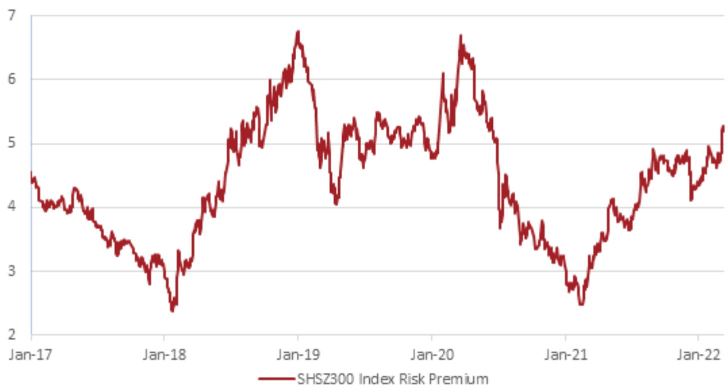
China Bulletin: Market View



The Chinese equity market corrected sharply last week, showing the characteristics of a liquidity shock, triggered by the escalation of geopolitical conflict and inflation concerns. However, we remain optimistic for the rest of the year. The external shock is still confined to sentiment level, and experience shows the most severe losses usually occur at the initial stage when the issue first comes to the market's attention. The inflationary pressure may worsen as oil and other commodity prices linger around current elevated levels. However, it is still far from causing the PBoC to be concerned, as it places more weight on endogenous inflationary pressure. The combination of decent earnings growth and undervalued pricing offers attractive risk adjusted returns for Chinese market equity investors in 2022, however volatility may remain elevated in the near future.

Policy stance is accommodative, though it may not meet market expectations, probably stemming from the difference between the market's bleak and policy makers' more optimistic growth outlook.

Explicit fiscal policy turns out to be weaker than expected, setting China's budget deficit to 2.8%, yet comprehensive fiscal policy is more active with the help of an innovative source of fiscal revenue. PBoC has announced it is delivering profit to its sole shareholder - the Ministry of Finance, to help fiscal spending in certain fields. The profit transfer, traditionally done annually and halted since the breakout of the pandemic, will increase fiscal deposits by around 1 trillion CNY or 0.8% of GDP, and is predicted to increase China's monetary base. The move is neither a MMT experiment nor an immediate expansion of the central bank's balance sheet, just a re-arrangement between items and an increase of the monetary base when the money is spent.

Even considering this PBoC profit transfer, the announced policy combination and the lack of a top-down change of tone towards the housing market has seen some dissatisfaction within capital markets. From our perspective, since housing policy has shifted to a structural framework where restrictions are being lifted in cities with lower housing prices, the necessity to adjust housing policy nationwide is decreasing. The latest financial data shows total long-term household loans decreased month by month in February (first time since 2007), implying pessimism still haunts the housing market. We will keep a close eye on developments in the real estate sector and any implications on the market and the wider economy.

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