Mizuho Flash: China

Economics & Strategy | Asia ex-Japan

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China Woes: Signals, Not Solutions

In a Nutshell:

- Gloomy economic data underscore chronic confidence deficit that drags across household consumption and business investments as the pernicious effects of the property sector slump.
- The sheer magnitude of balance sheet and cash-flow shocks mean that measured rates cuts (15bp to MLF and 10bp for overnight, 7-day and 1-month) are mere signals not solutions.
- Especially as further property sector and wealth management product risks threaten with fresh balance sheet and cash-flow shocks.
- Meanwhile, a suspension of youth unemployment data release, whether or not due to bona fide data revaluation reasons, inadvertently undermines confidence further; compounding, not distracting from, confidence deficit.
- As falling short of 5% growth remains a risk, Beijing has a much higher bar to clear in terms of putting through convincing stimulus measures that may be sufficient to achieve "escape velocity"; which requires reasonable reparation to confidence.
- In the meantime, fresh assaults on CNY stability pose an overarching policy challenge and dilemma; given sharp stimulus and stability trade-offs.

Stimulus Reflex, Not Resolution

In response to dismal July numbers confirmed economic gloom emanating from all fronts - be it industrial output, retails sales, real estate or wider investments - Beijing has been long on signals and short on solutions. For one, rate cuts led by the 15bp MLF cut to (from 2.65%) to 2.50% followed on with a slew of 10bp front-end cuts to lower overnight, 7-day and 1-month rate to 2.55%, 2.8% and 3.15% respectively, are all strong signals of intended credit and cash flow boost, but offer no solution to chronic demand deficit amid a crisis of confidence.

Pre-existing Pain & Precarious Asset Market Risks

And this is not just a matter of too little too late. Putting aside that the quantum of rate cuts are questionably small, the bigger issue is that the desire to borrow and appetite to lend are both highly impaired in the aftermath of the property slump, which has has resulted in untold balance sheet and cash-flow pain.

Moreover, with Country Garden now swooning alongside fears of defaults in wealth management products, warning of more adverse balance sheet and cash flow shocks, the PBoC's rate cut tools are unlikely to surmount the problem of being more a mechanical signal than a meaningful solution. Particularly as asset markets remain in a precarious state of fragilities with potentially far-reaching shocks.

No Easy Policy Solutions

And following up with deeper (50-100bp) of RRR cuts, which remains a prospect on the table given stretched banks, does not change that.

In that same vein, the drip-feed of measures aimed at reviving fiscal boost (either via local governments or directly through incentives for households/businesses) may also fall short. Admittedly, more targeted fiscal tools, if well-designed and executed, could gain more traction in reviving domestic demand.

But a response (to fiscal stimulus) is not a resolution (of the chronic confidence deficit). And so, stimulus efforts may be dogged by a deficiency of growth multipliers. This may in turn impair durability of economic momentum and the ability to achieve "escape velocity".

Obscuring the View Worsens Confidence:
What's more, judging from the headlines in the aftermath of data disappointments and rate cuts, Beijing not only needs to deal with intended signals falling short of solutions, but unintended signals causing a problem!

The suspension of youth unemployment data release (in the demographic sub components) is the unintended signals markets have seized upon as a sign of covering up appalling numbers.

In the context of economic gloom and precarious asset market risks, such unintended signals can unnecessarily accentuate pain as uncertainty further undermines confidence. And even if the statically agency has bona fide reasons to re-evaluate methodology (as it has suggested as reason for omission) that is rendered irrelevant, risking irrevocable damage.

Consequent CNY Stability Concerns
All said, given fears of economic tailspin not sufficiently arrested by policy backstop conspiring with precarious asset market risks entailing further balance sheet and cash-flow shocks challenges to CNY stability could re-emerge more prominently.

In managing these risks, Beijing ensuring that signals must convincingly convey a solution is a critical pre-condition. Especially as the threat, as the 2015-16 "China sell-off" informs us, is that solutions to stability entailing "cash burn" (such as FX reserve drawdown) can sometimes exacerbate pressures via self-reinforcing capital flight-currency depreciation feedback loops.

Downside Risks & Policy Dilemma Dominate:
For now, as the confidence crisis remain unresolved, asset market risks insufficiently mitigate, and policy clarity continuing to elude, we flag downside risks to growth (potentially not clearing the 5% bar) and a pick-up in underlying CNY sell-off pressures, which further accentuate the PBoC's policy dilemma (between easing and CNY stability).