Mizuho Chart Speak: China

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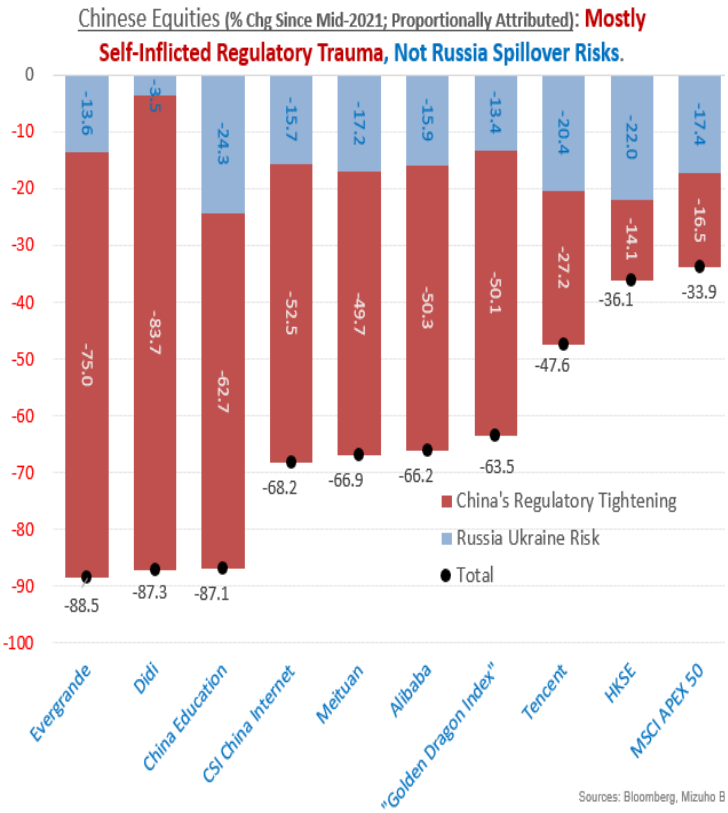
China's Policy Risk is "Too Little, Too Late"



In a Nutshell: As China gears up to shore up the economy, **Russia-Ukraine risks** and **COVID disruption** are admittedly unwelcome setbacks. Nonetheless, these "external risks" **pale in comparison to self-inflicted regulatory assault**, as the **single biggest threat to the economy**. Especially given the deep and wide economic pain these regulatory crackdowns may inflict via a conspiracy of balance sheet, liquidity and confidence channels. In contrast, the **ability to nimbly exploit efficient vertical supply-chains** and **domestic demand** alongside adequate policy buffer provide comparatively greater cushion against such geo-political; shocks and pandemic disruptions.

All said, the **real danger** is not a lack of policy capacity or willingness, but that **Beijing may do "too little, too late" in a misguided pursuit of conflicting regulatory/social objectives**. The hope is that recent announcements about backstopping markets translates into decisive and emphatic stimulus, but the reality may be a messier struggle to coordinate and align conflicting regulatory and economic objectives.

No Pain Like Self-Inflicted Wounds

China's single-biggest "spook factor" at this moment is *neither the threat of stagflationary fallout from uncontrollable Russia-Ukraine conflict, nor risks of activity disruptions from COVID lockdowns.* Rather, its **self-inflicted regulatory assault**. *Especially* from ***acute liquidity constraints*** and ***elevated uncertainty imposed on*** the **expansive property** sector and the **fast-growing high-tech** space.

It takes little to surmise from **benchmark Chinese equities** *(Evergrande* to *Didi, Meituan, Alibaba and Tencent),* **a brutal story of "poster-to-whipping boy"**. The **greatest trauma** has undeniably been **inflicted by Beijing's regulatory clamp-down**; once equity moves are appropriately attributed (See Charts above).

Blind Spots & Buffers

Counter-intuitively, **Beijing's own policy blind-spots pose the greatest threat**. What's perverse is that the *"illusion of control"* on regulatory policies risk breeding complacency, resulting in potentially devastating **policy miscalculations**. Whereas, **despite a lack of control over geo-political or pandemic risks**, or perhaps because of, China may mobilize **substantial policy buffers to blunt "external" blows**.

Point being, **if China musters all its policy levers**, it **may yet ride out geo-political disruptions**. Especially given *extensive vertical supply-chain* housed onshore along with *significant domestic demand* confers significant advantages over Europe or the rest of EM Asia. Moreover, industrial efficiencies to *rapidly restore supply-side activity* will mitigate **economic drag from COVID disruptions** (as was the case before). But it **cannot fix that which it cannot identify**; rendered far more **vulnerable to its own policy blind-spots**.

Scepticism

Accordingly, there has been **deep scepticism born out of policy dissonance,** *and not just indifference due to forward-looking COVID disruption worries,* **about the stellar economic out-run across industrial activity, retail sales and fixed asset investments** (for Jan-Feb).

From Muddling Through to Mis-firing

Particularly, with regards to very real dangers that Beijing **inadvertently stumbles from muddling through uncoordinated crackdowns** across various sectors **to mis-firing altogether**; *shooting its own foot.* Especially *given* that *continued stress in the property and tech sectors* not only staunchly oppose, but **threaten to overwhelm**, the **policy intent to unambiguously stimulate the economy** to greater buoyancy.

(Balance) Sheet Hitting the Fan

In particular, **balance sheet shocks**, exacerbated by, and aggravating, the **liquidity crunch** (as lenders spooked by plunging collateral valuations pull lines) and **adversely impacting jobs/investments** via **pernicious confidence channels** pose an **asymmetric and disproportional downside risk**. One that is *not as easily reversible by means of policy dial back.*

"Too Little, Too Little" Risks

Notwithstanding the **overarching policy stance of unambiguous stimulus** (revealed first at December's CEWC, then reiterated at the NPC in March), the **real danger is that stimulus may be "too little, too late"** *to sufficiently offset significant drag from the property and tech sectors;* both which have yet to experience meaningful relief. **Especially given**, what is likely to be, **underestimated negative shocks multipliers** associated with the pervasive reach of both these sectors.

To that end, **pronouncements of government support to backstop excessive equity market sell-off** today is **encouraging**. ***But* falls short of a guarantee that policy mis-steps will be averted**. But the trouble is, there are **no unequivocal signs that Beijing has resolved the policy contradictions** inherent in (and amplified by) the misguided pursuit of property/tech crack-down in the midst of global economic headwinds. And so, the risk of a ***messy path caught between economic exigencies and the politically important "common prosperity" campaign may more likely not cost the economy***.