



CONFERENCE ON GLOBAL ECONOMIC ISSUES



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

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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



犯罪嫌疑人被押回徐州
图片由警方提供

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

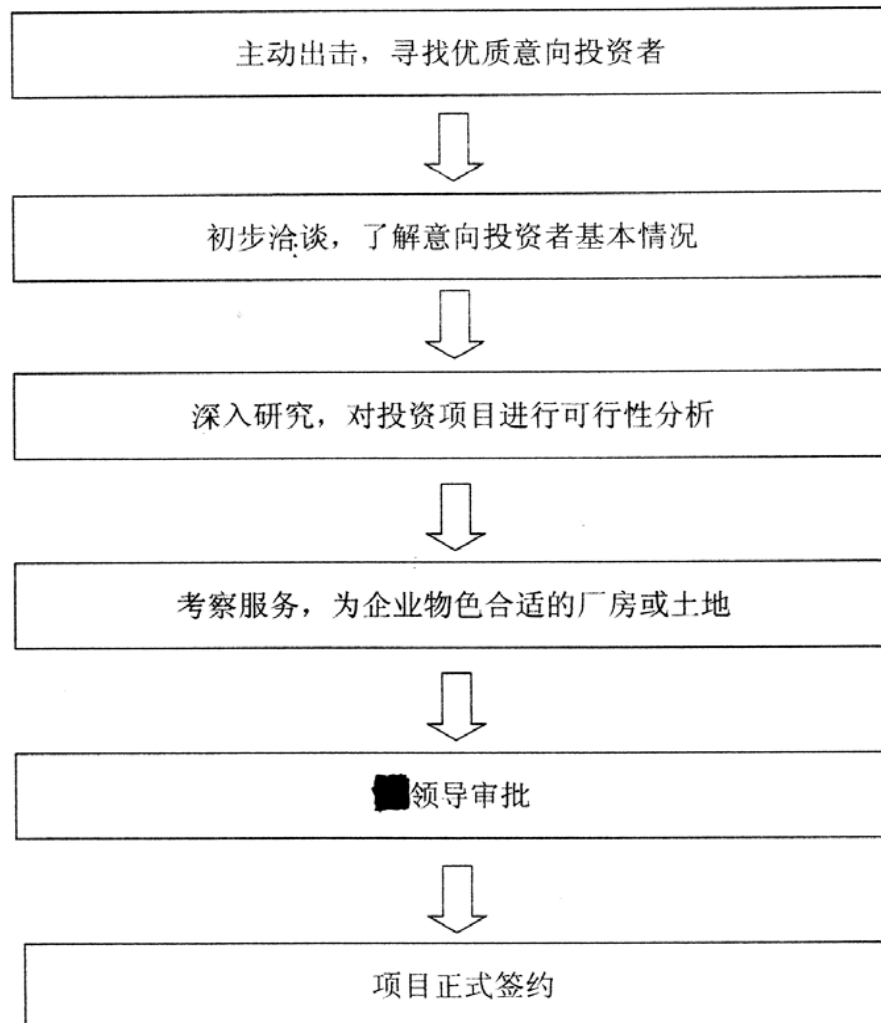
40位抗战老兵聚会
南京体彩组织专车接送

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

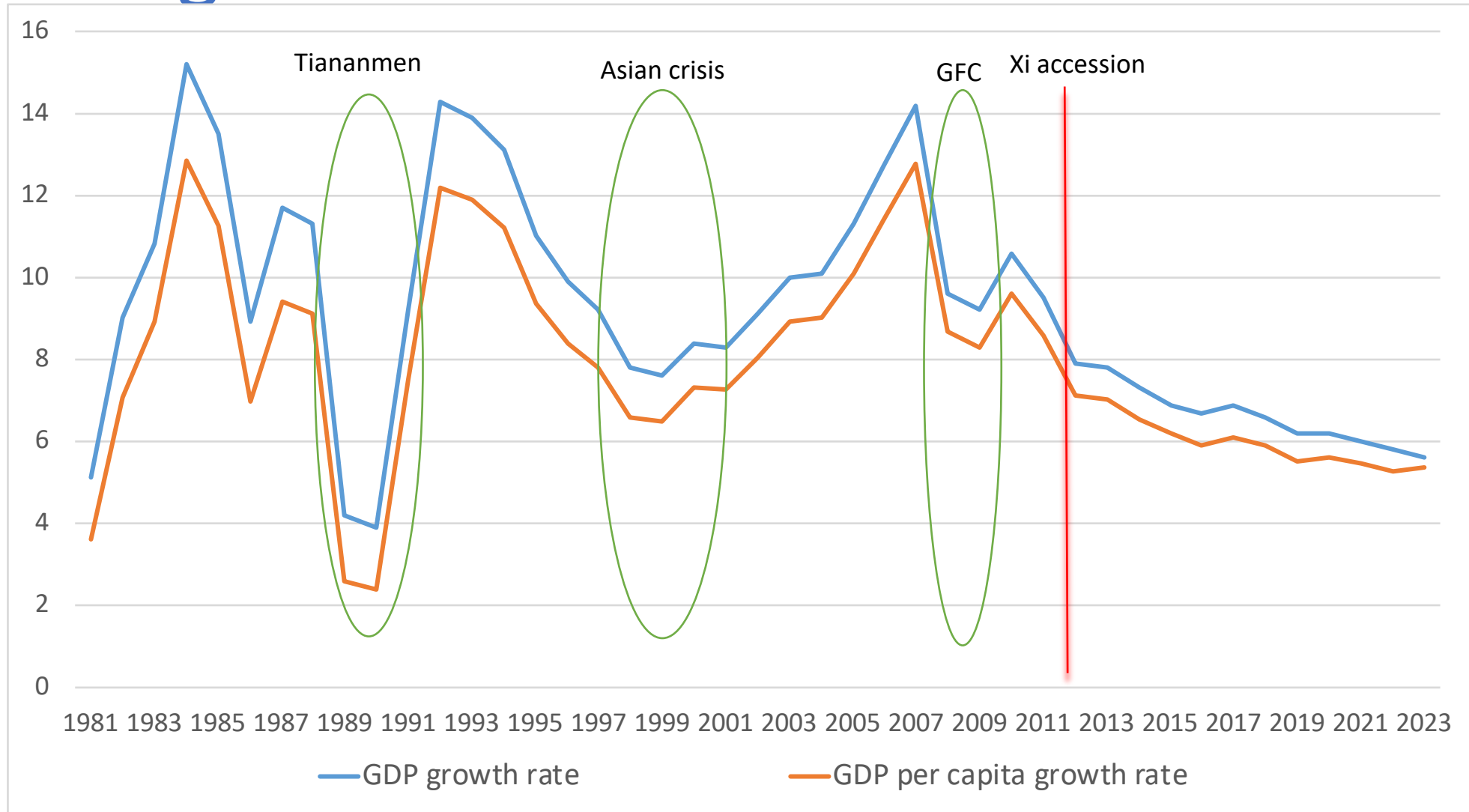
University of California, Berkeley; Peterson Institute; NBER; and CEPR

Clausen Center Conference on Global Economic Issues

UC Berkeley

November 16, 2019

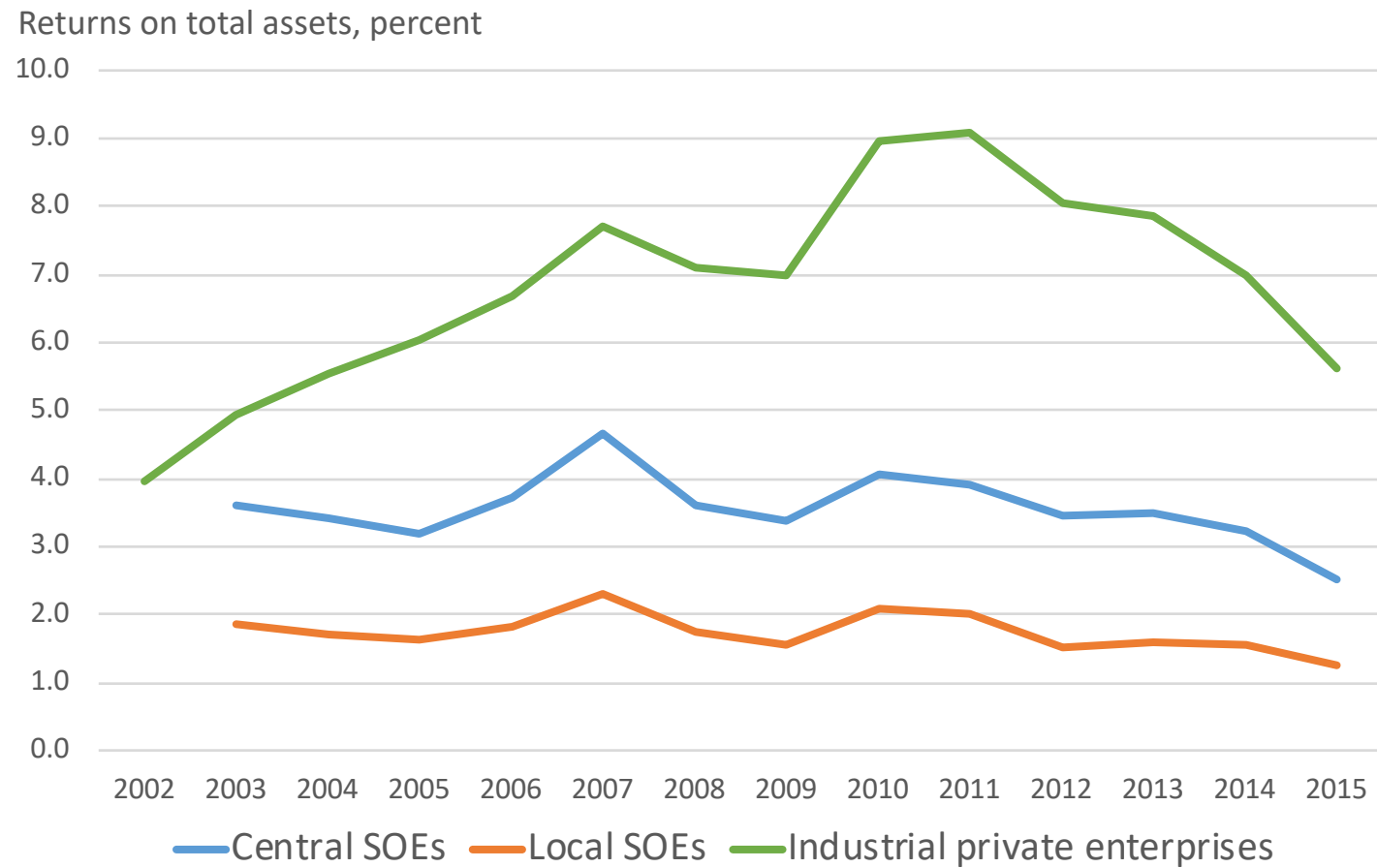
China's growth smoother post-Xi, but declining



Several trends lowering growth (complex reality)

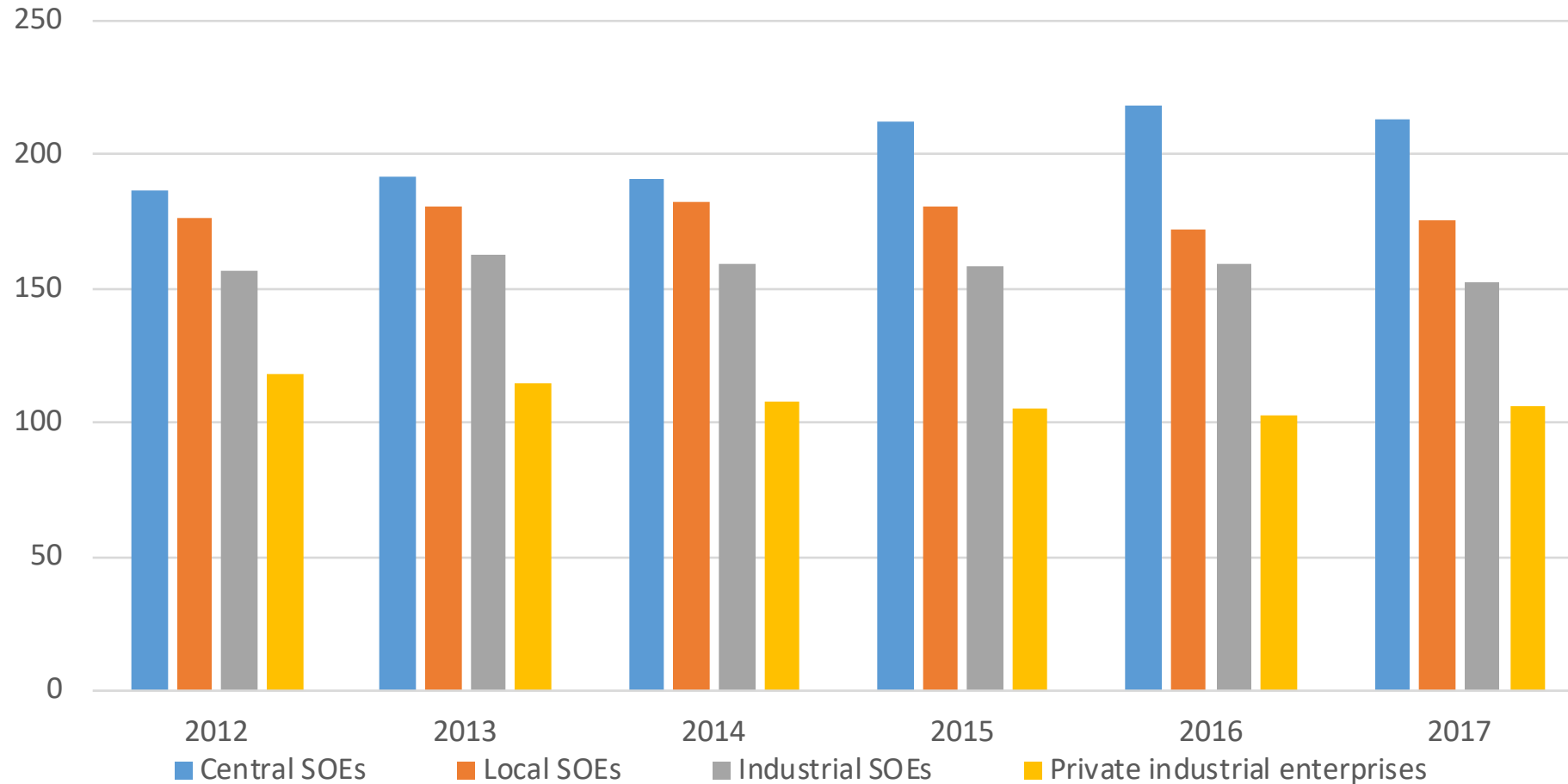
- Rebalancing toward consumption and services.
- Demographics.
- Less potential to move labor out of the countryside.
- Convergence in general (Pritchett-Summers).
- A growth model that has become unsustainable, counterproductive:
 - E.g., Keyu Jin, “China’s Steroids Model of Growth,” in L. A. V. Catão and M. Obstfeld, eds., *Meeting Globalization’s Challenges*, Princeton U Press, 2019.
- Xi has disproportionately favored low-productivity state enterprise over private sector in his bid to strengthen Party (i.e., his) control:
 - E.g., Nicholas Lardy, *The State Strikes Back: The End of Economic Reform in China?* Peterson Institute for International Economics, 2019.

Profitability of firms by ownership class



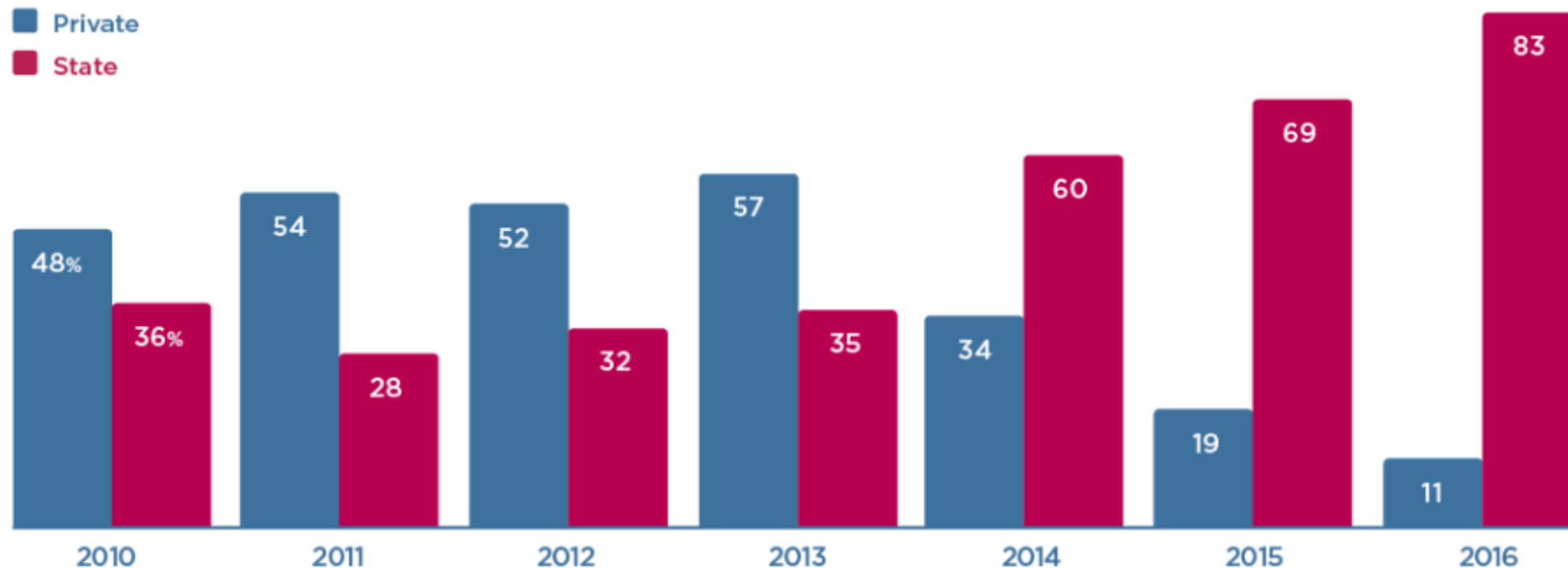
Source: CEIC and IMF staff estimates

Debt-to-equity ratios for SOEs and private enterprises (percent)



Source: IMF (2018)

Flow of loans to nonfinancial firms, 2010-2016

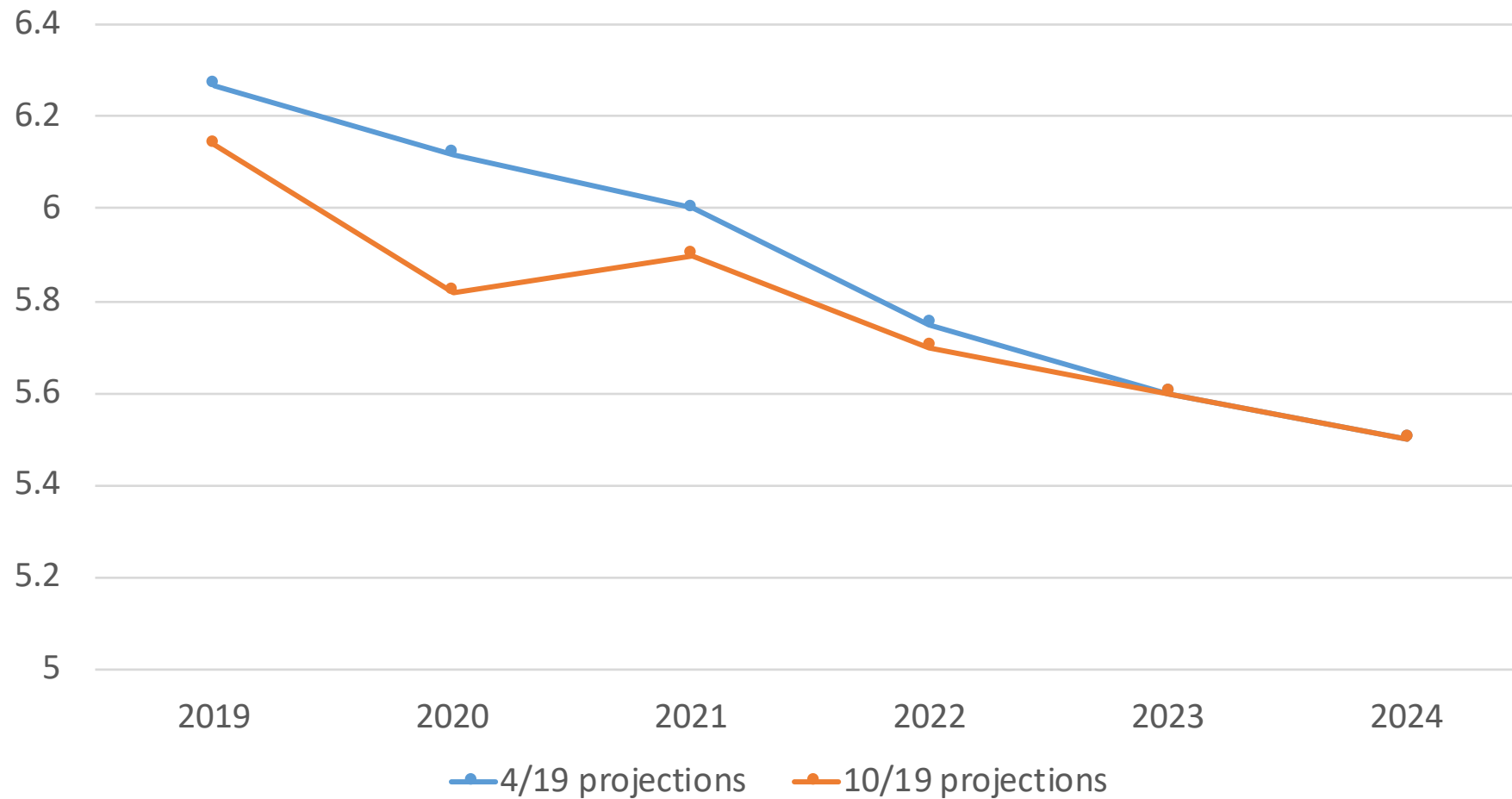


Source: Nicholas Lardy, <https://www.piie.com/system/files/documents/lardy2019-11-06ppt.pdf>

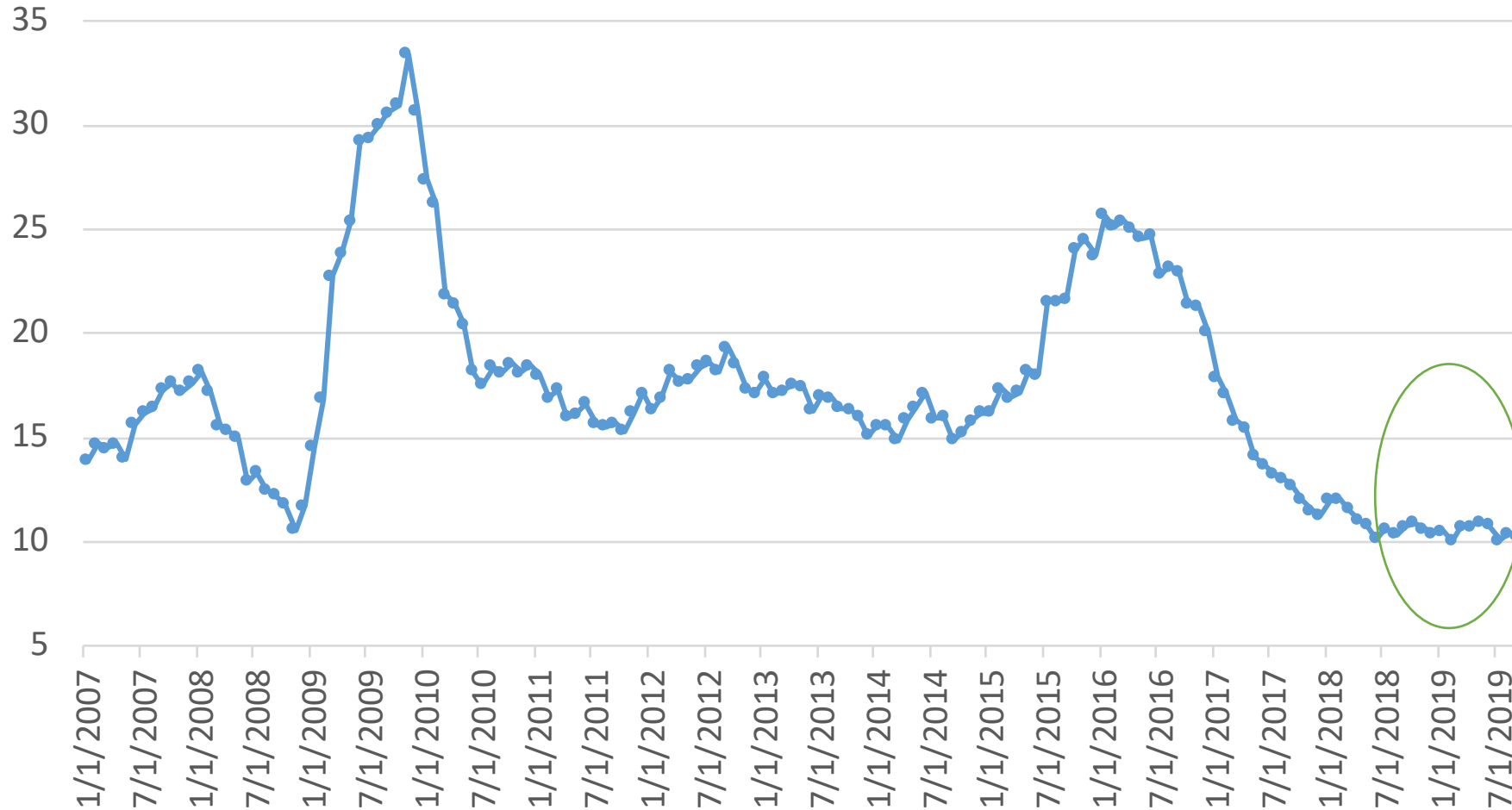
Shorter-term growth obstacles are also in play

- 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.
 - The *direct* effects on China's growth are likely pretty small (e.g., Lardy's recent blog).
 - Which is not to deny a substantial *global* impact – 0.8% by 2020 as per IMF.
 - In particular, big regional effect – with implications for China itself.

Recent headwinds: WEO growth revisions

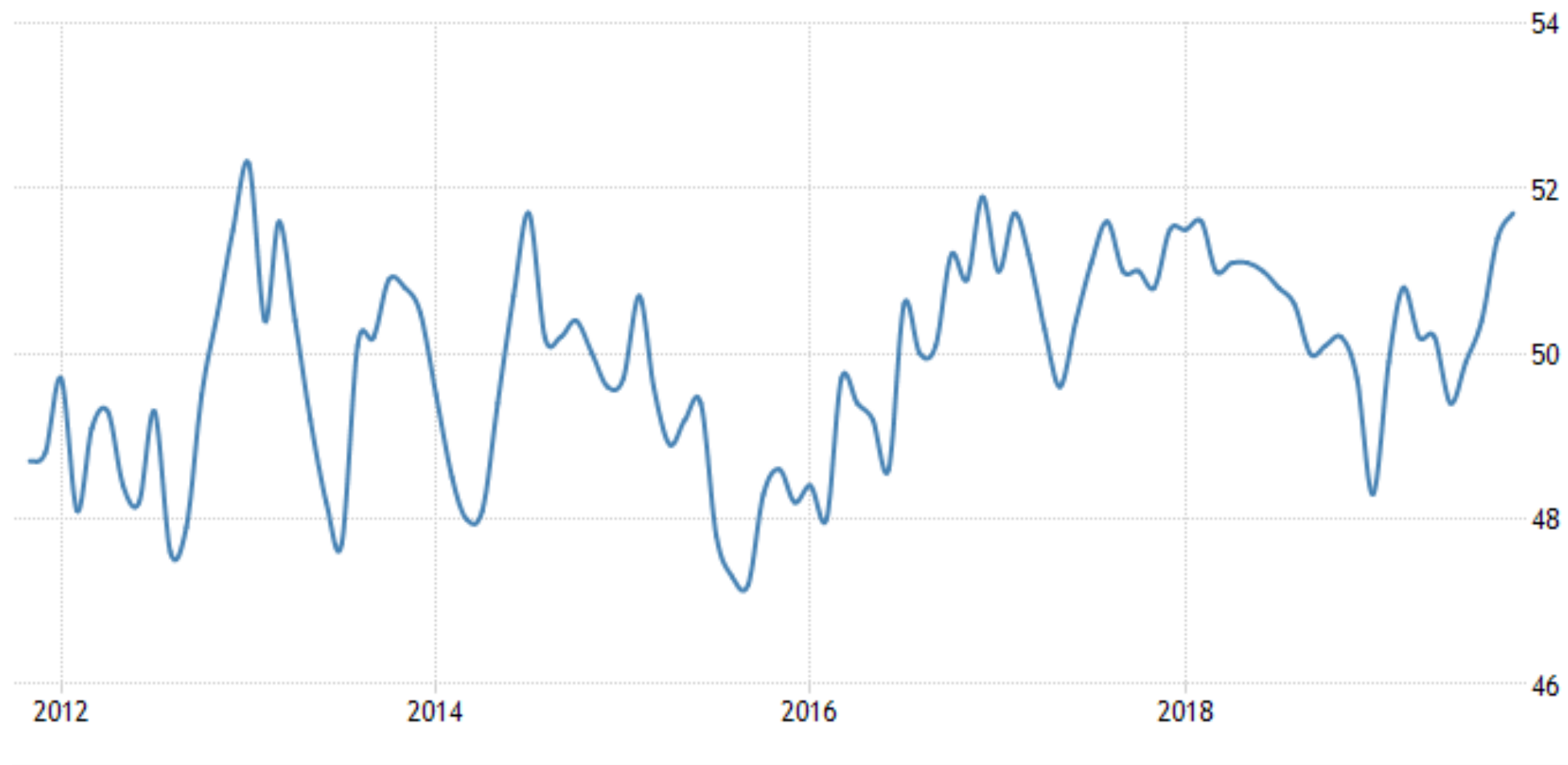


Authorities have slowed domestic credit growth

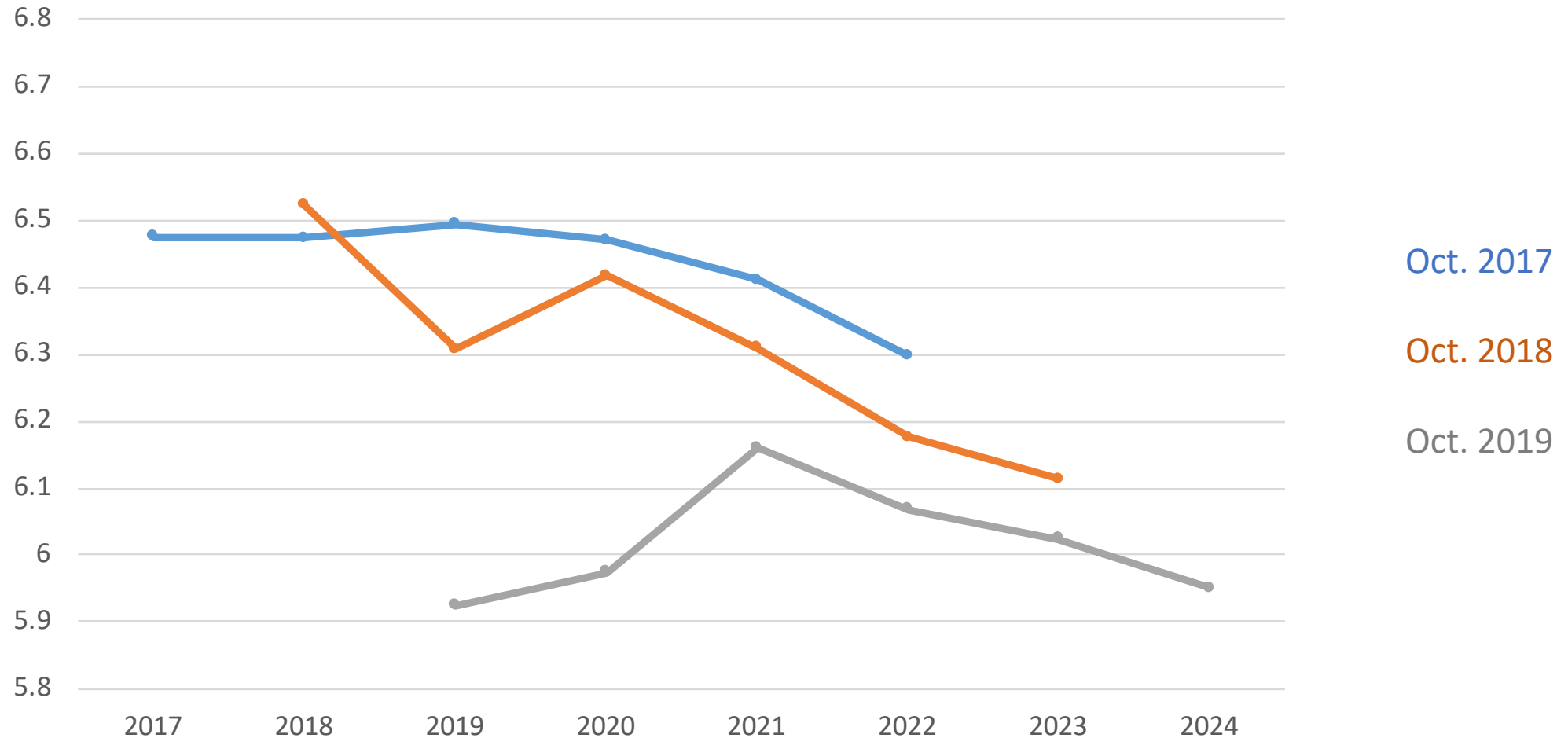


Source: Year-on-year growth rates from CEIC

Manufacturing PMI (Caixin) relatively resilient



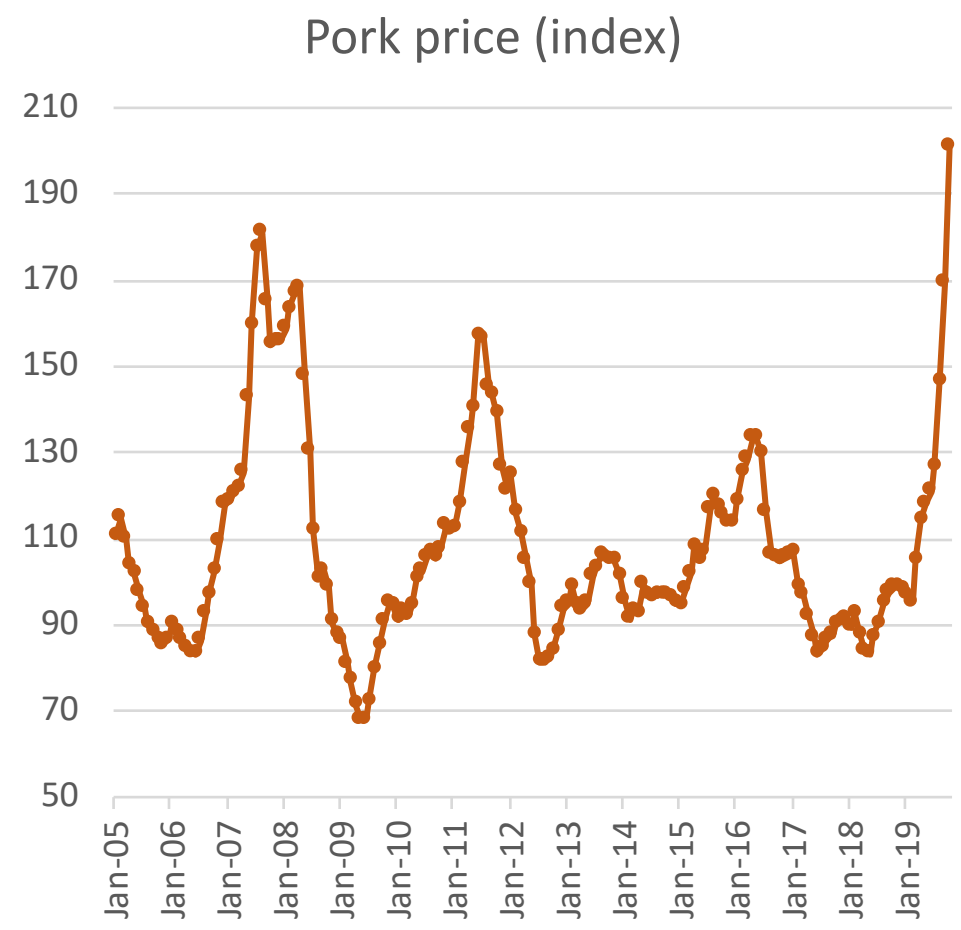
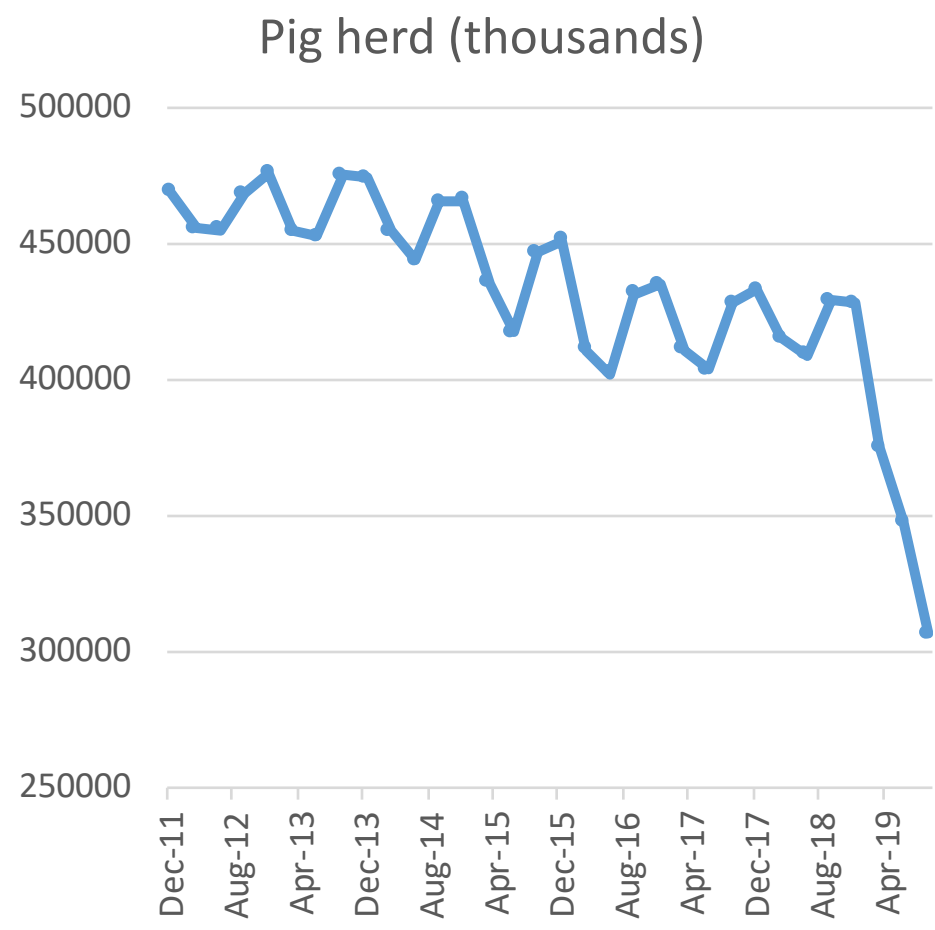
IMF growth revisions for EMD Asia



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.
 - Limited goal of reducing bilateral deficit?
 - Broader objective of changing Chinese system?
 - 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



Two other regime challenges: Hong Kong



Jeff Shen

Co-CIO Active Equity
Co-Head Systematic Active Equity

Oct 2019

BlackRock®

China Macro Views

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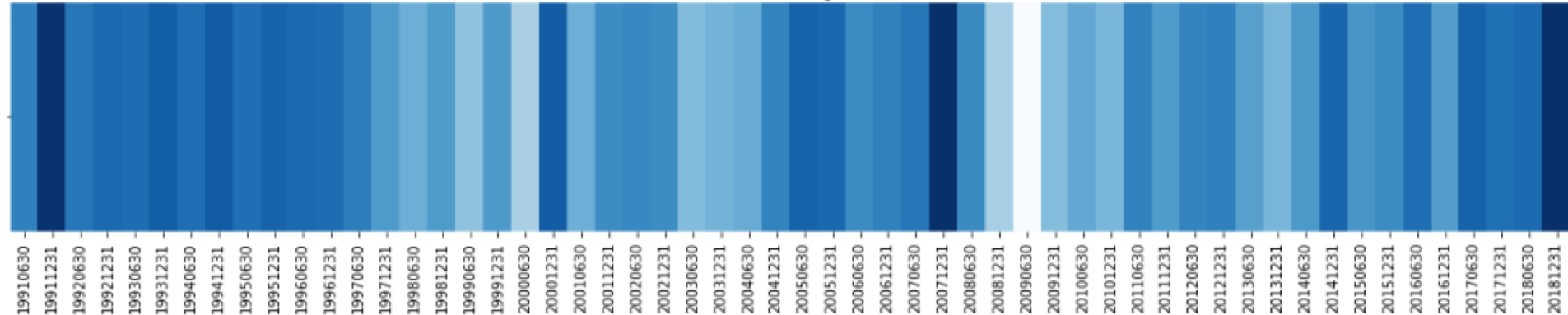
Domestic markets are opening up. Data/evidence based Investment approach is key for China.

1

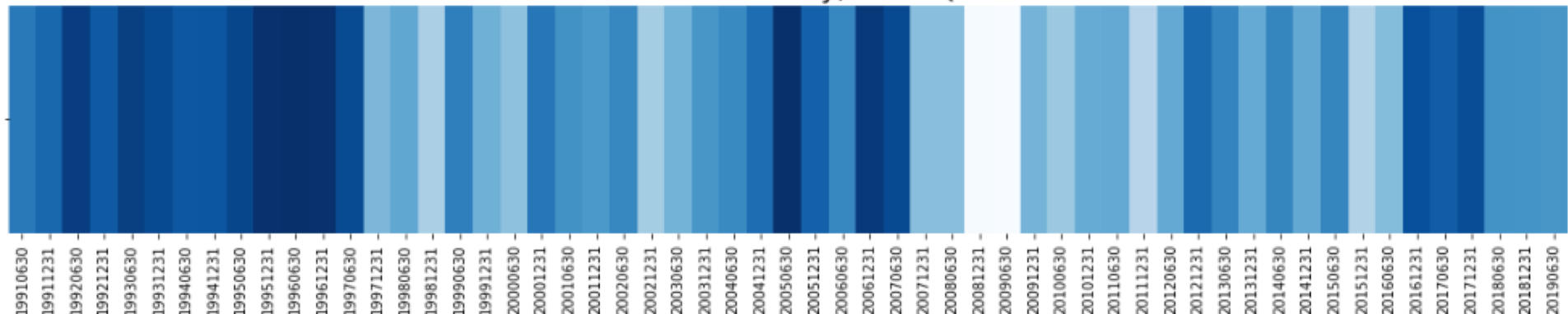
Where are we in the cycle?

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

Market similarity, 2018 Q4



Market similarity, 2019 Q3



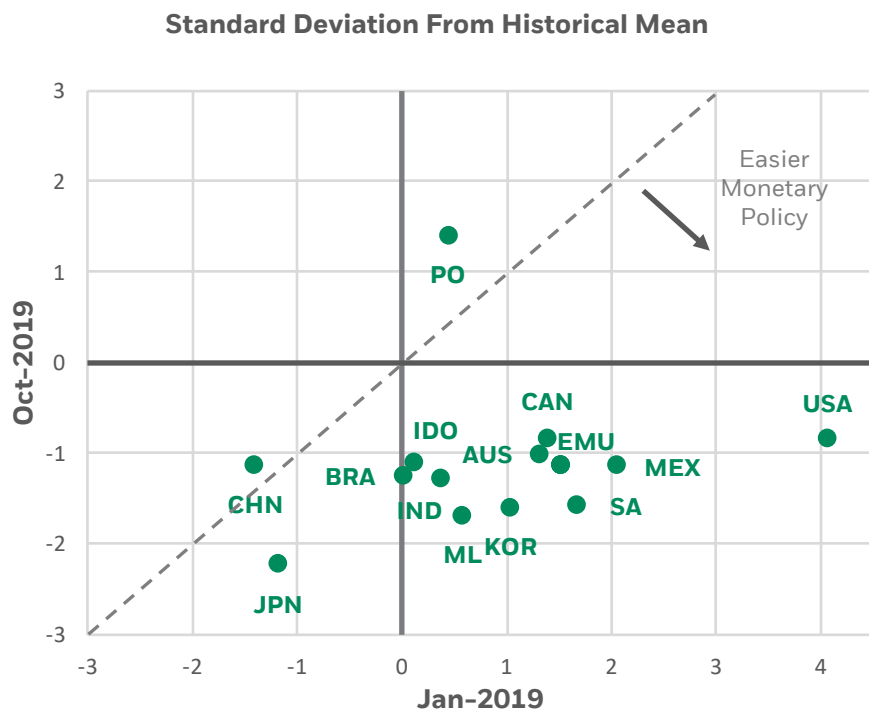
Source: BlackRock, as of September 30, 2019. For illustrative purposes only. The market similarity measure is based on our proprietary signal that draws multi-dimensional comparisons between different periods. A darker gradient signifies more similarity with the target period and lighter signifies less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

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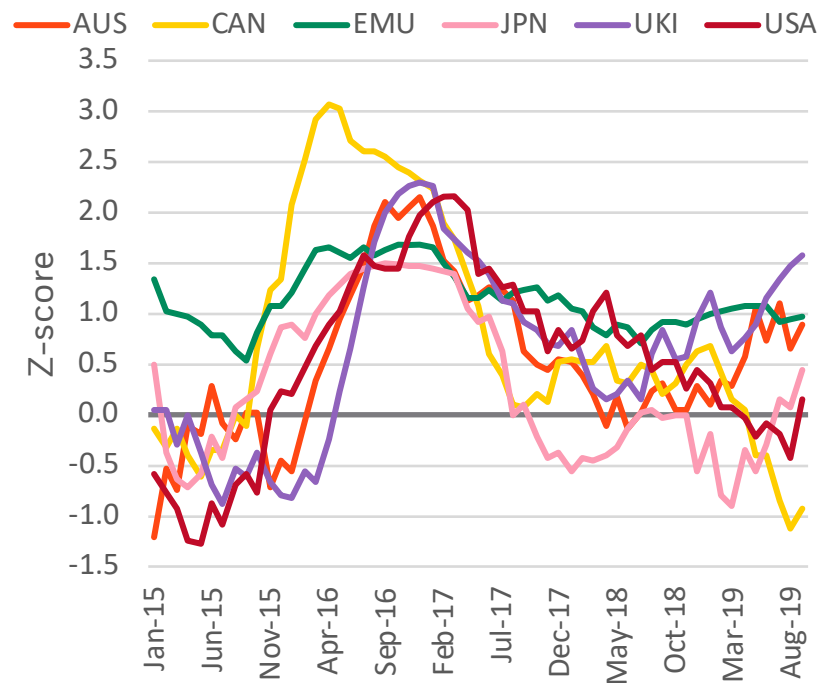
Monetary and Fiscal policy with Natural Language Processing (NLP)

- ▶ 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



Developed Market (DM) Fiscal Sentiment



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.

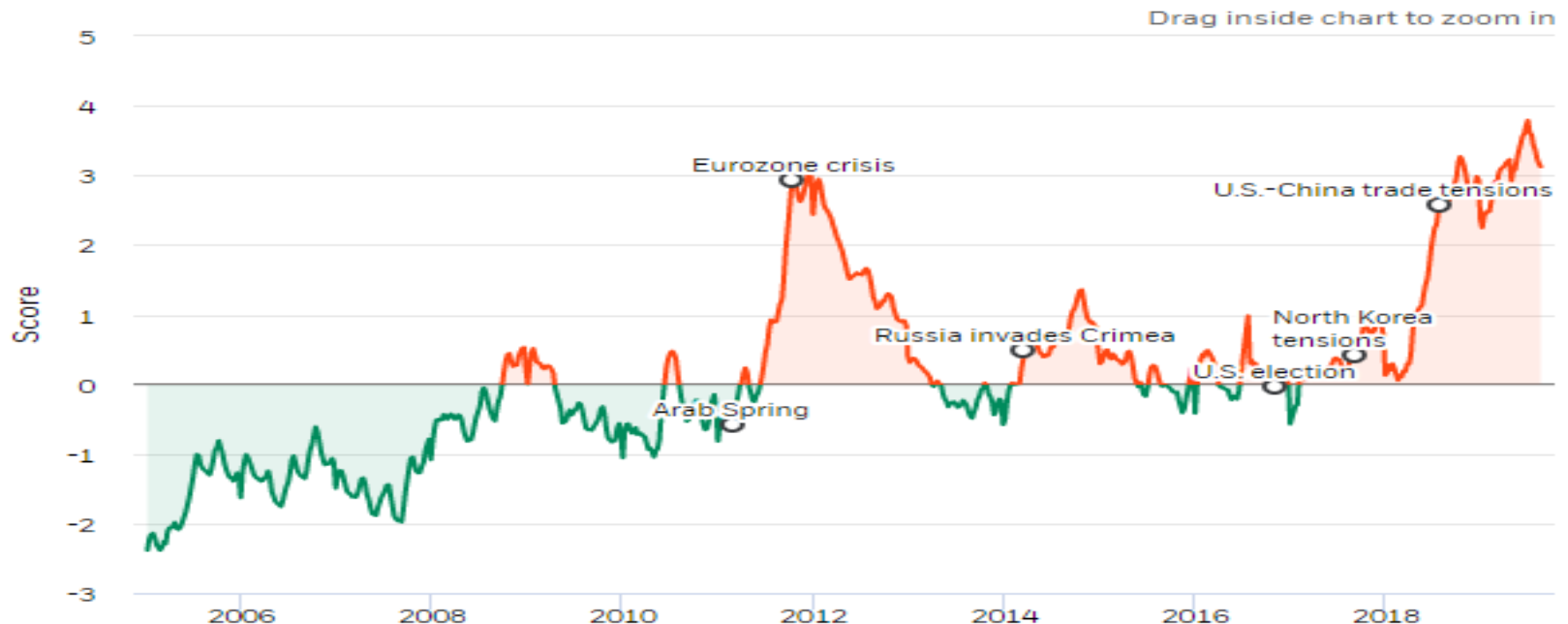
Source: BlackRock, as of September 30, 2019. The above chart is based on our proprietary signal which measures fiscal policy sentiment across developed market countries. For illustrative purposes only.

1

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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Domestic markets are opening up. Data/evidence based Investment approach is key for China.

2

Risks in Chinese economy skewed to downside

Trade tension weighs on China's growth...



Sources: Wind, IMF forecast, August 2019

...alternative data confirms the slow down

Activity through satellite images vs. official PMI



Source: SpaceKnow, BlackRock, as of 28 February 2019, for illustrative purposes only

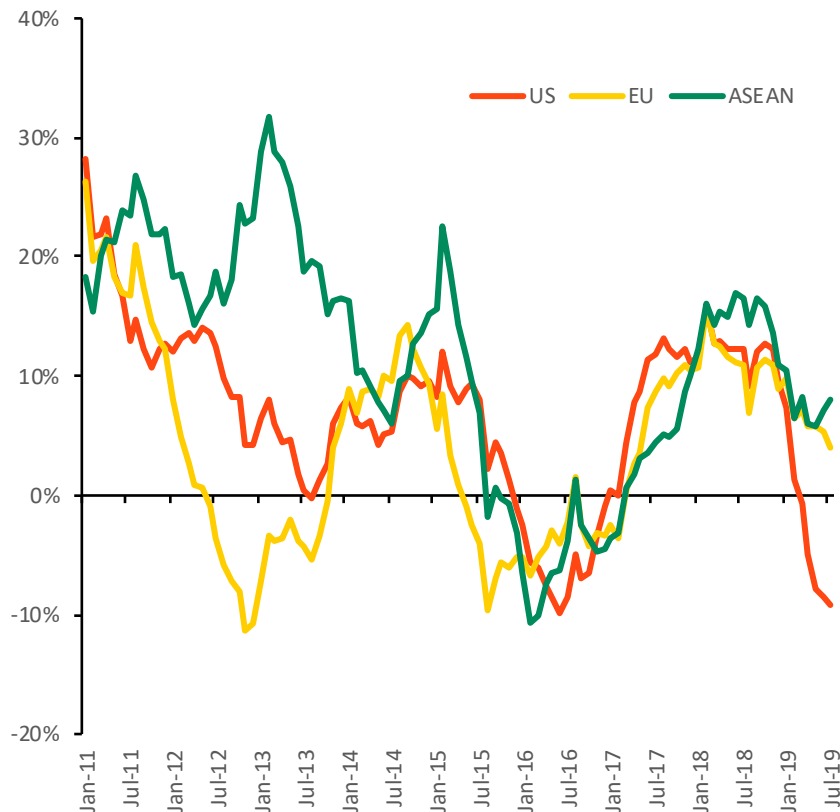
Exports likely to be a bigger dragger next year

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

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

China's exports

12mma yoy %



Source: Wind, as of August 2019

Share of Chinese exports by destination

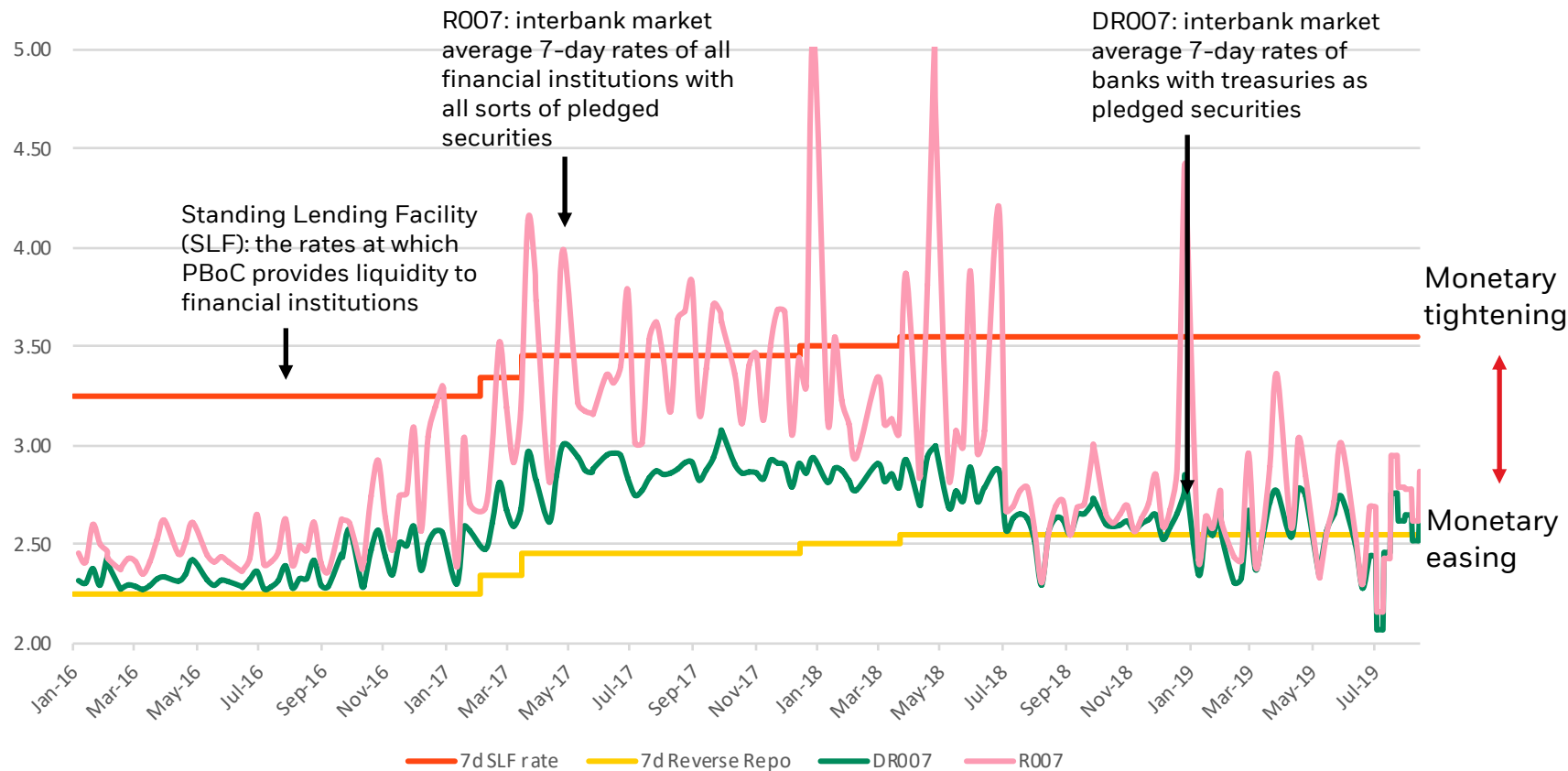


Source: Wind, BlackRock calculation, as of August 2019

2

Monetary easing aims primarily to reduce corporate funding cost

Market rates (%) versus policy interest rate corridor

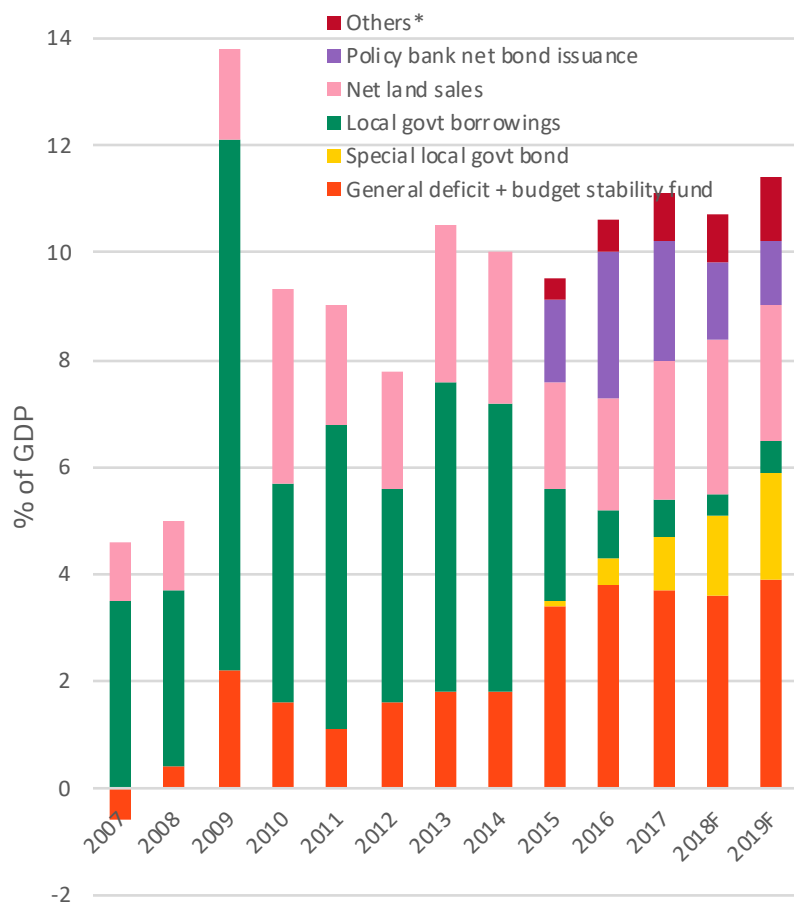


Source: Wind, BlackRock as of August 14, 2019.

2

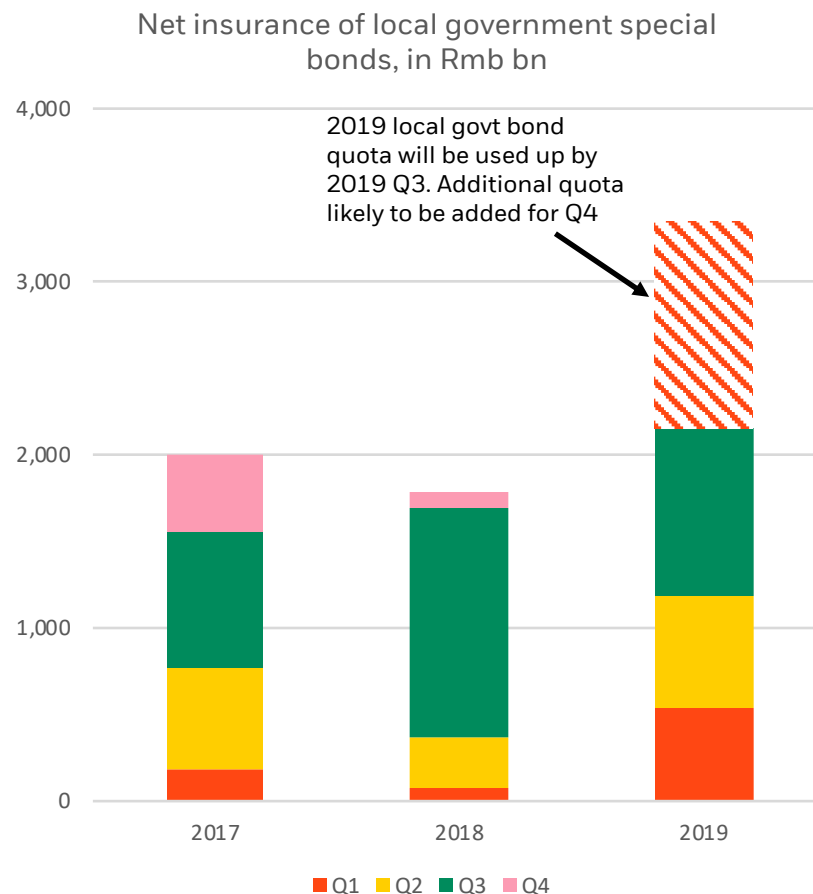
Fiscal stimulus becomes more visible in Q2 2019 and onwards

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



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

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

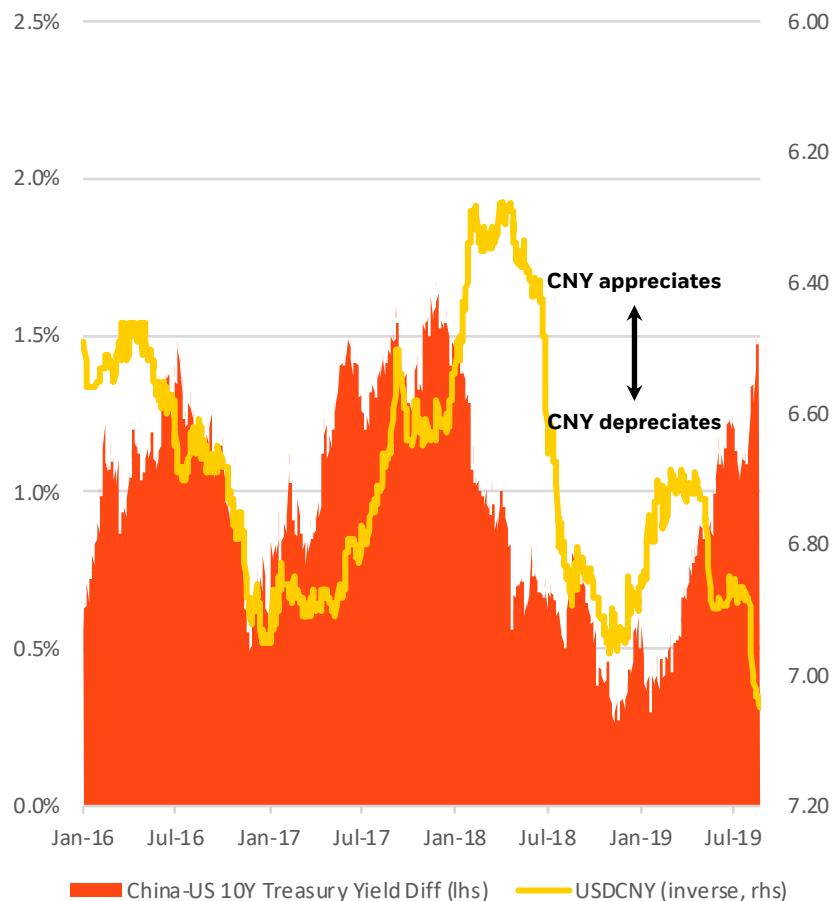


Source: PBoC, Ministry of Finance, August 2019

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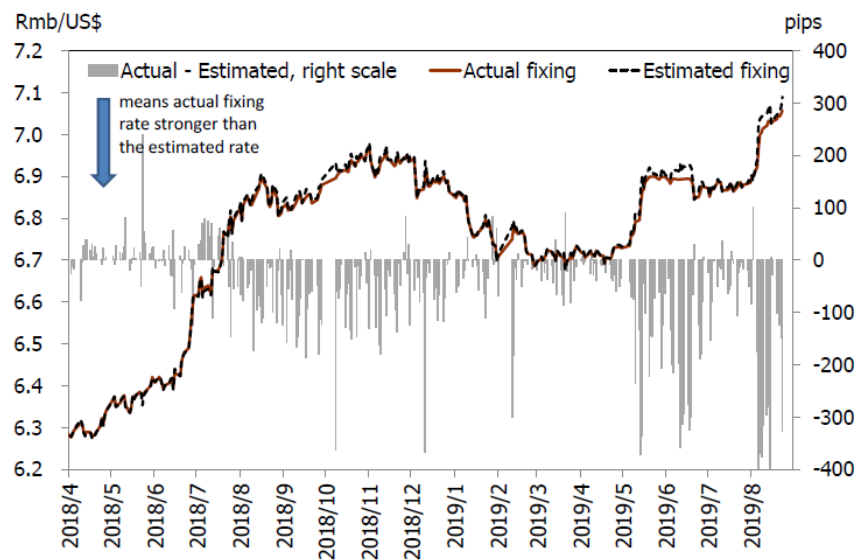
FX policy: geopolitical considerations overwhelms fundamentals

USDCNY has deviated from the anchor of interest rate differentials



Source: Wind; BlackRock, as of August 2019

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



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

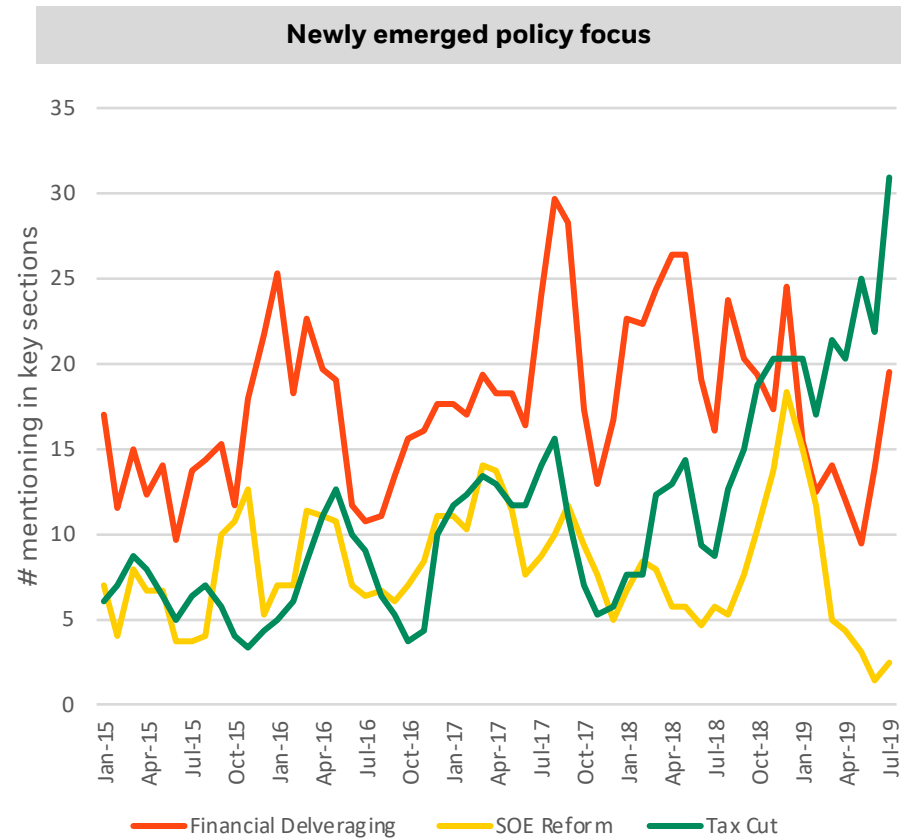
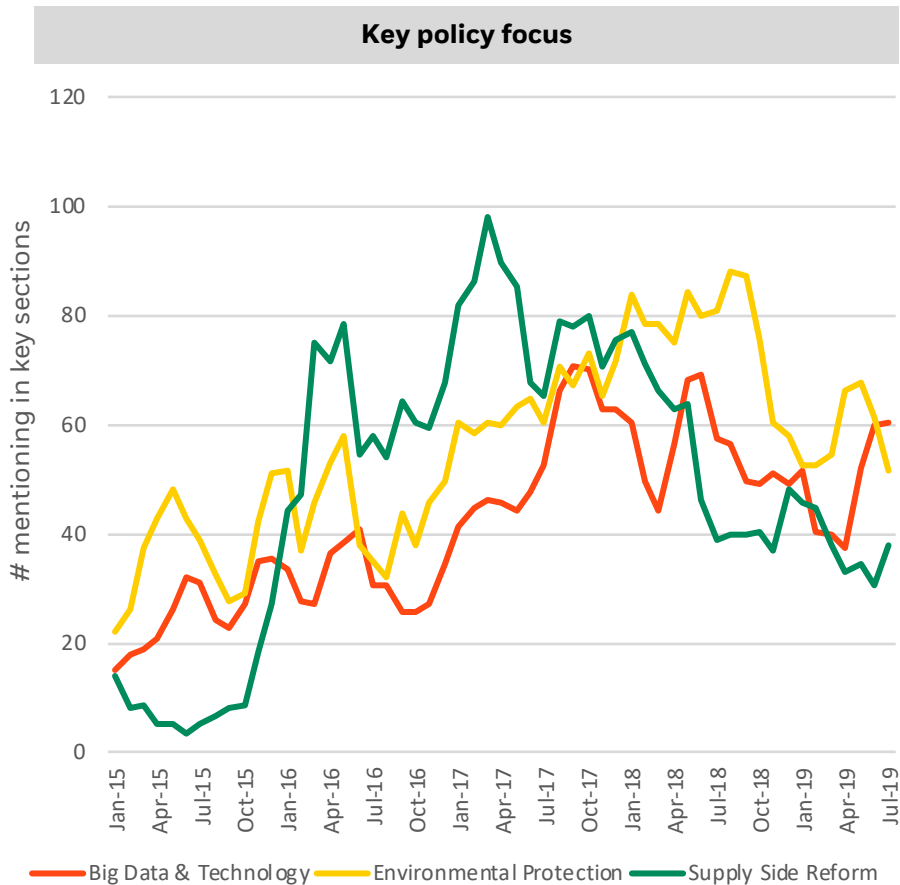
Text mining long term policy



2

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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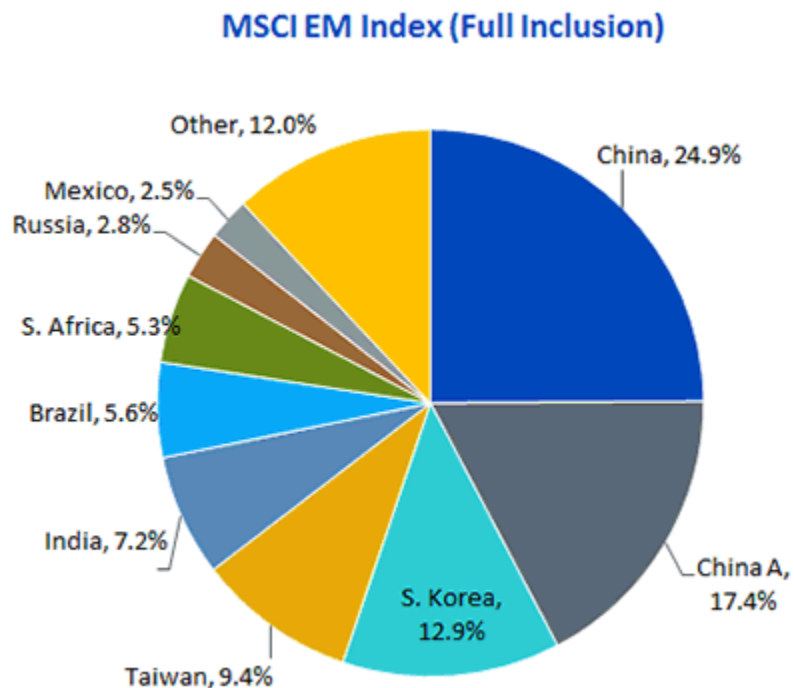
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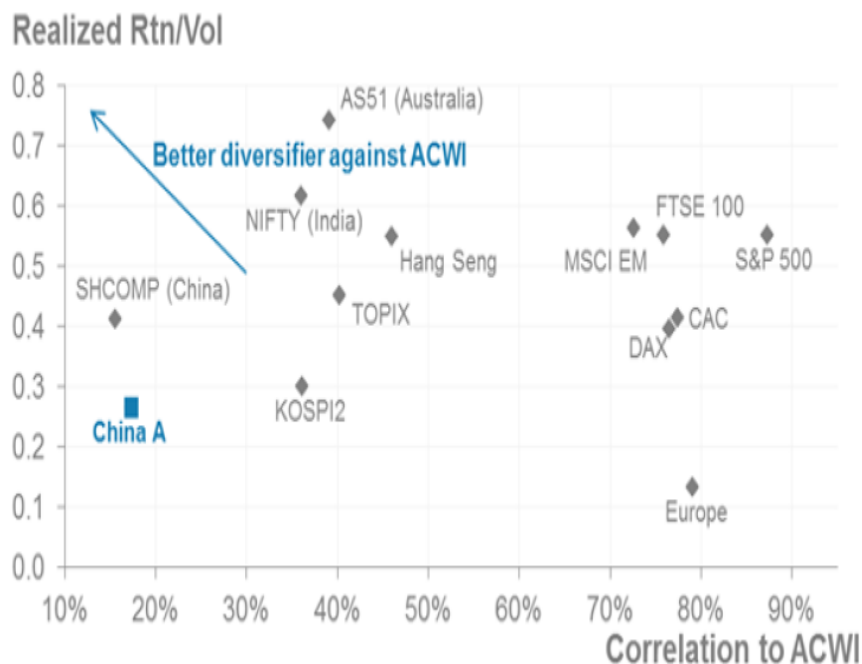
Global index inclusion of China onshore equities

MSCI index inclusion to add more than US\$100bn



Source: MSCI, as of April 2019

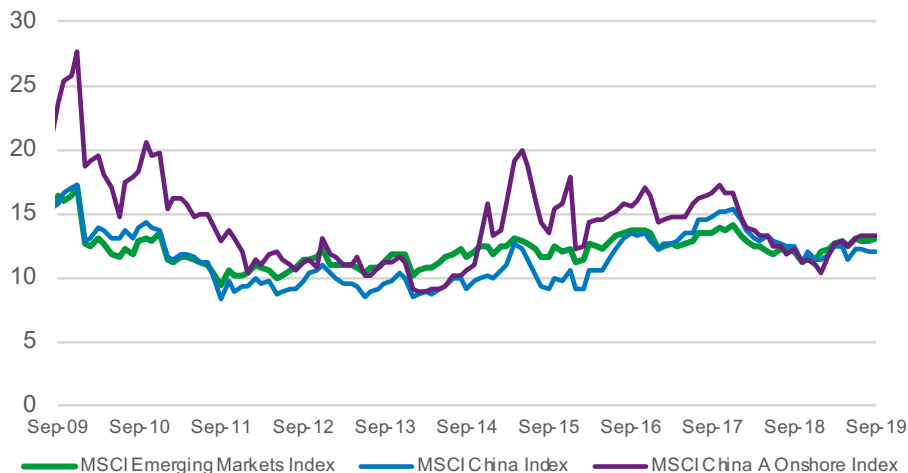
China A-shares provide diversification to global equity investors



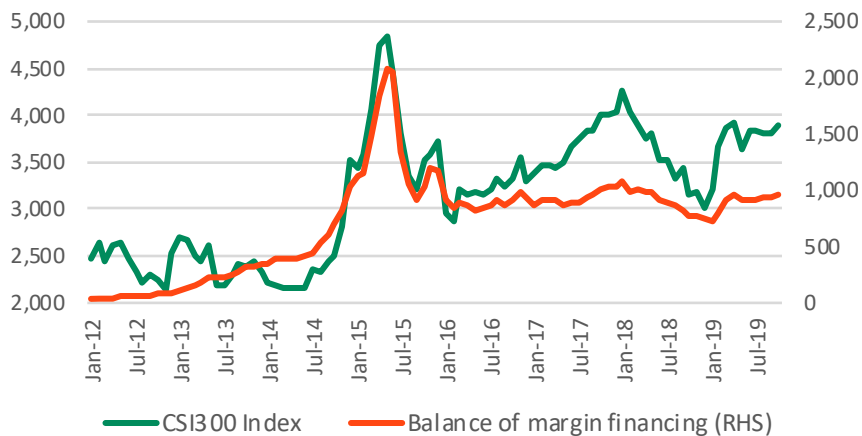
Source: Bloomberg, as of end of November 2018

3 China A Share Market Valuation and Sentiment

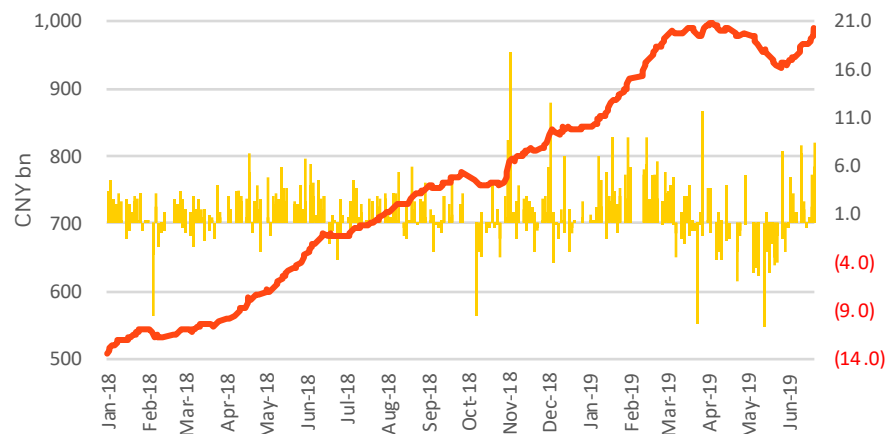
Forward PE of China A Low Relative to History



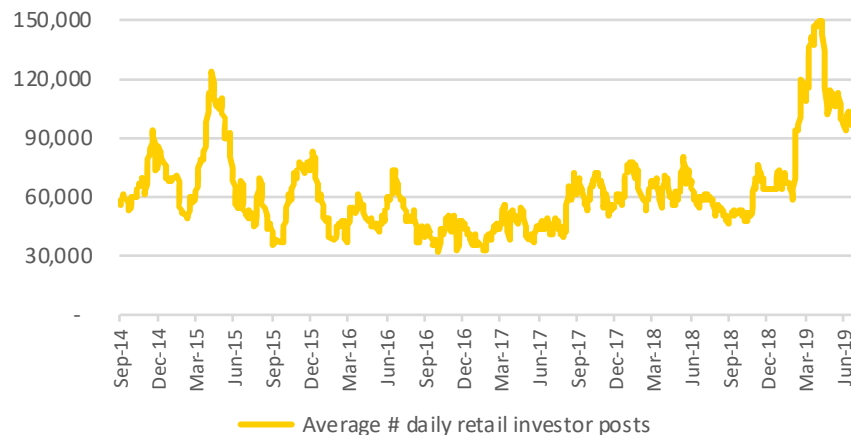
Stock market rallied with little leverage increase



Northbound flows recovered, cumulative vs daily (RHS)



Number of investor online posts normalized

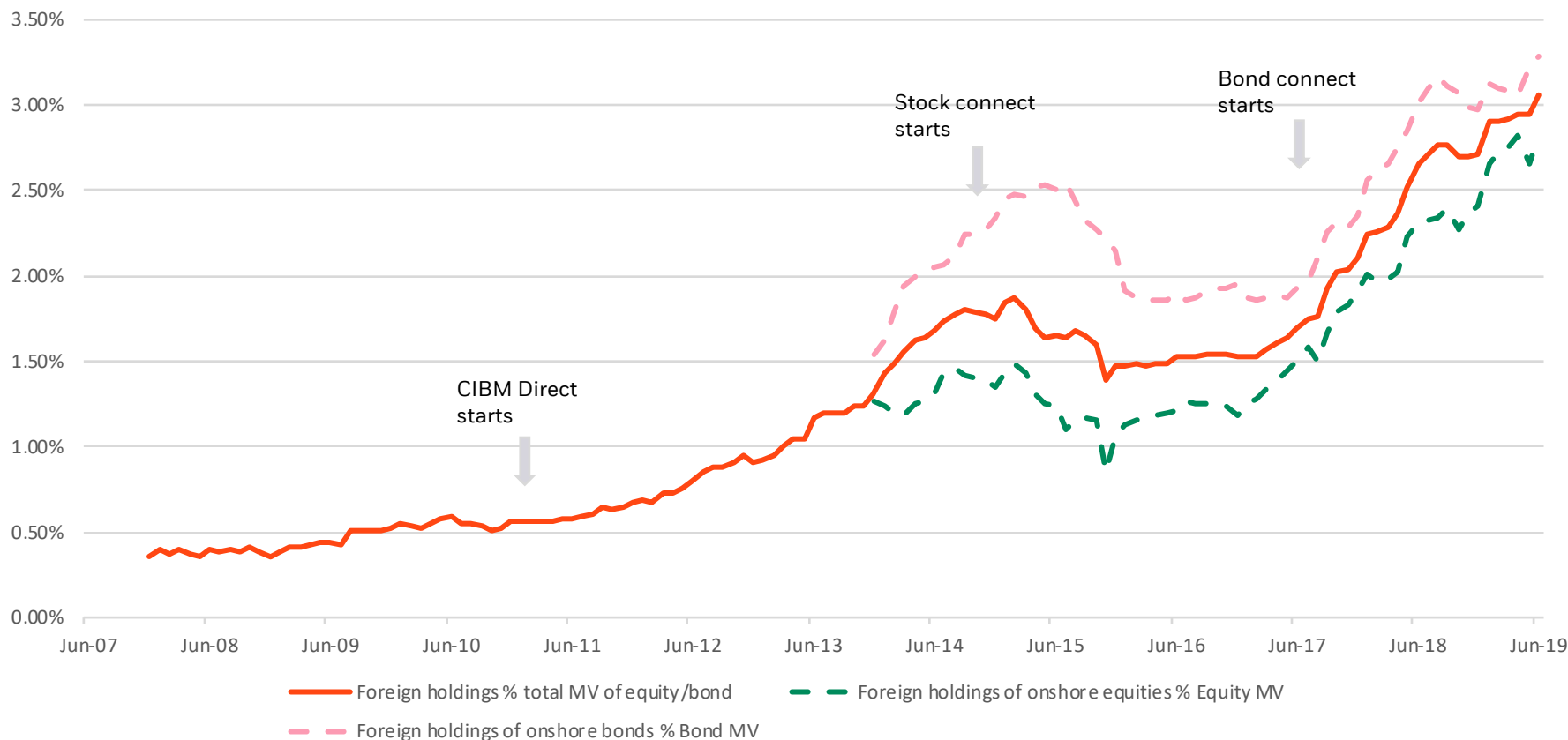


3

Foreign investors' presence in China is small and keeps rising

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

Foreign holdings China onshore equity/bond



Source: PBoC, Wind, as of June 2019

3

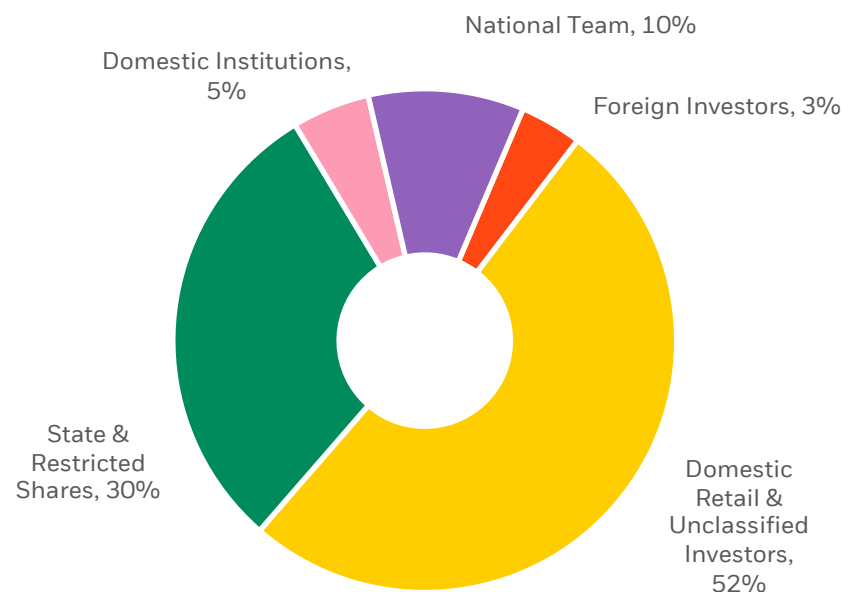
Chinese Equity Market Structure

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



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

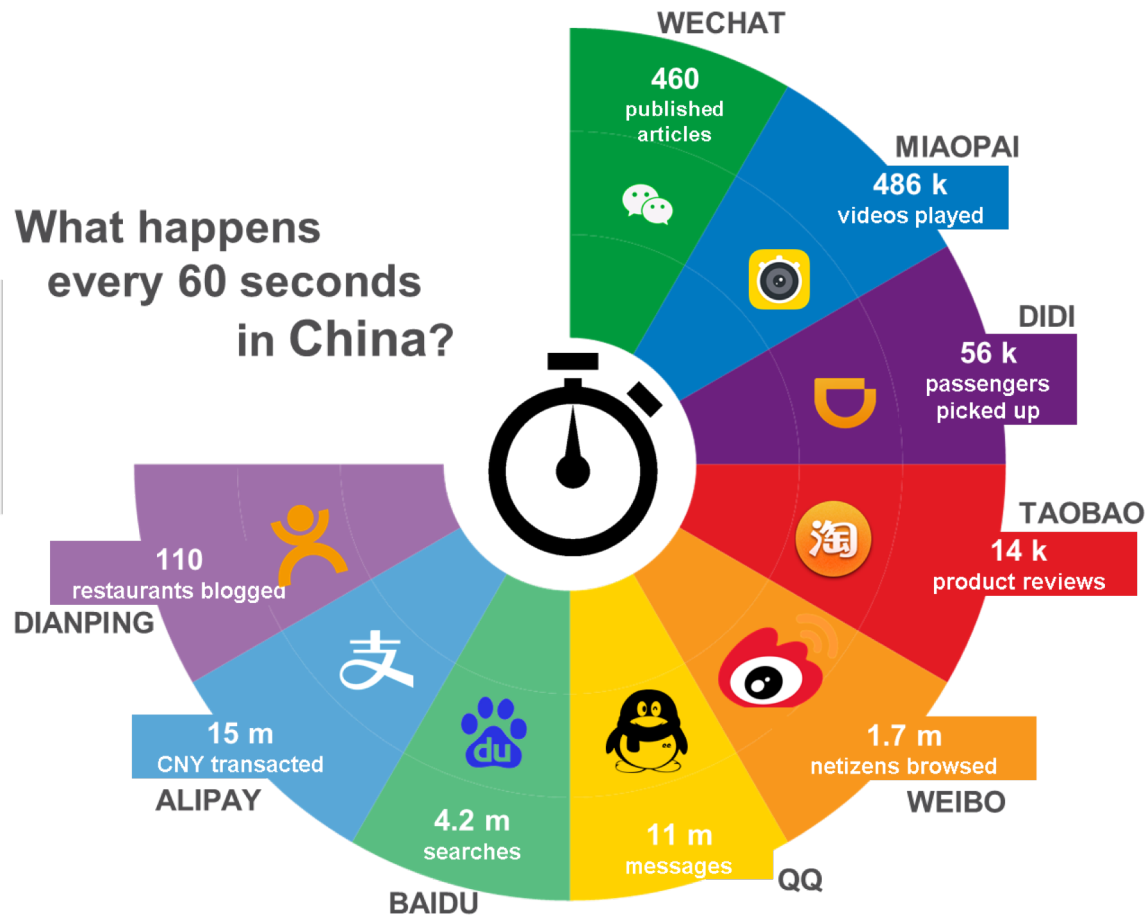
China A Equity Market Ownership Structure



Source: Blackrock, Wind, Hong Kong Exchange, SZSH ex, as of 31 December 2018

3

Data as the new precious commodity



Source: Kantar Media CIC, BlackRock, as of 31 December 2018

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