WS Global Chief Investment Office
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Market Watch

China's fiscal plan; more to come

Summary

China unveils fiscal plan. The Ministry of Finance (MoF) press conference on 12 October mildly surprised on the upside in signalling (1) increased fiscal debt and deficits in future years, and (2) expanded usage of local government bond funds for undeveloped land and unsold home purchases. However, there was no new stimulus for consumption aimed at overcoming deflationary pressures.

Equities to consolidate near term. After breaking above technical resistance of 22,700, the Hang Seng Index pulled back. It will likely trade within our "base case" range of 20,000-22,500 near term, pending details on the fiscal plan from the NPC Standing Committee meeting at the end of October. Should stimulus come in above expectation, HSI could trade towards our "bull case" level of 24,500.

Fiscal policy, global risks key to sustaining gains over the long term. Deflation, debt levels and US elections are key risks to monitor.

Background

The Hang Seng Index rose ahead of the MoF press conference. China's MoF announced on 9 Oct it will host a press briefing on 12 Oct (Sat). The Hang Seng Index (HSI), having pulled back for 2 days, had stabilised since then and surged ~3% last Thursday (Friday closed for a holiday) in anticipation of a CNY2tn fiscal stimulus.

MoF focused on tackling structural problems, not stimulus. The MoF did not announce a fiscal stimulus amount or any direct stimulus towards consumption. Instead, it focused on addressing a few key challenges facing the country:

(1) As a one-off measure, lift central government debt quota to swap local governments' hidden debt;

(2) Stem the decline in the property market by allowing local governments to use special bond funds to buy undeveloped land and unsold homes;

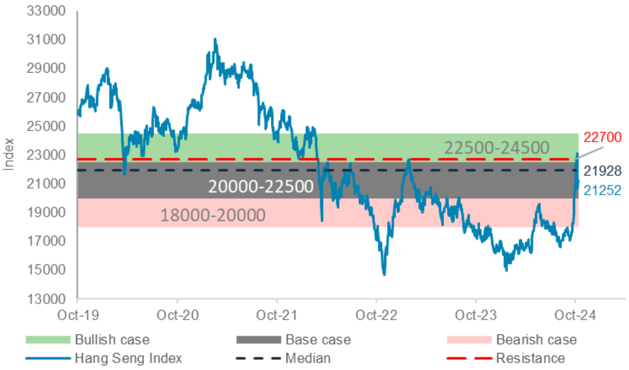
(3) Improve state-owned banks' tier-1 capital with special government bond issuances to boost their ability to extend loans;

(4) Increase social security support to alleviate poverty, including doubling scholarships to students.

Hints of more fiscal stimulus to come. The MoF indicated during the briefing that only policies that went through the decision-making process were covered, with additional measures still being studied. This leaves room for more fiscal stimulus to be announced at the upcoming NPC Standing Committee meeting at the end of the month.

Hang Seng Index (HSI) to consolidate within our 'base case' range in the near term

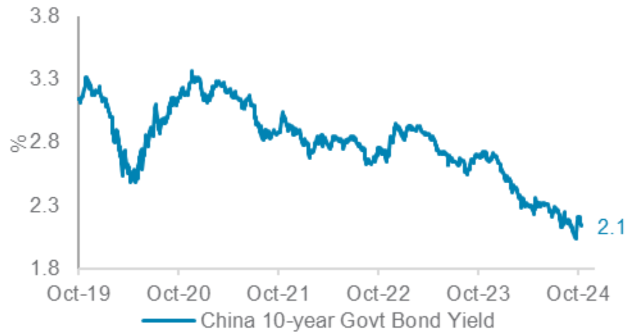
HSI 5-year median, resistance, Base/ Bull/Bear case



Source: Bloomberg, Standard Chartered; 10 Oct close

China's onshore bond yields have likely troughed, but deflation risks linger pending detailed fiscal stimulus measures

China 10-year government bond yield over last 5 years



Source: Bloomberg, Standard Chartered

What does this mean for investors?

Reduced downside risk to growth but limited help to counter deflationary pressures. The announcements signal that fiscal impulse could turn positive from October onwards, lowering the downside risk to GDP growth. However, consumer inflation in September moderated and producer deflation worsened. The lack of consumption stimulus, coupled with declining fiscal spending growth YTD, offers limited help to counter deflationary pressures in the near term.

Equities likely to consolidate in the near term. Some market participants may be disappointed with the absence of a clear fiscal stimulus guidance from the MoF, especially after the 16% rally in the Hang Seng Index since 23 September. We expect the HSI to trade within our "base case" range of 20,000-22,500 near term, awaiting further clarity on the fiscal stimulus plan from upcoming meetings, including the NPC Standing Committee at end of this month. Should any such fiscal stimulus plan seek to boost consumption and fiscal spending surpass market expectation, the index can trade up to our "bull case" range of 22,500-24,500, which is within +1SD above the 5-year historical average. Should the fiscal support come in later/lower than expected, or uncertainty rises due to Middle East tensions and/or US elections, the index may pull back to the bear case range of 18,000-20,000.

Opportunity to rotate out of banks and developers. While banks and property developers gained following the MoF announcement, we advise caution given the uncertain outlook on banks' earnings and the property market. We would use this opportunity to rotate into consumer, communication, technology, and high dividend yielding non-financial state-owned enterprises listed in Hong Kong.

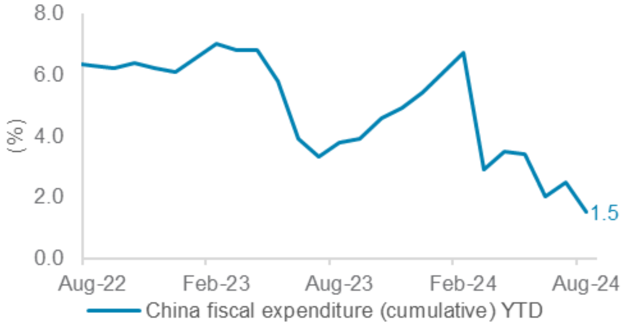
CNY upside potential likely limited. Improving confidence about potential resolution of ongoing structural issues should be supportive of the CNH, though growing deficits in future years could limit upside.

Onshore bond yields likely troughed. Onshore yields have likely bottomed as the PBoC continues with its 'operation twist' measures aimed at steepening the yield curve (long-term rates higher than short-term rates). However, deflationary pressures linger, causing the 10-year onshore government yield to come off slightly to 2.136%. We would closely watch the magnitude of additional CGB issuances; if the amount surpasses the CNY1tn market estimates, it could trigger a re-pricing of the 10-year bond yield higher.

Deflation, debt levels and US elections key risks to monitor. Markets are likely to closely monitor the impact of fiscal easing on deflation. China's bond yields provide one barometer of the market's assessment. Overall debt levels remain a second indicator to monitor. With China' national debt at 300% of GDP, any significant fiscal support could raise the focus on this risk in the long run. Finally, US elections remain a key external risk, especially if the US new administration adds trade and tariff measures on Chinese exports and investments.

China's fiscal spending growth has slowed this year; new spending proposals should revive spending in Q4

China's cumulative fiscal spending YTD, % y/y



Source: Bloomberg, Standard Chartered

CNH strengthened modestly after stimulus measures unveiled in recent weeks, but further gains likely limited

USD/CNH

Source: Bloomberg, Standard Chartered

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