

# China's short and long term outlook: Opportunities ahead

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Oct 2020



## KEY ISSUES

- **China's outlook after the pandemic**
- **What about the long run?**

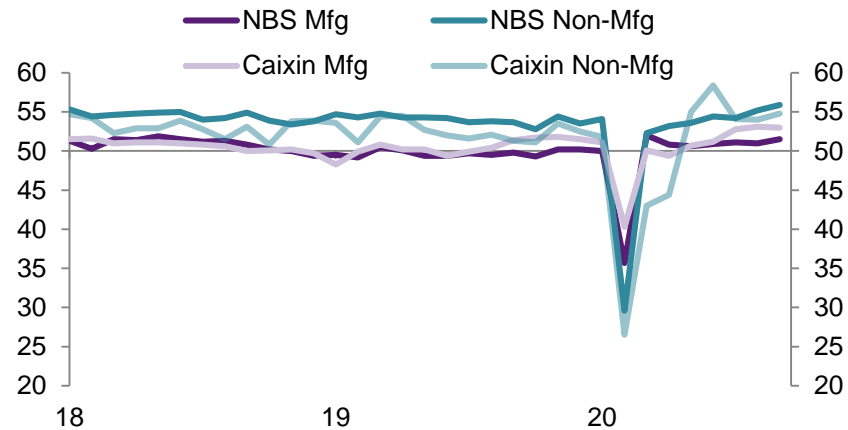
1

# CHINA'S ECONOMY IS RECOVERING WELL FROM THE PANDEMIC ALTHOUGH RISKS REMAIN



# The way to economic recovery has been confirmed by PMI data, both on services and manufacturing

### Manufacturing purchasing Manager Index

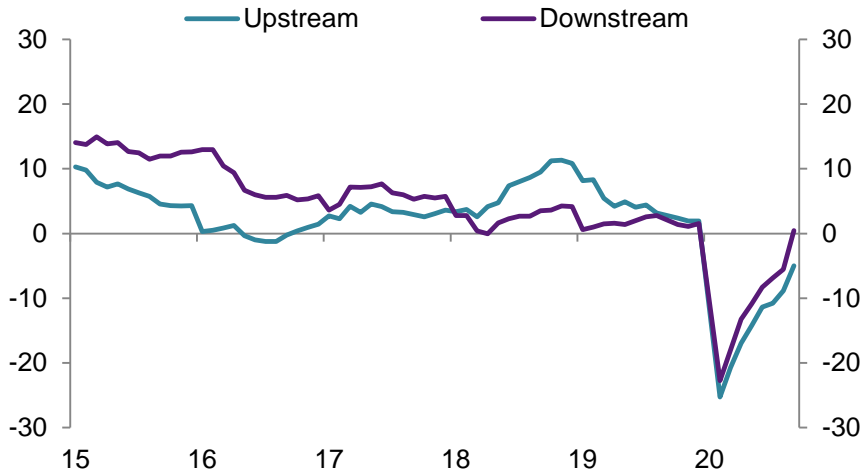


Sources : PBoC, Natixis, WIND

# But with some caveats:

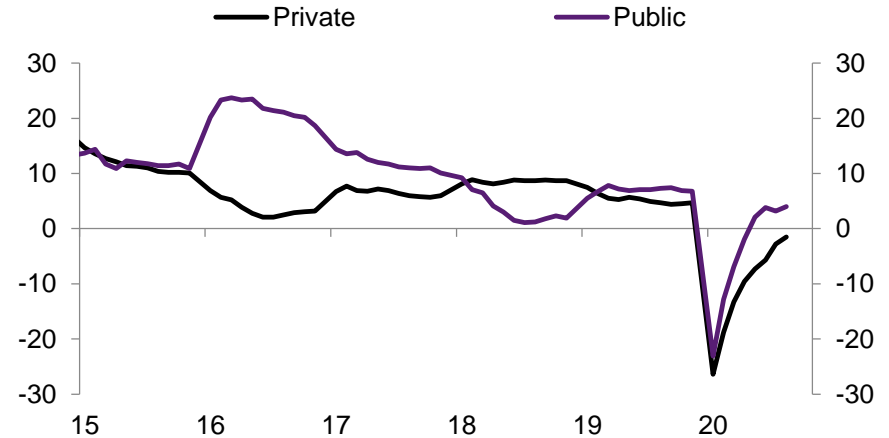
## 1. Fixed asset investment led by the public sector

### Industrial fixed asset investment (%YoY)



Source: Natixis, CEIC

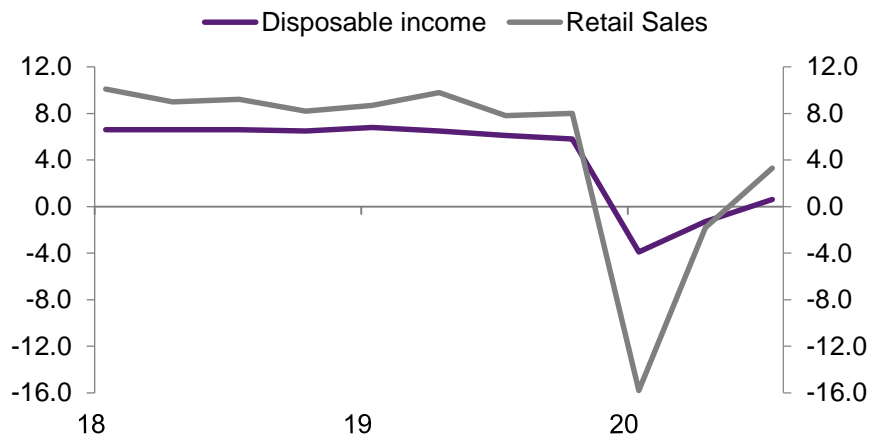
### Fixed Asset Investment (%YoY)



Source: Natixis, Bloomberg

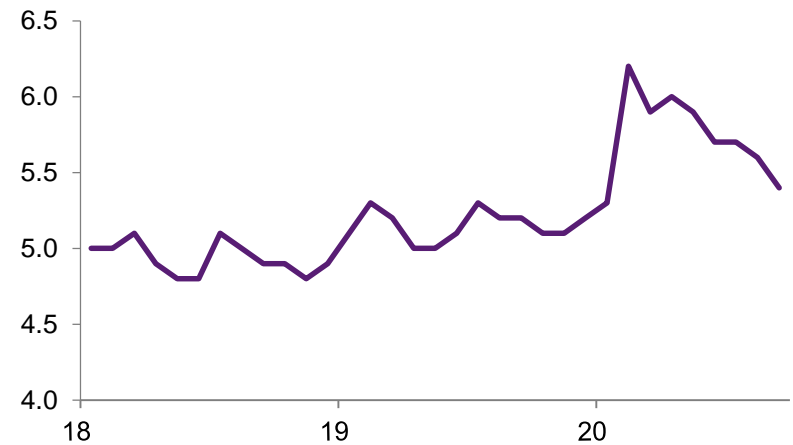
## 2. Household's disposable income not back to pre-Covid levels so hard to support consumption. Labor market also not back fully

### Disposable income and retail sales (%YoY)



Sources: Natixis, WIND

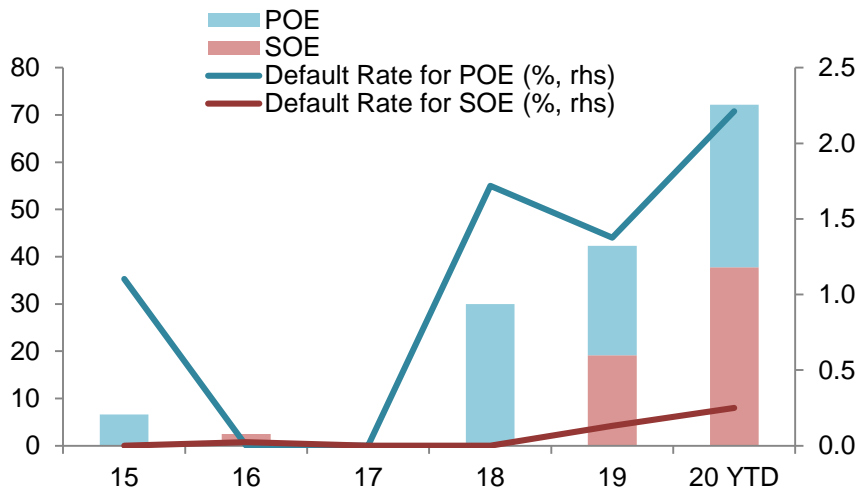
### China Urban Unemployment Rate (%)



Sources: Natixis, WIND

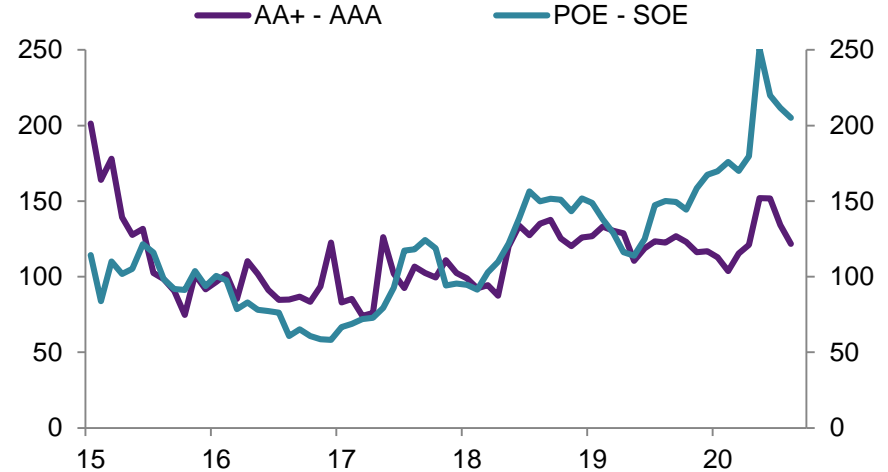
### 3. Financial risk remains elevated: credit risk at local government/local SOE level and private sector

Onshore Bond Defaults by Chinese Firms by Ownership (CNY bn)



Source: Natixis, Bloomberg

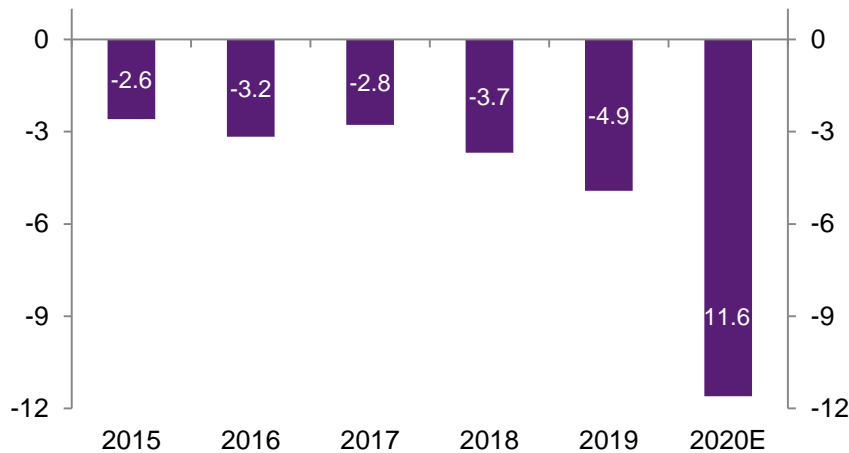
Credit Spreads (bps)



N.B. Included bonds with maturity more than one year. Excluded certificate of deposits.  
Source: Natixis, Bloomberg

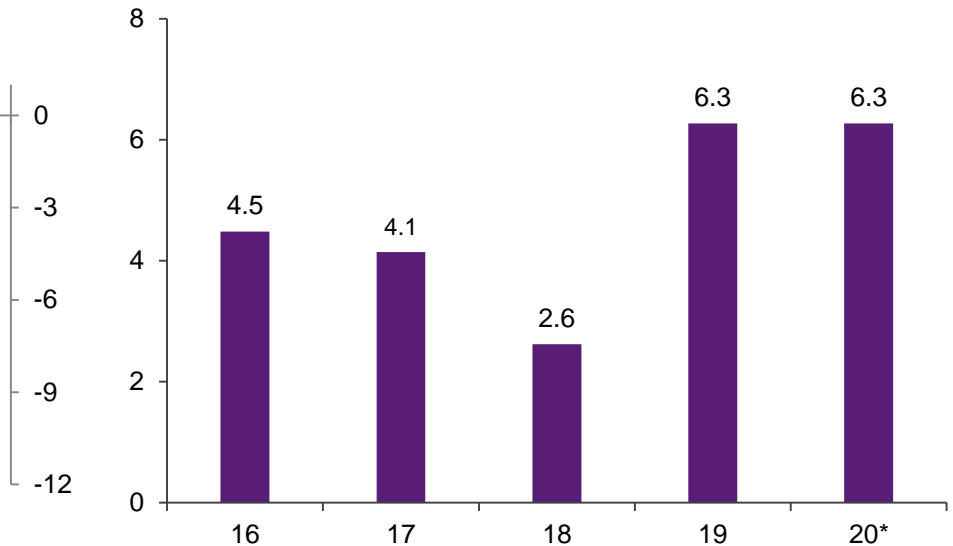
# Recovery happening but not organically. Fiscal stimulus is the key. Fiscal deficit has doubled. Local governments finances very stretched

On-balance sheet measure of China's fiscal deficit (% GDP)



Source: Natixis, WIND

Off-balance sheet deficit: LGFV (% GDP)

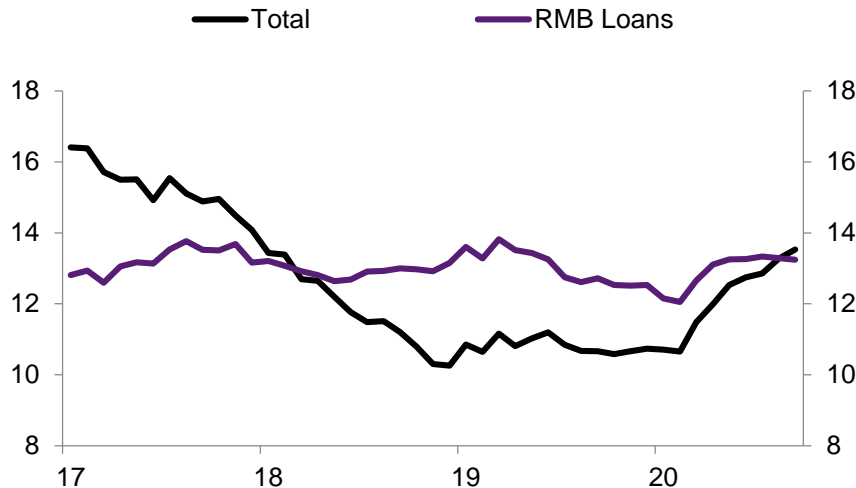


Source: Natixis, WIND



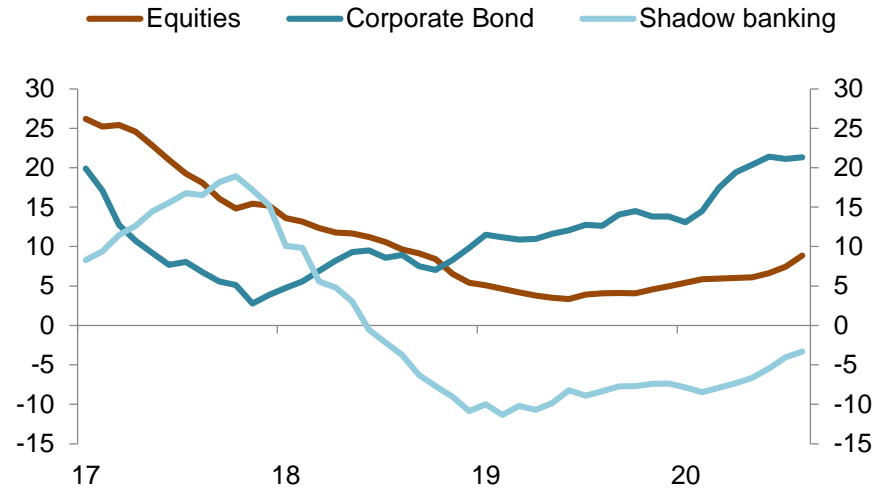
For monetary stimulus, a sharp easing at the beginning of the year, to foster credit growth, has eased lately, with a more prudent PBoC.

Total Social Financing (%YoY)



Source: Natixis, People's Bank of China, WIND

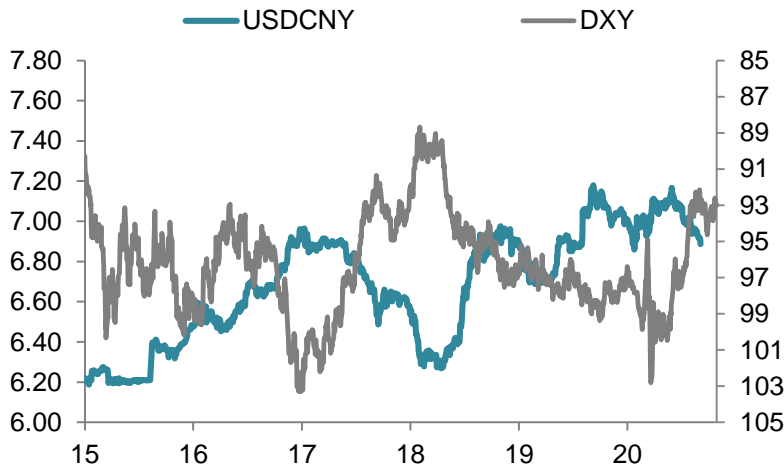
Total Social Financing - Other Instruments (%YoY)



Source: Natixis, People's Bank of China, WIND

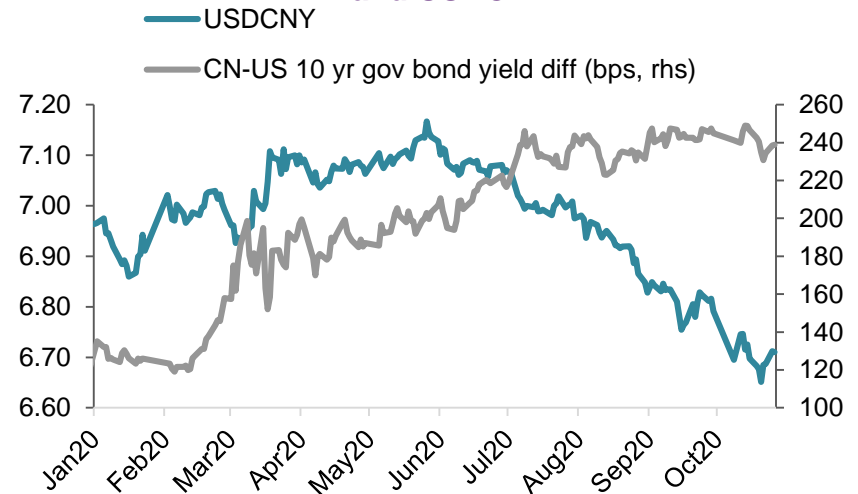
# RMB appreciated rapidly given USD weaknesses and yield differential, but moderated recently in the led-up to US election and still hinge on US-China tensions in the medium run

USDCNY & DXY Index



N.B. As of Oct 27th, 2020  
Source: Bloomberg, Natixis

China-US 10yr gov bond yield differential and USDCNY



N.B. As of Oct 27th, 2020  
Source: Natixis, Bloomberg

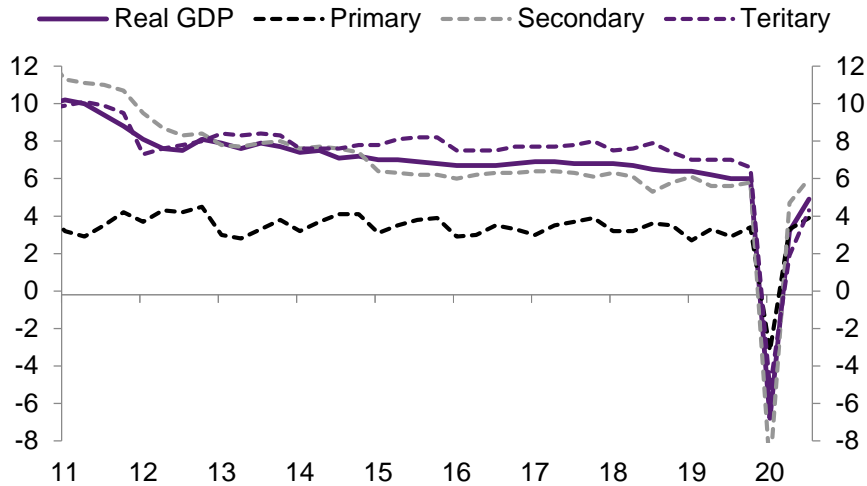
# 2

**IN THE LONGER RUN, THE CHINESE GOVERNMENT IS EXPECTED TO MOVE FORWARD WITH THE TECHNOLOGY STRATEGY**



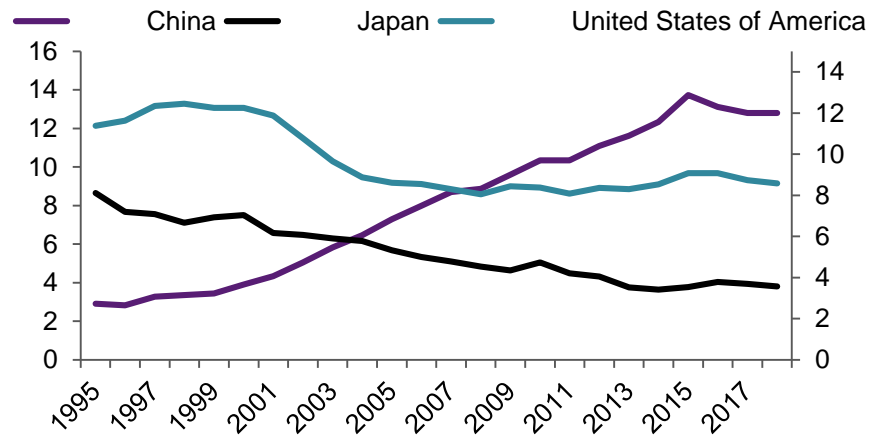
# China's economic slowdown calls for technology development

Real GDP by industry (%YoY)



Source: Natixis, NBS

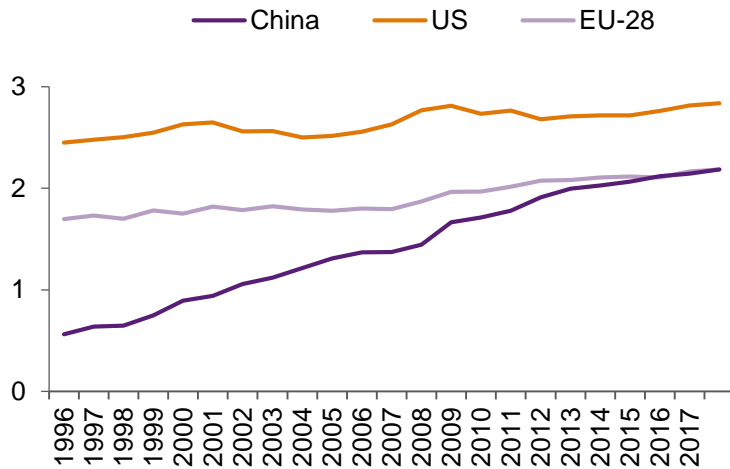
Share in global exports (%)



Source: Natixis, UNCTAD

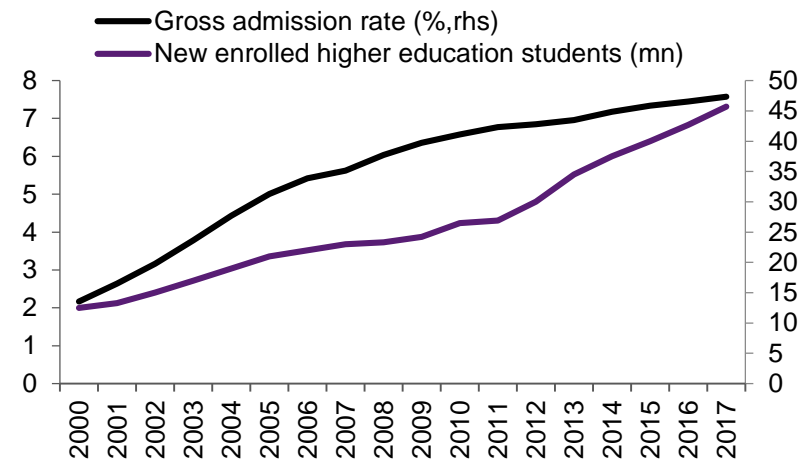
# The focus has been on factor enhancement: R&D investment and skilled labor

R&D Spending as a share of GDP (%)



Source: Natixis, World Bank

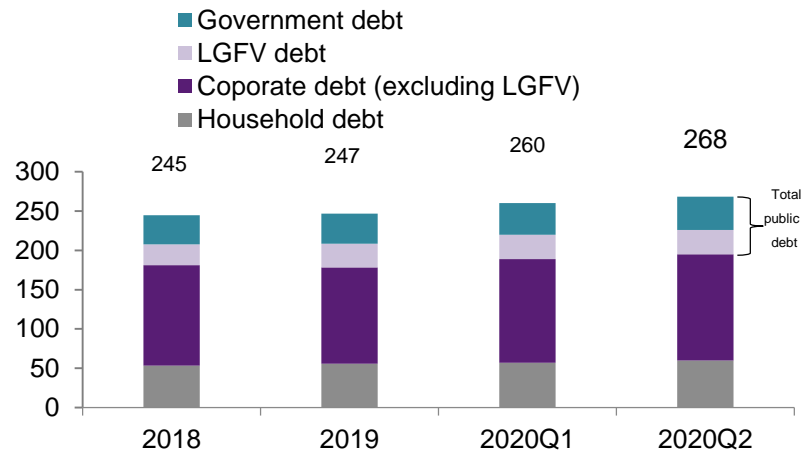
New enrolled higher education students and gross admission rate



Source: Natixis, Chinese Ministry of Education

A higher household debt, which have already been on the rise for the past few years, will erode the household's ability to consume, negatively affecting the demand for high-technology products in the long run

China's debt by sectors (% to GDP)

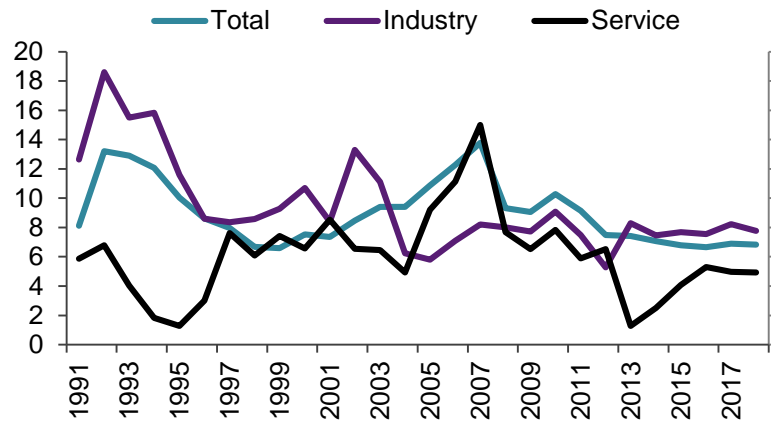


Source: Natixis

N.B. LGFV only includes the marketized value for all the entities that publicly report financial statements or issue bond. The LGFV data for 2019 and 2020Q1 is estimated based on the bond issuance data.

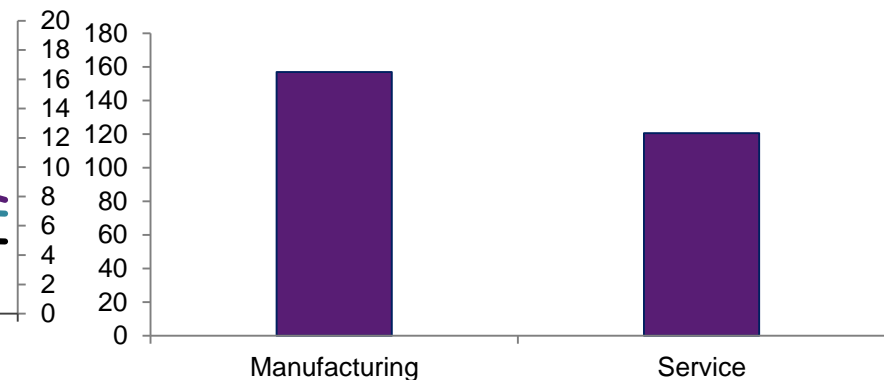
The direct assessment of these technology endeavors by analyzing China's productivity growth also shows a less rosy picture.

China's labor productivity growth (%)



Source: Natixis, Wind

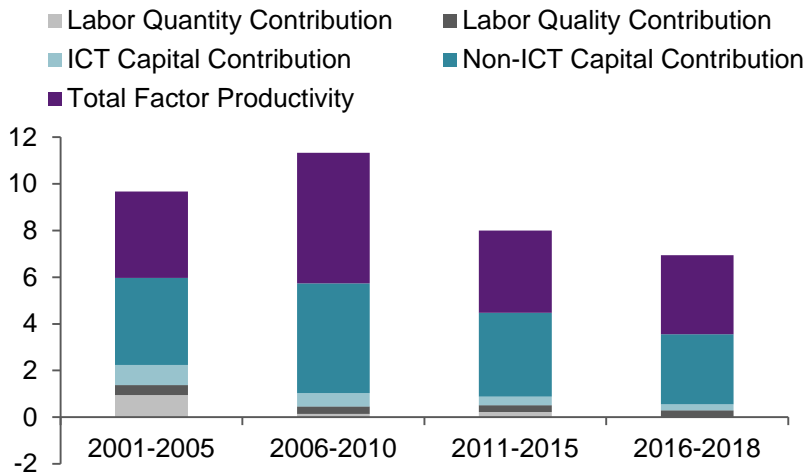
Average labor productivity in the manufacturing and service sector, 2018 (Thousand yuan per person, annual)



Source: Natixis, Wind

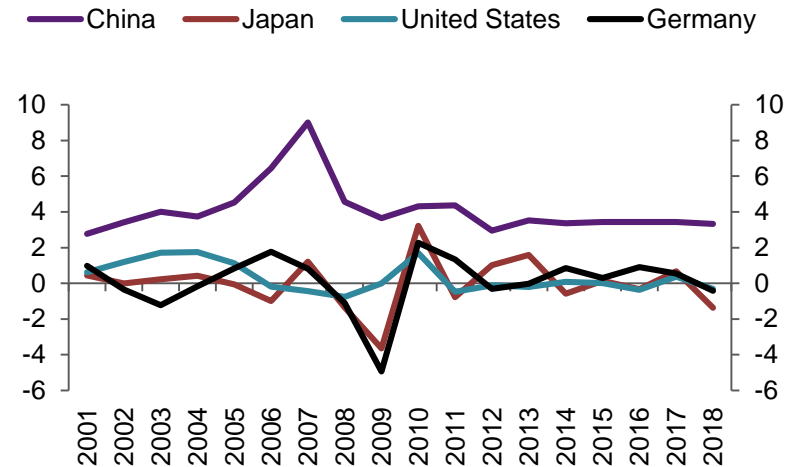
# Further taking into the consideration of rising human capital and slower growth of physical investment in China, the growth rate of the actual total factor productivity has not been increased

Sources of growth in China, 2001-2018 (%)



Source: Natixis, Conference Board

Contribution of TFP to GDP Growth (%)



Source: Natixis, Conference Board





3

## SOME TAKEAWAYS



- Key is simply too large to be ignored.
- Furthermore, given the huge shock to the global economy due to the pandemic, China remains one of the key engines of growth.
- This time around, China may share less of its growth, compared to 2008, but there is no other engine in town anyway.
- Still, risk remains from the sluggish disposable income and financial risks.
- In the medium term, the key question is whether China's innovation drive can be enough to avoid a rapid deceleration of potential growth, due to aging and decreasing labor productivity.
- Still, China's market is large enough to offer opportunities even with decelerating growth.

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