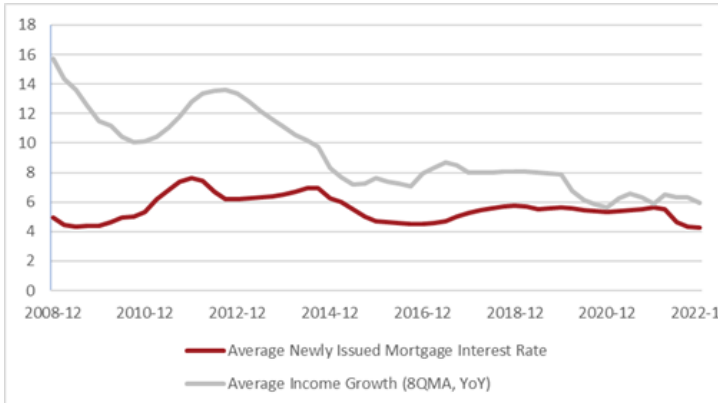


China Bulletin: Market View



China's recovery has gained strength on almost all fronts, despite doubts in onshore markets. Although slowing export demand has had an impact through reduced production and fixed asset investment in export-reliant sectors, the heavily indebted housing sector's structural problems have been alleviated, providing cause for optimism. While decelerating house sales may be seen as evidence of weakening momentum, it is expected to bottom out rather than see sustainable recovery. As such, our base case scenario is a mediocre recovery, though considerably higher than last year's economic activity level.

The household sector, however, still faces a troublesome structural problem with a heavy debt burden, which is expected to improve marginally in the short term. Local government combined debt is even larger; estimated at 77% of GDP, with ~27% in the form of local government bonds and ~50% in financing vehicles. However, the consolidated government debt to GDP ratio is below 100% and the average financing cost is far lower than nominal GDP growth. Conversely, the household sector is confronted with a less-than-ideal situation of sluggish income growth and a steady

mortgage rate, particularly until mid-2023, when the housing market should experience the peak of its downturn. The narrower gap between income growth and mortgage rates discourages household consumption and the buying of homes.

The long-awaited April politburo meeting focused on promoting household income and reducing high youth unemployment rates, with accommodative housing policy remaining unchanged. The recovery in the housing market is the key to watch in the coming months, with policy makers vowing appropriate support to boost domestic demand. Despite cyclical factors weighing on growth, we reiterate our optimism for the recovery in the following quarters.

📍 3rd Floor | 75 King William Street London
EC4N 7BE

☎ +44 203 617 5260

✉ marketaccess@chinapostglobal.co.uk

🌐 www.chinapostglobal.com

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 2nd Floor | 75 King William Street
London EC4N 7BE

 +44 203 617 5260

 marketaccess@chinapostglobal.co.uk

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