China’s recovery remains on track despite softer data

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Disappointing data from China last week drove equities lower, but we don't think they are as bad as they appear. Current valuations have yet to factor in potential earnings grades, and Beijing’s pro-growth stance remains solid. We maintain the view that there is more upside in Chinese equities and we like select sectors that should continue to benefit from its recovery.

A slew of softer-than-expected economic data from China has weighed on investor sentiment in recent days. New total social financing for April missed consensus by a wide margin (CNY 1.2tr versus 2tr), driven mainly by disappointing new bank loans while government and corporate bond issuance also moderated. Last month’s trade data also surprised to the downside, with imports down 7.9% y/y on weaker manufacturing demand.

The MSCI China index was down 2.3% last week, bringing the year-to-date underperformance relative to the Asian benchmark to over 3 percentage points.

However, we maintain the view that China’s economic recovery is on track to see a GDP expansion of at least 5.7% this year, and that Chinese equities have yet to price in such rebound in growth.

Recent data set is not as bad as they appear. A deeper look into China’s latest trade data showed that the decline in imports mainly came from crude oil and technology related products, and that the drag from oil was due to lower prices instead of volume. In fact, import volumes of major commodities held up relatively stable. High-tech and mechanical & electrical imports, on the other hand, have come under pressure since last year amid ongoing geopolitical tensions and export restrictions from the US, with semi-related products a clear drag.

On the credit side, we acknowledge the weakness in household loans amid lingering advance mortgage repayment pressure and slower housing sales, but we also see resilience in money supply (M2 growth) as well as long-term corporate
loans. Overall, we take the view that a very strong 1Q23 suggested some front-loading in recovery trajectory, while seasonality also played a part in April’s data.

Beijing’s pro-growth stance remains solid. As suggested at the April Politburo meeting, policy support on housing, consumption and employment to boost private sector confidence is likely to ramp up in the coming months, in our view. In fact, the People’s Bank of China has recently guided large state-owned banks to make more loans, and we think local governments are likely to continue rolling out supportive housing measures. While we do not foresee large-scale stimulus packages from the central government, targeted policy support should continue to serve as a tailwind.

Earnings should drive the equities’ next leg up. Several US-listed Chinese stocks were up 5–7% late last week after e-commerce firm JD.com reported a narrow beat in 1Q23 revenue, driven by resilient demand. This followed noticeable sequential recovery in consumer demand, reported by a number of internet and consumer companies over the past months. At current valuations, we think markets are likely to see meaningful relief once potential earnings upgrades in the coming quarters are factored in, as the rebound in consumer confidence gradually works its way into corporate profit growth. We maintain our mid-teens earnings growth forecast for this year.

So, we continue to see upside in Chinese equities this year and prefer the consumer, internet, transportation, capital goods, and materials sectors in our positioning. Our positive outlook on China also forms part of our most preferred rating on emerging market equities in the global strategy.