Mizuho Chart Speak: China Risks

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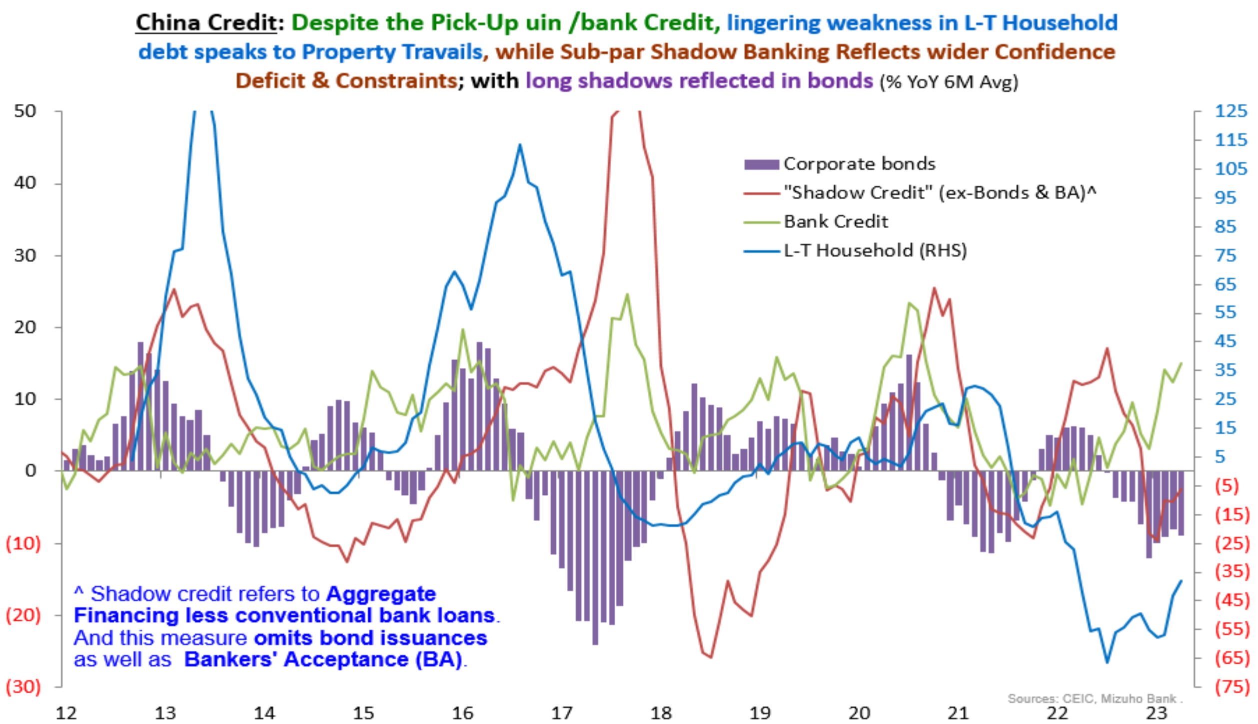
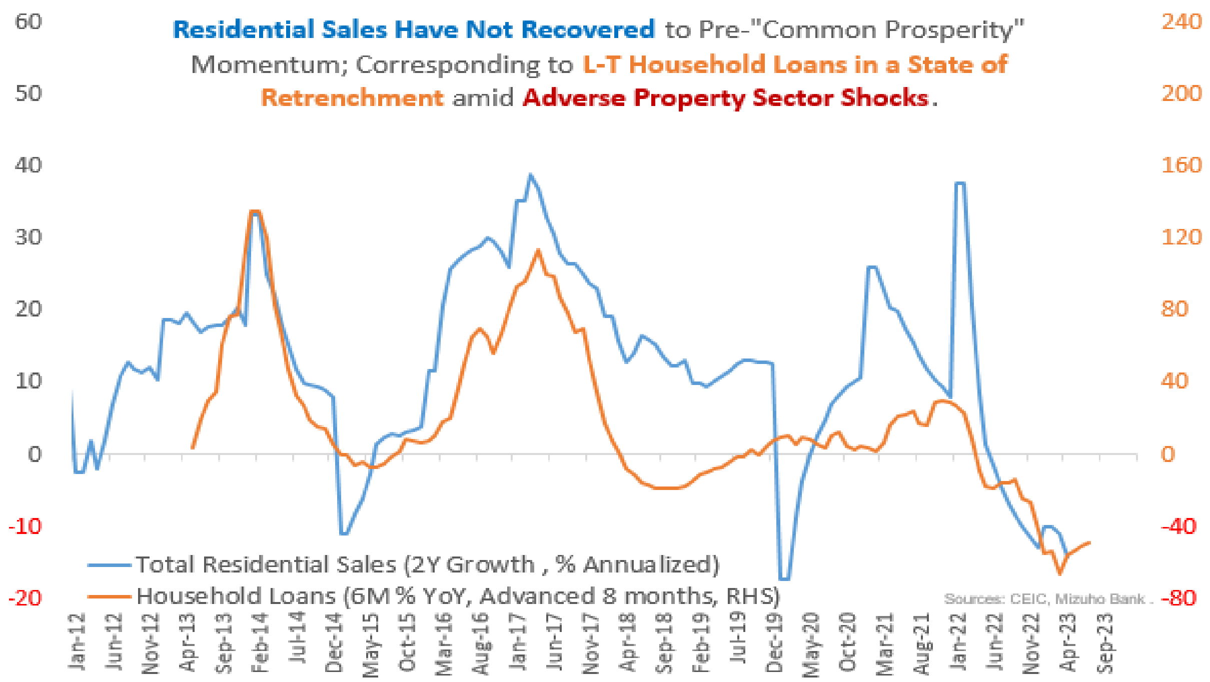
Why PBoC Cuts Don't Cut It





"That (lack of belief) is why you fail" – Master Yoda

In a Nutshell:

- The PBoC's rate cuts failing to impress reflects worrying state of chronic confidence deficit.
- And confidence below a critical threshold will severely compromise the ability of **credit stimulus** to rejuvenate amid a conspiracy of flows, stock and stability impediments to credit stimulus.

- Specifically, lacks confidence in future "flows" of profits curtails credit appetite, while stock/balance sheet risks trigger retrenchment of debt and financial stability inherently restrains credit stimulus.
- Blunt policy options and sharp trade-offs render optimism premised on bigger stimulus precarious.

Policy Stimulus Disappoints: The **PBoC's recent rate cut** (7-day reverse repo rate cut by 10bp to 1.90%) **has not only failed to impress**, **but arguably accentuated misgivings** about the **ability of Beijing to engineer a durable boost** for the economy; as activity falls short of re-opening optimism. Consequently, *any current optimism about China is perversely premised on expectations of further and more emphatic stimulus* to compensate for the shortfall in stimulus efforts thus far.

Question is, **why** the PBoC's most recent **easing**, **fell flat, if not backfired** in terms of inspiring economic optimism; and attendant market exuberance. Afterall, *while the quantum of easing (rate cut) was* admittedly *token*, the *desire to punch above its weight in conveying an emphatic easing intent* was arguably evident.

Confidence Deficit: **At the heart of the problem** is the fact that the **PBoC's rate cut is ill-suited for, and hence misses the mark on, redeeming the nagging deficit of confidence**. Tellingly, while headline **bank credit has picked up on the surface** (see Chart above), long-term household credit, "shadow" credit and bond issuances reflecting details across the private sector reveal

Consequent (Credit) Demand Dampening: Specifically, **cutting the price of credit** (which is what interest rates cut essentially do) **does not restore confidence**; essential to spurring "animal spirits" and attendant demand (including for credit). Put another way, the *"price sensitivity" (of demand for credit) is impaired by chronic confidence shortfall; some self-inflicted, and others structural (economic or geo-political).* And so, **confidence falling below critical thresholds** means that the usual playbook of monetary stimulus will be *compromised via both flows and stock channels.*

A Blow to Flows: Specifically, a **lack of confidence about future prospects**, in particular regarding **restoring organic cash-flows** and **adequate profitability**, **flags the dangers of not being able to "grow" out of debt**. Inadvertently, this imposes **reservations about upping leverage**; as **eroding confidence about sufficiency of future (profit/cash-) "flows" inflicts a serious blow to credit-driven growth strategies**.

De-Stocking Credit : Crucially, a **loss of confidence in the property market**, which accounts for 70% of urban household wealth and some 30% of wider economic activity, effectively **arrests credit-driven property investment cycles**. In fact, the *"stock impact" of de-stocking credit amid threats of adverse balance sheet risks* (for households, developer and banks alike) **flags retrenchment of, not stimulus from, credit**; *squaring with growing evidence of private sector preference to pay down debt.*

Financial Stability Compromise: What's more, **pre-existing concerns of financial stability** from the post-GFC bloat in China's overall leverage **fundamentally constrain scope for policy-induced credit boost**. In fact, the overriding **imperative to avert a so-called "Minsky moment"** (referring to adverse financial implosion) inherently **compromises policy confidence**; diminishing scope for virtuous credit stimulus.

Blunt (Policy) Options & Sharp Trade-Offs: Given the **"force"** that would be **required to surmount structural and geo-political impediments inherent in China's debilitating confidence deficit**, the danger is that **reviving "animal spirits"** to ensure private sector spillover and revive emphatic growth multipliers **may perversely require pushing the envelope to the point of fuelling bubbles/imbalances**. *With policy options that are lamentably blunt and the trade-offs dangerously sharp,* **speculation of more "bigger and better" stimulus and optimism premise don that are precarious at best**.