HSBC Asset Management

China's pro-growth policy pivot and market implications

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Key takeaways

- China's recent announcement of additional stimulus is aimed at reviving domestic demand, stabilizing the property market, boosting market confidence, and mitigating risks related to local government hidden debt, property developers and banks. We are still waiting for more implementation details to further assess macro implications. More policy easing is also likely underway
- The clear pro-growth policy pivot should help improve the cyclical growth outlook and sequential price momentum into 2025. However, we think more demand-side (fiscal) stimulus with its timely and effective implementation, further property stabilisation efforts, and structural reforms to rebalance the economy and facilitate the economic transition toward quality and sustainable growth are likely needed to fundamentally reflate the economy
- The outlook for Chinese equities is cautiously optimistic. The monetary policies, which were widely anticipated though surprising in terms of upside magnitude, are certainly helpful. We believe that policymakers will still need to take up additional fiscal easing to boost consumption and address the deflation issues to sustainably turn around investor confidence
- In addition to lowering of existing mortgage rates ~50bp, other property sector measures should help improve the housing market sentiment and demand in the near term. The China USD bond market has so far benefitted from the stimulus measures, with private property developers seeing the biggest boost, followed by the industrials sector

Source: Bloomberg, HSBC Asset Management, October 2024.

What do the recent economic numbers say about the state of China's economy?

Renee: China's September activity data showed a modest pickup in domestic growth momentum toward the quarter-end. However, consumer confidence remained subdued amid ongoing future jobs and income worries, private credit demand and underlying inflation stayed sluggish, and export growth softened (albeit partly due to weather distortions).

Real **GDP growth** in Q3 rose 0.9% quarter-on-quarter sa. – a modest rebound from Q2 (+0.5% quarter-on-quarter sa.). On a year-on-year basis, real GDP growth in Q3 was largely stable at 4.6%, but the 4.8% growth during the first three quarters put this year's '~5%' growth at risk without more policy support. Nominal growth – which is more relevant for corporate earnings, household income and debt ratios – stayed weak at 4.0% year-on-year on continued GDP deflator deflation.

September **domestic activity** data largely beat market expectations, especially industrial production and retail sales, which likely partly reflected some effects from recent policy measures to promote consumer goods trade-in of home appliances and autos and to support corporate equipment upgrade. There are also nascent signs of policy effects on infrastructure investment and credit growth from accelerated government bond issuance since July.

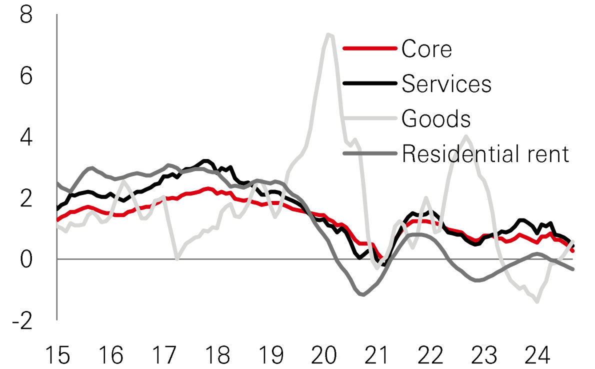
Property sales improved on a month-on-month basis with the year-on-year contraction narrowing further in September, but overall **housing sector indicators** remained weak (new starts, investment, etc.) with ongoing home price declines.

September **inflation** data showed persistent PPI deflation and muted headline and core CPI inflation (Fig. 1). This largely reflects the lingering domestic demand-supply imbalance (i.e. weak domestic final demand and industrial overcapacity).

Robust **exports** have been a key growth driver this year. However, rising risks on external demand and geopolitical uncertainties speak to the need for more domestic demand stimulus.

Fig. 1: Muted core CPI reflects subdued domestic demand/confidence with falling residential rent

% year-on-year; 3mma



Source: CEIC, HSBC Asset Management, October 2024

What are your views for what we can expect for further monetary policy easing?

Renee: On 24 September, the PBOC delivered a 20bp cut to the 7-day reverse repo rate (policy rate) and a 50bp cut to RRR for large banks. The policy rate cut translated to a 25bp reduction in the 1-year and 5-year loan prime rates (LPR) on 21 October. Major banks also lowered their demand/time deposit rates by 10bp/25bp on 18 October to cushion the impact on their net interest margins (NIM). PBOC Governor Pan guided markets that the central bank stands ready to further cut the RRR by additional 25-50bp by the year-end, while leaving the option open for more monetary easing.

We see the **scope for further 20-40bp cuts to the 7-day reverse repo rate** in the coming months/quarters, with **greater emphasis on "price stability"** in the latest PBOC communications. The US Fed easing cycle has eased external constraints on PBOC rate cuts, though domestic concerns remain – including the squeeze on bank NIMs and the risk that further deposit rate cuts would prompt outflows from deposits and inflows into wealth management products that have higher yields. We also **expect more efforts to improve transmission** via policy framework reforms and targeted credit support. The PBOC can also deploy quantitative tools to **facilitate fiscal policy operation** and aid the government quality growth agenda. For instance, the PBOC's CNY300 relending facility will support local state-owned enterprises (SOE) to purchase unsold, completed homes for conversion into affordable housing. In the past, the PBOC's pledged supplementary lending (PSL) had supported the monetised resettlement for shanty-town redevelopment during 2015-18. Now, policymakers also plan to renovate one million additional units of urban village and dilapidated buildings with cash compensation.

Overall, future policy actions will likely depend on incoming macro data and on market conditions. That said, monetary easing has its limits. We think effective demand-side fiscal stimulus and structural reforms are needed to rebalance and fundamentally reflate the economy.

What has been the focus of the recent fiscal policy announcement?

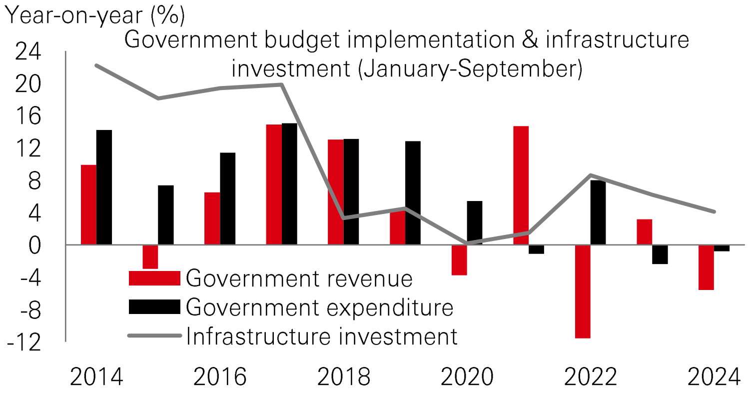
Renee: On 12 October, the Ministry of Finance (MOF) pledged **more efforts to mitigate risks related to local government debt, property, and banks**, which should be positive for medium-term macro stability and debt sustainability. *(continued on next page)*

Source: HSBC Asset Management, China Ministry of Finance, Bloomberg, CEIC, October 2024.

The MOF laid out key areas for incremental fiscal support in the near term. These include additional efforts for local government (hidden) debt resolution (including raising the government debt limit and a larger bond issuance quota for debt swap); special central government bond (CGB) issuance to replenish SOE banks' capital; and a combination of local government special bonds, designated funding and tax policies to support the property market – special bonds can be used to buy back unsold homes and undeveloped land from developers. For Q4, the MOF called for better utilisation of the remaining fiscal room within the debt ceiling to address local government revenue shortfalls and reverse the fiscal austerity so far this year (Fig 2.).

The MOF sent **a clear pro-growth forward guidance**. It indicated further support is underway and that there is a large scope for the central government to increase fiscal deficit and raise debt. We think this likely indicates a meaningfully expansionary budget for 2025 (e.g. deficit target exceeding the normal 3% of GDP limit), as well as a larger scale of local government debt swap programme and the potential for an increase in quotas for ultra-long-term special CGBs in the coming years. We await further fiscal policy clarity. The upcoming National People's Congress (NPC) standing committee meeting (4-8 November) and Central Economic Work Conference in December are key events to watch on fiscal measures.

Fig. 2: (Local) gov't revenue shortfall led to fiscal austerity this year



Source: CEIC, HSBC Asset Management, October 2024

What are the overall macro implications of the recent easing measures?

Renee: We are still waiting for implementation details of recent policy measures to assess the potential implications. The composition of policy measures matters as we believe fiscal support to households (with higher propensity to consume) and to corporate investment (with the potential to create high-quality, high-paying jobs and boost long-term productivity gains) will likely have a higher policy multiplier compared to the credit multiplier of infrastructure or property investment.

Overall, we see the recent and upcoming policy easing moves as a comprehensive and coordinated attempt to **rein in the downward spiral of lower asset prices and weaker sentiment** seen in recent years. There appears to be a strong commitment from the top leadership to reflate domestic demand, stabilise the property market and reviving market confidence, with **clear forward guidance of further policy support in the pipeline**. We think the **positive medium-term impact of local government debt resolution may be underappreciated by markets**.

A pro-growth policy pivot helps improve the cyclical growth outlook and sequential price momentum into 2025. We expect GDP growth to recover sequentially in Q4 2024 and into Q1/H1 2025, though countercyclical policy easing is unlikely to materially alter the structural prospects. We also expect higher but still moderate inflation in 2025. That said, China's deflationary / disinflationary pressures come from both cyclical headwinds and structural imbalances. We think timely and effective implementations of demand-side stimulus, further property stabilisation efforts, and structural reforms to rebalance the economy and facilitate the economic transition toward quality growth are likely needed to fundamentally reflate the economy with a return to benign inflation on a sustainable basis.

Policy easing may help stabilise credit growth with the potential for a modestly higher credit impulse in the coming months as policy effects gradually feed through. However, to restore households' borrowing risk appetite, we would need to see better prospects of housing market stabilisation and macro improvements. There are some concrete measures to support consumption, such as consumer durable goods trade-ins. Additionally, the ~50bp cut to existing mortgage rates potentially benefits ~50 million households and 150 million individuals, which could help household disposable income and consumption at the margin. That said, **more consumption support is likely needed**, such as fiscal measures and a more favourable regulatory environment that can support jobs creations and tackle the youth unemployment issue as well as further social welfare spending to reduce precautionary savings.

The step-up in **property policy easing should help improve the housing market sentiment and demand in the near term**, especially in tier 1-2 cities, with the potential for the physical market to gradually stabilise on a sequential basis over 2025. However, the **sustainability of any sentiment improvement or sales recovery depends on effective policy execution** and the overall macro trajectory. Home prices may still be under pressure in the near term as the inventory overhang will likely take an extended period to clear before it returns to a more reasonable or normal level nation-wide, even with the government's pledge to control new housing construction.

Source: HSBC Asset Management, China Ministry of Finance, Bloomberg, CEIC, October 2024.

What does the latest round of stimulus mean for Chinese stocks?

Caroline: Following the easing announcements on 24 September, the PBOC on 18 October officially launched unprecedented measures including a swap facility and a relending program that are especially beneficial for equity markets. These steps indicate a more aggressive fiscal approach from the central government, providing hope for a stabilizing effect on the economy and markets. Under the swap facility, the PBOC launched the first batch with an approved size of RMB 200 billion, whereby eligible institutions can pledge their assets, such as stocks and bonds, in exchange for liquid assets, with an aim of improving market liquidity. Under the relending program, listed companies are allowed to borrow from 21 financial institutions selected by the PBOC to fund share buybacks or shareholding increases, which should bolster shareholder returns.

The stimulus package was delivered after successive months of soft macro data that put China's full-year official growth target of around 5% at risk. The style of communication was firm, direct and even had forward guidance, suggesting a high level of consensus and authority. It shows that the central government is increasingly concerned about weakness in the economy and markets. However, implementation remains key while the long-term sustainability of market sentiment improvement and rebound rally are more dependent on macro recovery as well as corporate earnings growth bottoming out. Near term relaxation in the property sector may support a short-term rally but structural oversupply remains. Policy visibility is also low with local government fiscal revenue worsening.

Going forward, measures such as easing monetary policy, increasing local government bond issuance, and utilizing unused budget funds are designed to support key sectors, including property, financials, and technology.

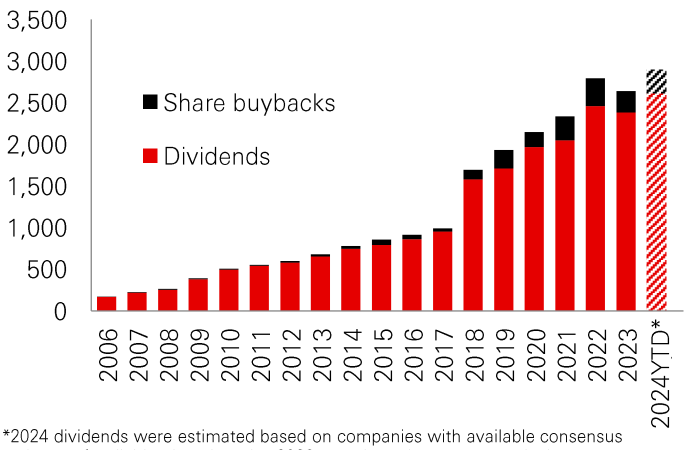
What's the outlook for Chinese equities?

Caroline: The outlook for Chinese equities is cautiously optimistic. The widely-anticipated (though surprising in terms of upside in magnitude) monetary policies are certainly helpful. We believe that policymakers will still need to take up additional fiscal easing to boost consumption and address the deflation issues, especially against a backdrop where loan demand is weak and real interest rates have been restrictive given the persistent deflationary pressures, to sustainably turn around investor confidence.

On a positive note, valuations of Chinese stocks are currently inexpensive and positioning of international investors in Chinese equities remains light. With China's ongoing efforts to stabilize its economy and implement supportive policies, there is a strong potential for growth and recovery, making now an opportune time for investors to carefully consider adding Chinese equities to their portfolios. In our HSBC Chinese equities strategy, we continue to favor quality growth companies, while dividend-paying companies remain attractive to us on the backdrop of a deflationary cycle amid a property market downturn. However, we remain vigilant to potential risks, including geopolitical tensions and global economic conditions.

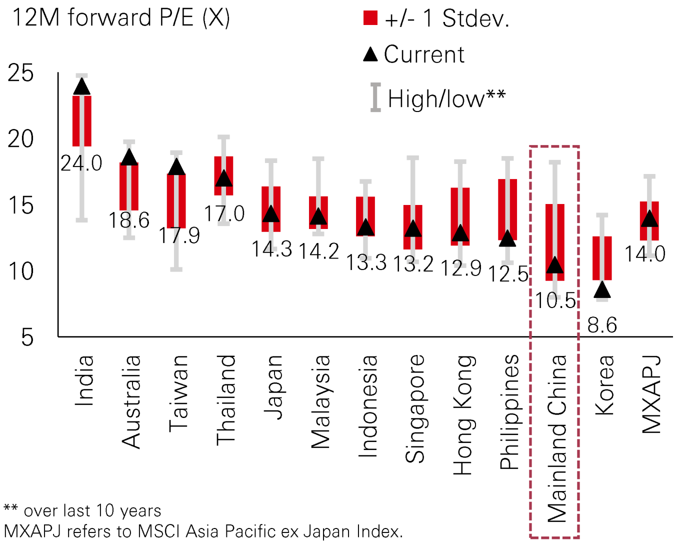
Fig. 3: Policy/valuation driven share buyback may mitigate downside pressures

Share buybacks/dividends for all China listed universe (Rmb bn)



*2024 dividends were estimated based on companies with available consensus estimates for dividends; otherwise 2023 actual numbers were used; share buybacks in 2024YTD includes year-to-date actual buybacks as estimates data were generally not available.
Source: Goldman Sachs, HSBC Asset Management, data as of September 2023.

Fig. 4: Chinese equities: attractive valuations



** over last 10 years
MXAPJ refers to MSCI Asia Pacific ex Japan Index.
Source: MSCI, Goldman Sachs, data as of October 2024

Source: HSBC Asset Management, Bloomberg, MSCI, October 2024.

What are the implications for China fixed income in light of supportive policies?

Ming: We are very encouraged by the latest stimulus measures announced by the Chinese authorities, but we must remain vigilant and keep a close eye on further announcements and the impact of the measures. Any positive outcome is likely to benefit the credit market most. Meanwhile Chinese rates remain low, but Chinese domestic government bonds maintain their strong diversification benefits.

CNY / CNH bonds

5-year CGB (China government bonds) yields are now at 1.85% as of 24th October (Fig. 5). With the strong rally in the onshore equity market from mid September through early October, the allocation of flows from bonds to equity was a key driver of the move up in yields. CGB yields are likely to trade within a range, though we will continue to closely monitor the yield level should the policy stimulus fail to reignite growth momentum. In the HSBC RMB fixed income strategy, we hold a small overweight duration position with varying underlying contribution, whereby we are overweight duration in the offshore CNH space but underweight duration in the onshore CNY portion. In terms of allocation, we are overweight CNH bonds and underweight CNY bonds due to the attractive carry in the former.

Fig. 5: China government bond yields

5-year CGB yields (%)

Source: Bloomberg, 24 October 2024.

On the currency front, the RMB has seen a brief appreciation since the stimulus press conference on 24 September. We may see some continued pressure from the ongoing easing of interest rates, but the strong stimulus measures being implemented and increased capital inflows could bolster the currency. In the longer term, the RMB's fundamentals remain supported by China's export competitiveness, solid external balances, and positive fund flow dynamics.

China USD bonds

The China USD bond market has so far benefitted from the stimulus measures, particularly within the high yield sectors. China private property developers have seen the biggest boost, followed by the industrials sector, thanks to improved sentiment. On a year-to-date basis, yields have come down by 100bp to 6.4% and produced a return of 6.9% as of 24th October,[1] but are still relatively attractive compared to other global credit markets.

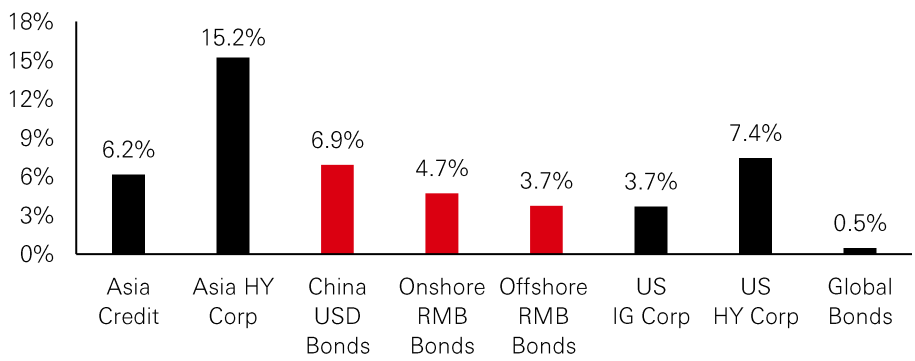
While we believe there is still momentum in the property sector in the near term and have increased our overweight position in the sector across our Asia bond strategies, we continue to remain highly selective. The robust rebound in physical property sales is a consequence of recent policy easing and hinges on economic stability.

Outside of the property market, we see investment opportunities in TMT companies, which have strong balance sheets and cashflows, as well as the consumer and industrial sectors in a selective manner.

It should be noted that year-to-date, China USD bonds, along with Asia USD bonds, have been outperforming other bond markets in other parts of the world this year (Fig. 6).

Fig. 6: China USD bonds strong year-to-date performance

Performance, unhedged USD for non-USD indices (%)



Source: Bloomberg, JPMorgan, BofA, 24 October 2024.

Note 1: Source is JPMorgan, based on JACI China as of 24 October 2024.
Source: HSBC Asset Management, Bloomberg, October 2024.

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