

Outlook bright for China

- China has potential for sustainable recovery in 2010
- Underlying domestic demand is strong in China and there are signs of recovery in domestic demand

Christina Chung, Senior Portfolio Manager at RCM, the global equity company of Allianz Global Investors, gives her macroeconomic outlook on the investment environment in China:

The recovery of domestic demand

“From a bottom up perspective, domestic demand is recovering.

“We have seen recovery in consumption as indicated by the performance of various retail companies and consumer brands. For example, retail sales for wine, apparel, footwear, etc. were generally weak in Q1/2009 but there was a general pickup in sales since April this year. The property market in China has also seen a significant turnaround with certain listed property companies achieving strong sales in the first five months of this year. There has also been some price recovery and inventories of properties have reduced substantially. In certain cities like Shanghai there is now even a shortage of supply.

“Underlying domestic demand is strong in China. The level of household debt level is low and the household savings rate is high, whilst income is slowly rising. Property and stock market gains have contributed to the recovery in domestic consumption in China and the sharp recovery in the property sector is beyond even the expectations of Chinese developers themselves.”

Economic recovery

“While fiscal spending on infrastructure has contributed to the economic recovery, loose credit conditions are equally important. New bank loans were reported at about RMB5.8 trillion in the first five months of this year and it is expected that in June we will see another RMB1 trillion of new loans. If credit expansion continues at the pace it did in the first half of this year, new loans could amount to RMB9 trillion for the whole of 2009, compared to about RMB5 trillion for 2008, an increase of some 80%. This will imply an acceleration in loan growth from 16% in 2008 to 25% in 2009, i.e. loans will expand at a rate in excess of two times of nominal GDP growth.

“The economy should be well supported in 2009. The Chinese Government is determined to support economic growth, even at the risk of an asset inflation bubble. Following the strong credit growth this year, we may experience some subtle tightening of credit in the second half, such as closer scrutiny of credit extension by banks to ensure they follow the China Banking Regulatory Commission guidelines. We believe, however, that the policy stance will be quite neutral, focusing on administrative controls to prevent overheating in asset markets, as well as managing the risk exposure of the banking system.”

The future

“Given underlying demand remains strong in China, we believe it has the potential for a sustainable recovery in 2010. After a period of disinvestment for the most part of this year, private sector investment should recover when government

investment takes the lead in fixed asset investments. The risk is that the global economy deteriorates sharply from here on, which would put significant pressure on the domestic sector and therefore employment in China which could increase the risk of social instability.

“Profit earnings should recover in the second half of the year, particularly in the fourth quarter, helped by a low base of comparison. In the short-term, valuations are not very compelling but with the potential of a brighter outlook into 2010 there could be medium-term upside.

“We continue to favour the sectors that we believe have long-term structural growth potential and also sectors that tend to be less sensitive to the short-term macroeconomic environment. These are companies in sectors such as consumer, telecommunication equipment, IT services and infrastructure-related industries like cement.”

“Given its cautious outlook on the global economy, the Chinese government will take quite a proactive role in supporting economic growth and 2009 growth should be well supported. However if the macroeconomic environment deteriorates further we would expect to see further easing of fiscal policy.”

- Ends -

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