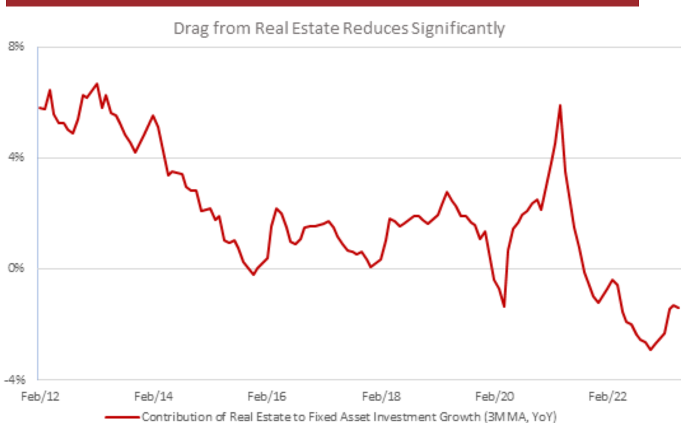
China Bulletin: Market View



The recent rate cut by the People's Bank of China (PBoC) comes as no surprise, considering the escalating concerns over economic growth since May. However, the way in which the PBoC executed this cut is rather unusual compared to its previous actions. Unlike the typical simultaneous adjustment of the daily 7-day policy rate and the monthly adjusted 1-year rate under the current monetary policy regime, the PBoC chose to cut the 7-day policy rate two days before the 1-year rate. This deviation from convention, previously seen only during the sudden onset of the pandemic in early 2020, indicates that policymakers are acknowledging the mounting pressure on growth and business confidence. It suggests that policy rate and benchmark loan rate cuts are being deployed as the initial measures to support the economy.

The most recent financial and economic data paint a broad picture of fragility, further undermining market sentiment. Notably, the unemployment rate among individuals aged 16-24 has risen by approximately 10% compared to pre-pandemic levels, resulting in an increase of 3 million young job seekers, as highlighted by officials. This persistent labour market slack is expected to continue weighing on growth. An expanding service sector driven by robust business confidence could be an effective remedy. However, this may take longer to materialise due to the lingering negative effects of certain previous initiatives, such as tighter regulations on the internet and financial sector, which have yet to see a meaningful reversal.

Another significant but diminishing drag on growth is the downturn of the housing sector. Its negative contribution to fixed asset investment growth has receded from its peak of 3% to the latest figure of 1.3% in just one quarter. Initially, it was projected that this drag would diminish significantly as early as mid-2023, but the worsening economic sentiment may delay the turning point until the second half of 2023 (23H2). The absence of the long-expected substantial loosening of market restrictions in major cities clearly demonstrates policymakers' firm determination to diversify growth and employment away from the real estate sector. Fortunately, the spillover effects on non-financial sectors are well controlled due to supply-side reforms implemented in previous years, which have reduced the capacity in the most affected sectors. However, the impact on the financial system remains contingent on the sustainability of employment and income growth.

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