China Economy

Beijing Attempts to Stabilize Housing Sales

February 20, 2024

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What happened

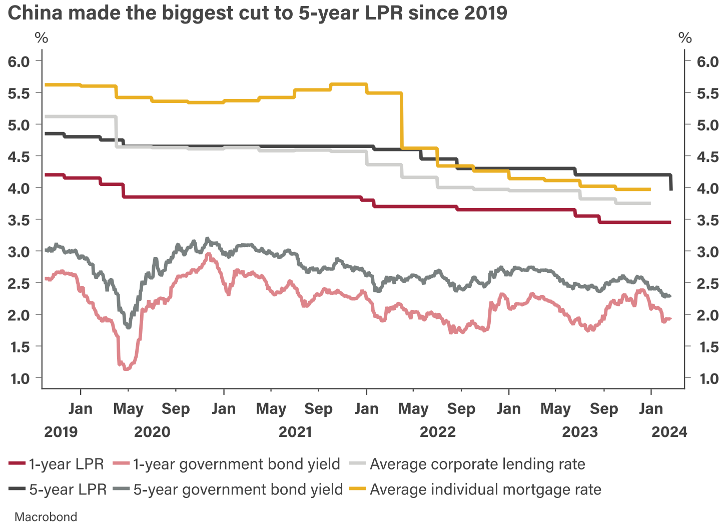
- On 20 February, China's central bank announced 25bp cuts to the five-year loan prime rate (LPR)—the benchmark reference rate for mortgages—from 4.2% to 3.95%. This is the first cut in eight months and the biggest since introduction of the rate in 2019. Meanwhile, the central bank kept the one-year LPR unchanged, which is what most loans in China are based on.

Analysis

- **The move is anticipated**: two days earlier, the central bank's media outlet published an article signaling its intention to guide LPR lower, especially for five-year rate. Since 2019, the article points out, the decline of five-year LPR is 15bp less than that of one-year, while long-term interest rates have fallen more than short-term. Therefore, LPRs need to reflect the narrowed gap between market rates.

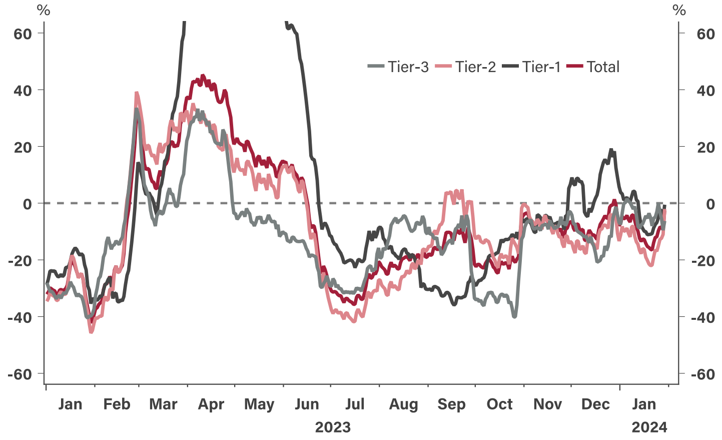
- Indeed, since 2019, average individual mortgage rate has fallen by 1.65ppt and that of corporate lending has fallen by 1.37ppt. In comparison, the five-year LPR has dropped by only 0.65ppt until the latest cut, while the one-year rate has dropped by 0.75ppt. After the cut, the gap of the two LPRs narrowed to 0.5ppt, closer to the difference between government bond yields of similar maturities.

China made the biggest cut to 5-year LPR since 2019



- The article also reasoned the cut as a move to help stabilize market confidence, promote investment and consumption, and support healthy development of the housing market. **This suggest that Beijing is concerned about housing sales this year and is working to mitigate downside risks.** Indeed, high frequency data suggest that China's housing sales by volume was still down 3% in January, worsened during the Chinese New Year holiday, and is set to report very bad yoy growth in 1H 2024 given a high base last year.

Housing sales could look really bad in 1H
Yoy growth of housing sales in selected cities, 30dma



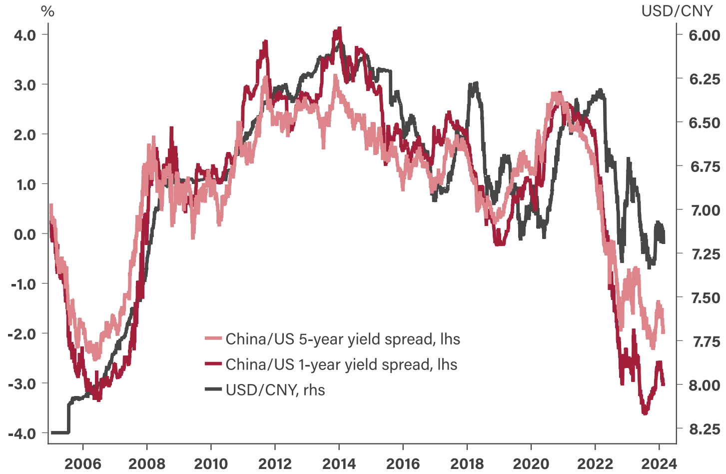
Wind

- **Such targeted interest rate cut can only offer marginal help, however**. After two years of housing market downturn, Chinese households have become much less confident in the future value of houses, especially as the country's population started shrinking. They also have much less room to borrow, with leverage already above 60% and dampened income growth after three years of the pandemic. **In other words, housing sales is likely to lag rather than lead the recovery of China's economy this time.**

- The impact of such cut on investment and consumption appears even more minimal. Most of China's corporate loans are based on one-year LPR, which stayed the same. And rates of most existing mortgages will not be affected until next year.

- More cuts are necessary to provide serious support to the economy, yet China's central bank also faces serious constraint to do so. While the central bank's article is claiming credit in stabilizing China's government bond yield curves, the China/US yield spread is widening again thanks to a stronger-than-expected US economy, especially in the short-end. In such a case, **China has little room to lower one-year LPR without adding downward pressure to RMB until the US Fed starts rate cuts, likely in the summer**.

Yield differential still present significant pressure on RMB



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