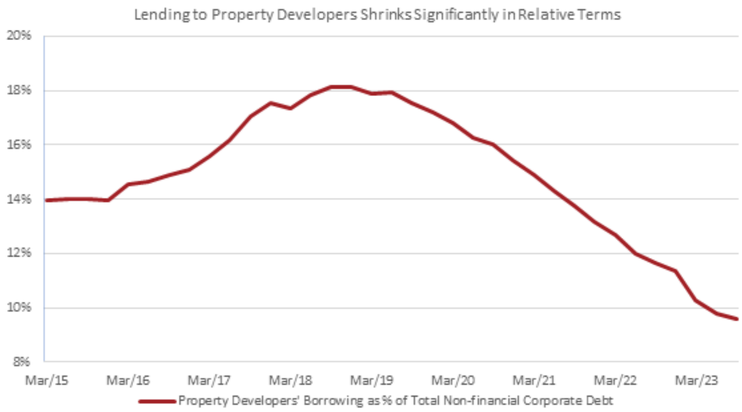
# China Bulletin: Market View




China legislature's annual general meeting, the National People's Congress, last week set a growth target of around 5% and a fiscal balance to GDP ratio of 3%. Additionally, it green-lit an off-budget ultra-long-term special bond program, starting with a hefty 1 trillion CNY infusion in 2024. While this move could push the de facto budget deficit to 3.8% or higher, thanks to the unexpected bond issuance in late 2023, its impact should be tempered, as it primarily seeks to counteract the shrinking expenditure of local governments. With a neutral stance on monetary policy and an emphasis on enhancing policy efficiency and considering a GDP growth of around 4% in 2023, the legislature's economic aspirations appear rather optimistic, even with the easing drag from the real estate sector.

Despite the ongoing contraction in the housing market, China's financial system stands resilient. Lending to property developers, including non-traditional forms of financing, constitutes a relatively small portion of total non-financial corporate debt, significantly reduced from its pre-pandemic peak. The absolute amount stands at about 17.5 trillion CNY, posing very limited risk to banks' 300 trillion CNY balance sheet. However, with factors such as balanced housing supply and demand, a high down payment ratio, and stable employment and income growth, the risk of large-scale mortgage delinquencies remains mitigated. Although developer failures may persist and entail further losses, the strain on the financial system is expected to remain manageable.

In a surprising turn of events, China's long-end interest rates hit historic lows despite improving growth momentum and the introduction of the ultra-long bond program. Market participants, seeking yield in the wake of declining returns associated with the property market and local government financing vehicles (LGFVs), are the primary drivers of this shift, rather than cautious risk sentiment or a bleak growth outlook. However, as the central bank scales back liquidity support and focuses more on structural tools, the front-end of the yield curve is lagging behind the rally, leading to a significant flattening of the curve. While long-term rates may persist at historically low levels, the reduced drag from the housing sector, coupled with generous fiscal support and accelerating personal consumption spending, is poised to bolster market sentiment and buoy short-term rates, further compressing various spreads.

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