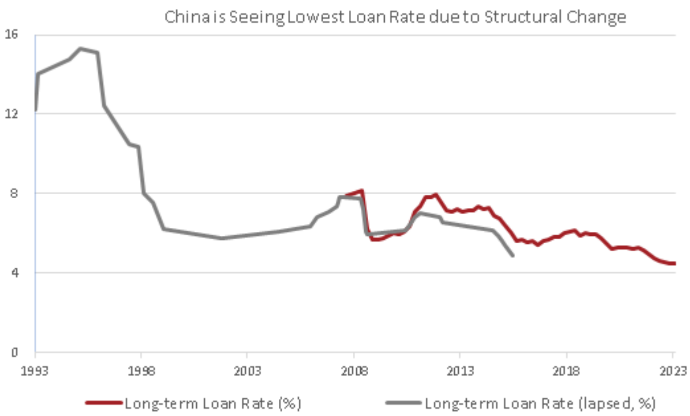
China Bulletin: Market View



After an unprecedented policy rate cut, the benchmark long-term loan rate, 5-year loan prime rate, is surprisingly kept unchanged. The move, as well as the cut to deposit rates, is to balance the negative impact on banks' profitability from the lowering of existing mortgage rates, which is the regulator's latest initiative to reduce debt servicing costs to boost consumption. The cut to mortgage rates, estimated to amount to 1-1.5% of household income, and newly announced additional personal income tax relief should encourage consumption spending. Falling credit demand reflects the weakness of the housing sector rather than the whole economy, as local government, property developers and homebuyers have been the main borrowers in the past decade. More than 10 quarters into the housing sector contraction, the financial system is healthy with limited exposure and household consumption remains resilient, as demonstrated by travel traffic and various spending indicators.

The finally-loosening mortgage rule in the biggest cities marks the adjustment of housing policy from restrictive to neutral, with only a handful of private developers in play. Roughly speaking, the relative size of the housing sector in the Chinese economy is down to the level seen in 2009, when China turned to the property sector for growth following the global financial crisis. The adjustment of housing policy and the gradually improving sentiment in the housing market implies that the end of the housing slump could be within sight, though the down trend may not be reversed so easily. As a result, we would suggest investors take a structural view when assessing China's growth, isolating housing related sectors from other part of the economy.

Withstanding the shock of the housing slump and weak sentiment, the service sector has grown steadily since the post-Covid reopening. Though there is limited timely data depicting this part of the economy due to China's long tradition of placing more weight on the secondary sector, the Purchasing Managers Index (PMI) points to an improving service sector. In addition, retail properties are seeing rising occupancy rates and consumer traffic. Employment and office properties however are lagging the recovery and are influenced by the weakening sentiment. Going forward, the marginally improving housing market; less drag from the housing slump and the upbeat service sector performance will eventually feed into employment and investment, acting as a tailwind to growth momentum.

3rd Floor | 75 King William Street London
EC4N 7BE
+44 203 617 5260
marketaccess@chinapostglobal.co.uk
www.chinapostglobal.com

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

+44 203 617 5260

marketaccess@chinapostglobal.co.uk

www.chinapostglobal.com

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