Rosefinch Weekly

What's Behind A-share Correction?

Last week the China stock market saw SHSE +0.04%, SZSE -0.86%, and GEM -2.72%. This was despite favorable macro environment and increased liquidity. What's behind the market correction?

On the monetary policy front, PBOC reduced 1Y MLF rate from 2.95% to 2.85% and 7D reverse Repo rate from 2.20% to 2.10%. The monthly published LPR rates followed suit with 1y LPR from 3.8% to 3.7% and 5y LPR from 4.65% to 4.6%. While the PBOC delivered first rate cuts since April 2020, it usually takes some time for the real economic demands to respond. Traditionally Jan is a big month for loan disbursement, but the rate cut didn't come ahead of the annual wave. The loan demand remained weak as market waited for the expected cuts. The overall economic condition remains soft with weak consumption demand the structural employment issues. Now that PBOC has started its rate cuts, we'd expect continued loose monetary policy until increasing credit and funding demands feed through the economy.

PBOC official said: "(PBOC) needs to open wider the monetary policy toolbox in order to avoid credit and loan market's collapse; to precisely and proactively move forward with fast response to market concerns; financial institutions should not only welcome incoming clients, but proactively go out to engage them." These words of concern reflect PBOC's determination to support the economy and continue its rate cut campaign while guiding looser credit conditions towards targeted areas of the economy.

The PBOC rate cut effectively reduced the A-share pressure from US rate hikes. These cuts demonstrated central bank's determination for "monetary independence", and shifted market's gaze from FED tightening to domestic monetary and credit conditions. Even though the US and China rates are heading in opposite directions, the tightening rate spread did not lead to large capital outflow. Instead, the strong supportive domestic policy and relatively stable economic conditions provide favorable fundamentals for China A-share market. We see sustained buying of A-shares via Stock Connect, with over 29 bio RMB Northbound purchases this week. Despite the PBOC rate cut, the USD/CNY exchange rate actually saw CNY strengthening, showing market's favorable view of China's macro conditions.

So if monetary policy is supportive, capital flow is positive, why did we still see some correction in the China equity market? Last week the China stock market saw SHSE +0.04%, SZSE -0.86%, and GEM -2.72%. **The drop reflected some disappointment in the actual loan disbursements in January. The rate cut announcement does help, but will take time to feed through the financial system.** It remains to be seen if the monetary stimulus can translate into sustained higher economic activities. **The subsequent policy moves may target actual delivery of looser credits towards targeted areas in the real economy. As valuation recovers, the equity market's attractiveness will increase again.**

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We have recently published a number of articles as part of our 2022 Research series: please see the Market Insight section at http://www.rosefinchfund.com/en/index.html

And lastly, China will be on holiday next week for the Chinese New Year celebration! We will be away from office for the week of Jan 31st.

On behalf of the whole Rosefinch Team, we wish you a very healthy, wealthy, and happy Year of Tiger ahead!