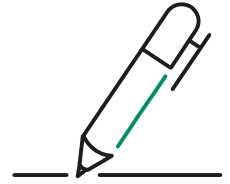


TALKING HEADS PODCAST



By **Daniel Morris**, Chief Market Strategist | **Zhikai Chen**, Head of Asian Equities

EMERGING MARKET EQUITIES: IT'S ALL EYES ON THE CHINESE CONSUMER

Daniel Morris: Hello and welcome to the BNP Paribas Asset Management Talking Heads Podcast. Every week, Talking heads, will bring you in-depth insights and analysis on the topics that really matter to investors. In this episode, we'll be discussing China and emerging market equities. I'm Daniel Morris, chief market strategist. And I'm joined by Zhikai Chen, head of emerging market equities. Welcome, Zhikai. Thanks for joining me.

Zhikai Chen: Thanks for having me, Daniel. Good to be here.

Daniel Morris: So if we look at the performance of emerging market equities relative to developed market equities over the last year or so, in fact, the underperformance that we had certainly last year in a bit of the year before and even the outperformance we've had this year has actually almost entirely been driven by China. That is under net performance has been China's under or outperformance. And if you look at then the rest of EM equities versus developed market equities, it's more or less been in line. So clearly China's been the fulcrum around which everything is pivoted.

If we start with some of the factors that drove that underperformance previously, of course, the restrictions around Covid, the crackdowns or restrictions on property market, similar restrictions on several companies in the tech sector and then geopolitics. And it seems that really all of those four factors have improved and turned around. Of course, we have the reopening. We see government support now again for the property market. The tech crackdown seems to have ceased and it looks like China and the US are trying to get along a little bit better. So that's the good news. Otherwise, if we think about the global macro context, certainly a drag for parts of EM last year was the rise in the dollar, the rise in US Treasuries, but very clearly we've seen that reverse so far this year. So going from a headwind to a tailwind. So really a pretty good context if we think about the outlook for China. So first question then, Zhikai, what is the lifting of the zero-Covid restrictions and the reopening of the economy mean for China's outlook in the near term and a little bit further than that?

Zhikai Chen: A good question, Daniel. I think actually the four points that you mentioned earlier, you can probably reduce it to one major policy change, which is post [the Party Congress](#) in late October and in early November, there has been a very abrupt change to basically support economic growth as the key development over the last three months. If you take a look at it specifically, the first two policies that you mentioned, one of the things to bear in mind is that these are internally imposed policy and they will remove. There had been a complete U-turn on zero corporate policy and the crackdown on the property sector, which lasted almost, almost three years now, has also been largely reversed. So the zero corporate policy U-turn was the most significant move, and I think this caught most of us watchers by surprise. The resulting infection from an exit wave was massive, but also laid the groundwork for a very rapid exit from a zero-Covid policy. Previously in, say, mid-November, we are still thinking about whether there will be a reversal of this as infection risk goes up further. But it seems very clear now they are all in for the reopening and that's good for the surrounding economies, which I'll touch upon in a bit. And now we have seen that after two and a half months, well, actual data is scarce. From what we can see that most provinces are indicating that infections are on the wane. And we can also see concretely that domestic travel during Chinese New Year has rebounded strongly, which is positive for services and consumption. And on the property side, we can also see that they have largely effectively unwound the prior three red lines on leverage and importantly are directly backstopping some of the largest developers with financing and liquidity. This has also stopped the further financial situation of the largest Chinese developers, but it remains to be seen whether property sales can recover after the steep declines that we saw in 2022.

Daniel Morris: We all now have had an experience with lockdowns from reopenings, really, to understand that now that the restrictions have been lifted. You really should see a pretty quick rebound in the economy. So certainly encouraging for the outlook for the country itself. If we step back a bit and think about the impacts more broadly in Asia, everyone's looking, I think, for the return of Chinese tourists. Certainly a lot of countries and hotspots are anticipating that. We think about exports in general to China. What are some of the themes you see in terms of the regional impact?

Zhikai Chen: I think specifically for the nearer neighbours in Asia, this recent developments have obviously. Sharply changed economic outlook from just three months ago. The resumption of travel is clearly going to be very positive for some of the more dependent Asian economies, for example, like Thailand.



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I do think that you take some time for Chinese tourism to resume to pre-pandemic levels. But a U-turn and firm U-turn in zero-Covid policy has basically brought forward this resumption of outbound tourism forward by probably 6 to 9 months. So this is a significant tailwinds for economies, a significant tourism dependency. Then for the rest of Asia, more commodities exporting economies, not just in Asia but around the world, faster Chinese economic growth will likely increase imports, which is beneficial for global emerging market economies, particularly those endowed with energy or materials and endowments. As the year goes by in 2023.

Daniel Morris: As you pointed out, this has been a pretty big change in what we all thought 2023 was going to be like compared to three months ago, which certainly is going to have a big impact on how you're investing and the themes that you're looking for. So could you highlight what you see now as the key themes for China, for emerging markets more broadly this year? And then maybe talk about some of the sectors that you think are going to benefit?

Zhikai Chen: Sure. So aside from the China reopening tailwinds, Asians and emerging market economies will also likely enjoy more monetary policy flexibility going forward, particularly Latin America. The largest economies are likely at the tail end of the hiking cycle at this particular point in time, with a likely pause in the US rate hike cycle. These economies are probably at a point where they can also likely pause their tightening cycle and maybe cut later on this year as well. In Asia, we are also seeing a more benign inflation outlook in most of the economies. So the fear that emerging market central banks will need to tighten monetary policy in lockstep with the Federal Reserve has largely diminished. So this is clearly positive for economic growth support in emerging markets. In terms of sectors, we believe that for certain economies and certain sectors, the rebound in our tourism will be certainly helpful. We have certain investment in companies that are going to be benefiting from this particular theme. We are probably still a little bit more cautious on the pull on commodity demand from China reopening because of the high degree of investments that's already put in 2022 and fixed asset investment expansion in China. Because if you recall in 2022, consumption growth was quite anemic even in China. So a lot of the growth came from fixed asset investments. So from the really significant base, we are not sure that there will be another, shall we say, tailwind kicker from the reopening that will be as strong. I think all eyes right now is on the Chinese consumer to basically come out and basically spend hopefully like what we saw in the other developed economies and other emerging economies when they exited zero-Covid, for example.

Daniel Morris: I thank you very much for joining me.

Zhikai Chen: Thanks for having me, as always.

