Manulife Investment Management

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Mainland China (China) recently announced a raft of policy support measures to ease COVID-related curbs, bolster financing and the property sector. Paula Chan, Senior Portfolio Manager, Asia Fixed Income, and Isaac Meng, Portfolio Manager, Asia Fixed Income, see opportunities in China credits amid the government's property market support. They view the latest measures positively, which point to China's economic reopening and eventual recovery of its property sector.

China's double pivot — A major shift in China's COVID and property sector policies

China recently announced a raft of policy support measures to ease COVID-related curbs, and bolster financing support with a focus on the property sector. Here are the key measures announced:

1. Adjustments to Covid-related restrictions

On 11 November, China announced 20 measures to fine-tune its zero-COVID policy.[1] The seven-member Standing Committee of the Politburo of the Chinese Communist Party, China's top decision-making body, held a meeting to discuss measures aimed at improving the country's COVID controls.

Key announcements included:

- A shortening of the quarantine requirement for close contacts and inbound travellers to five days of quarantine and three days of home monitoring. This replaces seven days of quarantine and three days of home monitoring.
- A suspension of the "circuit-breaking" mechanism for inbound flights.
- Restrictions on the unscientific approach of conducting two-to-three PCR tests per day.
- Local officials will be held accountable for unnecessary control measures, such as suspending face-to-face classes and production, implementing traffic controls, and introducing arbitrary lockdowns.

While the default "dynamic COVID-zero policy" remains essentially unchanged, the Standing Committee asked the government to fine-tune its approach to COVID-control policies in a more "scientific and precise" way.[2]

2. Financing support for the property sector

On 9 November, the National Association of Financial Market Institutional Investors (NAFMII), together with the People's Bank of China (PBoC), announced that a RMB250 billion funding facility ("the second arrow") would provide support for private corporate-bond financing.[3] This includes the purchase of property-developer bonds in both the primary and secondary markets. The RMB250 billion package, which can be increased if required, equates to roughly one-third of all private developers' outstanding onshore and offshore bonds maturing in the next 12 months. In total, property sector bailouts have added up to about RMB600 billion, which is

[1] Bloomberg, 11 November 2022.
[2] China Daily, 15 November 2022.
[3] Global Times, 9 November 2022.

close to meeting the short-term liquidity needs of the sector.

On 21 November, the PBoC announced plan to issue RMB200 billion interest-free relending loans to six commercial banks through 31 March 2023, in an aim to help ensure delivery of unfinished property projects.

Also, on 23 November, the PBoC and China Banking and Insurance Regulatory Commission (CBIRC) officially issued a notice with 16 measures that will support financing for the property sector.[4] The focus will be on developer loans to promote stability and the healthy development of the housing sector. In contrast to previous piecemeal announcements, the measures take a more comprehensive and concerted approach to addressing the financing needs of developers – the policies include guaranteed bond issuance, developer loans, trust loans, mortgages, and acquisition loans.

Regulators also called on financial institutions to support the extension of maturity dates for developer and trust loans. For loans due in the next six months, lenders have been asked to extend the repayment period by one year, while bond issuers and bondholders have been encouraged to reach agreements on repayment and loan extensions before the bonds mature. At the same time, banks are being encouraged to assume control of any high-quality developers' problem projects via acquisition loans. National and local asset-management companies have also been asked to collaborate with developers and banks to accelerate asset disposals.

A more constructive outlook of China's property sector

In our opinion, the recently announced zero-COVID fine-tuning ("20 measures") and financing programs for property-sector developers ("16 measures" and "the second arrow") support our 2023 base case. We expect further economic reopening after March, property sales and investment could bottom and stronger domestic demand to support GDP growth throughout 2023.

The "20 measures" fine-tuning of China's zero-COVID policy is positive as it signals an eventual economic reopening. While we have observed early signs that some of these measures have been implemented in a limited number of cities, the timing and extent of reopening will depend on COVID case numbers through the winter months. In the near term, a rebound in the macro economy will likely be limited as overall COVID-control policies remain strict. Meanwhile, we already see a rise in winter cases, with daily numbers breaching 20,000 for the first time since May, although most are without symptoms.

We view the announced "16 measures", "the second arrow" policies and the RMB200 billion relending loan plan as positive, easing the onshore debt refinancing risk of Chinese developers, particularly among the privately owned enterprises (POEs). However, we note that policymakers are focusing on safeguarding onshore stakeholders, including onshore bondholders, homebuyers, and the banking system. Offshore bondholders will indirectly benefit from POEs having lower onshore refinancing risk, including bond and bank lending. Nevertheless, these measures can help the sector find a bottom over the next 12 to 18 months. To see a sustained recovery in China's real-estate sector, we will closely monitor the effective implementation of the announced measures and any recovery in physical market sales.

Overall, we view the latest policy announcements positively, as they should pave the way for economic reopening and an eventual recovery in the property sector from the second quarter of next year. That said, near-term market volatility should remain high as economic activity is expected to stay sub-par for another few quarters.

[4] CBIRC, 23 November 2022.

Stay disciplined amid increasing policy support

Leading up to these policy pivots, the China bond team closely monitored developments that could lead to a more constructive tone in China credit. This included the prospects for "The Reopening Trade" and "All in Policy Bazooka" to support China's economic recovery (refer to our previous Investment Note – China bonds: a potentially resilient risk diversifier, 18 October 2022).

While we may not be there yet in terms of an "all in" effort by the government to boost economic growth, we view the latest developments as a significant and favourable shift in policy towards China credit. To date, investors might have taken advantage of the market rally to trade and rebalance property exposure across their portfolios tactically. Looking ahead to the year's end, we believe remaining disciplined and maintaining credit beta at around current levels would be rewarding. However, as we gain more visibility and conviction around China's economic recovery, investors can seek opportunities to add risk.

We continue to take a disciplined approach to our property exposure. We see increasing policy support as constructive for China property and the broader China credit universe, given the improved prospects for economic recovery as we enter 2023. Following the steep declines experienced by property-sector bonds in 2022, valuations are now attractive for those developers explicitly backstopped by government funding support. As sentiment towards the sector continues to improve, we would expect asymmetric upside potential for the performance of our China bond strategies over the next few quarters.

Conclusion

In our view, the latest developments indicate a significant shift in policy direction, which could potentially be favourable towards China's credit market. Despite this, we remain disciplined towards year-end, until China's economic recovery shows more visibility. For actively managed China bond strategies, we expect to see more upside than downside potential over the next few quarters.

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