# Fixed Income Insights

## Implications of China's stimulus measures

January 2025

For professional investors only

HSBC Asset Management

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## Foreword

Factors such as global trade, commodity prices, and global interest rates will play a crucial role in shaping the investment landscape in the coming years.
A comprehensive understanding of both domestic and international dynamics will be essential for navigating the complexities of China's economy and its markets.

**Michael Cross**
Global CIO, Fixed Income
HSBC Asset Management


Welcome to the latest edition of our Fixed Income Insights series, where we present the findings from our quarterly Strategic Forum. As we publish this edition, the uncertainty surrounding the outcome of the United States elections has shifted to questions about US policy and its potential implications. Any future changes in fiscal and trade policy could have significant macroeconomic impacts both regionally and globally, including in China. Conversely, it is important to recognise that China's economic policies also extend beyond its borders, influencing global trade dynamics, commodity prices, and inflation. The interconnectedness of economies means that shifts in China's economic landscape can have substantial repercussions for other countries, especially emerging markets. This is why we have chosen to focus this edition on China's recent stimulus measures.

First, we examine their domestic macroeconomic impact. Recent policy updates from Chinese leadership demonstrate a commitment to stabilising growth and restoring confidence amid mixed macroeconomic trends and geopolitical risks. While these initiatives are essential for mitigating immediate threats, they are unlikely to significantly enhance the structural prospects of the economy on their own. Nevertheless, with the right fiscal support, achieving a growth rate of approximately 5% in both 2024 and 2025 remains attainable.

In the second section of this edition, we delve into the impact of these measures from a sectoral perspective. China's recent policies highlight the interconnectedness of local government financing, the stabilisation of the property sector, and the resilience of the banking system, all of which are crucial for the near-term stability of the economy. To address local government fiscal stress, a significant 10 trillion RMB debt swap has been initiated to alleviate financial stress and mitigate the risks of defaults. Concurrently, the Chinese government has expressed its commitment to stabilising the property market, which continues to grapple with a substantial amount of unsold inventory. Another notable aspect of this new set of measures includes the recapitalisation of six major state-owned banks that are heavily exposed to real estate loans. The impact of these new policies will be less significant and more nuanced in other sectors, but warrants investigation within the context of an active – and selective – investment approach in the region.

I trust you will find our analysis and insights both interesting and useful.


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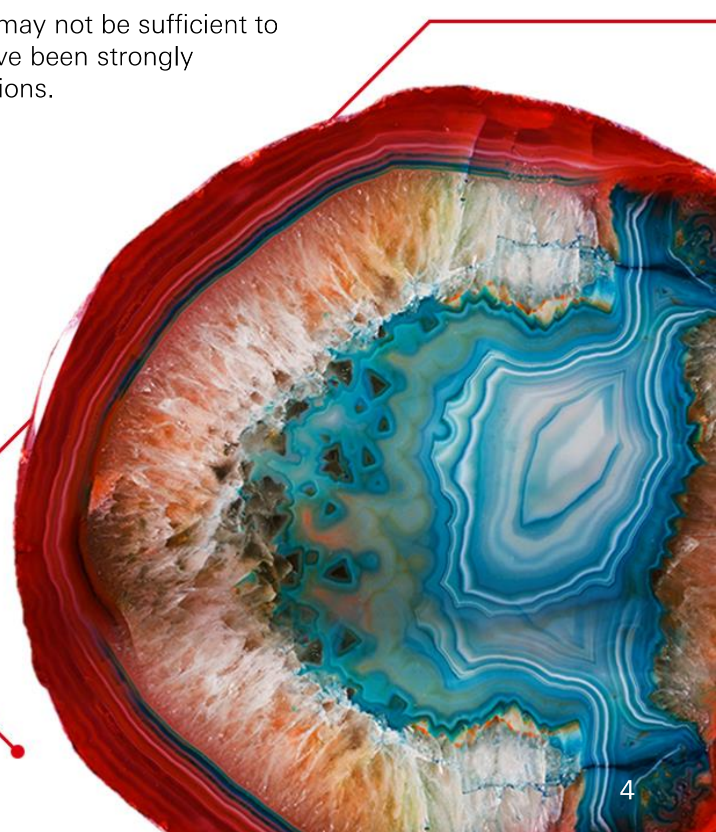
# In a nutshell

## Macro implications of China's stimulus measures

- Recent stimulus measures reflect a commitment from Chinese leadership to stabilise growth and confidence amid mixed macro trends and geopolitical risks.
- While these measures are necessary and reduce immediate risks, they are unlikely to materially improve the structural prospects of the economy in isolation. The pace of continued recovery is likely to remain uncertain until the next phase of policy is announced.
- In addition to domestic challenges, external factors such as US tariffs must also be considered. China is likely to respond to US tariff hikes with retaliatory actions, and while RMB depreciation may be considered, it could have undesirable collateral consequences.
- Despite these challenges, achieving a growth rate of around 5% in 2024 and 2025 is feasible with additional fiscal support.
- China's economic policies have far-reaching effects on global trade, commodity prices, and inflation. The interconnectedness of economies means that changes in China's economy can significantly impact other countries, particularly emerging markets.

## Sectoral implications of China's stimulus measures

- China’s policies emphasising local government financing, stabilisation of the property sector, and resilience of the banking system underscore their interconnections and pivotal role in the near-term stability of the economy.
- Local government fiscal stress is being addressed through a 10 trillion RMB debt swap aimed at stabilising finances and mitigating the risks of defaults. Simultaneously, the Chinese government has signalled its intent to stabilise the property market, which is still facing substantial unsold inventory.
- One of the key announcements is the recapitalisation of the six major state-owned banks, which are significantly exposed to real estate loans.
- Recent stimulus measures are also expected to yield positive short-term earnings for internet companies and e-commerce platforms that benefit from a program aimed at boosting consumer spending on electronics and home appliances.
- However, for some other sectors, pro-consumption initiatives may not be sufficient to reverse consumer sentiment and spending patterns, which have been strongly impacted by macroeconomic headwinds and geopolitical tensions.



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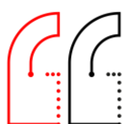
# Macro implications of China's stimulus measures



China's recent stimulus announcements represent a critical response to the challenges facing its economy. But the implications of China's economic policies also extend beyond its borders, influencing global trade dynamics, commodity prices, and inflationary trends.

**Renee Chen**
Investment Strategist

**Nick Stamenkovic**
Economic Analyst

**A pro-growth policy shift aims to stabilise growth and confidence amid deflationary pressures and rising external/geopolitical risks.**

China's economy has faced a myriad of challenges in recent years, including a slowdown in growth, persistent deflationary pressures, and a struggling property market. We believe that the recently witnessed pro-growth policy shift reduces the risk of downward spirals in confidence, property values, local government debt, and deflation. There appears to be a strong commitment from top leadership to boost domestic demand and revive market confidence. The counter-cyclical policy package is comprehensive and coordinated across all ministries and regulators, with clear forward guidance of further policy support in the pipeline. However, while these measures are necessary and reduce immediate risks, in isolation they are unlikely to be sufficient materially to improve the structural prospects of the economy. The pace of continued recovery is likely to largely hinge on further policy/reform implementations amid rising external trade/geopolitical risks.

Figure 1: Select macro and market policy measures announced between 24 September and 8 November 2024

| | |
|---|---|
| **Monetary** | • 20bp cut to the 7-day reverse repo rate (policy rate), which translated to 25bp cut to both 1-year and 5-year loan prime rates (LPR) and 30bp cut to 1-year medium-term lending facility (MLF) rate<br>• SOE banks lowered demand/time deposit rates by 10/25bp to cushion the NIM impact<br>• A 50bp cut to the reserve requirement ratio (RRR) for large banks; forward guidance that the PBoC (The People's Bank of China) stands ready to further cut the RRR by additional 25-50bp by the year-end |
| **Fiscal** | • To pre-approve/ front-load the investment project list worth CNY200bn (~0.2% of GDP) for 2025 to this year<br>• A CNY12trn plan to resolve the local government “hidden” debt issue. This includes a CNY10trn local government debt swap plan over 2024-28 and pre-commitment to the repayment of CNY2trn hidden debt from shantytown redevelopment, coming due in or after 2029<br>• Special central government bond (CGB) issuance to replenish major SOE banks' core tier-1 capital<br>• More efforts to stabilise the property market via a combination of local government special bonds, designated funds and tax policies. Special bonds will be used to support housing de-stocking and purchase of undeveloped land from developers<br>• Targeted fiscal subsidies to certain groups including people in extreme poverty and students<br>• Forward guidance of a large scope for the central government to increase fiscal deficit and raise debt |
| **Property** | • Repricing of existing mortgage rates lower (by ~50bp on average) benefitting ~50m households and 150m individuals<br>• Minimum downpayment ratio for second home purchase lowered from 25% to 15%, same as the first home purchase<br>• The PBoC to provide full funding (instead of 60%) for the CNY300 relending facility to support local governments/SOEs on property destocking<br>• To increase credit support quota for the “whitelist scheme” for bank lending from CNY2.2trn to CNY4trn by end 2024 to support home delivery<br>• An incremental 1 million units of urban village renovation through monetised resettlement<br>• Lowered deed tax and VAT for housing transaction |
| **Equity market** | • A CNY500bn swap facility for qualified securities firms, funds and insurance companies to tap liquidity from the PBoC to buy stocks<br>• A CNY300bn relending facility for banks to support listed companies and major shareholders to buy back shares and raise holdings<br>• To study the establishment of a state-backed market stabilisation fund<br>• Guidelines to promote M&As and restructuring, as part of efforts to boost listed companies' value and their governance and profitability |

Source: Source: HSBC AM based on official announcements, November 2024.

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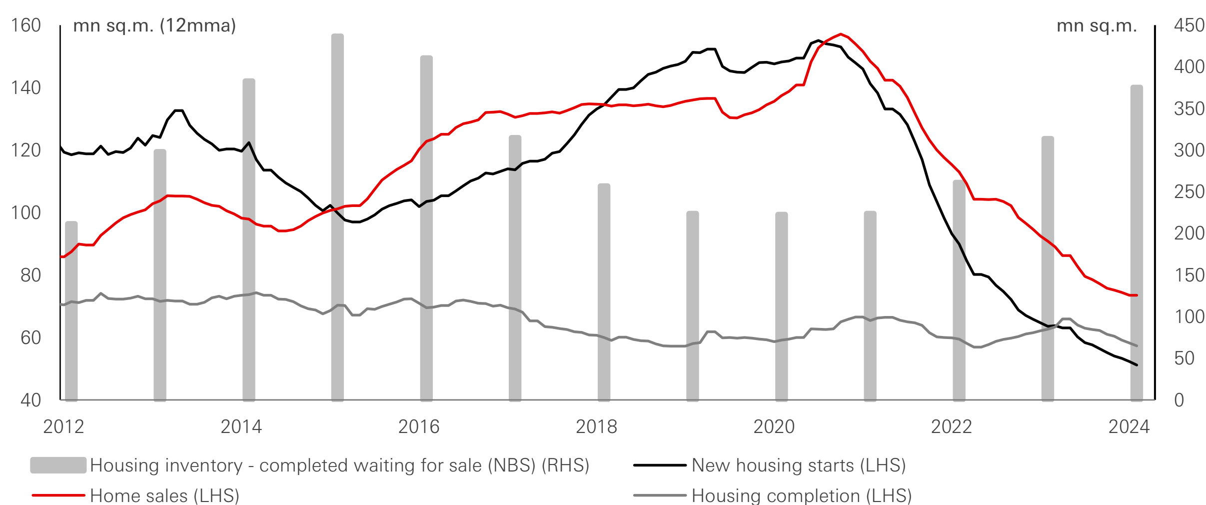
**Property market stabilisation remains key to reviving confidence and sentiment, but more policy efforts are likely needed and policy execution is key.**

The health of the property market is crucial for restoring market confidence and preventing a downward spiral in values. Recent macro data have been mixed but overall indicate home sales have recovered, and year-on-year housing price corrections have narrowed. However, the sustainability of any sentiment improvement or sales recovery depends on effective policy execution and the overall macro trajectory. The massive inventory overhang nation-wide will likely take an extended period to clear. While the sector has gone through substantial adjustment, real estate investment is likely to fall further – at least through 2025 – according to the International Monetary Fund (IMF) projections[1].

Figure 2: Ongoing property adjustment and inventory overhang (select housing indicators)




Source: IMF (February 2024), CEIC, HSBC AM, August 2024

**Debt swaps help address structural impediments to economic growth from strained local government finances; more fiscal stimulus to aid domestic/consumer demand is expected.**

Despite the challenges, there is cautious optimism regarding China's cyclical growth prospects. Recent macro data trends indicate a likely sequential growth rebound in the fourth quarter. Analysts have raised their growth forecasts, factoring in increased countercyclical policy support, especially more proactive fiscal policy to support consumption, employment and household incomes.

Fiscal policy was constrained by revenue shortfalls in 2024, largely at the local government level due to the property downturn weighing on land sales revenues, slower nominal GDP growth, and some residential tax cut effects. This prompted recent policy efforts to ease local governments' fiscal stress and reverse unintended fiscal austerity. The Chinese government is expected to implement a wider official fiscal deficit target of at least 3.5% of GDP this year, up from 3% in the previous year, along with a larger bond issuance quota.

The authorities also announced plans, mainly debt swaps, to tackle local government debt risks. The IMF estimates that local government financing vehicles (LGFVs) hold over $60 trillion in debt, amounting to nearly 50% of GDP. Debt swaps will reduce total debt servicing burden for local governments, helping to restore the normal operation of local governments and potentially offering local governments greater fiscal space over the medium term.

Still, fiscal reforms that close local governments' structural mismatch between revenues and spending obligations will also be needed to reduce their reliance on land sales and property activity.

[1] https://www.imf.org/en/News/Articles/2024/02/02/cf-chinas-real-estate-sector-managing-the-medium-term-slowdown

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This debt situation also necessitates careful management of fiscal policies to ensure that cyclical growth targets can be met without exacerbating existing debt issues. More efficient capital/credit allocation is key to growing with less debt, in our view.

While it is uncertain as to whether the Chinese economy is on the verge of a cyclical upswing, we are more confident that it is at an inflection point of structural transformation, shifting from a phase of high-speed growth to a period of high quality development. This transition needs time and will inevitably mean ongoing short-term adjustment pain. The key medium-term priorities are to deepen structural reforms to strengthen productivity growth and private investment and entrepreneurship in the face of China’s demographic challenges and diminishing returns on fixed capital investments, while accelerating rebalancing toward consumption, services, and green growth.

Figure 3: Local government debt (IMF definition & estimate)

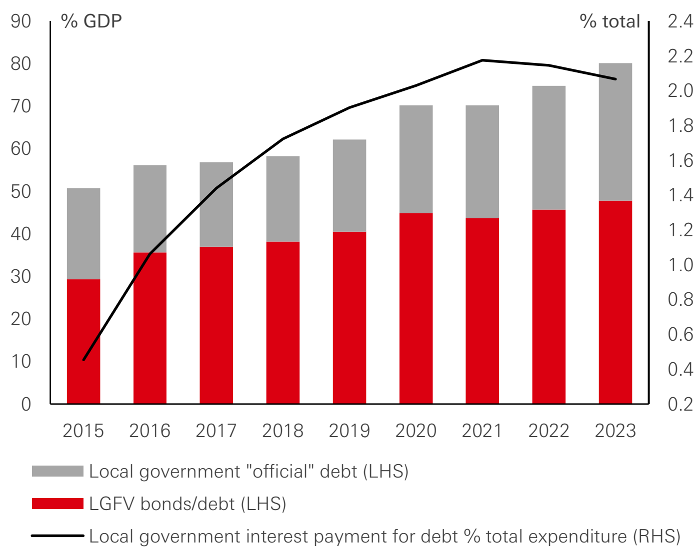
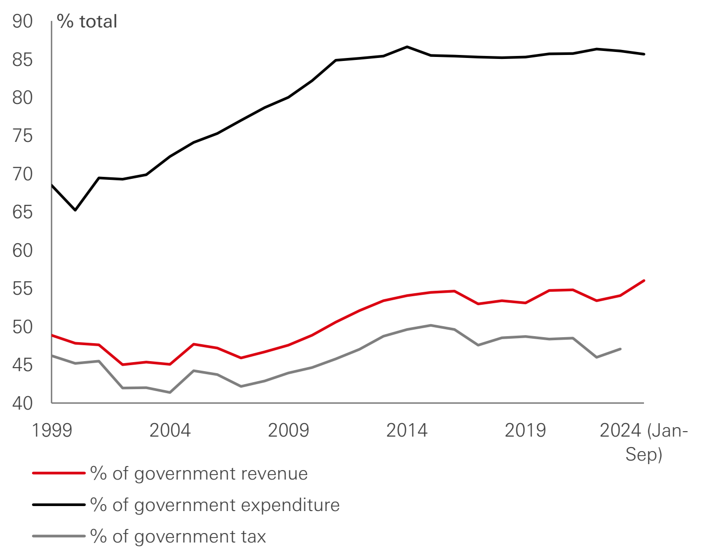



Figure 4: Local government revenue and expenditure




Source: IMF, CEIC, HSBC Asset Management, October 2024

**External uncertainties, such as US tariffs/protectionist policies, have to be considered. China is likely to intensify policy efforts to boost domestic demand and diversify export markets and production.**

In terms of responses to US tariff hikes, we believe that Chinese authorities would likely impose some retaliatory actions, for example on critical minerals needed for green transition and various technological applications. Some degree of RMB depreciation could be implemented to offset the tariff impact, but we believe authorities would still manage or defend RMB stability against any rapid or excessive currency moves to anchor expectations and support market confidence, particularly given the falling US share in China's exports over the past few years and China’s already-high export price competitiveness. RMB devaluation may not benefit China’s goods trade significantly, particularly given the risk of competitive devaluation across other key trading partners and exporting countries.

China’s Ministry of Finance announced that it will remove or cut the export tax rebate for some products, especially those highlighted in recent trade disputes. But this is not significant at the macro level, accounting for a small portion of China’s total exports. The move is unlikely to impact export prices significantly or change trade flows.

Chinese companies will likely also accelerate the pace of diversification of export markets and products and to further increase outward FDI to relocate production lines, though the trade diversification effect could be smaller this time around, given a higher starting share of emerging markets in China's exports. Lastly and most importantly, we think China will more actively use countercyclical macro policies to boost domestic demand in response to any trade shock.

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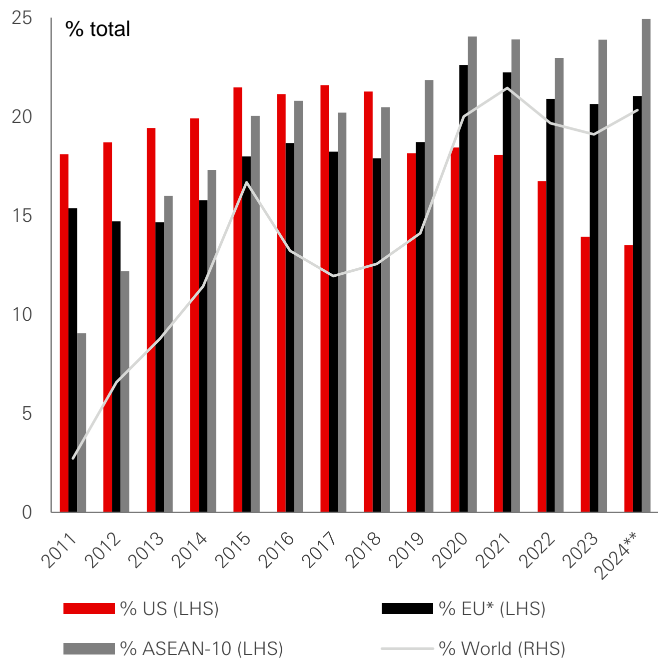
Figure 5: Market share of Chinese exports in select markets




Note: * Non-EU trade. ** January-September for 2024 data.
Source: WTO, CEIC, HSBC Asset Management, December 2024.

Figure 6: China's export prices are "competitive" and RMB real effective exchange rate has fallen

Note: the pink shade indicated 2018-19 US-China tariff tension, and the grey shade indicated Phase 1 trade agreement. Source: CEIC, HSBC Asset Management, October 2024.

We expect fiscal expansion to be complemented by calibrated monetary easing and targeted credit support. Monetary policy focuses on supporting inflation and enhancing policy transmission via the ongoing reform of its policy framework. We expect further policy rate and bank reserve requirement ratio (RRR) cuts in 2025, but there are domestic concerns over the squeeze on bank net interest margins and external risks from increased FX volatility, as well as the weaker credit impulse. This could put greater weights on fiscal response to counter any negative tariff/ external shocks on China's exports and economy. The PBoC can also deploy quantitative tools to facilitate fiscal policy operation and the government quality growth agenda.

Overall, we think more demand-side stimulus, further property stabilisation efforts, and structural reforms to rebalance the economy are likely needed to fundamentally reflate the economy. China's underlying deflationary pressures come from both cyclical headwinds and structural imbalances, including the supply-centric industry policy. Insufficient domestic demand and weak firm pricing power amid industrial excess capacity and intense market competition have been intensified by the property downturn and local government fiscal stress. The reflationary path is likely to remain gradual and bumpy this year.

**The interconnectedness of trade, investment and prices means that the effectiveness of China's stimulus could have a material impact on global growth, commodity prices and inflation.**

China's policies do not exist in a vacuum; they have significant implications for global economies. The interconnectedness of trade and investment means that changes in China's economic landscape can reverberate across the globe. Emerging markets, particularly in Asia, are highly exposed to China's economic performance. Meanwhile, an economy like Mexico's could face severe repercussions if the U.S. imposes tariffs on Chinese goods that are transhipped through Mexico.

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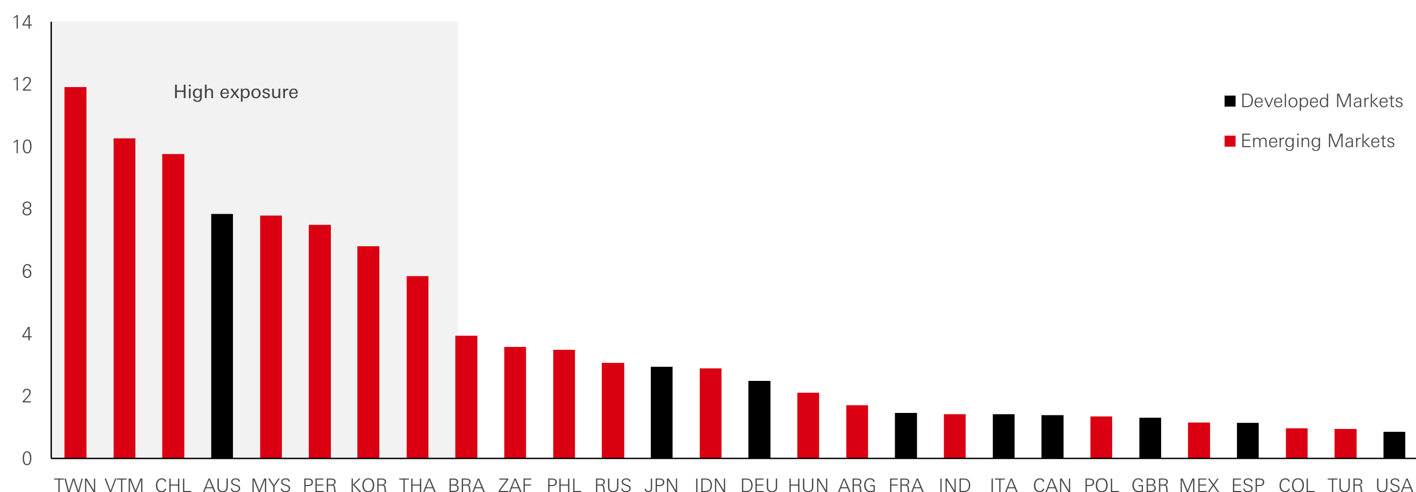
Additionally, China's demand plays a crucial role in shaping global commodity prices. As a major consumer of various commodities, any stimulus measures that boost domestic demand in China could lead to increased demand for raw materials. The relationship between China's producer prices and global inflation is complex, but while higher Chinese import prices can lead to inflationary pressures in other economies, the extent of this impact may be muted compared to previous cycles. The impact of inflation transmission is most likely, then, to be felt through the commodity channel.

Recent research indicates that the spillover effects of China's growth on other economies may also be more muted than in previous cycles. The IMF has noted that the impact of a 1% growth acceleration in China typically results in a 0.3% increase in GDP for its trading partners. However, this relationship may not hold as strongly in the current context, where domestic consumption is expected to play a larger role in driving growth.

Figure 7: Share of China's final demand in total value added (%, 2020)




Source: OECD TiVA, Macrobond, HSBC Asset Management, November 2024.

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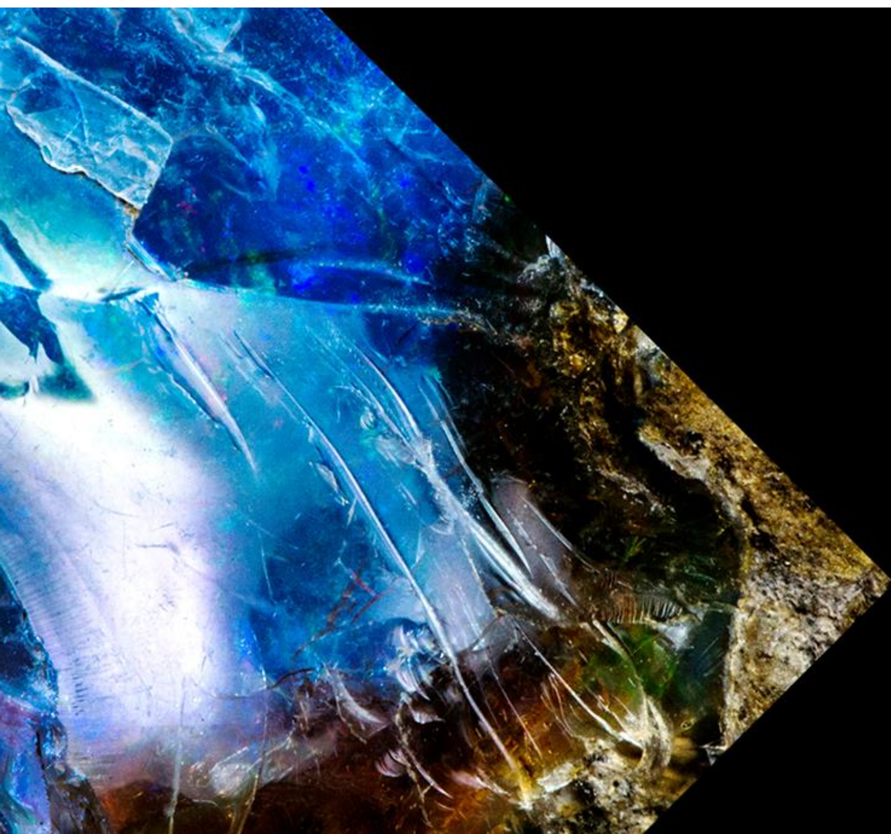


# Sectoral implications of China's stimulus measures

We identify the local government financing vehicles, property sector and banking sector as those where recent stimulus measures are most targeted, while also being pivotal to the near-term stability of the economy.

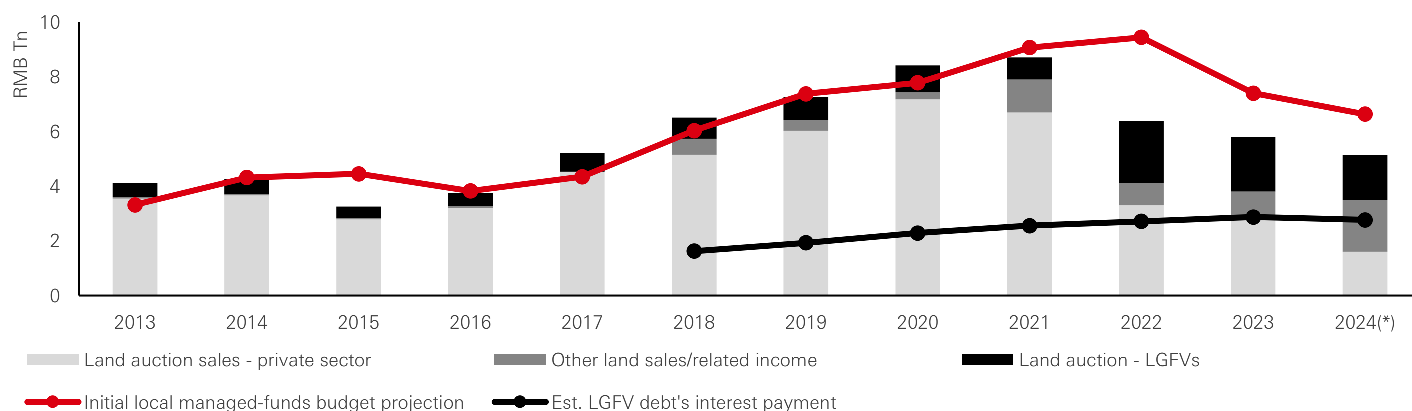
**Zoe Chuang**
Credit Analyst (Asia)

**Tim Yip**
Credit Analyst (Asia)

**Local government fiscal stress is being addressed through a 10 trillion RMB debt swap to stabilise finances and mitigate risks of defaults amid rising debt levels and declining land sales**

The announcements made at the end of September aim, most importantly, to address the fiscal stress faced by local governments. A pivotal measure in this regard is the 10 trillion RMB debt swap over the next three to five years, which allows local governments to issue special-purpose bonds to repay local government financing vehicles (LGFVs) debts. This program effectively transfers some of the off-balance-sheet LGFV debts onto the balance sheets of local and central governments. The decline of the property market has severely impacted land sales, which are local governments' main source of revenue, exposing their fragile fiscal position with a managed funds' budget shortfall of approximately RMB 3 trillion, or 2.5% of GDP per year vs. 2019-20 levels. Authorities have been grappling with rising LGFV debt levels, which have reached over RMB 60 trillion, a significant portion of China's total debt, estimated to be around RMB 300 trillion. This debt swap is particularly important as it aims to convert short-term debt into long-term LG bonds, thereby easing the immediate repayment pressures on local governments and lowering interest costs. Additionally, this initiative is expected to significantly reduce potential defaults, thereby stabilising LG/LGFVs that have been under significant strain.

Figure 1: Collapsed land sales led to significant and persistent fiscal gap in LG's managed fund accounts




Source: China's National Bureau of Statistics, China's Ministry of Finance, WIND, Huaxi Securities (* Annualised from September 2024 data).

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**Property sector challenges include substantial unsold inventory and the need for targeted policies to stabilise prices while recognising a long recovery ahead for the real estate market**

The second focal point for policymakers is the property sector itself. A significant concern is the substantial unsold inventory in the market, which poses a barrier to a robust recovery. According to market data, the average inventory level in key cities stands at 33 months, compared to a long-term average of around 15 months. This overhang poses a substantial barrier to a robust recovery, and further targeted policies will likely be necessary to address these challenges effectively over the long term. Additionally, tax reforms could provide a short-term boost, particularly benefiting state-owned enterprises (SOEs) focused on first and second-tier cities. However, a genuine recovery may take at least two years, with developers holding idle land likely to be the first batch to benefit. The Chinese government has signalled its intent to stabilise the property market, emphasising the need to halt the decline and stabilise prices. This strong signal has prompted various departments to launch supportive policies. However, execution risks remain high, as past rounds of policy easing have shown that local governments often struggle to implement measures effectively. Unless these measures are clearly tied to key performance indicators for local governments, the desired outcomes may not materialise.

**Banking sector vulnerabilities arise from significant exposure to LG/LGFV, necessitating recapitalisation to maintain stability amid ongoing risks and potential defaults**

Stress tests conducted on various risks, including those associated with commercial real estate (CRE), LG/LGFVs, and small and medium-sized enterprises (SMEs), indicate that banks are more sensitive to LG/LGFVs risks. The average non-performing loan (NPL) ratio for LG/LGFVs exposures is currently low, ranging from 0.5% to 1%, while the average NPL ratio of 7 large Chinese banks in the first half of 2024 is around 1.2%, with specific sectors, such as CRE, exhibiting higher ratios. However, this may not fully reflect the underlying risks due to recent debt relief programs and asset quality relaxation policies.

One of the key policy measures announced by the Chinese government is the planned recapitalisation of the six major SOE banks, which is expected to amount to approximately RMB 1 trillion. This figure represents about 0.95% of the risk-weighted assets of these banks. While this recapitalisation is viewed as credit positive in the near term, its long-term benefits depend on the size and utilisation of the funds. The overarching goal of the new policies is to stabilise the banking system and stimulate domestic demand. This includes support for LG/LGFVs and SMEs, with an intended move to support the execution of property policies. The banking sector's health is indeed vital for overall economic stability, and this capitalisation is seen as a necessary step to ensure that banks can absorb potential losses while continuing to lend. Importantly, the Chinese regulators perform annual stress tests on the banking system, for early identification of key credit risks and weak links in the system. Despite these measures, numerous structural issues remain, and the execution of current policies is likely to be a multi-year process.

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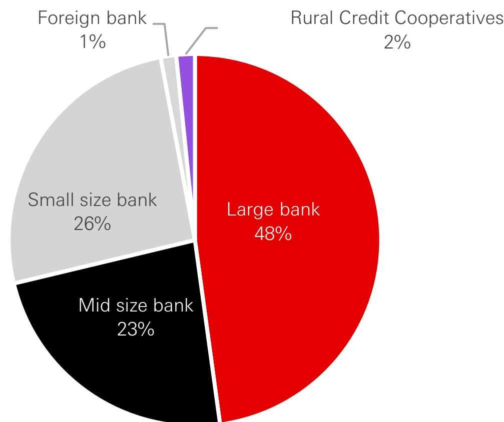
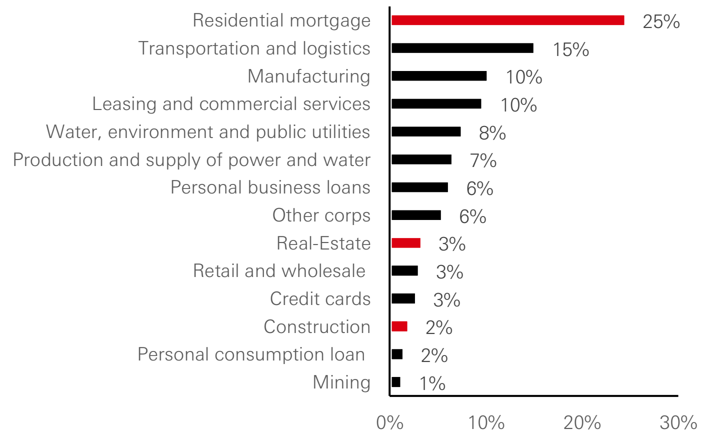
Figure 2: Bank industry by total asset size




Source: China Financial Stability Report 2023.

Figure 3: Typical loan book of a large bank




Source: HSBC AM, Corporate statements, September 2024. Industrial & Commercial Bank of China as proxy

**The internet and technology sector outlook shows positive short-term earnings for internet companies while hardware technology face challenges from geopolitical tensions and market dynamics.**

The Chinese government's recent stimulus measures are expected to yield positive short-term earnings for Internet companies. A notable initiative is the introduction of a trade-in subsidy program, which allocates approximately RMB 150 billion ($21 billion) from August to December 2024. This program aims to boost consumer spending on electronics and home appliances, with sales in these categories reportedly increasing by nearly 40% year-on-year in October, up from 20% in September. E-commerce platforms are also poised to be the primary beneficiaries of this consumption recovery. For instance, online retail sales of goods grew by 11.3% year-on-year in October, compared to 6.4% in September.

In contrast to these sectors, the hardware technology segment has yet to experience the same level of positive impact from consumption initiatives. Recent data indicates that smartphone shipments in China remained flat year-on-year in the third quarter, while PC shipments declined by 10%. This suggests that the replacement cycle for these devices is driven more by technological upgrades than by trade-in programs. Potential geopolitical tensions, particularly with the United States, looms large over the hardware tech sector. Any increase in tariffs on electronics could disproportionately affect companies which have significant exposure to the U.S. market. Additionally, the possible rollback of the CHIPS Act could hinder semiconductor companies, impacting their ability to secure funding for U.S. investments. While further sanctions and trade restrictions from U.S. remain tail risks, potential delisting risks from U.S. should be manageable given most dollar issuers are now dual-listed in both the U.S. and Hong Kong. However, the potential for a sector-wide sell-off, similar to 2018, remains a concern if tensions escalate beyond market expectations.

**Other sectors face challenges as pro-consumption initiatives are introduced amid macroeconomic headwinds and geopolitical tensions impacting consumer sentiment and spending patterns.**

Macroeconomic headwinds and geopolitical tensions have altered consumer behaviour, leading to a "consumption downgrade" that may not be easily reversed. The government's commitment to fiscally support consumption in the coming years may revive sentiment, with the market expecting fiscal support ranging from RMB 0.5 to 1 trillion in 2025. Despite these challenges, selected sectors like domestic travel and electric vehicles should continue to thrive under current policy.

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**The universe of US dollar-denominated bonds from China is contracting as USD funding costs stay elevated and those in the domestic RMB market continue to fall. China US dollar denominated bonds benefit from strong technical support, reinforced by keen demand from Mainland China for higher yielding assets. Our fundamental assessment advocates modestly defensive positioning in China offshore credit.**

The investment universe for US dollar-denominated bonds in China continues to contract, particularly within the high-yield segment. Despite this shrinking universe, the technical backdrop remains robust, especially in sectors including state-owned enterprises (SOEs) where there is a notable local bias favouring selected Chinese credits from Mainland investors.

Meanwhile, the outlook for China's sovereign credit has been downgraded to negative by both Moody's and Fitch, threatening to lower the sovereign rating, which would have a contagious impact on sovereign related credits.

Looking ahead, several key factors need to be monitored. The overall scale of the fiscal package is anticipated to be between 2% to 3% of GDP per year over the next several years, with a consensus emerging that a more substantial stimulus may be implemented under the Trump 2.0 administration. Additionally, the stabilisation of house prices and the property sector will be critical, alongside a sustained improvement in the labour market and domestic consumption stimulus. Restoration of corporate confidence and the business cycle will also play a significant role in shaping the economic landscape.

In terms of recommendations from our Asia credit research teams, a fundamentally driven approach suggests a generally defensive positioning. There is a preference for SOEs within the Chinese property sector, as well as interest in China's internet companies, Macau leisure, and select idiosyncratic issuers in investment-grade and high-yield.

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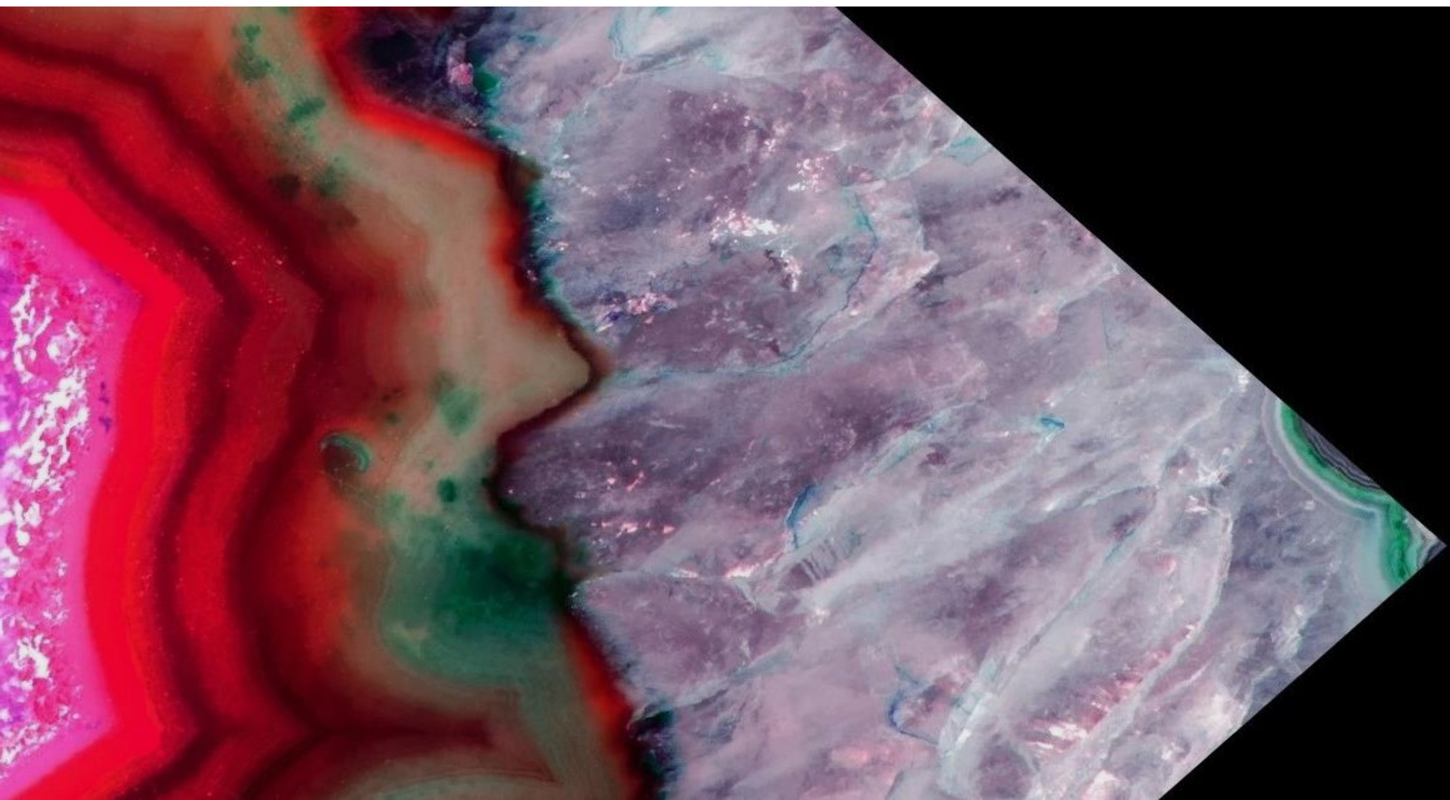

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