



R&R Weekly Column
By Brunello Rosa



China Still Needs to Provide More Fiscal and Monetary Stimulus To Avert Deflation

[In our column](#) last week we discussed the extraordinary performance of financial markets during the past few weeks, and how a determining factor of this performance was the stimulus package introduced by the Chinese authorities in late September. We discussed how Hong Kong's Hang Seng index had gained 30.3% in a month, making up almost the totality of the 33.4% increase it had recorded from January; and how in mainland China the Shanghai stock index had managed to reverse its previous decline: a 20.6% increase in the last month had brought its yearly performance into positive territory, with a 12.5% gain year-to-date up to that point.

In fact, [in September the Chinese authorities implemented a series of stimulative measures](#). On the monetary front, the People's Bank of China (PBOC) introduced several monetary easing measures to inject liquidity into the financial system, support the flagging property market, and encourage lending to businesses. These included cutting the seven-day reverse repo rate by 20 basis points, from 1.7% to 1.5%, and reducing the required reserve ratio (RRR) for banks by 50 basis points. [The RRR cut would lower the weighted average RRR for financial institutions](#) to about 6.6%, while banks that previously implemented a 5% RRR would not be involved in the cut. This RRR cut was expected to inject approximately 1 trillion yuan worth of long-term liquidity into the financial market.

On the fiscal side, Chinese authorities introduced a series of fiscal-easing measures aimed at bolstering the country's slowing economy. Key elements of this package included a significant increase in the debt ceiling, to address the growing local government debts. The government aims to replace hidden local government debts with more transparent liabilities, easing fiscal pressure and freeing up resources for economic development. Additionally, the issuance of 2.3 trillion yuan in special-purpose bonds was announced to support infrastructure projects and stabilize the property market by promoting affordable housing.

In the financial sector, the authorities plan to issue special treasury bonds to recapitalize major state-owned banks, enhancing their capacity to support the real economy. These fiscal moves are complemented by targeted support for vulnerable groups, including increased financial aid for students and one-time subsidies for low-income households to stimulate consumption. These measures are part of a broader strategy to ensure that China meets its 2024 economic growth targets (5% GDP growth) despite challenges in fiscal revenues and rising debt risks.

In spite of this long list of measures, [last week Chinese stocks suffered their worst fall in 27 years](#). On Wednesday the Shanghai stock exchange lost 6.6%, while the Shenzhen composite index tumbled by 8.2%. According to press reports, this fall in equities on Wednesday was caused by the disappointing outcome of the National Development and Reform Commission on Tuesday. On that day, the Commission held a press conference in which officials were expected to reveal the details of the stimulus measures announced in September. Instead, the NDRC officials mostly reiterated September's announcements and commented on the general economic situation, thus disappointing investors.

However, we believe this is likely to be a temporary hiccup. The Chinese economy is ailing, and deflation is biting, driven by an incipient decrease in population. If China does not want to repeat the experience of Japan, where the economy was mired in deflation for almost 30 years, it will need to provide all the needed fiscal stimulus. That is the reason [China's finance minister held a press conference on Saturday to reassure market participants](#) that China is ready to do more spending and borrowing to support banks and the ailing economy. Additionally, we expect another 25 to 50 bps cut in the RRR by the end of the year, depending on market and economic conditions. We expect this "bad news for the economy, good news for the market" situation to prove supportive for equity markets into the year's end.

Our Recent Publications

🌀 [Preview: ECB To Cut Rates in October and Possibly Back-to-Back Until March](#), by Brunello Rosa, Nouriel Roubini and Nato Balavadze, 11 October 2024

🌀 [France on Edge: Can Barnier's Government Survive the Political Gridlock?](#), by Lāsma Kokina, 10 October 2024

🌀 [Vuhledar's Fall, Zelensky's Peace Plan and Its Strategic Consequences](#), by Marco Lucchin, 9 October 2024

🌀 [Germany at a Crossroads: Navigating Economic Stagnation, Energy Dependence, and Global Pressures](#), by Nato Balavadze, 8 October 2024

Looking Ahead

The Week Ahead: Inflation To Fall In EZ And UK; QoQ GDP To Advance In China; ECB To Cut Rates

In the US, in September, retail sales are expected to increase by 0.3% m-o-m (*p*: 0.1%).

In the EZ, in September, headline and core inflation rate are seen easing off to 1.8% y-o-y (*p*: 2.2%) and 2.7% y-o-y (*p*: 2.8%). In October ZEW economic sentiment index is expected to increase to 16.9 (*p*: 9.3). Still in October, industrial production is seen rising to -1.2% y-o-y (*p*: -2.2%). Among the largest EZ economies, in September, headline inflation rate is seen falling to 0.7% y-o-y (*p*: 1.1%) in Italy.

In the UK, in September, headline and core inflation rates are likely to ease off to 1.9% y-o-y (*p*: 2.2%) and 3.5% y-o-y (*p*: 3.6%). In August, unemployment is expected to remain at 4.1%. In September, retail price index is seen rising by 3.1% y-o-y (*p*: 3.5%).

In China, in Q3, GDP growth rate is expected to advance by 4.6% y-o-y (*p*: 4.7%). In September, industrial production is expected to increase by 4.6% y-o-y (*p*: 4.5%).

CBs to cut rates. In the EZ, the ECB is expected to cut its main policy rates by 25 bps, i.e. its *i*) interest rate on the 'main refinancing operations' to 3.40%; *ii*) interest rate on the 'marginal lending facility' to 3.65%; and *iii*) 'deposit facility' to 3.25%.

The Quarter Ahead: China Announces Growth-Boosting Fiscal Measures; Israel Plants To Target Iranian Military

China unveils fiscal stimulus measures to revive growth. China's Finance Minister Lan Fo'an said the government has room to increase the deficit. The finance ministry announced a stimulus package to boost the economy, including increased government debt to aid low-income households, support the property market, and recapitalize state banks, though the size of the package was not disclosed. Economists agree China needs more fiscal support, with estimates ranging from 2 trillion to over 10 trillion yuan.

The US officials say Israel is planning to target Iranian military and energy sites in response to the October 1 attack, but no final decision or timeline has been set. The Israeli military is prepared, and a response could come during Yom Kippur. Iran's attack caused minimal damage in Israel.

Last Week's Review

Real Economy: Headline Inflation Fell In US And Germany; Retail Sales Rose In EZ And UK

In the US, in September, headline inflation rate eased off to 2.4% y-o-y (*c*: 2.3%; *p*: 2.5%), whereas core inflation rate rose to 3.3% y-o-y (*c*: 3.2%; *p*: 3.2%). On a monthly basis, inflation increased by 0.2% (*c*: 0.1%; *p*: 0.2%). In October, Michigan Consumer Sentiment edged down to 68.9 (*c*: 70.8; *p*: 70.1).

In the EZ, in August, retail sales increased by 0.8% y-o-y (*c*: 1.0%; *p*: -0.1%).

Among the largest EZ economies, headline inflation rate cooled off to 1.6% y-o-y (*p*: 1.9%) as expected in Germany.

In the UK, in August, IP is expected rose to -1.6% y-o-y (*c*: -0.5%; *p*: -2.2%).

Financial Markets: Stock Prices Increased; Yields Edged Up; Dollar Increased; Oil And Gold Prices Increased

Market Drivers: Stocks hit record highs boosted by positive surprises at the start of earnings season. NVIDIA's rise boosted growth stocks. Meanwhile, hopes for a half-point rate cut faded after a consumer inflation surprise. Bond yields rose on inflation data. In Europe, stocks gained on hopes of ECB rate cuts and more China stimulus.

Global Equities: Increased w-o-w (MSCI ACWI, +0.6%, to 852.73). The US S&P 500 index rose (+1.1% w-o-w, to 5,815.03). In the EZ, share prices increased (Eurostoxx 50, +1.0% w-o-w, to 5,068.55). In EMs, equity decreased (MSCI EMs, -1.7%, to 1,159.56). Volatility decreased rose marginally to 21.20 (VIX S&P 500, 52w avg.: 14.6; 10y avg.: 18.1).

Fixed Income: w-o-w, the 10-year US Treasury yields rose (+9 bps to 4.07%). The 2-year US Treasury yields edged up (+3 bps to 3.95%). The German 10-year bund yields increased (+6 bps to 2.21%).

FX: w-o-w, the US Dollar Index increased (DXY, +0.4%, to 102.89; EUR/USD -0.4%, to 1.09). In EMs, currencies declined (MSCI EM Currency Index, -0.6% w-o-w, to 1,771.01).

Commodities: w-o-w, oil prices jumped (Brent, +0.9% to 78.76 USD/b). Gold prices increased w-o-w (+0.2% to 2,674.20 USD/Oz).



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Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year

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