

State Of the Markets: Best Long & Short Strategies 2024Q4
Part II: Current China Stimulus Is Not Enough, Substantially More Is Needed

Alan Brazil

October 2024

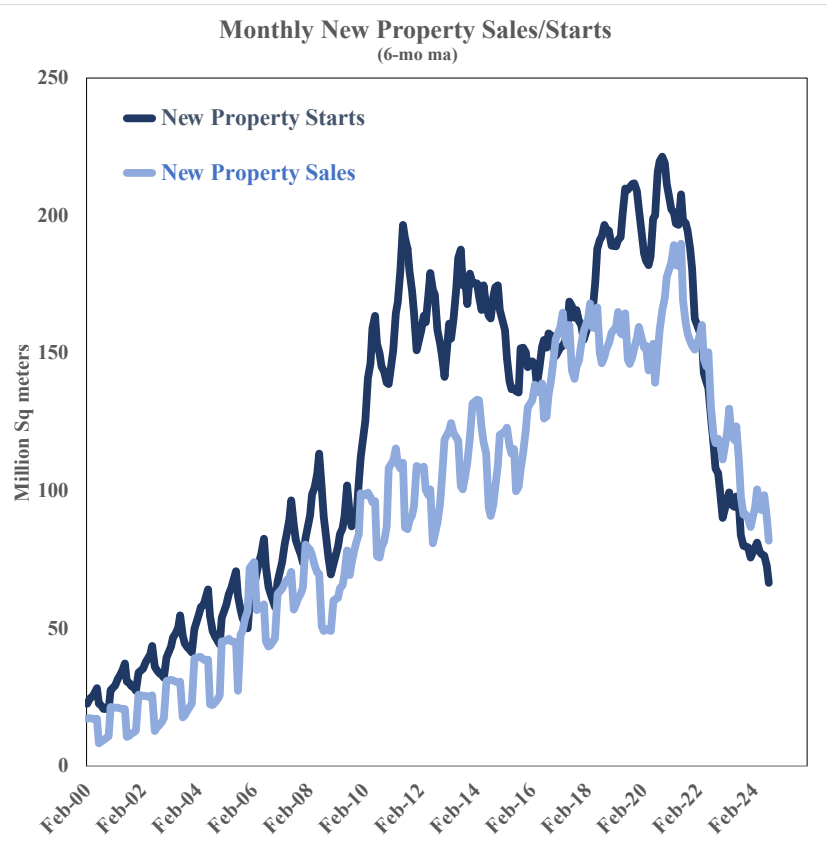
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Part II: Current China Stimulus Is Not Enough, Substantially More Is Needed

Step 1: Identify A Macro Theme

Is China Stimulus Enough To Stop The Collapse of The Property Market Or the Fall In GDP?

China Property Market Has Collapse Back To 2015 Levels...



While China's Growth Continues To Fall



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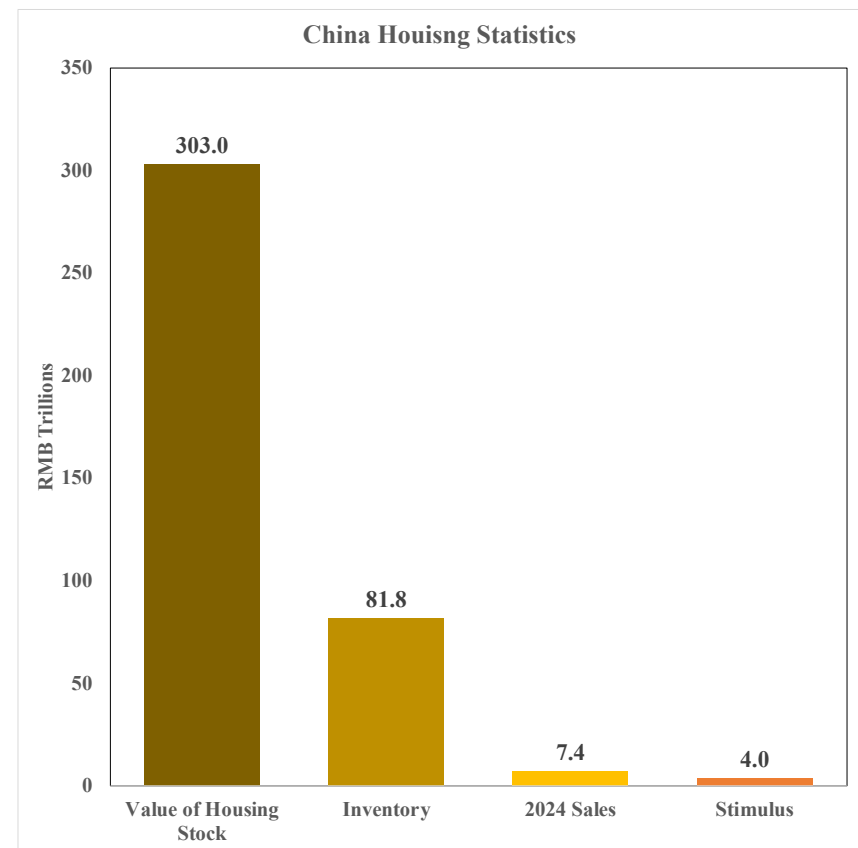
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Step 2: Fundamental Economic Framework

Stimulus Is Not Even Enough To Stop The Property Collapse, Much Less The GDP Slowdown

Current Announced Stimulus		
Sector	Current Stimulus Package	Potential Impact
Monetary Policy	20 bp cut in PBoC policy rate 50 bp cut in Required Reserves to 8%	Potentially opening up RMB 1,000 of additional bank lending
Bank	NFRA plans to raise Tier 1 Capital for large state-owned	Potential 1 trillion RMB
Fiscal	Addition central government debt quota	Potential 1 -2 trillion RMB
Equities	RMB 500 bn asset swap facility directly from PBoC for non-bank financials to investing in equities RMB 300 bn relending facility to support corporate buybacks	Open to doing more to support equity markets
Property	Cut minimum downpayment of 2nd homes to 15% from 25% 50 bp cut in mortgage rates by end of October Increases to 100% from 60% for local governments buying housing inventory to coverts in rentals Increase bank lending for "whitelist" property projects to RMB 4 trillion from RMB 2 trillion by end of october	Potentially giving borrowers RMB 150 bn of extra income PBoC will provide 100% financing up to RMB 100 bil Funding for developers to complete unfinished developments and deliver pre-sold units

Announced Stimulus Rounding Error Given The Inventory Overhang



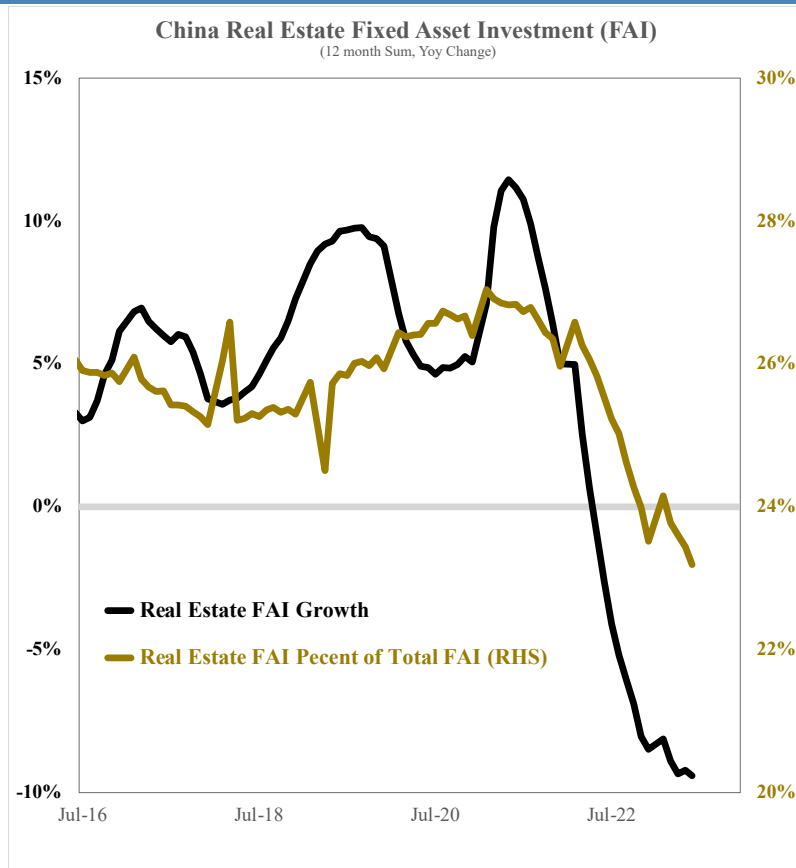
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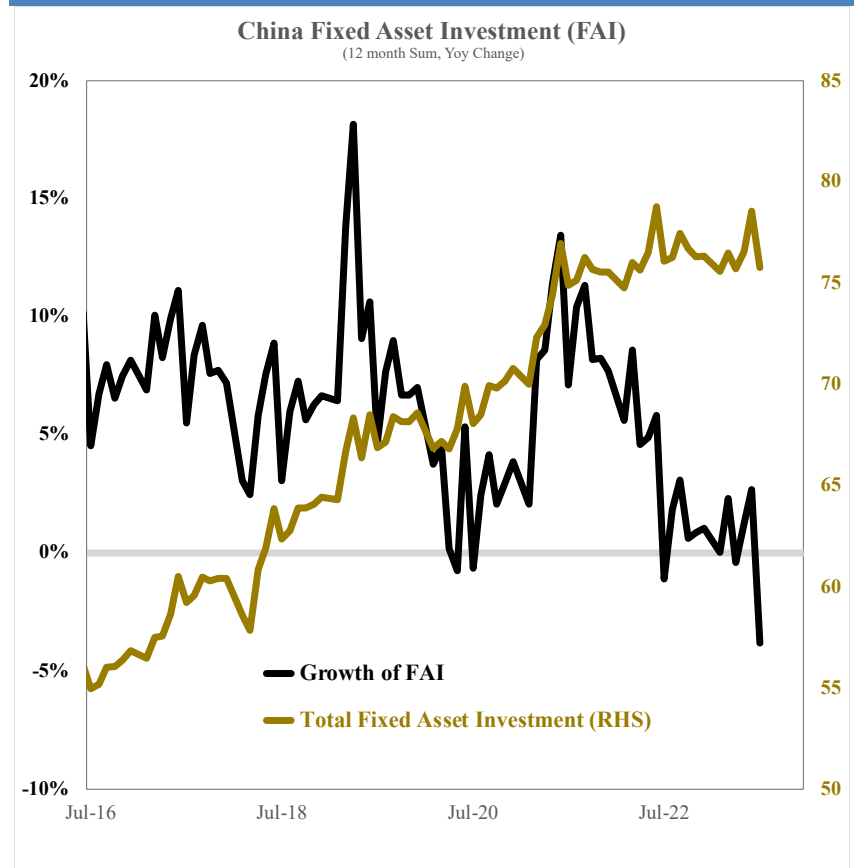
Step 2: Fundamental Economic Framework

RE Investment And Fixed Investment Are Now Negative Creating A Big Hole In GDP Growth

RE Investments Is Now Negative..



As Is Total Fixed Investment Given The Fall In RE Investment



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Housing Investment Is Projected To Continue To Fall, Driven In Part By Falling Fundamental Demand

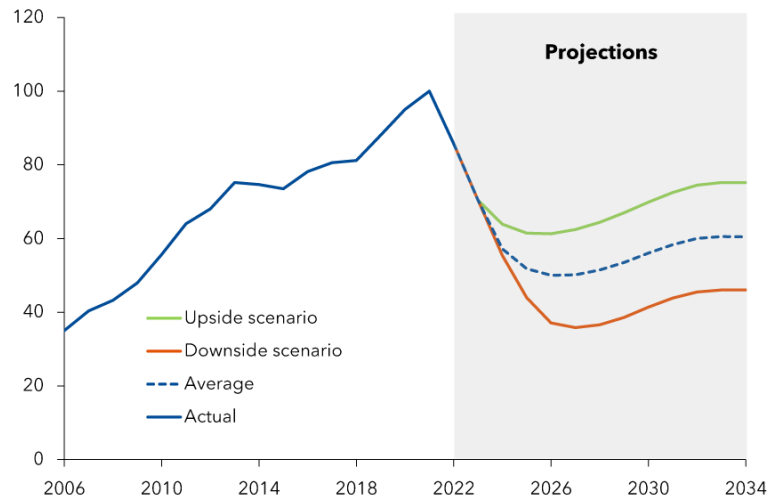
The Downturn Is Projected To Continue To Fall

Housing Demand Will Fall From Recent History

Construction to fall further

Housing investment is likely to fall almost 45 percent on average and remain subdued thereafter.

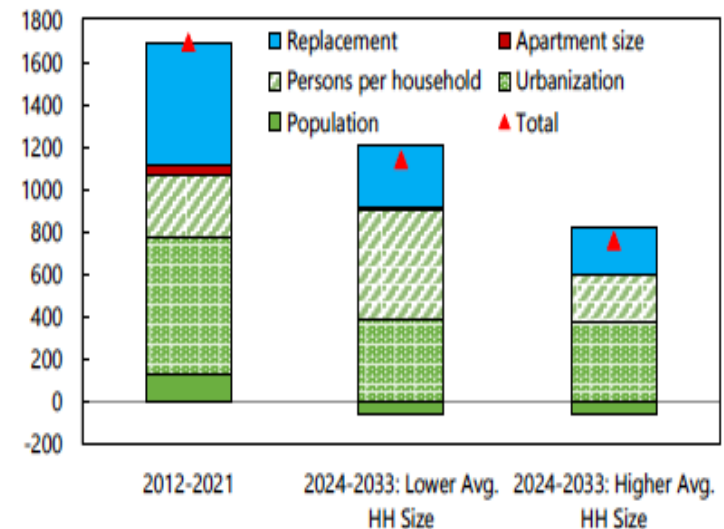
China: Real estate investment
(index: 2021=100)



Source: CEIC and IMF staff calculations.
Note: Upside and downside scenarios are for fundamental housing demand.
Data shown is staff's estimate of price-adjusted real estate gross fixed capital formation.



Estimated Annual Average Fundamental Housing Demand
(Millions of square meters)



Sources: CEIC Data Company Limited; and IMF staff calculations.

Note: HH=Household.

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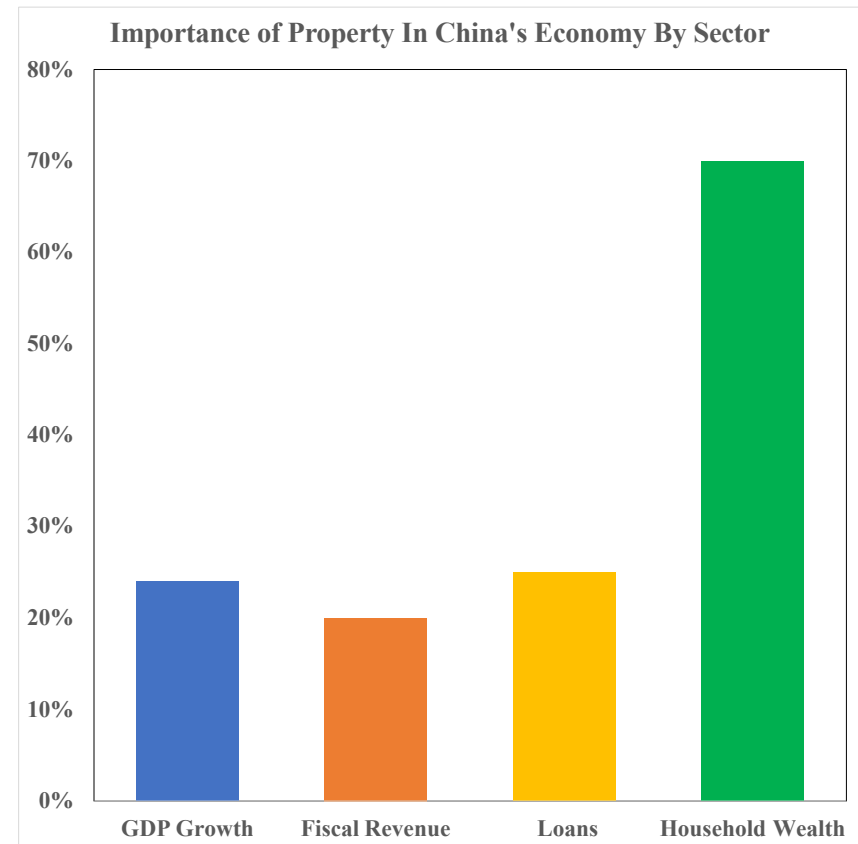
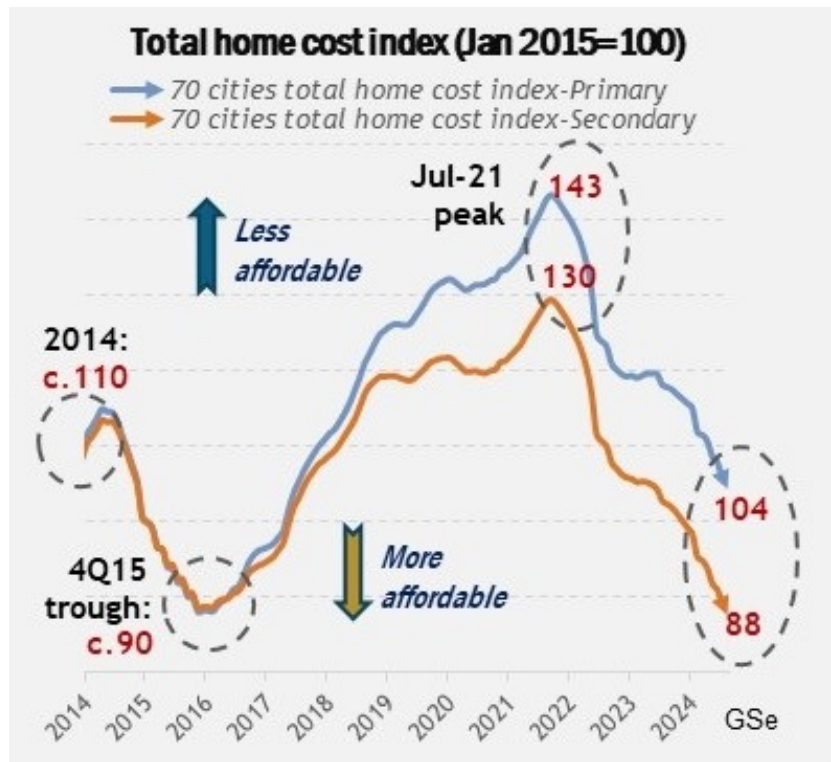
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The 30 to 40% Decline In China Housing Prices Will Have a Significant Impact On Their Economy

Housing Prices Are Down 30 to 40% Already, And That Will Have A..

Huge Effect On Their Economy And On Household Consumption



1. Goldman Sacks
 2. Rogoff, Yang, "Peak China Housing," NBER Working Paper 27697, August 2020

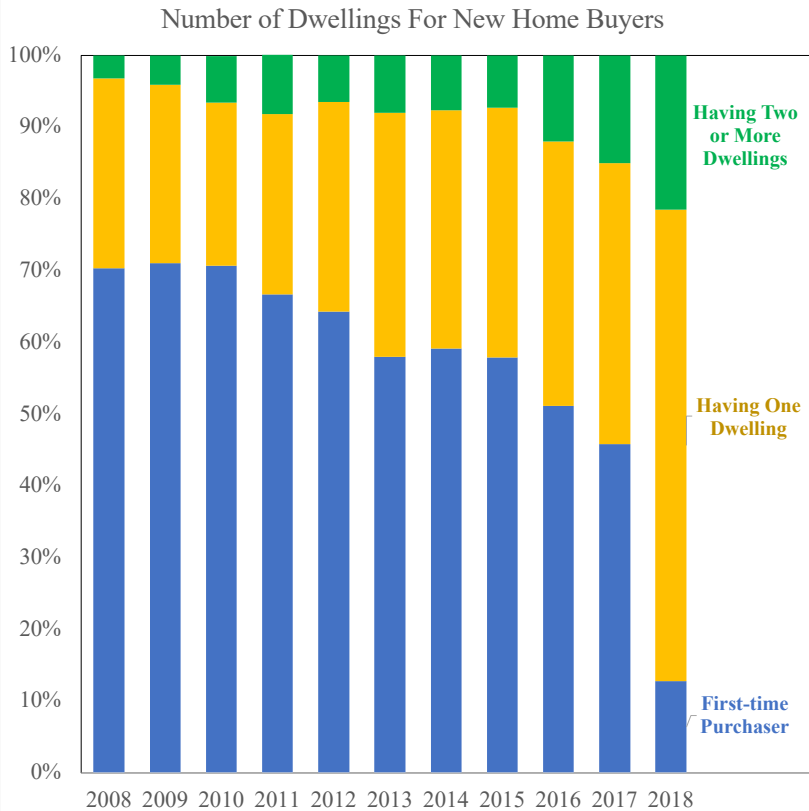
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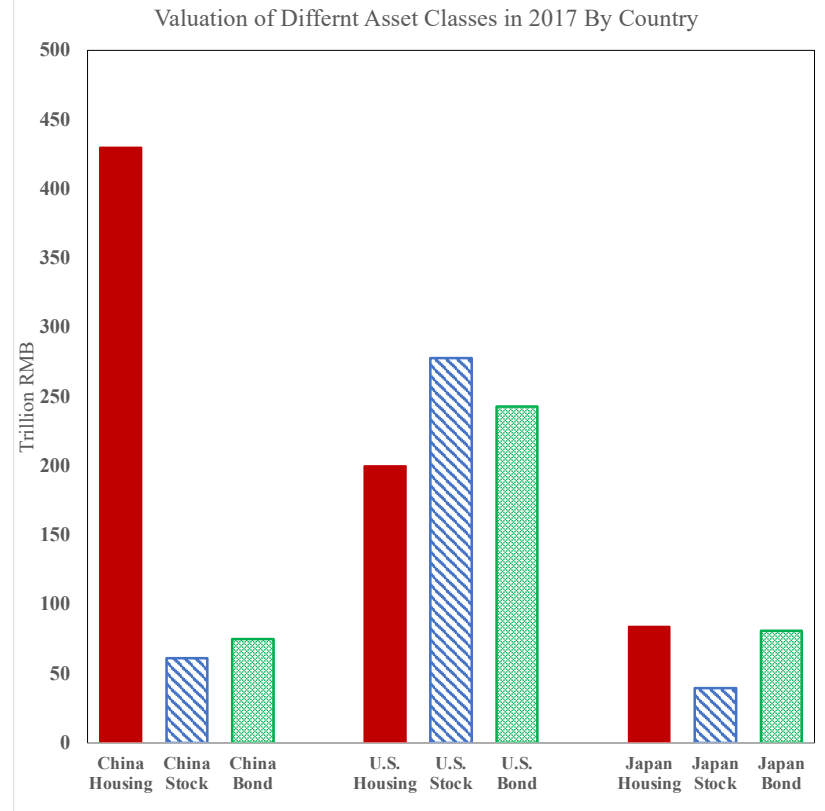
Step 2: Fundamental Economic Framework

Housing Price Declines Impact on China Households Is Measured In The Trillions And....

Housing Is Now Being Driven By Investment Demand



Housing Investment Dwarfs Traditional Asset Investment



1 Rogoff, Yang, "Peak China Housing," NBER Working Paper 27697, August 2020

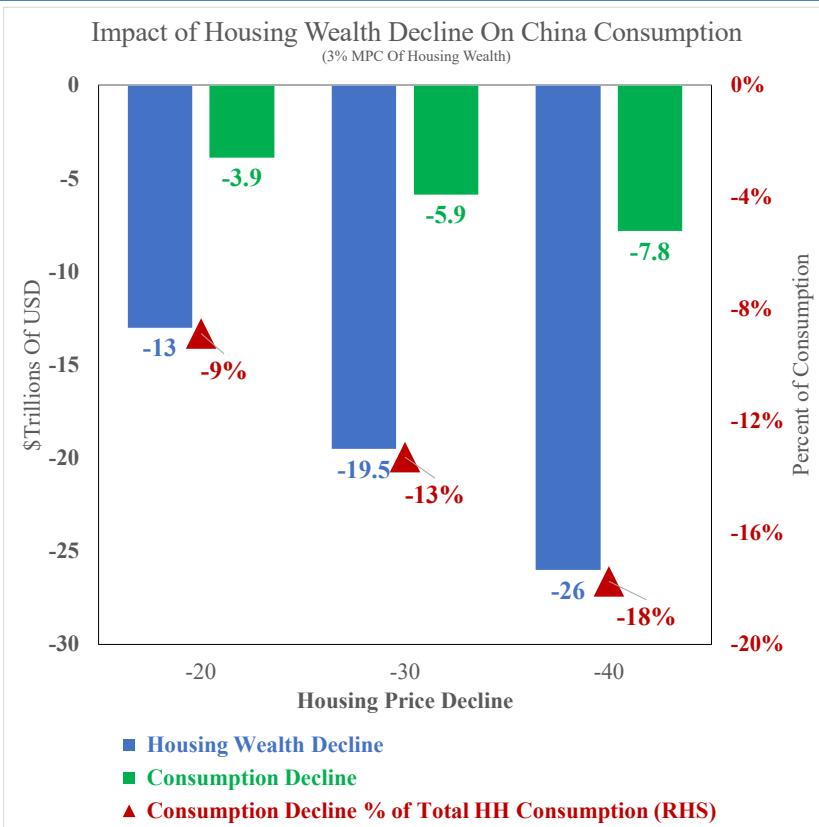
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Step 2: Fundamental Economic Framework

The Decline In Housing Wealth Will Push Up Savings, Drive Down Consumption And GDP

Falling Housing Prices Could Lead to Falls In HH Consumption



Lower Consumption/Higher Savings Will Be Drag On the Economy



1. Painter, Yang, Zhong, "Housing Wealth and Household Consumption: Evidence From Urban China", Jan 2021, Presentation To The AEA
2. I use the MPC out of wealth from the reference above
3. Bloomberg

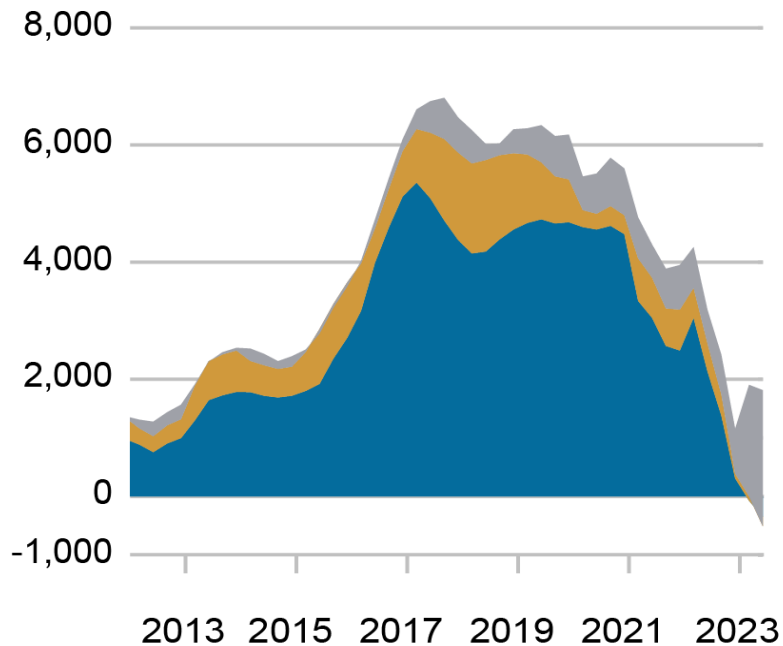
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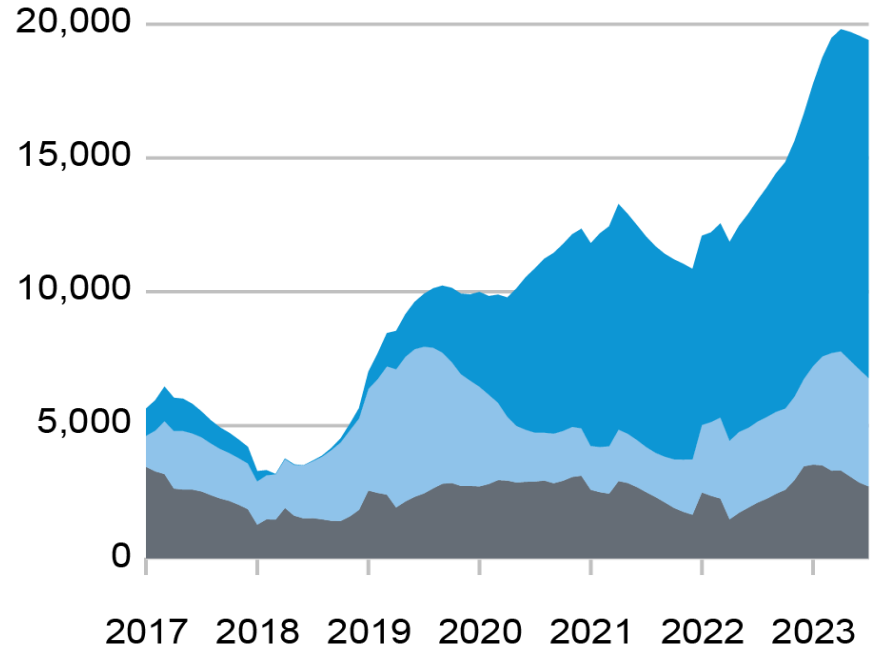
Step 2: Fundamental Economic Framework

Households Are Retrenching Paying Down Mortgages And Add Deposits Instead of Consuming

New household loans
(RMB billions, year-over-year)



New household deposits
(RMB billions, 12-month rolling sum)



■ Mortgage ■ Credit card ■ Other consumption

■ Demand ■ Other household deposits ■ Time deposits

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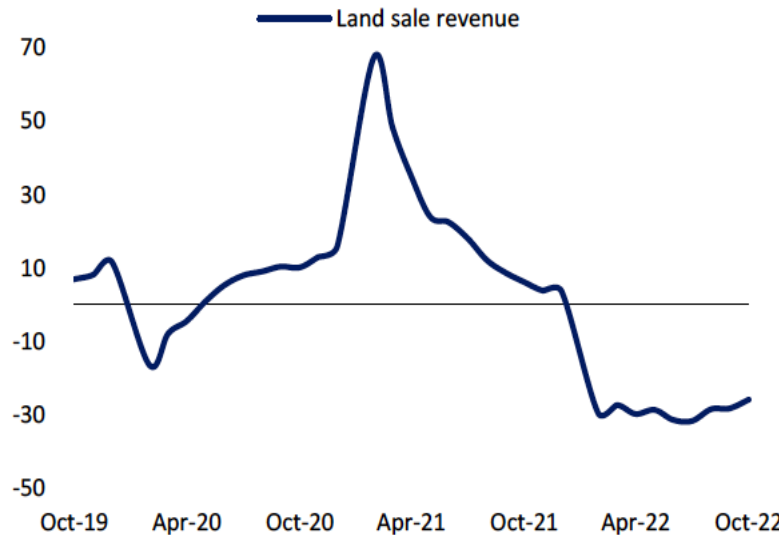
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The Property Collapse Has Put Put Pressure On Local Governments As Land Sales Have Fallen

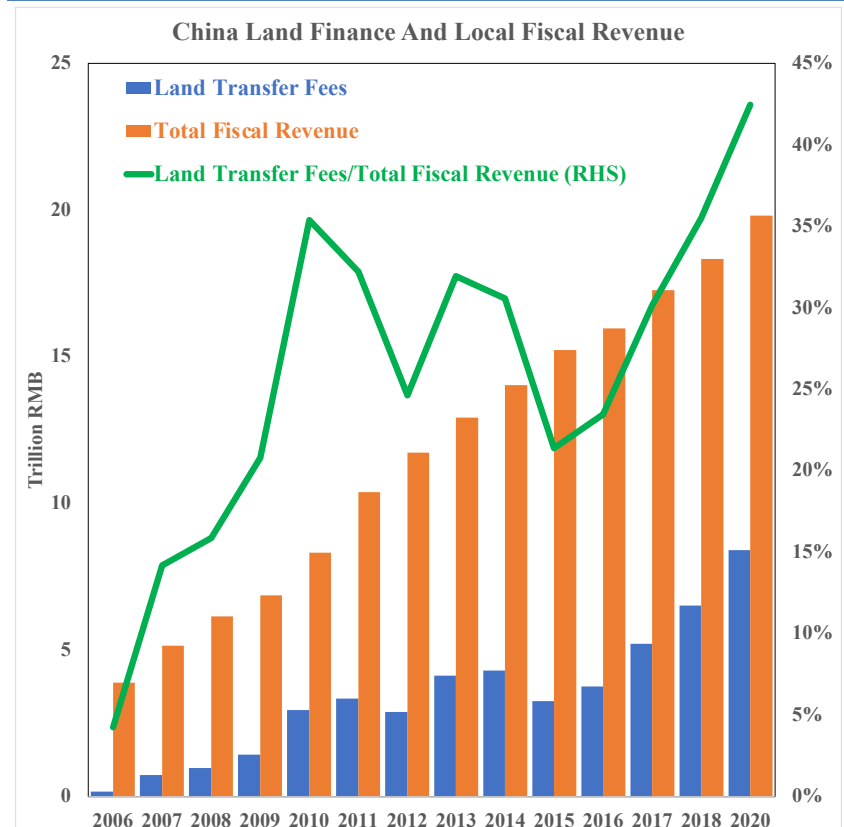
Land Sale Revenue Was Down 30% Even Prior to 2023/24

C. Land sale revenue (y/y percent, ytd)



Source: Ministry of Finance (MoF); World Bank.

Land Sales Were The Driving Forces of Local Government Revenue



1. Rogoff, Yang, "Peak China Housing," NBER Working Paper 27697, August 2020
 2. China Economic Update, "Navigating Uncertainty, China's Economy in 2023", December 2022, World Bank

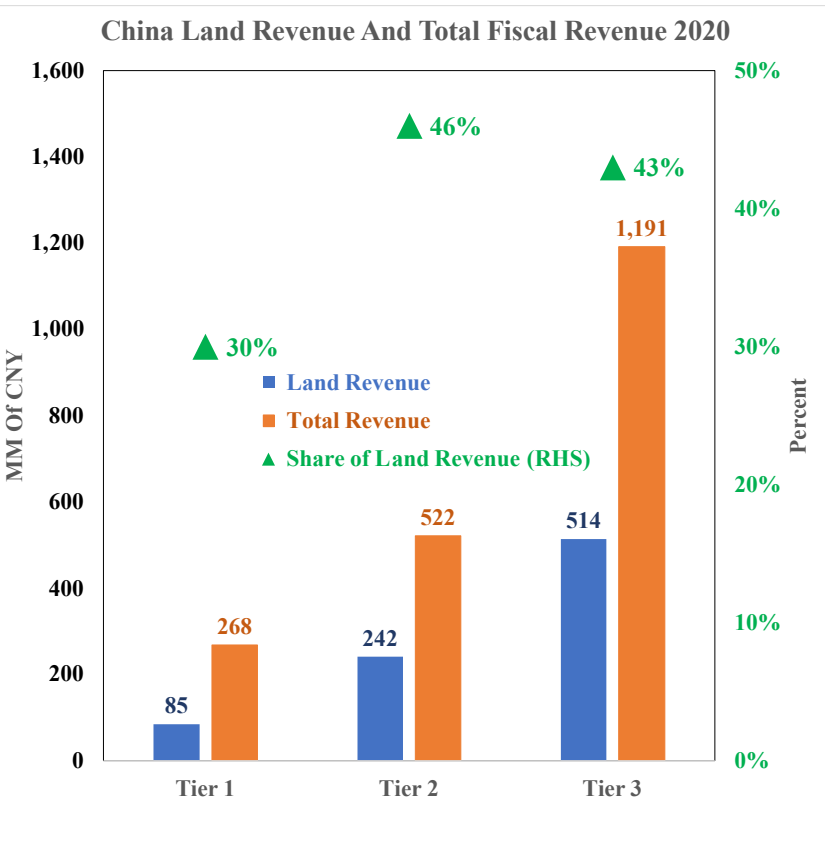
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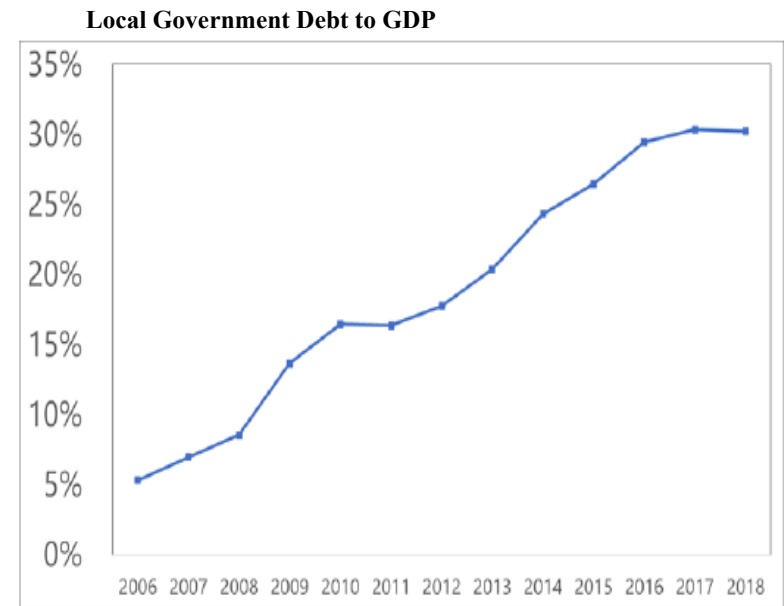
Step 2: Fundamental Economic Framework

Vulnerability of China's Local Governments To Land Revenue Could Be Another Headwind To Growth

Local Governments Dependent On Land Sales For Revenue



Local Government Debt Defaults Could Put Pressure On the Economy



Sources: CEIC, Wind, China Central Depository and Clearing Company Limited

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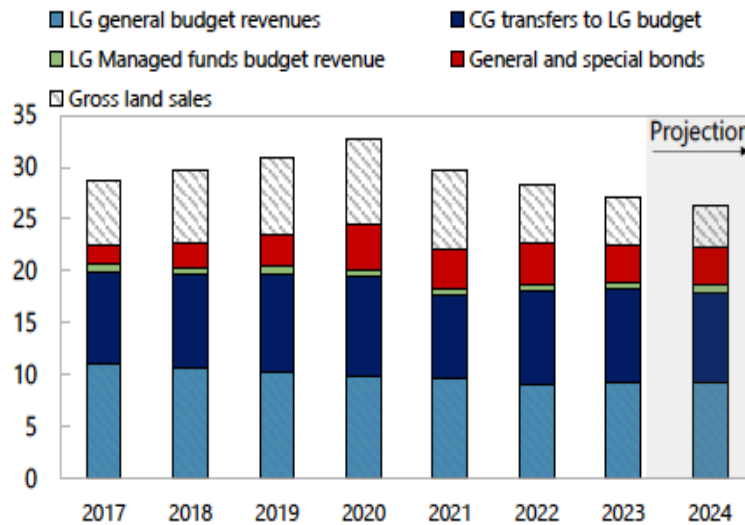
Step 2: Fundamental Economic Framework

The Collapse of the Property Market Could Lead To Financial Crisis From Local Government Defaults....

The Fall In Revenue Has Put Pressure on Local Government...

Local Government Budget Financing 1/

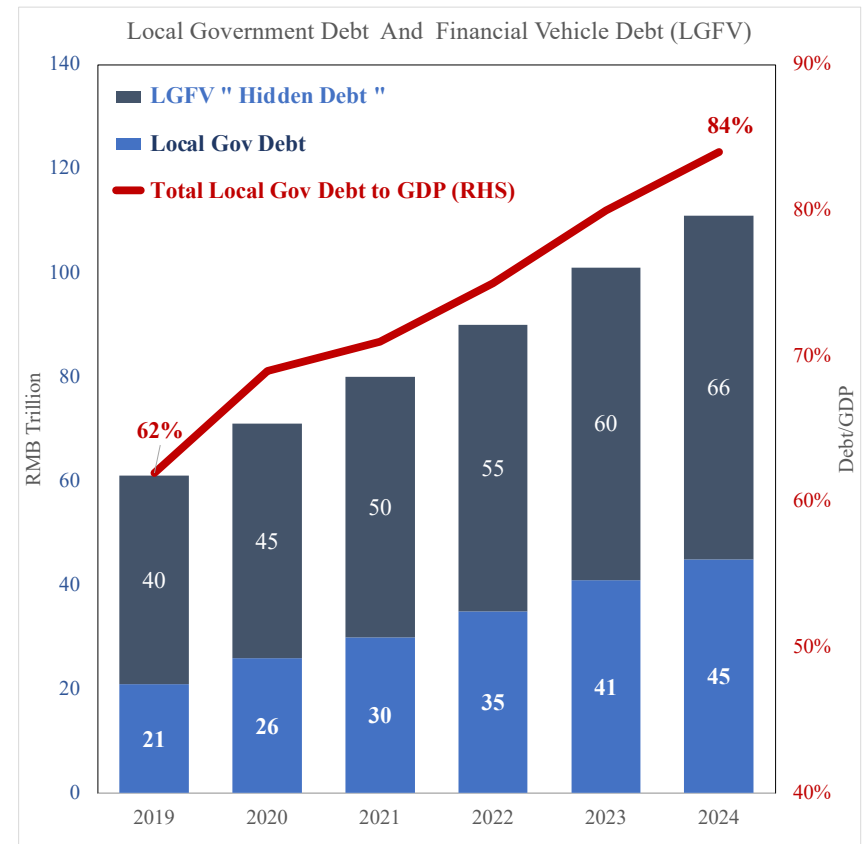
(In percent of GDP)



Sources: CEIC Data Company Limited; Ministry of Finance 2022 budget; and IMF staff calculations.

1/ Local government general budget and local government managed fund budget. Excludes off-budget financing.

They May Not Be Able To Support Their Rising Debt Load



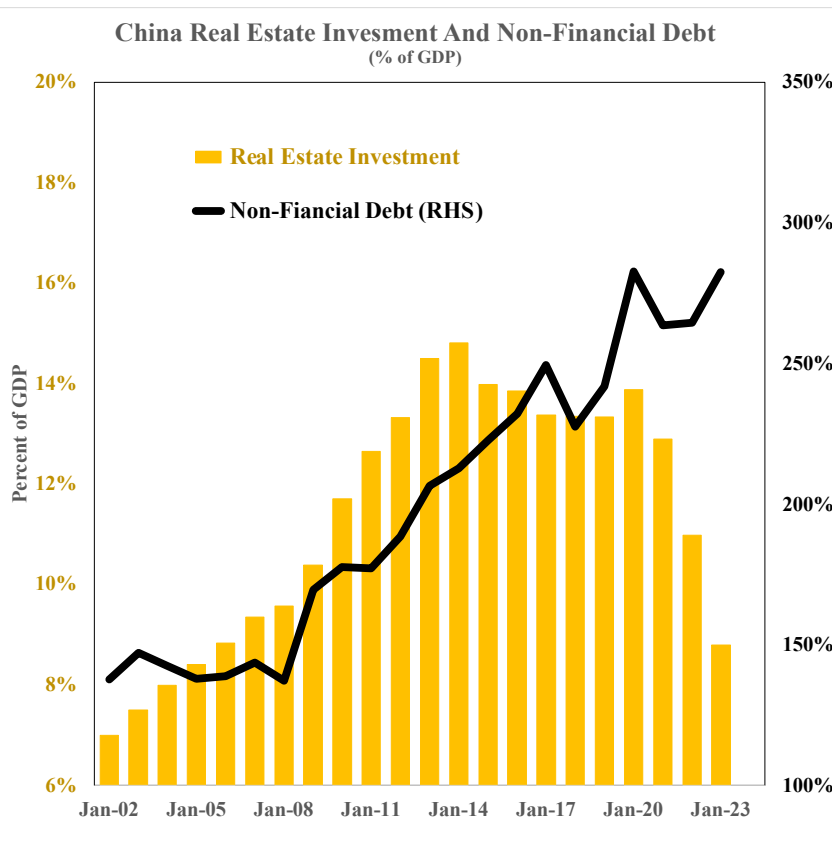
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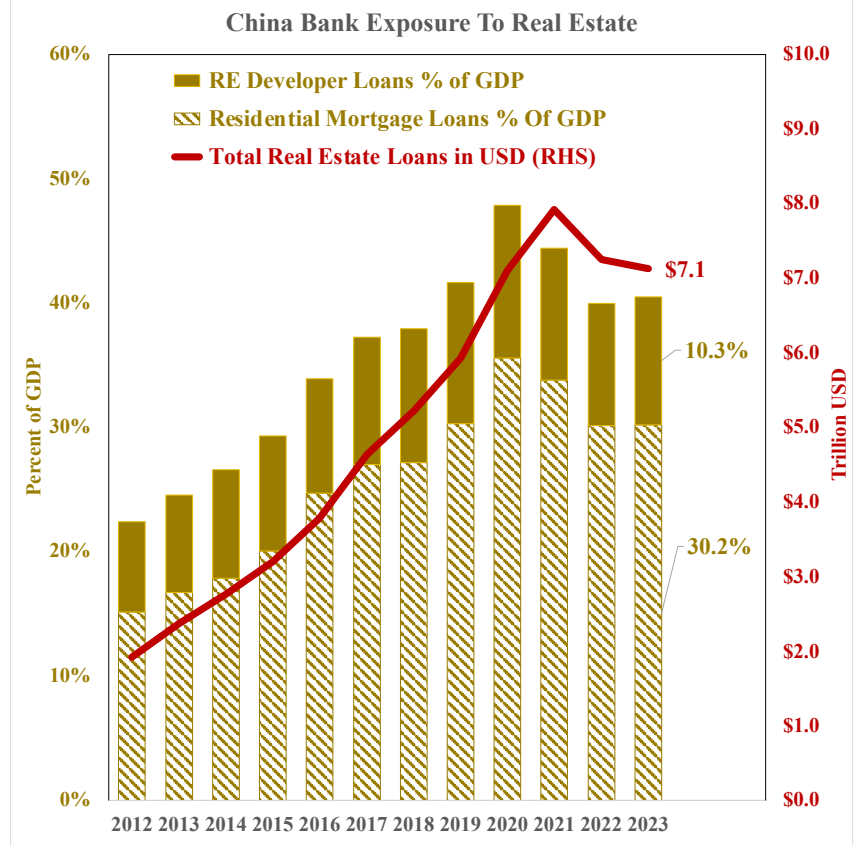
Step 2: Fundamental Economic Framework

And Losses On Bank Loans to From Default From Developers And Mortgage Borrowers

Debt Grew To Support Investment.. But At The Cost Of



Ever Increasing Credit Impulses Were Needed to Offset Slowdown



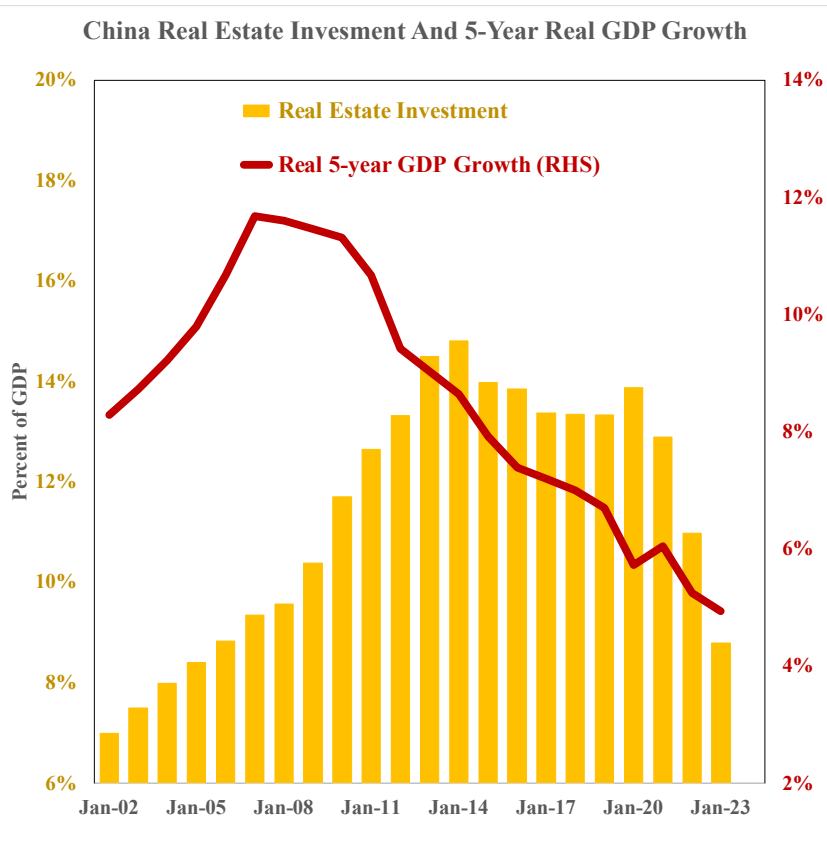
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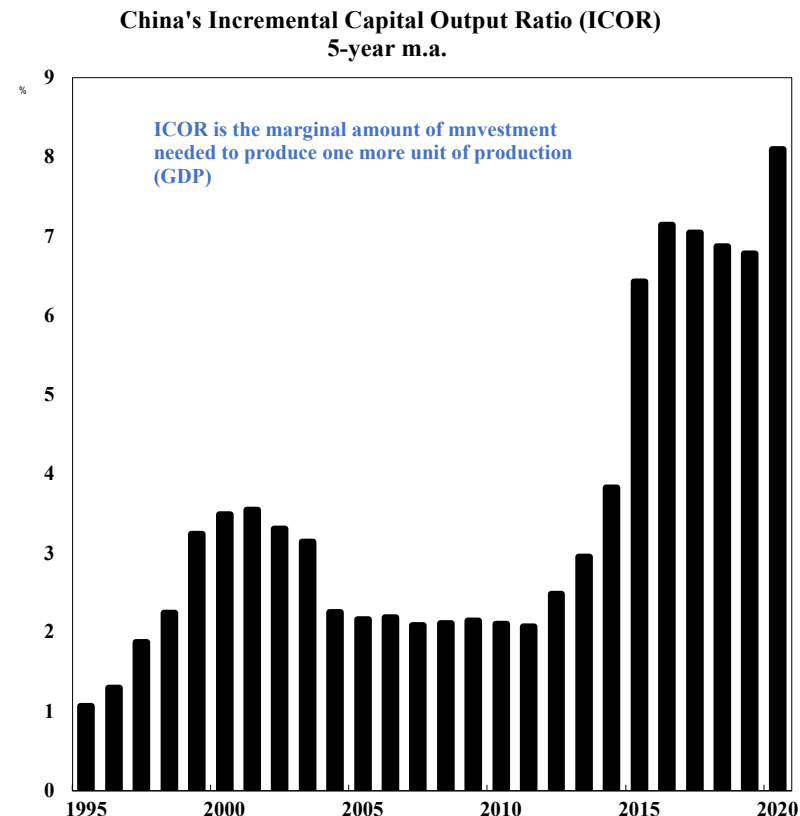
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More importantly, The RE Investment Model of GDP Growth Has Failed...So What's Next?

RE Investment Could Not Reverse The Downturn In Growth...



Because the Impact of Investment On Growth Diminished



1. Bloomberg
2. OECD China Economic Survey 2022

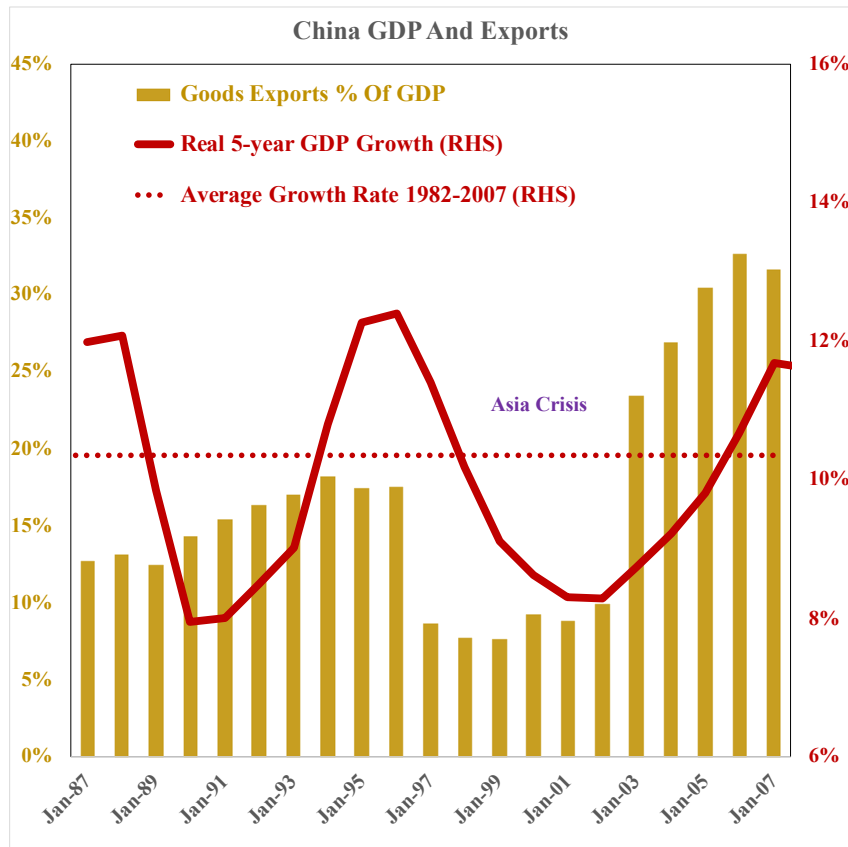
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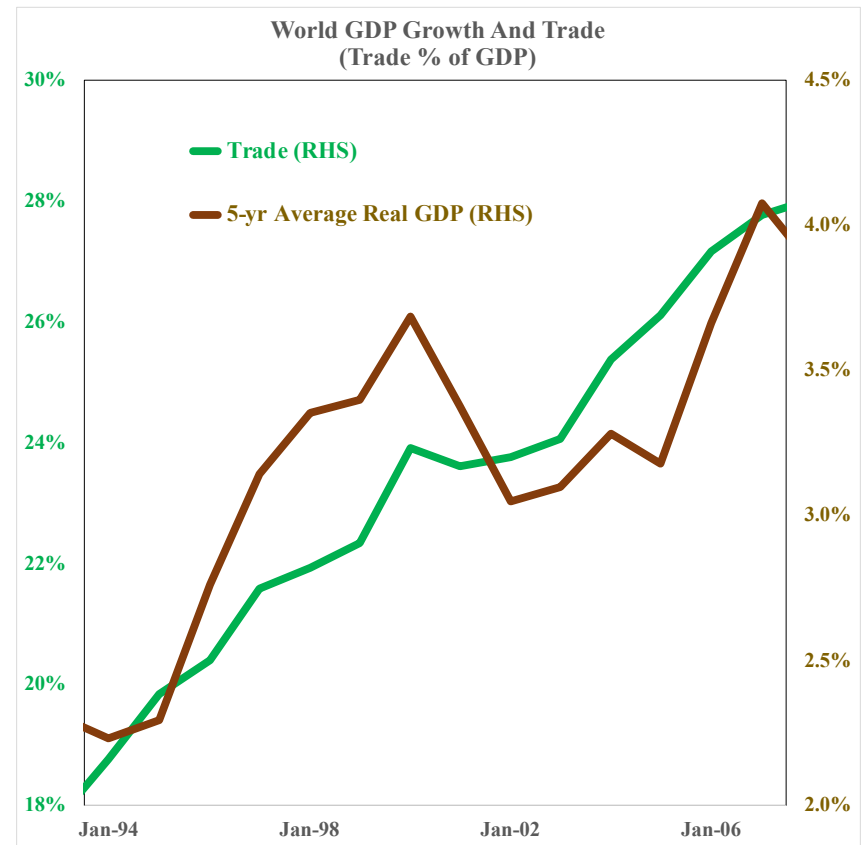
Step 2: Fundamental Economic Framework

China Could Go Back To Its Original Drive of Growth...

China Trade Model Drove Double Digit Growth Prior To 2008



China Trade-Driven Growth Led to Trade-Driven World Growth



1. Bloomberg
2. World Bank Data Base

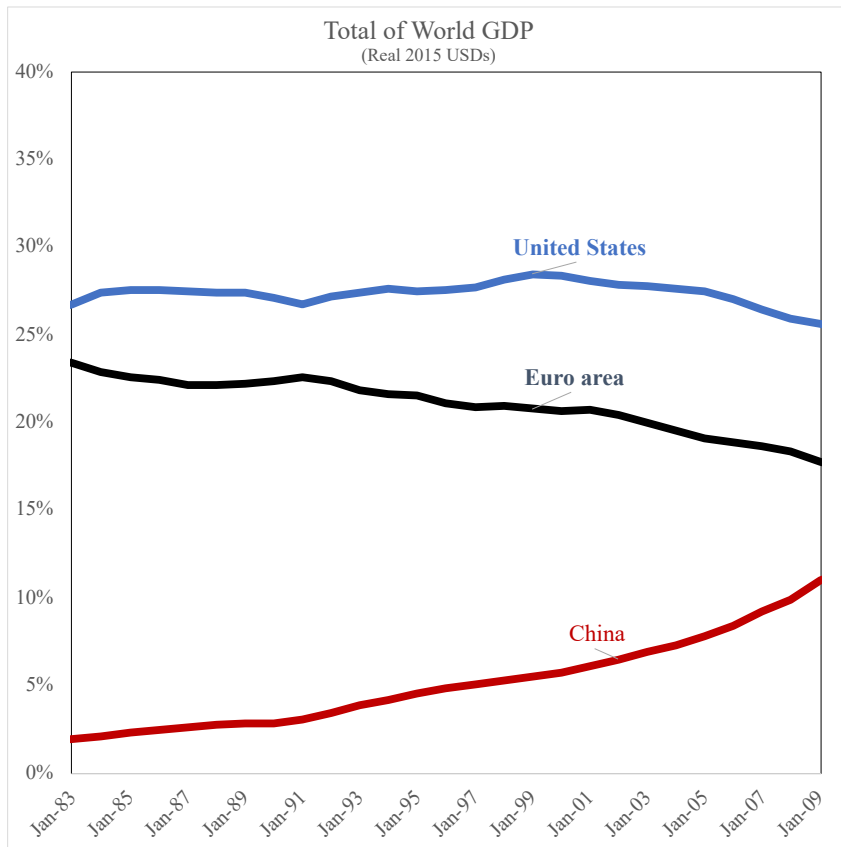
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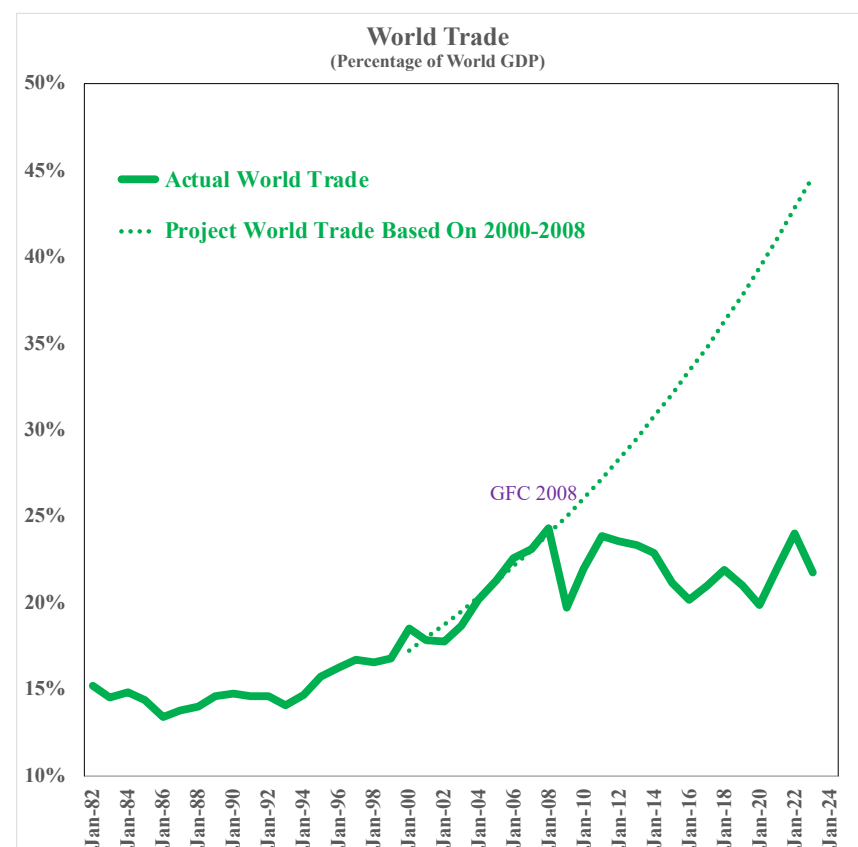
Step 2: Fundamental Economic Framework

Before 2008, China's Growth Drove The ROW Through Trade, But That Stopped After The GFC

Trade-driven Growth Pushed China's GDP To Approach Europe's



But That All Stop After The Collapse of Trade Post 2008



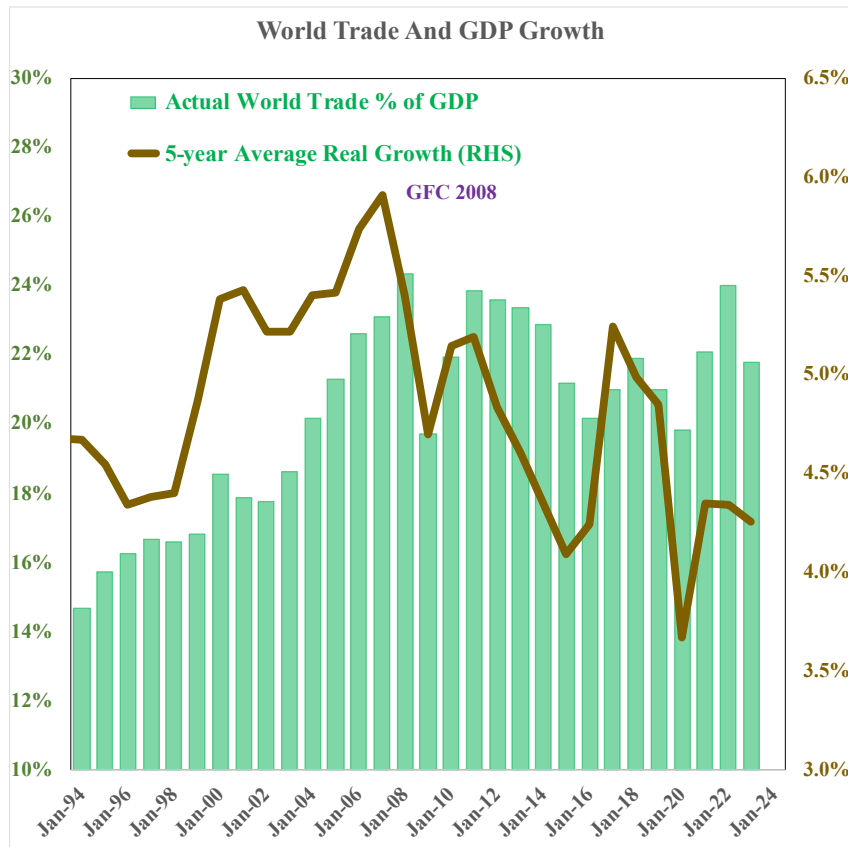
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The Collapse of China's Trade Model Led To A Slowdown In the World And China's Growth...And

World Growth Fell Along The Slowdown In Trade ...



This Reflected The Failure of China's Trade Model



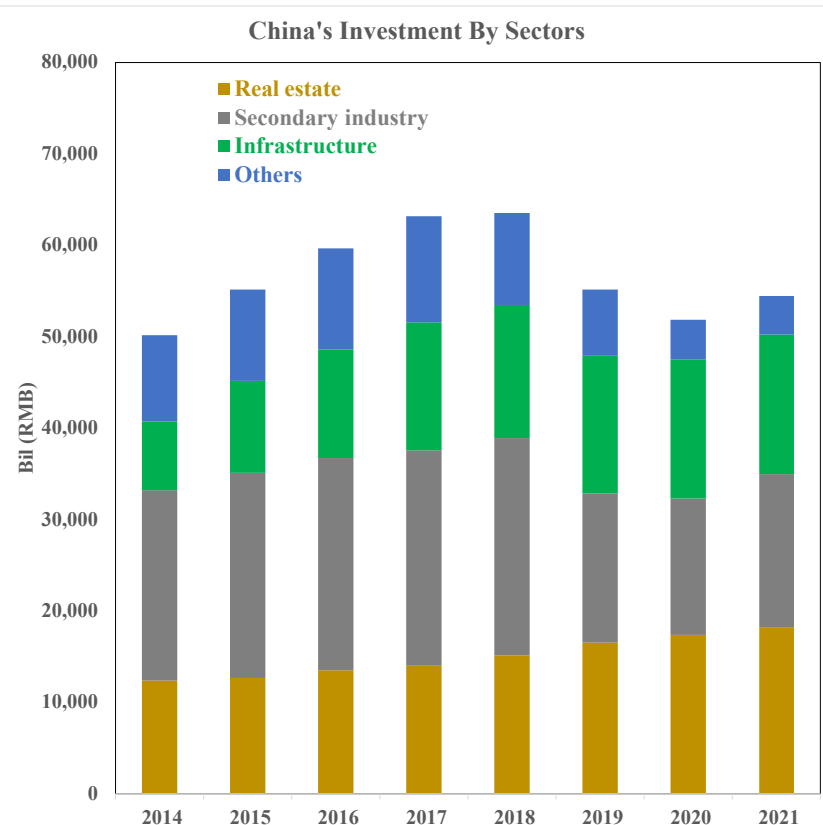
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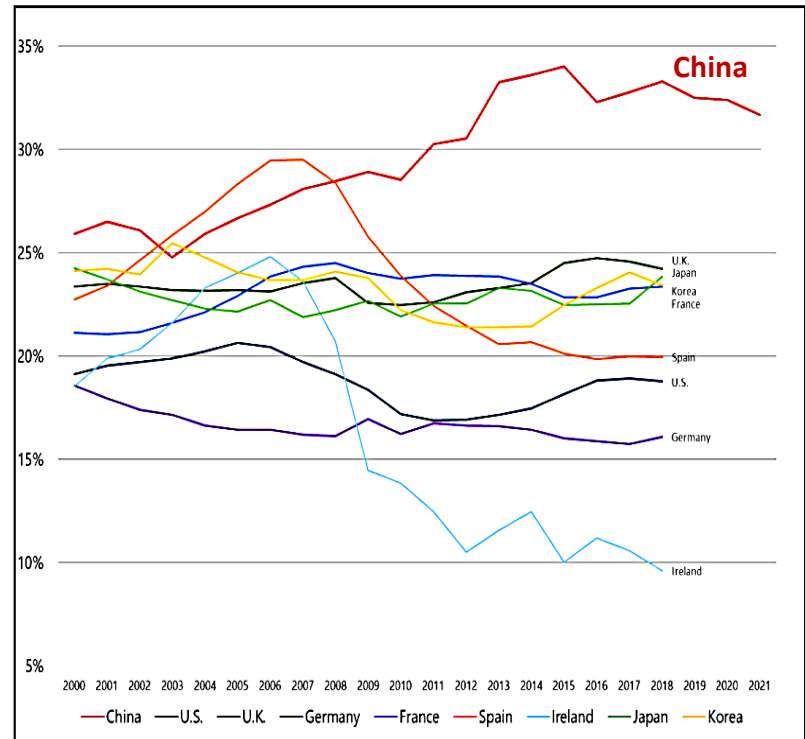
Step 2: Fundamental Economic Framework

The Collapse Of RE Investment Model Has Left A Big GDP Hole For China To Fill.. So, What's Next?

Real Estate Investment Has Been A Key Component of Investment



Real Estate Investments Is Now Over 1/3 Of China's Economy



1. Brandt, et al., "China's Productivity Slowdown and Future Growth Potential", Policy Research Working Paper 9298, June 2020, World Bank
 2. Rogoff, Yang, "Peak China Housing," NBER Working Paper 27697, August 2020

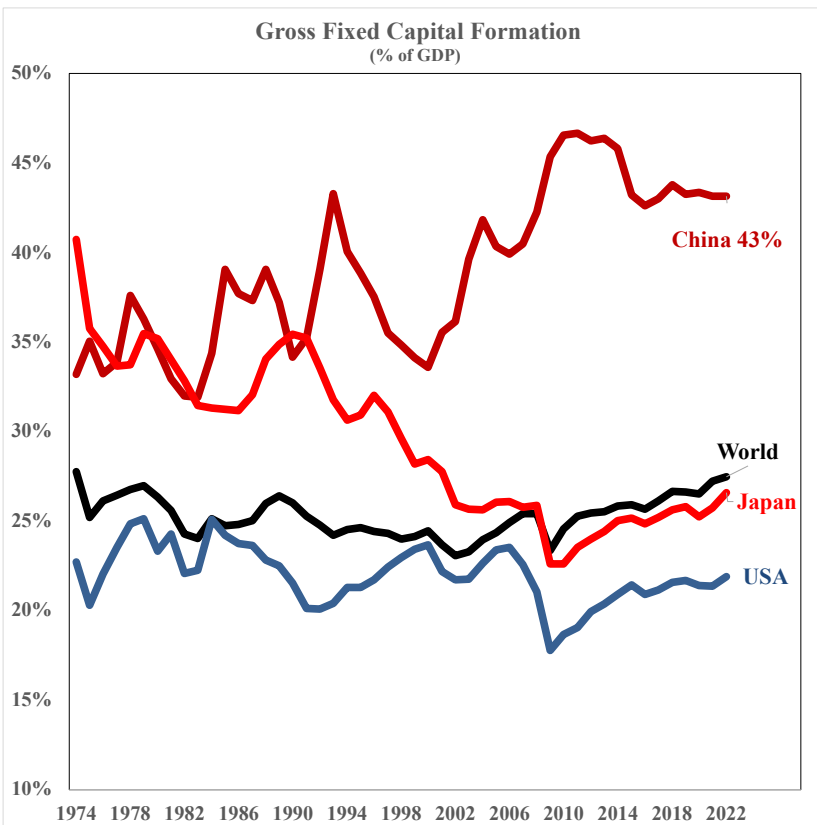
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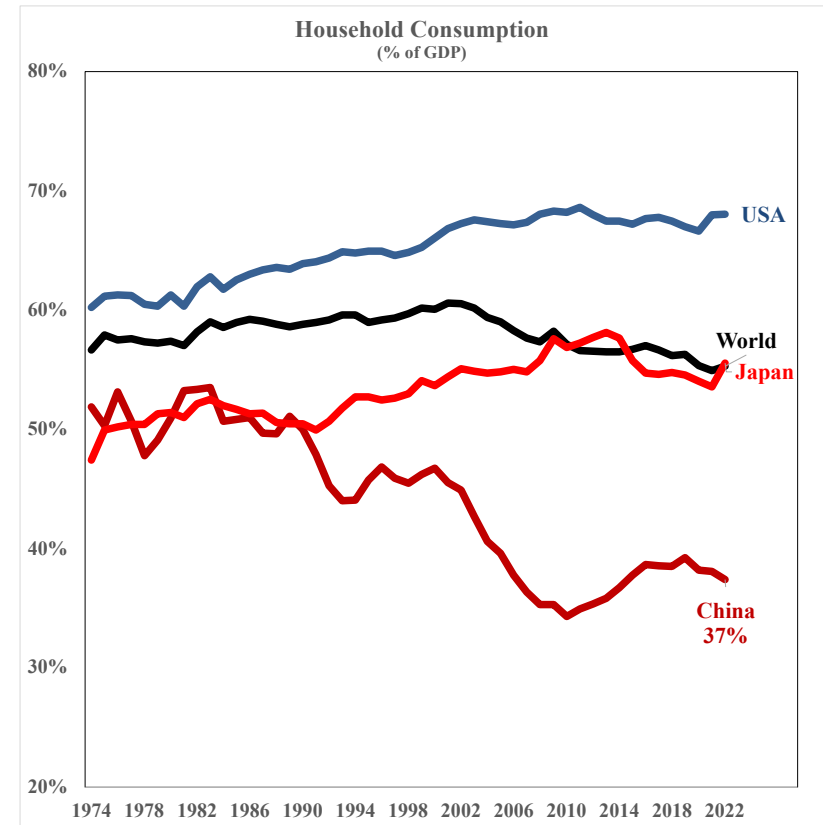
Step 2: Fundamental Economic Framework

Could China Use Consumption To Replace Trade And RE Investment To Drive GDP?

China Investment Driven GDP Is An Outlier..



Which Means They Could Turn To Consumption To Drive Growth



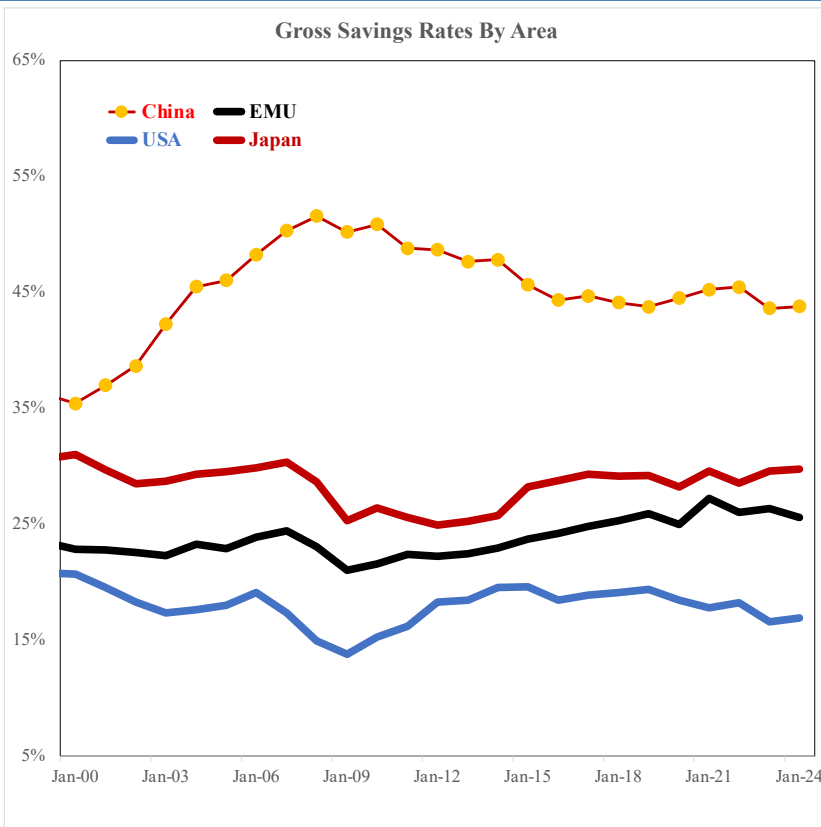
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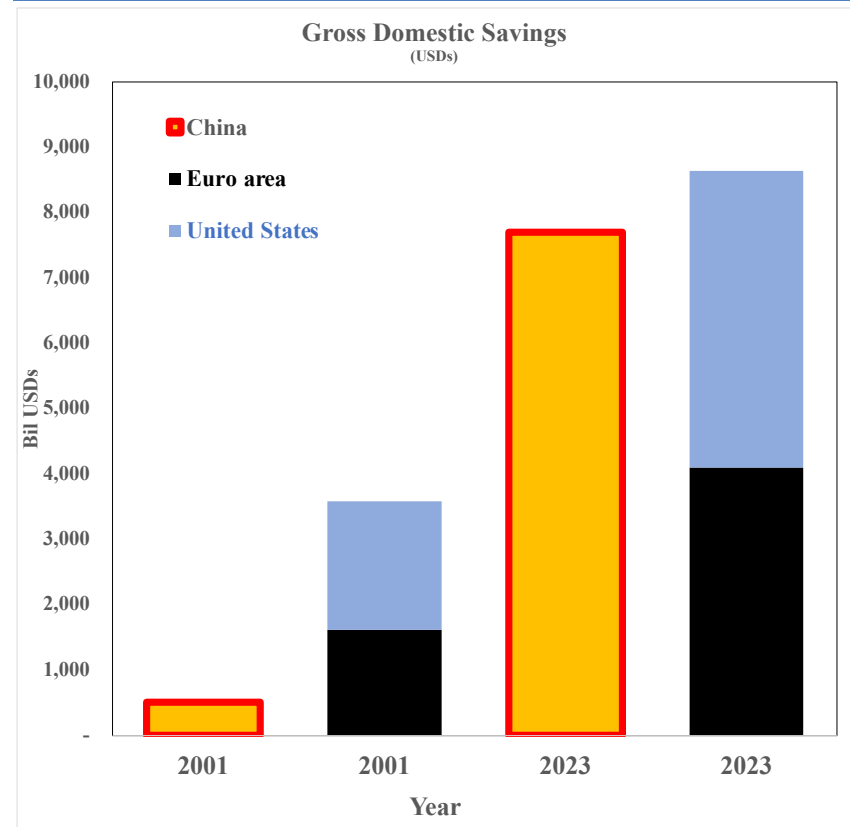
Step 2: Fundamental Economic Framework

That Would Be Huge For China And World Growth Given Their Massive Levels Of Savings..But No!

China Saves Almost Half of GDP Every Year....



And Their Savings Is Almost The Same As That of G3



1. OECD Data Base
2. World Bank Data Base

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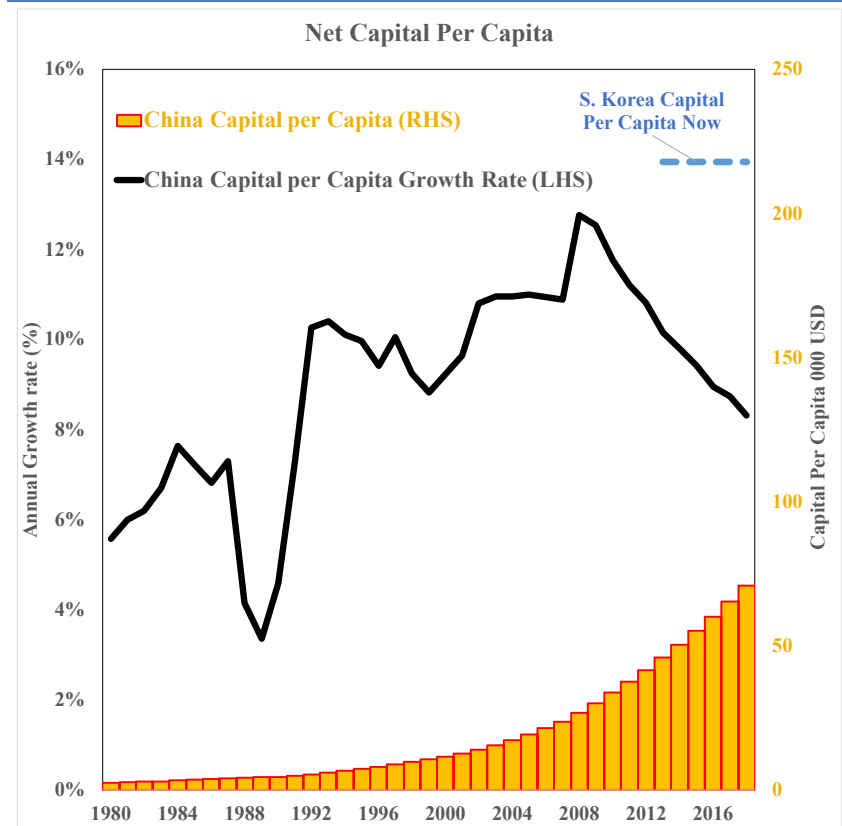
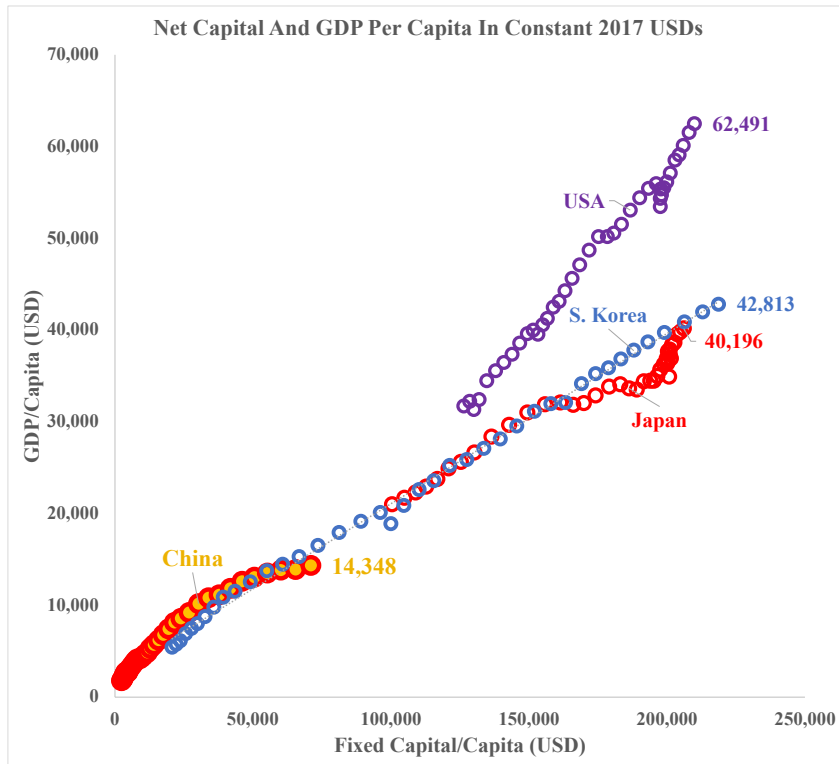
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Step 2: Fundamental Economic Framework

China Will Need High Levels Of Investment For Decades To Catch Up To The Korea Of 20 Years Ago

Chinese Capital Stock Is Still Less than 1/3 of South Korea

China Needs 30 Years of Current Investment to Reach Korea



1. World Bank Database
 2. "Innovative China, New Drivers of Growth," Development Research Center of the State Council, World Bank, 201

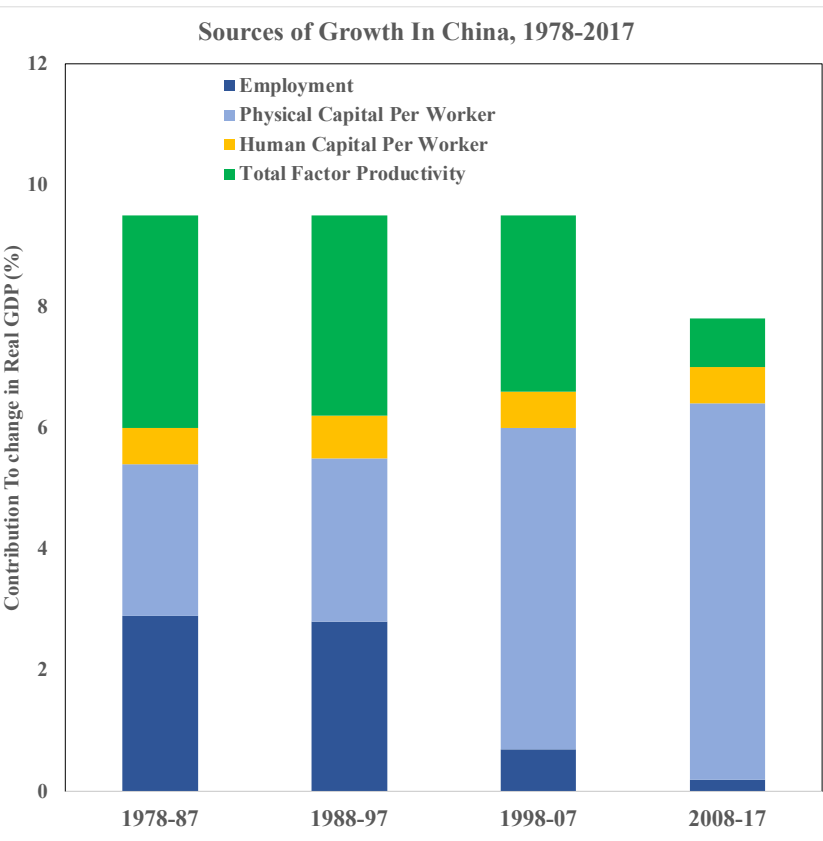
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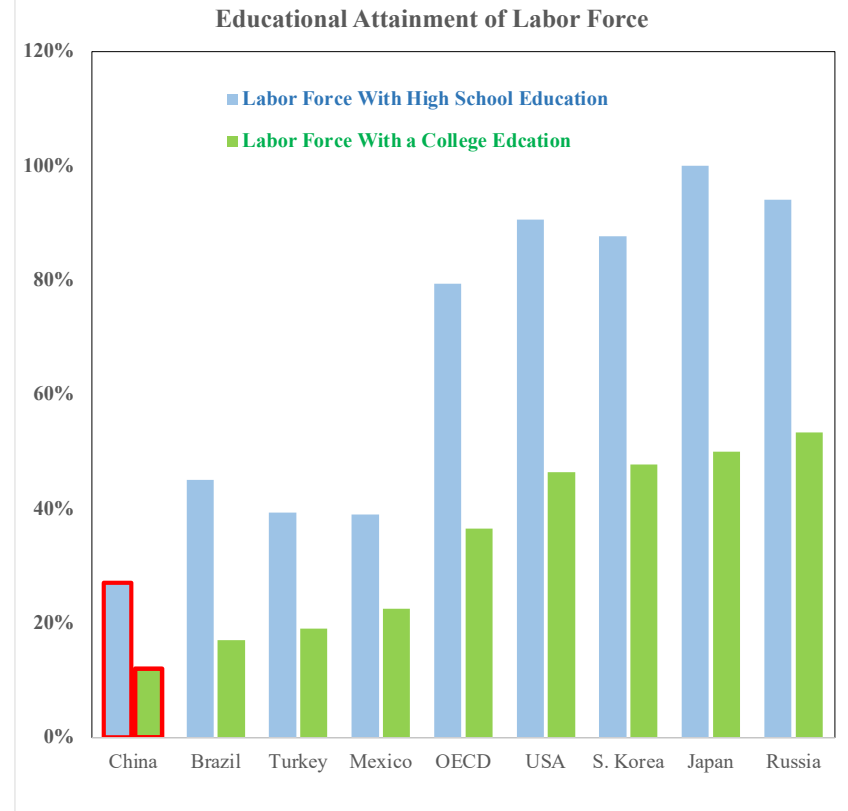
Step 2: Fundamental Economic Framework

High Levels of Investment Are Even More Important Given China's Low Levels of Labor Productivity

Chinese Growth Dependent On Capital Growth Not Labor



China Has A Huge Deficit Of Human Capital



1. World Bank Database
 2. "Innovative China, New Drivers of Growth," Development Research Center of the State Council, World Bank, 201

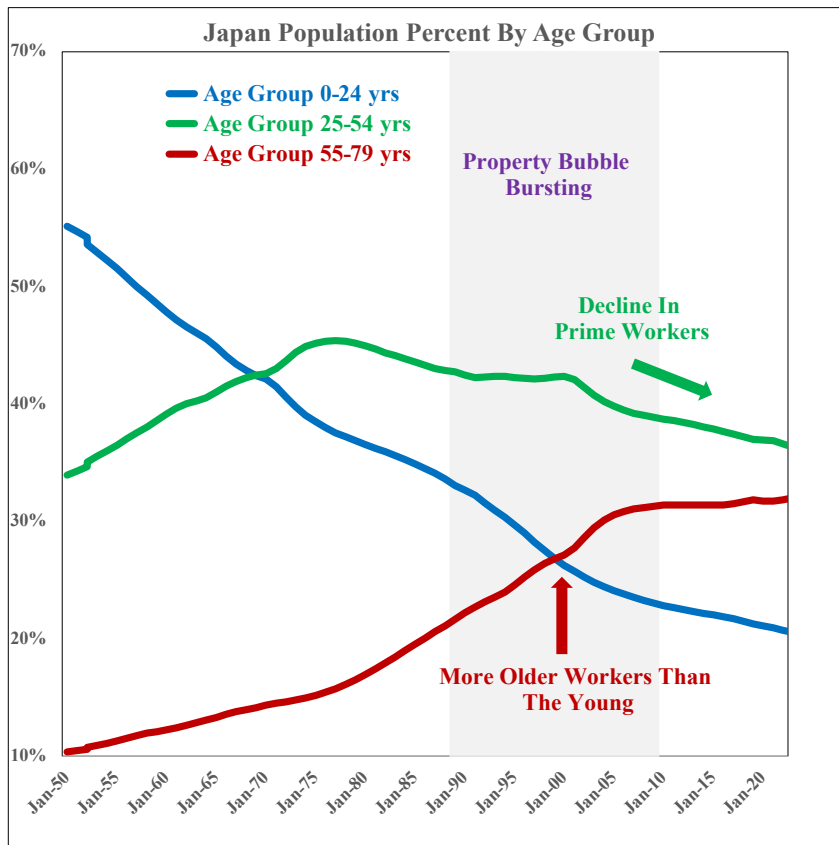
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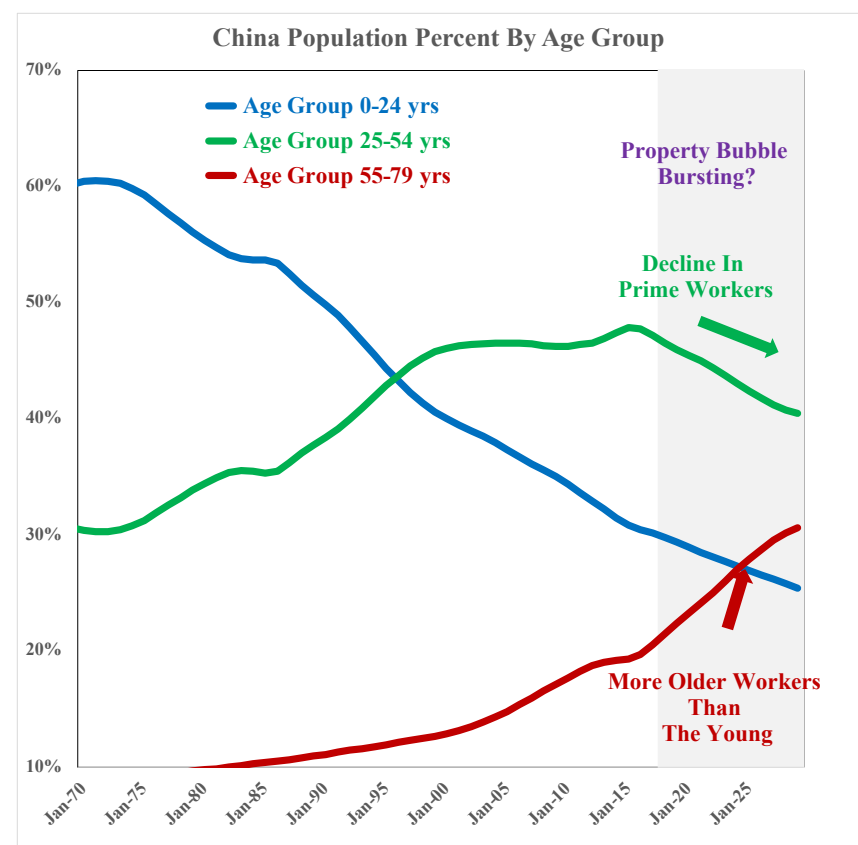
Step 2: Fundamental Economic Framework

And Headwinds From Demographics With Falling Labor Supply And Prime Savers

Japan's Demographics



China's Demographics



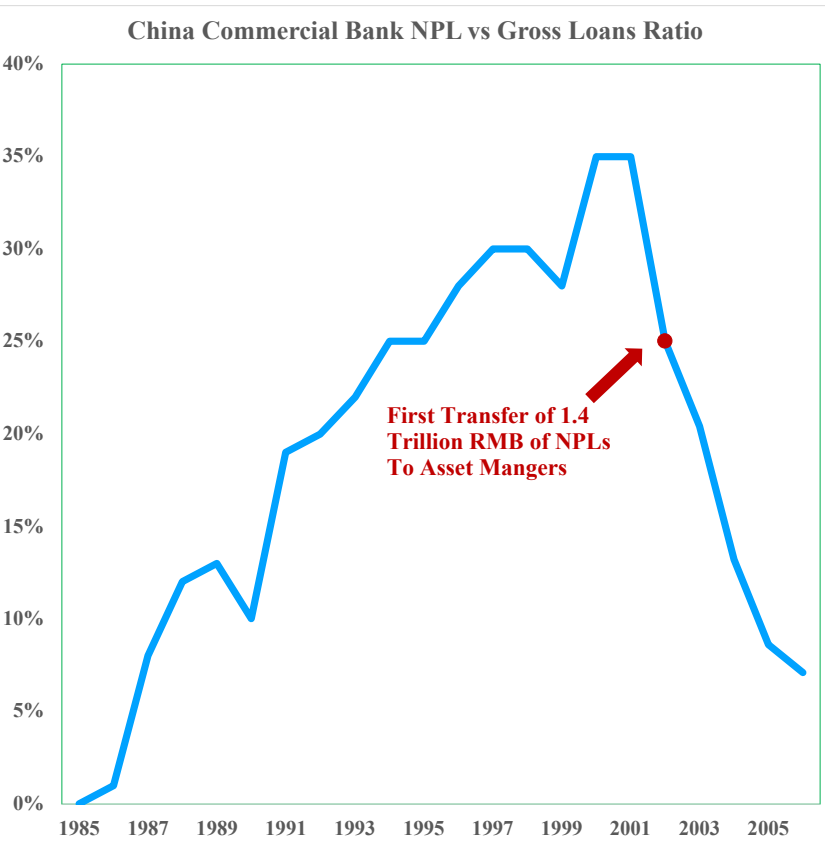
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Step 3: Identify Potential Repricing Catalysts

China Socialize Risk By Taking Bad Loans Off Balance Sheets As They Did In 2001

NPLs On Chinese Bank Grew to 35% of Loans



Losses Then And Losses Now Could Be Substantial

Sector	Loans Outstanding (RMB Billions)	NPLs Percent of Loans	NPLs	Value of Underlying Asset	Cash Recovery	Recovery Rate	Losses % of GDP
Big Four Banks 2001	6,600	42%	3,400	300	60	2%	34%
China Property Loans 2023	13,174	42%	5,533	487	98	2%	4%
China Mortgage Loans 2023	38,370	42%	16,115	1,418	284	2%	12%

1. Fung & Ma, "China's Asset Management Corporations", BIS Working Paper no 115, Dec 2005
2. Turner, tan and Sadeghian, "The Chinese Banking System", Reserve Bank of Australia, September 2012
3. Bloomberg

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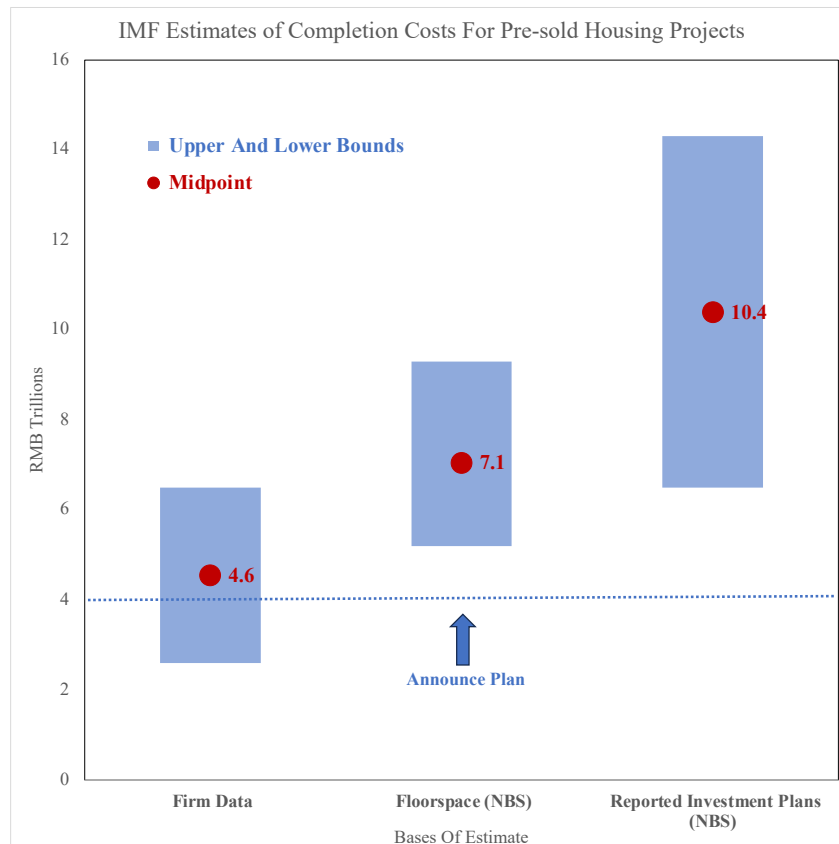
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Step 3: Identify Potential Repricing Catalysis

China Increases Stimulus By Multiples Of Current Levels In Order To Fix The “Pre-Sold” Overhang

Need Could Be As Much As RMB 14 Trillion For Completions..

But Could Be Double That To Clear Developer Inventory



State of Uncompleted Pipeline	GFA (bn sqm)	Capital Needed To Complete (RMB Trillions)
Saleable Work-in-Progress (WIP)	2.1	4.9
Construction In Progress (unsaleable)	1.7	5.3
Raw Land	4.2	17.7
Total	8.0	27.9

1. IMF Article IV China 2024
2. Goldman

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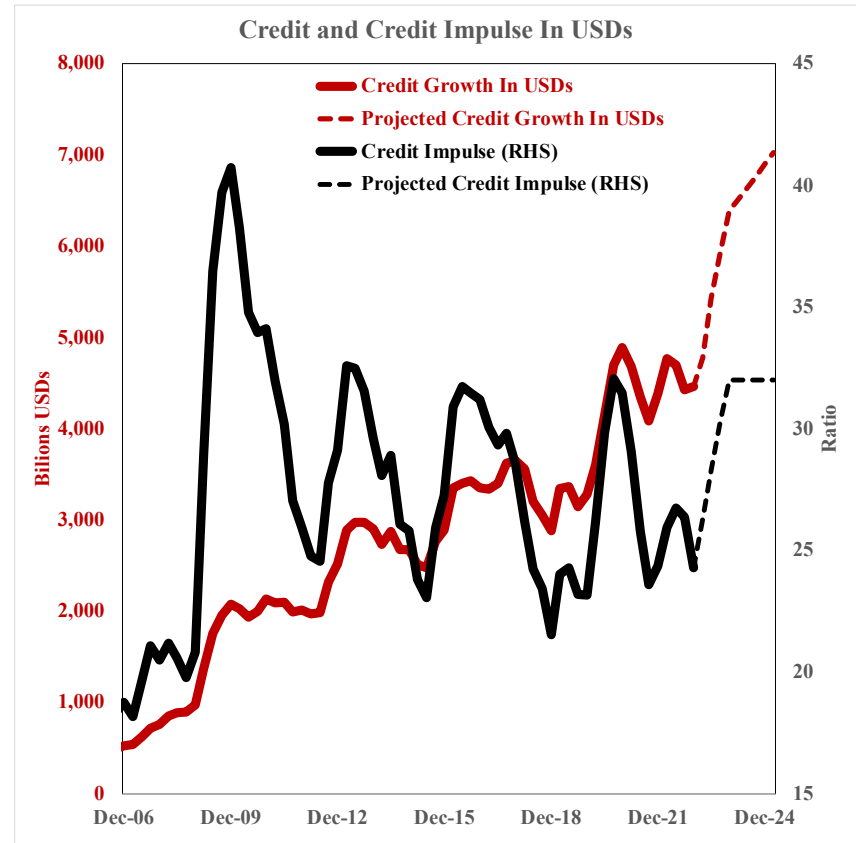
Step 3: Identify Potential Repricing Catalysis

China Steps On The Credit Gas, As Current Stimulus Measures Will Be Inadequate

Current Stimulus Is Just A Drop in The Bucket



Multiples of Current Stimulus Is Needed to Move The Needle



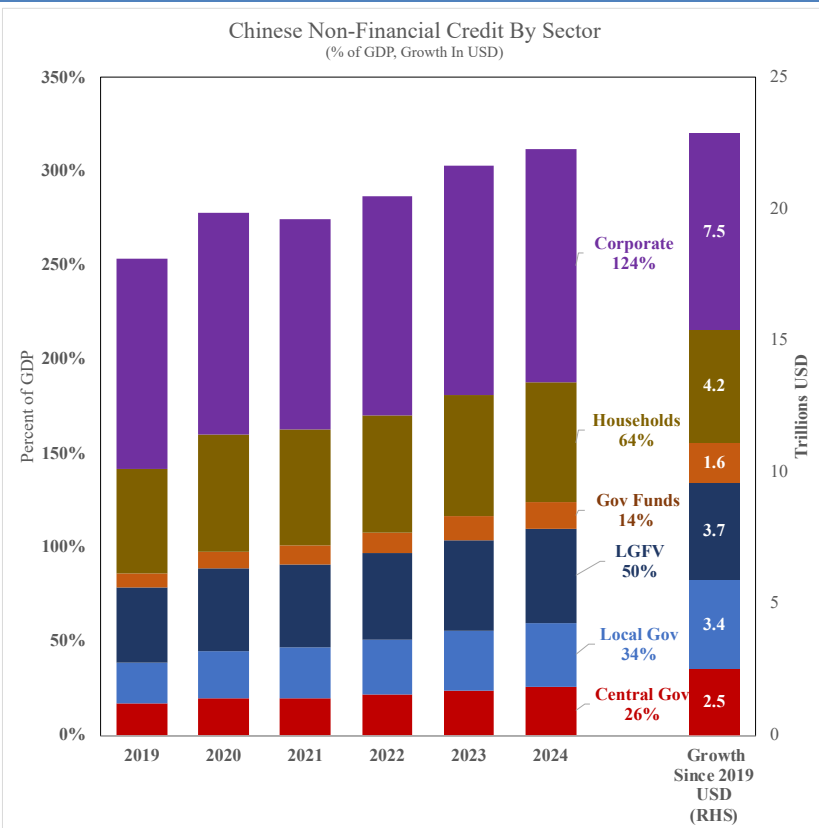
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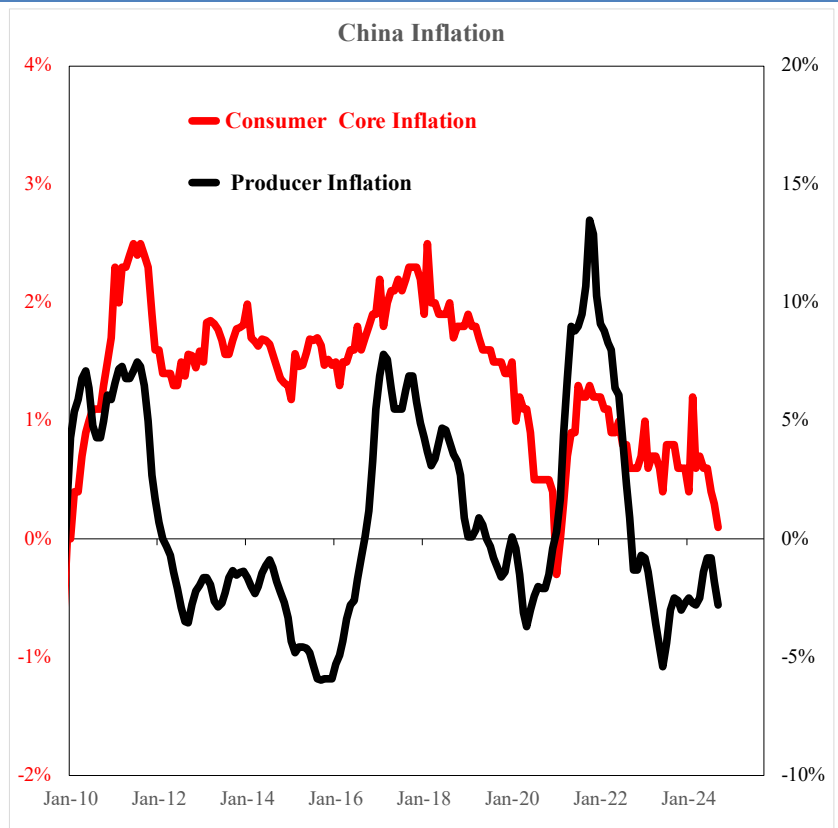
Step 2: Fundamental Economic Framework

Deflation Has Amplified The Impact of The Property Market On the Economy Given Debt Loads

Debt Loads Have Growth Substantially Since 2019 And



Deflation Has Put Even More Pressure On Borrowers to Pay it Back



1. IMF Article IV China 2024
 2. Bloomberg

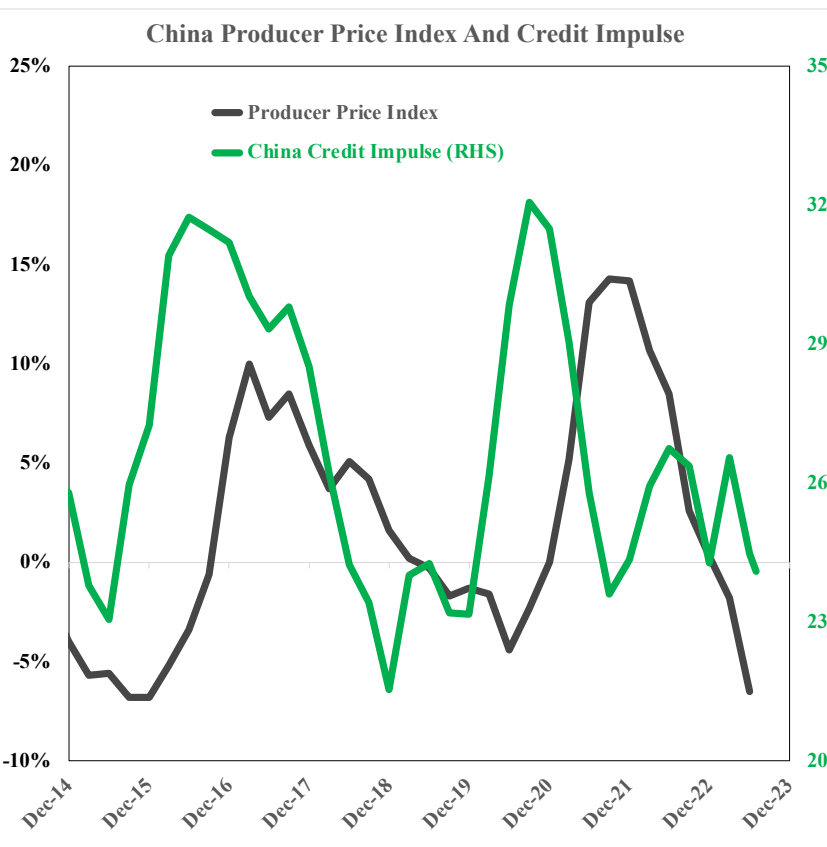
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Step 3: Identify Potential Repricing Catalysts

Another Spike In Credit Growth Is Needed To Offset Deflation

Deflation to Some Degree Reflects The Lack Of A Credit Impulse



Export Prices Are Free Falling To Levels Not Seen Since The GFC



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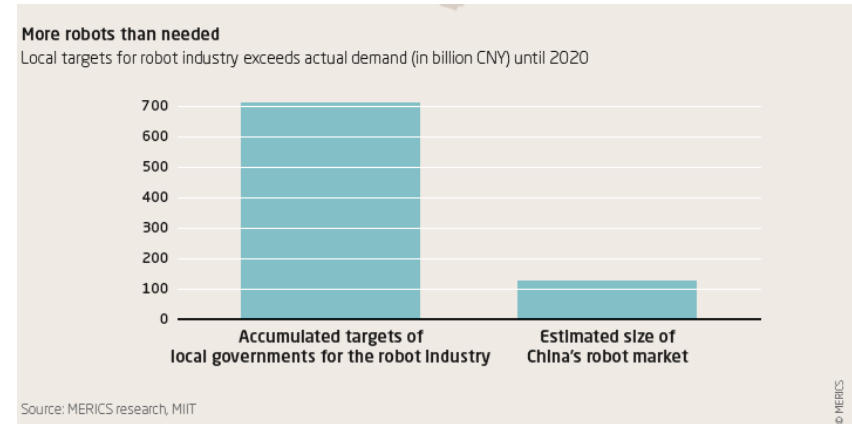
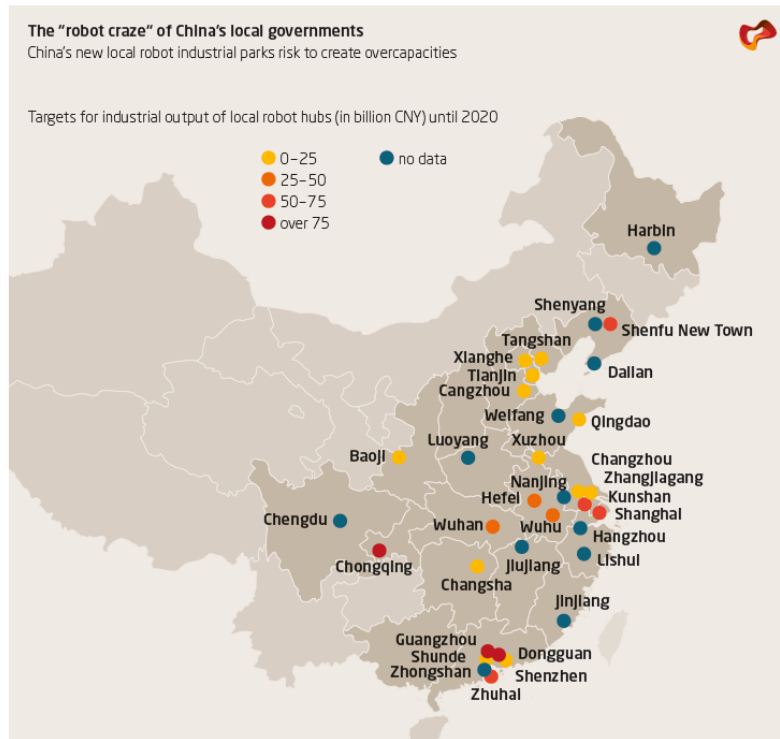
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Step 3: Identify Potential Catalysts

China Turns Back To Trade To Drive Growth: China Exports Robotics to The World

Robotics Production Capacity In China Will Grow Substantially

Planned Capacity Growth Dwarfs Growth in Chinese Demand



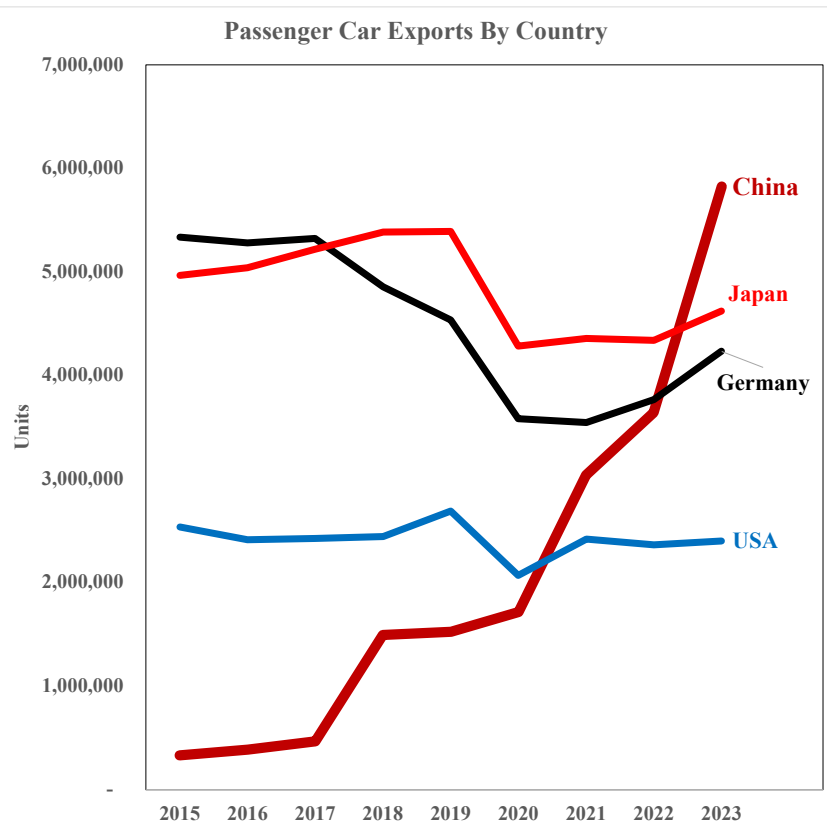
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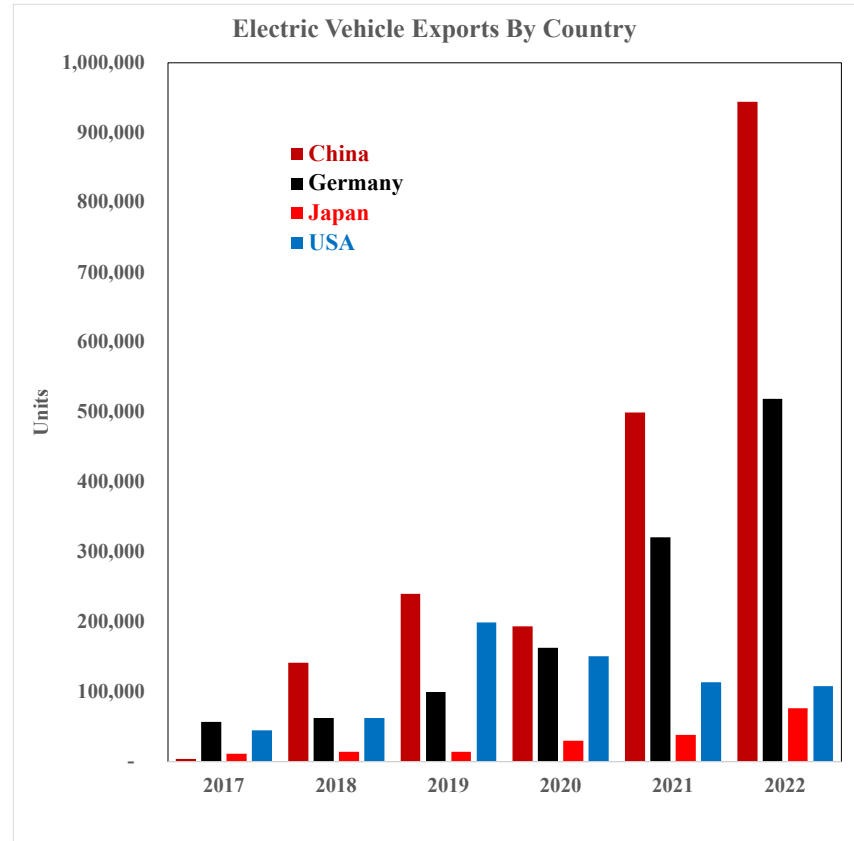
Step 3: Identify Potential Catalysts

Another Example Is the Growth of Chinese Auto Exports, Particularly Electric vehicles

China Is Now Exporting More Cars Than Japan and Germany



They Export Almost Double The EVs of Germany



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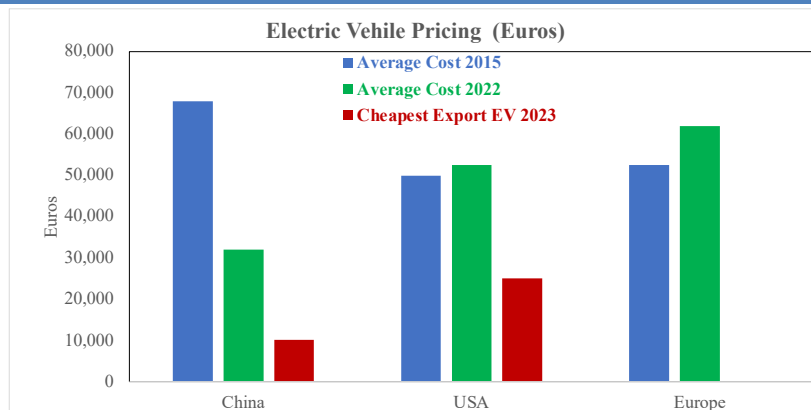
Step 4: Identify Asymmetric Trades

Buy 1-yr 5% OTM CNY Puts/USD Calls

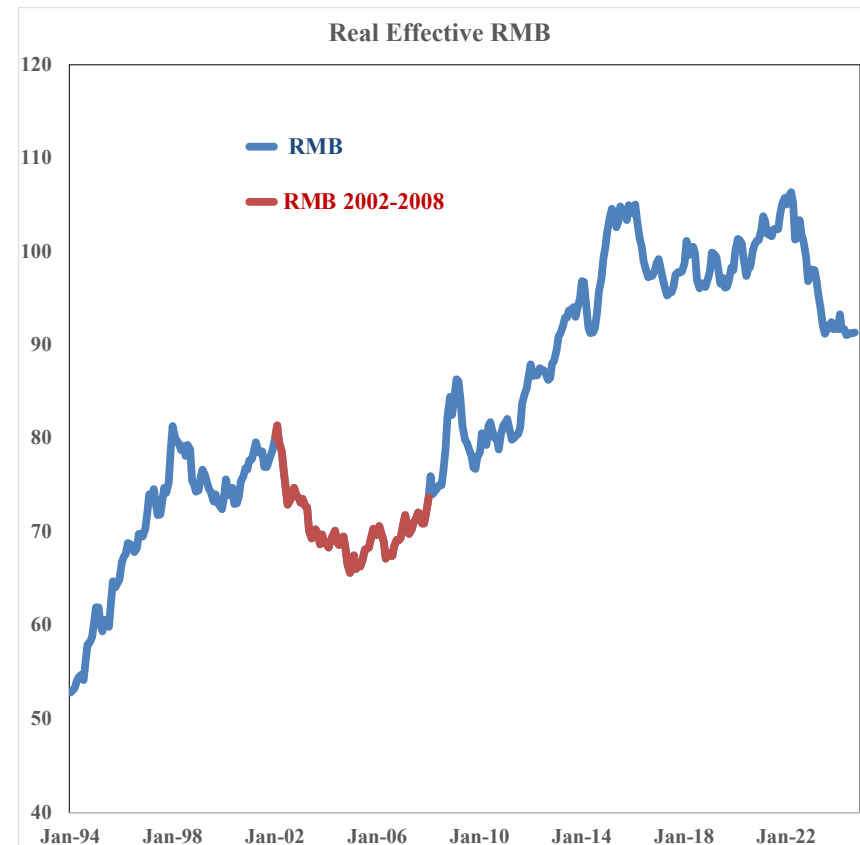
Trade Thesis

- China's current growth model is not sustainable
 - Baby bust, property bust, and now inflation are significant headwinds to China's existing growth model
 - Capital growth and consumption growth cannot support a 5% growth target without credit growth
 - A credit growth impulse to pull China out of deflation is too large to be realistic and causes too many imbalances
- China needs to return to its trade model for sustainable growth
- China needs to depreciate its currency for trade to become an alternative to investment growth alone
 - RMB would need to depreciate close to 20% or more to get back to levels during the trade boom in 2002-2008

China Already Produces the Cheapest EV, What Happens With It Devalue?



The RMB Needs To Devalue 20% To Get Back to GFC Levels



1. Bloomberg
2. Ptolemus

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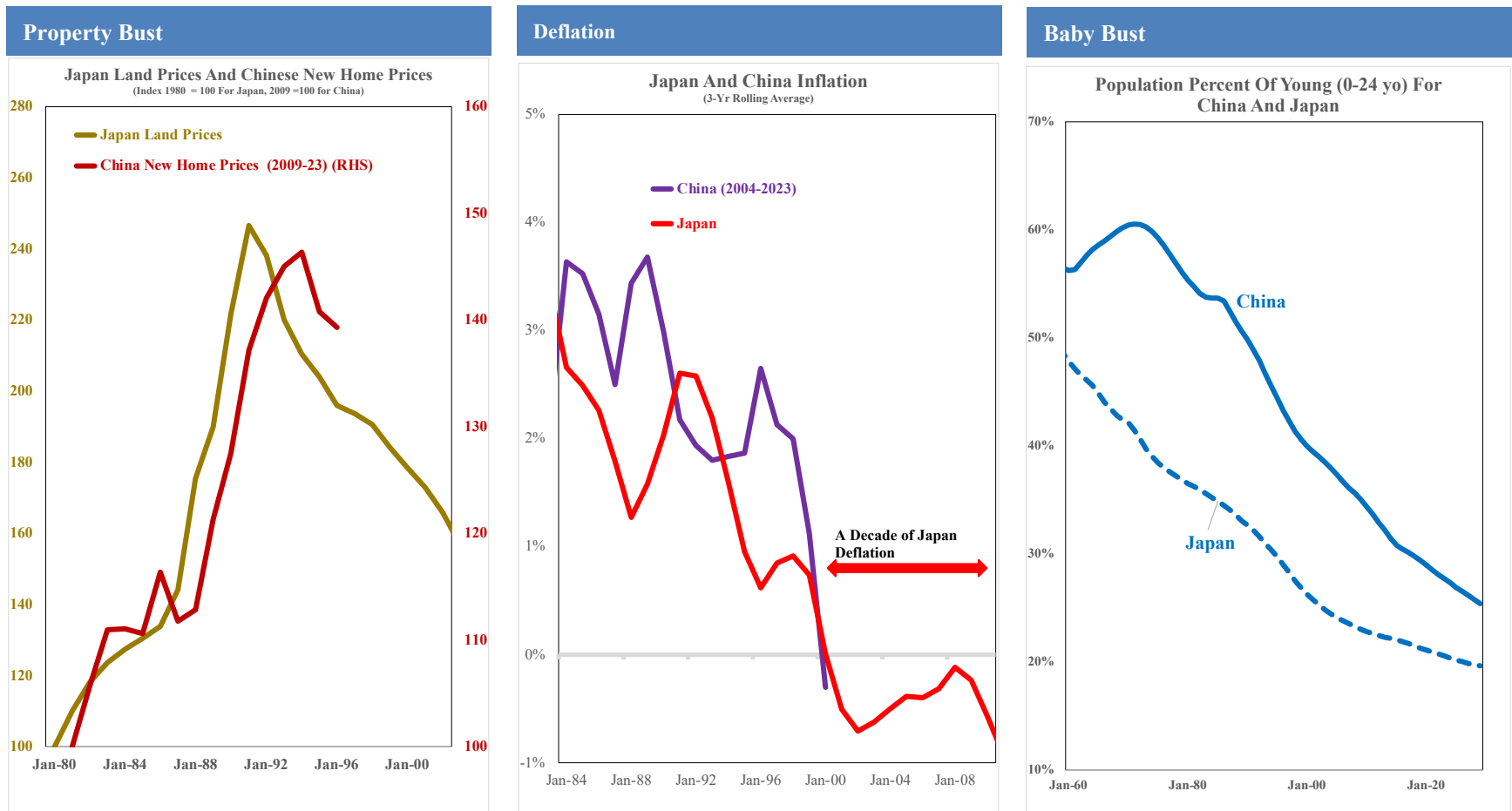
China Becomes Japan

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Step 2: Fundamental Economic Framework

China Is Now Faced With Same Property Bust, Deflation And A Baby Bust As Japan



1. Bloomberg
2. BOJ
3. IMF

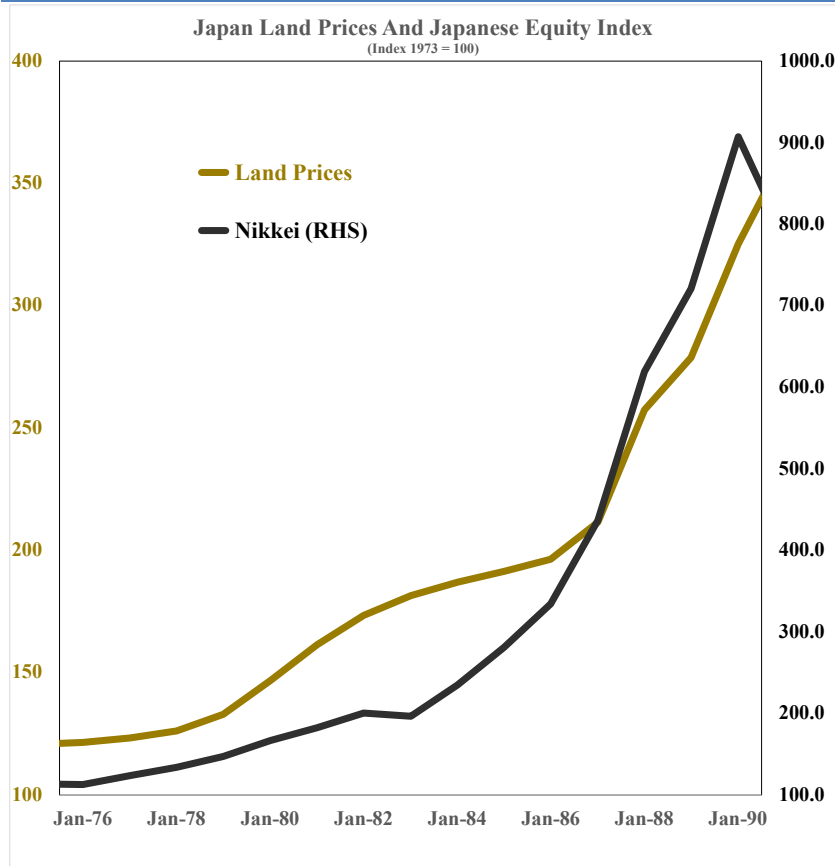
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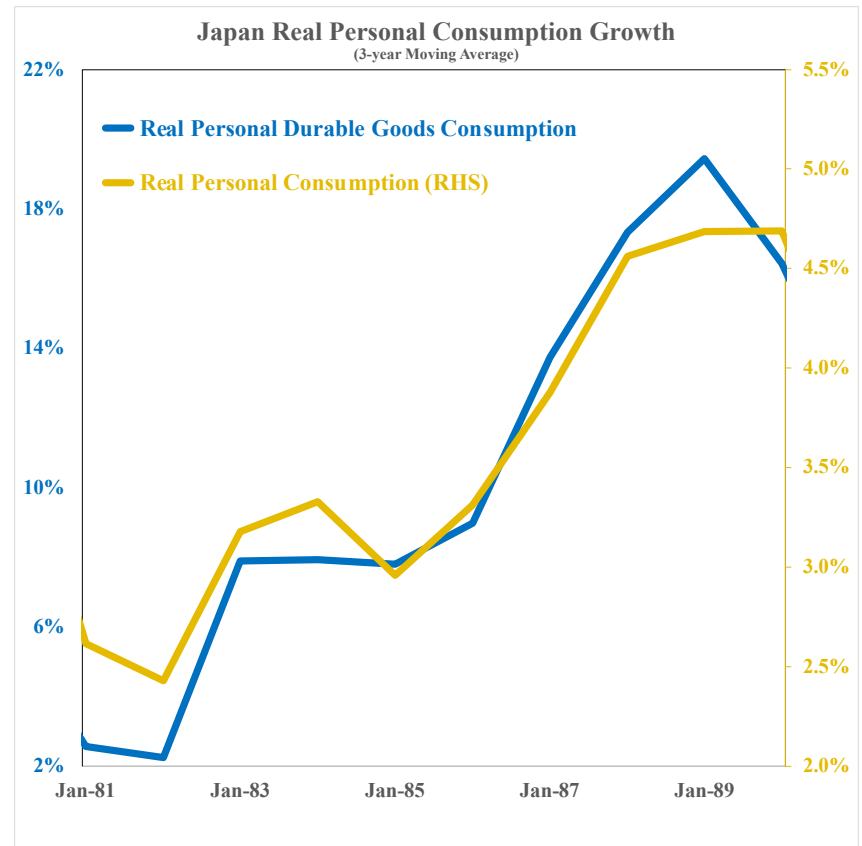
Step 2: Fundamental Economic Framework

Japanese Wealth Growth Led To Unustainable Levels of Consumption

All Assets Followed Land Prices Higher Creating Wealth That



Supported A Doubling In Real Personal Consumption



1. Bloomberg
2. BOJ

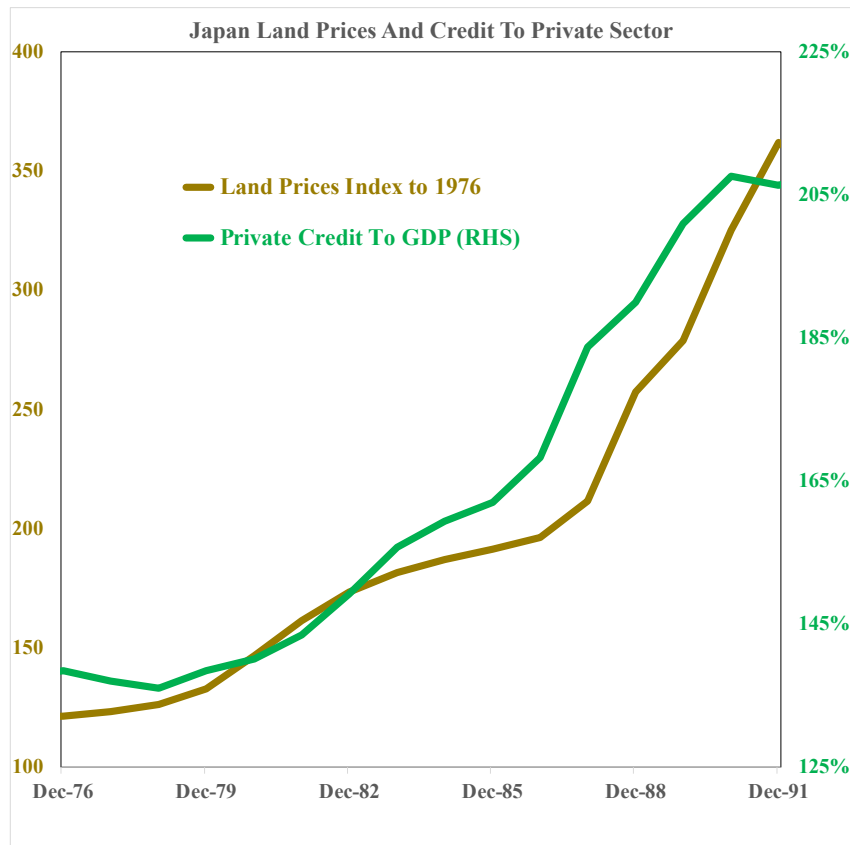
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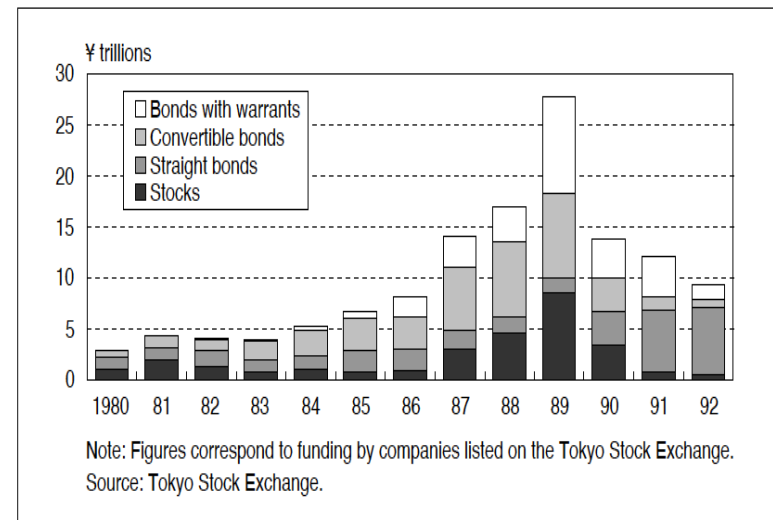
Before China, Japan Had A Property Bubble And Subsequent Bust

Japanese Land Prices Quadrupled Supported By Credit...



Credit Was The Primary Source Of Funding For Capital Markets

Figure 8 Fund-Raising In Capital Markets by the Private Sector



1. Bloomberg
2. BOJ

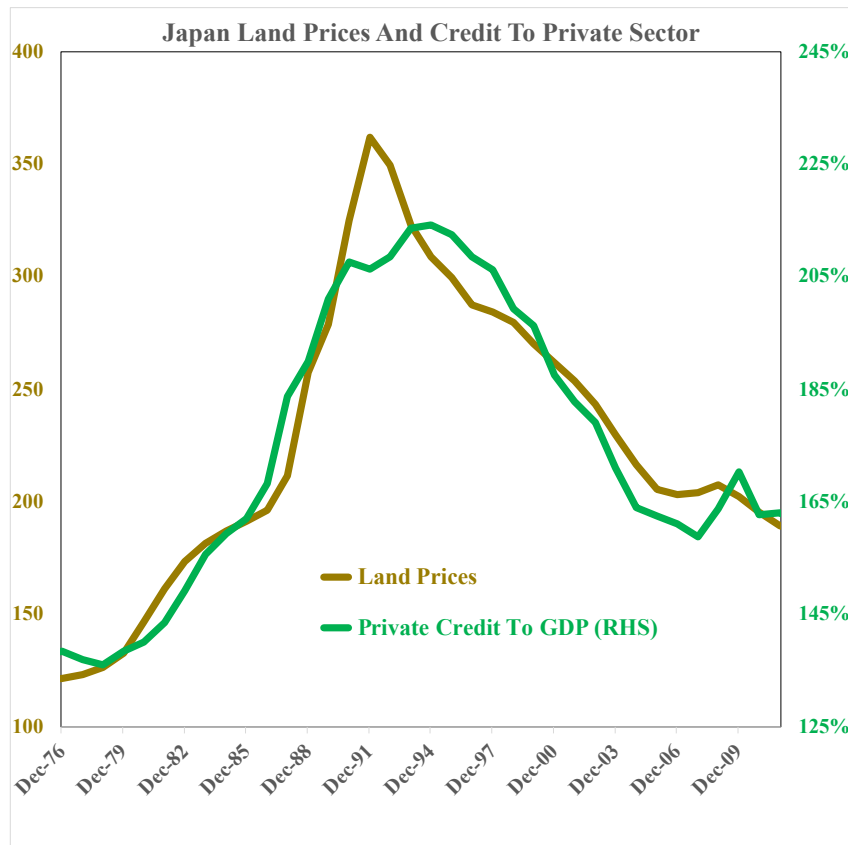
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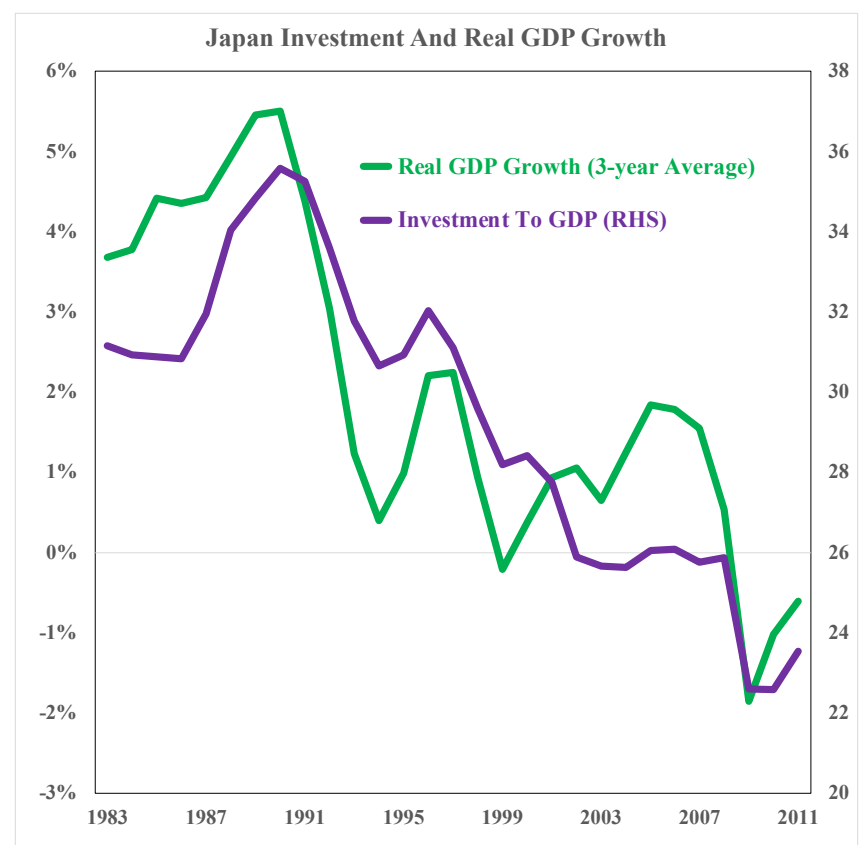
Step 2: Fundamental Economic Framework

The Japanese Economy Collapsed As Credit, Investment, And GDP Fell With Asset Prices

Credit Supply Fell With Asset Price Declines....



Without Credit, Investment Shrank Driving Down GDP



1. Bloomberg
2. BOJ

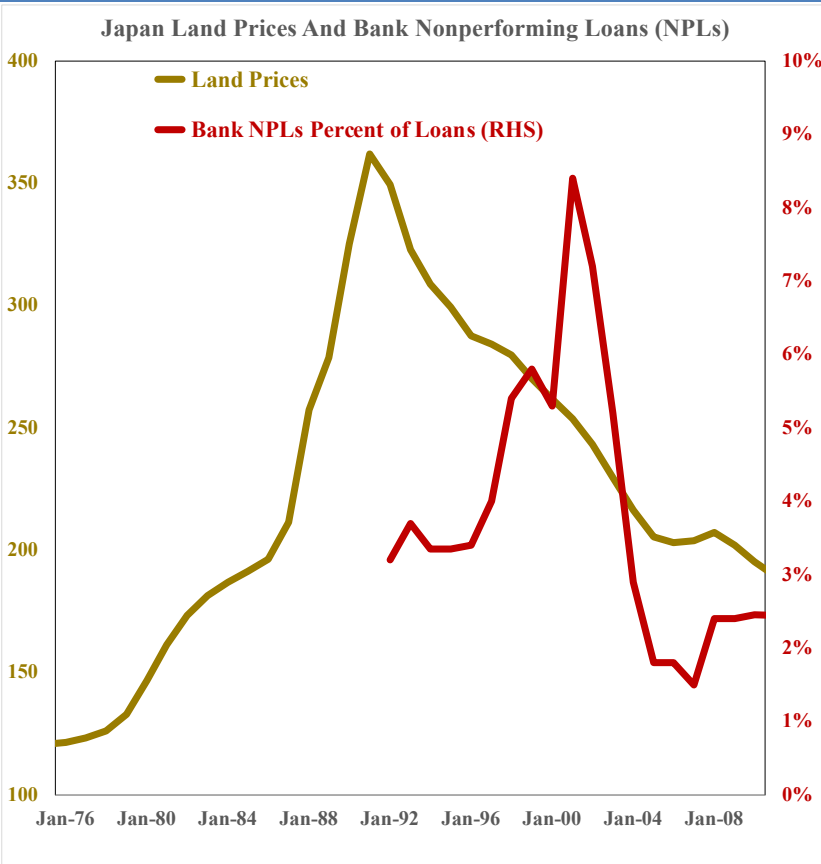
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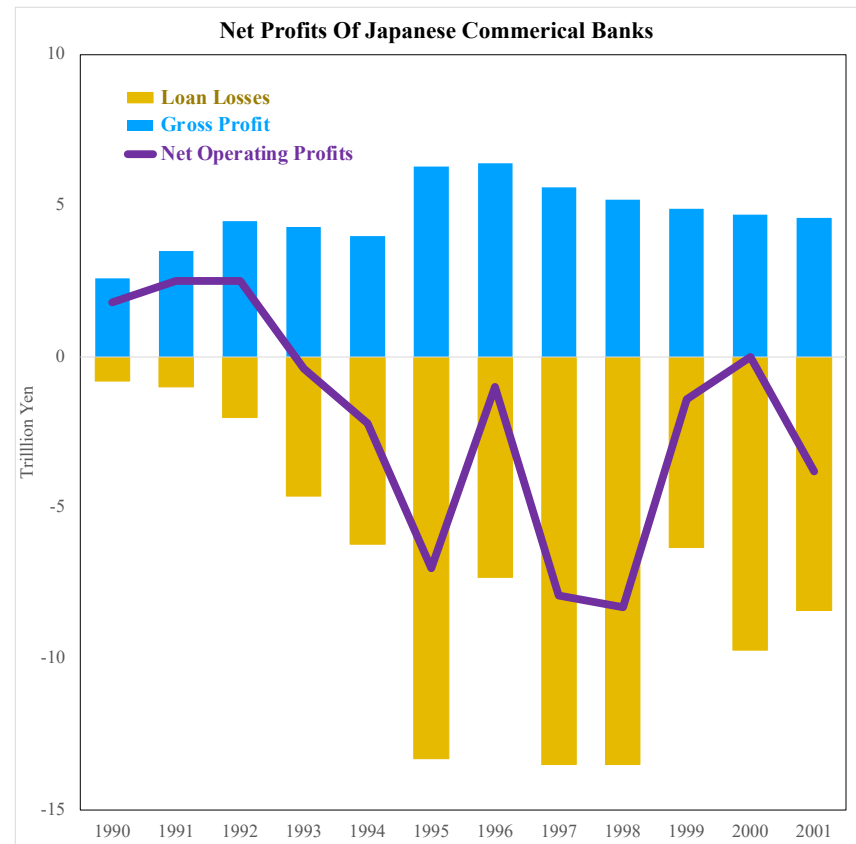
Step 2: Fundamental Economic Framework

The Fall In Asset Prices Led To a Surge In Bank NPLs And Losses--“The Japanese Lost Decade”

Reported NPLs Grew Ultimately And Bank Recognized Bad Loans



Loan Losses Wiped Out 10 Years of Bank Profits



1. Bloomberg
2. BOJ

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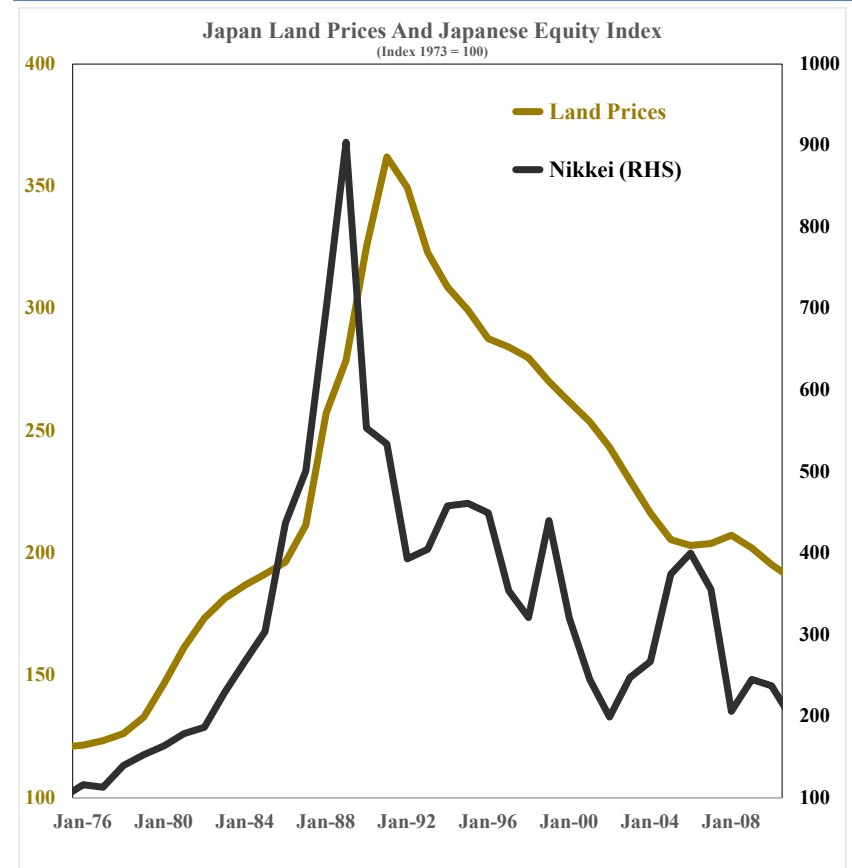
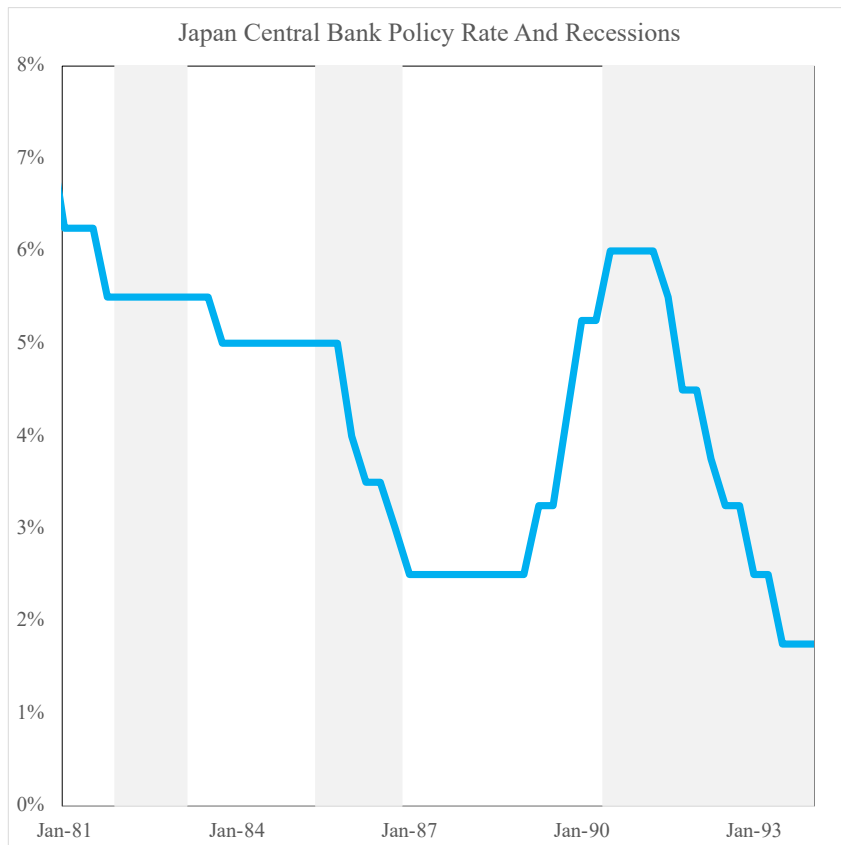
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Step 2: Fundamental Economic Framework

BOJ Popped the Asset Bubble With A Rapid Increase in Rates But BOJ Rate Cuts Could Not Stop the Bust

Policy Rates Reached Pre-Bubble Levels Then Were Cut As Fast,,,

Yet, Land And Asset Prices Continued Their Free Fall



1. Bloomberg
2. BOJ

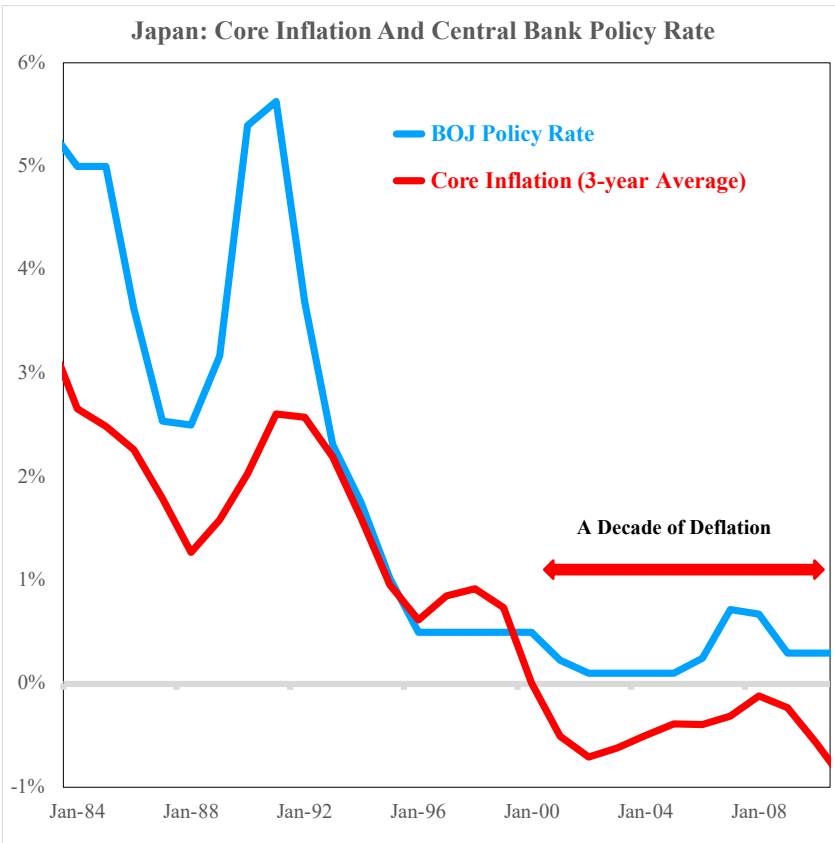
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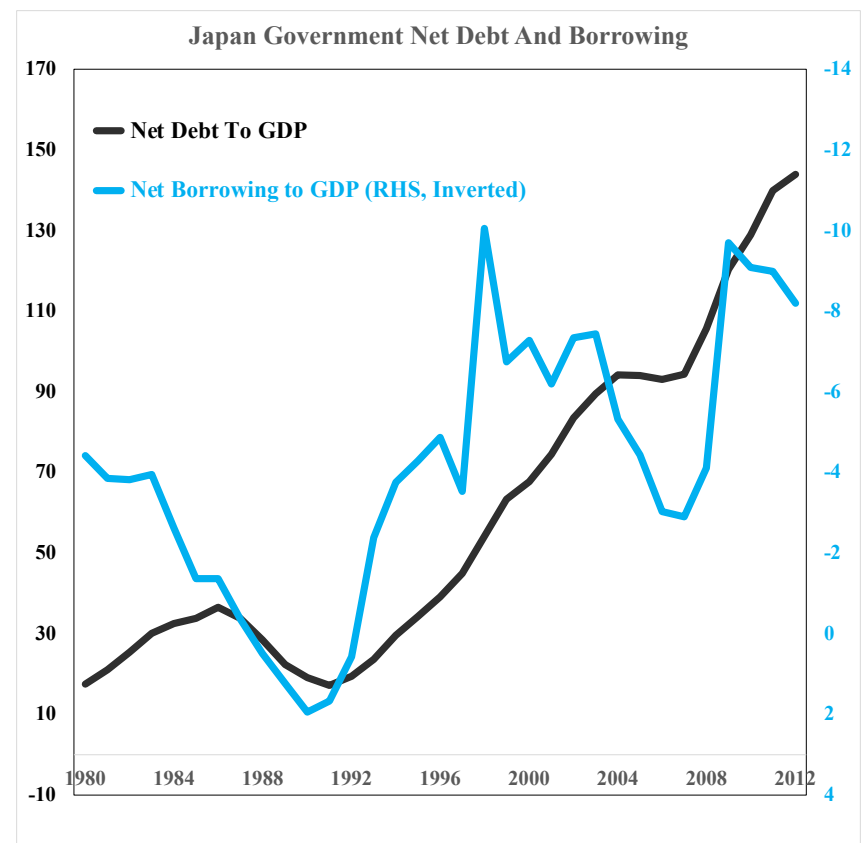
Step 2: Fundamental Economic Framework

China Faced Similar Pressures Which They Fought With Lower Rates And Government Spending

Demand Did Not Rebound Nor Inflation Even With Zero Rates



Government Failed to Push Up Inflation Even With More Spending



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