3 takeaways from China's V

China's economic resilience, its important contribution to global growth and the RMB's increasing attractiveness make the case for Chinese assets in investment portfolios. China's 14th Five-Year-Plan will reveal what the government's upcoming key priorities are and where the potential opportunities for investors lie.

China's economy grew 4.9% in 3Q20 from 3.2% in the previous quarter. While growth came in below consensus, the mainland is probably the only large economy to have delivered the elusive "V" in its economic recovery. See Fig. 1.

Industrial output, fixed asset investment and exports maintained their positive trends since bottoming out in the first quarter of the year. Notably, export orders in September recorded its strongest increase (50.8) since January 2011. That said, the broadening out of the recovery to domestic consumption was perhaps the most encouraging read. Retail sales expanded by 3.3% yoy in September, up from 0.5% yoy in August, after contracting for 5 consecutive months. Healthy retail sales registered during the recent Golden Week (October 1-8) suggest that domestic spending may continue to recover, if consumer confidence grows. During the Golden Week, daily average sales rose 4.9% yoy versus the recent highest reading of 0.5% yoy in August. A recovery in China's service sector will be key to broaden its economic recovery to date. Nevertheless, China appears on track to deliver around 2-3% GDP growth in 2020.

Fig 1: China real and nominal GDP growth (%yoy)

Source: NBS and Citi Research

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We believe that there are three takeaways for investors:

1. CHINA'S ECONOMIC RESILIENCE

China's ability to deliver positive growth in 2020 despite internal and external challenges, reflects the resilience and potential of China's economy. This is unlikely to be a one-off feat. According to estimates from the IMF, China is expected to be the largest contributor to global growth in 2025. See Fig. 2. This underscores the need for investors to have exposure to Chinese assets in their portfolios.

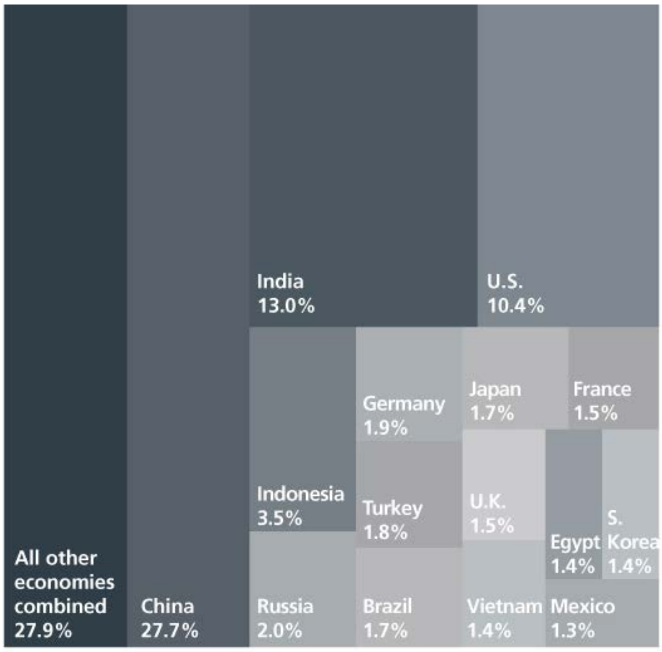
2. THE RMB'S INCREASING ATTRACTIVENESS

The RMB is up more than 7% against the USD since May[1]. According to **Goh Rong Ren, Portfolio Manager, Fixed Income, Eastspring Singapore**, while the RMB may become more volatile heading into the US Presidential election, China's superior response to the pandemic, its economic rebound to date, the attractive yields of its onshore bonds and its favourable balance of payments pits the RMB favourably against the greenback over the medium term. Given global central banks' vast holdings of the US dollar and the RMB's improving profile, some diversification of global foreign exchange reserves cannot be ruled out. **William Xin, Head of Fixed Income, Eastspring China**, believes that with the Chinese government bonds' attractive yields, China bonds will be one of the key beneficiaries of any reserve diversification. Fig. 3.

3. OPPORTUNITIES IN CHINA'S DIGITAL ECO-SYSTEM

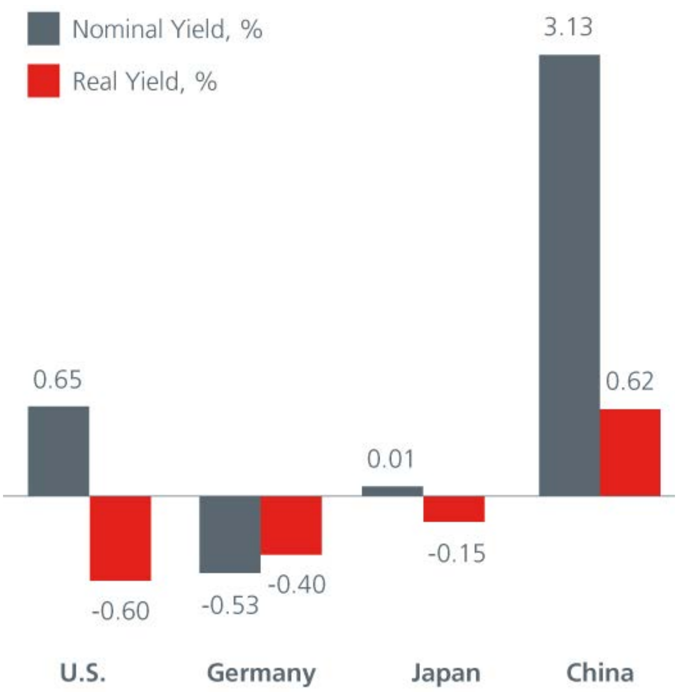
On the back of the Chinese economy's rapid rebound, the Chinese A-share market is up 21% year to date[2] in USD terms, outperforming the MSCI Asia ex Japan Index as well as the S&P 500. On a 12-month forward price to earnings ratio, the China A-share market is more attractively priced than its regional and global peers, although it is

Fig 2: Fifteen biggest contributors to global GDP growth in 2025



Source: Bloomberg analysis of IMF data. Individual economy's forecast growth, as a share of increase of world GDP, between 2024 to 2025; Purchasing Power Parity based.

Fig 3: Nominal and real yield comparison of government bonds



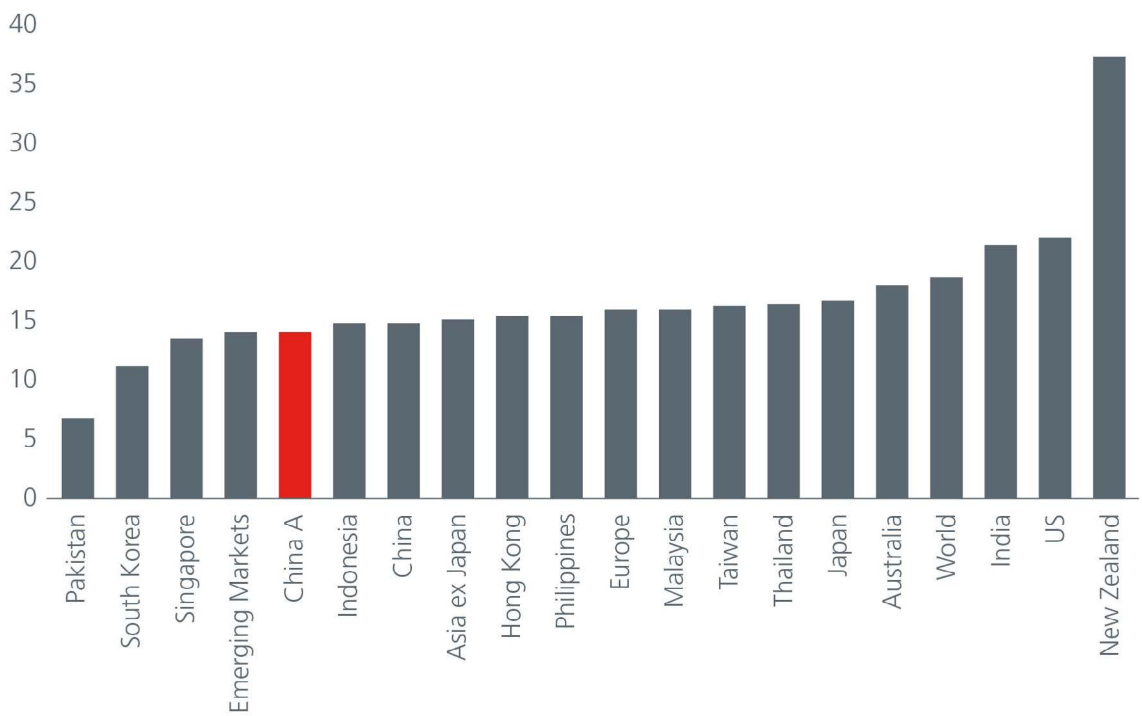
Source: Data as at 24 September 2020. Bloomberg.

Source: [1]Bloomberg. As of 19 October 2020. [2]CSI 300 Index as of 20 October 2020.

trading above its own historical average. Fig. 4. With further policy fine-tuning appearing limited, a stronger than expected recovery in the economy and corporate earnings would be key to drive the market higher.

Following the China A-share market's rally, investors need to be more discerning on the themes and sectors they invest in going forward. China's 14th Five-Year-Plan will reveal what the government's upcoming key priorities are. The digital economy has been imperative in supporting the people's well-being during the COVID-19 outbreak. **Michelle Qi, CIO Equities, Eastspring China** expects the government to put in place more policies to foster the digital economy. On-line platforms have changed consumer behaviour, creating investment opportunities across the entertainment, health, education, insurance and e-commerce sectors. Investors however will need to look beyond the obvious beneficiaries in these sectors in order to find alpha generating opportunities within their respective eco-systems. As such, combining macro themes with in-depth bottom-up analysis would be key to capturing the best investment opportunities.

Fig 4: 12-month forward price to earnings ratio – China A still cheaper than most



Source: Worldscope, MSCI, Factset. 16 October 2020.

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