



CIO Memo

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Authors:

Stefanie Holtze-Jen
Chief Investment Officer APAC

Swati Bashyam
Investment Officer APAC

Wolf Kisker
Capital Markets Strategist

China: Q4 GDP weak amidst deflation

Key takeaways

- Q4 GDP growth was lower than estimates due to ongoing deflation and property market drag.
- Markets reacted strongly to the weak GDP data with equity indices down to multi-year lows. CNY was unchanged.
- We believe the worst has been priced in and see value in strategic sectors, where we maintain a constructive long-term outlook.

1. What happened?

China's Q4 GDP grew 5.2% YoY. This was slightly below consensus estimates of 5.3% as a prolonged property market crisis and deflationary pressures have weighed on growth momentum. QoQ growth decelerated to 1% vs 1.5% in Q3. However, full year 2023 GDP growth came in at 5.2%, above the government's 5% target.

The downtrend in home prices has continued to deepen with December prices down -0.4% MoM vs -0.3% in November. On the inflation front, moves in both consumer price index (CPI) and producer price index (PPI) remain deflationary. CPI was -0.3% YoY in December, negative for a third consecutive month, due mainly to lower food and energy prices. Core CPI (excl. food and energy) remained stable at 0.6% YoY in December. PPI has now remained negative for 15 straight months, with a -2.7% YoY fall in December reflecting weak factory gate prices. Separately, retail sales grew 7.4% YoY in December, down on estimates of 8%. Despite the weak domestic data, the PBoC has kept the one-year medium term lending facility rate unchanged at 2.5% and has refrained from rate cuts widely expected by the markets as it tries to control currency depreciation.

On the bright side, infrastructure and industrial investment have increased thanks to policy support. Industrial production growth accelerated to 6.8% YoY in December, compared to analyst expectations of 6.6%. The same is true for fixed asset investment, which grew at a rate of 3.0% YoY from January to December vs consensus expectations of 2.9%.

While the domestic economy continues to remain challenged, global trade is showing early signs of recovery. Exports were a bright spot, growing 2.3% YoY in December on the back of reversal of inventory cycles in sectors including semiconductors and automobiles. A similar trend for December exports was also reported by South Korea and Germany.

China has resumed reporting a youth unemployment rate for 16-24 year olds. This was 14.9% in December vs a record high of 21.3% in June. The overall unemployment rate was 5.1% in December vs 5.0% in November.

2. How did markets react?

Equity indices fell to multi-year lows today following the weaker-than-expected China GDP data. The Hang Seng Index was down -4%, while the Hang Seng Tech Index was down -6%. China A shares and the Shanghai Composite both declined by -2%, while the Shenzhen Component was down -3%. The CNY remained unchanged against the USD today, with a -1% YTD drop reflecting rising yield differentials with the U.S.

3. What does it mean for investors?

China is in the midst of a strategic transformation as it shifts focus from the property sector towards hi-tech manufacturing. To give background to the current GDP report, the production of solar cells, new energy vehicles and power-generating devices grew in 2023 by 54%, 30% and 29% respectively. Investments in hi-tech industries grew 10.3% YoY in 2023.

The government recently announced its plan for a "silver economy" with the aim of catering for an elderly population. The demographic shift towards an aging population in China will likely provide an opportunity for businesses such as care homes, hi-tech product manufacturing for elderly care, healthcare etc. Although details and timelines are not available, the government aims to establish about 10 industrial parks focused on the silver economy.

While fiscal measures are aimed in the right direction to support long-term growth, we expect more monetary policy action to boost consumer sentiment in the immediate term. We expect household consumption and investment in manufacturing and infrastructure to be the key growth drivers of China's economy in 2024. We forecast China's GDP growth will be 4.7% in 2024 vs 5.2% in 2023.

We have a long-term constructive view on strategic sectors in Chinese equities. The MSCI China index is currently trading at a 1 year forward P/E of 8.6x, -25% below its 5-year average with earnings growth expectations of 20% for 2024. We believe that the worst has been priced in and strategic sectors could offer value to investors.



Glossary

China-A Shares are securities of companies incorporated in mainland China that trade on either Shanghai or Shenzhen stock exchanges and trade in Chinese Yuan. A shares can only be traded by residents of China.

CNY is the currency code for the Chinese yuan.

The **Consumer Price Index (CPI)** measures the overall change in consumer prices based on a representative basket of goods and services over time.

Gross domestic product (GDP) is the standard measure of the value added created through the production of goods and services in a country during a certain period.

The **Hang Seng Index (HSI)** includes the 50 largest companies traded on the Hong Kong stock exchange.

Hang Seng Tech index represents the 30 largest technology companies listed in Hong Kong that have high business exposure to technology themes.

The **MSCI China Index** captures large and mid cap shares representing about 85% of the China equity universe.

The **National Bureau of Statistics (NBS)**, is a deputy-cabinet level agency directly under the State Council of the People's Republic of China.

People's Bank of China (PBoC) is the central bank of the people's republic of China.

The **Producer Price Index (PPI)** measures the change in the prices paid to producers of goods and services.

Purchasing Managers Index (PMI) is an economic indicator comprised of monthly reports and surveys from private sector manufacturing firms. The index surveys product managers, who are the individuals that buy the materials needed for a company to manufacture its products.

The **Shanghai Composite Index** contains all shares traded on the Shanghai exchange.

The **Shenzhen Component Index** is an index of 500 stocks that are traded at the Shenzhen Stock Exchange (SZSE).

USD is the currency code for the U.S. Dollar.



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