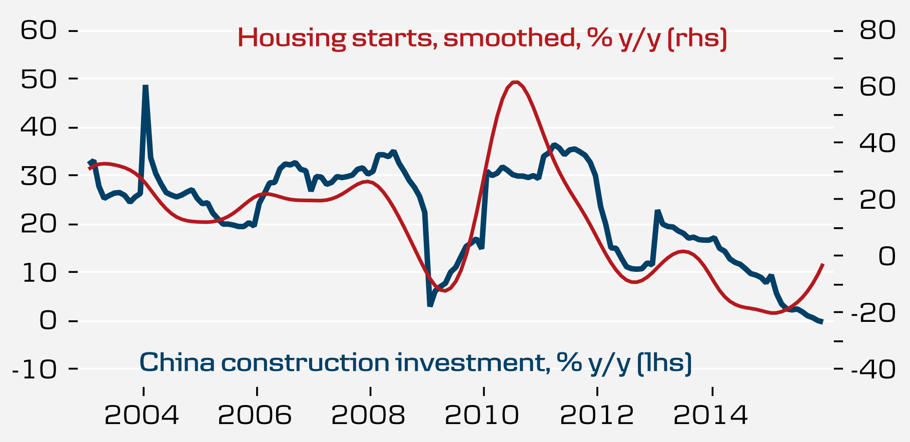
2 February 2016

Flash Comment

China eases further – aimed at ailing construction sector

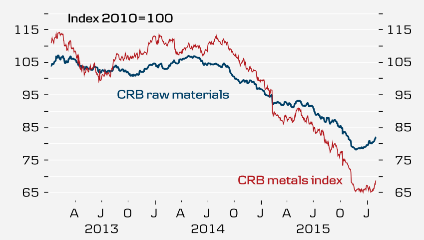
- **China has today eased policy further aiming its ammunition at the ailing construction sector.** It has cut the down payment for first-time buyers from 25% to 20% (in cities without purchase restrictions such as Beijing and Shanghai). The down payment was also reduced last year, by 5 percentage points, in an attempt to support housing.
- A major reason behind the economic challenges in China over the past couple of years has been a significant oversupply of houses, which has pushed the construction sector into a very hard landing following years of construction investment of around 20-30% annually (see chart below). **Hence, in our view, a key to a recovery in China is to deal with this housing oversupply.** Since November 2015, this has been a key policy priority. On 10 November 2015, president Xi Jinping said the government needed to 'draw down the housing inventory'.
- Part of the problem with big overcapacity in the steel, cement and aluminium industry relates to the construction stagnation. Hence, **turning construction is also key for dealing with industry overcapacity and bad loans in these sectors and so on.**
- Chinese home sales picked up in 2015, rising to close to 15%. This has led to a reduction in oversupply but it is still not back to normal. With the new measure, the government aims to speed up the reduction in oversupply by supporting home sales.
- There is a small light at the end of the tunnel in housing starts as seen in the chart below but the y/y rate is still slightly negative.

Construction sector in hard landing over past year – key to China's economic woes



Source: Macrobond Financial

Commodity prices would benefit from Chinese construction recovery

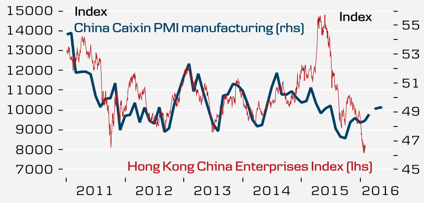


Source: Macrobond Financial

Chief Analyst
Allan von Mehren
+45 45 12 80 55
alvo@danskebank.dk

- Supporting construction and dealing with overcapacity has a **much higher priority in Chinese policymaking than boosting exports. This is another reason we do not see a devaluation as a likely move from China**, as it would also risk destabilising the Chinese economy due to capital outflows and a global currency war. In contrast with cutting interest rates, it also does not risk adding to the depreciation pressure on the CNY.
- A moderate recovery of the construction sector is part of our case for a moderate improvement in the Chinese economy outside services. This should help ease the market fears of a Chinese recession.
- **The hard landing in Chinese construction is a major reason global metal prices have been suppressed.** For example, around 50% of global demand for steel, copper and aluminium came from China before the construction slowdown hit. The base metal markets have reacted positively to the news today, with prices up 1.0-1.5% despite overall negative risk sentiment today.
- A turn in base metal prices **would also help to reduce global deflationary pressures**. Hence this should have a positive impact on global inflation expectations and bond yields.

We look for a moderate recovery in China – should support stocks



Source: Macrobond Financial

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