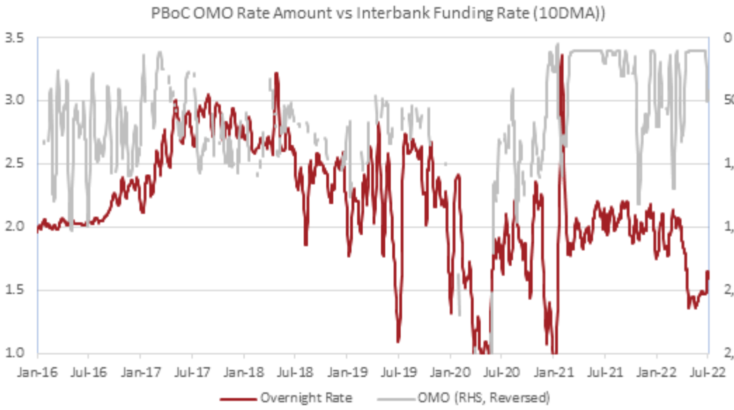
China Bulletin: Market View



Several positive signs have appeared and boosted equity market sentiment in the last fortnight, ranging from Covid containment policy adjustments to fiscal spending on infrastructure. The latest official guidelines for containing the pandemic, published June 30th, reduce the quarantine period from 14 days to 7 days. Additionally, with some adjustments, policy makers are trying to adopt a more precise approach, maintaining the zero-Covid goal but at a lower cost. Thereby reducing the concerns about economic pain from a prolonged containment policy. At the same time, recent rhetoric and anecdotal evidence suggest a more positive attitude from the Finance Ministry towards government debt and infrastructure investment. Thereby reversing its traditional cautious tendency. This change is helping to increase employment and growth momentum, as well as market sentiment.

Furthermore, the PBoC has signalled the end of super accommodative monetary policy, in response to the outbreak of Omicron in several major cities, and the resulting disruption to production.

The central bank has cut open market operations (OMO securities transactions by the central bank to implement monetary policy) to 3 billion CNY from the neutral 10 billion just a week after half year-end. This echoes their change of stance in early 2021, when overnight spikes saw the highest OMO level since 2014. Though inflation may not currently be a major concern for the PBoC, the continuous and accelerating rate hikes by the US Fed may induce more and more depreciation risk in 22H2, giving the PBoC more reason to adjust its monetary stance to neutral.

The Bond market as a result, will see increasing pressure going forward, especially at the short end of the curve. Into July, the interbank market is seeing draining liquidity. Mostly due to a change to the previous overly pessimistic risk sentiment, and secondly the PBoC's most recent OMO adjustment. Rates are also trading marginally higher. Credit spreads remain intact, which may be temporary due to still ample liquidity. However, credit creation recovery is also promising based on evidence from individual bank levels, and historically bond yields tend to edge higher in response. Therefore, a shorter duration high grade credit portfolio is more likely to outperform in current market conditions.

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