China Insights

Monthly update on Chinese markets November 2019

Summary

- Strong September industrial production and retail sales data suggest the overall economy is holding up relatively well, offsetting concerns over the slowing headline growth rate
- The authorities have demonstrated their preference to use quantitative tools to revive growth in the near term
- A surge in inflation has curbed the magnitude of easing measures, while the economy continues to face mounting downward pressure

Hot topic: Chinese economy shows signs of resilience

China's third-quarter GDP growth came in at 6%, slightly below the market expectation of 6.1% but in line with our overall assessment of slowing global economic growth.

In the absence of substantial stimulus measures, economic growth in the world's second-largest economy is holding up relatively well, in our opinion. Chinese authorities have taken adequate action to ensure ample liquidity in the real economy, while refraining from a massive stimulus programme to avoid inflating the already-high property prices. In contrast, major central banks around the world have launched new easing measures to buffer growing downward pressures in their economies. The European Central bank is due to begin a new round of its bond buying programme (EUR20 billion a month) in November, while the Federal Reserve could potentially cut its benchmark rate for the third time this year after it trimmed rates in July and September to cushion the US economy against rising threats to growth.

Recognising resilience

The latest macro data from China seems to indicate the state of the economy is better than what the headline numbers suggest and its ability to weather external shocks has improved, supported by vibrant domestic consumption. September industrial production (IP) growth was above market expectations and showed a recovery from August. IP growth came in at 5.8% in September from a year earlier, higher than the 4.4% in August, according to National Bureau of Statistics. The pick up was driven by growth in the production of computer and electronic equipment and electrical machinery, offsetting the general weakness in automobile manufacturing.

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Growth in industrial production and retail sales underpins our confidence in the economy

Auto sales contracted by 2.2% year-on-year in September, compared with a decline of 8.1% in the prior month. The overall retail sales expanded by 7.8% year-on-year last month, in line with market expectations, and up from 7.5% in August. However, retail sales excluding auto moderated marginally to 9% from 9.2% in August.

Amidst fading productivity growth, the third-quarterly GDP growth figure was the lowest on the record (quarterly data goes back to 1992), but it should be noted that the economy is roughly 32 times larger now. It was USD14.1 trillion in 2018, compared with USD426.9 billion in 1992, according to data compiled by the World Bank.

In our opinion, the current slowdown reflects a stabilisation in the economy after the hockey stick growth witnessed in the past two decades, though the downward pressures remain evident. Nonetheless, we see signs of bottoming out in the economy. Data points including the China's Li Keqiang Index and OECD leading indicator are showing signs of recovery or a stabilisation in their latest readings.

Easing up on easing

On the other hand, the easing efforts have largely been focused on credit growth, without any aggressive monetary easing or credit stimulus. The unchanged October lending rates belied market expectations and sent a signal to the market that authorities are likely to adopt a more neutral monetary policy stance.

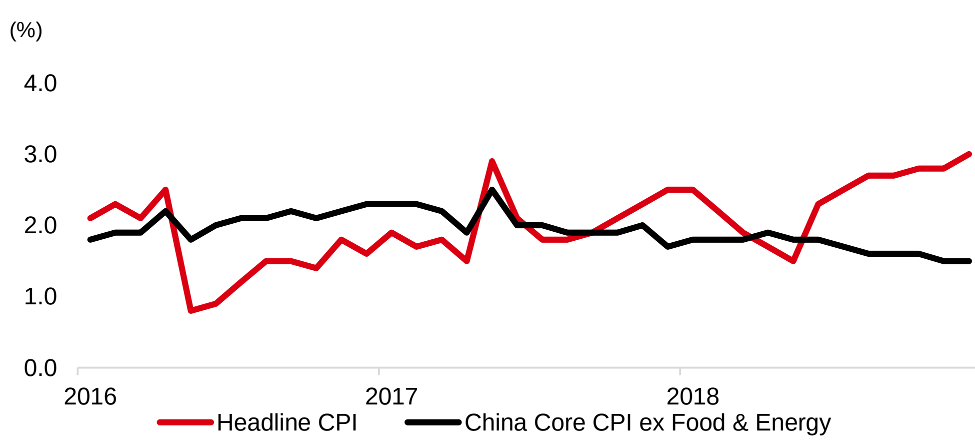
We think authorities are confident about monetary policy transmission at the moment and want to conserve policy ammunition for future use. Previously the market was expecting a further cut in the one-year and five-year loan prime rates following a mild reduction in September, but the PBoC didn't make any such moves. As a result, we see limited room for LPR to fall without a cut in deposit rate or medium-term lending facility rate, a gauge of the banks' cost of borrowing from the PBoC and the reference they use when setting LPR.

Policymakers have shown their preference for quantitative tools such as window guidance instead of price-based tools such as interest rates

What is clear is that policymakers have shown their preference for quantitative tools such as window guidance instead of price-based tools such as interest rates, as rising inflation and a slowing economy pose a dilemma for authorities. The September CPI number expanded to 3% year on year, driven by a 69% surge in pork prices.

Going into the fourth quarter, we expected continued policy support and improving sentiment from the trade deal. With the benefit of hindsight, we expect overall economic growth will hold up at the target range of 6–6.5%, while the downward pressures from manufacturing sector and labor market may start to appear. Meanwhile, growth in 2020 could fall below such range, as investment and trade have weakened significantly. The IMF forecast the growth in China could fall to 5.8%, down from a projected growth of 6.1% this year.

CPI inflation, year-on-year: 2016 to Present



Source: NBS, HSBC Global Asset Management, data as of Sep 2019

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Equity market

PBoC kept the LPR fixing at unchanged rate, suggesting the authorities' improved confidence on monetary policy transmission

- MSCI China and MSCI China A Onshore Index – the offshore and onshore benchmarks – advanced 3.2% and 1.8% in the month of October (as of 25th Oct in US dollar terms), respectively, supported by hopes the US and China are moving towards a trade pact. The US President on 18th October indicated that a trade deal could be signed by mid-November
- With the external environment looking less certain, investors looked to corporate results for clues as listed companies began to report their third quarter earnings
- Over 100 offshore-listed Chinese companies have reported their third-quarterly earnings, with their net profit growth expanding 13% year on year, or up 8% for the first nine months of 2019. In the onshore market, net profit growth for 95 A-share companies rose 19% in the three months to September, or up 13% for the first nine months of 2019. However, both onshore and offshore listed companies, excluding financials, are faced with squeezed margins amidst slowing global growth
- Generally speaking, Chinese companies have delivered solid quarterly results so far, outperforming regional peers, with their earnings tracking at 81% of their full-year estimates, higher than the historical average of 77%. In contrast, companies in the Asia ex Japan region were tracking at 75% of their full-year estimates, or 0.9% below their average
- In terms of new policy, China will allow domestic investors to buy dual-class shares traded in Hong Kong for the first time, paving the way for new dual-class listings in Hong Kong. The new policy will be effective October 28th under the Stock Connect programme
- The forward 12-month price-earnings ratio of MSCI China A onshore is currently trading at 13.7x, after the onshore benchmark rallied over 30% so far this year, while the MSCI China is trading at 12.1x

Onshore Chinese stocks extend rally

Source: Bloomberg, HSBC Global Asset Management, as of 25 October 2019. Total return in local currency terms.

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Sector views*

Sector	Views
Consumer Discretionary	◆ We are overweight on consumer discretionary sector. In particular, we like the education space as it is relatively less sensitive to macro headwinds
Consumer Staples	◆ We are overweight consumer staples as the trend of premiumization on the back of rising income underpins higher pricing power and margin expansion capability of selected strong staple brand names. VAT cut and the recent pickup in inflation also bodes well for consumer staple plays
Energy	◆ We are underweight energy as oil price is expected to trade within a narrow range.
Financials	◆ We are underweight banks as lower rates may put pressure on their net interest margin
Healthcare	◆ We are overweight healthcare and favour those with strong R&D capabilities for innovative drugs
Industrials	◆ We are underweight this sector as we do not see any near-term catalysts
Information Technology	◆ We are overweight this sector as iphone sales are better than expected and we are optimistic about 5G development
Materials	◆ We are underweight commodities as we do not see any upside on the demand front
Property	◆ We are negative on Chinese property developers as government intends to control property prices
Communication Services	◆ We only like telecommunication company that may benefit from 5G development. We are conscious that competition amongst major telecoms remains intense
Utilities	◆ We are underweight utilities sector as we see limited catalysts in this sector

Source: Bloomberg, HSBC Global Asset Management, as of October 2019.
*NOTE - Sector views of HSBC Global Asset Management's offshore Chinese equity team
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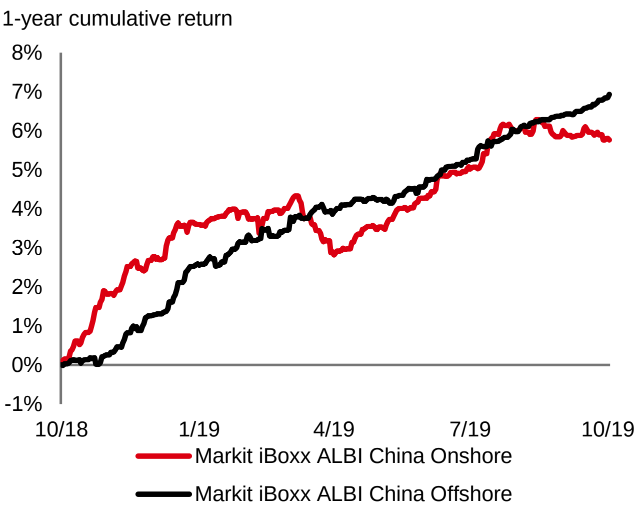
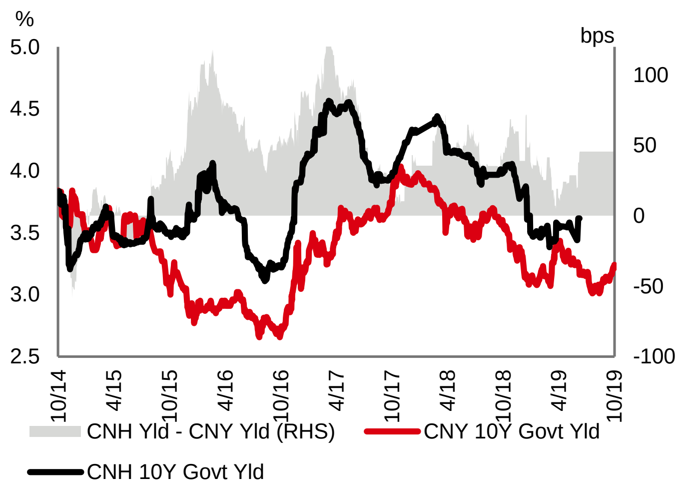
Fixed income

> Renminbi rebounds amidst positive signs of trade talks and strong credit growth in September

- Onshore and offshore Chinese bonds were largely unchanged in October, while the Chinese currency has stabilised a bit on the back of positive developments on trade talks. As of October 25th, the onshore Chinese bonds edged down 0.1% due to a recent sell-off in the long-end of the curve. The offshore renminbi bonds and Chinese USD credit both advanced 0.5%. Meanwhile, the value of renminbi gained 1% in October against the greenback, rebounding slightly after a decline earlier this year
- In October the yield curve of Chinese government bonds steepened, due to a mixed bag of optimism towards phase-one trade deal with the US, inflation reaching 3% and rebound of September activity data. Notably, yield of the five-year notes rebounded to the 3% mark, indicating a further reduction of expectations on monetary easing
- The uptick in the sovereign yield curve underscores strong credit data and rebound in industrial output. September new bank loans rebounded after dropping in the two previous months, extending RMB1.38 trillion in net new loans. In the first nine months, total new bank loans surged 17.7% from a year earlier to RMB13.14 trillion, and were on track to eclipse last year's RMB13.53 trillion. Meanwhile, industrial production grew 5.8% year on year in September, after a 4.4% increase in the previous month, suggesting a mild recovery in business activity amid ongoing trade disputes
- In terms of fund flows, September saw a significant reversal of inflows in the bond market, driven by inflows into sovereign credits. Net bond inflows rose to USD12 billion from USD2 billion in August, with USD7 billion and USD2 billion buying in Chinese government and policy bank bonds. In our view, the stabilisation of renminbi and the sentiment boost from JP Morgan's index inclusion announcement have encouraged foreign investors to increase their positions in the onshore market. Currently foreign investors represent 3.3% of the total market and are expected to increase their exposure to Chinese bonds amidst the rising trend of negative yielding bonds globally
- On October 22nd, the People's Bank of China conducted a RMB250 billion reverse repo at an interest rate of 2.55%, the largest amount of injection in the open market operation since May. The central bank said it aims to offset the impact of tax payments and local treasury deposit maturities
- Going forward, we favour government and policy bank papers amidst expectations that interest rates would be lower for longer, while remaining constructive on selective names that should benefit from further easing measures. At the same time, we anticipate a steady rise in non-performing assets as the economy slows

Chinese bonds rally amid signs of global easing





Source: Bloomberg, Markit data as of 25 October 2019. Total return in local currency terms.
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Data watch

Indicator	Date	Actual	Consensus	Prior	Analysis
Industrial production (IP) (yoy)	Sep	5.8%	4.9%	4.4%	Q3 GDP came in at 6.0% yoy, the lowest quarterly growth rate on record. However, the monthly data showed a modest sequential pickup in September activity from weak levels in July-August, likely reflecting some effects of countercyclical policies and higher credit growth. The IP growth rebound despite production restrictions for emission controls before the National Day holiday celebrations reflected stronger production of certain (electronics) exporting goods and was likely due to end-quarter seasonality. Overall, trade tension and slower global growth contributed to slower Q3 growth, particularly through the impact on private sector confidence and corporate capex. The growth deceleration has also reflected a more cautious stance towards domestic policy easing (than during the previous cycles) and structural headwinds such as falling return on capital, elevated leverage and demographic changes, etc. We think policy commitment remains firm to managing systemic financial risks and preserving policy space for future challenges (given narrowing policy room), while counter-cyclical policies will be unable to address structural issues. We expect a pro-growth policy stance to continue into 2020, with fiscal policy doing much of the heavy lifting, e.g. via more funding for infrastructure, support for SMEs/private enterprises, as well as social safety net and measures to encourage consumption upgrades, etc., accompanied by further structural reforms and opening up of domestic markets.
Fixed Asset Investment (FAI) (ytd, yoy)	Sep	5.4%	5.5%	5.5%	In September alone, FAI growth picked up slightly driven by manufacturing, while infrastructure gained modest momentum (amid intensified policy support) and real estate remained resilient. Higher tariffs and trade uncertainties have hurt business confidence and corporate earnings and weighed on manufacturing FAI despite the stimulus measures including tax cuts and targeted credit easing. Property sector activities were mixed but generally held up. Tighter liquidity/credit policy, cooler land sales and new starts this year, and weaker sales in lower-tier cities pose downside risks for the 2020 outlook. However, while broader policy relaxation looks unlikely barring signs of a sharp slowdown, city-level policy fine-tuning could help offset some negative impact from higher mortgage rates during the transition period of the new loan prime rate (LPR) mechanism and provide some cushion against downside risks.
Retail Sales (yoy)	Sep	7.8%	7.8%	7.5%	Auto, a key drag on retail sales, stayed weak but the YoY fall narrowed. We expect auto sales growth to bottom out in the near term. Labour market indicators have showed resilience amid external uncertainties and macro headwinds. Unemployment concerns/job losses in (lower cost) manufacturing could partly be off-set by ongoing structural changes in the economy (e.g. the growing share of the labour-intensive services sector, ageing population, and slowing farm-to-factory migration, etc.). Tax cuts and consumer durables measures could help consumption at the margin.
Exports (USD) (yoy)	Sep	-3.2%	-2.8%	-1.0%	Exports and imports continued to reflect weak external and domestic demand, with the imposition of extra US tariffs on 1 September, although on a sequential (MoM, seasonally adjusted) basis, exports and non-oil ordinary imports had showed signs of stabilisation. Imports for processing trade continued to weaken, likely reflecting some degree of supply-chain adjustments, structural trend of industrial upgrading, and the acceleration of China's localisation of tech materials and intermediate goods. On the US-China trade front, the US tariff increase initially scheduled to take effect on 15 October has been suspended as the two countries appear to have reached in principle a tentative "Phase 1" agreement. Despite the trade truce, existing tariffs have not been rolled back and a comprehensive deal or a full resolution looks difficult to achieve, in our view, particularly in structural issues such as China's industrial, SOE and economic policy as well as the enforcement/versification mechanism.
Imports (USD) (yoy)	Sep	-8.5%	-6.0%	-5.6%	
Trade Balance (USD)	Sep	39.7 bn	34.8 bn	34.8 bn	
CPI Inflation (yoy)	Sep	3.0%	2.9%	2.8%	Food prices (especially surging pork prices) drove headline CPI inflation to hit the 3% upper bound of the desired inflation range. Headline will likely rise further as pork prices may not peak until H1 2020, being a hurdle for aggressive monetary easing. Government supply measures may help smooth price fluctuations but will unlikely reverse the cycle. Meanwhile, non-food, services and core CPI inflation has stayed modest and stable, indicating muted underlying demand-pull pressures and still allowing policy to stay accommodative, while PPI was negative YoY, though it may stabilise in the near term with the sequential PPI inflation already turning positive.
PPI Inflation (yoy)	Sep	-1.2 %	-1.2%	-0.8 %	
Total Social Financing (TSF)(RMB)	Sep	2,270 Bn	1,900bn	1,980 Bn	TSF growth was driven by new RMB loans, corporate bond issuance and narrowed contraction of shadow banking credits. New corporate loans rebounded for a second consecutive month, showing early signs of corporate credit demand recovery amid government policies to encourage banks' lending to the corporate sector. Consumer credit/mortgage loan growth remained robust, despite the cooling measures in the property sector. We continue to expect credit growth to pick up modestly.
New yuan loans (RMB)	Sep	1,690 bn	1,360bn	1,210 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 October 2019

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