China Bulletin: Market View

Recent economic data paints a picture of underperformance across multiple sectors, even as the structural shift in the economy advances steadily. China's service sector, however, stands out as a beacon of hope, expanding at an annual rate of 5.1% over the 5-year period from 2019 through 2023, with expectations pointing toward sustained growth. By contrast, fixed asset investment is displaying only moderate growth. The manufacturing sector, especially the higher-end subsectors, has been increasing capital expenditure notably. Surprisingly, industrial production is showing resilience despite cyclical pressures from slowing external demand and the ongoing structural contraction in housing investment. The labour market, however, is sending less optimistic signals, with the jobless rate for individuals aged 25-29, the most vulnerable group, standing at 6.1%. This is well above the overall unemployment rate, highlighting underlying weaknesses.

As emphasised in our previous reports, the most influential theme in China's economy over the past three years has been the contraction of the housing sector. Encouragingly, signs indicate that this trend may be reversing since the third quarter of 2023. Although the housing market is still grappling with weaknesses in sales and investment, the worst may have passed in terms of its impact on overall growth. Estimates suggest that the drag on nominal growth peaked around mid-2023, reaching over 2% on a rolling annual basis, and is anticipated to decline to approximately 1.5% by year-end. Multiple indicators illustrate that investment activity in the housing sector has regressed to levels reminiscent of the period prior to the global financial crisis, when the rapid expansion of the housing sector began. The challenges faced by property developers have placed certain strains on the financial system, particularly impacting shadow lenders such as trust companies and private wealth managers. This, in part, elucidates the fragile confidence in the financial market, as many of these investors bear the brunt of the losses. However, taking a broader view, both households and the financial system remain robust, with limited redundancy in the housing market, creating a more promising foundation for a substantial recovery.

In a surprising move that caught the market off guard, recent monetary policy actions seem to signal a shift toward a more neutral stance. The central bank has maintained its policy rate, and banks have responded with unchanged benchmark loan rates. However, the unexpected reduction in the required reserve ratio added an element of unpredictability. With weaker demand for financing and an already extremely accommodative credit environment, the effectiveness of monetary policy in stimulating growth and prices may not be as pronounced as before. Consequently, liquidity in the interbank market has tightened following the cut, and the yield curve may continue to flatten. This situation is compounded by pervasive weak market sentiment, although there are signs of gradually strengthening growth momentum on the horizon.

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