



好久不见，你
好吗？ - (It's
been a long
time, how
are you?)



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好久不见·你好吗? - (It's been a long time, how are you?)

- China's recent fiscal measures are preventive and are primarily aimed at buffering the economy against a potential downturn.
- China faces a "perfect storm" for deflation: 1) indebted local governments; 2) households saving instead of spending; and 3) excess vacant properties.
- We see an interesting opportunity in China's large-cap tech sector.
- China's stock market has performed very poorly, not because the companies are bad, but because of the fear of risk that China's government represents.

It's been a long time, how are you? That might be the phrase you'd share with an old friend or relative you haven't seen in a while. But here, let's turn that phrase

into considering what is unfolding in China today. When we say, "it's been a long time," we're highlighting the extended tenure of the Chinese Communist Party (CCP), which celebrated its 100th anniversary in 2021. Remarkably, the CCP has governed China since 1949, when Mao Zedong led it to victory in the Chinese Civil War against the Kuomintang.

While Mao's leadership left a complex legacy, marked by an estimated 36 million deaths from starvation, his successor Deng Xiaoping transformed China's economic trajectory with his "Socialism with Chinese Characteristics" reforms. Known as the "Architect of Modern China," Deng introduced sweeping changes that opened the country to foreign investment, promoted market-oriented policies, and established Special Economic Zones to drive trade and modernization. One of his most impactful reforms, the Household Responsibility System, allowed farmers to lease land and keep profits, significantly boosting agricultural productivity and rural incomes. According to the World Bank, these reforms lifted over 760 million Chinese people

out of poverty, reshaping the country's socio-economic landscape.

Deng's legacy brings us to the present day, where Xi Jinping has been at the forefront of the Chinese Communist Party and the country since 2012. Building on Deng's reforms, Xi has introduced initiatives that align with his predecessor's vision while adapting them to today's global landscape. Central to Xi's strategy is the "dual circulation" policy, launched in 2020, which aims to reorient China's economy toward stronger domestic consumption while maintaining an openness to foreign trade and investment. The goal of this policy is to build a more self-sustained economy, reducing reliance on international markets. This shift is evident in China's debt structure, which is predominantly denominated in local currency rather than foreign currency, signaling a focus on internal stability.

So, "how are you? I know it's a bit hard to tell right now". The historical context around China's government is crucial for understanding its current political and economic stance. After 75 years of continuous rule, we can argue that the Chinese Communist Party operates as an autocratic government, which has led markets to view China's macroeconomic indicators with increasing skepticism. Many argue that these indicators may be politically influenced to project an image of growth to the rest of the world. Consider China's Consumer Price Index (CPI) as an example. Unlike many other major economies, China does not disclose the weightings of its CPI components, complicating efforts to identify which sectors are contributing to inflation. This lack of transparency extends to GDP figures as well; for instance, the National Bureau of Statistics revised China's 2018 GDP upward by 2.1%, a move that conveniently aligned with the country's long-standing objective of doubling GDP by 2020.

With the recent announcement of a fiscal stimulus in September, there is growing interest in what this shift may signal for China's economy. For a country

that tightly controls economic data and has maintained rapid growth, this move is raising questions. We can think that China may be feeling pressure to support its economy more actively, hinting at potential underlying challenges that even the world's second-largest economy cannot ignore.

What are the measures that China has announced and what should we expect?

Firstly, it is our view that China's recent fiscal measures are preventive and are primarily aimed at buffering the economy against a potential downturn. Policies announced by the government are strategically aligned with the goal of reaching its 5% GDP growth target of 2025.

Since late September, China's key institutions have introduced a range of initiatives to stimulate economic activity and manage financial risks. These measures target three critical challenges: persistent deflation, highly leveraged local governments and an unprecedented slump in the property sector.

Xi's "dual circulation" strategy, intended to boost domestic consumption, is facing several obstacles as China enters into its sixth consecutive quarter of deflation—the longest streak since 1999. This economic environment, marked by reduced consumer spending and falling prices, has weighed heavily on the real estate sector. Major property developers like Evergrande have gone bankrupt, adding to the downturn that has persisted since 2021. Together, deflation and the real estate crisis have intensified funding challenges for the government, leading to sharp declines in revenues from taxes and land sales.

China's current deflationary pressures can be traced to multiple factors. As an example, high levels of local

1. Policy Measures and its Explanation

Source: JP Morgan, Insigneo

Measure Type	Policy Easing Measure	Context
Monetary	1-year MLF 30bps rate cut	The MLF is the main rate at which the central bank lends to big commercial banks
	50bps RRR cut, 7-day reverse rate cut by 20bps	The RRR is the amount of cash that banks must hold as reserves
	LPR and deposit rate cuts by 20-25bps	The LPR is the interest rate that commercial banks in China charge their best customers
	PBOC 500bn yuan swap facility allowing securities firms, funds and issuers to borrow for stock purchases	
	PBOC 300bn yuan re-lending facility to fund buybacks at 2.25% annual interest rate for listed companies and their major shareholders	
Housing	Increase PBOC’s contribution from 60% to 100% for the Affordable Housing Relending Scheme	China’s affordable housing relending scheme is a program that provides funds to local governments to purchase unsold homes and convert them into affordable housing
	Rate reduction for existing mortgages (average 50bps)	
	Minimum downpayment requirement for second home mortgage lowered to 15%	
	Politburo meeting: relax home purchase restriction, increase lending to white-list projects, stop the decline of the housing market	The Politburo is the highest political body of the Central Committee of the CC
	Tier-1 cities rolled out easing measures (Guangzhou, Shanghai, Shenzhen and Beijing)	Tier-1 cities are the most developed cities in China
Fiscal	Fiscal support for local government debt resolution	
	Special CGB issuance to support big banks’ core tier -1 capital injection	CGB: China Government Bonds
	Expanding LGB proceeds to support housing destocking and purchase of undeveloped land	LGB: Local Government Bonds
	Targeted cash support for people in extreme poverty and students	

government debt have led to delays in employee salary payments, reducing disposable income and weakening consumer confidence. Another factor is rising youth unemployment: while the official urban unemployment rate hovers around 5%, unemployment among people under 24 is close to 20%. Although some analysts attribute deflation to money supply issues, the broader picture suggests that households are shifting to a “wait-and-save” mindset, cutting back on spending as they anticipate further price drops. Why spend now if prices will likely keep falling?

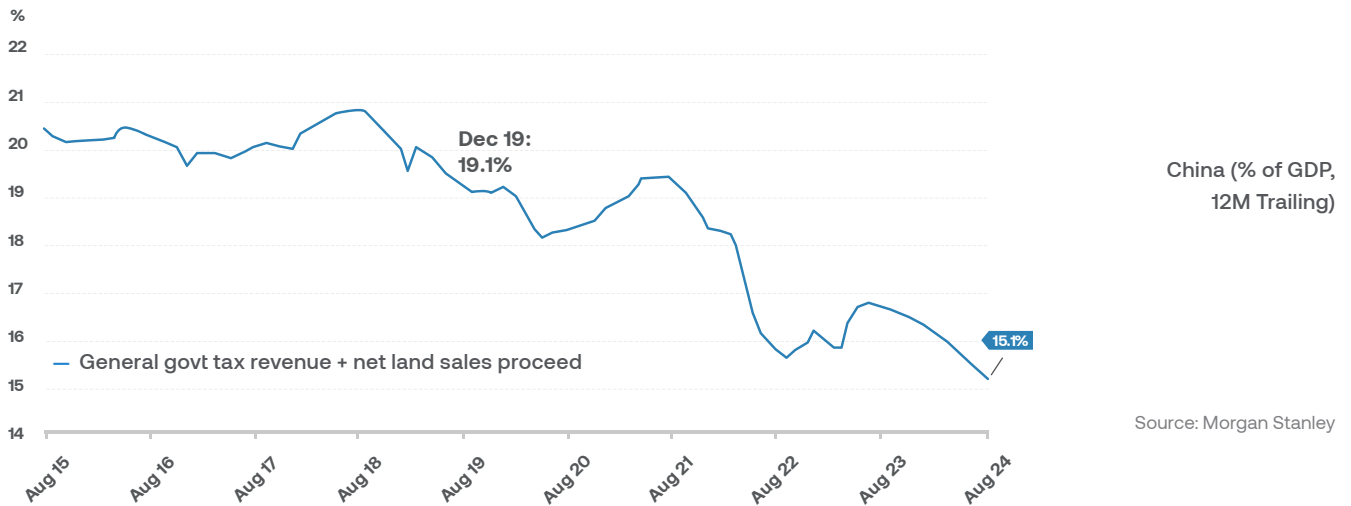
In an effort to boost consumption, the Chinese government has injected loans into the industrial sector. However, this has largely resulted in an oversupply of consumer goods at a time of low demand, creating further downward pressure on prices. The significance of this deflationary trend is underscored by Xi’s econom-

ic policy, which is heavily centered on driving domestic consumption.

The deflationary climate mirrors the challenges in China’s housing sector and the electric vehicle market. The government previously promoted rapid property development, often at any cost, resulting in an excess of unsold properties—an issue unique to China compared to other developed markets. This surplus has now led the Politburo to take direct action, aiming to “stop the decline” in home prices by easing purchasing restrictions in tier-1 and tier-2 cities. To illustrate the significant decline in real estate prices, let us look at graph 4, which compares the recent downturn in housing prices with the peaks observed in the United States in 2006 and Japan in 1991.

China faces a “perfect storm” for deflation: 1) indebt-

2. Tax and Land Sales Revenues



ed local governments unable to drive job growth or consumer spending; 2) households saving instead of spending in an oversupplied consumer market; and 3) excess vacant properties pushing down real estate prices. Together, these factors create a cycle that deepens deflationary pressures and complicates economic growth objectives.

As illustrated in Table 1, China’s recent measures encompass monetary, housing, and fiscal policies aimed at tackling economic challenges. On the monetary front, the country has reduced MLF and RRR rates, which

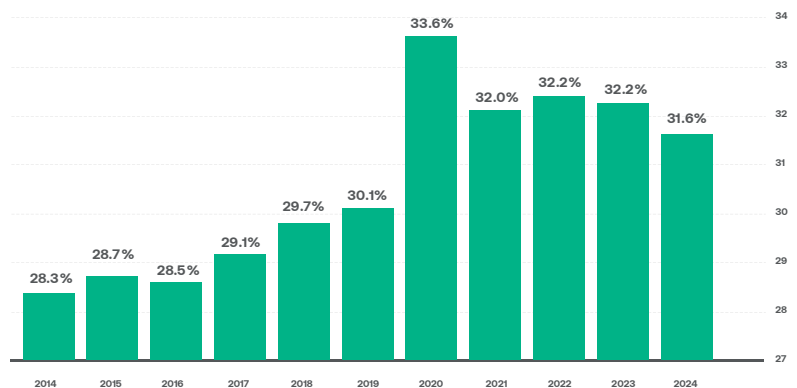
allows banks to better digest risk and extend more loans to consumers and businesses. The cut in the LPR is designed to lower the profitability of deposits, encouraging individuals to withdraw their savings and stimulate spending. Finally, Yuan swaps and re-lending facilities further aim to provide incentives for consumers and businesses to invest and participate in the stock market.

In the housing sector, the government is actively working to lower obstacles for potential homebuyers by relaxing purchase requirements and facilitating state

3. China’s Households % of Disposable Income

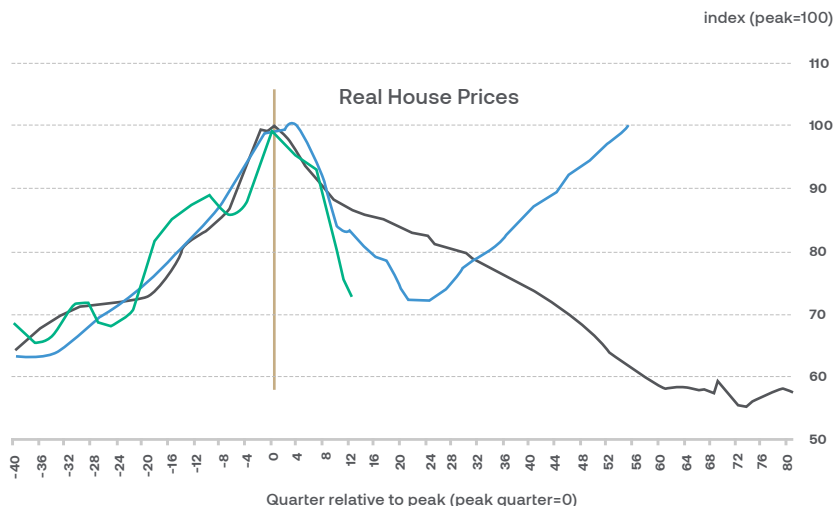
China 3Q surveyed household saving rate (% of disposable income 4Q trailing sum)

Source: CEIC, Morgan Stanley Research



4. China's House Prices Decline Compared to the US and Japan Housing Crisis

- China (2021 Q3)
- US (2006 Q1)
- Japan (1991 Q1)



Source: Haver Analytics, Centaline, Goldman Sachs Global Investment Research

acquisitions of properties. This initiative aims to transform these properties into affordable housing solutions. On the fiscal front, China plans to issue debt to address the excess inventory in the housing market while simultaneously enhancing the balance sheets of local governments. Finally, the government will introduce targeted subsidies, including consumer vouchers in tier-1 cities or subsidies to the unemployed, to promote consumer spending and boost overall economic activity.

Last Friday, the National People's Congress (NPC) concluded a five-day session, approving a five-year CNY 10 trillion (~USD 1.4 trillion) fiscal package to address local government debt concerns. This package initiates the fiscal stimulus effort, with markets now awaiting measures for housing de-stocking and consumer support. Further CCP announcements on fiscal policy are expected to align with potential U.S. government actions. To give some context, analysts estimate that a 20% tariff on Chinese exports could reduce China's GDP by 0.7%, while a 60% tariff might result in a 2% contraction. These potential impacts suggest that responsive strategies will be central to CCP discussions. With the possibility of a larger and deeper trade war, we are left to ask the CCP: it's

been a long time; how are you?

Where does this leave us as investors?

At the time of this writing, Trump has been elected as the U.S. president, which could introduce additional risks for potential investments in China. A proposed 60% tariff on U.S. imports would fundamentally shift global trade, with potentially sweeping effects on cross-border supply chains. While we might speculate on which sectors could suffer or benefit amid a trade war, such an approach would be impractical for investors at this stage. We will revisit these considerations in greater depth once concrete proposals emerge from Trump's Administration.

In the meantime, we see an interesting opportunity in China's large-cap tech sector. First of all, it is important to note that investing in Chinese stocks requires a long-term horizon and an aggressive risk tolerance. Given the autocratic nature of the Chinese government, political decisions are often made to prioritize consumer benefits over shareholder interests. For instance, when

Xi Jinping aimed to establish China as a global leader in Electric Vehicles (EVs), 130 EV producers emerged, making vehicles like the BYD Seagull available for under \$10,000. With that in mind, Chinese equities continue to be a major point of uncertainty. The recent proclamation by the government is being well received by the markets. However, we are still not completely convinced that the recent rally in equities is not a temporary reaction. In theory, if China were a capitalist market, the Chinese consumer would have the final say. In reality, the Chinese consumer has the floor until the government intervenes. An investor who wanted to invest in this market should do so very cautiously, limiting their exposure, or "dipping their toe in the water". However, we believe that a "wait and see approach" could be the most prudent thing to do. That being said, even if a 60% tariff was imposed by the incoming US administration on China's exports, established companies like JD, Baidu, and Alibaba (BABA) are solidly positioned with extensive consumer bases that go beyond the United States.

The most popular ETF to invest in China is the iShares

Large Cap China ETF (FXI). Something to keep in mind when investing in this country is that, in general, international investors tend to migrate to certain stocks as proxies to invest in this market, mainly Alibaba, Baidu, Tencent, JD.Com, etc. Basically, Large Cap Tech. This is important, because as we know, China's stock market has performed very poorly, not because the companies are bad, but because of the fear of risk that China's government represents, a risk that is difficult for markets to quantify. As a result, global investors may choose to take a "wait and see" approach. Therefore, it is more likely that as international investors begin to invest in the country, they will do so through companies in the Large Cap Tech space, mentioned above, which also form part of FXI. At this point, investing in Chinese equities, even if it involves the Large Cap Tech companies that we mention above is akin to purchasing a nice house in a questionable neighborhood. It could potentially be a great investment if the neighborhood eventually improves, but it is not for everyone. Again, it is important to note that the potential ideas mentioned above are only suitable for clients with a very high tolerance for risk. ■

House Views Matrix

	TACTICAL (UP TO 3 MONTHS)	CYCLICAL (UP TO 12 MONTHS)
Global Asset Allocation		
Equities	NEUTRAL	NEUTRAL
Fixed Income	NEUTRAL	OVERWEIGHT
Cash	NEUTRAL	NEUTRAL
Regional Breakdown		
US Equities¹	OVERWEIGHT	OVERWEIGHT
European Equities	NEUTRAL	NEUTRAL
Japanese Equities	OVERWEIGHT	OVERWEIGHT
Emerging Market Equities	UNDERWEIGHT	NEUTRAL
Chinese Equities	NEUTRAL	NEUTRAL
US Treasuries²	NEUTRAL	OVERWEIGHT
Investment Grade Fixed Income	NEUTRAL	NEUTRAL
High Yield Fixed Income	NEUTRAL	NEUTRAL
Emerging Market Sovereign	NEUTRAL	NEUTRAL
US Dollar	NEUTRAL	OVERWEIGHT
Energy³	NEUTRAL	UNDERWEIGHT
Precious Metals	OVERWEIGHT	OVERWEIGHT

¹Relative to global equities in USD

²Relative to aggregate fixed income markets in USD

³Relative to an overall commodity allocation

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