3 May 2022

China Policy

Implications of the Politburo meeting

The politburo committed to a 5.5% growth target, stronger policy loosening, more infrastructure investment, further property policy easing, more friendly tone towards platform companies and continuing support to hard-tech sector. It maintained Covid-zero policy but vowed to minimize the policy's impact on growth. China would restart its credit expansion to boost growth as three signals we notice three signals before the politburo meeting. First, renminbi started to sharply depreciate against US dollar, paving the way for further monetary loosening. Second, money market rates like the seven-day repo rates declined by 30bps in April, indicating further liquidity easing. Third, private enterprises' credit spread in the onshore bond market dropped over 30bps from the middle of March. A policy-driven rebound has been on the way for the stock markets, which should be stronger than the previous cycle after the meeting of the Financial Stability and Development Committee on 16 March. The rebound may possibly evolve into a reversal, but it is too early to judge. The Covid-zero policy will limit the room of China's economic resumption, while the high inflation should keep the US Fed hawkish. We may need 2-3 months to see a marked improvement in China's economic fundamental and a noticeable decline of US inflation. Real estate, financials, infrastructure construction sector has outperformed the market in the year to date and they should usher in the second rally. Internet sector would benefit from the strong policy signal. Consumer discretionary especially those in the downstream of property sector may have more upside room as China starts to reflate its credit growth. Hard technology and machinery sector should also have some upside room because of sentiment improvement and significant declines year to date. Energy and material sectors will also be boosted by China's stronger policy easing. But it is difficult for them to continue to outperform the market as global macro risk gradually shifts from inflation to recession.

- **Commitment to the 5.5% GDP growth target with a bit flexibility allowed.** The politburo pledged to "strive to achieve full-year economic and social development goals". The renewed commitment to the 5.5% target should be a support to the market confidence about China's growth. But the policymaker clearly knows the difficulty in achieving the growth targets and should allow a bit flexibility as it uses the word of "strive to".

- **Covid-zero policy maintained to seek a balance between epidemic control and economic growth.** The politburo maintained the Covid-zero strategy, but vowed to minimize its impact on the growth. In near term, the Covid-zero policy will continue to restrain the resumption of re-opening related sectors such as catering, hotel, tourism, and cultural, sports & recreational services. In the medium term, China may take a gradual manner to ease up its virus controls with the balance gradually tilting towards the growth. On a press conference last Thursday, the Chinese health experts listed the conditions for reopening. First, the vaccination rate for the elderly and people with underlying diseases should further increase. China's vaccination rate for the population over 60 years old reached 81.5%, which needs further increase in future. Second, China needs to make good preparations in isolation beds and effective drugs. Thirdly, the virus mutates in the direction of decreasing severity with lower hospitalization and fatality rates.

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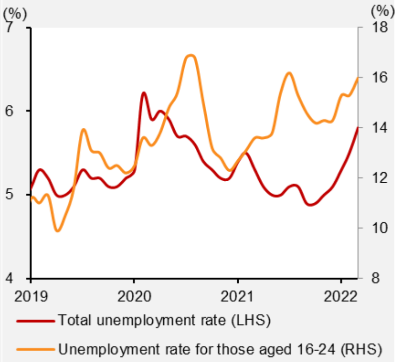

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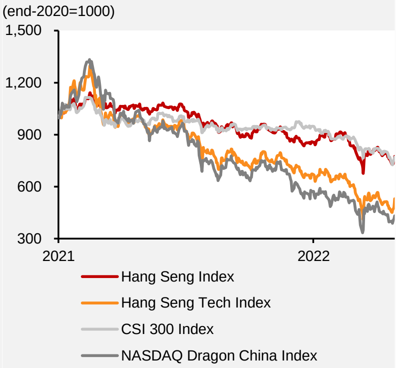

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- **Stronger policy loosening to boost infrastructure investment and support SMEs, individual business and those sectors affected by the epidemic.** The politburo said to increase the magnitude of policy loosening with new policies in plan to support the economy. We expect additional cuts in RRR or LPRs may arrive in next two months. The policymaker focused on boosting infrastructure investment and supporting SMEs, individual business and those sectors affected by the epidemic.
- **Strong commitment to energy & food supply security, employment stability and supply chain stability.** The top policymaker paid much attention to the energy & food supply security especially after the Ukraine crisis. We will see an increase of fixed investment in the production and supply of energy and agricultural products. The authority also focus on employment stability. SMEs, individual business in services and platform economy are important sectors for employment stability. The politburo also emphasized to keep supply chain stability as the epidemic and lockdowns in Shanghai caused concern about the supply chains.
- **Policy easing for real estate sector.** The politburo repeated the phrase that “housing is for living and not for speculation”. But it encouraged local governments to adjust their policies to support housing market especially the first-house purchase and upgrading demand. The regulation over property developers’ presale fund will be adjusted to alleviate their cash flow pressure. Real estate market is of great importance for China’s growth and financial system stability. We expect further loosening of property policies ahead to stabilize property sales and development investment as the real estate sector is the key.
- **Supportive stance for platform companies and continuing commitment to hard technology innovation.** The politburo said to support the development of the platform companies, indicating a further shift of policy tone to boost business confidence. This change is mainly due to three reasons. Firstly, China needs to boost business confidence to stabilize growth. Secondly, the platform companies employ substantial young workers and the employment condition is under great pressure. Thirdly, IT is an important sector for the Sino-US competition and China needs those platform companies to compete with their US counterparts. The politburo maintained its commitment to hard technology innovation and autonomy in the medium to long term.
- **Implications for stock markets.** The strong policy signals from the politburo meeting has ignited a rally in Chinese stock markets last Friday. A rebound has been on the way, which should be stronger than the previous cycle after the meeting of the Financial Stability and Development Committee on March. The previous rebound cycle lasted 2-3 weeks from the middle of March to early April, with the CSI 300 index and Hang Seng index respectively up 7.3% and 22.2%. Property sector led the rally in A share market and platform companies & healthcare sector led in HK market. The markets slumped again from early April due to the epidemic outbreak in Shanghai, US Fed’s hawkish stance and weaker-than-expected policy easing in China. The CSI 300 index and Hang Seng index respectively dropped 11.5% and 11.7%, with the former seeing a new low in the slump. Looking forward, the current rally may last a few weeks with more upside room than the previous rebound as the signal of policy loosening is far stronger and the worst time for China economy is about to over.
- **Will the current rebound cycle evolve into a reversal?** Maybe. But it is still early to judge. For one thing, the Covid-zero policy will limit the room of

China's economic resumption as the country tries to seek a difficult balance between the two goals. The political reshuffle this year also increases the difficulty in the balance. Besides, there is some time lag between the policy launch and its effect on the growth. We still need two months to see a marked improvement in China's economic fundamental and corporate earnings. For another thing, US inflation may have seen the peak but should remain high in 2Q22. The high inflation will keep the US Fed hawkish. We may need 2-3 months to see a noticeable decline of US inflation.

- **Sector implications.** The policy signal from the politburo is positive for internet platforms, hard-technology companies, infrastructure investment, agriculture & energy related investment and property sector. It is slightly negative for reopening-related consumption in the short term. Internet sector will definitely benefit from the strong policy signal. Real estate, financials, infrastructure construction sector had already outperformed the market in the past several weeks and they should usher in the second rally. Consumer discretionary especially those in the downstream of property sector may see more upside room as China starts to reflate its credit growth. Hard technology and machinery sector may also see a rebounding because of sentiment improvement and significant declines in the previous period. Energy and material sectors will also be boosted by China's stronger policy easing. But it is difficult for them to continue to outperform the market as global macro risk gradually shifts from inflation to recession.

Figure 1: Annual Incremental Employment in 2013-2018 by Sectors

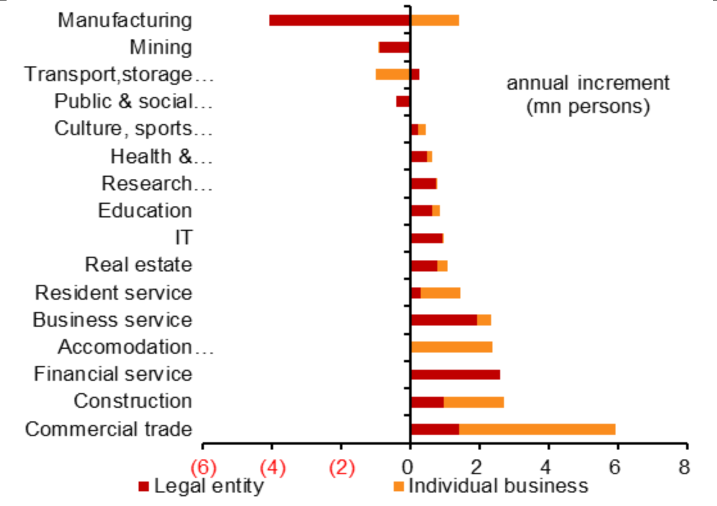

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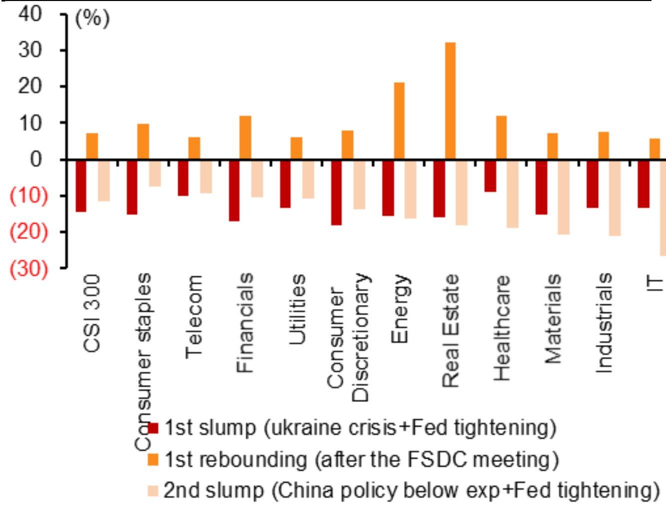
Figure 2: Recent Slump & Rally of A Shares by Sectors



Source: Wind, CMBIGM

Figure 3: Recent Slump & Rally of HK Stocks by Sectors

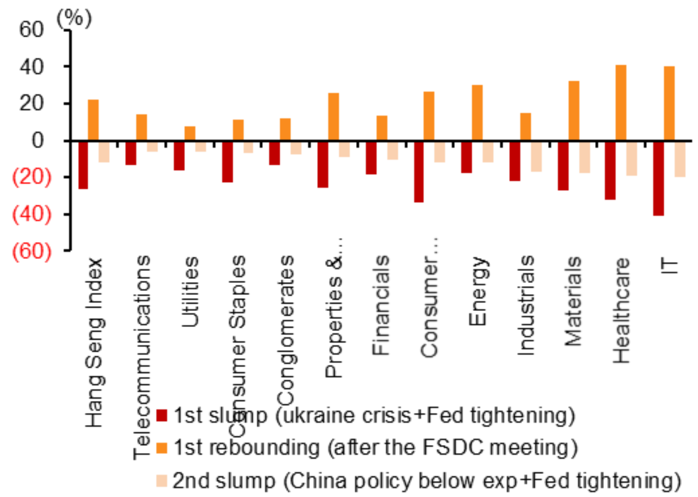


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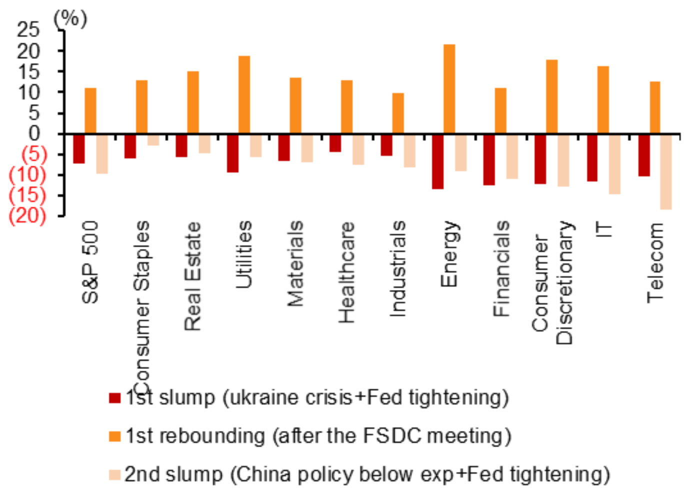
Figure 4: Recent Slump & Rally of US Stocks by Sectors



Source: Wind, CMBIGM

Figure 5: Margin Trading in A Share Market

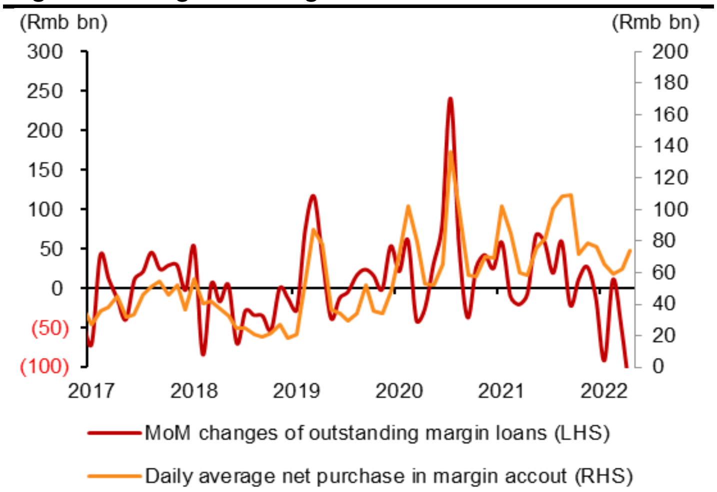


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Figure 6: China Stock Mutual Funds' Share Changes

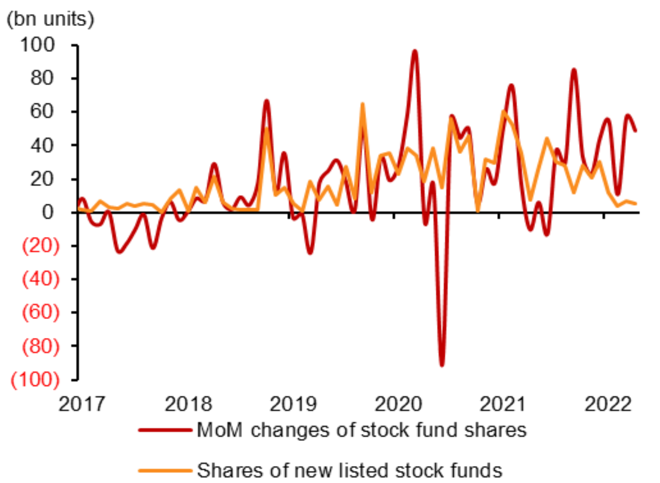

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Figure 7: EM ETF Volatility & NB Net Flows

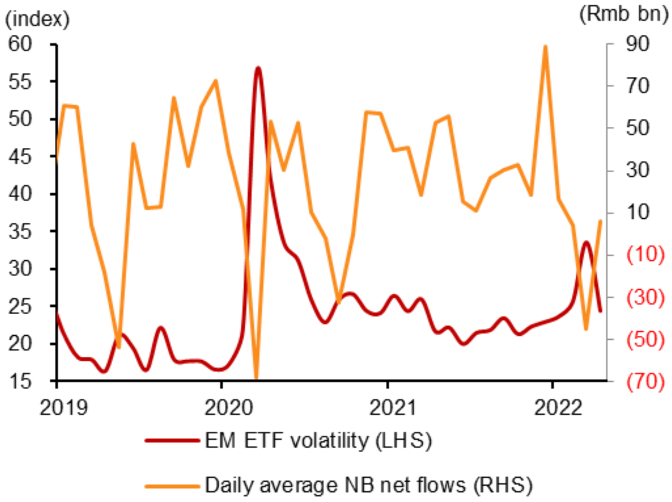

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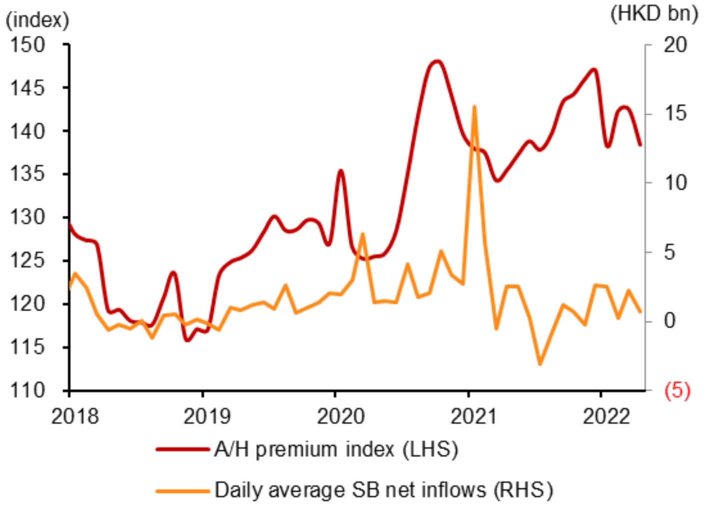
Figure 8: A/H Premium & SB Net Flows



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