Will Chinese Reflation Work?

The poor reading of Chinese Q3 growth numbers released last week is likely the reason behind Beijing's recent abrupt policy changes (**Chart 1**). Investors and analysts are focusing squarely on second-guessing the exact size of the stimulus "bazooka." The market has been on a roller coaster ride following each policy announcement out of Beijing.

Our view is that this is Beijing's "whatever it takes" moment. We doubt the authorities have a clear idea of how much stimulus the economy really needs, and therefore, they have an open-ended commitment to boost growth until the economy improves. The bad news is that after the initial jolt, further policy easing will likely be a data-dependent process. The good news is that several important factors suggest that Chinese reflation should work.

Tally The Stimulus

Details are still sketchy to gauge the full scale of Beijing's current round of growth measures, but there is no question that the easing efforts are coordinated across major government agencies, focusing on all key areas.

- On monetary policy, regulators have cut interest rates and reserve requirements and set up lending facilities to directly support the stock market. Yesterday the central bank cut loan prime rates by 25 basis points, and pledged more easing before year-end (**Chart 2**).

Chart 1   **GDP Growth Fell Further Behind Target**

China: Real GDP*

5% Target

GDP Deflator
PPI

© Alpine Macro 2024

Chart 2   PBoC Gets More Aggressive

Chinese 1-Year Loan Prime Rate

© Alpine Macro 2024
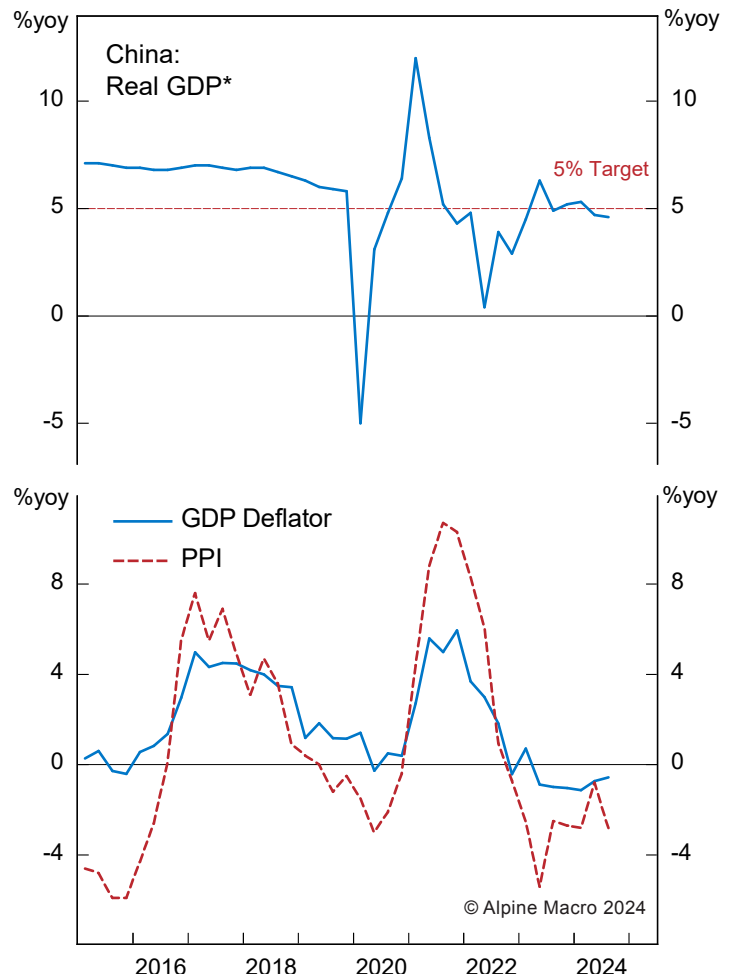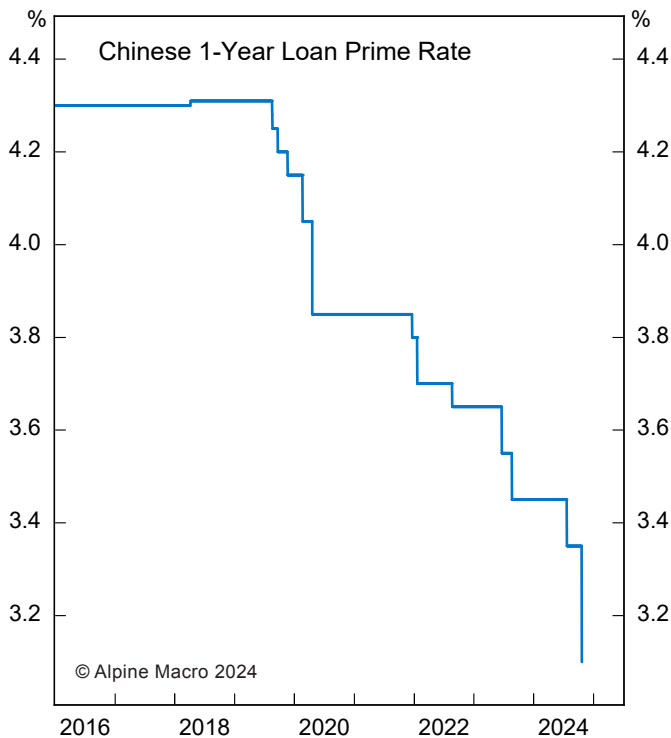
- On housing, all previous demand restrictions have been removed, mortgage interest rates and down payment ratios have been lowered, and regulators are considering measures to improve the financial conditions of developers. Beijing is also mandating local governments to absorb residential inventories and convert them to social housing projects, financed by bond issuance.

- On fiscal policy, Beijing is conducting another round of local government "debt swap," recapitalizing state-owned banks, and providing welfare benefits to special groups, such as low-income households and unemployed youth.

- An important message is that policymakers have stated that the stimulus efforts are not limited to these measures. The Ministry of Finance suggests that the central government has "fairly large" flexibility to increase the fiscal deficit and debt to support growth.

In some recent reports, we outlined the "three arrows" Beijing must use to revitalize the economy: large stimulus measures to boost demand, decisive debt-relief programs for local governments, and a credible commitment to advancing liberal reforms.[1] Recent developments suggest that Beijing continues to move in this direction. The first two arrows have been checked off, while the third is still missing.

Will Reflation Work?

With Q3 GDP growth coming in at 4.6%, we doubt the government will meet its 5% growth target for the year. Nonetheless, we see reasonable odds that the economy will improve in the wake of reflation efforts.

First, our view has always been that China's poor growth is mostly a "man-made" disaster rather than a result of "structural imbalances," as many have argued. In short, policymakers failed to support aggregate demand when the economy was operating below trend, creating a deflationary downward spiral (Chart 3). Beijing long demonized strong countercyclical measures as "flooding the system," and the overall macro environment remained far too tight despite ailing growth. As recently as this summer, top decision-makers were still downplaying the rapidly deteriorating economic signals and repeatedly ruled out "massive stimulus," further weakening confidence and dampening demand.
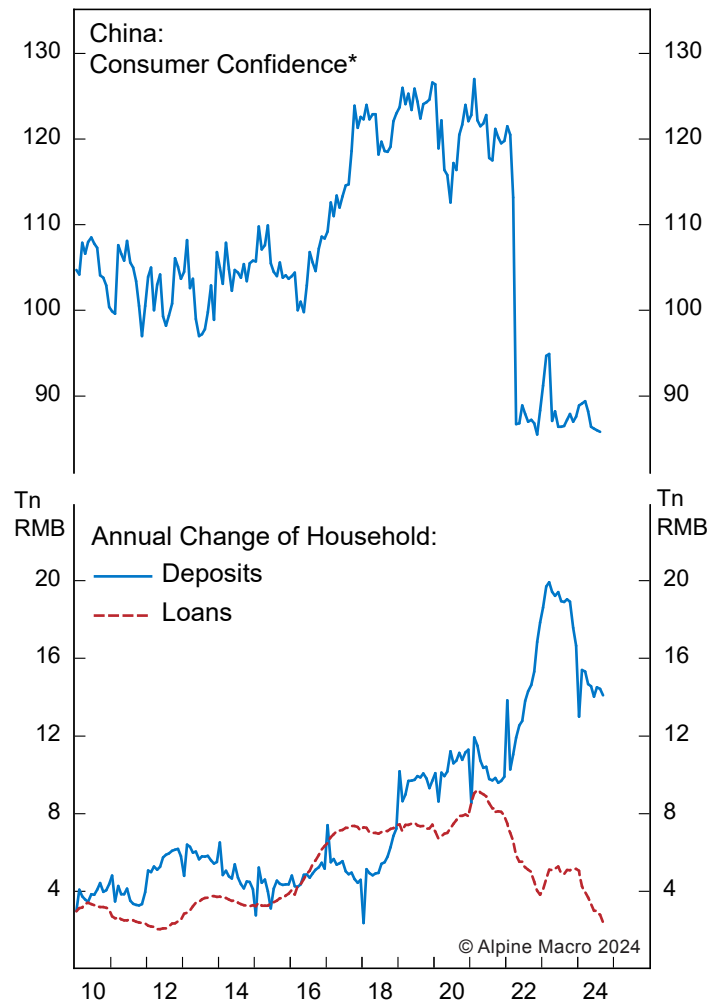
1   Alpine Macro *EM & China Strategy* "Is China In A Slow-Motion Implosion?" (August 27, 2024).

Chart 3   Beijing's Failure To Support Ailing Growth

China: Real GDP

- GDP
- Exports
- Retail Sales
- Real Estate Investment

© Alpine Macro 2024
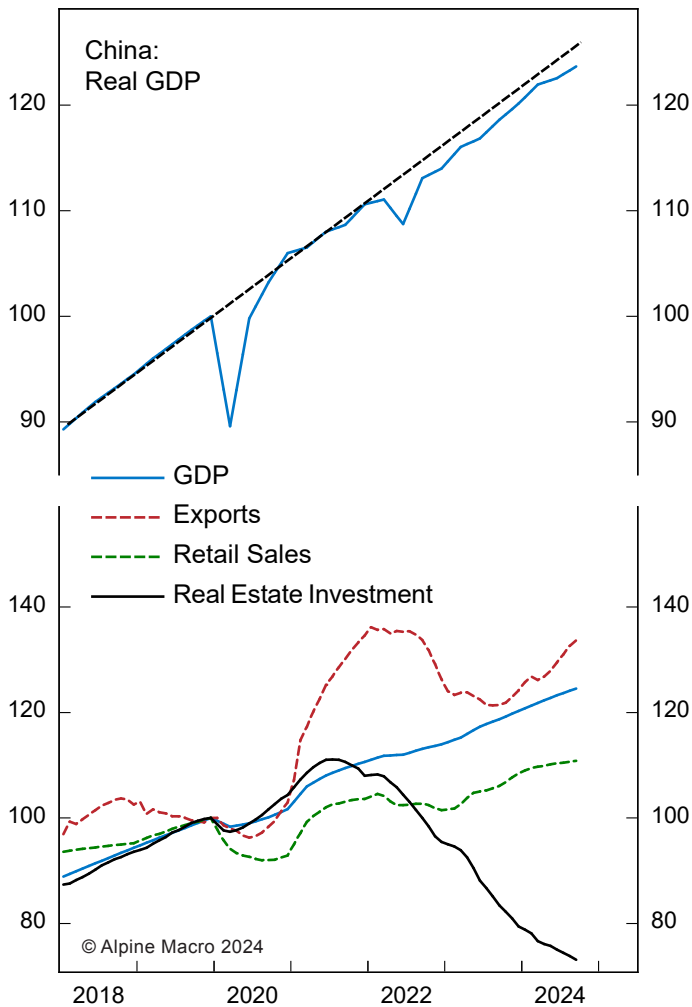
Note: All series are shown in real terms and rebased to Dec 2019 =100; series in bottom panel are shown as 12-month moving sum

Chart 4   Upside Potential For Consumer Demand

China: Consumer Confidence*

Tn RMB — Annual Change of Household:
- Deposits
- Loans

© Alpine Macro 2024

*Source: National Bureau of Statistics

In this context, recognizing the economic challenges and removing the self-imposed policy straitjacket is a crucial first step toward addressing these issues. The policy change itself sends a strong pro-growth signal to both government officials and the business community.

Second, the pandemic and poor economic performance in recent years have led to enormous pent-up demand in the household sector. Unlike other countries, China's household confidence has never recovered from the pandemic lows (Chart 4).
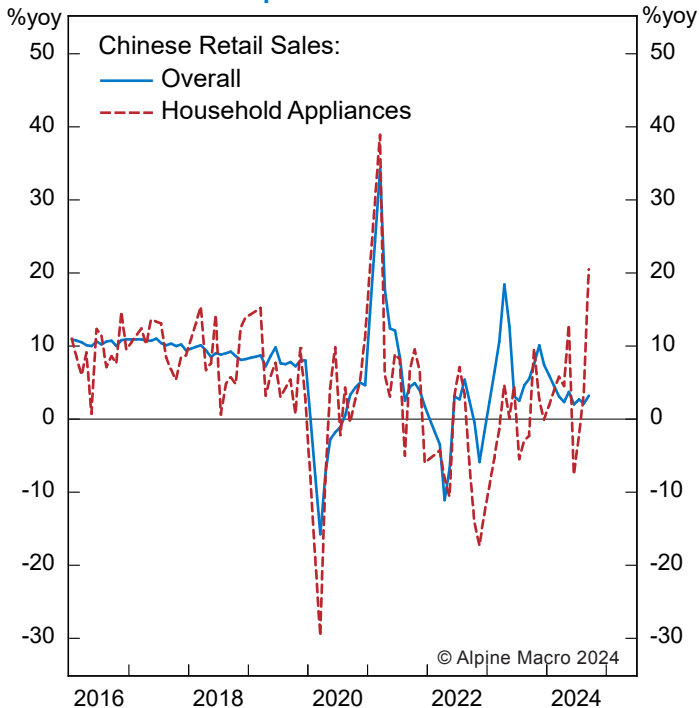
The yawning gap between household deposits and loans in recent years represents a massive mountain of precautionary savings, which can be released as growth conditions improve and confidence recovers.

It remains to be seen whether Beijing's latest confidence-boosting campaign can successfully mobilize household savings into consumption. What's more certain is that household balance sheets are in reasonably good shape and should respond to the right incentives. A case in point is the

Chart 5 Chinese Consumers Will Respond To Incentives

Chart 6 The Chinese Housing Meltdown Is Likely Overdone

*Source: "Has China's Housing Production Peaked?" by Kenneth Rogoff & Yuanchen Yang, China and the World Economy 21 (1): 1-31
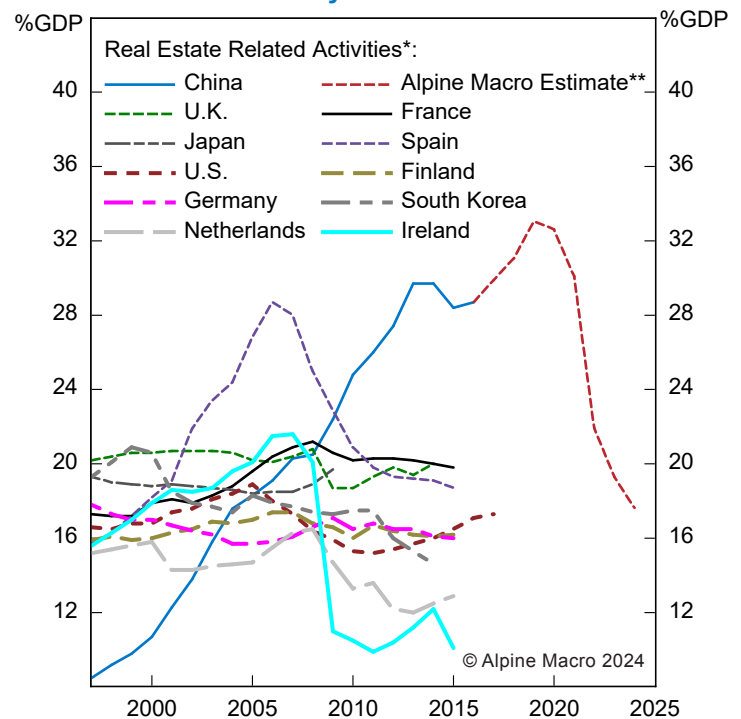**Alpine Macro proprietary model based on housing starts

strong sales of consumer durable goods in recent months, as Beijing has been offering subsidies for consumers to upgrade household appliances. Sales of household appliances jumped by over 20% last month compared to a year ago, a rare bright spot in an otherwise bleak economic backdrop (Chart 5). Similar measures could further unlock household savings, contributing to a stronger growth recovery.

Finally, we believe China's housing meltdown has undershot long-term fundamentals, which should at least limit the downside of further contraction. In an earlier report published in 2021, we argued that China's housing supply may not be as excessive as commonly perceived, and that Beijing's crackdown on developers was dangerous.[2] Fast forward to today: China's real estate-related activities as a

share of GDP, by our estimate, have fallen to early 2000s levels, even below those in many highly urbanized and developed economies (Chart 6). This, along with Beijing's latest easing measures, increases the odds of a bottoming process in the Chinese housing sector.

What To Watch?

Page 6 provides an update of our *China Macro Watch* chartpack, covering the country's latest growth and market indicators. Most economic indicators remain deeply depressed, with deflationary pressures intensifying. This is old news. After the initial reflex rally in Chinese stocks since September, markets will soon look for evidence of whether the easing measures will bear fruit.

---

2   Alpine Macro *EM & China Strategy* "Why Rogoff *et al.* (And Chinese Policymakers) Are Wrong" (October 20, 2021).

As discussed in last week's webcast,[3] three groups of indicators are particularly important to gauge the reflation and recovery process:

- Confidence and demand among households and companies

- Credit and monetary aggregates

- Housing activities

For now, we give policymakers the benefit of the doubt that China's business cycle will improve following the latest growth push and remain long/overweight on Chinese stocks. We will continue to closely monitor policy developments and growth conditions going forward. Stay tuned.

Housekeeping

Our stop point for the long position on MSCI China was breached last week during the pullback following the sharp rally. However, we are maintaining the long position with a new 10% rolling stop to manage risk.

Our long position on the South African rand versus the U.S. dollar is not working. We're concerned that the Fed may not ease as much as the market anticipates, which could keep the dollar well-supported against EM currencies. As a result, we are closing the long ZAR/USD position with a 1.3% loss, and will focus on pair trade ideas among EM currencies.

Please continue to page 6 for the *China Macro Watch* chartpack.

Yan Wang, CFA
Chief Emerging Markets & China Strategist

3　Alpine Macro *EM & China Strategy Webcast* "China's 'Whatever It Takes' Moment: An Update" (October 13, 2024).

CHINA MACRO WATCH

Market Performance

Equity Benchmark*	Level	YTD Return (%)	1-Month Return (%)	1-Year Return (%)	P/E	P/B	Chinese Bond Yields	Level (%)	YTD Chg (bps)	1-Month Chg (bps)	1-Year Chg (bps)
MSCI China Free (US$)	67.8	24.2	21.8	23.4	13.1	1.5	10-Year Government Bonds	2.12	-43.2	7.6	-58.4
CSI 300	3935.2	16.5	23.1	13.3	16.0	1.7	Spread over U.S. 10-Year Treasury	-1.96	-60.2	-29.9	26.6
Shanghai A Shares	3425.4	10.1	19.5	11.2	15.8	1.4	5-Year AAA-Rated Corporate Bonds	2.24	-70.3	10.0	-89.4
STAR 50	1000.4	20.6	53.6	19.1	82.2	5.0	**Currency**	**Level**	**YTD Chg (%)**	**1-Month Chg (%)**	**1-Year Chg (%)**
Shenzhen A Shares	2026.0	6.8	29.4	9.0	35.9	2.3	USD/CNY	7.115	0.0	-0.6	2.8
ChiNext	2210.3	20.5	42.9	18.5	32.8	4.3	Nominal Broad Effective RMB (CFETS)	99.19	1.4	1.3	-0.5

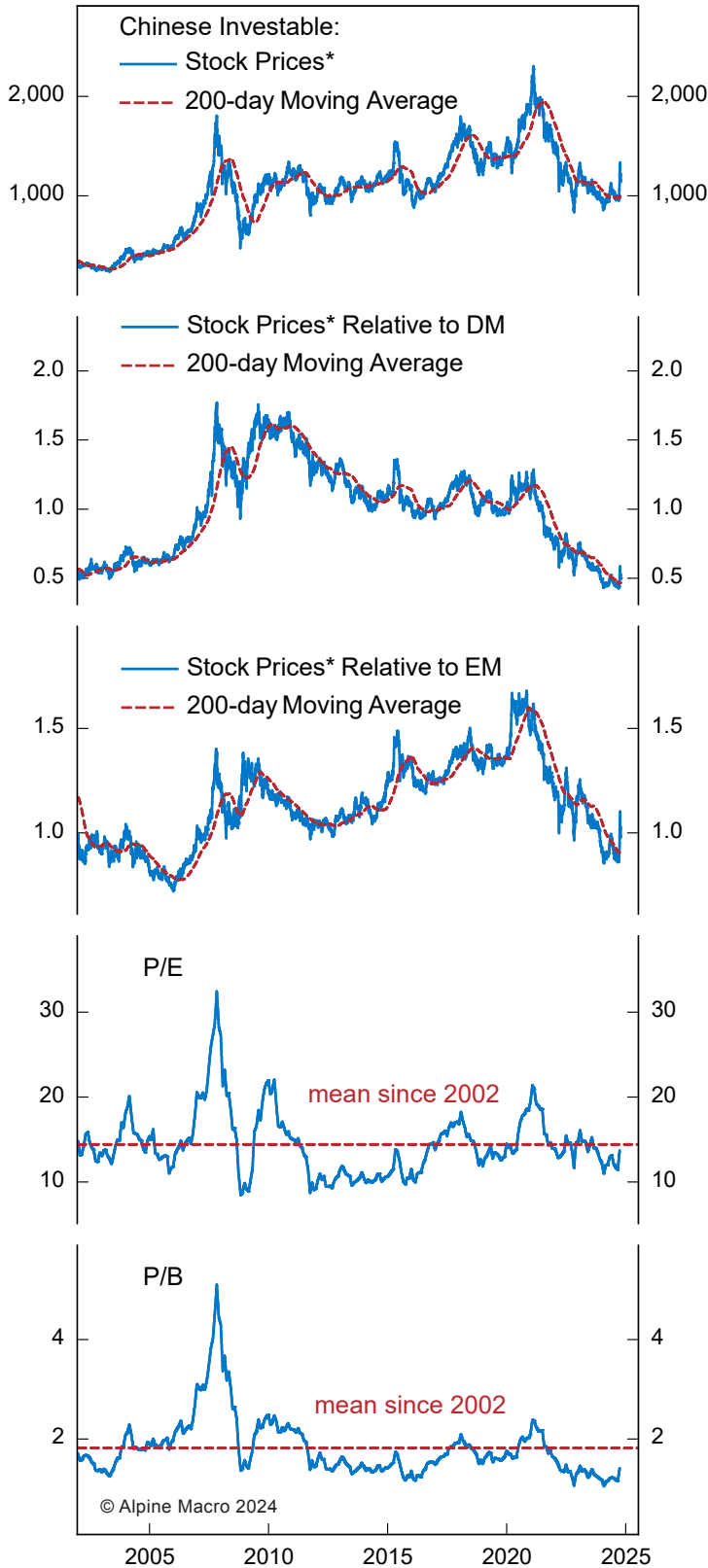*In local currency terms, unless otherwise specified
Note: Data as of October 21, 2024

Economic Barometer

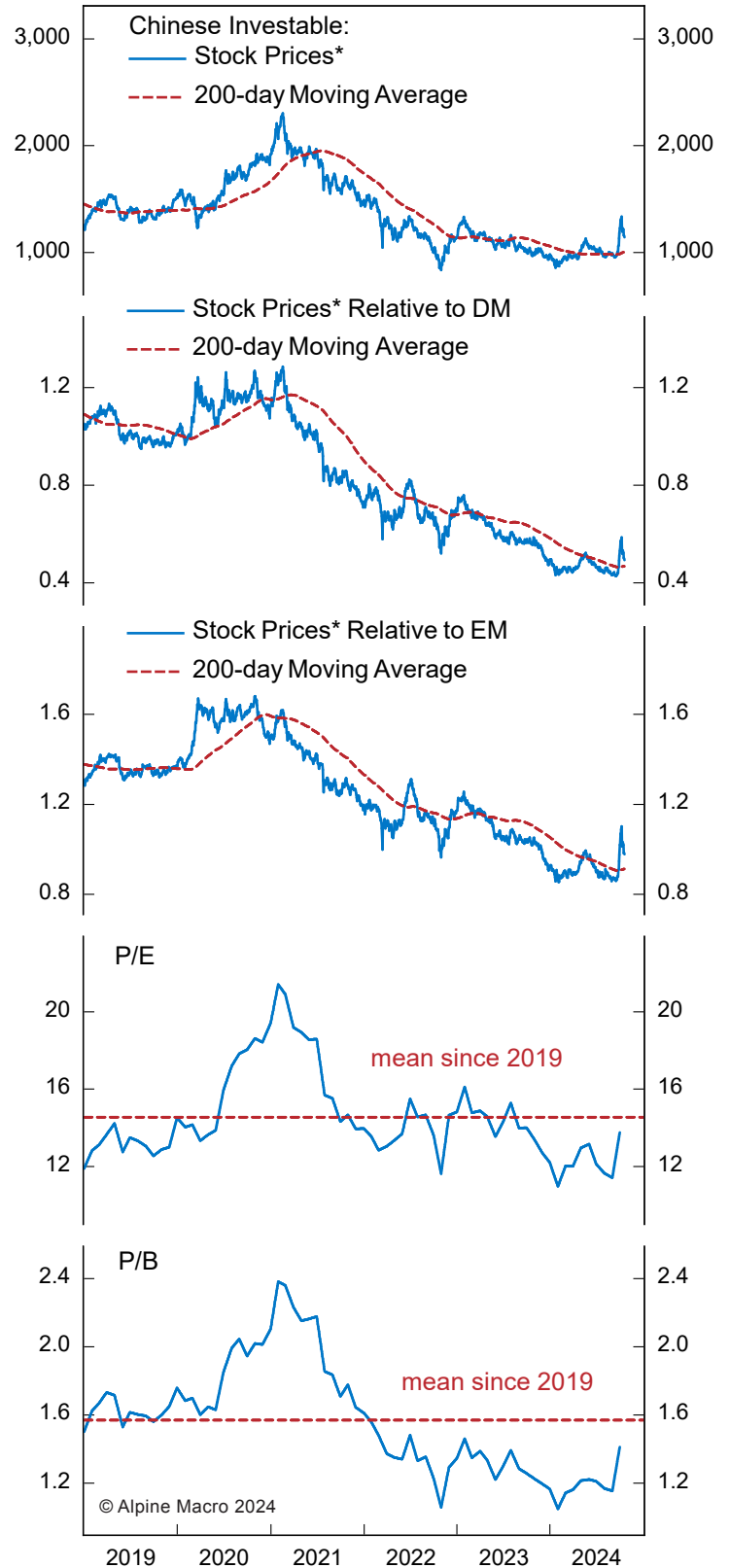|		2023-09	2023-10	2023-11	2023-12	2024-01	2024-02	2024-03	2024-04	2024-05	2024-06	2024-07	2024-08	2024-09
Leading Indicator	NBS PMI	50.2	49.5	49.4	49.0	49.2	49.1	50.8	50.4	49.5	49.5	49.4	49.1	49.8
	Caixin Manufacturing PMI	50.6	49.5	50.7	50.8	50.8	50.9	51.1	51.4	51.7	51.8	49.8	50.4	49.3
	Caixin Services PMI	50.2	50.4	51.5	52.9	52.7	52.5	52.7	52.5	54.0	51.2	52.1	51.6	50.3
Inflation (%yoy)	CPI	0.0	-0.2	-0.5	-0.3	-0.8	0.7	0.1	0.3	0.3	0.2	0.5	0.6	0.4
	Food CPI	-3.2	-4.0	-4.2	-3.7	-5.9	-0.9	-2.7	-2.7	-2.0	-2.1	0.0	2.8	3.3
	Core CPI	0.8	0.6	0.6	0.6	0.4	1.2	0.6	0.7	0.6	0.6	0.4	0.3	0.1
	PPI	-2.5	-2.6	-3.0	-2.7	-2.5	-2.7	-2.8	-2.5	-1.4	-0.8	-0.8	-1.8	-2.8
Economic Activity	Unemployment Rate (%)	5.0	5.0	5.0	5.1	5.2	5.3	5.2	5.0	5.0	5.0	5.2	5.3	5.1
	Fixed Asset Investment* (%yoy)	3.1	2.9	2.9	3.0	3.6	4.2	4.5	4.2	4.0	3.9	3.6	3.4	3.4
	Industrial Production (%yoy)	4.5	4.6	6.6	6.8	6.9	7.0	4.5	6.7	5.6	5.3	5.1	4.5	5.4
	Retail Sales (%yoy)	5.5	7.6	10.1	7.4	6.0	4.5	3.1	2.3	3.7	2.0	2.7	2.1	3.2
	Car Sales Annual Change (Mn)	0.2	0.3	0.6	0.6	0.8	-0.4	0.2	0.2	0.0	-0.1	-0.1	-0.1	0.0
International Trade (%yoy)	Exports in US$	-6.2	-6.4	0.5	2.3	4.7	7.1	-7.5	1.5	7.6	8.6	7.0	8.7	2.4
	Imports in US$	-6.2	3.0	-0.6	0.2	1.9	3.5	-1.9	8.4	1.8	-2.3	7.2	0.5	0.3
	Imports of Crude Oil**	14.0	13.9	12.2	11.9	12.4	12.9	10.5	11.1	9.4	4.7	3.0	-0.1	-1.3
	Imports of Iron Ore**	5.3	5.4	6.2	6.7	6.7	6.8	5.6	6.2	6.4	5.9	6.6	5.3	5.4
	Imports of Copper**	-7.7	-5.6	-6.0	-5.8	-4.8	-3.8	-0.9	0.8	2.5	3.6	3.6	3.0	3.4
	Imports of Coal**	59.5	60.8	64.3	68.7	64.7	60.6	48.1	43.0	36.2	28.0	23.9	20.0	18.8
Real Estate (%yoy)	Floor Space Sold*	-7.5	-7.8	-8.0	-8.5	-14.5	-20.5	-19.4	-20.2	-20.3	-19.0	-18.6	-18.0	-17.1
	Floor Space Started*	-23.4	-23.2	-21.2	-20.4	-25.1	-29.7	-27.8	-24.6	-24.2	-23.7	-23.2	-22.5	-22.2
	Floor Space Completed*	19.8	19.0	17.9	17.0	-1.6	-20.2	-20.7	-20.4	-20.1	-21.8	-21.8	-23.6	-24.4
	Housing Price	-0.6	-0.6	-0.7	-0.9	-1.2	-1.9	-2.7	-3.5	-4.3	-4.9	-5.3	-5.7	-6.1
Credit	M1 (%yoy)	2.1	1.9	1.3	1.3	5.9	1.2	1.1	-1.4	-4.2	-5.0	-6.6	-7.3	-7.4
	M2 (%yoy)	10.3	10.3	10.0	9.7	8.7	8.7	8.3	7.2	7.0	6.2	6.3	6.3	6.8
	New Loans Annual Change (Bn RMB)	-155.6	123.2	-120.0	-234.8	20.0	-360.0	-800.0	11.2	-410.0	-921.2	-85.9	-460.0	-720.0
	Aggregate Social Financing (%yoy)	8.8	8.7	8.7	8.7	8.4	7.8	7.6	7.4	7.3	6.8	6.8	6.6	6.3
Financial Markets & Interest Rates	MSCI China Free (%MoM)	-2.9	-4.3	2.5	-2.6	-10.6	8.4	0.9	6.5	2.1	-2.6	-2.3	0.9	23.6
	CSI 300 (%MoM)	-2.1	-3.0	-2.1	-3.1	-5.0	9.4	2.3	0.2	-0.4	-3.1	-1.0	-5.1	23.1
	Iron Ore Price (%MoM)	7.9	1.3	1.4	4.8	-0.7	-10.1	-13.6	10.5	0.7	-6.7	-6.4	0.5	2.4
	Copper Price (%MoM)	-3.6	0.3	1.7	0.6	-0.1	-0.6	4.9	13.1	0.4	-5.0	-4.9	0.1	6.8
	Steel Price (%MoM)	-0.5	0.0	3.0	1.1	-0.5	-0.7	-5.6	1.4	0.2	-3.8	-5.8	-4.4	0.2
	Loan Prime Rate 1-Year*** (%)	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.4	3.4	3.1
	SHIBOR 3-Month (%)	2.3	2.4	2.5	2.5	2.4	2.2	2.2	2.0	2.0	1.9	1.9	1.9	1.8
	10-Year Government Bond Yield (%)	2.7	2.7	2.7	2.6	2.4	2.3	2.3	2.3	2.3	2.2	2.1	2.2	2.2

*Shown as year-to-date
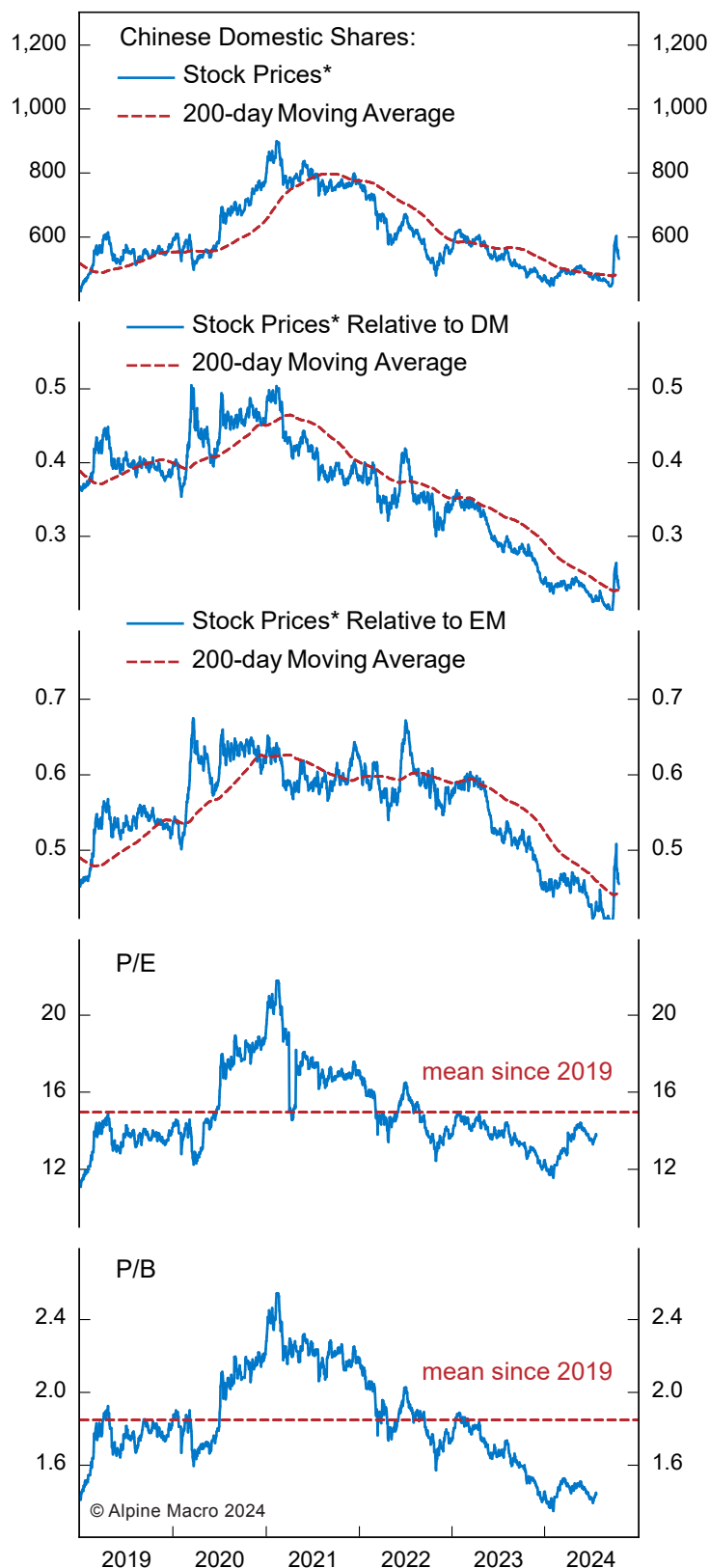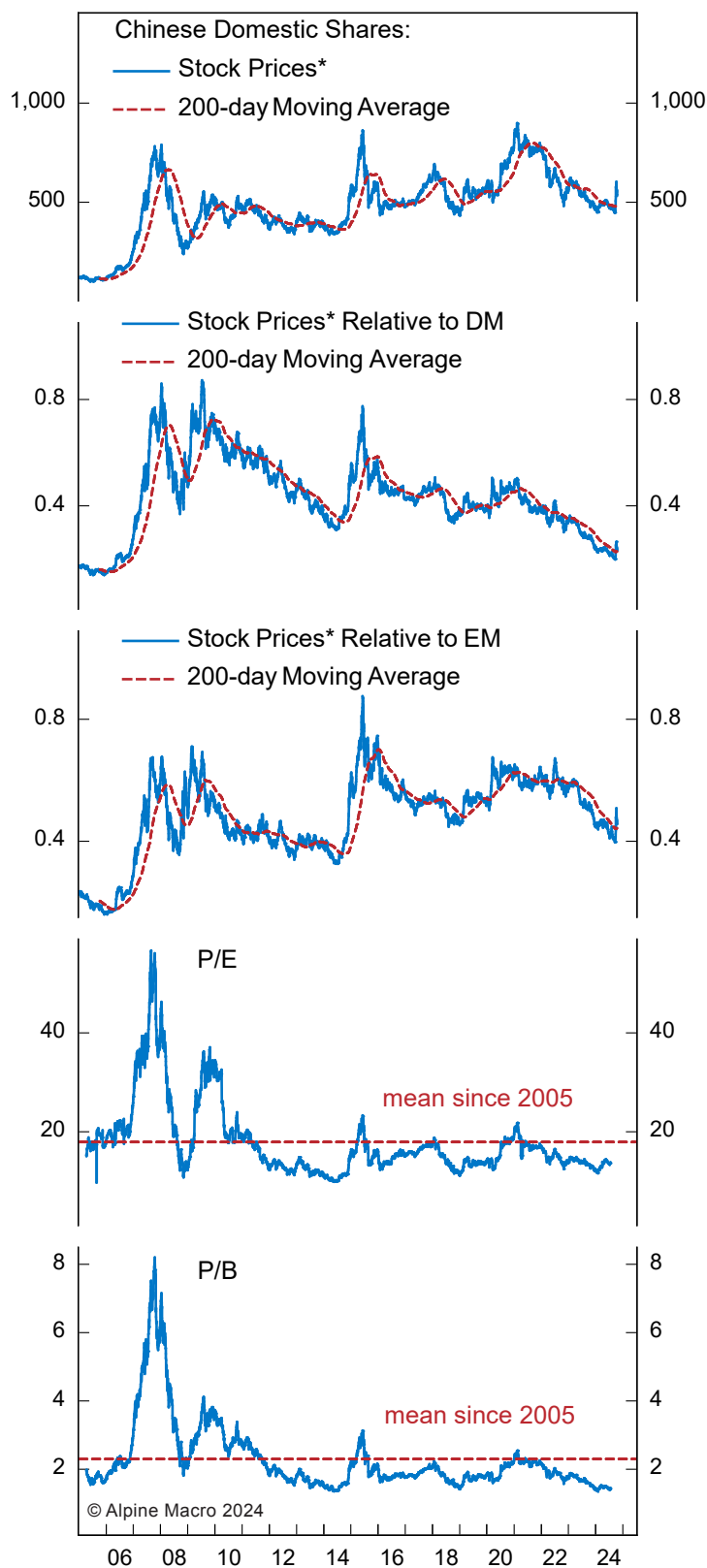**Imports in volume terms; shown as 12-month moving average
***Latest available rate

Chinese Investable:
- Stock Prices*
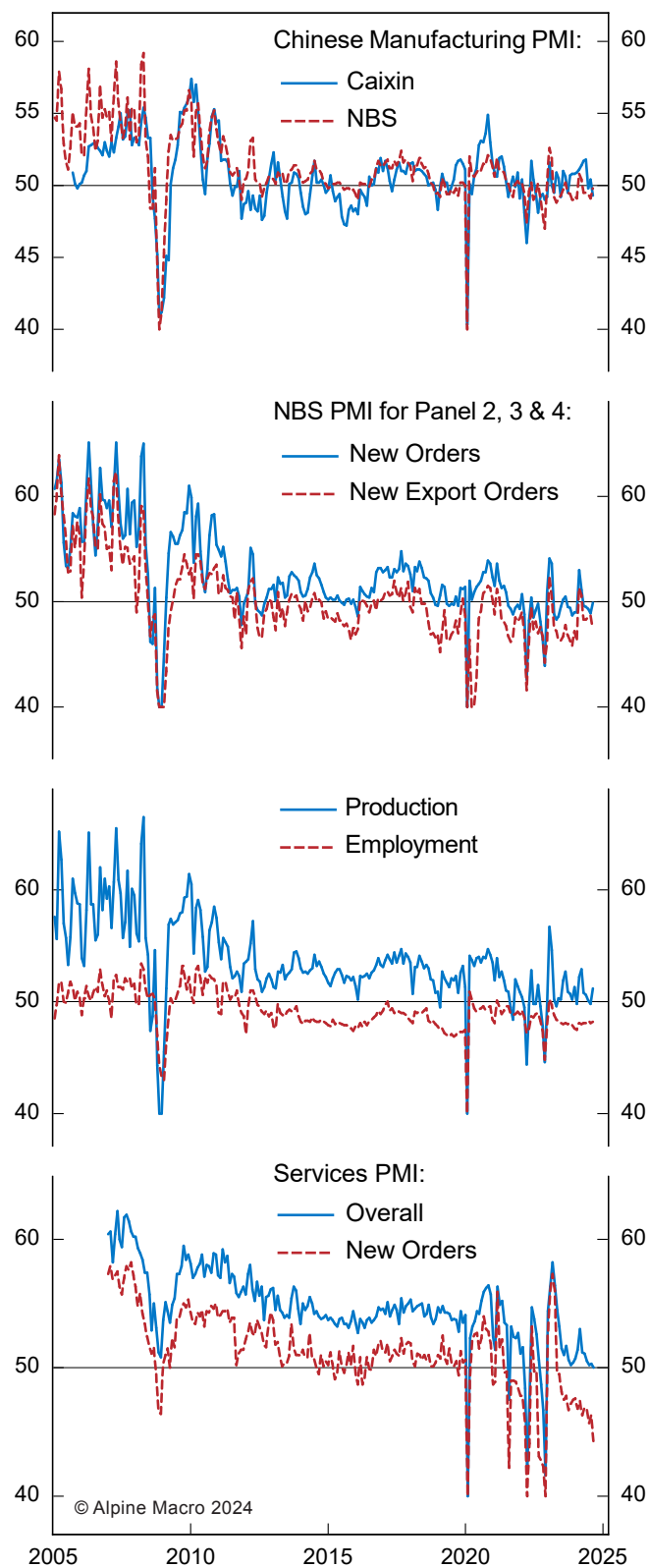- 200-day Moving Average

Chinese Investable:
- Stock Prices*
- 200-day Moving Average

- Stock Prices* Relative to DM
- 200-day Moving Average

- Stock Prices* Relative to DM
- 200-day Moving Average

- Stock Prices* Relative to EM
- 200-day Moving Average

- Stock Prices* Relative to EM
- 200-day Moving Average

P/E

mean since 2002

P/E

mean since 2019

P/B

mean since 2002

P/B

mean since 2019

© Alpine Macro 2024

© Alpine Macro 2024

*In US$ terms
Source: MSCI

*In US$ terms
Source: MSCI

Chinese Domestic Shares:
— Stock Prices*
-- 200-day Moving Average

— Stock Prices* Relative to DM
-- 200-day Moving Average

— Stock Prices* Relative to EM
-- 200-day Moving Average

P/E — mean since 2005

P/B — mean since 2005

© Alpine Macro 2024

*CSI 300 in US$ terms; source: China Securities Index Company Ltd

Chinese Domestic Shares:
— Stock Prices*
-- 200-day Moving Average

— Stock Prices* Relative to DM
-- 200-day Moving Average

— Stock Prices* Relative to EM
-- 200-day Moving Average

P/E — mean since 2019

P/B — mean since 2019

© Alpine Macro 2024

*CSI 300 in US$ terms; source: China Securities Index Company Ltd

Chinese Manufacturing PMI:
— Caixin
- - NBS

NBS PMI for Panel 2, 3 & 4:
— New Orders
- - New Export Orders

— Production
- - Employment

Services PMI:
— Overall
- - New Orders

© Alpine Macro 2024

Note: All series are truncated at 40
Source: S&P Global; Choice; China National Bureau of Statistics

China:
Economic Surprise Index*

General Business Conditions**

Credit Suisse & CFA Society Survey***:
— Current Economic Situation
- - Economic Expectations

Corporate Financing Condition**

© Alpine Macro 2024

*Source: Citi
**Source: Cheung Kong Graduate School of Business
***Source: Credit Suisse

Chinese Exports*

Imports

For Top Two Panels:
— In Value
--- In Volume

Terms of Trade:
— NBS (ls)
--- Citi (rs)

— Trade Balance**
--- Current Account Balance**
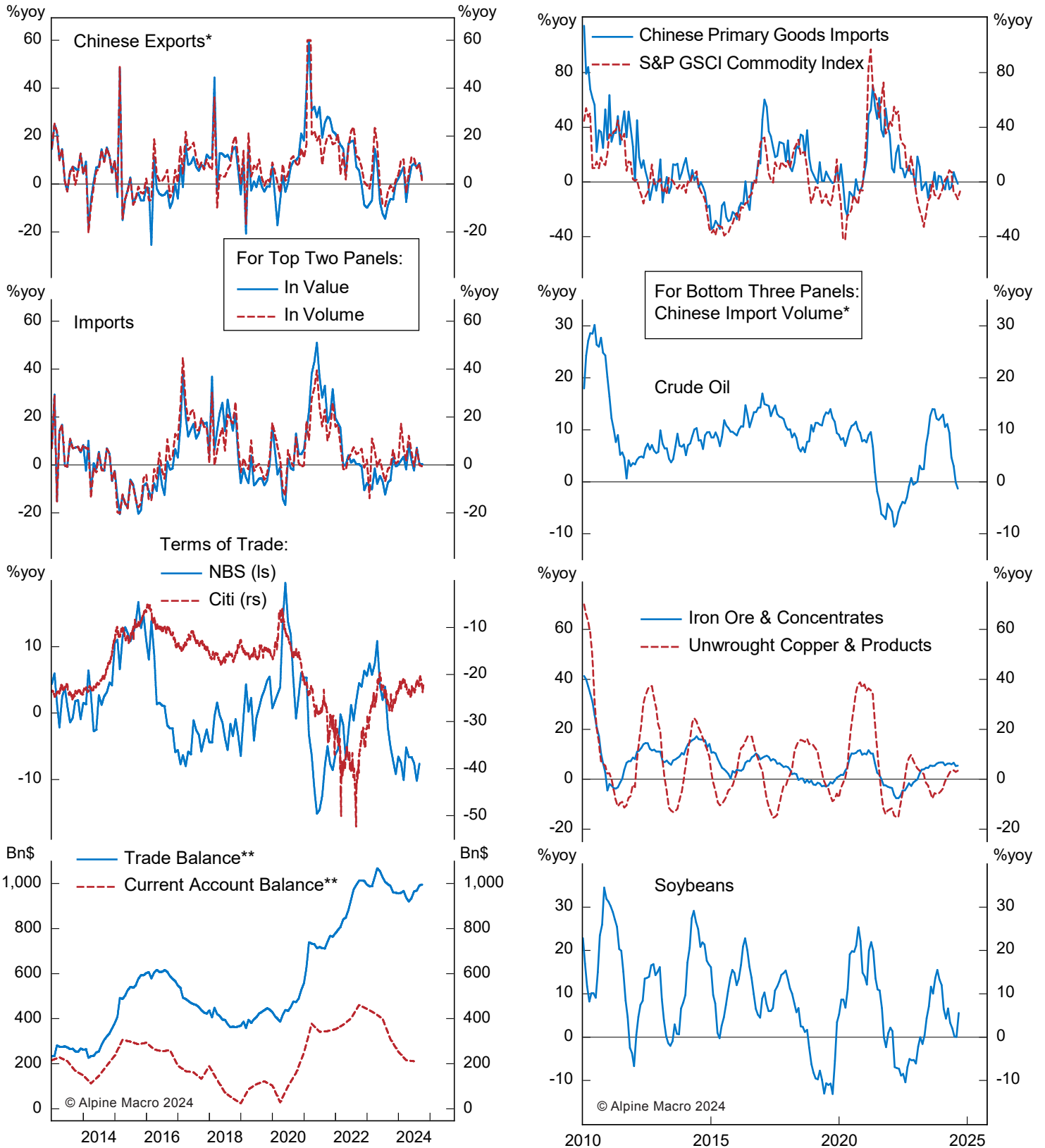
© Alpine Macro 2024

*Truncated at 60
**Shown as 12-month moving sum

Chinese Primary Goods Imports
S&P GSCI Commodity Index

For Bottom Three Panels:
Chinese Import Volume*

Crude Oil

Iron Ore & Concentrates
Unwrought Copper & Products

Soybeans

© Alpine Macro 2024

*Shown as 12-month moving average

China: Industrial Production* / 12-month Moving Average

Chinese Retail Sales*: In Value / In Volume

Electricity Generation**

Passenger Car Sales**

Railway Freight Volume

Retail Sales Value: Furniture

Cement Production

Retail Sales Value: Catering Services***

© Alpine Macro 2024

*Truncated at +20/-5
**Truncated at 30

*Truncated at +/-20
**Truncated at 100
***Truncated at +/-40

Fixed Asset Investment:
Year-to-Date
Monthly*

Infrastructure Investment

Real Estate Investment

Excavator Sales**

© Alpine Macro 2024

*Truncated at +/-40
**January and February data are averaged

Floor Space Sold:
Year-to-Date
Monthly*

Floor Space Started:
Year-to-Date
Monthly*

Floor Space Completed:
Year-to-Date
Monthly*

Housing Prices:
70-City**
National*** (6-month advanced)

© Alpine Macro 2024

*Alpine Macro calculation based on year-to-date data
**Source: NBS
***Calculated as transacted value divided by units; source: NBS
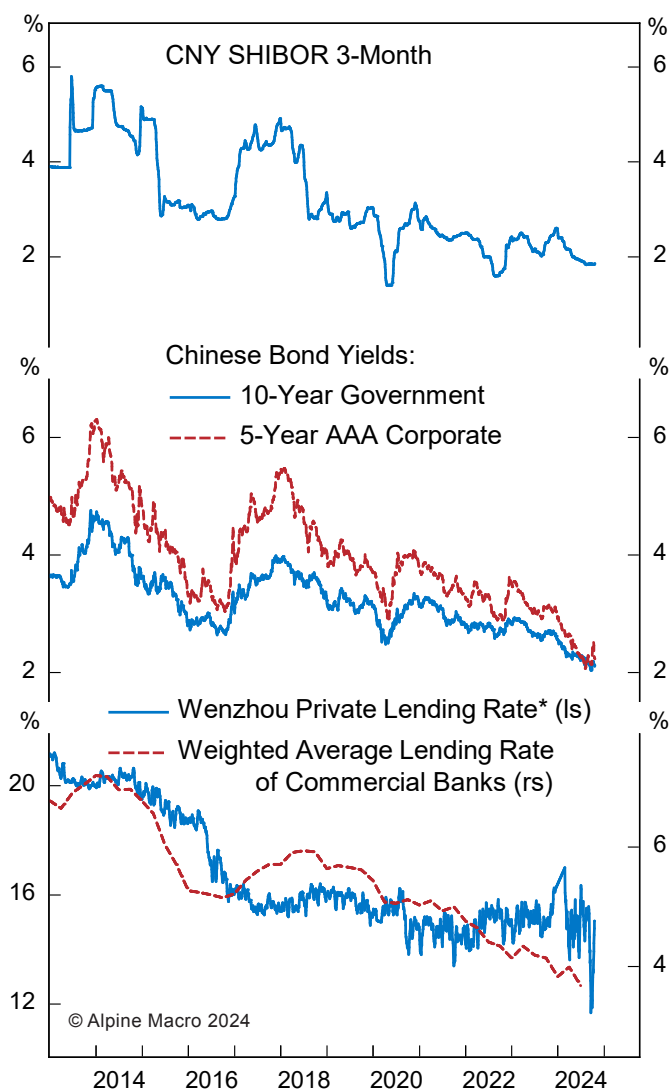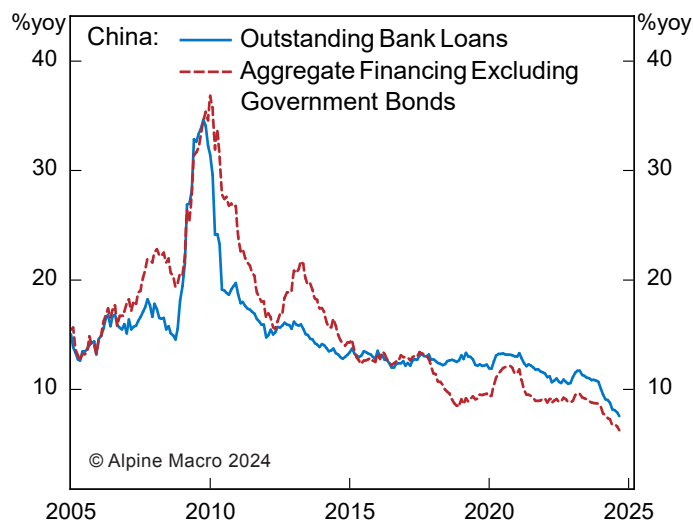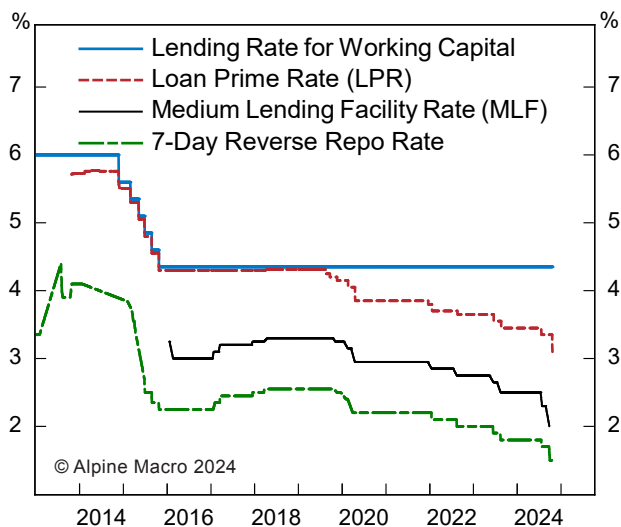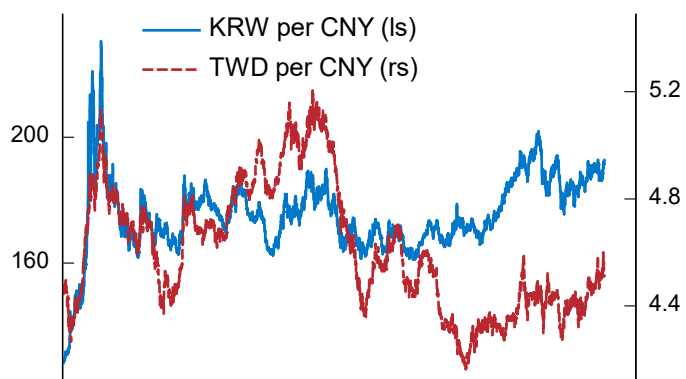
*Shown as 10-day moving average
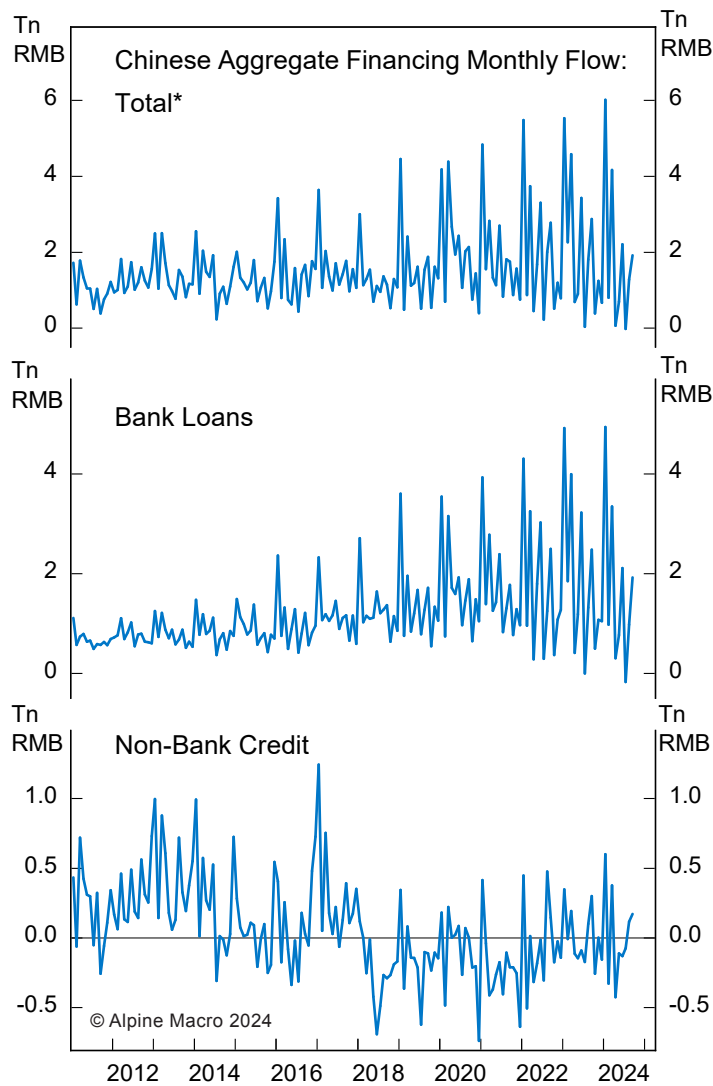
*Includes bank loans, non-bank credit, corporate bonds & equity issuance

© Alpine Macro 2024

China: Headline CPI

CPI Inflation Rate:
- Core
- Services

- Food CPI (ls)
- Agricultural Products Wholesale Price Index (rs)

- PPI (ls)
- PPI Diffusion Index* (rs)
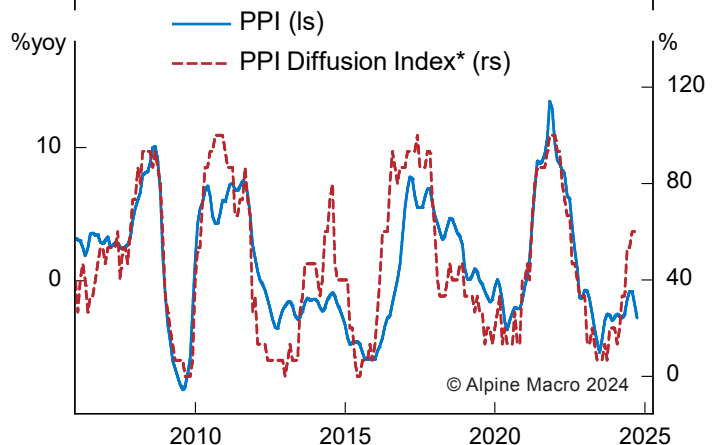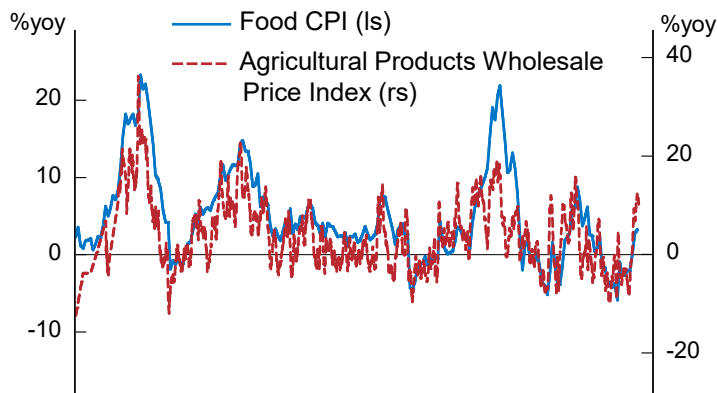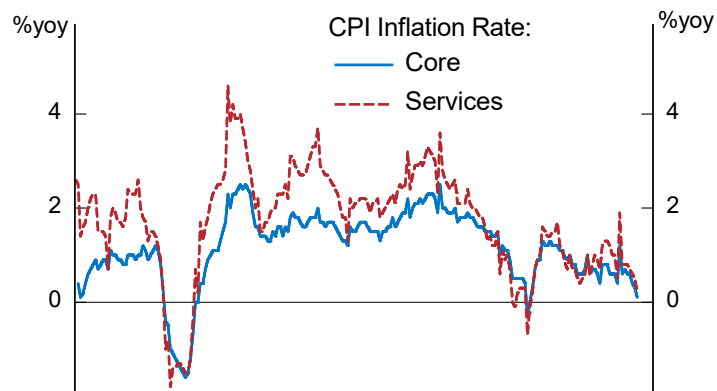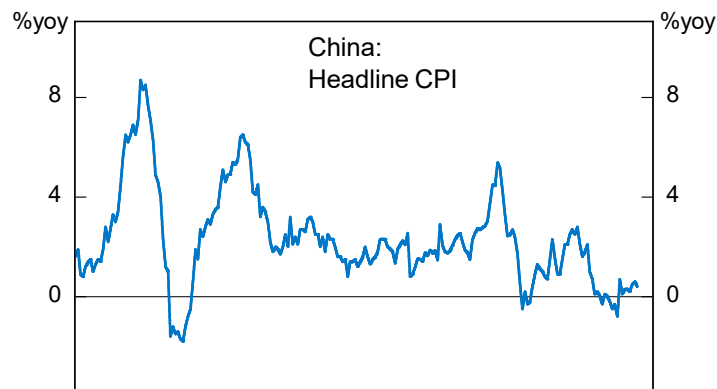
© Alpine Macro 2024

*Percentage of major industries with higher prices than last year; Alpine Macro calculation

Nanhua Commodity Index

- Level
- 3-month Moving Average

ANZ Bank China Commodity Index

Iron Ore Price Index

Cement Price

© Alpine Macro 2024

CNY per USD / CNH per USD

JPY per CNY (ls) / CNY per EUR (inverted; rs)

Nominal Effective Exchange Rate*: CFETS / BIS

KRW per CNY (ls) / TWD per CNY (rs)

Real Effective Exchange Rate**

INR per CNY (ls) / VND per CNY (rs)

FX Reserves

BRL per CNY (ls) / MXN per CNY (rs)

© Alpine Macro 2024

© Alpine Macro 2024

*Both series are rebased to Jan 2016=100
**Source: BIS

Investment Recommendations

Strategic Positions (6 - 12 months)			
Recommendations	**Open Date**	**Closing Date**	**Total P&L**	**Notes**
Long Colombian 10-year Government Bond, Currency Unhedged	11/21/2023		6.5%	Long Colombian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long MSCI Greece Equity Index	11/21/2023		12.0%	Long MSCI Greece Equity Index in US$ terms; stop point at -10%.
Long Indian 10-year Government Bond, Currency Unhedged	06/04/2024		3.6%	Long Indian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long Malaysian Equities, Currency Unhedged	08/20/2024		1.9%	Long MSCI Malaysia Equity Index in US$ terms; stop point at -10%.
Long ASEAN Equities, Currency Unhedged	09/17/2024		0.4%	Long MSCI EM ASEAN Index in US$ terms; stop point at -10%.
Long BRL/MXN	09/23/2024		0.0%	Long Brazilian *Real* versus Mexican Peso; stop point at -10%.

Tactical Investment Positions (3 - 6 months)			
Recommendations	**Open Date**	**Closing Date**	**Total P&L**	**Notes**
Short CZK/HUF	06/05/2023		3.4%	Short Czech Koruna versus Hungarian Forint; rolling stop point at -5%, or -2.7% from current level.
Long MSCI China Equity Index	02/20/2024		29.7%	Long MSCI China Equity Index in US$ terms; rolling stop point at -10%, or -10% from current level.
Short COP/CLP	03/05/2024		7.5%	Short Colombian Peso versus Chilean Peso; rolling stop point at -5%, or -1.3% from current level.
Long ZAR/USD	09/23/2024	10/21/2024	-1.3%	Long South African Rand versus U.S. Dollar; position closed.
Long CSI 300 Index	02/20/2024*		10.2%	Long China A-shares Index in US$ terms; stop point at -10%. *Trade opened on 20 Feb, 2024, closed on 13 Sep, 2024 and reopened on 24 Sep, 2024.

EM Equity Country Allocation

Strong Overweight	Overweight	Neutral	Underweight	Strong Underweight
	Brazil		India	
	Chile		Czech Republic	
	China		Hungary	
	Colombia		Mexico	
	Greece		Peru	
	South Africa		Poland	
	Indonesia		Taiwan	
	Philippines		Turkey	
	Malaysia			
	Thailand			
	South Korea			

EM Equity Sector Allocation

Strong Overweight	Overweight
	Materials
	Health Care
	Consumer Discretionary
	Consumer Staples
Neutral	
Energy	
Communication Services	
Information Technology	
Financials	
Strong Underweight	**Underweight**
	Industrials
	Utilities

EM Local-Currency Government Bond Allocation

Overweight	Neutral	Underweight
Indonesia	Poland	Czech Republic
Peru	Hungary	Thailand
Brazil	South Korea	China
Colombia	Malaysia	Taiwan
Chile	Philippines	Turkey
India	South Africa	
	Mexico	

Archive Of Previous Reports:

Please contact us if you are interested in our recent reports:

1. EM Equity Allocation For Q4'24 - October 8, 2024
2. More On China And EM Scorecard -October 1, 2024
3. Special Alert: China's "Whatever It Takes" Moment? - September 24, 2024
4. Central Bank Decisions: The Fed, Brazil, And South Africa - September 24, 2024
5. ASEAN's Breakout, Mexico's Adjustment And China's Slump - September 17, 2024
6. India: Passing Cyclical Peak, How Much Downside? - September 3, 2024
7. Is China In A Slow-Motion Implosion? - August 27, 2024
8. Buy Malaysia: Riding On The Tech Boom - August 20, 2024
9. Muse On U.S. Recession Risk And Explore The EM ETF Universe - August 6, 2024
10. Trump 2.0: Impact On China And EM - July 30, 2024
11. China: Policy Paralysis And The Third Plenum - July 23, 2024
12. EM Equity Allocation For Q3'24 - July 9, 2024
13. Brazil: Which Lula Is Showing Up? - July 2, 2024
14. China: A Critical Spot - June 25, 2024
15. Post-Elections: Back To Basics - June 11, 2024
16. India: A Budding Low-Inflation Boom - June 4, 2024
17. Taiwan Presidential Inauguration And A Steamy Summer of EM Politics - May 28, 2024
18. Beijing's Bazooka: More Gains Ahead - May 21, 2024
19. Argentina: Darkest Before The Dawn? - May 7, 2024
20. Another "Higher For Longer": What To Do With EM? - April 30, 2024
21. South Africa: Clashing Political And Economic Crosscurrents - April 23, 2024
22. EM Equity Allocation For Q2'24 - April 9, 2024
23. No, China Should Not Suffer A "Balance Sheet Recession"! - April 2, 2024
24. China: Market Musings And Growth Watch - March 26, 2024
25. Chinese Policy Tea Leaves And Indian Growth Surprises - March 12, 2024
26. Capitalize On Realignment Among EM Currencies - March 5, 2024
27. Buy China: Six Catalysts - February 27, 2024
28. EM LC Bond Themes And Strategy - February 13, 2024
29. Chinese Reflation: What's Changing? What's Lacking? - February 6, 2024
30. China: Sleepwalking Into Japan, Part II - January 23, 2024
31. Taiwan: After The Election - January 16, 2024
32. EM Equity Allocation For Q1'24 - January 9, 2024
33. 2023 EM Asset Tracker - January 2, 2024
34. China In 2024: Three Key Issues - December 12, 2023
35. India Macro Watch: How Sustainable Is Strong Growth? - December 5, 2023

ALPINEMACRO

A Unique Mind On The Markets