China: Beyond the headlines

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Are you a China Bull or a Bear?

China slowdown is global economy’s biggest threat, Rogoff says

China slowdown not as bad as feared

Relax, China’s banks aren’t about to have a meltdown

China banks may need $1.7 trillion injection as credit quality worsens: S&P

Beijing’s tough new property cooling measures see immediate results

China’s Housing Boom Looks Like Last Year’s Equities Bubble

Source: Various news publications
Bear myth #1: Hard landing?
GDP: Growth is slowing, but it’s not sudden

Source: CEIC, HSBC Global Asset Management, data as at October 2016
Divergence in growth among sectors

- Consumption-upgrade sectors maintain relatively solid growth, while mining/overcapacity sectors slow down.

Source: CEIC, HSBC Global Asset Management, data as at October 2016
Bear myth #2: Running out of growth drivers?
Consumption’s contribution to GDP growth continues to increase

Source: CEIC, HSBC Global Asset Management, data as at October 2016
Services = New engine for growth

Source: CEIC, HSBC Global Asset Management, data as at October 2016
Bear myth #3: Reforms have stalled
RMB: Move towards more market-driven regime

Source: Bloomberg, HSBC Global Asset Management, data as at October 2016
RMB: Special Drawing Rights (SDR) inclusion

- RMB’s SDR inclusion on 1 October 2016 marks a major step in RMB internationalisation

Source: IMF, HSBC Global Asset Management, data as at October 2016
China bond market opens up to foreign investors

- With new regulations announced in 2016, most real money investors with a “medium- or long-term investment horizon” are eligible to invest in the China Interbank Bond Market.

China bond market is the third largest in the world

1. US: $40.5 trillion
2. Japan: $9.8 trillion
3. China: $6.5 trillion

Foreign participation is growing, but remains low at 3%

J.P. Morgan placed China under Index Watch. Weighting could go up to 10% in GBI-EM Global Diversified series

US$155bn of potential capital inflows

Note:
1. According to J.P. Morgan estimates, if Chinese government bonds are included in the three leading global bond indices. Estimates as of May 2016. Any forecast, projection or target contained in this document is for illustrative purpose only and is not guaranteed in any way. HSBC accepts no liability for any failure to meet such forecasts, projections or targets. Source: CEIC, HSBC, Sifma Statistics, Asian Development Bank, JP Morgan, as of March 2016.
Launch of Shenzhen-Hong Kong Stock Connect in 2016

- The Shenzhen-Hong Kong (SZ-HK) Stock Connect programme will be effective by the end of 2016

<table>
<thead>
<tr>
<th>Northbound (HK – SZ)</th>
<th>Southbound (SZ – HK)</th>
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<tbody>
<tr>
<td><strong>Daily Quota</strong> (no aggregate quota)</td>
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<tr>
<td>RMB13bn</td>
<td>RMB10.5bn</td>
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<tr>
<td><strong>Eligible stock universe</strong></td>
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</tr>
<tr>
<td>- Constituents of index below with RMB6bn or above(^1, 2)</td>
<td>- Hang Seng Composite Large Cap Index</td>
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<td>- SZSE Component Index</td>
<td>- Hang Seng Composite Mid Cap Index</td>
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<tr>
<td>- SZSE Small/Mid Innovation Index</td>
<td>- Constituents with HKD5bn or more market cap(^2) in Hang Seng Composite Small Cap</td>
</tr>
<tr>
<td>- Dual listed names in SZSE (A-share) and HKEx (H-share)</td>
<td>- A/H dual-listed H shares</td>
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Notes:
1. ChiNext stocks are only available to institutional professional investors under HK related regulations in the beginning of the launch until further notice
2. Market cap calculation methodology will be provided by Shenzhen Stock Exchange & Hong Kong Exchange later
Source: Goldman Sachs, data as of June 2016
Bear myth #4: Monetary policy is no longer accommodative
Move towards interest rate-based monetary policy framework

Benchmark interest rates on hold, but market-based rates have come down

Source: CEIC, Bloomberg, HSBC Global Asset Management, data as at October 2016
Bull myth #1: Government is committed to unleashing market forces
SOE reforms focused on relatively simple measures

Number of SOE reforms undertaken/announced

Source: CICC Research, as at August 2016
Bull myth #2: China is finally deleveraging
Excessive corporate leverage

Leverage continues to build up, particularly corporate debt

Bank NPLs continue to rise

Source: CEIC, BIS, HSBC Global Asset Management, data as at October 2016
Bear myth #3: The government has a strong fiscal position
Fiscal deficit larger than official budget figures suggest

Source: CEIC, IMF, HSBC Global Asset Management, data as at October 2016
Bull myth #3: Property is back
The recovery is real, but the overhang is more real

The reality is neither bull nor bear
Growth driven by public sector investment

China: Fixed Asset Investment (FAI) growth

%y-o-y; 3mma

Source: CEIC, HSBC Global Asset Management, data as at October 2016
The “impossible trinity” or “trilemma” – which one to give up?

Impossible Trinity: at a certain time, a country can only have a combination of any two of the three conditions – not all of the three.

Fixed/stable foreign exchange rate
- China is trying to maintain a relatively stable foreign exchange rate.

Independent monetary policy
- China wants an independent monetary policy.

Free capital flows
- China is accelerating capital account liberalisation.

Opening the capital account while maintaining a fixed exchange rate regime, especially when domestic macroeconomic policies are not consistent with the requirements of the regime, has been followed by crisis in many countries.

Source: HSBC Global Asset Management as of October 2016
Government debt in China remains manageable

Source: IMF, HSBC Global Asset Management, data as at October 2016

% GDP

For Professional Investors only. Not for further distribution.
Rapid property price gains restricted to select cities

Source: WIND, HSBC Global Asset Management, data as at September 2016
Private sector industries have been addressing overcapacity issues

- Certain private sector industries now enjoy stronger pricing power on the back of more balanced industry demand-supply dynamics

China containerboard capacity

Any forecast, projection or target contained in this presentation is for information purposes only and is not guaranteed in any way. HSBC accepts no liability for any failure to meet such forecasts, projections or targets. Source: RISI, UMPaper, data as of July 2016
Don’t be a bull or a bear!
Be a chicken….be selective!
Key risks and disclosures
Key risks

- Investor should be reminded that investment in some of the developing Asian countries may involve special considerations and risks. Political changes, government regulation, social instability or diplomatic development, etc. could affect adversely the economies of such countries or the value of the investment.

- Change of interest rate may affect the value of the investments. Bonds and other fixed income securities are more susceptible to fluctuation in interest rate and may fall in value if interest rates change.

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- The investments may have exposure in credit risk whereby investments in non-investment grade debt obligations involves a high amount of risk. An issuer suffering an adverse change in its financial condition could lower the credit quality of a security, leading to greater price volatility of the security.

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- Currency movement and market condition may affect the value of investments.
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