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Q&A-China cenbank to stick with gradual easing; Chance of near-term large-scale economic stimulus "low": Ju Wang, BNP Paribas



China's central bank will stick to a gradual easing approach, with the next interest rate cut expected in the fourth quarter of 2024, **Ju Wang, head of Greater China FX and rates strategy at BNP Paribas,** told the Reuters Global Markets Forum on Tuesday, August 20.

Wang said the People's Bank of China's (PBoC) next cut could be "10-bps (basis points) in OMO (open market operations) and MLF (medium-term lending facility) rates, with some probability of slightly larger cut in LPR (loan prime rate)".

A cut in reserve requirement ratio (RRR) also can't be ruled out, as an accelerated government bond issuance programme would require liquidity support, Wang said.

She also put the chance of near-term large-scale economic stimulus as "low", saying that the Politburo meeting at the end of July did not hint at any additional stimulus, instead emphasising on the implementation of existing policies.

"If economic momentum continues to deteriorate in Q3, we do not rule out the possibility that the authorities could beef up policy stimulus in Q4 to ensure delivery of the annual 5% growth target, for example by adding fresh government bond quotas," Wang said. She forecasts a China to grow at 5% in 2024 and 4.5% in 2025.

Below are edited excerpts from the conversation:

Q: What is your outlook on China's economy, given somewhat mixed data prints recently? Is it turning a corner, or more pain to come?

A: Indeed, Chinese economy has disappointed again in Q2, and July data show that China's economic momentum generally stayed on the same sluggish track as in prior months. July's sub-5% growth will keep China's macroeconomic policy stance accommodative in H2. As the Politburo economic meeting at end-July did not hint at any additional stimulus, but instead emphasised the implementation of existing policies, we think the chances of near-term large-scale stimulus are low. But if economic momentum continues to deteriorate in Q3, we do not rule out the possibility that the authorities could beef up policy stimulus in Q4 to ensure delivery of the annual 5% growth target, for example by adding fresh government bond quotas.

PBoC left rates unchanged today, in line with our view that it will stick to a gradual easing approach, i.e., one cut per quarter, 2-3 times per year. We think the next cut will be in Q4, 10bp in OMO and MLF rates with some probability of slightly larger cut in LPR. RRR cut can't be ruled out too especially considering government bond issuance has start to accelerate here which requires liquidity support at some point.

Q: What impact do you see from recent PBOC action on bond markets? Can yields meaningfully rise from this point on?

A: We think PBoC currently monetary policy is a little unconventional. It is accommodative in the front-end as policy rates will be gradually let go lower. However, the central bank is also a little hawkish by having an effective reverse YCC (yield curve control) for long-end bond yield - it prefers these yields to stay in a range rather than going sharply lower. As such, we are taking a neutral approach now, just to avoid the risk of duration correction into Q3, somewhat similar to Q3 last year when bond supply increased notably -- RMB1.4 trillion refinancing bonds followed by RMB1 trillion off the budget CGBs (Chinese government bonds).

Fundamentally, China real yield is high and bond curve is getting steep. Foreigners will still have buy-on-dip bias

for this market, but probably waiting for a correction first.

Q: What constraints does the PBOC face as it seeks to support growth while preventing more yuan falls?

A: Strong USD and high for longer DM rates regime is external constraint. Under this new regime, we have seen other low yielding Asian economies initiating tightening cycle, something they could not do in past decades, for instance BoJ and CBC action in recent months. China has capital account not fully open up, and enjoys the large economy's advantage in exchange rate policy, ie, it does not need to be price taker, but sometime instead to be price setter. Still, it can't fully ignore the influence of the powerful carry trade.

Q: Do you expect the PBoC to keep the yuan as well as yields supported, as we have seen so far?

A: A steep yield curve serves two important purposes in our view. Externally, it prevents the currency from having too much volatility. As discussed earlier, foreigners have interest in China bonds as steep curve naturally guarantees a steady return despite low absolute yield. Foreigners were strong buyers of China onshore bonds since November due to very low onshore FX swap points.

A steep yield curve's second purpose to ensure that banks do not get hurt too much in an environment where its NIM is squeezed significantly by property sector and local government deleveraging processes. Banks hold more than 50% government bonds in China, and they are somewhat subsidized with this steep curve - funding cost gradually lower but their bond assets offer steady return.

Q: Are China's overcapacity problems here to stay, and is a slow and now a given?

A: China does have a capacity that currently cannot be fully absorbed by domestic demand. Some industrial consolidation may have started lately in the sectors such as solar panels, as we can tell from media reports. However, if we zoom out to have a longer horizon, it may be too early to conclude the capacity is excessive. Afterall, we still have emerging markets that in urgent needs for infrastructures and their industrialization process is ongoing. China's trade with EM is rising and cheap China products certainly have advantages in emerging markets where buyers are more price sensitive.

Q: RMB still has the onshore/offshore mechanism - do you see them consolidating this at some point?

A: As long as USD is in a strong cycle and USD yields enjoy large carry advantage over Asian low yielders, having somewhat a firewall between onshore and offshore is still prudent. But recently we have seen a major carry trade unwind on Fed easing expectation, and we note that PBoC has brought back market mechanism to daily USDRMB fixing - allowing it goes up or down depending on market conditions.

Q: China’s stock exchanges stopped releasing daily data on overseas fund flows yesterday, depriving investors of a key sentiment indicator to track the $8.3 trillion market - could that dampen sentiment?

A: China stocks are suffering from insufficient domestic demand and deflationary pressure. Ideally, domestic policies should turn more supportive. However, with a top-down policy that puts emphasis on quality growth, stimulus has been very measured. We would monitor if they add fresh government bond quotas in Q4 to ensure the 5% GDP target … measures announced post-July politburo meeting have underwhelmed expectation.

Q: What is your GDP forecast for 2024 and 2025, after the Q2 miss? And do you see any bright spots?

A: We forecast 5% for 2024 and 4.5% for 2025. So far, exports - and hence industrial productions - have been the bright spot. FAI remains depressed due to the property sector restructuring, and retail sales are lukewarm as household has hold back spending due to negative wealth effect caused by falling housing prices.

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