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ABCI Policy Insight

Macro, investment, and industry analysis of 2020 China Government Work Report

Policy Insight

Andy Yao, Economist

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Macro comments on 2020 China Government Work Report

China achieved the economic growth targets in 2019

China's Premier Li Keqiang delivered his annual government work report in the third session of the 13th National People's Congress on May 22, 2020. The report reviewed the economic performance in 2019 and 2020, and set targets for the overall deployment of economic work in 2020 and a number of economic indicators.

As shown in Exhibit 1, China's economy grew 6.1% in 2019, achieving the economic growth target of 6.0%-6.5%. Economic indicators of employment, including the new urban job creation and the registered urban unemployment rate, have also successfully met the targets. In 2019, new urban job creation was 13.52mn, exceeding the target of 11mn; the registered urban unemployment rate was 3.62% in 2019, below the target of 4.5%. The fiscal expenditure for 2019 was RMB 23.89tr, exceeding the expenditure target of RMB 23tr. For 2019, tax and fee reductions for enterprises and individuals reached RMB 2.36tr, which also exceeded the target of RMB 2tr. Meanwhile, China's economic structure has continued to optimize, and the role of consumption in driving economic growth has been further strengthened. Urbanization rate exceeded 60% for the first time, and major regional strategies were implemented in depth.

Exhibit 1: China's economic indicators in 2019 – targets VS actual performance

Economic indicators	Target	Actual
Real GDP growth, %	6.0-6.5	6.1
New urban jobs created, mn	above 11.0	13.52
Registered urban unemployment rate, %	below 4.5	3.62
Fiscal expenditure, RMB tr	23.0	23.89
Tax and fee reduction, RMB tr	About 2.0	2.36
CPI, %	about 3.0	2.9
Decline in energy consumption per unit of GDP, %	about 3.0	2.6

Source(s): 2019 and 2020 Government Work Reports, China's Government Network, ABCI Securities

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2020 China Government Work Report does not set a target for economic growth

Due to the great uncertainties imposed by the COVID-19 pandemic, this report did not establish any target for economic growth in 2020 (Exhibit 2). However, it mentioned that the “six guarantees” is the focus of “six stabilities”. The first item in both “six guarantees” and “six stabilities” is job creation, indicating that employment is the utmost priority in current and future fiscal and monetary policies. China’s GDP fell by 6.8% in 1Q20. According to the Okun’s Law in economics, for every 1% of GDP decline, the unemployment rate rises by about 0.5%, so China’s employment pressure is not small. Looking ahead, as the pandemic ebbs, production resumes, and pent-up consumption is released; together with the supportive financial and monetary policies, we expect China's economic growth in 2Q20 to turn positive. Governments around the world have devoted significant efforts in containing the virus outbreak; we expect the pandemic will dwindle in 2H20. As China's external demand improves, growth will continue to rebound in 2H. On the whole, we expect China’s economy to expand by 2.0% for 2020E, much lower than 6.1% in 2019, but a respectable growth rate considering the losses and disruptions resulted from the pandemic.

Exhibit 2: China’s economic targets for 2020

Economic indicators	Target	ABCI Forecasts
Real GDP growth, %	NA	2.0
New urban jobs created, mn	above 9.0	10.0
Registered urban unemployment rate, %	about 5.5	5.0
Surveyed urban unemployment rate, %	about 6.0	5.5
Fiscal deficit as a proportion of GDP, %	above 3.6	4.0
CPI, %	about 3.5	3.0

Source(s): 2020 Government Work Report, ABCI Securities estimates

The report pledges to pursue a prudent monetary policy in a more flexible and appropriate way. A variety of tools including RRR cuts, interest rate reductions, and relending will be used to ensure M2 and aggregate financing would grow at notably higher rates than last year. China will increase financial support to keep business operations stable and promote steady reduction of interest rates. Large commercial banks should increase inclusive lending to micro and small businesses by more than 40%, higher than the target of 30% in 2019. PBOC is likely to keep liquidity abundant to support loan growth for private firms and SMEs. We predict new RMB-denominated loans and new aggregate financing to increase to RMB 19.0tr and RMB 29.0tr in 2020E. The rates for one-year LPR and five-year LPR are expected to be 3.45% and 4.45% for end-2020E. RRR would continue to trend down, given the economic downturn. We expect an RRR of 12.0% for large financial institutions and 9.0% for medium and small financial institutions at end-2020E. We expect M2 to grow by 10.5% for 2020E.

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The fiscal deficit target is lifted to 3.6% of GDP in 2020 from 2.8% in 2019, suggesting the government will continue to adopt a more proactive fiscal policy to support economic growth. China will increase by RMB 1tr in fiscal deficit and issue RMB 1tr of special central government bonds to mitigate the COVID-19 effect. The quota for special local government bond has been lifted to RMB 3.75tr for 2020 from RMB 2.15tr in 2019. According to the above fiscal resource arrangement, China will increase fiscal expenditure by RMB 3.6tr in 2020 compared with last year, accounting for ~3.63% of total GDP in 2019. In addition, the tax and fee reduction is planned to be RMB 2.5tr for 2020, up from RMB 2tr for 2019.

Job creation target is lowered to 9mn for 2020 from 11mn for 2019, while registered unemployment rate and surveyed unemployment rate are set at about 5.5% and 6.0%, higher than the 4.5% and 5.5% targets for 2019. We believe that adjustment in the employment target is related to the COVID-19 impact on the labor market. The survey unemployment rate was 6.0% in Apr, 1ppt higher than that in the same month last year. The new urban job creation was 3.54mn in 4M20, a decrease of 1.05mn from 4M19. There will be 8.74 mn of college graduates in 2020, and a large number of migrant workers are implicitly unemployed, thus the employment market will face great pressure. However, we believe the three targets are achievable with the resumption in economic growth.

The report proposes the implementation of a strategy to expand domestic demand and accelerate the transformation of economic development. The first is to promote the recovery of consumption, mainly by stabilizing employment to increase income and increase residents' willingness and ability to consume. The second is to expand effective investment. China plans the special local government bond to increase by RMB 1.6tr compared with last year, and increase the proportion that can be used as project capital. China will strengthen the construction of new infrastructure including 5G applications, commence construction of 39,000 old urban communities, and increase the national railway construction capital by RMB 100bn. We expect the infrastructure investment growth to rebound from 3.8% in 2019 to around 5% in 2020. Since external demand faces greater uncertainty due to the COVID-19 crisis, economic growth can only rely more on domestic demand.

CPI target is lifted to 3.5% for 2020 from 3.0% for 2019. Nonetheless, we believe this is more of a soft guidance than a hard target. CPI inflation is expected to slightly rebound to 3.0% in 2020E from 2.9% in 2019 due to higher food prices, especially the pork price as supply will continue to be tight on the African Swine Fever. The pork price is likely to remain high in 1H20 and then ease in 2H20 with recovery in pork supply, therefore CPI is likely to trend up in 1H and moderate in 2H. We forecast PPI inflation to ease to -1.0% in 2020E from the -0.3% for 2019E with moderating commodity prices and softening domestic demand. We believe that inflation in 2020 will not become a constraint on macro policies.

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Philip Chan, Head of Research

To support the sustainable development of economy, one should first identify the leverage points

- **Science and technology competition between China and the US: China needs to increase R&D investment in hardware and software used for the production of core components**

- **Ensuring food supply security: bioscience industry will attract market attention**

- **PBOC takes a different approach from that of the developed regions to support the economy, revealing confidence in its monetary policy**

- **Chinese households do not lack money; consumer confidence and demand would take time to recover**

China's R&D capability needs time and resources to catch up

To maintain global competitiveness, China would needs to invest heavily in R&D for the next few years. In China, R&D investment intensity (R&D / GDP) increased from 2.14% in 2018 to 2.19% in 2019. According to OECD data, in 2018, the R&D intensities of OECD, the US, Japan, and South Korea were 2.40%, 2.83%, 3.26% and 4.53%, respectively. We estimate that if China increases the intensity of R&D based on the level of OECD, the annual R&D expenses will increase by more than RMB 200bn to RMB 2.4tr. In order to catch up with the US competitors, the annual R&D expenses would need to increase by more than RMB 600 bn to RMB 2.8tr.

R&D of core component technologies: such as technologies in the supply chains of semiconductor industry and bio-pharmaceutical products.
R&D of applied technologies: such as cloud computing, AI, data center, 5G, edge computing, NB-IoT applications, autonomous driving, etc.

In view of the current situation, China's technology giants perform well in the commercial application of technologies. The corresponding local market leaders may become the global market leaders, but their weakness lies in the production technology of core components. In our opinion, R&D in the production technology of core components could be strengthened through the national guidance to centralize financial and human resources – this is one of the effective ways to realize technological independence in the next 3-5 years. In response, competitors from around the world will increase ramp up R&D to defend their market positions. Subsequently, in the next five years, the growth in global science and technology is likely to expedite. Such development prospects will bring investment opportunities for science and technology stocks at home and abroad.

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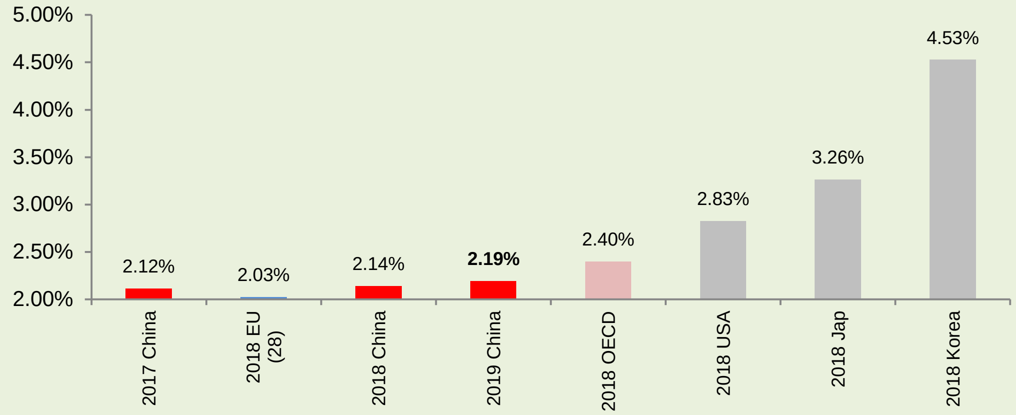
Exhibit 1：R&D intensity (%)：Continuous input of capital and human resources are crucial in winning the global technology competition



Source(s)：OECD, NBS, ABCI Securities

Exhibit 2：China's position in the global semiconductor industry: mainland companies included in the Top 10 ranking in market segments (from upstream to downstream)

EDA (Electronic design automation)	Fabless design house	Silicon wafer production	Chip equipment production	Chip foundry	Package & test
No	Hisilicon Tech	No	No	SMIC	JCET Group
	UNISOC			Hua Hong Semi	Huatian Tech
					Tongfu Micro

Source(s): ABCI Securities

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Only by ensuring food and energy security, China can safeguard the livelihood and operation at the basic level. When the supply chains of industries are stable, the market and the enterprises can be protected. By protecting the enterprises, employment, income and consumption can be secured and promoted

Food and fuel are necessary to sustain a society and the real economy. In Apr, China's food CPI increased by 14.8% YoY, reflecting the severe imbalance between food supply and demand. While controlling the demand and supply in the economy can help suppress food inflation, the development in biosciences can also play a role. Without an effective vaccine against the African swine fever, hog supply will continue to be disrupted. Agricultural insurance, while sharing the potential economic loss, is unable to eliminate the risk of loss. The development of vaccines to protect human health is as important and urgent as those for the livestock. To improve the yield and crop quality for food and non-food uses, agricultural industrialization and gene modification are the multiplier factors.

Given the limited land and water resources, developing biosciences is crucial in ensuring food supply. The theme of "Healthy China" applies to not only human but all organisms in the ecosystem. We believe the Chinese animal vaccine manufacturers, including Jinyu Bio-tech (600201 CH), China Animal Husbandry (600195 CH), Tecon Biology (002100 CH), Ringpu Bio-tech (300119 CH), and Pulike Biological (603566 CH), will draw market attention for the increasingly important roles they play in ensuring food supply and safety in China.

Exhibit 3：Chinese scientists compete with international giants for Sars-CoV-2 vaccine development (ranked by changes in market value)

Vaccine development company	Share price currency	Share price	Share price chg (%Ytd)	Mkt cap (US$ mn)	Mkt cap chg (US$mn, Ytd)	R&D (US$mn)
ASTRAZENECA	GBp	8,961.00	17.8	143,753	21,721	6,059
MODERNA	USD	67.05	242.8	26,071	18,465	496
CANSINO BIOLOG-H	**HKD**	**214.00**	**263.0**	**6,144**	**4,452**	**21**
BIONTECH SE	EUR	47.48	55.7	11,886	4,250	248
J&J	USD	146.71	0.6	386,521	2,213	11,355
INOVIO PHARMA	USD	14.24	331.5	2,251	1,730	88
TRANSLATE BIO	USD	18.98	133.2	1,194	682	76
SANOFI	EUR	86.99	(2.9)	119,667	(3,618)	6,591
GLAXO	GBp	1,664.20	(6.5)	102,071	(7,041)	5,584
PFIZER	USD	37.26	(4.9)	206,973	(10,665)	8,650
SINOVAC BIOTECH	**USD**	**Suspend**				**24**

Data as of May 21, 2020
Source(s): Bloomberg, ABCI Securities

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Since the COVID-19 outbreak causes huge losses globally, the economic value of SARS-CoV-2 vaccine is substantial. So far, no vaccine has been successfully developed in the market. Based on the efficient market theory in the capital market, the SARS-CoV-2 vaccine development companies with the largest increase in market value so far in 2020 reflects the higher perceived likelihood of success in launching the vaccine - the UK-listed AstraZeneca, the US-listed Moderna, and the Hong Kong-listed Cansino Bio are the top three companies with the largest market value gain so far this year. Considering the vaccine development theories put forth by these companies, we believe they all have a high chance in developing the effective vaccines - but it is important to be the forerunner obtaining the largest market share and revenue. The prerequisite is to complete all clinical trials and prove its efficiency, and be able to implement mass production and commercialization while ensuring product quality. Large scale production and commercialization are the strengths of multinational giants but major challenges to small companies.

Unlike the central banks of most developed economies, PBOC has not taken radical actions to expand its balance sheet so far this year, reflecting its judgment that economic risks are controllable

So far this year, central banks in the US and Eurozone have lowered interest rates while expanding their balance sheets to increase liquidity supply to the economy. In 4M20, PBOC slashed the MLF interest rates; consequently, LPR declined twice. Unlike the Fed’s expanding its balance sheet by ~ 60% in 4M20, PBOC has shrunk its balance sheet by ~3%. From this perspective, PBOC still has a room to expand its balance sheet to cushion external economic shocks and promote economic growth when necessary. We believe the control on balance sheet expansion will allow PBOC to boost the economy when the timing is right.

Exhibit 4：Major central banks’ asset scale

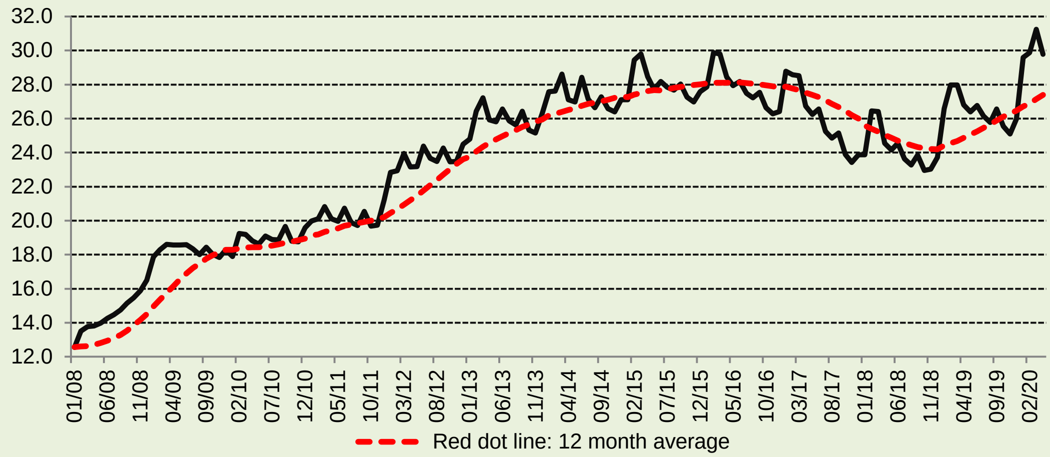
	12/2019	4/2020	Change
PBOC (RMB tr)	37.113	36.035	-2.9%
FED (US$ tr)	4.166	6.656	59.8%
ECB (Euro tr)	4.692	5.347	14.0%
BOJ (JPY tr)	573.053	619.031	8.0%

Source(s)：PBOC, Fed, ECB, BOJ, ABCI Securities

Private consumption sector – Households' net cash on hand increased, but consumer confidence and demand will take time to recover

Increase saving and reduce spending - the rational response of the middle class to the economic crisis. Household net deposits (i.e. household RMB deposits minus household RMB loans) declined from 2016 to 2018 before recovering at the beginning of 2019, with further surge in net deposits in 4M20. Net deposit of households increased from RMB 25,982.6bn at end-Dec 2019 to RMB 29,779.4 bn at end-Apr 2020, an increase of 14.6% or RMB 3,796.8bn. In 2019, the net deposits of households increased by RMB 2,263.0bn or 9.5%. From end-2015 to end-2018, the net savings of households decreased by 14% or RMB 3,866.8bn. We believe the Sino-U.S. trade war and the COVID-19 outbreak have curbed spending and investment while increasing savings in 2019. We expect households to increase consumption or investment when the economic outlook is clearer and consumer confidence is restored, although the process will take time.

Exhibit 5: Household net deposits（deposits minus loans) trend, RMB tr



Source(s)：the PBOC, ABCI Research

Delayed delivery of new homes suppresses consumption demand. In 2017-19, the sales of new homes in China increased, but the completion of new homes decreased. The expansion of consumer demand after the purchase of new housing has been delayed. In 2017-19, the presales area of new homes increased by 7.5%, 9.8, and 5.9% YoY, respectively; meanwhile, the completed area of new homes decreased by 7.0% and 8.1% YoY in 2017 and 2018 before rebounding by 3% YoY in 2019. There has been a high growth in new home presold in the past few years, but a low or negative growth in new home completion means that many homebuyers will delay buying consumer goods until after their new homes are delivered. Construction activities were adversely affected in 1Q20 on the pandemic. The completed area of new homes fell by 14.5% YoY. We expect the completion of new homes will decrease in 2020, which will subsequently suppress the consumption demand of households.

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Global consumers are more price sensitive; value-for-money as key to attract consumers. Soaring unemployment has become a common issue in most industrial nations. The adverse effects of falling income and lowering job security will lead to lower consumer spending. These adverse effects will severely hit countries whose economies are highly dependent on tertiary industry or private consumption. In addition, consumers will be more price sensitive. In 2020, consumers have turned more price sensitive and demand has become more elastic, import tariffs imposed by the trade war last year will dampen demand more severely this year.

China Banks Sector

Johannes Au, Analyst

Related Policy:

- Under the impact of COVID-19 pandemic, stabilizing employment, enterprises' survival, and people's livelihood have become the priorities; preventing major financial risks remains important.
- Deploying flexible and appropriate monetary policy becomes crucial. M2 growth and the scale of total social financing will be supported by RRR cuts, interest rates cuts, and refinancing lending tools. Policy targets to enhance enterprise lending with lower average lending rates, and assists MSEs and individual business owners amid hardships
- To strengthen financial support for enterprises, policy of deferred principal repayment for medium enterprises and MSEs would be extended from June 2020 to Mar 2021. Banks are encouraged to substantially increase credit facility, granting first loan, and offering non-principal loan repayment for MSEs. Meanwhile, growth rate of inclusive lending of large commercial banks should exceed 40%. Banks are guided to limit profitability. In addition, lending to MSEs should increase while comprehensive financing cost should be reduced.
- Small and medium-sized banks would strengthen capital position and improve corporate governance to serve the medium, small and micro enterprises.

Industry impacts:

- There were two main focuses in this work report concerning the banking sector: 1) effective prevention of major financial risks; 2) flexible and appropriate use of monetary policy to increase enterprise lending and reduce lending interest rates. Under the impacts of COVID-19 pandemic, policy focuses mainly on supporting medium, small, and micro enterprises, individual business owners, and inclusive finance. Mild structural adjustments in the sector would be seen, with exposure to the abovementioned areas increasing over time. In fact, these changes have started to show in banks' financials and industry data in 4Q19 and 1Q20. Without significant changes in policy direction, industry trend will remain in line with our previous expectations.

Policy Insight

- Asset quality has always been a concern in the banking sector. The work report stipulates the extension of deferred principal repayment policy for medium, small and micro enterprises from June 2020 to Mar 2021, indicating the government's emphasis on maintaining the stability and sustainability of these enterprises so as to secure the livelihood and employment of citizens. We believe the extension would suppress the growth in overdue loans and NPLs, thus system NPL ratio would remain stable. Nevertheless, banks would maintain their NPL handling efforts and increase risk-buffering capacity through large provisions. As of 1Q20, system NPL ratio rose by 5bps QoQ to 1.91%, of which the average NPL ratios of large banks and joint-stock banks (JSBs) were stable QoQ at 1.39% and 1.64%; the figures in city commercial banks and rural commercial banks increased by 13bps and 19bps QoQ to 2.45% and 4.09%, indicating asset quality risks are higher in district banks.

- For interest rates, the average lending rate of banks has gradually declined from 5.62% in Sep 2019 to 5.08% in Mar 2020 since the LPR reform last year. In addition to the declining trend of LPR, pricing of bank loans has been declining, as reflected by the lower proportion of loans priced at above the LPR in Mar 2020 (72.83%) from Sep 2019 (83.04%). The work report reiterated the goals of lowering lending rate, compromising profitability of banks within reasonable means, and reducing comprehensive financing cost. Therefore, we project banks' NIM pressure to persist over the interest rate cut cycle. In 1Q20, system NIM narrowed QoQ by 10bps to 2.1%; average NIM of rural commercial banks was slashed most by 37bps QoQ to 2.44%, while other bank categories declined by 3bps-9bps to 2.00%-2.09%.

- The work report demands large banks to increase inclusive finance loans by 40% YoY or more in 2020, compared to the requirement of a 30% loan growth for MSEs in 2019. The increase in loan growth reflects a larger inclusive finance lending demand resulted from the pandemic. We expect loan growth in banks to stay robust in 2H20, while solid balance sheet growth would partially offset the pressure on NIM. In 1Q20, inclusive finance lending of large banks grew 15.2% QoQ, the fastest among all bank categories.

- While the work report last year emphasized mainly on supplementing the capital of large banks through multiple channels, this year it has switched to the capital supplementation for small and medium-sized banks. This reflects the government's heightening awareness that both RRR cut and capital sufficiency are both necessary to promote loan growth. While capital positions of large banks are increasingly robust, CARs of district banks are still relatively low.

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China Securities Sector

Steve Chow, Analyst

Related Policy:

- Increase flexibility of a solid and stable monetary policy. Comprehensive use of policy tools, such as RRR cut and refinancing, to boost growth in aggregate social financing to levels higher than last year (2019 aggregate social financing growth : 10.7% YoY).
- Support corporates to expand bond financing. In addition, the government plans to issue RMB 3.75tr special local government bonds in 2020, an increase of RMB 1.6tr over last year's total.
- Reform GEM and introduce registration-based IPO system.

Industry impacts:

- The work report targets at a significantly higher growth in aggregate social financing than last year, which is consistent with the government's long-term strategy to increase the proportion of direct financing and promote the healthy development of the multi-tiered capital market. This is beneficial to the investment banking business of securities firms, including equity financing and bond financing. These goals were also mentioned in previous government reports, showing that the government has not changed its long-term strategy for the capital market.
- The increase in special local government special bonds in 2020 and support for companies to expand bond financing should be beneficial to the bond financing business of brokers. The question lies on whether this will lead to substitution effects, meaning that demand for financing businesses, such as project equity financing, will be reduced accordingly. In our view, the potential substitution effect may not be too significant given the growth target of aggregate social financing is set at a much higher level in 2020.
- The work report mentions the reform of the GEM and registration-based IPO system, which could be referenced to the setting up of the Sci-Tech Innovation Board (STAR) in Shanghai last year. Overall, this should expedite the listing of companies on the GEM, although the division of labor between the GEM and the STAR has yet to be determined. For the securities industry, equity financing business may benefit from such reforms.
- In general, the work report is beneficial to the securities industry, especially the investment banking business.

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China Property Sector

Kenneth Tung, Analyst

Related Policy:

- "Adhere to the positioning that houses are built to be lived in, not for speculation; each city can apply its own policies to address the needs of local property market; promote a stable and healthy development of the real estate market."

- "Increase tax and fee reduction efforts. This year, lower value-added tax rate and enterprise pension insurance rate will be implemented, and tax cuts and fees will be reduced by ~RMB 500bn. The policy of tax reduction and fee reduction which were introduced earlier this year and due before June (including exemption of small and medium-sized enterprise pension, unemployment and industrial injury insurance unit contributions, reduction and exemption of small-scale taxpayers VAT, exemption of public transportation, catering accommodation, tourism and entertainment, culture Sports and other services value-added tax, civil aviation development fund, port construction fee reduction and exemption) will all be extended to the end of this year. The income tax payment for small and micro enterprises and individual industrial and commercial households will be postponed until next year. It is estimated that the annual reduction for enterprises will exceed RMB 2.5tr."

- "Expedite the implementation of regional development strategies. Continue to promote the development of the western region, the comprehensive revitalization of the northeast, the rise of the central region, and the development of the eastern region. Further promote the coordinated development of Beijing, Tianjin and Hebei, the construction of the Guangdong-Hong Kong-Macao Greater Bay Area, and the integrated development of the Yangtze River Delta."

Industry impacts:

- **No major changes in policy stance.** The working report once again emphasizes that home is not for speculation. The direction of real estate policy has not changed significantly. Economic growth has been impacted by the COVID-19 pandemic, yet we have not seen any signs of relaxation on price control and home purchase restriction so far. In fact, home price growth is accelerating. In Apr, among the 70 large and medium-sized cities, 50 registered a MoM increase in new home prices, compared with 38 in Mar. New home prices for Tier-1, Tier-2 and Tier-3 cities rose at a faster rate of 0.2%, 0.5% and 0.6% MoM in Apr, compared to 0.2%, 0.3% and 0.2% MoM in Mar. As the property prices have failed to show meaningful corrections, tightening policies are likely to continue.

- **Tax and fee reduction measures will help reduce labor costs in the property management (PM) industry.** The policy of tax and fee reduction, including the suspension of social insurance contributions for SMEs, will be extended to the end of 2020 instead of June. This will help the labor-intensive PM industry reduce costs. Some smaller regional or city companies of the listed property management companies (PMCs) may benefit from the above policy. Listed PMCs may turn more eager to acquire the smaller competitors since SMEs will enjoy significant labor cost reduction on social insurance suspension. According to the National Bureau of Statistics, PMCs whose operating income is below RMB 50mn are classified as small, medium and micro enterprises.

• **Property management companies in the western region will continue to benefit from the Great Western Development Strategy.** We expect more supportive policies to follow after the confirmation of preferential tax rate extension for enterprises in western region. Previously, the Ministry of Finance announced that from Jan 1, 2021 to Dec 31, 2030, corporate income tax will be levied at a reduced rate of 15% for a list of encouraged industries located in western region, including PM. This should ease concerns over the continuation of preferential policies for western property management companies such as Justbon (2606 HK).

Policy
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China Environmental Protection / Alternative Energy

Kelvin Ng, Analyst

Related Policy:

- Energy: ensure energy security; promote clean and efficient use of coal, develop renewable energy; improve the supply and consumption system of oil, natural gas and power generation; enhance energy reserve capacity; reduce production and operating costs of enterprises; policies regarding the 5% reduction in electricity prices for industrial and commercial will be extended to end-2020.

- Environmental protection: improve the effectiveness of ecological environment governance; emphasize pollution control; deepen the air pollution control in key areas; increase construction of sewage and garbage disposal facilities; accelerate the relocation and transformation of hazardous chemical production enterprises; strengthen energy conservation and environmental protection

Industry impacts:

- **Overall impact on electricity tariffs.** We believe the country will continue to reduce the production costs of enterprises to reduce electricity tariffs. In 2019, the National Development and Reform Commission (NDRC) and the National Energy Administration (NEA) have issued policies to promote the "subsidy-free tariff" policy for new energy sources (such as wind, solar, etc.) to screen out uncompetitive enterprises, enhance industry efficiency, reduce production costs, and ultimately reduce the overall electricity tariffs to ensure the survival of downstream MSEs. Therefore, hydropower operators with low production costs will benefit.

- **Impact on China's overall power generation**. We believe strategies to expand domestic demand, increase fiscal deficits, and the introduction of the RMB 1tr special anti-epidemic government bonds will help increase economic activity and national power generation in 2H20. According to the National Bureau of Statistics, China's cumulative power generation from Jan-Apr reached 2,138.8 bn kWh, a 5% YoY decline, better than 1Q20's 6.8% YoY decline, indicating a resumption to normalcy. If production resumes in 2H20, we estimate the national power generation to grow by 2% YoY. The national revitalization plan will stimulate both economic activities and power demand.

- **Alternative energy and renewable energy industries (hydropower, nuclear, wind, solar etc.).** We believe China's support for the alternative energy industry will continue. Traditional coal-fired power generation contributes to air pollution; also, coal is a non-renewable strategic resource that should be used sparingly. Coal transportation is cumbersome, and the suspension of traffic during the pandemic also has affected coal-fired power generation. Therefore, renewable energy sources such as hydropower, wind, solar, as well as alternative energy sources such as nuclear power, will all experience significant development in the future.

Policy Insight

- **Wastewater treatment.** We believe that the country's efforts in environmental governance will increase. In terms of policy, emphasis is placed on improving the effectiveness of ecological environment governance by increasing the construction of sewage and garbage disposal facilities and emphasizing on domestic sewage treatment. According to the data from the Ministry of Housing and Urban-Rural Development, as of end-2018, the domestic wastewater discharge reached 62bn tons, up 5.6% YoY. Total volume of wastewater being treated reached 59bn tons, up 6.3% YoY. Wastewater treatment rate reached 94.8%. With the advancement of urbanization, the population of large cities will further increase, and so will the local government's investment in sewage treatment.

- **Solid waste incineration.** We believe that the country will gradually strengthen the treatment of residential solid waste to improve sanitation. Solid waste incineration is a rather environmental friendly and efficient method to treating solid waste because it does not pollute groundwater and the surrounding environment like landfills or require a large area. In earlier days, such method was rejected by many local governments because of the high cost. However, the rapid increase in urban population has rendered solid waste incineration a suitable treatment approach in the urban area. According to the Ministry of Housing and Urban-Rural Development, as of end-2018, urban solid waste generation reached 295mn tons, up 4.2% YoY; total volume of solid waste treated reached 288mn tons, up 5.9% YoY; treatment rate was 98%. Solid waste processed by incineration reached 112mn tons, up 20.4% YoY. Incineration currently accounts for only 39% of total amount of solid waste treated, lower than the 58% by landfill treatment.

China Education Sector

Paul Pan, Analyst

Related Policy:

- Provide financial support for vocational training education to stabilize the job market; 2020-21 enrollment targets for vocational training and higher education are 35mn and 2mn.

- Strengthen the development of boarding schools in rural area and county/township schools; provide further support for special education and continuing education; support and regulate private education; provide relief to private kindergartens; develop first-class universities and program.

Industry impacts:

- Increasing the no. of participants in vocational training and new student enrollment in higher education institutions would help support the development of the private education industry; in 2019, the total no. of student enrollment in higher education institutions was 40.02mn; assuming the targeted new student enrollment is achieved in the next two years, the total student enrollment size would increase by 5%.

- Emphasis on support and regulation for private education industry shows the important role it plays in national education development; in 2019, the private kindergarten and high schools contributed to 56.2% and 42.8% of national student enrollments, while contribution of private higher education was low at 6.4%.

- As the policy support for private education would increase in the next two years and the industry scale of private higher education is still small relative to the national one, we believe the former would see more growth opportunities.

Policy Insight

China Consumer Goods Sector

Paul Pan, Analyst

Related Policy:

- 2020 CPI target is set at 3.5% YoY
- Stabilize job market and increase income level to improve consumption willingness and capabilities of domestic residents; launch policies to support recovery of catering, shopping malls, cultural activities, tourism, and household service industries; promote offline-online integration.
- Deepen supply-side structural reform, and simultaneously improve consumption and investment; major investment projects include strengthening investments in new generation infrastructure, development of information network, expansion of 5G application, and promoting consumption of new energy vehicles.

Industry impacts:

- The 2020 CPI target is higher than the 2019 actual CPI of 2.9% YoY, showing that inflationary pressure is likely to persist; despite recent declines in pork prices and other major food products, food supply chain disruption overseas resulted from the pandemic would potentially refuel the inflationary pressure. Persisting inflationary pressure would decrease the purchasing power of consumers, challenging the post-outbreak consumer market recovery; high inflation, however, would increase the pricing power of consumer goods companies.
- During the COVID-19 outbreak, online consumption turned popular, companies with a strong online channel were able to achieve better results than those without; we believe more companies would explore development of online channels and their synergies with offline channels, and those who cannot execute the online strategy quickly would fall behind.
- Polices mentioned by the work report to boost consumption mainly focus on infrastructure investment; we believe, as economic growth continues to slow and the global pandemic remains unresolved, recovery in the consumer market recovery would face challenges.

Policy Insight

Internet Media & Consumer Commerce

Steve Chow, Analyst

Related Policy:

- Support e-commerce and express delivery into rural areas and expand rural consumption; multiple measures to stimulate consumption to meet the diverse needs of consumers; reform and improve cross-border e-commerce and other new business supporting policies.

- Support the restoration and development of service industries such as catering, shopping malls, culture, tourism, and housekeeping, and promote online and offline integration.

- Further promote entrepreneurship and innovation; develop venture capital and increase entrepreneurial secured loans; deepen a new round of comprehensive innovation reform experiments and build a new batch of innovative show-cases; develop a platform economy and a shared economy, and stimulate higher social creativity.

- Promote the upgrade of manufacturing industries and the development of emerging industries; develop industrial Internet and promote intelligent manufacturing. New business models such as e-commerce online shopping and online services have played an important role in the fight against the pandemic. Continue to introduce supporting policies, promote "Internet +", and create new advantages in the digital economy.

- Deepen international scientific and technological cooperation. Strengthen the protection of intellectual property rights.

Industry impacts:

- In general, the work report is beneficial to internet/high tech industry.

- During the COVID-19 outbreak, new business models such as online services have rapidly developed and changed users' online behavior. This has structurally helped the industry and accelerated the offline-to-online digital transformation.

- Increasing entrepreneurial guaranteed loans will allow more startups to obtain financial support for further development. In the medium term, it could potentially lead to more unicorn companies (startups valued at more than US$ 10 bn).

- Strengthen the protection of intellectual property rights and encourage scientific and technological enterprises to increase investment in R&D.

Policy Insight

- Support for e-commerce, express delivery into rural areas, and expansion of rural consumer cross-border e-commerce, and other new business supporting policies will be beneficial to e-commerce platforms, especially those with advantages in low-tier cities and rural areas.

- Promoting online and offline integration is beneficial to large internet platforms and consumer service e-commerce platforms.

- Innovative business models, such as the sharing economy, often conflict with existing regulations. As a result, supporting the development of new business models should help smoothen the relationship between innovative business models and regulation.

China Telecom Sector

Ricky Lai, Analyst

Related Policy:

- Expanding domestic demand and accelerating the transformation of the economic development model.
- Strengthen infrastructure construction, develop a new generation of information networks, expand 5G applications, promote new energy vehicles, stimulate new consumer demand, and facilitate industrial upgrading.

Industry impacts:

- The three major telecom operators will speed up the construction of 5G networks. In 2020, the total CAPEX of telecom operators will be RMB 334.8 bn, up 11.7% YoY, including RMB 180.3 bn for 5G CAPEX. Over 300,000 5G base stations have been built in China, and the figure will exceed 600,000 in 2020. In 2020, telecom operators will develop 5G independent networks to improve network speed and transmission quality. With the recovery of production and business activities in the domestic market, we expect business of telecom operator to rebound in 2Q20. Telecom operators will accelerate the development of 5G networks and plan to reach the year-end 5G network construction target by 3Q20.
- The 5G network will drive the rapid growth of information consumption and support economic development. The low latency and high speed of the 5G network will promote the development of autonomous driving, the development of industries in entertainment, security, and the Internet of Things, facilitate consumption upgrades, and improve the quality of life and efficiency of residents. Various enterprise organizations are actively introducing 5G technology to accelerate the development of modernization, intelligence, and digitalization.
- China Mobile (941 HK) will benefit from the growth of 5G users. It has 950mn mobile users, of which 30mn are 5G users. It is expected that 5G users in China will reach over 100mn in 2020. China Mobile has built 140,000 5G base stations, covering 56 cities, and the scale of its 5G base stations will exceed 300,000 by end-2020. China Mobile has a large user base, which will allow it to enjoy the scale effect that enhances profit margins.

Recommended Stocks

Company	Code	Rating	TP	Upside (%)	FY20E P/E (x)	FY21E P/E (x)	FY20E P/B (x)	FY21E P/B (x)	FY20E Yield (%)	FY21E Yield (%)
ABC	1288 HK	BUY	HK$4.9	55.9	4.7	4.5	0.5	0.5	6.7	7.0
CCB	939 HK	BUY	HK$8.9	42.6	5.2	5.0	0.6	0.6	5.9	6.1
A-Living	3319 HK	BUY	HK$51.4	20.1	30.4	22.0	7.4	6.3	1.6	2.3
Aoyuan	3883 HK	BUY	HK$11.1	25.9	3.6	2.6	1.1	0.9	8.3	11.7
CGN Power	1816 HK	BUY	HK$2.2	18.9	8.4	8.3	0.9	0.8	4.2	4.2
China Yangtze Power	600900 CH	BUY	RMB 20.0	17.5	16.6	13.8	2.4	2.2	3.9	4.7
WH Group	288 HK	BUY	HK$9.6	44.4	8.1	6.9	1.3	1.13	5.0	5.7
Shuanghui	000895 CH	BUY	RMB44.8	12.2	24.2	19.6	5.8	5.3	2.91	3.6
CEG	839 HK	BUY	HK$15.2	12.3	28.8	21.6	3.3	3.0	1.5	1.4
Tencent	700 HK	BUY	HK$500.0	14.8	31.9	25.5	7.2	5.8	0.3	0.4
Alibaba	9988 HK	BUY	HK$254.0	23.2	29.7	23.5	5.7	4.6	-	-
Shenwan Hongyuan	6806 HK	BUY	HK$3.0	56.3	6.7	5.5	0.5	0.5	4.4	4.9
China Mobile	941 HK	BUY	HK$82.0	40.8	9.6	9.5	0.9	0.9	5.7	5.7
ZTE	763 HK	BUY	HK$29.0	30.6	17.7	13.7	2.8	2.4	0.0	0.0

Data as of May 21, 2020
Source(s): Bloomberg, ABCI Securities estimates

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Disclosures

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Philip Chan holds H-shares of Agricultural Bank of China Ltd (1288 HK).

Definition of equity rating

Rating	Definition
Buy	Stock return ≥ Market return rate (10%)
Hold	- Market return (-10%) ≤ Stock return < Market return rate (10%)
Sell	Stock return < - Market return (-10%)

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 (HSI total return index 2008-19 CAGR at 10%)

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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