China Insights

March 2021

NPC 2021 – a roadmap for future development

Summary

- The National People's Congress holds its annual meeting to assess the current state of the nation and determine future courses of action. Economic targets for 2021 have also been set.
- The 14th Five-Year-Plan includes some policy priorities that have significant investment implications.
- The central government will encourage domestic consumption and urbanisation to sustain economic growth.
- A focus on technology self-reliance and environmental protection will help ensure growth is of a high quality.

NPC annual meeting

Commencing on 5 March 2021, the National People's Congress ("NPC") holds its annual meeting to assess the current state of the nation and determine future courses of action. The meeting this year is of particular symbolic and practical importance because the 14th Five-Year Plan (for 2021-25) will be finalised and 2021 marks the Chinese Communist Party's 100th anniversary.

In his delivery of the annual "progress report", Premier Le Keqiang has not only reaffirmed the accomplishments of the government in navigating a difficult year but also laid out concrete economic goals for the nation to achieve in the year to come, most fundamental of which are: a GDP growth of above 6 per cent, an urban unemployment rate of 5.5 per cent, a CPI increase of 3 per cent, and 11 million new urban jobs. Looking beyond 2021, the NPC is also set to approve the final draft of the 14th Five-Year Plan ("the Plan"), providing a framework for the Chinese government's long-term strategy of transitioning from quantity to quality economic growth and its vision of achieving "developed nation" status by 2035. Under this overarching framework, a number of priorities have been identified for policy initiatives, of which we recognize four key areas with significant investment implications: a domestically driven economy, industrial upgrade and technology self-reliance, urbanisation, and the protection of climate and environment.

Table 1. Government's targets for 2021
• GDP growth of over 6 percent
• a surveyed urban unemployment rate of around 5.5 percent
• CPI increase of around 3 percent
• over 11 million new urban jobs
• steady increases in both the volume and quality of imports and exports
• a drop of around 3 percent in energy consumption per unit of GDP
• grain output of over 650 million metric tons
• a continued reduction in the discharge of major pollutants

Source: State Council of the People's Republic of China, March 2021

Domestic demand to drive economic growth

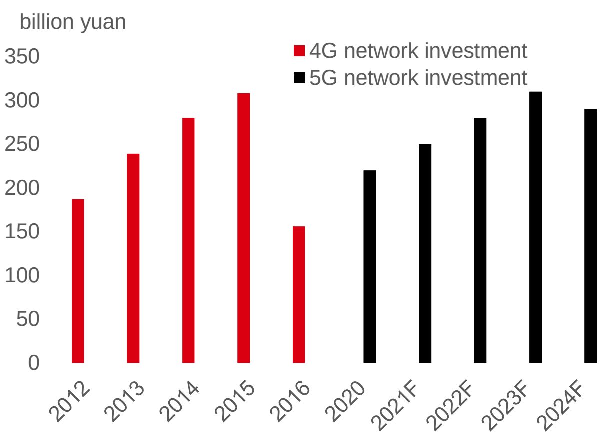
As China aims to create a potent domestic market to propel future economic growth, priority will be given to domestic circulation (under the dual circulation economic model). To achieve stronger domestic circulation, the government looks to boosting consumption by promoting local goods and services. On the "goods" side, the public will be encouraged to spend more on consumer durables such as home appliances and automobiles. The Plan specifically mentions that charging facilities and other infrastructure necessities for electric vehicles will be built, to encourage purchases of these automobiles. On the other hand, services pertaining to healthcare, culture, tourism and sports will be promoted. This shifting emphasis in China's economic strategy seems especially sensible in light of recent geo-political developments, namely the COVID-19-induced universal incentive to de-globalize, and the ongoing economic rivalry between the United States and China.

Home-grown technology and industrial upgrade

In a bid to revitalise the manufacturing sector, the central government will continue to pursue upgrading its industrial base and modernizing its supply chain. The success of this initiative lies upon the foundation of national scientific and technological prowess. Therefore, the nation is devoted to improving its basic research capabilities – the central government will increase its expenditure in this area by 10.6 per cent in 2021 alone. Although not listed out in the Plan or the progress report explicitly, there are a few key scientific and technological areas in which China is especially keen to see progress, according to previous announcements made by high-ranking officials.

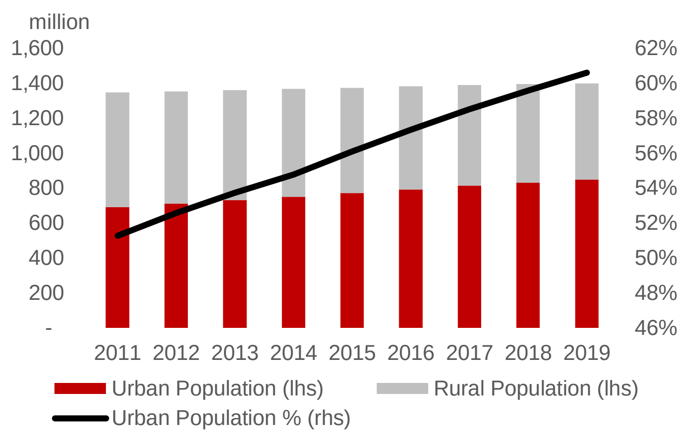
China is setting its eyes on cutting-edge technologies of the 21st century: 5G, artificial intelligence, semiconductors, electric vehicles, etc. The country is poised to invest heavily in the deployment of 5G (see Fig. 1) as it looks to become a global leader in this next generation of mobile technology. Also realizing that the basis of all modern technology resides in the micro chip, Chinese authorities have previously aimed to have domestic production meet 70 per cent of the country's chip demand by 2025. However, at the current percentage of just around 16 per cent for 2020, China might still have a long road ahead.

Fig. 1. China is committed to deploying 5G



Source: CAICT, February 2021

Fig. 2. Rural Chinese have been steadily moving to cities



Source: National Bureau of Statistics of China, March 2021

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From farmland to cities

To alleviate poverty and improve the well-being of its citizens, the central government is undertaking a strategy of "people-centered urbanisation", moving people from rural to urban areas in a manner so not to overload the capacity of the cities. Migrating to urban centres would provide former rural dwellers the opportunity to engage in more productive employment, thereby unlocking their economic potential. In the previous five years, 100 million people from rural areas were granted urban residency. To complement this policy, the government has renovated old urban residential communities, resulting in 21 million new housing units to handle the influx of new residents. By continuing with this policy, China aims to reach an urban population ratio of 65% by 2025, which shall potentially expand the middle class and strengthen economic growth.

A green economy

The central government has a lofty goal for China's climate policy: peak carbon emission by 2030 and net zero emission by 2060. Preserving the country's "lucid waters and lush mountains" and protecting them against pollution have also become an important governing objective. All these point to a shift in energy policy from fossil fuels to renewables. In fact, China has a goal for the next five years to reduce energy consumption and carbon emissions by 13.5 per cent and 18 per cent respectively, per unit of GDP. As a recent policy example, the State Grid Corporation of China has announced its plan to upgrade its electricity grid over the next five years to accommodate the usage and storage of renewable energy. Heavy state investment in the relevant technologies is required to make this happen – particularly infrastructure for electricity storage.

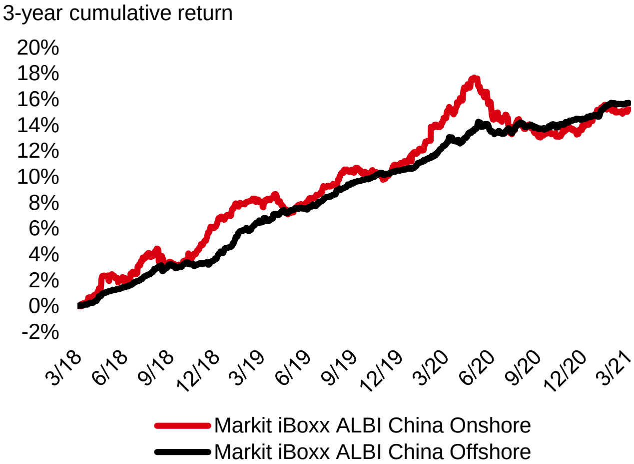
In the following pages we will take a deeper look at how recent events and policy measures are impacting Chinese fixed income and equity markets:

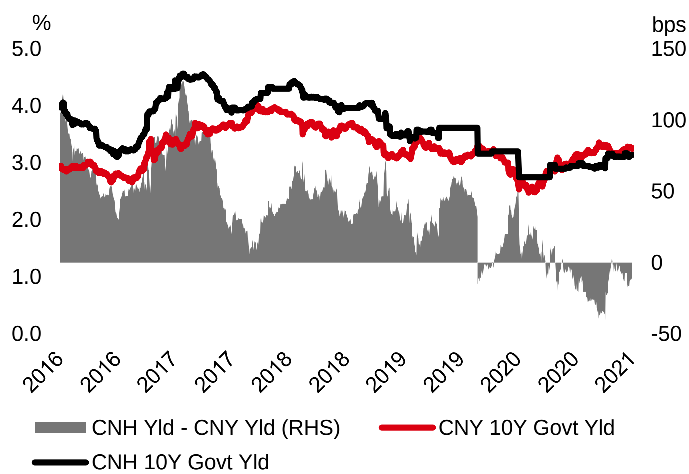
Fixed income

> The sharp rise in long-end US Treasury yields year-to-date has triggered a sell-off in government bonds across the globe.

- The Chinese Government Bond (CGB) 5-year and 10-year yields rose by 8 bps and 10 bps respectively in February. The sharp rise in long-end US Treasury yields year-to-date has triggered a sell-off in government bonds across the globe, with Chinese and Japanese government bonds experiencing the mildest impact, relatively speaking
- The iBoxx ALBI China Onshore and Offshore indices retreated 0.3% and 0.5% in USD terms in February, respectively, largely due to RMB depreciation against the dollar. For the same reason, the onshore and offshore indices in USD terms recorded losses of -0.4% and -0.5% respectively in the first week of March. For comparison, the Bloomberg Barclays Global Aggregate, a gauge of global investment-grade debt from twenty-four local currency markets, lost 1.4% in February
- Concerns regarding the financial health of the property sector intensified when a medium-sized developer defaulted on a USD530 million bond at the end of February. This happened after the central government imposed restrictions on debt financing by property developers, requiring them to meet certain financial criteria before allowing them to expand their scale of debt. The resulting cautionary sentiment among investors and rising US Treasury yields have weighed on the Chinese bond market
- In terms of fund flows, the onshore bond market received USD15 billion inflows in February, bringing the year-to-date total to USD49 billion, already 32% of the 2020 total. Given a favourable RMB outlook, a persistent yield spread over developed markets credit, and the likely prospect of FTSE including Chinese government bonds into its World Government Bond Index (final confirmation expected at the end of March), we anticipate continuing strong inflows throughout the year
- The spread between the Chinese and US 10-year government bond yield has tightened around 25 bps in February, to 187 bps. It has gone further down to 168 bps by the end of the first week of March, while the RMB has appreciated 0.5% against the greenback so far this year. US Treasury yields are rising on optimism about the passing of the USD1.9 trillion stimulus. The dollar index, which measures a basket of currencies, bounced back from 89 in December to 92 currently. In 2021, we hold a positive view on Chinese fixed income, given the base case of strong foreign inflows and a continuing economic recovery

Chinese bonds remain steady amidst economic recovery





Source: Bloomberg, Markit data as of 5 March 2021. Total return in local currency terms.
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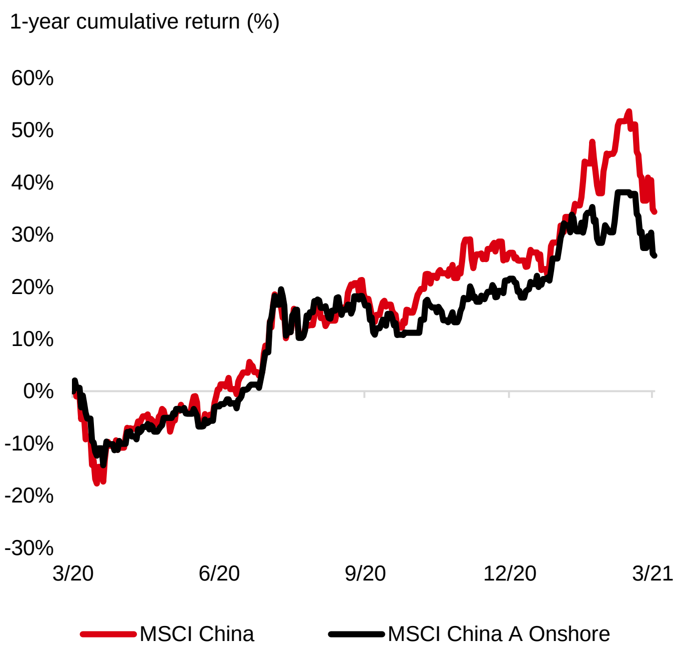
Equity market

Sector-wise, energy, materials, and real estate performed best in both the onshore and offshore MSCI indices in February.

- MSCI China A Onshore and MSCI China – the onshore and offshore gauge – retreated 0.8% and 1.0%, respectively, in February. Locally the CSI 300 Index of the country's largest companies lost 1.0% in US dollar terms, while its offshore counterpart, the Hang Seng Index, rose 2.5%
- During the first week of March, the first three aforementioned indices lost 1.4%, 1.6%, 1.7% respectively, reacting to PMI numbers for February that came out on the low side – manufacturing at 50.6 and non-manufacturing at 51.4. Nevertheless, Hang Seng still recorded a modest gain of 0.3%.
- Sector-wise, energy, materials, and real estate performed best in both the onshore and offshore MSCI indices in February. The former two benefited from a rally in commodities, in anticipation of an widespread economic recovery. The latter benefited from a recently announced government policy of restricting land sales to just three times a year in 22 key mainland cities. This policy is believed by many to benefit larger players with stronger cash reserves in the property space. On the other hand, there was a minor correction (around -5%) in the info tech sector, as investors are beginning to be wary of the possibility of over-valuation
- The southbound channel, which allows mainland investors to buy Hong Kong-listed companies – saw USD10 billion inflows in February, down from the peak of USD40 billion in January. This can partly be attributed to the week-long Chinese New Year holiday in the mainland. Conversely, northbound trade amounted to USD6 billion inflows, about the same as the January figure
- In terms of valuations, the 12-month forward price-to-earnings of MSCI China and CSI 300 are now trading at 17.1x and 14.5x, respectively, with a 2021 consensus earnings growth of 40% for the former and 37% for the latter

Chinese stocks continue to climb supported by ongoing recovery



Source: Bloomberg, HSBC Asset Management, as of 5 March 2021. Total return in local currency terms.

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Sector*	Outlook	Comment
Consumer Discretionary	O	In particular, we like e-commerce platform with faster adoption rate and expanding net margin along with better logistics system. We also prefer names that benefit from domestic consumption, electric appliances
Consumer Staples	+	We prefer Chinese liquor names that could provide long term growth as their margin expansion capability remains large with higher pricing power and ecommerce channel.
Energy	O	Vaccine hope has increased market expectation of economy activity normalization.
Financials	-	We are underweight banks as lowered rate may bring pressure to their net interest margin and asset quality remains cloudy. However, as the rate has seen its bottom and we have reduced our underweight to banks and insurance companies at low valuation given a value factor pick-up.
Healthcare	+	We favour service providers with high growth visibility and solid business model, which are less affected by the national reimbursement drug list policy. Companies with strong R&D and clinical development capabilities on innovative drugs will also outperform.
Industrials	+	Industry leaders with accelerated capacity expansion can gain more global market share. We prefer beneficiaries in electric vehicles production chain and machinery with higher environmental standard.
Information Technology	+	We like names that can benefit from continuous tech upgrade. The Biden administration will provide more consistency and predictability in the markets, especially with regards to restrictions imposed on some tech companies. Technology localisation trend will sustain for longer term as well. We also prefer semiconductor names as demand for hardware tech is still healthy and semi inventory remains low.
Materials	O	We prefer copper mining companies within the sector as electric vehicle penetration will require incremental copper for batteries and charging stations.
Real Estate	-	The potential new "three red lines and four categories" policy may hinder long term growth for developers. Policy tightening in the property market is likely to continue, and there is no sign of loosening in the near terms.
Communication Services	-	We selectively prefer gaming, social platform and cloud services companies as coronavirus outbreak will speed up technology adoption. We underweight telecom names due to the lack of catalysts.
Utilities	-	Increasing supplies from alternative source such as wind, solar and nuclear continue driving down the sector returns. Demand remains lacklustre due to slower economic growth.

Source: Bloomberg, HSBC Asset Management, as of February 2021.
*NOTE - Sector views of HSBC Asset Management's offshore Chinese equity team; "+" = positive, "–" = negative, "O" = neutral
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Indicator	Date	Actual	Consensus	Prior	Analysis
Industrial production (IP) (yoy)	Dec	7.30%	6.90%	7.00%	Q4 GDP growth picked up further to 6.5% yoy from 4.9% in Q3, taking the full-year growth to 2.3%. In sequential terms, GDP growth grew 2.6% qoq sa after expanding 3.0% in Q3. Q4 growth was driven by strong exports and broadening of domestic activity recovery from investment to consumption. Tertiary industry growth accelerated to 6.7% yoy from 4.3% in Q3, with gains across sectors (catering & accommodation turned to a positive YoY growth of 2.7% after three quarters of declines) and amid continued strength in IT, financials and real estate services. Manufacturing growth also picked up to 6.9% in Q4 from 5.6% in Q3. Recent data show an ongoing solid cyclical recovery into 2021, despite near-term risks to offline and service consumption due to the latest Covid-19 resurgence in some northern China cities and tightening of restrictions over traveling and social distancing measures. The impact on industrial sector activity will likely be limited while export strength may provide some offsets. We expect a strong 8.0-8.5% growth rebound in 2021, led by consumption, manufacturing capex and services. Export momentum should remain positive, though property sector activities and infrastructure investment may soften on fading policy support. We expect monetary policy normalisation, fiscal consolidation and tighter property and financial regulation, but no material policy tightening. In terms of monthly data, robust IP growth was aided by a pick-up in mining and electricity generation and robust manufacturing activity. Industrial profits continued to register solid growth (+20.1% yoy) with full-year profit growth coming in at 4.1%, reversing the pre-Covid decline of -3.3% in 2019. Benign demand backdrop and PPI reflation should support industrial profit growth in coming months.
Fixed Asset Investment (FAI) (ytd, yoy)	Dec	2.90%	3.20%	2.60%	For full-year 2020, FAI growth was driven by infrastructure FAI (+0.9%) and real estate FAI (+7.0%) amid policy support and credit easing, while manufacturing FAI contracted -2.2%. Going into 2021, we expect public and real estate investment to moderate, amid fiscal policy consolidation and normalisation in credit policy, while solid industrial profits and continuing economic recovery should support manufacturing capex. Financial tightening in the property sector aimed at curbing the sector leverage and asset bubble risks as well as guiding credit to priority sectors may result in slower land purchases though construction may stay solid. We also expect tighter central government scrutiny of local government debt risks.
Retail Sales (yoy)	Dec	4.60%	5.50%	5.00%	Slower December retail sales were led by goods consumption, likely in part reflecting the payback from strong November sales boosted by the Singles' Day shopping festival promotion. Online goods sales and auto sales eased, while catering sales growth edged higher partly due to the base effect. Surveyed urban unemployment rate stayed at 5.2%. In the near term, more restrictive policies on travel and holiday activities nationwide around the Lunar New Year holiday could weigh on consumer spending, but improving employment conditions and income growth should continue to support consumption as the virus situation will likely remain manageable. More policies to boost consumption upgrading are also likely.
Exports (USD) (yoy)	Feb	154.9%	N.A.	24.8%	Exports surged 60.6% yoy in the first two months, reflecting a low base of 2020 (-17.2%) as Covid-driven demand for tech/ work-from-home and personal protective equipment stayed strong, while an earlier-than-usual resumption of business activity following the lunar new year holiday this year (thanks to the majority of migrant workers remaining in their workplace cities during the holiday) likely also contributed to the export strength. Imports also rose strongly (+22.1% in January-February), reflecting recovering domestic demand and demand for trade processing as well as higher commodity prices. We expect China's exports to hold up amid a recovering global economy, despite expected easing of pandemic-related demand amid vaccine deployments and a catchup in production capacity elsewhere from Q2, while this year's global recovery is likely to be more driven by services normalisation, which tends to be less trade intensive. China is likely to benefit from a more stable and predictable trade relationship with the US under a Biden administration. That said, we think the pressure may remain on China to respond to US bipartisan concerns about structural issues such as SOE subsidies and fair trade, market access, forced technology transfers, and intellectual property right protection, etc. The US-China (tech) competition will likely remain fierce in the medium-to-long term. Meanwhile, imports should continue to pick up amid an ongoing domestic activity recovery and supported by commodity price reflation.
Imports (USD) (yoy)	Feb	17.2%	N.A.	26.6%	
Trade Balance (USD)	Feb	$37.9bn	N.A.	$65.4bn	
CPI Inflation (yoy)	Jan	-0.30%	0.00%	0.20%	The dip in CPI inflation was mainly driven by a higher YoY comparison base due to different timing of the Lunar New Year holiday. Higher food prices partly reflected cold weather. PPI returned to inflation on commodity price increases. We see moderation of headline CPI inflation in 2021, largely due to the base effect and easing pork price inflation as supply is expected to improve. Core inflation should pick up modestly as services consumption recovers further. Supply side pressure from food price volatility and rising oil/ commodity prices need to be watched, but the pass-through to CPI inflation still appears relatively weak. We think inflation is unlikely a major policy consideration or constraint in the near term.
PPI Inflation (yoy)	Jan	0.30%	0.30%	-0.40%	
Aggregate financing (AF) (RMB)	Jan	5170bn	4600bn	1719bn	AF growth eased for a third straight month, to 13.0% yoy from 13.3% in December. Bank loan growth eased modestly with solid growth in medium- and long-term loans. Corporate bond issuance picked up somewhat in January, along with moderate government bond issuance. Meanwhile, following the notable contraction in December, shadow credit ticked up in January, led by bankers' acceptance bills. Overall, the credit data are consistent with policy normalisation. We expect tighter financial regulation and moderately slower credit growth in 2021, though targeted credit support will likely continue.
New yuan loans (RMB)	Jan	3580bn	3500bn	1255bn	

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, Wind, HSBC Asset Management, as of March 2021

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