China
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China: MoF press conference exceeded expectations

- The Ministry of Finance's press conference on Saturday, while not disclosing specific figures, exceeded market expectations in terms of overall support. While the NDRC press conference disappointed investors by only focusing on achieving the 5% growth target in 2024, the Ministry of Finance press conference signaled that China is getting serious about tackling deflation. This is precisely the message the market has been waiting for.

- Overall, the balance of revenues and expenditures, along with the four incremental measures, suggests that government bond issuance will likely increase further in the fourth quarter. The additional issuance could reach as high as 3 trillion yuan in the near term. The overall fiscal stimulus could reach 10 trillion yuan spreading over next few years given this is the strongest debt restructuring measure introduced in recent years.

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The Ministry of Finance's press conference on Saturday, while not disclosing specific figures, exceeded market expectations in terms of overall support. The conference emphasized the importance of government leverage as a driving force for nominal growth, which could help the economy emerge from deflationary pressures.

While the NDRC press conference seemed more focused on achieving the 5% growth target in 2024, the Ministry of Finance press conference signalled that China is getting serious about tackling deflation. This is precisely the message the market has been waiting for.

I have three key takeaways from the press conference. First, there was a clear focus on achieving the 2024 budget targets. Second, four major incremental fiscal stimulus measures, which are already in the decision-making process, were highlighted. Third, it was explicitly stated that there is substantial room for central government borrowing and increasing the fiscal deficit. Although the final figures will only be confirmed at the National People's Congress at the end of October and during next year’s Two Sessions, the clues provided offer some basis for preliminary estimates.

I. Achieving Fiscal Balance in 2024
At the press conference, Finance Minister Lan stated, "It is expected that the national general public budget revenue growth will fall short of expectations." However, he also emphasized that "China’s fiscal system has enough resilience, and through comprehensive measures, we can achieve a balance between revenue and expenditure and meet the full-year budget target."

The target for general public budget revenue growth in 2024 is set at 3.3%, amounting to approximately 22.4 trillion yuan. However, for the first eight months of the year, cumulative revenue growth was down by 2.6% year-on-year. If this trend continues, it will result in a shortfall of around 1.3 trillion yuan by year-end to meet the revenue target.

To address this gap and achieve fiscal balance, two primary options are available: First, the government could draw from central carryover and surplus funds, adjust resources through budget stabilization funds, or increase transfer from institutional profits. Alternatively, the shortfall could be filled by issuing national or local government general bonds. As of the end of 2023, the approved local government debt ceiling stood at approximately 42.2 trillion yuan, with an actual balance of around 40.7 trillion yuan, leaving a positive gap of 1.4 trillion yuan. Additionally, there is an 830 billion yuan balance remaining in the national debt ceiling. Utilizing these available balances would not require further approval from the National People's Congress.

Beyond the general public budget, the government fund revenue account faces a significant shortfall of 1.5 trillion yuan due to weak land sales. It remains unclear whether Minister Lan's goal of achieving the full-year budget includes this second account. If it does, the scale of short-term fiscal support in 2024 alone may exceed market expectations for entire fiscal stimulus.

II. four new incremental fiscal measures

At this press conference, Minister Lan clearly announced four incremental measures, covering debt restructuring to control risks, replenishing bank capital, policies to stabilize the real estate market, and social welfare support.

First, in terms of supporting local governments in managing debt risks. The MoF announced that there will be a significant increase in debt quotas to help local governments address implicit debts, enabling them to free up more resources and capacity to promote development and safeguard people's livelihoods. The minister specifically mentioned, "A one-time large-scale debt limit swap for existing implicit local government debts is planned. It is important to emphasize that this upcoming policy represents the strongest debt restructuring measure introduced in recent years."

Since 2015, China has conducted at least three rounds of debt restructuring to deal with the implicit debt problem: 12.2 trillion yuan in 2015-2018, 157.9 billion yuan in 2019, and 1.17 trillion yuan from 2020-2022. Since July 2023, the Ministry of Finance has arranged a total of 3.4 trillion yuan in debt quotas for restructuring local government debts.

These efforts have yielded results, reducing the balance of implicit debt on the national government debt information platform by 50% from its 2018 peak. Various estimates suggest that implicit debt may have reached 30 trillion yuan in 2018, implying that by the end of 2023, this could have narrowed to approximately 15 trillion yuan. Given the ministry's statement that this is the strongest debt restructuring measure in recent years, fiscal support for restructuring could potentially reach 10 trillion yuan. However, the timing for this debt restructuring window remains uncertain, making it difficult to annualize the figures.

Second, China will issue special government bonds to support state-owned banks in replenishing core Tier 1 capital. This bond issuance will strengthen the ability of major state-owned commercial banks to withstand risks and expand their lending capacity, enabling them to better serve the development of the real economy. According to a September report by Bloomberg, the market generally anticipates the issuance to be around 1 trillion yuan.

Third, China will utilize tools such as local government special bonds, special funds, and tax policies to stabilize the real estate market. Special bonds will be allowed for land reserves, addressing the significant amount of idle, undeveloped land in various regions. Local governments will be supported in using these bonds to recover eligible idle land, and in certain areas, to undertake new land reserve projects. This policy aims to regulate the supply-demand balance in the land market, reduce idle land, and alleviate liquidity and debt pressures on local governments and real estate companies.

The use of special bonds for land reserves was suspended following a State Council executive meeting in September 2019, which prohibited their use for land reserves or real estate-related projects. Since 2021, special bonds were only permitted for rental housing projects, excluding general real estate projects. This press conference marks the reintroduction of special bonds for land reserves, broadening the scope of local government bond use, and helping to close the funding gap faced by local governments.

Fourth, China will continue its focus on social welfare, particularly in education, by expanding student aid policies for higher education. However, previously discussed demand-side policies, such as fiscal support for families with second children, were not addressed at this conference.

The Ministry of Finance also mentioned aligning fiscal policies with China's demographic changes, enhancing social welfare, improving residents' income expectations, and stimulating consumption potential. It is likely that the demand-side measures that the market is concerned about will be delayed until after 2025.

III. room for higher central government debt and fiscal deficit.

Minister Lan emphasized that countercyclical adjustments are not limited to the four measures mentioned earlier. While these policies have already entered the decision-making process, other tools remain under consideration. For instance, there is still significant room for the central government to increase borrowing and raise the deficit, opening up possibilities for further fiscal measures. This sets the stage for continued leverage expansion by the central government.

Overall, the Ministry of Finance press conference was well-received. Most of my onshore contacts were optimistic about the outcomes, and a survey by a local broker indicated that the majority believe the press conference met or exceeded expectations. The next key event to watch is the National People's Congress meeting in late October, where the approval of additional debt issuance may take place. Between late October and the Two Sessions in March 2025, China is likely to progressively unveil more measures.

The only area that underperformed market expectations was the lack of demand-side measures to support social welfare. Aside from education, there were limited announcements to boost consumption and population growth.

Overall, the balance of revenues and expenditures, along with the four incremental measures, suggests that government bond issuance will likely increase further in the fourth quarter. The additional issuance could reach as high as 3 trillion yuan. Given that government bonds are predominantly purchased by banks, the next step will likely involve significant liquidity support for the banking sector. This also aligns with the People's Bank of China's (PBoC) September 24 announcement, which hinted at the possibility of another reserve requirement ratio (RRR) cut of 0.25 to 0.5 percentage points within this year, depending on market liquidity conditions. We expect another 50bps RRR cut in Q4.

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