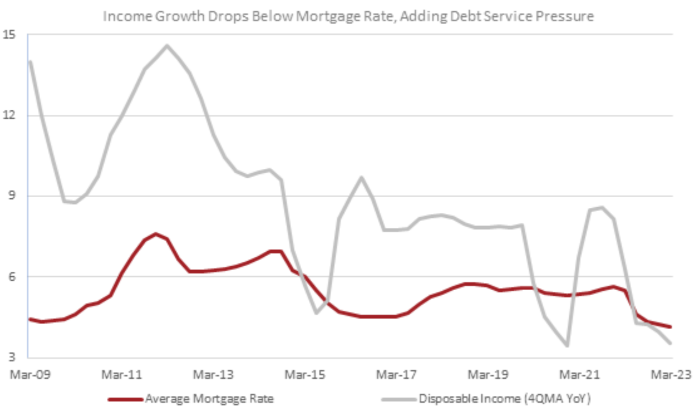
China Bulletin: Market View



Confidence remains weak following the State Council's policy meeting at the end of June, with the much-anticipated adjustment of housing market restrictions in core cities still elusive. This absence has led to the equity market hitting a year-to-date low. In contrast to prevailing expectations of a boost in economic growth through fixed asset investment in the housing sector, we contend that a different approach is required. Given the heavy debt burden on households, sluggish income growth, and pessimistic income outlook, it is critical to implement policy actions that stimulate consumption spending. This could involve lowering household debt service ratios, reversing the downtrend in income growth, or both.

The visit of top officials from the Biden administration and the appointment of a PBoC veteran as the central bank's new governor carry positive signals. While tensions between the US and China persist and are likely to endure in the long term, the focus is expected to remain confined to trade and technology disputes, with the probability of a military confrontation being extremely low. Both countries are seeking avenues for cooperation, particularly in the realm of climate issues. Temporary mitigation is both plausible and meaningful, as it can help prevent a free-fall in risk sentiment. Another concern impacting risk appetite in China's financial market is the potential for a crackdown akin to the 2021 internet regulatory measures. However, the expected appointment of the new central bank governor provides some relief, even in the face of tightening regulations.

The significant depreciation of the Chinese yuan (CNY) versus the US dollar since early May may find support around the USDCNY level of 7.25 following policy intervention through guidance. The acceleration of China's growth momentum in the first quarter of 2023 proved to be a short-term impulse resulting from the reopening of the economy. However, the drag from the property market downturn continues, with weakening domestic and export demand not fully offsetting its impact. In contrast to our previous report on the subject, we now anticipate the negative impact of the housing sector to diminish significantly by the end of 2023 instead of mid-2023. This would raise the possibility of a material pickup in economic activity in 2024. Against the backdrop of strengthening US growth in the second half of 2023 (23H2), the CNY may remain relatively weak until the end of 2023.

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