adjusting housing purchase restriction policies, lowering interest rates on existing mortgages, and promptly improving land, fiscal, and financial policies to promote the construction of a new model for real estate development.”

Everyone is very excited about the pledge to “promote the stabilization of the real estate market” (some translations read this as “stop the decline”) yet ignoring how they intend to do it – by “strictly controlling new construction.” Does that sound like stimulus?

> “The meeting emphasized efforts to boost the capital market, guide medium and long-term funds into the market, and remove obstacles for social security, insurance, and wealth management funds to enter the market. It called for supporting mergers and acquisitions of listed companies, steadily advancing the reform of public funds, and studying and introducing policy measures to protect small and medium-sized investors.”

Again, more stuff that was already announced at the Tuesday PBoC / CSRC presser. Continuing…

> “The meeting pointed out the need to help enterprises overcome difficulties and further standardize law enforcement and regulatory behaviors related to enterprises.”

That’s interesting – the practice of revenue-starved local governments shaking down enterprises for cash is apparently widespread enough to elicit acknowledgement from the top. Might this suggest that fiscal difficulties at the local level aren’t going to be overcome by an extra Y1t in special bond issuance?

> "It called for the introduction of a law to promote the private economy and create a favorable environment for the development of the non-public sector."

Blah blah blah – we've been hearing this stuff about supporting the private sector for years (even as the regime is increasingly repressing its most successful and conspicuous examples).

Next is a discussion of measures to support consumption, which has many market participants in a lather in anticipation of the long-awaited policy shift:

> "The meeting stressed combining consumption promotion with people's welfare, promoting income increases for middle and low-income groups, and upgrading consumption structure. It called for cultivating new types of consumption patterns, supporting and regulating social forces in developing elderly care and childcare industries, and promptly improving the childbirth support policy system."

Maybe we're missing something, but that doesn't get us all that jacked.

> "The meeting also emphasized increasing efforts to attract and stabilize foreign investment, promptly advancing and implementing reform measures such as foreign investment access in the manufacturing sector, and further optimizing a world-class business environment based on market principles, rule of law, and international standards."

More empty promises are not going to alter the trend of foreign multinationals souring on their prospects in China.

> "The meeting stressed the importance of maintaining the bottom line of people's livelihoods, focusing on employment work for key groups such as recent college graduates, migrant workers, people lifted out of poverty, and zero-employment families. It called for strengthening assistance for groups facing employment difficulties, such as older individuals, people with disabilities, and long-term unemployed. The meeting emphasized strengthening assistance for low-income populations and ensuring the supply and price stability of important goods such as food, water, electricity, gas, and heat. It stressed the importance of food and agricultural production, caring for farmers' income increases, and ensuring national food security."

Again, there is little new in terms of supporting consumption here. These poverty-alleviation programs are all in place but extremely limited. This will produce marginal changes, at best.

<u>*There just isn't anything new here – certainly nothing that one could characterize as a sea change in policy*</u>. Of course, that hasn't stopped those who erroneously identified a sea change in policy in March of 2022, December of 2022, and February of 2024 from doing so again.

If there is one element of the policy package that is meaningful on the margin it's the 800 RMB monthly stipend for children. While this is more geared towards social engineering that developing a Chinese welfare state, it does constitute a permanent program (as opposed to a one-off) that the bulls cheering on China can point to as marginally beneficial.

That's not the case for the holiday cash handouts which are one-off, *de minimis*, and not unusual. *Bloomberg*:

> "**China to Give Cash Handouts to the Poor in Rare Use of Aid**
>
> "China said it will give one-off cash handouts to residents facing hardship and vowed more benefits for some unemployed people, in a rapid-fire round of measures seeking to boost consumption and allay growing economic anxiety ahead of a key national holiday.
>
> "The Chinese government didn't say how many people will benefit from the cash handouts or their total value in a brief statement. It called for local authorities to ensure the funds reach their recipients before Tuesday, the 75th anniversary of the founding of the People's Republic, to show 'the party and the government's love and care for people in need.'
>
> "China's ministries budgeted 154.7 billion yuan ($22 billion) for financial assistance and subsidies to people including those earning the lowest income, in extreme poverty, orphans and the homeless this year, according to a government notice in April. It's unclear if the coming one-time allowance will come out of this budget.
>
> "Also on Wednesday, the State Council said it will provide some social security benefits for college graduates who haven't found a stable job two years after leaving school in an effort to boost employment. The country introduced a similar initiative in 2020 when the pandemic first hit."

Same goes for the Shanghai consumption vouchers – too small, and it's been done before to little effect. Here is *Xinhua*:

> "**Shanghai to issue consumption vouchers worth total of 500 million yuan**
>
> "Shanghai will allocate 500 million yuan (about 71.14 million U.S. dollars) from its municipal budget to issue consumption vouchers for the dining, accommodation, cinema and sports sectors, the Shanghai municipal government's information office said on Wednesday.
>
> "Funds for the vouchers will be distributed based on each sector's consumption share and demand: 360 million yuan will go to the dining sector, 90 million yuan to accommodation, 30 million yuan to

> cinema, and 20 million yuan to sports. The first round of vouchers will be available from Sept. 28.
>
> "Dining vouchers have four discount levels: a 50 yuan discount on spending of 300 yuan, 100 yuan on spending of 500 yuan, 200 yuan on spending of 800 yuan, and 300 yuan on spending of 1,000 yuan. Accommodation vouchers provide discounts of 50 yuan on spending of 300 yuan, 130 yuan on spending of 600 yuan, 220 yuan on spending of 900 yuan, and 300 yuan on spending of 1,200 yuan."

Almost lost in the shuffle in the array of policy measures was a Bloomberg story suggesting that authorities are considering a 1 trillion RMB injection of capital into the big state banks (also funded by special bond issuance). This doesn't seem like something you'd do if you anticipated being able to reflate asset prices. (Although to be clear, there is no official announcement on this yet.)

> "**China Weighs Injecting $142 Billion of Capital Into Top Banks**
>
> "China is considering injecting up to 1 trillion yuan ($142 billion) of capital into its biggest state banks to increase their capacity to support the struggling economy, according to people familiar with the matter.
>
> "The funding will mainly come from the issuance of new special sovereign bonds, said the people, asking not to be identified discussing a private matter. The details have yet to be finalized and are subject to change. Such a move would be the first time since the global financial crisis in 2008 that Beijing has injected capital into its big banks.
>
> "China is rushing to replenish its banks — even though the top six have capital levels that far exceed requirements — after unveiling broad reductions to mortgage rates and slashing key policy rates to revive the economy. Enlisted to support the economy over the past years, lenders such as Industrial & Commercial Bank of China Ltd. and Bank of China Ltd. are now battling record low margins, sinking profits and rising bad debt.
>
> "'In theory, the big banks don't need more capital to sustain operations unless they will be asked to take more credit risk,' said Francis Chan, a senior analyst at Bloomberg Intelligence. 'In this case, 1 trillion RMB will be more or less for that purpose.'"

The 22% rally in the H-Fin China financials this week is setting up for a juicy shorting opportunity. A bank recap only makes sense if the banks are going to be asked to once again "take one for the team," and the booking of losses is seen as increasingly inevitable. Record-low net interest margins are here to stay and extend-and-pretend to protect non-performing loan ratios can only go so far. The ultimate destination for the equity in China's big banks is zero.

CHINA STOCK MARKETS:

What is it about the Chinese stock market that after decades of underperformance, investors still seem to feel like they're short if they're flat – as if they're still going to miss out on some growth miracle of the future, even though that growth miracle is well behind us and never produced the level of sustained corporate profitability to generate meaningful equity performance in the first place?

Of course, the rallies tend to be sharp, extreme, and momentum-driven, which we suppose is an allure – if you can get on-board them without getting dragged through the endless months of sagging performance. Despite this week's insane rally, this has been a market that's been better avoided for the past few years.

- *We talk to a lot of people involved in Chinese markets and global macro, and we're not aware of anyone who was short Chinese equities into this rally. We're as bearish as it gets on China, and even we weren't short, because the market was trading ridiculously cheap, even to the dire economic outlook*. Reportedly many international fund managers are underweight, but if they've been underweight for any period of time they've saved themselves a lot of pain.
- So, what is driving this rally? From the China cheerleading we see on X and elsewhere, no one seems to have dug too deeply into the detail of what actually has been has (and hasn't) been announced this week. The sentiment seems to be something like that the specifics don't really matter – it's not what they said, but how they said it.
- And how they said it suggests that Xi Jinping has finally succumbed to his long-suppressed urge to stimulate the bejeezus out of everything. It'll be special bonds by the trillions from here on out and stepped-up printing to boot!
- *Except that's what they all said the last three times authorities put on a show for the purposes of short-term market stabilization. Is the fourth time a charm?*
- We're certainly not betting that way. If you're underweight China and feeling the FOMO, take a deep breath and relax in the knowledge that Chinese stocks remain in a multi-year bear market.

Maybe these folks know something… From *Bloomberg*:

> "**Shareholders Cash Out of China Stocks After Stimulus Package**
>
> "Shareholders in some Chinese companies have cashed out more than $1 billion from their holdings in the past week, taking advantage of improving market conditions brought on by an adrenaline shot to the country's economy.

> “Internet investing firm Prosus NV has sold its entire stake in online travel agency Trip.com in a $743 million block trade, Bloomberg News has reported. Chinese search engine Baidu Inc. later sold$534 million in the company’s American depositary shares.
>
> “Chinese internet firm Tencent Holdings Ltd. emerged as the seller in a $206 million placement of shares in brokerage-platform operator Futu Holdings Ltd., people with knowledge of the matter said Thursday. Last week, entities tied to DCM Ventures sold their entire stake in Kuaishou Technology for $477 million. A group of pre-IPO holders of Sichuan Kelun-Biotech Biopharmaceutical Co. also raised $49 million.
>
> “Secondary share sales in Chinese companies have raised $6.4 billion this year, according to data compiled by Bloomberg. That eclipses the $2 billion and $3.5 billion raised in all of 2022 and 2023, respectively.”

THE ENDGAME

This week’s announcements are not a fix for China’s economic problems. There is no fix.

- *Everyone is obsessed with weak demand in China but it’s not ultimately a demand problem. It’s a supply-side problem*. China’s supply side is hugely inefficient. The bulk of allocated capital is directed by central planners in Beijing, not by entrepreneurs seeking profits.
- This is not to say there hasn’t been a thriving entrepreneurial sector with great fortunes made.
- The entire system doesn’t need to be centrally planned to cause existential problems. The central planning just needs to be pervasive enough to drag economy-wide returns on investment below the cost of capital – and the nation’s finances will go pear-shaped.
- That’s clearly the case in China. And what’s worse, *the power of the central planners relative to the entrepreneurs is growing* – the opposite of what China might need to present a credible case for being able to grow out of its debt problems.
- *If the Chinese government were to shift to a policy of widescale social spending to boost consumption – in the absence of a major restructuring of the supply side which dramatically shrinks the role of the central planners – it would simply accelerate the march towards national bankruptcy.*
- *Debt-deflation requires a monetary response*. An asset bust leaves the economy drowning under the weight of an unsustainable real debt load. Asset liquidation and a reluctance to both extend and accept credit weighs on prices, which further exacerbates real debt loads.
- *Accelerated fiscal spending in the absence of highly accommodative monetary policy increases the debt load without addressing the*

underlying problem of too-low nominal growth – and simply works to further swell the real debt load. In the absence of demand for credit (with ROI's below funding costs), government spending financed by money creation can goose aggregate demand and work to reverse the deflation. But fiscal spending financed by bond issuance will not generate a significant multiplier and might even exacerbate the broader debt problem.

While this week's policy package will do little to alter the trajectory of Chinese economic growth, it does take us one step closer to the endgame.

- There is good reason for President Xi to have resisted all the calls for widescale fiscal stimulus until now, and then not to have done more. It's unlikely to work in anything other than the micro-term and it's the last card he has to play.

Local government balance sheets are tapped out. Household balance sheets are decimated by a decatrillion dollar loss of wealth. *Now, with great reluctance, the authorities are bringing the central government balance sheet to the table -- again*.

- *For this to work, you have to believe that things that didn't work the last three times, when conditions were better, will work this time, when they're worse. After that, there's nothing else to try*.

Bottom line

The Peoples Bank of China and the Politburo have announced monetary and fiscal stimulus, and equity markets have responded with a large rally. But the measures announced are almost literally the same things that have already been tried over the last four years of a relentless bear market. Why should they work this time? Throwing more debt at an already debt-heavy economy won't help, and its usual transmission channel – housing speculation – is moribund. Demand-side measures will fail, when the issue is China's supply-side inefficiency, worsened by a an increasingly repressive regime of central planning. The authorities cannot buy their way to a prosperous totalitarianism by pushing the string of credit.