22/7/2024

Special Coverage: Market implications of China's Third Plenum

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.

Patrick Ho

Chief Investment Officer, North Asia, HSBC Global Private Banking and Wealth

Desmond Kuang

Chief Investment Officer, China, HSBC Global Private Banking and Wealth

Regina Feng

Investment Strategist, China, HSBC Global Private Banking and Wealth

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.

- 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.

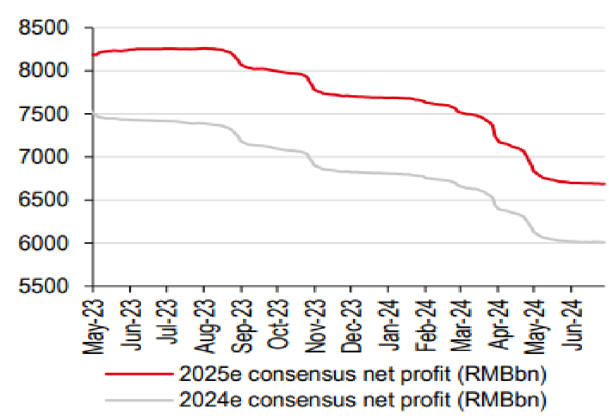
- We expect enhanced market access, particularly in the services sector and the capital markets, would help attract more foreign investment in China. A key focus for offshore investors will be the expansion of Stock Connect and Bond Connect via 1) expanding the scope of eligible ETFs; 2) incorporating 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 confident. 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.

Disclaimer

This document or video is prepared by The Hongkong and Shanghai Banking Corporation Limited ('HBAP'), 1 Queen's Road Central, Hong Kong. HBAP is incorporated in Hong Kong and is part of the HSBC Group. This document or video is distributed and/or made available, HSBC Bank (China) Company Limited, HSBC Bank (Singapore) Limited, HSBC Bank Middle East Limited (UAE), HSBC UK Bank Plc, HSBC Bank Malaysia Berhad (198401015221 (127776-V))/HSBC Amanah Malaysia Berhad (20080100642 1 (807705-X)), HSBC Bank (Taiwan) Limited, HSBC Bank plc, Jersey Branch, HSBC Bank plc, Guernsey Branch, HSBC Bank plc in the Isle of Man, HSBC Continental Europe, Greece, The Hongkong and Shanghai Banking Corporation Limited, India (HSBC India), HSBC Bank (Vietnam) Limited, PT Bank HSBC Indonesia (HBID), HSBC Bank (Uruguay) S.A. (HSBC Uruguay is authorised and oversought by Banco Central del Uruguay), HBAP Sri Lanka Branch, The Hongkong and Shanghai Banking Corporation Limited – Philippine Branch, HSBC Investment and Insurance Brokerage, Philippines Inc, and HSBC FinTech Services (Shanghai) Company Limited and HSBC Mexico, S.A. Multiple Banking Institution HSBC Financial Group (collectively, the "Distributors") to their respective clients. This document or video is for general circulation and information purposes only.

The contents of this document or video may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose. This document or video must not be distributed in any jurisdiction where its distribution is unlawful. All non-authorised reproduction or use of this document or video will be the responsibility of the user and may lead to legal proceedings. The material contained in this document or video is for general information purposes only and does not constitute investment research or advice or a recommendation to buy or sell investments. Some of the statements contained in this document or video may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. HBAP and the Distributors do not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. This document or video has no contractual value and is not by any means intended as a solicitation, nor a recommendation for the purchase or sale of any financial instrument in any jurisdiction in which such an offer is not lawful. The views and opinions expressed are based on the HSBC Global Investment Committee at the time of preparation and are subject to change at any time. **These views may not necessarily indicate HSBC Asset Management's current portfolios' composition. Individual portfolios managed by HSBC Asset Management primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity.**

The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. Past performance contained in this document or video is not a reliable indicator of future performance whilst any forecasts, projections and simulations contained herein should not be relied upon as an indication of future results. Where overseas investments are held the rate of currency exchange may cause the value of such investments to go down as well as up. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Economies in emerging markets generally are heavily dependent upon international trade and, accordingly, have been and may continue to be affected adversely by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries with which they trade. These economies also have been and may continue to be affected adversely by economic conditions in the countries in which they trade. Investments are subject to market risks, read all investment related documents carefully.

This document or video provides a high-level overview of the recent economic environment and has been prepared for information purposes only. The views presented are those of HBAP and are based on HBAP's global views and may not necessarily align with the Distributors' local views. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. It is not intended to provide and should not be relied on for accounting, legal or tax advice. Before you make any investment decision, you may wish to consult an independent financial adviser. In the event that you choose not to seek advice from a financial adviser, you should carefully consider whether the investment product is suitable for you. You are advised to obtain appropriate professional advice where necessary.

The accuracy and/or completeness of any third-party information obtained from sources which we believe to be reliable might have not been independently verified, hence Customer must seek from several sources prior to making investment decision.

The following statement is only applicable to HSBC Mexico, S.A. Multiple Banking Institution HSBC Financial Group with regard to how the publication is distributed to its customers: This publication is distributed by Wealth Insights of HSBC México, and its objective is for informational purposes only and should not be interpreted as an offer or invitation to buy or sell any security related to financial instruments, investments or other financial product. This communication is not intended to contain an exhaustive description of the considerations that may be important in making a decision to make any change and/or modification to any product, and what is contained or reflected in this report does not constitute, and is not intended to constitute, nor should it be construed as advice, investment advice or a recommendation, offer or solicitation to buy or sell any service, product, security, merchandise, currency or any other asset.

Receiving parties should not consider this document as a substitute for their own judgment. The past performance of the securities or financial instruments mentioned herein is not necessarily indicative of future results. All information, as well as prices indicated, are subject to change without prior notice; Wealth Insights of HSBC Mexico is not obliged to update or keep it current or to give any notification in the event that the information presented here undergoes any update or change. The securities and investment products described herein may not be suitable for sale in all jurisdictions or may not be suitable for some categories of investors.

The information contained in this communication is derived from a variety of sources deemed reliable; however, its accuracy or completeness cannot be guaranteed. HSBC México will not be responsible for any loss or damage of any kind that may arise from transmission errors, inaccuracies, omissions, changes in market factors or conditions, or any other circumstance beyond the control of HSBC. Different HSBC legal entities may carry out distribution of Wealth Insights internationally in accordance with local regulatory requirements.

Important Information about the Hongkong and Shanghai Banking Corporation Limited, India ("HSBC India")

HSBC India is a branch of The Hongkong and Shanghai Banking Corporation Limited. HSBC India is a distributor of mutual funds and referrer of investment products from third party entities registered and regulated in India. HSBC India does not distribute investment products to those persons who are either the citizens or residents of United States of America (USA), Canada, Australia or New Zealand or any other jurisdiction where such distribution would be contrary to law or regulation.

The following statement is only applicable to HSBC Bank (Taiwan) Limited with regard to how the publication is distributed to its customers: HSBC Bank (Taiwan) Limited ("the Bank") shall fulfill the fiduciary duty act as a reasonable person once in exercising offering/conducting ordinary care in offering trust services/ business. However, the Bank disclaims any guarantee on the management or operation performance of the trust business.

The following statement is only applicable to PT Bank HSBC Indonesia ("HBID"): PT Bank HSBC Indonesia ("HBID") is licensed and supervised by Indonesia Financial Services Authority ("OJK"). Customer must understand that historical performance does not guarantee future performance. Investment product that are offered in HBID is third party products, HBID is a selling agent for third party product such as Mutual Fund and Bonds. HBID and HSBC Group (HSBC Holdings Plc and its subsidiaries and associates company or any of its branches) does not guarantee the underlying investment, principal or return on customer investment. Investment in Mutual Funds and Bonds is not covered by the deposit insurance program of the Indonesian Deposit Insurance Corporation (LPS).

Important information on ESG and sustainable investing

Today we finance a number of industries that significantly contribute to greenhouse gas emissions. We have a strategy to help our customers to reduce their emissions and to reduce our own. For more information visit www.hsbc.com/sustainability.

In broad terms "ESG and sustainable investing" products include investment approaches or instruments which consider environmental, social, governance and/or other sustainability factors to varying degrees. Certain instruments we classify as sustainable may be in the process of changing to deliver sustainability outcomes. There is no guarantee that ESG and Sustainable investing products will produce returns similar to those which don't consider these factors. ESG and Sustainable investing products may diverge from traditional market benchmarks. In addition, there is no standard definition of, or measurement criteria for, ESG and Sustainable investing or the impact of ESG and Sustainable investing products. ESG and Sustainable investing and related impact measurement criteria are (a) highly subjective and (b) may vary significantly across and within sectors.

HSBC may rely on measurement criteria devised and reported by third party providers or issuers. HSBC does not always conduct its own specific due diligence in relation to measurement criteria. There is no guarantee: (a) that the nature of the ESG / sustainability impact or measurement criteria of an investment will be aligned with any particular investor's sustainability goals; or (b) that the stated level or target level of ESG / sustainability impact will be achieved. ESG and Sustainable investing is an evolving area and new regulations are being developed which will affect how investments can be categorised or labelled. An investment which is considered to fulfil sustainable criteria today may not meet those criteria at some point in the future.

THE CONTENTS OF THIS DOCUMENT OR VIDEO HAVE NOT BEEN REVIEWED BY ANY REGULATORY AUTHORITY IN HONG KONG OR ANY OTHER JURISDICTION.

YOU ARE ADVISED TO EXERCISE CAUTION IN RELATION TO THE INVESTMENT AND THIS DOCUMENT OR VIDEO. IF YOU ARE IN DOUBT ABOUT ANY OF THE CONTENTS OF THIS DOCUMENT OR VIDEO, YOU SHOULD OBTAIN INDEPENDENT PROFESSIONAL ADVICE.