What is happening in China?

Unio Global Macro Committee Outlook

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Granted that it is the second largest economy, we know relatively little about what is really happening economically and politically in China.

In the past decade, Western investors have put less weight on headline economic measures such as GDP in favour of micro indicators like electricity usage, owing to fears that official indicators do not 'tell the real picture'.

Politically, there is a sense that China is much less an 'open book' and it is therefore harder to read the intentions of its government.

US political concerns such as losing its pre-eminence in foundational technologies has led to economic restrictions described by US National Security advisor Jake Sullivan as "small yards and high fences" e.g. restrictions on exports to China of advanced semiconductor chips and their manufacturing technologies.

US national security concerns rather than economic competition has led to "small yards and high fences"

In the absence of economic clarity and political distrust, investors are staying away from China - inbound investment into China is now the lowest in thirty years (at USD 33bn).

Reflecting that, the performance of Chinese assets has been lethargic, and valuations (of equities) are now very low. Compare for example the performance of Alibaba to that of Amazon.

As such, we begin to wonder if the concerns that investors have over China are now priced in.

Beijing’s revival

At this month’s Global Macro Council, we debated investor concerns related to three broad areas – US/China relations and the risk of a conflict around Taiwan, the structural risks to China’s economy (Irish readers will recognise the risks to the Chinese property market), and the apparent lack of urgency in economic policy making.

Some of these risks are ebbing, for the time being. The Taiwanese presidential election has passed without incident and diplomatic communications between the US and China have improved.

Economically, risks remain. China wants and needs to grow at a rate of close to 4% for the next decade to stay on track with its ‘grand plan’. It has not had a major recession in recent decades but as a result, is likely accumulating the ingredients of a structural downturn – notably over capacity, inefficient investment and large pockets of debt.

External risks remain – a new trade war with the US (should Trump win another term) and a robust European response to the dumping of electric vehicles, are just two scenarios.

Our sense is that when large markets are considered ‘uninvestable’, as was the case with the euro-zone in the mid 2010’s, it is time to start to warm up the investment case.

China is cheap but we do not yet have a catalyst, either an overwhelming stimulus or a form of mini-crisis (trade war or debt blow out).

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