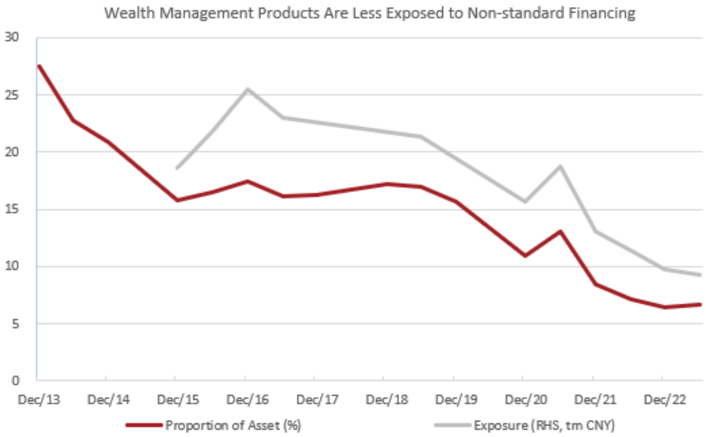
China Bulletin: Market View



Economic data for July continues to underscore a diminishing recovery, signaling China's economic resilience is eroding. Termed the "great slowdown," China's waning growth is predominantly attributed to the declining housing market, evident through contracting housing investment, diminishing local government land revenue, and fragile confidence, as outlined in our previous reports.

The housing sector's trajectory is anticipated to transition from a two-year freefall to a subdued contraction, with robust household balance sheets, controlled financial system exposure, and balanced supply versus demand. Dwelling units per household is estimated to be 1.05-1.09 as of end 2021 according to various sources. Mortgage delinquency rates have stabilized too, versus previous quarters. We expect economic policy to focus on long-term objectives, of safeguarding household financial positions and fostering consumption-driven growth.

The People's Bank of China (PBoC) has taken an unconventional step by reducing the benchmark 7-day lending rate by 10bps and the 1-year rate by 15bps, marking the first adjustment since the formal introduction of the 1-year policy rate. Meanwhile, the much-awaited relaxation of housing policy in tier-1 cities, keenly anticipated by the domestic market, remains absent. This indicates a strong government policy preference for long-term goals, with the imperative of a financially robust household sector. This policy choice will likely trigger short-term economic challenges, reduced confidence levels, local government revenue contractions, and property developer defaults. Such defaults and the resulting distressed assets will likely be the strongest and most persistent headwind to China's economy. Nevertheless, the impact on the financial system is expected to be limited, after years of regulatory action.

Despite numerous property developer failures over the past two years, China's financial sector remains resilient. Undoubtedly, the housing downturn will lead to write-downs and short-term sentiment dips, as shown by the recent equity market sell-off following news of payment defaults from a prominent shadow banking institution. However, over the last five years, China's financial regulators have harmonized rules across various licensed asset management institutions, facilitated the acquisition of struggling commercial banks, introduced the "three red lines" to curtail developer borrowing, and reduced non-standard financing, effectively untangling the once-complicated web of the shadow banking system. Accordingly, while the housing slump may well entail some losses, the overall systemic risk is assessed as low.

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