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Trivium China

## Markets Note

# Has China bottomed?

October 26, 2023 / No. 187

The market narrative around China is shifting rapidly – with bearish sentiment giving way to more positivity around Chinese assets in the wake of Tuesday’s announcement that officials will issue RMB 1 trillion in central government bonds in Q4 to support infrastructure spending.

- We’ve argued that this fiscal move is less impactful than the headline number suggests – with only RMB 500 billion set to be transferred to local governments to fund public works in Q4, and the rest to be transferred in 2024 – so the abrupt shift in sentiment is surprising.

That said, we’ve argued for weeks that China does indeed seem to be nearing its cyclical low point (see September 22, [Promising green shoots in August, but the private sector still lags](#)) – and said since August that a move to plug the looming Q4 fiscal gap at the October NPC meeting [was all but inevitable](#).

More generally, we see constructive signs in: [the consumer data](#), a [short-term leveling off of US-China tensions](#), ongoing [moves to support domestic equity markets](#), and [an emerging toolkit to stabilize local government debt](#).

In our view, the big puzzle pieces left in consolidating China’s budding economic recovery will need to involve:

- Positive developments at the National Financial Work Conference (NFWC) – set to take place next week – especially in outlining a more comprehensive approach to local government finances and debt
- A boost to the fiscal impulse in 2024 – which we see an increasing number of domestic policy advisors calling for
- An improvement in private sector sentiment to support private investment
- A stabilization of property sales, and a bottoming in the contraction of overall property activity

None of the above factors are certainties – although we are relatively more confident that some marginally positive signs will emerge from the NFWC and that officials will look to send a strong signal of fiscal support for next year, beginning in November or December when the preliminary local government special purpose bond quota for 2024 will be approved by the NPC.

We outline the latest dynamics for each of the key parameters that will shape any further improvement in both sentiment and cyclical economic momentum for China below.

The bottom line: On balance, we are starting to see more positive signs for a consolidation of economic growth in the months ahead – and for the trajectory of related Chinese asset prices. And while we disagree with the growing market sentiment that this week’s new bond issuance announcement marks a turning point in the size and scope of Beijing’s approach to economic support – we do see it as yet another important cumulative policy step undergirding an imminent cyclical upswing.

## Avoiding a fiscal cliff (highly positive)

- Chinese officials have effectively achieved this goal this week with the newly approved RMB 1 trillion in central government bonds that will be issued in Q4 2023.
- While only RMB 500 billion of these funds will be transferred to local governments in Q4 2023, this amount is equal in magnitude to the RMB 500 billion in previously unused SPB quotas that authorities authorized to plug the Q4 fiscal gap in 2022.
- Perhaps most importantly though, we expect the central government's move this week to bring public works funding directly onto its balance [may be a new model for Beijing](#) to gain more control over local spending, while maintaining requisite growth of infrastructure investment going forward.
- Additionally, the NPC is set to approve the preliminary special purpose bond quota for 2024 in November or December, and we expect a large quota to be set.
- The preliminary quota for 2023 was RMB 2.1 trillion, up from RMB 1.4 trillion in 2022 – and we'd expect officials to approve an amount at or above the 2023 level, which importantly, will be required to be deployed before the end of June 2024.

## Geopolitics (highly positive)

- As we've highlighted consistently in recent months, US-China relations have undoubtedly stabilized – and even seem to have marginally improved, thanks to the spate of high-level and working-level meetings that have taken place since August.
- While still not yet confirmed, a meeting between Xi Jinping and Joe Biden during the APEC gathering in San Francisco (Nov. 11-17) seems like a virtual certainty at this point.
- Foreign Minister Wang Yi is visiting Washington DC this week and is reportedly set to meet with Joe Biden at the White House on Friday – a strong sign that the groundwork for a bilateral head-of-state meeting is being finalized.
- Importantly, US officials reportedly worked to communicate recent updates to semiconductor export controls – which were unveiled earlier this month – to the Chinese ahead of time, to keep from catching them off guard and potentially scuttling the Xi-Biden meeting.
- While such a meeting next month would of course not set US-China ties on a fundamentally better course, a temporary lowering of tensions – and an increase in ongoing dialogue – will work to buoy sentiment toward China.

## Stock market support (highly positive)

- Beijing has ramped up a steady spate of support measures for domestic equity markets in recent months – on the back of the Politburo's July call to "enliven capital markets."
- Officials have indicated that they see a rising equity market as one key path for boosting overall sentiment – especially among households.

- While the measures have yet to be particularly effective – it's clear that officials will continue turning whatever dials they have until stock markets at least stabilize.
- Moves on this front have included direct purchases – most notably, the recent CSI 300-linked ETF purchases by Central Huijin to the tune of roughly RMB 5 billion.
- Other direct purchase interventions have included: Central Huijin purchasing RMB 500 million worth of shares in state banks; share buy-backs by 10 central SOEs of a combined RMB 7.4 billion; exhortations by the CSRC for funds and listed companies to buy their own shares – of which 17 funds and 50 companies took part for an undisclosed amount.
- Officials have also reduced fees for stock transactions, cut stamp duties on stock trades, cut margin requirements for share purchases, and increased margin requirements for short selling.

### Local government debt (positive)

- At its July meeting, the Politburo called for a “basket of measures” to address intensifying local government debt challenges.
- While they have taken some time to materialize, officials have now rolled out several measures to address the most unstable parts of the local government debt picture.
- Officials have greenlit provinces to tap into unused SPB quotas to issue debt refinancing bonds – with planned issuance now standing at RMB 1.04 trillion, with RMB 726 billion of that having already been issued in 24 localities.
- Officials will likely allow another RMB 500 billion of such issuance before year-end, and we would not be surprised to see another large chunk of refinancing bonds – perhaps to the tune of another RMB 1 trillion – approved by the NPC for 2024, likely on top of the regular SPB quota.
- Likewise, the PBoC has reportedly instructed the major banks to roll over LFGV debt for up to 10 years, at an interest rate no higher than Chinese government bond yields (currently at 2.7%).
- Finally, Caixin has reported the PBoC is also considering setting up a special purpose vehicle (SPV) to directly purchase LGFV debt – which if confirmed at the CFWC next week, could provide a significant short-term backstop for the most financially distressed localities.

### Consumer spending (positive)

- Consumer spending has started to show more signs of life in September and October, as household balance sheet adjustments look to be coming to an end.
- Former PBoC governor Yi Gang – still a key economic advisor at the CPPCC – argued in September that China's post-pandemic household balance sheet adjustment would take “about a year,” a timeframe that is now approaching.
- Retail sales of consumer goods accelerated in September – up to 5.5% y/y growth from 4.6% in August, and posting the highest growth rate since May.

- Auto purchases jumped to 2.9 million units in September, showing 9.5% y/y growth – and posting the best September print on record.
- Domestic tourism revenue during the Golden Week holiday in early October posted 1.5% growth over 2019 levels – finally pushing above pre-pandemic levels.

### **National Financial Work Conference (marginally positive)**

- The National Financial Work Conference (NFWC) is set to be held October 30-31 in Beijing.
- The NFWC, held roughly every five years, is a marquee gathering for officials to set key financial strategy for the years ahead – and will likely be directly overseen by Xi Jinping.
- The 2017 NFWC kicked off a five-year campaign of aggressive financial sector reform that reined in shadow banking and deleveraged the banking system.
- This NFWC will reportedly focus on financial risk, particularly in the property sector and among local governments – as well as discussing China's strategy for making the financial system more resilient against US sanctions.
- While we don't expect any immediate blockbuster outcomes from the meeting, any additional detail around a more comprehensive approach to local government debt sustainability and the banking system's role in restructuring property developer debt would be quite positive.

### **Private sector sentiment (marginally positive)**

- Behind finding a bottom in the property market, boosting household and private sector sentiment stands as the second biggest stumbling block to a more robust economic recovery.
- But even here, some positive signs are emerging – with private sector investment contracting just 3.6% y/y in September, much improved from the recent low of 9% contraction in July.
- Adjusting for the ongoing contraction in property investment – which accounts for one-third of private sector investment – other types of private sector investment are already well into positive territory.
- Importantly, then, if overall property market investment stabilizes – even at a low level – private sector capex could offer a significant growth dividend in the months ahead.

### **Property market support/sales (neutral/marginally negative)**

- Stabilization in the property market is of course the biggest variable – and biggest wild card – for a genuine cyclical improvement in economic growth heading into 2024.
- However, on this front as well, central authorities have made a series of steady tweaks to lower transactions costs, reduce down payments, and unlock marginal demand since August.

- **Mortgage easing:** On August 25, the housing regulator (MoHURD) and two other ministries called on cities to lower down payment requirements for people who previously held a mortgage.
- **Fiscal incentives:** On August 25, the finance ministry (MoF) extended an existing personal income tax rebate scheme for individuals who buy a new home within one year of selling their old one.
- **Down payment reductions:** On August 31, the central bank (PBoC) and financial regulator (NFRA) lowered the nationwide minimum down payment requirements for first- and second-home buyers to 20% and 30%, respectively.
- **Home-loan cuts:** Existing mortgage holders can renegotiate their mortgage interest rates with banks from September 25.
- **Removal of local purchasing caps:** Dozens of cities – including provincial capitals like Guangzhou, Nanjing, and Wuhan — have partially or completely abolished limits on who can buy property and how many units they can own.
- **Removal of land price ceilings:** Since late September, at least four major cities have abolished price ceilings for land auctions.

**Need anything more?**

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