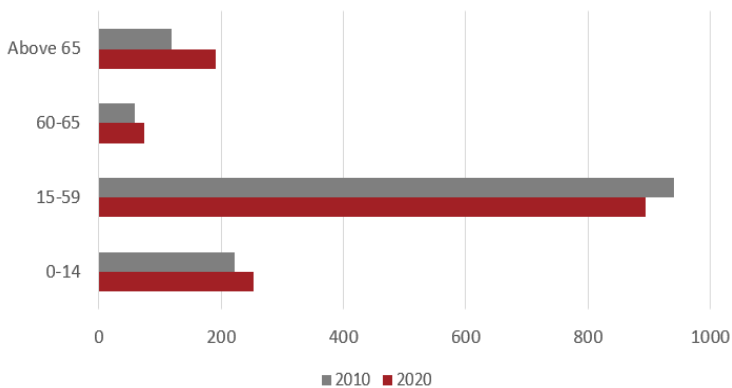


China Bulletin: Market View

Population of China (in millions)



China's economy is still supported by strong external demand, while its domestic sector is also gaining strength. The surveyed unemployment rate and growth of fixed asset investment in the manufacturing sector both remain upbeat and give policy makers more confidence to deal with structural problems. Local government debt is believed to be next on the list. The probable direction will be to end state underwriting of Local Government Financing Vehicles (LGFVs) and local SOEs while honoring existing debt, avoiding any drastic shock to financial markets.

The China A share market advanced generally in the last fortnight, and the deflation trade faded, due to the easing of concerns about rising commodity prices leading to inflation and, eventually, tightening of monetary policy. Though retreating from recent highs, the Cyclical sector is in a much better position compared with 5 years ago and is worth watching for opportunities given the improved dynamics in the sector. The Financial sector is still one of our top picks given the improving asset quality and interest rate margin.

China's bond market has stayed largely immune to inflation concerns as the 10Y rate rallied 7-8 bps. The rally is a natural result of significantly lower than expected government bond issuance in April and May, and the subsequent tamed money market. Additionally, PBoC marginally turned its tone towards accommodative, further promoting market sentiment. The Credit market was boosted by the Politburo's statement to hold local government officials responsible for financial risk to eliminate the moral hazard. In our view, the risk-reward for China bonds is not as attractive as it was in February to March and thus a cautious stance is recommended.

Another notable point is the release of the seventh census report showing that China's working age population, aged 15-59, shrunk 4.8% from 2010 to 2020. It is also expected that China will see its population peak before 2030. The data implies a potential adjustment of policy focus from employment to caring for the elderly. The urbanization rate rose to 63.89% from below 50% in 2010, and is expected to reach 70% in the coming years, hinting at a slowdown of infrastructure construction in the near future.


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