China's updated stimulus framework and its implications

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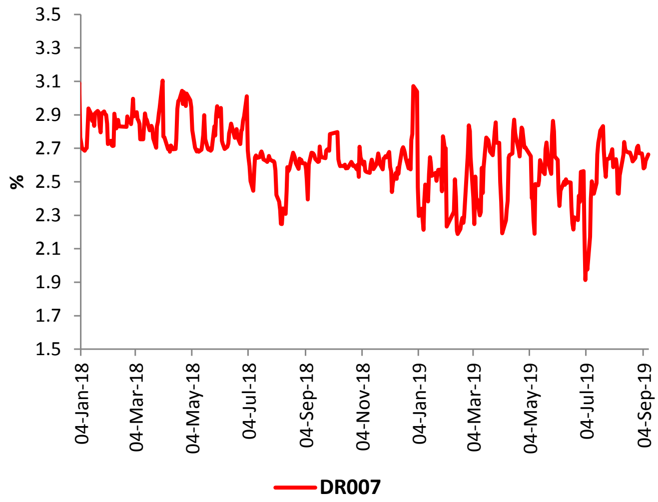
- **China has been clearer on its stimulus plan in the past two weeks. Under the updated framework, there will be three pillars supporting the growth including conventional monetary policy, counter cyclical measures and boosting consumption.**
- **China's move away from direct prime-pump may limit the spill-over effect of China's stimulus on the regional economies.**
- **On the positive note, however, China's return to conventional monetary policy may help alleviate the pressure on RMB as currency is not the only tool to fight the trade war. This is supportive of Asian currencies.**

After a few months' confusion, China has sent by far the clearest signals how China plans to stimulate its economy in the past two weeks. The regular State Council meeting on 4 September was a game changer in our view.

Previous confusion

In the past few mini-cycles, China has usually supported its growth via a combination of easing monetary policy, proactive fiscal policy and loosening property policy. However, since May 2019, despite three rounds of escalation of US-China trade war, China has been extremely calm in terms of stimulus measures. China has reiterated to keep its monetary policy prudent and vowed that it will not use property as a short term stimulus tool. Meanwhile, China guided its benchmark 7-day repo rate back to above 2.6% after breaking below 2% in early July via tight liquidity management, sending no clear signals that China will ease its monetary policy soon.

Chart 1: China guided the interbank rate back in August sending no signal of imminent monetary easing



Source: Bloomberg, OCBC Bank

Although China's fiscal policy remains proactive, the still sluggish infrastructure investment growth due to local government funding constraints raised the question about how much the fiscal policy can support the growth without the help of monetary policy.

As a result of uncertain policy dynamics from usual policy tools, market increasingly believed that currency policy could be the main tool for China to alleviate the pressure from the trade war. This explained why RMB has broken a few psychological important levels in the past few months.

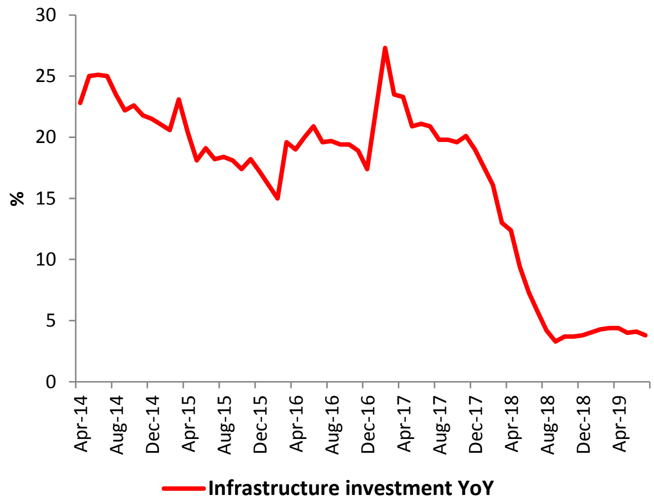
Three pillars to support growth
Nevertheless, the confusion has started to wane in the past two weeks after China re-painted its framework to support the growth. We think there will be three pillars supporting China's growth including conventional monetary policy, counter cyclical measures and boosting consumption.

First pillar, on monetary policy, the resurface of the "universal RRR cut" in the State Council meeting on 4 September sent a strong signal that China may go back to conventional monetary easing path. PBoC did not disappoint and announced both universal and targeted RRR cuts on 6 September.

The fifth RRR cut since April 2018 is expected to inject about CNY900 billion liquidity into the system including CNY800 billion by the 50bps universal RRR cut and CNY100 billion by the 100bps targeted RRR cut. The RRR cut will help lower the funding costs for banks which will be likely to guide the upcoming LPR fixing lower due to falling credit premium. It remains unclear whether China will roll over the maturing MLF in the next two weeks as universal RRR cut was usually used to replace the MLFs in the past. We think the latest universal RRR cut ahead of MLF rollover may lower the probability of MLF rate cut in the coming weeks.

Second pillar, on counter cyclical measures, China's State Council confirmed in the latest meeting that China will approve some of 2020 local government special bond quota earlier to support the major infrastructure investment projects. Meanwhile, the State Council reiterated that the special bond is not allowed to support land acquisition and property related projects. In addition, the State Council also quantified that 20% of local government special bond can be used as capital for infrastructure investment. We expect China's fixed asset investment to rebound on the back of rising issuance of local government special bond.

Chart 2: Infrastructure investment growth remained sluggish but expected to recover from 4Q.



Source: Bloomberg, OCBC Bank

Third pillar, on consumption, China's State Council unveiled 20 measures to stabilize consumption expectation and boost confidence in consumption led by promoting car sales and purchase of environmental friendly electronic products.

Implications

For the regional economies, you may feel disappointed if you expect a similar size fiscal stimulus from China as we saw in 2008 which saved the global economy. Clearly, China is moving away from the direct prime-pump while focusing more on boosting consumption and structural reform. This may limit the spill-over effect of China's stimulus on the regional economies.

However, on the positive note, China's clarity on its stimulus framework in particular the return to conventional monetary policy tool proves that currency policy is not the only tool for China to fight the trade war. This may help alleviate the pressure on RMB, which in turn is supportive of Asian currencies in our view.

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