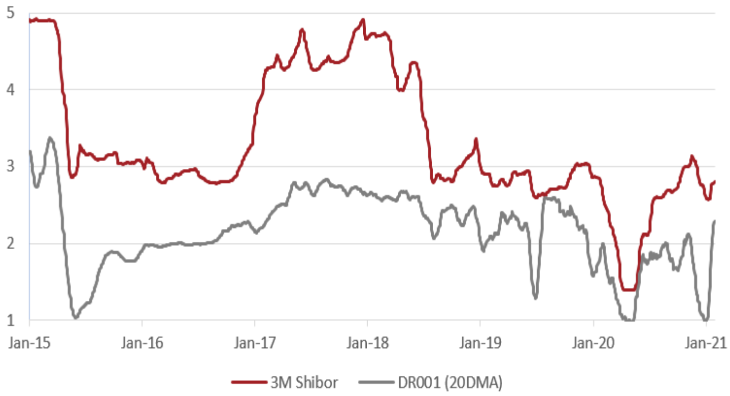
China Bulletin: Market View



China short-term rates: 3-month & overnight

The persistent tight money market conditions caused some concern about a faster-than-expected change of monetary policy, but the central bank appeased the market by suggesting that participants watch the periodic average money market rate as an indicator of monetary policy. The most well-known financing rates, DR001 and 3-month Shibor, which represent overnight and 3 month borrowing rates between banks, remain anchored to the PBoC's policy rate. Yet the tightening is certain, implying pressure on stock prices that are currently extremely over-valued and benefits to commercial banks. Positive developments with regards to the Covid-19 vaccine have also boosted the healthcare sector. Due to Chinese New Year, the equity market closed on 11 Feb and will reopen on 18 Feb, thus it has generally been unexciting as turnover has dropped below 1 trillion RMB per day since the end of Jan.

A notable phenomenon in the onshore market is the increasing concentration of the asset management industry. Total assets under management of the top 45 active equity portfolio managers totals about 2 trillion RMB, which is equivalent to 40% of the total actively managed equity mutual fund assets, or approximately 3% of the A share free float market capitalization. This naturally leads to more concentrated institutional holdings and therefore an increased persistence of market biases. These more concentrated conditions mean it can take longer for investors to see a positive return from their investment in the Chinese equity market.

China's bond market has undergone a rather drastic sell-off recently, with 10Y rates moving 20bps higher than their mid-Jan levels. The sell-off was justified to us as the market had become too optimistic, which pushed bond yields below the levels suggested by their fundamentals. After the sell-off we remain neutral on China's bond market in 21Q1; we hold a moderately positive view about fundamental growth for 2 reasons. Firstly, the policy of encouraging migrant workers to avoid travelling home over the Chinese New Year holiday is expected to effectively reduce the migration by approximately 70-80%, making the suspension of production shorter and less severe than in previous years. Secondly, the latest Covid-19 outbreaks in several provinces are well under control, and the roll-out of vaccines will help to lift the pandemic-induced restrictions, bringing the Chinese economy closer to normality.

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