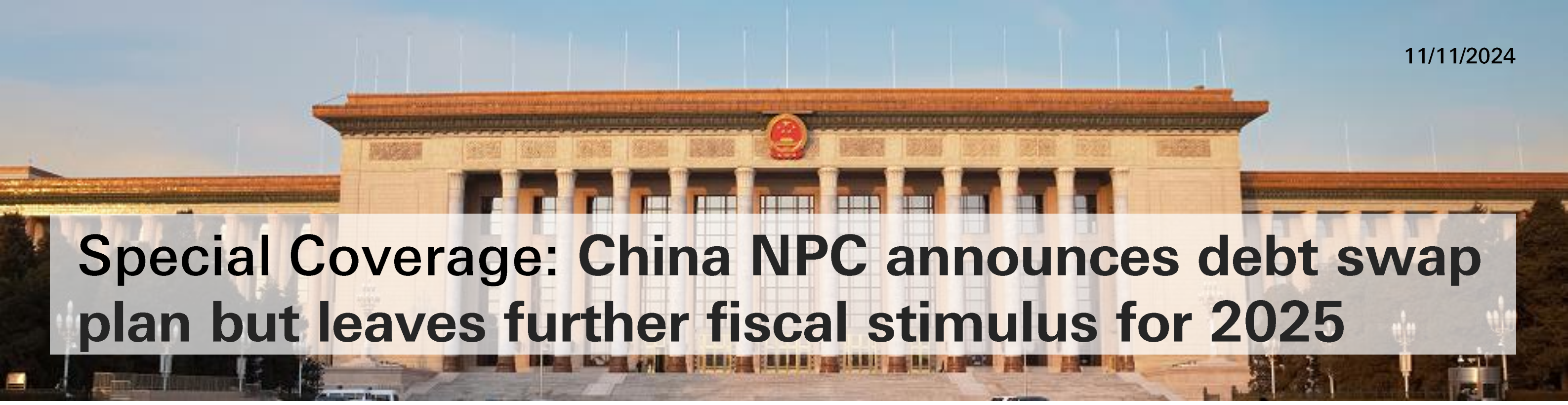

Special Coverage: China NPC announces debt swap plan but leaves further fiscal stimulus for 2025

Cheuk Wan Fan

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

Patrick Ho, CFA

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

Desmond Kuang

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

Key takeaways

- The China National People’s Congress (NPC) Standing Committee meeting on 8 November approved an incremental increase of RMB6trn in the local government special debt limit to swap hidden debt over three years through the end of 2026.
- Adding up RMB4trn allocation from the existing special local government bond issuance quota for debt swaps over five consecutive years and RMB2trn existing fiscal resources for repayment of hidden debt related to shantytown renovation, the total scale of debt swaps for local governments will amount to RMB12trn over the next five years. We expect negative near-term market responses to the below-expectation new fiscal impulse, and the lack of new demand-size stimulus to boost the property sector and consumption. However, looming uncertainties surrounding trade tensions and potential tariff hikes under the Trump administration will likely trigger further policy stimulus from China to mitigate downside risks to growth in 2025.
- We stay neutral on mainland Chinese and Hong Kong equities in anticipation of increased market volatility driven by the developments of Beijing’s policy stimulus and Trump’s trade tariffs. We favour quality Chinese internet stocks with steep valuation discounts to their US tech peers, above-sector-average earnings prospects and improving shareholder returns. In Hong Kong, we favour undervalued high dividend stocks in the insurance and telecom sectors, as well as select oversold property developers with strong balance sheets. Within the A-share market, we prefer high-quality SOEs paying attractive dividend yields, high-end manufacturers with global competitiveness and overseas market positioning and resilient consumer leaders that can benefit from potential enlarged policy support for consumption.

What happened?

- The NPC Standing Committee meeting on 4-8 November approved an incremental fiscal support package for the local government debt swap plan. The fiscal package fell short of elevated market expectations for a “big bang” comprehensive stimulus package with the size of RMB6trn to RMB12trn to tackle the problems of local government debt, property market stress, bank recapitalisation needs and subdued consumption.
- The new fiscal package includes the following support measures:
  1) **RMB6trn increase in local government special debt limit to swap hidden debt** – The additional RMB6trn local government special bond quota will be used over three years through the end of 2026, implying RMB2trn annual additional fiscal impulse for swapping hidden local government debt.
  2) **Annual allocation of RMB800bn from special local government bond issuance quota for debt swaps** – Starting in 2024, RMB800bn will be allocated from the special local government bond (SLGBs) issuance quota each year for five consecutive years to be used for debt repayment, including swapping hidden debt, totalling RMB4trn allocation from 2024 to end-2028.
  3) **RMB2trn repayment for hidden debt** related to shantytown renovation due in 2029 and subsequent years will still be repaid according to the original contracts.

- Finance Minister Lan Fo'an provided forward guidance on potential increase in fiscal stimulus and other countercyclical policy support in the future without sharing specific details on potential support for the property market and private consumption:
  1) **Property support policies** – The MoF is formulating a plan for local governments to use funds raised by the issuance of SLGBs to purchase idle land and acquire unsold property inventory for conversion into affordable housing to accelerate the de-stocking of unsold properties. Supportive tax policies to support the property sector have been submitted for NPC review and approvals.
  2) **Recapitalisation of commercial banks** – The MoF is accelerating preparation work for the issuance of special central government bonds (SCGB) to replenish core Tier-1 capital of the six larger state-owned commercial banks.
  3) **Further fiscal support to boost consumption** – Potential increase in fiscal stimulus to support equipment upgrading and consumer durable goods trade-in to boost domestic demand.

Investment implications

- We expect the below-expectation fiscal support and the lack of demand-side stimulus announced by the NPC Standing Committee, along with the US election results with policy tariff on all Chinese import products, will likely add volatility to the mainland Chinese and Hong Kong stock markets in the coming months. Hence, we stay neutral on these two equity markets.
- The Chinese internet stocks are less vulnerable to trade tensions and tariff risks. We continue to see re-rating opportunities in quality Chinese internet stocks and prefer internet leaders that are priced at substantial discounts to their US Big Tech peers, and those with above-sector-average earnings prospects and improving shareholder returns through share buybacks. We also favour the local services, e-commerce, and online gaming sub-sectors as they offer a better risk-reward outlook.
- We favour quality Chinese SOEs paying high dividends and with above-market average earnings growth. Given the deep discount of the H-shares to A-shares on a like-for-like basis, the SOEs with their H-shares trading at attractive discounts to their A-shares could see better Southbound flows. We think the Southbound flows through the Stock Connect should continue given the low-for-longer rate environment in mainland China.
- We stay selective towards mainland Chinese property companies and banks in the offshore market given that there is no new direct support for the property market. For the Chinese banks, the policy to recapitalise the six largest state-owned commercial banks remains a key investor focus. We also attach focus on the net interest margin outlook due to lower mortgage and other lending rates and the bad debts of the banks.
- In Hong Kong, we favour undervalued high dividend stocks in the financials and telecom sectors and select oversold property developers with strong balance sheets. The stock market should benefit from the fall in US policy rates lowering funding costs. Banks and insurers should also benefit from the better fee income from wealth management business. The housing market will remain under near-term pressure given the supply overhang.
- In China's onshore market, our preference for quality SOEs paying high dividends remains intact, as they offer attractive dividend income that boost total returns. We also selectively position in high-end Chinese manufacturing leaders with a proven track record of global competitiveness and overseas market positioning, allowing them to withstand tariff risks. In the consumer sector, we favour services leaders which deliver resilient earnings and consumer discretionary stocks that benefit from ongoing government-sponsored replacement subsidies.

Volatility of A-share market will likely surge amid uncertainty over policy stimulus and US trade tariffs

Source: Bloomberg, HSBC Global Private Banking and Wealth as at 10 November 2024.
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