China Watch

Singapore marketing trip feedback: lingering doubts on recovery and policy

During April 24-28, we met with investors from more than 30 institutions in Singapore across FICC, equities and multi-assets.

Despite keen interest in China macro, overall sentiment seems weak. Many investors are skeptical whether China's recovery still has legs and find it difficult to trade the reopening theme across China's asset classes. Equity investors are baffled by the disconnect between the recent strong macro headline data and disappointing equity market performance. On the fixed-income side, investors no longer seem to have a strong conviction on China rates due to crosscurrents, while "proxy trades" through other EM Asia currencies that would benefit from China spillovers remain the preferred expressions compared with outright CNY exposure.

The investors we met were interested in the rationale behind our recent GDP growth upgrade (6.3% in 2023), i.e., investment-led cyclical momentum, which differs from the market consensus. Most investors agreed with us on the strong credit impulse in 1Q, though some expressed concerns whether such credit will flow into the real economy and boost investment growth soon, given still fragile confidence in the private sector.

Key concerns on China's recovery and policy direction

The most frequently asked questions by clients were regarding the sustainability and strength of consumption rebound, property market recovery, labor market conditions and local government fiscal situation. Compared with other regions, investors in Singapore asked less about risks from geopolitical tensions or supply chain decoupling.

Our discussion with investors indicated four commonly shared concerns:

1. **Property market recovery**: Investors are worried about downside risks to growth if the property market does not recover soon. Some also expressed concerns about the longer-term implications as they see no alternative growth driver that can fully replace the role of the property sector.

2. **Consumption recovery**: Investors are skeptical whether China's consumption recovery can be sustained in the coming quarters. Singapore investors seem to be particularly concerned about the labor market situation, especially the elevated youth unemployment rate. They are keen on the key messages from our proprietary BofA China Consumer Survey (see the report April Consumer Survey).

3. **LGFV risks**: Some investors are concerned about potential LGFV defaults and broader impact, given local governments' fiscal strains and weak land sales.

4. **Policy uncertainty**: With better-than-expected 1Q GDP data and a low annual growth target (about 5%), some investors feel anxious that policy makers may roll back support or even tighten policy/regulation soon, just as what happened in 2021. We believe the messages from the Politburo meeting last Friday (see meeting takeaways) should reassure investors and reduce such concerns.

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Abbreviations:

FICC: fixed income, currencies, and commodities

EM: emerging market

LGFV: local government financing vehicle

Equities: disconnect between headline data and market

The disconnect between the strong headline economic data and disappointing equity market performance was baffling for the investors we met. Some are cautious about the mixed signals from macro vs. micro-level data, particularly the divergence between downward earnings revisions and upside surprise of 1Q GDP.

Investors pointed out a few key factors that could make them more bullish on China growth/equity market, including better corporate earnings, improvement in the labor market, recovery of property sales extending from the secondary into the primary market etc. Sentiment could weaken if 2Q data trail expectations. It is also worth noting that overseas investors assess China on a relative basis — the economic and earnings outlook in the overseas market (especially in the US) in 2H will likely have strong implications on their China views and exposures.

FX: proxy trades more favored than outright long CNY

Many investors acknowledged that the USDCNY move in recent months was mainly driven by the USD leg, with limited market reaction to China data. Our core view of CNY underperformance relative to other EM Asia currencies in a weak USD environment was well received by investors. With China's declining current account (CA) surplus and negative carry, proxy trades for 'China reopening' theme – such as long KRW or THB – remain the most favored expressions. This is in line with the results from BofA FX and Rates Sentiment Survey (see the survey report for more details).

Some investors commented that low volatility in CNY isn't necessarily a bad thing. Unlike last year when China's soft growth and weak currency were risk factors for all regional peers, this year the well-anchored CNY allows them to trade other currencies with a higher degree of freedom. Given the lack of clarity on US economic outlook and the Fed's policy trajectory, many investors are inclined to long high-carry EM Asia currencies like INR and IDR, in some cases against short CNH.

Rates: low vol + lack of conviction = wait on the sidelines

On swap rates, investors have shifted towards a lighter and more balanced position from the consensus 'paying back-end and/or receiving front-end' bias at the beginning of the year. Conviction on China rates is low, and our higher swap rates view has faced some headwinds lately from subdued CPI inflation and further decline in bank deposit and lending rates. That said, we still expect higher rates in 2H, premised on (1) a notable pick-up in CPI inflation, and (2) a slowdown of demand for government bonds against a faster issuance pace in 2Q and 3Q. Among real money investors, interest in China bonds remains muted given more attractive yield levels elsewhere. Some investors suggested they would re-engage with China bonds once the Fed starts cutting rates and yield differential turns positive again.

Some European-headquartered investors we met in Singapore expressed interest in Swap Connect and raised questions about onshore swap rates market liquidity, eligibility, etc (see more details in the report China rates - get ready for Swap Connect). On the other hand, for some funds that are headquartered in the US, geopolitical risk consideration may restrain their exposure to onshore cash bonds and swap rates, so they are likely to stay with the CNY NDIRS space.

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