CBH | Investment Management

China: Authorities Have taken Action, but Caution is Warranted

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CREATIVITY WITHIN EXCELLENCE

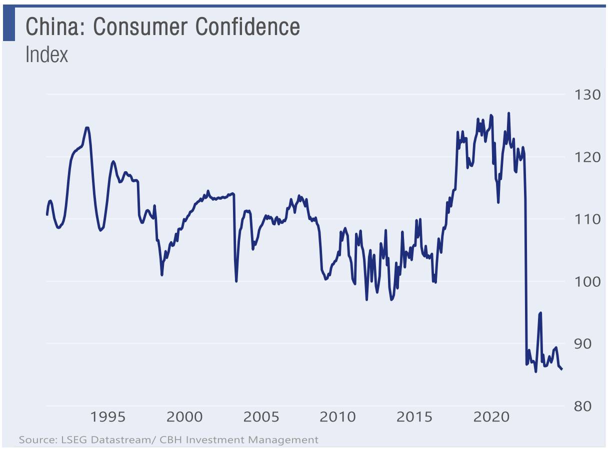
China: Authorities Have taken Action, but Caution is Warranted

Against a challenging economic backdrop of deflationary pressures, a deepening real estate crisis and a struggling stock market, the Chinese authorities unveiled a substantial package of stimulus measures to revive growth and support the property and stock market. The scale and coordination of these efforts exceeded expectations, boosting market sentiment and triggering a sharp response. As a result, the CSI 300 blue-chip index surged more than 25% in just one week, reflecting renewed optimism.

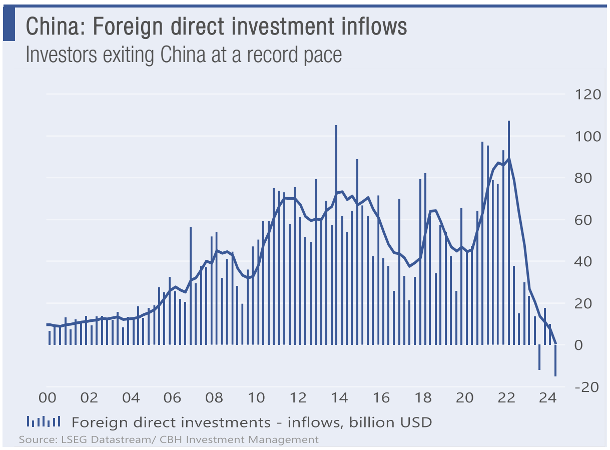
1. China is a leading trade partner, but the macroeconomic environment is weak

China remains the world's largest manufacturing center and a leading trade partner, playing a crucial role in the international supply chain. The country has become a major driver of global innovation, with rising R&D spending. In addition, China is also a dominant player in the global mineral processing industry.

China's weak social protection system has however led households to accumulate substantial precautionary savings, much of which has been invested in property. But, as property values fall amid the ongoing real estate crisis, this has triggered a negative feedback loop. Falling property prices are eroding household wealth, further undermining consumer confidence and leading to an even greater propensity to save. In response, many Chinese are shifting their savings into assets perceived as safer, such as gold, as they seek to protect their wealth amid rising uncertainty and economic headwinds. This dynamic is exacerbating the current crisis, with weakened consumer demand stalling the economic recovery and putting additional strain on the broader economy.



Although the stimulus measures are designed to inject liquidity into the housing and stock markets, their future impact on growth and retail sales is likely to be limited due to inadequate targeting. In our view, a greater focus on demand-side measures is critical to improving growth prospects, especially given the external challenges China faces. Foreign investor sentiment remains weak, with multinationals cutting back on new investments or even divesting from existing assets. These domestic economic hurdles, combined with deteriorating geopolitical relations, are further undermining investor confidence.



2. The economic impact of the measures may be limited

Monetary easing may lower borrowing costs, but both households and companies may remain reluctant to borrow, while banks may be cautious about lending. Additionally, Chinese households no longer view real estate as a preferred investment, a sentiment that will be difficult to reverse. Recent policy signals from the Politburo have raised hopes for a substantial fiscal stimulus to stabilize the property market, along with structural reforms focused on boosting employment, supporting low- and middle-income households, and encouraging foreign investment. However, no specific stimulus measures were unveiled at the National Development and Reform Commission's press conference on October 8th, leaving markets uncertain about concrete actions.

3. China's stock market hit by decline in investor confidence

Retail investors dominate China's A-share markets in Shanghai and Shenzhen, holding roughly 80% of the total market share. Meanwhile, around 80% of Chinese household wealth is tied up in real estate. In this context, the ongoing property crisis has taken a toll on consumers, driving them away from the stock market.

Foreign investors have also become wary of Chinese assets due to regulatory uncertainty, the severity of the property liquidity crisis, and sluggish consumer demand. Escalating tensions between the U.S. and China have only worsened this outlook, with some investors, including the U.S. federal government's main pension fund, excluding Chinese and Hong Kong-listed stocks from their portfolios, as evidenced by the fund's decision to halt investments in China at the end of 2023.

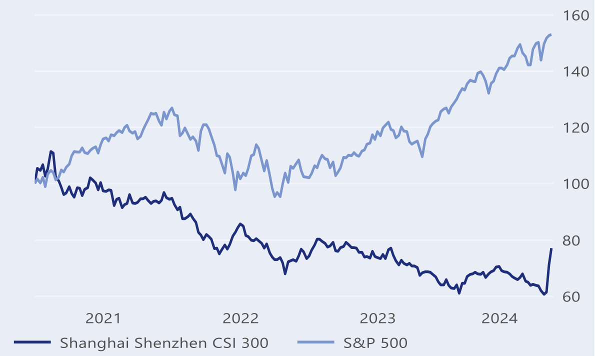
4. How to navigate this environment?

Chinese, European, and mining equity markets have rallied in response to the recent stimulus package. However, the economic impact may not be as strong as anticipated. Sectors linked to China, such as luxury goods and mining, are unlikely to see a sharp rise in demand, especially as China has been stockpiling commodities.

The recent rebound in Chinese markets is correcting some of the excessive pessimism of recent years, but it will take time to restore confidence among both domestic and foreign investors. Market volatility is likely to persist, and high expectations may lead to disappointment. While China faces significant structural and cyclical challenges, its leadership in key industries remains significant. Investors should remain cautious and selective, focusing on fundamentals to navigate this uncertain environment.

US & Chinese Equity Markets

Index, rebased



Source: LSEG Datastream/ CBH Investment Management

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Geneva
Headquarter
CBH Bank
Bd Emile-Jaques-Dalcroze 7
P.O. Box
1211 Geneva 3, CH
cbhbank.com
t +41 22 839 01 00

Zurich
Branch Office
CBH Bank
Bahnhofstrasse 82
P.O. Box 1213
8021 Zurich, CH
cbhbank.com
t +41 44 218 15 15

Luxembourg
SICAV
1618 Investment Funds
106, route d'Arlon
L-8210 Mamer
Grand Duché de Luxembourg
1618am.com

London
Subsidiary
CBH Wealth UK Limited
2-4 Cork Street, London
W1S 3LG, UK,
cbhbank.com
t +44 207 647 1300

Hong Kong
Subsidiary
CBH Asia Limited
Suite 2001, 20th Floor, K11 ATELIER, 18-24 Salisbury Road, Tsim Sha Tsui, Kowloon, Hong Kong, HK
cbhbank.com
t +852 2869 0801

Nassau
Subsidiary
CBH Bahamas Ltd.
CBH House, East Bay Street
P.O. Box N-1724
Nassau, N.P., Bahamas
cbhbank.com
t +1 242 394 61 61

Rio de Janeiro
Subsidiary
1618 Investimentos
Av. Ataulfo de Paiva, 204 Salas 305 a 308
Leblon, Rio de Janeiro/RJ
CEP: 22440-033, Brazil
1618investimentos.com
t +55 21 3993 6901

São Paulo
1618 Investimentos Subsidiary
Rua Iguatemi, 192
Itaim Bibi, São Paulo -SP
CEP: 01451-010
Brazil
1618investimentos.com
t +55 11 4550 4401

Tel Aviv
Representative Office
CBH Bank
Rehov Tuval 40
Ramat Gan
5252247 Israel
cbhbank.com
t +972 73 793 62 22

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CBH | Compagnie Bancaire Helvétique

Asset Management
Boulevard Emile-Jaques-Dalcroze 7
P.O.Box
CH - 1211 Geneva 3

am@cbhbank.com
www.cbhbank.com