



農銀國際

ABC INTERNATIONAL

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ABCI Policy Insight

2021 China Government Work Report

Macro, investment, and industry analysis

2021 China Government Work Report: **Macro, investment, and industry analysis**

Macro comments on 2021 China Government Work Report

China achieved the key economic targets in 2020

China's Premier Li Keqiang delivered his annual government work report ("the Report") in the fourth session of the 13th National People's Congress on Mar 5, 2021. The Report is divided into three main parts – it opens with a review of the work in 2020, followed by the development milestones achieved in the 13th Five-Year Plan period and the main objectives and tasks of the 14th Five-Year Plan period, and finally, an outline of the main economic targets and the deployment of major work tasks for 2021.

As shown in Exhibit 1, due to the great uncertainties imposed by the COVID-19 pandemic, there was no economic growth target in 2020. China was the first to achieve a resumption of production in 2020 and the economy recovered better than expected, with a real GDP growth of 2.3%. New urban jobs created, an economic indicator on employment, reached 11.86mn in 2020, exceeding the target of 9mn. The urban survey unemployment rate and registered unemployment rate were 5.2% and 4.2% in 2020, lower than the targets of 6.0% and 5.5%. The annual tax and fee reduction for market players reached over RMB 2.6tr in 2020, exceeding the growth target of RMB 2.5tr. In addition, China made significant progress in poverty alleviation in 2020, lifting 5.51mn rural poor people and 52 poor counties out of poverty.

Exhibit 1: China's economic indicators in 2020 – targets vs. actual performance

| Economic indicators | Target | Actual |
|---------------------------------------|---------------|---------------|
| Real GDP growth, % | NA | 2.3 |
| New urban jobs created, mn | above 9.0 | 11.86 |
| Surveyed urban unemployment rate, % | ~ 6.0 | 5.2 |
| Registered urban unemployment rate, % | ~ 5.5 | 4.2 |
| Tax and fee reduction, RMB tr | above 2.5 | above 2.6 |
| CPI, % | ~ 3.5 | 2.5 |

Source(s): 2020 and 2021 Government Work Reports, ABCI Securities

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A GDP growth target at above 6% for 2021

The Chinese government has set the economic growth target for 2021 at above 6%, indicating the country's focus on the quality growth instead of speedy growth (Exhibit 2). We believe China's growth will rebound significantly in 2021 on the back of improving domestic demand and possible easing of the US-China conflict, as well as the low base in 2020. Overall, we expect China's real GDP to grow by 8.0% in 2021E, which should be achieved without great difficulties. The GDP growth target of over 6% for this year is mainly to allow room for structural reforms and innovation development to achieve quality growth. Introducing the main objectives of economic and social development in the 14th Five-Year Plan period, the Premier proposes that the growth of total labor productivity would be higher than the growth of GDP. In addition, the highly achievable growth target means that macro policy will gradually normalize this year.

Exhibit 2: China's economic targets for 2021

| Economic indicators | Target | ABCI Forecasts |
|------------------------------------------|------------|----------------|
| Real GDP growth, % | above 6.0 | 8.0 |
| New urban jobs created, mn | above 11.0 | 13.0 |
| Surveyed urban unemployment rate, % | ~ 5.5 | 5.0 |
| Fiscal deficit as a proportion of GDP, % | ~ 3.2 | 3.5 |
| CPI, % | ~ 3.0 | 1.2 |

Source(s): 2021 Government Work Report, ABCI Securities estimates

The Report proposes to maintain continuity, stability, and sustainability of macro policy this year. Macro policy should continue to provide relief to market players, maintaining the necessary support and consistency without major or sudden reverse in policy directions. Adjustments will be made timely according to the situations to enhance economic fundamentals. We believe there will be changes in macro policy: (1) the ultra-loose macro policy in 2020 will normalize in 2021; (2) the process of normalizing will be gradual - the overall policy will still be loose in 1H and gradually tightens in 2H.

In terms of fiscal policy, the Report proposes that an active fiscal policy would be more effective and sustainable. In view of the effective control of the epidemic and the gradual recovery of the economy, the deficit rate in 2021 will be around 3.2%, down from last year's target of 3.6%, and no special government bonds will be issued. The issuance of local government special bonds is revised down to RMB 3.65tr for 2021 from RMB 3.75tr in 2020. Fiscal policy in 2021 will gradually return to normal. The focuses will be on regular tax and fee reductions, increasing general local transfers, and increasing the size of the regular fiscal funds direct delivery mechanism. We expect the government to record another small fiscal deficit of ~3.5% of GDP in 2021, as fiscal spending growth is higher than the revenue growth.

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In terms of monetary policy, the report proposes that a prudent monetary policy should be flexible, precise, and reasonable. China will maintain the growth of money supply and social financing at rates matching with the nominal GDP growth while keeping the macro leverage ratio stable. China will continue to defer debt repayment on loans to SMEs and increase its efforts to support inclusive finance with refinancing and rediscounting. Loans from large commercial banks for SMEs should grow by more than 30%. The PBOC will push for further reductions in real lending rates and continue to guide the financial system to make concessions to the real economy. We predict new RMB-denominated loans and new aggregate financing to be RMB 20.5tr and RMB 33.0tr in 2021E. By the end of 2021E, the broad money supply (M2) is expected to grow by 9.5%, basically matching the nominal GDP growth. In addition, with nominal GDP growth expected to rebound substantially next year, we expect the macro leverage to fall slightly.

The target for new urban employment in 2021 has been revised up from 9mn in 2020 to 11mn, while the urban survey unemployment rate is targeted at ~5.5%, down from 6.0% for 2021. With China's economic growth to rebound this year, we believe these employment targets will be met. Although the Chinese economy was hit hard by COVID-19 in 2020, the number of new urban jobs still reached 11.86mn while the urban survey unemployment rate was low at 5.2%. Meanwhile, the job market has remained tight, with the urban labor demand-to-supply ratio staying high at 1.4 in 3Q20.

The Report advocates adherence to the strategy of expanding domestic demand and fully explore the potential in domestic market. The first step is to stabilize and expand consumption, which can be attained by increasing residents' income through multiple channels and advancing the consumption of automobiles, home appliances and other consumption. The second step is to expand effective investment. The central government intends to arrange RMB 3.65tr of special bonds for local governments and RMB 610 bn within the central budget in 2021. The central government will promote the construction of "two new and one heavy" - strengthen the construction of new infrastructure and new urbanization, and strengthen the construction of major projects, including transportation and water conservancy. 53,000 old urban communities will be renovated. Although financial support for infrastructure investment may fall this year, infrastructure investment is expected to be higher than last year. .

CPI target is lowered to 3.0% for 2021 from 3.5% for 2020. Nonetheless, we believe this is a soft guidance instead of hard target. CPI inflation is expected to ease to 1.2% in 2021E from 2.5% in 2020 due to the lower food prices, especially the pork price as supply improves. We forecast PPI inflation to rebound to 1.5% in 2021E from the -1.8% in 2020 with higher commodity prices and improving domestic demand. We believe the macro policy will not be constrained by inflation in 2021.

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The Report outlines the main objectives for economic and social development in the 14th Five-Year Plan period, with the economic growth to stay within a reasonable range, R&D investment to increase by more than 7% annually, the per capita life expectancy to increase by one year, the urbanization rate to reach 65%, the urban survey unemployment rate to stay below 5.5%, and the basic pension insurance participation rate to increase to 95%. 2021 is the first year of the 14th Five-Year Plan. According to the Fifth Plenary Session of the 19th Central Committee of CPC, quality will be the major development theme of the 14th Five-Year Plan and after. China's economy will shift from the rapid-growth stage to one that emphasizes on quality expansion.

Looking forward to the 14th Five-Year Plan period, the increased technological blockade of the West, mainly led by the US, against China will present threats to China's economic and social developments. Nonetheless, thanks to the mammoth size of the Chinese economy and rapid development in the emerging industries represented by 5G and Internet+, we believe China will maintain a reasonable economic growth at an annual rate of 5%-5.5% during the 14th Five-Year Plan period. The country will accelerate industrial transformation and upgrades, expand the real economy, and tap into the full potential of domestic demand. More importantly, it will strengthen frontier basic scientific research and accelerate independent research on key technologies. We believe that China will surpass the middle-income trap to become a high-income country.

Special Topic

Technology: Increasing R&D investment to raise national competitiveness

In the Government Work Report (“the Report”) , Premier Li Keqiang of the State Council pinpoints that during the 14th Five-Year Plan period, China should adhere to the core position of innovation in the modernization of China, and take scientific and technological self-reliance as the strategic support for national development.

The central government is expected to take the following actions:

1. Improve the national innovation system
2. Speed up the construction of strategic science and technology force led by the National Laboratory
3. Develop key core technologies
4. Formulate and implement a 10-year action plan for basic research
5. Enhance the technological innovation ability of enterprises
6. Stimulate the innovation vitality of talents
7. Improve the scientific and technological innovation system and mechanism
8. The R&D investment of the whole society will increase by more than 7% annually, and R&D intensity strives to be higher than the 13th Five-Year Plan.

The Report encourages the upgrade of traditional industries, developing strategic emerging industries, and promoting the service industry. The country will create an ecosystem for development of digital economy. China will promote the construction of traditional infrastructure and new infrastructure as a whole.

To strengthen the national strategic important technologies, the Report outlines the following actions and initiatives.

- Continue to implement the Technology Innovation 2030–Major Projects (“The Projects”). The Projects were first unveiled in 2016 and outlined 15 kinds of technologies or projects to be achieved by 2030
- Support local governments to build international and regional science and technology innovation centers, and enhance the leading role of national independent innovation demonstration zones
- Strengthen the technology used for disease prevention

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- Facilitate the collaboration of technology development
- Strengthen the protection of intellectual property rights
- Increase inputs in basic research. Increase central government led research expenditure by 10.6%
- Improve evaluation of projects and talents
- Encourage research staff to focus on scientific exploration

In terms of tax incentive, the additional 75% R&D tax-deductible expenses will be maintained. Moreover, the extra R&D tax-deductible expenses for manufacturing enterprises will increase to 100%. The objective of tax incentive is to encourage enterprises to increase R&D investment. Innovation will lead the development of enterprises.

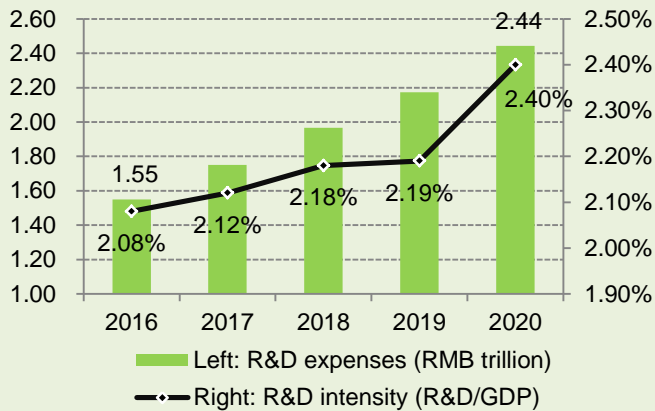
In order to remain competitive, it is essential to increase R&D expenses and intensity. Our analysis shows that the global health crisis since the beginning of 2020 has resulted in numerous deaths and weakened the input of global labor; however, it has led to the expansion of capital. We still believe that the competitiveness of any countries in the future will mainly depend on the growth capacity of total factor productivity. The synergistic effect of labor and capital investment propels progresses in science and technology – a key factor in determining China's international competitiveness.

Based on this, China must increase efforts to encourage investment in R&D. According to the NBSC, in 2020, R&D expenditure in China was RMB 2.44tr, up 10.3%YoY, equivalent to 2.40% of GDP. By absolute value, China's R&D expenditure is high – the figure is equivalent to ~20% of South Korea's GDP. Among the major industrial countries, however, China's R&D intensity at 2.4% is relatively low. In 2018, the R&D intensity of South Korea, Japan, the US and OECD were 4.53%, 3.26%, 2.83%, and 2.40%, respectively. The R&D intensity of China's neighbors in North Asia is much higher than that of China.

According to the Report, it is estimated that the R&D expenditure of the society will increase by more than 7% annually in 2021-25. Compared with the growth rate of 10.3% in 2020, the target growth rate of R&D expenditure in 2021-25 is somewhat conservative. During the 13th Five-Year Plan period, the average annual growth rate of R&D expenditure is ~11.5%. We expect the total R&D expenditure in 2021 will be no less than RMB 2.61tr. The government predicts that the real growth rate of GDP in 2021 will be higher than 6%. Considering the inflation factor, the R&D intensity in 2021 is expected to be about 2.40-2.45%, slightly higher than that in 2020.

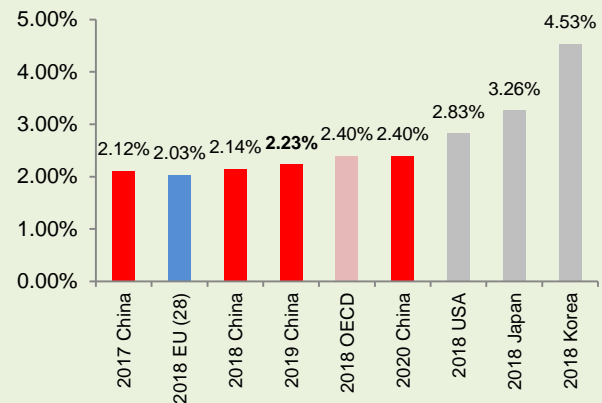
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Exhibit 1: China's R&D intensity increasing



Source(s): 2015-20 National Economic and Social Development Statistics, NBSC

Exhibit 2: R&D intensity (R&D/GDP)



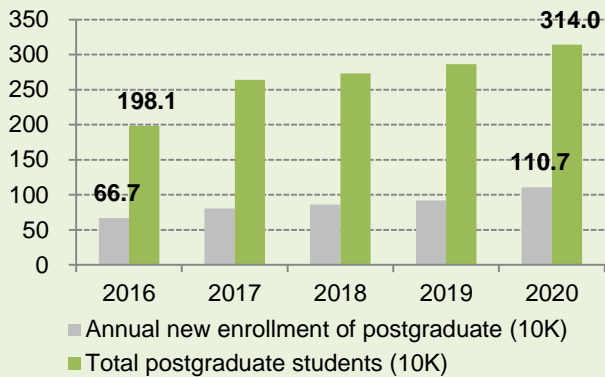
Source(s): OECD, NBSC

Education departments and higher education institutions are building a talent pool in China. To maintain a long-term economic growth, capital is one of the input factors, with talent being another. It takes time to cultivate talents. We have identified a bright spot in China's talent cultivation. This is a rapid growth in the number of postgraduate students. The annual new enrollment of postgraduate education increased from 667K in 2016 to 917K in 2019, and 1,107K in 2020. In 2020, there were 3.14mn postgraduate students. The outstanding number of postgraduate students in China was equivalent to 6% of the total population of South Korea or 2.5% of the total population of Japan. In addition, nearly half of China's postgraduate students are female. In 2019, female postgraduates took up 50.6% of total. China has managed to achieve a high degree of gender equality in its higher education system. Different genders may have different strengths, so the high proportion of women in higher education may bring some unexpected breakthroughs in the field of science and technology.

The annual new enrollment of undergraduate and junior college students increased from 7.49 mn in 2016 to 9.15 mn in 2019 and 9.67 mn in 2020. The annual new enrollment of vocational education has also increased from 5.93mn in 2016 to 6.45mn in 2020. In the next few years, when more and more graduates enter the workforce, the positive cumulative effect of Chinese talents will emerge. The foundation of China's scientific and technological competitiveness will rely on the supply of talents.

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Exhibit 3: It will take time for China to go to cultivate a high-end talent pool



Source(s): 2015-20 National Economic and Social Development Statistics, NBSC

Exhibit 4: The focus of education has shifted to training high-end talents, accelerating the provision of highly educated talents to the society

| | 2015-2020 | | |
|-------------------------------------------|-----------|---------|-------|
| | 2015 | 2020 | CAGR |
| <u>Annual new enrollment (10K people)</u> | | | |
| Postgraduate | 64.5 | 110.7 | 11.4% |
| College | 737.8 | 967.5 | 5.6% |
| Vocation training | 601.2 | 644.7 | 1.4% |
| <u>Students (10K people)</u> | | | |
| Postgraduate | 191.1 | 314.0 | 10.4% |
| College | 2,625.3 | 3,285.3 | 4.6% |
| Vocation training | 1,656.7 | 1,663.4 | 0.1% |

Source(s): NBSC

Future competitiveness of China's industry: R&D expenditure and R&D intensity will determine the competitiveness of the industry in the global market. There are a host of reasons behind the US's hostility against the Chinese telecom equipment manufacturers. Let's discuss it from the perspective of R&D.

Over the past few years, China's telecom equipment industry had the largest R&D cost among major industries. The global competitiveness of China's telecom equipment manufacturers at present and in the next few years is the result of R&D activities in previous years. The rising competitiveness of these manufacturers in the global communication industry is presenting a threat to existing players. Counterattacks and defensive measures from the foreign competitors will continue in the next few years, which we believe is natural and inevitable in a highly competitive market.

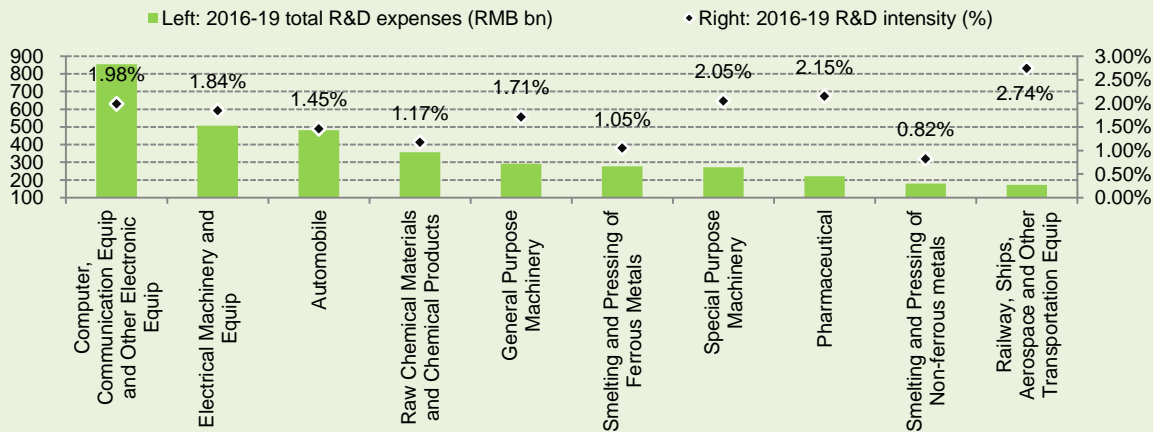
Chip fabrication facilities - the bottleneck of China's semiconductor industry. Chip equipment is considered to be within the special equipment industry. Based on the statistics, the total R&D cost of the special equipment manufacturing industry was not high – it has been lower than that of the chemical industry for the past years, and insufficient input has led to the current bottleneck problem. To resolve this, China must increase R&D- there is no shortcut.

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China's automobile industry may become a star industry on the global stage in the near future. These automobile manufacturers have undertaken huge R&D expenses in the last few years, and the global competitiveness of China's automobile industry will improve subsequently. Tesla has commenced to export new energy vehicles (NEVs) from its Shanghai factory. Some Chinese NEV manufacturers are also exporting their autos to Europe. We believe that this is an early sign of rising competitiveness of China's auto supply chain in a global context.

In the future, China's pharmaceutical industry will be another force to be reckoned with in the global market. The industry has also invested heavily in R&D. Drug development has a long lead cycle - the huge R&D investment in the past implies that numerous new products will be launched in the future. China's large population provides an ideal ecosystem for drug developers to develop new products and commercialize for domestic and foreign users.

Exhibit 5: Top 10 high R&D expenditure industries in China, 2016-19



Source(s): NBSC, ABCI Securities

Policy Insight



China Banks and Internet Finance Sector

Johannes Au, Analyst

Related policy:

- Maintain a prudent monetary policy with high flexibility and suitability; prioritize the goal to serve the real economy, and balance the relationship between economic recovery and risk prevention. Resolve financing difficulties of MSEs, and extend the principal and interest payment deferral policy for inclusive MSE loans; increase refinancing and rediscounting measures to support inclusive finance.
- Guide banks to expand credit loans, increase the number of first-time lenders, promote loan-on-demand. Direct funding to support technological innovation and green development sectors, and increase funding support to MSEs, individual business owners, and new agricultural business entities. Targeted support for industries and enterprises affected by COVID-19. Inclusive MSE loans of large commercial banks to increase by more than 30%. Develop an innovative supply chain financial service model and reasonably reduce the transaction fees for MSEs.
- Optimize supervision of deposit interest rates; further reduce the actual lending interest rates. Financial system should transfer their profits back to the real economy. Ease MSE financing and reduce overall financing costs in 2021.
- Develop multiple capital channels for small and medium-sized banks and enhance corporate governance.
- Strengthen the supervision of financial holding companies and financial technology to ensure innovations are conducted under prudent monitoring. Improve the financial risk management mechanism, define the responsibilities of all parties, and defend the bottom line of avoiding systemic risks. Financial institutions must uphold their duty of serving the real economy.

Industry impacts:

- The Report concurs with the directions set in the Central Economic Work Conference in 2020. The operating environment of the banking and internet finance sectors are in line with our previous expectations. Policy directions are still focusing on maintaining a prudent, flexible, and appropriate monetary policy, with the primary goal of serving the real economy while balancing between economic recovery and risk prevention. By industry, funding is directed to support technological innovations, green development, MSEs, individual business owners, and Sannong-related innovative entities.

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- Amongst, support for inclusive MSEs financing is still prioritized. Banks are explicitly expected to extend the principal and interest deferral policy for inclusive MSE loans despite no mandatory measures are set in place. Last year, inclusive MSE loans by the large commercial banks exceeded 50% YoY. The new target for 2021 is no less than 30% YoY for large commercial banks. We believe lower policy target indicates the urgency of inclusive MSE financing have been easing in 2021.
- Meanwhile, the Report stipulates the need to further reduce actual lending rate, guide the financial system to transfer profits back to the real economy, increases the financing ease for MSEs while reducing the overall financing costs. Earlier in a press conference, Guo Shuqing, the chairman of CBIRC, expects lending interest rate to rebound although it will remain at a relatively low level. With the impact of LPR reform being fully reflected, we believe the room for lowering the average lending rate still exists for 2021. The average lending rate will be more stable in 2021 compared to the year prior. In 2020, the financial system surrendered RMB1.5tr in profits for the real economy. The Report guides that the financial system should continue to surrender profits to the real economy, although no explicit target has been set. We believe this indicates the economic situation has been improving gradually.
- Given the rapid growth in balance sheets among banks, the Report reiterates to develop multiple channels to boost capital in small and medium-sized banks. The government is aware of the necessity to replenish capital as a result of robust loan growth. Unlike the large commercial banks, the capital need of district banks remain high.
- Avoiding systemic risks remains a top priority; more specifically, the need to strengthen supervision of financial technology and innovations was mentioned. One can expect regulatory requirements to tighten for internet finance and new products. We believe both the banking and Internet finance sectors will be rife with policy risk. For the latter, regulation and supervision will be a recurring theme, which hints at a higher policy risk. Fundamentals of the industry participants would face major changes. Regulatory environment of the Internet finance industry will turn increasingly similar to that of the traditional financial industry, especially for fast-growing sub-segments. Policy focus will be on risk prevention, liquidity, and capital adequacy.

Policy Insight



China Securities Sector

Steve Chow, Analyst

Related policy:

- Promote the reform of the registration-based initial public offering mechanism; improve the delisting mechanism; strengthen the foundation of the bond market; develop a multi-level capital market and expand the financing channels in capital market.
- Improve the financial risk handling mechanism; consolidate the responsibilities of all parties, and resolutely maintain the bottom line of avoiding systemic risks.
- Strengthen the supervision of financial holding companies. Financial institutions must uphold their duty of serving the real economy.

Industry impacts:

- Generally speaking, the policy on the securities industry remains largely unchanged, that is, increasing the proportion of direct financing and promoting the healthy development of the multi-level capital market. This is beneficial to securities firms' investment banking businesses such as equity financing and bond financing.
- The Report proposes to strengthen the development of the bond market, which is consistent with the general direction of supporting enterprises to expand bond financing
- The Report proposes to improve the financial risk handling mechanism and resolutely guard against systemic risks, reflecting the government's efforts to prevent potential risks in the current economic environment.

Policy Insight



China Property Sector

Kenneth Tung, Analyst

Related policy:

- Fulfill the housing needs of the public; remain resolute on the position that houses are built to be inhabited and not for speculation; stabilize land prices, housing prices, and expectations.
- Resolve the housing issues in big cities, and increase the supply of affordable rental housing and shared property housing by increasing land supply; arrange project funds, and centralize construction. Standardize the development of the long-term rental housing market, reduce the burden of rental housing taxes and fees, and provide reliefs for new citizens and young people on housing.
- Commence renovation of 53,000 old communities in cities and towns and improve the level of public service in county towns.

Industry impacts:

- **Anti-speculation stance unchanged.** The Report reiterates the anti-speculative stance in housing, and the direction of real estate policy remains unchanged. Resolving the prominent housing problems in big cities may imply further policy tightening in the first-tier cities. In fact, home prices in 70 major cities in Jan 2021 showed the continuous divergence in price growth. Price of new homes in the first-tier cities rose by 0.6% MoM in Jan, significantly higher than the 0.3% growth in Dec; the prices of new homes in the second/third-tier cities rose by 0.4%/0.2% MoM, lower than that in tier-1 cities.
- **Stabilize housing prices through land supply.** It has been reported by the media that 22 key cities, including the four first-tier cities of Beijing, Shanghai, Guangzhou, and Shenzhen, will adopt a centralized land sale program such that all land auctions will be limited into three times a year; also, the land supply for bidding will increase in each auction. Share prices of some leading developers, such as Vanke (2202 HK), Evergrande (3333 HK), and Country Garden (2007 HK), rose 12%, 6.6%, and 7.4%, respectively, on the day when the news was out. The market is highly optimistic on the centralized land sale policy since it may improve developers' gross margins on lower land prices. However, in our view, the decline in land prices does not necessarily benefit developers. The ultimate goal of lowering land prices is to lower housing prices, making it more affordable for homebuyers. We believe that the government may introduce more stringent price-limiting policies when developers launch their projects for presale to ensure the benefit of the lower land price will translate into lower home price instead of higher profits for developers.

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- **Standardize the development of the long-term rental housing market.** The Report proposes to ease the operating pressure of long-term rental apartment companies from the supply side and cost side. Increasing the land supply for rental housing is expected to lower land prices and reduce the initial investment of long-term rental apartment companies; also, reducing the tax burden of rental housing will ease operating cash flow.
- **The renovation of old communities will bring opportunities for value-added services (VAS) in property management (PM) industry.** Speeding up the renovation of old communities, as highlighted in the Report, will create new business opportunities for the property management industry. In fact, relevant support policies have begun to emerge last year. In July last year, the General Office of the State Council issued the "Guiding Opinions on Comprehensively Promoting the Reconstruction of Old Communities in Urban Areas" stated that 39,000 old and urban communities involving nearly 7 mn residents would be renovated in 2020. The Report mentioned that in 2021, new construction to transform 53,000 old communities in cities and towns will commence, which implies a 36% YoY increase. This ambitious target could become a new growth driver for PM sector's VAS.

Policy Insight



China Alternative Energy Sector

Kelvin Ng, Analyst

Related Policy:

- Accelerate the green transformation of development mode; promote high-quality economic development and protection of the ecological environment, and reduce energy consumption and carbon dioxide emissions per unit of GDP by 13.5% and 18%, respectively. Energy consumption per unit of GDP will be reduced by about 3%; the release of major pollutants should continue to trend down. .
- Continue to increase ecological environment governance. Strengthen the overall treatment, prevention, and control of air pollutants; enhance the coordinated management of PM2.5 and ozone, and achieve a clean heating rate of 70% in the northern region.
- Ensure progress in carbon peaking and carbon neutralization. Formulate an action plan for carbon peaking by 2030; optimize industrial structure and energy structure.
- Promote the clean and efficient use of coal; develop new energy and nuclear power while ensuring safety.
- Accelerate the development of a trading market for national energy rights and carbon emission rights, and improve the dual control system for energy consumption. Implement specific financial policies to support green and low-carbon development, and devise support tools for carbon emission reduction.

Industry impacts:

- **Reduced energy consumption and increased atmospheric governance to support alternative energy industries.** The Report proposes that energy consumption and carbon dioxide emissions per unit of GDP and energy consumption per unit of GDP will be reduced; enhance measure will be in place to prevent and control the release of air pollutants, including PM2.5 and ozone, and a higher clean heating rate will be targeted in northern region. All these show that the country will continue to promote the development of the alternative energy industry to replace thermal power since it is polluting in nature. Thermal power still accounts for more than 60% of China's total power generation, and future changes in the national energy structure will prompt growth in alternative energy industry.

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- **Financial support for alternative energy companies.** The Report proposes to speed up the construction of a national energy rights and carbon emission rights trading market and improve the dual control system for energy consumption. Policies to provide financial support for green and low-carbon projects will be devised. The lack of electricity tariff subsidies has always been the bottleneck in the development of alternative energy sources, especially for wind and solar power. The main reason is that the production cost of wind and solar power is higher than that of thermal power; hence the lack of electricity tariff subsidies will discourage investment and production. The effective operation of the carbon emission trading market will alleviate the shortage of funds in the alternative energy industry, and the effective operation of green and low-carbon development finance will also attract more private capital to the sector.

Policy Insight



China Environmental Protection Sector

Kelvin Ng, Analyst

Related Policy:

- Continue to enforce environmental protection –air, land and water. Complete the goals set for different stages in the battle against pollution. Major works in ecological protection and restoration in the Yangtze River, the Yellow River, and the coastal zone will be implemented in depth, and ecological construction will increase. Continuously improve the environmental quality and seek to eliminate heavy pollution weather as well as malodorous blackwater in cities. Implement the Intended Nationally Determined Contributions (INDCs) objectives for 2030 to combat against climate change.
- Renovate the sewage outfall into the sea and urban black and odorous water bodies; improve the treatment capacity of urban domestic sewage collection and wastewater disposal from the industrial zones; strictly prevent and control the source of soil pollution, and strengthen the treatment of agricultural pollution.
- Promote the classification of urban domestic waste in an orderly manner; expedite the green transformation of delivery packaging. Strengthen the collection and treatment of hazardous waste and medical waste.

Industry impacts:

- **Water environmental treatment.** The Report proposes that major projects to protect and restore major ecosystems should be implemented in depth. We think it will boost the number of water environment management projects. In the past two decades, the rapid development of Chinese cities marked by rising populations and industrial and commercial activities have aggravated pollution, especially in important river basins. Moreover, the lack of government support for the governance of rivers and coastal waters has slowed restoration. We believe that the government will introduce more in-depth policies for river management and increase investment in the area, which in turn will benefit the water environment management industry.

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- **Wastewater treatment.** The Report proposes to manage the sewage outfalls entering the marine environment and the urban blackwater, and improve the capacity of urban domestic sewage collection and industrial wastewater treatment in the industrial areas. We believe rapid development of the Chinese cities, higher hygienic requirements for new cities, and urbanization policies will increase the pressure on urban wastewater treatment facilities. It is important to upgrade the existing municipal wastewater treatment capacity. Moreover, the content of industrial wastewater in industrial parks is getting increasingly complex, and demand for upgrading the industrial wastewater treatment plants will increase. The government's requirements will bring greater opportunities to urban sewage operators.
- **Waste incineration.** The Report promotes the classification of urban domestic waste and green transformation of delivery packaging. The rapid growth of urban population, the prevalence of online shopping, and the pollution of underground water and soil caused by landfill have prompted the government to increase waste incineration. Incineration is both environmentally friendly and efficient; for one, the facility occupies a limited area, and processing capacity can be easily expanded by setting up additional plants. Other methods, such as landfill requires a large area. With the rising land prices in modern cities, incineration presents an ideal waste treatment method. We believe the classification of urban domestic waste will lay the foundation for waste incineration. The popularity of online shopping will also increase the per capita solid waste production, which will benefit waste incineration operators.

Policy Insight



China Education Sector

Paul Pan, Analyst

Related Policy:

- Promote balanced development of compulsory education in urban and rural areas by improving the rural school conditions and compensation structure of rural teachers
- Raise admission rate of preschool education; enhance the safety-net mechanism of universally beneficial preschool education and encourage private capital to enter preschool education industry.
- Enrollment in higher education to expand by 1mn.
- Enhance the applicability of vocational education and integration & cooperation of industries and education; implement grading system for vocational skill certification; develop first-class universities and programs.

Industry impacts:

- The Government Work Report reiterates the government's support for the education industry. We believe comprehensive support would be provided to the entire industry.
- For the higher education industry, the new enrollment target of 1mn will drive growth in private higher education service providers.
- The emphasis on vocational education would be beneficial to the private education service providers.

Policy Insight



China Consumer Sector

Paul Pan, Analyst

Related Policy:

- CPI target is 3% YoY for 2021
- Stabilize and expand consumption; increase per capita income; improve logistics system connecting urban and rural areas to accelerate penetration of ecommerce in the latter and increase rural consumption. Stimulate consumption of automobile and household appliances, and remove unreasonable restrictions on second-hand automobile sales; increase the number of carpark, charging stations, and battery changing station, and expedite the development of EV battery recycling system.
- Expand consumption of healthcare services, cultural products, tourism, and sports activities; support innovation of products and services; create easier access of new products in market and push for quality alignment of products in the domestic and overseas markets.
- Utilize the Internet Plus strategy to deepen integration of online and offline consumption; develop new business models to better serve consumers.

Industry impacts:

- The CPI target of 2021 is 3%, though lower than last year's target by 0.5 ppt, is still relatively high and may reduce purchasing power and affect consumption growth.
- The COVID-19 pandemic has impacted the income and spending growth; in 4Q20, income/spending per capita grew 7.1%/3.2% YoY vs. 9.1%/9.4% YoY in 4Q19, showing that post-pandemic consumption pattern remains conservative. Consumption growth would be limited by the willingness to spend, a concern the Report attempts to address.
- We believe the further integration of online and offline consumption after 2020 would bring more opportunities for the consumer sector.

Policy Insight



Internet Media & Consumer Commerce

Steve Chow, Analyst

Related Policy:

- Improve the national innovation system, accelerate the development of a strategic scientific and technological force led by the national laboratory, and formulate and implement a ten-year action plan for basic research. The investment in R&D will increase by more than 7% annually, and the government will strive to raise the investment higher than the actual amount during the 13th Five-Year Plan period.
- Basic research is the source of scientific and technological innovations. It is necessary to improve the support mechanism and substantially increase investment. The expenditure on basic research at the central government level will increase by 10.6%. The country will encourage leading companies to form innovative consortia and expand channels for integration of industry, university, research and application.
- Stabilize and expand consumption. Increase residents' income through multiple channels. Improve the urban and rural distribution system, speed up ecommerce and courier services to rural areas, and expand rural consumption.
- Strengthen the supervision of financial holding companies and FinTech companies to ensure that financial innovation is carried out under the premise of prudential supervision.

Industry impacts:

- The Report supports the continuous scientific research and development of the new-economy industry, especially basic research. In addition, leading companies are encouraged to form innovative consortia, which may increase strategic cooperation or investment activities in the industry.
- FinTech has become one of the focuses of supervision. The business model of the current large-scale FinTech platform may change in the future, but the overall financial risk should be reduced at the same time.
- Expanding consumption, accelerating ecommerce, and improving courier services to rural areas will boost the ecommerce industry.

Policy Insight



China Telecom Sector

Ricky Lai, Analyst

Related Policy:

- Develop the industrial Internet by building technology R&D platforms and enhancing the innovation capabilities of SMEs; improve the coverage of 5G networks and optical networks.
- Improve the adoption of online and offline consumption through the Internet Plus strategy. Develop new business models, and provide consumers with more convenient services.

Industry impacts:

- The overall revenue of the domestic telecom services is improving. We expect the fixed-line business in 2021 will continue to drive the growth of the telecom sector revenue, while the declining mobile business revenue will rebound. The development of 5G telecom network encourages new applications, which will stimulate the usage of mobile data and benefit telecom operators' revenue growth.
- Telecom operators added 900,000 new mobile base stations in 2020, bringing the total number to 9.3 mn, of which the number of 5G base stations exceeded 700,000. The MIIT plans to build 600,000 new 5G base stations in 2021, bringing the total number of 5G base stations to 1.3 mn. In addition, telecom operators are upgrading their 5G telecom networks to standalone 5G network standard to improve the network quality. As of Dec 2020, the number of 5G users has exceeded 300 mn. Telecom operators are boosting the size of 5G users by launching the latest 5G smartphones and lower-priced service packages. We estimate the 5G users to exceed 550 mn in 2021.
- Demand for short videos, online games, live video, e-commerce and social networks increases. As of Dec 2020, the average data usage per user was 10.35GB, up 32.4% YoY. The utilization rate of 5G telecom networks has risen, and the growth of average data usage per user in 2021 will further improve.
- Driven by the increasing demand for 5G smartphones, overall smartphone shipments are expected to rebound in 2021. We expect the overall figure to grow by 9.0% YoY in 2021 while domestic shipment would increase by 11.0% YoY. Due to the demand for 5G smartphone upgrade, the ASP of smartphones will rise and upstream component suppliers will benefit.

Policy Insight

ABCI Research Team



Head of Research - Philip Chan
philipchan@abci.com.hk



Macroeconomics - Andy Yao
yaoshaohua@abci.com.hk



China Banks and Internet Finance - Johannes Au
johannesau@abci.com.hk



China Securities/Internet Media& Consumer
Commerce - Steve Chow
stevechow@abci.com.hk



China Property – Kenneth Tung
kennethtung@abci.com.hk



China Alternative Energy/ Environmental
Protection - Kelvin Ng
kelvingng@abci.com.hk



China Education/Consumer - Paul Pan
paulpan@abci.com.hk



China Telecom - Ricky Lai
rickylai@abci.com.hk



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Disclosures

Analyst Certification

The analysts, CHAN Sung Yan, AU Yu Hang, Johannes, CHOW Sau Shing, LAI Pak Kin, NG King Chuen, PAN Hongxing, TUNG Yiu Kei, Kenneth, YAO Shaohua, being the persons primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

Definition of equity rating

| Rating | Definition |
|--------|-------------------------------------------------------------------------------------------------------|
| Buy | Stock return rate \geq Market return rate ($\sim 10\%$) |
| Hold | - Market return rate ($\sim 10\%$) \leq Stock return rate $<$ Market return rate ($\sim +10\%$) |
| Sell | Stock return $<$ - Market return ($\sim 10\%$) |

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
 Market return rate: average market return rate since 2008 (For reference: HSI total return index 2008-20 CAGR at 9.2%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.
Tel: 852) 2868 2183