Cutting interest rates to boost consumption and invest - ment may have limited effect

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China does not have the macro conditions and foundation for sustained interest rate cuts.

ings, which is partly due to deposit rates decline eroding household wealth income and accelerating precautionary savings.

Weaker-than-expected economic indicators since the second quarter of this year reflect the uneven recovery of China's economy. The central bank in June cut the policy interest rate, and the loan prime rate (LPR) was also lowered, a move seen by some market analysts as the beginning of a downward policy interest rate trend. However, would further interest rate cuts effectively stimulate consumption and investment in the short term?

Given that the expectations of economic entities have not substantially improved, risk aversion has increased, and asset prices remain relatively low, we believe that further interest rate cuts have limited effect on stimulating consumption and investment in the short term. In particular, consumption and investment are not isolated from each other; they each promote and complement the other. Simply put, the interest elasticity of demand is not simply a sum of the interest elasticity of consumption and that of investment, but is more likely to have a multiplier effect. Weak household consumption will reduce business investment demand and lead to sluggish employment, incomes, and consumption, ultimately affecting aggregate demand. Considering the current social, economic, and livelihood developments, China does not have the macro conditions and foundation for sustained interest rate cuts.

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Weak private sector financ-
ing supply and demand
makes it difficult to trans-
late financing into effective
investment, thereby reduc-
ing the interest rate elastic-
ity of investment

Despite reasonable and ample liquidity LQ &KLQD·V ÀQDQFLDO PDUNHW DQG VXIÀFLHQW funding supply in commercial banks, as well as the stable growth of the social financing scale and broad money supply since the outbreak of the COVID-19 pandemic, China didn't see a significant increase in investment growth (around 5%).