Session 2

China
China in mid 1990s

Economy dominated by state owned firms

State owned firms inefficient

Capital, labor, and access to world markets misallocated
What changed?

“Grasp the Large, Let Go of the Small” (1998-2005)

State owned firms better managed
Better allocation of labor
Capital misallocation unchanged

Access to world markets, foreign investment and inputs
World Bank Doing Business Indicators (2013)

Starting a Business: 151

Congo: 152
Haiti: 140

Construction Permits: 181
Getting Electricity: 114
Access to Credit: 70
Protection of Investors: 100
Paying Taxes: 122
企业盖栋楼，要交95种税费盖192个章
南京民企老总抱怨懒政之下办事难；江苏确定简政放权路线图，行政审批大幅“瘦身” 封5~7

守着银行 专偷“大户”
徐州破获特大盗抢案
4人团伙流窜9省1市
8年盗抢1200万元
封8

南京一名医生
一天看了192个病人
封12

27岁南通小伙
任职福建龙海副市长
封17

充气时轮胎爆炸
汽修老板不幸身亡
封10

亚运会上再遭羞辱
国奥0:2不敌泰国
A10

40位抗战老兵聚会
南京体彩组织专车接送
封19
"Long March" for Licenses
"Small" City (2 million people) in Southern China

- Actively look for quality prospects
- Initial discussion to learn about investor
- Feasibility Analysis
- Identify land and other needed services
- Approval by Vice-Mayor
- Sign agreement
What is the Chinese System?

Formal Institutions are like the Congo

Strong Informal Institutions

Local governments will help you get anything done

Local governments are entrepreneurial; willing to experiment

“Free entry into special deals”
Costs of System of Special Deals

Some firms do not have special deals

Small local firms; firms in other cities

No protection of property rights for firms without special deals

Resource misallocation

Depends on discretion of local officials

Why do local officials do this?
What has changed?

Financial liberalization ("off-balance sheet fiscal policy")

Anti-corruption campaign

Trade war
Recent Chinese Growth Dynamics

Maurice Obstfeld  
*University of California, Berkeley; Peterson Institute; NBER; and CEPR*

*Clausen Center Conference on Global Economic Issues*  
UC Berkeley  
November 16, 2019
China’s growth smoother post-Xi, but declining

![Graph showing GDP growth rate and GDP per capita growth rate with key events marked: Tiananmen, Asian crisis, GFC, Xi accession.]
Several trends lowering growth (complex reality)

• Rebalancing toward consumption and services.
• Demographics.
• Less potential to move labor out of the countryside.
• Convergence in general (Pritchett-Summers).
• A growth model that has become unsustainable, counterproductive:
• Xi has disproportionately favored low-productivity state enterprise over private sector in his bid to strengthen Party (i.e., his) control:
Profitability of firms by ownership class

Returns on total assets, percent

Source: CEIC and IMF staff estimates
Debt-to-equity ratios for SOEs and private enterprises (percent)

Source: IMF (2018)
Flow of loans to nonfinancial firms, 2010-2016

Shorter-term growth obstacles are also in play

• Anti-corruption campaign freezes risk-taking, initiative – though it’s been a key tool of Xi’s consolidation of power.

• Credit clampdown – disproportionately hurting private firms.

• Anti-pollution drive.

• Trump’s trade war.
  
  o The direct effects on China’s growth are likely pretty small (e.g., Lardy’s recent blog).
  
  o Which is not to deny a substantial global impact – 0.8% by 2020 as per IMF.
  
  o In particular, big regional effect – with implications for China itself.
Recent headwinds: WEO growth revisions

![Graph showing WEO growth revisions from 2019 to 2024. The 4/19 projections are shown in blue, and the 10/19 projections are shown in orange. The projections indicate a decrease in growth over the years, with 4/19 projections starting higher and 10/19 projections starting lower.]
Authorities have slowed domestic credit growth

Source: Year-on-year growth rates from CEIC
Manufacturing PMI (Caixin) relatively resilient
IMF growth revisions for EMD Asia

Oct. 2017
Oct. 2018
Oct. 2019
Prospects for the trade war

• Short term “phase one” deal possible by year’s end.
• Whether there is further progress will depend on nature of US objectives.
  o Limited goal of reducing bilateral deficit?
  o Broader objective of changing Chinese system?
  o Even broader objective of resisting China’s geopolitical and economic ambitions.
• Deep conflicts over technology (Huawei, for example) could lead to further frictions, while also disrupting even more US-Europe relations.
• My guess: we are in for a long-term struggle.
Two other regime challenges: Swine fever

Pig herd (thousands)

Pork price (index)
Two other regime challenges: Hong Kong
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Where are we in the cycle?

- It appears we are mid-to-late cycle, similar to 2005-2007 and 1996-1997
- Q4 2018 looks like an anomaly

Source: BlackRock, as of September 30, 2019. For illustrative purposes only. The market similarity measure is based on our proprietary signal that draws multi-dimensional comparisons between different periods. A darker gradient signifies more similarity with the target period and lighter signifies less similarity.
Sellside strategists have become markedly more dovish recently, as compared with the start of the year.

Similarly, sentiment for fiscal policy is also turning more supportive in many DM countries.

### Monetary Policy Sentiment, YTD Change

![Monetary Policy Sentiment Chart]

**Source:** BlackRock, as of September 30, 2019. The above chart is based on our proprietary signal which measures monetary policy sentiment from sell side strategists, across countries. For illustrative purposes only.

### Developed Market (DM) Fiscal Sentiment

![Developed Market Fiscal Sentiment Chart]

**Source:** BlackRock, as of September 30, 2019. The above chart is based on our proprietary signal which measures fiscal policy sentiment across developed market countries. For illustrative purposes only.
BlackRock geopolitical risk dashboard

Rising risks of US-China competition, Gulf tension, and European fragmentation

Global index

Source: BlackRock Investment Institute, with data from Refinitiv. Data as of August 15, 2019. Notes: We identify specific words related to geopolitical risk in general and to our top-10 risks. We then use text analysis to calculate the frequency of their appearance in the Refinitiv Broker Report and Dow Jones Global Newswire databases as well as on Twitter. We then adjust for whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average BGRI level over its history from 2003 up to that point in time. A score of one means the BGRI level is one standard deviation above the average. We weigh recent readings more heavily in calculating the average. We recently improved the methodology of our global BGRI, tying it closely to our other risks and updating the keywords. The chart may look different from previous updates as a result.
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2 Risks in Chinese economy skewed to downside

Trade tension weighs on China’s growth...

% yoy

China real GDP growth

...alternative data confirms the slow down

Activity through satellite images vs. official PMI

Sources: Wind, IMF forecast, August 2019

Source: SpaceKnow, BlackRock, as of 28 February 2019, for illustrative purposes only
Exports likely to be a bigger dragger next year

Negative feedback loop between China and global demand can intensify in 2020

... and export reliance on G3 countries still amount to 40%

Source: Wind, as of August 2019

Source: Wind, BlackRock calculation, as of August 2019
Monetary easing aims primarily to reduce corporate funding cost

Market rates (%) versus policy interest rate corridor

Fiscal stimulus becomes more visible in Q2 2019 and onwards

Augmented fiscal deficit to expand by more than 1.5% of GDP in 2019...

... with a front-loaded timeline and more room to expand

Source: CEIC, JP Morgan Research, BlackRock, April 2019

Source: PBoC, Ministry of Finance, August 2019
2. **FX policy: geopolitical considerations overwhelms fundamentals**

**USDCNY has deviated from the anchor of interest rate differentials**

CNY fixing came stronger than forecasts, indicating aversion to a sharp depreciation

**Source**: Bloomberg, Wind Info, CICC Research, as of August 2019

Source: Wind; BlackRock, as of August 2019
Text mining long term policy

- Supply side reform
- Environment protection
- The 19th Communist Party Congress
- Deleverage
- One Belt One Road

Source: BlackRock, 31 December 2017
Policy trends through NLP

- Environmental protection and Big Data/Technology remain key focus
- Tax Cut continued to receive more coverage, while SOE reform plunged with Deleveraging and Land Reform

Source: BlackRock, as of 31 Jul 2019. Key sections refer to top 7 sections from the People Daily’s News website, For illustrative purposes only.
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Global index inclusion of China onshore equities

MSCI index inclusion to add more than US$100bn

Source: MSCI, as of April 2019

China A-shares provide diversification to global equity investors

Source: Bloomberg, as of end of November 2018
China A Share Market Valuation and Sentiment

Forward PE of China A Low Relative to History

Stock market rallied with little leverage increase

Northbound flows recovered, cumulative vs daily (RHS)

Number of investor online posts normalized

Source: BlackRock, Bloomberg, as of 30 Sep 2019; BEst figures quoted. It not possible to invest directly in an index.

Source: BlackRock, Wind, CSDC, as of 31 October 2019. It is not possible to invest directly into an index.

Source: BlackRock, Hong Kong Stock Exchange, as of Jun 30 2019.

Source: BlackRock, average daily measure, as of Jul 31 2019
Foreign investors’ presence in China is small and keeps rising

Foreign investors keep buying Chinese onshore assets even in adverse market environment

Source: PBoC, Wind, as of June 2019
Chinese Equity Market Structure

A-H share premium widens on external geopolitical risks and domestic policy supports

China A Equity Market Ownership Structure

Source: Hang Seng indexes, Wind, as of August 2019

Source: Blackrock, Wind, Hong Kong Exchange, SZSH ex, as of 31 December 2018
3 Data as the new precious commodity

What happens every 60 seconds in China?

- WECHAT: 460 published articles
- MIAOPAI: 486k videos played
- DIDI: 56k passengers picked up
- TAOBAO: 14k product reviews
- DIANPING: 110 restaurants blogged
- ALIPAY: 15m CNY transacted
- BAIDU: 4.2m searches
- QQ: 1.7m netizens browsed
- WEIBO: 11m messages

Source: Kantar Media CIC, BlackRock, as of 31 December 2018
The companies mentioned above are stated for illustrative purposes only and not meant to be a recommendation to buy or sell any security.
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