CHINA Insights

OCBC Bank

Politburo meeting: back to structural reform

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Highlights:

- **The removal of "six stability" shows there is limited room for further marginal easing.**
- **The resurface of "structural de-leverage" suggests that the liquidity operation will be more targeted. This was echoed by PBoC OMO last week.**
- **The persistent downward pressure on Chinese economy from the structural issues signals that a policy U-turn is unlikely in the near term.**
- **The focus shifts back to structural reform, eyeing for solving the funding difficulty faced by smaller private owned companies.**
- **Bond correction may continue, however, the room for yields to go up may be capped. Otherwise, China will miss its target to lower the funding costs for smaller companies by 100bps in 2019.**

In China's April politburo meeting, the top policy making bodies reckoned that the economy is better than expected in 1Q. It dropped the phrases on six stability (stable job, stable finance, stable external demand, stable foreign investment, stable investment and stable expectation) in the statement.

Meanwhile, the wording on structural de-leverage resurfaced in the statement. And the politburo also reemphasized the housing market is not for speculative.

However, the meeting also said the pressures on slowing economy is not only due to cyclical reasons but also due to structural and systemically reasons.

	Key messages from the Politburo meeting		
	Apr-19	**Dec-18**	**Oct-18**
Economic Assessment	1Q better than expected. Downward pressure on economy remains due to structural and systemically issues other than cyclical issue.	Sense of urgency to look at the change of domestic factors and external factors dialectically.	Rising downward pressure for economic growth. External environment has changed
Key policy tone	Focus on the balance among stable growth, reform, structural changes, social welfare and prevention of risk. Structural reform to stablize domestic demand and structural de-leverage Focus more on quality of growth	Six stability including stable job, stable finance, stable external demand, stable foreign investment, stable investement and stable expectation to boost market confidence. Celebrating the 70th anniversary of founding of PRC with good result.	Six stability including stable job, stable finance, stable external demand, stable foreign investment, stable investement and stable expectation to ensure a stable growth.
Housing market	House is for living not for speculation	Nil	Nil
Private owned economies	Expedite the financial supply side reform to solve funding difficulty faced by POEs.	Nil	Study and solve the funding difficulty faced by POEs.

The removal of "six stability" aim in the latest politburo meeting confirmed market view that the room for further marginal monetary easing, such as the RRR cut as speculated in April, is limited. However, as mentioned by the politburo for the first time that the economy is still facing downward pressure due to structural and systemically reasons, this implies that there is no U-turn in China's stimulative policies in the near term.

Overall, we think China's top policy makers are happy to see the stronger than expected growth in 1Q as it means their counter cyclical measures are working. However, they are also hesitating to roll out more measures to repeat the mistakes made 10 years ago.

As a result of positive development of Chinese economy, China's policy makers started to fine tune their policy stance in three top level policy making meetings last week including 1Q PBoC monetary policy meeting, regular State Council meeting and April politburo meeting. Some may find the messages from three meeting are overwhelming or confusing, however, we see the consistency from three meeting. The key takeaway from the meetings is that there is limited room for further marginal monetary easing. As such, the chance of RRR cut in the near term is slim. However, we don't see a U-turn of its monetary policy any time soon.

The recent economic recovery, together with the positive development of US-China trade talk, has bought China more time to shift their focus back to structural reform, mainly on how to solve funding difficulties faced by small and private owned companies. This is why the State Council meeting last week announced more measures to support lending to smaller companies.

As a result of fine-tune of policy stance, China's PBoC surprised the market with lower injection via MLFs last week. PBoC is likely to return to a more active liquidity management via short term liquidity operation. The liquidity operation is expected to be more targeted going forwards. This is also in line with the resurface of "structural de-leverage" in the politburo meeting as the excessive liquidity is likely to lead to higher leverage in state-owned sector.

Market is expected to further digest the fine-tuning of policy stance this week, which may lead to higher volatility. Both bond market and equity market may remain jittery. Small correction cannot be ruled out. However, on currency, we have turned more positive on RMB after global central banks have turned more easing in the past two months. The recent fine-tune of China's monetary policy stance further reinforce our positive outlook on RMB this year. We expect the USDCNY to test 6.68 again in the near term.

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