

# Policy Note



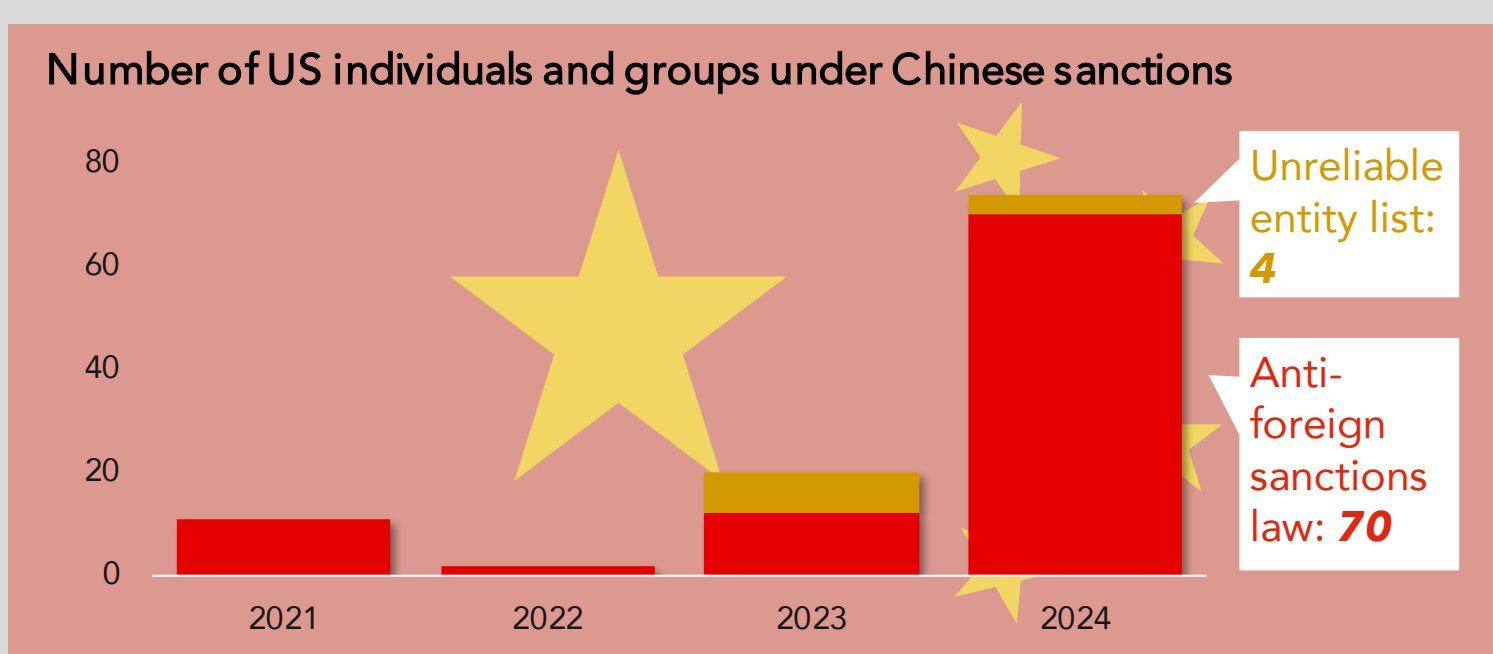
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## China is Ready This Time

China and President Xi Jinping arguably misread President Trump time and again in the 2018-19 trade wars. Not this time. Even with an economy under pressure, China's policy toolkit is formidable and the world's second largest economy has prepared powerful countermeasures to retaliate against US companies and markets. China's response is likely to be measured and surgical, but powerful nonetheless.

- **Fiscal stimulus:** Extensive policy toolkit still available to support the economy. RMB trillions of additional stimulus available, if needed.
- **Currency devaluation:** RMB depreciated 10% in 2018-19 trade war to offset impact of tariffs
- **Targeted tariffs:** comparable retaliation directed toward US agriculture and other sensitive sectors
- **Export controls:** restrictions on key raw materials and rare earths critical to semiconductors and electronics (lithium, gallium, germanium, antimony)
- **Entity list:** expansion of sanctions and "unreliable" entity list directed toward US companies
- **Selling USTs:** at ~\$800 bn, China is the 2nd largest foreign holder of US debt
- **Redirecting trade:** Well underway over last decade. Less exposure to Washington. More outreach to Europe & emerging markets.



## China's Four Red Lines

At the G20 meeting in Lima, Peru in early November, President Xi Jinping signaled to outgoing President Joe Biden that China is willing to improve relations with the US, but is ready for escalation if necessary. Notably, Xi reiterated China's "four red lines" as it relates to US-China policy.

### China's "Four Red Lines"

- 1 Any attempts to undermine the CCP's grip on power
- 2 Any efforts to push China toward Democracy
- 3 Any policies to contain China's economic rise (i.e., tariffs, restrictions)
- 4 Any explicit support or encouragement of Taiwan's independence

"The four red lines must not be challenged. These are the most important guardrails and safety nets for China-US relations."

China's President, Xi Jinping, at the G20 Meeting in Lima, Peru (November, 2024)



## China Saving "Dry Powder" for "Trade War"

As part of the September 24 announcement, the PBoC surprised the market with a broad based package of rate cuts, including its largest ever decrease to its 1-year medium term lending facility interest rate. The PBoC continued its efforts to support the economy by lowering the 1-year loan prime rate by 25 bps in October, more than the market expected and the largest reduction on record.



Much of President Xi's COVID-era policy response targeted the supply side of China's economy. In a sign of renewed economic stress, Xi overcame his reticence with "demand-side" stimulus with a litany of new policy measures announced in late September. Though the market had been expecting even larger policy measures, it appears that Xi may be saving "dry powder" in his policy toolkit to evaluate the outcome of the US election and related trade war risk.

### China's announced policy measures since September 2024

Monetary Easing	Property Market	Capital Markets
<ul style="list-style-type: none"> <li>• <b>7-day reverse repo rate cut by 20bps:</b> Surprised markets that expected smaller, gradual cuts</li> <li>• <b>Reserve requirement ratio (RRR) cut by 0.5%:</b> This move frees up CNY 1 trillion (\$142 billion) in liquidity and could be followed by another 0.25-0.50% cut later this year</li> <li>• <b>1-Year MLF rate cut by 30bps:</b> Further easing to stimulate credit and investment</li> <li>• <b>1-Year &amp; 5-Year loan prime rate cuts by 25bps:</b> Lower interest rate payments on existing loans; reduce the price of new loans</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Lower mortgage rates for existing loans:</b> Aims to provide relief for households, while stimulating household spending and investment</li> <li>• <b>Down payment ratio for second homes cut to 15% from 25%:</b> Aimed at reviving property market activity</li> <li>• <b>Affordable housing initiative:</b> PBoC will fully fund a CNY 300 bn loan initiative to enable SOEs to purchase unsold homes and convert them into affordable housing units</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Debt Swap Plan:</b> CNY 10 trillion (\$1.4 trillion) program to help local government tackle their "hidden debt" (debt accumulated through local gov financing vehicles), including a CNY 6 trillion increase in debt ceiling</li> <li>• <b>CNY 500 bn liquidity support for Chinese stocks:</b> Funds and brokers now have access to PBOC liquidity to buy stocks, signaling strong support for equity markets.</li> <li>• <b>Relending facility:</b> Relending facility of CNY 300 bn (with an interest rate of 1.75%) to guide banks to support listed companies' stock buybacks and purchases.</li> </ul>

Source: (1-7) FT, "China Arms Itself For Potential Trade War With Donald Trump," OpenSanctions, China's Ministry of Foreign Affairs, Ministry of Commerce. The entity list was enacted in 2020 and first applied in Feb 2023, the anti-foreign sanctions law was passed in June 2021 and first used in July in the same year. Bloomberg, Data as of November 18, 2024. MUFG FX Focus, "Review of China Stimulus Plan and Market Implications" (September 27, 2024). Oxford Economics, "PBoC Offers a Full Package of Stimulus Following the Fed's Bold Cut" (September 24, 2024). Capital Economics, China Briefing, "Decoding China's Recent Economic Stimulus Package: What Investors Need to Know."

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"Macro stability isn't everything, but without it, you have nothing."