BANK OF COMMUNICATIONS BBM

Macro Monthly Letter

October 2024

The significance of the new stimulus measures for China

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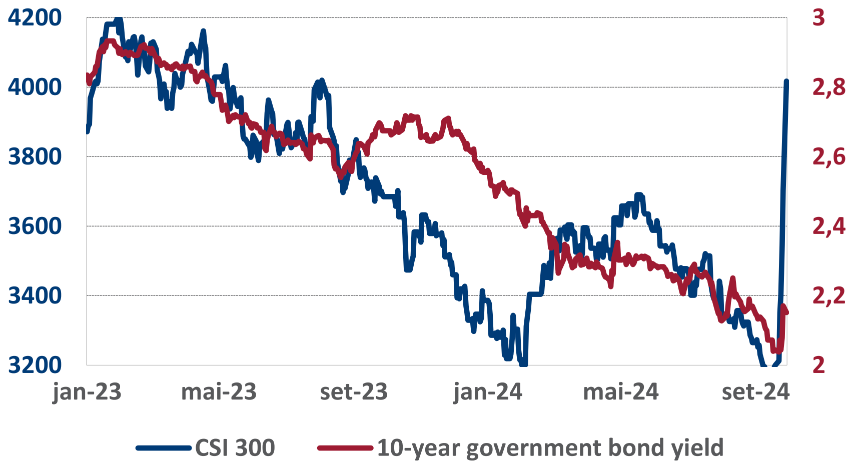
The latest set of mainly monetary stimulus measures announced by the Chinese central bank (PBOC) came as a surprise and were warmly welcomed by the financial markets. Expectations of fiscal measures, which appear to be even more important than this package, gained momentum after the Politburo promised to step up fiscal and monetary support to accelerate China's economic growth. Rumors about the format and scale of these policies circulated in the media but have not been confirmed so far.

Several indicators, such as stock indices and interest rates, reacted positively to these developments, reversing China risk sentiment (Figure 1). The stimulus measures in their entirety will significantly support the economy as it undergoes important rebalancing processes along similar lines to those that are already occurring in the real estate and labor markets.

Figure 1: China - CSI 300 Index and 10-Year Government Bond Yield

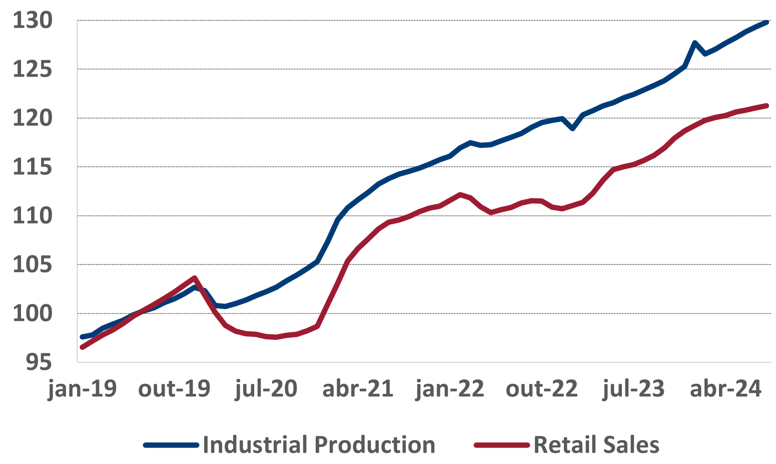


Source: BOCOM BBM, Macrobond

The measures announced so far include a cut of 20-bps in the main policy rate (known as the seven-day reverse repo rate), from 1.7% to 1.5%. Other rates, such as the loan prime rate (LPR), the benchmark for most corporate and household loans, and the one-year marketplace lending (MPL) rate are expected to follow suit. In addition, a 50-bps cut in the reserve requirement ratio should inject more liquidity into the financial system by enabling banks to increase their lending.

This easing of monetary policy is an important countercyclical step, taken in response to clear signs of economic slowdown from the latest indicators. Industrial production, a key variable that has contributed to China's strong export performance, has been decelerating for some time. Yet industrial growth is still growing more than retail sales, which underscores the challenge of stimulating Chinese domestic consumption (Figure 2).

Figure 2: China – Industrial Production and Retail Sales (Index 2019 = 100)



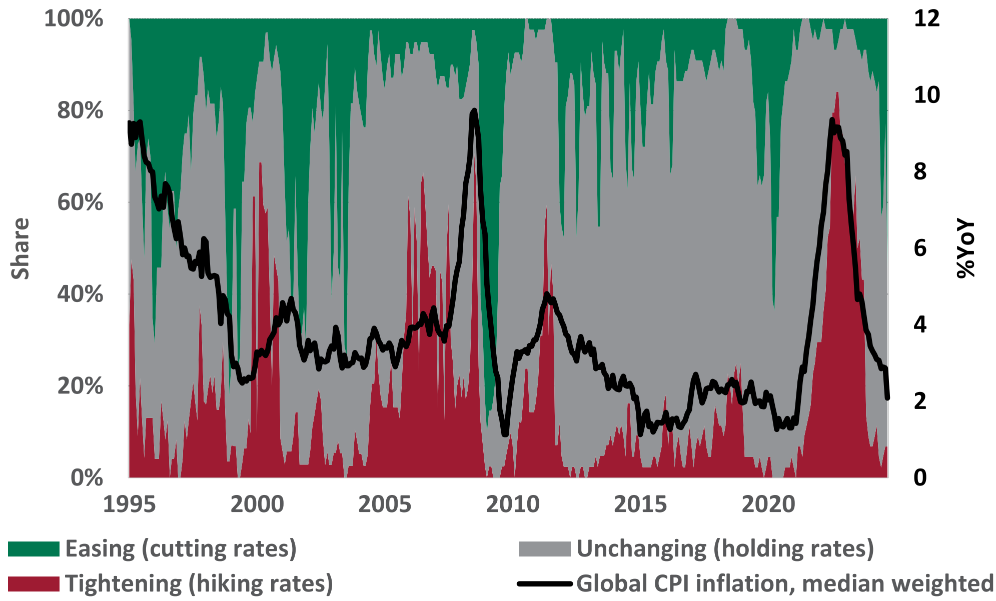
Source: BOCOM BBM, Macrobond, NBS

The Chinese government has also introduced measures aimed at stabilizing the real estate sector, where key indicators such as home sales and new construction starts have been falling since the pandemic. Existing mortgage rates have been cut to narrow the gap between new and old home loans, aiming to discourage households from trying to pay off existing mortgages early, and the minimum downpayment for second homes has been lowered from 25% to 15%.

It is too soon to be sure how effective the officially announced measures will be: their impact on the economy will depend on the appetites of households and firms to consume and invest more. However, the Politburo's forceful message on the need to support growth via fiscal and monetary policy only two days after the PBOC unveiled the largest monetary stimulus package since the pandemic suggests these will be more coordinated and determined measures to boost the economy.

Another key variable that should help the government drive up economic growth while containing domestic prices is global economic conditions, which include coordinated monetary easing across several countries. The PBOC's stimulus package was announced less than a week after the US Federal Reserve (Fed) cut its policy rate by 50 bps, more than expected by many analysts. Other central banks in both the developed countries (such as the EU's ECB, UK's BoE and Switzerland's SNB) and emerging markets (e.g. Colombia, Chile and Mexico) have also begun lowering rates (Figure 3).

Figure 3: Share of economies (GDP top 50) with higher/unchanged/lower policy rates



Source: BOCOM BBM, Macrobond, World Bank

In contrast, Brazil is in the middle of a series of rate hikes, which the Central Bank (BCB) says is a response to domestic challenges associated with fiscal policy and de-anchored inflation expectations. On one hand, the new conditions in China and a wider interest-rate differential with the US tend to favor the Brazilian Real (BRL); on the other hand, they boost domestic incomes at a time when the Brazilian economy is outpacing its growth potential. In light of these challenges, we expect the Selic to end 2024 on 11.75%. Our other projections are shown in the table below.

ECONOMIC FORECASTS	2019	2020	2021	2022	2023	2024F	2025F
GDP Growth (%)	1.2%	-3.3%	4.8%	2.9%	2.9%	3.1%	1.7%
Inflation (%)	4.3%	4.5%	10.1%	5.8%	4.6%	4.4%	4.1%
Unemployment Rate (eoy ,%)	11.1%	14.2%	11.1%	7.9%	7.4%	6.8%	7.2%
Policy Rate (eoy, %)	4.5%	2.0%	9.3%	13.8%	11.75%	11.75%	11.50%
External Accounts							
Trade Balance MDIC (US$ bn)	35	50	61	62	99	80	95
Trade Balance (US$ bn)	27	32	36	44	81	74	89
Current Account Balance (US$ bn)	-68	-28	-46	-48	-31	-45	-32
Current Account Balance (% of GDP)	-3.6%	-1.9%	-2.8%	-2.5%	-1.3%	-2.0%	-1.3%
Fiscal Policy							
Central Government Primary Balance (% of GDP)	-1.3%	-9.8%	-0.4%	0.5%	-2.1%	-0.5%	-0.8%
Government Gross Debt (% of GDP)	74.4%	86.9%	77.3%	71.7%	74.4%	77.4%	81.9%