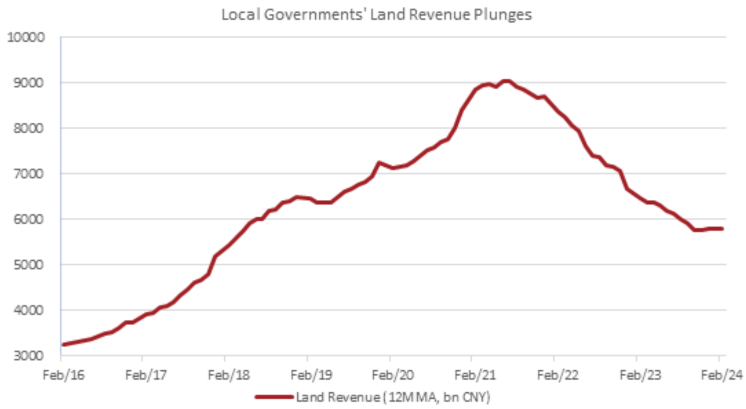
China Bulletin: Market View



China’s inaugural government work report of March 2024 paints a persistent picture of a contracting housing market juxtaposed against resilient industrial production. Despite a bold mortgage rate cut in late February, core cities continue to witness lacklustre home turnover and price dynamics - with both falling short of market expectations. Projections indicate a further decline of 5-10% in housing investment for 2024. With the housing sector’s drag on China’s nominal growth expected to decrease below 1%, compared to the previous year's 1.6%. Consequently, without additional policy intervention, economic growth could edge up to 4.6% in 2024, building on the 4% annual expansion compounded annually witnessed from 2021 to 2023. The deployment of the government’s special bond program aims to offset local governments' dwindling revenue from land sales, signalling the potential conclusion of the structural transformation initiated in 2021.

Given the context of relatively high down payment ratios, limited speculative activity in the housing market, and manageable impacts on the financial system, the special bond program is poised to alleviate economic strains stemming from weaker local governments and reduced construction demand. While infrastructure spending can aid in navigating the transition to much lower reliance on the housing sector, the crux of the challenge lies in bolstering local government revenues. Fiscal data underscores a significant loss in annual land sale revenue, estimated at 3 trillion CNY from its peak, a gap that could be substantially mitigated by the special bond program. It therefore appears that China's growth is bottoming out.

Following the substantial rate cut in February, China has maintained the status quo with unchanged policy rates and benchmark loan rates. Despite assurances from central bank officials regarding policy flexibility, money market rates are being carefully managed to remain above the policy rate. Meanwhile, the yield curve remains flat, although the ultra-long end is experiencing heightened volatility as select market participants hedge their equity exposure with ultra-long rates. While many onshore investors attribute the central bank's pause to cautionary cues from the Federal Reserve, we believe that the People's Bank of China may prioritise shoring up market confidence through rhetorical support rather than resorting to further rate cuts. Thus, even in the event of rate cuts by the Fed mid-year, the PBoC may opt to diverge if domestic growth indicators maintain a positive trajectory.

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