China Bulletin: Market View

Bond Market

The Onshore Bond market tumbled in anticipation of marginal tightening from PBoC. 10Y CGB yields increased more than 10bps to 3.11% and 5Y bonds saw a more drastic sell-off, with yields rising approx 30bps. The concern is rising due to PBoC's newly invented monetary policy tool to boost credit growth and its latest stance of reducing speculative activities that take advantage of historically low funding costs in money markets. CGB rates are close to their short-term equilibrium level and offer attractive risk-adjusted returns, yet a market consensus is still absent so rates may trade sideways in the coming weeks.

Equity Market

The Equity market is likely to deliver a 3% rally with mid-cap names outperforming large-caps. Market sentiment was helped by decent PMI data and a less than expected escalation of US-China tensions. Sector wise, telecommunication and transportation are favored due to the expectation of higher infrastructure investment by the government, as well as the retail and financial sectors due to the policy of boosting consumption and credit growth. We prefer the financial sector, especially non-banking financial names, as their valuations are fair and they will benefit from ongoing capital market reforms, while banks may be suppressed by the concern of a lower net interest margin.

Economic Data

Economic data is largely absent in the first week of each month, with only PMI delivering an optimistic signal. Caixin PMI, which is more small and medium enterprise oriented, outperformed official PMI. Both show that the economy is on course to recovery and that the most significant shortfall is the external demand, which we expect to continue to be a drag during the rest of 2020. Latest data also shows industrial production and fixed asset investment is back to normal levels at a fairly fast pace. Consumption improved at a slower pace, due to worsening employment and wage growth.

Economic Policy

Policy still remains accommodative, even after the recent adjustment from PBoC. A huge amount of government and policy bank bonds were sold to fund the expected spending on infrastructure investment, and fiscal spending will accelerate in 20H2 after the annual NPC session. Despite the recent shift of monetary policy towards credit growth, its stance still remains accommodative amid the current economic downturn and will avoid any effective hawkish signals before a solid recovery is confirmed.

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