



Market Watch

China unveils CNY 10tn debt swap

Summary

China's policymakers announced a new 3-year CNY 6tn local government debt-swap program. The Standing Committee of the National People's Congress (NPC) also allocated CNY 4tn from the debt quota for ongoing local government special projects over five years for the swap. The aim is to refinance local governments' 'hidden debt', unlocking their ability to spend on growth-supportive projects.

USD/CNH broke above 7.20, China government bond yields slumped and MSCI China equity index plummeted as markets were disappointed by both the scope and scale of the plan relative to expectations. However, China's finance minister hinted 'more forceful' fiscal spending measures may be unveiled in 2025.

We stay Neutral on China equities and expect CNH weakness to linger. While we maintain our base case for the Hang Seng Index at 20,000-22,500, we see downside risks should upcoming Q3 earnings reports also disappoint. We expect USD/CNH to trade in the 7.16-7.31 range near term.

Policy details and implications

Local government debt burden to ease. The approved increase in the local governments' debt limit to CNY 35.52tn from CNY 29.52tn allows the CNY 6tn new issuances (to be spread over 3 years). Local governments will also allocate CNY 800bn for each of the next 5 years from their ongoing special project debt quota to replace 'hidden debt'. Coupled with the CNY 2tn implicit debt for rebuilding shanty town to be repaid in 2029 and later, total local governments' hidden debt is expected to fall from CNY14.3tn to CNY2.3tn, notably easing their financial burden, according to officials at the NPC briefing. Local governments have suffered from declining land sales and tax revenues, impeding their ability to spend and incentivising them to raise non-tax revenue via fines on individuals and corporates.

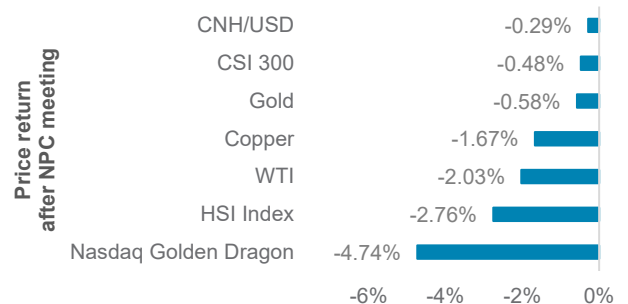
Economic significance underappreciated. Doubts have been raised whether swapping hidden debt would result in any additional room for local government spending. It has also been argued that the support equal to 4% of China's GDP pales in comparison with the 2008 stimulus totalling 10% of GDP. We disagree.

A key de-risking move to restore confidence. The debt swap is estimated to produce CNY 600bn of interest savings. Such fiscal support to local governments should help improve sentiment, boost spending, and increase the velocity of money in the long run.

Housing market, banking sector and consumption not mentioned. We believe authorities view support in these areas as less urgent, given leading economic indicators and retail sales stabilising thanks to prior stimulus measures. Hints of more "forceful"

China related asset class returns since NPC briefing

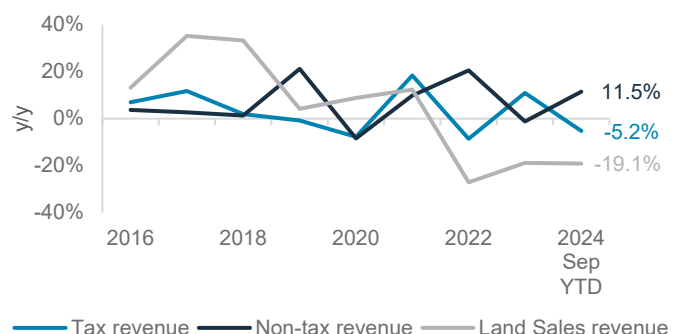
Performance of asset classes since 8 Nov close



Source: Bloomberg, Standard Chartered; As of 10:00AM SGT

Local government debt swap key to unlocking interest rate savings in an environment of falling land sale and tax revenues

China's land sales revenue, tax revenue, non-tax revenue



Source: WIND and Standard Chartered

fiscal measures in 2025 suggest that we can look forward to more support after the December Central Economic Work Conference and the “Two Sessions” in March 2025. This approach possibly leaves enough dry powder to counter any potential trade measures announced by the new US administration. The housing market has also shown signs of stabilisation, with new home sales returning to y/y growth for the first time this year.

What does this mean for investors?

Expect China equity valuation discount to persist. The Hang Seng Index (HSI) currently trades at 9.3x P/E, a discount to the 5-year average of 10.5x. Disappointment over the announced fiscal measures will likely cause the discount to persist, or even widen, until more forceful stimulus measures are announced. We maintain our base case expectation for the HSI at 20,000-22,500, though we recognize downside risk towards our bear case range of 18,000-20,000 should the upcoming earnings season disappoint. Among the equity sectors, we continue to favour quality high-dividend paying non-bank state-owned enterprises listed in Hong Kong, while preferring to add on pullbacks to consumer discretionary, communication and technology sectors within Chinese equities.

Neutral on Chinese USD bonds. While sentiment towards the local government financing vehicle (LGFV) segment should improve, we believe the direct impact on credit fundamentals is likely limited. Continued loosening of monetary conditions, supported by recent cut in deposit rates, should be supportive, but yield premiums over US government bonds are already quite tight. Furthermore, we view the US interest rate trajectory and trade policy outlook as key risk factors.

Onshore China government bond yield curve to stay largely unchanged. The magnitude of announced bond issuance for the local government debt swap appears to pose a limited upside risk to Chinese Government Bond (CGB) yields. While more special bond issuances are likely in the coming years for a range of needs, such as supporting bank capital and growth, a continued monetary policy easing bias by the PBoC over the next 6-12 months means we expect the government bond yield curve to stay largely unchanged in the near term.

CNH to weaken, with Trump’s trade policies the next challenge. The announced bond swap program is likely to dampen market sentiment around the CNH as investors remain concerned about China’s economic recovery path. Capped Chinese bond yields risk a further widening of the interest rate differential in favour of the USD. Additionally, a Republican “clean sweep” of the US presidency and both houses of Congress heightens the risk of implementation of Trump’s proposed trade tariffs, which are likely to impact China’s exports. Amidst these concerns, we expect USD/CNH to stay above its 100-day moving average of 7.162, with resistance at 7.311, the July 2024 high.

China retail and home sales have likely troughed

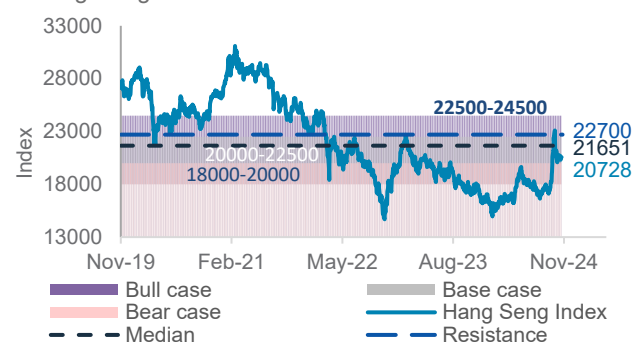
Top 100 developers’ new home sales; retail sales



Source: Bloomberg, Standard Chartered

Hang Seng Index (HSI) hovers within our base case range, but a lack of upside surprise in fiscal stimulus and earnings raises downside risks

Hang Seng Index: Our Base case vs. our Bear/Bull case



Source: Bloomberg, Standard Chartered (last close 8 Nov)

CNH likely to weaken on concerns over China’s growth outlook and Trump’s trade tariff proposal

USD/CNH; technical trading range



Source: Bloomberg, Standard Chartered

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