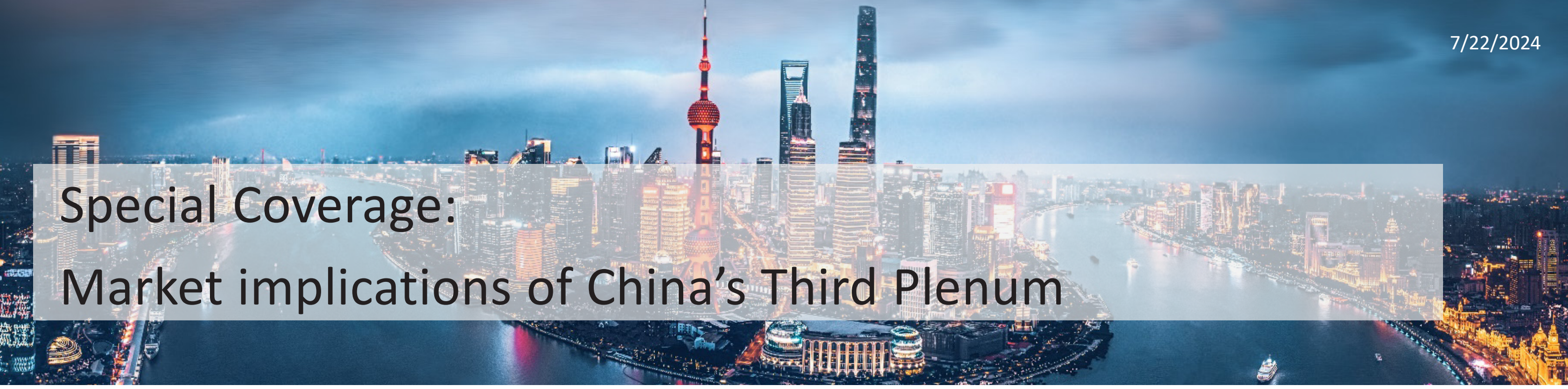

Special Coverage:
Market implications of China's Third Plenum

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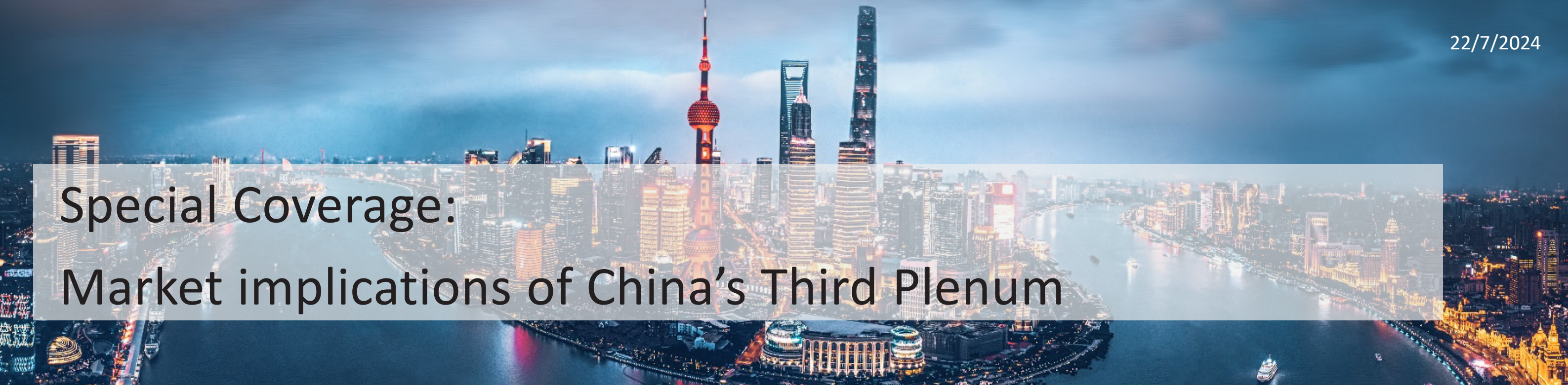
22/7/2024



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Key takeaways

- The communique of the Third Plenum laid out key structural reforms for the coming years with focus on high-quality development in five areas – new quality productive forces, technological innovation, macroeconomic policy governance, integrated urban and rural development, and further opening up foreign trades and investment.
- Despite initial positive effects from the supportive policies announced since late April, we think it is premature to conclude if the tentative improvement in property pricing, sales and financing costs in June is sustainable given mixed macro data in June and July.
- While the need to reach this year's 5% GDP growth target was reiterated, we think more near-term policy stimulus will be needed to sustain growth recovery and to revive business and consumer confidence. More policy details in coming weeks and Politburo meeting later this month will provide better clarity on policy priorities and implementation plans. We stay neutral on Chinese equities.

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What happened?

- The Third Plenum of the Chinese Communist Party's (CCP) 20th Central Committee took place on 15-18 July. The communique laid out key structural reforms for the coming years and highlighted the importance of high-quality development in these five areas:

  1. **New quality productive forces** will be established to promote integration of the digital and other parts of the economy, with the services sector, new infrastructure and resilient supply chains to be prioritised.
  2. **To foster technological innovation**, further investment in education, basic science, technology, and institutional reforms for talent development is committed.
  3. **Macroeconomic policy governance** will be put in place to enhance consistent implementation of macro policies for the fiscal systems, tax regime, financial sectors, and other major policy areas.
  4. **Integrated urban and rural development** will be achieved through two-way flows of production factors between the cities and rural areas to narrow the disparities between the two. Reform of the land ownership system will also be deepened.
  5. **To further open up foreign trades and investment**, the CCP will expand the foreign trade sector, improve the management systems for inward and outward investment, and optimise the Belt and Road Initiative.

- The Third Plenum also reiterated the commitment to mitigate risks in real estate, local government debt, small and medium financial institutions, and other key areas.

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- To mitigate risk of the property market downturn, the Politburo, State Council, People's Bank of China (PBoC) and other ministries have announced a series of supportive policies since late April. The Chinese authorities also announced a property rescue package in mid-May. On the supply side, the State Council allowed local governments to acquire unsold housing projects at reasonable prices and turn them into affordable and social housing. On the demand side, mortgage rates and minimum down-payment were lowered.

- Second-hand home prices in Beijing, Shanghai, Hangzhou, and Nanjing recorded m-o-m growth in June, reversing the 6-month decline. New home sales value for top 100 developers fell 17% y-o-y in June but increased 36% m-o-m. Nevertheless, we think it is premature to conclude if the tentative improvement in property pricing, sales and financing costs in June is sustainable given mixed macro data in June and July.

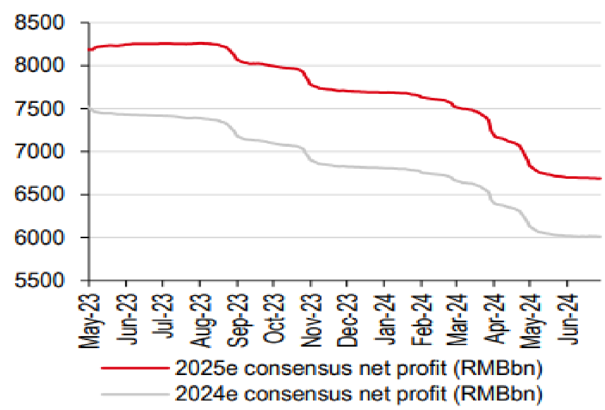
- We expect enhanced market access, particularly in the services sector and the capital markets, would help attract more foreign investment in China. A key focus for offshore investors will be the expansion of Stock Connect and Bond Connect via 1) expanding the scope of eligible ETFs; 2) incorporating real estate investment trusts (REITs) into Stock Connect; 3) supporting the inclusion of RMB-denominated stocks into Southbound Stock Connect; 4) enhancing the scheme of mutual recognition of funds; and 5) supporting the listing of leading mainland Chinese companies in Hong Kong. These measures have seen positive results.

Investment implications

- To address the issue of local government debt, we expect that the upcoming fiscal reforms will better align revenue and expenditure of local governments and believe systemic credit crisis in the local government financing vehicle bond market is unlikely. We prefer quality issuers in this space.

- We believe a durable re-rating of the Chinese equity market would require more sustainable fundamental improvement in terms of cyclical growth outlook and corporate earnings performance in H2 2024. Consensus A-share earnings forecasts for 2024 and 2025 have been revised down YTD due to lacklustre property demand, weak private investment, and concerns about the debt deflationary spiral. Hence, we stay neutral on Chinese equities and remain selective in quality companies, including corporate governance reform winners, such as SOEs paying high dividend yields and strong cashflow companies.

Consensus earnings estimates for 2024 and 2025 have been on downtrend



Source: WIND consensus earnings estimates, HSBC Global Private Banking and Wealth as of 19 July 2024. Past performance is not a reliable indicator of future performance.

- In the A-share market, the high-tech sectors (e.g. self-reliance software and hardware leaders in big data processing and storage, semiconductors, and computing) and high-end competitive manufacturers (e.g. leading EV makers and lithium battery firms) should stand to benefit from policy support for innovation.

- Further enhancement of social safety net and land reforms will likely take some time to take effect. Retail sales momentum will continue to slow in the coming quarters. We prefer service consumption companies to producers of consumer goods given high resilience of service consumption versus general goods sales. Leisure and travel demand remains robust during recent Labour Day Golden Week holidays.

- While the Third Plenum reiterates the need to achieve this year's 5% GDP growth target, the structural reforms outlined are largely medium to long-term initiatives. We believe more near-term policy support will be needed to sustain the growth recovery momentum and to revive business and consumer confidence. We expect to see more policy details to be announced in coming weeks and at the July Politburo meeting.

- The PBoC's policy stance to maintain exchange rate stability will play a determinant role in capping downside risk in the RMB, which is expected to likely stay volatile in the near term due to rate differential against major currencies, growing concerns about heightened tariff risks ahead of the US election, etc.

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