MARKET REPORT

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CHINA'S NEXT STEPS

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China's financial markets have been under the spotlight due to a series of formidable challenges that have left analysts pondering its path ahead. Despite initial optimism for robust economic performance this year, China's economy has fallen short of expectations, struggling to break free from the constraints of its rigorous zero-Covid policy. The nation's financial markets have weathered a significant downturn marked by an extraordinary exodus of capital. The CSI 300 index currently resides well below pre-pandemic levels, hitting its lowest mark since February 2019.

These occurrences are in the context of reverse globalization and friend-shoring, as corporations look to de-risk their global value chains from politically turbulent environments. Investors and corporations have been dissuaded from China in the backdrop of an increasingly authoritarian Xi Jinping premiership. This includes stringent COVID-19 restrictions, erratic regulatory crackdowns, and favouritism towards domestic companies. Strategists have been unable to predict the increasingly arbitrary operating environment Beijing has set forth. Sony and Samsung have relocated their camera production and workforce to Thailand, seeking a more predictable and secure production environment, while Dell has announced plans to cease using Chinese-produced chips by 2024. Meanwhile, Apple's supplier, GoerTek, invested $280 million in facilities in Vietnam to manufacture AirPods, a symbolic shift away from its notorious China heartland.

The escalating geopolitical rivalry between Washington and Beijing has been a significant factor in the stock market sell-off. Businesses operating in China have become attuned to the vulnerabilities posed by their substantial exposure in the region, already exemplified by losses in Russia following strict sanction regimes. As liabilities mount on the balance sheet, firms have aimed at mitigating their exposure to avoid becoming entangled in a resulting quagmire.

Despite the recent downturn, some hold an optimistic view of China's financial markets and foreign investment. China possesses a large and increasingly affluent middle class, driven by ambitious economic eforms, offering a promising investment landscape. Boasting the largest sustained GDP growth in modern history, and with an economy size surpassing the EU and rivalling the US, many analysts argue the global south will no longer be dictated by policymakers in the West. Furthermore, signs of economic stabilization have been observed. BCA Research analysts have detected positive trends, with China's credit growth improving in August. Deflationary pressures that were prevalent earlier in the summer have subsided, with consumer prices showing an incremental 0.1% increase year-on-year, a marked improvement from the 0.3% decline in July.

Concurrently, relations with Washington may be thawing; The Biden administration has moved to a policy of ‘congagement’ with China, restarting state visits and communications. Secretary of State Anthony Blinken visited China in June, the first US diplomat to do so in five years, in what was widely perceived as a successful visit. Strategists hope that the more Washington and Beijing converse, the lower the existential risk becomes.

However, amidst the uncertainty regarding China's markets, the overarching factor that looms large is the Taiwan issue. China has unequivocally expressed its intention to reunify with Taiwan, even if it necessitates the use of kinetic action, while President Biden has said America would defend the island. This enduring prospect is unlikely to dissipate, and if the threat of great power conflict persists in this region, China’s markets will unlikely gain investor confidence and recover to previous levels.