GLOBAL MARKETS ANALYSIS

"China's market intervention in attempt to revive long-term growth"

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1. Introduction to China's Current Economic Situation

1.1 Sluggish Growth and a Major Shift in Economy

China, the world's second-largest economy, has long been a driver of global growth. With a GDP driven by strong exports, a massive manufacturing sector, and rapid urbanisation, it has been repeatedly called the global factory and has experienced a meteoric rise in influence. However, recent years have revealed economic challenges that threaten this momentum, including a significant slowdown in growth, a severe crisis in the property market, and escalating debt concerns. These issues are creating a complex landscape, not just for China, but for economies worldwide that are closely tied to China's economic health and rely on Chinese exports. We outline these key issues to provide a context for understanding the necessity and potential impact of recent economic stimulus measures by China's central bank, the People's Bank of China.

Recently, China's economy has witnessed a noticeable deceleration in growth, falling short of government targets and diminishing the expansion that marked the previous few decades. China's manufacturing sector, a crucial pillar of its economic strength, has struggled with inflationary pressures, which combined with trade tensions, have reduced export demand for Chinese goods. On top of that, China's population has started to decline, reducing the availability of younger workers. This demographic shift also places pressure on government services and the need for economic support programs for an aging population.

One of China's most visible and urgent economic issues is its ongoing property market crisis. The property sector has historically been a major driver of growth, but aggressive borrowing, overbuilding, and high levels of speculative investment have left the sector in a fragile state. Developers like Evergrande and Country Garden, which once led China's real estate boom, now face crippling debt and financial challenges that have caused them to delay or abandon projects. One of the reasons is that property developers relied too heavily on debt to fuel growth. When the government introduced the "three red lines" policy to control excessive leverage in 2020, some companies struggled to adapt. Evergrande, for example, amassed over $300 billion in debt, ultimately failing to meet obligations. These situations have shaken investor confidence, triggering a cascade of delays in project completions and mortgage defaults.

Critically, the real estate crisis extends beyond housing, affecting construction, steel, and manufacturing industries that supply the building sector. The slowdown in real estate directly impacts employment, as millions depend on these related industries for jobs. Additionally, local governments, which rely on land sales to finance infrastructure projects and public services, face reduced revenues due to the declining property market. This scenario places additional strain on government resources needed to stabilise the economy.

China's economic performance significantly impacts global markets. Its integration into global trade, investment, and financial markets means that its economic challenges do not exist in isolation. China's status as a key exporter means that its economic health influences global supply chains. A downturn in China's economy could lead to supply disruptions and increased costs for companies worldwide, especially in sectors like technology, electronics, and consumer goods. Furthermore, China has been a major investment destination for global financial markets. Economic instability and reduced investor confidence in China might drive capital outflows, weaken the Chinese yuan, and impact stock markets worldwide. Finally, China's economic growth has been a major factor in global demand for commodities such as oil, steel, and copper. A slowdown in China can lead to reduced demand and price volatility for these resources, impacting economies and investors dependent on commodity exports.

The outcome of the PBOC's interventions will influence China's trajectory as a global economic powerhouse and have ripple effects across international markets. In response to these economic pressures, the People's Bank of China has implemented a series of stimulus measures aimed at stabilising growth and restoring confidence in the economy. We will assess the potential effectiveness and broader implications of the PBOC's actions, including whether these stimulus measures will be sufficient to restore confidence among consumers and investors and how this might translate into increased spending and investment.

2. Economic Context and Rationale for PBOC's Stimulus Actions

2.1 Global Context

China's economic situation has become increasingly complex, with slowing growth, a property market crisis, and high levels of household debt. All these contribute to an overall dissatisfaction and sense of financial uncertainty. Now, we will explore these issues and the underlying factors that create the economic pressures within China.

China's GDP growth has slowed significantly compared to previous years, largely due to weakening demand both domestically and internationally. This slowdown has affected multiple sectors, from manufacturing to retail, reducing overall economic output. Once a global manufacturing hub, China's production sector has been especially impacted by trade tensions and reduced foreign demand. USA-China trade disputes, mixed with global inflationary pressures, have limited demand for Chinese exports, further stopping growth.

The property market crisis has exposed issues in Chinese economic structure. The high reliance on real estate as a driver of growth has backfired, with the sector now in crisis due to high levels of debt and an oversupply of housing. With projects delayed or abandoned, frustrated homebuyers have begun boycotting mortgage payments on unfinished properties, leading to unprecedented mortgage strikes. This phenomenon has undermined confidence in the real estate sector and introduced new risks to China's banking system.

The property market downturn has extended to a variety of sectors, adding to economic strain, as millions of Chinese workers are employed in industries linked to property development. Moreover, rising concerns about the economic outlook have dampened consumer spending and borrowing. This reluctance has stalled economic momentum, as household spending is a crucial element of economic growth.

Recent actions by major economies, particularly the United States, have influenced financial conditions in China. Its economic slowdown is occurring within a particularly challenging global environment, adding further pressure on its economy.

The recent rate cut by the US Federal Reserve, aimed at providing relief to the US economy, has also affected China's financial markets. On the one hand, lower US rates reduce pressure on China to raise its own rates, on the other, a stronger dollar can make Chinese exports more expensive, adding strain to its export-dependent economy. Furthermore, inflation and supply chain disruptions continue to affect global demand and prices for goods, further limiting export growth. These factors, coupled with ongoing geopolitical tensions, have complicated China's economic recovery efforts.

Given the combination of slowing growth, property market turmoil, and high household debt, the People's Bank of China has deemed it necessary to implement stimulus measures aimed at stabilising the economy.

China's economic growth is below its desired targets, prompting the need for stimulus to boost the economy. The PBOC's measures like interest rate cuts aim to make borrowing more accessible and encourage spending among businesses and households. High borrowing costs have constrained corporate investment and consumer spending. By lowering interest rates, the Central Bank seeks to support some of the financial strain on indebted households and companies. The support measures for the property market such as easing property minimum down payments are intended to stabilise prices and foster urbanisation, which is crucial given the role of real estate in China's economy.

These interventions aim to restore confidence in the Chinese economy by signalling that the government and central bank are committed to supporting growth and stabilising key economic sectors. A newfound confidence among consumers and investors should lead to increased spending and investment, boosting overall economic activity.

3. Details of the Stimulus Measures

3.1 Interest Rate policies

The People's Bank of China (PBOC) has introduced several interest rate policies to reduce the cost of borrowing for households and businesses, aiming to spur economic activity and stabilize the real estate market. These include adjustments to mortgage rates, reductions in the Loan Prime Rate (LPR), and tailored policies for first-time and second-time home buyers.

U.S. Fed's Rate Cut and Yuan Stability: The recent rate cut by the U.S. Federal Reserve provided a window for China to lower rates without putting excessive pressure on the yuan, minimizing depreciation risks that could trigger capital outflows. With global central banks adjusting rates, the PBOC's cautious rate cut aligns with an international trend, allowing China to stimulate growth while maintaining currency stability

Mortgage Interest Rate Cuts on Existing Loans: On April 2024, the PBOC implemented a 0.5 percentage point reduction on existing mortgage interest rates, targeting relief for approximately 50 million households as Governor Pan Gongsheng indicated. By easing the debt burden on homeowners, this measure is expected to enhance disposable income and encourage household spending, which is essential given China's current low consumer demand. Indeed, lower interest rates on existing mortgages immediately improve household cash flow, resulting in a positive wealth effect potentially lifting consumer spending, alleviating pressure in the debt-laden property sector and restoring confidence in the housing market.

Interest Rate Cuts on Provident Fund Loans: Effective May 18, 2024, the PBOC lowered interest rates on personal housing provident fund loans by 0.25 percentage points. The new rates for provident fund loans are as follows:

- For first-time home buyers: 2.35% for loans with maturities of five years or less, and 2.85% for loans with maturities over five years.

- For second-time home buyers: 2.775% for loans with maturities of five years or less, and 3.325% for loans with maturities over five years.

Adjustments to the Nationwide Policy Floor on Mortgage Rates: In a notable policy shift, the PBOC removed the nationwide floor on mortgage rates for first-time and second-time home buyers, giving local branches increased discretion. Under the new "city-specific" principle, provincial branches now have the authority to set lower or remove limits on mortgage rates based on local real estate market conditions and regulatory requirements. This flexibility allows regional branches to respond dynamically to local market fluctuations, tailoring mortgage rate policies to align with each city's housing needs and economic conditions.

Enhanced Flexibility for Commercial Housing Loan Rates: The PBOC has refined the structure for commercial housing loans by allowing borrowers to choose between fixed and floating interest rates for new loan contracts. For those opting for floating rates, the interest rate is now linked to the Loan Prime Rate (LPR) with a spread, which can vary based on market supply, demand, and borrower risk profiles. Moreover, from November 1, 2024, borrowers with existing fixed-rate loans may renegotiate their contracts to adopt a floating rate based on the latest LPR, if market conditions have changed significantly.

Loan Prime Rate (LPR) Reductions: In addition to targeted mortgage rate cuts, the PBOC has implemented a series of LPR reductions over 2024 to support broader lending and reduce National Interbank Funding Center (NIFC) are:

- One-year LPR: Set at 3.1% in October 2024, down from 3.35% in earlier months. This reduction aims to stimulate short-term borrowing by reducing rates on various credit products tied to the one-year LPR.
- Five-year LPR: Set at 3.6% in October 2024, down from 3.85% in prior months. The five-year LPR, commonly used as a reference for mortgage loans, is expected to make long-term financing more affordable for households and businesses alike.

Figure 1: Evolution of Loan Prime Rate (LPR). Nov 2023-Oct 2024

These LPR adjustments, alongside targeted mortgage rate reductions, are designed to reduce the overall cost of credit, boost economic activity, and provide a more favorable environment for property purchases and investments.

3.2 Bank Reserve Requirements

Furthermore, adhering to its accommodative monetary policy stance, the PBOC has also reduced the reserve requirement ratio (RRR) for financial institutions by 0.5 percentage points (excluding those that are already subject to an RRR of 5 percent), freeing up capital and increasing liquidity. This intervention, that has been effective since September 27, 2024, follows another similar measure that has been taken by the end of January 2024 with the same intent of strengthen the upward trend of economic recovery. Altogether these measures lowered the weighted average RRR for financial institutions from about the 7.0 percent to the expected roughly 6.6 percent after the cut of September 2024 as PBOC reported (see Figure 2).

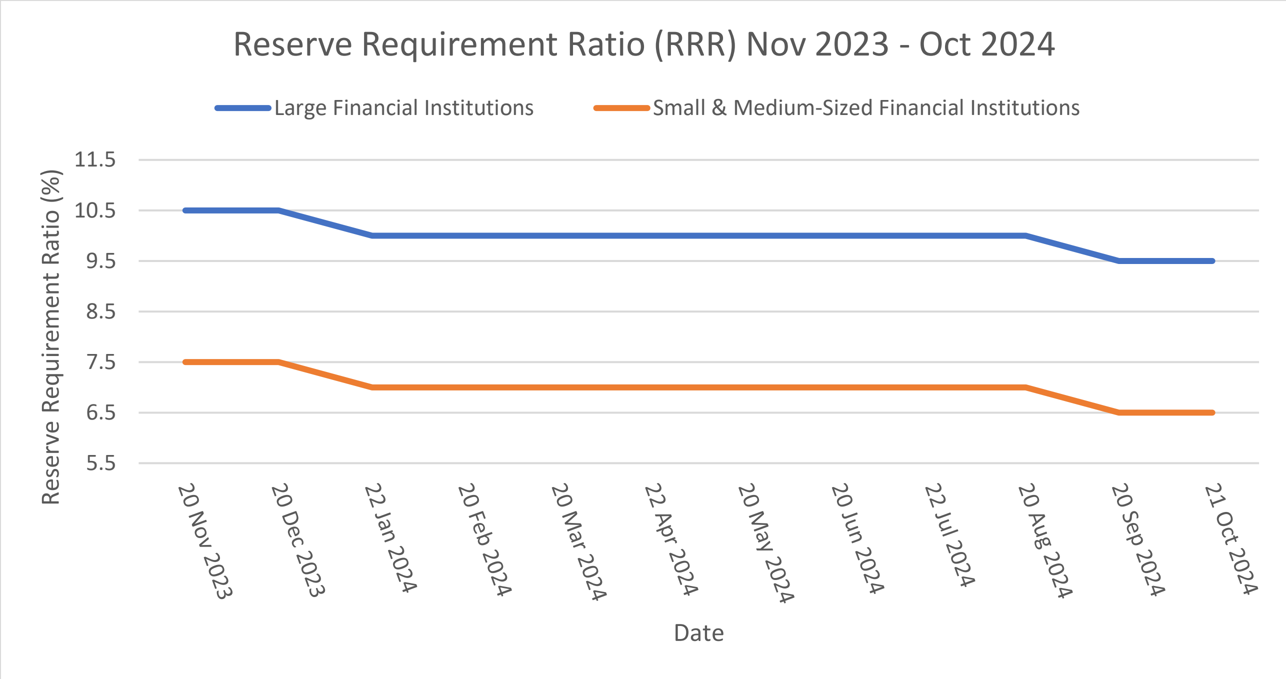


Figure 2: Evolution of the Reserve Requirement Ratio (RRR) for Large, Small & Medium-Sized Financial Institutions. Nov 2023 - Oct 2024

Credit Expansion and Liquidity Boost: Lower reserve requirements enable banks to lend more extensively, thus benefitting sectors such as property, small- and medium-sized enterprises (SMEs), and consumer finance and also providing much-needed liquidity to distressed sectors. Therefore, the policy is expected to revitalize investment activity, support consumer loans, and potentially aid struggling property developers with fresh credit (see Figures 3-6). In particular, the interest rate cuts alongside the lower RRR is estimated to reduce the annual interest burden by roughly 150 billion yuan (£16 billion). Thus, by alleviating financial pressures, the policy aims to support consumption growth and stabilize homeownership sentiment amid a prolonged downturn in property values.

Limited Fiscal Measures Raise Concerns: While monetary policy changes, such as rate cuts and RRR reductions, provide immediate liquidity and confidence boosts, experts like Julian Evans-Pritchard argue that a full recovery may depend on significant fiscal support. Current plans for fiscal stimulus remain modest, with some analysts concerned about whether the available funds are sufficient to address structural economic issues, especially within the property market.

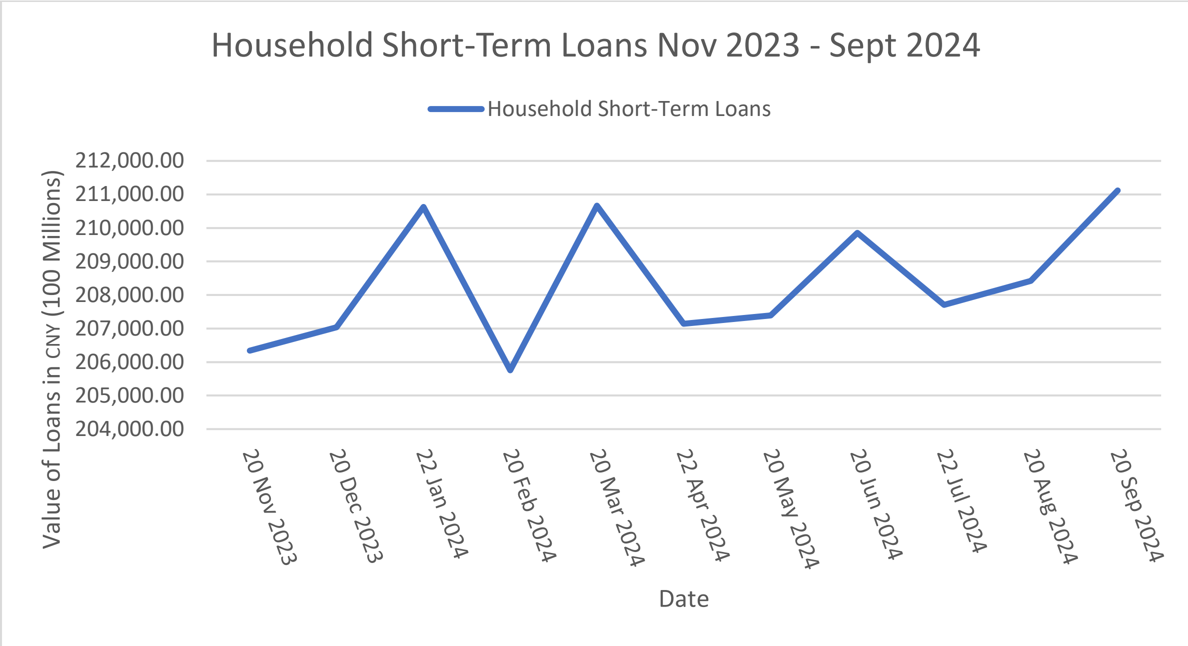


Figure 3: Evolution of Household Short-Term Loans. Nov 2023 - Sept 2024

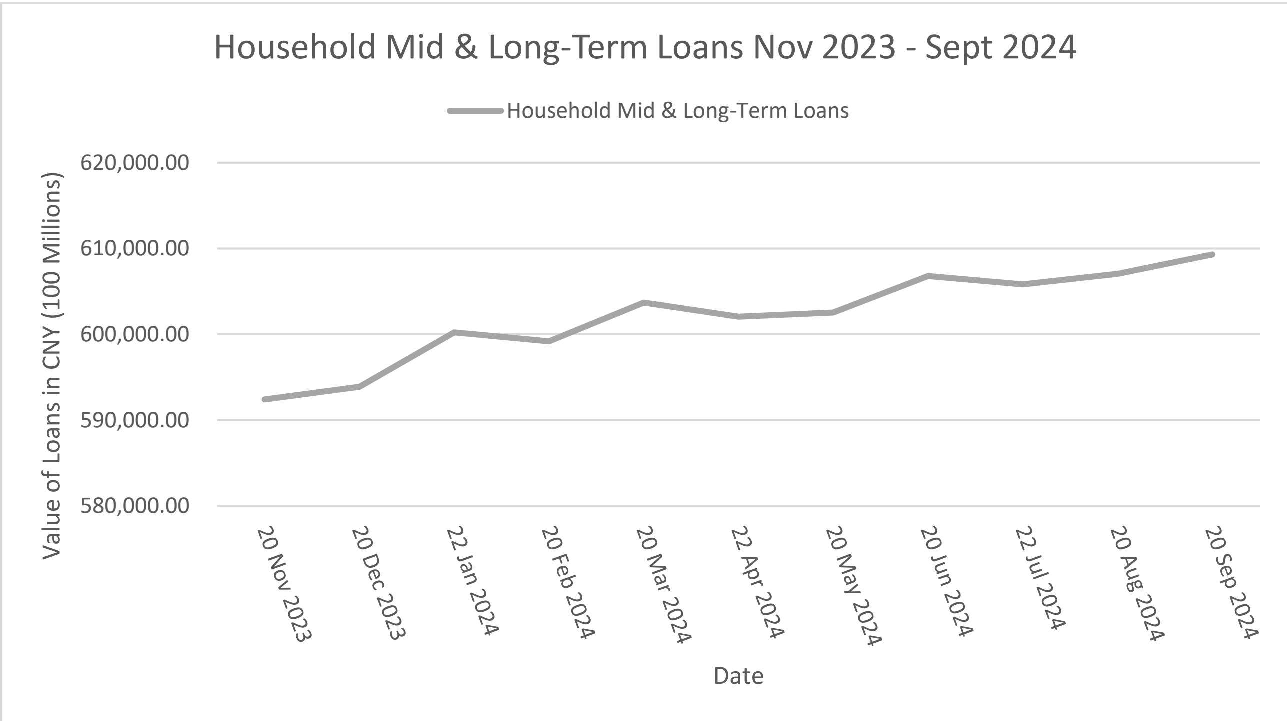


Figure 4: Evolution of Household Mid & Long-Term Loans. Nov 2023 - Sept 2024

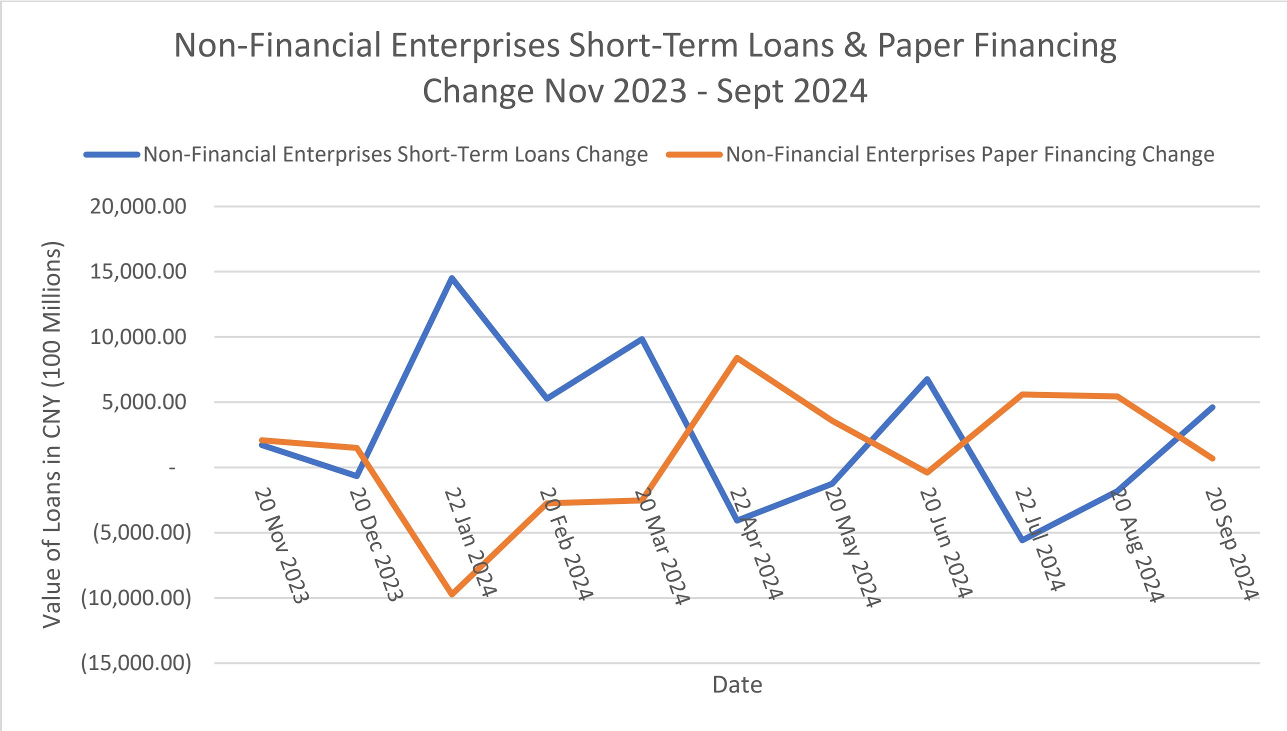


Figure 5: Evolution of Non-Financial Enterprises Short-Term Loans & Paper Financing Change. Nov 2023 - Sept 2024

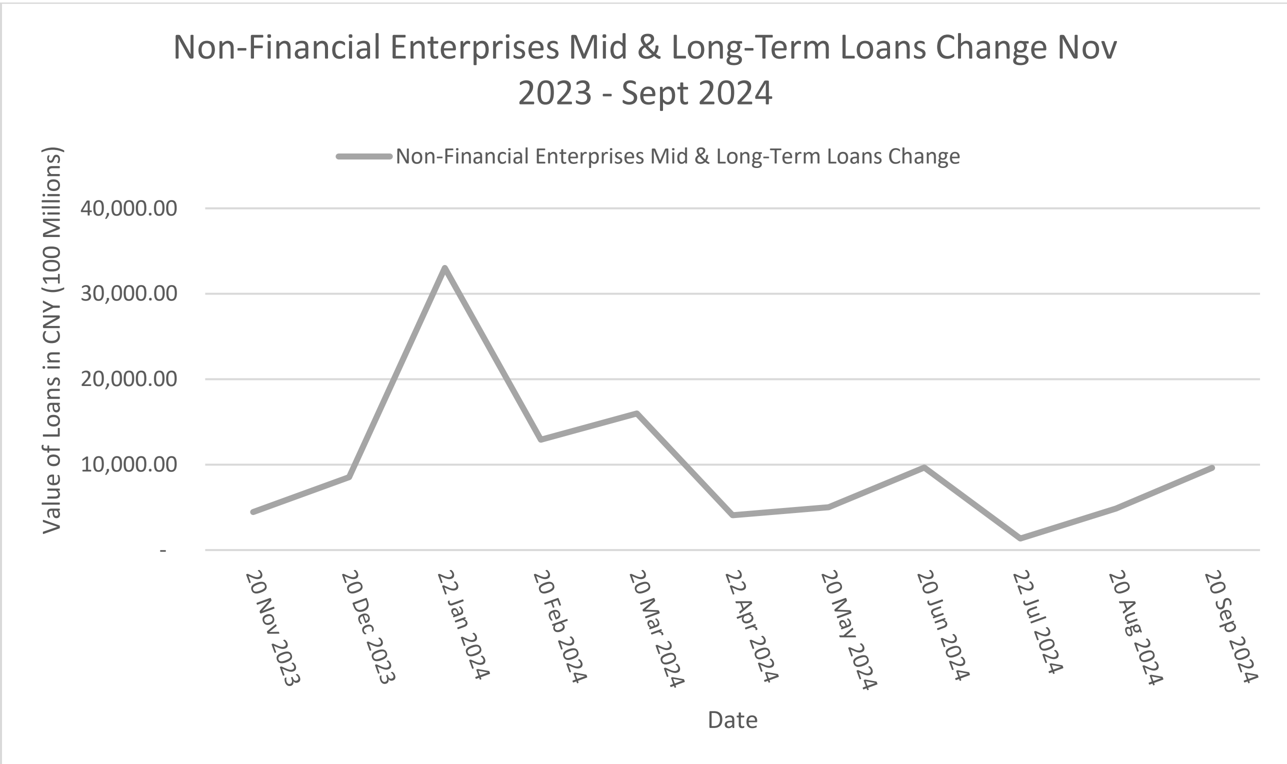


Figure 6: Evolution of Non-Financial Enterprises Mid & Long-Term Loans Change. Nov 2023 - Sept 2024

3.3 Housing Market Stimulus

Along the measures described above, the ongoing challenges in China's real estate sector, marked by declining sales, liquidity crises for developers, and stalled projects, have prompted the People's Bank of China (PBOC) and other government bodies to initiate a series of targeted stimulus initiatives. These efforts seek to stabilize the market and support consumer confidence, but analysts caution that the impact may take time and require additional fiscal intervention.

Lowering Minimum Down Payments for Second Homes: In an attempt to encourage home-buying, the PBOC has reduced the minimum down payment requirement for second homes from 25% to 15%. This measure is designed to attract buyers who have been discouraged by high deposit requirements, especially those considering a second property. By lowering this barrier, the government aims to stimulate demand, thus providing developers with much-needed liquidity. With increased transactions, developers may find relief from the current cash-flow crunch, potentially mitigating defaults and stabilizing the overall real estate sector.

Comprehensive Stimulus and Inventory Destocking Measures: The recent policy actions represent a coordinated effort, distinct from the previous piecemeal approach. Analysts at Goldman Sachs and S&P Global believe this is a crucial inflection point in reversing the downward trend in the housing market. In May, the PBOC introduced a 300 billion yuan relending facility to help state-owned enterprises buy up unsold completed homes and convert them into affordable housing. Though this accounts for only 4–6% of total unsold housing stock, it marks a step toward reducing excess inventory. Analysts predict that sustained government intervention will be needed to address the estimated 20 million pre-sold but unfinished homes. Nomura reported that only 4 million homes had been delivered by late 2023, underscoring the need for faster support to complete these units and restore consumer confidence.

3.4 Stock Market Investment Measures

To invigorate the stock market and channel capital from real estate into diversified investments, the People's Bank of China (PBOC) implemented relaxed regulations on borrowing to invest in equities in April 2024. This move aligns with broader government efforts to boost asset valuations, enhance investor confidence, and create a more balanced financial landscape for Chinese households. The announcement had a rapid impact: on the same day, the Shanghai Composite Index rose by over 4%, and within days by over 8%, reflecting widespread optimism over an anticipated capital inflow and signaling market approval of the policy.

However, the context surrounding China's recent stock market stimulus reveals both opportunities and challenges for sustained market growth.

Long-term Government Commitment and Policy Shifts: Investors have historically been cautious of short-lived recoveries in Chinese equities due to inconsistent policy follow-through. Goldman Sachs analysts believe that this cycle may be different. Since September, the government has rolled out a comprehensive stimulus package encompassing over ten major policies across monetary and fiscal domains, specifically targeting equity and property markets. This breadth and scale suggest a more enduring commitment, potentially rivalling major past interventions, like the 2015 A-share rescue plan. By signaling steadfast support for the stock market, the government aims to reassure both domestic and foreign investors of its dedication to maintaining economic stability.

Potential for Earnings Growth: Analysts expect that every trillion yuan of fiscal stimulus channeled into the real economy could boost GDP growth by 40 basis points, adding roughly 2% to earnings growth for stocks in major Chinese indexes, such as the MSCI China and the CSI300. These projections have prompted analysts to raise their price-to-earnings targets, forecasting gains of 27% and 15% over the next 12 months for MSCI China and CSI300 indexes, respectively. Despite previous underperformance in earnings, the projected modest improvement aligns with an optimistic, yet measured, view on stock valuations as the broader economic outlook strengthens.

A Shift in Household Investment Preferences: Amid ongoing property market volatility, the Chinese government is encouraging households to diversify away from real estate and into equities. With property investments carrying high risks and stagnating values, equities are positioned as a viable alternative for growing household wealth. This trend could provide a more balanced growth model that depends less on real estate and more on diversified investment avenues. This could attract both domestic and international investors looking for exposure to Chinese growth sectors, particularly as foreign central banks have recently made similar rate adjustments. As a consequence, this shift could benefit both retail and institutional investors who seek stable, long-term investments beyond property. Some fund managers, like David Jane at Premier Miton Investors, have increased their exposure to Chinese stocks, believing that while the overall economic recovery may remain uncertain, the stimulus measures may drive funds into the stock market as Chinese savers gradually diversify their portfolios.

4. Analysis of the Potential Impact

4.1 Short-term Economic Growth

With a suite of stimulus measures in place, short-term growth prospects appear moderately improved. The IMF recently projected that China's economy would grow by 4.8% in 2024, just below Beijing's 5% target. By enhancing household cash flow, boosting bank liquidity, and supporting the stock market, the government aims to bridge this gap, although underlying structural challenges remain. Indeed, sustained growth may depend on further fiscal action to address the underlying structural issues in China's economy, including the high debt levels and declining property values.

Consumer Spending: The reduction in mortgage rates is expected to immediately improve household cash flow, potentially leading to a rebound in retail spending, which has recently underperformed at 2.3% year-on-year growth.

Investor Confidence: Market optimism following stock market-related policy changes, including eased borrowing requirements and a 8% surge in the Shanghai Composite Index, indicates a likely boost in investor sentiment that could support further economic activity.

4.2 Property Market Effects

The relaxation of down payment requirements for second homes and interest rate cuts for mortgages reflect a decisive attempt to stabilize the housing market and restore consumer confidence in property investments. The implications are of course very broad and needs to be studied carefully in order to understand the possible effects of such interventions.

Short-term Relief for Households and Developers: As discussed above, reducing mortgage rates and down payments is anticipated to relieve financial pressure on households, thereby improving market sentiment and addressing some liquidity issues for property developers. Therefore, these measures also aims to stimulate demand for housing, potentially reversing the 10.5% contraction in property investment observed in early 2024.

Risks of Reigniting a Housing Bubble: On the other hand, by encouraging second-home purchases, there is a potential risk of speculative behavior. While the current policies are designed to support genuine demand rather than drive speculative investment, prolonged application of these measures without adequate oversight could exacerbate structural imbalances in the housing market

Wealth Effect and Consumer Confidence: Stabilizing or slightly increasing property values is critical to fostering a wealth effect for homeowners, who may feel more financially secure as their perceived wealth rises. Since housing accounts for a significant portion of household wealth in China, steady or appreciating property values can have a pronounced effect on consumer confidence. This effect is central to the government's approach, as it encourages greater spending and investment from households, countering deflationary pressures. S&P Global notes that reversing the current downward spiral in housing prices could also improve sentiment in other sectors reliant on consumer demand. Indeed, stabilizing home prices could support consumer spending, while looser mortgage requirements and lower down payments could ease financial concerns, encouraging spending and investment across other sectors.

Fiscal Support Requirements and Risks: To fully stabilize the market, analysts from Goldman Sachs estimate that an additional 8 trillion yuan ($1.12 trillion) in government fiscal spending could be necessary. This funding would likely target developer liquidity, inventory reduction, and the completion of unfinished homes. Without such substantial support, the market downturn could last another three years. However, the analysts warn of risks if these policies fall short: a potential further 20–25% drop in property prices, exacerbating liquidity issues and deepening the market's challenges. Furthermore, while these policies may create short-term relief, they could also increase household debt and speculative buying if not closely managed, potentially risking a renewed bubble.

Long-Term Outlook and Market Challenges: Despite recent improvements, such as an October contraction in property sales in major cities that was less severe than September's, analysts remain cautious. Goldman Sachs forecasts that property prices will not fully stabilize until late 2025, and that property sales and new construction will remain subdued until 2027. The excess of unsold inventory continues to weigh on developers, who have been forced to cut prices to attract buyers. S&P estimates that property sales will decline from 18 trillion yuan in 2021 to around 9 trillion yuan this year, and potentially as low as 8 trillion yuan in 2025.

4.3 Stock Market Response

The easing of restrictions on stock investment borrowing and the implementation of a £50 billion stock market support program have spurred immediate market gains, with the Shanghai Composite Index climbing over 4% on the same day of the announcement (September 24, 2024).

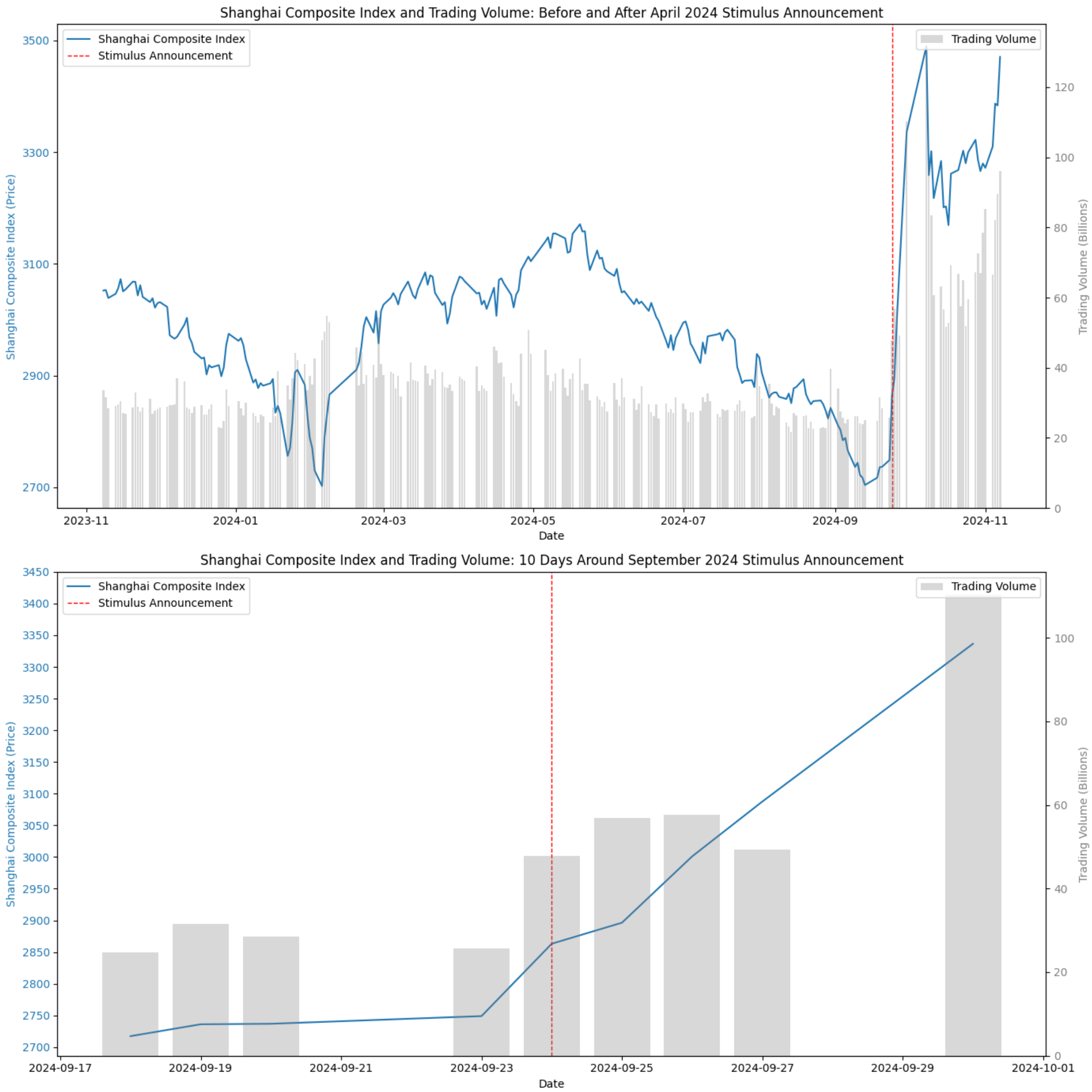


Figure 7: Shanghai Composite Index and Trading Volumes Before and After Stimulus Announcement. Nov 2023 - Nov 2024

Challenges and Risks to Sustained Recovery: Despite these promising signs, uncertainties linger. Analysts are cautious that market gains could reverse without clear fiscal policy execution. The property sector's downturn, marked by low consumer confidence and a negative wealth effect, complicates the stimulus strategy. The decline in property values has eroded household wealth, dampening consumer spending power and overall sentiment. Stimulus policies must address this challenge effectively, as the real estate sector accounts for a substantial portion of household wealth and economic activity. Moreover, potential deflation risks, driven by low consumer demand and artificially low prices in some sectors, could limit the effectiveness of monetary stimulus alone.

Global and Domestic Factors Impacting Market Sentiment: Externally, factors like trade relations and policy decisions from major economies could influence market outcomes. TS Lombard's economists warn that any resurgence in tariffs on Chinese goods could further stress the economy by reducing export demand at a time when domestic consumption is restrained by high household debt. Internally, local governments face fiscal constraints that may limit their ability to support housing prices effectively, an issue Beijing is expected to address. If property values can be stabilized, the resulting "wealth effect" might improve consumer confidence, making fiscal stimulus more impactful by encouraging spending across the economy.

Global Investment Considerations: China's policies are also significant for global markets, given that Chinese equities are a key component of emerging market indices. Indeed, the expected recovery in China's property and construction sectors, along with the 1% rise in Brent crude prices ($75 a barrel) following the announcement, signals an increase in demand for commodities. If China sustains growth, this could positively impact global commodity suppliers, especially those in emerging markets reliant on Chinese demand. However, with declining confidence in China's growth story, some international investors have been hesitant to directly invest in Chinese stocks. Instead, they are adjusting their strategies in sectors like mining, which previously depended on China's robust construction demand. Meanwhile, European luxury goods sectors, reliant on Chinese consumers, face headwinds as China's economy slows. But, with relaxed borrowing conditions and stabilized property prices, demand for high-end products from European companies may recover, supporting European equities that are heavily weighted in luxury and export sectors. Nonetheless, China's equity market still offers diversification benefits due to its idiosyncratic nature, providing portfolio resilience in a globally synchronized market.

4.4 Debt Implications

While these measures aim to stimulate demand, there are concerns that they may lead to increased debt levels among households and corporations, which could undermine financial stability in the long term.

Household Debt Accumulation: The reduced deposit requirements and mortgage rate cuts may lead to a rise in household debt levels. Although lower rates alleviate immediate financial burdens, the long-term effect of increased debt exposure could be risky, especially if household incomes remain stagnant. Therefore, to sustain growth, the PBOC and government policymakers must balance short-term stimulus with long-term debt reduction strategies, gradually guiding the economy toward lower, more stable growth while avoiding abrupt contractions.

Structural Adjustments to Avoid Middle-Income Trap: As China aims to transition from an export-driven to a consumption-driven model, supporting consumer confidence and reducing reliance on real estate as the primary investment asset are key. A balanced approach will likely include expanded fiscal support to address structural imbalances, including high household debt and declining demographics, to build a resilient economic foundation

Corporate Debt and Banking Sector Risks: Increased lending to developers and SMEs, while necessary for economic revitalization, also raises concerns about credit risk within the banking system. If property prices or consumption rates do not recover as anticipated, banks may face rising default rates, potentially impacting the stability of the financial system.

5. Expert Opinions

In order to analyze more in depth, the complexity and possible effectiveness of China's measures, it's useful to consider some insights from expert economists and opinions prevalent in the markets and among financial operators.

Several economists have expressed positive views on China's recent economic stimulus measures, seeing them as a crucial step toward stabilizing and supporting growth, despite ongoing challenges in the economy.

Andrew Hencic, Senior Economist at TD Economics, notes that China's monetary and fiscal measures, including cuts in the required reserve ratio and rate reductions, are seen as a response to deflationary pressures and sluggish consumer demand. While Hencic acknowledges that more may be needed for a sustained recovery, he believes that these actions show a proactive effort to stabilize the economy, signaling a positive shift from earlier hesitance. The increased liquidity and targeted support to the housing market, alongside adjustments in lending policies, are expected to encourage some economic recovery.

Economists at Deutsche Bank are similarly optimistic, particularly about the scope of fiscal and monetary stimulus. They highlight the larger financial injections and focus on real estate as beneficial to stabilizing asset prices and reducing market uncertainty. They view the comprehensive nature of the stimulus, including liquidity support and rate cuts, as having the potential to revitalize the housing market, which is key to maintaining broader economic stability.

UBS and Nomura Analysts have also revised their forecasts for China's GDP growth, citing the positive effects of recent policy interventions. UBS, for example, raised its growth forecast, pointing to signs of recovery, partly driven by these measures. The stimulus package, which includes reductions in mortgage rates and targeted measures for struggling sectors, is expected to help meet growth targets in 2024, a sign of the policies' early effectiveness.

Overall, the market seems to recognize that further measures may be necessary to fully address structural challenges, however, there is a consensus that China's recent policy shift has the potential to support economic recovery in the short term and stabilize key sectors, including real estate and domestic demand.

Despite these supportive viewpoints, there are significant critiques of China's approach, particularly concerning the adequacy of fiscal stimulus and structural reform:

Insufficient Fiscal Support: A primary criticism is that China's fiscal measures are not aggressive enough compared to the scale of economic challenges. While there have been infrastructure investments and targeted tax reliefs, they have not been as substantial or widespread as many believe necessary. Economists argue that without a more substantial fiscal boost, household consumption is unlikely to see a strong revival. The caution in fiscal policy may thus be limiting the overall impact of recovery efforts.

Need for Structural Reforms: Critics assert that China's stimulus packages lack robust structural reforms that could address underlying economic imbalances. With high corporate debt and reliance on state-led investment, some argue that China's economy needs deeper structural shifts to ensure long-term growth. Economists call for more comprehensive reforms, such as measures to stimulate private-sector growth, increase labor market flexibility, and strengthen social safety nets to reduce household savings rates and boost spending.

Concerns over Limited Consumer Stimulus: Another limit is that China's policy measures have not effectively boosted consumer confidence and spending. Although there has been support for SMEs and some fiscal incentives, broader consumer stimulus measures, like direct cash transfers to households, have been minimal. This lack of strong consumer support is seen as a key barrier to recovery, particularly as household spending is a crucial component for a balanced economic rebound.

Reliance on Investment-Driven Growth: There is a concern that China's reliance on investment, particularly in infrastructure and real estate, may not be sustainable. While these investments create short-term growth, they may not generate long-term demand. Economists argue that more emphasis on consumer-driven growth would help reduce the risk of debt accumulation and support a more resilient economic structure.

Looking through various experts' opinion on China's economy and recent fiscal and monetary policy, it's absolutely worth mentioning Gary Ng's contribution.

Gary Ng, a Hong Kong-based economist at Natixis, frequently comments on China's economic strategies, focusing on the challenges and implications of its policy moves.

In his recent analyses, Ng has addressed China's efforts to stimulate growth amid a period of slower economic expansion and consumer caution. He notes that while government spending on infrastructure and adjustments to monetary policy (like rate cuts) signal attempts to boost confidence, these measures alone may not be enough to spur sustained consumer demand. Chinese consumers continue to demonstrate caution, as seen in restrained holiday spending and cautious investment in big-ticket items. This trend results in an underlying lack of confidence in future economic stability, potentially stalling recovery efforts.

Additionally, Ng has warned that China's dependency on consumer spending for growth will be challenging in an environment where consumers prefer saving due to uncertain economic conditions. In his view, while these consumption-driven strategies are important, they may lack the strength to offset issues such as the weakened real estate market and export pressures.

Ng emphasizes the importance of boosting consumer confidence through broader, long-term reforms that go beyond short-term policy adjustments and calls for innovations in areas like digital transformation and technology investment to sustain competitiveness and self-sufficiency in a global market facing rising geopolitical pressures.

6. Challenges and Risks

Among several challenges and risks of China's measures, main points of discussion and reflection are about: timing of the response, concerns about debt accumulation and geopolitical risks.

Delayed Response: There has been considerable debate about the timing of China's economic interventions. Critics argue that the government's cautious approach to stimulus measures has often led to delayed responses when the economy has faced downturns. This delay, they suggest, has reduced the overall effectiveness of recovery efforts.

Economists contend that a more timely intervention could have softened the economy from the shocks caused by global trade disruptions and domestic demand weaknesses.

For example, if China had introduced more aggressive fiscal support or reduced interest rates earlier, the economy might have been better protected from deep contractions in key sectors, such as real estate and manufacturing, ultimately minimizing the negative effects on employment and household incomes.

Moreover, these timing issues have been further complicated by global economic uncertainties, including fluctuating trade conditions and pandemic-related disruptions. A more proactive approach, many believe, would have better positioned China to stand external pressures, particularly in export-driven industries that are sensitive to shifts in global demand.

Risk of Debt Accumulation: China's low-interest-rate environment, designed to stimulate growth, has raised concerns about the long-term sustainability of borrowing.

By making credit more accessible, these policies have facilitated a significant increase in debt levels among businesses and local governments. While this has supported short-term growth, it raises the risk of entering a dangerous cycle of debt, where borrowed funds are used to finance growth that doesn't guarantee enough return to pay back the debt.

This situation recalls previous issues in China's history, notably in the real estate sector, where overleveraging by developers led to defaults and liquidity crises. These risks are not confined to the property sector; other industries and local governments are now accumulating significant debt, which could present challenges if the economy slows further.

The accumulation of excessive debt also places a strain on China's banking system, heightening the risk of defaults that could spread through the financial sector, ultimately weakening investor confidence.

While China has taken steps to mitigate these risks, such as limiting lending to high-risk sectors, there is concern among many economists that relying too heavily on debt-driven growth could compromise long-term financial stability.

Geopolitical Considerations: China's economic policies are increasingly influenced by its evolving geopolitical landscape, particularly its trade relations with major global powers such as the United States and European Union.

Ongoing trade tensions, tariffs, and technology export controls have created a more challenging environment for China's export-driven sectors. As China navigates these external pressures, its policy decisions will need to find a balance between boosting domestic growth and maintaining competitiveness in international trade.

In response to these challenges, China has adopted a "dual circulation" strategy, which aims to promote domestic consumption while continuing to support international trade. However, this shift requires significant changes to economic policies, and some experts argue that current fiscal and monetary measures may not be sufficient to achieve this dual focus without further reforms.

At the same time, China is making strategic investments in technology, infrastructure, and green energy as part of its broader plan to increase economic resilience and reduce dependence on Western economies. However, these efforts could heighten tensions with other nations, which may have consequences for global trade flows and foreign investment, particularly if more countries adopt protectionist policies in response to China's actions.

These concerns highlight the complex relationship between China's internal policy decisions and its external economic positioning, with significant implications for both its growth prospects and global trade dynamics.

In summary, while China's monetary and fiscal measures have been effective in certain respects, these critical perspectives highlight potential drawbacks. A delayed response may have reduced the immediate impact, while low borrowing costs risk accumulating unsustainable debt, and geopolitical considerations continue to shape the constraints and opportunities for China's economy. Together, these factors underscore the complexity of maintaining stable growth in the face of both domestic challenges and global uncertainties.

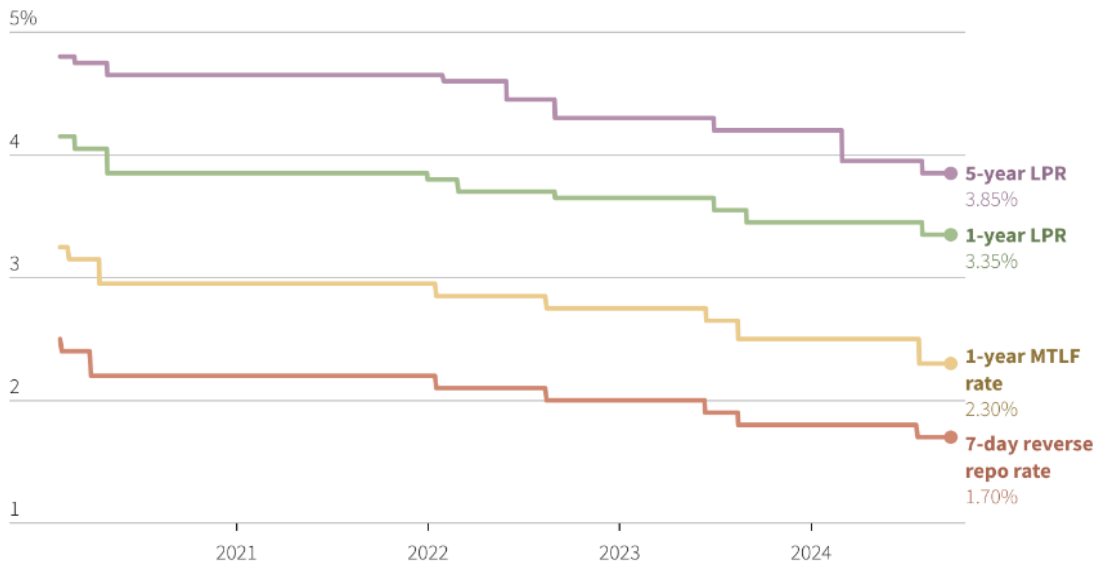
7. Conclusion and Recommendations

China's most recent economic stimulus package, announced in September 2024, aims to address China's economic slowdown, focusing on liquidity improvements, boosting the property market, and stabilizing financial markets. Key measures include interest rate cuts, a reduced reserve requirement ratio (RRR), and support for the struggling real estate sector.

In summary what the PBOC implemented:

- PBOC to cut rates, RRR and provide more property market support;
- China facing deflationary pressures, growth target at risk;
- Analysts say more fiscal stimulus needed to restore confidence;

The People's Bank of China said it will cut the seven-day repo rate by 0.2 percentage points while the interest rate on the medium-term lending facility will drop by about 30 basis points, and loan prime rates by 20-25 bps.



Key anticipated effects include:

- Short-term Effects:

- Reduced interest rates and reserve requirements, alongside targeted fiscal support, are expected to boost consumption, ease household debt pressures, and moderate the downturn in real estate. These measures may stimulate stock market performance and improve investor sentiment, helping drive near-term economic activity.
- The announcement of China's latest economic stimulus package has led to a pronounced immediate reaction in the stock markets, exemplified by a notable surge in the CSI 300 index which increased by 4.3 percent following the stimulus announcement.

- Investors are optimistic that the measures aimed at boosting consumer spending and supporting the real estate sector will translate into higher corporate earnings, particularly in sectors directly impacted by the stimulus.

- Long-term Effects:

- The long-term effects of these measures are more uncertain due to structural challenges in the economy, such as high household debt, aging demographics, and the risks of speculative behaviour in real estate. Analysts indicate that, without further structural reforms, China risks over-reliance on investment-driven growth, which could hinder sustainable recovery.
- While the immediate stock market reaction has been favorable, analysts caution that the long-term outlook remains tentative. The potential for sustained growth will depend on several critical factors, including the effectiveness of the stimulus measures in fostering a stable economic environment and the ability of Chinese authorities to implement necessary structural reforms.
- The effectiveness of any future measures will depend on how they address both supply-side constraints and stimulate consumer demand, a key factor in sustaining economic growth beyond 2024.

Indeed, while the stimulus is likely to provide a short-term boost to the stock markets, there are concerns about whether this momentum can be maintained over the long haul. Investors will be closely monitoring indicators of economic health, such as consumer confidence, industrial production, and employment rates

7.1 Future Recommendations

As we mentioned some of the challenges that were met was the delayed response, the debt accumulation, the geopolitical risks.

To address the problem of the debt accumulation China announced $1.4 trillion package over five years to tackle local governments' 'hidden' debt. China on Friday announced a five-year package totaling 10 trillion yuan ($1.4 trillion) to tackle local government debt problems, while signaling more economic support would come next year.

However, a lot of investors were expecting for a much stronger fiscal support. For these reasons some of our recommendations would be:

1. Enhanced Fiscal Support: Increase direct fiscal measures to further support households and reduce their savings inclination, thus bolstering domestic consumption.

2. Debt Management Strategies: Implement measures to monitor and manage corporate and household debt levels to prevent overleveraging and potential defaults that could strain the banking sector.

We also previously mentioned the Dual Circulation Strategy, something that could be done to further stimulate healthy growth would be to reinforce the "dual circulation" policy by strengthening initiatives that foster domestic consumption while maintaining balanced export growth, ensuring long-term economic stability amidst global trade tensions.

7.2 Outlook

The economy has shown signs of life in the few months. Purchase subsidies offered to people who trade in old cars or appliances for new ones helped auto sales rebound in September. A survey of manufacturers turned positive in October after five straight months of decline, and exports surged 12.7% last month, the largest increase in more than two years.

For most of the year, the ruling Communist Party appeared more focused on addressing long-term structural issues with the economy rather than short-term ones. Previous steps to boost the economy were piecemeal, seemingly aimed at keeping the economy afloat rather than sparking a robust recovery.

In recent weeks, the party has signalled a growing concern about the economy's sluggishness as it tries to meet its goal of achieving growth of around 5% this year. The central bank's monetary easing was followed by government pronouncements that it still has ample funds to pump into the economy.

Still, the longer-term goals of transforming China into a high-tech and green energy economy seem likely to remain the chief aims of the Communist Party, which doesn't face election pressures like the ones that toppled the Democrats and swept Donald Trump's Republicans to power in America this week.

Over the next year or so, the economic package is likely to succeed in its limited aims: reversing the decline in housing sales and providing local governments with relief from interest payments so they can pay back wages to their employees and overdue bills to the companies that supply them with goods and services.

This should be enough to stabilize GDP growth at somewhere close to the 5 percent target. The benefits to the rest of the world, however, will be modest. Neither consumer spending nor commodity demand will enjoy a dramatic pickup.

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