



FOR PROFESSIONAL INVESTORS – 4 September 2023

Chi Time

Is China Investible – a macroeconomic perspective

*Take the attitude of a student,
never be too big to ask questions, never know too much to learn something new.*

Og Mandino

Global investors have turned bearish on China, understandably so given the weakening economic growth momentum, the rise in financial and property market woes, and the disappointment with the policy response to these problems since China re-opened its economy after Covid-19 in April 2023. However, these concerns have confused China's cyclical problems with structural issues, in my view, with the [media has aggravating](#) the confusion. China's structural transformation seems to remain on track.

The [conventional wisdom](#) is that Beijing's policy in handling the Covid crisis was flawed and it had [intensified](#) the country's economic weakness, which portends a [serious long-term problem](#) that will unfold in the post-pandemic years. America's narrative about China has now been changed to a '[wounded dragon](#)' from a '[peer competitor](#)', with President Biden reportedly calling China a '[time bomb](#)' in economic problems.

The bear that meets the eye

Hence, market players have downgraded China's GDP growth forecasts in response to the wave of disappointing economic data that was released recently. Indeed, Chinese exports and imports have fallen sharply; both PPI and CPI have turned negative; the housing slump has continued with one of the largest developers, Country Garden, falling into financial trouble; and some asset management firms with AUM more than RMB1 trillion have defaulted.

[Some](#) observers have argued that China's huge debt burden had limited Beijing's options to deal with the problems. This view is myopic, as I have [argued repeatedly with evidence](#) China's debt is a manageable problem and is not a constraint on Beijing's macroeconomic policy. The slow growth is by Beijing's policy design as the



BNP PARIBAS
ASSET MANAGEMENT

The sustainable
investor for a
changing world

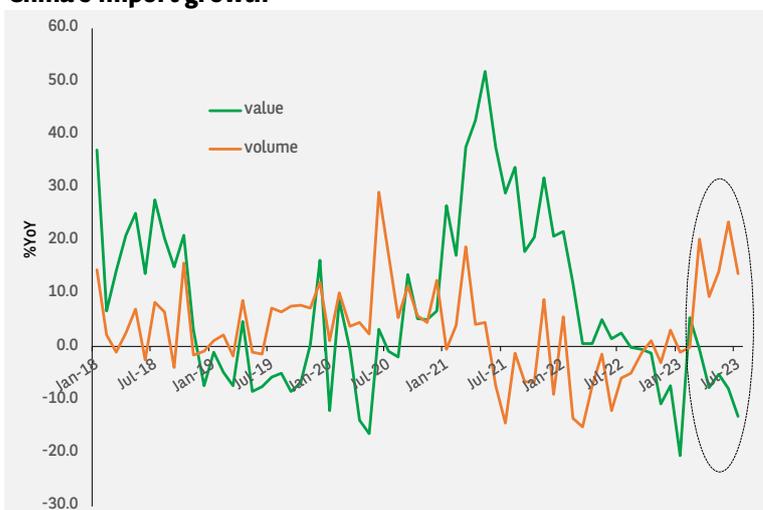
leadership quits the old debt-fuelled supply-expansion growth model, thus refuses to go back to the old playbook of massive reflation and is willing to tolerate slower growth rates.

The economic problems that the world is dwelling on are cyclical problems, which can be resolved by policy stimulus. The economic malaise is, thus, a matter of Beijing’s overly cautious policy but not of its inability to boost growth.

The devil in the details

Given all the weakness in the economy, nevertheless, it is not in a dire state as the media has painted. The sharp decline since March in China’s imports, an indicator of domestic demand strength, is misleading because in volume terms imports are still growing (Exhibit 1).

Exhibit 1
China's import growth

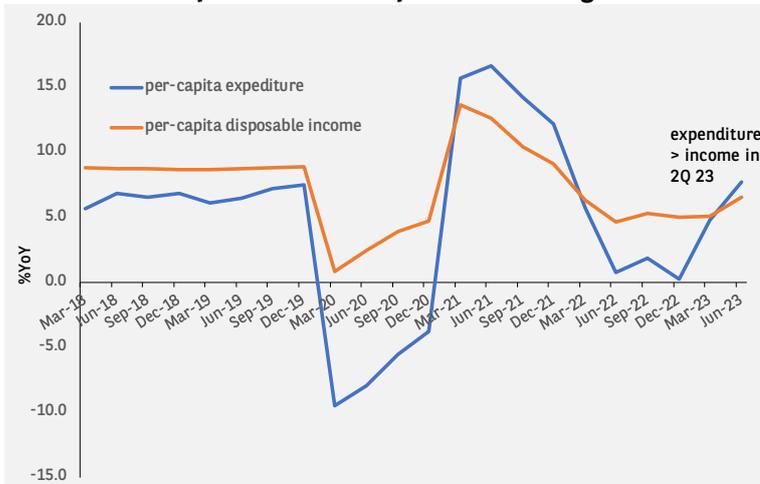


sources: CEIC, BNP Paribas Asset Management 25 Aug 2023

Urban per-capita expenditure growth also outpaced per-capita income growth in 2Q 2023, suggesting a recovery in urban consumer demand funded by saving (Exhibit 2). The recovery may not be as strong as the market expects, but this data implies that the loss of consumer confidence might not be permanent, and that more assertive policy easing could [likely revive](#) confidence and boost consumer spending.

Exhibit 2

China's urban expenditure and disposable income growth

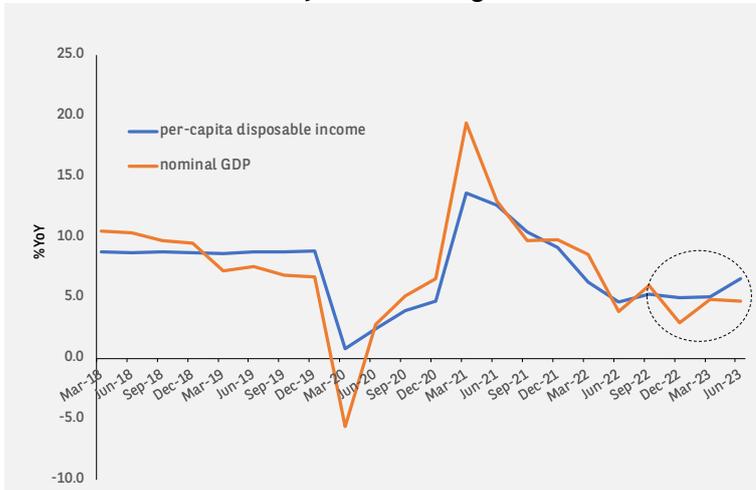


sources: CEIC, BNP Paribas Asset Management 25 Aug 2023

Furthermore, per-capita disposable grew faster than nominal GDP in 1H 23 (Exhibit 3), suggesting that the share of output accruing to households was rising, not falling as it is wrongly perceived. The combination of rising personal income and consumption funded by saving means that future household consumption could surprise on the upside if Beijing eases policy more assertively.

Exhibit 3

China's nominal GDP and disposable income growth



sources: CEIC, BNP Paribas Asset Management 25 Aug 2023

Granted, falling consumer prices, as seen in July's negative CPI data, could prompt households to delay consumption on the expectation that goods would be cheaper tomorrow. However, China is not likely to fall into prolonged deflation as the pre-conditions of deflation are [absent](#).

Structural transformation...

There is nothing new about the world's view that China has too much savings and that it would need structural rebalancing to put more income in the hands of the consumer. This would let consumption take over investment as the long-term growth driver

However, the slogan of ‘invest less, consume more’ makes not much sense, in my view. This is because China still needs investments in many under-developed parts of the country to create income and consumption growth. Consumption alone is not a panacea, as many have assumed. Does China need more televisions and furniture but fewer flats/houses to put them in, should China have more cars for consumers but worse roads, fewer petrol stations, trains and other transport means?

The reason why the Chinese can save so much is because they have incomes. And where do these incomes come from? A large part is from jobs created by investments. So, contrary to conventional wisdom, the average Chinese household is not income constrained. If it were, it would not be able to save so much. Simple economics tells us that saving should equal investment in the long run. This also implies that high saving should lead to high investment. Hence, blindly following the ‘invest less, consume more’ mantra make no sense for a country that still have areas for development.

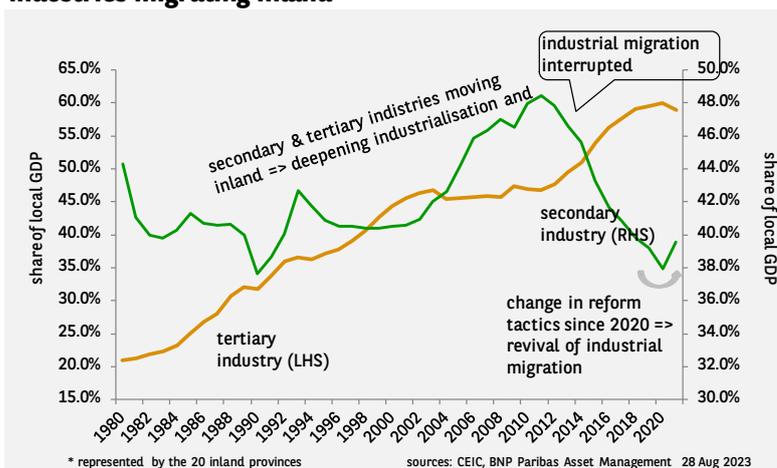
Furthermore, high saving should naturally lead to high debt because financial intermediation, notably by banks in China’s debt-financed growth model, channels saving into investment by transforming the former into debt for funding the latter.¹ High debt is not necessarily an evil for China unless it is not backed by any assets or is backed by bad assets.

... What’s new?

Recognising this investment-consumption cycle and past reform errors, Beijing made a tactical shift in structural reforms under its broad ‘[dual circulation](#)’ strategy in the second half of 2020. The new tactics favour ‘hard tech’ over ‘soft tech’ development² and engage the private sector as a driver for innovation.

This latest reform approach should revive industrial migration to the interior provinces, a trend started in 2005 but was interrupted in 2013, with high-value-added industries leading the way. Data shows that this resumption is already happening (Exhibit 4). When properly implemented, these tactics should [revive](#) GDP growth momentum and raise productivity in the longer-term when the new industries tap cheaper resources inland.

Exhibit 4
Industries migrating inland*



¹ “Demystifying China’s Mega Trends – The Driving Forces That Will Shake Up China and the World”, pp. 111-114, Chi Lo, Emerald Publishing, 2017.

² Hard tech refers to the production of hardware and components that caters for the country’s strategic and high-tech development. Soft tech refers to the e-commerce development that caters for non-strategic consumption demand.

Is China investible?

China's post-Covid economic recovery is fragile, but the problems are mainly cyclical and can effectively be resolved by aggressive fiscal expansion facilitated by monetary easing. It is a matter of the government's calculated easing move.

The structural transformation is ongoing with renewed investment growth focusing on high-value manufacturing and high-tech industries. Beijing's key tasks lie in improving education, health care and the labour market structure by matching jobs to skills, in providing for the elderly, in curbing pollution and controlling climate change and, at the same time, in cutting the debt ratio.

These efforts are tall orders and there is no guarantee that they will succeed. However, they are on China's policy agenda and will be implemented over time.

Is China investible?

What so you think?

Chi Lo BNP Paribas Asset Management

DISCLAIMER

BNP Paribas Asset Management France, “the investment management company,” is a simplified joint stock company with its registered office at 1 boulevard Haussmann 75009 Paris, France, RCS Paris 319 378 832, registered with the “Autorité des marchés financiers” under number GP 96002.

This material is issued and has been prepared by the investment management company.

This material is produced for information purposes only and does not constitute:

1. an offer to buy nor a solicitation to sell, nor shall it form the basis of or be relied upon in connection with any contract or commitment whatsoever or
2. investment advice.

This material makes reference to certain financial instruments authorised and regulated in their jurisdiction(s) of incorporation.

No action has been taken which would permit the public offering of the financial instrument(s) in any other jurisdiction, except as indicated in the most recent prospectus and the Key Investor Information Document (KIID) of the relevant financial instrument(s) where such action would be required, in particular, in the United States, to US persons (as such term is defined in Regulation S of the United States Securities Act of 1933). Prior to any subscription in a country in which such financial instrument(s) is/are registered, investors should verify any legal constraints or restrictions there may be in connection with the subscription, purchase, possession or sale of the financial instrument(s).

Investors considering subscribing to the financial instrument(s) should read carefully the most recent prospectus and Key Investor Information Document (KIID) and consult the financial instrument(s)' most recent financial reports. These documents are available on the website.

Opinions included in this material constitute the judgement of the investment management company at the time specified and may be subject to change without notice. The investment management company is not obliged to update or alter the information or opinions contained within this material. Investors should consult their own legal and tax advisors in respect of legal, accounting, domicile and tax advice prior to investing in the financial instrument(s) in order to make an independent determination of the suitability and consequences of an investment therein, if permitted. Please note that different types of investments, if contained within this material, involve varying degrees of risk and there can be no assurance that any specific investment may either be suitable, appropriate or profitable for an investor's investment portfolio.

Given the economic and market risks, there can be no assurance that the financial instrument(s) will achieve its/their investment objectives. Returns may be affected by, amongst other things, investment strategies or objectives of the financial instrument(s) and material market and economic conditions, including interest rates, market terms and general market conditions. The different strategies applied to financial instruments may have a significant effect on the results presented in this material. Past performance is not a guide to future performance and the value of the investments in financial instrument(s) may go down as well as up. Investors may not get back the amount they originally invested.

The performance data, as applicable, reflected in this material, do not take into account the commissions, costs incurred on the issue and redemption and taxes.

All information referred to in the present document is available on www.bnpparibas-am.com