Focus of Asset Allocation Shifts from Commodity to Equity amid the Structural Recovery of the Chinese Economy from Another Bottom-out

Hong Kong, 29 August 2022 -- The Research Institute of China Chengxin International Credit Rating Co., Ltd. (hereinafter referred to as "the CCXI Research Institute") recently released a report titled "Focus of Asset Allocation Shifts from Commodity to Equity amid the Structural Recovery of the Chinese Economy from Another Bottom-out: H1 Analysis and H2 Outlook of Macroeconomic Operation and Allocation of Asset Classes. According to the report, the short-term impact inflicted by the COVID-19 flare-ups was mainly felt in the second quarter. Afterwards, the macro economy is expected to have an asymmetric "W-shaped" rebound amid the recovery. The report added that with the economic restoration in the second half of the year, the stock market might experience a bumpy upturn, of which the policy-supported infrastructure industry chain and the consumer segment benefiting from the economic rally after the recent COVID-19 outbreak are expected to outperform others.

After making a detailed analysis of the macroeconomic operation in the first half of 2022, the report pointed out that the macroeconomic operation deviated from the long-term growth trend line again after a number of indicators contracted in March, April, and May this year. On the production front, industrial production was of great resilience overall in the first half of the year, whereas the service sector hard hit by the pandemic flare-ups contracted significantly and remained on a rocky footing for sustained recovery. From the demand point of view, demand was severely deficient, internally uneven, and mainly underpinned by policy factors in the first half of the year. To be specific, manufacturing investment growth rate retreated from its high due to logistics disruptions and slowed supply chain cycles; real estate investment continued to grow slower under the sustained negative market expectations; the up-front fiscal spending and the accelerated implementation of local infrastructure projects drove up the infrastructure investment growth steadily in the second quarter; total retail sales of consumer goods grew much slower for three consecutive months due to the COVID-19-inflicted impact; and exports would be complicated by the contraction of foreign demand, despite the short-term resilience. On the price side, the continuously shrinking spread between the producer price index (PPI) and the consumer price index (CPI) in the first half of the year helped ease the profit pressure on the industries mid-stream and downstream, but it is necessary to track the impact of rising consumer goods prices on consumer confidence. From the financing perspective, financing demand contracted sharply by the end of the first quarter due to the impact of the COVID-19 flare-ups. The aggregate financing got its scale and structure improved in the second quarter thanks to the accelerated issuance of special bonds, but the sustainability of such improvement remained to be seen.

The report indicated that the operation of the Chinese economy now still faces a string of risks and challenges. Internationally, the Russian-Ukrainian conflict has escalated geopolitical tensions and strained the supply of metals, energy, and food worldwide, inflationary pressures in advanced economies are amplifying the risk of stagflation that faces the global economy, and the US continues to seek the accelerated "decoupling" from China. Internally, China has to deal with challenges in the following four aspects. First, the COVID variants become so covert and transmissible that there is still uncertainty about the pandemic resurgence. Second, weak expectations are still an important factor holding back the macroeconomic recovery, including the release of domestic demand, as business owners fall short of confidence and new savings in the resident sector have reached a record high for the same period in history. Third, micro entities face multiple difficulties; market is deprived of vitality; the number and loss-making companies in the enterprise sector and the amount of losses sustained both at their highs; and the resident sector is under great employment pressure, with the unemployment rate among young people remaining persistently high. Fourth, the macro debt risk persists, and the macro leverage ratio risks further rising at a time when the policies of stabilizing economic growth became increasingly effective. Coupled with the accelerated exposure of risks in key areas such as real estate, we should be highly alert to the spread of risks arising from the intentional mass mortgage defaults.

When providing an outlook on the economic landscape and policy environment in the second half of the year, the report indicated that the macro economy would register in the second half of the year a structural recovery, which may be an asymmetric "W"-shaped process, considering the inconsistent pace of rally among different sectors of the economy and the delay of policy effects. As predicted in the report, China's economy would expand by about 4.4% in a baseline scenario. In terms of policy environment, the theme of policies in the second half of the year remains stabilizing growth, but risk prevention is the bottom line. In other words, China won't introduce super large-scale stimulus measures in exchange for an excessively high growth target. The monetary policy would prioritize stability while pursuing progress. In the second half of the year, it may mainly use structural policy tools in combination with fiscal and financial policies to prioritize credit easing and channeling the flow of stagnant liquidity to the real economy. While remaining a positive tone, the fiscal policy may shift the focus to the expenditure end. In the second half of the year, it would center on the implementation of policies, especially the use of special bonds. Specific measures to be adopted include adjusting the capital fund ratio of fixed investment projects and expanding the fields where special bonds are used. The possibility of using incremental instruments such as special Chinese government bonds (CGBs) cannot be ruled out, if policies take effect later than expected or are less effective than actually needed.

With regards to asset allocation, the report predicted that the focus of asset allocation would shift to equity products in the second half of the year. As pointed out by the report, various types of assets delivered divergent performance in the first half of the year, with commodities rising overall, the bond market fluctuating within a specific range, and the stock market tumbling significantly despite a temporary rally by the end of April. Products are ranked by returns are: commodities > bonds > stocks. As the Chinese economy is very likely to recover marginally in the second half of the year, the stock market may go up amid fluctuations, of which the policy-supported infrastructure industry chain and the consumer segment benefiting from the economic rally after the recent COVID-19 outbreak are expected to outperform others; the bond market yield may rise but to a limited extent compared with the first half of the year; and commodities may face downward pressures amid the Federal Reserve's continued interest rate hikes and the growing expectations for a global recession.

To obtain the full report, please call our Customer Service Hotline +852-2860 7111.

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中诚信国际
CCXI

中诚信国际信用评级有限责任公司

地址： 北京市东城区朝阳门内大街
南竹竿胡同 2 号银河 SOHO6 号楼
邮编：100020

电话： (8610) 6642 8877

传真： (8610) 6642 6100

网址： http://www.ccxi.com.cn

China Chengxin International Credit Rating Co., Ltd

Address: Building 6, Galaxy SOHO,
No.2 Nanzhugan hutong, Chaoyangmennei Avenue,
Dongcheng district, Beijing, 100020

Tel: (8610) 6642 8877

Fax: (8610) 6642 6100

Website: http://www.ccxi.com.cn

中誠信亞太
CCXAP

中国诚信(亚太)信用评级有限公司

地址: 香港中环康乐广场 1 号
怡和大厦 19 楼 1904-1909 室

电话: (852) 2860 7111

传真: (852) 2868 0656

网址: http://www.ccxap.com

China Chengxin (Asia Pacific) Credit Ratings Company Limited

Address: Suites 1904-1909, 19/F, Jardine House,
1 Connaught Place, Central, Hong Kong

Tel: (852) 2860 7111

Fax: (852) 2868 0656

Website: http://www.ccxap.com