# Opportunities and Challenges for Asset Managers after China's Policy Reversals and Developed Market Slowdowns

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PGIM FIXED INCOME

# Domestic Factors Have Turned Positive

- Policy reversals on property cooling, zero-covid, and private-sector/tech regulation are removing key drags to a recovery.
- Meanwhile, the authorities are stressing the need to boost consumption and domestic demand.
- However, the external environment is not favorable.
- A wide range of outcomes are possible, and our above-consensus call rests on yet-to-be implemented additional policy stimulus.

**China GDP Growth Projections/Forecasts**

*(Percent, Annual Average)*

| | 2022 | 2023 | 2024 |
|---|---|---|---|
| PGIM | 3.0 | 5.7 | 4.5 |
| Consensus | 3.0 | 5.2 | 5.0 |
| IMF | 2.6 | 4.2 | 5.1 |
| Memorandum Item: | | | |
| Statistical Carry Over | | | |
| Q/Q Basis | 1.7 | 1.3 | n.a. |
| Y/Y Basis | 2.6 | 2.5 | n.a. |

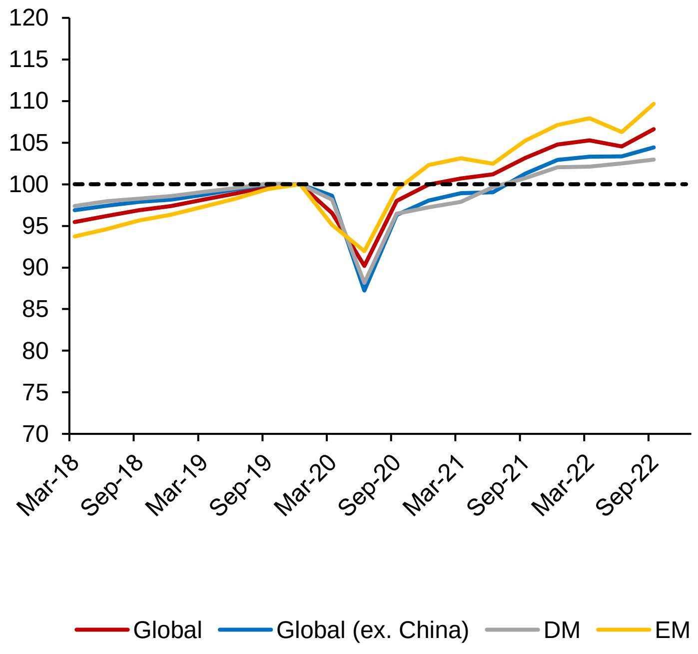
*Source: PGIM Fixed Income and Haver Analytics. As of February 22, 2023. Projections are not guaranteed, and actual results may vary.*

# China was First Out of the V…

- China was “first in-first out” (except for Taiwan)
- China also staged a V-shaped recovery (so did the US and EM)
- This recovery was led by EM, the US and North Asian tech exporters
- While Japan and the euro-zone lagged along a more prolonged “w-shaped” path.

**Real GDP**

*Index, 2019-Q4 = 100*

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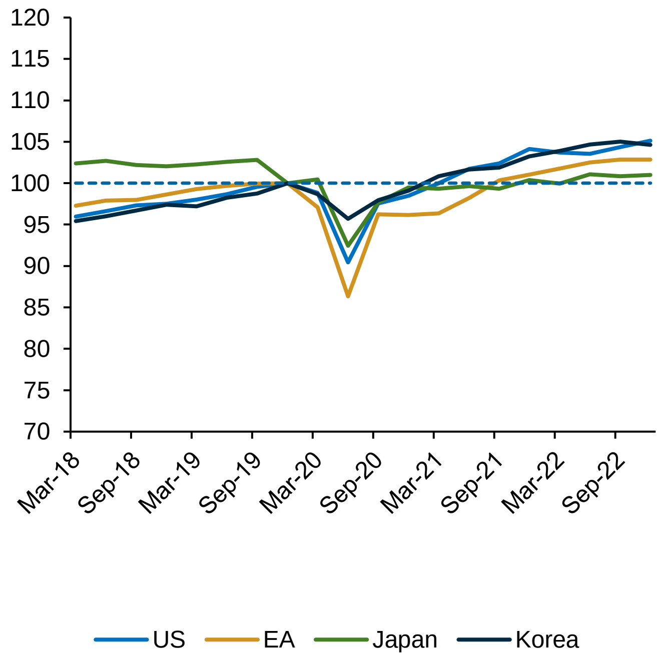
*Index, 2019-Q4 = 100*




**Real GDP**

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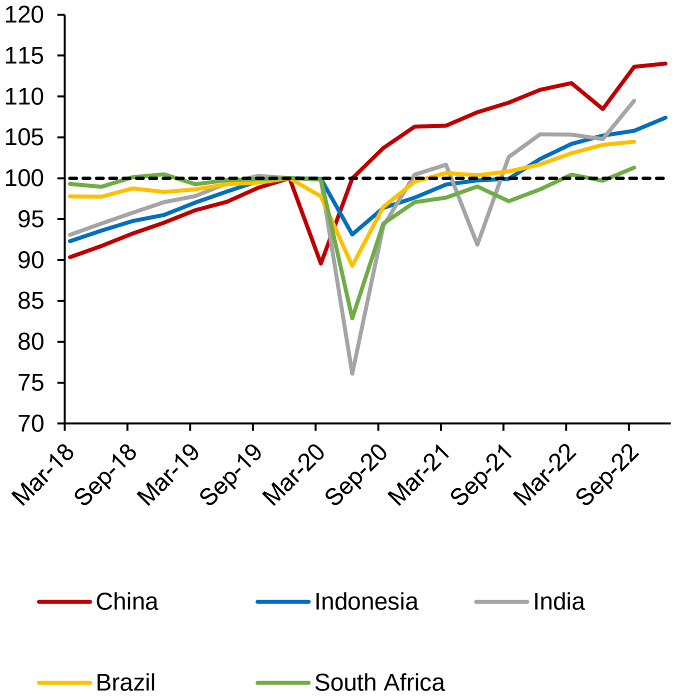
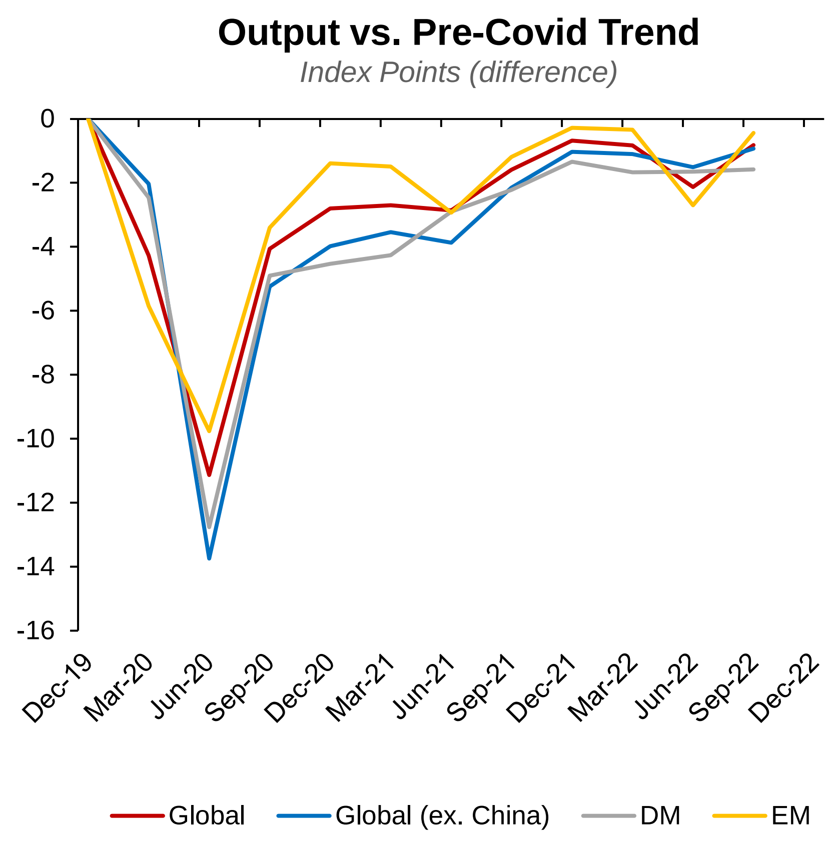
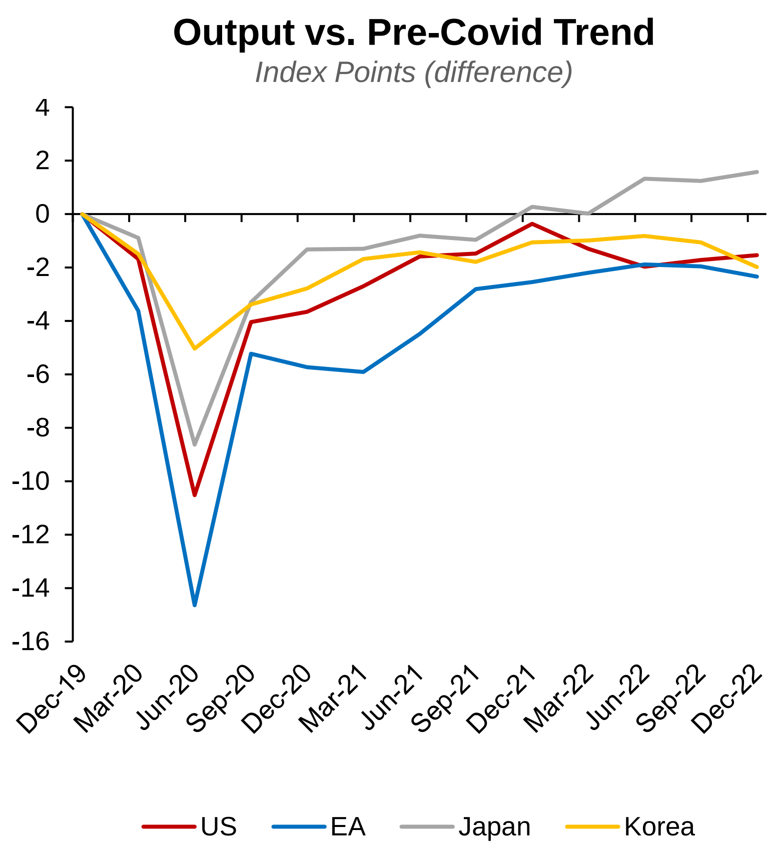


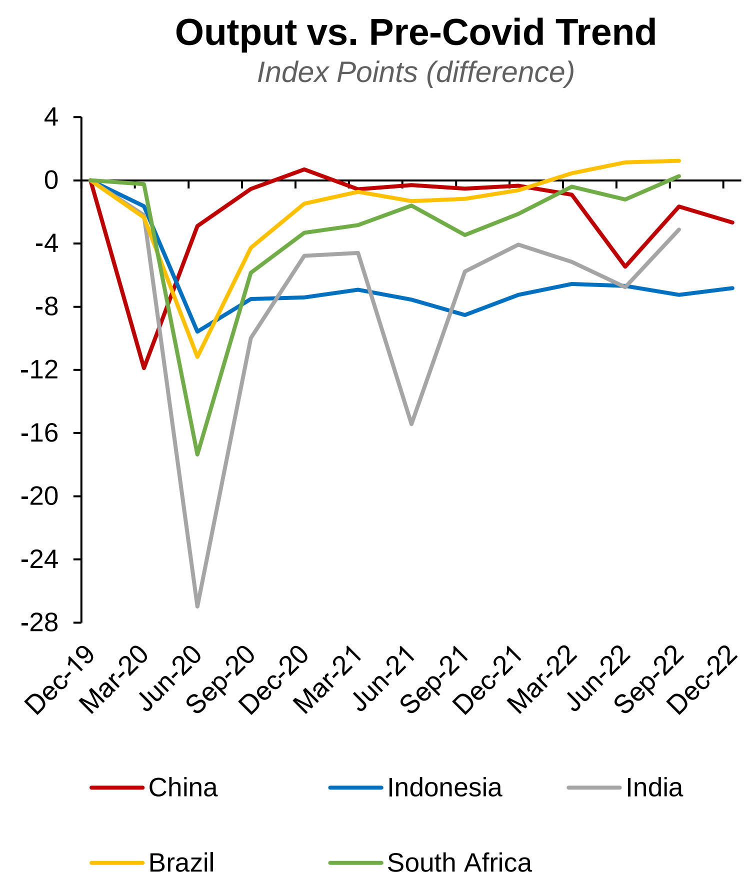

*Source: PGIM Fixed Income and Haver Analytics. As of February 22, 2023.*

# …Though Global Scars Remain

- After early success China is struggling to keep catching up to its pre-2020 GDP growth trend, similar to other regions and countries.



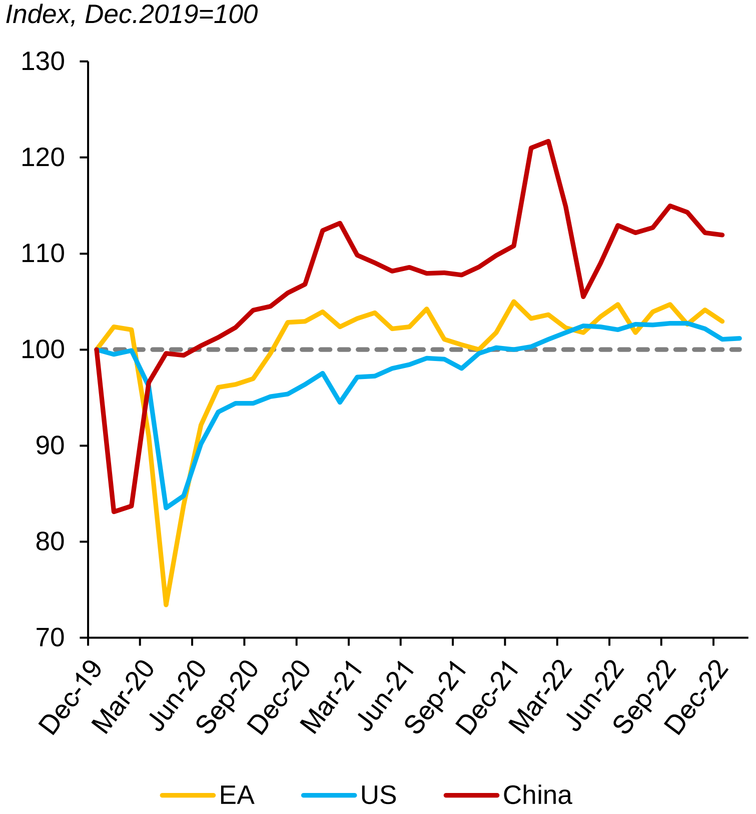

*Source: PGIM Fixed Income and Haver Analytics. As of February 22, 2023.*

# After Filling the Global Void, China's Industry and Exports are dragging…

- Prolonged and disruptive lockdowns in much of the world cut into production while large-scale income support lifted demand, resulting in large excess demand for goods
- China quickly scaled up production and exports to fill this void, resulting in further world market share gains

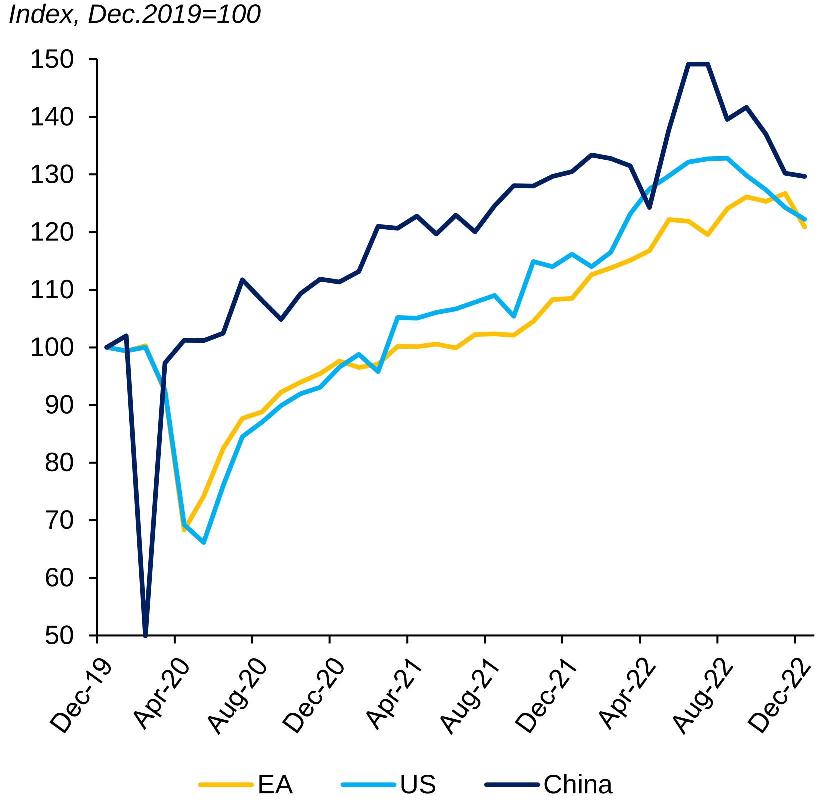
**Industrial Production Excluding Construction**

*(SA, 2019=100)*



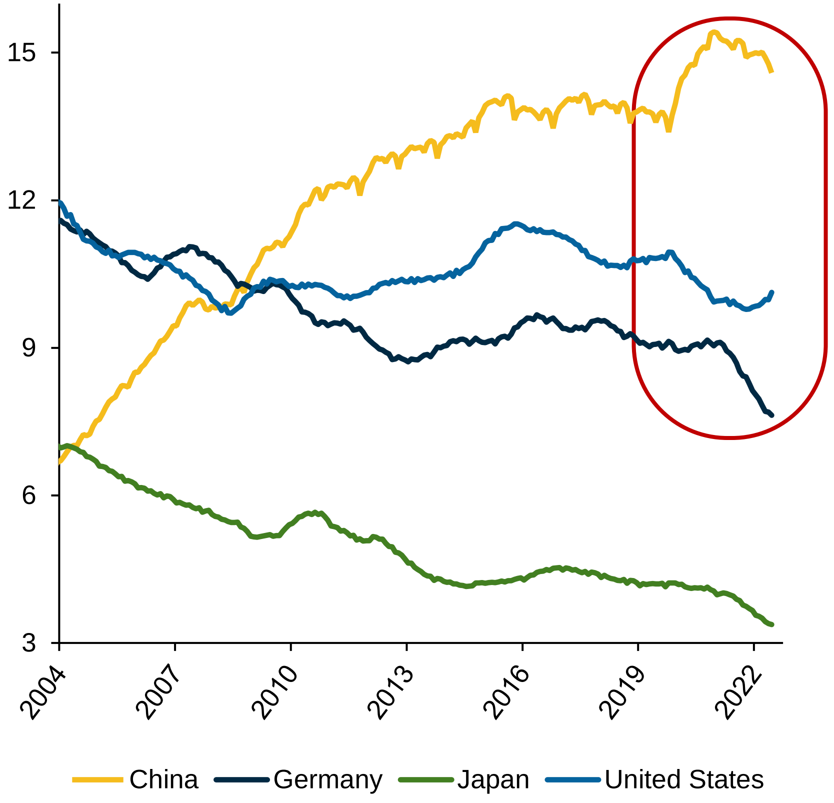

**Goods Exports**

*(SA, Mil US$, 2019=100)*




**Global Export Market Share by Country**

*(in %)*



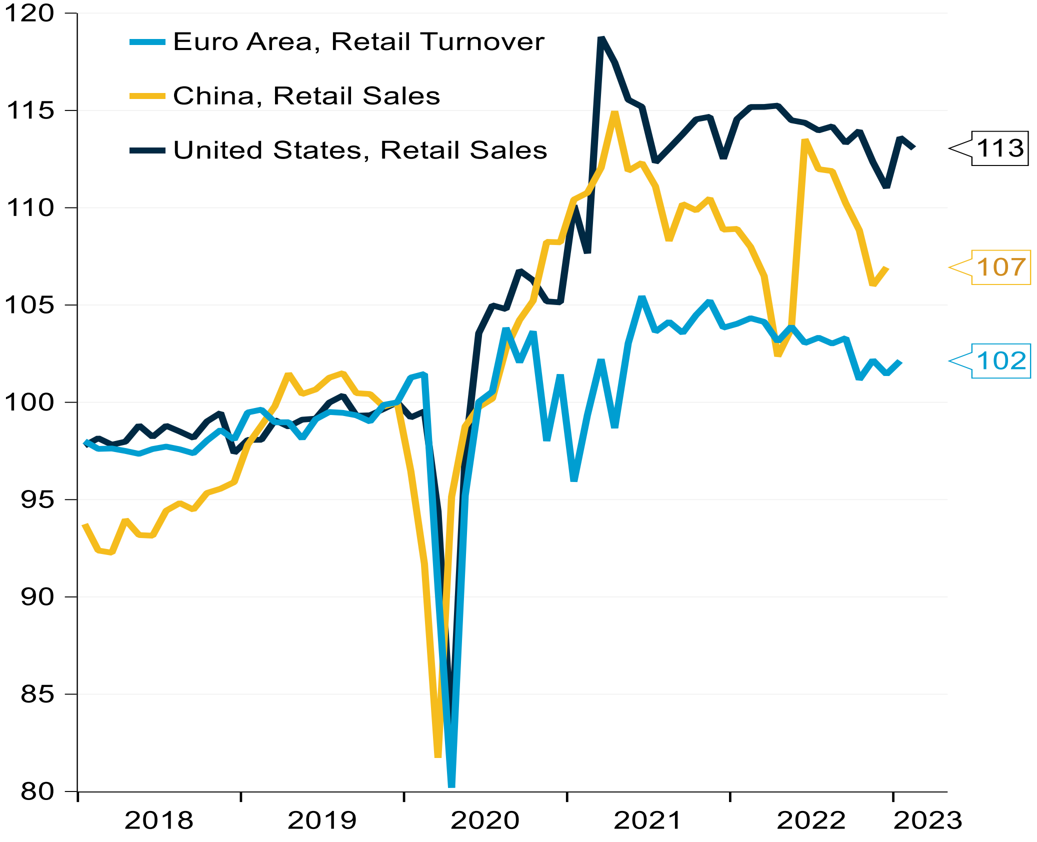

*Source: PGIM Fixed Income and Haver Analytics. As of February 22, 2023.*

# … While Consumers Pulled Back

- Meanwhile, SARS-CoV-2 protocols in China and industry crackdowns kept consumption lagging.
- This is the opposite of what happened in the US.
- The key question for the outlook is how much and how fast will China's consumers catch up?

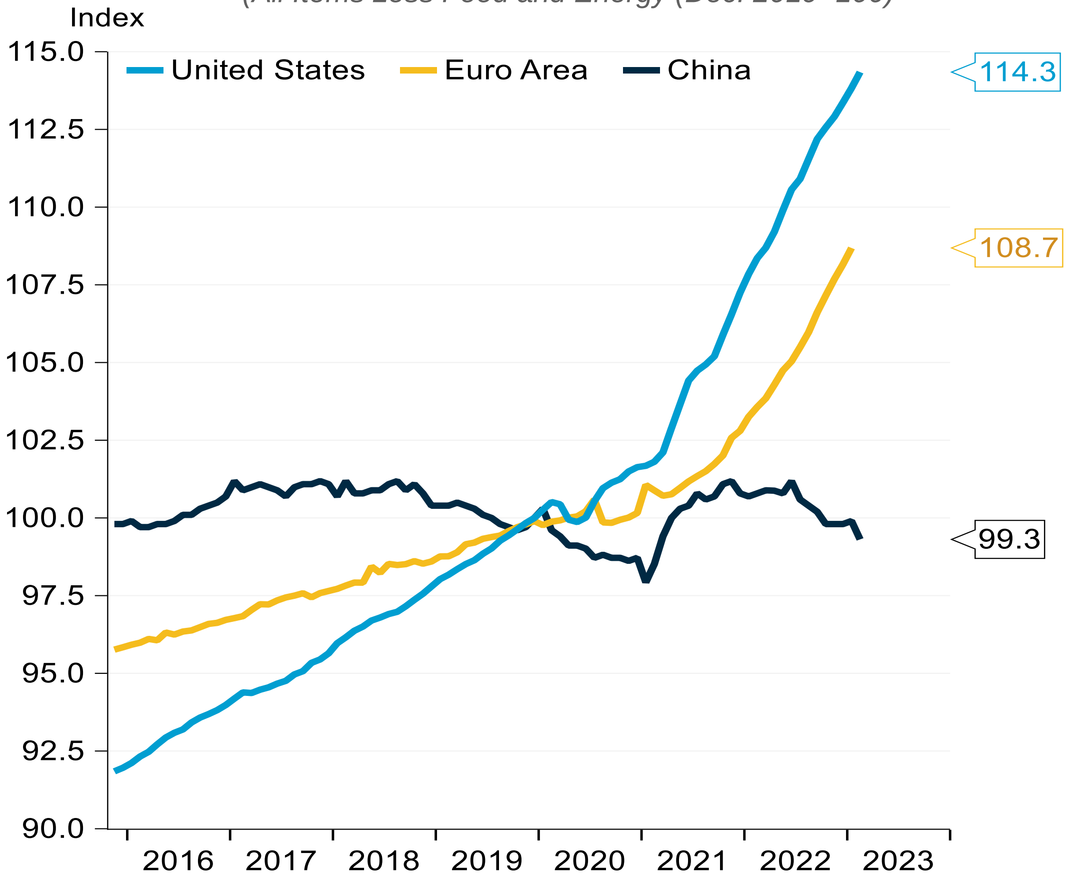
**Real Retail Sales & Food Services: China**

*(SA Calendar year adjusted, deflated by CPI, Dec. 2019=100)*




**Core CPI**

*(All Items Less Food and Energy (Dec. 2019=100)*

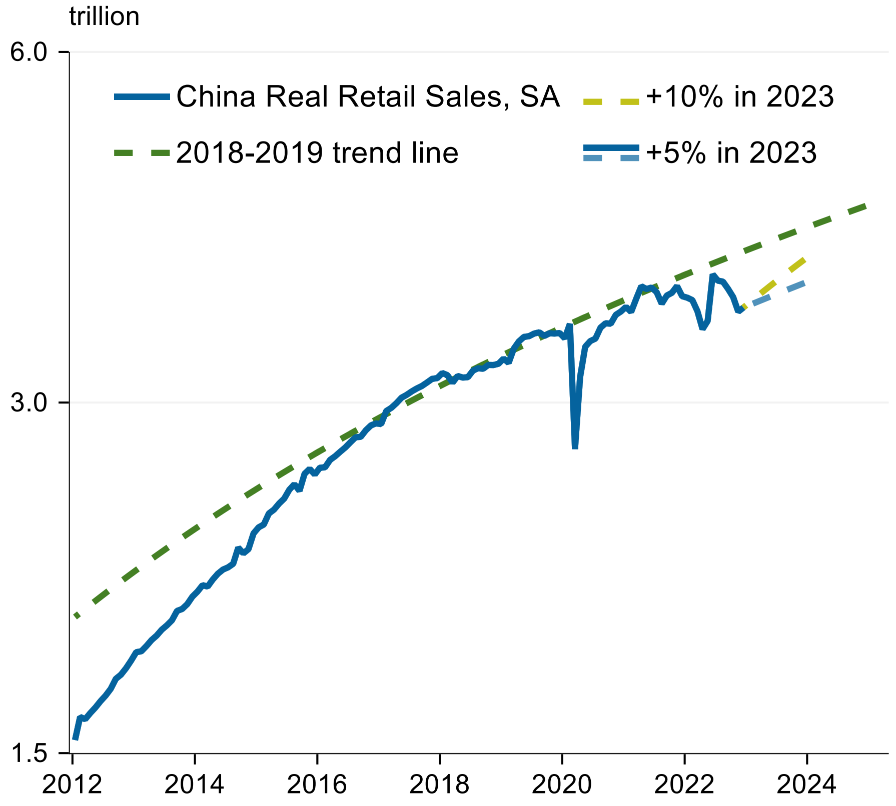



*Source: PGIM Fixed Income and Macrobond. As of February 22, 2023.*

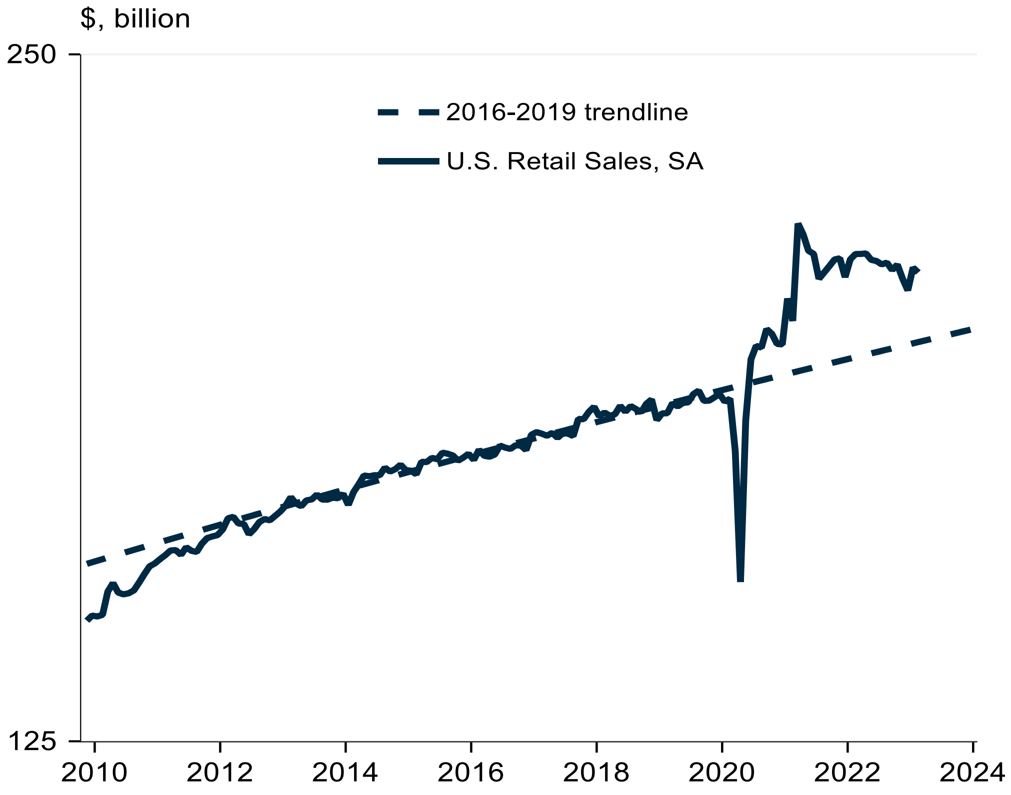
# The US Experience Is Not The Template-1

- In contrast to the US, Chinese consumption is only moderately below (a historically slowing) trend.

**Real Retail Sales & Food Services: China**
*(SA Calendar year adjusted, deflated by CPI)*




**Real Retail Sales & Food Services: US**
*(SA Calendar year adjusted, deflated by CPI)*

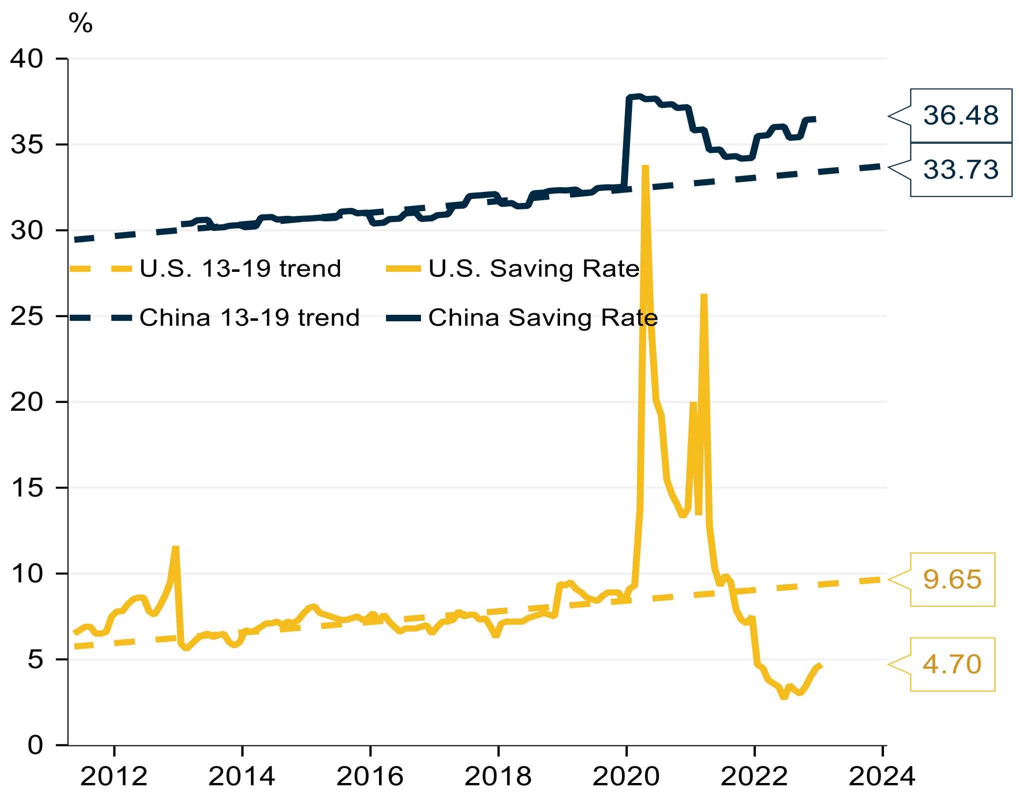



*Source: PGIM Fixed Income and Macrobond. As of February 22, 2023.*

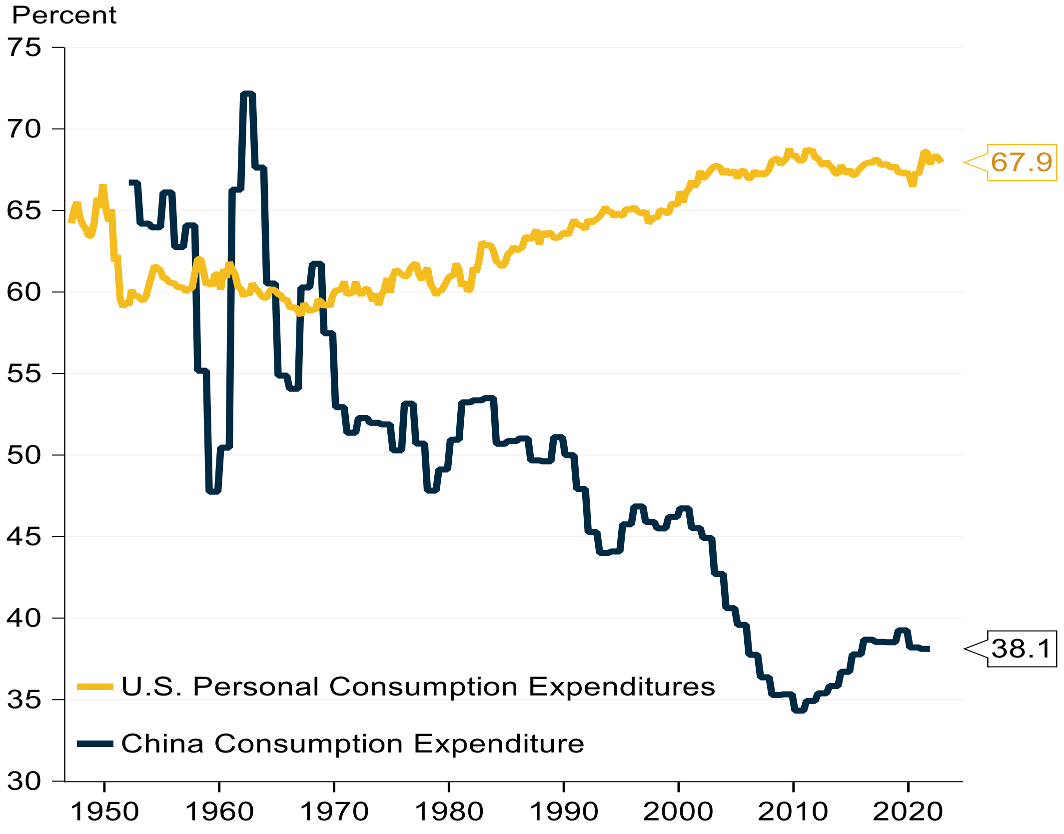
# The US Experience Is Not The Template-2

- The surge in consumption and creation of excess savings in the US are due to large income transfers, which have no parallel in China.
- China's consumption share is much lower than the US' AND has been declining; a 10 percent real increase will only result in GDP growth of 3¾ percent, compared to almost double that in the US.

**Comparative Household Savings Rates**
*(SA Calendar year adjusted, in percent of Disposable Income)*



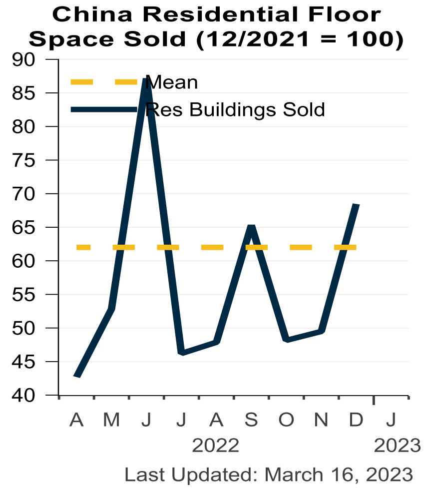

**Consumption Share**
*(In percent of GDP)*

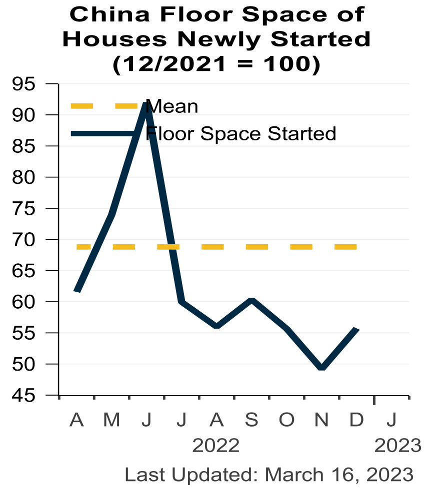


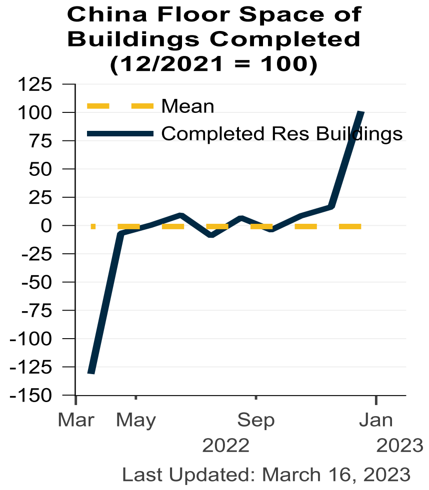

*Source: PGIM Fixed Income and Macrobond. As of February 22, 2023.*

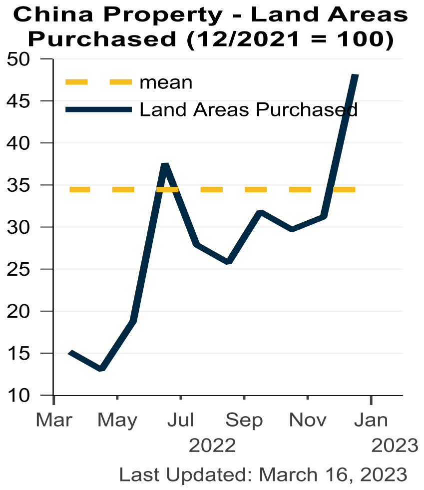
# Policy-stimulus will likely be Required

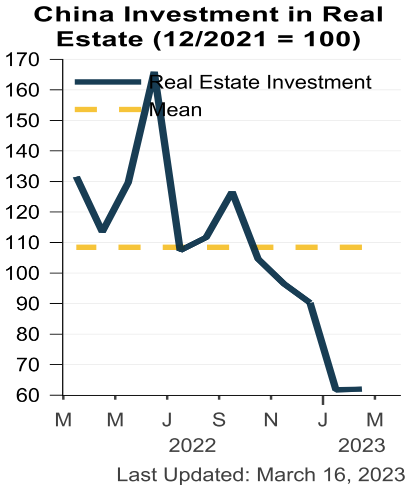
- Infrastructure investment will need continued support, lest it become a growth drag.
- With a global slowdown and shift to services, manufacturing will need to be increasingly geared toward the domestic market.



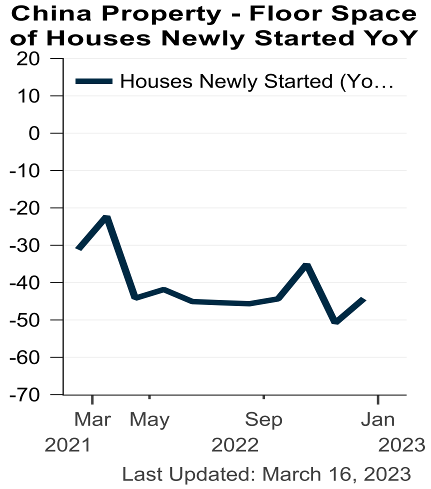



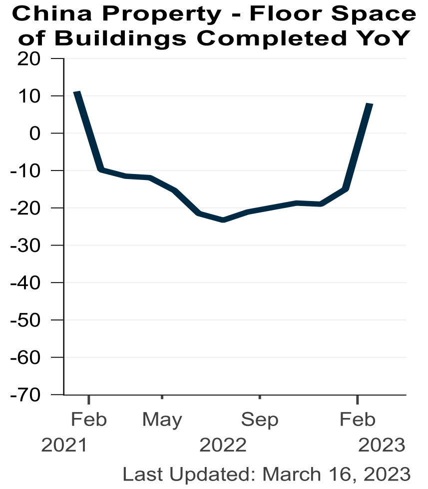



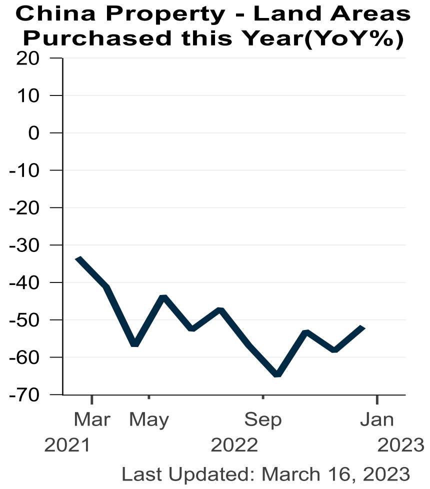



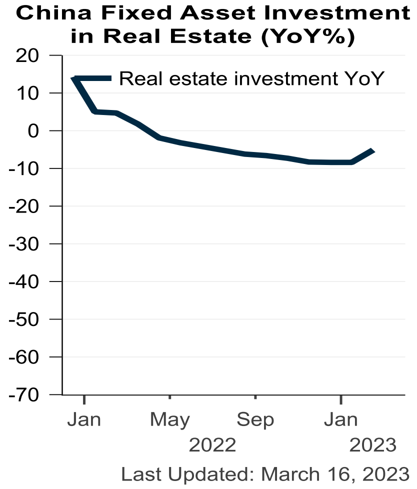







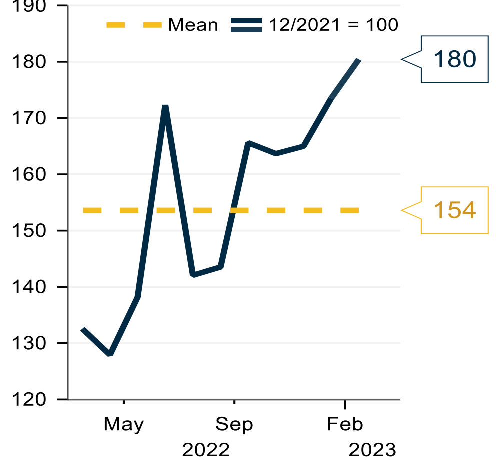




*Source: PGIM Fixed Income and Macrobond. As of February 22, 2023.*

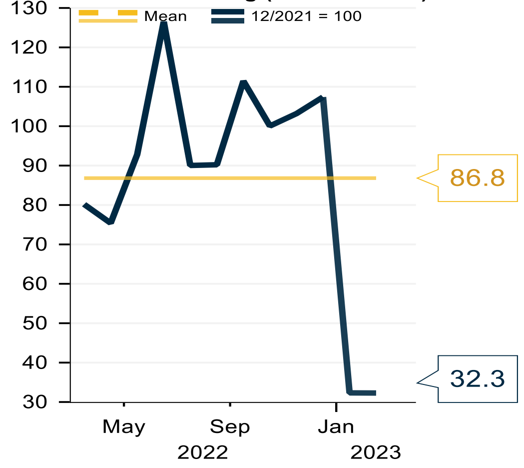
# Policy-stimulus will likely be Required

- Infrastructure investment will need continued support, lest it become a growth drag.
- With a global slowdown and shift to services, manufacturing will need to be increasingly geared toward the domestic market.

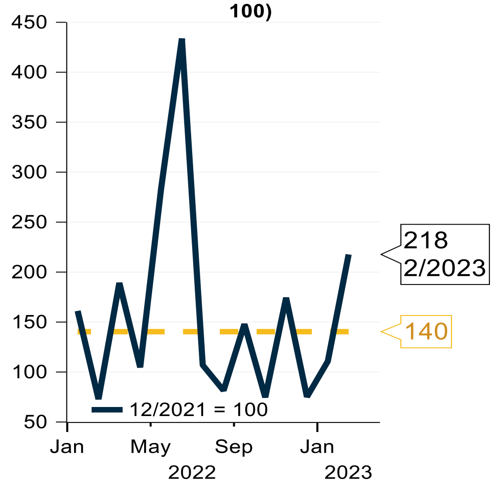
**China Fixed Assets Investment in Infrastructure (12/2021 = 100)**




**China Fixed Assets Investment in Manufacturing (12/2021 = 100)**

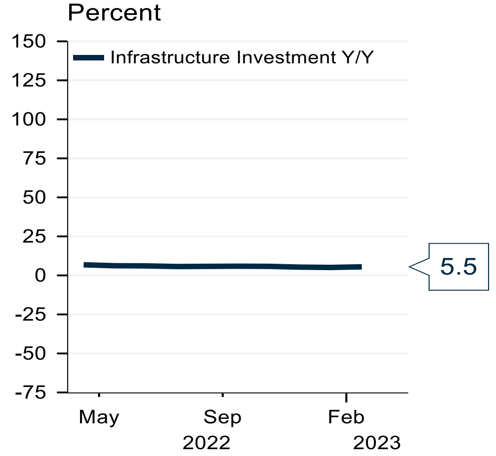



**China, Government Bond Issuance (12/2021 = 100)**

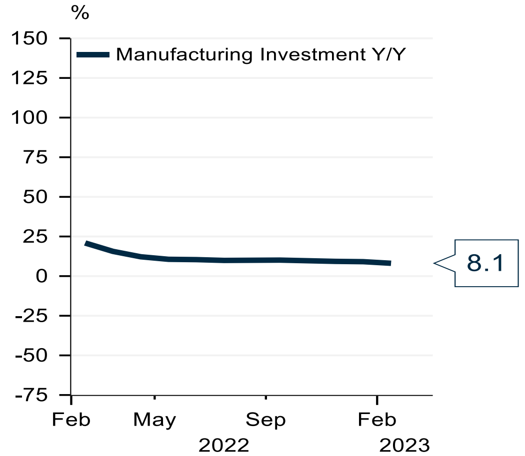



**China Exports (12/2021 = 100)**

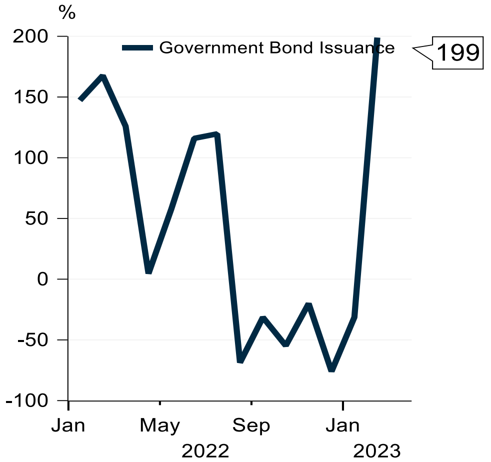

**China Fixed Assets Investment in Infrastructure Cum. YoY**




**China Fixed Assets Investment in Manufacturing Cum. YoY**




**China, Social Financing, In Flow, Issuance of Government Bonds**

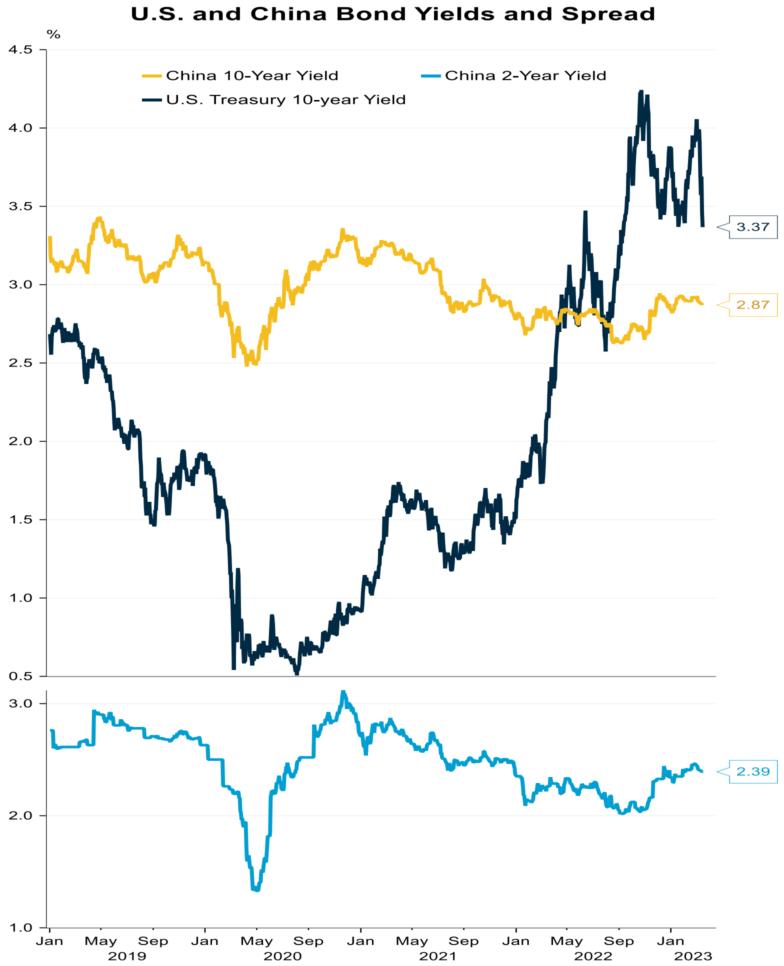


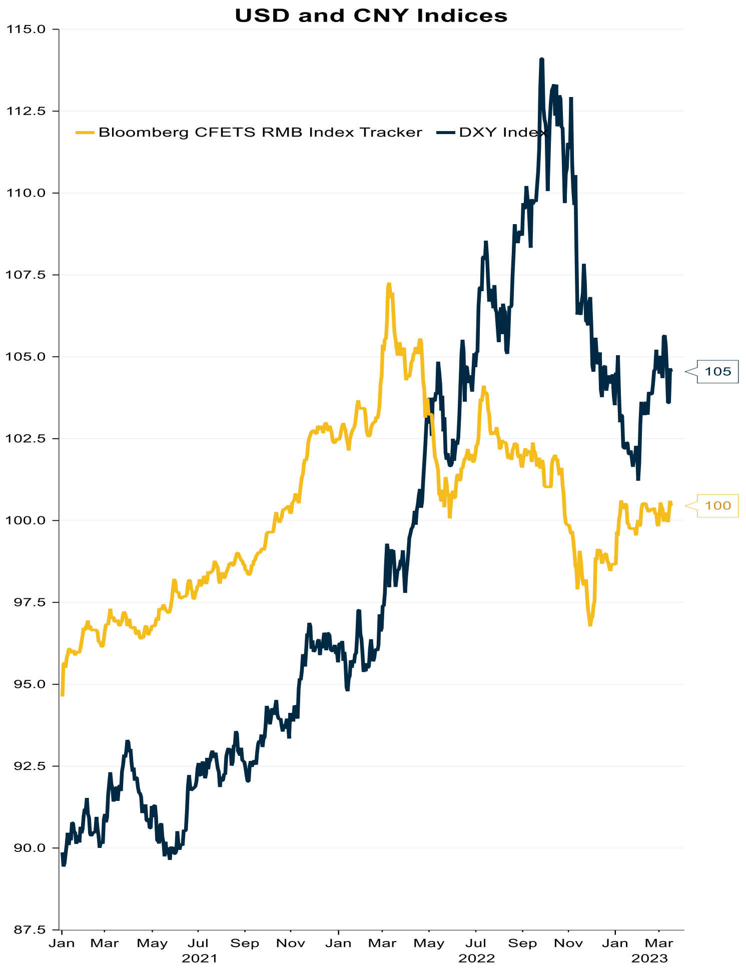

**China Exports YoY**

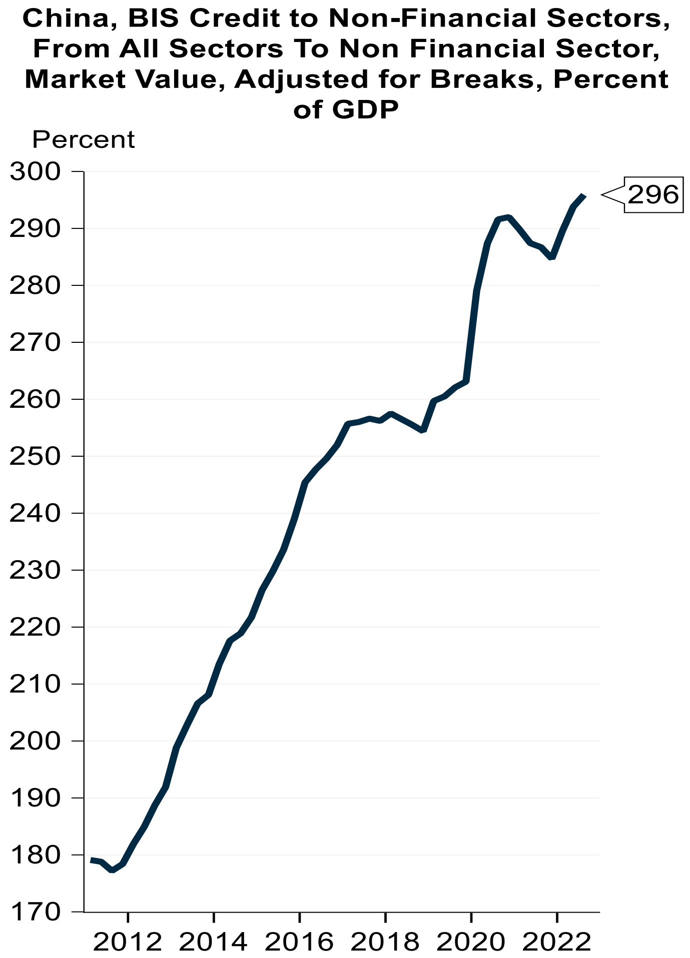

*Source: PGIM Fixed Income and Macrobond. As of February 22, 2023.*

# Macroeconomic Easing also via Rates and FX

- The debt burden is set to take yet another leg higher, putting a premium on higher nominal growth and lower interest rates.
- We expect China to continue to be able to buck the trend of globally higher rates
- Meanwhile, the authorities will likely not stand in the way of correcting FX overvaluation to support external demand



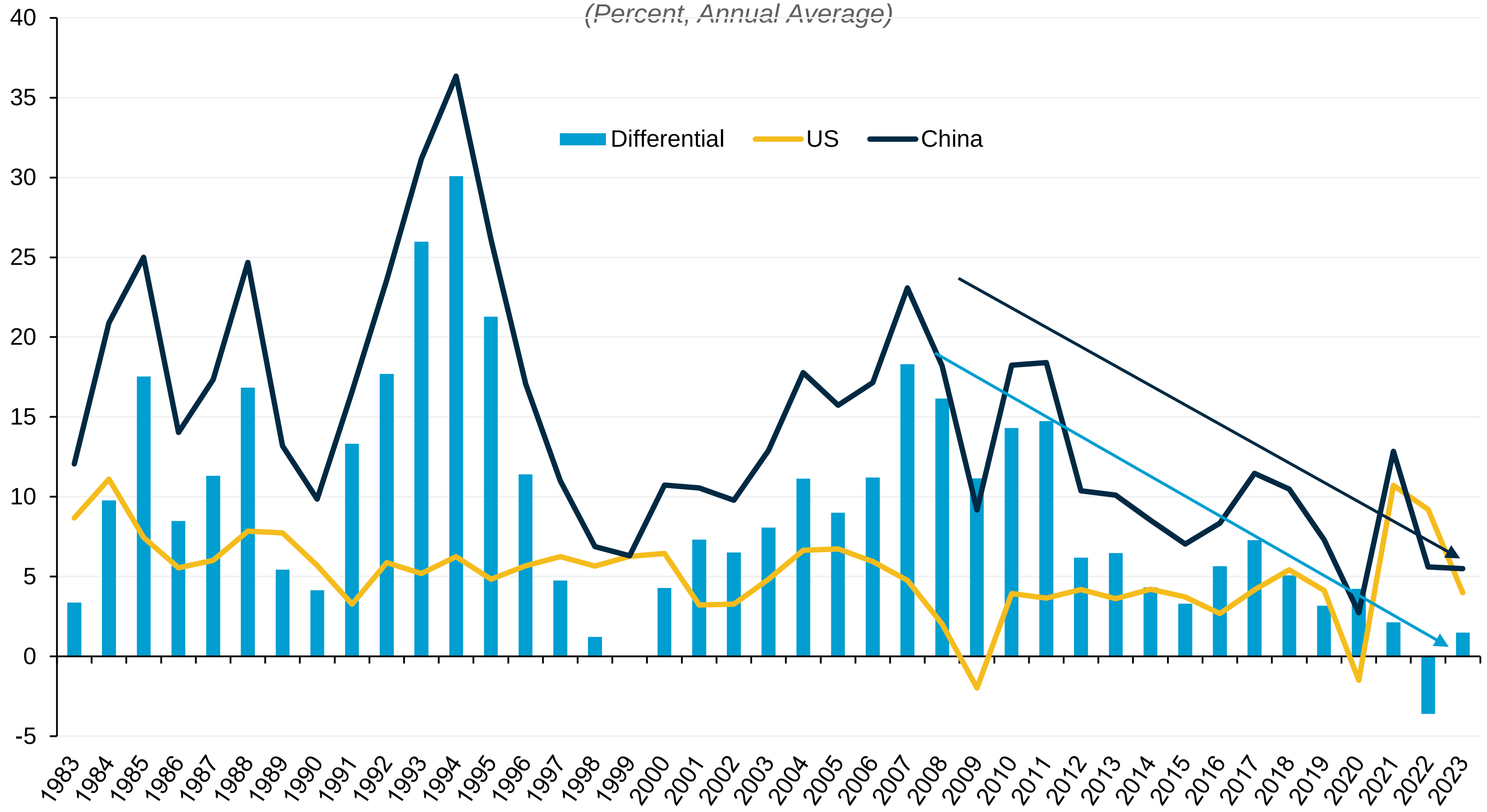

*Source: PGIM Fixed Income, Macrobond, and Bloomberg. As of February 22, 2023.*

# China Will Lift the Global Economy Less This Time

- This is the first consumption-led Chinese recovery.
- Global spillovers will be less commodity and more tourism related.
- Moreover, the nominal growth impact and differential are less favorable.

**Nominal GDP Growth**

*(Percent, Annual Average)*



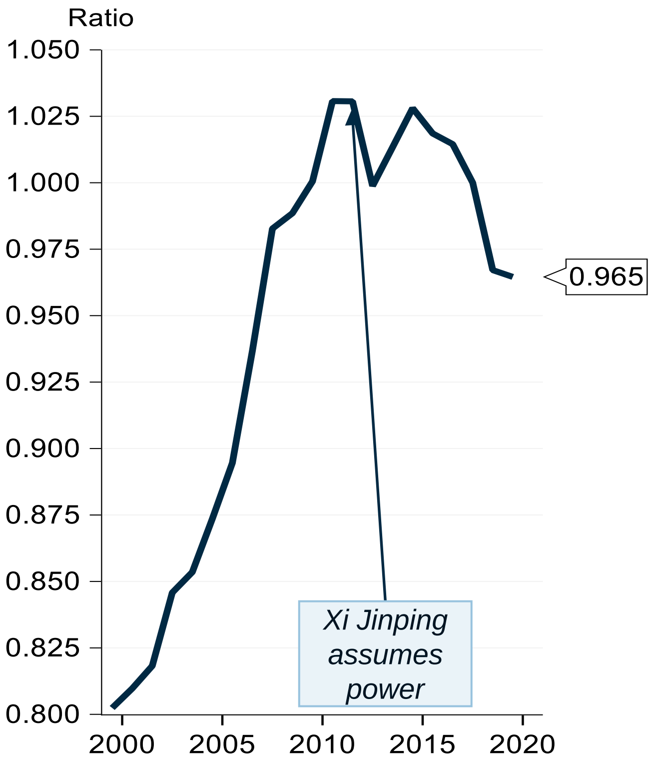

*Source: PGIM Fixed Income and Haver Analytics. As of February 22, 2023.*

# Beyond the Bounceback—Nothing But Challenges

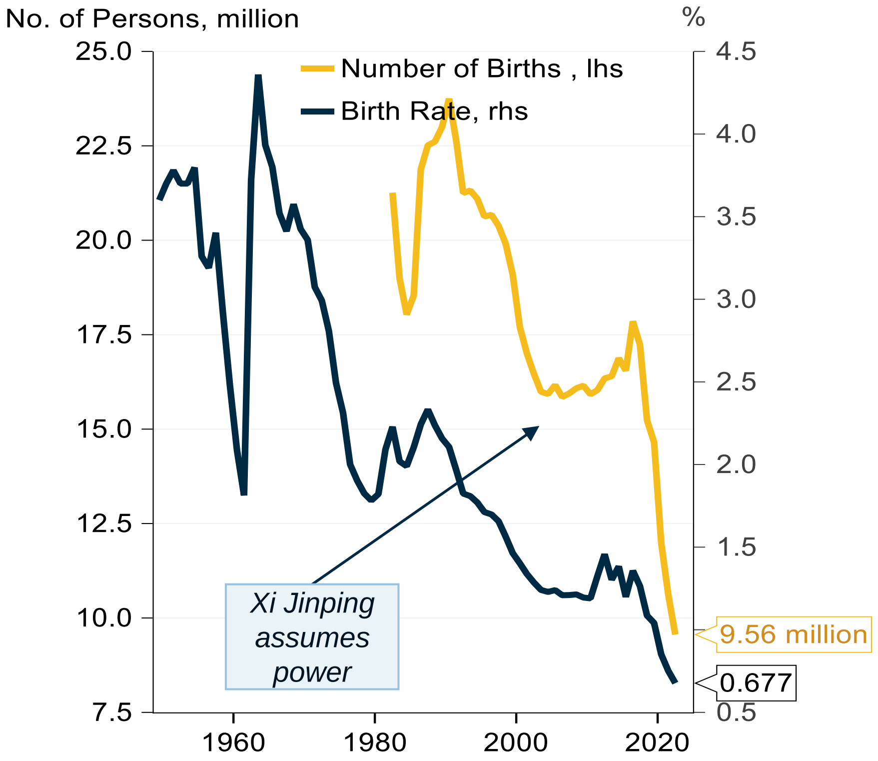
- Fundamental long-term growth drivers have taken large hits in the last 10 years.
- Beijing Government's more interventionist and anti-private-sector policies have resulted in sharply curtailed TFP growth to a level not sufficient to escape the middle-income trap (0.7% prior to the pandemic).
- Demographics have further worsened despite official prodding for higher births.
- Combined with too high growth targets, this has resulted in even greater reliance on debt (even before the new surge from current stimulus)

**Total Factor Productivity**

*Index (2017=1)*

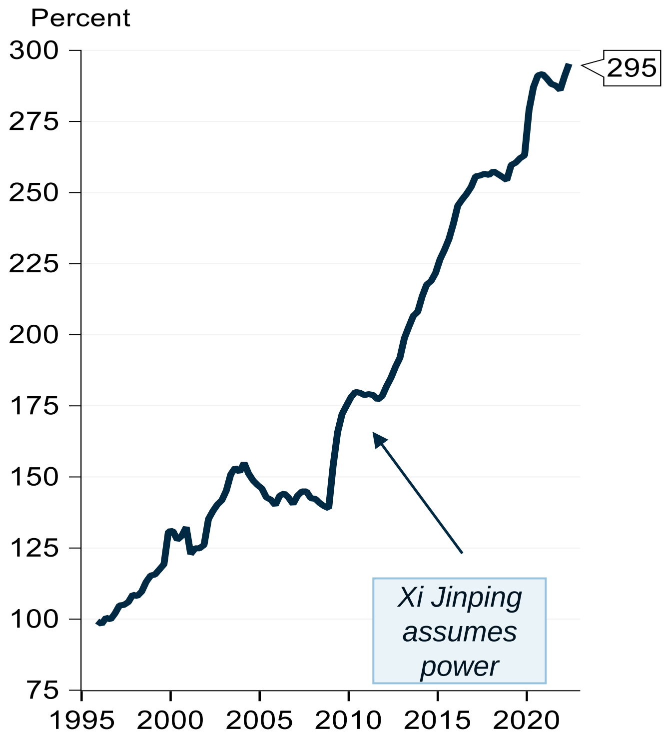



**Population Fertility**




**Debt Burden**

*(Percent of GDP)*



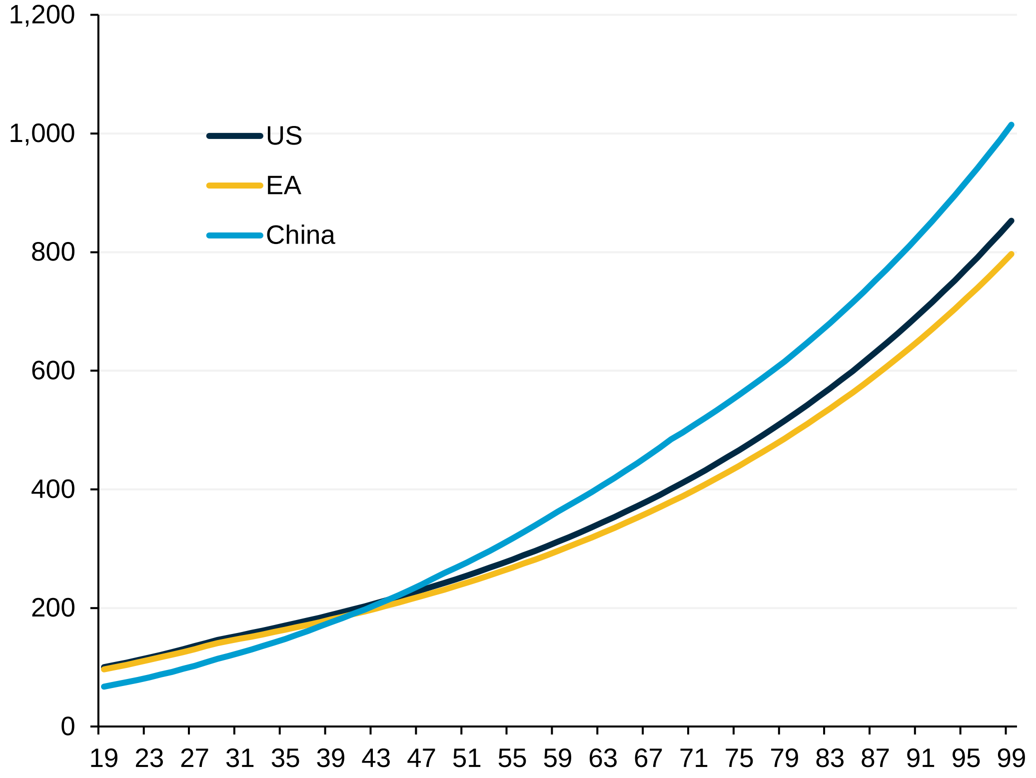

*Source: PGIM Fixed Income, Penn World Tables, and Macrobond. As of February 22, 2023.*

# Claims of the “Chinese Century” Less Plausible

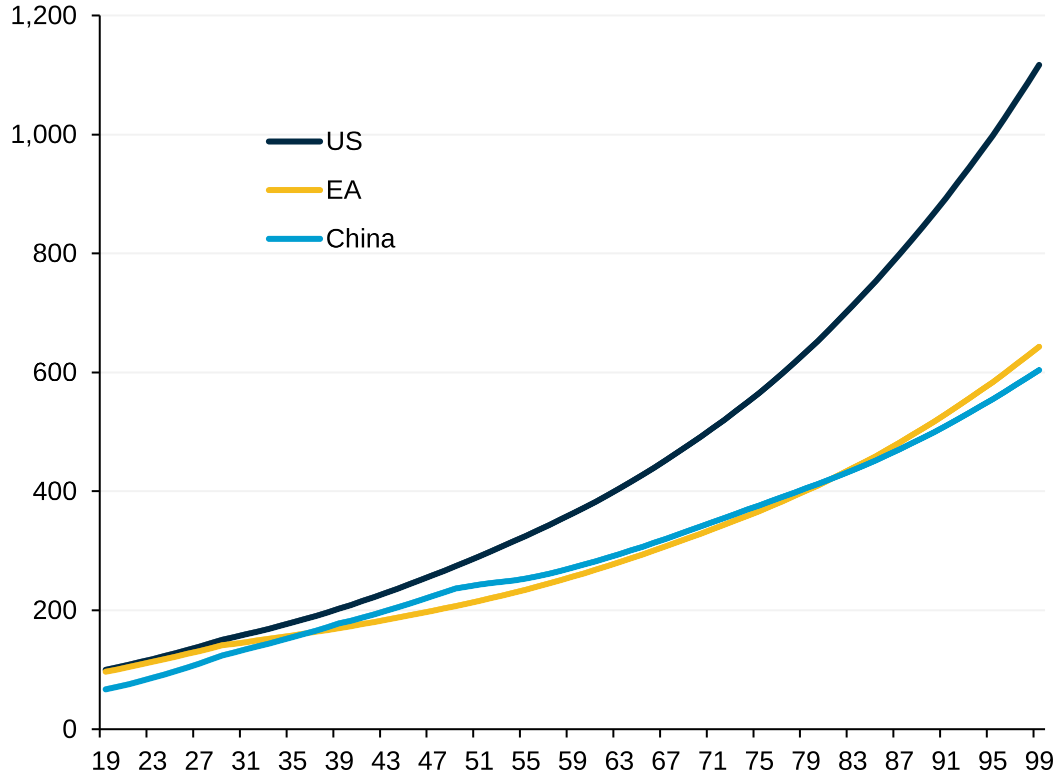
The adverse productivity trends, coupled with demographic decline make it unlikely that China’s GDP will surpass the US’s

- If true, markets may further sour on China
- Geopolitical risk, as China’s leadership may be tempted to “Use or Lose” its relative and military position before they erode
- Other strongly growing Asia economies (e.g., Korea, Taiwan) experienced (forced) leadership transitions to more innovative open-societies at similar points in their development

**GDP Projection Based on Consensus Potential Growth**
*(US 2019 GDP=100)*



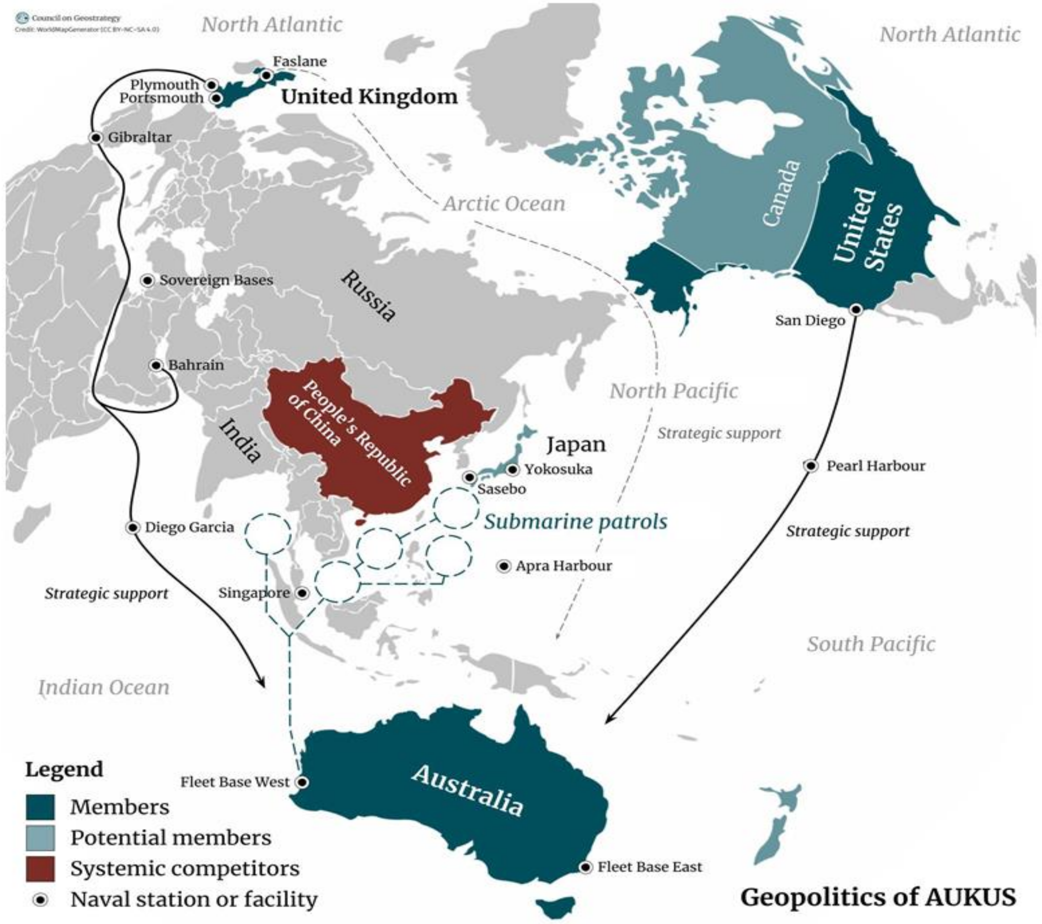

**GDP Projection Based on Working-Age Population & Future TFP Growth**
*(US 2019 GDP=100)*




*Source: PGIM Fixed Income and Haver Analytics. As of May 16, 2022.*

# A Harsher International Environment

- The very poor economic showing, coupled with policy reversals, re-surging debt and lower international standing may may trigger more assertive foreign policy moves
- Conversely the poor showing of Russia's military in Ukraine suggests lower chances of direct military conflicts between China and Taiwan and thus a lower likelihood.



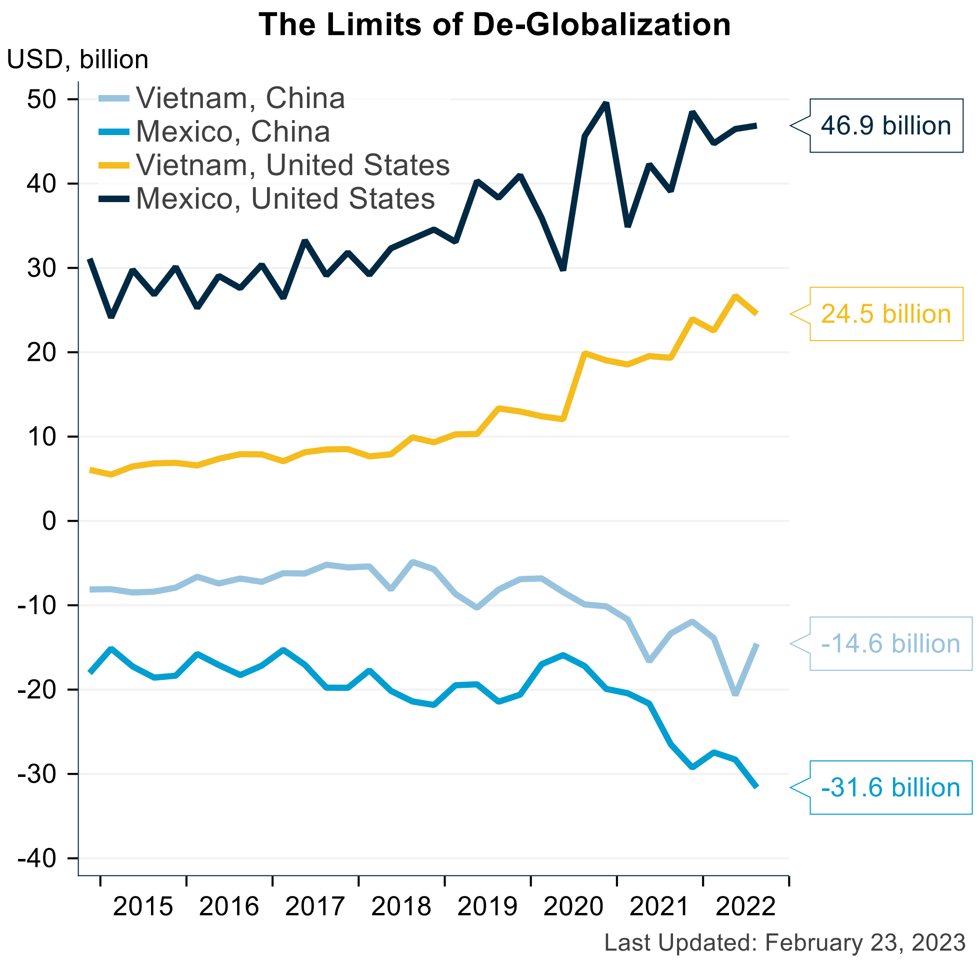

## 60 Miles to Kiev from Belarus

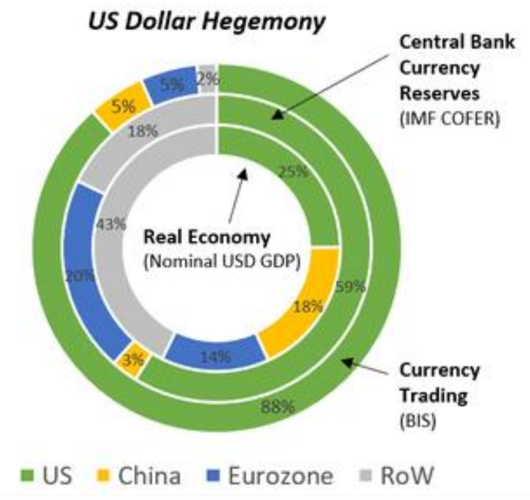

## 180 Miles to Taiwan from China

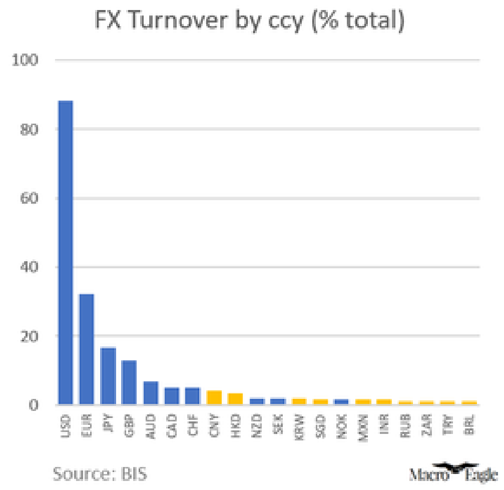

Source: PGIM Fixed Income, Council on Geostrategy, and AdobeStock License 107277386 and 486751357. As of May 16, 2022.

# Beware of Popular Narratives

- Deglobalization and “friend-shoring” are more likely to lead to trade diversion rather than threatening Chinese industry.
- Increased use of financial sanctions by the West may yet lead to increased RMB internationalization, if only for trade settlement.




*Source: PGIM Fixed Income and Macro Eagle and Macrobond. As of February 22, 2023.*

# Reference

# Presenter Biographies

**Gerwin Bell, PhD,** is a Principal, Lead Economist for Asia on the Global Macroeconomic Research team at PGIM Fixed Income. Mr. Bell joined the Firm in 2012 from the International Monetary Fund (IMF). As Mission Chief in the IMF's European Department, Mr. Bell was responsible for a number of developed and emerging countries and negotiated several IMF loan programs. Previously, he was instrumental in shaping IMF policy on official and private sector debt restructuring, and also oversaw nation-building efforts in the Balkans. Prior to the IMF, Mr. Bell taught at U.S. and German universities. Mr. Bell has authored numerous country and policy publications for the IMF, as well as scholarly articles in peer-reviewed journals. He received Masters degrees in Economics from Trier University in Germany and Yale University and received a PhD in Economics from Trier University.

**Helen Chang, CFA,** is a Managing Director and the Head of Asia Pacific ex Japan Client Advisory for PGIM Fixed Income. Based in Hong Kong, Ms. Chang has regional responsibilities in leading the institutional sales, consultant relations, marketing and relationship management efforts. Ms. Chang is a board member of PGIM (Hong Kong) Limited. Prior to joining the Firm in 2020, she was Managing Director and Head of Greater China Institutional Sales at Principal Global Investors where she spent more than 12 years building the regional business. Previously, Ms. Chang developed extensive experience in reserves management at the Hong Kong Monetary Authority and served as division heads in direct investment and external relations respectively. She started her career as a corporate banker having worked with JP Morgan Chase and Credit Suisse. Ms. Chang received a BA in Finance from University of Western Ontario and an MBA from Yale University. She holds the Chartered Financial Analyst (CFA) designation.

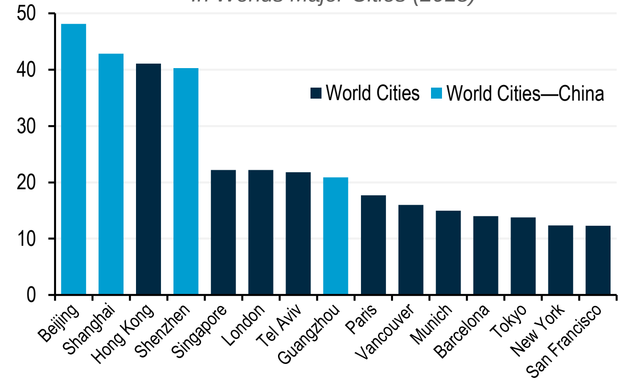
*For purposes of the biographies, the "Firm" is defined as Prudential Financial, Inc. ("PFI"). All PGIM and Prudential named entities are subsidiaries or affiliates of PFI. PFI. of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom.*

# Property Policy May Have tightened too Much

- Property IS very expensive in China
- That has made it a key component of household wealth, i.e. “houses are for living not speculation” has it backwards: Houses are speculation and often remain empty
- Property accounts for about 25% of GDP, without adding in the household wealth effect, nor its importance for fiscal revenue….

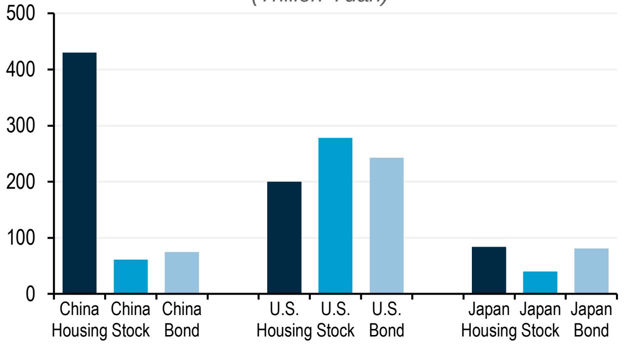
**Home Price-to-Income Ratios**

*In Worlds Major Cities (2018)*



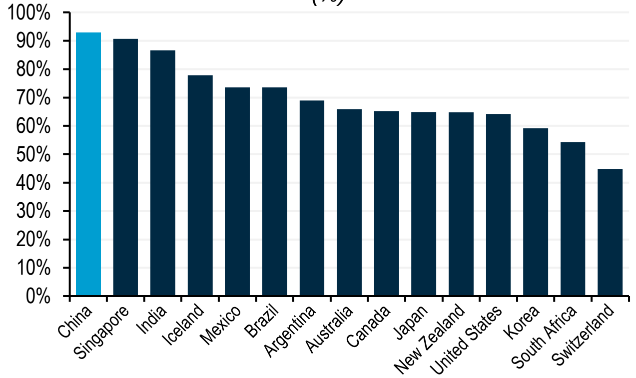

**Valuation of Different Asset Classes in 2017**

*(Trillion Yuan)*



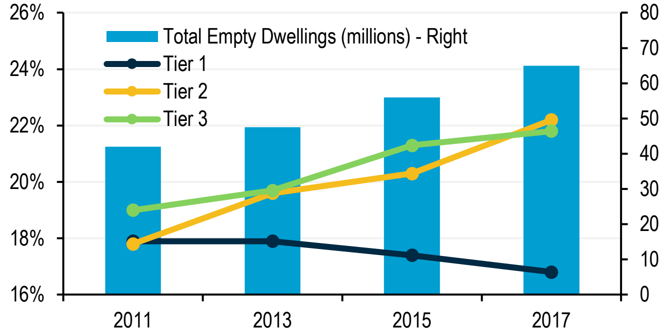

**Home Ownership by Country**

*(%)*



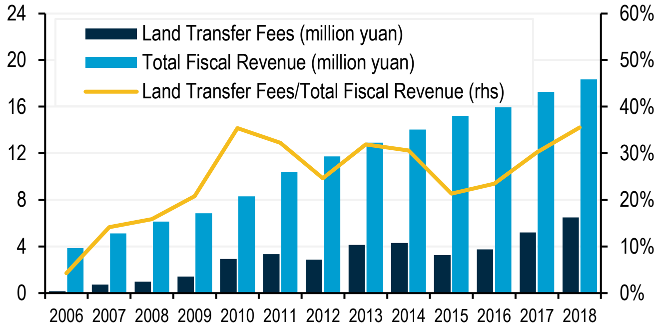

**Housing Vacancy Rates by City Tier**

*(2017)*



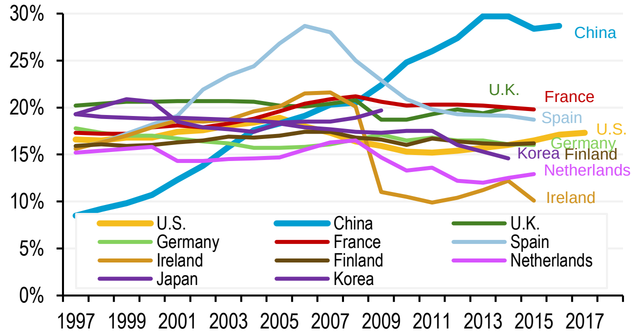

**Land Finance**

*(Million Yuan)*




**Real Estate Related Activities’ Share of GDP**

*(% by Country)*




Source: Rogoff and Yang (2020).

# Notice Page

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