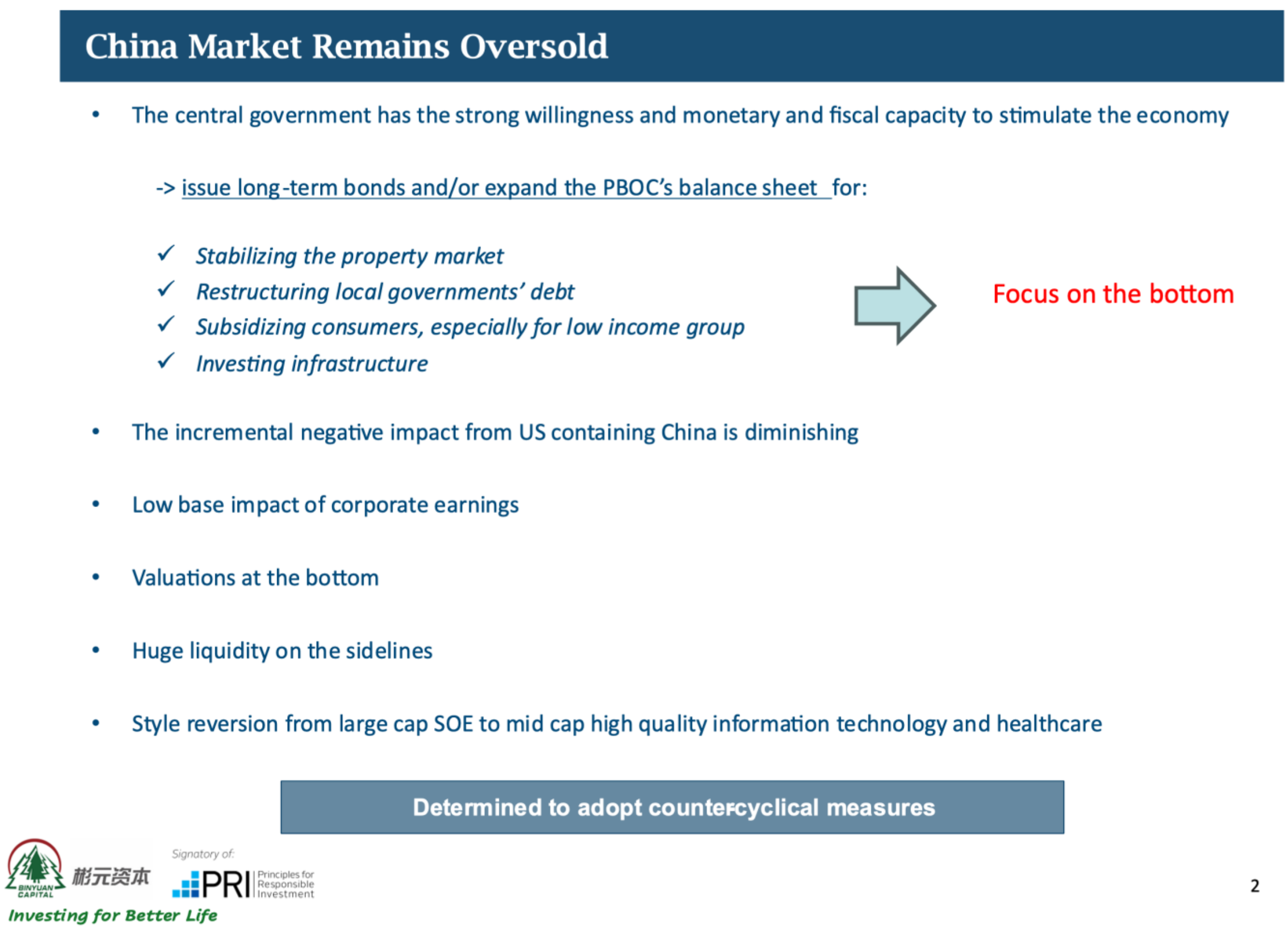
Dear Clients,

I hope you are doing well. Recently, there are lots of announcements and news events occurring in China. Following our recent webinar please a summary of the call and our latest views.

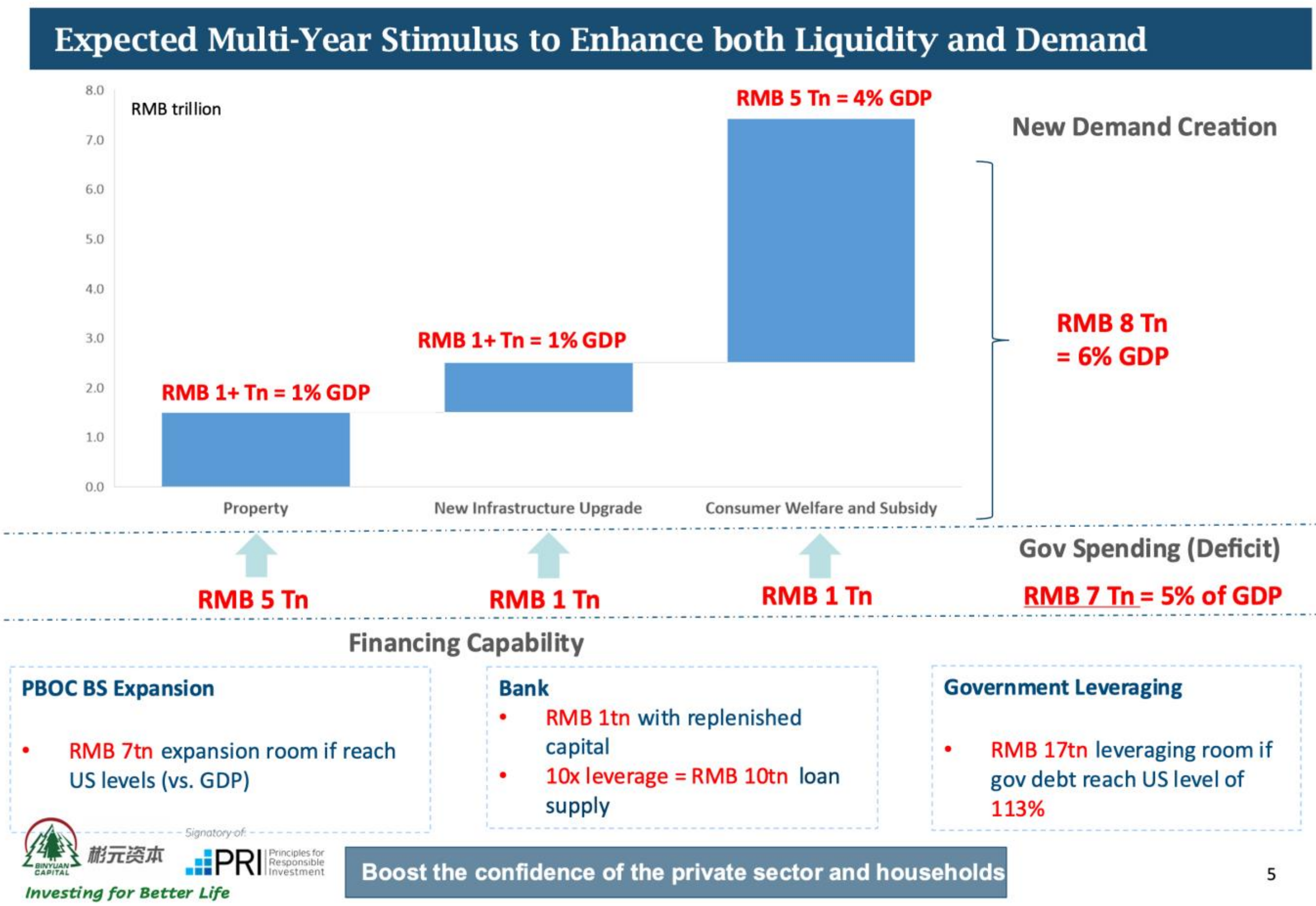
The recent government press conferences held over the past 3 weeks have generated a wide range of media and broker comments. Some have expressed disappointment at the lack of clear numbers. Our perspective is different.



1. The messages sent out from the press conferences by the NDRC, MOF, and MOHURD were strong indications that the <u>Chinese government is determined to stimulate the economy through counter-cyclical measures that include both monetary and fiscal policies.</u> The first step is to bring back confidence. While certain western media and investors may be seeking specific stimulus figures, the government's current objective is to improve the financial conditions of lower income households by reducing interest rates and securing their incomes. Simultaneously, efforts will be made to refinance the balance sheets of lower tier cities in order to assist them in meeting their liabilities. We believe that the

existing packages provided through both monetary and fiscal policies should be adequate to restore some confidence. Reflating the economy will be a gradual process, with additional packages being released to stimulate the economy later. Anticipating a single significant stimulus announcement is not aligned with the approach of the Chinese government and would lead to disappointment. We expect an improvement in economic data towards the end of the 4Q extending into 2025.

2. The key to reflating the economy lies in rebuilding confidence among households and private sectors. We think the Chinese government has the potential to increase spending by RMB 7 trillion (5% of GDP) in order to generate an additional RMB 8 trillion in demand (6% of GDP) over the next 2-3 years to support growth (Bin Yuan estimates).



1) It is crucial to stabilize the property market by addressing issues such as unfinished buildings (requiring RMB 1-2 trillion), renovating shanty towns (requiring RMB 1 trillion), and providing affordable housing through land and property acquisition from the market (requiring RMB 2-3 trillion) in order to support prices. Total government spending may reach RMB 5 trillion to absorb the inventory, halt the decline of the market, and boost demand. Given that property constitutes a significant portion of household wealth, this stabilization of property prices has

a positive impact on confidence. These measures may generate new property-related demand of more than RMB 1 trillion.

2) Allocate an additional RMB 1 trillion towards upgrading new infrastructure to enhance global competitiveness for companies and improve employment opportunities.

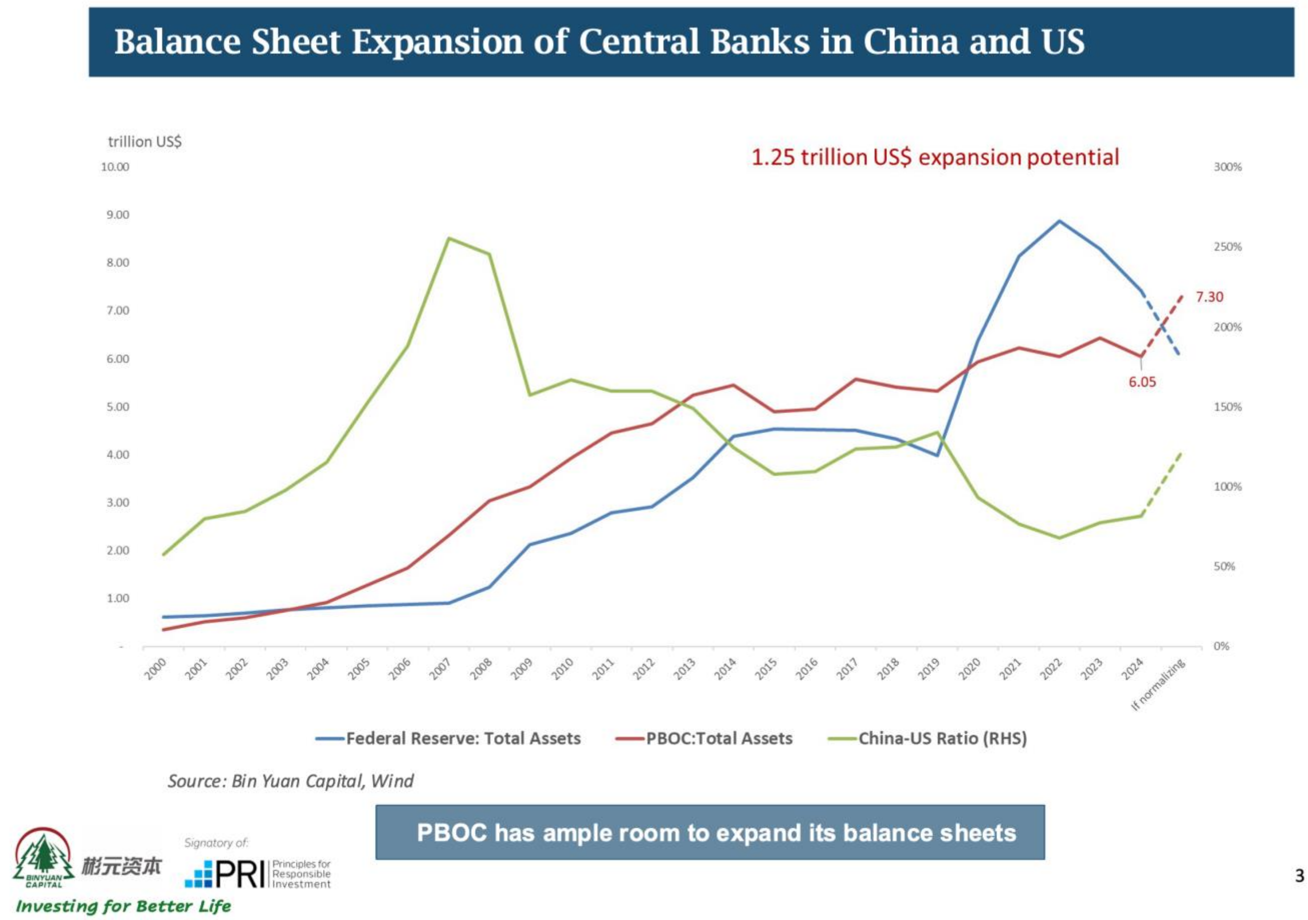
3) Subsidize low-income groups and invest in welfare to lift consumption and promote trade-in programs for appliances and auto…etc. to boost consumption of middle-income class. The multiplier effect of subsidies (how much dollar demand generated per every dollar subsidy) could be 5x or even higher when confidence recovers. It is possible that government spending of RMB 1 trillion could generate RMB 5 trillion in new demand.

The efforts to restore confidence have already had a positive impact since September 24th, as evidenced by the surprising increases in national holiday consumption.

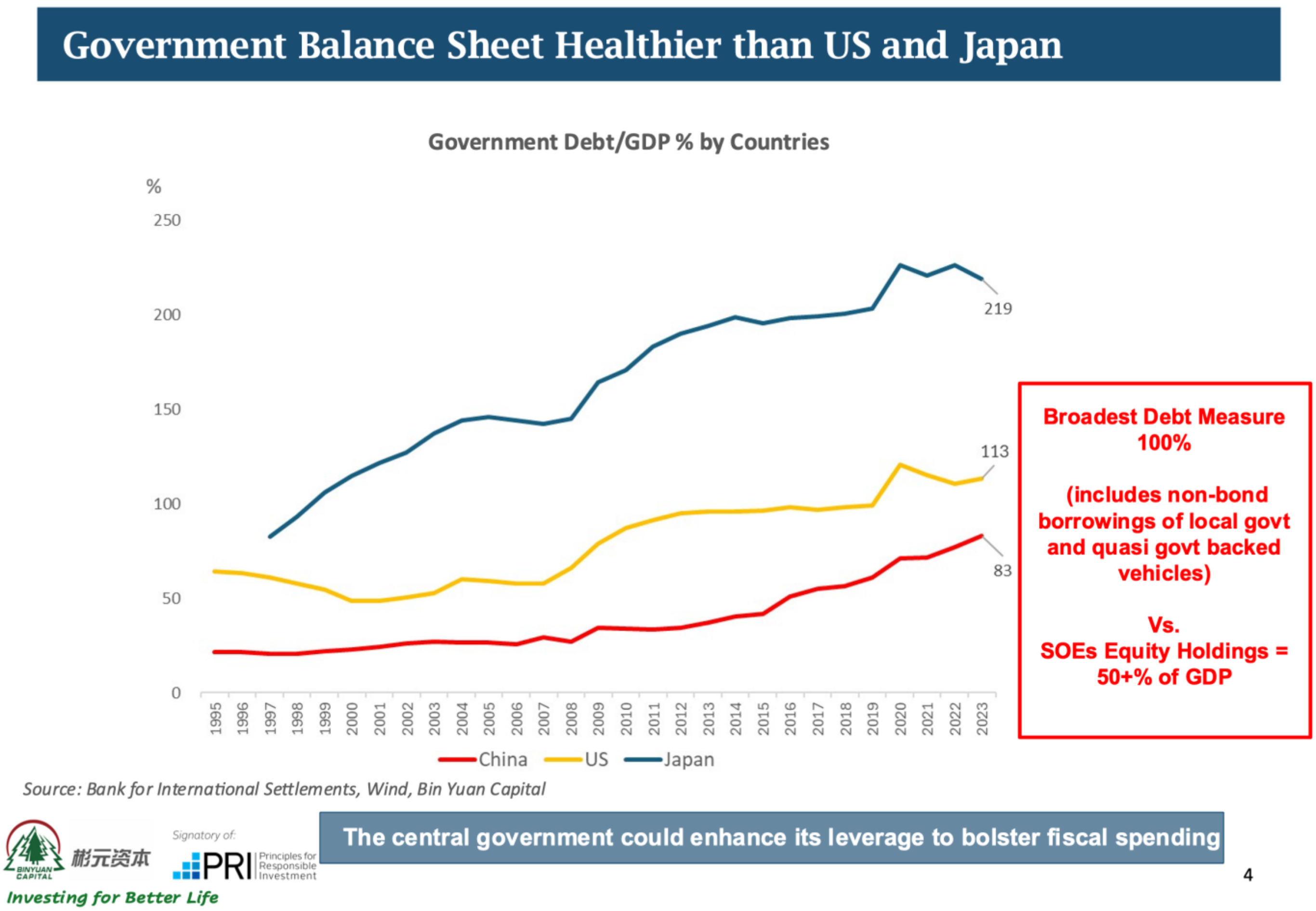
3. <u>The central government has articulated a strong willingness and has ample financing capabilities to support the stimulus</u>. The PBOC has significant room to expand its balance sheet, and the central government's balance sheet is in

a very healthy state, allowing for increased leverage.

The People's Bank of China (PBOC) has implemented a prudent monetary policy in the three years following the Covid pandemic, especially compared to the United States and historical trends. The ratio of central bank assets to GDP for China and the US (green line) has decreased to historically low levels. If we were to adjust this ratio back to its historical average, the Chinese central bank would have potential room to expand its balance sheet by USD 1.25 trillion (RMB 7 trillion).



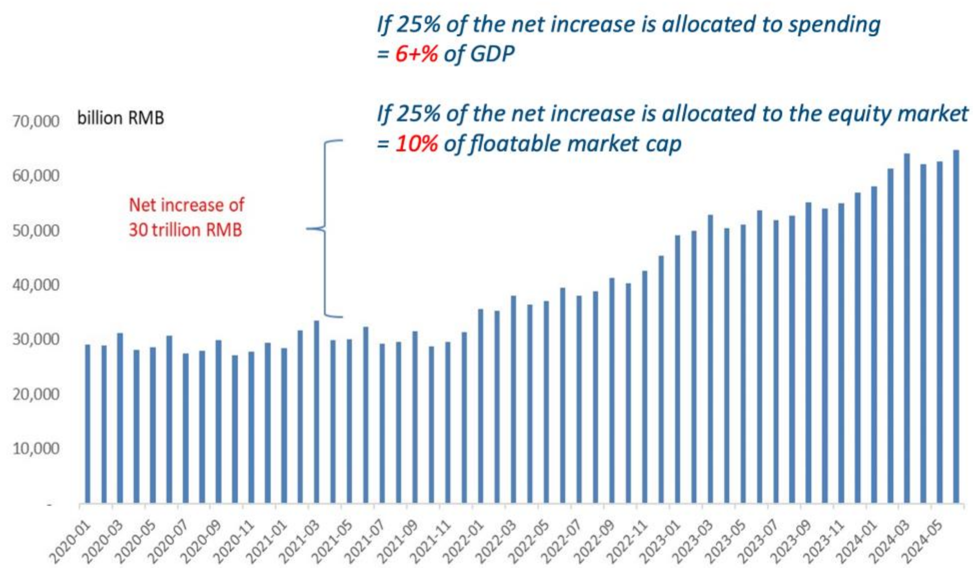
The Chinese government's balance sheet remains healthy compared to those of the US and Japan. The broadest measure of debt to GDP ratio, which includes non-bond borrowings of local debt and quasi-government backed vehicles, stands at 100%, significantly lower than the US's 113% and Japan's 219%. Additionally, the central government holds assets in state-owned enterprises, such as banks, with strong cash flow. The equity holdings of these SOEs amount to 50% of GDP. If the Chinese government were to benchmark its leverage level against that of the US, the central government would have room for RMB 17 trillion to bolster fiscal spending.



4. <u>The current market volatility indicate that investor liquidity remains on the sidelines and skepticism persists, suggesting that the China market remains oversold.</u> Substantial domestic liquidity could potentially flow into the equity market. Over the past three years, there has been a net increase of RMB 30 trillion in household deposits (household deposits minus household loans). If 25% of this amount was allocated to spending, it would equal more than 6% of GDP; if 25% was allocated to the equity market, it would equal 10% of the floatable market cap. Any potential reversal of foreign capital outflow is positive.

The market adjustment is healthy, which provides foreign investors with greater opportunities to build or initiate their China exposure and capitalize on the uptrend.

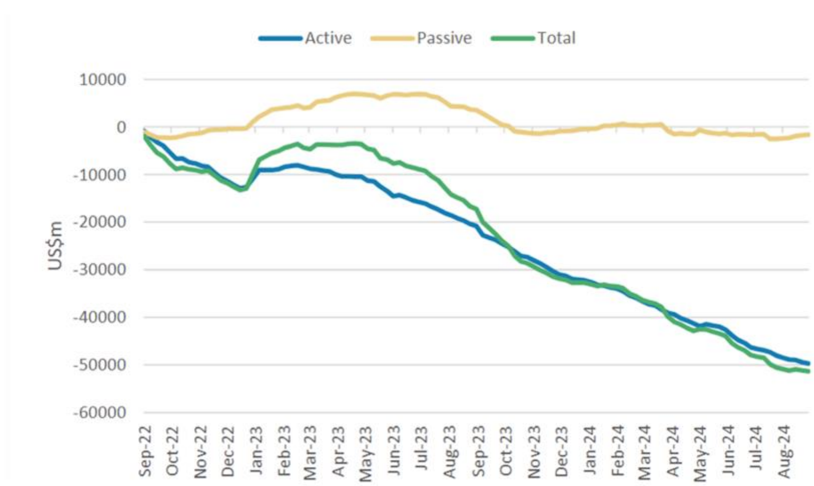
Potential Funding Source - Household Deposits Minus Household Loans



Restoring confidence is crucial, and it has started to show its influence

Foreigners Largely Sold Out of China Equities

Weekly Cumulative Net Fund Flows (US$m) into China Equities by Active and Passive Funds



Source: EPFR, Morgan Stanley Research. Note: Data as of September 18, 2024. Only GEM equity funds benchmarked against MSCI EM are included

Any potential reversal of foreign capital outflow is positive

Thank you all!

Ping and Team

Shanghai

October 21, 2024

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