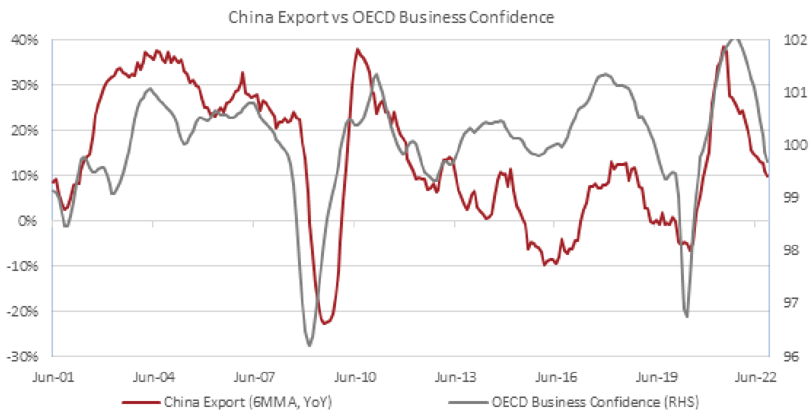
China Bulletin: Market View



The significant loosening of the containment measures announced on Friday is the most substantial normalization effort since the Covid outbreak. A shorter quarantine period, and a narrower range of affected people, show the direction policy will move in. We will keep a close eye on policy development and its impact on the economy.

The surprisingly weak October export growth is a sign of retreating overseas demand that may weigh on China's growth momentum. This disappointing signal, coming earlier than the market expected, and coupled with the ongoing downturn in the housing market, may dampen or delay China's recovery. The loosening of containment and policy support, especially from the fiscal side, is expected to offset the drag from reduced export demand. At least until the housing sector starts to recover, which may happen as early as 23Q1 as mentioned in previous pieces. Policy makers' tolerance for lower economic growth is considerably higher than before, given the lighter pressure from the labor market, the limited policy room left, and the ineffectiveness of traditional stimulus measures.

Equity market sentiment recovered despite the weak economic data, showing resistance approaching historically low valuation levels. The falling inflation levels, especially the year-on-year decrease of China's producer price index, is helping to keep accommodative policies. With the drag from the housing sector abating, China's growth may gain momentum in the year ahead, even if the outlook for the global economy is gloomy. As a result, China may see a combination of tamed inflation, policy tailwind, improved growth momentum and attractive valuations - a very favorable environment for equities.

Another noticeable change should be China's marginally higher and steadily increasing money market rate. Since the end of August, the funding rate has traded gradually higher on a moving average basis, but is still below the policy rate. The funding rate is continuing to trade higher, and credit spreads are widening consequently, amid lackluster economic data. If the money market rate continues to increase, China's bond market may not deliver as remarkable a return over the next year as it has in the last two years. We would stay cautious and recommend a shorter duration portfolio.

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