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China: More stimulus on the horizon?

Market update

There is a rising urgency for Chinese policymakers to act more decisively to stabilise consumer and investor confidence given the recent onslaught of bad news. We believe that more property stimulus will take place in this current quarter which should help support the economy in the fourth quarter of the year.

China's weak economic momentum continued into July. Investment, production, and consumption edged lower, while the property sector remained in a down cycle. Investment and production may have been negatively impacted by the deadly floods in Northern China although the actual impact is difficult to estimate. Meanwhile the latest inflation readings showed that China has slipped into deflation. In recent days, missed payments by property developer Country Garden and financial conglomerate Zhongzhi have added to investor concerns.

Jingjing Weng, Research Lead at Eastspring Shanghai believes that more defaults by trust companies cannot be ruled out as long as the property downturn persists. Weaker investor risk appetite may also hurt liquidity for these companies. That said, the trust sector's exposure to the property sector had already slipped to ~5% since the issuance of new asset management regulations in 2018. Those regulations then were a concerted attempt by China's regulators to curtail the shadow banking sector and reduce financial risks. On a positive note, the recent developments within the trust sector may prompt greater policy support as preventing systemic risk is one of the highest priorities for China's policymakers.

Following the government's earlier reluctance to stimulate the economy more aggressively, there appears to be signs of a shift in policy tone. Post the Politburo meeting in July, a statement by policymakers that they would look to adjust and optimise real estate policy had buoyed the real estate sector. Since then, the Chinese central bank has cut the Medium-term Lending Facility rate by 15 bps and the 7-day Open Market Operations rate by 10 bps in August. At the point of writing, there is news that a few Tier-2 cities are planning to lower mortgage down payment requirements. There is rising urgency for policymakers to act more decisively to stabilise consumer and investor confidence given the recent onslaught of bad news and high youth unemployment rate.

According to **Clement Chong, who oversees credit research in Eastspring's Asian Fixed Income team**, stabilising the property sector is key to maintaining investor sentiment and home buyer confidence. Should home buyer confidence fall further, the corresponding declines in sales revenue and operating cash flows, and higher risk aversion among banks could worsen the liquidity conditions for the property sector. The non-performing loan ratio for the banking sector's property-related loans is expected to rise in 2023 and 2024, but Clement believes that China's large national banks have the financial strength to withstand a property sector downturn and they remain systematically important to receive ongoing government support, if required.

Jingjing sees July's economic data weighing on China's third quarter GDP. She expects more property stimulus to take place during the quarter which should help support the economy in the fourth quarter of the year. As such, China should still be able to meet its full year GDP growth target of 5% in 2023. As inventories get depleted and the downward trajectory for inflation bottoms out, Jingjing is of the view that a restocking cycle within the manufacturing sector will help drive earnings in the second half of the year. The decline in China's producer prices had narrowed in July and the base effect appears favourable in the coming months. Meanwhile, China's core consumer price reading was relatively strong in July. Jingjing believes that readings could turn positive for China's Consumer Price Index in August and for producer prices early next year.

The China A share market is currently trading around its lows for the year. Given investors' bearishness, the market is likely to be highly sensitive to any positive newsflow. Going forward, the Chinese government's desire to rebalance the Chinese economy as well as elevated geopolitical tensions from China's growing economic influence will continue to drive macro and market volatility. Investors will need to be nimbler in the short term while staying focused on strategic industries that help the Chinese government achieve its desired "security" in supply chains, energy, technology and information in the long term. Eastspring's China A-share equity team continues to be positive on the high-end manufacturing industry as well as new economy industries such as new energy, consumer, medical services, technology and cyber security.

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