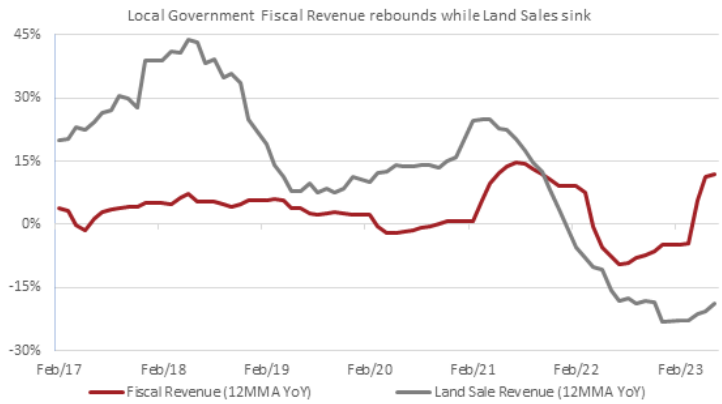
# China Bulletin: Market View




The July politburo meeting, held earlier than usual, indicates a potential end to the structural shift that has weighed significantly on China's growth over the past two years. For the first time since 2019, the meeting's readout omits the words "preventing speculation in the housing market". It focuses instead on addressing associated growth-related issues. These issues include the impact on local government revenue of the housing market downturn, and the high household debt servicing ratio. The proposed solutions involve reforming the fiscal system to tackle revenue shocks and lowering existing mortgage rates to alleviate household debt burdens. As China emerges from a severe contraction period, it is poised to experience less drag from the housing sector and a shift towards stronger reliance on personal consumption.

One of the most visible shocks lies in the slump of local government revenue from land sales, which is comparable in size to local governments' fiscal revenue in 2020. This revenue is closely linked to fixed asset investment in infrastructure and the operation of local government financing vehicles (LGFVs). While economic activity and fiscal revenue have rebounded in recent months, the downward trend in land revenue persists and may continue. Consequently, LGFVs in highly stressed cities face mounting pressure to roll over maturing debt, raising concerns about debt sustainability. However, China's state-led financial system enables the possibility of large-scale debt restructuring, alleviating the disruption to credit creation. Despite potential wider credit spreads on LGFV bonds and some pressure on earnings of banks in stressed areas, we remain optimistic about China's ability to manage the impact of a potential debt restructuring.

The People's Bank of China (PBoC) has shifted its phrasing from "encourage" to "guide" as part of its bid to lower existing mortgage rates. Since mid-2022, the downturn in the housing market has intensified, leading to mortgage boycotts in response to construction halts. As a result, interest rates on newly issued mortgages have been adjusted downward by more than 130 basis points, currently standing around 50 basis points lower than rates on existing mortgages. Looking back at 2009, a similar situation saw a narrowing gap between rates on newly issued and existing mortgages under the guidance of the central bank, resulting in a 50 basis point reduction in rates on existing mortgages.

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