China Insights

Monthly update on Chinese markets

Jan/Feb 2020

Summary

- Effective January 6, the latest RRR cut releases about RMB800 billion in long-term liquidity to boost the slowing economy
- The latest cut is intended to address the seasonal demand ahead of the week-long Chinese New Year holiday, as well as to fire up funding for infrastructure projects
- In 2020, monetary policy should remain prudent, with the government's focus shifting towards ensuring effectiveness and transmission of various support measures into the real economy

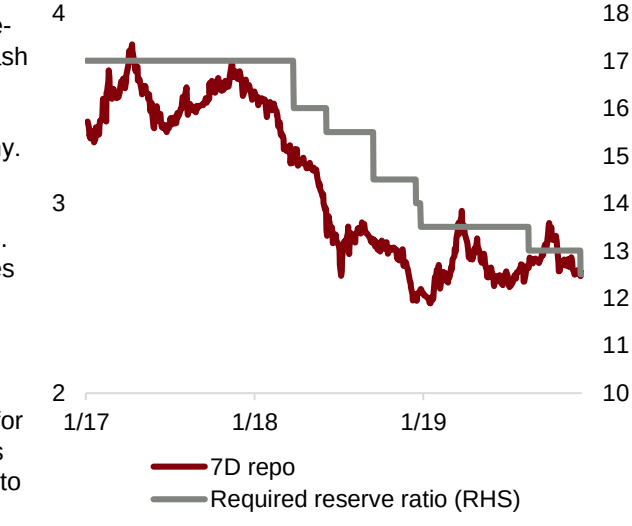
Hot topic: China cuts RRR to rejuvenate growth

The People's Bank of China (PBoC) announced a 50bp across-the-board cut in the reserve requirement ratio (RRR), the amount of cash that all banks must hold as reserves, on January 1. The move was largely in line with market expectations, and follows Premier Li Keqiang's call for more relief measures to support the real economy.

Effective January 6, the RRR cut released about RMB800 billion long-term liquidity with an aim to lower real economy funding costs. Given the policy priority, we expect more monetary policy measures ahead, amidst supportive liquidity conditions in the first quarter.

The latest cut came after Premier Li raised expectations of an imminent RRR cut in a speech in late December, saying the policymakers were mulling measures to bring down funding costs for smaller companies. The central bank has now cut RRR eight times since early 2018 to free up more liquidity for banks to lend in a bid to shore up growth.

RRR cuts: Liquidity remains reasonably ample



Source: NBS, HSBC Global Asset Management, Jan 2020

HSBC Global Asset Management

What are the implications?
We think the latest RRR cut reflects the policymakers' confidence in the health of the economy since the magnitude of the latest round is smaller than the 100bp cut, a year ago on January 1 2019. In fact, resilient consumer demand and the government's accommodative monetary policies have been effective in buffering the weakness in manufacturing sector and exports.

Looking ahead into 2020, we expect the pace of structural reforms will accelerate

Retail sales of consumer goods rose 8.0% year on year to RMB3.81.trillion in November, up from a 7.2% increase in October and beating market consensus. Meanwhile, total social financing, a broad measure of credit and liquidity, expanded to RMB1,750 billion in November from RMB619 billion in October.

In addition, we think the authorities are pre-emptively boosting the size of cash injections into the banking system in anticipation of major liquidity withdrawal during the Chinese New Year holiday. Besides the obvious reason for increase in cash demand ahead of the week-long holiday, the cash injection is also in preparation for a seasonally higher tax payment in January, which is estimated to be around RMB1 trillion according to prior years.

Secondly, it helps with the liquidity required for the purchase of large local government bond issuances. According to economists' estimates, there are about RMB130 billion of bonds in the pipeline. Government spending slowed as the annual quota for 2019 was fully utilised closer to the end of the year.

Thirdly, there is an operational need to smooth out the fluctuations ahead of sizable maturities in the banking system in January. Based on the central bank's data, the medium-term lending facility and open market operations loans due to be repaid in January will be RMB850 billion.

In terms of policy direction, monetary policy will likely remain reasonably prudent, with an aim to address the funding problems among small and private businesses

Going into 2020…
We see recent signs of stabilisation in growth and reduction in the producer price index. Cement production posted strong year-on-year growth, establishing that construction activities remain resilient. Passenger vehicle sales, a widely watched barometer of consumer spending, is gradually recovering from a steep contraction over the past year. Railway freight and industrial production accelerated further, indicating strong domestic consumption.

On the flip side, the downward pressures persist, as cost-saving initiatives amongst Chinese companies remains high. Over the past several months, major technology companies have announced their restructuring plans as they aim to boost their operational efficiency.

In addition, exports outlook remains challenging, even with the US and China agreeing to a trade truce. The phase one deal, which is set to be signed on January 15 in the White House, draws the two economies closer to a resolution, but some fundamental differences over technology, capital markets and investments are expected to stay on the discussion table for a prolonged period.

From a macro perspective, the lingering debate is whether the economic slowdown in China is a cyclical or structural one. Looking ahead into 2020, we expect the pace of structural reform will accelerate in order to address some of the stumbling blocks in China's long-term transition from a investment-led to a consumer-driven economy.

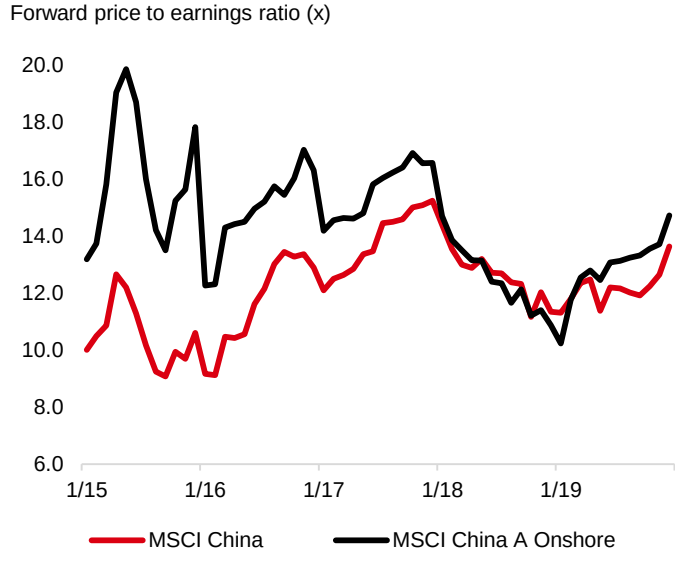
In terms of policy direction, monetary policy will likely remain reasonably prudent, with an aim to address the funding problems among small and private businesses. Policymakers will focus on improving the effectiveness of monetary and fiscal policy measures in 2020 to help achieve the annual growth target of around 6%.

Equity market

After blockbuster secondary listing of a Chinese tech major in Hong Kong last year, other US-listed Chinese firms are expected to list their shares in the Asian financial hub

- Both onshore and offshore Chinese equities started the year higher, extending their 2019 rally. As of 7th January, the MSCI China A Onshore Index rose 2.2%, while the MSCI China added 1.9%. Whereas the CSI 300 Index of the largest three hundred companies in China and Hang Seng Index advanced 1.6% and 0.5%, respectively
- Within the MSCI China universe, offshore-listed bank and insurance stocks edged lower after the People's Bank of China announced a broad-based 50bp cut in reserve requirement ratio on New Year's Day. Meanwhile, policy sensitive property developers, which directly and indirectly contribute 20% of the country's GDP, declined despite signs of a more relaxed policy environment for the industry
- On a brighter note, tech heavyweights and education companies continued their bull run, reflecting optimism over their earnings growth despite a slowing economy. Elsewhere, oil majors surged on fears of escalating conflict and potential Middle East supply disruptions after a US-led drone strike against Iran. Brent reached its highest since September while WTI rose to its strongest since April
- Despite slowing GDP growth, the 2020 earnings growth for MSCI China is expected to be 10%, as we expect better earnings growth from the "new economy" companies and lower funding costs
- Generally speaking, market sentiment has improved in the past few weeks as US-China trade tensions continued to ease, after the US President stated that he would sign the phase one trade deal on 15 January in Washington. The trade deal, struck in early December, is expected to reduce tariffs and boost Chinese purchases of American agricultural products
- In terms of market development measures, CSRC, China's securities regulator, approved the revised Securities Law with provisions to expand registration-based IPO and stricter information disclosure
- The USD12.9 billion secondary listing of a Chinese tech major last year has prompted its US-listed peers to mull a similar Hong Kong listing in the near term, according to mainland media reports. These US-listed Chinese companies represent over USD2 trillion in market cap
- The forward 12-month price-earnings ratio of MSCI China A onshore is currently trading at 13.8x,while MSCI China is trading at 12.4x

Onshore and offshore Chinese stocks extend rally



Source: Bloomberg, HSBC Global Asset Management, as of 7 January 2019. Total return in local currency terms.

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Sector views*

Sector	Views
Consumer Discretionary	◆ We are overweight consumer discretionary sector. In particular, we like the education space as it is relatively insensitive to macro headwinds. We like e-commerce plays given penetration into Chinese consumption continues to increase. We also like online gaming plays as a more favourable policy backdrop this year could result in a more robust pipeline for key companies.
Consumer Staples	◆ We are overweight consumer staple sector as the trends of premiumization on the back of rising income underpin higher pricing power and margin expansion capability of selected strong staple brand names. Demand should remain stable.
Energy	◆ We have neutralised our position in energy as oil prices might be impacted by the Iran situation. We prefer oilfield services due to the capex upcycle in China
Financials	◆ We are underweight banks as lowered rate may bring pressure to their net interest margin
Healthcare	◆ We are overweight healthcare and favour those with strong R&D capabilities on innovative drugs and service providers with high growth visibility.
Industrials	◆ We are currently underweight this sector but might see improvement in 1Q / 2Q20
Information Technology	◆ We are positive on handset lens upgrade trend and we like names that can benefit from continuous tech upgrade
Materials	◆ We are underweight on commodities as we question the sustainability of the demand strength
Property	◆ We expect property sector to remain stable to support economic growth and developers will benefit from the looser demand-side measures and monetary policies
Communication Services	◆ We are turning positive on telcos due to historical low valuation with business improvement
Utilities	◆ We are underweight utilities sector as we are not positioned defensively in the current market

Source: Bloomberg, HSBC Global Asset Management, as of January 2020.
*NOTE - Sector views of HSBC Global Asset Management's offshore Chinese equity team
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Fixed income

Chinese bonds will be added to JP Morgan's emerging market benchmark from February 2020 over a 10-month process

- Both onshore and offshore Chinese bonds ended 2019 and began 2020 on strong notes. As of 7th January, onshore bonds edged up 0.2% in US dollar terms, while its offshore renminbi and dollar counterparts each added 0.6%, with investors turning more hopeful that the geopolitical tensions in the Middle East would not escalate further

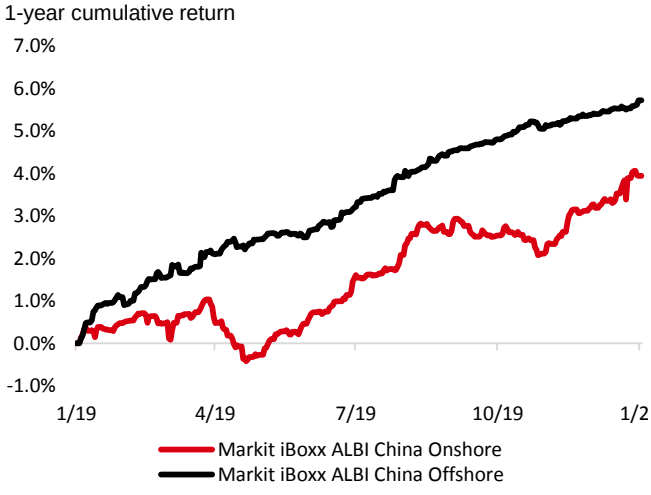
- Looking into 2020, we still see value in sovereign and policy bank notes, valuations of which are more attractive than those of developed markets. With the expectation for accommodative policies ahead, we see a steeper yield curve as an opportunity to extend duration within investment grade

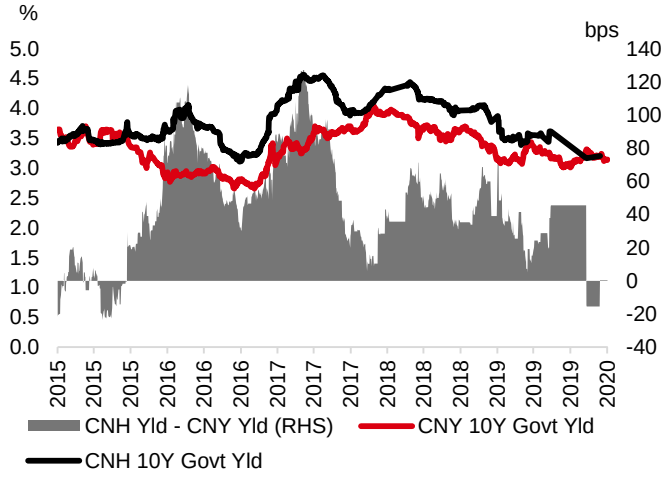
- At the same time, the macro backdrop should continue to be the major driver of the markets, in particular the policymakers' stance on interest rate policy and investment, as well as its tolerance of default situations. To be sure, the overall pace of defaults in 2019 was similar to the pace we saw in 2018, with 35 new defaults in onshore and 6 defaults in offshore bonds. While investors are keen to monitor how these credit events would settle, the gradual change in the government's stance, allowing certain debt heavy, less strategically important state-owned enterprises default could be vital to successful credit selection in 2020. To achieve high quality, sustainable growth in longer term, it is paramount for China to reallocate its resources from these less productive SOEs to profitable privately owned enterprises

- The onshore renminbi spot rate rallied and held up above the 7 mark amid trade optimism. In the near term, the renminbi could appreciate further as the phase one deal is set to be signed in January. Meanwhile, the central bank lifted its official midpoint to the highest level in five months on 8th January to reflect strong gains in the spot rate

- Separately, China's inclusion in the JP Morgan GBI-EM index starting from February 2020 will be another key development to watch. According to market estimates, the 10-month inclusion could draw USD3 billion of foreign inflows into the onshore market per month

Chinese bonds rally amidst signs of global easing





Source: Bloomberg, Markit data as of 7 January 2020. Total return in local currency terms.
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Data watch

Indicator	Date	Actual	Consensus	Prior	Analysis
Industrial production (IP) (yoy)	Nov	6.2%	5.0%	4.7%	The industrial production expanded 6.2% year on year in November, up from a 4.7% rise in the previous month and beating market consensus of a 5% gain. It was the fastest year-on-year growth since June, after the policymakers stepped up efforts to prop up growth. The output in manufacturing sector rose 6.3% year on year in November, up from 4.6% in October; Mining posted a 5.7% increase in November, up from 4.6% in October; Utilities were up 6.7% from 6.6%
Fixed Asset Investment (FAI) (ytd, yoy)	Nov	5.2%	5.2%	5.2%	China's fixed-asset investment grew 5.2% year on year to RMB53.37 trillion from January to November, the same pace as in the first 10 months of the year and matching market expectations. By sector, growth in mining FAI continued, rising 25.3% year on year in November up from 25.1% year on year in October. Growth in water conservancy, environment and public facilities rose from 2.8% year on year in November, up from 2.7% the prior month; growth in utilities rose 3.6% year on year in November, up from 1.9% in October
Retail Sales (yoy)	Nov	8.0%	7.6%	7.2%	China's retail sales of consumer goods rose 8.0% year on year to RMB3.81 trillion in November, up from a 7.2% increase in October and above market census. By category, cosmetics sales increased further to 16.8% year on year in November up from 6.2% in October, while home appliances surged 9.7% from 0.7%. Furniture sales expanded 6.5% in November from 1.8% in October, while personal care rose 17.5% from 12% for the same period. Elsewhere, automobiles sales fell 1.8% in November, compared with a contraction of 3.3% the prior month, while building materials sales dropped 0.3%, reversing from a 2.6% increase
Exports (USD) (yoy)	Nov	-1.3%	0.8%	-0.8%	Exports from China declined 1.3% year on year in November, compared with a 0.8% fall in October and below market consensus, while imports expanded 0.3%, reversing from a 6.4% decline. Trade balance came in at USD38.7 billion in November, compared to market estimates of USD44.5 billion and USD42.9 billion the prior month, amid ongoing trade disputes with the US
Imports (USD) (yoy)	Nov	0.3%	-1.4%	-6.4%	
Trade Balance (USD)	Nov	38.7bn	44.5bn	42.9bn	
CPI Inflation (yoy)	Nov	4.5%	4.3%	3.8%	The headline consumer prices accelerated to a near eight year high of 4.5% in November, up from 3.8% in the previous month and above market expectations of 4.2%. The surge was mainly due to rising pork prices, the most popular meat in the country, which jumped 110.2% in November after a 101.3% spike in October. In contrast, the producer price index, seen as a gauge of corporate profitability, fell 1.4% year on year in November, falling for the fifth month in a row. That compared with a 1.5% decline forecast by economists and 1.6% fall in October
PPI Inflation (yoy)	Nov	-1.4%	-1.5%	-1.6%	
Aggregate financing (AF)(RMB)	Nov	1,750bn	1,485bn	619bn	Aggregate financing accelerated faster than expected in November, driven by pick up in new loans in China. The aggregate financing, a broad measure of credit and liquidity, surged to RMB1,750 billion in November from RMB619 billion in October. Meanwhile, the Chinese lenders issued RMB1,390 billion in new loans in November, compared with RMB661 billion in October and exceeding market expectations
New yuan loans (RMB)	Nov	1,390bn	1,200bn	661bn	

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 December 2019

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