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The Central Economic Conference: Expect intensive rollout of policies to prompt domestic demand

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Expect intensive rollout of policies to prompt domestic demand

Identifying and resolving the root causes of economic problems will help build a quality foundation for new economic development and achieve sustainable growth. The Political Bureau of the Communist Party of China held the Central Economic Conference ("the Conference") to analyze and study the current economic situation and economic work. It was pointed out that the current economic operation faces new difficulties and challenges, mainly insufficient domestic demand, difficulties in some enterprises' operation, and numerous hidden risks in key areas, and a complex and testing external environment. After the smooth transition of pandemic prevention and control, the economic recovery progresses in a wave-like and zigzag manner.

The Central Economic Conference has proposed measures to address economic shortcomings. Here, it should be pointed out that domestic demand refers to domestic consumption and investment. Insufficient domestic demand refers to sluggish investment and consumption. In 1H23, fixed asset investment increased by 3.8% YoY, of which state-controlled fixed asset investment increased by 8.2% YoY, while private fixed asset investment fell by 0.2% YoY. The imbalance in the sources of investment growth will increase the fiscal burden on the government or state-owned enterprises. We believe that the government has recognized this problem, therefore, in July, the government issued two important documents: (1) the Central Committee of the Communist Party of China and the State Council issued "Opinions on Promoting the Development and Growth of the Private Economy"; (2) the National Development and Reform Commission issued "Notice on Further Grasping and Promoting Private Investment Work to Mobilize Enthusiasm for Private Investment".

The former document reaffirms the central government's emphasis on private enterprises and boosts the confidence of private enterprise, while the latter echoes the former, urging various government departments to select good investment projects for private enterprises. Both documents mention REITs as a financing tool to help private enterprises raise funds for investment.

The Central Committee of the Communist Party of China and the State Council issued "Opinions on Promoting the Development and Growth of the Private Economy".

Our Views:

From the perspective of financial or capital market investors, the Opinions convey a clear message to the market: where the central government will support and expect the development of private enterprises.

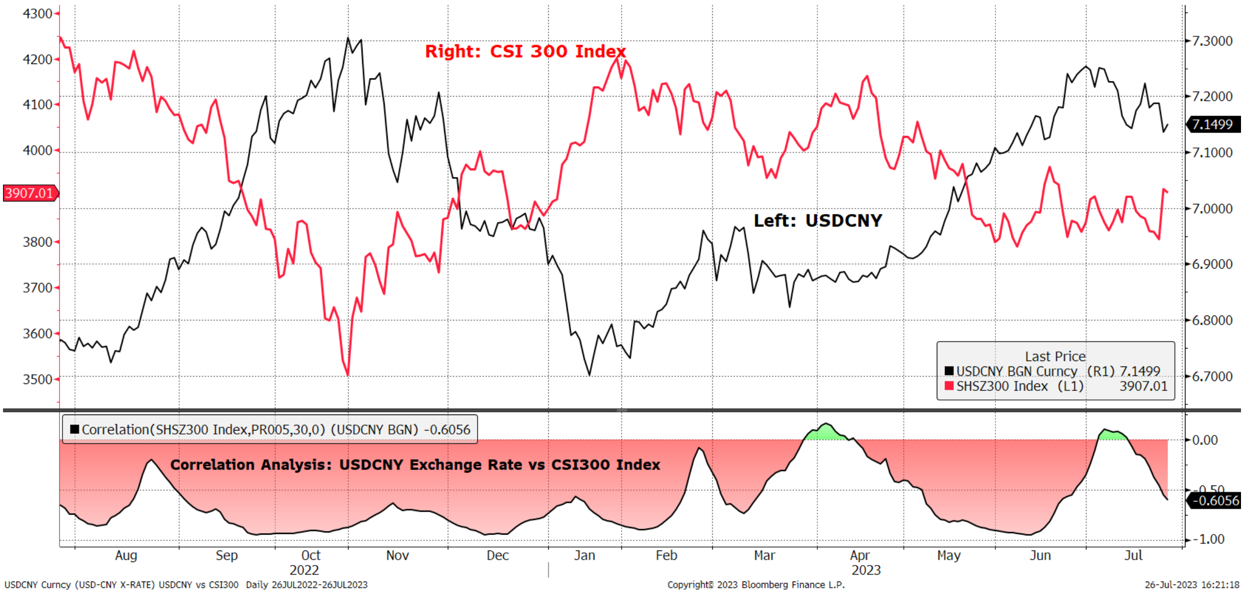
We have summarized the key points related to finance and capital markets:

- Support eligible private small and micro enterprises to raise funds in the bond market, encourage eligible private enterprises to issue bonds from technology innovation companies, as well as promote the expansion of coverage and increase of credibility of the special support plan for private enterprise bond financing.
- Support eligible private enterprises for IPO financing and refinancing, and back private enterprises in the iterative application of innovative products.
- Promote innovation in enterprises of different ownerships and sizes, and carry out joint development on common technologies.
- Support private enterprises to strengthen basic and cutting-edge research and result transformation, and encourage the digital transformation of SMEs, promoting the application of low-cost, modular intelligent manufacturing equipment and systems.
- Support private enterprises to participate in promoting carbon peaking and carbon neutrality, provide carbon reduction technologies and services, increase investment in renewable energy power generation and energy storage, and participate in carbon emission rights and energy use rights transactions.
- Support private enterprises to participate in rural revitalization, promote new agricultural business entities and social service organizations to develop modern farming, and to contribute to the quality development of the modern agricultural product processing industry.
- Support private enterprises' participation in infrastructure construction, guide private capital to participate in new-type urbanization, transportation, water conservancy and other major projects, and construction in areas that fell behind in development.
- Support platform companies to excel in job creation, consumption expansion, and international competition, and to promote the standardized, healthy, and sustained development of the platform economy.
- Encourage representatives of the private economy to play a greater role in international economic activities and economic organizations.

Implementing counter-cyclical monetary policy and continuing existing fiscal stimulus measures provide a favorable market environment to attract investment. From the perspective of private enterprise investors, economic fluctuations are not conducive to investment. However, continual government policies enhance the predictability of investment, and a good financial and capital market environment is beneficial for raising necessary investment funds. It was pointed out in the Conference that it is necessary to implement precise and powerful macro-control and strengthen counter-cyclical adjustments and policy reserves. It is necessary to continue implementing proactive fiscal policies and prudent monetary policies, as well as extend, optimize, improve, and properly implement tax and fee reduction policies. There is a need to give full play to the role of aggregate and structural monetary policy tools, and vigorously support technological innovation, the real economy, and the development of small and micro businesses. It is necessary to maintain the basic stability of the RMB exchange rate at a reasonable and balanced level. It is necessary to invigorate the capital market and boost investor confidence. In this regard, the central bank will adopt a more relaxed attitude in 2H23 to implement counter-cyclical measures to smooth economic fluctuations, and the fiscal support measures in some industries and fields will continue.

Exchange rate changes are the result of changes in economic development and the direction of capital flows. Changes in stock market trends are also the result of changes in business and economic prospects and the direction of capital flows. In response to exchange rate risks, the PBOC and the State Administration of Foreign Exchange have adjusted the macro-prudential adjustment parameter for cross-border financing of enterprises and financial institutions from 1.25 to 1.5, which was implemented on Jul 20, 2023. This measure allows domestic enterprises or institutions to increase foreign currency borrowings abroad, that is, to short foreign currencies, in a bid to alleviate the pressure of RMB depreciation. In Oct 2022, after this parameter was raised, the RMB appreciated by nearly 8% in the following three months. The CSI 300 index, which tracks A-share large-cap stocks, also rose by nearly 8%, and the Hong Kong Hang Seng Index has soared by nearly 54% from Oct last year to Jan this year.

(Above): Stock index CSI 300 (left axis) vs USD/CNY exchange rate (right axis) (7/2022-7/2023)
(Below): Correlation analysis between the stock index and the USD/CNY exchange rate
The correlation analysis shows that when the RMB exchange rate appreciates (or depreciates), the stock index also tends to rise (or fall).



Source(s): Bloomberg

The Jul PMI from Eurozone, the US, the UK, and Japan shows that the weakness in external demand continues into the third quarter. China needs to bolster domestic demand in the third quarter to support the economy and mitigate external adverse factors.

Our Views:

The latest Jul PMI from the main developed countries shows that the weakness in the manufacturing sector in 2Q23 may continue into 3Q23. This trend will continue to suppress global demand for bulk commodities and China's export sector in 3Q23. With the continuous weakness in external demand, it is imperative for China to strengthen domestic demand support for the 3Q23 economy.

The initial values of the Jul manufacturing PMI for the US, the EU, the UK, Japan, and Australia are 49.0, 42.7, 45.0, 49.4, and 49.6, respectively. Their average manufacturing PMI for the 1Q/2Q23 is also below 50. Preliminary statistical data show that there is a high probability that the weakness in their manufacturing sector in the past two quarters will continue into the third quarter, spreading adverse effects globally through the supply chain.

Demand for bulk commodities such as basic materials and energy will be suppressed. The US and the EU are China's two major trading partners. China's export industry will be adversely affected in the third quarter, and industrial production for export will be constrained.

According to data from the National Bureau of Statistics, the value of industrial export deliveries in Jun fell by 9.5% YoY, and fell by 4.8% in 1H23 compared with the same period last year. To counter potential adverse externalities, China needs to expand domestic demand to support industrial production and the economy.

Consumption is growing in a wave-like pattern. Looking at consumption, the total retail sales of consumer goods increased by 8.2% YoY in 1H23. However, the growth rate of retail sales soared from 3.5% in the first two months of 2023 to 18.4% in Apr, but the year-on-year growth rate of retail sales slowed down to 3.1% in June. The pattern of retail growth is wave-like as described in the Conference, but the wave is moving forward in a zigzag manner. The risk is the uncertainty of the driving force of the wave's progress, so the government must intensify efforts to rev up consumption.

The question of how to promote consumption was one of the focuses of the Central Economic Meeting. The Conference emphasized the need to actively expand domestic demand and give full play to the fundamental role of consumption in driving economic growth. It was suggested to expand consumption by increasing residents' income and drive effective supply through terminal demand, organically combining the strategy of expanding domestic demand with deepening supply-side structural reform. It was proposed to boost consumption of major items such as cars, electronic products, and home furnishings, and promote service consumption such as sports and leisure, and cultural tourism. Government investment should be better utilized to accelerate the issuance and use of special bonds by local governments. Policies and measures should be formulated and introduced to promote private investment. Multiple measures should be taken to stabilize the base of foreign trade and foreign investment. Increase international flights and ensure the smooth and stable operation of China-Europe freight trains.

Several high-level government departments jointly issued consumer stimulus measures before the Conference, reflecting the government's efficiency and the urgency of promoting consumption. Over the past three weeks, several consumption stimulus measures have been introduced successively, including the notice on "Several Measures to Promote Home Consumption" issued by the Ministry of Commerce and 12 other departments on Jul 12, the notice on "Several Measures to Promote Electronic Product Consumption" issued by the National Development and Reform Commission and six other departments on Jul 20, and the notice on "Several Measures to Promote Car Consumption" issued by the National Development and Reform Commission and 12 other departments on Jul 20. The frequent issuance of notices by multiple high-level government departments indicates the government's emphasis on promoting consumption. Moreover, the direction to stimulate consumption is clear - cars, electronic products, and home consumption. The clear messages issued by the government will provide guidance for investment decisions in the financial and capital markets.

Household purchasing power is strong, but effectively stimulating consumption requires new demand and new markets. The total amount of household RMB deposits increased from RMB 120.34tr at the end of 2022 to RMB 132.24tr at the end of Jun 2023, an increase of RMB 11.9tr. The total amount of household deposits exceeded the nominal GDP in 2022, with the nominal GDP last year being RMB 121tr. The three notices of consumption stimulus measures mentioned above aim to identifying new demand and new markets. The common point of these notices is - new demand and new supply are for green intelligent products, and the new market is to increase penetration in rural markets.

The Conference pointed out that consumption can be expanded by increasing residents' income. In 1H23, the per capita disposable income of residents nationwide nominally grew by 6.5% compared to the same period last year. After adjusting for price factors, the real increase was 5.8%. Looking at urban and rural areas, the nominal growth of per capita disposable income for urban residents was 5.4%, and the real growth was 4.7%; for rural residents, the nominal growth of per capita disposable income was 7.8%, and the real growth was 7.2%.

The positive aspect is that the income growth rate of rural residents is faster than that of urban residents. The downside is that the actual income growth rate of urban residents is lower than the actual GDP growth rate.

In 1H23, retail sales in rural areas increased by 8.4% YoY, a growth rate that is 0.2 ppt faster than in cities. The lower actual income growth rate of urban residents will weaken consumer confidence and drive in the urban market. On the contrary, the higher income growth of rural residents is beneficial to enhance the consumption capacity of the rural market.

Therefore, the government needs to help unleash the potential of the rural consumer market and support the growth of income and consumption in the urban market.

The middle class continues to grow, the social security network continues to expand, consumer confidence will recover, and purchasing power will be released. The Conference emphasized the need to strengthen the guarantee of people's livelihood, consider stabilizing employment at a strategic height, ensure and solidify the "three guarantees" baseline at the grassroots level, and expand the middle-income group; it's necessary to strengthen the protection and quality improvement of cultivated land, consolidate and expand the achievements of poverty alleviation, and comprehensively promote rural revitalization; it's important to resolutely prevent major and extraordinarily major safety accidents and ensure the supply of energy and electricity for peak summer demand.

With the risks in the real estate market and local government debt, the Central Economic Conference implies that a slew of solutions are underway. Responding to major risks, it was pointed out in the Conference that it is essential to effectively prevent and resolve risks in key areas, adapt to significant changes in the supply-demand relationship in the real estate market, adjust and optimize real estate policies timely, adjust policies based on each city's needs, and make good use of policy toolboxes. The aim is to better meet residents' rigid and upgrade housing demand and promote the stable and healthy development of the real estate market.

Increased efforts are needed to construct and supply affordable housing, actively promote the reconstruction of urban villages and the construction of public infrastructure for both peace and emergency times. Also, it's important to revitalize and transform idle properties.

Effective prevention and resolution of local government debt risks are needed, along with the development and implementation of a comprehensive debt solution. Strengthening financial supervision and steady promotion of risk transformation of high-risk small and medium financial institutions is needed.

Although the Conference did not provide details, the message conveyed is very clear, that is, various solutions are ready to be deployed.

The challenges emerged from the old economic structure can be addressed through the development and implementation of a high-quality, innovative new economy. There is a prevailing belief that some of the risks in the real estate market and local government debt are the costs associated with the old economic development model. However, addressing these issues does not imply a regression into the old economic paradigm. The Central Economic Conference has underscored the necessity to vigorously advance the construction of a modern industrial system, hasten the growth of strategic emerging industries, and build more fundamental industries. This includes the need to foster the deep integration of the digital economy with advanced manufacturing and modern services, while ensuring the safe evolution of artificial intelligence. Moreover, the healthful and standardized development of platform companies has been emphasized.

The Conference has also emphasized the deepening of reform and opening up, steadfastly adhering to the "two unswervingly". This means effectively bolstering the core competitiveness of state-owned enterprises and optimizing the development environment for private enterprises. China is committed to rectifying random fees, fines, and apportionments, and to resolving the issue of government arrears to enterprises. It is essential to establish a regular communication mechanism with enterprises, to inspire them to bravely forge ahead, take risks, and actively create markets.

The Conference has called for support to be given to qualified free trade pilot zones and free trade ports to align with international high-standard economic and trade rules, promoting a strategy of leading and piloting reform and opening up. Finally, the country is tasked with meticulously organizing the third Belt and Road Forum for International Cooperation.

The National Development and Reform Commission, along with six other departments, have released a notice titled "Several Measures to Promote the Consumption of Electronic Products

Our Views:

During 1H23, the retail sales of household appliances, audio-visual equipment, and communication equipment witnessed year-on-year growths of 1.0% and 4.1%, respectively. However, these growth rates fall short of the 6.8% growth seen in the total retail sales of consumer goods during the same period.

The subdued consumption of electronic products not only poses adverse effects on manufacturers but also influences e-commerce platform operators, given the increasing trend of consumers purchasing electronic products online. The key challenge in bolstering the consumption of electronic products is to generate new demand and explore fresh markets. The "Several Measures to Promote the Consumption of Electronic Products" (the Measures) primarily target these two issues.

The Measures encompass 12 facets: expediting the upgrade and replacement of electronic products, establishing new consumption scenarios for electronic products, focusing on eliminating usage barriers for electronic products, continuously advancing the rural penetration of home appliances, enhancing the sales and distribution network of electronic products, organizing exhibitions and sales activities for green and smart electronic products, standardizing the electronic product recycling system, encouraging centralized and remote recycling, ensuring adequate temporary sites for electronic product recycling, reinforcing privacy protection, refining the quality standard system, and fostering a green consumption environment.

Emphasizing the theme of innovation driving the demand for product upgrades, these measures also encourage a deeper incursion into the rural market.

The National Development and Reform Commission and 12 other departments have issued a notice on "Several Measures to Promote Automobile Consumption."

Our Views:

"Several Measures to Promote Automobile Consumption" (the Measures) consists of ten items, which include optimizing vehicle purchase restriction policies, supporting the renewal of old vehicles, accelerating the cultivation of the used car market, strengthening the construction of new energy vehicle supporting facilities, striving to improve the rural power grid's carrying capacity, reducing new energy vehicle purchase and usage costs, promoting an increase in new energy vehicle purchases in the public sector, strengthening auto finance services, encouraging automotive companies to develop economical and practical models, and continuously alleviating parking difficulties and chaos.

The market investment sentiment in the automotive industry is very optimistic. In 1H23, fixed asset investment in the automobile manufacturing industry increased by 20.0% YoY, which is higher than the national fixed asset investment growth rate of 16.2 ppt during the same period.

The increase in the capacity utilization rate of the automobile manufacturing industry has enhanced the manufacturers' investment enthusiasm. In 2Q23 and 1H23, the capacity utilization rates of the automobile industry were 73.3% and 72.7%, respectively, an increase of 4.2 ppt and 2.0 ppt compared to the same period last year.

In 1H23, automobile production was 13.103mn units, a YoY increase of 6.1%. Of these, new energy vehicle production was 3.611 mn units, a YoY increase of 35.0%. This implies that the production of non-new energy vehicles fell by about 2% to 9.492 mn units.

From the statistical data, the automobile manufacturing industry represents the supply side situation. Due to the significant increase in fixed asset investment by automobile manufacturers in 1H23, it is expected that the industry's capacity will increase in the next 12 months. The supply will continue to increase, and the challenge in the near future lies on the demand side.

Therefore, the government needs to introduce measures to stimulate automobile demand. In 1H23, the retail sales of automobiles were RMB 2.2409tr, an increase of 6.8%. The "Measures" focus on new energy vehicles and the rural market. Therefore, the "Measures" require optimizing and enriching the supply of cost-effective models.

The Ministry of Commerce, along with 12 other departments, has issued a notice titled "Several Measures to Promote Home Furnishing Consumption."

Our Views:

In examining this development, it's crucial to consider what the transition from a high-growth market to a flat-growth one implies for the residential property market. In an expansion market, the delivery of new houses generates new demand for products including furniture, decoration materials, household appliances, kitchenware, home textiles, and bathroom products. However, when the expansion market slows down, this new demand is suppressed, leading to a consequent drag on the retail and industrial production of these products. As a result, the adverse effects will be transmitted upstream through the supply chain, impacting the manufacturing and basic materials industries. To overcome or mitigate these adverse effects, one potential approach is to create new demand within the existing home .

Creating new demand within the existing home market is a concept we believe lies at the heart of the initiative "Several Measures to Promote Home Furnishing Consumption", a notice issued by the Ministry of Commerce and 13 other departments. The notice highlights that home furnishing consumption, spanning areas such as home appliances, furniture, home textiles, and home decoration, is a significant part of consumer spending and serves as a direct reflection of people's aspirations for a better quality of life. So, how can we generate new demand within the existing home market? The Notice provides an answer: by remodeling existing residences and substituting current home furnishings with eco-friendly and smart home products.

The Notice requires financial institutions to provide credit support for homeowners to carry out renovations and upgrades to green products. Furthermore, it encourages these institutions to bolster credit support for home furnishing consumption while ensuring adherence to laws, regulations, and risk control measures. In this context, financial institutions are urged to reasonably determine loan interest rates and repayment terms, optimize approval processes, improve financial services, and promote online, instant processing. The Notice also fosters stronger cooperation between financial institutions and home furnishing manufacturers, markets, and decoration companies, with the aim of providing financing support for businesses and enterprises across the supply chain. Additionally, it supports qualified home furnishing market and commercial outlet projects in issuing Real Estate Investment Trusts (REITs) within the infrastructure sector. Continuing its support for urban residents in old districts, the Notice endorses the withdrawal of housing provident funds for home renovations, such as installing elevators. This policy extends to cover renovations in the self-occupied houses of both the individual and their spouse's parents.

The Notice establishes two strategies to boost sales - launching consumer promotion activities and promoting rural home furnishing consumption. It encourages regions with the necessary conditions to introduce targeted policy measures, guiding enterprises to improve the quality and level of home furnishing consumption supply. This includes providing more high-quality, personalized, and customized home furnishing products, increasing discounts, and supporting residents in replacing or purchasing new green smart home products, as well as carrying out renovations of old houses.

The Notice also emphasizes the need to continuously advance the construction of a county-level commercial system. This involves guiding home furnishing enterprises, e-commerce platforms, and others to penetrate the rural market, optimize the county-level circulation network and channels, increase the supply of suitable home furnishing products, and improve the level of after-sales service.

In a bid to enhance logistics, the Notice advocates improving the three-tier logistics distribution system which spans counties, towns, and villages, and encourages the development of intensive distribution. Furthermore, it urges the execution of in-depth activities to bring green building materials to the countryside, expanding the pilot area further. Regions with sound financial conditions should provide appropriate subsidies or loan discounts for green building materials consumption.

Finally, the Notice encourages those regions with suitable conditions to promote home appliances, furniture, and home decorations in rural areas. In line with local conditions, it supports rural residents in purchasing green smart home products and carrying out home renovations.

Residences that have been standing for over 5-10 years might be showing signs of ageing, but their property value could have appreciated significantly during this time. These homeowners should find financial institutions ready to extend credit to them, aiding in the renovation and upgrading of their existing homes. As per the National Bureau of Statistics, between 2005 and 2017, a staggering 8.3bn sqm of new residential area was finished, averaging to an annual completion of 639mn sqm. The period from 2018 to 2022 saw a total of 3.35bn sqm of new residential area completed, with a slightly higher average annual completion of 671mn sqm. In 1H23 alone, the newly completed residential area totaled 246mn sqm, marking an 18.5% increase compared to the previous year.

The statistics points out two crucial factors. Firstly, the scale of the existing residential market greatly surpasses that of the incremental market. This suggests that if government policies can stimulate new demand within this existing market, the potential for consumption is vast. Secondly, referring to the limited available historical data and considering residences completed from 2005 onwards, the current market consists of over 8.3bn sqm of residences that are over 5 years old, and nearly 4.5bn sqm of residences that are over 10 years old. This underscores a strong demand for house decoration or lifestyle upgrades among owners or occupants of these older properties.

Disclosures

Analyst Certification

The analyst, CHAN Sung Yan, being the person 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. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. We and/or our associates have no financial interests (except "Disclosures of Interests" below) in relation to the listed company(ies) covered in this report, and we and/or our 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≥ Market return rate (~9%)
Hold	- Market return rate (~-9%) ≤ Stock return rate < Market return rate (~+9%)
Sell	Stock return < - Market return (~-9%)

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 2006 (For reference: HSI total return index 2006-22 averaged at 8.4%)

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.

Disclaimers

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