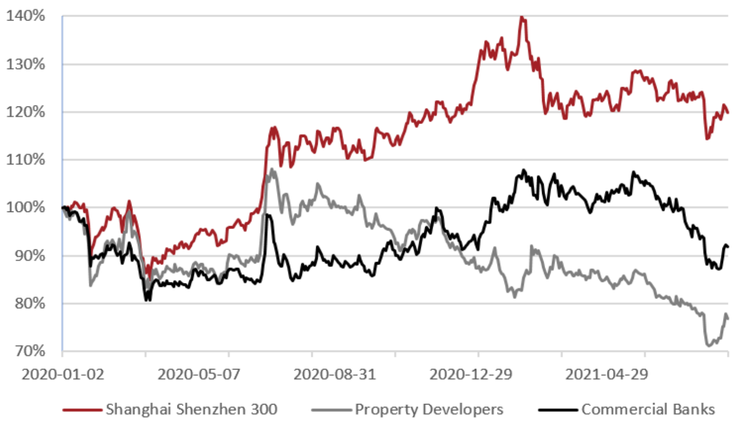
China Bulletin: Market View

<u>Property developers and commercial banks performance vs the market</u>



China's A share market rebounded mildly after the shock of harsh regulation imposed upon China's private tutoring sector. Hard technology companies with solid fundamentals and tailwinds are pursued, most notably new energy names, yet the semiconductor manufacturing supply chain generally retreated. Carbon neutrality policy may be the trigger, but after years of development, solar technology is now able to generate power at a similar cost to traditional fossil fuels. The healthcare sector remains sluggish, as the expansion of centralized procurement may erode the profit of pharmaceutical firms. The market has been pricing in a lower issuance of government bonds than the target set at the beginning of the year, and with it a lower expectation for infrastructure spending. However, following the politburo meeting at the end of July, policy makers indicated that the target should still be met by the beginning of next year. This positive policy gesture reignited expectations of increased spending on infrastructure construction and related names delivered a decent rally. Though it should be noted that this reaction is merely a reversal of overly pessimistic expectations for fiscal policy, rather than the rise in expectation of a more active fiscal expansion.

Another notable issue is the marginal loosening of policy towards property developers. In recent years, various policies have tried to suppress the rise of housing prices while leaving land prices unregulated, which is understandable given local government is the only seller in the land market. Frozen housing prices and unregulated land prices has driven overstretched developers into a very difficult position. This situation is among the main reasons for the under-performance of banks and property developers since 2020. Several nationwide developers defaulted in recent months and more are on the brink of bankruptcy. To avoid possible further risk, policies to contain land prices have been deployed recently, with the real estate and banking sectors as major beneficiaries.

China rates are trading higher after the strong rally following the required reserve ratio cut, and market participants are watching heavily indebted property developers for any sign of contagion. It is probably the darkest time before the dawn, as the fall of several nationwide developers is forcing policy makers to reconsider their policy set, as mentioned above. We remain neutral to the China bond market as a result.

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