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MACRO MORNING BRIEFING

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China: Shock and Awe Easing Measures

In response to the deteriorating macroeconomic data and sagging confidence, the People's Bank of China (PBoC) this week unveiled a fresh round of easing measures in three key areas: the reserve requirement ratio (RRR) and 7-day reverse repo benchmark rate; mortgage-related measures; and a new monetary policy tool to support the stable development of equity markets.

First, the PBoC will reduce the reserve requirement ratio (RRR) by 50bp from 10% to 9.5%, which is expected to unleash CNY 1,000bn in liquidity into the system. This is the second RRR reduction this year, for a total cut of 100bp in 2024, following a total reduction of 50bp in both 2022 and 2023. The average RRR for banks will be eased to 6.6%.

The 7-day reverse repo benchmark reference has been reduced by 20bp from 1.7% to 1.5%, following a reduction of only 10bp, from 1.8% to 1.7%, in mid-July 2024. In our view, this is significant both in terms of magnitude (the reduction was the biggest since April 2020 when the 7d reverse repo was cut from 2.4% to 2.2%) and proximity to the most recent reduction. The last time rates were cut with such urgency was at end of 2019/beginning of 2020 and during the 2015 economic downturn.

Second, the PBoC announced additional property market support, with a 50bp reduction in average interest rates for existing mortgages and a decrease in the minimum downpayment requirement for second-home buyers from 25% to 15%. The PBoC tweaked the conditions for the previously announced CNY 300bn relending loan facility, increasing the central bank's funding support ratio for affordable housing from 60% to 100%.

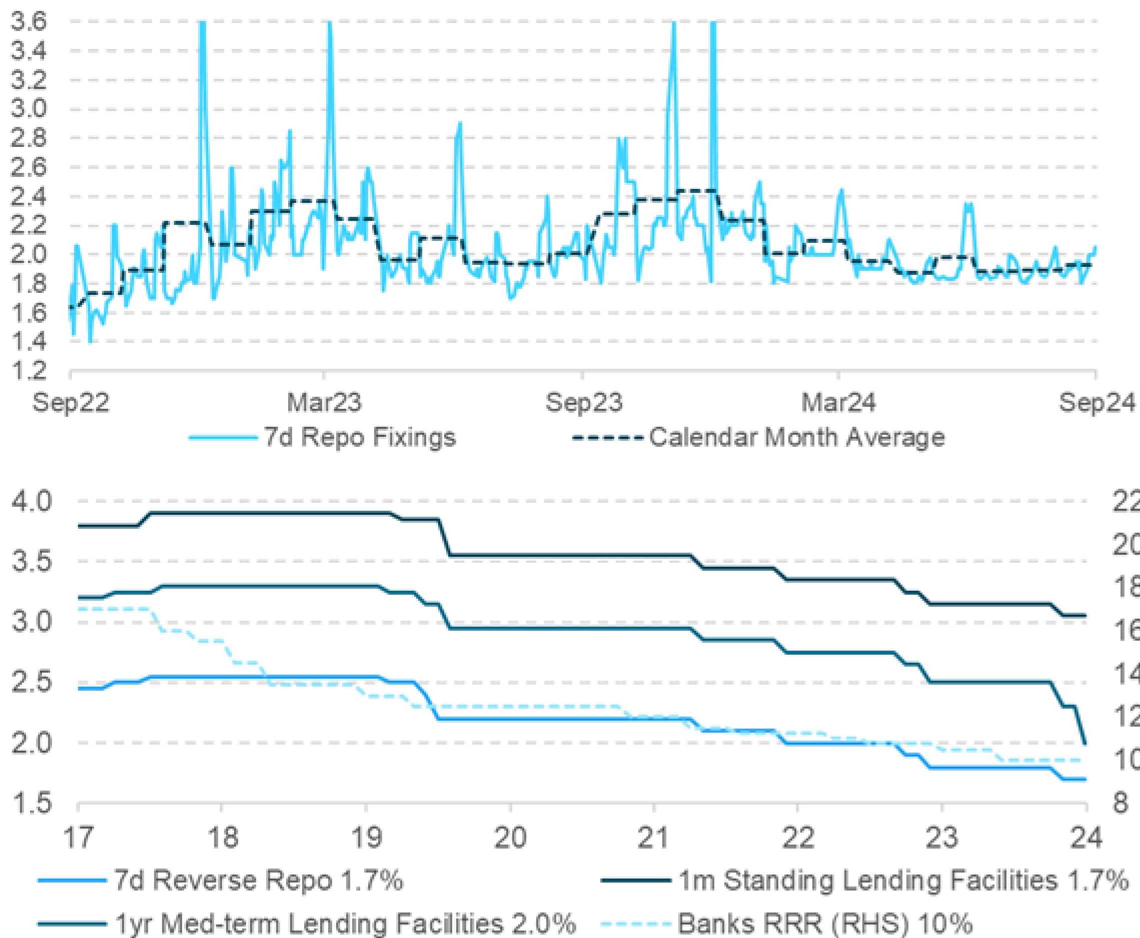
Will it work? We are hopeful and cautiously optimistic. The forward-looking commitment, with the PBoC signaling a potential 25bp-50bp reduction in the RRR in Q4 2024, depending on the market liquidity situation, is in our opinion significant for providing a macro backstop. The RRR cut might have limited impact on current market liquidity conditions, but it will guide further policy and funding rates lower. The September MLF has been cut by 30bp, from 2.3% to 2.0%, while LPR rates, at 3.35% for 1yr and 3.85% for 5yr, are expected to be lowered by 20-25bp as soon as next month.

Daily 7-day interbank repo fixings have been averaging around 1.90%, or 20bp higher than the benchmark reference of 1.70%, since July 2024 as opposed to fixing close to or below the reference rates during periods of growth slowdowns, like 2015/16 and 2020/2021.

Finally, there was also an announcement related to the equities market, supplementing the “nine-point guideline” published by the State Council in April 2024. The PBoC is said to be providing liquidity support for equity markets through CNY 500bn in swap facilities, allowing securities firms, funds and insurance companies to tap liquidity from the central bank for stock purchases and CNY 300bn in relending facilities. It is also exploring the option of setting up a market stabilization fund.

The policy rescue of the equity market is arguably as important as macro measures in terms of restoring investor and domestic confidence.

Exhibit #1: China Policy Measures



Source: BNY, Bloomberg L.P.

The immediate market reaction to the stimulus measures was very encouraging. This was driven in part by the larger-than-expected rate reduction and more importantly the message to the equities market (see above) as well as likely adjustments to short-cover positions. That said, as we alluded in the previous section, investor flows into Chinese equities have been uniformly negative over the past few months, including this week's post-stimulus announcement, according to BNY iFlow data.

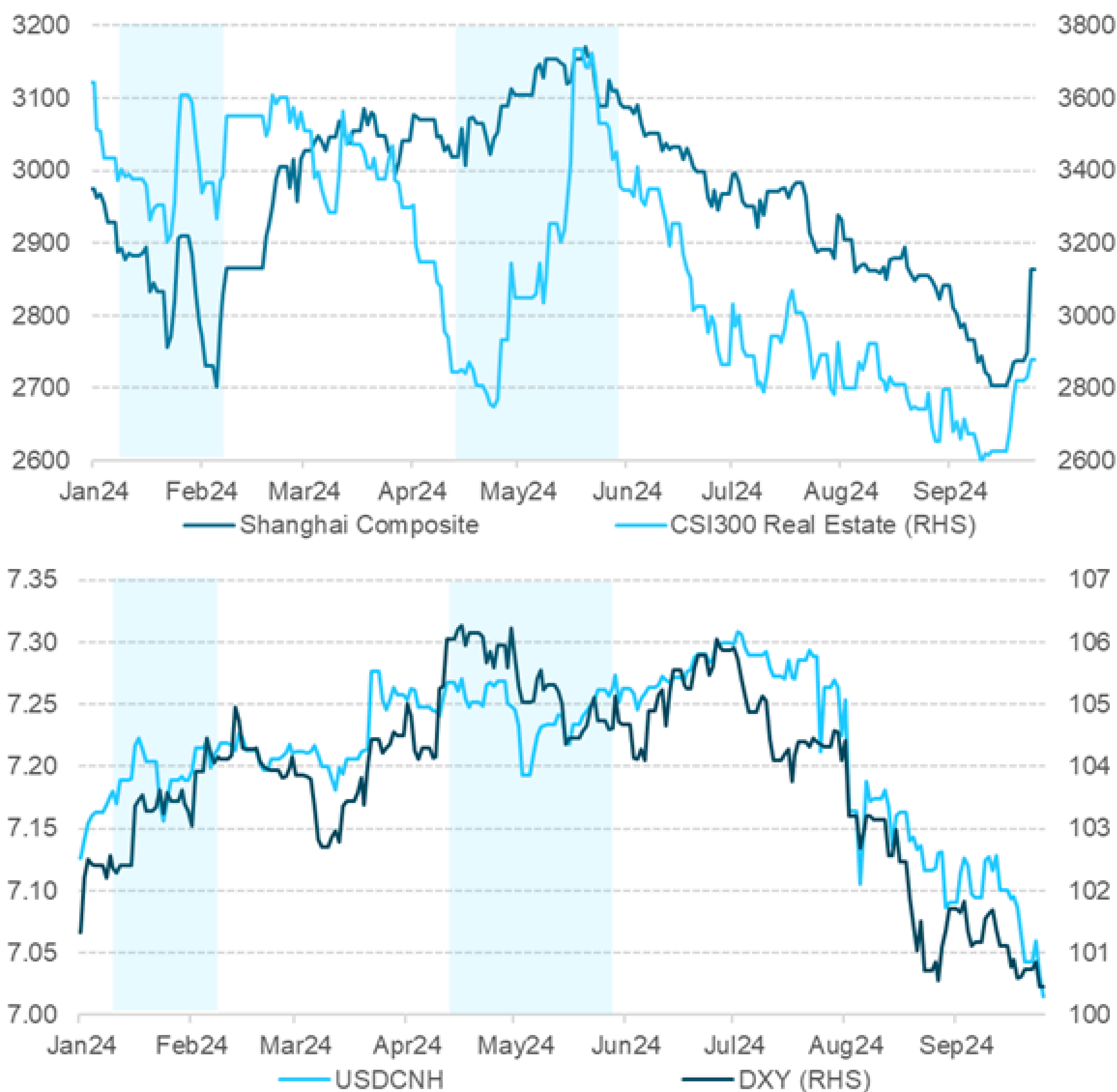
We believe that sustained upside momentum for risk assets is crucial to revive market sentiment. The Shanghai Composite rallied by 4% on Tuesday on the back of the stimulus announcement, the highest daily gain since July 2020. The increase is especially impressive considering the composite gained a total of 5.5% between April and May following the announcement of the “new nine-point guideline” equity reform.

We will also be paying attention to the performance of the real estate sector. This is a difficult sector that has experienced a number of false starts and significant volatility of late, with the market rallying briefly before being overwhelmed by disappointing real estate data.

In the currency complex, CNH has been trading well over its average past few weeks, benefiting from the weaker DXY trend. While CNH strength is positive in eliminating the acute depreciation pressure observed over the summer months, it might not be conducive to economic growth. It could also exert further disinflationary pressure as a result of lower import costs.

As mentioned above, we are hopeful and cautiously optimistic about the stabilization of macro conditions in China and all data going forward will be closely scrutinized.

Exhibit #2: Performance of Chinese Equities and Currency



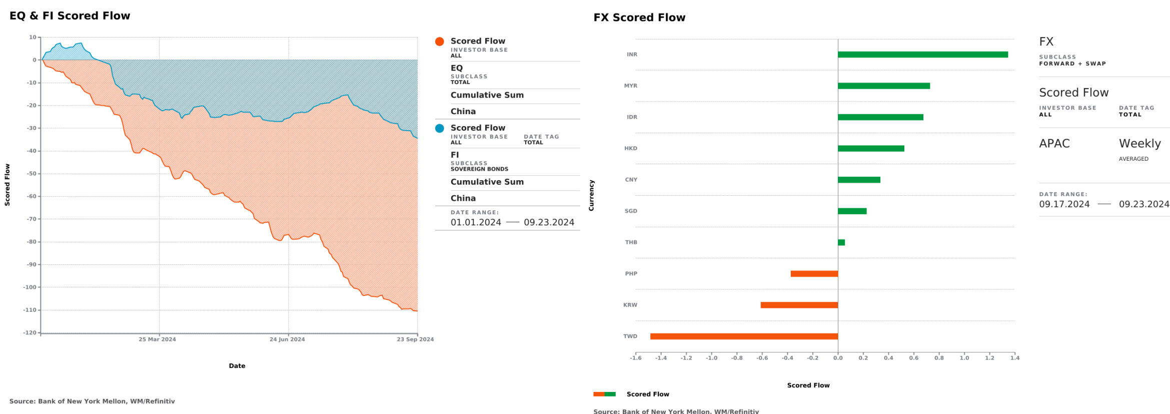
Source: BNY, Bloomberg L.P.

Over the past week, APAC currency flows have been mixed despite risk-on asset flows dominating following the larger-than-expected Fed interest rate cut and the trend toward USD outflows. Indeed, there was a wide dispersion in FX flows globally leading to a mild inflow in G10 and LatAm but outflows in EMEA.

Within APAC, tech-related TWD and KRW posted the highest outflows, while inflows were recorded in INR, MYR, and IDR. The accelerated inflows into INR pushed it to the most overheld currency in the iFlow universe, with weekly average scored holdings of nearly 4.00.

Despite the relatively risk-on sentiment in the region, investor appetite for Chinese assets remains low. As shown in Exhibit #3, there have been persistent outflows in equities throughout the year and renewed selling pressure in the Chinese fixed income complex of late. Indeed, equities and sovereign bonds are in their tenth and eighth straight week of selling, respectively. Flows into Chinese assets are worth monitoring in the near term to gauge the impact of the latest easing measures on sentiment.

Exhibit #3: Chinese Asset Outflow Momentum – TWD, KRW Most Sold



Source: BNY, Bloomberg L.P.

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Please direct questions or comments to: iFlow@BNY.com

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