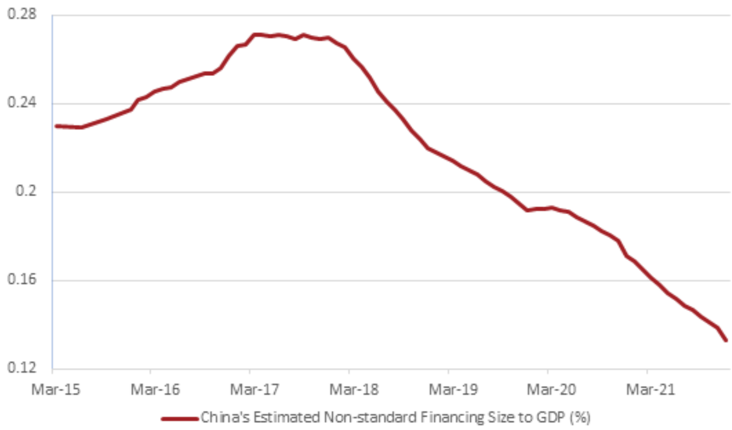
China Bulletin: Market View



The embryonic liquidity crisis in China has eased substantially, after Vice Premier Liu spoke to appease the market and regulators vowed to act to end the jolt. Looking retrospectively, the shock, as well as the amplifying market volatility stemmed at least partially from the ongoing transformation of commercial banks' present 29 trillion CNY in wealth management products, from shadow banking financing channels to legitimate asset management products. Based on our experience, the structural change still has a long way to go and both equity and bond markets may have to embrace higher volatility. However, this temporary headwind is a critical and necessary step to solve the shadow banking problem. Up until now, the process of suppressing shadow banking is progressing successfully, confirming our view that local government financing vehicle debt and the housing market are the two most critical issues for policy makers.

China's economic data for the first two months has surpassed market expectations, especially housing sector data, hinting at a weak recovery ahead. Industrial production and fixed asset investment appear to be recovering from the trough in late 2021, brought down by the collapsing housing sector and coal supply crisis. The decent housing sector data may be misleading, as the price factor could play a larger role when the market is in decline. More easing measures have been introduced across the nation though core cities, with the most stringent restraints, namely Beijing, Shanghai and Shenzhen, remain unchanged. The combination of property developers' rapidly worsening financial position, expensive housing prices, and heavy debt relative to household income, pose a thorny trilemma to policy makers, and the balance among them will remain the most noteworthy factors in monitoring China's economy.

The latest signal shows the US-China confrontation is peaking, though their competition will certainly exist a long way into the future. We would expect the competition in economic, technological, diplomatic and ideological fields to persist and even intensify in certain times, yet the damage to capital markets will be less significant if it is confined within the conventional framework. More quarrels like the recent dispute regarding the audit of the US-listed Chinese companies will emerge in more fields before the necessity to collaborate prevails again.

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