

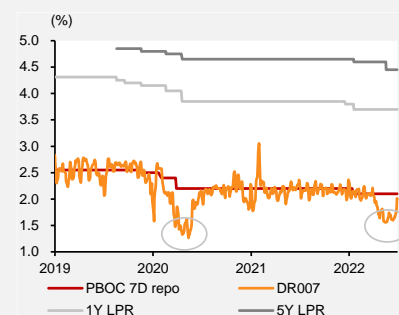
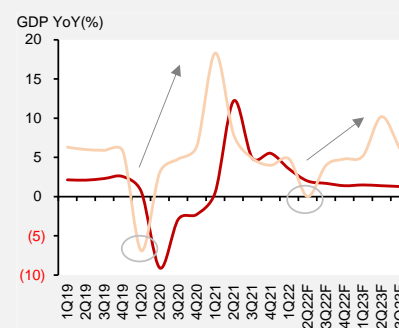
China Policy

MP may remain accommodative with fine-tuning in 2H22

Monetary easing has been the key for the recent rally of Chinese stocks. China's economy has started to resume with a loosening in both economic policy and Covid-zero policy. The most accommodative period for monetary policy may be over soon. But monetary policy should remain accommodative in 2H22 as GDP growth will still be below potential growth and core CPI growth is likely to remain low. The upside risk for CPI may be from the live hog, but it should be temporary. DR007, as an indicator for liquidity condition, has climbed recently as liquidity demand increased amid credit expansion and investors' risk-taking. We expect DR007 to remain below PBOC's 7D repo refinancing rates with gradual increases in 2H22. It is possible to see targeted RRR cut for small & medium or regional banks as they face stress amid unbalanced economic recovery. The possibility of further LPR cuts declines, but credit supply should remain accommodative. China will tolerate an increase of the debt to GDP ratio and a moderate depreciation of renminbi to support the growth in 2H22. Monetary policy prospect in 2023 depends on Covid-zero policy dynamics and economic resumption progress. We expect China to gradually shift towards a prudent monetary policy with structural or targeted easing in 2023.

- **Monetary policy should remain accommodative with mild fine-tuning in 2H22.** Liquidity condition will remain ample with possible mild adjustments. DR007 has climbed from its lowest level in mid-May recently because liquidity demand has increased amid investors' risk-taking and gradual recovery of credit expansion. We expect DR007 may see some gradual and mild increases in 2H22. But it should remain below PBOC's 7D repo refinancing rates for several months, implying ample liquidity condition. It is still possible to see further targeted RRR cut for small & medium regional banks. Those banks are important in supporting SMEs, individual businesses and undeveloped regions. But they have faced more severe stress as economy has resumed more slowly in lower-tier cities. The possibility of further LPR cut declines, but credit supply should remain accommodative as real demand remains weak.
- **Monetary policy condition depends on Covid-zero policy dynamics, economic resumption progress and inflation pressure.** China's economy has passed its worst in April and gradually resumed from May, thanks to reopening in Shanghai, economic policy easing and loosening Covid-zero policy. The economy should continue to recover as Chinese stocks have outperformed global markets and housing sales, auto demand and service activities have rebounded noticeably recently. China's GDP growth may reach 4% in 3Q22 and 4.8% in 4Q22, still below the potential growth. CPI may gradually pick up as grain, live hog and some service items rebound. The upside risk for CPI may be from live hog, which will see strong YoY growth in 3Q22 due to base effect. But core CPI growth should remain low because of weak consumer demand. Therefore, monetary policy should remain accommodative with some mild fine-tuning in 2H22.
- **Renminbi exchange rates should be more flexible to absorb external shocks and facilitate domestic policy independence.** The PBOC increased renminbi exchange rate flexibility in late April, causing a rapid depreciation of renminbi against US dollar. We considered this movement as

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a strong pro-growth signal from the Chinese policymakers. The central bank vowed in its 2Q22 MP report to further increase exchange rate flexibility to facilitate the independence of domestic monetary policy. USD/RMB generally moves along with US-China interest spreads and reflects dynamics of the two countries' gap in economic fundamentals. In the short term, US-China divergence in monetary policy may further increase as the US Fed will continue to sharply raise its policy rates. Renminbi has additional room to depreciate against US dollar in 2H22. In the medium term, however, China's economy is in the resumption cycle while the US economy will gradually slow down. Renminbi exchange rates have some support in 2023. We expect US\$/RMB may reach 6.8 at end-2022 and 6.6 at end-2023.

- **Monetary policy prospect in 2023.** China's monetary policy prospect in 2023 basically depends on three key factors: 1) Covid-zero policy dynamics and domestic economic resumption progress; 2) global recession risk and its spillover effect on China; 3) commodity prices and domestic inflation. We expect China may gradually shift towards a prudent monetary policy with structural or targeted easing in 2023. First, China's economy is still in the resumption progress with GDP growth probably still below potential growth. Economic performance in some regions or sectors may remain weak, as the latest round of resumption seems more slowly than in 2Q20-1H21 and global economy faces recession risks. Second, the CPI growth may mildly rise yet should remain below 2.5% as domestic consumption remains tepid and commodity prices are expected to decline.

Figure 1: Money Market Funding Rates



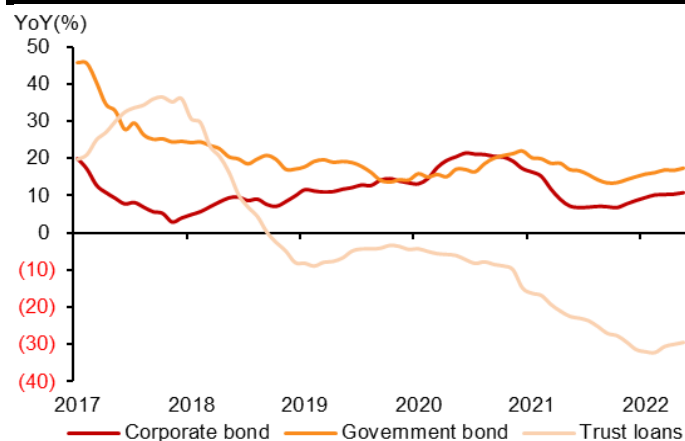
Source: WIND, CMBIGM

Figure 2: Credit and M2 Growth



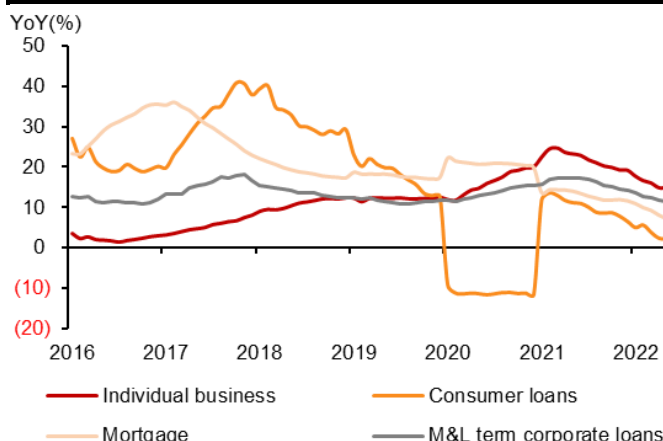
Source: WIND, CMBIGM

Figure 3: Growth of Outstanding Bonds & Trust Loans



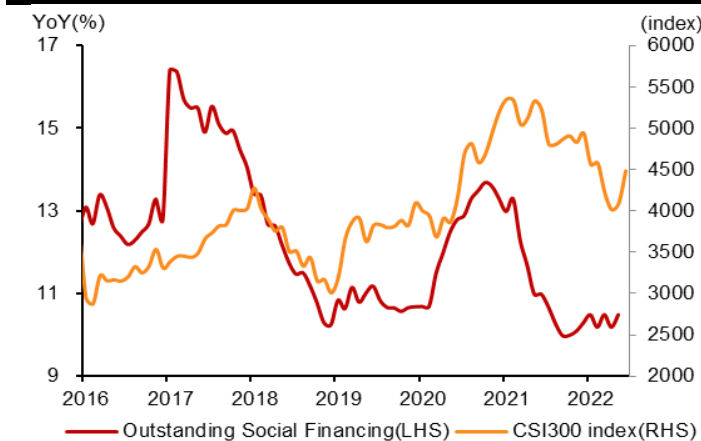
Source: WIND, CMBIGM

Figure 4: Growth of RMB Loans



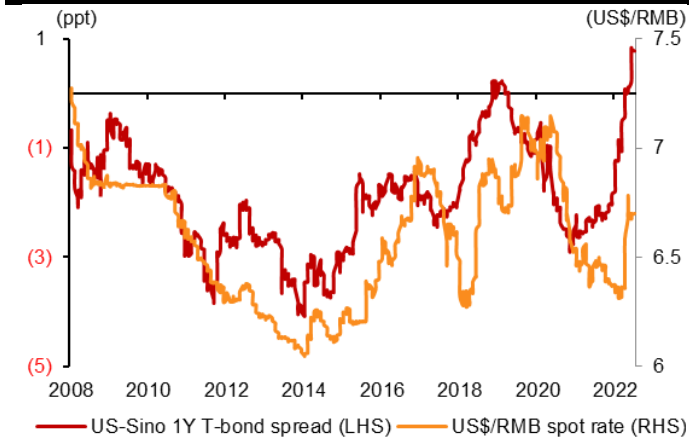
Source: WIND, CMBIGM

Figure 5: Credit Cycle and A Share Market



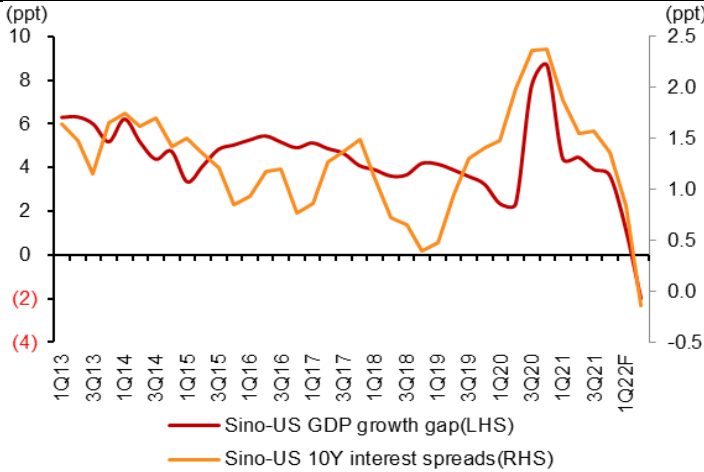
Source: WIND, CMBIGM

Figure 6: US\$/RMB Rates & Interest Spreads



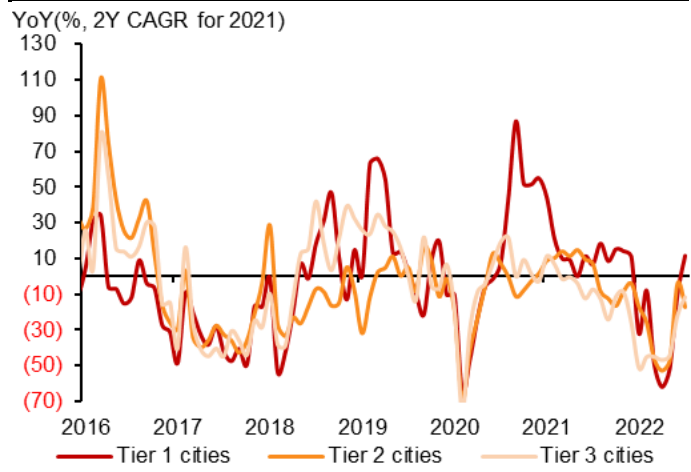
Source: WIND, CMBIGM

Figure 7: China-US Growth Gap & Interest Spreads



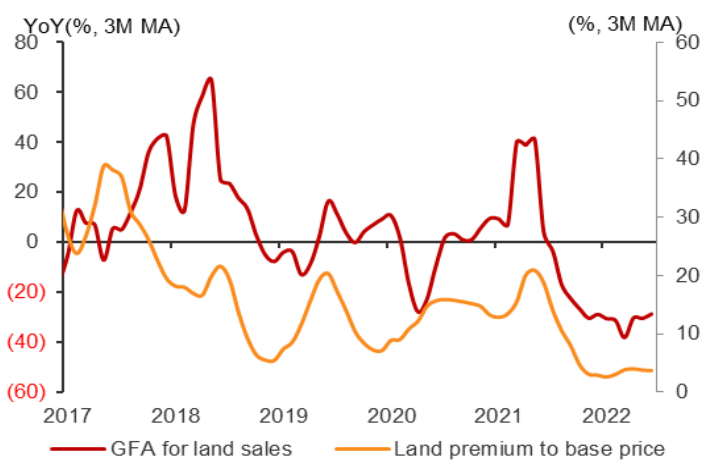
Source: WIND, CMBGM

Figure 8: Growth of Housing Sales by Cities



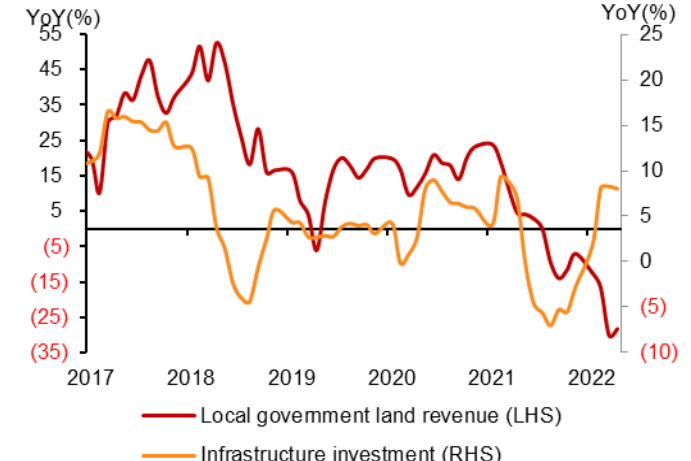
Source: WIND, CMBGM

Figure 9: Land Market Performance



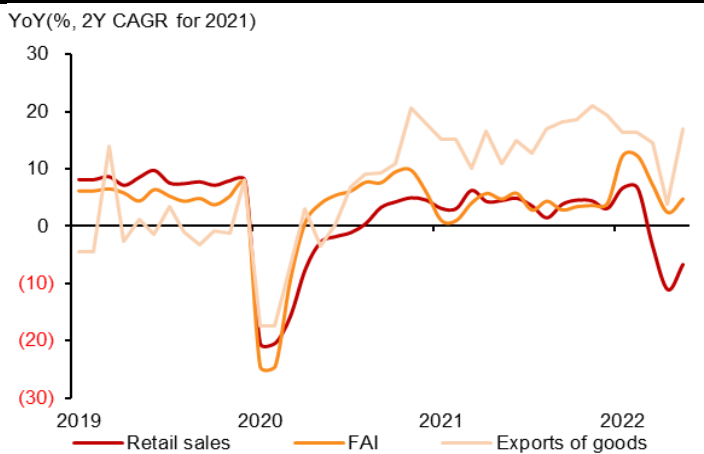
Source: WIND, CMBGM

Figure 10: Land Revenue and Infrastructure FAI



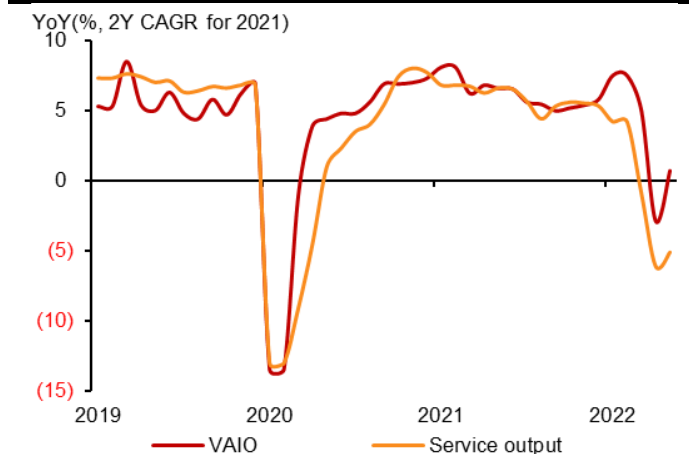
Source: WIND, CMBGM

Figure 11: Growth of Retail Sales, FAI & Exports



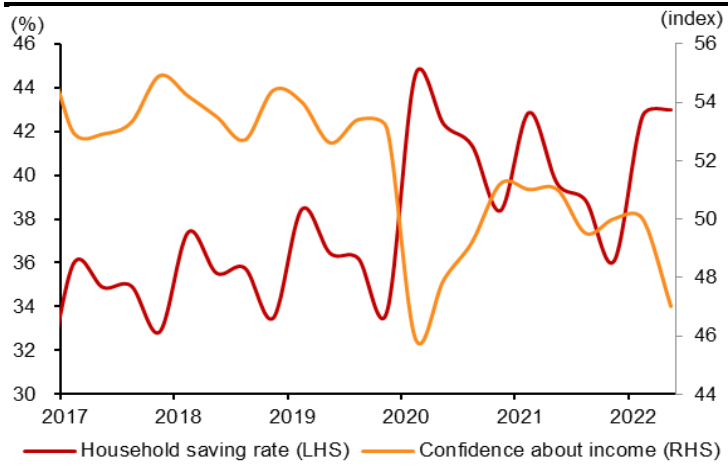
Source: WIND, CMBGM

Figure 12: Growth of VAIO & Service Output Index



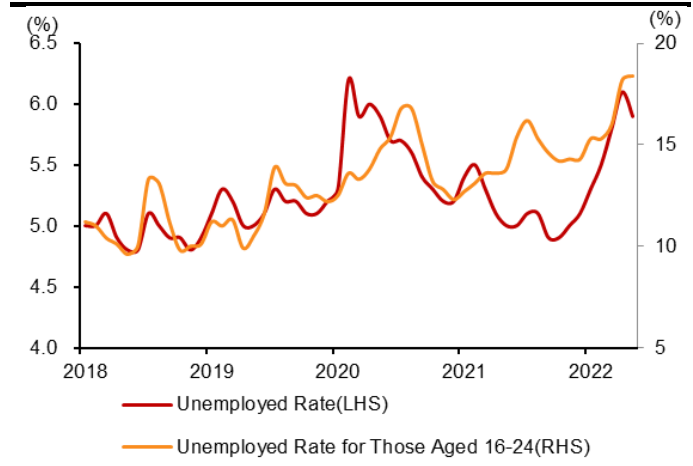
Source: WIND, CMBGM

Figure 13: Household Saving Rate & Confidence



Source: WIND, CMBGM

Figure 14: Urban Unemployment in Survey



Source: WIND, CMBGM

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