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Policy Analysis and Economic Effects of Changes in Financial Asset Prices in China

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Abstract: China is in a period of high-quality development. Therefore, this paper studies the package of incremental policies issued by the People's Bank of China under the background of the great downward pressure of domestic economy and the complex international environment. This paper analyzes the policy goals and economic impact of the price fluctuation in financial assets in China. The release of this package of incremental policies is aimed at stabilizing economic growth, enhancing market confidence and creating jobs. Its key measures include lowering the required reserve ratio and interest rates, supporting the real estate market, and providing financing support for micro, small and medium-sized enterprises. On the positive side, the policy guarantees employment, stimulates consumption, and promotes the recovery of the real estate market. On the challenging side, this includes policy sustainability and insufficient consumer incentives. The package of incremental policies is particularly targeted and will have a significant impact on China's future economic development. However, its sustainability and effectiveness remain questionable, indicating the need for a gradual and orderly implementation.

Keywords: incremental package policy, financial asset prices, economic development.

1. Introduction

Entering into a new era, China's economic development has shifted from high-speed growth to a stage of pursuing high-quality development. At present, China is also facing the major tasks of transforming the mode of development, optimizing the economic structure and changing the growth impetus. Therefore, the implementation of China’s economic policies, particularly monetary policy, will have significant effects on the future trajectory of the economy. However, for a long time, China is facing increasing downward pressure on the economy, coupled with the explosion of risk in the real estate sector, resulting in a lack of confidence in China's economic development, unwillingness to spend and slowing down in various industries.

On the morning of September 24, 2024, the press conference held by The State Council Information Office aimed to announce measures to support monetary policies. Gongsheng Pan, the President of the People's Bank of China, announced three broad measures to facilitate the support. The first is to raise the reserve requirement ratio and reduce interest rates. The policy announced a 0.5% cut in the reserve requirement ratio, releasing around 1 trillion yuan in long-term funds. The policy lowered the seven-day reverse repurchase operation rate, the main policy interest rate, by 0.2%

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from 1.7% to 1.5%, and guided the Loan Prime Rate (LPR) and deposit rates to fall simultaneously, keeping the net interest margin of commercial banks stable. The second is a set of five policies to support the recovery in the real estate market. The policies will guide commercial banks to lower the existing mortgage rate close to that of new loans, which is expected to drop by about 0.5 percentage points on average, and unify the minimum down payment ratio of first and second mortgages at the national level to 15%. Finally, the policy mentioned creating "Securities, Funds and Insurance companies Swap Facility (SFISF)" and "Share Repurchase Special Reloan" to support the stock market. Among them, the SFISF assists eligible securities fund insurance companies in obtaining liquidity from the central bank through asset pledging. The "special refinancing for stock buybacks and additional holdings" encourages banks to extend loans to listed companies and significant shareholders to facilitate stock repurchases and additional holdings [1].

Scholars examining the package of incremental policies introduced by the central bank concentrate on the policies' background and objectives, highlighting their importance for China's economic development by stabilizing growth, boosting market confidence, generating employment, and providing forecasts for future policies. At the same time, it is also pointed out that the key to the implementation of this package of incremental policies is to ensure that all policies and measures are implemented in coordination with each department in order to fully play its due role. The policy promulgated this time is a package of incremental policies with a wide range and far-reaching impact.

Therefore, this paper aims to study the reasons for the promulgation of this package policy and the policy itself by integrating existing academic opinions and recent data and events, and to analyze its impact on China's economy and potential risks and challenges in combination with domestic and foreign situations.

2. Analysis on Policy Objectives

This package of incremental policies is strong and involves many industries and fields, and the central government has invested a lot of money. China launched such a policy at this time for specific reasons and to achieve certain goals.

Since the Reform and Opening-up, China has experienced rapid economic growth for about three decades. According to data from the Trading Economics, especially from 2000 to 2010, China's Gross Domestic Product (GDP) has reached to 6.09 trillion US dollars from 1.21 trillion US dollars, maintaining an average growth rate of 11.33% annually. In 2007, it recorded an astonishing growth rate of 14.23%. Although the GDP has been increasing, its growth rate has been declining year by year since 2011, to only 6.75% in 2018, and China is facing a slowdown in economic growth and downward pressure. In recent years, heightened complexities and challenges in the international landscape, coupled with the significant effects of the COVID-19 epidemic, have intensified the downward pressure on the economy, leading to a recorded rate of -6.9% in the first quarter of 2020 [2]. Even as China's economy begins to recover in the post-pandemic era, the World Economic Outlook of International Monetary Fund (IMF) does not forecast a growth of more than 5% between 2023 and 2024. China needs a strong policy push to give its economy a boost.

2.1. Exchange Rate

Before September 2024, the People's Bank of China had implemented numerous stimulus policies, and at the beginning of this year, it cut the reserve requirement ratio and the LPR. The issuance of this package of incremental policies at this time is due to the exchange rate. China's monetary policy implementation report clearly points out the necessity to "pay close attention to the monetary policy trend of major central banks overseas," especially the Federal Reserve. The US interest rate has been at a high level, and if China cuts interest rates significantly, the Chinese yuan will face great

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depreciation pressure. On September 18, 2024, the Federal Reserve Board declared a 50-basis-points' reduction in the target range for the federal funds rate, set to take effect one week following the introduction of a series of policy measures. Due to the Federal Reserve's cut in interest rates, a large number of dollar funds will flow out of the United States to find the next "foothold". At this time, China promulgated the package of incremental policies not only to attract a large amount of foreign investment into China, but also to make China's original large number of overseas capital return to China.

2.2. Stimulate Domestic Economy

China has stepped up the introduction of the package of incremental policies to promote healthy economic development, which includes the following aspects. The first is to expand domestic demand. On the one hand, by increasing support for specific groups, the government promotes their income growth and enhances their willingness to consume. On the other hand, large-scale equipment renewal and the replacement of consumer goods with old ones are not only conducive to the release of demand potential, but also to promote conservation of energy and carbon reduction, and promote comprehensive green transformation.

The second aspect is to provide more support for enterprises, especially for small, medium and micro enterprises. According to the Office of the United States Trade Representative, small businesses in China account for 70% of new job creation and 58% of the country's GDP is contributed by them. Despite their significant role in driving social and economic development, small businesses have historically faced even more severe financing challenges and have struggled more than larger firms to secure the necessary resources for their operations and growth [3]. Due to the frequent reluctance of financial institutions providing loans to small businesses and the prevalent information asymmetry affecting external lenders, these small enterprises face considerable uncertainty and risks when it comes to borrowing and lending [4]. Additionally, small businesses encounter challenges such as having limited transaction histories, insufficient reputational standing, and a lack of resources for collateral and guarantee mechanisms, all of which further hinder their borrowing capability [5]. Therefore, the policy requires the establishment of a coordination mechanism to facilitate the financing of small and micro enterprises, and guides financial institutions to provide financing support in accordance with market-oriented principles.

The final aspect is to boost the real estate market. In December 2016, the Central Economic Work Conference for the first time clearly pointed out the positioning of "housing does not hype", and has been emphasized every year since. However, Evergrande Real Estate Company still blindly hoarded land, carried out contrary expansion, and invested limited funds into too many "diversified" commercial purposes, which eventually led to a huge gap in the capital chain [6]. The heavy reliance on bank credit for real estate financing has resulted in financial risks primarily being concentrated within commercial banks, which indicates that there are signs of financial risk in financial market related to real estate [7]. Due to the substantial scale of investments in real estate and the significant impact of scale effects, the vulnerability of real estate to financial risks has increased significantly [8]. If there is persistent reluctancy in purchasing properties, the presale pressure of housing enterprises is increased, and the leverage accumulated by taking land in the early stage cannot be transferred to residents in a timely manner; it will lead to the contraction of cash flow structure of real estate enterprises, which will then lead to a debt crisis [9]. The onset of the debt crisis will not only worsen the operational challenges faced by the real estate sector but also instill fear among consumers, leading to a decrease in their purchasing intention. This creates a detrimental cycle. Consequently, the policy emphasizes the importance of lowering the interest rates on existing mortgage loans, increasing the "white list" project loans, and using special bonds to support the revitalization of idle land.

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3. Policy Impact

The introduction and implementation of this package of incremental policies will undoubtedly bring positive development impacts onto China, but at the same time it will face severe challenges, which will also provide references for China's future policy direction.

3.1. Positive Influences

The promulgation of this package of incremental policies has brought many positive impacts to China. The first aspect is to ensure employment. On the one hand, the package of incremental policies has provided support to micro, small and medium-sized enterprises, ensuring the survival of enterprises and stabilizing jobs. On the other hand, due to the large inflow of foreign capital into China, this will boost the Chinese stock market and raise investment in various industries, especially manufacturing. If the struggling enterprises can get enough capital, they will not have to cut jobs and capacity to make ends meet. Better-developed businesses can use the money to expand, and jobs will be created, lowering the unemployment rate.

The second aspect is to stimulate consumption. One of the reasons is that the stock market rallied. The Shanghai Stock Exchange Composite Index rose 29.3 percent from 2,748.9 on September 23rd to 3,554.8 on October 8th, according to data from Trading Economics. Investors benefit from the stock market rally, increasing their assets and thus their willingness to spend.

The next is that the interest rate cut announced in this package of incremental policies reduces the interest rate of Chinese yuan deposited in the bank, brining a large inflow of Chinese yuan into the market, and the probability of trading would also be increased. Then, it is job security. Therefore, people are less worried about their survival, and consumption willingness may also increase. The last reason is the reduction in interest rates on outstanding mortgages. On the one hand, for home buyers, lower interest rates can reduce the financial burden. As the monthly loan amount to be repaid will be reduced, their willingness to spend will be strengthened. On the other hand, this measure can also invigorate the real estate market and draw more participants into it.

3.2. Challenges

Although this package of incremental policies has many positive effects, the potential challenges cannot be ignored. The market and people lack confidence in economic development. The first reason is that in recent decades, China's economy has grown rapidly, and many problems in economic development have not been discovered. Many unknown risks and challenges might have been brought to China, and many economic problems might have appeared for a long time. Such problems can be the real estate bubbles, severe economic downturn, increasing corporate debt burden, local debt defaults, and many others. The second reason is the slowing-down in China's economic that the downward pressure on the economy has become greater. This has led the public to concern about China's economic prospects. The third reason is the declining profitability of Chinese enterprises (especially in traditional manufacturing), and the lack of adequate financial support for emerging industries and enterprises. All of these factors have contributed to a decrease in investor confidence.

The mixture of investors in China's stock market differs from other countries. In developed countries, pension funds and other institutional investors make up 70-80% of total stock market investments, contributing significantly to market stability. In contrast, China's stock market is predominantly driven by retail investors, who represent over 80% of the total trading volume. While individual investors can enhance liquidity, their high trading frequency often leads to excessive speculation and minimizes rational long-term investment. Moreover, the tendency for individual investors to engage in herding behavior further intensifies market volatility [10].

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Whether this package of incremental policies can be sustained is an open question. One example is China's "4-trillion yuan" stimulus package after the Global Financial Crisis (GFC) in 2008. Since then, China's economic growth has experienced slow growth. In order to promote economic recovery and steady and rapid growth, the Chinese government issued ten measures in November of the same year, supporting the adoption of a two-year investment package of 4 trillion yuan. China's economy quickly recovered after the implementation of the policy, and its economic growth rate increased. However, in the absence of further stimulating policies, along with the ending of the two-year plan, the domestic economy slowed down and inflation continued to fall. China's economy grew 7.9% in real terms in 2012, for the first time it has fallen below 8% since 2000, according to the National Bureau of Statistics [11].

4. Conclusion

The promulgation of this package of incremental policies is of a larger scale and intensity in recent years, and it is also a more targeted one, which would have a crucial impact on the direction and outcome of China's future economic development. Through domestic and foreign factors, combined with relevant data and policy documents, this paper analyzes the causes and effects of this package of incremental policies. Domestic factors are related to the accumulated downward pressure onto the economy in the past decade, the outbreak of financial risks in the real estate market, the pressure of survival for small and medium-sized enterprises, and the low willingness of private consumption. The main foreign factor is the Federal Reserve's rate cut.

This incremental policy package would have a predictable impact on China. On the positive side, the policy will ensure people's employment and stimulate the consumption of Chinese residents to some extent, as well as promoting the recovery of the real estate market and the development of small, medium and micro enterprises. However, in the meanwhile, there are potential challenges. On the one hand, the sustainability of the package of incremental policies is worth re-examining. On the other hand, people's willingness to consume under the stimulus of this policy is still insufficient. Therefore, policy makers need to combine the current economic situation in China and the potential economic movements after the implementation of the package of incremental policies, promote stable input and progress, and make appropriate policy adjustments when necessary. In addition, the introduction of this policy is partly related to the interest rate cut by the Federal Reserve, so it is necessary to plan in advance the policy countermeasures when expecting a raise in interest rate, and explore ways to reduce the its influence on China's economy. Simultaneously, it must focus on the growth of micro, small, and medium-sized enterprises and introduce more policies that benefit the people and stimulate people's consumption on the basis of this policy, and the progress should be made to avoid a deluge of strong stimulus policies.

However, there are some limitations in the analysis of this article. This package of incremental policies has just been released, and the positive impact and potential challenges are analyzed in combination with the impact of previously announced policies, lacking support from latest data. Therefore, future studies can take into account the long-term impact of this policy by analyzing the economic evidences after the promulgation of the policies.

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