Economic Watch

China | Understanding 2023 July Poliburo meeting: tackling short-term and long-term issues

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The meeting of the Political Bureau of the Communist Party of China Central Committee, presided over by President Xi concluded on July 24th, 2023. It analyzed the current economic situation and pointed out the policy direction in the second half of 2023 and in the long term.

In the context that Chinese economic recovery came to a halt in Q2 2023 amid the fading effect of reopening from "zero Covid" policy, the July Poliburo meeting became particularly important, as the market anticipates the Poliburo meeting will start a new round of policy stimulus to support economic recovery in the second half of the year, particularly on stimulating the sluggish real estate market and domestic demand.

Chinese economy indeed faces many challenges at the current stage as the reopening effect faded, which is mainly dragged by weak consumption momentum, continuing sluggish real estate market and decelerating external demand amid global economic slowdown. On top of that, Chinese economy is entering into a deflation cycle with zero growth of CPI and negative PPI for the past several months. As long as deflation expectation is formed among households and enterprises, it is difficult to alter. At the same time, China also faces a series of long-term challenges, such as local government debt overhang, aging, industrial upgrading and transformation etc. We believe the key point to reverse the current situation is to promulgate and implement further monetary and fiscal stimulus at the central government level to significantly rebuild market sentiments and to reverse the "balance sheet recession" for households and enterprises.

The July Politburo meeting was trying to tackle the above short- and long-term issues and to dispel the market concerns. Its concentrations include several perspectives, such as promulgating stimulus measures, promising housing market easing measures, promulgating local government debt resolution plans, promoting industrial upgrading and boosting capital markets development etc. It pledges more forceful countercyclical efforts to enhance domestic demand and improve market sentiments in the short term, while promulgates a series of structural reform measures to prevent risks in the longer term. Against the background of policy stimulus announced in July Poliburo meeting, we expect a meaningful growth rebound in Q3 and Q4, making the government's 2023 full-year growth target of 5% easy to achieve.

We summarize and analyze five important policy signals of the 2023 July Poliburo meeting from the perspectives of (i) economic growth evaluation and policy stimulus, (ii) housing market easing measures, (iii) local government debt resolution, (iv) industrial upgrading and transformation, and (v) to foster capital market development:

Economic growth evaluation- affirms the achievements of 1H 2023 but points out "new challenges" and announcement of policy stimulus. Due to the statistical low base effect of Q2 2022, the first half of 2023's GDP growth achieved 5.5% compared with 3% annual growth in 2022. However, to remove the base effect, we take average of 2023 Q2 and 2022 Q2 growth (0.4% y/y), the two-year Q2 average growth is only 3.35%, much lower than two-year Q1 average growth at 4.65% y/y. The quarter-on-quarter growth of Q2 also significantly slowed to 0.8% qoq from 2.2% qoq in Q1 2023, suggesting the previous strong recovery momentum in Q1 came to a halt in

Q2 amid the fading effect of reopening. Thus, the Poliburo meeting points out several "new challenges" of the economy going forward: weak external demand amid global recession risk, the operational difficulties and weak sentiments of private enterprises as well as sluggish household demand.

Under this circumstance, the Poliburo meeting emphasizes the 2H 2023's policy stimulus will focus on the following elements: (i) To continue to boost infrastructure investment: the meeting urged stronger government investment with faster issuance and usage of local government special bonds; (ii) Monetary policy easing measures: it emphasizes better use of aggregate and structural monetary policy tools, indicating the possible room for further cuts in RRR and interest rates, as well as more targeted easing measures on SMEs, private firms and green economy etc.; the meeting also emphasized the importance of "maintaining RMB exchange rate stable" to react the recent sharp RMB depreciation amid the FED interest rate hike cycle. (iii) Consumption incentives: to stimulate auto, electronics, and home appliances etc., consumption with possible subsidies; income distribution reform and social insurance policy adjustment to increase the willingness of consumption of low-income groups.

Housing market easing measures: China's real estate market, which used to be the main pillar of economic growth, has remained very sluggish since 2021's policy-led housing market crash. Against the background of economic slowdown as reopening effect faded, it is crucial for the authorities to release housing market restrictions both to supply (housing developers) and demand side (households). The July Poliburo meeting dropped the paraphrase of "housing is for living, not for speculation," which was mentioned continuously in the previous years' high-level meetings, indicating a kind of policy "turnaround" in housing sector. It also emphasized to fine-tune housing policy "given a fundamental shift in supply-demand dynamics", with better use of city-specific policy tools to cater to residents' demand for first homes purchases and home upgrades. Altogether, we expect further relaxation of home purchase restrictions in Tier-1 and Tier-2 cities in a bid to rebuild market expectations and anticipate housing market will gradually bottom-out in Q4 2023 and 2024.

Local government debt resolution. The Poliburo meeting also wanted to implement a series of measures to resolve local government debt overhang issue in the long term. In particular, Chinese government may adopt a "muddle-through" approach by requiring provincial governments to coordinate debt service efforts, before embarking on more comprehensive reforms in the long term, such as SOE reforms, with higher dividend payout ratios and transferring assets to LGFVs; fine-tuning of central-local fiscal relationships and to dilute "economic growth target" as the single target for local government officials' evaluation; large-scale local government debt swaps or restructuring.

Industrial upgrading and transformation. Industrial upgrading means the industrial transformation from low-end manufacturing to high-end manufacturing together with technology advancement. The meeting emphasizes the importance of digital economy, the high-end manufacturing and modern service industry. The authorities continue to promote the "new infrastructure" investment such as 5G, AI, Block Chain, Cloud computing etc. to combine with the traditional infrastructure investment to support growth. (see our China Economic Watch: China | Understanding the new growth model) Based on the experience of US's sanctions on large amount of Chinese tech companies, China will boost its ability to ensure control over and self-sufficiency in its industrial chains and supply chains.

Foster capital market development: The Poliburo meeting also first mentioned "to revitalize capital markets and to rebuild investors' sentiments". Except for the economic policies stated above, the meeting pledged to improve the business environment for private enterprises and platform economy, to foster the capital market development, and to rebuild investors' confidence on China. We see this as the government's efforts to help maintain market sentiments, a key step we believe to resolve the ongoing household and enterprises' "balance sheet recession".

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