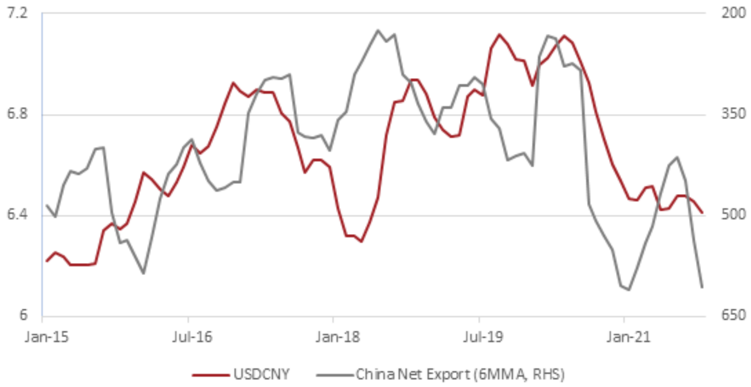
China Bulletin: Market View



The most influential event in China during the last fortnight was the routine yearly Central Economic Work Conference, where the top policy making body - The Central Committee of the ruling party, discusses and lays out economic policies for the upcoming year. The meeting acknowledged the downward pressure on the economy and vowed to step up support through multiple channels. It also reassured the market that policies such as common prosperity and carbon neutrality shall be implemented in a steady manner and in accordance with economic reality, avoiding any shocks to the economy as some policies did this year.

The worrisome income inequality that the common prosperity policy aims to reverse, stems from the oversupply of labor relative to scarce capital stock in developing China. We believe policy makers are patient enough to fine tune the income distribution and avoid any dramatic shock to the current social structure. As for carbon neutrality, carbon emissions cannot be effectively reduced by only disrupting fossil-fuel production. And the policy goal can only be achieved by building a more reliable and cleaner power system, which is one of the focuses for policy makers. In a word, the policy environment will be friendlier next year.

For the equity market, new energy players will still be favored as the policy tailwind and the shift towards a cleaner power system continues. Investment banks, following a more imminent expectation of long-awaited IPO reform, may rally upon improved earnings and rising valuations. Media names, including gaming companies, may have a break eventually as the policy headwind may be about to end, or at least pause. Cyclical names such as steel manufacturers and traditional energy producers, should be treated with more caution, with cyclical forces trending down. Furthermore, the Healthcare sector has been suffering from the threat of sanctions from the US and the domestic pricing reform to make healthcare more affordable. However, the concern is proving to be a false alarm and the sector is expected to continue to benefit from domestic substitution and China’s aging population.

Chinese monetary policy remains accommodative, though if the Fed speeds up tapering then other central banks may follow. This mismatch may persist and lead to certain depreciation pressure on CNY. Since June 2020 we’ve seen a rapid and substantial rally of CNY, not only against USD but also against a basket of currencies measured by the CFETS RMB Index. Despite PBoC’s recent move to hike the required reserve ratio for foreign currency deposits and a more hawkish Fed, CNY remains strong. Yet the strength may wane into 2022, as the most notable driving forces over the last 18 months, strong external demand and relatively tighter monetary conditions, may both abate.

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