

China Insights

NPC 2020 – No target but still focused

June 2020



Summary

- ◆ In a delayed session of the National People's Congress (NPC) China dropped its numerical growth target for 2020, reflecting significant macro headwinds from the COVID-19 pandemic and high level of external uncertainties
- ◆ Accommodative macro policies and an emphasis on effective implementation should help an ongoing economic recovery from a sharp contraction in Q1, though challenges remain and the recovery path is uncertain
- ◆ The spending priority will be on reviving domestic demand, through higher health spending, more support for enterprises/SMEs, and tech-focused infrastructure initiatives

NPC 2020 – No target but still focused

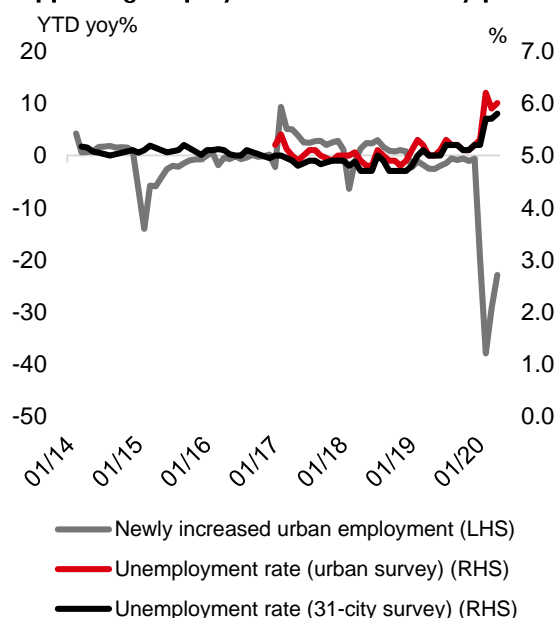
In a delayed session of its annual meeting China's parliament refrained from setting a GDP growth target for the first time in almost two decades and committed to more government spending to revive its pandemic-hit economy.

Focus on employment and socio-economic stability

The lack of a numerical growth target for 2020, reflects the significant macro headwinds from the COVID-19 pandemic and the high level of external uncertainties over global economic outlook and US-China relations. This makes policy support even more crucial to ensure stability. We think the absence of a growth target would allow the continuation of a targeted and measured policy approach.

Supporting employment has been flagged as the key priority this year and the government has pledged to create 9 million new urban jobs and keep the surveyed unemployment rate at ~6% (vs. 11 million and 5.5% respectively in 2019). In the first four months, urban new job creation was down 22.9% yoy, though the number of "go-out" migrant workers (from other provinces) recovered to 90% of the April 2019 level. The service sector accounted for most of the job losses in the first half, but manufacturing jobs face risks from weak exports, faster automation and potential supply-chain shifts. An ongoing recovery should help absorb a large part of the displaced workforce in the second half of the year, but pressures on the labour market remain.

Supporting employment is China's key priority



Source: NBS, HSBC Global Asset Management, May 2020

NPC 2020 – No target but still focused (cont'd.)

Expansionary and proactive fiscal policy with a wider fiscal deficit

To deliver economic and social stability, the government has set a general budget deficit target of 3.6% of GDP (the government projected 2020 GDP) or above, higher than the 2019 target of 2.8% and representing an increase in the revenue-expenditure gap by RMB1 trillion. The government has expressed its flexibility and willingness to raise the level if necessary. That said, the actual budget deficit is likely to be larger at ~6.5% of GDP, after taking into account the planned transfers from budget adjustment funds and drawdowns from fiscal deposits. Meanwhile, expenditure in the government managed fund is projected to rise strongly by 38% yoy and the fund deficit will be mainly financed by issuances of local and central government special bonds (LGSB & CGSB) for pandemic relief. The CGSB proceeds and the extra RMB1trn planned in general budget deficit will be transferred to local governments under a special transfer scheme, to fund tax and fee cuts and rental and interest subsidies and to support employment, consumption and investment. The annual corporate cost saving is expected to exceed RMB2.5trn vs. RMB2.36trn realised in 2019. Overall, combining the general budget deficit with the LGSB and CGSB issuances, the broader deficit would amount to 8.1% of GDP vs. 5.0% in 2019. Moreover, quasi-fiscal financing such as LGFV bonds, bank loans to LGFVs, policy bank special bonds and China Railway Corp.'s borrowings, may accelerate LGFVs raised a net RMB1.0trn in onshore bond markets over the first four months (vs. RMB1.2trn over full-year 2019).

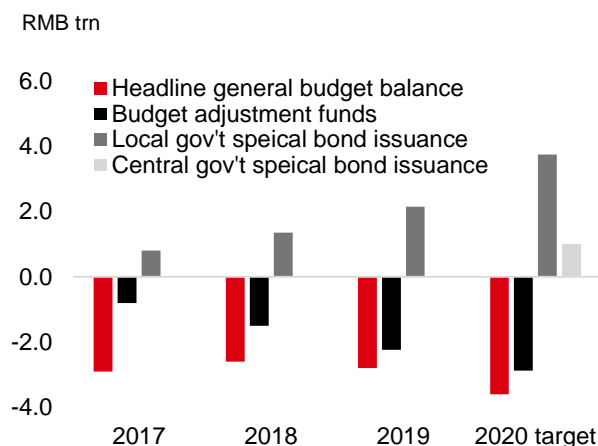
“Flexible and appropriate” monetary policy

Authorities will utilise multiple policy tools, including RRR and rate cuts and re-lending, etc. to boost (M2) money supply and aggregate financing growth “significantly above” 2019 levels. We think the focus will be on the credit transmission to support the real economy, reducing the financial burden on the corporate sector (especially SMEs) and accommodating the financing of fiscal deficits/bond issuances. To aid MSMEs, the debt moratorium will be extended to March 2021 from June 2020, and large banks will be required to increase lending to SMEs by $\geq 40\%$ yoy this year. Authorities will improve the government guarantee mechanism, support corporate bond financing, and develop supply-chain finance. The current inflation trajectory and outlook suggests that the 3.5% CPI target this year is unlikely to constrain the implementation of more expansionary policy, in our view.

Focus on reviving domestic demand

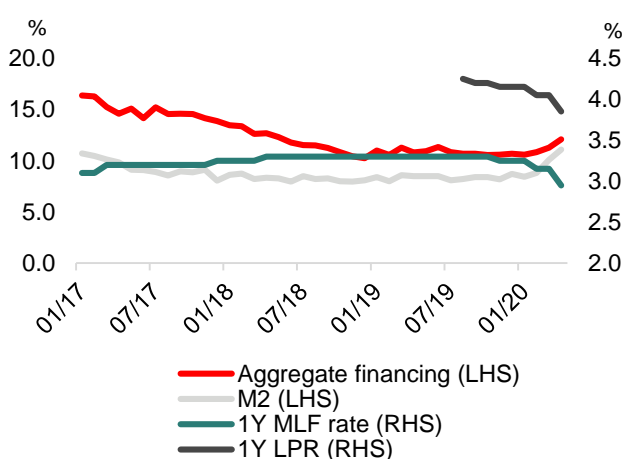
We think accommodative macro policies and an emphasis on effective implementation should help an ongoing economic recovery from a sharp contraction in Q1, though challenges remain and the recovery path is uncertain. The spending priority will be on reviving domestic demand, through, among others, higher health spending; more support for enterprises/SMEs; and “effective” investment with a focus on “new” infrastructure (e.g. 5G network, industrial internet, data centres and NEV charging stations, etc. to drive its global technology dominance plan) and new urbanisation (e.g. renovation of 39,000 old urban communities this year vs. 2019 target of 19,000). But investment in urbanisation-related “traditional” infrastructure will continue to get policy support. No big property policy easing is expected, but more accommodative monetary and credit conditions as well as land and hukou reforms may be supportive. In addition to factor market reform (land, hukou financial, etc.), the government has also pledged further opening of the domestic market and SOE reforms (e.g. using capital market and securitisation to raise state capital returns for SOEs in competitive sectors, and protecting an equal footing of private property rights).

Expansionary and proactive fiscal policy



Source: NBS, HSBC Global Asset Management, May 2020.

“Flexible and appropriate” monetary policy



Source: PBoC, HSBC Global Asset Management, May 2020.

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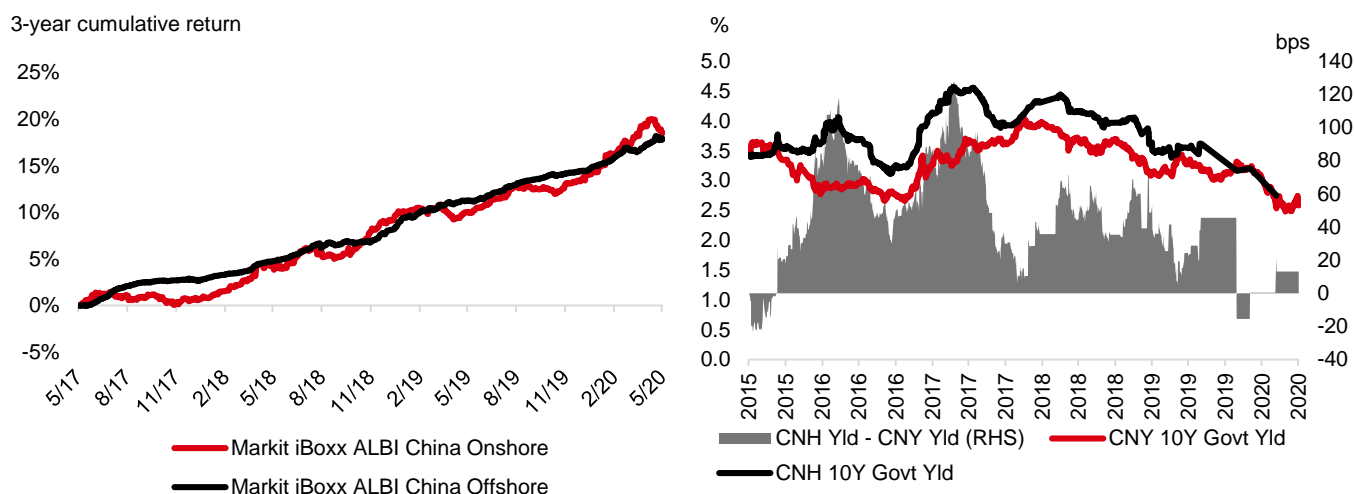
In the following pages we will take a deeper look at how recent events and policy measures are impacting Chinese fixed income and equity markets:

Fixed income

April saw USD7 billion of inflows into the onshore bond market, driven by foreign purchases in short-dated government papers

- ◆ In the past month, the onshore government bond yield curve has steepened due to a mixed bag of increased supply, growth recovery expectations, positioning adjustments and global rate curve steepening. As a result, the onshore RMB bonds, measured by iBoxx ALBI China Onshore Index, shed 1.2% in the month ending 22 May, reversing a 1.4% increase in April. The offshore gauge, the iBoxx ALBI China Offshore Index, added 0.2% for the same period, after a 0.8% pick up in the previous month. In the offshore China dollar credit market, investors continued to prefer risky asset, with the high-yield bonds rising 2.2% in the month. The investment grade universe added 0.8% in May
- ◆ Market participants are currently expecting a further reduction in medium-term lending facility (MLF) rate and reserve-requirement ratio in the upcoming months
- ◆ A slew of recent credit data has suggested that monetary policy has been effective thus far. This means authorities may reevaluate the effectiveness of the next round of easing measure, probably to provide more targeted measures to aid small companies and employment in the service sector. We believe monetary policy support has not run its course yet as the pace of economic recovery may be hampered by domestic and external challenges going into the second half
- ◆ In terms of fund flows, China bond market received decent inflows in April, largely driven by short-dated government bonds. Net inflows into onshore bonds reached USD7 billion last month, reversing a moderate outflow in the prior month. This is mainly due to USD7.3 billion worth of foreign purchases in short-dated government bonds in the 1-3 year notes, followed by 3-5 year bonds. On a year-to-date basis, foreign inflows have reached USD18 billion
- ◆ Besides the PBoC's easing stance, carry of Chinese bonds has become more attractive given enlarged China-US rate differentials. In the current environment, we continue to favour long duration and stay prudent in our credit selection

Chinese bonds remain steady amidst new rounds of global easing



Source: Bloomberg, Markit data as of 22 May 2020. Total return in local currency terms.

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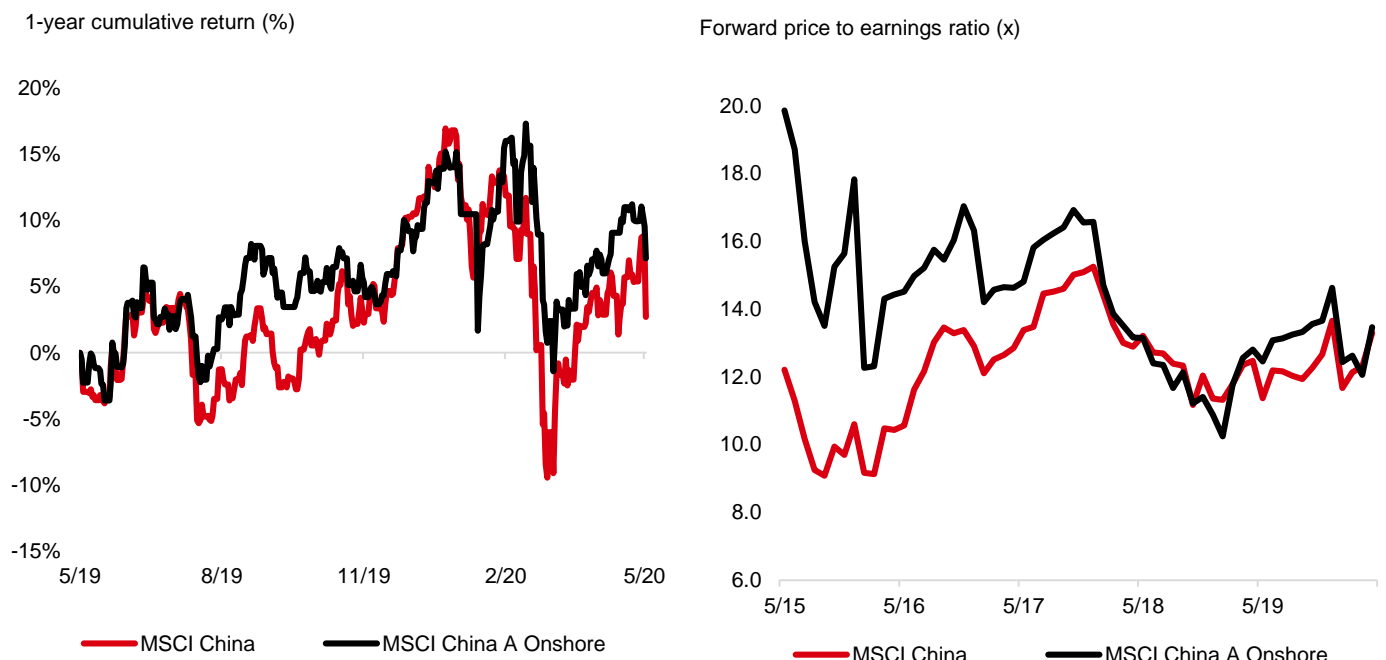
Investment involves risks. Past performance is not indicative of future performance

Equity market

After a recent pull back in the regional market, the 2020 price-to-earnings ratios for MSCI China and CSI 300 Index are at 12.3x and 11.5x, respectively

- ◆ Both onshore and offshore Chinese equities fell in May, in part due to worries over the trajectory of China's economic recovery and renewed China-US tensions. On a month-to-date basis, MSCI China A Onshore and MSCI China shed 1.8% and 2.9% ending 22 May, respectively, while the tech-heavy ADRs gave up 0.5% over the same period. CSI 300 Index of the largest companies in the countries gave up 2.1%, while the ChiNext Index, the gauge of small-cap stocks, dropped 1.1%
- ◆ Among the market moving incidents over the past month, the US Senate passed the Holding Foreign Companies Accountable Act on 20 May, prompting concerns over potential de-listing of Chinese ADRs
- ◆ On the other hand, the Hang Seng Indexes company announced that weighted voting rights or secondary-listed companies will be eligible for inclusion in the Hang Seng Index and Hang Seng China Enterprise Index, effective from August. Elsewhere, in a continuation of the index inclusion theme we've been witnessing over the past two years, FTSE will raise the China A-share inclusion factor in its global indices from 17.5% to 25% from 22 June
- ◆ In terms of fund flows (as of May 22), the southbound trade through the Stock Connect has recorded USD34.4 billion of net buying so far this year, while the northbound trade has seen USD7.2 billion of net purchase for the same period. For onshore investors, the Hong Kong-listed financial companies such as banks and insurance companies look attractive due to the valuation difference between A and H-traded shares. The equal-weight A/H premium is 102% and the market cap weighted premium is 45% over the A shares
- ◆ Following a recent pull-back in the regional market, valuations are now in an attractive range in terms of PE and earnings yield vs. bond yields. The 2020 price-to-earnings ratios for MSCI China and CSI 300 Index are trading at 12.3x and 11.5x, respectively, with an EPS growth of -1% and 9%. Going into the second half, we believe the government will launch more targeted stimulus measures to revive spending and investment, which could be supportive of equity market performance

Chinese stocks fall amidst global volatility



Source: Bloomberg, HSBC Global Asset Management, as of 22 May 2020. Total return in local currency terms.

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| Sector* | Outlook | Comment |
|------------------------|---------|--|
| Consumer Discretionary | + | ◆ In particular, we like the education space as it is relatively less sensitive to macro headwinds. Amid domestic consumption recovery, we prefer local brand names with strong online sales channel and low inventory levels, like sportswear companies. We added some local hotel and travel agency names as elimination of overseas travel will boost local travel. |
| Consumer Staples | + | ◆ Margin expansion capability of select strong staple brand names remains large with higher pricing power and ecommerce channel. Demand should recover quickly after COVID-19 outbreak, specially for alcoholic beverage, with policy support like “consumption coupons” |
| Energy | - | ◆ Oil price has dropped to lower levels with sharp drop in demand due to city lockdown and travel bans during global coronavirus outbreak, which we believe will take a long time to recover |
| Financials | - | ◆ We expect more loosening monetary policy in the next few months due to the weak economy. We are underweight banks as lower rates may add pressure to their net interest margins. We are adding some high quality insurance companies with long term growth opportunities at attractive valuations |
| Healthcare | + | ◆ We favour companies with strong R&D capabilities in innovative drugs and service providers with high growth visibility and solid business models |
| Industrials | O | ◆ We are currently underweight this sector but we are turning positive with more infrastructure projects to boost economy and full resumption of construction works |
| Information Technology | + | ◆ We are positive on the handset lens upgrade trend and we like names that can benefit from continuous tech upgrade as smartphone demand remains stable despite the coronavirus outbreak |
| Materials | - | ◆ We question the sustainability of the demand strength given global economic slowdown due to coronavirus outbreak. We prefer gold mining companies within the sector given the surge in gold price. |
| Real Estate | O | ◆ We are turning positive to property names as their funding cost pressure will be relieved by a loose monetary policy. We prefer property management companies from the longer term perspective as a defensive business with ongoing market consolidation. |
| Communication Services | - | ◆ We selectively prefer social platforms and cloud services companies, which are major ‘stay at home’ beneficiaries. Coronavirus outbreak will speed up technology adoption. |
| Utilities | - | ◆ We are not positioned defensively in our portfolio in the current market |

Source: Bloomberg, HSBC Global Asset Management, as of May 2020.

*NOTE - Sector views of HSBC Global Asset Management’s offshore Chinese equity team; “+” = positive, “-” = negative, “O” = neutral

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Data watch

| Indicator | Date | Actual | Consensus | Prior Analysis |
|---|------|----------|-----------|----------------|
| Industrial production (IP) (yoy) | Apr | 3.9% | 1.5% | -1.1% |
| Fixed Asset Investment (FAI) (ytd, yoy) | Apr | -10.3% | -10.0% | -16.1% |
| Retail Sales (yoy) | Apr | -7.5% | -6.0% | -15.8% |
| Exports (USD) (yoy) | Apr | 3.5% | -11.0% | -6.6% |
| Imports (USD) (yoy) | Apr | -14.2% | -10.0% | -0.9% |
| Trade Balance (USD) | Apr | 45.34 bn | 8.68 bn | 19.90 bn |
| CPI Inflation (yoy) | Apr | 3.3% | 3.7% | 4.3% |
| PPI Inflation (yoy) | Apr | -3.1% | -2.5% | -1.5% |
| Aggregate financing (AF) (RMB) | Apr | 3,090 bn | 2,775 bn | 5,150 bn |
| New yuan loans (RMB) | Apr | 1,700 bn | 1,800 bn | 2,850 bn |

- Indicates improved data on month-on-month/quarter-on-quarter/year-on-year basis
- Indicates worsened data on month-on-month/quarter-on-quarter/year-on-year basis
- Indicates no change in data on month-on-month/quarter-on-quarter/year-on-year basis

Source: Bloomberg, HSBC Global Asset Management, as of May 2020

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