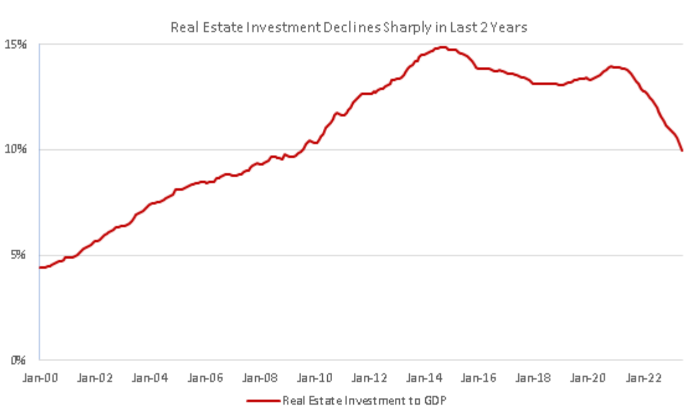
# China Bulletin: Market View




Chinese economic recovery slowed significantly in 23Q2 as the drag from the housing sector continues to weigh on sentiment. Though personal consumption and exports are holding up well, the persistent downturn in the property market acts as a relentless headwind to growth. Along with the heavy household debt burden and sluggish business confidence. To navigate through the very necessary transition, policy initiatives aim to reduce household debt servicing costs by encouraging banks to lower interest rates on existing mortgages. It does cast a certain pressure on the banks' net interest margin but is expected to slow mortgage prepayment, which registered its fastest pace in years due to the widening interest rate difference between existing and newly issued mortgages.

The sell-off of Chinese banks triggered by Goldman Sachs' recent bearish report on the sector has been much more intensive in the offshore market than in the onshore market. In the fortnight following publication of the report, the CSI Banks Index dropped 1.2% while the Hang Seng Mainland Banks Index fell 10%. Similarly, the spreads of offshore-issued capital instruments generally widened while onshore issues saw tighter spreads. The slump is probably overdone since most banks are significantly undervalued even under the quite unrealistic assumptions in the report. From our perspective, the decline of interest rate margins may only be limited as deposit rates are guided down already and may well trend lower. The exposure to the housing sector is worth watching as it marks China's shift away from the growth model of the last 15 years.

Despite its unexpectedly rapid pace, the contraction of the housing sector is very well anticipated. The aim is to trim its influence on economic growth and to reduce the overvaluation in the residential property market. As a very rough but useful measure, the ratio of real estate investment to GDP, in nominal terms and including land purchases up to building completion, reached its peak in 2014 before a large-scale stimulus and consequently a housing market boom. The ratio then saw a mild decline, interrupted by accommodative policies during the pandemic. Into 2021, restrictive policies against the housing sector resumed and induced a severe downturn into the beginning of 2023, coinciding with the opening up of the economy post-pandemic. As of today, the economy's reliance on housing has reduced greatly - as shown by the property investment to GDP ratio returning to its 2009 level. As government policies towards the property market return to neutral, and given a largely healthy household balance sheet, the drag on China's economy from the housing sector is expected to wane.

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