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MACRO MORNING BRIEFING

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China Equities Get Vote Of Confidence

China's equity markets have had a solid recovery after suffering a rout in early February. The Shanghai Composite has rebounded from a loss of nearly 10% this year to a gain of 3.5% as of Wednesday, outperforming the sub-1% year-to-date gain in MSCI Asia ex-Japan.

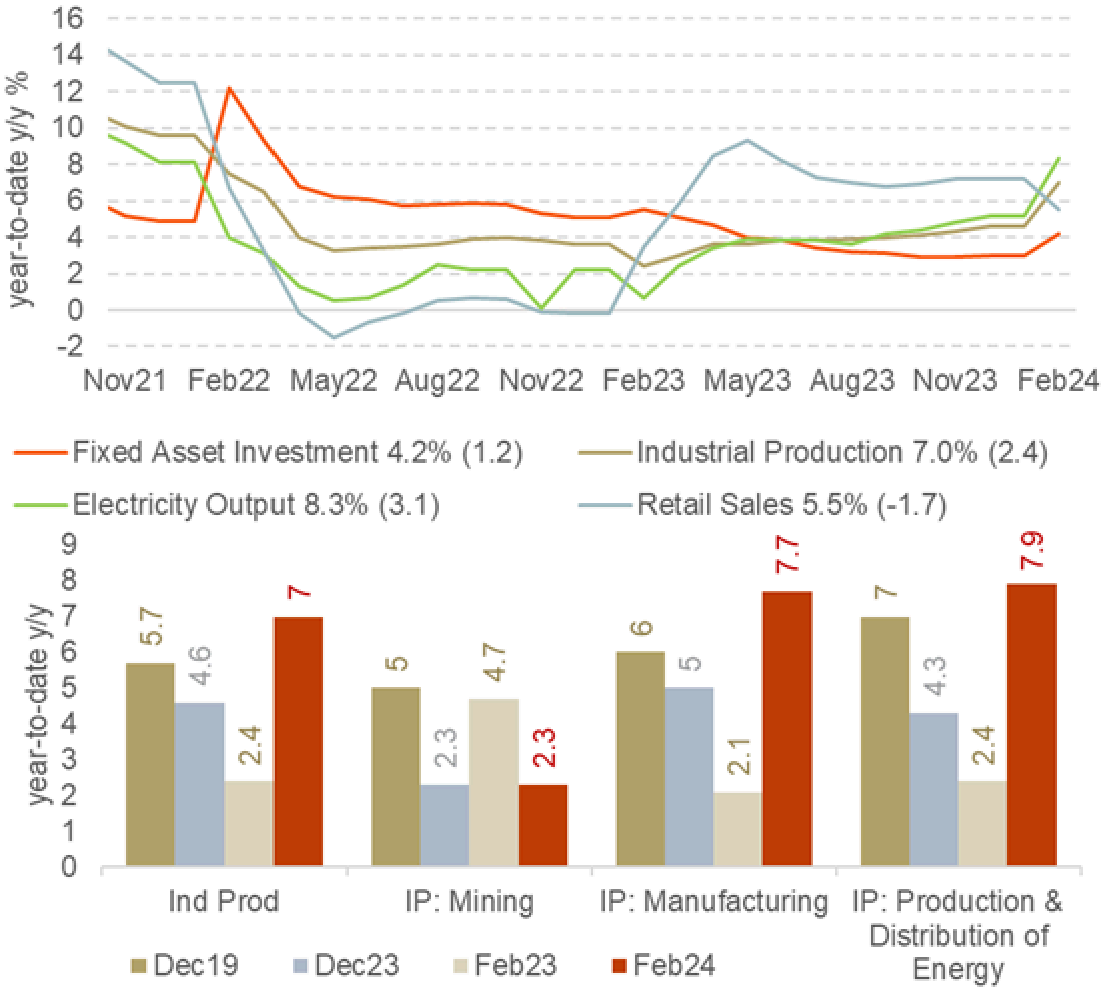
Northbound stock-connect, a proxy for foreign demand, posted net inflows of CNY 61bn in February, the largest monthly inflows since CNY 141bn in January 2023 amid COVID-reopening optimism. Foreign investor demand has continued into March, with the year-to-date total of CNY 72bn more than the CNY 44bn net northbound inflows in 2023. Local stock exchanges' outstanding balance of margin trading, a proxy for domestic participation, rose in March after sharp unwinding pressure over the prior three months. As of this week, the total outstanding is just shy of CNY 1500bn, 6% from the December 2023 high of CNY 1600trn.

We find the rebound in asset prices and the recovery of sentiment impressive considering the relatively neutral Government Work Report (GWR), which we discussed here: *Macro Morning Briefing: Takeaways From China's Annual Two Sessions, March 7, 2024*. We believe that the recovery in sentiment towards China will pick up in momentum in the months ahead, supported by strong investment and activity data, as well as by anticipated stabilisation in or a rebound of credit growth as early as Q2.

Fixed asset (excluding rural households) investment reached 4.2% ytd y/y in February, the highest since April 2023. Investment in manufacturing surged to 9.4% ytd y/y, the most since October 2022. Infrastructure investments, excluding electricity, posted the second monthly y/y gains after a prolonged decline in 2023. Industrial production kicked off the year strongly, at 7.0% ytd y/y. By sector, mining, manufacturing, and production & distribution of energy were up 2.3%, 7.7% and 7.9% ytd y/y, respectively. Growth in the latter two far exceeded February 2023 levels (see chart), as well as levels in 2019, pre-COVID. Electricity output (linked to economic activity) advanced 8.3% ytd y/y, the most since November 2021.

The real estate sector, however, continues to be the main downside risk to China's economy and financial stability. There is no quick fix. We believe short-term pain in the deleveraging process is a necessary precursor to stronger and sustainable long-term growth. Struggles in the real estate sector might continue to have a negative knock-on effect on consumption. China's retail sales in February slowed to 5.5% ytd y/y from 7.2% at the end of December.

Exhibit #1: China Investment & Production Off To Strong Start



Source: BNY Mellon Markets, Bloomberg L.P.

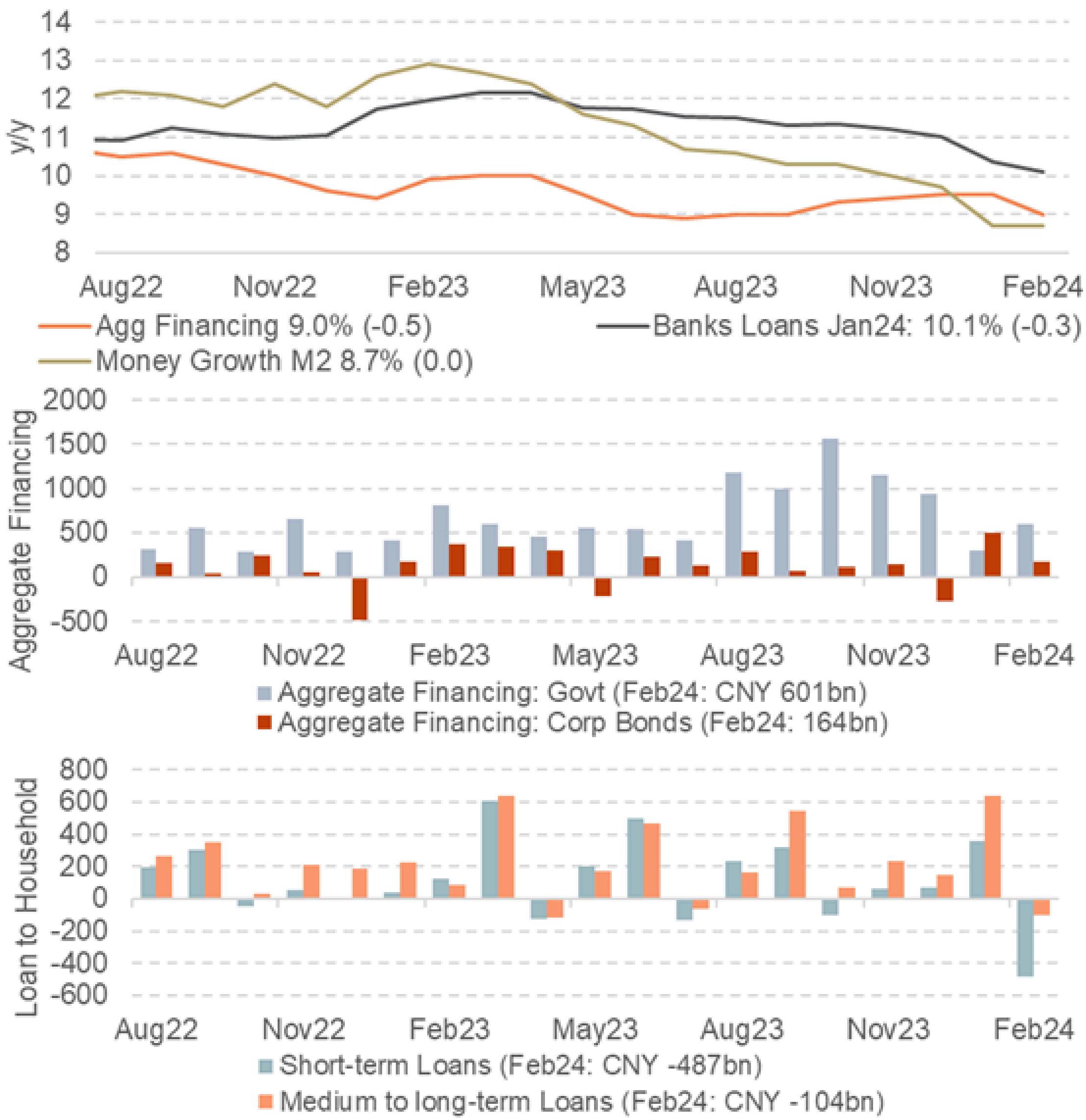
China's credit and monetary growth continues to slow. Loans by financial institutions reached at new lows at 10.1% y/y, while broad money supply (M2) and aggregate financing are near the lower end of ranges, at 8.7% and 9.0% y/y, respectively. There is a possibility that credit growth drifts lower in the near term with growth slowing and the GDP deflator negative. The GDP deflator posted a second-consecutive negative reading, -1.04% y/y in 2023 after -0.42% y/y in 2022, with GDP growth steady around 5% y/y.

The official stance of China's government is to implement prudent monetary policy in a flexible, appropriate, targeted, and effective way. It also wants aggregate financing and money supply to keep in step with projected economic growth and an increase in CPI.

We will pay close attention to how credit growth develops, especially corporate bond and domestic equity financing, which are indicators of credit confidence. Government bonds, via 'special' bonds, are expected to compensate for any potential shortfall in traditional bank loans. Corporate bond issuance in February slowed to CNY 176bn from CNY 495bn in January, while government bond issuance doubled to CNY 600bn from CNY 300bn.

Households' borrowing appetite fell in February, short-term loans by CNY 487bn, the most since the CNY 1978bn plunge in January 2020. Medium- to long-term loans, a proxy for mortgages, fell CNY 103bn, the first drop since July 2023. Watch this space: we would be concerned were the contraction in households' borrowing to persist.

Exhibit #2: Slow Credit Recovery In China

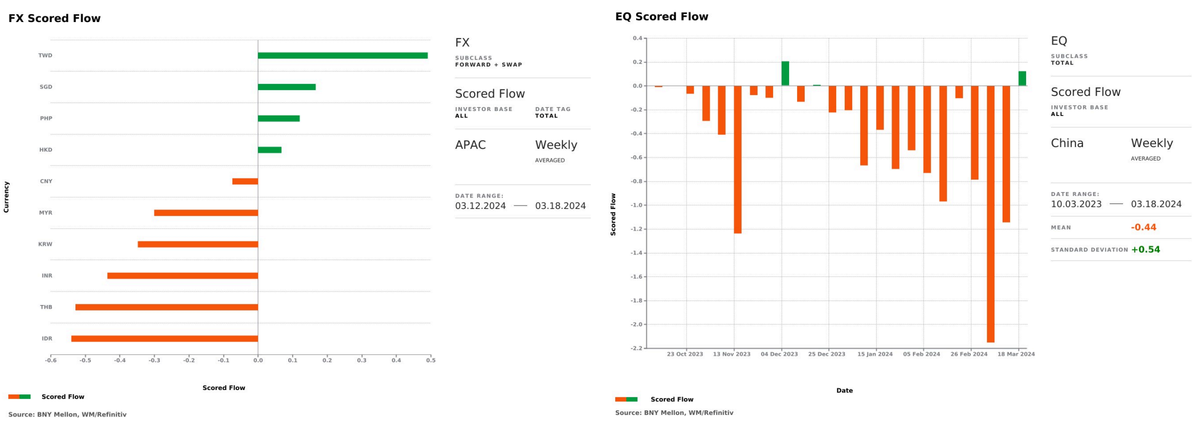


Source: BNY Mellon Markets, Bloomberg L.P.

Our APAC FX flows over the past week were mixed: inflows into TWD and moderate outflows from the rest. THB and IDR were the most sold, with average weekly scored flows at around -0.5. CNY inflows flattened out after three weeks of buying. On an aggregate basis, APAC FX remains the most underheld region, with marginally positive profitability. THB, MYR and HKD are the top-three most underheld among currencies we track.

Another encouraging sign for China equities: the first weekly buying this year; that's the third weekly inflow since Q4 2023. Closely monitor such flows as a gauge of investor confidence.

Exhibit #3: Sign Of Turnaround In China Equity Flows



Source: BNY Mellon Markets, Bloomberg L.P.

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Please direct questions or comments to: iFlow@BNYMellon.com

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