NAVIGATING CHINA

January 8, 2024

China Strategy

2024 outlook: Restoring confidence

- Strong determination by policymakers to strive for a higher growth target this year should be beneficial in restoring investors' confidence, in our view.
- A new round of reforms to revive long-term growth momentum, compelling valuations, and the peak in US dollar should also encourage fund inflows.
- We hold a constructive view on the HK market; expect 20% upside potential.
- We are Overweight on Consumer Discretionary, Communication Services, Information Technology (upgrade from Neutral), and Insurance sectors.

Analyst(s)

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Higher GDP growth target to help improve investor confidence

The new slogan "promoting stability using progress", introduced during the annual Central Economic Work Conference, demonstrates policymakers' strong determination to strive for an aggressive GDP growth target in 2024F. By stabilising the labour market and property sector, and preventing deflationary pressure from becoming self-fulfilling, we expect a higher growth target to help restore business and household confidence, and in turn lift investors' confidence in China's stock market. Policymakers also announced a new round of structural reforms on the fiscal and tax system this year, which should help revive China's long-term growth momentum, especially household consumption potential. We view the risk-reward for China stocks as attractive. Valuation is already at the low-end of its five-year historical range, with Hang Seng Index trading at 1.5 s.d. below five-year historical average, and only 15% above the Oct 22 trough level. Meanwhile, earnings growth outlook remains solid (2023F: 22%, 2024F: 10%). The peak in the US dollar strength would likely encourage fund inflows to emerging markets, as historical data show strong negative correlation between US dollar index and emerging market stock performances. Foreign fund outflows from the China market showed signs of abating in Nov-Dec 23, based on northbound stock connect data. We hold a constructive view on offshore Chinese equities.

Expect more proactive, intensive and frontloaded policy support

GDP growth target is likely to be set at "around 5%" for 2024F, in our view. Ensuring the achievement of the growth target calls for significant step-up in policy support. We expect overall policy response to shift from a reactive mode to a more proactive one. The intensity of policy support for 2024F will be much higher compared to 2023 and the pace will be more frontloaded. Fiscal policy will do the heavy lifting of boosting growth, while an easing monetary policy stance will be maintained. Central government will likely take on more leverage and shoulder greater spending responsibilities. Meanwhile, local governments will continue to focus on defusing hidden debt risk through debt swapping and restructuring. Property policy will focus on breaking the negative feedback loop between developer stress and weak housing demand, by further relaxation of home purchase restrictions and stepping up financing support for developers. "Three major projects" will play a key role in offsetting the decline in commercial residential property investment and we expect low-cost funding to be provided for these projects through Pledged Supplementary Lending (PSL).

We project 12-month upside of 20% for Hang Seng Index

Our 2024F year-end index targets are 20,400 for Hang Seng and 67 for MSCI China Indices, based on forward P/E targets of 9.7x and 10.6x (0.8x and 0.5x s.d. below their five-year historical average). The potential upside of c.20% from current levels is driven by both valuation expansion and earnings growth. We expect a revaluation of c.10% for forward P/E ratio, while earnings growth for 2024F should reach c.9%.

Prefer sectors with policy/structural growth tailwinds

We prefer sectors with solid growth prospects, favourable policy support and attractive valuations. We are Overweight on Consumer Discretionary, Communication Services, Information Technology, and Insurance sectors. We upgrade the Information Technology sector due to a pick-up in global tech cycle. We stay Underweight on Healthcare and Diversified Financials. For a list of our high conviction names, please refer to page 7.

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Executive summary

Policy outlook: flexing fiscal muscle to rebuild confidence

For 2024F, we expect policymakers to set the GDP growth target at "around 5%", as an aggressive target is warranted to restore confidence by stabilising the labour market and property sector, prevent the deflationary pressure from becoming self-fulfilling, and avoid another year of sluggish growth to further erode long-term consumer and business confidence. The new slogan "promoting stability using progress", introduced during the recent Dec politburo meeting, indicates strong determination by the government to stem the risk of the Chinese economy being caught in a confidence trap.

Ensuring the achievement of the growth target calls for significant step-up in policy support. We expect overall policy response to shift from a reactive mode to a more proactive one. The intensity of policy support for 2024F will be much higher compared to 2023 and more frontloaded, in our view. Fiscal policy will play a primary role in boosting growth, while an easy monetary policy stance will be maintained. The central government will likely take on more leverage and shoulder greater spending responsibilities. Meanwhile, local governments will continue to focus on defusing hidden debt risk through debt swapping and restructuring.

Fiscal policy will be more expansionary, frontloaded and flexible. For 2024F, we expect the fiscal deficit ratio target to be set at around 3.5% (2023: adjusted from 3.0% to 3.8%) while local government special bond quota will likely be around Rmb4tr (2023: Rmb3.8tr). The impact of Rmb1tr additional sovereign bond issuance announced in late-Oct 23 will mostly be reflected in 2024F, in our view. Besides, we expect policymakers to retain flexibility, with likelihood of mid-year adjustment to fiscal deficit ratio/additional sovereign bond issuance, or introduction of other fiscal policy tools, if recovery momentum deteriorates.

Property policy will focus on breaking the negative feedback loop between developer stress and weak housing demand. For 2024F, we expect policymakers to step up policy support for the sector on multiple fronts, including further relaxation of home purchase restrictions and reduction in downpayment ratio and mortgage rates, stepping up financing support for developers, and providing direct funding support for "three major projects" (affordable housing, urban village redevelopment and public infrastructure for both civil and emergency purposes). Pledged Supplementary Lending (PSL) is likely to be used to provide additional low-cost and long-term funding to these projects. PSL is a monetary policy tool for the central bank to inject long-term liquidity into the banking system, and an off-budget channel for the government to raise funds for major projects.

Economic outlook: achieving a firmer recovery

Recent data pointed to signs of bottoming out for the Chinese economy, although the recovery is not on a strong footing yet. For 2024F, we expect China's GDP growth to reach around 5%, on the back of forceful, proactive, and frontloaded policy support. Among the three key components of economic growth, we expect the growth rate of consumption to decelerate and investment growth to speed up, while the drag from net exports will narrow. The drag on growth from the prolonged property market downturn will be offset by step-up in policy support for infra investment, especially the "three major projects". The property sector remains the biggest source of downside risk next year, in our view.

Figure 1: Overview of our economic forecasts for China

	2022	2023F	2024F
GDP (% yoy)	**3.0**	**5.2**	**5.2**
- Gross capital formation	5.7	2.6	4.5
- Final consumption expenditure	3.5	8.3	5.8
Fixed asset investment (% yoy)	**5.3**	**3.0**	**3.9**
- Manufacturing	9.1	6.2	3.1
- Infrastructure	9.4	6.5	10.5
- Property development	-10.0	-9.6	-7.0
Retail sales (% yoy)	**-0.3**	**7.0**	**4.9**
Industrial production (% yoy)	**3.6**	**4.2**	**4.4**
Export (in US$, % yoy)	**7.2**	**-4.1**	**1.2**
Import (in US$, % yoy)	**1.0**	**-5.1**	**1.7**
CPI (% yoy)	**2.0**	**0.4**	**1.0**
PPI (% yoy)	**4.1**	**-3.1**	**0.8**
Total social financing (TSF) balance (% yoy)	**9.6**	**9.6**	**10.1**
USDCNY (period end)	**6.95**	**7.09**	**6.90**
1-year loan prime rate (LPR) (period end)	**3.65**	**3.45**	**3.25**

SOURCES: CGS-CIMB RESEARCH ESTIMATES, CHINA GALAXY SECURITIES RESEARCH ESTIMATES, WIND

Market outlook: constructive view on offshore Chinese equities

Offshore Chinese stocks are trading at the low end of their five-year historical range. The forward P/Es of both Hang Seng and MSCI China Indices are currently at c.19% discount to their five-year historical median levels, or 1.5x and 1.3 s.d. below their five-year historical average, and only around 14-15% above the trough levels in Oct 22 before the lifting of the Covid-19 restrictions. Their valuation discounts vs. EM peers are also at relatively high levels by historical standards. Equity risk premium (earnings yields less sovereign bond yield) also shows offshore Chinese stocks are not expensive relative to bonds, based on our calculation. Meanwhile, the HK market has registered a record level of stock repurchases for two consecutive years, indicating that the corporates believe their shares are trading at depressed levels.

Bloomberg consensus now anticipates solid earnings growth rates for offshore Chinese equities. Hang Seng Index/Hang Seng ex-financials are expected by Bloomberg consensus to register earnings growth of around 22%/19% in 2023F (2-year CAGR: 11%/13%), and 10%/14% in 2024F, respectively. We see the risk of earnings revision as tilted to the upside due to the step-up in policy support and recovery momentum.

We hold a constructive view on offshore Chinese equities. We expect the market to bottom in 2023 and stage a rebound in 2024F.

i) We expect the government to strive for a higher growth target, in order to restore business and household confidence, which should in turn help lift investors' confidence in the China market. The intensity of policy support will witness a significant step-up in 2024F compared to 2023, and the pace should be more frontloaded.

ii) China will kick off a new round of structural reforms on its fiscal and tax systems this year, which should help revive China's long-term growth momentum, especially household consumption potential, and reduce risks related to local governments' hidden debt.

iii) We see the risk-reward for China stocks as attractive, with valuation at the low end of the five-year historical range, while earnings growth outlook remains solid.

iv) As the Fed's rate hike cycle approaches its end, we expect to see the peak in the US dollar strength, which would likely encourage fund inflow to emerging markets. Based on historical data, the US dollar index has shown strong negative correlation with the performance of emerging market stocks. Foreign fund outflow from China market showed signs of abating in Nov 23 and Dec 23, based on northbound stock connect data.

Our 2024 year-end index target for Hang Seng is 20,400 based on forward P/E target of 9.7x. Our 2024 year-end target for MSCI China Index is 67, based on forward P/E target of 10.6x. The potential upside of c.20% from current levels is driven by both valuation expansion and earnings growth. We expect a revaluation of c.10%, while earnings growth for 2024F should reach c.9%.

Key downside risks include i) "higher-for-longer" Fed rates, ii) weak domestic economic recovery, iii) ineffective policy implementation, and iv) geopolitical tensions. For the upcoming US presidential election, we believe the past few years have proved that whoever is elected to the White House will not change Washington's overall strategy toward China. However, the short-term policy choices might introduce renewed uncertainty to the bilateral relationship and potentially add to stock market volatility.

Sector preferences: prefer sectors with solid growth prospects and favourable policy support

We prefer sectors which enjoy favourable policy support, have solid earnings growth potential and are currently trading at attractive valuations.

Our recommendations are as follows: Overweight (OW) on Consumer Discretionary, Communication Services, Information Technology, and Insurance sectors. We upgrade Information Technology sector due to the pick up in global tech cycle. We stay Neutral on Real Estate, Banks, Consumer Staples, Materials, Industrials, Utilities and Energy. We remain Underweight (UW) on Healthcare and Diversified Financials.

For investors who want to position for a potential earlier-than-expected rate cut by the Fed, we recommend the HK property sector, as a faster rate cut will help hasten a recovery in Hong Kong's physical property market and reduce the financial cost burden on developers. Besides, the favourable immigration policy introduced by the HKSAR government in Oct 23 that seeks to attract highly skilled or talented persons to settle in Hong Kong will encourage population inflow and improve housing demand, in our view.

Figure 2: We prefer sectors with solid growth prospects, accommodative policy environment and attractive valuations

Sector	Rating	P/E (x)		P/BV (x)		Dividend Yield (%)		ROE (%)	
		2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F
Communication Services	OW	14.8	12.7	2.4	2.0	0.9	1.0	12.9	13.3
Consumer Discretionary	OW	15.9	12.7	2.0	1.8	0.7	0.8	10.6	12.2
Insurance	OW	5.9	4.6	0.6	0.5	6.8	7.8	10.3	11.8
Information Technology	OW ⬆	19.0	16.5	1.9	1.7	1.4	1.3	9.7	10.1
Consumer Staples	Neutral	21.7	17.3	3.4	3.0	2.4	2.9	15.4	17.4
Materials	Neutral	12.2	9.7	1.2	1.1	2.6	3.1	9.2	10.8
Real Estate	Neutral	11.6	7.1	0.6	0.6	4.4	4.7	5.3	7.9
Industrials	Neutral	8.5	7.6	0.9	0.8	3.7	3.8	10.1	10.1
Utilities	Neutral	7.7	6.8	0.9	0.8	5.8	6.1	11.2	11.6
Energy	Neutral	6.2	6.0	0.8	0.7	9.1	9.1	12.3	12.0
Banks	Neutral	3.4	3.3	0.4	0.3	8.7	9.0	10.8	10.4
Healthcare	UW	31.4	26.0	2.5	2.2	1.1	1.3	7.9	8.5
Diversified Financials	UW	8.9	7.6	0.6	0.6	3.6	4.3	7.2	7.8
MSCI China		**10.5**	**9.1**	**1.2**	**1.1**	**2.6**	**2.8**	**10.5**	**11.1**
Hang Seng		**8.8**	**8.0**	**1.0**	**0.9**	**4.1**	**4.5**	**10.7**	**11.0**

SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

High conviction: seizing structural growth opportunities; "going global" investment theme

We select our high conviction names among the universe of China stocks, based on: 1) sector preference, 2) company specific fundamentals, and 3) valuations.

We recommend investors seize the investment opportunity arising from Chinese firms going global. Investing in Chinese companies nowadays is no longer equivalent to investing in China, as Chinese listed firms are embarking on a journey towards transforming into MNCs (multinational corporations). Compared with listed companies in the US and Europe, the international revenue exposure of Chinese listed companies is still relatively low and we see plenty of room for improvement. We believe this trend will provide significant earnings growth potential in the years to come, and potentially act as a re-rating catalyst. Among our high conviction names, companies which fulfil this investment theme include PDD Holdings, Trip.com, BYD, Xiaomi and Sunny Optical.

Figure 3: High conviction names: China stocks

Ticker	Company	Analyst	Sector	Rec.	Curr.	Mkt cap	Target price	Current price	Upside/ (downside)	EPS growth		P/E		P/BV	Div Yld
						(US$bn)				23F	24F	23F	24F	24F	24F
PDD US	PDD Holdings	Lei YANG, CFA	Consumer Discretionary	Add	USD	197.9	177.0	149.0	18.8%	31%	21%	29.7	24.4	6.6	0.0%
9961 HK	Trip.com	Lei YANG, CFA	Consumer Discretionary	Add	HKD	23.4	460.0	281.6	63.4%	748%	9%	15.1	13.8	1.2	0.0%
9901 HK	New Oriental Education	Lei YANG, CFA	Consumer Discretionary	Add	HKD	12.6	65.5	55.4	18.2%	60%	21%	29.6	24.5	2.7	0.0%
600519 CH	Kweichow Moutai	Lei YANG, CFA	Consumer Staples	Add	CNY	293.0	2,266.0	1,694.0	33.8%	18%	17%	28.4	24.3	7.3	2.1%
1299 HK	AIA Group	Michael CHANG, CFA	Insurance	Add	HKD	93.3	91.0	64.9	40.3%	1300%	129%	29.2	12.8	2.4	2.6%
1211 HK	BYD	Ray KWOK	Auto	Add	HKD	78.1	389.0	210.6	84.7%	82%	26%	18.3	14.6	7.2	0.1%
1810 HK	Xiaomi	Ray KWOK	Tech Hardware	Add	HKD	48.0	21.5	15.0	43.5%	107%	5%	18.8	17.8	1.5	0.0%
2382 HK	Sunny Optical	Ray KWOK	Tech Hardware	Add	HKD	8.9	88.0	65.1	35.3%	-25%	97%	35.0	17.8	2.8	1.1%
2669 HK	COPL	Raymond CHENG, CFA	Real Estate	Add	HKD	2.6	14.5	6.2	135.8%	32%	29%	12.0	9.2	2.9	3.3%
300760 CH	Mindray	Yolanda Yin	Health Care	Add	CNY	48.3	390.7	289.8	34.8%	20%	20%	29.9	24.9	7.5	2.4%

SOURCES: CGS-CIMB RESEARCH ESTIMATES, BLOOMBERG
Note 1: Data as of 3 Jan 2024; Estimates are based on CGS-CIMB's analyst forecasts.
Note 2: For New Oriental Education, 23F/24F refer to fiscal years ended May 24/May 25

Restoring confidence

Policy outlook: fiscal policy to take on primary role

China to set GDP growth target at “around 5%” for 2024F

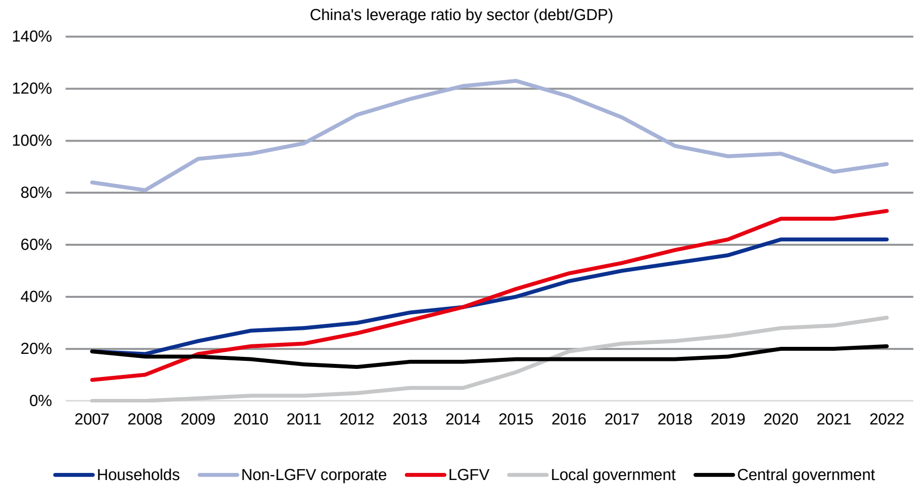
China will set growth target at “around 5%” to restore confidence. For 2024F, we expect policymakers to set the growth target at “around 5%”, same as 2023. Our calculation shows the 2-year CAGR of 2023F GDP growth is around 4.1%. The unchanged growth target essentially indicates growth acceleration compared to 2023, due to the absence of a low base, which calls for significant step-up in policy support to ensure the achievement of the target. We believe an aggressive target is warranted to restore confidence, prevent the deflationary pressure from becoming self-fulfilling, and avoid another year of sluggish growth to further erode long-term consumer and business confidence.

The late-year announcement of Rmb1tr sovereign bond issuance indicates strong determination by the government to jumpstart the economy in 2024F and ensure the sustainability of the current recovery momentum. The meeting statement for the Dec Politburo meeting introduced a new term “promoting stability using progress”, sending a strong signal that the growth target will be set at a more aggressive level. Besides, our calculations indicate that China would need to achieve a CAGR of approximately 4.7% from 2022 to 2035F in order to meet the goal of doubling the size of the economy between 2020 and 2035F, as mentioned by President Xi Jinping in 2020.

China will step up policy support to ensure the aggressive target will be achieved. The intensity of policy support for 2024F will be much higher compared to 2023, and the pace will be more frontloaded, in our view. We expect the fiscal deficit ratio target to be set at a relatively high level of around 3.5%, while the local government special bond quota will be around Rmb4tr. The “three major projects” – namely affordable housing, urban village redevelopment and public infrastructure for both civil and emergency purposes - will play a key role in offsetting the drag on GDP growth from further decline in property investment, in our view. The government will provide more direct funding support for these projects, likely through PBOC lending facility (i.e., PSL). Besides, more forceful direct financing support will be introduced for property developers, in order to break the negative feedback loop between developer stress and weak housing demand. We also see the likelihood for authorities to provide low-cost financing to local governments for them to purchase homes from developers and offer them as public rental housing to low-income people. To facilitate fiscal policy, the central bank will maintain an easy monetary policy stance, with potential policy rate cut of around 20bp and more RRR cuts.

Central government will shoulder more expenditure responsibility in the long term. China has historically relied on local governments to carry out countercyclical measures, resulting in rapid increase in both explicit and hidden local debt burden. The Central Financial Work Conference held over 30-31 Oct 2023 stressed the need of “optimising the debt structure of central and local governments”. The recent announcement of Rmb1tr sovereign bond issuance also sends an encouraging signal that in the longer term the central government is willing to take on more leverage and shoulder greater fiscal responsibilities, pivoting away from the old growth model. The official central government debt was only 21% of GDP as of 2022, providing plenty of room to leverage up. Meanwhile, local governments will focus more on debt defusing and risk containment over the next two to three years, with the likelihood of a new round of debt swaps amounting to c.Rmb1tr in 2024F.

Figure 4: The central government still has plenty of room to leverage up



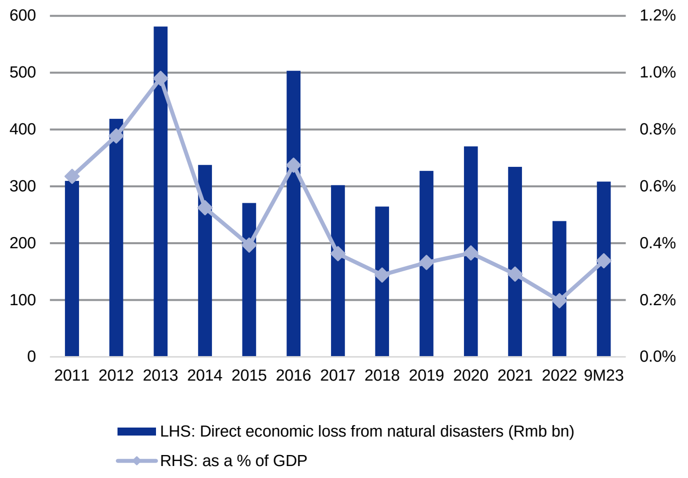
SOURCES: CGS-CIMB RESEARCH, NATIONAL INSTITUTION FOR FINANCE & DEVELOPMENT

Fiscal policy: more expansionary, frontloaded and flexible

Most of the policy impact of Rmb1tr sovereign bond issuance will be reflected in 2024F. On 21 Oct 2023, the NPC approved additional sovereign bond issuance amounting to Rmb1tr. The additional bonds were issued in 4Q23 and allocated to local governments through transfer payments. The announcement said half of the funds will be utilised in 2023 while the remaining Rmb500bn will be carried forward to in 2024. The funds raised will mainly be used to 1) support post-disaster recovery and reconstruction efforts, 2) address weaknesses in disaster prevention, reduction and relief, and 3) enhance China's overall ability to withstand natural disasters. As of 23 Dec 2023, more than Rmb800bn of the additional sovereign bond has been earmarked to two batches of public investment projects. Given the timing of the announcement and considering that most of the funds will be allocated to North China and Northeast China (i.e, Beijing-Tianjin-Hebei, Jilin and Heilongjiang) which generally experience a slowdown or suspension of construction during the winter season, we expect that the majority of the policy impact to be reflected in 2024F instead of 4Q23.

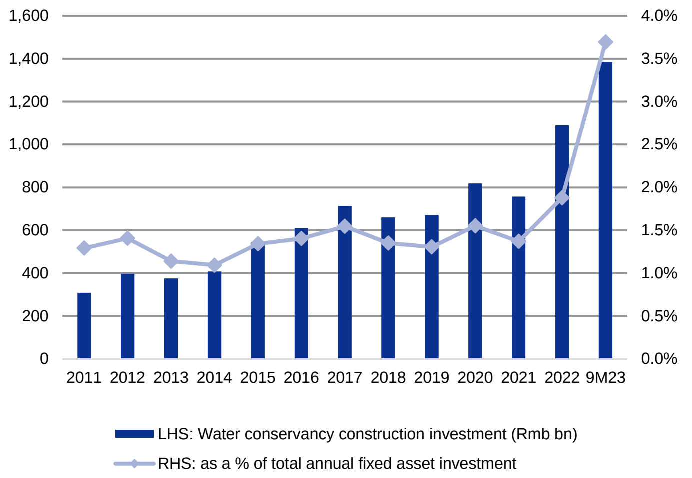
Budget deficit ratio and local government special bond quota to be set at around 3.5% and Rmb4tr respectively. The recent plan to issue additional sovereign debt will raise the 2023 fiscal deficit ratio from 3.0% to 3.8%. The upward adjustment to budget deficit also paves the way for China to potentially exceed the 3% red line that it has adhered to in the future. China has historically kept its budget deficit ratio at or below 3%, with recent exceptions being the pandemic years of 2020 and 2021. For 2024F, we expect the fiscal deficit ratio target to be set at around 3.5%. We expect the local government special bond quota to be around Rmb4tr (2023: Rmb3.8tr). Policymakers will also retain flexibility in setting fiscal policy, with the likelihood of mid-year adjustment to fiscal deficit ratio/additional sovereign bond issuance, or introduction of a new round of policy-based developmental financial instruments through policy banks, if recovery momentum deteriorates.

Figure 5: Direct economic loss from natural disasters reached Rmb300bn in 9M23



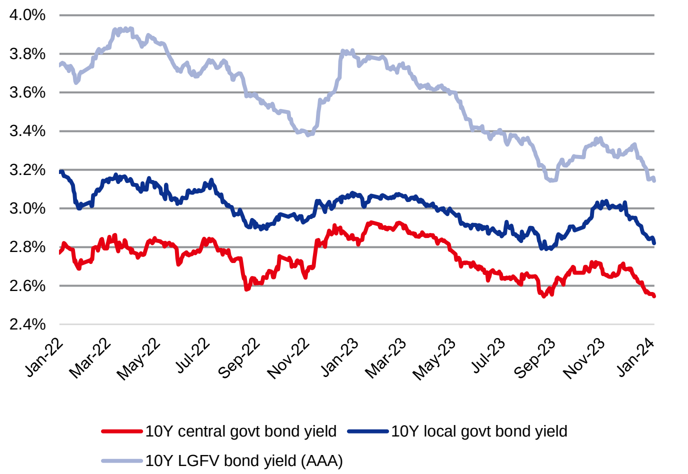
SOURCES: CGS-CIMB RESEARCH, MINISTRY OF EMERGENCY MANAGEMENT, WIND

Figure 6: China stepped up investments in water conservancy projects in recent years



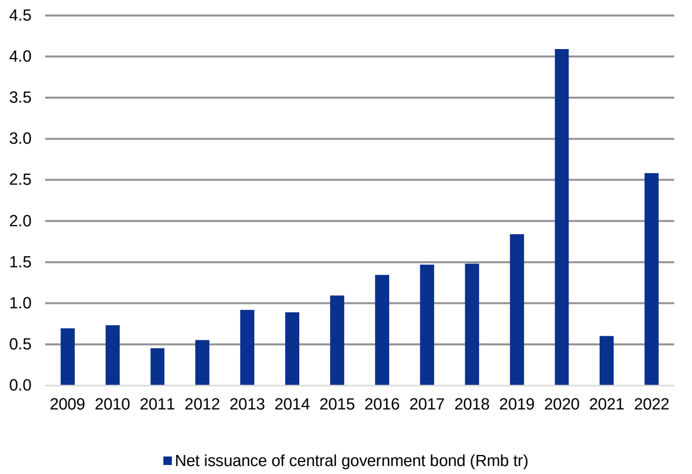
SOURCES: CGS-CIMB RESEARCH, WIND, MINISTRY OF WATER RESOURCES

Figure 7: Central government can issue bonds at lower interest rates compared to local governments



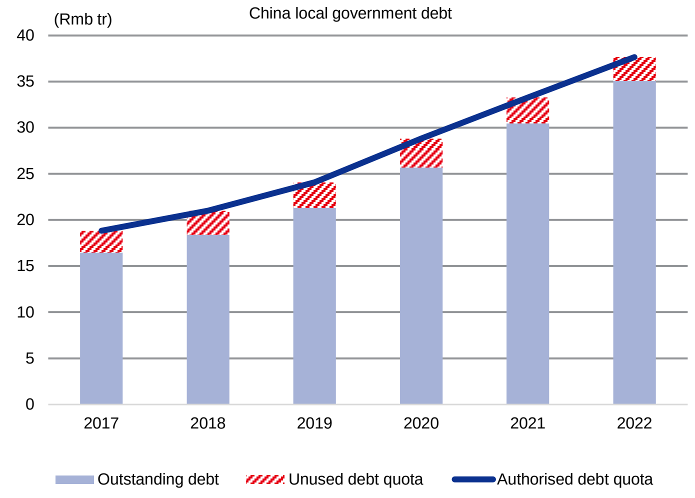
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 8: Net issuance of sovereign bond reached Rmb2.6tr in 2022



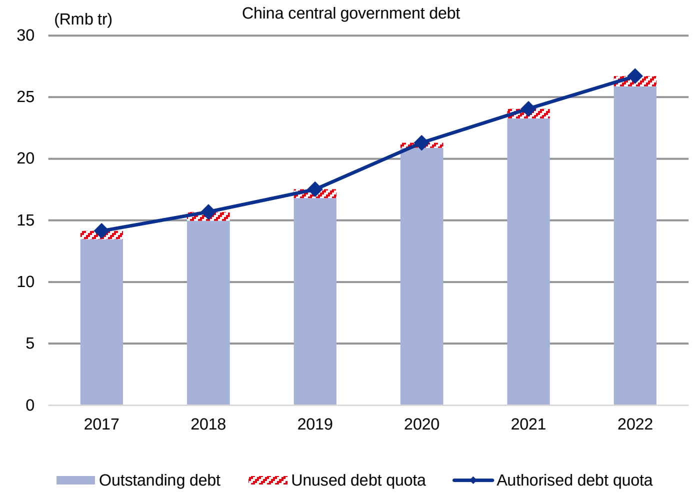
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 9: Local governments had c.Rmb2.6tr unused debt quota as of end-2022



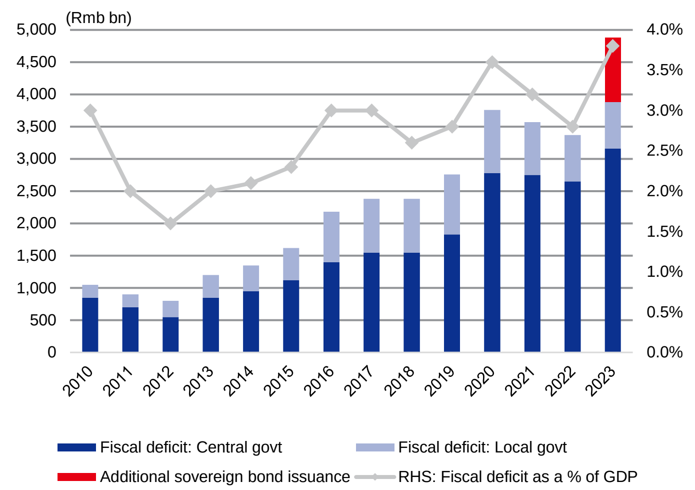
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 10: Central government had c.Rmb830bn unused debt quota at end-2022



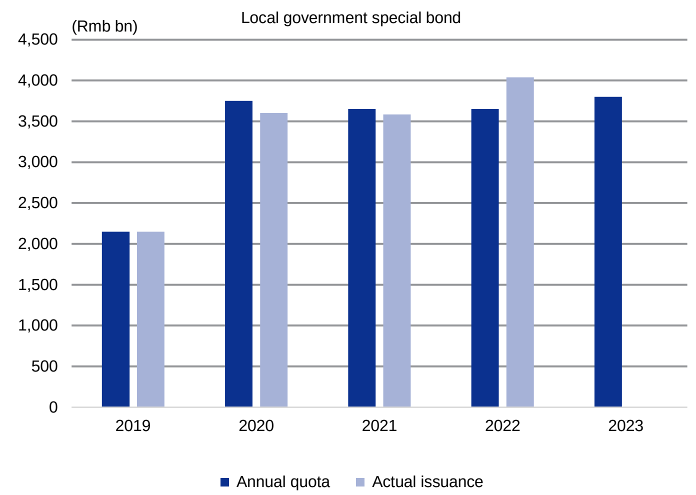
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 11: Fiscal deficit ratio target for 2023 was raised from 3.0% to 3.8%



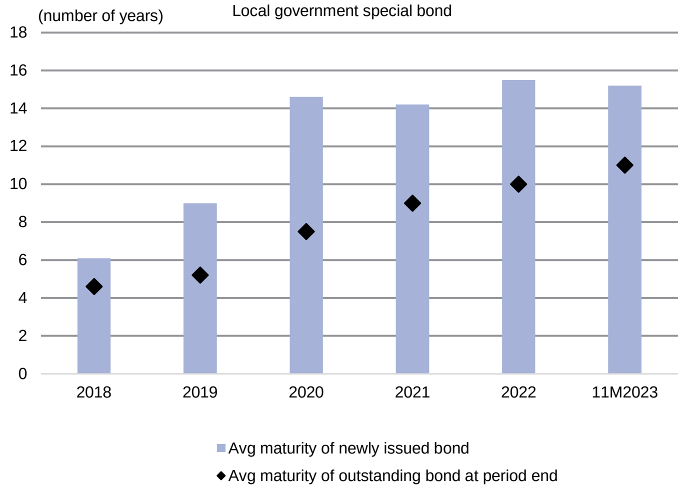
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 12: Local government special bond quota was set at a slightly higher level in 2023 than the previous year



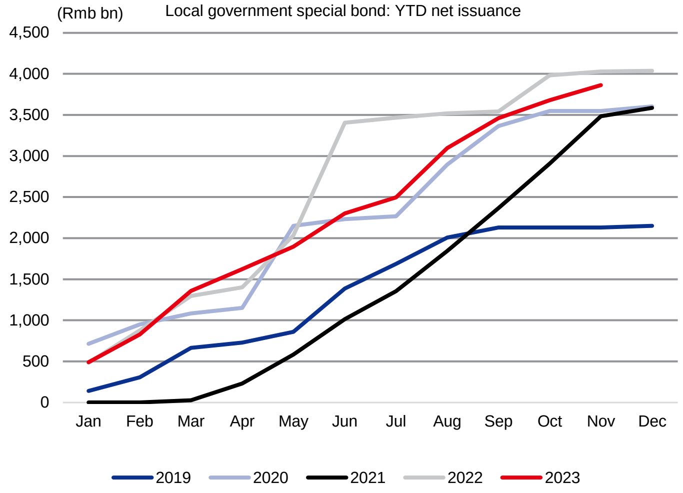
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 13: The maturity structure of local government special bonds has been improving



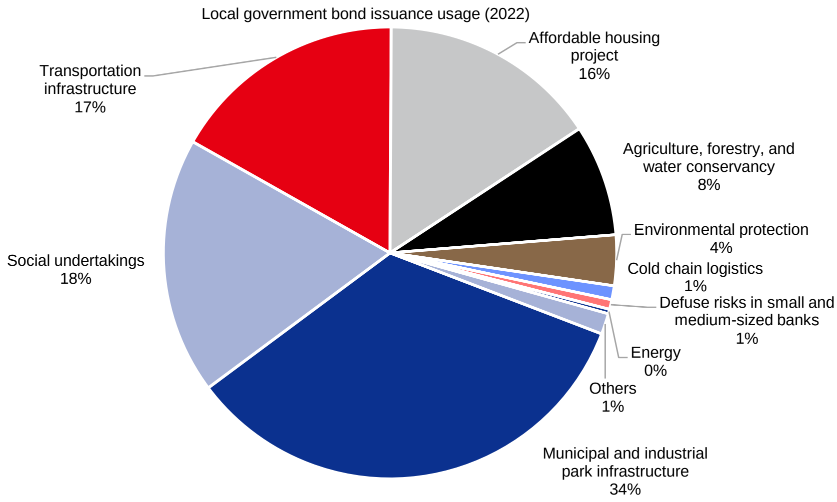
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 14: Issuance of local government special bond has been more backloaded compared to last year



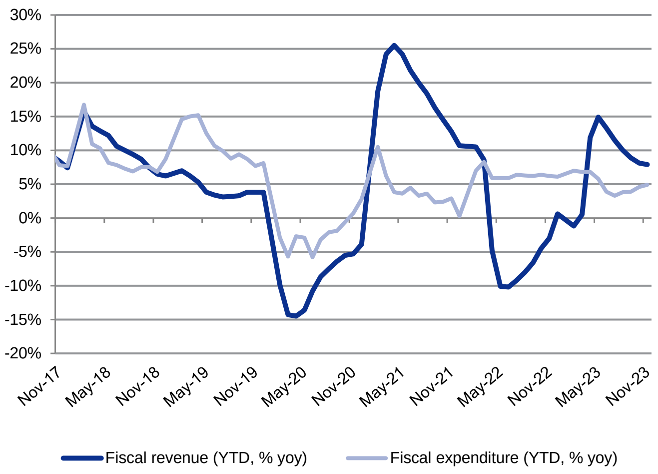
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 15: The funds raised through local government special bond issuance were used for municipal and industrial parks, social undertaking, transportation infrastructure and affordable housing projects in 2022



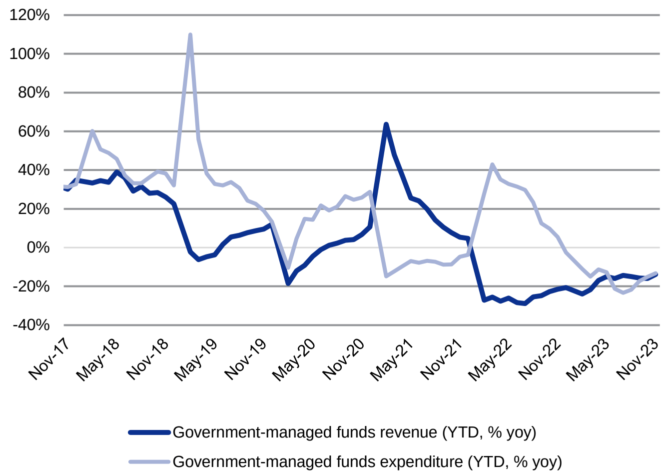
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 16: Fiscal revenue growth slowed in recent months



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 17: Revenue of government-managed funds continued to slump due to decline in land sales revenue



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 18: On 31 Aug 2023, the State Council announced an increase in pre-tax deductions for certain expenses related to childcare, education, and elderly support. The new deductions will be retroactively applied from 1 Jan 2023

Deductible item	Deductible amount (Before)	Deductible amount (After)
Care expense for children under the age of 3	Rmb**1,000** per child per month	Rmb**2,000** per child per month
Elderly care	Up to Rmb**2,000** per month depending on the status	Up to Rmb**3,000** per month depending on the status
Child education	Rmb**1,000** per child per month	Rmb**2,000** per child per month
Continued education	Rmb400 per month or Rmb3,600 per year depending on the type of qualified continued education	No change
Mortgage interest	Rmb1,000 per month	No change
Rental expense	Rmb800, Rmb1,100, or Rmb1,500 per month depending on the location	No change
Major medical expense	Qualified self-paid portion above Rmb15,000 and capped at Rmb80,000 per year for each eligible individual	No change

SOURCES: CGS-CIMB RESEARCH, STATE COUNCIL

Property policy: break the negative feedback loop

The impact of favourable demand-side policies has been below expectations. Policymakers implemented favourable demand-side property policies since late Aug 23, including revising the definition of “first-time homebuyers”, reducing the downpayment ratio for the first and second homes, and lowering the mortgage loan rates on the second home. Property sales briefly rebounded in tier 1 cities on a month-over-month basis in Sep 23 but the policy impact started to diminish since Oct 23. Secondary-market listings rose significantly since the introduction of favourable policy. However, overall housing demand remained sluggish, leading to difficulties for middle and high-income households which are looking to upgrade to sell their existing property.

Property development investment will decline further in 2024F based on leading indicators. Property development investment slumped 9.4% yoy in 11M23. The decline in YTD property investment has been partly mitigated by the strong growth in new home completions, which rose 17.9% yoy in 11M23 due to policymaker's effort to ensure delivery of unfinished housing projects. However, new home starts declined by 21.2% yoy in 11M23. The significant decline in new home starts suggest that new homes under construction might shrink further in 2024F, weighing on property investment. The persistent weakness in property investment shows that more supportive policies ahead are warranted, in our view.

We expect policymakers to step up policy support for property sector on multiple fronts. Looking ahead, we believe the policymakers' bottom line is to prevent further collapses among large developers, which will further weigh on the confidence of potential homebuyers and exacerbate the current negative feedback loop between developer stress and weak housing demand. In the longer term, policymakers have laid out the blueprint of building "a new property development model", a structural shift toward a property sector with improved supply of affordable housing for lower-income households.

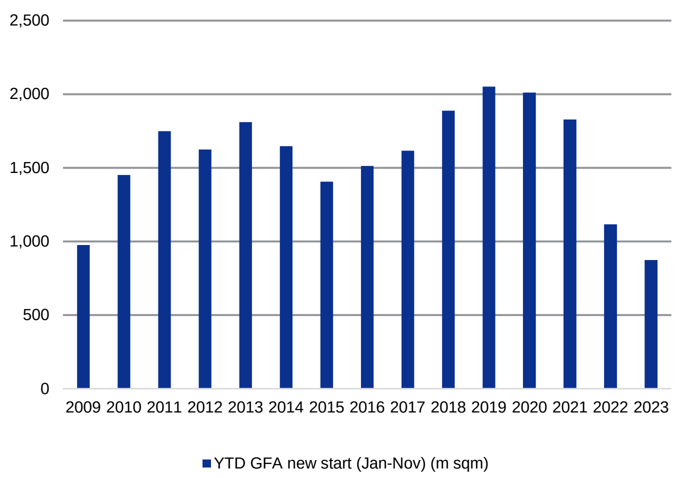
For 2024F, potential policy support might include 1) further relaxation of home purchase restrictions and reduction in downpayment ratio and mortgage rates, 2) stepping up financing support for developers, and 3) providing direct funding support for "three major projects" to partially offset the decline in commercial residential property investment. We also see the likelihood for authorities to provide low-cost financing to local governments for them to purchase homes from developers and offer them as public rental housing to low-income people, a policy option raised by PBOC governor Pan Gongsheng during his keynote speech made in Hong Kong in Nov 23.

We expect forceful measures to be taken to better meet financing needs of developers. Since late 2022, regulators have repeatedly urged banks to step up credit support and fulfil the financing needs of different types of developers. However, policy implementation has so far fallen short of expectations. The collective risk aversion behaviour of banks has led to credit being disproportionately allocated toward state-owned enterprise (SOE) developers ("faith in SOEs"). The Central Financial Work Conference held in late Oct 23 emphasised the importance of meeting the reasonable financing needs of different types of property developers. On 17 Nov 2023, top financial regulators jointly introduced three "not lower than" directives: i) each bank should ensure that its own property loan growth rate is not lower than the industry average; ii) the growth rate of corporate loans for non-SOE developers should not be lower than the bank's overall property loan growth rate; and iii) the growth rate of residential mortgages for homes purchased from non-SOE developers should not be lower than the bank's overall mortgage growth rate. Caixin media also reported that the regulators are drafting a whitelist, which will probably cover more than 50 SOE and private developers. The introduction of the three "not lower than" guideline is the first time that regulators have clearly stipulated how they would like the policy of stepping up credit support for developers be enforced. We expect the policies to mainly benefit large private developers and quasi-SOEs.

"Three major projects" will play a key role in growth stabilisation in 2024F. Both the politburo meeting held in late Jul 23 and the Central Financial Work Conference held in late Oct 23 highlighted the new property development model, which is based on the "three major projects" – including affordable housing, urban village redevelopment and public infrastructure for both civil and emergency purposes. We expect policymakers to step up direct funding support in 2024F for these projects, especially affordable housing and urban village redevelopment, in order to partially offset the decline in commercial residential property investment. In the longer term, we expect the improvement in the supply of affordable housing will help address the structural shortage of housing supply in regions/city clusters experiencing population inflow, as well as encourage consumption by reducing precautionary saving.

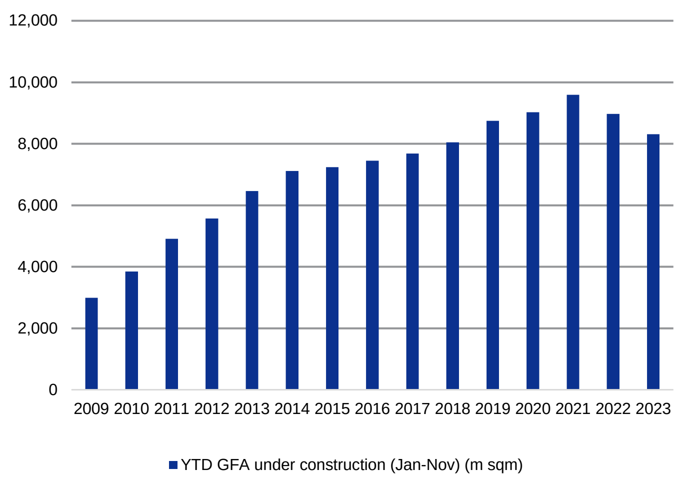
Pledged Supplementary Lending (PSL) is likely to be used by the authorities to provide additional low-cost and long-term funding. PSL is a monetary policy tool for the central bank to inject long-term liquidity into the banking system, and an off-budget channel for the government to raise funds for major projects. It was originally designed to support shantytown redevelopment programme over 2015 to 2018 and was again briefly revived in late 2022 to help policy banks provide funding to infrastructure projects during the pandemic. Data released by PBOC showed that the central bank made Rmb350bn in loans to policy banks through PSL in Dec 23. We expect to see more PSL issuance in the next few months. We estimate the size of funding to increase by around Rmb1tr in 2024F compared to 2023, with the possibility of topping up in the middle of the year if further downward pressure on the economy emerges.

Figure 19: YTD new property starts (measured by area) have fallen to 43% of the 2019 level



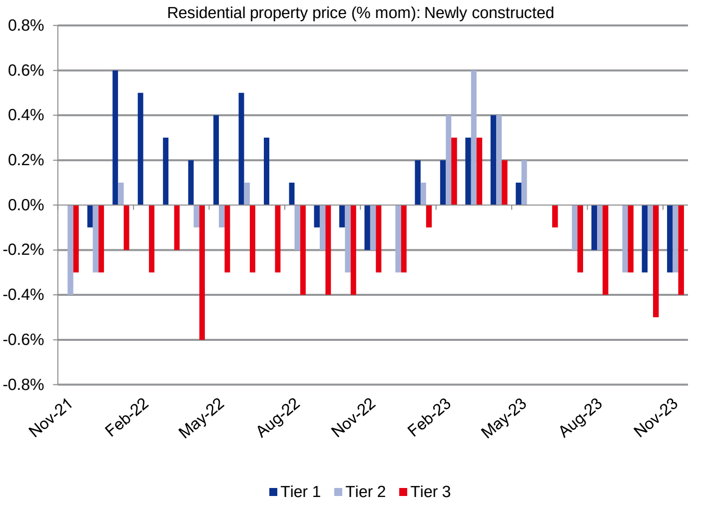
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 20: YTD GFA under construction has fallen to 87% of the 2021 level



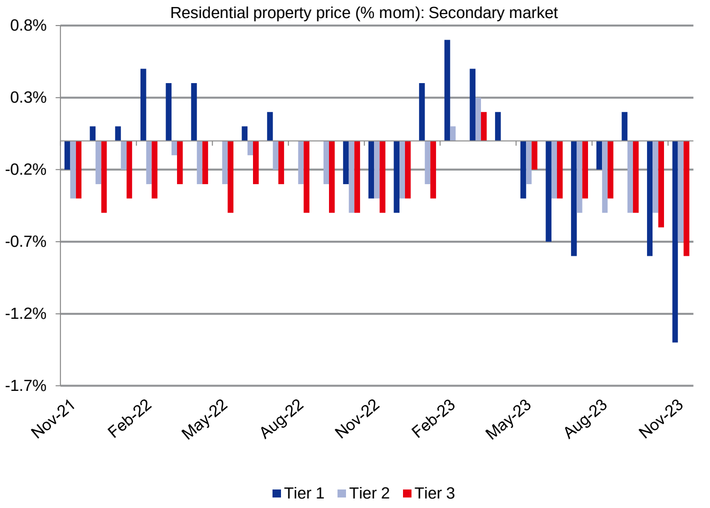
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 21: The mom decline in new home prices widened in Oct 23 and Nov 23



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 22: The mom decline in second-hand home prices widened further in Nov 23



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 23: The impact of demand-side property policy introduced in late-Aug 23 had largely diminished

	Property sales (by floor area, % yoy)				Property sales (by floor area, % mom)			
	Top 30 cities	**Tier 1**	**Tier 2**	**Tier 3**	**Top 30 cities**	**Tier 1**	**Tier 2**	**Tier 3**
Jan 23	**-40.0%**	-31.4%	-43.9%	-38.8%	**-39.5%**	-20.2%	-43.8%	-45.9%
Feb 23	**31.4%**	9.8%	27.1%	78.5%	**29.4%**	5.5%	34.0%	48.5%
Mar 23	**44.9%**	63.0%	35.5%	52.9%	**47.6%**	52.7%	42.4%	55.1%
Apr 23	**31.2%**	127.4%	15.0%	13.7%	**-23.2%**	-12.0%	-24.5%	-30.6%
May 23	**24.6%**	86.1%	19.1%	0.2%	**3.8%**	-9.7%	16.0%	-9.8%
Jun 23	**-32.0%**	-18.5%	-38.7%	-24.3%	**-5.0%**	8.4%	-10.3%	-4.1%
Jul 23	**-26.7%**	-16.9%	-32.4%	-23.0%	**-23.9%**	-15.8%	-29.2%	-19.3%
Aug 23	**-22.8%**	-30.4%	-15.6%	-31.2%	**-1.0%**	-18.2%	10.3%	-5.9%
Sep 23	**-22.3%**	-24.7%	-16.7%	-31.9%	**7.7%**	26.9%	-0.1%	7.9%
Oct 23	**-2.6%**	-7.7%	9.8%	-23.2%	**2.7%**	-10.8%	10.2%	1.2%
Nov 23	**-15.2%**	-17.2%	-7.4%	-29.9%	**-7.0%**	-6.9%	-8.2%	-3.3%
Dec 23	**-11.6%**	-6.5%	-10.3%	-19.3%	**30.3%**	16.5%	34.7%	34.6%

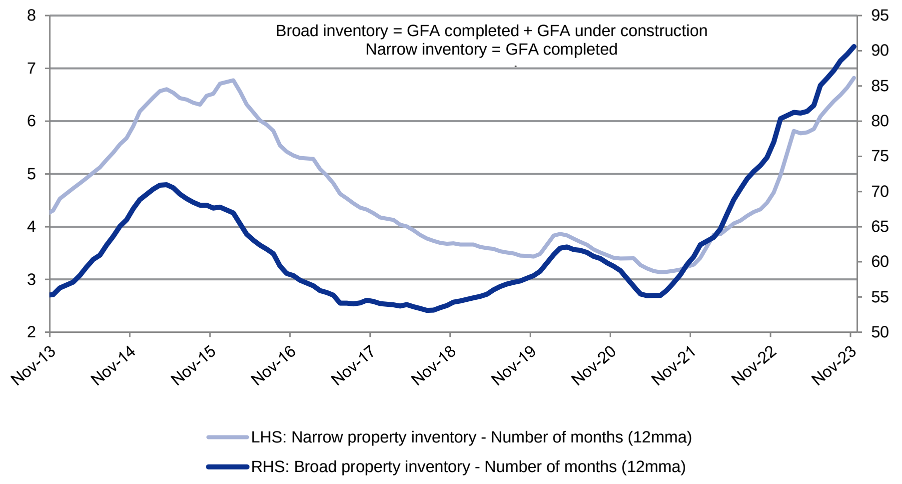
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 24: The latest policy tone on property sector stressed meeting reasonable financing needs of different types of property developers

Date	Policy statement on property sector
Central Economic Work Conference 12 Dec 2023	Actively and prudently resolve property related risks, **treat different types of property developers equally to meet their reasonable financing needs**, and promote the stable and healthy development of the property market. Accelerate the construction of affordable housing, "dual-use" public infrastructure, and the redevelopment of urban villages, known as the "Three Major Projects". Improve relevant fundamental systems and accelerate the establishment of a new model for property development.
Politburo meeting 24 Jul 2023	To effectively prevent and resolve risks in key areas, it is important to **adapt to the significant changes in the supply-demand relationship in China's property market**. It is necessary to timely adjust and optimise property policies, apply differentiated policies according to local conditions, and make good use of the policy toolbox to better meet both basic housing needs and the demand for better housing, promoting the stable and healthy development of the property market. Efforts should be made to increase the construction and supply of affordable housing, actively promote the redevelopment of urban villages and the construction of "dual-use" public infrastructure, and effectively utilise and transform various types of idle properties.
Politburo meeting 28 Apr 2023	**Adhere to the principle that houses are for living in, not for speculation.** Implement tailored measures based on the specific circumstances of each city, support both basic housing needs and the demand for better housing. Carry out various tasks such as **ensuring the completion of housing projects**, sustaining the stability of people's livelihoods, and safeguarding the overall stability. Promote the stable and healthy development of the property market, and promote the establishment of new development model of the property sector. Actively and steadily promote the redevelopment of urban villages in megacities and the construction of "dual-purpose" public infrastructure. Plan and construct affordable housing.
Central Economic Work Conference 7 Dec 2022	Ensure the stable development of the property market, effectively carry out various tasks such as **ensuring the completion of housing projects**, maintaining the stability of people's livelihoods, and safeguarding the overall stability. Meet the reasonable financing needs of the industry, promote industry restructuring and mergers, and effectively prevent and resolve risks associated with top-quality property developers. Additionally, efforts should be made to improve the asset-liability situation. Adopt differentiated policies based on each city's circumstances, support both the basic housing needs and the demand for better housing. Address the housing issues faced by new residents, young people, and others, and explore the development of the long-term rental housing market. **Adhere to the principle that houses are for living in, not for speculation.** Promote a smooth transition of the property sector towards new development models.

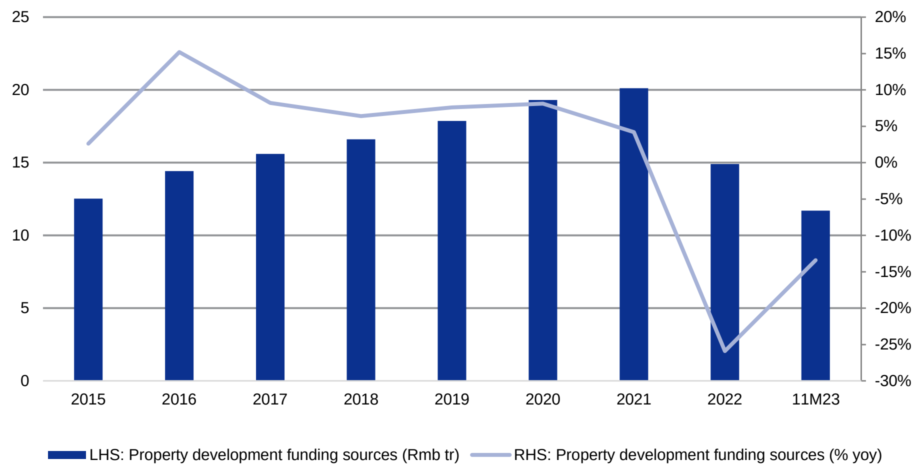
SOURCES: CGS-CIMB RESEARCH, XINHUA NEWS AGENCY

Figure 25: Excess inventory implies a prolonged period of depressed new-home construction



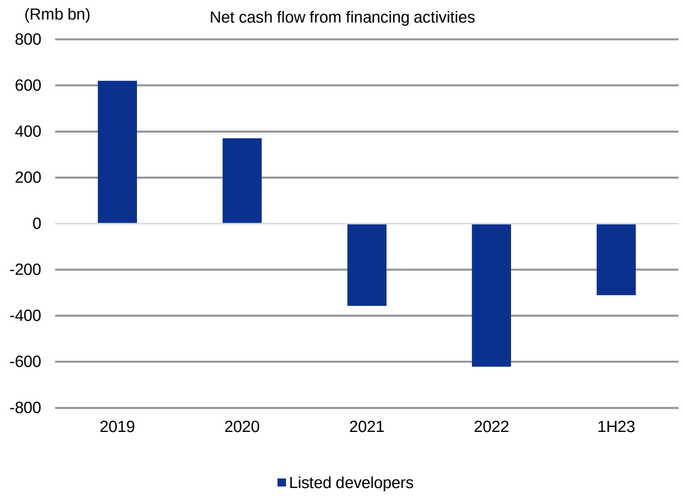
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 26: Developers' funding conditions deteriorated further in 2023



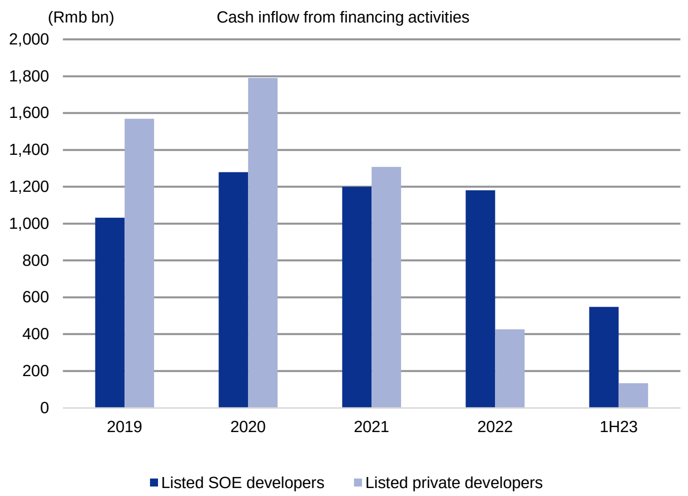
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 27: Net cash flow from financing activities for listed developers remained negative in 1H23



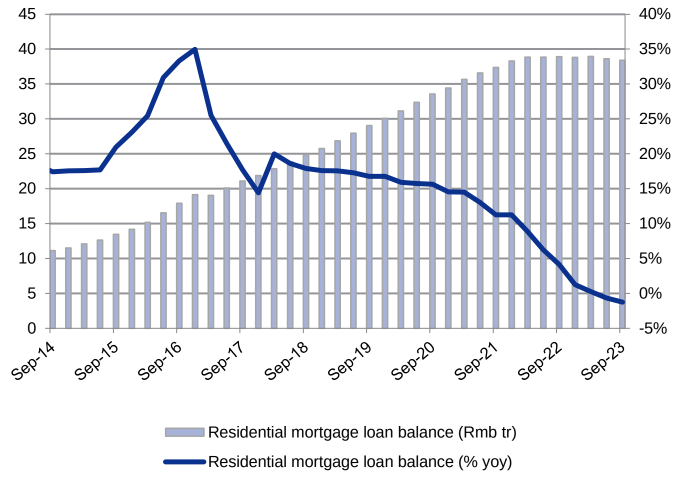
SOURCES: CGS-CIMB RESEARCH, NATIONAL INSTITUTION FOR FINANCE & DEVELOPMENT

Figure 28: Financing cash flow diverged between SOE and private developers due to strengthening of "faith in SOE" by banks



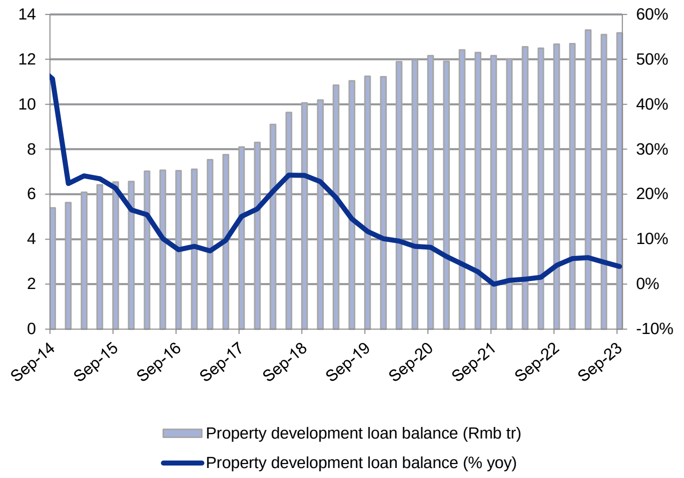
SOURCES: CGS-CIMB RESEARCH, NATIONAL INSTITUTION FOR FINANCE & DEVELOPMENT

Figure 29: Residential mortgage loan balance continued to register negative yoy growth



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 30: The growth rate of property development loan remained sluggish



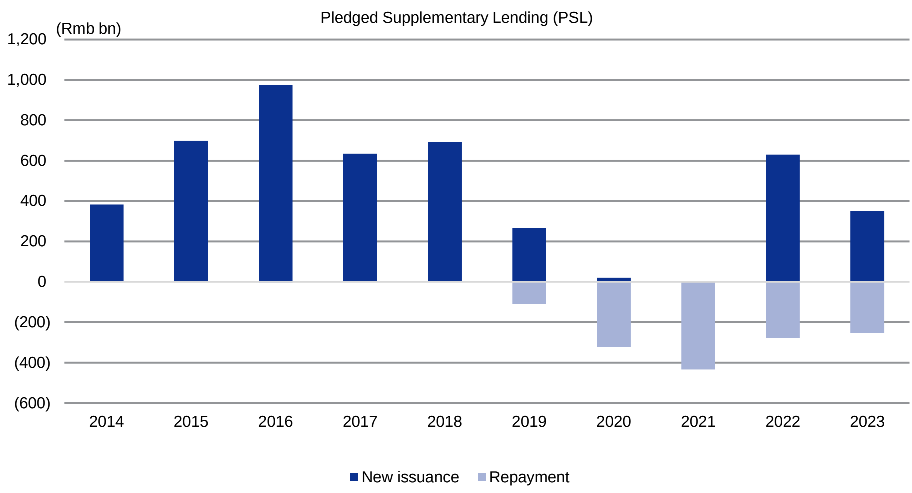
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 31: Three structural monetary policy tools targeting property sector have barely been used as of end-Sep 2023

PBOC structural monetary policy tools	Designated financial institutions	The scope of policy support	Interest rate	Quota	Utilisation	Begin	End
				(Rmb bn)	(Rmb bn)		
Special facility to ensure delivery of housing projects	Six large banks	Issue loans to ensure delivery of housing projects that has been sold but whose delivery has been delayed	0.00%	200	5.6	Dec 22	May 24
Affordable rental housing loans support facility	Six large banks and China Development Bank	Launch pilot project in eight cities, including Chongqing, Jinan, Zhengzhou, Changchun, Chengdu, Fuzhou, Qingdao and Tianjin; support the designated financial institutions to acquire existing housing projects and expand the supply of rental housing	1.75%	100	0.0	Feb 23	Dec 23
Relending facility to provide support to distressed property developers	Five nationwide AMCs	Support nationwide AMCs to acquire housing projects from distressed property developers	1.75%	80	0.0	Jan 23	Dec 23

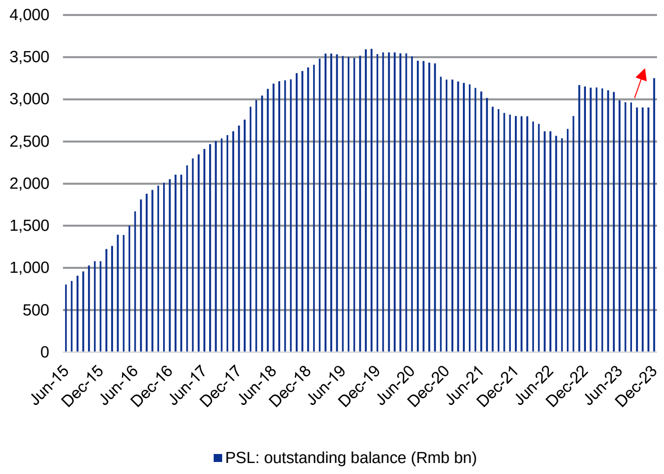
SOURCES: CGS-CIMB RESEARCH, PBOC

Figure 32: PBOC's PSL played a key role in the 2015-18 monetised shanty town renovation projects



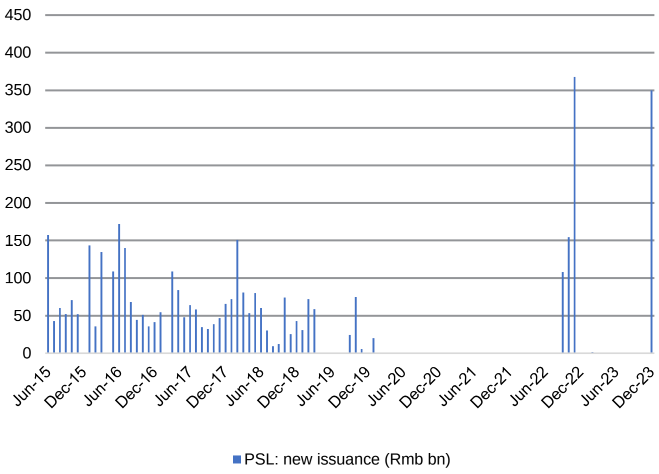
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 33: PBOC made Rmb350bn in loans to policy banks through PSL in Dec 23



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 34: In late 2022, PBOC also provided low-cost loans through PSL of around Rmb630bn to fund infrastructure projects



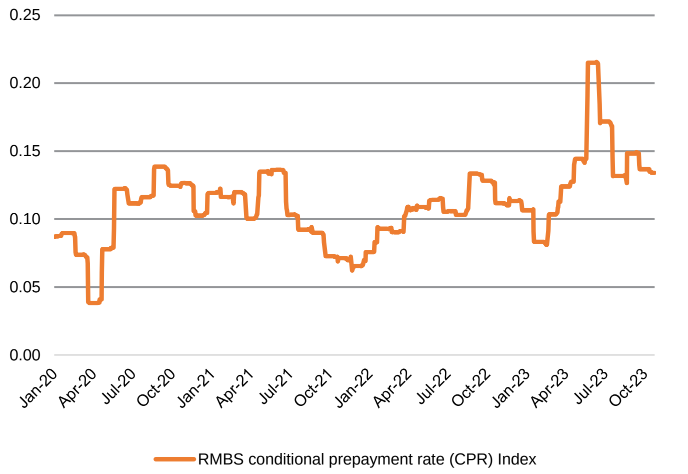
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 35: There are 7 mega cities and 14 super cities in China, which will be covered by the initiative of urban village redevelopment

(million)	Population	Urban residential population
Mega cities (urban residential population: > 10m)		
Shanghai	24.87	19.87
Beijing	21.89	17.75
Shenzhen	17.49	17.44
Chongqing	32.05	16.34
Guangzhou	18.68	14.88
Chengdu	20.94	13.34
Tianjin	13.87	10.93
Super cities (urban residential population: 5m-10m)		
Wuhan	12.45	9.95
Dongguan	10.47	9.56
Xi'an	12.18	9.28
Hangzhou	11.94	8.74
Foshan	9.50	8.54
Nanjing	9.31	7.91
Shenyang	9.07	7.07
Qingdao	10.07	6.01
Jinan	9.20	5.88
Changsha	10.05	5.55
Harbin	10.01	5.50
Zhengzhou	12.60	5.34
Kunming	8.46	5.34
Dalian	7.45	5.21
Total	**292.55**	**210.43**

SOURCES: CGS-CIMB RESEARCH, WIND

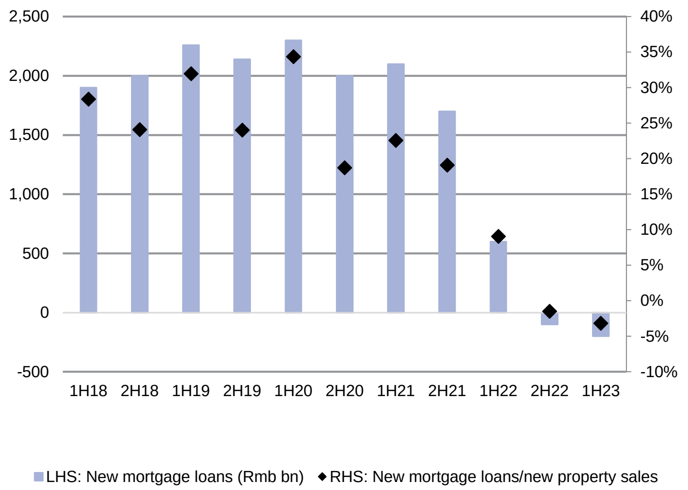
Figure 36: The RMBS CPR Index shows that the trend of mortgage prepayment has started to slow



SOURCES: CGS-CIMB RESEARCH, WIND

Note: The index is calculated based on the pool of residential mortgage-backed securities that are publicly listed in the domestic market only

Figure 37: Our estimation shows excess mortgage prepayment amounted to c.Rmb2.8tr over 2022 and 1H23



SOURCES: CGS-CIMB RESEARCH, WIND

Monetary policy: space for interest rate cuts has narrowed

Interest rate cut and RRR cut: PBOC implemented two rounds of rate cuts in 2023, in Jun and Aug, respectively. The reserve requirement ratio was also lowered twice, in Mar and Sep respectively. Looking ahead, as the US comes to the end of its monetary policy tightening cycle and starts to implement rate cuts, we expect PBOC to carry out LPR cuts of around 20bp in 2024F as the narrowing interest rate differential reduces the pressure on renminbi exchange rate. In mid-Dec 23, major commercial banks coordinated the third round of deposit rate cut in 2023, which probably paves the way for a policy rate cut in 1Q24F. We also see the likelihood of further RRR cuts to ensure reasonable and sufficient liquidity and accommodate additional bond issuance.

However, room for significant interest rate cuts is quite limited in China, in our view.

- The net interest margins (NIM) of Chinese banks have been on a downward trajectory since 2020 and they are faced with increasing margin pressure. The PBOC monetary policy report for 2Q23 stressed the need for commercial banks to maintain reasonable levels of profit and NIM level, in order to support loan extension to the real economy and leave sufficient capital buffer for credit provision.
- China's major commercial banks coordinated three rounds of deposit rate reductions in 2023, in an effort to protect profitability. However, the room for further reductions is also limited as i) the deposit rate on demand deposit has already been lowered to 0.2%; and ii) depositors might transfer more deposit toward longer-term fixed deposits, weighing on household consumption and investment.
- Lowering interest rates has so far shown limited evidence of simulating spending and borrowing. Credit demand has remained weak in recent months. Meanwhile, money supply has been growing at a faster pace than total social finance, indicating blockage in the transmission of easy monetary policy to credit expansion.
- The interest rate differential between China and the US will have an impact on the renminbi exchange rate.

Structural monetary policy tools:

i) As mentioned in the previous section, we expect the authorities to use monetary policy tools, such as pledged supplementary lending (PSL), to provide low-cost and long-term funding for China's "three major projects". Data released by PBOC showed that the central bank made Rmb350bn in loans to policy banks through PSL in Dec 23 and we expect to see more PSL issuance in the next few months.

ii) In order to help local governments address the hidden debt risks, the PBOC will set up an emergency liquidity tool (SPV) to provide short-term liquidity to LGFVs when needed.

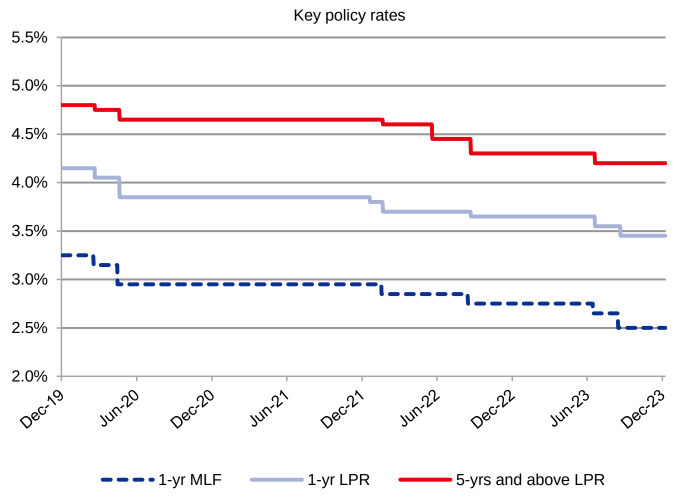
iii) PBOC set up three structural tools in late 2022 and early 2023, with an aggregated quota of Rmb380bn, to support the property market. As of end-Sep 2023, the facilities have only recorded utilisation of Rmb5.6bn. We expect policymakers to promote the utilisation of these tools to extend support to property developers.

Figure 38: China has reduced policy rates twice since mid-2023

Monetary policies implemented since mid-2023			
Type of policy tools	**Interest rate cut**	**Structural monetary policy tools**	**RRR cut**
Date and announcement	On 20 Jun 2023, the PBOC announced that it will reduce the one-year and five-year Loan Prime Rate (LPR) by 10bp respectively. On 21 Aug 2023, the PBOC announced that it will lower the one-year LPR by 10bp again, while keeping the five-year LPR unchanged.	On 30 Jun 2023, the PBOC announced that it has decided to increase the relending and rediscount quota for the agricultural sector and small enterprises by Rmb200bn.	On 14 Sep 2023, the PBOC announced that it will lower the reserve requirement ratio (RRR) by 25bp from 15 Sep 2023. The move is expected to free up over Rmb500bn in medium to long term liquidity.

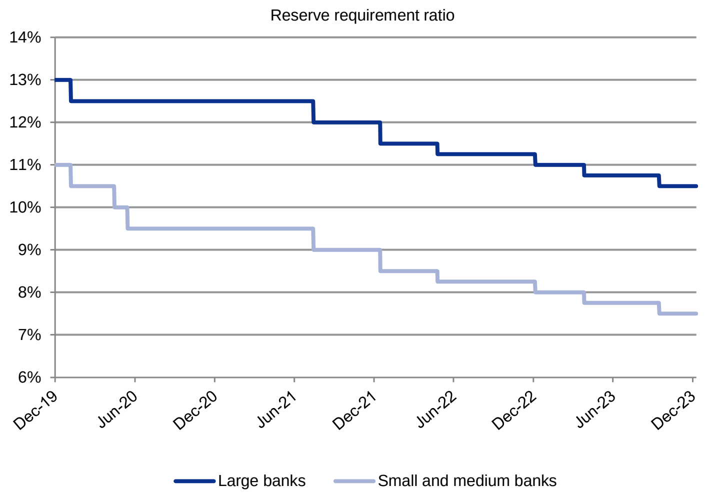
SOURCES: CGS-CIMB RESEARCH, PBOC

Figure 39: China's key policy rates have been gradually declining since the launch of LPR reform in 2019



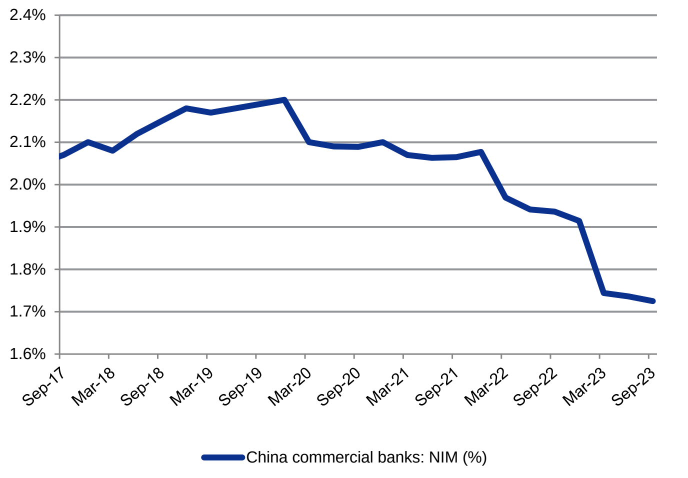
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 40: Reserve requirement ratio was cut in Sep 23



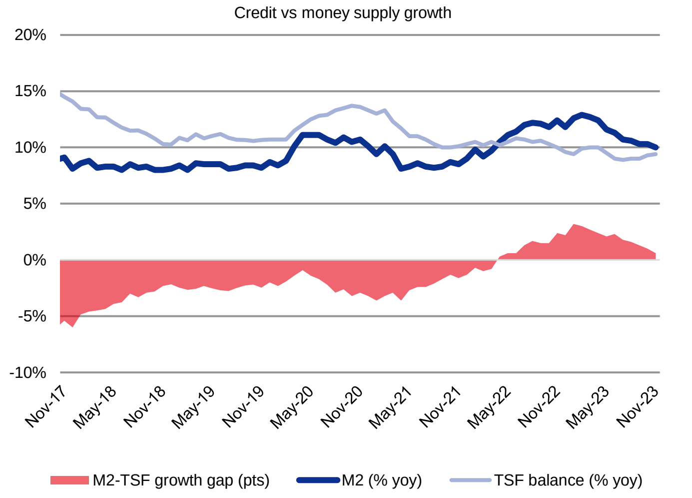
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 41: Chinese banks face increasing margin pressure



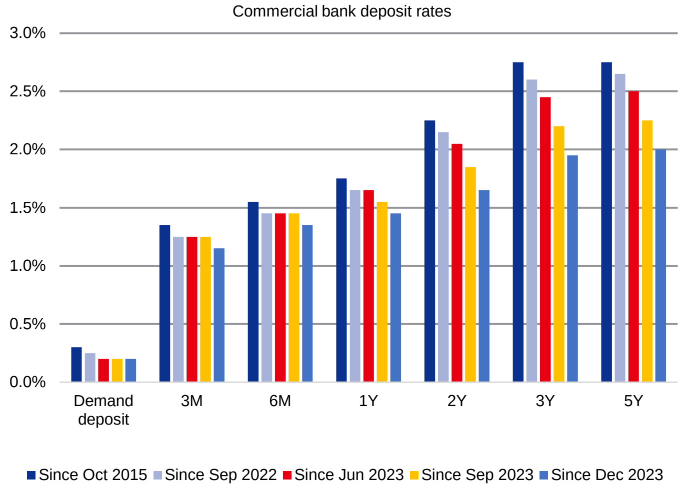
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 42: Money supply has been growing at a faster pace than total social finance



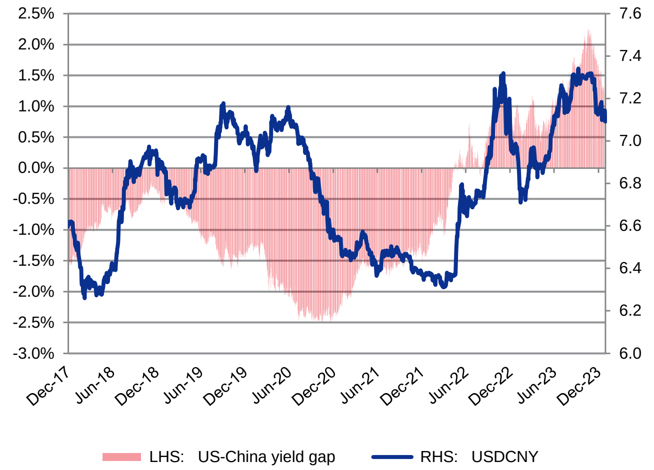
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 43: Chinese banks implemented three rounds of deposit rate cuts in 2023 to cushion the impact from margin squeeze



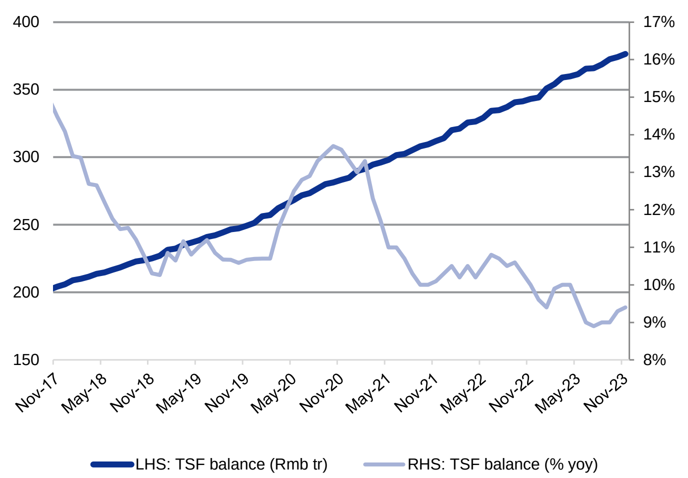
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 44: The interest rate differential between China and the US can have an impact on the renminbi exchange rate



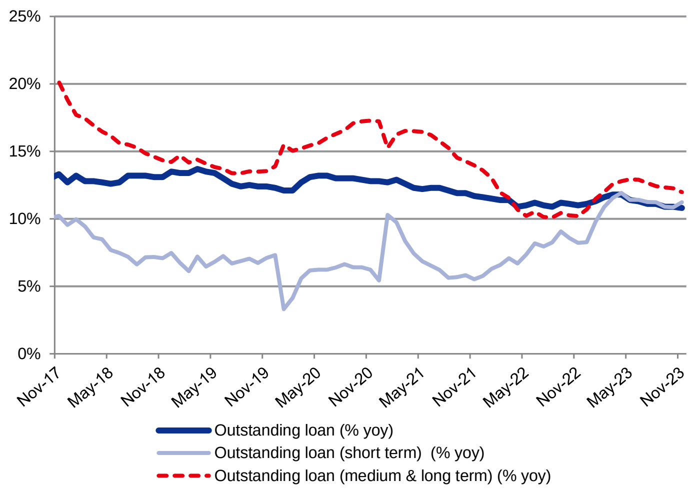
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 45: Total social financing balance rose 9.4% yoy in Nov 23



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 46: Outstanding loan balance rose 11.2% yoy in Nov 23



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 47: The aggregate outstanding balance of structural monetary policy tools was Rmb7.0tr as of end-Sep 2023, amounting to 16% of the central bank's total assets

PBOC structural monetary policy tools	Status	Interest rate	Quota	Balance	Begin	End
		(1Y)	(Rmb bn)	(Rmb bn)		
Long-term tools						
Re-lending facility targeting small enterprises	Continued	2.00%	1,785	1,565.5	2014	N/A
Re-lending facility for agriculture	Continued	2.00%	810	599.1	1999	N/A
Rediscount facility	Continued	2.00%	740	528.9	1986	N/A
Short-term tools						
Carbon-emission reduction facility (CERF)	Continued	1.75%	800	509.8	Nov 21	Dec 24
Re-lending for clean and efficient use of coal	Continued	1.75%	300	262.4	Nov 21	Dec 23
Special facility to ensure delivery of housing projects	Continued	0.00%	200	5.6	Dec 22	May 24
Affordable rental housing loans support facility	Continued	1.75%	100	0.0	Feb 23	Dec 23
Relending facility to provide support to distressed property developers	Continued	1.75%	80	0.0	Jan 23	Dec 23
Inclusive loans support tool for micro and small enterprises	Continued	/	80	49.8	Dec 21	Dec 24
Bond financing support instruments for private enterprises (II)	Continued	1.75%	50	0.0	Jan 22	Oct 25
Relending facility for inclusive elderly care services	Continued	1.75%	40	1.6	Apr 22	Apr 24
PSL (Pledged Supplementary Lending)	Continued	2.40%	/	2,902.2	2014	N/A
Relending facility for sci-tech innovation	Expired	1.75%	400	345.6	Apr 22	N/A
Special relending facility to support equipment upgrading	Expired	1.75%	200	167.2	Sep 22	Jan 22
Special relending facility targeting transport and logistics	Expired	1.75%	100	45.1	May 22	Jun 23
Interest rate reduction support tool for micro and small enterprises loans	Expired	/	/	26.9	Oct 22	Dec 22
Toll road loan support facility	Expired	/	/	8.3	Oct 22	Dec 22
Total				**7,018.0**		

SOURCES: CGS-CIMB RESEARCH, PBOC

Defusing hidden debt risks: expect more debt swaps ahead

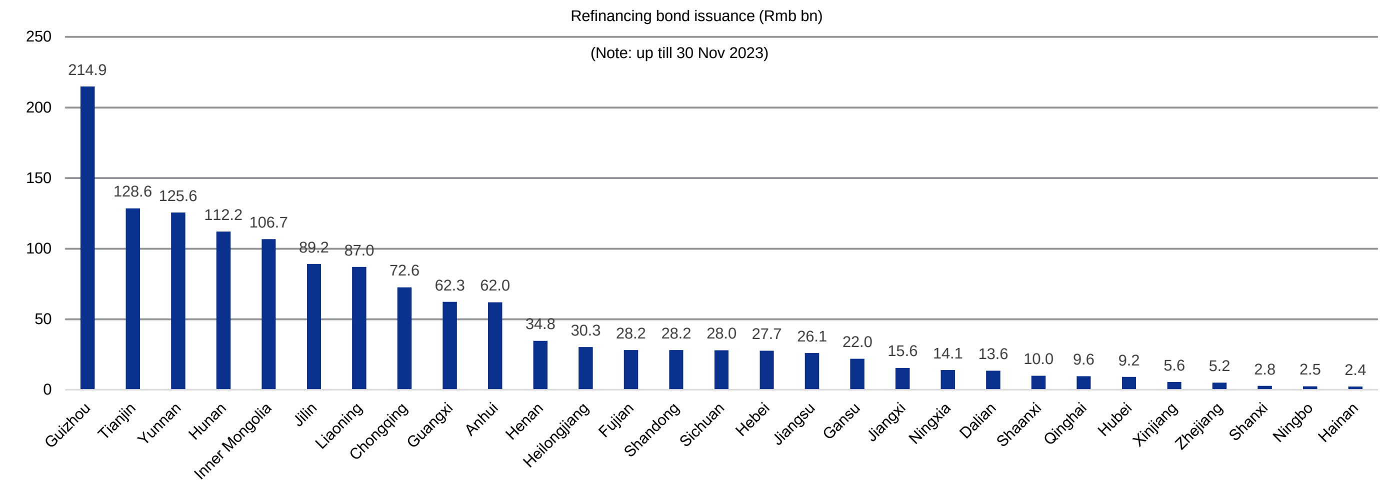
The central government has become more proactive in solving local government hidden debt risk. The politburo meeting held in Jul 23 pledged for the first time that, to effectively prevent and resolve local government debt risks, it is important to formulate and implement "a basket of debt-reduction plans". The statement represented a significant shift in policy tone compared to the Politburo meeting in Apr 23, during which policymakers stressed "strict control of the increase in hidden debt".

Local governments carried out a new round of debt swap programmes in 4Q23. Since Oct 23, China's local governments have kicked off a new round of debt swapping programme by issuing refinancing bonds to swap outstanding hidden debt concentrated in local government financing vehicles (LGFVs). The debt swap programme will essentially convert implicit debt into explicit debt, which will increase outstanding debt balance of local governments. As of end-Nov 23, accumulated issuance of refinancing bonds has reached Rmb1.4tr. The allocation of quota has been skewed towards provinces/regions with higher debt repayment pressure. **For 2024F, we expect another round of debt swap programmes with a size of approximately Rmb1tr.**

Policymakers' debt defusing effort also included debt restructuring and introduction of central bank emergency liquidity tool. Apart from the debt swap programme, policymakers' debt-reduction plan also included debt restructuring. In late Sep, the PBOC instructed commercial banks to formulate plans to help defuse LGFV debt risk, including optimising the term structure and reducing interest rates on bank loans made to LGFVs. In addition, the PBOC said it will set up an emergency liquidity tool (SPV) with banks to offer loans to LGFVs to solve any short-term liquidity stress. These efforts should help alleviate imminent pressure on the LGFVs, in our view.

Policymakers aim to establish long-term mechanism for defusing local debt risk. Based on the International Monetary Fund's (IMF's) estimates, the outstanding balance of LGFV debt amounted to Rmb56.7tr at end-22, equivalent to 46.8% of China's GDP in 2022. In the longer term, we believe structural reforms are necessary to address the longstanding misalignment of revenue sources and expenditure responsibilities for local governments that has prevailed since the 1994 fiscal reform. The Central Financial Work Conference held in late Oct 23 pledged to optimize the debt structure of central and local governments. It also stressed the need of "establishing a long-term mechanism of preventing and resolving local government debt risk".

Figure 48: As of end-Nov 23, the latest round of refinancing bond issuance has reached Rmb1.4tr



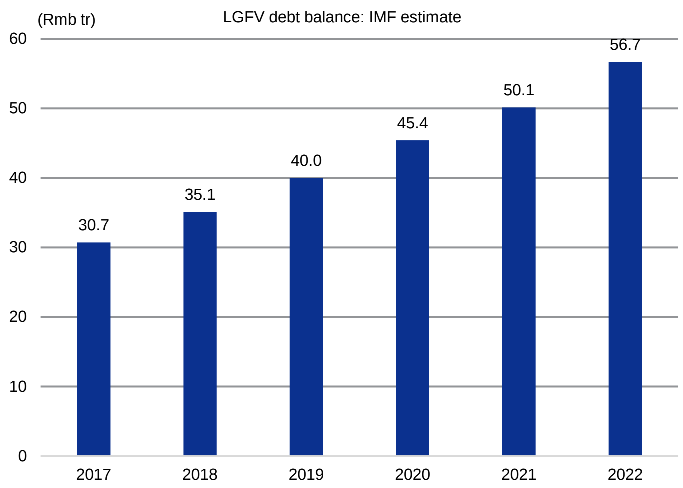
SOURCES: CGS-CIMB RESEARCH, XINHUA NEWS AGENCY
Note: Dalian and Ningbo are listed separately as they are two of the five cities in China that enjoy independent budgetary status from the provinces they belong to.

Figure 49: The central government has initiated four rounds of debt swaps for local governments' hidden debt since 2015

	Four rounds of local government debt swap since 2014			
Time	**2015-18**	**2019**	**End-2020 to Sep 2021**	**Oct 2021 to Jun 2022**
Size	Rmb12.2tr	Rmb142.85bn	Rmb612.8bn	Rmb502.4bn
Target of swap	Outstanding local government debt at end-2014 (based on two rounds of audit on local government debt by National Audit Office (NAO) in 2011 and 2013)	Conducting pilot programmes for debt reduction in certain county-level governments in six provinces, including Guizhou, Hunan, Inner Mongolia, Liaoning, Gansu, and Yunnan	Issuing refinancing bonds for the pilot programme of repaying the hidden debt of some county or district-level governments	Issuing special refinancing bonds for the pilot programme of eliminating hidden debt in Beijing, Shanghai, and Guangdong

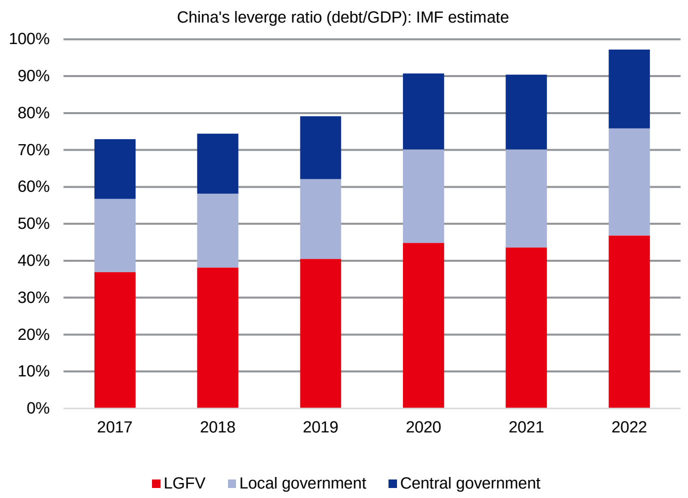
SOURCES: CGS-CIMB RESEARCH, XINHUA NEWS AGENCY

Figure 50: LGFV debt balance amounted to Rmb56.7tr at end-2022 based on IMF estimate…



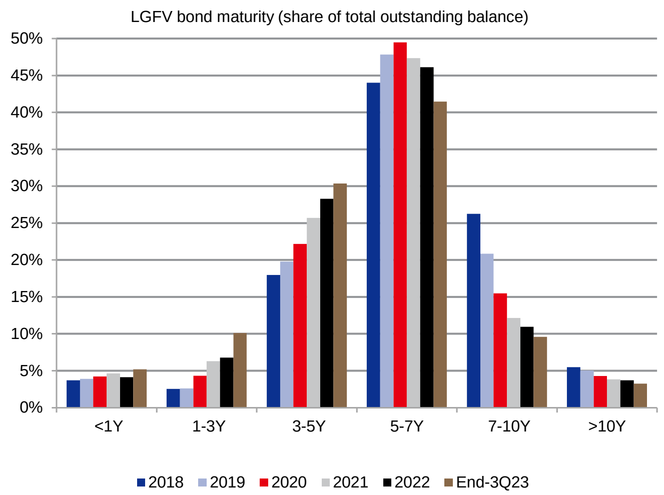
SOURCES: CGS-CIMB RESEARCH, IMF

Figure 51: … equivalent to 46.8% of GDP



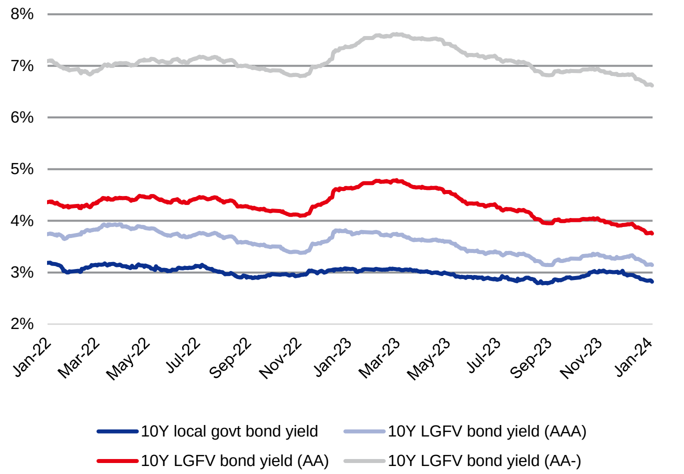
SOURCES: CGS-CIMB RESEARCH, IMF

Figure 52: LGFVs are increasingly issuing short-term bonds to fund long-term infrastructure projects



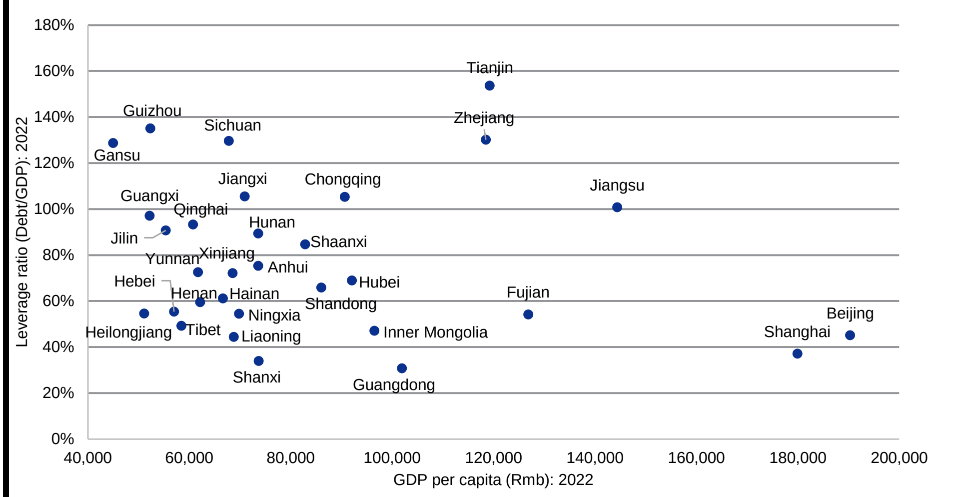
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 53: Interest rates on LGFV bonds are much higher than those issued by local governments



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 54: Leverage ratio vs. GDP per capita by province – uneven distribution of debt burden relative to fiscal strength



SOURCES: CGS-CIMB RESEARCH, WIND
Note: Local government debt for each province includes both explicit and hidden debt (i.e., issued by LGFVs)

Figure 55: Policymakers outlined six major strategies that can be used to resolve local governments' hidden debt

The six strategies to resolve local governments' hidden debt proposed by the MoF (August 2018)					
Arrange repayment through government funds	Sell government equity and state-owned assets	Use project carry-over funds and operating income for repayment	Convert borrowings into business debts	Roll over existing debt by issuing new debt	Use of bankruptcy reorganisation or liquidation

SOURCES: CGS-CIMB RESEARCH, XINHUA NEWS AGENCY, MINISTRY OF FINANCE

Structural reform: unlock long-term growth potential

The annual Central Economic Work Conference (CEWC) held during 11-12 Dec 2023 called for deepening structural reform and planning for a new round of fiscal and tax reforms. This reform has been long awaited for by China watchers due to the longstanding misalignment of revenue source and expenditure responsibilities for local governments. We expect the upcoming Third Plenum of the 20th Central Committee, widely expected to be held in early 2024 after some delay, to provide a blueprint for the next round of fiscal and tax reforms.

Comprehensive fiscal reform is necessary in China to i) ensure appropriate allocation of spending responsibilities and funding to improve public service delivery and reduce regional growth disparities; ii) address the structural deficiencies in the social security system, in the face of challenges posed by population ageing and ongoing urbanisation; and iii) improve government borrowing frameworks, contain off-budget financing and reduce fiscal risks.

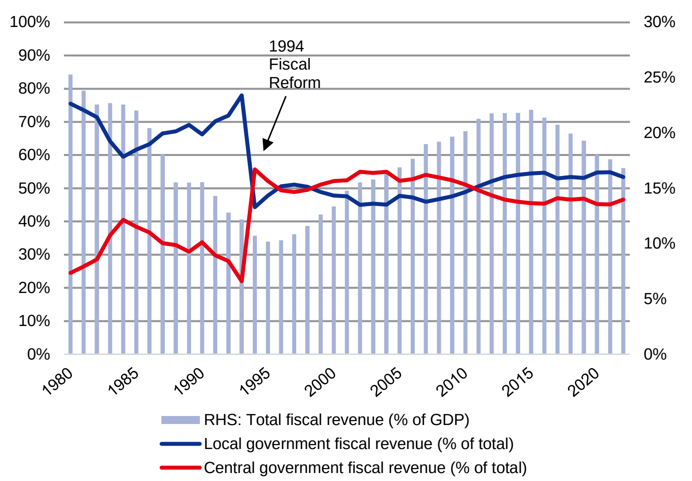
The fiscal reform of 1994 established the fundamental features of China's current fiscal system. The reform successfully increased overall revenue but caused local governments' budgetary surpluses to turn into sustained deficits. Fiscal transfers from the central government have been insufficient to cover the rapidly increasing spending mandates of local governments. As a result, local governments resorted to land sales and borrowing through off-budget special purpose vehicles (i.e., LGFVs), especially following the 2008-09 economic stimulus plan.

The latest round of major reform to China's fiscal reform took place in 2014. The key achievement of this round of reforms was the adoption of the new budget law, which improved local governments' budgeting process. The law also allowed provincial governments to issue bonds for capital expenditure but prohibited off-budget financing activities carried out by local governments. Over 2015-18, a debt swap programme amounting to Rmb12.2tr was carried out to facilitate the conversion of LGFV debt into local government debt. Since 2015, provincial governments are also allowed to issue bonds, subject to central government's approval. However, borrowing through LGFV was still ongoing and not fully solved. Local governments' hidden debt continued to expand rapidly and has become one of the key sources of risks posing a threat to the financial system.

Compared to other major economies, government spending on social services in China (pension, unemployment insurance, healthcare, education, and social assistance) are more decentralised, as local governments are largely responsible for delivering public services and managing the social safety net. The insufficient coverage of public services for migrant workers without local residency permit indicates a major deficiency in social security coverage. Hence, fiscal reform calls for the reallocation of expenditure responsibilities to the central government and better protecting households against unexpected shocks. This will reduce the necessity for households to build up precautionary savings, and in turn encourage consumption and support the rebalancing of the economy. It will also reduce the disparities in public services among different regions and residents with different types of hukou to promote "common prosperity".

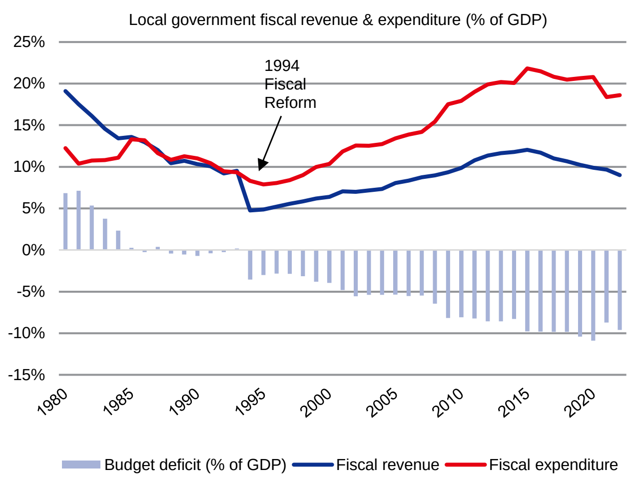
In our view, enhancing public service delivery to migrant workers can greatly unleash household consumption potential. According to Cai Fang, a member of the PBOC's Monetary Policy Committee, the per capital annual income of migrant worker households reached Rmb42,000 in 2022, approaching the average income of Rmb44,000 for the middle-income tranche of urban households. However, due to lack of equal access to basic public services, the consumption level of migrant workers is well below the average level of Rmb30,391 for urban residents, and the level of suppression is around 23%. If the 172m migrant workers can enjoy equal access to public services, the per capita consumption could increase by Rmb6,686, resulting in a total increase in household consumption of over Rmb1tr (0.8% of GDP).

Figure 56: The 1994 fiscal reform increased overall fiscal revenue but reduced the share of revenue for local governments



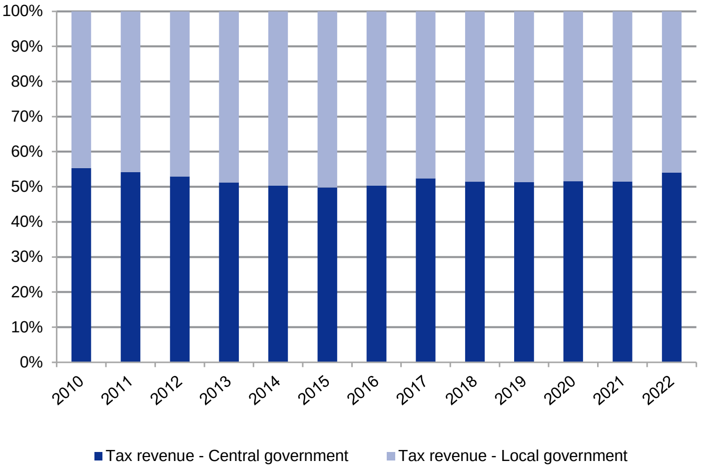
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 57: The 1994 fiscal reform led to sustained deficit for local governments



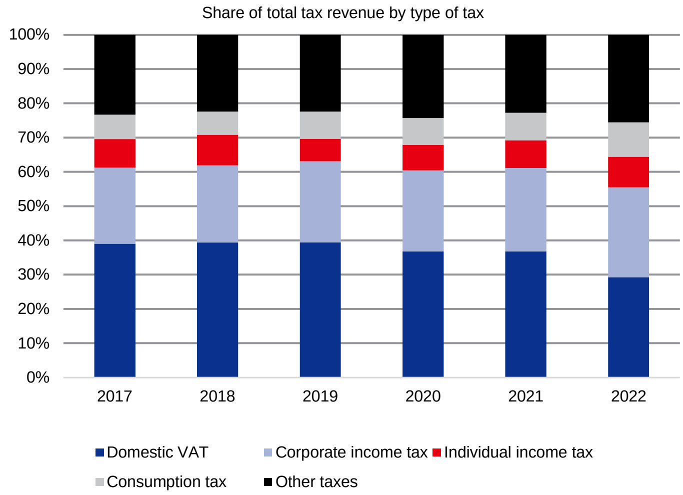
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 58: Local government's share of tax revenue has been consistently less than 50%



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 59: China's four major types of taxes contributed to around three fourths of total tax revenue



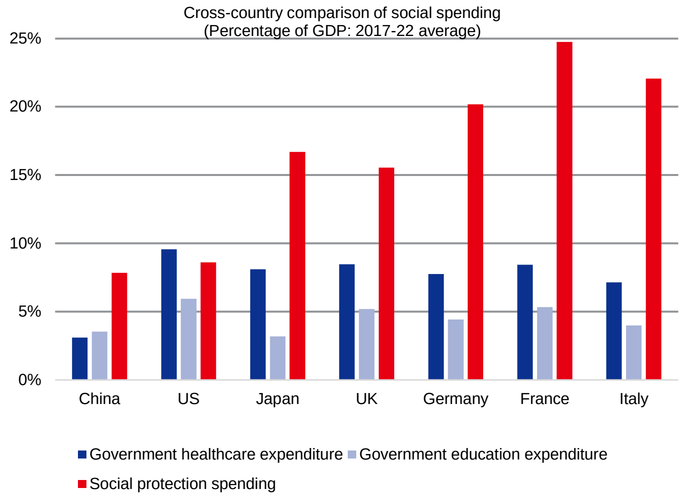
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 60: Tax sharing between central and local governments (2021)

		Central	Local	Central (Rmb bn)	Local (Rmb bn)	Total (Rmb bn)	Share of total tax revenue
Shared taxes							
Domestic VAT		50%	50%	3,175	3,177	6,352	37%
Corporate income tax		60%	40%	2,316	1,544	3,859	22%
Individual income tax		60%	40%	840	560	1,399	8%
Central taxes							
Consumption tax		100%	-	1,388		1,388	8%
Vehicle purchase tax		100%	-	352		352	2%
Corporate income tax	Certain types of corporates	100%	-	345		345	2%
Tariffs		100%	-	281		281	2%
Stamp duty	Securities transaction	100%	-	248		248	1%
Urban maintenance and development tax	Certain types of corporates	100%	-	21		21	0%
Resource tax	Certain types of corporates	100%	-	6		6	0%
Cargo tax		100%	-	6		6	0%
Trade-related consumption tax and VAT		100%	-	-168		-168	-1%
Other central taxes		100%	-	86		86	0%
Local taxes							
Tax on deeds		-	100%		743	743	4%
Land appreciation tax		-	100%		690	690	4%
Urban maintenance and development tax		-	100%		501	501	3%
Property tax		-	100%		328	328	2%
Resource tax		-	100%		223	223	1%
Urban land use tax		-	100%		213	213	1%
Stamp duty	Excluding securities transaction	-	100%		160	160	1%
Tax on the use of arable land		-	100%		107	107	1%
Tax on vehicles and boat operation		-	100%		102	102	1%
Environmental protection tax		-	100%		20	20	0%
Tobacco tax		-	100%		12	12	0%
Others		-	100%		2	2	0%
Total				**8,895**	**8,379**	**17,274**	**100%**

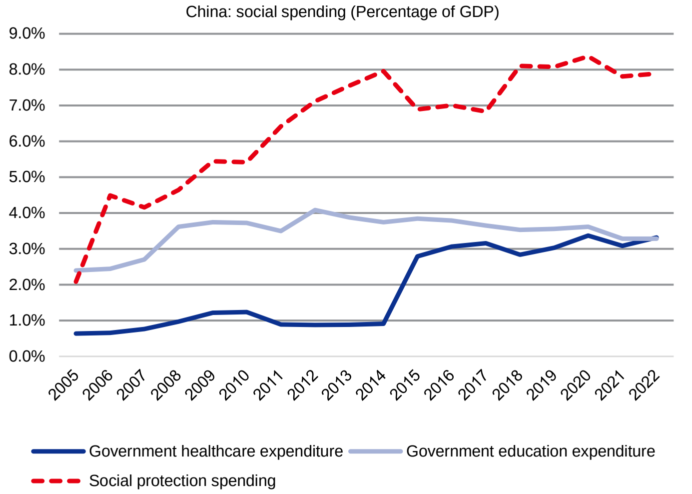
SOURCES: CGS-CIMB RESEARCH, MINISTRY OF FINANCE, WIND

Figure 61: Social spending in China still lags major advanced economies



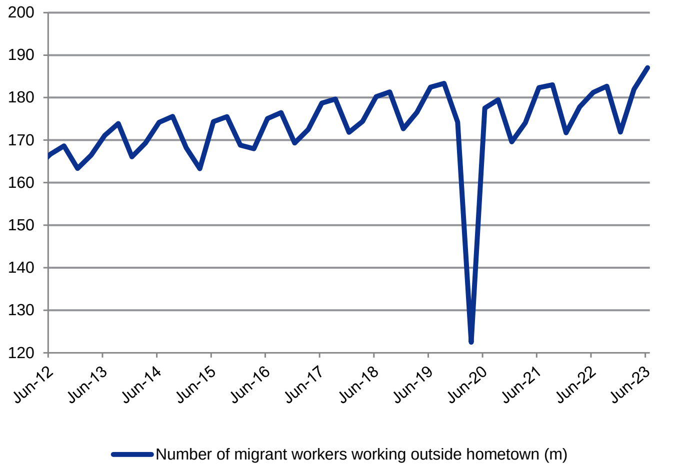
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 62: China's public service has been improving over the past two decades



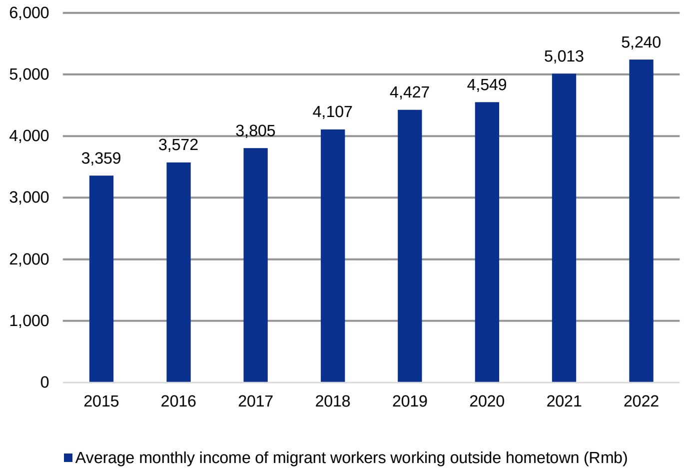
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 63: As of mid-2023, there were approximately 187m migrant workers residing outside their hometowns



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 64: The average monthly income of these migrant workers was around Rmb5,240 in 2022



SOURCES: CGS-CIMB RESEARCH, WIND

Economic outlook: achieving a firmer recovery

Overview of China's economic outlook in 2024F

Recent data pointed to signs of bottoming out for Chinese economy, although the recovery is not on a strong footing yet. We expect the recovery momentum to strengthen in early 2024F due to the recent step up in policy support, especially the Rmb1tr sovereign bond issuance.

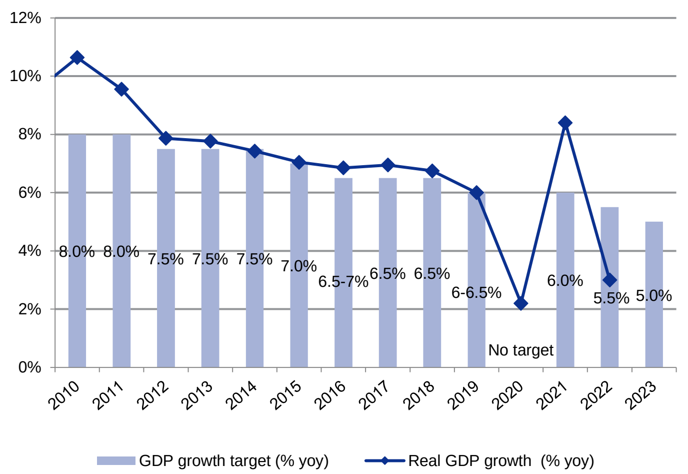
We now project GDP growth to reach around 5% in 2024F, on the back of forceful and proactive policy support. Among the three key components of economic growth, we expect the growth rate of consumption to decelerate and investment growth to speed up, while the drag from net exports is expected to narrow. The drag on growth from the prolonged property market downturn will be offset by step-up in policy support for infra investment, especially the "three major projects". The property sector remains the biggest source of downside risk next year.

Figure 65: Overview of our economic forecasts for China

	2022	2023F	2024F
GDP (% yoy)	**3.0**	**5.2**	**5.2**
- Gross capital formation	5.7	2.6	4.5
- Final consumption expenditure	3.5	8.3	5.8
Fixed asset investment (% yoy)	**5.3**	**3.0**	**3.9**
- Manufacturing	9.1	6.2	3.1
- Infrastructure	9.4	6.5	10.5
- Property development	-10.0	-9.6	-7.0
Retail sales (% yoy)	**-0.3**	**7.0**	**4.9**
Industrial production (% yoy)	**3.6**	**4.2**	**4.4**
Export (in US$, % yoy)	**7.2**	**-4.1**	**1.2**
Import (in US$, % yoy)	**1.0**	**-5.1**	**1.7**
CPI (% yoy)	**2.0**	**0.4**	**1.0**
PPI (% yoy)	**4.1**	**-3.1**	**0.8**
TSF balance (% yoy)	**9.6**	**9.6**	**10.1**
USDCNY (period end)	**6.95**	**7.09**	**6.90**
1Y LPR (period end)	**3.65**	**3.45**	**3.25**

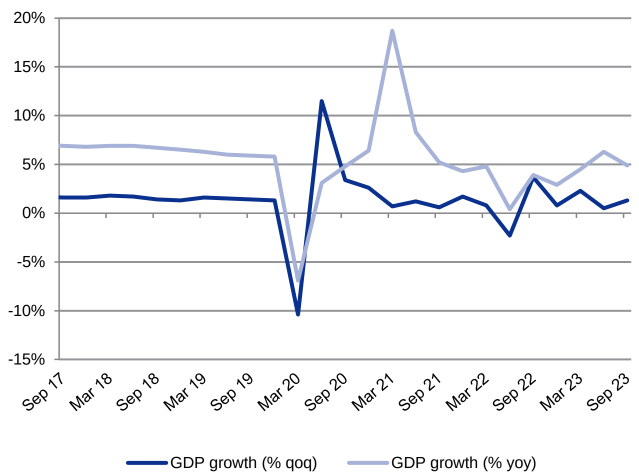
SOURCES: CGS-CIMB RESEARCH ESTIMATES, CHINA GALAXY SECURITIES RESEARCH ESTIMATES, WIND

Figure 66: China set a growth target of "around 5%" for 2023



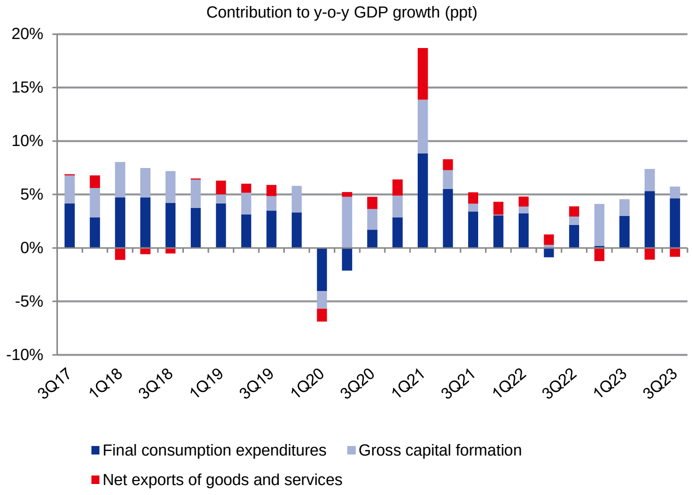
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 67: China's 3Q23 GDP growth surprised on the upside



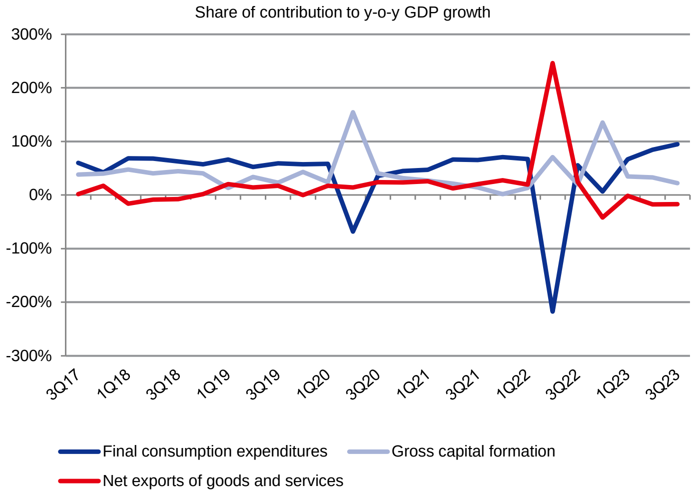
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 68: Net exports have made a negative contribution to China's GDP growth over the past four quarters



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 69: Share of contribution to GDP growth from final consumption expenditures reached 94.8% in 3Q23



SOURCES: CGS-CIMB RESEARCH, WIND

Consumption: catching up to pre-pandemic trend level

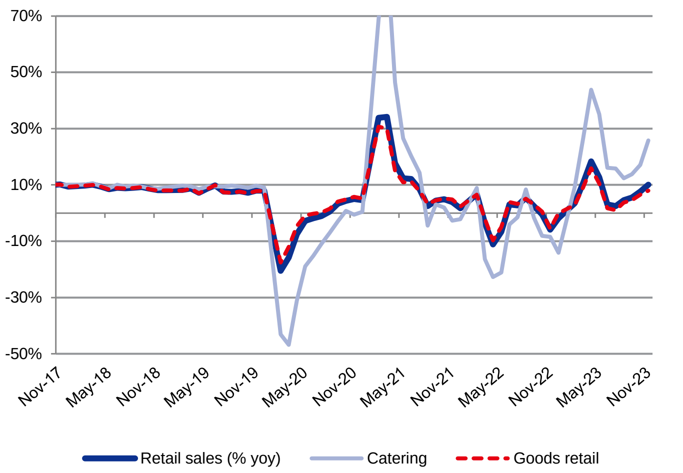
In 9M23, nominal disposable income per capita rose 6.3% yoy, outpacing nominal GDP growth of 4.9% yoy. Besides, the savings rate has declined on a consecutive basis over the past three quarters and is approaching pre-pandemic trend level, indicating a sustained recovery in consumer confidence. As a result, the contribution of final consumption expenditure to YTD GDP growth was 83.2% in 9M23, much higher than pre-pandemic level (2015-19 average: 62.7%). Service consumption far outpaced goods consumption, rising 19.5% yoy in 11M23 in nominal terms, while goods retail rose 5.9% yoy.

For 2024F, we expect consumption growth to decelerate compared to this year, during which the rebound was boosted by the lifting of Covid restrictions. Household consumption will continue to register solid growth in 2024F, as service consumption continues to recover to its pre-pandemic trend level. We also expect the excess savings accumulated during the pandemic and the stabilising labour market conditions to provide a tailwind to consumption.

However, the weak housing market would continue to be a major headwind to consumer confidence as residential property accounts for around 60% of assets for Chinese urban households. Specifically, property market related product categories (such as home appliances) and big-ticket spending will remain relatively weak.

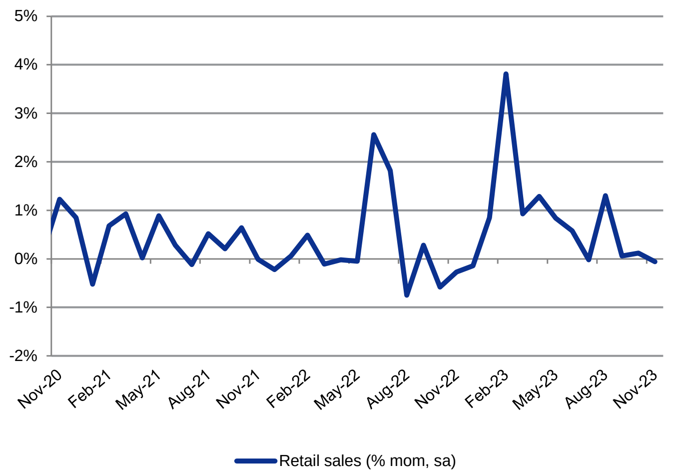
We do not expect the government to subsidise households directly through Hong Kong-style consumption vouchers or US-style direct cash payments and additional unemployment benefits. Academic studies across countries show that spending effects of direct fiscal transfers from governments to households are open to debate. Direct subsidies would be more effective when the payments are targeted at the right beneficiaries, i.e. low income and liquidity-constrained households. In practice, it is a challenging task for the government to determine the segment of population in need and implement the payment delivery. Instead, we expect the government to try to stabilise household consumption by improving the overall labour market conditions by stepping up policy support for infrastructure and property sectors.

Figure 70: Recovery of catering outpaced goods retail



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 71: Retail sales decreased 0.06% mom in Nov 23



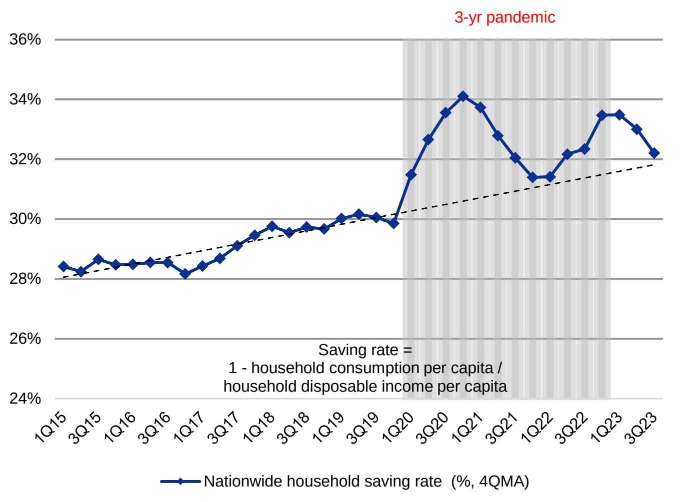
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 72: Home furnishings and appliances lagged, attributable to subdued home sales

	2022		2023										
	Nov	**Dec**	**Jan-Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**YTD**
Retail sales (% yoy)	-5.9%	-1.8%	3.5%	10.6%	18.4%	12.7%	3.1%	2.5%	4.6%	5.5%	7.6%	10.1%	7.2%
Retail sales (% mom)	-0.3%	-0.1%	3.8%	0.9%	1.3%	0.8%	0.6%	0.0%	1.3%	0.1%	0.1%	-0.1%	N/A
Retail sales (2Y CAGR)			5.1%	3.3%	2.6%	2.6%	3.1%	2.6%	5.0%	4.0%	3.5%	1.8%	3.5%
Goods retail (% yoy)	-5.6%	-0.1%	2.9%	9.1%	15.9%	10.5%	1.7%	1.0%	3.7%	4.6%	6.5%	8.0%	5.9%
Goods retail (2Y CAGR)			4.7%	3.3%	2.3%	2.5%	2.8%	2.1%	4.4%	3.8%	3.5%	1.0%	3.2%
Catering (% yoy)	-8.4%	-14.1%	9.2%	26.3%	43.8%	35.1%	16.1%	15.8%	12.4%	13.8%	17.1%	25.8%	19.4%
Catering (2Y CAGR)			9.1%	2.8%	5.4%	3.3%	5.6%	6.8%	10.4%	5.8%	3.7%	7.3%	6.3%
Retail sales ex auto (% yoy)	-6.1%	-2.6%	5.0%	10.5%	16.5%	11.5%	3.7%	3.0%	5.1%	5.9%	7.2%	9.6%	7.3%
Retail sales above designated size (% yoy)	-5.7%	-0.2%	1.5%	8.5%	17.3%	11.1%	1.4%	-0.5%	2.5%	4.7%	7.9%	9.0%	5.6%
Consumer staples													
Food, grain & oil	3.9%	10.5%	9.0%	4.4%	1.0%	-0.7%	5.4%	5.5%	4.5%	8.3%	4.4%	4.4%	5.1%
Clothing, shoes, hats & textile	-15.6%	-12.5%	5.4%	17.7%	32.4%	17.6%	6.9%	2.3%	4.5%	9.9%	7.5%	22.0%	11.5%
Daily necessties	-9.1%	-9.2%	3.9%	7.7%	10.1%	9.4%	-2.2%	-1.0%	1.5%	0.7%	4.4%	3.5%	3.6%
Medicines	8.3%	39.8%	19.3%	11.7%	3.7%	7.1%	6.6%	3.7%	3.7%	4.5%	8.2%	7.1%	8.5%
Office supplies	-1.7%	-0.3%	-1.1%	-1.9%	-4.9%	-1.2%	-9.9%	-13.1%	-8.4%	-13.6%	7.7%	-8.2%	-5.8%
Petroleum products	-1.6%	-2.9%	10.9%	9.2%	13.5%	4.1%	-2.2%	-0.6%	6.0%	8.9%	5.4%	7.2%	6.5%
Consumer durables													
Automobile	-4.2%	4.6%	-9.4%	11.5%	38.0%	24.2%	-1.1%	-1.5%	1.1%	2.8%	11.4%	14.7%	6.2%
Communication equipment	-17.6%	-4.5%	-8.2%	1.8%	14.6%	27.4%	6.6%	3.0%	8.5%	0.4%	14.6%	16.8%	6.6%
Consumer discretionary													
Cosmetics	-4.6%	-19.3%	3.8%	9.6%	24.3%	11.7%	4.8%	-4.1%	9.7%	1.6%	1.1%	-3.5%	4.7%
Jewellery	-7.0%	-18.4%	5.9%	37.4%	44.7%	24.4%	7.8%	-10.0%	7.2%	7.7%	10.4%	10.7%	11.9%
Sports & recreation	-8.2%	-13.3%	1.0%	15.8%	25.7%	14.3%	9.2%	2.6%	-0.7%	10.7%	25.7%	16.0%	10.7%
Property related													
Construction & decoration materials	-10.0%	-8.9%	-0.9%	-4.7%	-11.2%	-14.6%	-6.8%	-11.2%	-11.4%	-8.2%	-4.8%	-10.4%	-7.8%
Household appliances	-17.3%	-13.1%	-1.9%	-1.4%	4.7%	0.1%	4.5%	-5.5%	-2.9%	-2.3%	9.6%	2.7%	0.6%
Furniture	-4.0%	-5.8%	5.2%	3.5%	3.4%	5.0%	1.2%	0.1%	4.8%	0.5%	1.7%	2.2%	2.8%

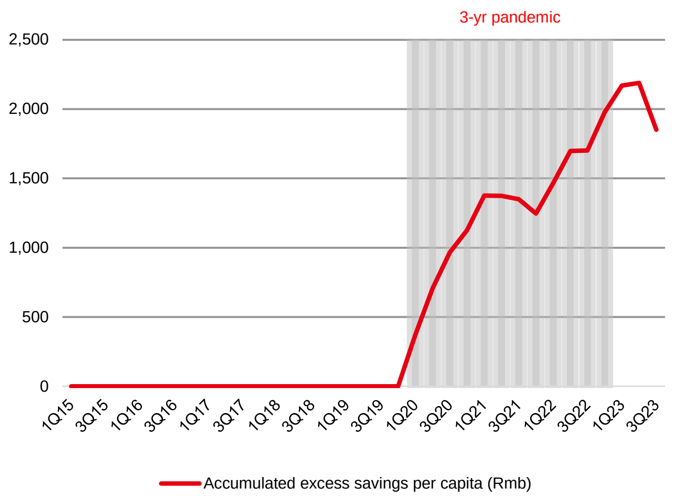
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 73: Savings rate declined notably in 3Q23, approaching pre-pandemic trend level



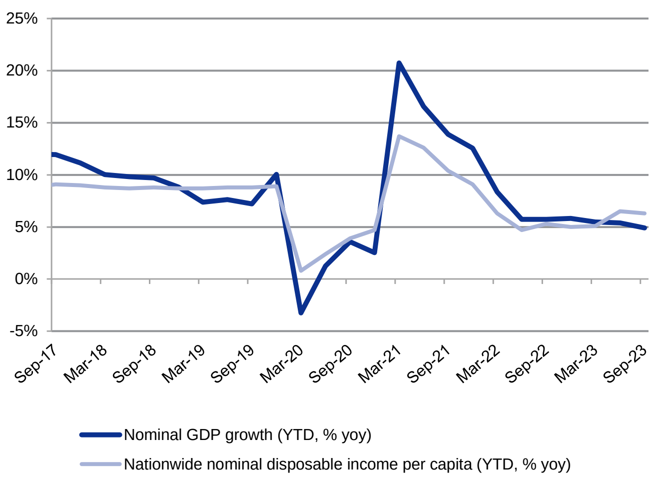
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 74: This led to a drawdown on excess savings accumulated during the pandemic



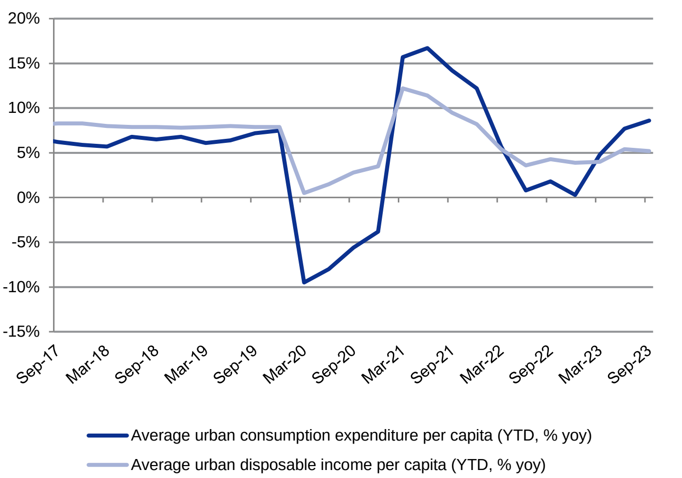
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 75: China's per capita disposable income has seen a growth rate that has outpaced GDP in 9M23



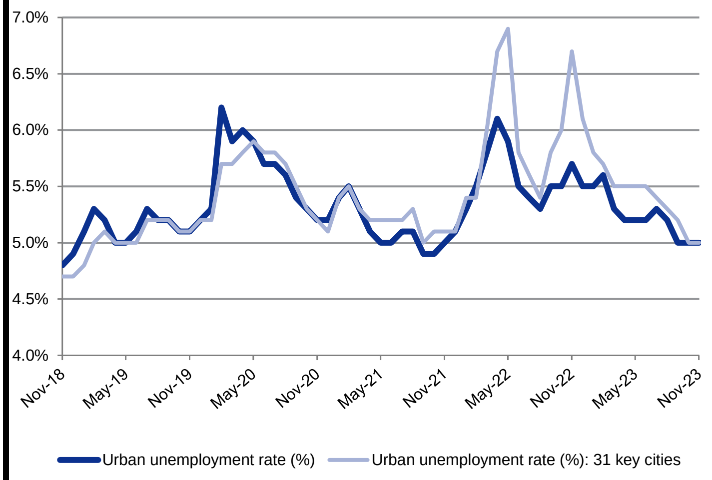
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 76: Per capita consumption expenditure also outpaced per capita disposable income in 9M23



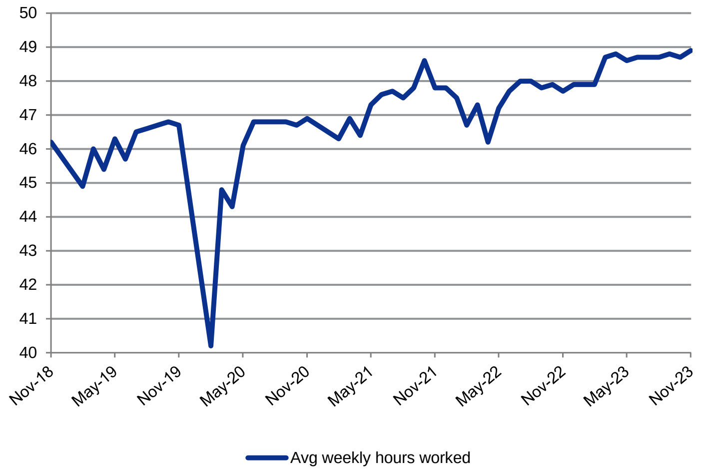
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 77: The gap between unemployment rate in key cities and overall unemployment rate has diminished



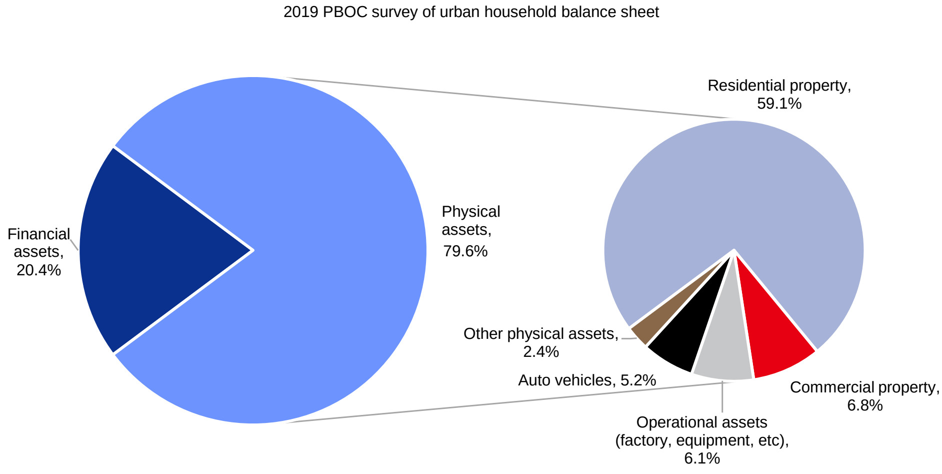
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 78: Average hours worked has been on an upward trend



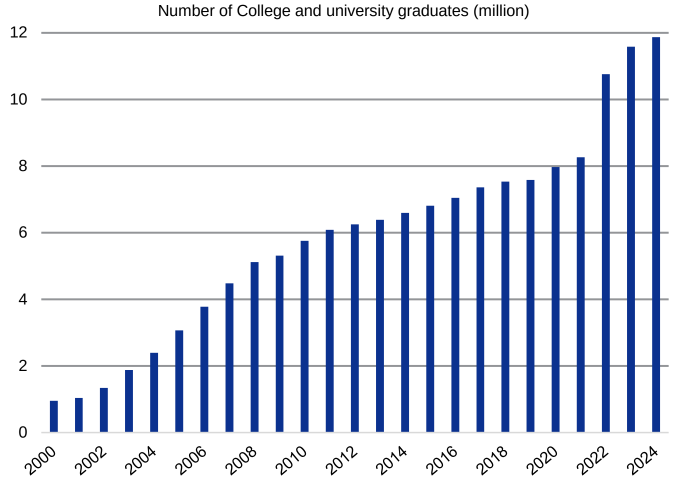
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 79: Residential property accounts for c.60% of urban household assets



SOURCES: CGS-CIMB RESEARCH, PBOC

Figure 80: Number of students graduating from colleges and universities will reach a new high in 2024F



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 81: China's university graduates are faced with increasingly challenging labour market prospects compared to a decade ago

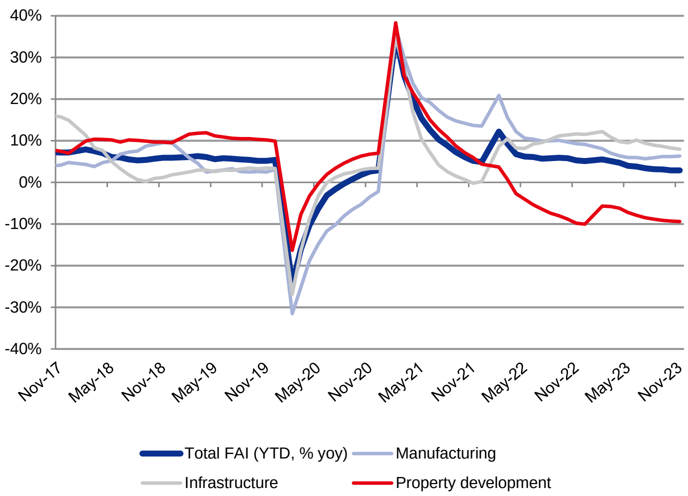
	Share of university degree (%)		Share of postgraduate degree (%)	
	2010	2020	2010	2020
Nationwide population	3.67	7.16	0.33	0.82
Nationwide employed workers	3.71	9.77	0.39	1.08
Nationwide employed workers (16-24yrs)	2.82	13.20	0.05	0.32
Urban unemployed workers	6.24	12.51	0.36	1.20
Urban unemployed workers (16-24yrs)	9.65	32.20	0.15	1.57

SOURCES: CGS-CIMB RESEARCH, CHINA LABOUR STATISTICAL YEARBOOK

Investment: acceleration on forceful policy support

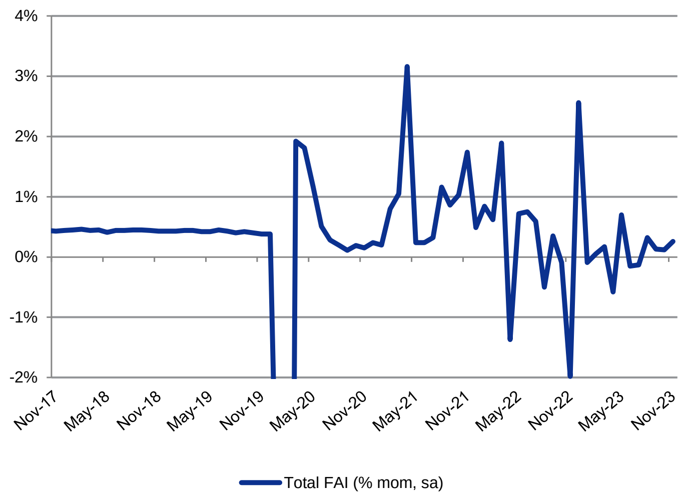
For the three key components of fixed asset investments, we expect continued divergence in 2024F. We expect infrastructure investment to pick up, manufacturing investment growth to slow, while property development investment should continue to decline but the magnitude should narrow. Overall fixed asset investments growth will pick up in 2024F compared to 2023, thanks to strong policy support for infrastructure investments and "three major projects".

Figure 82: Property investment continued to slump in 2023



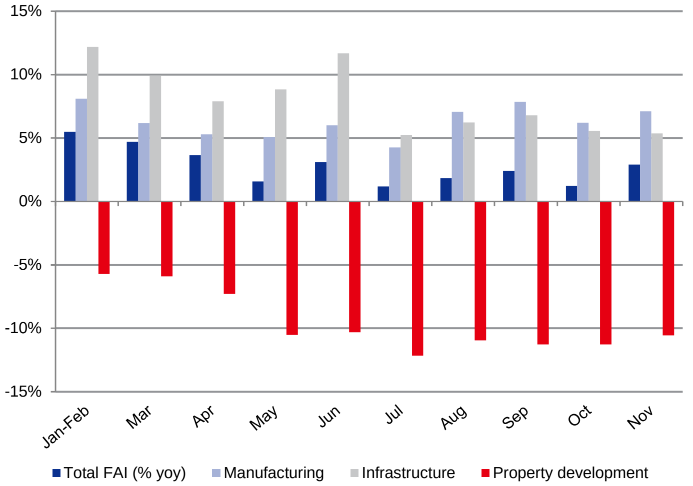
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 83: Fixed asset investment rose 0.26% mom in Nov 23



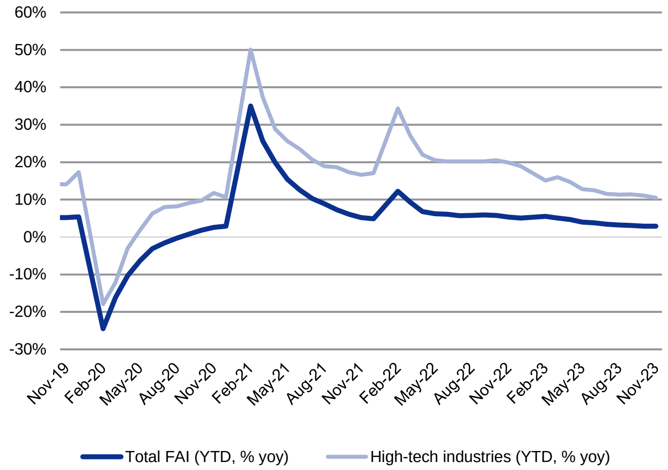
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 84: Our calculation shows infra investment slowed in Nov 23



SOURCES: CGS-CIMB RESEARCH, WIND

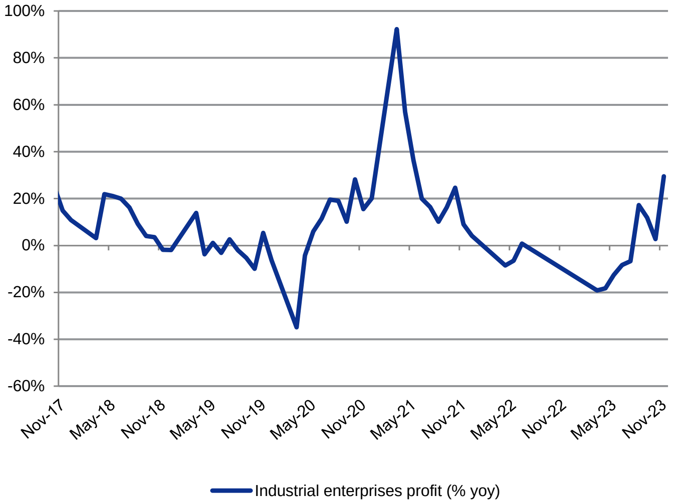
Figure 85: Investment in high tech industries continued to outpace overall fixed asset investment



SOURCES: CGS-CIMB RESEARCH, WIND

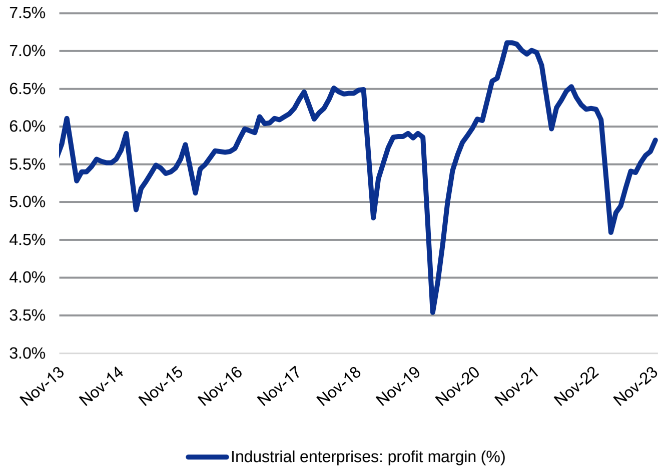
Manufacturing investment: We expect manufacturing investment to decelerate in 2024F. Industrial enterprises' profit returned to positive growth in Aug 23, which should provide support for manufacturing investment. Investment in advanced manufacturing sub-sectors (automobile, electrical machinery and equipment, computer and communication equipment), which play a crucial role in the national strategy of transitioning towards high-quality growth, should continue to drive overall manufacturing investment. However, we observed a downward trend in capacity utilisation in these advanced manufacturing sub-sectors over the past few years, indicating a certain level of overcapacity.

Figure 86: Industrial enterprises' profit returned to positive yoy growth since Aug 23, providing support to manufacturing investment



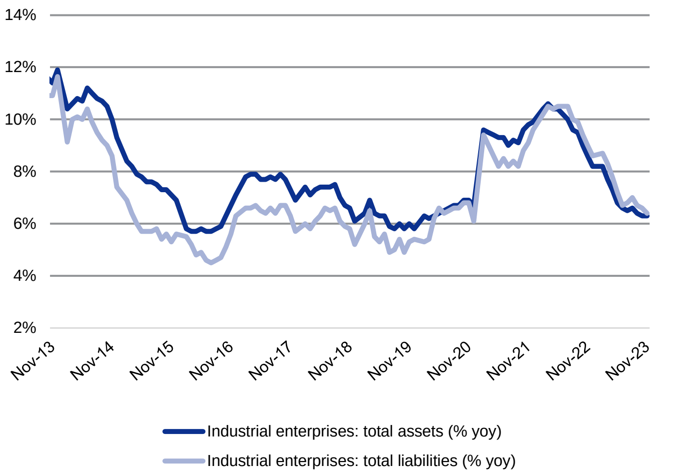
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 87: Profit margin improved in recent months



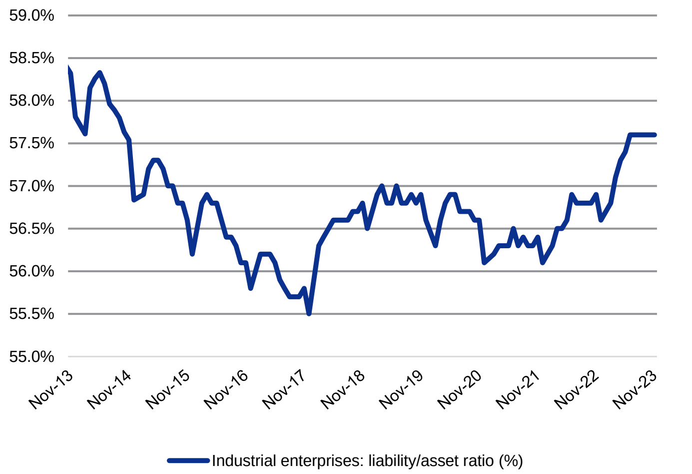
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 88: The growth rates of both total assets and total liabilities of industrial enterprises have been decelerating…



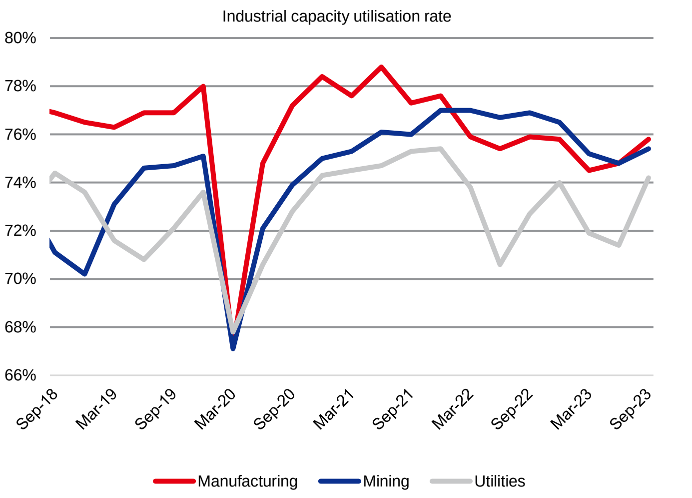
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 89: Liability ratio remained stable in recent months



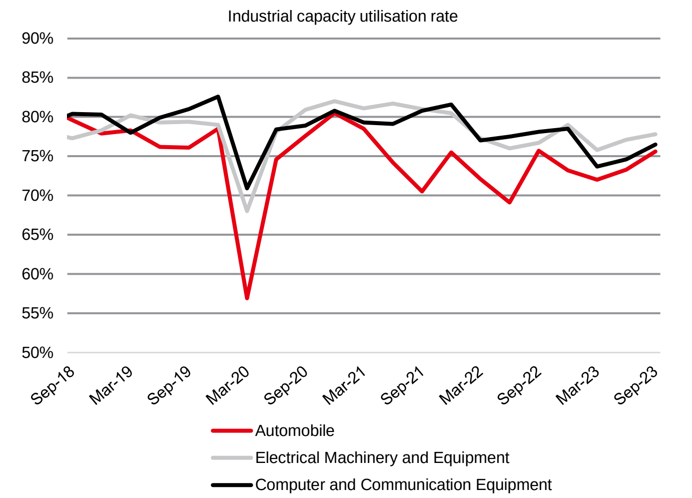
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 90: Capacity utilisation rates rebounded in 3Q23 for manufacturing, mining and utilities sectors



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 91: Capacity utilisation rates of advanced manufacturing sub-sectors also improved in 3Q23

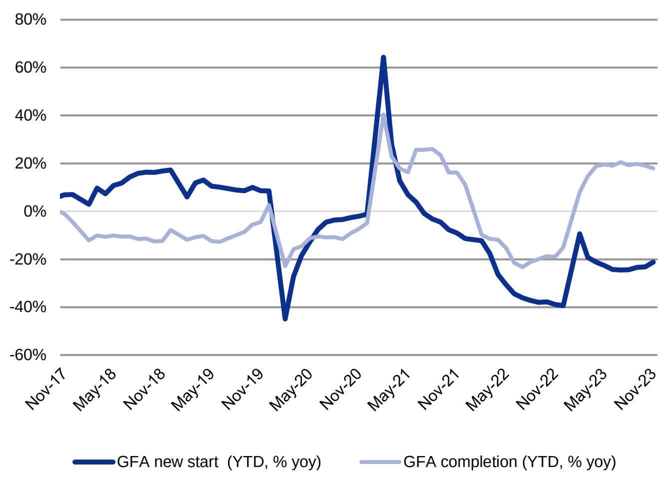


SOURCES: CGS-CIMB RESEARCH, WIND

Infrastructure investment: We expect infrastructure investment to accelerate in 2024F, as it will play a key role in policy support next year amid policymaker's effort to restore confidence. The policy impact of the Rmb1tr sovereign bond issuance announced in late 2023 will mostly be reflected in early 2024. We expect the government to set the local government special bond quota at around Rmb4tr in 2024F (2023: Rmb3.8tr).

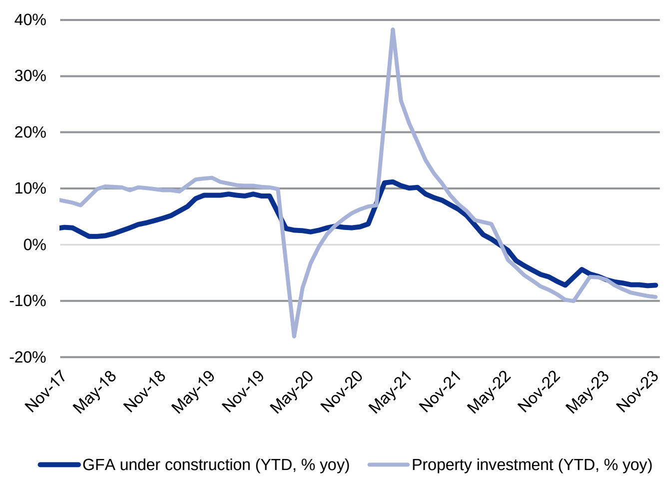
Property development investment: We expect the decline in property development investment to persist in 2024F, due to the sustained decline in new home starts (11M23: -21.2% yoy). As property developers have been primarily focused on delivering unfinished housing projects, rather than kick-starting new projects, property completion has far outpaced property new starts since mid-2021. The trend would likely persist in 2024F. However, the magnitude of decline in property development investment should narrow, as we expect policymakers to step up direct financing support for property developers.

Figure 92: Property completion has far outpaced property new starts due to policymakers' efforts to ensure delivery of unfinished housing projects



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 93: GFA under construction has continued to decline

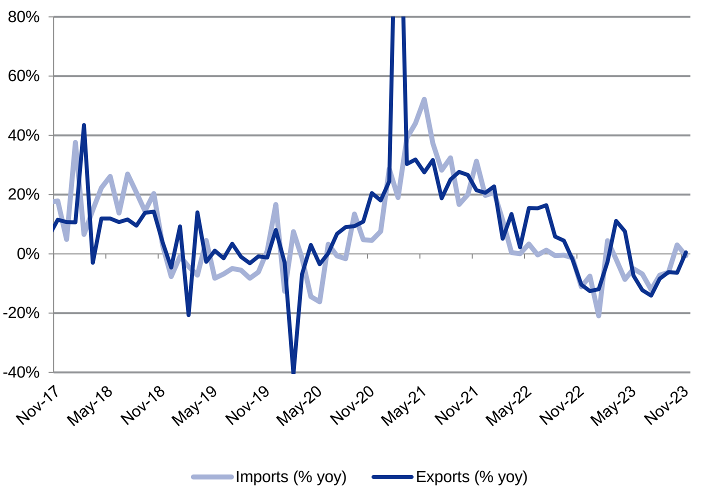


SOURCES: CGS-CIMB RESEARCH, WIND

Export: drag of net exports to narrow

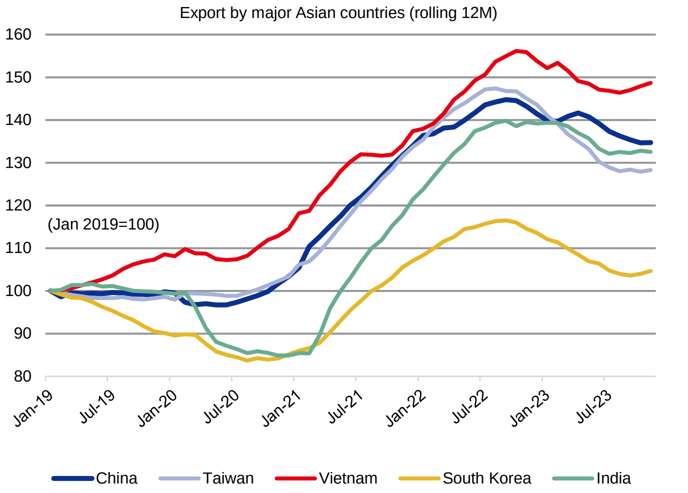
For 2024F, we expect China's goods exports to return to positive growth, while the drag of net exports on GDP growth should lessen compared to 2023. In particular, we expect consumer electronics products (PC and mobile) to start to make a positive contribution to goods export, as the downcycle of global consumer electronics market may have bottomed out in 3Q23. The global demand outlook remains mixed in 2024F, but we think that a soft landing is the mostly likely scenario for major advanced economies. The downside risk from the shift in the global supply chain will be partly mitigated by more diversified export destinations and Chinese manufacturers moving up the value chain.

Figure 94: In Nov 23, China's export rose for the first time since Apr 23



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 95: Other major Asian exporters have shown signs of bottoming out in exports



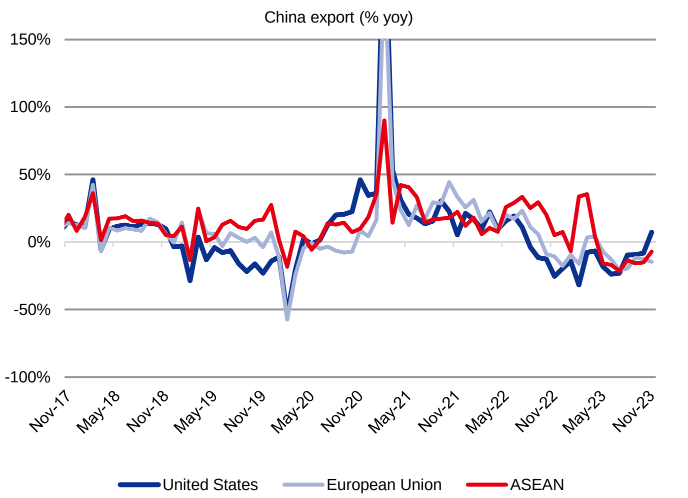
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 96: The US, ASEAN and the EU collectively accounted for c.48% of China's exports in 2022

China export by destination	2012	2017	2022
United States	17.2%	19.1%	16.3%
ASEAN	10.0%	12.5%	16.0%
European Union	16.3%	16.5%	15.7%
Hong Kong	15.8%	12.5%	8.5%
Japan	7.4%	6.1%	4.8%
South Korea	4.3%	4.6%	4.6%
India	2.3%	3.0%	3.3%
United Kingdom	2.3%	2.5%	2.3%
Taiwan	1.8%	1.9%	2.3%
Australia	1.8%	1.8%	2.2%
Mexico	1.3%	1.6%	2.2%
Russia	2.2%	1.9%	2.1%
Rest of world	17.3%	15.9%	19.6%
Total	**100.0%**	**100.0%**	**100.0%**

SOURCES: CGS-CIMB RESEARCH, WIND

Figure 97: Exports to the US and ASEAN improved in Nov 23



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 98: IMF World Economic Outlook projections: GDP growth (Oct 2023)

			Projections	
(% yoy)	**2021**	**2022**	**2023F**	**2024F**
World	**6.3**	**3.5**	**3.0**	**2.9**
Advanced Economies	**5.6**	**2.6**	**1.5**	**1.4**
United States	5.9	2.1	2.1	1.5
Euro Area	5.6	3.3	0.7	1.2
Germany	3.2	1.8	-0.5	0.9
France	6.4	2.5	1.0	1.3
Italy	7.0	3.7	0.7	0.7
Spain	6.4	5.8	2.5	1.7
Japan	2.2	1.0	2.0	1.0
United Kingdom	7.6	4.1	0.5	0.6
Canada	5.0	3.4	1.3	1.6
Other advanced economies (Advanced economies excluding G7 and Euro area)	5.7	2.6	1.8	2.2
Emerging Market and Developing Economies	**6.9**	**4.1**	**4.0**	**4.0**
Emerging and Developing Asia	7.5	4.5	5.2	4.8
China	8.5	3.0	5.0	4.2
India	9.1	7.2	6.3	6.3
ASEAN-5	4.0	5.5	4.2	4.5
Emerging and Developing Europe	7.3	0.8	2.4	2.2
Russia	5.6	-2.1	2.2	1.1
Latin America and the Caribbean	7.4	4.1	2.3	2.3
Brazil	5.0	2.9	3.1	1.5
Mexico	5.8	3.9	3.2	2.1
Middle East and Central Asia	4.3	5.6	2.0	3.4
Saudi Arabia	3.9	8.7	0.8	4.0
Sub-Saharan Africa	4.7	4.0	3.3	4.0
Nigeria	3.6	3.3	2.9	3.1
South Africa	4.7	1.9	0.9	1.8

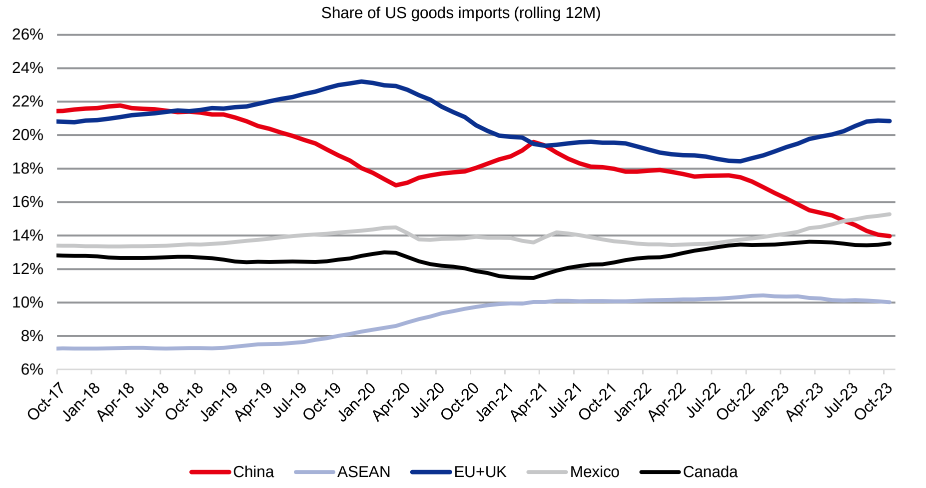
SOURCES: CGS-CIMB RESEARCH, IMF

Figure 99: S&P Global PMI of major advanced economies

S&P Global PMI	**2022**												**2023**											
Composite	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
United States	51.1	55.9	57.7	56.0	53.6	52.3	47.7	44.6	49.5	48.2	46.4	45.0	46.8	50.1	52.3	53.4	54.3	53.2	52.0	50.2	50.2	50.7	50.7	50.9
Eurozone	52.3	55.5	54.9	55.8	54.8	52.0	49.9	48.9	48.1	47.3	47.8	49.3	50.3	52.0	53.7	54.1	52.8	49.9	48.6	46.7	47.2	46.5	47.6	47.6
Germany	53.8	55.6	55.1	54.3	53.7	51.3	48.1	46.9	45.7	45.1	46.3	49.0	49.9	50.7	52.6	54.2	53.9	50.6	48.5	44.6	46.4	45.9	47.8	47.4
France	52.7	55.5	56.3	57.6	57.0	52.5	51.7	50.4	51.2	50.2	48.7	49.1	49.1	51.7	52.7	52.4	51.2	47.2	46.6	46.0	44.1	44.6	44.6	44.8
Italy	50.1	53.6	52.1	54.5	52.4	51.3	47.7	49.6	47.6	45.8	48.9	49.6	51.2	52.2	55.2	55.3	52.0	49.7	48.9	48.2	49.2	47.0	48.1	48.6
Spain	47.9	56.5	53.1	55.7	55.7	53.6	52.7	50.5	48.4	48.0	49.6	49.9	51.6	55.7	58.2	56.3	55.2	52.6	51.7	48.6	50.1	50.0	49.8	50.4
Ireland	56.5	59.1	61.0	59.6	57.5	52.8	52.9	51.0	52.2	52.1	48.8	50.5	52.0	54.5	52.8	53.5	51.9	51.4	50.0	52.6	52.1	49.7	52.3	51.5
United Kingdom	54.2	59.9	60.9	58.2	53.1	53.7	52.1	49.6	49.1	48.2	48.2	49.0	48.5	53.1	52.2	54.9	54.0	52.8	50.8	48.6	48.5	48.7	50.7	52.1
Japan	49.9	45.8	50.3	51.1	52.3	53.0	50.2	49.4	51.0	51.8	48.9	49.7	50.7	51.1	52.9	52.9	54.3	52.1	52.2	52.6	52.1	50.5	49.6	50.0
Manufacturing																								
United States	55.5	57.3	58.8	59.2	57.0	52.7	52.2	51.5	52.0	50.4	47.7	46.2	46.9	47.3	49.2	50.2	48.4	46.3	49.0	47.9	49.8	50.0	49.4	47.9
Eurozone	58.7	58.2	56.5	55.5	54.6	52.1	49.8	49.6	48.4	46.4	47.1	47.8	48.8	48.5	47.3	45.8	44.8	43.4	42.7	43.5	43.4	43.1	44.2	44.4
Germany	59.8	58.4	56.9	54.6	54.8	52.0	49.3	49.1	47.8	45.1	46.2	47.1	47.3	46.3	44.7	44.5	43.2	40.6	38.8	39.1	39.6	40.8	42.6	43.3
France	55.5	57.2	54.7	55.7	54.6	51.4	49.5	50.6	47.7	47.2	48.3	49.2	50.5	47.4	47.3	45.6	45.7	46.0	45.1	46.0	44.2	42.8	42.9	42.1
Italy	58.3	58.3	55.8	54.5	51.9	50.9	48.5	48.0	48.3	46.5	48.4	48.5	50.4	52.0	51.1	46.8	45.9	43.8	44.5	45.4	46.8	44.9	44.4	45.3
Spain	56.2	56.9	54.2	53.3	53.8	52.6	48.7	49.9	49.0	44.7	45.7	46.4	48.4	50.7	51.3	49.0	48.4	48.0	47.8	46.5	47.7	45.1	46.3	46.2
Ireland	59.4	57.8	59.4	59.1	56.4	53.1	51.8	51.1	51.5	51.4	48.7	48.7	50.1	51.3	49.7	48.6	47.5	47.3	47.0	50.8	49.6	48.2	50.0	48.9
United Kingdom	57.3	58.0	55.2	55.8	54.6	52.8	52.1	47.3	48.4	46.2	46.5	45.3	47.0	49.3	47.9	47.8	47.1	46.5	45.3	43.0	44.3	44.8	47.2	46.2
Japan	55.4	52.7	54.1	53.5	53.3	52.7	52.1	51.5	50.8	50.7	49.0	48.9	48.9	47.7	49.2	49.5	50.6	49.8	49.6	49.6	48.5	48.7	48.3	47.9
Services																								
United States	51.2	56.5	58.0	55.6	53.4	52.7	47.3	43.7	49.3	47.8	46.2	44.7	46.8	50.6	52.6	53.6	54.9	54.4	52.3	50.5	50.1	50.6	50.8	51.4
Eurozone	51.1	55.5	55.6	57.7	56.1	53.0	51.2	49.8	48.8	48.6	48.5	49.8	50.8	52.7	55.0	56.2	55.1	52.0	50.9	47.9	48.7	47.8	48.7	48.8
Germany	52.2	55.8	56.1	57.6	55.0	52.4	49.7	47.7	45.0	46.5	46.1	49.2	50.7	50.9	53.7	56.0	57.2	54.1	52.3	47.3	50.3	48.2	49.6	49.3
France	53.1	55.5	57.4	58.9	58.3	53.9	53.2	51.2	52.9	51.7	49.3	49.5	49.4	53.1	53.9	54.6	52.5	48.0	47.1	46.0	44.4	45.2	45.4	45.7
Italy	48.5	52.8	52.1	55.7	53.7	51.6	48.4	50.5	48.8	46.4	49.5	49.9	51.2	51.6	55.7	57.6	54.0	52.2	51.5	49.8	49.9	47.7	49.5	49.8
Spain	46.6	56.6	53.4	57.1	56.5	54.0	53.8	50.6	48.5	49.7	51.2	51.6	52.7	56.7	59.4	57.9	56.7	53.4	52.8	49.3	50.5	51.1	51.0	51.5
Ireland	56.2	61.8	63.4	61.7	60.2	55.6	56.3	54.7	54.1	53.2	50.8	52.7	54.1	58.2	55.7	58.4	57.0	56.8	56.7	55.0	54.5	52.6	54.2	53.2
United Kingdom	54.1	60.5	62.6	58.9	53.4	54.3	52.6	50.9	50.0	48.8	48.8	49.9	48.7	53.5	52.9	55.9	55.2	53.7	51.5	49.5	49.3	49.5	50.9	53.4
Japan	47.6	44.2	49.4	50.7	52.6	54.0	50.3	49.5	52.2	53.2	50.3	51.1	52.3	54.0	55.0	55.4	55.9	54.0	53.8	54.3	53.8	51.6	50.8	51.5

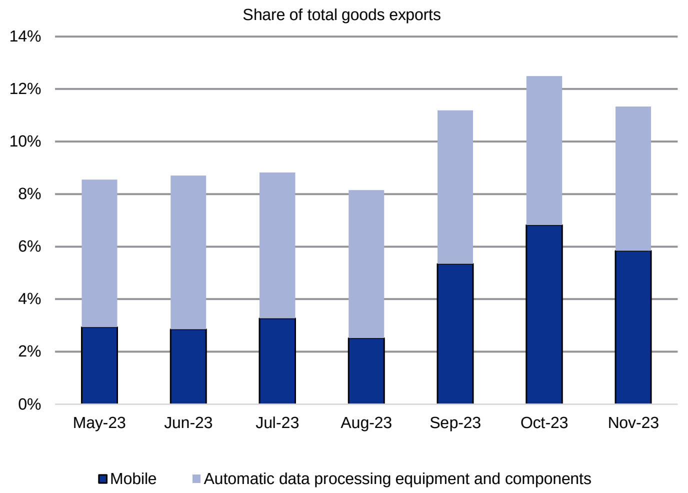
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 100: China's share of US goods imports has declined, as a combination of political and economic forces is driving the restructuring of the global supply chain



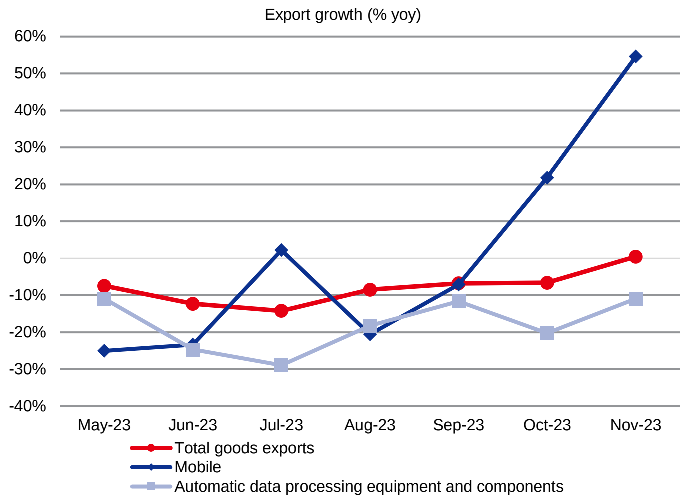
SOURCES: CGS-CIMB RESEARCH, US CENSUS BUREAU

Figure 101: Mobile and ADP collectively account for around 10% of China's exports



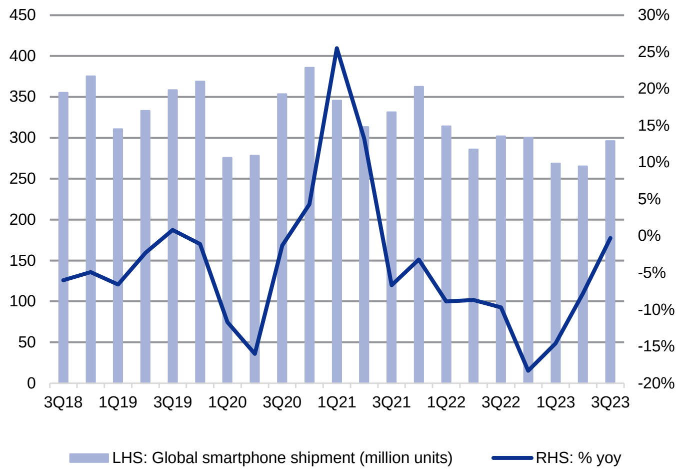
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 102: Mobile exports rebounded strongly in Nov 23



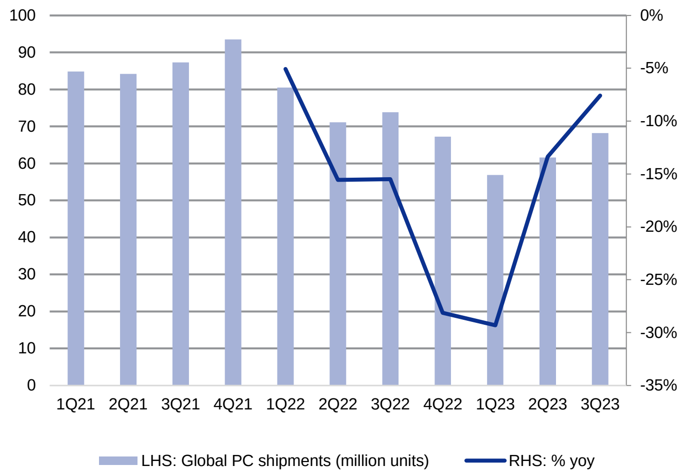
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 103: The decline in global smartphone shipment narrowed in 3Q23 …



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 104: … and so has the decline in global PC shipment

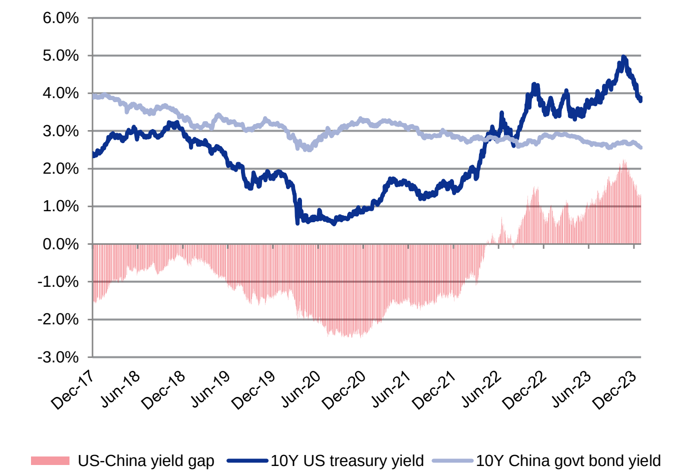


SOURCES: CGS-CIMB RESEARCH, IDC

Exchange rate: a modest appreciation in renminbi

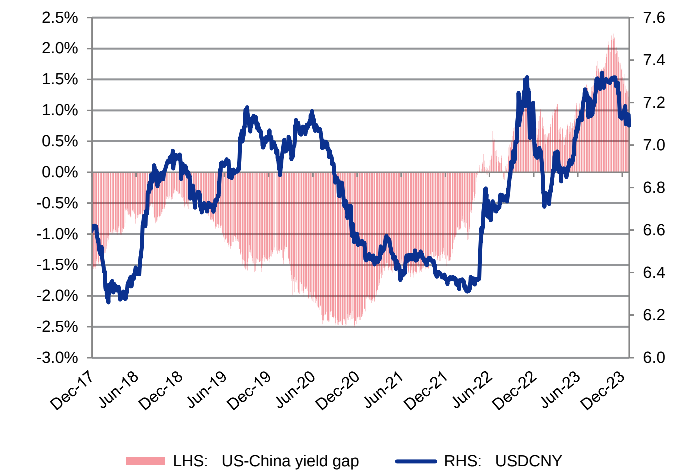
We expect the renminbi exchange rate to modestly appreciate, fluctuating within a range of 6.9 to 7.2 in 2024F. This is due to the softening of the US dollar index, as the US is expected to enter an interest rate reduction cycle. We see strong commitment from policymakers to maintaining the exchange rate at a relatively stable level to reduce capital outflow pressure.

Figure 105: The yield gap between the US and China has turned positive since early-2022



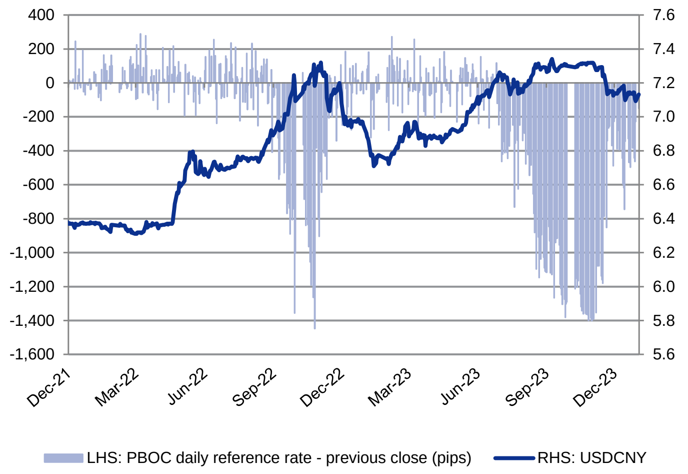
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 106: Renminbi strengthened recently on narrowing interest rate differential



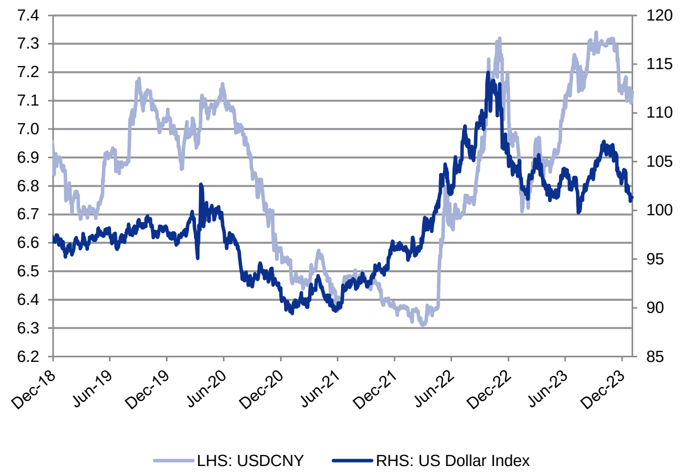
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 107: PBOC set the daily reference rate at a stronger-expected-level to slow the pace of renminbi depreciation



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 108: US dollar weakened recently as US inflation cooled and the Fed turned more dovish



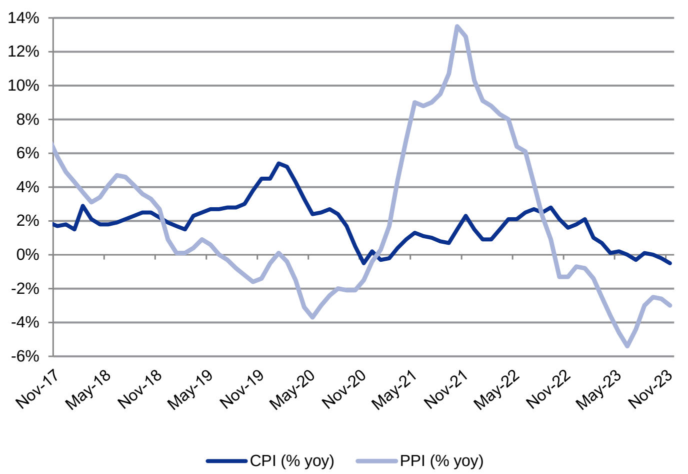
SOURCES: CGS-CIMB RESEARCH, WIND

Inflation: modest reflation in 2024F

We expect CPI inflation to pick up from 0.4% in 2023F to 1.0% in 2024F due to improvement in demand on the back of policy support.

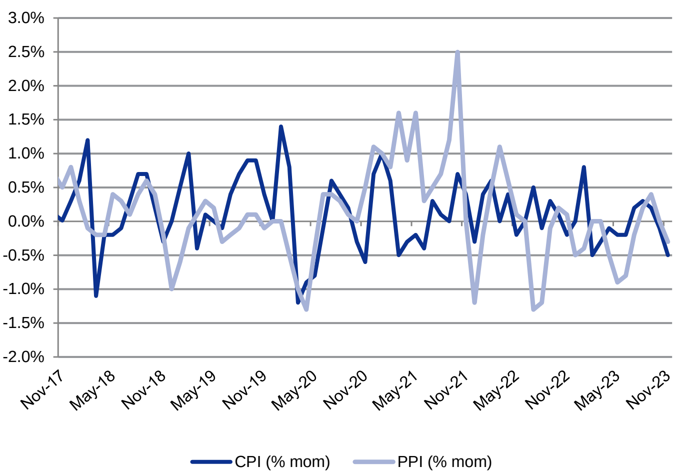
PPI deflation has started to narrow over the past few months but might continue in 1H24F. We expect PPI inflation to rise from -3.1% in 2023F to 0.8% in 2024F due to a low base this year.

Figure 109: PPI growth turned negative since Oct 22



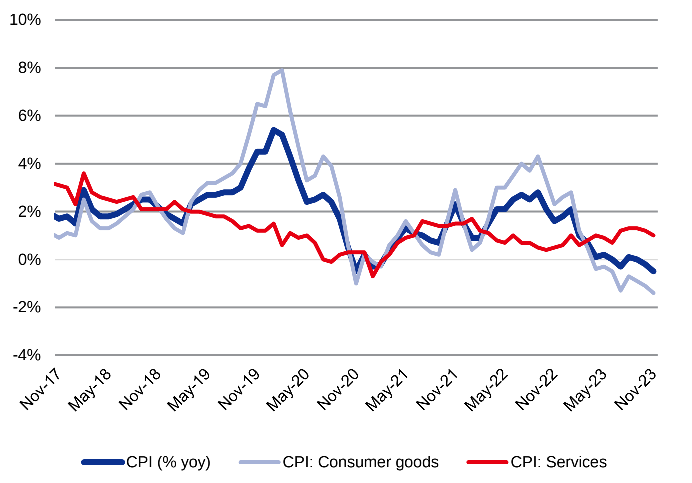
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 110: CPI registered negative mom growth in Oct 23 and Nov 23



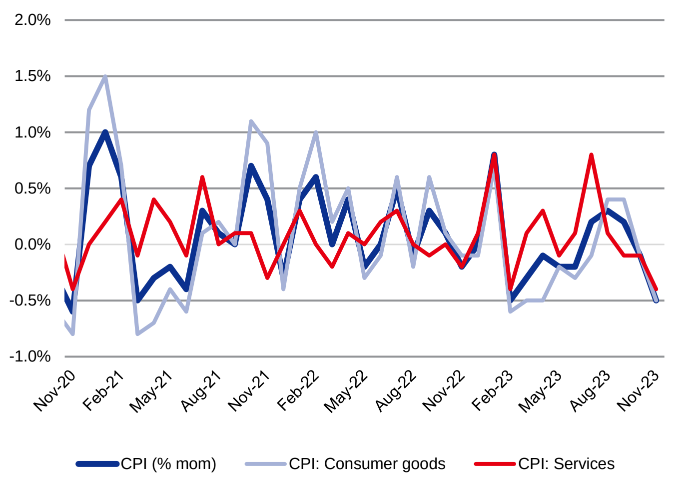
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 111: Services inflation has been rising at a faster pace than headline CPI



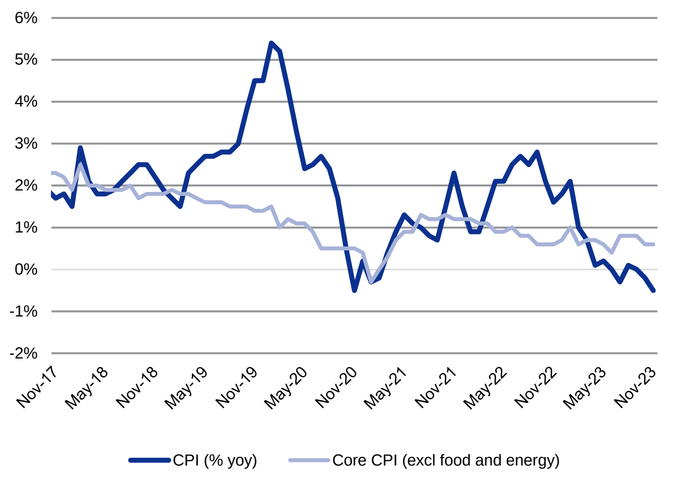
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 112: Services inflation turned to negative mom growth since Sep 23



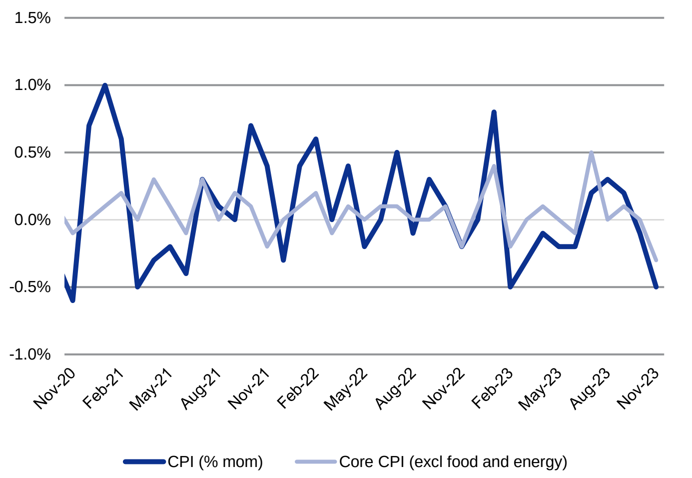
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 113: Core CPI growth has been largely stable in 2023



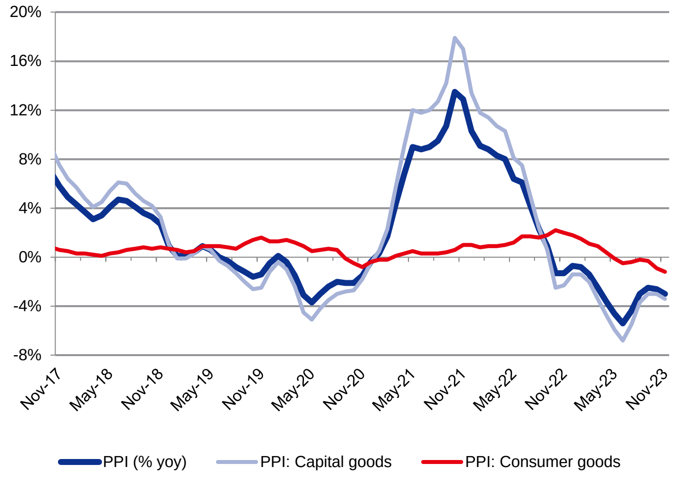
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 114: Core CPI declined 0.3% mom in Nov 23



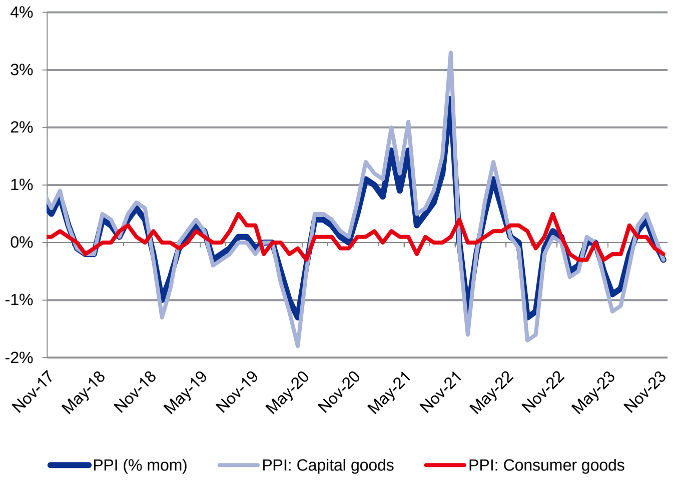
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 115: The decline in PPI widened in the past two months



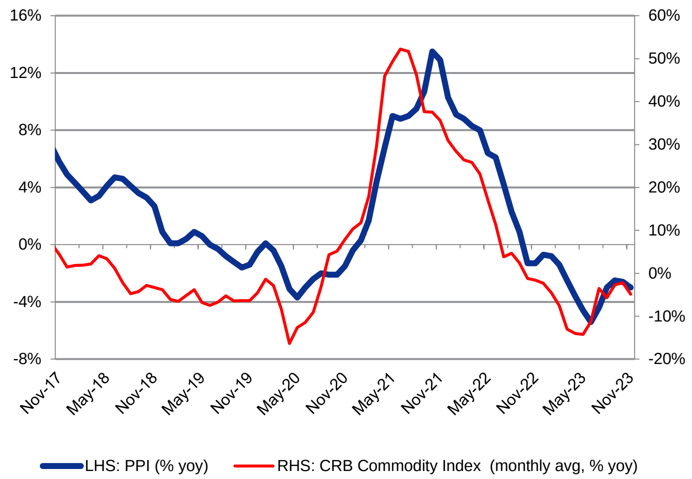
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 116: Capital goods PPI has been more volatile than consumer goods PPI



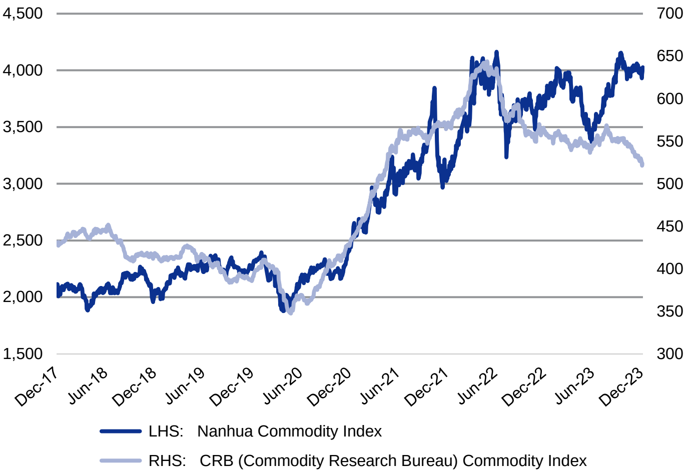
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 117: China's PPI closely tracks commodity price movement



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 118: Global commodity prices resumed downward trend in recent months



SOURCES: CGS-CIMB RESEARCH, WIND

Market outlook: constructive view on offshore Chinese equities

Year of election: potentially adding to stock market volatility

Year 2024 is packed with elections. Globally, more than 60 countries, representing around half of the world's population, will hold regional, legislative and presidential elections, according to Politico, a US based media company. The outcomes of these elections could have significant consequences for years to come. Some of the prominent names on the list are India, Indonesia, Mexico, South Africa, Pakistan, and the United Kingdom.

The elephant in the room is the US presidential election to be he held in November 2024, which is expected to bring renewed uncertainty to the Sino-US relationship, potentially adding to stock market volatility. Although the recent re-engagement between the two countries serves to reduce the risk of miscalculation and prevent competition from escalating into conflict, we anticipate continued efforts on the US side to restrict China's technological advancement through its "small-yard, high-fence" approach.

At this moment, it still seems likely that the presidential race will result in a rematch between Biden and Trump. However, the past few years have proved that whoever is elected to the White House will not change Washington's overall strategy towards China. The US will continue to mobilise resources to curb the growth of China, in our view.

Despite the convergence of the long-term direction in bilateral relationship, short-term policy choices of the two can be quite different. Biden's approach to China emphasises multilateralism, cooperation with allies, and the implementation of systematic and predictable strategies. But he has demonstrated willingness to engage in necessary strategic communications and seek potential cooperation in certain areas. In contrast, Trump's approach to China leans more towards unilateralism, prioritising "America First," which could be in the interest of China. However, Trump's presidency also implies more unpredictability and the potential for deliberate escalation of tensions.

Figure 119: 2024 is a record year for elections around the world

Time	Note	Country/Region	Population (2022) (million)	GDP (2022) (US$ bn)	Elections
7 Jan 2024		Bangladesh	171.2	460.2	National Parliament
13 Jan 2024		Taiwan, China	23.3	760.8	Presidency, Legislative Yuan
28 Jan 2024		Finland	5.6	282.9	Presidency
8 Feb 2024		Pakistan	235.8	374.7	National Assembly
14 Feb 2024		Indonesia	275.5	1,319.1	Presidency, House of Representatives
1 Mar 2024		Iran	88.6	413.5	Islamic Consultative Assembly, Assembly of Experts
15-17 Mar 2024		Russia	144.2	2,240.4	Presidency
31 Mar 2024	1	Ukraine	38.0	160.5	Presidency
10 Apr 2024		South Korea	51.6	1,673.9	National Assembly
Apr-May 2024 (Expected)		India	1,417.2	3,416.6	Lok Sabha (House of the People)
May-Aug 2024 (Expected)		South Africa	59.9	405.3	National Assembly
2 Jun 2024		Mexico	127.5	1,465.9	Presidency, Senate, Chamber of Deputies
6-9 Jun 2024		European Union	447.4	16,746.2	European Parliament
Before Sep 2024 (Potential)	2	Japan	125.1	4,232.2	Potential snap election (House of Representatives)
5 Nov 2024		United States	333.3	25,439.7	Presidency, Senate, House of Representatives
Late 2024 (Expected)	3	United Kingdom	67.0	3,089.1	House of Commons
Dec 2024 (Expected)		Venezuela	28.3	482.4	Presidency

SOURCES: CGS-CIMB RESEARCH, TIME.COM, WORLD BANK, WIND

Note 1: Uncertain due to martial law; Note 2: The next Japanese general elections are scheduled to be held by 31 Oct 2025. Japanese Prime Minister Fumio Kishida is likely to call a snap election before his tenure as LDP leader expires in Sep 2024; Note 3: Must be held no later than 28 Jan 2025

Earnings growth: solid growth expected in 2024F ›

The market now anticipates the Hang Seng Index/Hang Seng ex-financials earnings growth of around 22%/19% in 2023F (2-year CAGR: 11%/13%), and 10%/14% in 2024F respectively.

The projected yoy earnings growth in 2024F vs. 2023F (measured by 2-year CAGR) indicates an acceleration in non-financials earnings growth. This should justify a modest improvement in valuation, in our view.

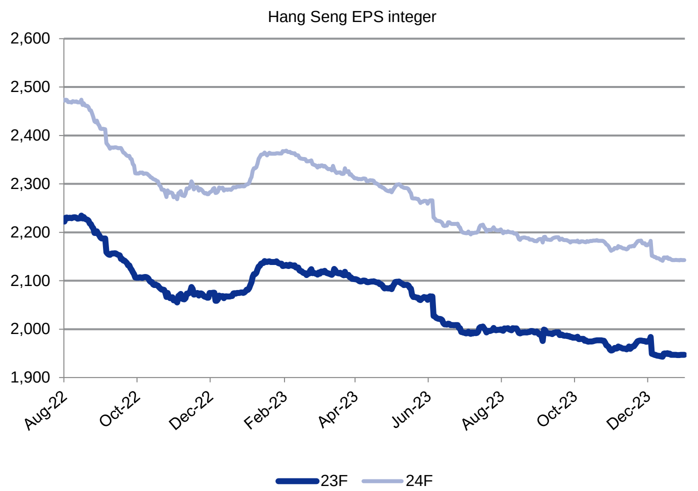
Due to the bottoming out of economic fundamentals and step-up in policy support, we expect an upward revision in consensus earnings projections ahead.

Figure 120: Hang Seng Index: earnings projection by sector (Bloomberg consensus)

	Index Weight	Revenue (% yoy)			Net profit (% yoy)		
		2022A	**2023F**	**2024F**	**2022A**	**2023F**	**2024F**
Financials	32.8%	-9.5%	13.7%	5.5%	-5.4%	24.8%	5.6%
Banks	19.3%	3.5%	3.6%	2.9%	13.0%	13.6%	1.7%
Insurance	10.4%	-25.0%	29.9%	9.0%	-66.2%	151.2%	25.5%
Diversified Financials	3.1%	-9.8%	31.0%	7.3%	-16.6%	26.2%	7.7%
Consumer Discretionary	25.4%	14.7%	16.6%	14.6%	34.3%	53.3%	21.2%
Communication Services	13.4%	5.9%	9.0%	8.5%	-0.2%	27.1%	11.4%
Real Estate	5.6%	-2.6%	6.9%	6.2%	-17.3%	12.8%	5.8%
Information Technology	4.7%	-6.5%	-6.8%	11.8%	-29.1%	-4.3%	15.1%
Energy	4.4%	24.8%	0.7%	5.8%	64.0%	-3.0%	4.6%
Consumer Staples	3.5%	8.5%	7.8%	7.1%	12.1%	6.2%	20.3%
Industrials	3.3%	6.0%	3.4%	5.3%	10.0%	-22.1%	12.5%
Healthcare	3.3%	8.6%	10.6%	11.4%	-20.7%	7.5%	16.5%
Utilities	3.0%	19.8%	3.7%	7.1%	-27.9%	81.2%	11.5%
Materials	0.8%	17.8%	6.1%	6.2%	-18.7%	11.4%	19.0%
Hang Seng	**100.0%**	**5.1%**	**9.0%**	**9.0%**	**1.2%**	**21.8%**	**9.9%**
Hang Seng ex financials	**67.2%**	**10.2%**	**7.6%**	**10.0%**	**7.6%**	**19.2%**	**13.8%**

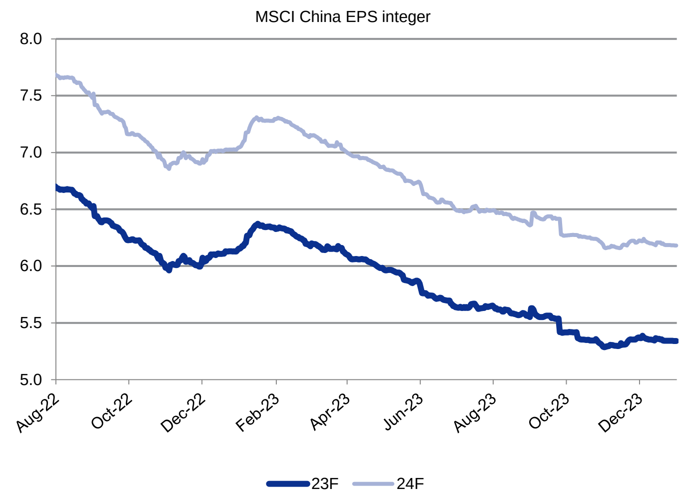
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 121: Hang Seng Index: EPS integer



SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 122: MSCI China Index: EPS integer



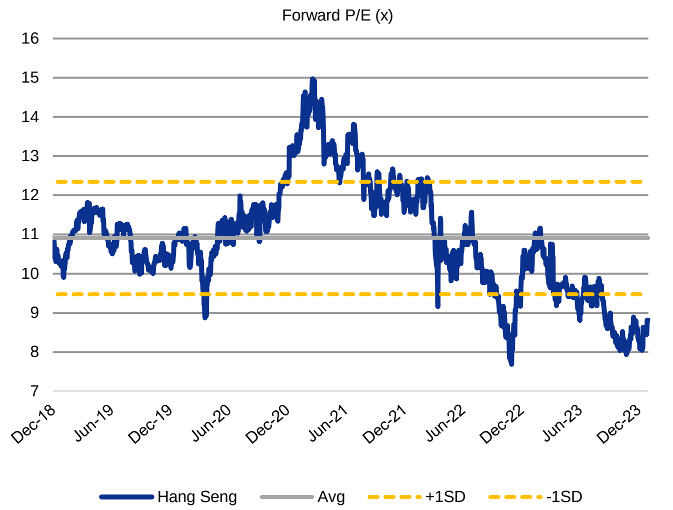
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Valuation: limited downside

The valuation of offshore Chinese stocks is quite low when considering both historical context and horizontal comparison. We see limited downside potential from the current valuation level.

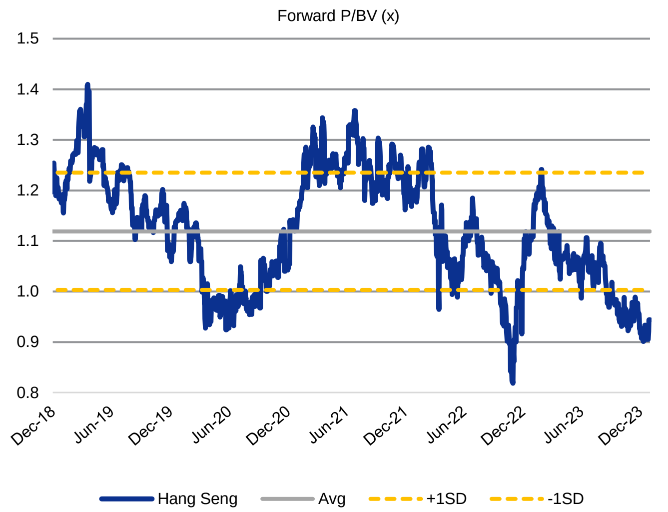
- Hang Seng and MSCI China Indices are currently trading at 8.8x and 9.6x forward P/E respectively, both at the low end of their five-year historical range. Their forward P/E are 19% below their five-year historical median, or 1.5x and 1.3x standard deviation below their five-year historical average. Compared to the trough level in Oct 22, their P/Es are only 14-15% higher.
- Their valuation discount vs. EM peers (including India, South Korea, and Taiwan) are also at a relatively high level by historical standards.
- Equity risk premium (earnings yield less sovereign bond yield) also shows offshore Chinese stocks are not expensive relative to bonds.
- Stock repurchases during 2023 rose further compared to the prior year, which was already a record high. The high level of share buybacks indicates that the corporates believe their HK-listed shares are trading at depressed levels.

Figure 123: Hang Seng Index is now trading at the lower end of five-year historical range…



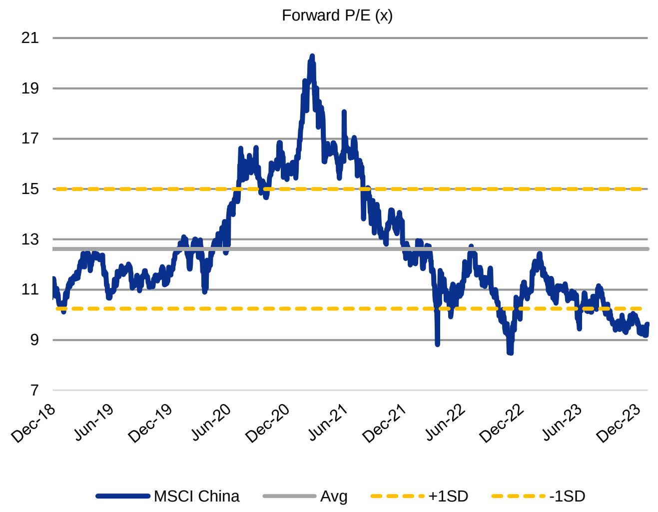
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 124: …while its forward P/BV is also close to the lower end of its historical interval



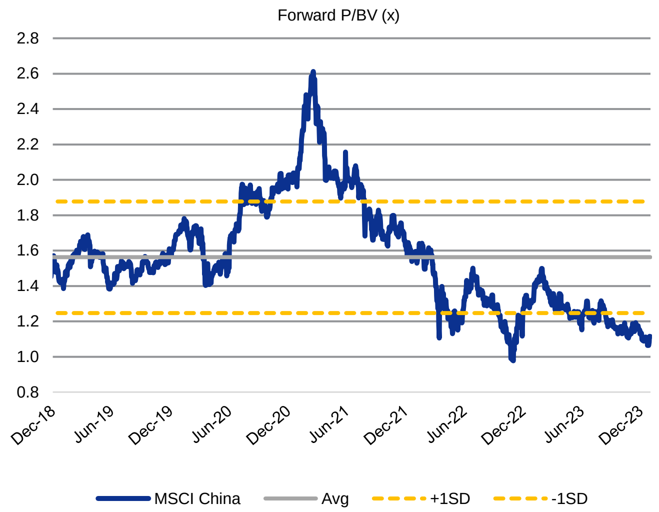
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 125: MSCI China Index is currently trading more than 1 standard deviation below its five-year historical average…



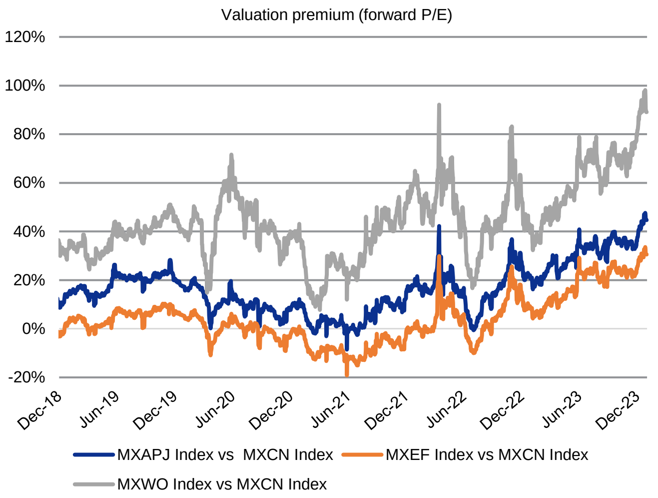
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 126: … which is also the case for its forward P/BV ratio



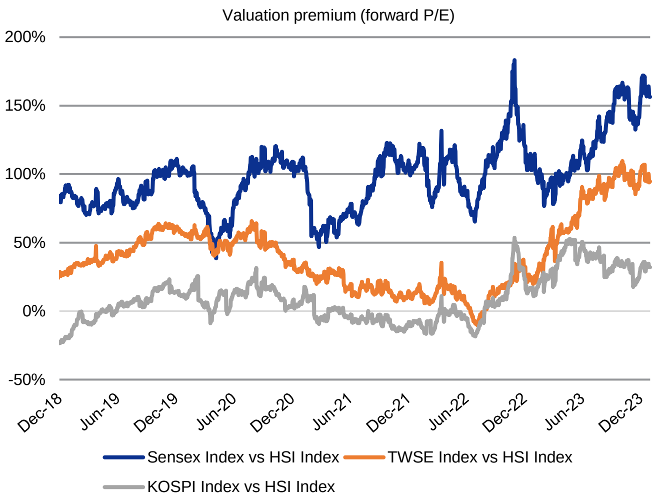
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 127: MSCI China is currently trading at a significant discount to other major indices



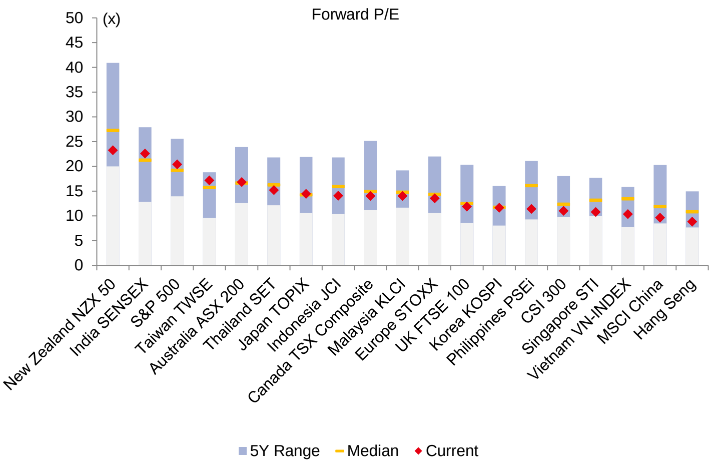
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 128: Hang Seng Index is also trading at a discount to India, South Korea, and Taiwan markets



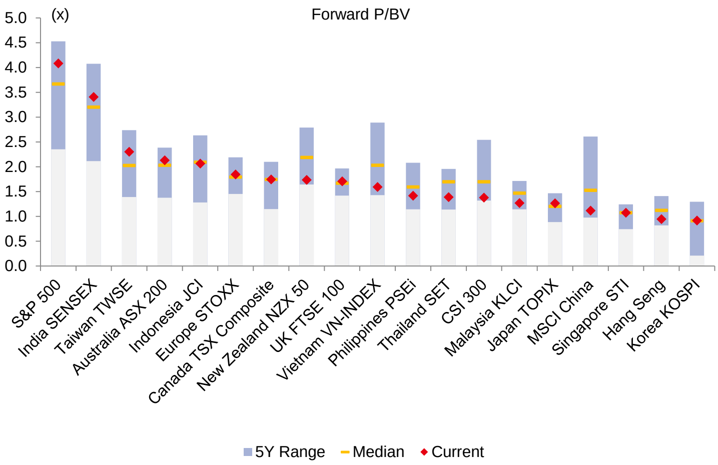
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 129: Current P/E ratio of major markets



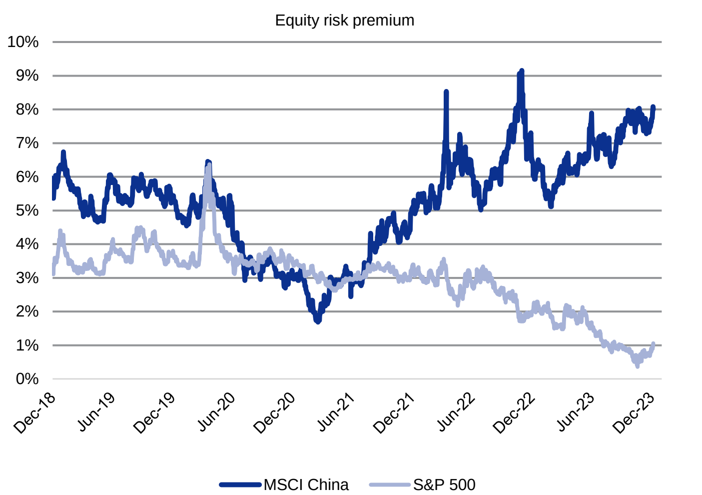
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 130: Current P/BV ratio of major markets



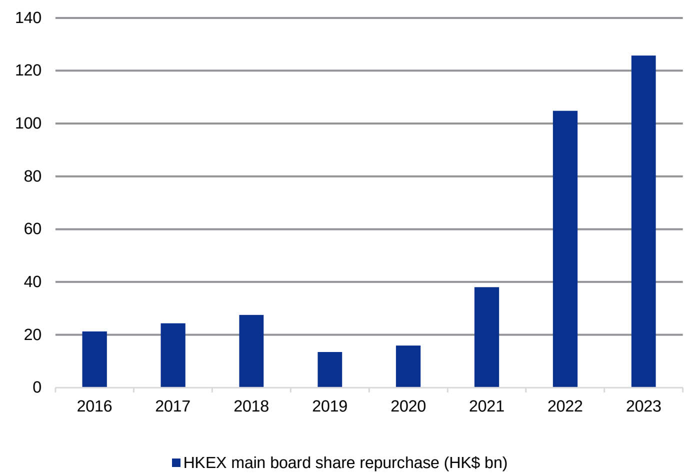
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 131: Equity risk premium (ERP): MSCI China vs. S&P 500



SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 132: Share repurchase in 2023 surpassed that of last year



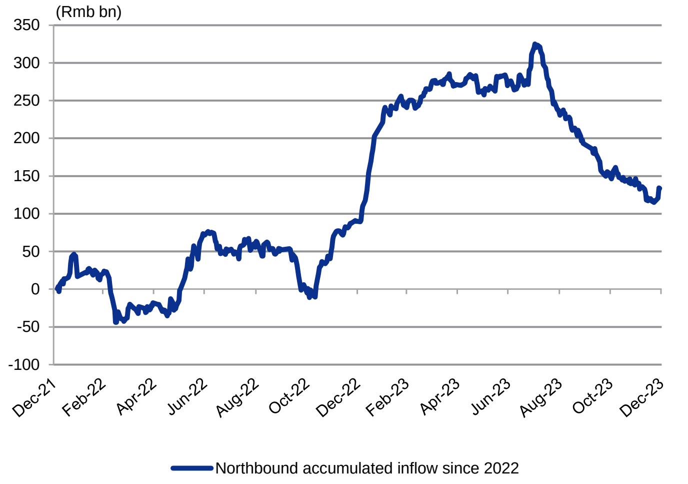
SOURCES: CGS-CIMB RESEARCH, WIND
Data as of 31 Dec 2023

Liquidity: Weakening in US dollar to boost EM stocks

Massive fund outflow from China market shows signs of abating

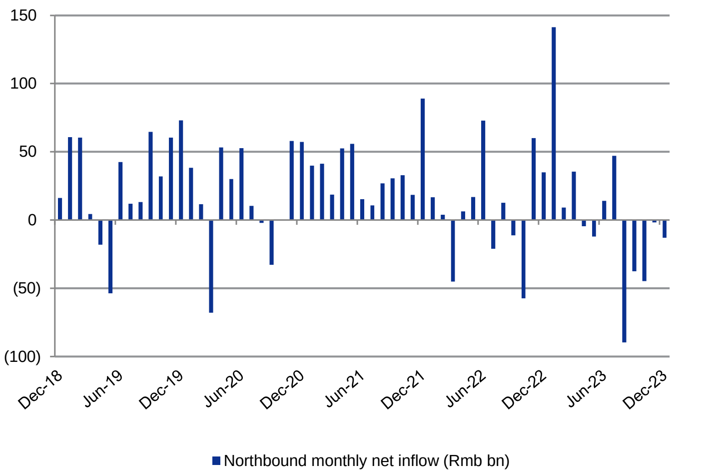
Foreign fund outflow from A-share market (we use this data as a proxy for foreign fund outflow from both onshore and offshore China market) has been unprecedented over Aug 23 and Oct 23. According to Reuters, persistent outflows had resulted in foreign long-only managers being their most underweight on China since 2018. However, the net outflow slowed significantly in Nov 23 and Dec 23, probably indicating that the trend of allocation reduction and structural shift of investment away from China has started to abate.

Figure 133: Foreign fund outflow via northbound trading of stock connect has been unprecedented in recent months



SOURCES: CGS-CIMB RESEARCH, WIND
Note: Data as of 31 Dec 2023

Figure 134: Foreign fund outflow from A-share market declined in Nov 23 and Dec 23



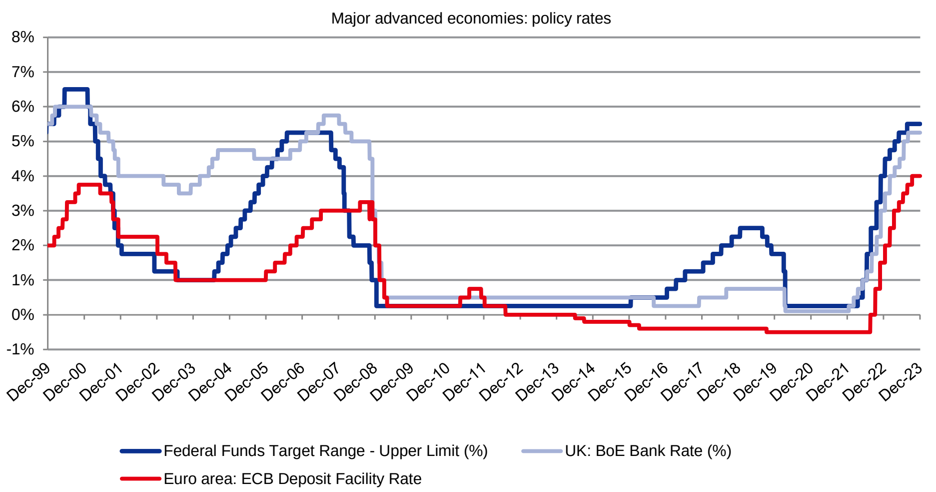
SOURCES: CGS-CIMB RESEARCH, WIND
Note: Data as of 31 Dec 2023

Major advanced economies to enter rate cut cycle next year.

Recent data indicates that US inflation has moved down significantly from its recent peak. Private consumption demand has been gradually moderating, while supply and demand in the labour market are coming into better balance. As a result, we expect US dollar strength to have peaked, as the Fed's rate-hiking cycle approaches an end. The weakening in US dollar should encourage fund inflow to emerging markets, in our view. Based on historical data, the US dollar index has shown strong negative correlation with the performance of emerging market stocks.

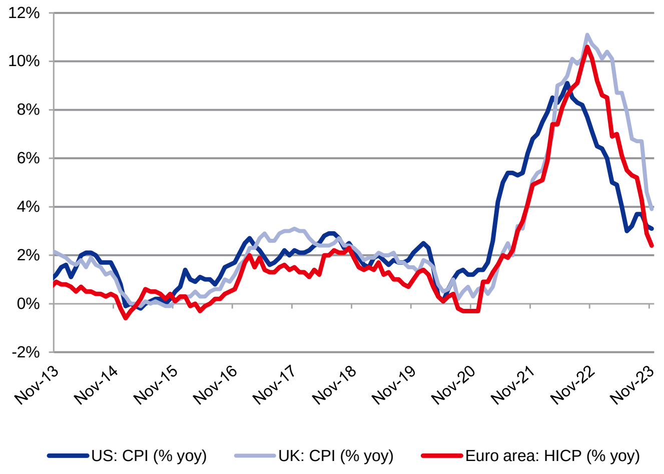
Our base case is for the Fed to start reducing rates around 2Q24. However, we still perceive the inflation risk as tilted to the upside, due to a resilient labour market and solid wage growth, which introduces uncertainty regarding the timing of the Fed's first rate cut and the magnitude of rate cuts next year.

Figure 135: Central banks of major advanced economies are closing in on end of rate hiking cycle



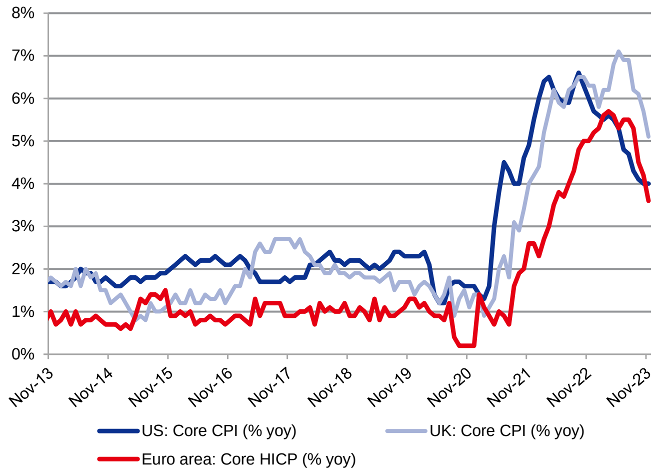
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 136: Headline CPI growth of major advanced economies have cooled significantly from their recent peaks…



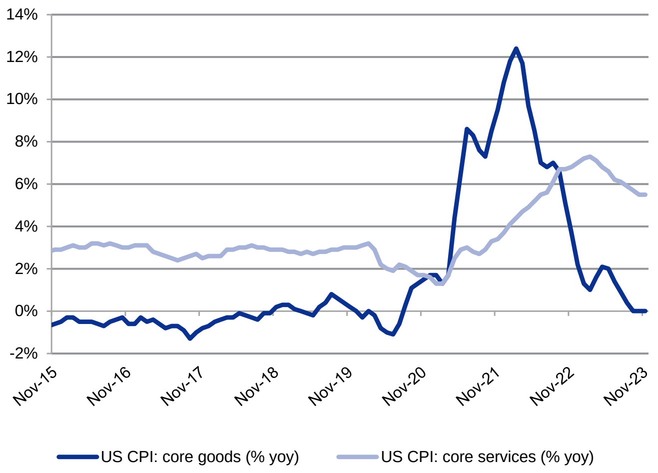
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 137: … while underlying inflation has proved stickier



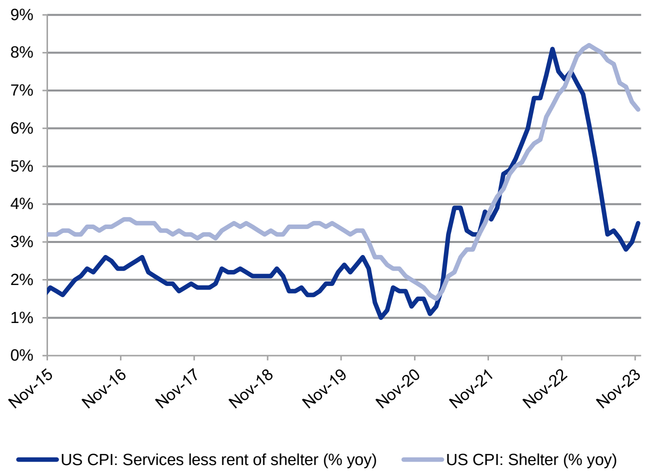
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 138: US goods inflation has largely abated but services inflation remains elevated



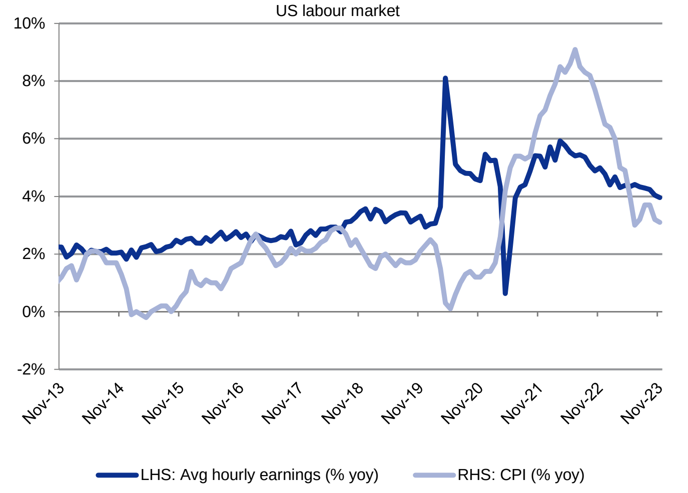
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 139: Shelter inflation has been a key driver of services inflation over the past year



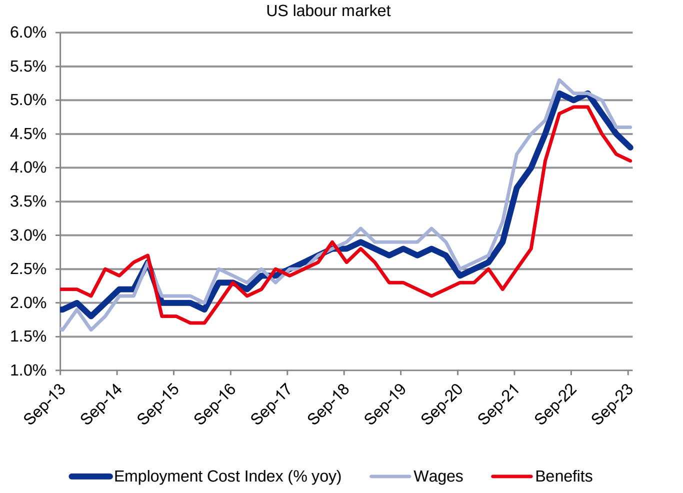
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 140: Wage growth has outpaced inflation in recent months, resulting in positive real (inflation-adjusted) wage growth and underpinning consumption demand



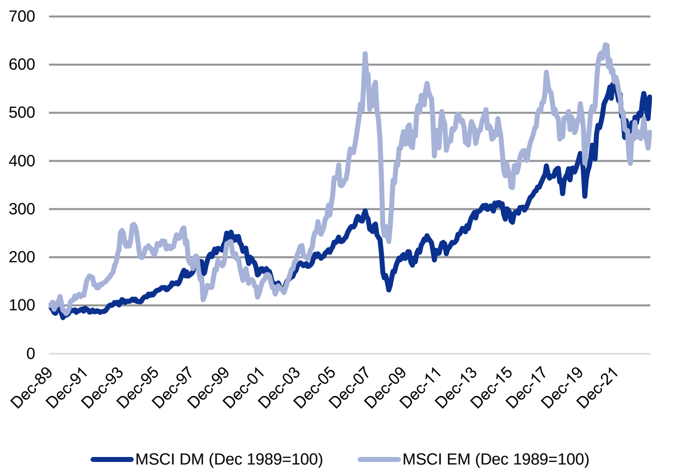
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 141: Employment Cost Index showed moderation, but remained above the level consistent with the Fed's inflation target



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 142: Index performance: developed markets vs. emerging markets

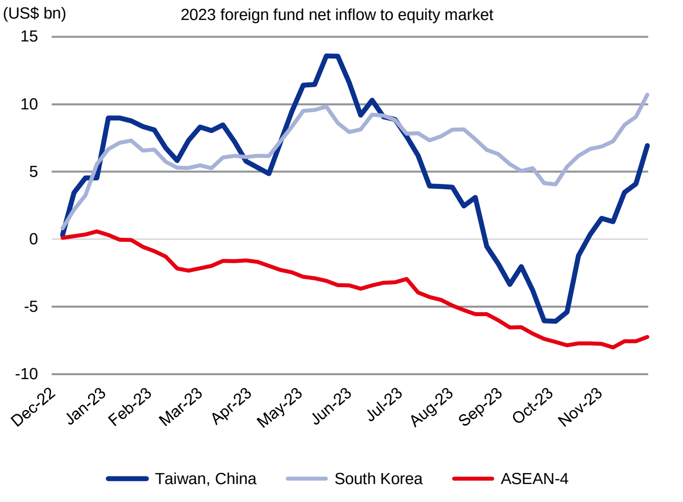


SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 143: The US dollar index has shown strong correlation with the relative performance between developed markets and emerging markets

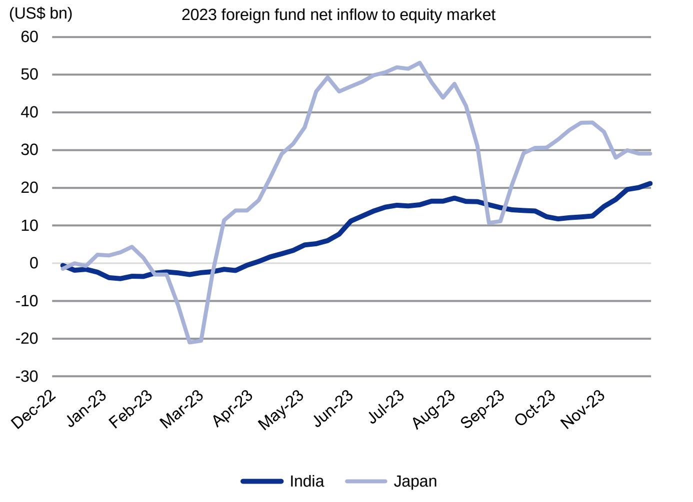
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 144: ASEAN markets have witnessed foreign fund outflows in 2023



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 145: Japanese stocks have been drawing in global investment inflows while Indian equities also enjoyed an increase in inflows

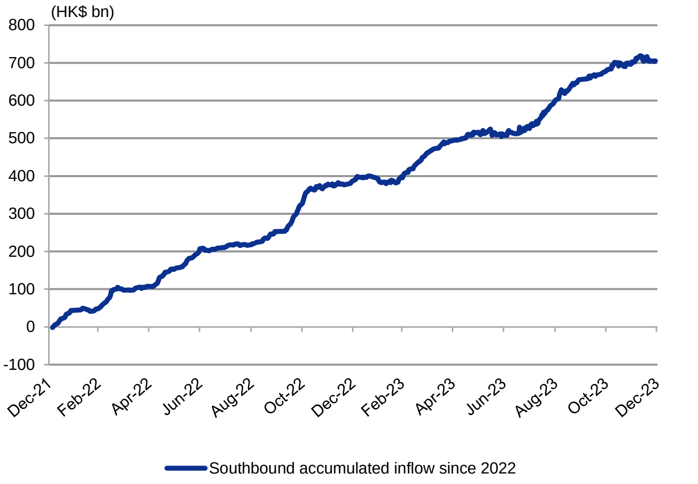


SOURCES: CGS-CIMB RESEARCH, WIND

Net inflow from southbound investors will continue but the marginal impact is likely to ease.

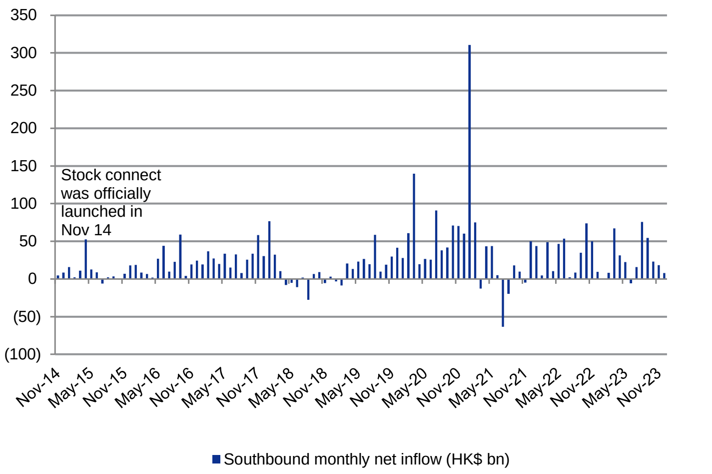
- Over the past few years, we witnessed sustained southbound net inflows to the Hong Kong stock market. Currently, the overall southbound investors' ownership in the Hong Kong stock market is around 7.2%, and we see room for this percentage to rise further to the double-digits in the next three to five years.
- We believe domestic investors' interest in offshore listed Chinese equities can be attributable to several factors: i) some sub-sectors with solid growth prospects are only available in the offshore market, such as NEVs and large-cap Internet platforms; ii) certain local Hong Kong stocks offer attractive dividend yields; iii) A/H premiums have seen a widening trend in recent years, defying conventional wisdom. As a result, H-share listed stocks offer more attractive yields relative to their A-share counterparts. We believe these factors should continue to underpin southbound net inflows for years to come.
- However, since reaching a peak in 2020, annual net inflows have been on a downward trend, likely due to a sluggish market performance. We believe southbound investors will continue to be an important source of incremental liquidity for the Hong Kong stock market, but their marginal impact is likely to decrease.

Figure 146: Hong Kong market witnessed sustained net inflow from southbound investors



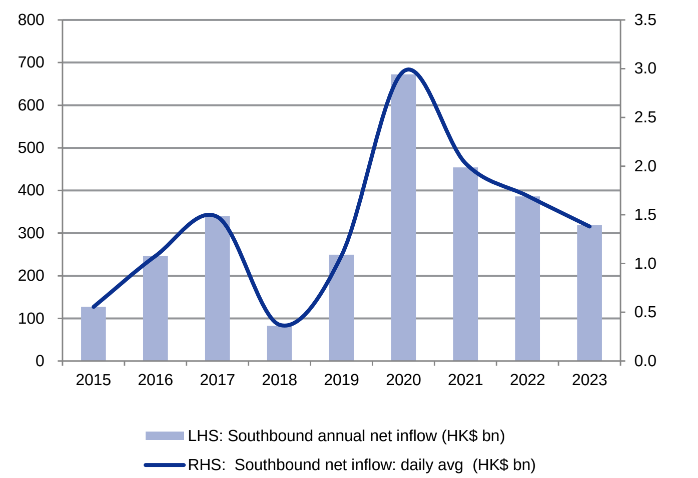
SOURCES: CGS-CIMB RESEARCH, WIND
Note: Data as of 31 Dec 2023

Figure 147: On a monthly basis, southbound net inflow has been in positive territory most of the time



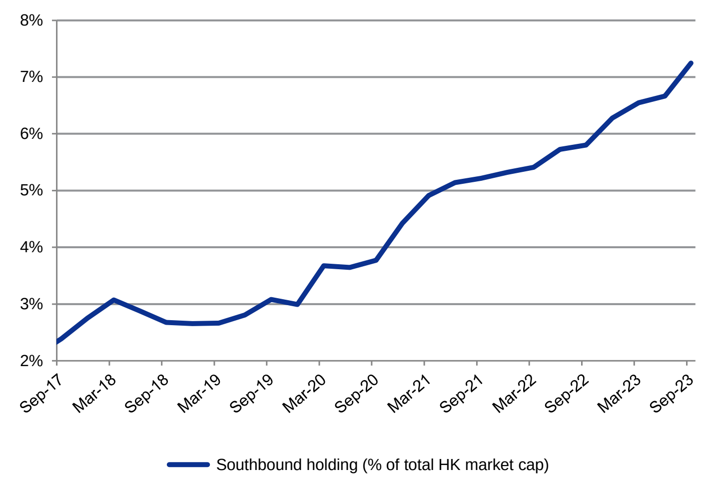
SOURCES: CGS-CIMB RESEARCH, WIND
Note: Data as of 31 Dec 2023

Figure 148: Southbound net inflows have slowed since 2020



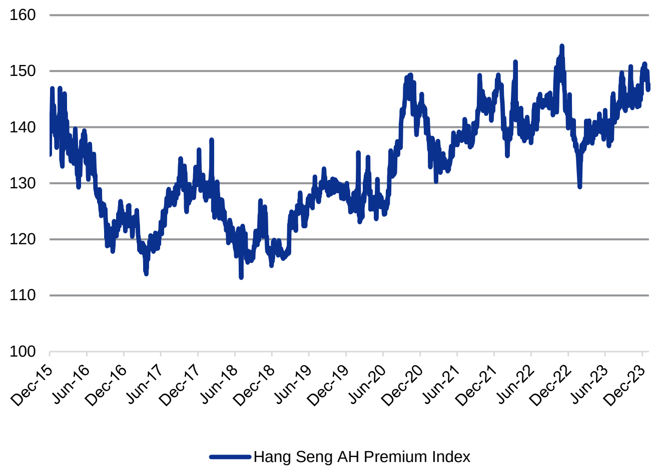
SOURCES: CGS-CIMB RESEARCH, WIND
Note: Data as of 31 Dec 2023

Figure 149: Southbound investors currently hold around 7.2% of total Hong Kong market cap



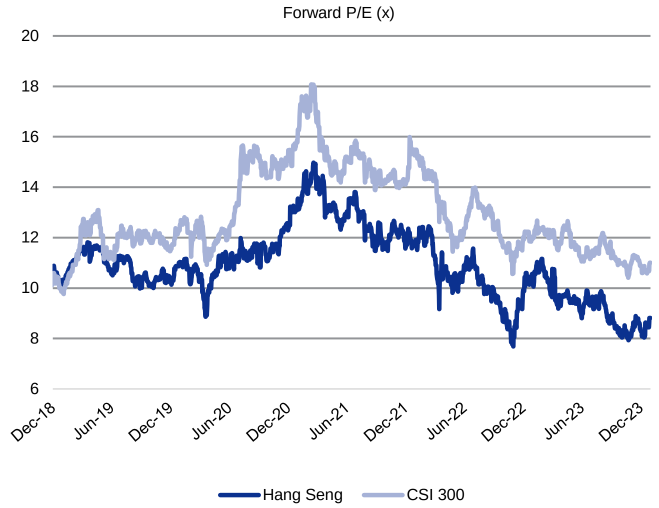
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 150: AH Premium Index points to widening price gap for A-H dual listed stocks



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 151: Large-cap A shares are trading at a premium relative to the Hong Kong market



SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

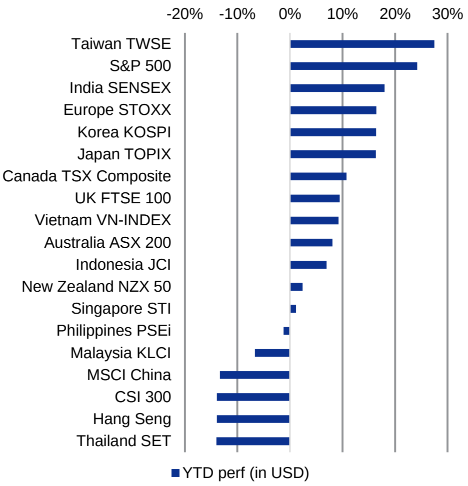
Index target: expect 20% upside from the current level

We hold a constructive view on offshore Chinese equities. We expect the market bottomed in 2023 and will stage a rebound in 2024F. i) We expect the government to strive for a higher economic growth target, in order to restore business and household confidence, which should in turn help lift investors' confidence in the China market. We see a significant step-up in the intensity of policy support in 2024F compared to 2023, and the pace to be more frontloaded. ii) China will kick off a new round of structural reforms on its fiscal and tax systems in 2024F, which should help revive China's long-term growth momentum, especially household consumption potential, and reduce risks related to local governments' hidden debt. iii) We see the risk-reward for China stocks as attractive, with valuations at the low end of the historical range, while earnings growth outlook remains solid. iv) As the Fed's rate hike cycle approaches its end, we expect to see US dollar strength hit a peak, which would likely encourage fund inflow to emerging markets. Based on historical data, the US dollar index has shown strong negative correlation with the performance of emerging market stocks.

Our 2024F year-end index targets for Hang Seng and MSCI China Indices are 20,400 and 67, respectively, based on forward P/E targets of 9.7x and 10.6x. The potential upside of c.20% from current levels are driven by both valuation expansion and earnings growth. We expect a revaluation of c.10%, while earnings growth for 2024F could reach c.9%.

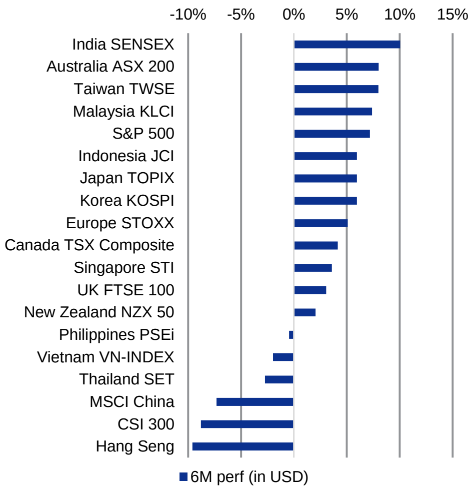
Key downside risks include i) "higher-for-longer" Fed rates, ii) weak domestic economic recovery, iii) ineffective policy implementation, and iv) geopolitical tension. For the upcoming US presidential election, we believe the past few years have proved that whoever is elected to the White House will not change Washington's overall strategy towards China. However, the short-term policy decisions may introduce renewed uncertainty to the bilateral relationship and potentially add to stock market volatility.

Figure 152: Global markets: YTD performance



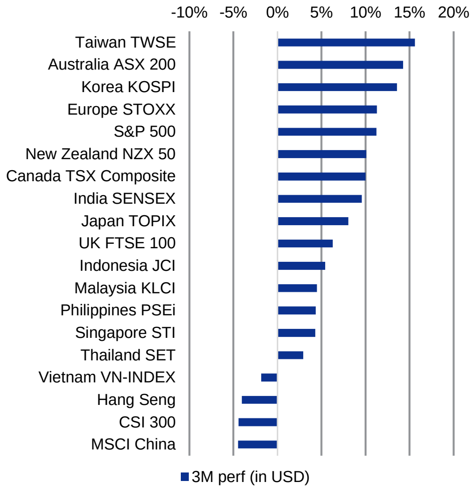
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 153: Global markets: 6M performance



SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 154: Global markets: 3M performance



SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 155: 2023 index performance breakdown by currency change, valuation change and earnings revision

Index	Index performance (in US dollar)	Currency chg	P/E change (23F)	EPS revision (23F)
Taiwan TWSE	27.5%	0.5%	56.9%	-19.2%
S&P 500	24.2%	0.0%	31.4%	-5.4%
India SENSEX	18.0%	-0.6%	23.9%	-4.2%
Europe STOXX	16.5%	3.3%	12.7%	0.0%
Korea KOSPI	16.4%	-2.0%	53.2%	-22.5%
Japan TOPIX	16.4%	-7.0%	23.8%	1.0%
Canada TSX Composite	10.8%	2.4%	24.0%	-12.8%
UK FTSE 100	9.5%	5.5%	13.3%	-8.4%
Vietnam VN-INDEX	9.2%	-2.6%	34.3%	-16.4%
Australia ASX 200	8.1%	0.2%	29.4%	-16.7%
Indonesia JCI	7.0%	0.7%	18.7%	-10.6%
New Zealand NZX 50	2.4%	-0.2%	13.0%	-9.2%
Singapore STI	1.2%	1.5%	-2.3%	2.0%
Philippines PSEi	-1.2%	0.6%	-6.1%	4.6%
Malaysia KLCI	-6.7%	-4.0%	11.8%	-13.0%
MSCI China	-13.3%	-0.1%	0.0%	-13.2%
CSI 300	-13.9%	-2.9%	5.9%	-16.3%
Hang Seng	-13.9%	-0.1%	-7.9%	-6.5%
Thailand SET	-14.0%	1.4%	9.3%	-22.4%

SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Sector preferences: prefer sectors with solid growth prospects and favourable policy support

We prefer sectors that enjoy favourable policy support, have solid earnings growth potential and are currently trading at attractive levels. We use Global Industry Classification Standard (GICS), an industry classification standard widely adopted by the global financial community.

Our recommendations are as follows:

- Overweight (OW) on Consumer Discretionary, Communication Services, IT and Insurance.
- We upgrade the IT sector due to a pick-up in the global tech cycle.
- Neutral on Real Estate, Banks, Consumer Staples, Materials, Industrials, Utilities and Energy.
- Underweight (UW) on Healthcare and Diversified Financials.

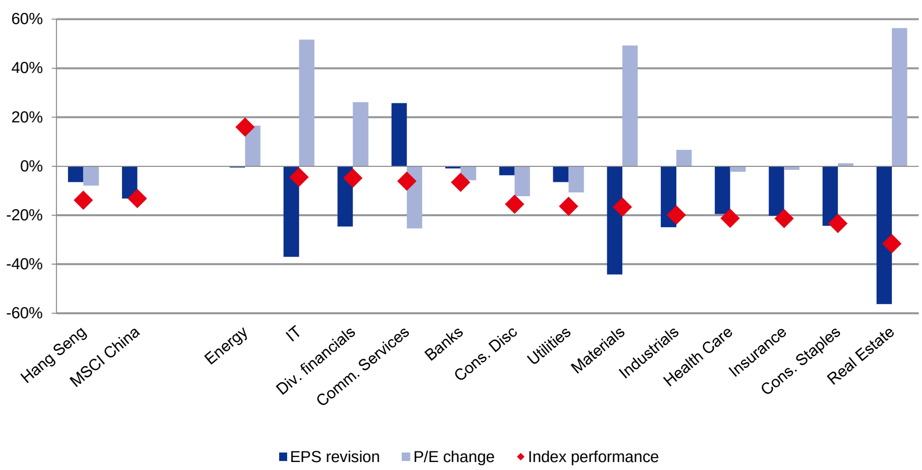
For investors who want to position for a potential earlier-than-expected rate cut by the Fed, we recommend the HK property sector, as a faster rate cut will help boost a recovery in Hong Kong's physical property market and reduce the financial cost burden on developers. Besides, the favourable immigration policy introduced by the HKSAR government in Oct 23 that seeks to attract highly skilled or talented persons to settle in Hong Kong will encourage population inflow and improve housing demand, in our view.

Figure 156: We prefer sectors with solid growth prospects, accommodative policy environment and attractive valuations

Sector	Rating	P/E (x)		P/BV (x)		Div Yld (%)		ROE (%)	
		23F	24F	23F	24F	23F	24F	23F	24F
Communication Services	OW	14.8	12.7	2.4	2.0	0.9	1.0	12.9	13.3
Consumer Discretionary	OW	15.9	12.7	2.0	1.8	0.7	0.8	10.6	12.2
Insurance	OW	5.9	4.6	0.6	0.5	6.8	7.8	10.3	11.8
Information Technology	OW ⬆	19.0	16.5	1.9	1.7	1.4	1.3	9.7	10.1
Consumer Staples	Neutral	21.7	17.3	3.4	3.0	2.4	2.9	15.4	17.4
Materials	Neutral	12.2	9.7	1.2	1.1	2.6	3.1	9.2	10.8
Real Estate	Neutral	11.6	7.1	0.6	0.6	4.4	4.7	5.3	7.9
Industrials	Neutral	8.5	7.6	0.9	0.8	3.7	3.8	10.1	10.1
Utilities	Neutral	7.7	6.8	0.9	0.8	5.8	6.1	11.2	11.6
Energy	Neutral	6.2	6.0	0.8	0.7	9.1	9.1	12.3	12.0
Banks	Neutral	3.4	3.3	0.4	0.3	8.7	9.0	10.8	10.4
Health Care	UW	31.4	26.0	2.5	2.2	1.1	1.3	7.9	8.5
Diversified Financials	UW	8.9	7.6	0.6	0.6	3.6	4.3	7.2	7.8
MSCI China		**10.5**	**9.1**	**1.2**	**1.1**	**2.6**	**2.8**	**10.5**	**11.1**
Hang Seng		**8.8**	**8.0**	**1.0**	**0.9**	**4.1**	**4.5**	**10.7**	**11.0**

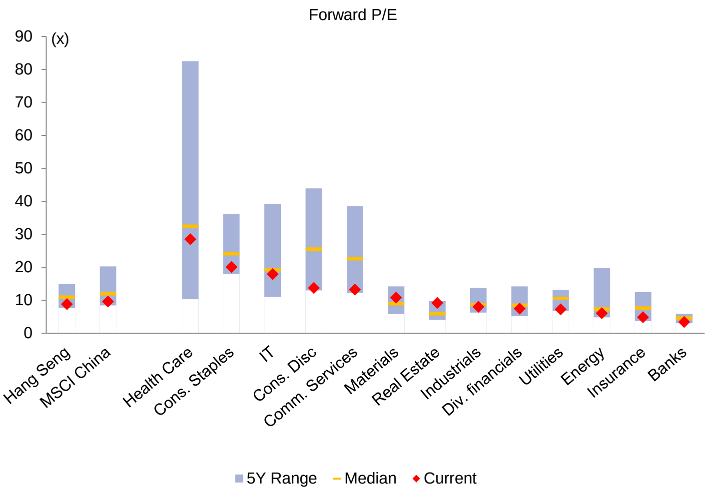
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 157: Offshore China stocks: YTD performance by valuation change and earnings revision



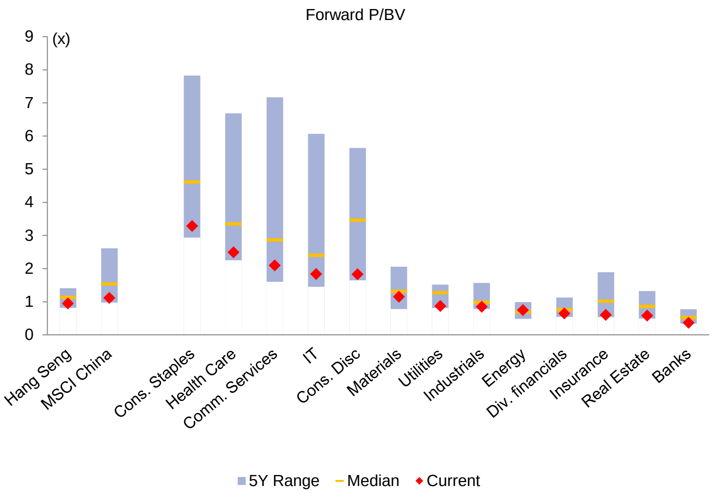
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 158: Offshore China stocks: forward P/E by sector



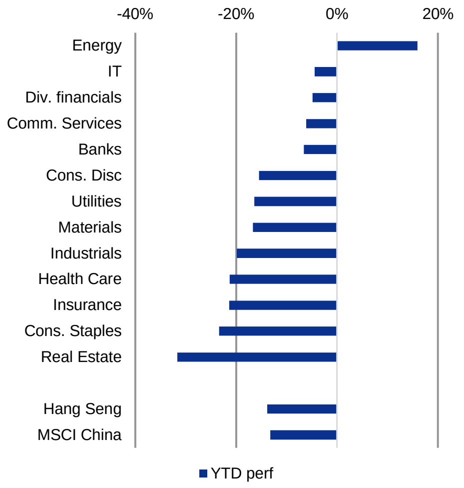
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 159: Offshore China stocks: forward P/BV by sector



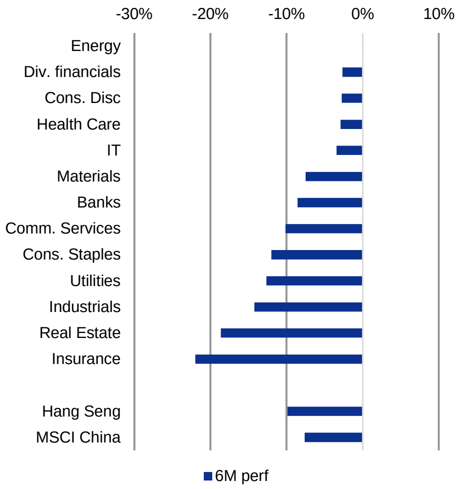
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 160: MSCI China Index: YTD performance



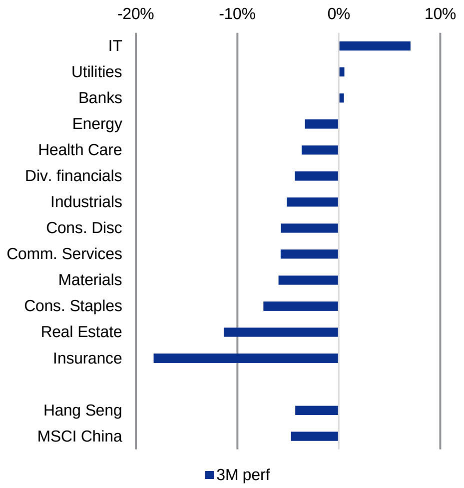
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 161: MSCI China Index: 6M performance



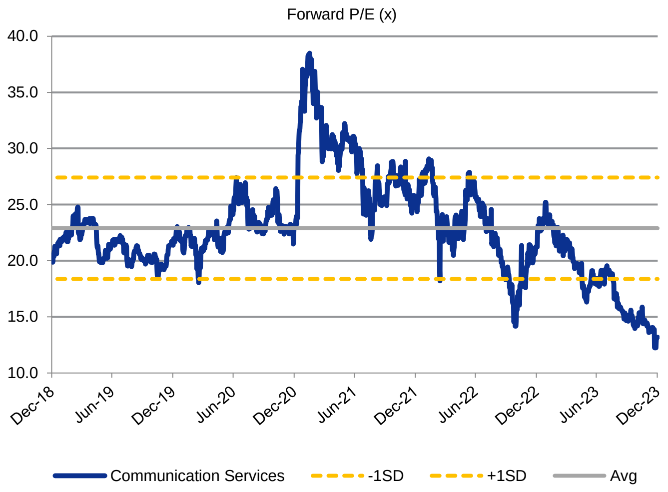
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 162: MSCI China Index: 3M performance



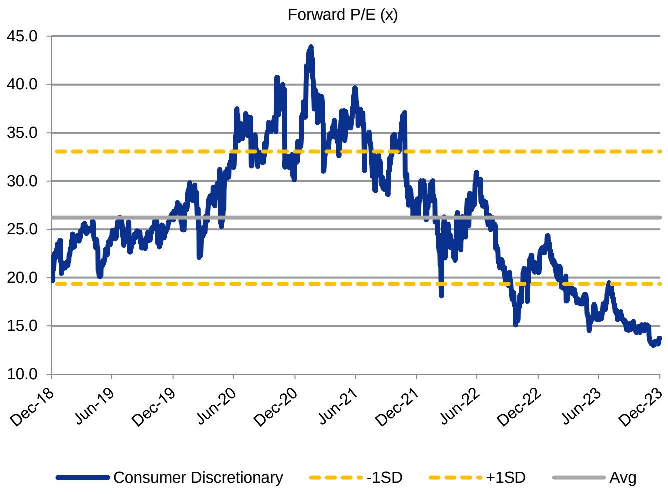
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Data as of 31 Dec 2023

Figure 163: Forward P/E ratio: Communication Services



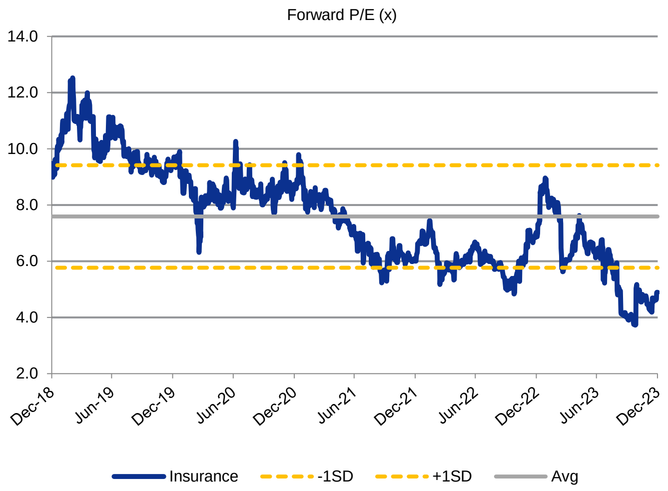
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 164: Forward P/E ratio: Consumer Discretionary



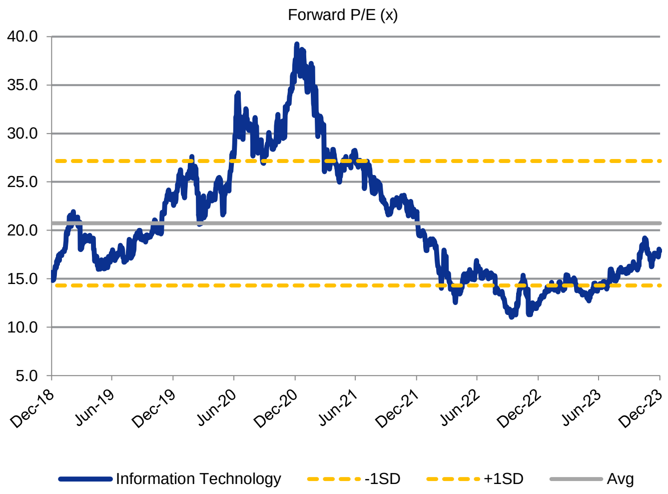
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 165: Forward P/E ratio: Insurance



SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Figure 166: Forward P/E ratio: Information Technology



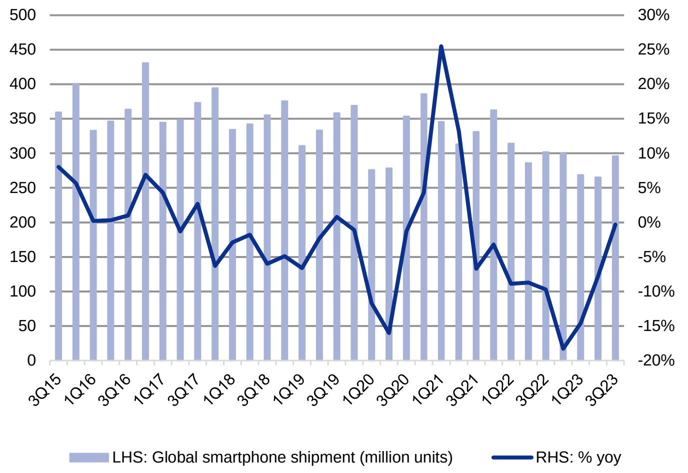
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

Upgrade to OW: Information Technology

Global smartphone demand showed signs of recovery in 2H23. Due to a push among vendors to introduce new models as well as healthy inventory levels, global smartphone shipments registered a mild decline of 0.3% yoy in 3Q23. We expect global smartphone shipments achieved positive qoq growth in 4Q23F and modest growth in 2024F, on the back of a continued recovery in consumption demand, new model launches and Huawei's return. We expect the smartphone supply chain to benefit from specification upgrades, driven by Huawei.

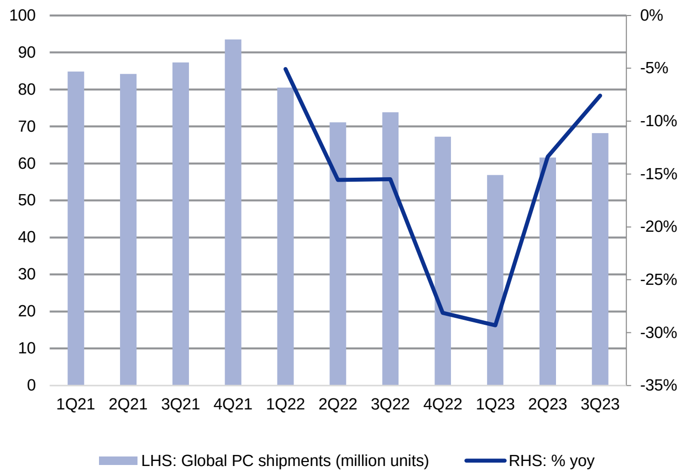
The decline in global PC shipments also narrowed in 3Q23 to 8%, indicating that the global PC demand has bottomed out. For 2024F, we expect global PC market to continue to recover, due to healthy inventory levels, device replacement cycle and transition to Win11. Besides, according to Canalys (a market analysis firm), major vendors expect to launch their first AI PC products in 2024F, bringing new opportunities.

Figure 167: The decline in global smartphone shipments narrowed further in 3Q23



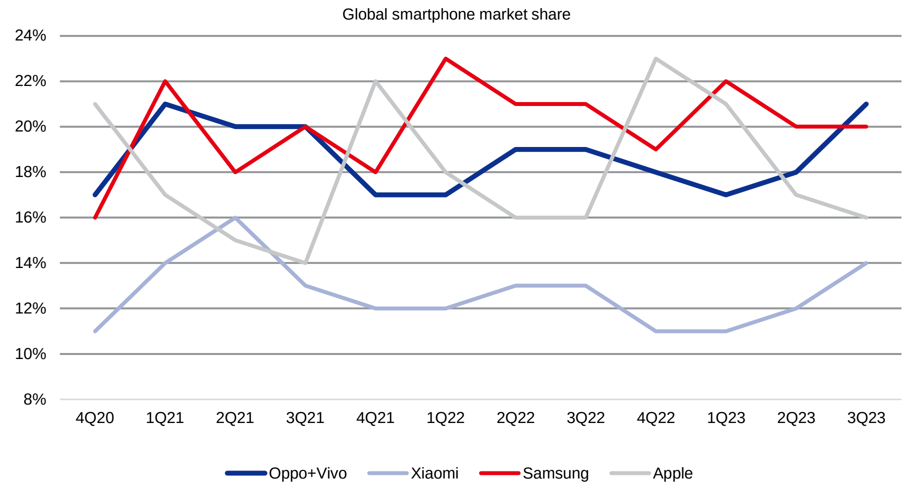
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 168: The decline in global PC shipments also narrowed in 3Q23



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 169: Major Chinese brands have been gaining market share in recent quarters

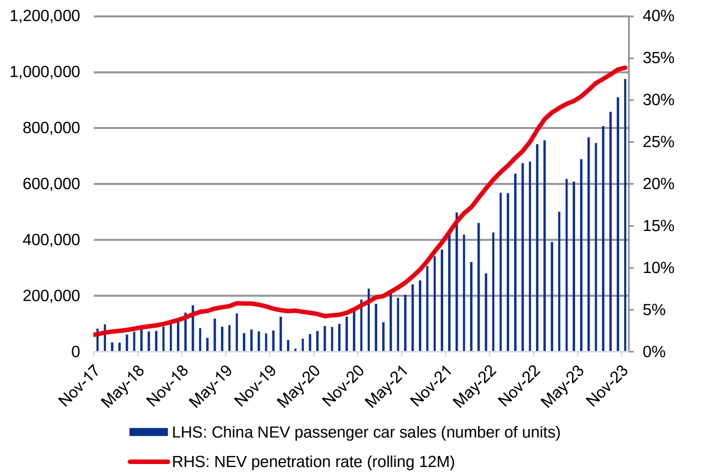


SOURCES: CGS-CIMB RESEARCH, WIND

Maintain OW: Consumer Discretionary, Communication Services and Insurance

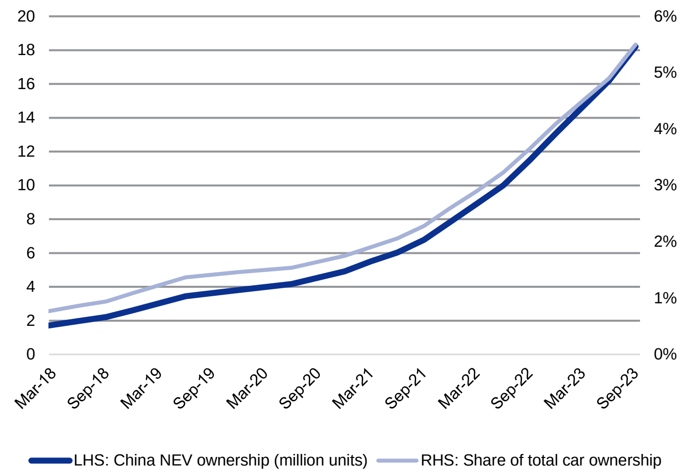
NEVs (sub-sector of Consumer Discretionary): i) Favourable domestic policies: We expect new energy vehicles (NEVs) to remain a key focus of China's auto consumption policies. Policymakers are likely to introduce more favourable policies to improve NEV adoption in rural areas by investing in charging and battery-swapping facilities in lower-tier cities and rural areas. The tax break for NEV has been extended through end-2027, providing a stable policy outlook for market participants. ii) Domestic market: China's NEV sales penetration rate has picked up rapidly in recent years. We expect further room for improvement in penetration in 2024F. iii) Overseas market: We see vast opportunities for Chinese NEV leaders in other emerging markets and some European countries, despite the EU anti-subsidy probe. We believe this is due to a lack of local players, low NEV penetration in these markets, competitive prices, and advanced technology. iv) Decline in battery cost: Decline in battery costs enables NEV makers to restore margins while maintaining competitive selling prices.

Figure 170: China's NEV sales penetration has picked up rapidly in the past three years and now stands at around 34%



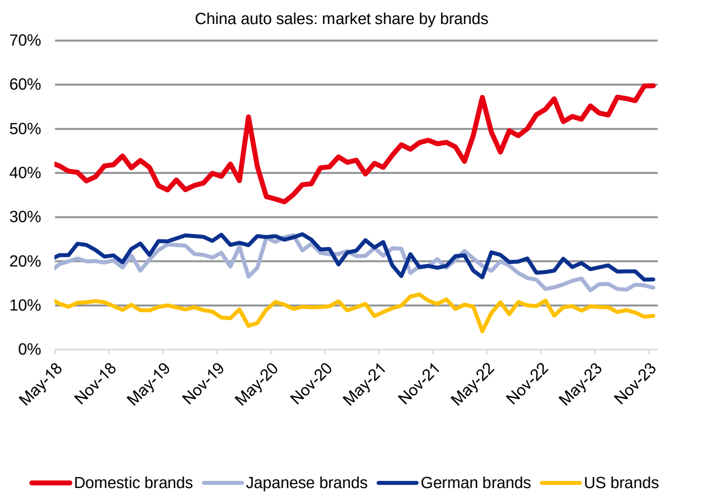
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 171: NEV accounts for around 5.5% of existing car ownership in China



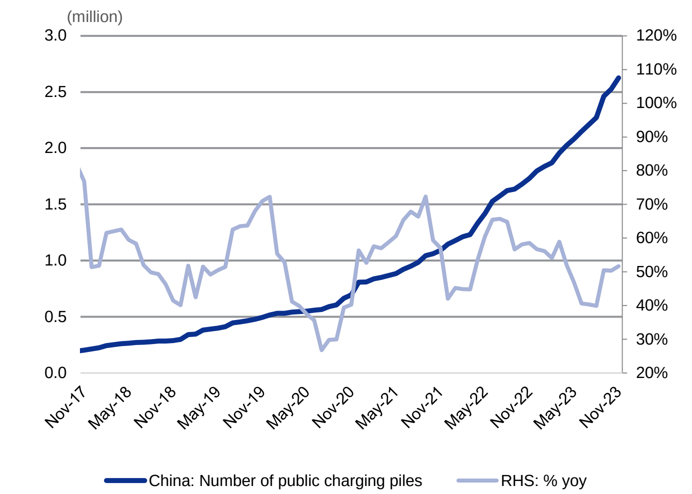
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 172: Domestic brands have been gaining market share, at the expense of Japanese and German brands



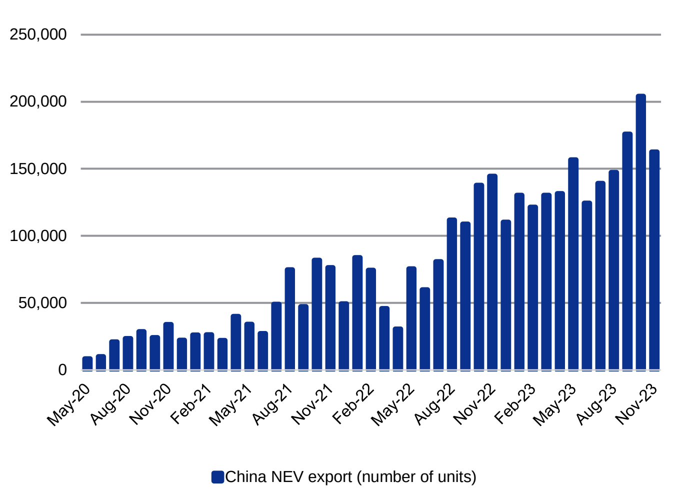
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 173: Charging infrastructure has improved rapidly on the back of favourable policy



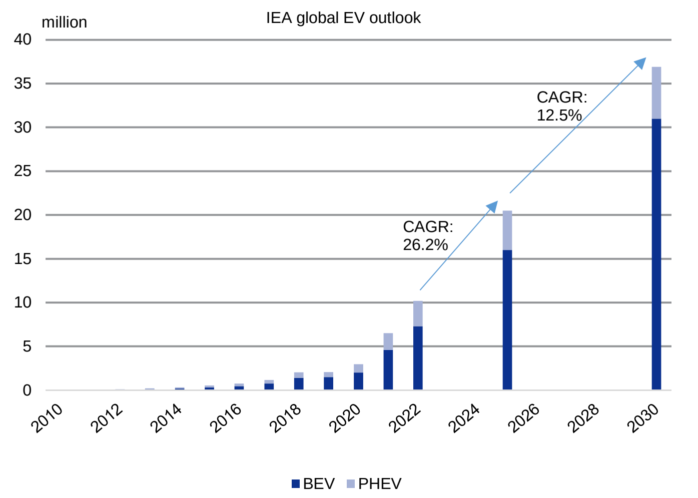
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 174: China's NEV exports also gained momentum



SOURCES: CGS-CIMB RESEARCH, WIND

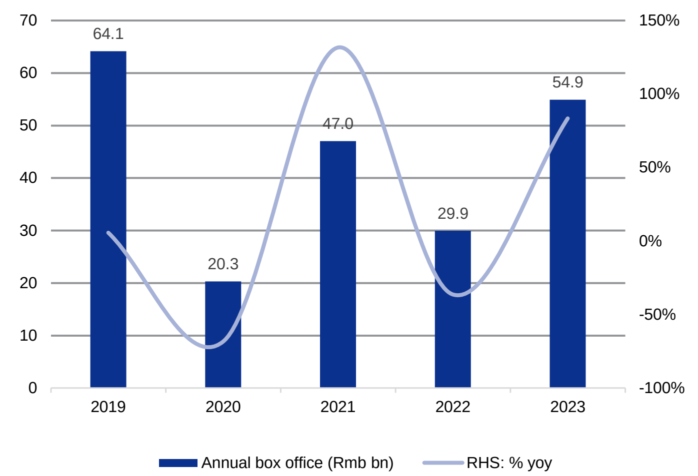
Figure 175: Global NEV market is expected to register double-digit annual growth at least until 2030



SOURCES: CGS-CIMB RESEARCH, IEA
Note: BEV stands for battery electric vehicle; PHEV stands for plug-in hybrid electric vehicle

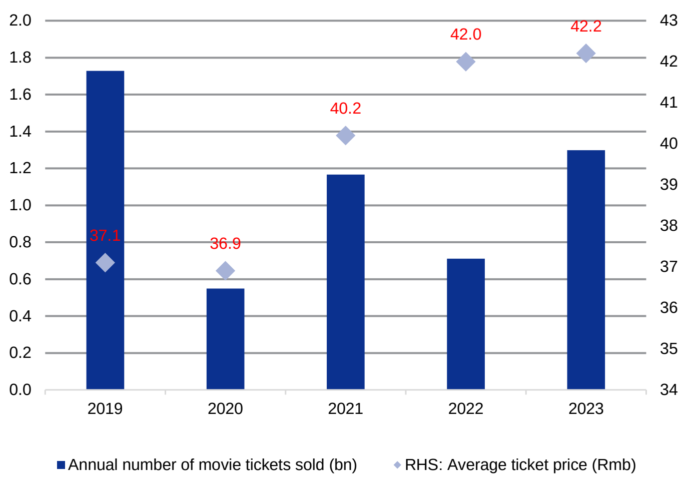
Catering and tourism (sub-sector of Consumer Discretionary): i) Despite weak confidence on the income outlook, Chinese consumers are still willing to "spend on experience" after three years of stringent lockdowns, and we expect the release of pent-up demand for leisure activities due to Covid-19 will sustain well into next year. ii) Domestic tourism has recovered to pre-pandemic levels, but remains below pre-pandemic trend level, indicating further room for growth. iii) Outbound travel is still catching up and remains well below pre-pandemic levels due to bottlenecks in airlines and visa approvals.

Figure 176: Box office revenue remained below 2019's level…



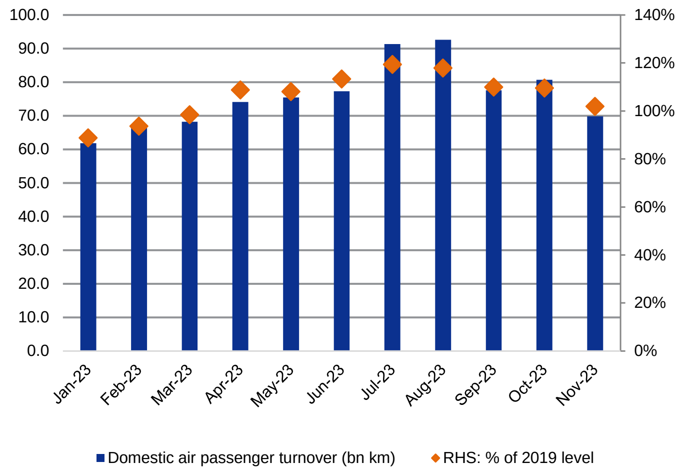
SOURCES: CGS-CIMB RESEARCH, CHINA FILM ADMINISTRATION

Figure 177: …so did the number of movie tickets sold



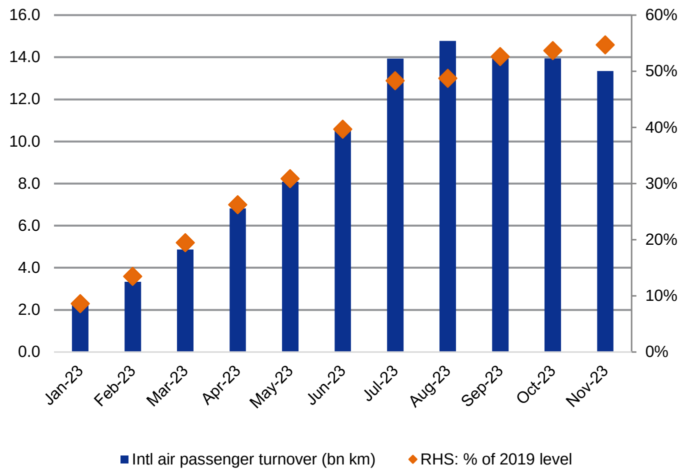
SOURCES: CGS-CIMB RESEARCH, CHINA FILM ADMINISTRATION

Figure 178: Domestic air travel has recovered to pre-pandemic levels



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 179: International air travel has yet to catch up due to a slow recovery and supply bottlenecks



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 180: Key tourism and consumption data during major holidays in 2023 and early 2024

2023 holiday tourism	Chinese New Year	Labor Day	Dragon Boat Festival	Mid-Autumn Festival/National Day	2024 New Year's Day
Number of domestic trips made (million)	308	274	106	826	135
As % of 2019 level	*89%*	*119%*	*113%*	*104%*	*109%*
Domestic tourism revenue (Rmb bn)	375.8	148.1	37.3	753.4	79.7
As % of 2019 level	*73%*	*101%*	*95%*	*102%*	*106%*
Revenue per trip (Rmb)	1,220.3	540.4	352.0	912.1	590.6
As % of 2019 level	*83%*	*85%*	*84%*	*98%*	*97%*

SOURCES: CGS-CIMB RESEARCH, WIND, MINISTRY OF CULTURE AND TOURISM

Internet (subsector of Consumer Discretionary and Communication Services): i) We see the risk-reward for China's internet sector as attractive, with forward P/E valuations in the low-teens vs. 2023-25F EPS CAGR of high-teens. ii) Concerns over the regulatory environment for Internet platform companies have largely abated. Video game licence approval has returned to a regular monthly pattern. iii) Efforts to cut costs have started to bear fruit. Further margin expansion is likely due to further operational enhancement, capex and spending discipline, and rational competition. iv) Industry leaders have been stepping up shareholder returns through buybacks or dividends. v) Overseas expansion by industry leaders (i.e. Pinduoduo) has been successful, driving topline growth. vi) Chinese tech companies are ramping up efforts in Generative AI products, providing potential sources of future growth while helping to improve take-rate and operational efficiency.

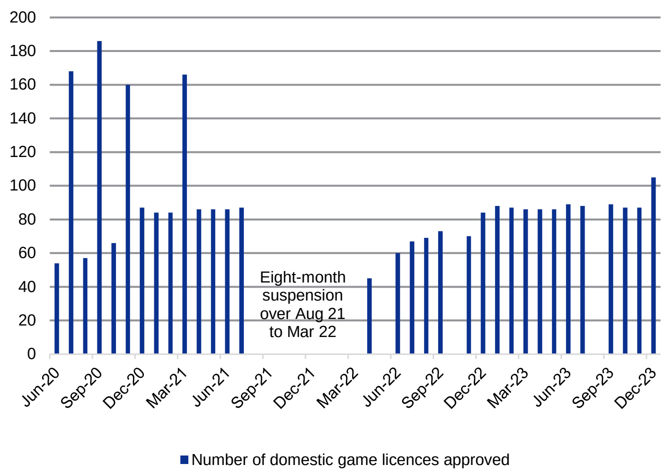
Recently, the National Press and Publication Administration (NPPA) issued a draft rule to solicit public opinion until 22 Jan 2024. The draft rule prohibits incentivising daily logins or consecutive spending. It also requires games to set limits on how much players can top up their digital wallets to restrict excessive spending. We expect larger game developers (i.e., Tencent, NetEase) to fare better under the draft gaming rules, due to their stronger R&D capabilities and means to boost user engagement and retain gamers. Besides, the regulator has sent strong signs of willingness to tamp down the backlash against the new regulations and potentially soften the enforcement of rules. It said the rules were designed to promote the healthy development of the industry, and it would further improve the draft rules after earnestly studying public views.

Figure 181: Cost-cutting efforts by Chinese tech platforms have started to bear fruit; market expects 2024F net income growth to reach the mid-teens

			Revenue						Net income					
Ticker	Company	Mkt cap	2020	2021	2022	2023F	2024F	2025F	2020	2021	2022	2023F	2024F	2025F
		(US$ bn)	(Rmb bn)						(Rmb bn)					
700 HK	Tencent	383.3	482.1	560.1	554.6	615.9	684.7	759.0	122.7	123.8	115.6	157.1	184.9	207.8
9988 HK	Alibaba	223.9	717.3	853.1	868.7	955.7	1,047.0	1,142.8	179.0	143.5	144.0	167.0	177.7	200.5
PDD US	Pinduoduo	127.5	59.5	93.9	130.6	206.1	266.4	330.2	-3.0	13.8	39.5	53.1	68.8	89.4
3690 HK	Meituan	96.5	114.8	179.1	220.0	276.4	335.2	399.4	3.1	-11.7	2.8	22.1	33.3	50.0
9999 HK	Netease	66.8	73.7	87.6	96.5	104.9	116.9	128.8	14.7	19.8	22.8	32.4	33.4	37.0
9618 HK	JD.com	48.9	745.8	951.6	1,046.2	1,078.6	1,162.2	1,251.0	16.8	17.2	28.2	33.1	36.7	42.4
9888 HK	Baidu	46.4	107.1	124.5	123.7	135.9	148.1	160.2	22.0	18.8	20.7	26.8	26.5	29.9
1024 HK	Kuaishou	35.4	58.8	81.1	94.2	113.4	130.7	147.1	-7.9	-13.0	-5.8	8.3	14.7	22.2
9961 HK	Trip.com	25.1	18.3	20.0	20.0	44.4	52.0	59.6	-0.9	1.4	1.3	11.0	11.4	13.5
VIPS US	Vipshop	8.0	101.9	117.1	103.2	111.3	117.0	122.7	6.3	6.0	6.8	8.9	9.2	9.8
9626 HK	Bilibili	5.7	12.0	19.4	21.9	22.8	26.5	30.3	-3.0	-5.5	-6.7	-3.5	-0.8	0.9
9898 HK	Weibo	2.9	11.7	14.6	12.4	12.8	13.5	14.4	3.8	4.6	3.6	3.6	3.9	4.3
	Total (Rmb bn)		**2,502.8**	**3,102.1**	**3,291.8**	**3,678.3**	**4,100.4**	**4,545.3**	**353.6**	**318.8**	**373.0**	**520.1**	**599.6**	**707.6**
	Growth (% yoy)		**28.7%**	**23.9%**	**6.1%**	**11.7%**	**11.5%**	**10.9%**	**19.2%**	**-9.8%**	**17.0%**	**39.4%**	**15.3%**	**18.0%**
	Net margin (%)								**14.1%**	**10.3%**	**11.3%**	**14.1%**	**14.6%**	**15.6%**

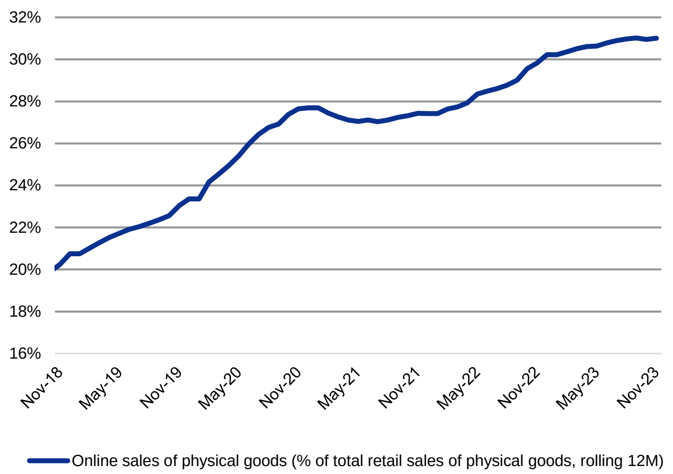
SOURCES: CGS-CIMB RESEARCH, BLOOMBERG
Note: The forecasts are based on Bloomberg consensus

Figure 182: Game licence approval has returned to a regular monthly pattern



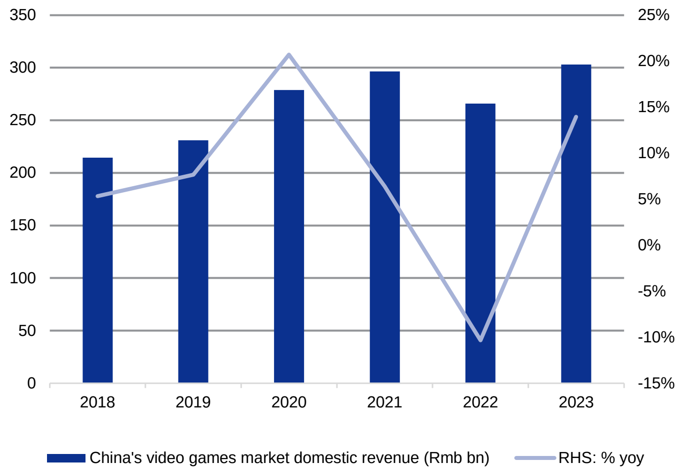
SOURCES: CGS-CIMB RESEARCH, NATIONAL PRESS AND PUBLICATION ADMINISTRATION

Figure 183: E-commerce still gaining market share from offline retailers



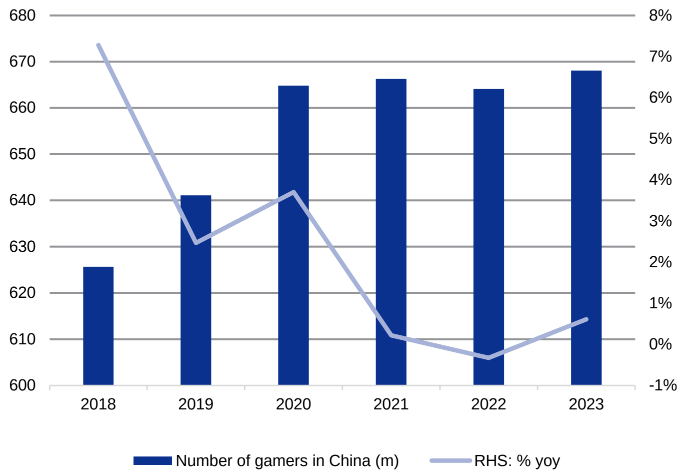
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 184: China's domestic video game market returned to double-digit growth in 2023



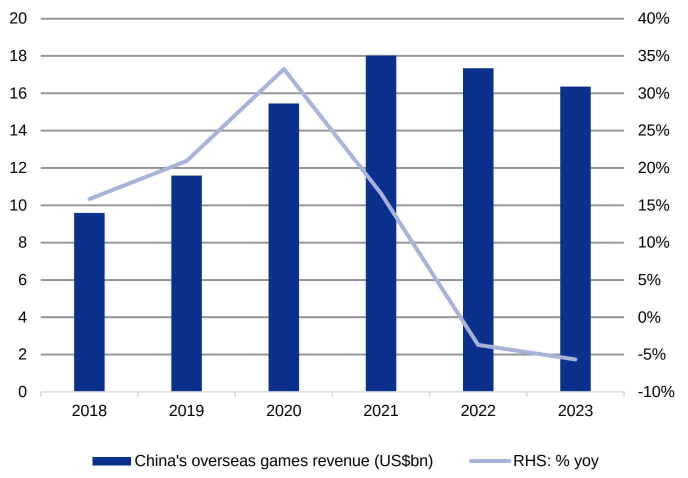
SOURCES: CGS-CIMB RESEARCH, CHINA GAME INDUSTRY GROUP COMMITTEE

Figure 185: The number of video game players has probably reached saturation



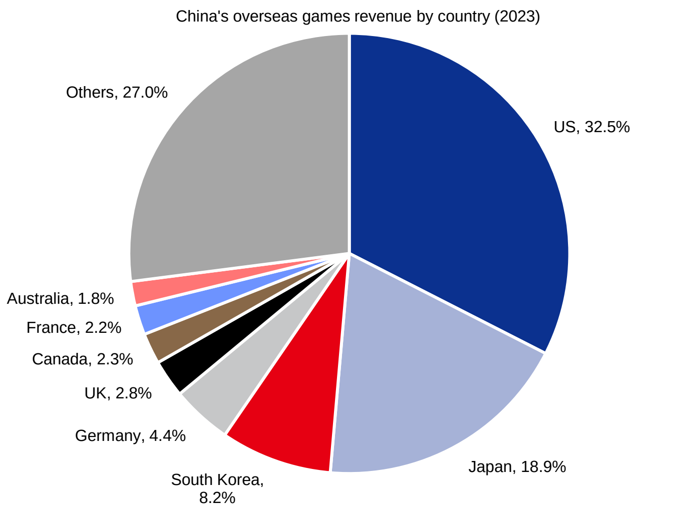
SOURCES: CGS-CIMB RESEARCH, CHINA GAME INDUSTRY GROUP COMMITTEE

Figure 186: China's overseas game revenues have declined for two consecutive years



SOURCES: CGS-CIMB RESEARCH, CHINA GAME INDUSTRY GROUP COMMITTEE

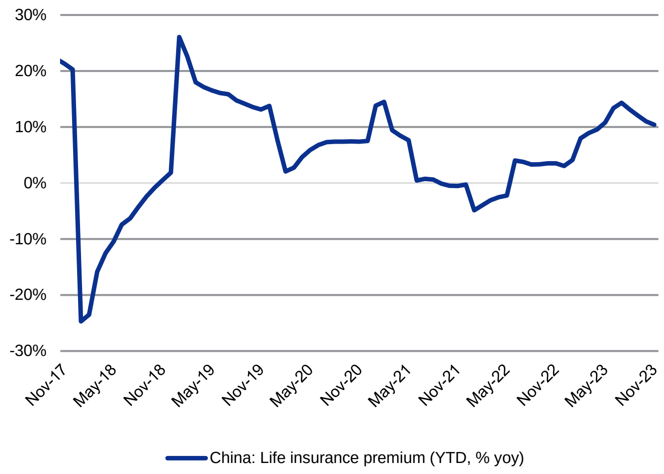
Figure 187: The US and Japan were the top destinations for overseas expansion of Chinese gaming companies



SOURCES: CGS-CIMB RESEARCH, CHINA GAME INDUSTRY GROUP COMMITTEE

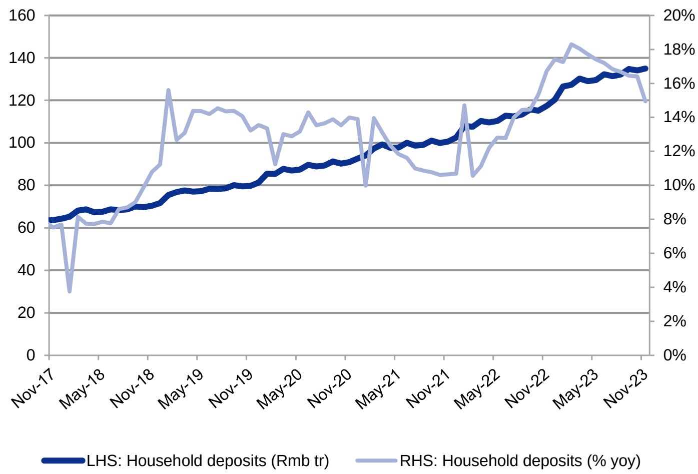
Insurance: i) China insurers: We expect a solid recovery momentum for life insurance products, amid the current low interest rate environment, while the household savings rate remained high. **ii) Regional insurers:** We also favour regional insurance companies (i.e., AIA, Prudential) due to the strong growth of mainland China visitors buying insurance in Hong Kong and Macau, following the reopening of the border in early-2023. The growth has been mainly driven by falling deposit rates in China, yield gap between the US and China, and strong US dollar.

Figure 188: Life insurance premiums registered solid growth in YTD 2023



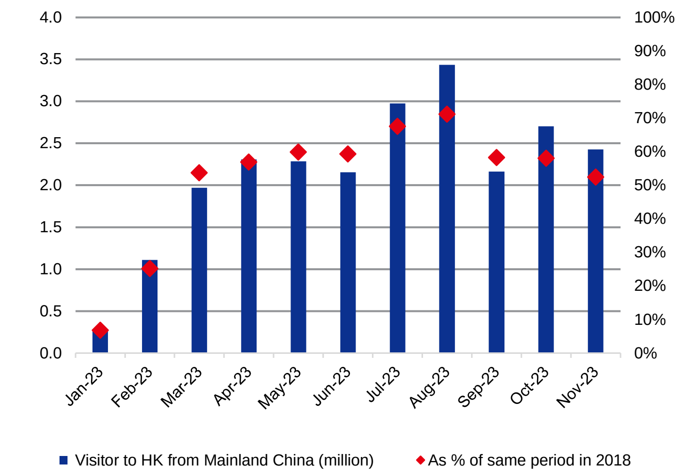
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 189: Household deposit growth remained above pre-pandemic levels



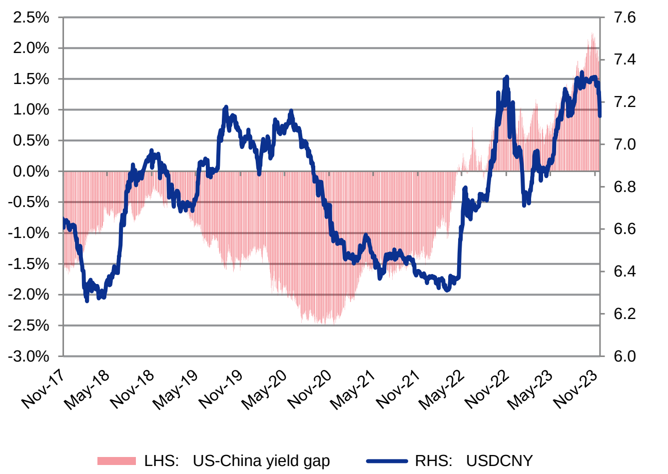
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 190: The number of Mainland Chinese visitors to Hong Kong has been largely stable since reopening



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 191: We expect a strong US dollar and US/China yield gap to continue to benefit HK-based insurance companies



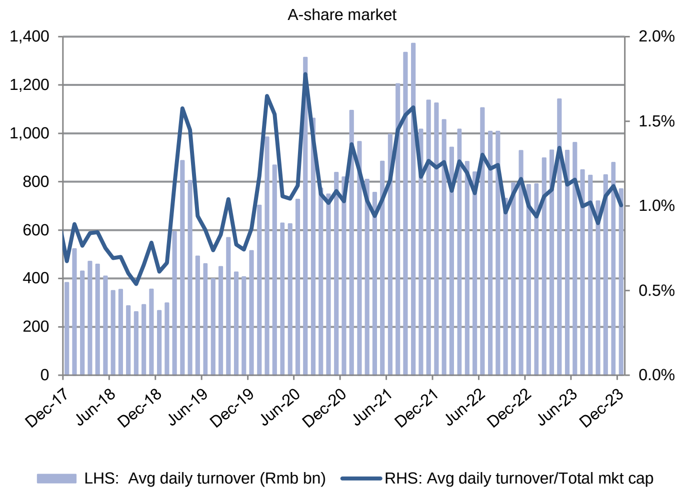
SOURCES: CGS-CIMB RESEARCH, WIND

Maintain UW: Healthcare, Diversified Financials

Healthcare: Ongoing anti-corruption campaigns in hospitals will continue to weigh on the near-term profits of pharmaceutical companies and investors' sentiment towards the healthcare sector.

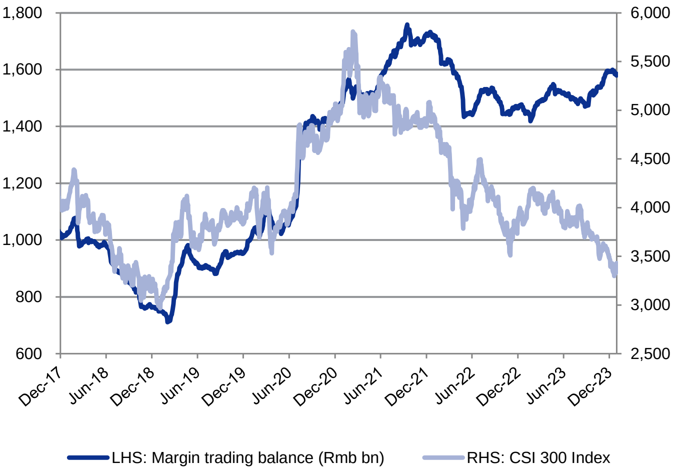
Diversified financials: We see multiple headwinds for Chinese brokers. i) The China Securities Regulatory Commission (CSRC) has announced a slowdown in the pace of IPOs and equity refinancing as part of a policy package to revitalise the capital market, with an uncertain timeline of normalisation. ii) The CSRC plans to reform the fee mechanism of the mutual fund industry and push for lower fees in an effort to protect investors' interest. The impact would gradually filter through to brokers who provide research and trading services to mutual funds.

Figure 192: Transaction volume and velocity of A-share market



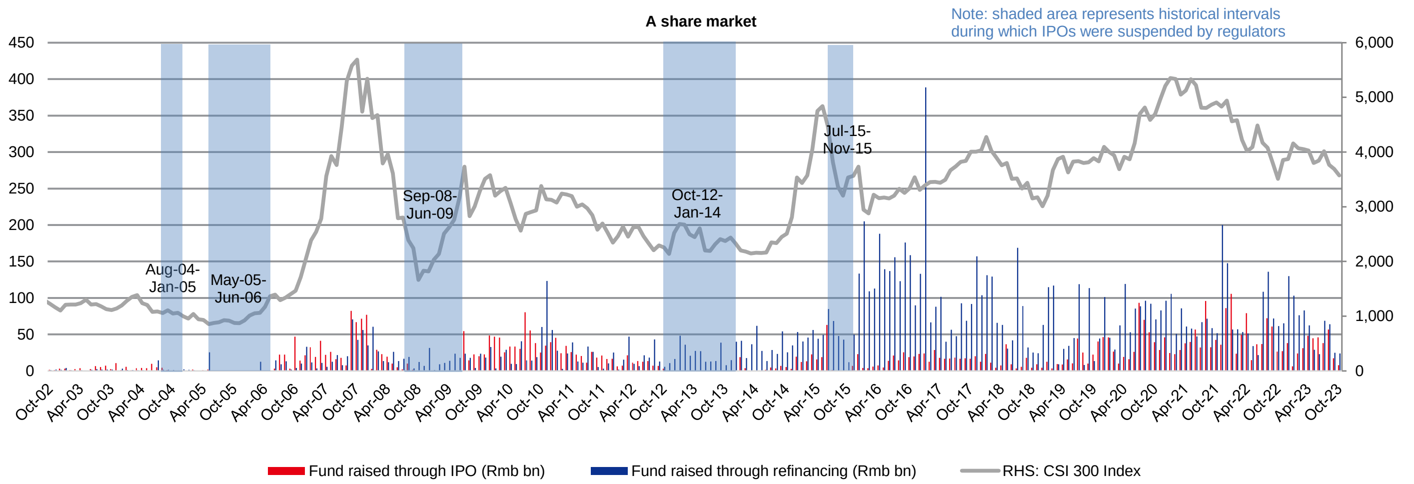
SOURCES: CGS-CIMB RESEARCH, WIND

Figure 193: Margin trading balance remained relatively stable



SOURCES: CGS-CIMB RESEARCH, WIND

Figure 194: CSRC suspended IPOs for five times over 2004 to 2015



SOURCES: CGS-CIMB RESEARCH, WIND, CSRC

High convictions: seizing structural growth opportunities

We select our high conviction names among the universe of China stocks, based on: 1) sector preference, 2) company-specific fundamentals and 3) valuations.

We recommend investors to seize the investment opportunity arising from Chinese firms going global. Investing in Chinese companies nowadays is no longer the same as investing in China. Chinese firms have made significant breakthroughs in the global market in recent years. The evolution of their globalisation strategy has transitioned from goods exports/OEM for foreign brands and overseas asset acquisition to value chain and business model globalisation. Additionally, the going-global strategy has become more market-driven rather than driven by state-led efforts like the Belt and Road Initiative.

According to MSCI, the international revenue exposure of the listed universe of Chinese companies was still relatively low and we see plenty of room for further improvement. As of mid-2020, roughly around 12.6% of the MSCI China Index's total revenue came from overseas, while the MSCI USA Index and MSCI Europe Index had 30% and 40%, respectively, of revenues generated from the rest of the world.

The commercial decision of expanding global footprint can be motivated by several key factors: i) a slowing domestic economy and saturated consumer market; ii) excess manufacturing capacity resulting from years of rapid expansion; and iii) technology leadership at the global level. Despite the inherent risks associated with globalisation, especially geopolitical tension, the trend appears to be ongoing. Chinese-listed firms are embarking on a journey towards transforming into multinational companies. We believe this trend will provide significant earnings growth potential in the years to come, and potentially act as a re-rating catalyst.

Among our high conviction names, companies that fulfil this investment theme include PDD Holdings (international e-commerce arm Temu), Trip.com (global OTA platform Trip.com), BYD (NEV export and localised manufacturing in some ASEAN countries), and Xiaomi and Sunny Optical (smartphone makers and supply chain).

Figure 195: High conviction names: China stocks

Ticker	Company	Analyst	Sector	Rec.	Curr.	Mkt cap	Target price	Current price	Upside/ (downside)	EPS growth		P/E		P/BV	Div Yld
						(US$bn)				23F	24F	23F	24F	24F	24F
PDD US	PDD Holdings	Lei YANG, CFA	Consumer Discretionary	Add	USD	197.9	177.0	149.0	18.8%	31%	21%	29.7	24.4	6.6	0.0%
9961 HK	Trip.com	Lei YANG, CFA	Consumer Discretionary	Add	HKD	23.4	460.0	281.6	63.4%	748%	9%	15.1	13.8	1.2	0.0%
9901 HK	New Oriental Education	Lei YANG, CFA	Consumer Discretionary	Add	HKD	12.6	65.5	55.4	18.2%	60%	21%	29.6	24.5	2.7	0.0%
600519 CH	Kweichow Moutai	Lei YANG, CFA	Consumer Staples	Add	CNY	293.0	2,266.0	1,694.0	33.8%	18%	17%	28.4	24.3	7.3	2.1%
1299 HK	AIA Group	Michael CHANG, CFA	Insurance	Add	HKD	93.3	91.0	64.9	40.3%	1300%	129%	29.2	12.8	2.4	2.6%
1211 HK	BYD	Ray KWOK	Auto	Add	HKD	78.1	389.0	210.6	84.7%	82%	26%	18.3	14.6	7.2	0.1%
1810 HK	Xiaomi	Ray KWOK	Tech Hardware	Add	HKD	48.0	21.5	15.0	43.5%	107%	5%	18.8	17.8	1.5	0.0%
2382 HK	Sunny Optical	Ray KWOK	Tech Hardware	Add	HKD	8.9	88.0	65.1	35.3%	-25%	97%	35.0	17.8	2.8	1.1%
2669 HK	COPL	Raymond CHENG, CFA	Real Estate	Add	HKD	2.6	14.5	6.2	135.8%	32%	29%	12.0	9.2	2.9	3.3%
300760 CH	Mindray	Yolanda Yin	Health Care	Add	CNY	48.3	390.7	289.8	34.8%	20%	20%	29.9	24.9	7.5	2.4%

SOURCES: CGS-CIMB RESEARCH ESTIMATES, BLOOMBERG
Note 1: Data as of 3 Jan 2024; Estimates are based on CGS-CIMB's analyst forecasts.
Note 2: For New Oriental Education, 23F/24F refer to fiscal years ended May 24/May 25

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Hold	23.7%	0.0%
Reduce	9.6%	0.2%

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