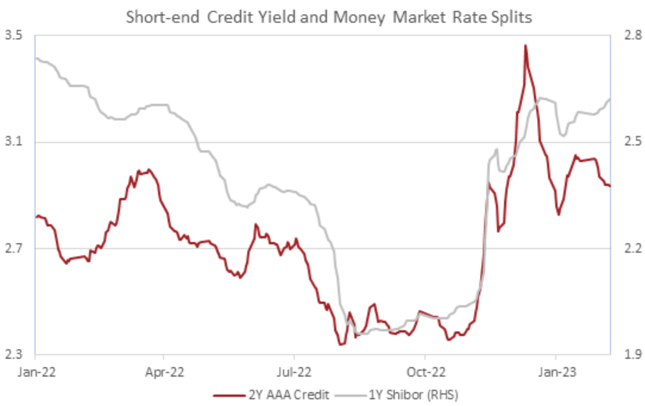
China Bulletin: Market View



Data and behavioral evidence point to a progressing recovery, which may be weaker than previous cycles and market expectation. The financial system, recently challenged by the prolonged housing market downturn, remains largely intact and is able to initiate credit creation, shown by the latest financial data. Corporate credit demand remains buoyant, supported by the tailwinds of structural monetary policy and industrial policy, despite slowing export growth. On the contrary, households are more cautious and less willing to borrow, largely because of the depressed housing market. In recent months, however, the housing market in tier 1 cities, including Beijing and Shanghai, is seeing growing turnover and improving sentiment. A more nationwide improvement, in our view, would still have to wait until mid-2023; only then will the drag from the housing sector reduce to flat.

The money market rate is moving to the policy rate level, and liquidity conditions remain quite tight since Chinese New Year. One explanation for the change is that liquidity is being drained from the interbank bond market by strong credit demand, stemming from restoring business confidence. Though the PBoC maintains a relatively accommodative policy, higher risk sentiment is sufficient to lift the risk free rate to a higher level. The bond market, regardless of tighter liquidity conditions, has been performing resiliently since the massive sell-off at the end of 2022. Short-end is particularly strong, ignoring traditional high correlation with the money market rate, as the market remains wary of stronger-than-expected recovery. Our view on China's bond market is adjusted to neutral from being underweight, and the long end appears more attractive on a risk-reward basis.

It is reasonable to expect additional measures aimed at boosting domestic demand, but in a different way to previously. While infrastructure investment is relied on to cushion downturn pressure, recent government policy comments signal raising income of families with higher marginal consumption propensity, namely lower income families, to encourage household consumption. Policy makers recognise the dilemma concerning the real estate sector; on the one hand preventing its downturn from bringing down the economy and financial system. But on the other hand, also containing the potential housing bubble, as the most significant risk, and policymakers are trying to strike the right balance. Up to now, policy is functioning as expected, and we will continue to monitor the housing market.

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