MARKET INSIGHTS

On the minds of investors

June 20, 2019

China: Is the recent stimulus enough?

Against the backdrop of a re-escalating trade friction with the U.S., the pressure is mounting on the Chinese economy. The latest data pointed to softening economic activities, reminding investors of a double-dip risk. Moreover, the liquidity condition is deteriorating among medium- and small-sized banks. Facing such risks, Chinese policy makers have been stepping up its economic support in the recent weeks.

On the fiscal front, China's Ministry of Finance (MOF) announced a new rule on June 10 to allow local governments to leverage up the investment in railway, highway and utilities projects. In the first five months, infrastructure investment only grew by 2.6% year-over-year, weaker than expected. Therefore, local governments are now allowed to use their proceeds from special bond issuance as equity capital in qualified projects, and then borrow debts from financial institutions.

This new rule might help boost the growth rate by 7.5 ppts in infrastructure investment growth. Local governments used about 20% of the proceeds from special bond issuance in qualified sectors, therefore the RMB 3.5trillion bond issuance in 2018 and 2019 might help bring in RMB 1.3trillion of debt financing. This might drive up the infrastructure investments growth to 10% year-over-year for the rest of this year.

On the monetary front, the People's Bank of China (PBoC) is delivering more easing measures to address the structural liquidity shortage for smaller banks. In the economic downturn, smaller banks are facing increasing credit risks from deteriorating collateral quality. On May 24, PBoC and China Banking and Insurance Regulatory Commission jointly take over a small local bank in Inner Mongolia as credit deterioration impacted its balance sheet.

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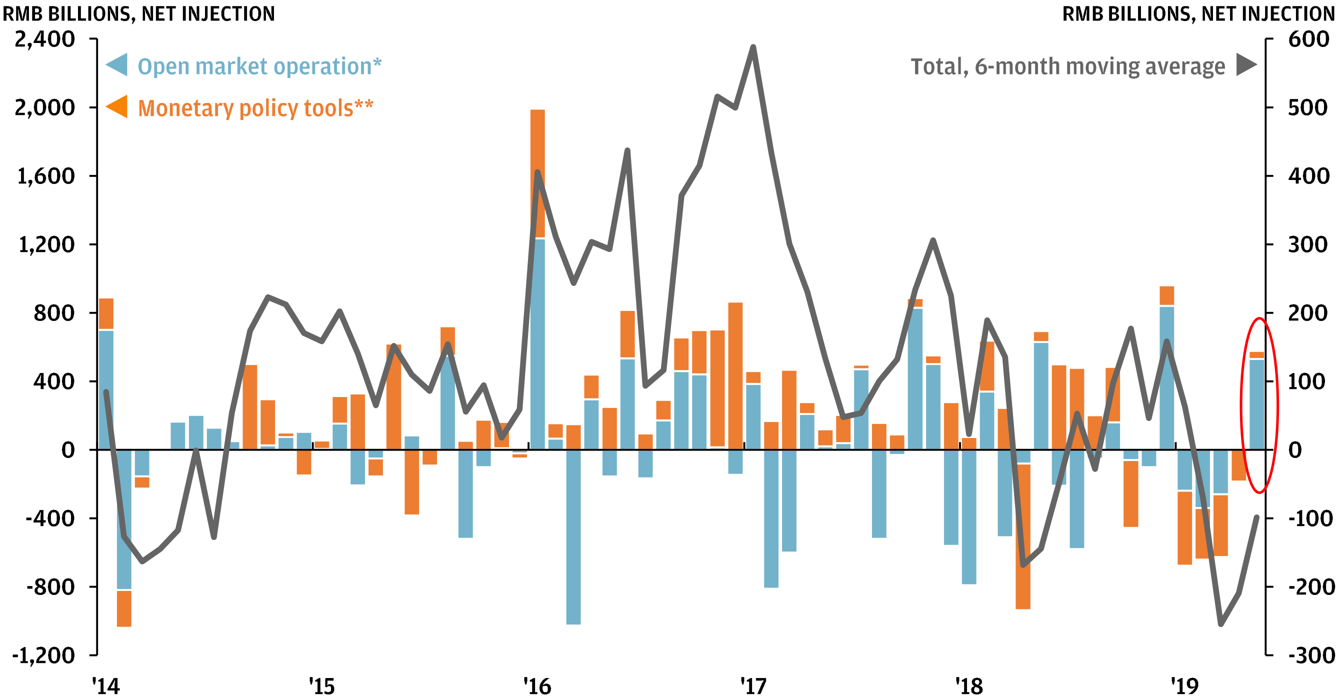
On June 14, the PBoC offered RMB 200billion rediscounting facility and RMB 100billion short-term liquidity facilities for small- and medium-sized banks. It has also conducted updated Medium-term Lending Facility earlier in June to inject additional liquidity into smaller banks. More importantly, smaller banks are allowed to expand eligible collateral scope to qualified bonds including negotiable certificate of deposits and commercial bills when obtaining liquidity support from the central bank.

The recent policy measures reflect the government's strong stance to stabilize the growth when it continues facing uncertainties from the trade friction and global economic slowdown. Looking forward, further expansionary measures are likely to be taken by the MOF, and the PBoC might have two more 25-bp Reserve Requirement Ratio cuts in the rest of the year so as to provide credit support for both the state and private sectors.

J.P.Morgan
Asset Management

EXHIBIT 1: LIQUIDITY INJECTION BY THE PBOC

THE PBOC IS RAMPING UP ITS TARGETED LIQUIDITY INJECTION TO HELP SMALLER BANKS



Source: CEIC, People's Bank of China, J.P. Morgan Asset Management.
*Open market operation includes reverse repo, repo and central bank bill issuance by the People's Bank of China.
**Monetary policy tools include short-term liquidity operations (SLO), standing liquidity facility (SLF), medium-term liquidity facility (MLF) and pledged supplementary lending (PSL).
Guide to the Markets - Asia. Data reflect most recently available as of 19/06/19.

Investment implications

The escalating stimulus measures have provided some support to market sentiment, while it is still too early to expect a bullish turnaround in markets. As the trade friction continues and domestic leverage remains at a high level, there are looming challenges to China's growth and corporate earnings outlook. Hence, investors need to be active in stock selection, so as to manage the volatility. At this stage, quality stocks in consumer, technology and financial service sectors offer better risk-reward balance. Meanwhile, as the U.S. Federal Reserve and PBoC both maintain an easing bias, investors might also consider Chinese bond investments as a way to diversify the risks.

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