December 2020

China Insights

China sets China 2021 – Gearing up for growth

Summary

- After bouncing back more swiftly than other economies, China could embark on a transition from extraordinary stimulus to policy normalisation, while offering more targeted relief measures to steer its economy
- China's consumers could emerge as a key GDP growth driver in 2021, supported by a recovery in the job market and household income
- The implementation of the new Five-Year Plan (2021-2025) and "dual circulation" strategy will be key to boosting productivity and long-term growth potential

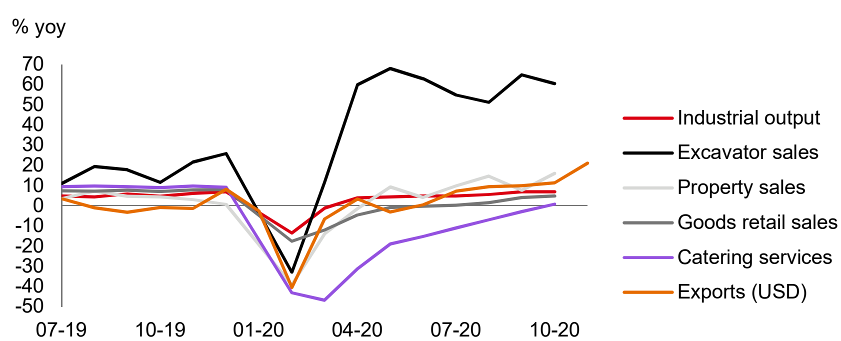
China 2021 – Gearing up for growth

China has undoubtedly outperformed the rest of the world in its recovery from the Covid-19 health crisis and consequent economic impact. It has benefited from the relatively rapid and successful containment of the pandemic, policy stimulus, and its 'first-in-first-out' advantage with earlier-than-expected normalisation of production activity which enables its exports to gain global market share. The recovery in China followed a two-speed pattern, led by manufacturing and investment, and then broadening to the lagging services sectors and consumption in recent months. China is likely to be the only major economy to record positive growth this year (~+2.0%) and we expect growth to accelerate to an above-trend pace of ~8.0% in 2021. China's economy already returned to pre-Covid-19 levels of output/GDP (taken as the prevailing level in Q4 2019) in Q2 and is poised to nearly return to the pre-pandemic "trend growth path" by end-2020.

Consumption and services to take the lead

Into 2021, we expect a rotation of growth drivers from investment to household consumption, from manufacturing to services, and within investment from infrastructure and real estate investment to manufacturing investment (supported by improving earnings and better demand outlook). Private consumption should be supported by improvements in the job market and recovery in household income.

Solid and broadening economic recovery



Sources: CEIC, Bloomberg, HSBC Global Asset Management, December 2020.
For illustrative purpose only.

China 2021 – Gearing up for growth (cont'd.)

Covid-19 vaccine deployment will likely have limited impact on China's activity normalisation, but we believe it is necessary for a complete recovery of the most virus-sensitive in-person/ consumer-facing services sectors.

China's exports likely to remain resilient; de-escalation of US-China trade tensions and regionalisation

We expect China's exports to stay resilient as the global recovery gathers pace in 2021, helped by wider availability of effective vaccines, even as global production recovery catches up. At the same time demand for anti-Covid-19 and staying-at-home products will likely peak in the coming months and consumer spending may shift towards services (from goods). We expect calmer and more predictable US-China trade relationship under a Biden administration, which will likely take a multilateral and rules-based, collaborative approach towards trade dispute. While we see the potential for Biden to modify or unwind some of Trump's China-targeted measures (e.g. tariffs) that he deems damaging to the US economy, we think any immediate or major changes to US tariffs or tech restrictions look unlikely given Biden's potential focus on domestic issues initially and the bipartisan support in the US for a tough stance on structural issues such as SOE subsidies/fair trade, market access, forced technology transfers, and intellectual property right protection, etc. The US will likely continue to see China as a strategic competitor and retain restrictions on China's access to US advanced technology, but it will also cooperate with China in areas of common interest (e.g. climate change, pandemic control). We expect easing trade tensions. With the newly signed Regional Comprehensive Economic Partnership (RCEP) agreement, China will further strengthen regional economic cooperation and increase its investment in supply chain linkage with ASEAN.

Monetary policy normalisation and fiscal consolidation; targeted support and calibrated approach to continue

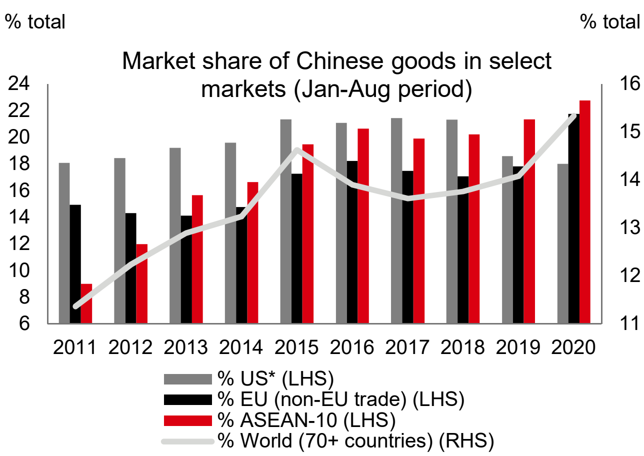
Given the swift growth recovery, we expect the authorities to taper its emergency monetary/ financial support in 2021, with gradual interest rate normalisation, slower credit growth, and a more hawkish tone on property and financial regulation. De-leveraging and debt cleanup, which was interrupted by the pandemic and debt forbearance, may be given higher priority. That said, we expect targeted easing measures and liquidity support to continue, particularly as default risks warrant close watch with policies deferring small and medium-sized enterprises' (SMEs) loan repayments due to expire next March. Despite a greater focus on credit differentiation, preventing systemic risks from emerging remains an important policy objective. Subdued inflation – headline in negative territory in the near term and likely to decelerate in 2021 vs. 2020 amid food/pork price disinflation on easing supply-side factors; core to pick up modestly amid gradual normalisation of services consumption – does not support an abrupt exit of policy support.

The government may also phase out some of the counter-cyclical fiscal stimulus measures (e.g. temporary tax/fee relief/waivers), which have focused on rescue measures for the corporate sector and support for public investment (vs. limited fiscal transfers to households). Fiscal prudence would help facilitate growth rebalancing towards consumption and private investment. We expect a reduction in the budget deficit and the local government special bond issuance quota for 2021 (and without the CNY1 trillion special Covid-19 Treasury bond), but we do not expect fiscal austerity. We expect more policy and reform efforts to expand domestic demand (e.g. urbanisation 2.0 as a key growth driver).

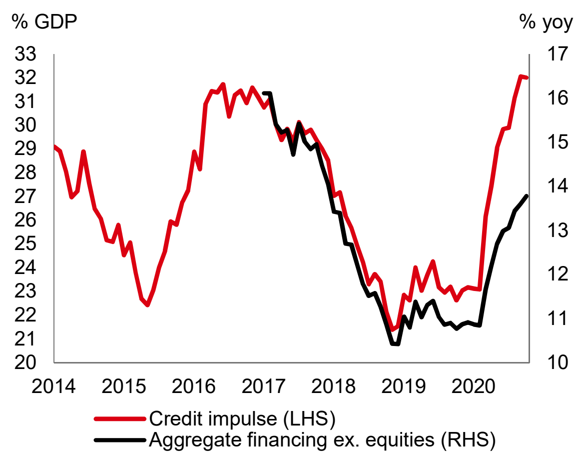
Focus on effective implementation of the 14th Five-Year Plan and "dual circulation" development strategy

We expect greater focus on structural reforms to boost productivity and longer-term growth potential. The 14th Five-Year Plan focuses on promoting indigenous technology and innovation, expanding and upgrading domestic (consumer) demand, and pursuing high quality and more balanced and sustainable growth. The "dual circulation" strategy focuses on strengthening self-sufficiency and competitiveness while continuing to push for opening-up, including the Belt & Road Initiative (with an emphasis on the quality of development/projects).

China's export strength this year



Credit impulse likely to ease from high levels in 2021



Note: * Jan-Oct data for the US; Source: WTO, CEIC, Bloomberg, HSBC Global Asset Management, December 2020.

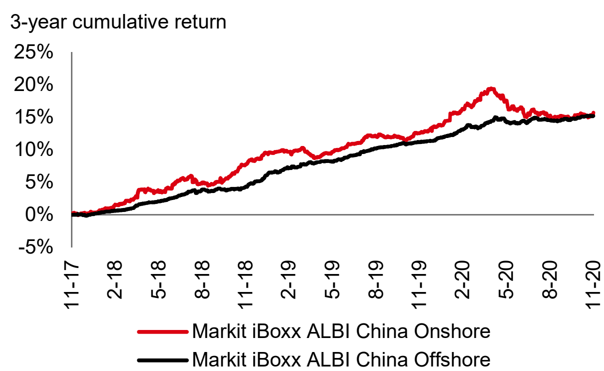
In the following pages we will take a deeper look at how recent events and policy measures are impacting Chinese fixed income and equity markets:

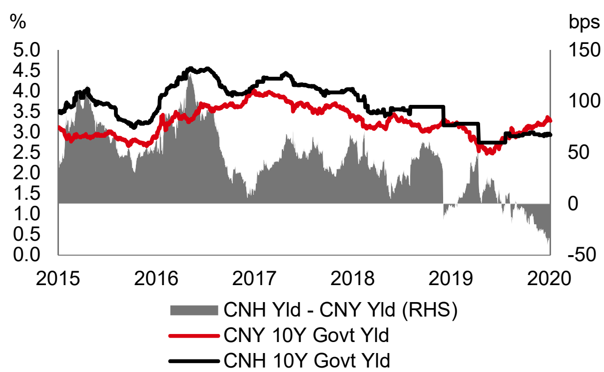
Fixed income

On a year-to-date basis, bond inflow has reached USD116 billion, driven by inflows into government and policy bank notes

- The yield curve of Chinese government bonds was effectively unchanged across maturities in November, even though investors were spooked by a string of recent bond defaults in the onshore market. Market sentiment has been recovering from the impact of the defaults after authorities reiterated a zero-tolerance policy towards debt evasion. In our view, those onshore defaults should be viewed as isolated cases and reflect a desire on China's part to ensure greater financial discipline
- In a surprising move on November 30, the PBoC introduced cash injections into the banking system, sending bond yields sharply lower. The central bank injected RMB200 billion through one-year MLF loans on that day, with an unchanged rate of 2.95%. It also conducted a RMB150 billion 7-day reverse repo operation and a net RMB110 billion was injected. As a result, the central bank has injected RMB400 billion in total in the month. The onshore RMB bonds, measured by iBoxx ALBI China Onshore Index, advanced 2.0% in USD terms in the month ending 30 November, bringing the year-to-date gain to 7.8%. The monthly gain was largely due to dollar weakness, as the greenback slipped 1.7% against the RMB
- In terms of fund flows, the onshore market saw USD8 billion of inflows in October, slowing down from a very strong third quarter with an average of USD21 billion per month. Government bonds and policy bank notes received inflows of USD8 billion and USD5 billion, respectively, down from USD11 billion and USD7 billion in the prior month. On a year-to-date basis, inflows reached USD116 billion at the end of October on the back of high bond yield and strong RMB. The spread between the Chinese and US 10-year government bond yield has widened to 200bp in November from 130bp from the beginning of the year, while the RMB has advanced 5.5% against the greenback in the same period
- The offshore gauge, the iBoxx ALBI China Offshore Index, rose 2.0% in USD terms in November, brining the year-to-date gain to 9.4%. Elsewhere, USD China credit gained 0.7% in November, as signs of funding stress have eased for some property developers, which raised fresh capital in equity and debt markets. The Bloomberg China investment grade credit index was up 0.4% in the month, while the China high-yield universe added 1.6% against the backdrop of relatively lackluster issuance
- Going into 2021, we remain confident in Chinese fixed income on the back of the strength of the fund flows and continued economic recovery in the world's second-largest economy. In addition, further upbeat Covid-19 vaccine news and dollar weakness appears positive for the growth in the asset class

Chinese bonds remain steady amidst economic recovery





Source: Bloomberg, Markit data as of 30 November 2020. Total return in local currency terms.
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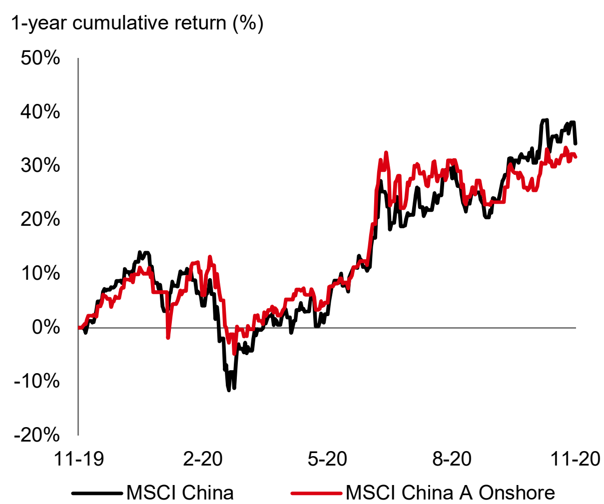
Equity market

Bouncing back from the pandemic-induced slump, the 12-month forward price-to-earnings of MSCI China and CSI 300 are now trading at 15.2x and 14.8x, respectively

- Both onshore and offshore Chinese equities continued to rally in November, as more macro data pointed to a continued recovery in the economy. On a month-to-date basis (30 November), MSCI China A Onshore and MSCI China – the onshore and offshore gauge – rose 4.9% and 2.8% for the month, respectively. Locally the CSI 300 Index of the country's largest companies added 7.5% in US dollar terms, while the Hang Seng Index surged 9.3%
- Upbeat data released in November suggested China is on track to become the first economy to shake off the impact of the pandemic, with industrial profits growth expanding steadily. The industrial profits accelerated to 28.2% yoy in October from 10.1% yoy in September, while profit margins for industrial companies expanded to 7.2% from 6.4% for the same period, or 1.1% higher than the same period last year
- In November the stock exchanges of Hong Kong, Shanghai and Shenzhen agreed that eligible pre-revenue biotech companies listed in Hong Kong and the STAR board in Shanghai will be included in the Stock Connect schemes. The inclusion is expected to start in early 2021 and implementation details and timing are subject to further clarifications from regulators and exchange operators. Separately, in mainland China, the local exchange operators issued a consultation paper about rules for companies listed in the New Third Board – the fundraising avenue for small and medium-sized enterprises – to migrate to the STAR and ChiNext boards
- In terms of fund flows (as of 30 November), the southbound trade through the Stock Connect channel has reached USD78 billion of net buying so far this year, and is poised to reach new record high as mainland investors continue to acquire tech, financial and consumer stocks in Hong Kong amid continued recovery. Meanwhile, China A-shares have attracted foreign flows of USD21 billion through the Northbound route, underpinned by hopes for improved relations between the world's two biggest economies under the new administration in the US
- In terms of valuations, the 12-month forward price-to-earnings of MSCI China and CSI 300 are now trading at 15.2x and 14.8x, respectively, with a 2021 consensus earnings growth of 22% for the former and 17% for the latter

Chinese stocks continue to climb supported by ongoing recovery



Source: Bloomberg, HSBC Global Asset Management, as of 30 November 2020. Total return in local currency terms.

Sector[1]	Outlook	Comment
Consumer Discretionary	+	In particular, we like e-commerce platforms with faster adoption rates and expanding net margins along with better logistical systems. We prefer companies that are likely to benefit from domestic consumption and tourism recovery.
Consumer Staples	+	Margin expansion capability of select strong staple brand names remains considerable with higher pricing power and through the ecommerce channel. Demand should recover quickly after COVID-19 outbreak, specially for alcoholic beverages. We like their defensiveness amid geopolitical risks and virus worries.
Energy	O	Vaccine optimism has increased market expectations for economic activity normalisation. Energy stocks have low valuations and will benefit from higher oil prices but actual demand will take time to pick up.
Financials	-	We are underweight banks as lower rates may add pressure to their net interest margins. We prefer high quality insurance companies with long term growth opportunities at attractive valuations.
Healthcare	+	We favour those with strong R&D capabilities in innovative drugs and service providers with high growth visibility and solid business models. Valuations look attractive after the recent correction.
Industrials	-	More infrastructure projects are on the cards and full resumption of construction works is underway but focus will be on “New Infrastructure” instead.
Information Technology	+	We are positive on the product upgrade trend and we like names that can benefit from continuing tech upgrade as smartphone demand remains stable despite the coronavirus outbreak and amidst the new product launches by Apple.
Materials	-	We question the sustainability of the demand rebound for construction and industrial materials given global economic slowdown. We prefer gold mining companies within the sector given the surge in gold price under easing environment.
Real Estate	-	The potential new "three red lines and four categories" policy may hinder long term growth for developers. We prefer property management companies from the longer term perspective as a defensive business, with strong cash flow, which is undergoing market consolidation.
Communication Services	-	We selectively prefer gaming, social platform and cloud services companies as coronavirus outbreak will speed up technology adoption. We are 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 lackluster due to slower economic growth.

Note:
1. Sector views of HSBC Global Asset Management’s offshore Chinese equity team; “+” = positive, “–” = negative, “O” = neutral.
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Source: Bloomberg, HSBC Global Asset Management, as of December 2020.

Indicator	Date	Actual	Consensus	Prior	Analysis
Industrial production (IP) (yoy)	Oct	**28.2%**	--	10.1%	Recent data showed China's economic recovery remains strong in the current quarter, with production activity continuing to grow at an above-trend pace while recovery in consumption and services having accelerated. Solid infrastructure investment, resilient property activities, and strong exports also continued to support overall growth. Service sector production also picked up notably, accelerating to 7.4% yoy in October from 5.4% in September. The strong growth reflected easing restrictions on services activity (due to the effective containment of Covid-19 infections in China) and the one-off effect of longer public holidays in October this year. Into 2021, we expect a rotation of growth drivers from investment to consumption and from public/infrastructure and real estate investment to private/ manufacturing investment. Laggard services sectors may take growth leadership as mass vaccination allows a faster reopening and return to normalcy in these hardest-hit sectors. With fiscal spending having undershot budgetary projections in the first three quarters of this year, there is notable room for fiscal spending to support growth in the current quarter. That said, we expect fiscal consolidation, fading monetary policy impulse, and more hawkish tone on property and financial regulation in 2021, though targeted support will continue to sustain the recovery.
Fixed Asset Investment (FAI) (ytd, yoy)	Oct	**1.8%**	1.6%	0.8%	Real estate investment maintained strength, while infrastructure and manufacturing FAI continued with a moderate recovery. We expect manufacturing capex to continue to recover, thanks to recovering domestic and external demand, enhanced credit support and a strong rebound in industrial profits (+28.2% yoy in October). Property activities and infrastructure investment are expected to lose some steam into 2021, with reduced incremental fiscal support for the former (we expect a smaller annual quota for local government special bond issuance) and the latter facing the challenges of tighter financing conditions for developers and restrictive measures taken by some local housing authorities. That said, we expect infrastructure investment to stay resilient amid continuing funding support. The government will likely continue its differentiated property policy stance and avoid over-tightening.
Retail Sales (yoy)	Oct	**4.3%**	5.0%	3.3%	Retail sales continued to recover, led by goods consumption while services growth also quickened, with catering sales returning to positive growth (+0.8% yoy) thanks to a longer Golden Week holiday this year which likely boosted demand for domestic travel and accommodation and restaurants/dining services. In terms of goods consumption, auto sales and other discretionary items (e.g. cosmetics, jewelry and communications products, etc.) also posted robust growth. Strong sales during the November Singles' Day online shopping season demonstrated Chinese consumers' strong spending power as consumer confidence continued to recover. Online sales at major outlets jumped 29% yoy during 1-11 November. Meanwhile, the labour market continued to gradually improve, with the urban survey-based unemployment rate falling further to 5.3% in October from 5.4% in September. We expect consumer spending to continue recovering with the laggard services sectors catching up into 2021, supported also by an expected deployment of Covid-19 vaccines.

Exports (USD) (yoy)	Oct	**11.4%**	9.2%	9.9%	Exports to the US, which surged 46% yoy, and Europe benefited from the Western holiday shopping season, despite the recent worsening of pandemic situation in the two regions. Shipments to other parts of Asia maintained solid growth momentum. Staying-at-home demand (e.g. high-tech products for digital adoption) and personal protective products also remained strong. Meanwhile, the stable import growth reflected weaker demand for some key commodities, possibly due to the high level of inventory domestically, and moderation in agricultural imports, while non-oil ordinary imports, an indicator of domestic demand, and imports for export processing, continued to pick up. We expect China's exports to hold up and import growth to improve further amid recovering global and domestic economy, despite likely easing of Covid-19-related demand into 2021 amid expected vaccine deployments and a catchup in production capacity elsewhere. That said, uncertainties remain over global virus containments and US-China relations. China is likely to benefit from a more stable and predictable relationship with the US under a Biden administration, which will likely take a more multilateral and collaborative approach. That said, we think the pressure may remain on China to respond to US bipartisan concerns about 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.
Imports (USD) (yoy)	Oct	**4.7%**	8.6%	13.2%	
Trade Balance (USD)	Oct	**58.44bn**	46.30bn	37.00bn	
CPI Inflation (yoy)	Nov	**(0.5%)**	0.0%	0.5%	The first negative headline CPI inflation print since 2009 was mainly driven by lower food inflation (especially pork prices due to increased supply and last year's very high base). Non-food and core inflation was muted at -0.1% and +0.5%, respectively. The hog down-cycle may remain a drag on headline inflation in the near-term, though core inflation is likely to pick up modestly through 2021 as services consumption gradually normalizes. PPI is expected to show a modest recovery in sequential terms as global goods demand continues to recover supporting commodity prices. Low inflation does not support policy tightening.
PPI Inflation (yoy)	Nov	**(1.5%)**	(1.8%)	(2.1%)	
Aggregate financing (AF) (RMB)	Nov	**2,310bn**	2,075bn	1,420bn	November data showed a tentative sign of credit growth normalisation. AF growth eased marginally to 13.6% yoy from 13.7% in October. RMB loan growth was stable at 13.3%, despite some recent moderation in medium- and long-term loans to the corporate and household sectors. On a monthly new incremental basis, government and corporate bond issuance slowed, while shadow banking credit stayed soft. Credit policy will likely remain focused on targeted support for SMEs and the manufacturing sector, while credit flow to property developers should be restrained. Credit growth is likely to decelerate into 2021.
New yuan loans (RMB)	Nov	**1,430bn**	1,450bn	689.8bn	

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

Sources: Bloomberg, HSBC Global Asset Management, as of December 2020.
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