China Bulletin: Market View

The very upbeat purchasing manager indices reflect the quickly improving business confidence amongst both large and small Chinese enterprises. Various metrics from credit creation to transportation traffic support the view that normalization is quite swift following the initial shock from post-Covid opening-up and that China's recovery is still at an early stage. Though exports have slowed since 22Q4 due to weakening external demand, manufacturing fixed asset investment is more resilient than in previous cycles, probably as a result of the widening de facto embargo. The property sector is being watched closely for improved growth momentum. Although the sector is seeing marginally better sentiment, it is yet to feed into housing investment. We maintain our previous view that the drag from the housing market should fade from mid-2023 onwards.

The equity market is driven by swings in market expectation about the recovery and policy. Although one may argue over the pace of returning to work after the holiday and the extent of retail sales pick-up, plus how much support policy will provide, it is widely recognized that the factors suppressing growth last year are largely removed now and that economic activity will naturally strengthen from here, even in the absence of policy support. Overall policy support is not expected to reduce significantly, and policy makers will be watching economic data closely. All of which translates into an optimistic outlook for the equity market in the coming quarters. We recommend a more active stance on China equity.

There has been much recent debate about debt risk in China's onshore market - with many arguing that the huge amount of debt and the worsening fiscal revenue of local governments poses a significant risk. The challenge has in fact been identified as a "grey rhino" for years; that stockpiled debt of local government financing vehicles (LGFVs) and their implicit guarantee from local governments encourages reckless and unproductive borrowing, crowding out more efficient borrowing. However, in our view, policy measures in recent years have forced LGFVs to make financing decisions on a more market-oriented basis, even if marginally. Additionally, most of LGFV's debt is denominated in local currency and held by domestic investors, leaving the sector less sensitive to external shocks. To sum up, LGFVs' heavy debt burden does impose a risk on the Chinese economy, though more in regards to long-term growth potential than short-term vulnerability.

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