The Importance of China

The Chinese economy emerged almost un-"virused" in 2020 making it virtually the only economy to avoid contraction. This was mainly powered by China's first-in-first-out situation and proactive policy supports. The growth recovery was broad-based, led initially by production activities such as investment and exports, and extended to consumption in recent months. China is expected to be the biggest economy in the world by 2030. Barring trade and political tension, their strict implementation of 5-year strategies will keep them firmly on the radar as a portfolio investment destination.

SPEED READ

- **China's economy grew by 2.3% in 2020 making it the only major economy to avoid contraction.**
- **The Chinese economy could be the largest by 2030 (or earlier), overtaking the US.**
- **The government's consistency with the implementation of Five-Year Plans has resulted in them weathering storms better than most.**

Willie Pelser

Future literature will cover many discussions, reports, and doctoral theses about the impact of Covid-19 on both economies and the human race. But more so, future topics and case studies will also focus on the after-effects of Brexit and Trump's tenure as president of the USA. There will be other topics as well and I will start with my few cents' worth of comments on China. Whilst the world became obsessed with Trump and the Brexit/EU debacle (and then COVID-19), China's politicians and companies stuck to their knitting. Some of you will recall a Toyota advertisement many years ago of a little boy in the back seat, telling his dad about the schoolyard chatter about which car is the best. The dad asked the lad, "and what did you say?" He answered, "I just smiled." Perhaps I can coin that saying for the Chinese economy – whilst the world was in chaos, they just smiled.

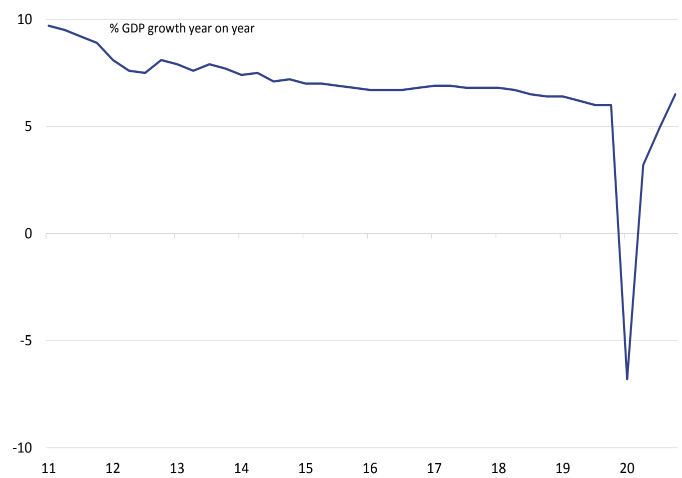
On 18th January 2021, the Chinese Bureau of Statistics released economic growth statistics. Headlines read:

1. The Chinese economy grew by 2.3% in 2020, making it the only major economy to avoid contraction.
2. GDP climbed 6.5% in the final quarter from a year earlier, fuelled by stronger-than-expected industrial output.
3. Quick decision making and early fiscal and monetary stimulus boosted infrastructure and real estate.

The early "war" on and containing the Covid-19 virus resulted in the reopening of factories to resume production. Growth was spurred by strong overseas consumer demand for Chinese exports, especially medical equipment, and work-from-home devices. Some statistics towards the end of 2020 show how industrial output rose 7.35% in December from a year earlier, and 2.8% in 2020. Retail sales growth slowed to 4.6% in December. For 2020, it shrank by 3.9%, led by a drop of 17% in catering and restaurants. Fixed Investment on the other hand was 2.9% larger in 2020 than in 2019. The jobless rate was 5.2% at the end of December.

The path to becoming the largest economy in the world had a "Covid-19 Boost". After a historic slump in the first quarter of 2020, when lockdowns brought most activity to

CHINESE GDP GROWTH

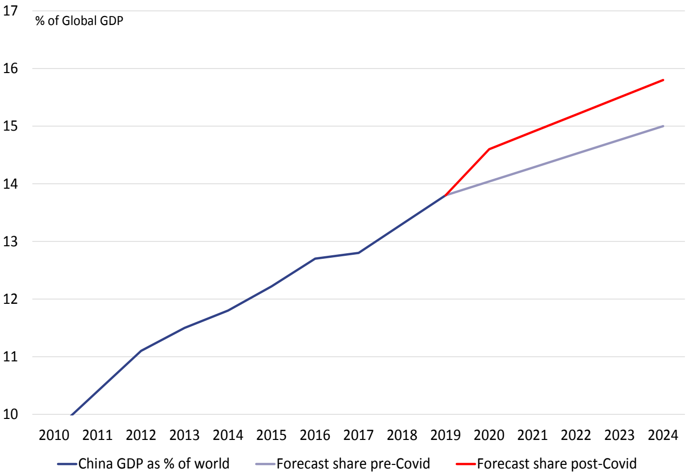


China's economy was one of the few v-shaped recoveries globally.

a halt, China emerged from the pandemic larger than when it started. This is a capstone for the world's second-largest economy. With global output likely contracting by 4.2% last year, China's gain implies that it increased its share in the world economy to 14.5% according to World Bank estimates. The US is still the largest in the world economy with a share of 22%. New projections from the IMF (and others) calculate that China will now overtake the USA by 2028, two years earlier than previously predicted. A research paper by JP Morgan: 10 Questions about China in 2021 also address the growing impact of China in the world economy. They highlight that the unexpected pandemic outbreak and the divergent sectoral performance in the post-pandemic recovery will have important implications for how long it will take for China to overtake the USA to become the largest economy in the world. Two years ago, the analysis pointed to the year 2030 as the year China will be the largest economy.

JP Morgan wrote: "The timeline for China to catch up with the US could be shortened by three to five years. China's outperformance in the post-pandemic recovery led to a widening of the growth differential between China and the US, and strong fundamentals caused the CNY (China's currency) to appreciate against the USD. Based on our estimate, China will jump from 66% of the US economy in 2019 to 78% in 2021." In the 5th Plenum of the CPC Party Congress that was held in late October 2020, President Xi announced that China will aim to double its GDP by 2035. This implies 4.73% average GDP growth in 2021-2035. JP Morgan and the IMF based their projections on these Chinese assumptions. The key to understanding here is that several key assumptions drive the projections as to when China will be the largest economy. For us, the takeaway is that the high average GDP performance of more than 6% per annum in

CHINA'S SHARE OF GLOBAL ECONOMY



China's share is expected to grow at a faster pace. The country is now forecast to overtake the USA as the largest economy in the world in 2028, two years earlier than prior estimates.

Table 1: Summary of the 13th Five Year Plan (2016-2020)

Target	2015	2020 [5yr chg]	Current status
Economic Development			
GDP (RMB bn)	67.7	>92.7 [36.9%]	29.4% cum. Growth (2019)
Urbanisation rate (%)	56.1%	60% [3.9%]	Up 4.5% (2019)
Service Sector as % of GDP	50.5%	56% [5.5%]	Up 6% (1H20)
Innovation Drive			
R&D as % of GDP	2.1%	2.5% [0.4%]	Up 0.1% (2019)
Patents per 1000 people (units)	6.3%	12 [5.7]	Up8.0 (1H20)
Internet Penetration ratio	40.0%	70% [30%]	Up 27% (1H20)
People's livelihood and Well-being			
Average life expectancy	76.3%	77.34 [1 year]	Up 0.66 year (2019)
New urban jobs created (mn)	64.31	> 114.31 [>50mn]	59.4mn (1H20)
Average years of education of the working-age population	10.23	10.8 [0.57 year)	Up 0.5 year (2019)
Reduce no. of rural residents in poverty (mn)	55.75	[55.75]	Down 50.24mn (2019)
Reconstruction of urban shanty towns (mn units)	-	[20]	21.4mn (2019)
Resouces and environment			
Energy consumption per GDP		[-15%]	-13.2% (2019)
Ratio of good air quality days in cities	76.70%	> 80% [>3.3%]	Up 5.3% (2019)
% of water meeting/exceeding Class III level	66%	>70% [>4%]	Up9% (2019)
Forest coverage	21.66%	23.04% [1.38%]	Up 1.3% (2019)

Despite Covid'S impact, China was saved from the worst of the turmoil by avoiding or aborting the set targets of a well-defined planning process.

China has been scaled back by their authorities, which make the projections not that farfetched at all.

Why the link to the Toyota advert earlier on? China just smiled because it all comes back to their Five-Year Plans (FYP). 2021 is the first year of the 14th FYP, the year to announce the achievement of building a wealthy society and to move on to the next stage of developing a high-income society, with the new objective of doubling GDP by 2035. In China's unique planning process, the successes are staggering. Refer to the table below that contains some of the highlights of the 13th FYP. Following the 5th Plenum of CPC Congress held in late October, the Party released recommendations for the 14th FYP. The government will then compile a detailed FYP (including numerical targets for economic and social developments), circulate and seek comments, and then submit the final draft to the National People's Congress in March 2021 to be approved and released.

Various people see the conflict between the US (started under Trump) and China as a global tension that could derail various global economic interactions. Firstly, there were the trade wars during 2018-2019. That spread to the second phase of conflict which focussed on the technology sector. The inauguration of the Biden administration also raises the question of how tactics in the US-China confrontation may shift on both sides. China's successful epidemic control and economic outperformance further enforce President Xi's leadership authority. They have realized that the change in US-China relationships is permanent and unlikely to be reversed anytime soon. Their response has focused on both the domestic and external relationships.

- Domestic - "security" has become a new keyword. The 14th FYP introduces the dual-circulation theory which addresses innovations and self-sufficiency in foundational technologies to increase the resilience and security of China's supply chain.
- External - China has stepped up its effort to strengthen economic links with the rest of the world. After the sign-off on the Regional Comprehensive Economic Partnership (RCEP) with another 14 Asian economies in November, China also completed its multi-year negotiation with the EU on the bilateral investment treaty in the last week of 2020 - The EU-China Comprehensive Agreement on Investment (CAI)

The selective decoupling between China and the US, and steady dominance of China's contribution to global economic growth, could strengthen a multi-polar global economy. China will continue to be central to the future of Emerging Markets and expand its role in global growth, globalization, and cross-border investment.

The ongoing recovery in 2021 will depend on whether China can prevent a large-scale spread of virus infections, and on whether it can pass the baton of spending from local governments and large state companies to smaller businesses and consumers. Household spending and investment by manufacturing companies have lagged overall growth in 2020.

China's economic track record is impressive and has resulted in its attractiveness as an asset class. The growing footprint in trade and financial flows into Emerging Markets suggests a growing acceptance of the Chinese currency as a foreign exchange reserve currency. For example, in the first 11 months of 2020, foreign holdings of Chinese bonds increased by 904 billion yuan and the share of foreign holdings of bonds outstanding rose from 1.5% in 2017 to 2.7% in 2020. The share of foreign holdings is even higher for Chinese government bonds (9.5% in November 2020). Meantime, foreign holdings in China's onshore equity market rose from 2.6% in 2017 to 4.8% in 2020.

China's equity market was one of the best-performing markets in 2020 and China's bonds are an attractive investment due to the interest rate differential and currency appreciation. It is also a result of the integration of China's financial markets into global markets via their inclusion in global bond and equity indices. RMB-denominated assets can provide a valuable diversification benefit. While more than US$30 trillion of developed market government bonds yield a return of 0.5% or less, China's government bonds provide a yield of between 2% - 3%. China doesn't come without its risks. The fiscal and monetary stimulus to support the economy through the pandemic has been accompanied by a surge in debt, a development that authorities are now seeking to address as the recovery takes hold. At a December meeting to lay out economic goals for 2021, the ruling Communist Party signalled that stimulus would be gradually withdrawn, although it will be done in a manner to avoid and "sharp turns" in economic policy.

Furthermore, the US-China tension could still spill over into the financial area and complicate foreign investment in Chinese assets - the executive order for institutional investors to divest from Chinese companies that are labelled as military-related, and the recent delisting of three Chinese telecom companies from the NYSE, represent examples of policy actions that impact global investors. Tensions are unlikely to abate altogether, and China's strict control over their economy and the role players within it means there is always going to be an element of regulatory risk when investing in Chinese stocks. It remains to be seen whether such risks can be kept at manageable levels. Nonetheless, just as investors need exposure to Europe and the US, they also need exposure to China and the associated growth in Asia. Investors can expect to see exposure to China rise, within both their local and offshore portfolios.

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Topic: **N/A**

Natal Midlands

Date:	N/A
Venue:	Fernhill Hotel Midmar / Tweedie Road (almost opposite entrance to Midmar
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	N/A
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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