China economy

Fiscal stimulus – who wins?

Sector Update

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Key points:

- Government announces RMB4,000b fiscal package, focusing on 10 major areas to stimulate the domestic economy. Investment in 4Q will be around RMB100b
- Package ranges from infrastructure investment to credit loosening to VAT reform
- Plan is hard hitting, direct and positive for China's economy near term. However, we expect a time lag between enacting the policies and benefits of these projects filtering through into the economy
- Thus, for the next one to two quarters, we expect the further weakening of China's GDP numbers and pressure on exports
- Beneficiary sectors include: consumer staple, environmental, infrastructure, agricultural and pharmaceutical/healthcare
- Negative sectors are export-related industrials, consumer discretionary and residential property development

News flow. In a bid to ward off the effects of the deepening global financial crisis and slowing of the global economy, the Chinese government announced a RMB4,000b fiscal stimulus package aimed at boosting domestic demand. The funds will be spent between now and end-2010 and are earmarked for a massive infrastructure program, loosening of credit and VAT reform in 10 major areas:

- *Housing* – construction of more affordable and low-rent housing, including the acceleration of a pilot program to rebuild rural housing
- *Rural infrastructure* – road and power grid improvement in the countryside to be accelerated, the use of methane promoted and environmental project investment (including the North-South water diversion project and water conservation) stepped up
- *Transportation* – expansion of the transport network through construction of trunk railways, passenger rail links, urban rail and new airports in western China, urban power grid upgrades
- *Health and education* – improving the medical system and accelerating the development of the cultural and education sectors; junior high school construction in rural western and central areas
- *Environmental* – enhancing the construction of sewage and refuse treatment facilities, support for energy conservation and pollution control projects
- *Industry* – enhancing innovation and industrial restructuring and support for high-tech and service industries
- *Disaster rebuilding* – accelerating reconstruction efforts in areas hit by the Sichuan earthquake
- *Incomes* – boosting average incomes in rural and urban areas increasing next year's minimum grain purchases and farm subsidies. Increasing subsidies for low-income urban residents and pension funds for enterprise employees
- *Taxes* – extending the VAT reform to all industries to cut corporate tax burden by RMB120b
- *Finance* – removing loan quotas on commercial lenders and increasing bank credit for priority projects, rural areas, SMEs, technical innovation and industrial rationalization through M&As

The package will be launched by end-2008. With RMB100b of central government funds from the current year budget and RMB20b brought forward from next year's budget, the total investment is expected to reach RMB400b in 4Q.

Our view. We expect the government to announce a series of complementary monetary policies to boost China's domestic consumption in the mid term. However, while fiscal policies such as infrastructure spending give the most "bang for buck" in terms of stimulating the economy, there is typically a time lag between enacting the policies and benefits of these projects filtering through into the economy. Thus, for the next one to two quarters, we expect the further weakening of China's GDP numbers and pressure on exports. Despite tax rebates across various export industries, demand remains anemic. At the recent Canton Trade Fair, China's largest trade fair, total value of contracts signed was RMB212b, down 17.5% HoH and down 16% YoY. We expect that fiscal stimulus packages to be announced by other countries to be protectionist biased, which may further depress export demand. Case in point, the EU recently imposed anti-dumping duties of up to 87% on Chinese made screws and bolts.

Winners/losers. We believe beneficiaries will include the following sectors: consumer staple, environmental, infrastructure, agricultural and pharmaceutical/healthcare. Our picks include **Fuji Catering (1175 HK, HK$3.66, BUY)**, **Shandong Weigao (8199 HK, HK$8.95, BUY)**, **Nine Dragons (2689 HK, HK$1.44)** and **Zhuzhou CSR (3898 HK, HK$4.88)**, **Chaoda Modern (682 HK, HK$5.35)**, **Hengan (1044 HK, HK$22.95, BUY)**, **Solargiga (757 HK, HK$2.19)** and **China Green (904 HK, HK$5.69, BUY)**. We are negative on sectors such as export-related industrials, consumer discretionary and residential property development.

Disclosure of interest: A fellow subsidiary of SBI E2-Capital Securities Ltd. was acted as the Independent Financial Adviser for the independent shareholders of Hengan International Group Company Limited in October 2008.

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STRONG BUY : absolute upside of >50% over the next three months
BUY : absolute upside of >10% over the next six months
HOLD : absolute return of -10% to +10% over the next six months
SELL : absolute downside of >10% over the next six months