Special Coverage: Extension of China rally hinges on decisive fiscal stimulus

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Special Coverage: Extension of China rally hinges on decisive fiscal stimulus

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Key takeaways

- Disappointment from a lack of new stimulus announcement at the press conference hosted by China's NDRC on 8 October triggered a 9.4% correction of the Hang Seng Index (HSI), which we regard as a short-term technical pullback.
- We expect further fiscal stimulus will likely be introduced by the Ministry of Finance to supplement monetary easing to revive domestic demand and shore up growth. However, the exact timeline of the policy announcement and the scale of fiscal stimulus remains uncertain.
- We maintain neutral on mainland Chinese and Hong Kong equities as we look for more evidence of a meaningful improvement in the fundamental outlook of the Chinese economy and corporate earnings. We believe the extension of the China rally will hinge on the fiscal policy. We favour quality Chinese SOEs paying high dividends, internet leaders with solid earnings and big valuation discounts to their global peers. In Hong Kong, we favour undervalued high dividend stocks in the insurance, telecom and utilities sectors, and select oversold property developers with strong balance sheets.

What happened?

- The widely anticipated press conference hosted by China's National Development and Reform Commission (NDRC) on 8 October turned out to be disappointing as no new stimulus was announced.
- Since the announcement of the comprehensive monetary, property and capital market support package on 24 September, the markets have been building up expectations of a "whatever it takes" approach of fiscal spending plan, with market projections of the stimulus package size ranging from RMB2trn to RMB10trn.
- The underwhelming policy communication triggered massive profit-taking and a sharp sell-off of the Hang Seng Index (HSI) by 9.4% to close at 20,927, with record daily trading volume of HKD620bn (USD80bn). Meanwhile, China's A-share benchmark, CSI 300, recorded a smaller-than-expected reopening rally of 5.9% (vs +10% limit up expectations). That said, the A-share markets still witnessed record daily turnover of RMB3.43trn (USD486bn), as onshore investors played catch-up with the massive gains of China's offshore equities during the Golden Week holidays.
- We view the sharp selloff of the HSI as a short-term technical correction after the index staged a stellar rally of 26.6% within nine trading days since the announcement of the China stimulus. A combination of short-term technical factors has exaggerated the magnitude of the market drawdown, including heavy profit-taking pressure, A-H pair trades, investor repositioning and tactical rotation from China's offshore equities into domestic A-shares to capture more revaluation upside after the Golden Week holidays.
- It is noteworthy that the lack of stimulus announcement from the NDRC should not be a surprise to the markets in the first place, given that the commission's mandate is to formulate economic reform strategies, set macroeconomic targets, and coordinate macro and structural reform policies. It should be the Ministry of Finance, not the NDRC, to announce financing plans for the fiscal stimulus package.

- We believe further fiscal stimulus will likely be on the way to supplement monetary easing to revive domestic demand and shore up growth. However, the exact timeline of the policy announcement and the scale of stimulus package remain uncertain. We think the ultimate size of fiscal stimulus will likely hinge on the central leadership's sense of urgency to offer additional policy support.
- The NDRC conveyed a constructive message that the Chinese economy is "stable" and showing "positive progress" in meeting the 2024 economic growth target of around 5%. The NDRC's policy tone seems to reflect reduced urgency for a fiscal stimulus bonanza. Existing fiscal initiatives highlighted by the NDRC:

  1) Special Local Government Bonds (SLGBs) – The NDRC called for accelerated usage of all the 2024 issuance quota for new SLGBs by end-October. Local governments are estimated to have about RMB290bn remaining quota left for construction projects in 2024, suggesting more room for additional special bonds to be issued this year.

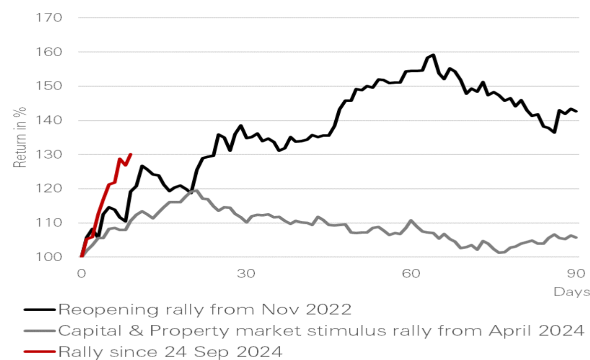
  2) Ultra-long Special China Government Bonds (SCGBs) – The NDRC provided no hint for lifting the quota for ultra-long SCGBs in 2024. Instead, the NDRC is preparing the project list for 2025.

  3) Front-loading 2025 project list – The NDRC planned to front-load the 2025 construction project list of RMB200bn (0.2% of GDP) to 2024, with RMB100bn of central fiscal spending to be issued by end-October.
- The NDRC reiterated the policy focus on increasing countercyclical support and boosting consumption demand, and emphasised the importance of stabilising the property sector and introducing powerful and effective measures to boost the capital markets, but it didn't provide specific policy details.

Investment implications

- We remain neutral on mainland Chinese and Hong Kong equities as we look for more evidence of a meaningful improvement in the fundamental outlook of the Chinese economy and corporate earnings. We think the support measures announced so far should be effective in avoiding further deterioration in the deleveraging and debt deflation spiral. But the markets require more sustained improvement in the growth outlook beyond 2024.
- We view the sharp spike in market volatility as a timely wake-up call to focus on fundamental quality. Looking ahead, we believe the extension of the China rally will hinge on the fiscal policy, which remains the key driver for China's structural growth outlook.

Chinese equity market performance in previous policy-driven rallies



Source: Bloomberg, HSBC Global Private Banking and Wealth as at 9 October 2024. Past performance is not an indicator of future performance.

- As it would take time for the stimulus measures to filter through the economy and drive fundamental improvement, we favour undervalued quality Chinese and Hong Kong industry leaders with strong earnings and high potential of improving shareholder returns by increasing dividend payment and share buybacks. We like quality SOEs paying high dividends, including select Chinese banks, telecom and energy stocks, and favour blue-chip internet leaders with resilient earnings outlook and significant valuation discounts to their US peers. In Hong Kong, we prefer undervalued high dividend stocks in the insurance, telecom and utilities sectors, which are expected to perform well in the global rate-cutting cycle. The MSCI China and HSI are trading at 12-month forward P/E of 11.5x and 9.9x, respectively, which remain below their 5-year averages.
- We remain cautious on Chinese property high-yield bonds and stocks of highly geared privately-owned Chinese developers. But we selectively position in quality Chinese SOE developers and Hong Kong property developers with strong financial strength to pay high dividends.
- We expect the low-for-longer rate environment will persist and Chinese IG bonds will remain well supported by central bank policy easing. We stay neutral on Chinese local currency bonds and hard currency bonds.

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