CHINA: Easing on housing and Covid signals shift towards pro-growth stance

- Policy changes on zero-Covid and housing suggest that the completion of the Party Congress may have eased policy paralysis that prevented aggressive action to revive economic growth.
- On housing, regulators signaled to banks that property lending is no longer politically incorrect, but it remains unclear how banks will respond to Beijing's call to increase such lending.
- On zero-Covid, changes will soften the impact on growth, but the adjustments look more like fine tuning to make the policy more sustainable than a step towards exiting the policy.

Chinese health authorities announced 20 measures that ease the zero-Covid policy on 11 November. Two days later financial regulators issued 16 measures to boost financing to the housing sector. Both policies clearly reflect policymakers' concern about slowing economic growth, for which "dynamic zero" and the weak housing market are mainly responsible. Political jockeying ahead of the 20th Party Congress apparently caused a degree of policy paralysis that has now eased. Less clear is whether these two policy shifts should be understood as a decisive shift towards a pro-growth policy stance or as incremental fine-tuning. Our view is that the shift on housing is more significant than the oneon zero-Covid.

Housing: a clear pivot

The 16 measures on housing appear to mark a major pivot away from a policy stance defined by President Xi Jinping's slogan that "houses are for living in, not for speculation." Until now, authorities have largely relied on local governments to support the property market, but localities have neither the fiscal resources to support housing developers directly nor the political muscle to force reluctant banks into doing so.

The latest measures instruct commercial banks to increase lending to financially strong developers; to extend repayment terms on soon-to-mature loans and bonds to avoid defaults; and to boost mortgage loans while cutting downpayment rates. The document also suspends the "two red lines" policy imposed in early 2021 that capped banks' total lending to homebuyers and developers.

Finally, the notice instructs two policy banks, China Development Bank and Agricultural Development Bank of China, to provide special purpose loans to support delivery of pre-sold homes. As previously discussed, the failure of cash-strapped developers to deliver pre-sold homes has triggered a collapse in confidence that has discouraged would-be homebuyers. That created a vicious cycle where weak sales reduced banks' willingness to lend to developers, which in turn further reduced their ability to complete pre-sold flats, which led in turn to even weaker sales.

Banks called to service

The document clearly signals to banks that lending for property is no longer politically incorrect. Still, it remains uncertain whether commercial banks, who are rightly concerned about credit risk in the property sector, will answer the call to increase lending. Though most lenders are state-owned, they still respond to market incentives and seek to protect their balance sheets. Over the last year, regulators have previously called for increased lending to the sector, but banks largely ignored these appeals. The latest instructions appear more forceful, but to have a real impact, authorities must pair the formal policy guidelines with the informal "window guidance" and other forms of arm-twisting necessary to recruit banks into what amounts to national service.

Moreover, because the policy shift is low-profile — the 16 measures were not formally announced, though the document has circulated widely — it may not serve to restore homebuyers' confidence to the same extent as a public bailout that directly commits fiscal resources. Indeed, the plan is primarily directed towards containing financial risk from the housing market turmoil, rather than directly boosting housing construction and sales, though the two objectives do overlap to some extent.

Overall, we believe that the latest policy marks a turning point for the housing sector, but that doesn't mean the recovery will be swift. Even less likely is a return to the golden age of property-driven economic growth. Regulators remain concerned about moral hazard among developers and don't want to reverse the progress they have achieved in reducing the economy's addiction to housing. The latest document re-affirms Xi's slogan on speculation. Even in an optimistic scenario for a housing recovery, overall housing completions by floor area are still unlikely ever to surpass the record high reached in 2021.

Zero-Covid: fine-tuning not exit

Over the last week, markets whipsawed in response to what have appeared to be conflicting signals on zero-Covid. On 10 November, the Politburo Standing Committee (PBSC) re-affirmed the leadership's commitment to dynamic zero, but markets rallied strongly a day later in response to the 20 measures, which some interpreted as a move towards phasing out the policy. The measures include eliminating home quarantine requirement for second-degree contacts of infected individuals; narrowing the scope of areas designated as "risky" to include individual buildings rather than whole neighborhoods; reducing quarantine times for inbound international travelers; and discouraging excessive PCR testing requirements.

These measures are significant and should soften the impact of dynamic zero on economic activity and daily life. Nevertheless, rather than a move towards exiting the policy, the 20 measures should be understood as fine tuning designed to make dynamic zero more sustainable. Viewed from that perspective, the apparent contradiction between the PBSC statement and the 20 measures largely dissolves. Indeed, a week earlier the National Health Commission already signaled its intention to "optimize and adjust" the policy a week earlier, even as the commission disappointed those who had bought into market rumors about a decisive exit from dynamic zero.

Covid stress test in progress

The new, looser version of dynamic zero is facing an immediate test. Daily new cases have surged in the last two weeks, reaching nearly 20,000 on 15 November, the highest since the height of the Shanghai lockdown in late April. But even the two centers of the recent outbreak, Guangzhou and Chongqing, have not imposed Shanghai-style citywide lockdowns. The risk is that a looser zero-Covid policy achieves the worst of both worlds by enabling the virus to spread widely, which ultimately forces a re-imposition of the harsh policies from which the 20 measures were designed to provide relief.

As for when authorities will make a more decisive shift away from dynamic zero, our forecast remains that this pivot is unlikely until after the National People's Congress in March. As previously discussed, widespread use of inhalable vaccines and the availability of effective therapeutics are a prerequisite, and the eventual shift will be well telegraphed in advance by a corresponding change in propaganda messaging.

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