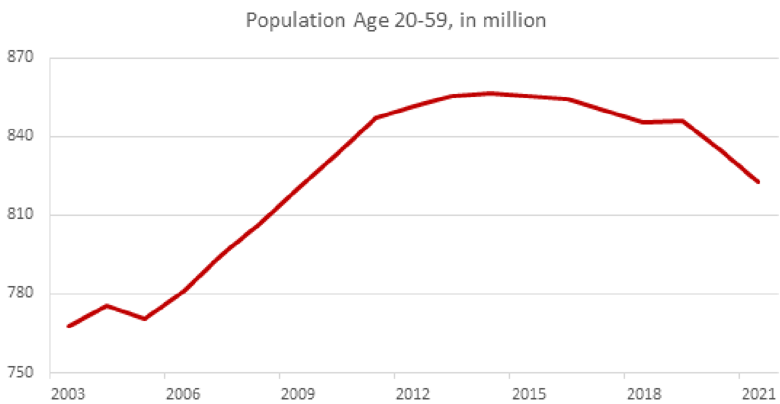
China Bulletin: Market View



While the spread of COVID-19 and the recovery of the infected are both rapid, the recovery of growth momentum may be much slower. Although China has stopped reporting COVID cases and deaths since late December, it has been estimated that more than 80% of Beijing's 21 million people have already been infected since 2020, 50% of whom may get reinfected within weeks of December's reopening. As a result of the low vaccination rate among the elderly, the majority of the population receiving the booster a year or more ago, and the seasonal mass migration before and after the upcoming Chinese New Year, a nationwide initial shock is expected within two months. This is defined as a surge of critical cases and a significantly stretched healthcare system.

After the initial shock, which may take 1-2 months to subside, the economy should proceed to normalise, best case starting from Q2 2023. The drag on China's economy from the housing sector is also expected to abate about the same time, after apparent policy adjustments in late 2022. Consequently, growth momentum should recover meaningfully from Q2 2023, although uncertainty about the impact and the length of the initial shock still exists.

Another notable point will be the development of inflation in China. In the last three decades, China's economy has seen a rapidly expanding manufacturing capacity and oversupply in the labour market. However, China passed the Lewis Turning Point a decade ago and the working age population reached its peak around 2015-2016, pointing towards an increasingly tighter labour market. As the proportion of the population with a college degree or above increased to 15.5% in 2020, from 8.93% in 2010 and 3.6% in 2000, the labour market is now seeing a structural imbalance. Skilled labour is competing for insufficient demand while unskilled labour is no longer in such oversupply. Thus, the impact of COVID may cause some inflationary pressure, especially in the service sector. However, since the working age population is still ample, any inflation increase above the 3% policy target would be a surprise.

2022 was a bumpy year for China's equity market, but the outlook for 2023 is much brighter. Twice in 2022, April and October, valuation indicators of major China equity indices revisited their low point of 2020 when the world was first hit by the pandemic. The equity market's retreat, starting in early 2021, was driven by the government crackdown on certain sectors, the slump in the housing market and expanded COVID containment measures in response to the Omicron variant. All of these factors have improved significantly. Although it may take some time to boost sentiment and growth momentum, we would recommend a more positive stance on China equity.

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