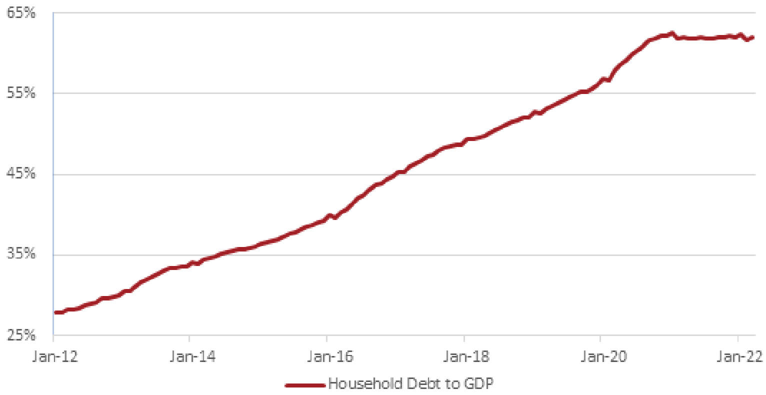
China Bulletin: Market View



China reports disappointing economic data as expected, while the outlook remains pessimistic due to the uncertainty stemming from the lockdown of Shanghai and the disruption of the supply chain. The lockdown, based on our information, has not been operated as efficiently as other parts of China, thus not as effective to contain the spread. While logistics and production have been interrupted and the disorder has lasted about a month to date, the market still awaits a more decisive move to change the course. The impact will very likely continue into 22Q2 and to spread across China, given Shanghai's position as China's most crucial hub of international trade, dragging on export, consumption, as well as fixed asset investment. It adds to the pressure on China's 5.5% growth goal for 2022 but may not quite derail it, only introducing more uncertainty. However, latest economic data does show that policy is stepping up support, and growth momentum may recover quite quickly once the logistics disruption is removed.

Uncertainty surrounding the housing sector continues to build. Though more cities have announced loosening measures, the heavy household debt burden is the obvious Damocles' sword. Policy makers are trying to avoid both a downward spiral and a speculative bubble in the housing market under delicate conditions, a challenging balancing act. To achieve this objective, it may be necessary to allow more participation of state-owned players to offset the withdrawal of private players. This change may mark the fundamental transition of the housing sector, at the risk of over-simplification, from Hong Kong mode to Singapore mode, but we will need to continue monitoring this.

The recent depreciation of CNY against USD is a direct result of the logistics chain being disrupted, although the trend is not as strong as the previous depreciation cycle yet. We had held a more positive view on CNY when the Fed started to accelerate tightening at the beginning of the year, based on China's strong exports and much milder capital outflow. The withdrawal of foreign capital from China is as inevitable as its inflow into China, while domestic conditions are very different now, meaning capital flight will be much less meaningful than a couple of years ago. In the short-term USDCNY may trade around 6.5, a key resistance level, and further movement will depend on the recovery of production and the logistics chain.

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