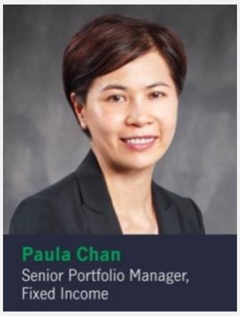


On Tuesday 3 November 2020, US voters decided who holds the balance of power in Washington. President-elect Joe Biden was declared the winner of the presidential election (7 November, ET), while at the time of writing (15 November, HKT), President Trump has not formally conceded defeat[1]. In this investment note, **Paula Chan**, Senior Portfolio Manager, Fixed Income, analyses the potential impact of the US presidential election on China's fixed income market and lends her insights into how the country's new five-year plan is expected to impact its economy and financial markets.

Potential implications of the US presidential election on China fixed income

Under the current base case, i.e. a Biden presidency and split Congress, we believe the outcome of the US presidential election is broadly constructive for China fixed income.

Sino-US relations should stabilise but will remain contentious

From a macro perspective, we believe that Sino-US relations have the potential to improve under the Biden administration. While it is unlikely that there will be a dramatic breakthrough in the two countries' contentious diplomatic relationship, more constructive rhetoric and policy continuity bode well for greater bilateral cooperation to promote trade and growth. There also may be less risk of economic decoupling between the two in the near term. Over the longer term, however, the trend of multinational companies relocating manufacturing and supply chains away from China should continue and needs to be closely monitored by investors for its economic impact.

The 14th Five-Year Plan (2021-2025): a key policy framework to watch

Regardless of the US election outcome, we believe that China's 14th Five-Year Plan (2021-2025) should play a major role in the country's near-term development trajectory. In October, the Chinese government released initial details of the five-year plan, which is slated to boost domestic innovation capacity, strengthen military defence capability, and focus on the quality of economic growth (rather than achieve mere GDP targets) to lift income levels and meet stringent environmental -protection goals[2].

Over the longer term, China is likely to focus on its "dual circulation policy"[3] that will seek to spur domestic demand and, simultaneously, develop conditions to attract foreign investment and boost export-production capacity.

The underlying message to investors is clear: China is preparing to eventually decouple from, or at least be less reliant on Western economies. The country will also continue to focus on improving the efficiency of and return on capital from its state owned enterprise (SOE) sector through reforms. The urbanisation theme will continue to provide an

[1] On Saturday 7 November 2020, Biden captured the presidency when The Associated Press declared him the victor in his native Pennsylvania at 11:25 a.m. EST. That victory won him the state's 20 electoral votes, which pushed him over the 270 electoral-vote threshold needed to prevail; Bloomberg: "Biden declares victory, calls on Americans to mend divisions", 8 November 2020;

[2] Wall Street Journal, "China stresses reliance on Its Own Technologies in Five-Year Plan", 29 October 2020.

[3] In May 2020, President Xi Jinping proposed the "dual circulation model", which promotes "internal circulation", or the domestic cycle of production, distribution, and consumption – as the main driver of growth. Reuters, 16 September 2020.

important boost to domestic consumption and growth.

Monetary policy should support onshore credit market

For the onshore bond market, we expect that the People's Bank of China will keep monetary policy relatively benign and supportive for credit. This should be constructive for Chinese government bonds as the central bank aims to buffer growth while the economy is still recovering from COVID-19 disruptions and slower global growth.

On the credit side, we expect strong demand by companies that could see greater issuance from newer emerging sectors and green bonds – this is in line with the environmental theme of the five-year plan. We also foresee growing interest among issuers that are already active in the US dollar credit space to issue domestically. As a result, Chinese issuers can tap into onshore liquidity pools and diversify funding sources, while also potentially lowering debt-related borrowing costs compared to overseas issuance.

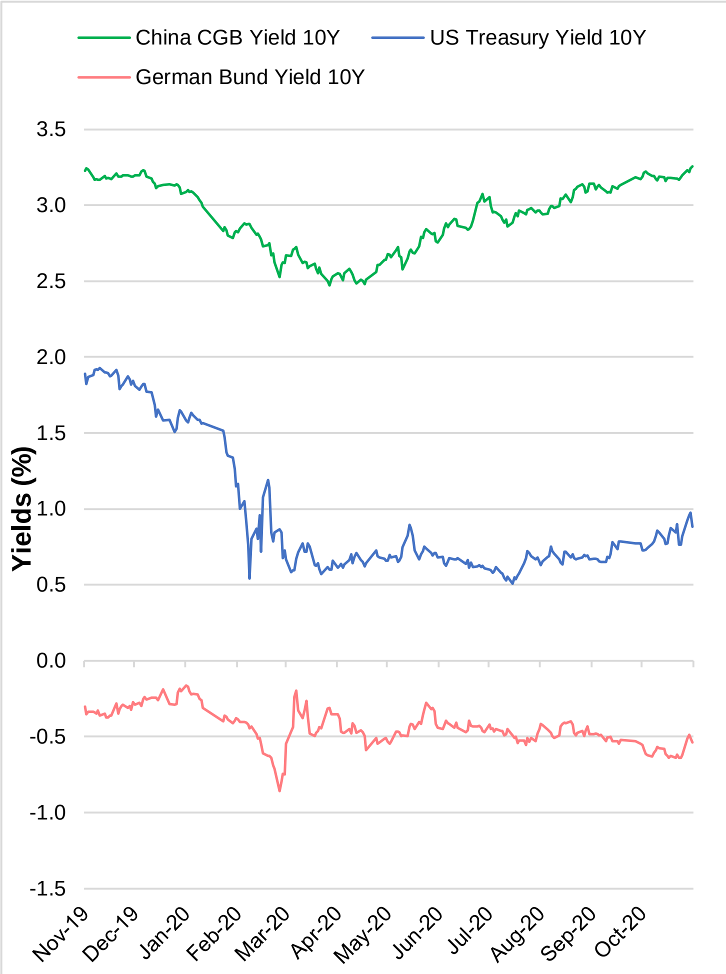
Indeed, as China's GDP accelerates, we believe that that the level (or number) of defaults should be contained and restricted to weaker segments, such as weaker private industrial companies. Reforms in the China SOE sector will also improve the credit fundamentals for this sector over the medium term.

Renminbi to be well-supported over the short-term

For the currency, we believe the renminbi (RMB) will be well-supported in the near term as the Chinese economy emerges from COVID-19 and shows stable (positive) growth relative to other major economies. The positive interest-rate differential against other major bond markets will also continue to attract inflows into Chinese assets, which will also help to support the RMB (see Chart 1).

Our base case is that the RMB will remain range-bound for now but could resume its appreciation on evidence that Biden's economic policies are in line with the market's expectations. On the other hand, the RMB could face pressure in the future if the proposed dual-circulation policy does not achieve the necessary economic growth targeted or if global growth deteriorates and trade with China is significantly impacted.

Chart 1: Yield spread between German, US, and China 10-year government bonds[4]



Conclusion

We believe that if the US election base case holds true, that the election of Joe Biden as US president should inject stability into the Sino-US diplomatic relationship, which is constructive for China fixed income. Having said that, China is looking at the long term with the country's new five-year plan that should boost its overall competitiveness and domestic demand, while reducing its current reliance on Western economies for growth.

[4] Bloomberg, as of 7 November 2020.

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