# China Insights

## Raring to recover after virus-induced slowdown

April 2020


## Summary

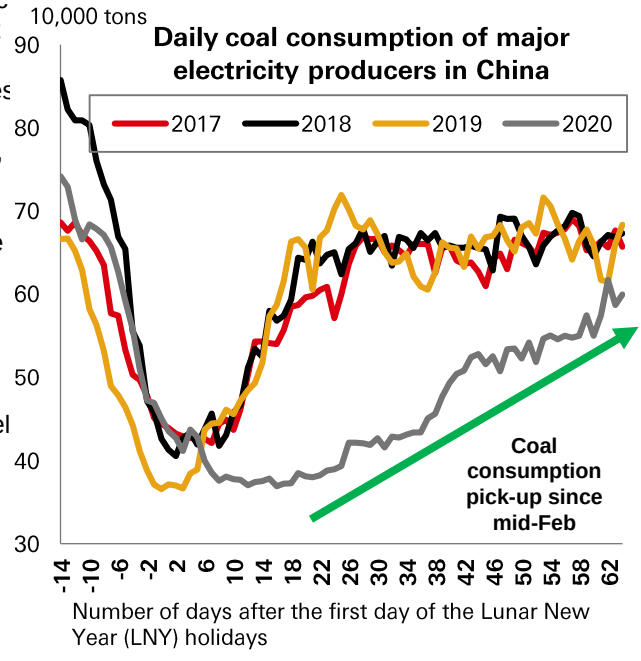
- Our high-frequency economic activities tracker suggests a nascent recovery in the Chinese economy after worse-than-expected January-February data
- Faster work resumption coupled with relaxation in containment measures and intensified macro policy support should allow for a sequential activity recovery in the coming months
- Given the challenging growth picture, we anticipate stronger policy responses ahead through a mix of fiscal and monetary stimulus measures to support the economy


## Hot topic: Raring to recover after virus-induced slowdown

Against the backdrop of a sharp near-term slowdown in economic activity in January-February, investor focus is now on the pace at which China's economy can return to normal. In recent weeks, Chinese authorities have gradually relaxed containment measures and lockdown policies and stepped up support to accelerate factory reopening and work resumption. The lockdown in Wuhan, the epicenter of the outbreak, is expected to be lifted on April 8.

There are several high-frequency indicators that help us track the activity momentum in a more timely manner than the official monthly data releases. Their trends overall suggest a gradual pickup in activity since mid-February, particularly in industrial production, construction, and property & land sales. Daily coal consumption of major electricity producers has accelerated, and railway-unloaded coal volume is comparable to that in 2018. Steel furnaces are now operational and the nationwide simple average of the air quality index is also close to normal levels.

According to the Ministry of Industry and Information Technology (MIIT), more than 95% of large and medium-sized industrial enterprises outside the Hubei Province had resumed operations by mid-March and that number is close to 100% in major industrialised provinces.




Source: WIND, HSBC Global Asset Management, March 2020.

HSBC

## Raring to recover after virus-induced slowdown (cont'd.)

The reopening rate is much lower among SMEs, but it has also picked up to about 70% as of 25 March from just about 50% in early March. The rate exceeded 90% in some major cities such as Shanghai. That said, it is important to note that the business re-opening rate does not necessarily take into account the fact that some firms are operating at well below normal utilisation rates, due to sourcing problems, labour shortages and sluggish demand. It should also be noted that the resumption rate is much lower in the services sector, such as restaurants and lodging.

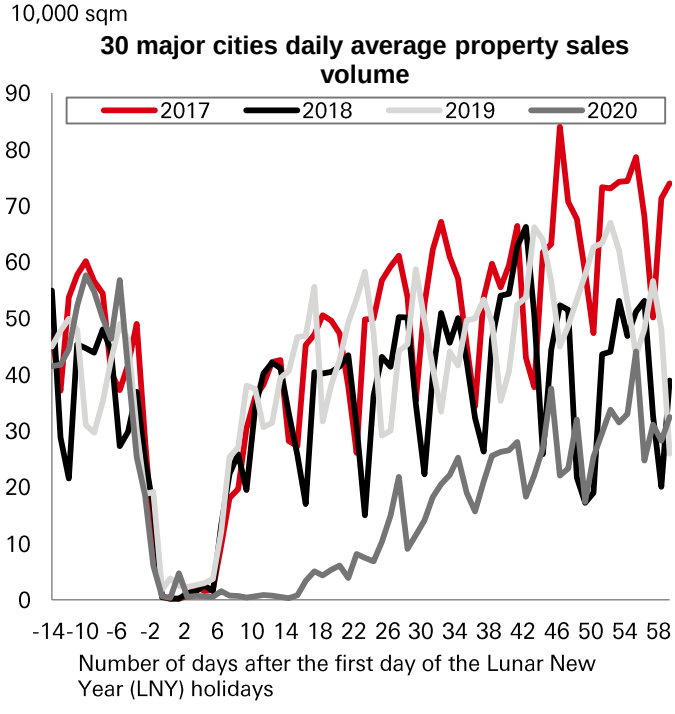
However, most indicators remained well below normal levels, especially passenger traffic (airlines, in particular) and consumption. Average daily property sales GFA of the 30 major cities were still down ~45% yoy in the week ended 21 March, though the trend has shown a clear and accelerated recovery back to 2018 levels. On the transportation side, national passenger flow by various transportation methods and metro passenger volume (of six major cities) remained subdued and well below year-ago levels. Passenger load factor in international flights still declined more than 30% yoy (domestic flights down more than 20%) in the reference week. That said, the traffic congestion/delay index has seen a rising trend over the past few weeks and nearly normalised to historical levels in top-tier cities. The Ministry of Transportation said that about 80% of total Chinese migrant rural workers had returned to work as of 19 March and estimated that all migrant workers would return to work by early April.

Meanwhile, wholesale food prices have eased from elevated levels on improving logistics. Weekly auto sales have recovered slowly since the week of 16 February from low levels. China Auto Dealer Association (CADA) statistics show that dealer level showroom traffic and retail volume had recovered to 61% and 57% of normal level, respectively, by 17 March. On the other hand, movie box office revenues which had stalled since February have shown little signs of a recovery. Overall, services activity (54% of GDP) has been hit harder than manufacturing and could take longer to normalise, in our view.

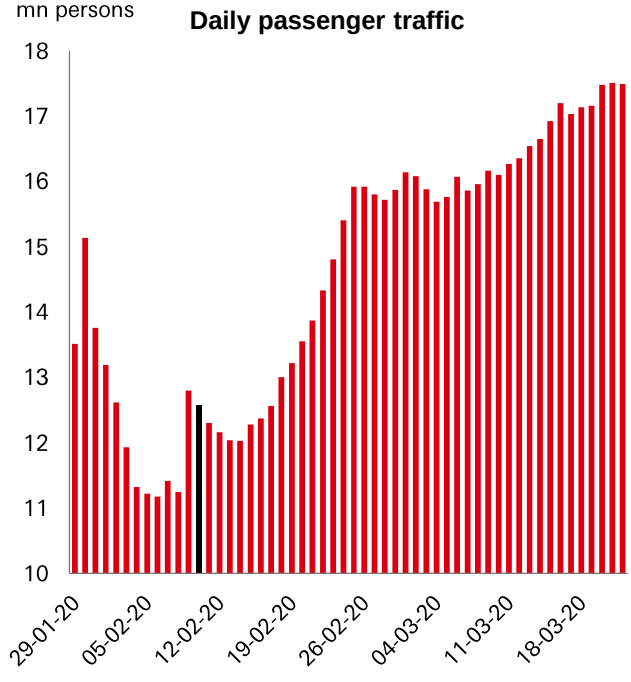
**Macro backdrop remains challenging despite signs of recovery**

Chinese policymakers have responded to the COVID-19 pandemic through mostly short-term, emergency and targeted fiscal and credit (relief) policies, as well as monetary easing to ensure financial system stability. More policy support is expected, to boost demand as supply-side disruptions may gradually ease.

All in all, faster work resumption coupled with relaxation in containment measures and intensified macro policy support should allow for a sequential activity recovery in March vs. February, though the overall growth likely remains subdued in March and Q1 is on track to show contraction. Even after assuming growth normalisation in April/Q2 and a further rebound in the second half of the year, the recovery is likely to be insufficient to fully offset the large negative shock in Q1. This coupled with increased risk of a global recession could result in significantly lower annual growth than 2019's 6.2%.




Source: WIND, HSBC Global Asset Management, March 2020.




Source: WIND, HSBC Global Asset Management, March 2020.

***In the following pages we will take a deeper look at how recent events and policy measures are impacting Chinese fixed income and equity markets:***

## Fixed income

Both onshore and offshore Chinese bonds have advanced on a year-to-date basis, underscoring economic resilience

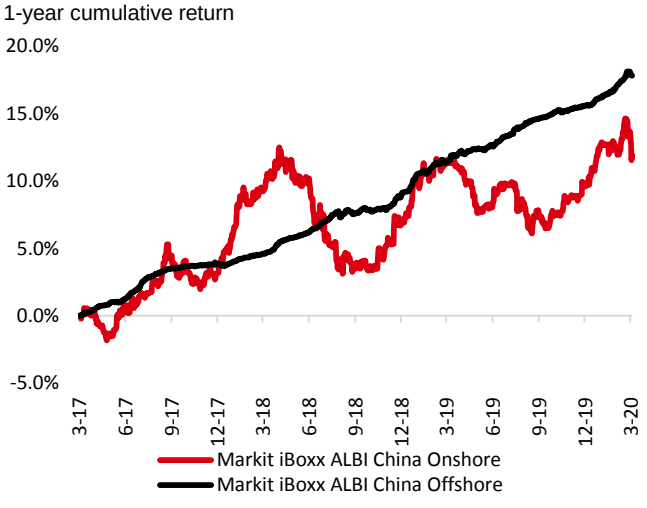
- Rising levels of volatility showed no signs of abating, with global markets continuing to be under pressure. The past month saw some of the biggest moves across the global bond market since the 2008 global financial meltdown, prompting central banks to act preemptively. In China, the PBoC cut the cash banks must hold in reserves in mid-March, releasing RMB550 billion to help its coronavirus-hit economy. The central bank lowered the reserve requirement ratio by 50-100 bps for banks that have met inclusive financing targets. Elsewhere, the US Federal Reserve slashed its benchmark interest rate to near zero in mid-March and said it would buy USD700 billion in Treasury and mortgage-backed securities in response to the global pandemic. Joining a new round of global easing, the ECB also unveiled a new €750 billion bond buying programme aimed at shoring up the Eurozone economy from the rapidly spreading coronavirus

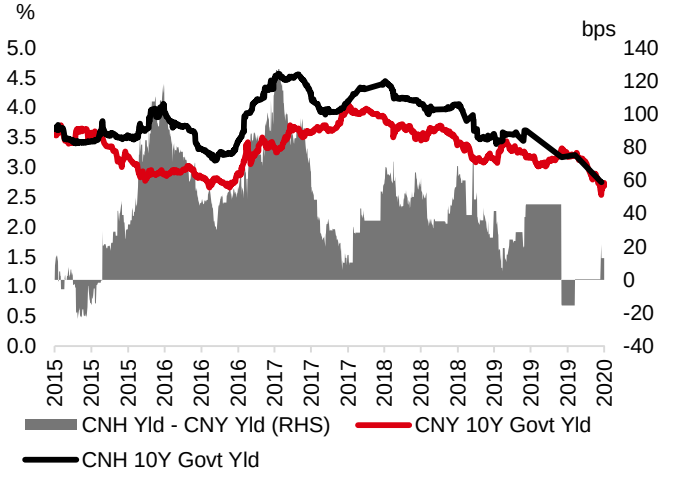
- Overall speaking, both onshore and offshore Chinese bonds were relatively steady in the month ending March 20, with the former losing 1.1% and the latter rising 0.3%. On a brighter note, the onshore and offshore bonds have gained 0.9% and 1.8% year-to-date, respectively. However, the offshore China dollar credit dropped 6.2% in March, reversing from a 1.3% gain in February. The monthly drop in dollar credit reflected heighted concerns over financial stress amongst some high-yield issuers as well as currency weakness

- The USD, measured by the dollar index, has been strong so far this year, rising 6.7% against a basket of major currencies. The renminbi declined only 1.9% year-to-date, mainly due to its recent weakness amid poor export outlook. The Chinese currency fell 1.5% in the month ending March 20

- On March 20, the PBoC kept its benchmark lending rates unchanged, defying expectations for a reduction with the economy battered by the coronavirus pandemic. The one-year loan prime rate was left unchanged at 4.05% from the previous month, while the five-year benchmark, a gauge for housing mortgages, stood at 4.75%. Looking ahead, the Chinese authorities are likely to launch more easing measures to boost liquidity and lower cost of funding in second quarter, which are supportive for bond prices

### Chinese bonds remain steady amidst new rounds of global easing




Source: Bloomberg, Markit data as of 20 March 2020. Total return in local currency terms.
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## Equity market

- Both onshore and offshore Chinese equities fell in March amidst a global sell-off on coronavirus worries, though Chinese stocks were relatively less impacted as Beijing signaled further support for the economy, and as new virus infections in China dropped significantly during the month

- On a year-to-date basis, all sectors in MSCI China were in the red with the exception of software & services companies, while energy companies were the biggest index laggards, amidst the oil price rout

> Following the sell off, valuations are now moving into an attractive range in terms of PE and earnings yield vs. bond yields

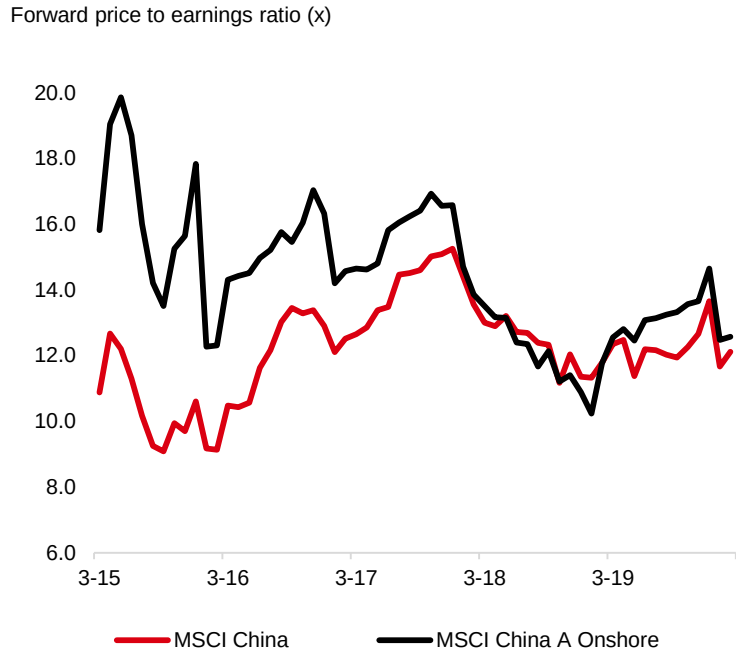
- In terms of monthly fund flows, the southbound trade through the Stock Connect saw USD14.44 billion of inflows as of March 20, ahead of the A-share inclusion factor increase by FTSE (15% to 25%) after the market close. Northbound flows reversed to USD10 billion of outflows, ending a nine month streak of net purchases. On a year-to-date basis, southbound route recorded net inflows, suggesting onshore investors' growing interest in Hong Kong-listed shares due to attractive valuations

- According to market consensus, the 2020/2021 earnings growth is 8.5%/12.9% for MSCI China, down from 10%/13% a month earlier. The forecast for CSI 300 is 15.2%/12.4%, compared with 15%/13% at the end of February. At the same time, the forward 12-month price-earnings (PE) ratio of CSI 300 and MSCI China index is currently trading at 12.1x and 12.2x, respectively, down 5%-10% from the previous trough

- Following the sell off, valuations are now moving into an attractive range in terms of PE and earnings yield vs. bond yields. However the key question remains around how long and how much the global outbreak is likely to impact the demand for Chinese goods. On the domestic front, going into the second quarter, the Chinese authorities are expected to launch a new infrastructure stimulus package to buffer the slowdown, but rising bad debt and capital fight risk make a massive stimulus less likely

- Within our portfolio we are more constructive on our positioning in the longer term as the recent volatility has given rise to significant mispricing opportunities, creating good entry point for several attractive stocks

### Chinese stocks fall amidst global volatility


Source: Bloomberg, HSBC Global Asset Management, as of 20 March 2020. Total return in local currency terms.

Investment involves risks. Past performance is not indicative of future performance

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| Sector* | Outlook | Comment |
|---|---|---|
| Consumer Discretionary | + | ◆ In particular, we like the education space as it is relatively insensitive to macro headwinds. We like e-commerce plays as their share of Chinese consumption continues to increase. We also like online video gaming companies as a more favourable policy backdrop this year could result in a more robust pipeline for key companies and the 'stay at home' policies during the coronavirus outbreak could be another catalyst |
| Consumer Staples | + | ◆ The trend of premiumisation on the back of rising income underpins higher pricing power and margin expansion capability of selected strong staple brand names. Demand should remain stable. |
| Energy | - | ◆ We are underweight this sector amidst the oil price correction and decline in demand due to coronavirus outbreak. |
| Financials | - | ◆ We are underweight banks as lower rates may add pressure to their net interest margins. We are adding some high quality insurance companies on dips. We expect more monetary policy loosening in the next few months due to the weak economy. |
| Healthcare | + | ◆ We favour those with strong R&D capabilities in innovative drugs and service providers with high growth visibility. |
| Industrials | - | ◆ We are currently underweight this sector but it might see improvement in 2Q20 as more infrastructure projects could be initiated to boost the economy |
| Information Technology | + | ◆ We are positive on the handset lens upgrade trend and we like companies that can benefit from continuous tech upgrade |
| Materials | - | ◆ We question the sustainability of the demand given the increased risk of a global economic slowdown due to the coronavirus outbreak |
| Real Estate | O | ◆ The coronavirus outbreak is putting developers' cashflow under great pressure but there could be sector wide policy support ahead. We prefer property management companies from the longer term perspective. |
| Communication Services | + | ◆ Social platforms, cloud services and gaming companies are major 'stay at home' beneficiaries. Coronavirus outbreak will speed up technology adoption |
| Utilities | - | ◆ We are not positioned defensively in the current market |

Source: Bloomberg, HSBC Global Asset Management, as of March 2020.
*NOTE - Sector views of HSBC Global Asset Management's offshore Chinese equity team; "+" = positive, "–" = negative, "O" = neutral
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## Data watch

| | Date | Actual | Consensus | Prior | Analysis |
|---|---|---|---|---|---|
| Industrial production (IP) (yoy) | Jan-Feb | -13.5% | -3.0% | 6.9% | January-February activity data show clear evidence of significant demand destruction and supply chain disruptions from the COVID-19 pandemic and containment measures, enforced social distancing including large-scale city lockdowns and travel restrictions. Given the deep contraction in first two months, even assuming a meaningful rebound in March activity with increasing policy support for factory re-opening and work resumption, Q1 GDP will likely contracted. Under the assumption of activity normalisation in April/Q2 and a further growth rebound in H2, driven by some pent-up demand as the fear factor eases and policy support intensifies, we think the recovery is likely to be insufficient to fully offset the large negative shock in Q1, leading to a materially slower annual growth. The risk of a global recession is rising as the coronavirus becomes a pandemic, while widespread restrictions on travels and other activities and some regional "lockdowns" implemented by many countries could lead to demand reduction and possible disruption in global production and capex activity, dragging on the near-term recovery in China's export-related manufacturing activity. Furthermore, the recovery in the services sector (54% of GDP) has lagged that in the industrial sector. The longer the economy takes to get back on track, the higher the risk is that there could be some permanent loss in output and consumption/services. |
| Fixed Asset Investment (FAI) (ytd, yoy) | Jan-Feb | -24.5% | -2.0% | 5.4% | FAI contraction was broad-based across infrastructure, real estate and manufacturing sectors. Looking ahead, several higher frequency trackers suggest construction activities have continued to recover. The government pushes for faster resumption of construction activity and plans to speed up the commencement of construction of planned infrastructure projects. Meanwhile, daily property sales GFA of major 30 cities continued to trend higher, albeit still staying well below normal (as of 21 March). More local governments have eased some tightening measures. New starts will likely also start to normalise in late march or April, as most developers have now resumed construction. An expected recovery in new home sales and new starts, coupled with resilient housing GFA under construction (+4.6% yoy in January-February), suggests real estate FAI would not deteriorate significantly further. |
| Retail Sales (yoy) | Jan-Feb | -20.5% | -4.0% | 8.0% | Despite the weak headline numbers, weekly data trajectory show sales declines narrowed through the month. Online sales (goods and services) were resilient, falling by only 3.0% yoy. Meanwhile, the urban surveyed unemployment rate rose notably to 6.2% in February, from 5.3% in January, in light of weaker economic activities and putting some pressure on household income growth. While China is on track to restore its labour input with migrant workers returning to their workplaces, one risk is weaker external demand translating into additional unemployment domestically. In particular, medium, small and micro enterprises employ 80% of the urban workforce. |
| Exports (USD) (yoy) | Jan-Feb | -17.2% | -16.2% | 7.6% | Export contraction mainly reflected fewer working days, production suspension, strict transportation restrictions and logistics challenges. The much smaller import decline may reflect that some contracts, especially for agricultural products (e.g. meat and soybean) and commodities, were signed previously, while increased imports agreed in the US-China phase one trade deal could have also helped. Looking ahead, global recession risk could hurt external demand, while Chinese importers may also hold off on placing large orders amid near-term demand uncertainty. That said, China appears to be in a better position to restore and maintain production relative to other economies. |
| Imports (USD) (yoy) | Jan-Feb | 4.0% | -16.1% | 16.3% | |
| Trade Balance (USD) | Jan-Feb | -7.1 bn | 38.9 bn | 46.8 bn | |
| CPI Inflation (yoy) | Feb | 5.2% | 5.2% | 5.4% | The modest moderation in CPI inflation reflecting the timing effects of the Lunar New Year holidays (in January vs. February last year) and as lower non-food price inflation offset higher food prices. Prices of major food items (particularly meat/pork) remained elevated partly due to the supply disruption amid transportation and logistics bottleneck. Fuel prices fell on global oil price declines. Sluggish consumer demand put downward pressures on prices of certain services such as tourism, transportation & communication and consumer durables. Overall, core inflation eased to 1.0% from 1.5% in January. PPI decline was led by the mining and raw materials sectors showing sluggish (downstream) industrial demand amid production suspension and/or slow work resumption. |
| PPI Inflation (yoy) | Feb | 0.4 % | -0.3% | 0.1 % | |
| Aggregate financing (AF) (RMB) | Feb | 855 bn | 1,586bn | 5,062 bn | Credit flows moderated partly on seasonality, but the YoY credit growth was steady. A notable decline in household loans likely reflected prolonged holidays, weaker credit demand for consumer spending and near term slowing in property transaction. Loans to the corporate sector held up better, likely due to an increased credit support for COVID-19 relief. We expect further policy easing to support a modest pickup in credit growth. |
| New yuan loans (RMB) | Feb | 956 bn | 1,120bn | 3,340 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 March 2020

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**Expiry date:** End of Quarter



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