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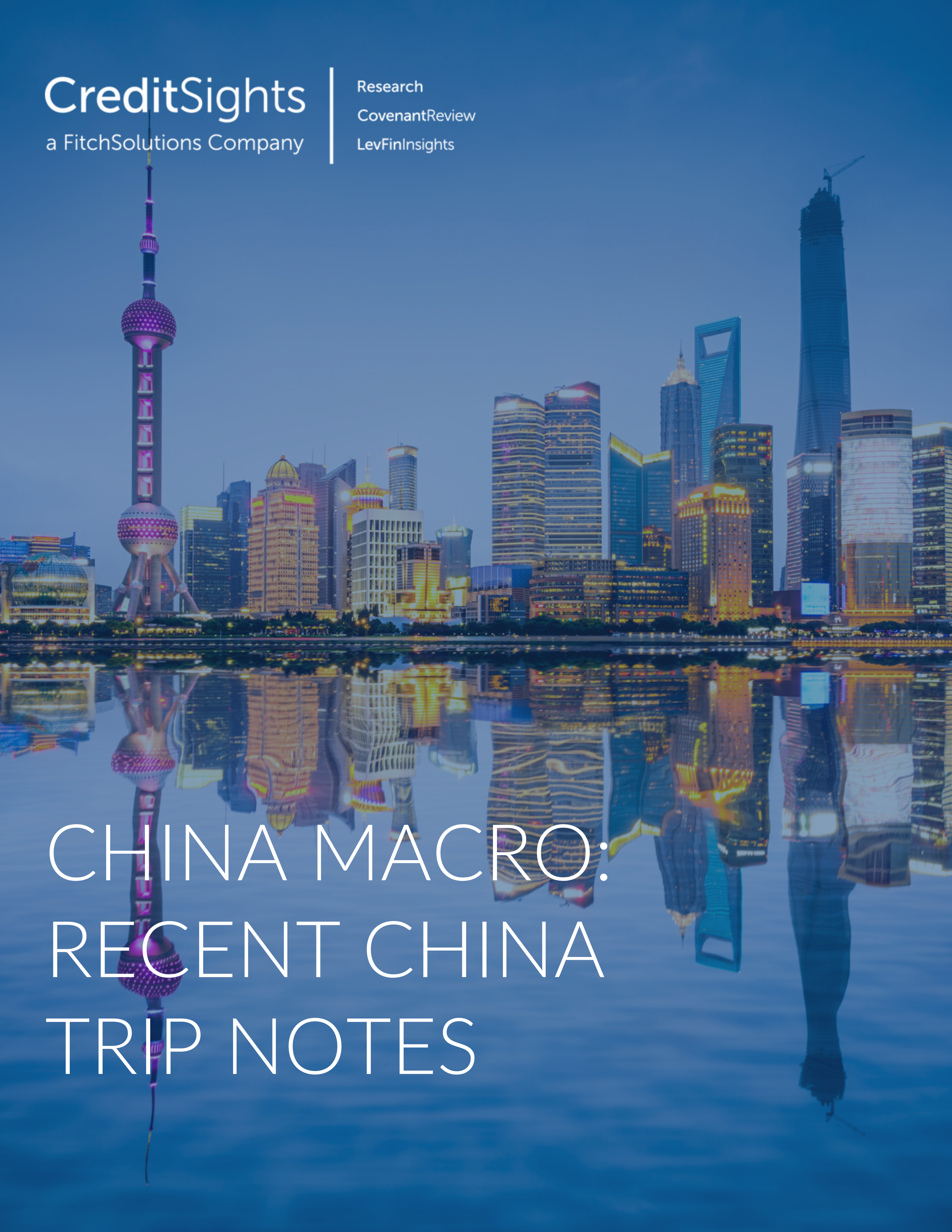

CHINA MACRO: RECENT CHINA TRIP NOTES

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China Macro: Recent China Trip Notes

13 Jun 2023, 5:16 AM

Executive Summary

- **We traveled to a few Chinese cities (Kunming, Suzhou, and Shenzhen) over the past fortnight and spoke with local investors, financial institutions, business owners, LGFVs and regulators.** Our last trip to China was at the start of the year, post the COVID reopening and the "exit wave".
- **Overall, onshore confidence in China's economic outlook appears to be weaker than offshore expectations.** We observed a few trends, including (1) an uneven consumption recovery; (2) a weak property market sentiment; (3) an improving but still dampened business confidence; and (4) better-than-feared LGFV funding conditions.
- **Our observations from the trip were largely in line with China's recent soft data prints.** We expect May credit, industrial production, retail sales, and investments, which will be released on Thursday 15th June, to remain soft; more policy support is needed to restore onshore confidence and address structural challenges, though the "around 5%" growth target for 2023 should be easy to achieve due to a low base.

Relative Value

For our latest China credit recommendation, please refer to **Asia Credit Recommendations: June 2023**

Uneven consumption recovery

Offline: Food & Beverage (F&B) demand remained strong across the Chinese cities that we visited. Compared to our last trip around the Chinese New Year, restaurant bookings and visitors to large malls and shopping areas remained resilient in Kunming, Suzhou and Shenzhen. However, foot traffic at shops is less encouraging and actual buyers were lacking, especially in less well-located malls. Tourism activities in Kunming and Suzhou (which are both popular domestic tourism spots) seemed subdued, likely because May/June does not fall in the summer holiday season. However, local tour agencies appeared to be optimistic about tour bookings for the upcoming summer school holidays, especially those booked via local services platforms. COVID reinfections emerged in some local communities, but we have not encountered any mobility restrictions. We think that the chance of a nationwide COVID infection and large scale lockdowns are unlikely for now.

Uneven Recovery of Offline Consumption

Foot Traffic is low in a shopping mall in Suzhou.	But restaurants are busy in Shenzhen.
	

Source: CreditSights

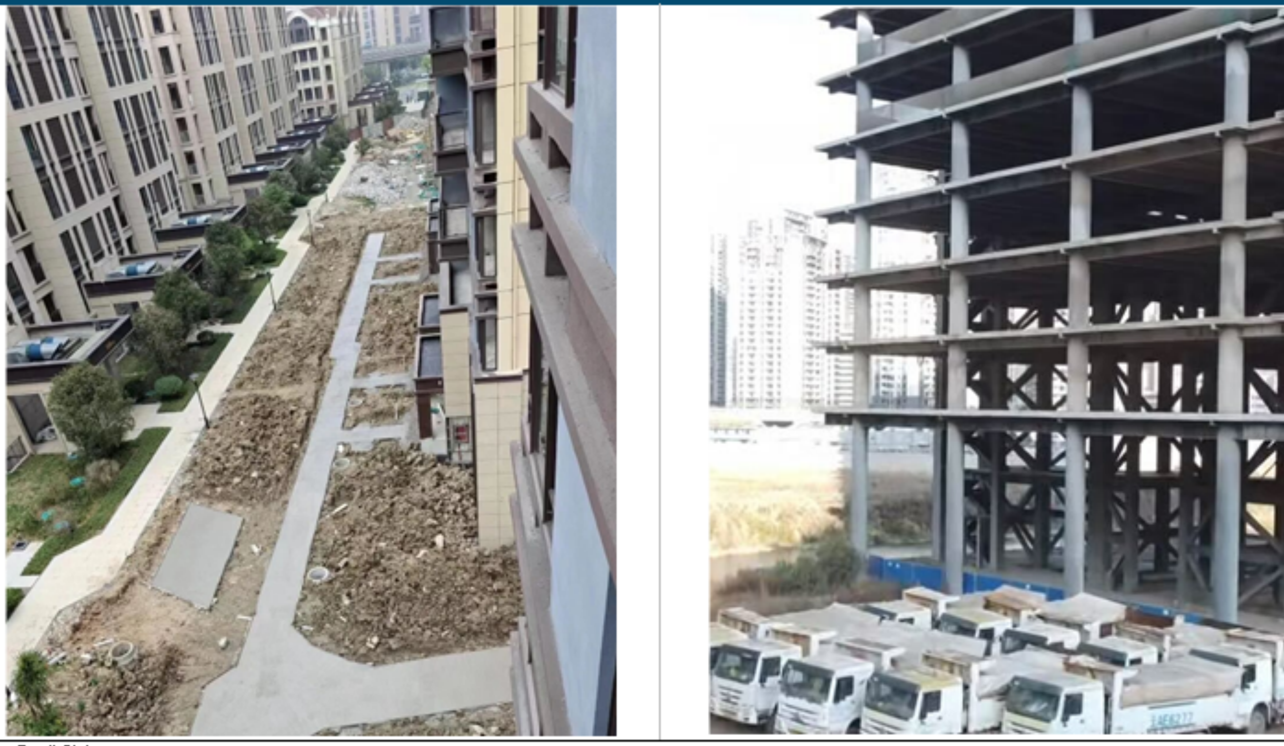
Online: Online retail is holding up better than offline retail. The "6.18" shopping festival, which lasts till around the 18th of June, started with strong pre-sales in late-May, in particular for electronics and beauty products. Major eCommerce platforms (Taobao/Tmall, JD.com) are offering more user subsidies to counter new market entrants (Douyin and Kuaishou), but the scale is smaller than our **expectations**. In particular, the usual general promotions (pro-rated discount for each RMB 100-300 of spending) is largely flat compared to 2022. That said, traditional eCommerce platforms are issuing additional coupons via live-streaming and short-form video modes. Pingduoduo and Tencent Video also participated in the shopping festival this year, offering user subsidies and merchant incentives.

Consumer sentiment: Conversations with locals showed that consumer sentiment remains fragile and is weaker than our **expectations**. Key concerns include (1) pay cuts of financial and IT professionals amid tighter regulatory scrutiny and cost control measures, and the resulting stagnant income growth of the middle-class; (2) an entrenched high youth unemployment rate due to headcount reductions at privately-owned enterprises (POEs), (3) a lower long-term expectation of house price increases, and the resultant negative wealth effect on consumption.

Weak property market sentiment

Home demand: The secondary market for home sales was soft in the three cities that we visited. In Kunming, a tourist destination located in balmy Yunnan province, agents lamented that buyers from coastal provinces, who accounted for more than half of the purchasers before COVID and used to purchase properties as a holiday home or as an investment, have yet to return; in Shenzhen, located close to Hong Kong, luxury condos in prime districts such as Luohu, Nanshan and Futian are offering ~30% discount to potential buyers, and we still saw a large number of incomplete home projects in Pingshan district; and in Suzhou, not far from Shanghai, sellers are offering agents commissions as high as 20% of the transacted value to get their properties sold. In addition, locals with multiple properties are worried about the potential rollout of property tax, and intend to offload some/all of their investments as and when prices recover.

Incompleted Home Projects in Shenzhen and Kunming



Source: CreditSights

Investor sentiment: Onshore market participants appeared less thrilled by the rumored additional property easing measures, which has pushed property $ bonds in the offshore market higher in the past two weeks. Most investors echoed our view that a reduction in down payment ratios, new home mortgage rates, and home purchase restrictions in 2nd and other lower tier cities is **not new and might not help home sales,** as homebuyers are waiting for prices to fall further. Some investors believe that removing home purchase restrictions in first-tier cities (Shenzhen, Guangzhou, Shanghai and Beijing) would boost sentiments, but most shared our concerns that better demand in these cities might not translate to or could even crowd out home sales in lower tier cities. Investors also shared our view that the Chinese policymakers are unlikely to engineer a large-scale shanty town reconstruction exercise, which induced a property upcycle in 2015-18, but are looking to manage the prolonged downturn. There is not much conviction in terms of the scale and effectiveness of additional funding support to property developers, including allowing the banks to rollover the extended property loans under the **16-point plan** released in November last year. Overall, market participants see a multi-year property downturn and continued drags on growth and local government budgets.

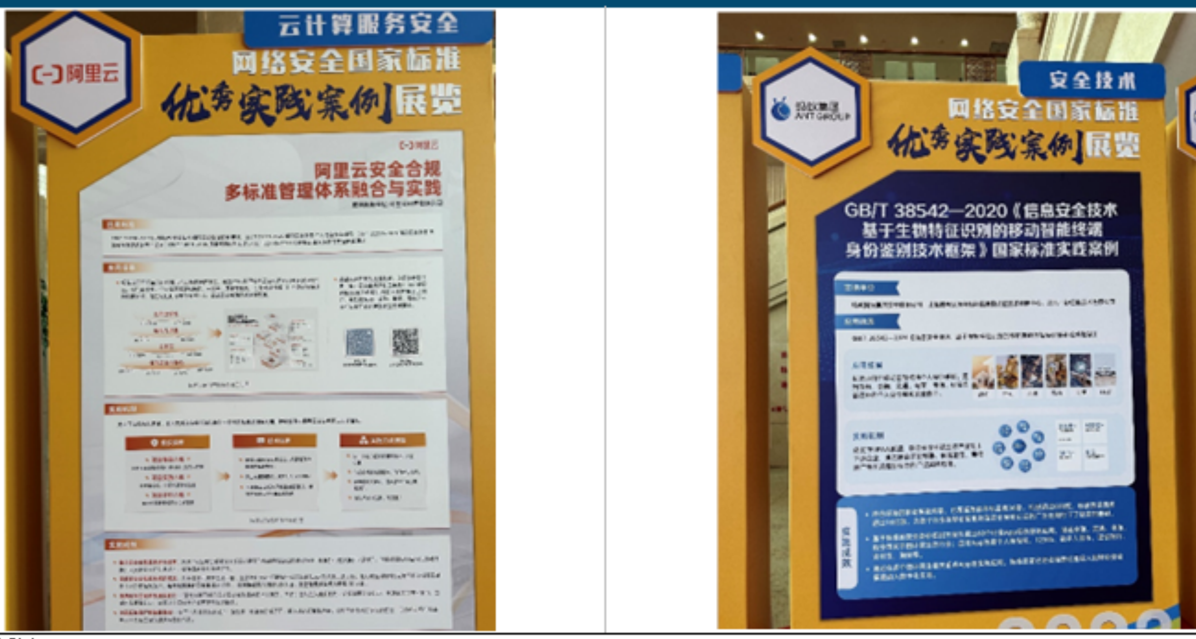
Improving but still dampened business confidence

Overall sentiment: The business owners we spoke with acknowledged that the business environment has significantly improved since the COVID reopening; however, they remain scarred following the tech and education crackdowns and the lack of a level playing field between POEs and SOEs (state-owned enterprises). Some noted that the policy rhetoric of extending more support to POEs is encouraging, but concrete measures and a more predictable, rule-based and well-communicated regulatory framework for POEs is needed before their confidence is restored to borrow and invest. We share the view of the onshore business owners that most of the pro-market measures announced at the **NPC** in March have not been delivered. We are watching out for the next politburo meeting in July for more structural reforms to address the weak business confidence of the POEs.

SMEs: The business confidence of private entrepreneurs that we spoke with in Suzhou remained fragile amid the exodus of foreign capital. Two industrial parks in the city used to host foreign and JV manufacturers of high-end equipment, pharmaceuticals, chemicals, electronics and tech products. A large number of foreign companies and sponsors in these two industrial parks closed their factories last year amid the stringent COVID lockdown and rising geopolitical tensions. This in turn hits the local private entrepreneurs along the value chain. The global tech hardware downturn has also negatively affected small privately owned business (POEs) in Shenzhen, such as suppliers of optical and acoustic parts for smartphones, tablets, PCs and wearables.

Big tech: Meanwhile, the regulatory environment for China big techs appeared to continue to improve, as we **expected**. We attended the "Data Security Standard" forum hosted by the Ministry of Industry and Information Technology in Kunming. Ant Financial (of Alibaba) and Tencent were praised by the regulator for their compliance with the data security and consumer protection laws established in 2021. Their tiered management and storage of consumer and business data was used by the regulator as case studies for government and SOE staff in data security and risk management at the forum.

Ant Financial and AliCloud Were Used as Case Study for Good Data Security Management at a Forum Held by MIIT



Source: CreditSights

Better-than-feared LGFV funding conditions

Onshore market participants do not seem to be overly concerned about disorderly LGFV public bond defaults, due to the local governments' strong willingness to pay despite a weakening budget performance; this is largely in-line with our **LGFV sector outlook**.

Bank funding: We spoke with the local branches of large state-owned banks and onshore investors in Kunming regarding the funding conditions of the city's LGFVs, which were **reported** to have defaulted on bank and trust loans and faced difficulties in repaying public bonds. We were told that the banks are well aware of the tight fiscal capacity of local governments in less developed regions such as Kunming city, but most banks chose to work out loan extensions with the LGFVs and local governments to preserve relationships and avoid impairment losses.

Bond market funding: Onshore investors view existing public bonds issued by the LGFVs of weak governments as high-yielding quality assets, as local governments strive to repay these bonds on time and in full as they fear contagion effects; supply is scarce as the central government has banned weak LGFVs from issuing new public bonds.

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