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Trivium China

Markets Note

After the Politburo meeting – What happens now?

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On Monday, July 24, the Politburo met for its quarterly discussion of the Chinese economy. What happens now?

Beijing isn't worried enough about the state of the economy to implement any radical policies. Policymakers believe additional economic support is necessary, but it will be incremental. We expect that:

- Restrictions on investment properties will be relaxed in an effort to breathe life into the property market.
- The PBoC might introduce another relending quota to provide additional sector-specific support, or it might expand an existing quota. And interest rates will be cut marginally to help reduce firms' borrowing costs.
- More funding will be made available for infrastructure investment.
- Efforts will be made to reduce the cost to local governments of servicing their debt, but bailouts aren't on the agenda just yet.

Regarding consumption, Beijing has recently rolled out measures to boost spending on cars, home improvements, and appliances.

- While these efforts might be expanded and refined, we don't expect to see any big consumption support policies.

Our big takeaway? Beijing won't boost consumption by providing direct income support for households.

- Instead, the Politburo thinks it will be able to increase consumption by using supply-side reforms to unleash latent demand.

We're aware that sounds innately contradictory, but Beijing is predisposed toward supply-side solutions.

- Changing that will take time and a lot more economic pain.

Following is a more detailed explanation of what we expect:

Infrastructure support

We think it's highly likely that the Politburo will approve additional debt for spending on infrastructure, probably in the range of RMB 1-1.5 trillion.

- In H2 2022, local governments received an additional RMB 500 billion SPB quota, and the policy banks deployed RMB 740 billion as capital in infrastructure projects. Without a similar boost in funding this year, infrastructure investment will drag in H2.

The question is, who will pay – local or central authorities? And what tools will be used to fund it – SPBs, policy banks, special treasury bonds, the central government budget, or a combination of these funding channels?

Monetary policy

The Politburo promised proactive fiscal policy and prudent monetary policy, and that the PBoC will continue to make the most of its structural policy tools.

- **In short, more of the same.**

“Structural policy tools” is bureaucratic shorthand for the PBoC’s relending facility and other mechanisms by which the central bank provides funding directly to key parts of the economy.

- It’s been the PBoC’s key policy tool for the last three years.

What about interest rates? We expect to see more cuts in H2, but they’ll be small.

- Our best bet is one or two 10 bps reductions in the five-year loan prime rate before year end.

As we wrote in our June 30 note, “[Interest rate cuts – Time to get unconventional?](#)”, influential voices in China are increasingly saying that aggressive – even unconventional – monetary policy is needed.

- The Politburo clearly remains unconvinced.

Beijing is worried that sharp cuts will further:

- Weaken the yuan
- Erode the net interest margins of small- and medium-sized banks, which are already under pressure

However, if producer prices remain in negative territory (June PPI declined 5.4%), lower rates will provide firms with much needed relief.

- Beijing would prefer not to cut rates at all, but small cuts are tolerable.

Finally, there’s been speculation that the PBoC will cut banks’ reserve requirement ratio in H2.

- We think this is likely to happen and will be timed to ensure there is adequate liquidity to fund the issuance of government bonds for H2 infrastructure investment or allow local authorities to refinance LGFV debt.

Property sector

The big news is that the Politburo didn’t mention Xi’s catchphrase – “housing is for living, not speculation” – in the readout of its meeting.

Significant? Yes. Game changing? No.

We expect authorities will gradually loosen restrictions on investment properties that were initially introduced to rein in aggressive price appreciation, between 2016-2019. Indeed, the same day as the Politburo meeting, a report [from Economic Observer](#) – a well-respected Chinese broadsheet – cited unnamed sources as saying policymakers are gearing up to relax restrictions on home purchases across China’s largest cities.

- Over the past year, several smaller cities have relaxed restrictions, but regulators were previously reluctant to loosen property rules in cities like Beijing and Shanghai.

Removing these restrictions isn’t going to reverse the property market downturn. However, by freeing up second- and third-home owners to

make additional purchases, authorities will generate some additional demand.

Local government debt

Now, this is interesting. In its readout of the meeting, the Politburo said it would:

“Implement a basket of debt restructuring plans for local governments.”

What might that involve?

- First and foremost, it won’t be a bailout. That might become necessary at some point, but we’re not there yet.

The focus of Beijing’s efforts will likely be upon making the burden of local government debt more sustainable.

- That will involve reducing the cost of the debt (perhaps by allowing local governments to issue refinancing bonds that they can use to buy up LGFV debt) or extending the maturity of debt (by having banks issue 20-25 year loans).

Reviving consumption

Prior to the meeting, there was widespread speculation that the Politburo might do something to boost household incomes, thereby providing people with the financial wherewithal to increase spending.

- **We thought Beijing was moving in this direction.** After all, China’s authorities have been flagging the need to increase incomes since December.

In fact, the Politburo said it again Monday, specifically that it intends to:

“Expand consumption by increasing residents’ income.”

To achieve higher incomes, the Politburo wants to increase the level and quality of employment by:

“Strengthening the protection of people’s livelihoods”

“Elevating stable employment to a strategic consideration”

“Expanding the middle class”

That might seem as though the Politburo is putting the cart before the horse.

- Employment conditions will only improve once the economy recovers. But recovery is dependent on people spending more – which they can’t do until their incomes increase.

But as far as the Politburo is concerned, higher incomes aren’t the only path to increased consumption. Authorities also believe that Chinese consumers will increase spending if only:

- Impediments to consumption are removed

- They have access to goods and services they want to purchase

Put another way, Beijing believes that it can boost consumption by unleashing latent demand.

What does that look like? Beijing's efforts to [boost car sales](#) are a good example.

- NEV sales in rural areas are weak. Beijing believes this is partly because a lack of recharging piles in rural areas is a disincentive to would-be buyers. It's encouraging the installation of recharging piles in rural areas to unleash new demand for NEVs.
- Similarly, it's encouraging the construction of more parking facilities on the assumption that parking difficulties crimp demand.
- And it's removing regulatory limits on car purchases – designed to reduce congestion – to free demand that's been artificially curtailed.

Similarly, the [economic planner's \(NDRC\) diagnosis](#) for why home appliance purchases this year have been so weak is that:

- People are happy with traditional rice cookers, fridges, and ovens.
- It's currently difficult to recycle and trade in old products.
- Rural residents and older adults have issues with market access and delivery.

Hence, the solution is to introduce new products, make trade-ins easier, and improve market access.

These are supply-side solutions to demand-side problems.

According to the Politburo, getting the economy back on track involves:

“Combining...expanding domestic demand with deepening supply-side structural reforms.”

Of course, there's no reason why authorities can't boost consumption by pursuing demand-side and supply-side policies at the same time.

- But a preference for supply-side solutions is hardwired into policymakers' DNA.

If the economy continues to lag, Beijing might eventually decide to boost consumption by putting more money directly into people's pockets. The test will be whether the current approach generates enough additional demand fast enough to satisfy authorities. We're unconvinced it will, not least because we believe the defining constraint on consumption is household income and a broad lack of confidence in the future among the public. Consequently, we suspect there is far less latent demand waiting to be released than Beijing presupposes.

Conclusion

The Politburo laid out a conservative course during its July meeting, opting for economic support at the margins rather than a full-scale stimulus package. The risk is that this support is insufficient and economic challenges – such as a shrinking property sector, stagnating

income growth, and dampening consumption rebound – continue to grow.

It will have an opportunity to revisit its conclusions when it meets again in October, and then again in December at the Central Economic Work Conference.

Until then, the thing to watch is whether consumption recovers adequately to stabilize employment and lift private sector investment.

- If not, the Politburo will be forced to reconsider its commitment to supply-side measures as a driver of demand.

Need anything more?

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