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China Takes Major Steps to Bolster Its Economy

China's central bank has dramatically lowered borrowing costs, and the Chinese government unveiled a sizable economic stimulus package.

Insight from sub-adviser Schroders Investment Management

On the heels of disappointing data that suggested China might be at risk of not meeting its target economic growth of 5% for this year, the country's central bank and ruling government body announced major initiatives to promote economic growth, bolster the country's struggling property market, and strengthen its capital markets.

Support From the PBoC

On September 24, key leaders from the People's Bank of China (PBoC), the Financial Regulatory Bureau, and the China Securities Regulatory Commission introduced several significant policies aimed at stimulating the economy and promoting long-term growth. Some of the key measures included:

- A series of interest-rate cuts: The Open Market Operation rate, a policy rate that affects short-term borrowing, was reduced by 20 basis points[1] (bps), more than double what many had expected. The one-year Medium-term Lending Facility (MLF) rate, which is the interest rate the PBoC charges commercial banks for medium-term loans, was cut by 30 bps. To help homeowners, the rate on outstanding mortgages was reduced by 50 bps to equal the rates that apply to new mortgages. The Loan Prime Rate, the benchmark lending rate, was also lowered by 20-25 bps to reduce borrowing costs for businesses and individuals.
- Changes to give banks more operating flexibility: Banks' reserve requirements were lowered to help release more funds into the banking system. The interest rate paid by banks on deposits will also be reduced to help banks maintain stable net interest margins.
- Increased support for Social Housing: The PBoC will increase funding support for the Social Housing relending facility that encourages banks to issue loans to local state-owned enterprises (SOEs) that buy completed but unsold properties and convert them into social housing.

New—And Considerable—Support for the Chinese Stock Market

With a new measure that surprised many, the PBoC also announced it will now provide direct funding to support the buying of stock shares and add liquidity to the market. Through a new swap facility, eligible financial institutions will be allowed to use any bonds, stock ETFs, or stocks in the CSI 300 Index that they own as collateral to obtain highly liquid assets such as government bonds or central-bank bills from the PBoC. A second facility focused on relending is designed to help commercial banks provide loans to companies who would like to buy back shares and to major shareholders who want to buy more shares of companies they own. In total, the PBoC committed 800 billion yuan (about $113 billion) to these efforts, with the promise of more to come.

Key Points

- China's central bank has announced key policy proposals to stimulate the economy, including rate cuts and greater operating flexibility for banks.
- China's Politburo announced it would issue about $284 billion in special bonds to stimulate consumption and investment.
- While investors may want to consider selectively increasing exposure to China, we caution against overexuberance since we don't know how these policies will be implemented.

China's Politburo Took Additional Measures to Stabilize the Economy and Markets

Two days after the central bank's announcement, in a meeting of the Chinese Politburo, the country's top leaders announced the government would issue an additional 2 trillion yuan (about $284 billion) in special bonds to stimulate consumption and investment. There was also discussion of providing banks with a capital infusion of 1 trillion yuan (about $142 billion). These measures are designed to strengthen the property sector and promote economic growth. Along with the help for the stock market that the PBoC will now provide, the Politburo also expressed its commitment to boosting the capital markets, supporting the mergers and reorganizations of listed companies, and advancing reforms in public funds.

Markets Reacted Positively to the News

Not surprisingly, markets were buoyed by Beijing's stronger-than-expected host of measures to stabilize the economy and boost consumption. Greater China shares and bonds rallied in response to the Politburo announcement, with the gains most pronounced among Chinese real-estate companies and their peers in Hong Kong.

Our View: A Start, But More Support Still Needed

Chinese policymakers' increased urgency to support the economy is a welcome move. We see the stimulus measures as necessary to lower near-term systemic risks and bring this year's GDP growth closer to the government's stated target of 5%. However, these measures alone aren't likely to be a game changer. There are growing expectations that additional fiscal stimulus will be needed to support the broader economy and the housing market, in particular. Longer term, we believe China will need to do more to revive confidence among both households and companies. The government's efforts in this regard could help spur genuine demand that would bolster the still-fragile market sentiment.

We will closely watch the policy stimulus details and their subsequent tangible economic outcomes. While we think investors could consider selectively increasing their exposure to China, we would still caution against overexuberance given that much remains to be seen about how all these new policies are implemented and what degree of additional fiscal stimulus may come from the government to support a sustained recovery.

These measures alone aren't likely to be a game changer; additional fiscal stimulus will be needed.

Talk to your financial professional to learn more about international investing.

[1] A basis point is a unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security

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