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EMERGING MARKETS DEBT | INTERNATIONAL/GLOBAL

China's Outlook Mixed After Reopening

By: Emerging Markets Debt | June 14, 2023

Boston - The relaxation of China's zero-COVID policy has once again opened the door for in-person country research. The Emerging Markets Debt team moved quickly to revisit the world's largest emerging market (EM) to conduct on-the-ground sovereign and corporate research, which acts as an essential input for building our proprietary views. In this post, we discuss the key highlights.

At the macro level, the economic rebound appears disappointing in terms of pace and magnitude, with March's figures whispered to be worse than February's. While sentiment remains weak, it is unclear whether we will see pent-up demand underpin stronger consumption and private investment in the coming months. The government is emphasizing "high quality growth," which we interpret to mean increased state intervention in practice.

Property: All go or all woe?

Our trip included an investor tour of the Greater Bay and Yangtze River Delta areas, which covered tier-one cities Shanghai and Guangzhou and other smaller locations. We visited the residential and commercial projects of state-owned enterprise (SOE) and private-owned enterprise (POE) developers, met their management teams and also consulted with property sector experts.

A number of property sector themes emerged from our meetings:

Uneven recovery. Top-tier cities appear better placed for a property recovery than second- and lower-tier locations, while urban centers look stronger than remote areas. For example, home prices in cities such as Shanghai have remained strong — despite price-caps on primary residences, which only sustained demand — while prices in Wuxi, Changzhou and Zhuhai have been lower, with developers even providing discounts of up to 10%. For commercial property, footfall in malls has recovered more strongly in cities than remote areas.

Recovery sustainability. Notwithstanding the recovery's uneven pace, sales performance was improving for the cities and the projects that we visited compared to the end of 2022. Pent-up demand post-lockdown provided the impetus for stronger activity. Sales for high-end projects outperformed the mid- to low-end segment, which may reflect a comparatively smaller impact from COVID on more affluent buyers. While the early sales bump was positive, the sustainability of the recovery now appears less certain, as sentiment and financing conditions remain relatively weak.

SOEs versus POEs. Homebuyers show a general preference for SOE companies, with POE developers plagued by investor fears over project completion. In this respect, refinancing and repayment plans are always key topics when meeting corporate management, as SOEs have an advantage in accessing funding while some weaker POEs are seeing bank credit lines cut. All in all, we prefer SOE property developers considering their stronger sales and consistent access to funding.

Gaming and TMT

Away from property uncertainty, we saw some brighter spots. In Macau's gaming sector, for instance, the recovery looks set to continue. Although the picture is mixed among operators, many are repairing balance sheets post-COVID, which should be helped by less onerous capex requirements under new gaming concessions. Visitor numbers from mainland China have exceeded expectations, and evidence suggests they will remain strong ahead. We expect Macau's gaming recovery to be similar to that of Las Vegas, Singapore and Malaysia, which have all seen activity bounce back above pre-COVID levels.

Elsewhere, technology, media and telecommunications (TMT) companies are also seeing healthier revenues. We expect the better quality businesses to remain disciplined on operating cash flows and leverage, even as revenues improve. Competitive pressures are unlikely intensify significantly, as companies remain cost conscious and the regulator would likely prohibit monopolistic behavior like subsidizing customers. On balance, the country's regulatory environment appears less unfriendly compared to 2021, with more regular video game license approvals of late, which is critical for the TMT sector.

High yield bonds

Refinancing of U.S. dollar (USD) bonds from high yield issuers in the current market is challenging, as companies remain reluctant to

refinance at double-digit interest rates. Investors, for their part, are less comfortable lending to companies that have limited onshore banking support.

That said, some issuers are seeing material improvement in operating cash flows post-reopening, which improves their liquidity and chances of receiving onshore financing. Other companies are actively exploring alternative funding sources, such as asset-backed financing, financial leasing, syndicated loans and onshore bonds. We will be watching for any progress from these borrowers ahead.

Bottom line: While virtual country visits have served us well in recent years, there is no substitute for being on the ground and witnessing developments first-hand. When there is a mixed outlook for an economy and company dispersion across sectors, such as we are seeing in China today, solid country and corporate research remain key for identifying opportunities and avoiding potential pitfalls.

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