To the rescue

Policy makers and resolutions for China's slowdown

November 2015

The Chinese economy has weakened much faster than most commentators expected this year. Some slowing was inevitable as China completed the most aggressive phase of its development.

However, a number of other shorter-term factors created a much broader slowdown including:

+ weakness in export markets
+ softened consumption due to the anti-corruption drive
+ slowing local government spending due to changes to financing rules
+ lower confidence due to the stock market fall.

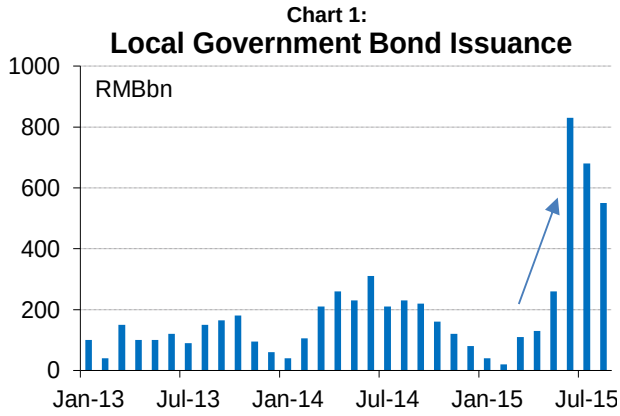
The better news is the policy response to these developments has already been aggressive. As the effect of some of the short term issues fade and the policy measures begin to work, we expect the outlook for China to improve over the next few months.

China's newly introduced major measures include changes to local government financing rules, fast tracked new projects, lower interest rates and easing in credit rules, support for the housing market and support for the auto sector. Tim Rocks, Head of Market Strategy and Research, discusses further in this article.

1. Changes to local government financing rules

Local governments are responsible for much of the infrastructure construction in China. Reforms to funding arrangements introduced in late 2014 had the unexpected effect of starving them of funds. These reforms were reversed in February, and additional rules allowing for easier bond issuance were introduced in May. This arrangement has led to a sharp rise in bond issuance by local governments, as shown in chart 1. These funds will allow for the early recommencement of previously stalled projects.

Chart 1:

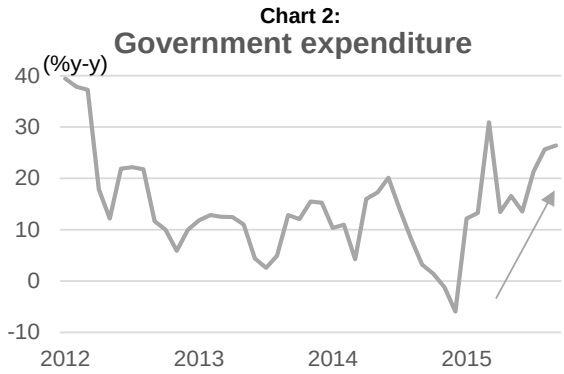


Source: Datastream

2. Fast tracked new projects

The authorities have fast-tracked a number of large-scale infrastructure projects. The Government announced several large-scale rail projects and released a list of proposed infrastructure projects for funding via public-private partnerships. It also urged banks to continue to lend to existing infrastructure projects. These measures have led to a sharp rise in government expenditure in recent months, as can be seen in chart 2.

Chart 2:

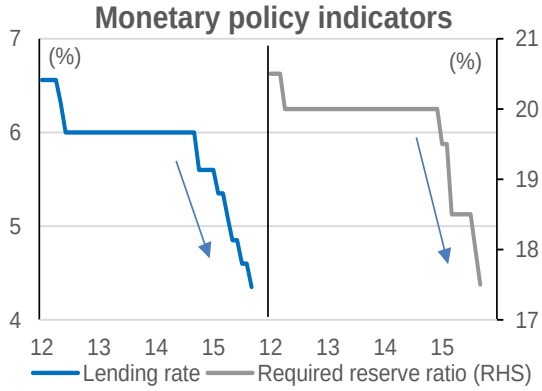


Source: Datastream

3. Lower interest rates and easing in credit rules

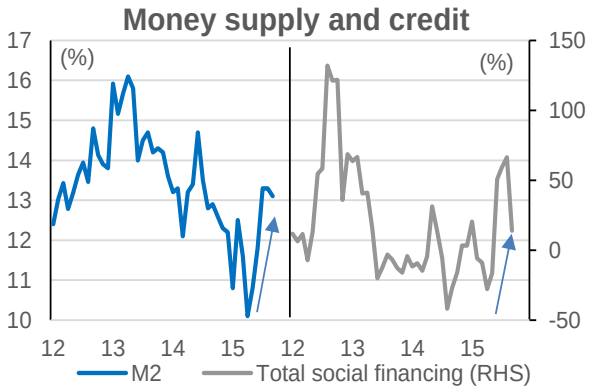
The People's Bank of China (PBoC) cut benchmark interest rates by 1.3% since the start of the year, acting to reduce financing costs and support lending. Indeed, credit and money growth have accelerated in recent months. The PBoC also lowered the percentage of reserves banks are required to hold, allowing them to increase credit.

Chart 3:



Source: Datastream

Chart 4:

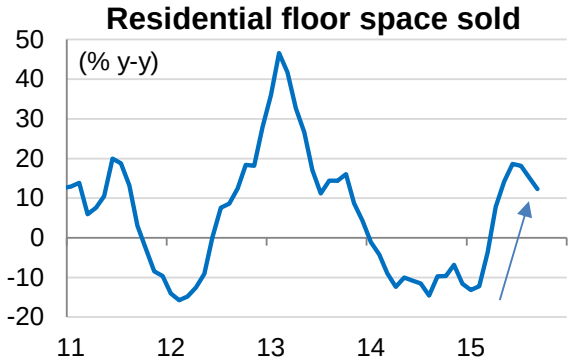


Source: Datastream

4. Support for the housing market

The authorities have moved to relax restrictions on home purchases. Households usually purchase property predominantly using savings rather than credit, with down-payment requirements for mortgages typically 30% for first homes and 60% for additional properties. In September, the minimum down payment was lowered for first home buyers to 25%. This follows previous relaxations to the rules over the past year. In addition, restrictions on foreign purchases of Chinese property were lifted in August. These changes should support the housing market in the near term. Indeed, new home sales have already started to strengthen while growth in house prices is back in positive territory over the year.

Chart 5:



Source: Datastream

5. Support for the auto sector

Finally, the Government acted at the end of September to support the automobile sector. The sales tax on small cars was reduced from 10% to 5%. This already appears to be having an impact, with Chinese passenger car sales up sharply in October.

These are not the only measures introduced. China has also introduced measures to stabilise its stock market, depreciated its currency, and introduced measures that will be positive over the longer term such as the removal of the one-child policy. Taken together, all of measures listed above should start to have a noticeable effect on the economy by the early months of 2016. This should alleviate many of the fears that have affected markets in recent months, and be a broad support for growth assets over coming months.

For more information about how activity in China impacts your investments, please contact us on 132 135.

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