China Bulletin: Market View

The release of April's economic data has raised skepticism among China's onshore market, as the numbers fell short of expectations. Despite that setback, China's overall economic growth has managed to maintain its momentum. The main challenges to the recovery lie in the persistently high youth unemployment rate and the cooling housing market.

In the early stages of a fragile recovery confidence tends to be delicate, leading corporations to exercise caution in expanding their operations, while households remain hesitant to take on loans for home purchases. Nonetheless, various sources indicate that consumer demand remains robust, laying a solid foundation for a rebound in the service sector. As a result, we can anticipate improved employment figures and more positive sentiment among households. It is important to recognise that this process may take longer than previous cycles driven by fixed asset investment, as the economy strives to reduce its reliance on the housing sector.

With fair valuations and an optimistic outlook, the Chinese equity market, particularly the growth style segment, presents a very attractive risk-reward proposition. Despite the ongoing recovery, the market has retraced nearly all its gains of 2023 YTD, and is approaching pre-open-up levels. The Chinext Index, which represents the flagship growth style companies, is currently testing new valuation lows not seen since the end of 2018. Back then, the equity market faced challenges due to credit tightening by the People's Bank of China (PBoC), interest rate hikes by the US Federal Reserve, and escalating trade tensions between China and the US. As we project a more concrete economic recovery and sustained policy support, we anticipate a rise in risk sentiment and equity market valuations, which are currently extremely suppressed. This bodes well for potential outperformance in the equity market in the coming quarters.

While monetary policy is expected to remain supportive and risk sentiment is currently cautious, we maintain a cautious stance on the China bond market. The interbank money market rate has declined significantly in 23Q2 and is trading lower than the PBoC's open market operation rate in May. However, despite economic data falling short of expectations, the yield on the 10-year Chinese Government Bond (CGB) has seen only a modest decrease of 10 basis points, hovering around the 2.7% level. This reflects market participants' doubt regarding the sustainability of a bond rally. Moreover, when we compare the valuation of major equity indices to the CGB rate, we find that equities appear extremely attractive, suggesting the potential for equity outperformance.

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