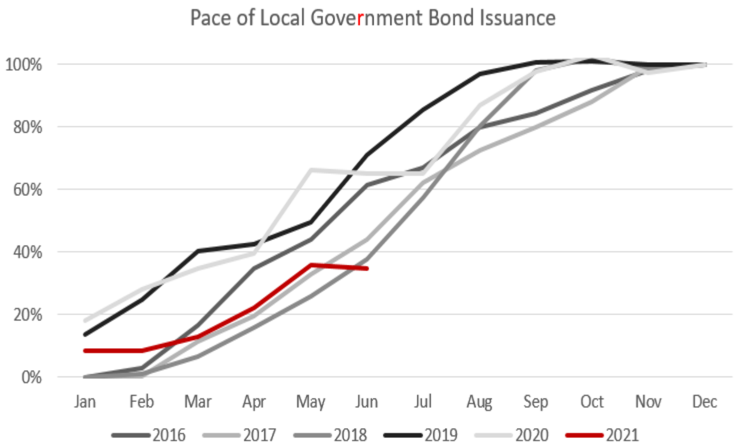
China Bulletin: Market View



The China A share market advanced again over the last fortnight, with the stand-out winners being clean energy names. Concern about an immediate tightening of monetary policy, either from the Fed or PBoC, has faded further. However, policy normalization still seems inevitable and thus we stick to our previous view that China's equity market may suffer from a rise in volatility in 21H2, even though a few sectors may withstand the challenge. The Healthcare sector is likely to be able to maintain its dramatic growth given China's aging population and increased spending by the government and households. Clean energy names, especially those in the electric vehicle supply chain, will continue to enjoy policy tailwinds as major economies are accelerating their efforts to progress into carbon neutral societies. Investment banks are worth being lifted to market weight from underweight in previous reports, since their valuations are attractive again and the reforms in capital markets will continue to boost their business and revenue.

China's rates moved higher while credit spreads tightened marginally. Through May rates traded lower than fundamentals and monetary policy suggested. The money market surprisingly remained tamed, partially due to lower-than-expected issuance of local government bonds. Rates may see an unexpected rise in 21H2 as this combination of factors seems to only be temporary and bond markets may underestimate the strength of the recovery. The Credit market, on the other hand, is less worried about a potential blow from local SOEs or LGFVs after the central government showed signs of establishing discipline among local governments. It is still unclear about how to trim the implicit debt of local government, which is the most remarkable problem, given that shadow banking and excess capacity are less of a problem now. We will keep a close eye on how this develops.

Going forward, the sustainability of external demand remains the primary concern for China's economy. Central banks' attitude is crucial for performance in both equity and bond markets. Should external demand remain strong and the Fed eventually resume talking about policy normalization, both Chinese equity and bond markets will be tested.

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