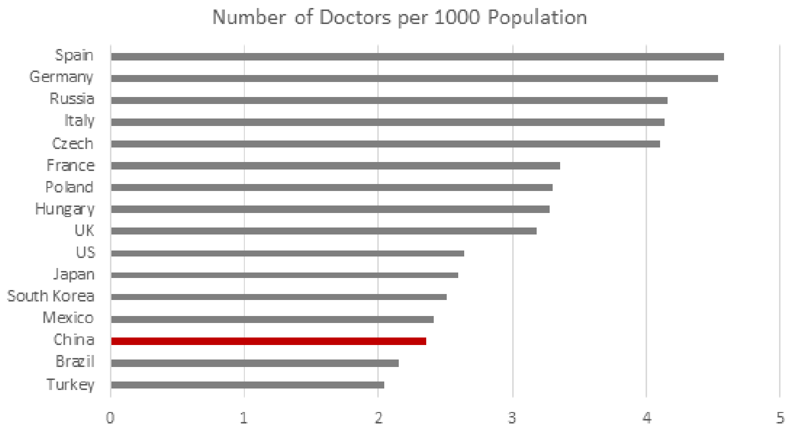
China Bulletin: Market View



The very sudden and radical easing of China's covid policy comes amid skyrocketing cases and mounting pressure, spurring the rally in the equity market and selloff in the bond market. The softening of restrictions was announced in a very rapid manner while preparation, based on our observations, is far from ideal. Going forward, the expectation of an effective reopening may keep equity market sentiment strong in the short-term. However, concern may grow and weigh on sentiment when the likely spike in Covid cases due to relaxed restrictions starts to bite. Depending on the pace and severity of the spike, the equity market may undergo a period of consolidation. If growth momentum recovers post-spike, equities should have a good run in 2023.

The initial spike in infections may be inevitable, yet its impact is highly uncertain. In the past three years, stringent containment measures have given almost the entire population of China effective protection against the pandemic, especially the vulnerable. Consequently the vaccination rate, especially among the elderly, is not as high as other economies during the transition period to reopening. Additionally, the healthcare system in China is more stretched than global peers with a similar age distribution, even pre-pandemic. This will make it more difficult to absorb the initial spike, which may hit major cities as early as mid-January, just before the Chinese New Year.

Growth momentum remains weak at present, as overseas demand continues to slide while domestic demand is yet to pick up. Exports fell 8.7% in the year to November 2022, which is likely to persist as overseas demand is declining. The services sector, accounting for half of total employment, may have to wait until the end of the initial spike to recover meaningfully. The housing sector is seeing more favorable policy after a relentless downturn, and we would maintain our view that the housing sector will stop falling from 23Q1.

The storm in the bond market has generally died down, except for lower-rated credit issues. The vicious cycle following the transformation of wealth management products may still take a few weeks to settle down, while government bonds and the money market rate are highly unlikely to rise amid still sluggish growth momentum. Yet with higher rates we would maintain our cautious view in the medium term, as growth momentum may consolidate after the initial infection spike, and inflation should rise after the country fully reopens.

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