China Bulletin: Market View

Chinese Consumer and Producer Prices Indices

China's equity market was shocked by the Fed's FOMC and a divergence has appeared among sectors. The correction started on June 16th, before the meeting had taken place, while only a few sectors have bounced back since. Semi-conductor manufacturers, new energy names and software suppliers are obvious winners, though all are now facing overstretched valuations and high expected growth, which could leave their share price quite vulnerable in a tightening monetary environment.

The Healthcare sector is in a stronger position, as its valuations are much more consistent with the industry's expected growth levels. Commercial banks should benefit from a tighter monetary policy, due to better asset quality and wider interest rate margins. Investment banks traded lower due to the less optimistic outlook for the equity market, though their valuations are rather attractive. Cyclical names generally underperformed over the last fortnight, resulting from the crackdown on a skyrocketing commodity market. We remain cautious about the overall equity market in 21H2, yet certain sectors do offer a decent risk reward. We still prefer Commercial banks and the Healthcare sector, and recommend a low volatility portfolio.

China's Producer Price Index rose to 9% in May, close to its all-time highs. This reading doesn't, and shouldn't, cause any alarm as the inflation pressure in China remains transitory and PBoC is unlikely to adjust its stance in response to rising prices. Economic data shows that the recovery continues at a slower pace, yet the surveyed unemployment rate has decreased to its pre-pandemic level, reducing the necessity for a policy reaction if growth slows. In fact, policymakers are consistently withdrawing supportive policies and warning against the shock from tightening external conditions. A slower growth rate in 21Q4 to 22H1 is anticipated by policymakers and a drastic shift in policy is not expected as long as the two most crucial indicators remain robust - namely the surveyed unemployment rate and fixed asset investment growth in the high-end manufacturing sector.

China's bond market remains uneventful, as 10Y CGBs trade sideways within a range of 20bps. The Credit market has been surprisingly tranquil after central and local governments realised the importance of capital market rules. Heavy debt burden is a structural problem, yet it is the ambiguity between government debt and SOE debt that is causing the widespread concern over the problem. A clear path to solve the problem is still absent and worth watching.

2nd Floor | 75 King William Street
London EC4N 7BE
+44 203 617 5260
marketaccess@chinapostglobal.co.uk
www.chinapostglobal.com

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London EC4N 7BE

+44 203 617 5260

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www.chinapostglobal.com

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