

The Outlook of China's Financial System

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Outline

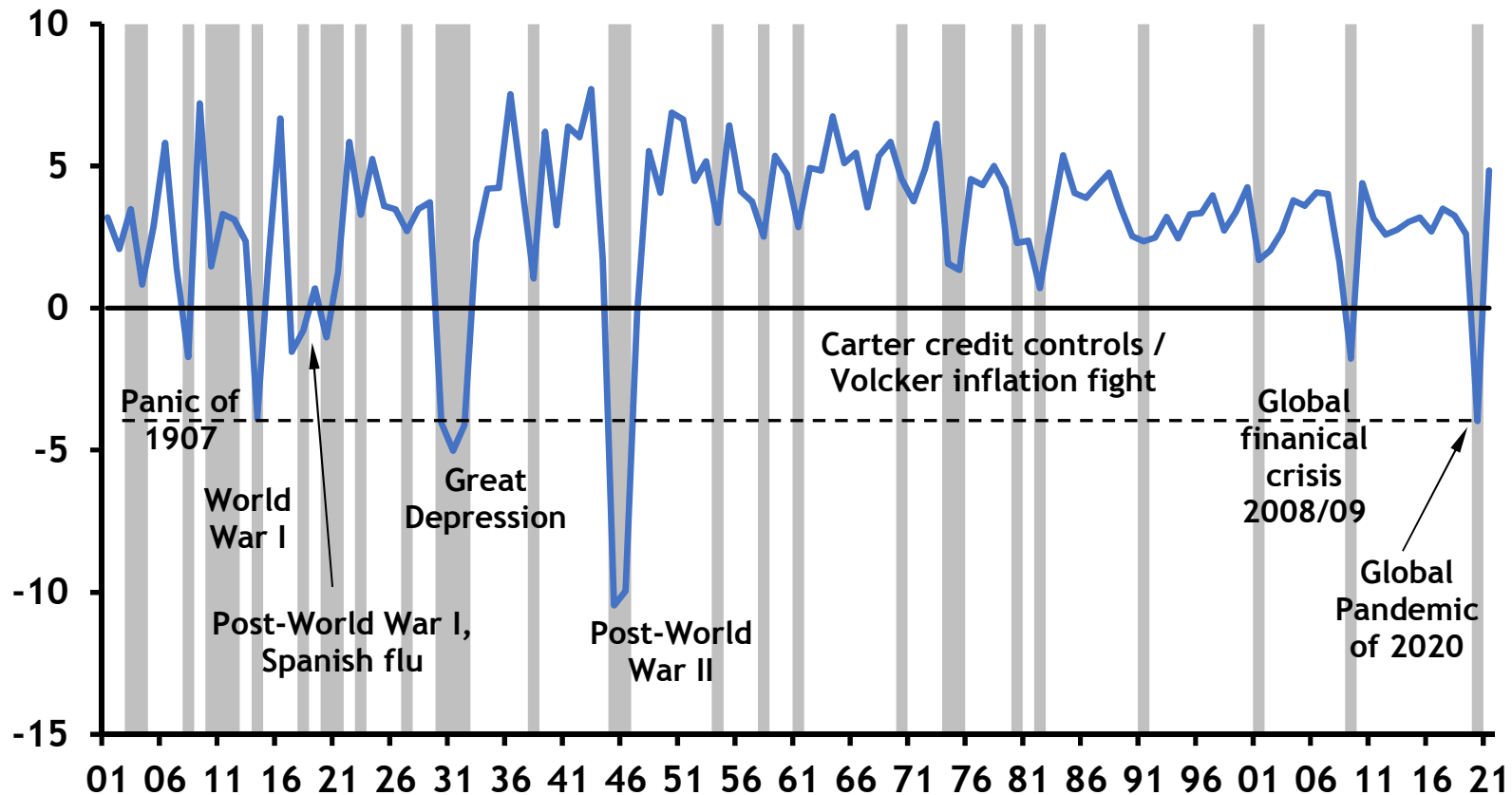
- China's role in global economy
- China's role in global financial market

COVID-19: an unprecedented economic shutdown

Deepest, and also shortest economic contraction since WWII

Global real GDP: The eight global recessions over the past century

%yoy; US recession bars shown in grey (2020-21 forecast)



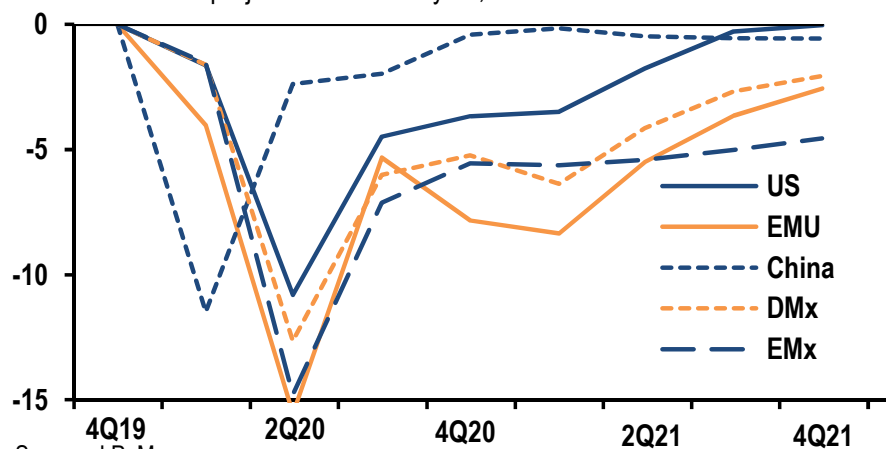
Source: J.P. Morgan

Recovery path: China vs. Global

China's V-shape recovery

Real GDP, COVID-19 impact

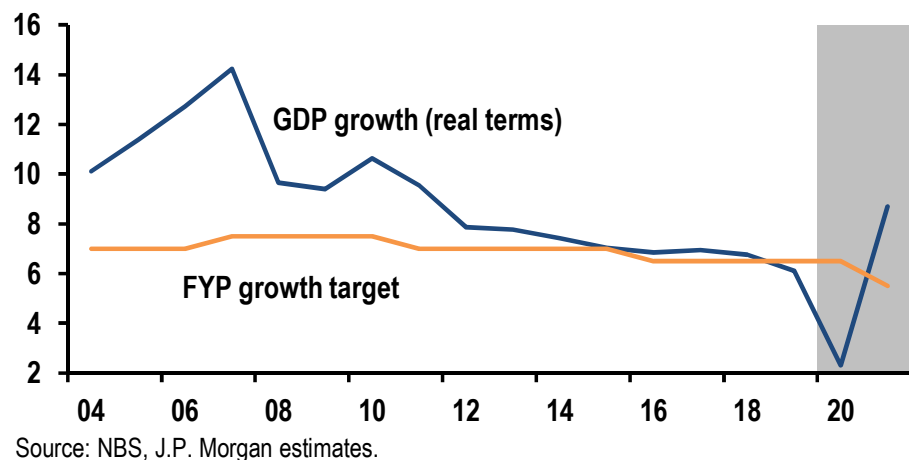
% deviation from projection on January 24, 2020



Positive outlook on China's growth in 2021

China real GDP growth

% oya

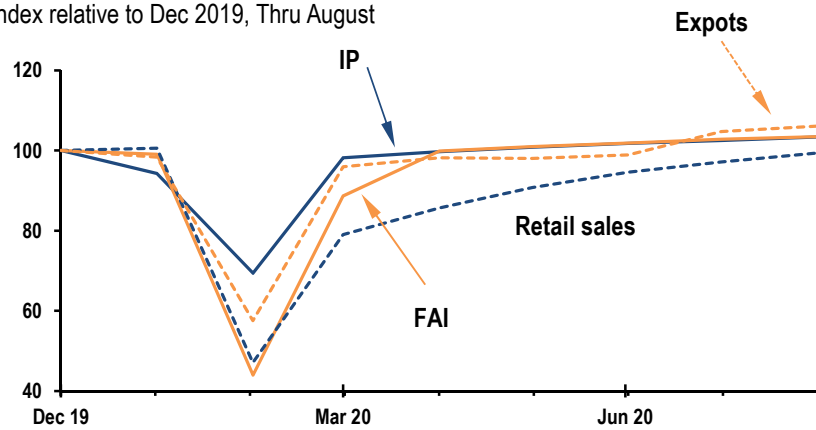


Recovery path: China vs. Global

China: Production ahead of consumption

China's economic recovery

Index relative to Dec 2019, Thru August

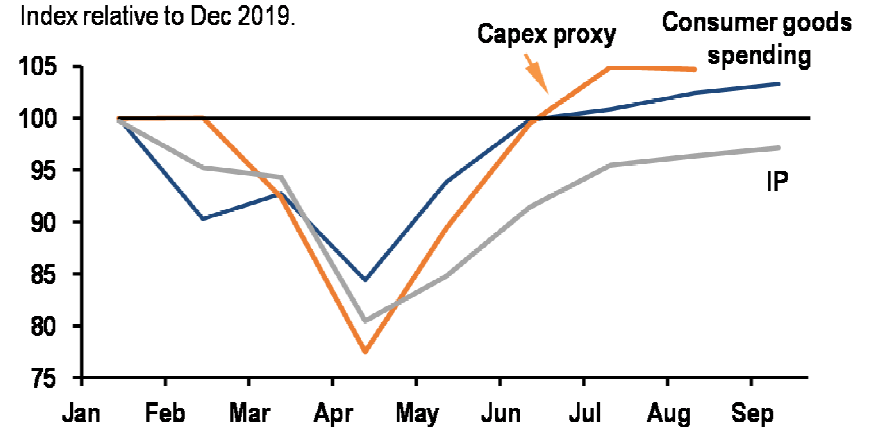


Source: NBS; J.P. Morgan

Global: IP lagged behind consumption

Global goods sector activity

Index relative to Dec 2019.



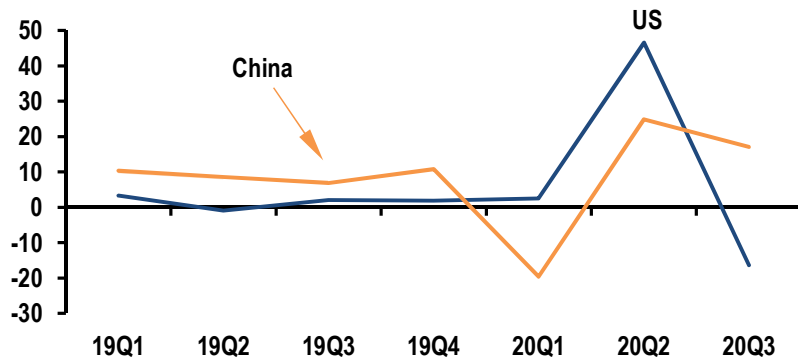
Source: J.P. Morgan

Recovery path: China vs. Global

Policy stimulus has different focus

Figure: Disposable income

%q/q saar

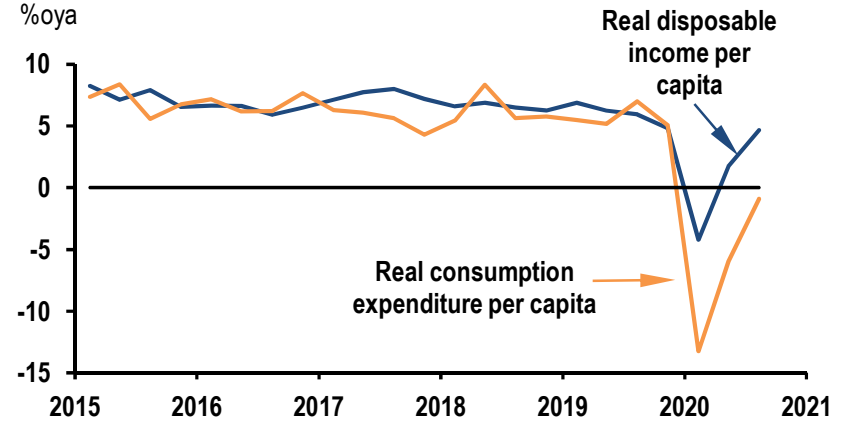


Source: NBS, Bureau of Economic Analysis, J.P. Morgan

Higher savings during pandemic shock

Disposable income vs. consumer spending

%oya

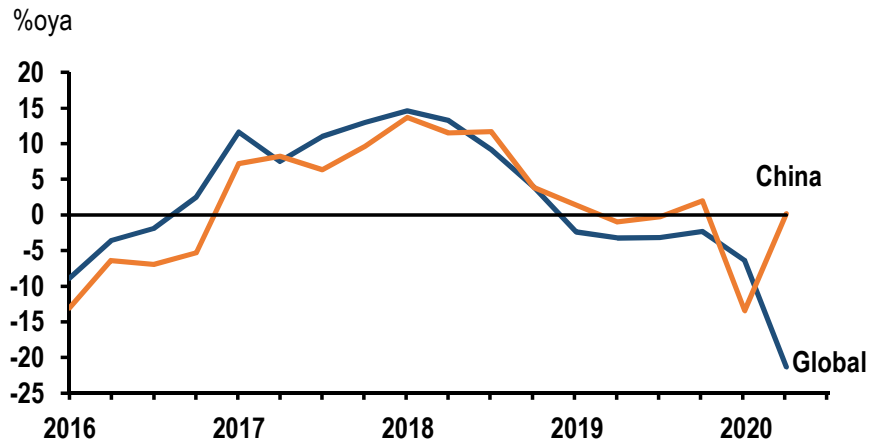


Source: NBS, J.P. Morgan

Recovery path: China vs. Global

Unexpected resilience in China's exports

Merchandise goods exports growth

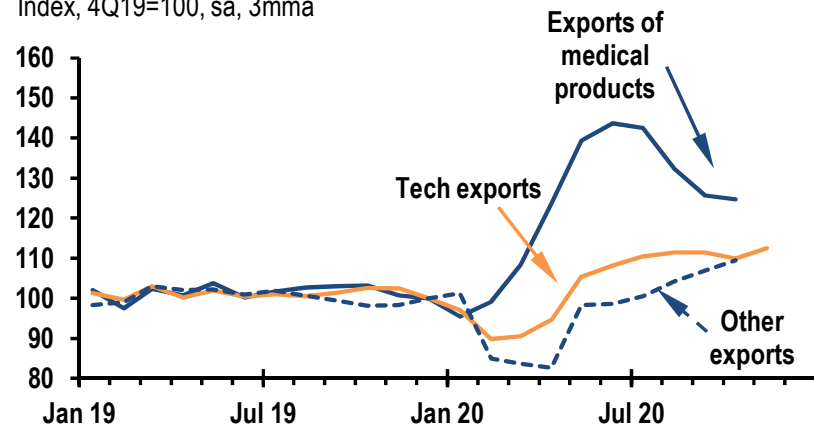


Source: WTO, J.P. Morgan

Exports led by medical supplies and electronics

Exports by product group

Index, 4Q19=100, sa, 3mma



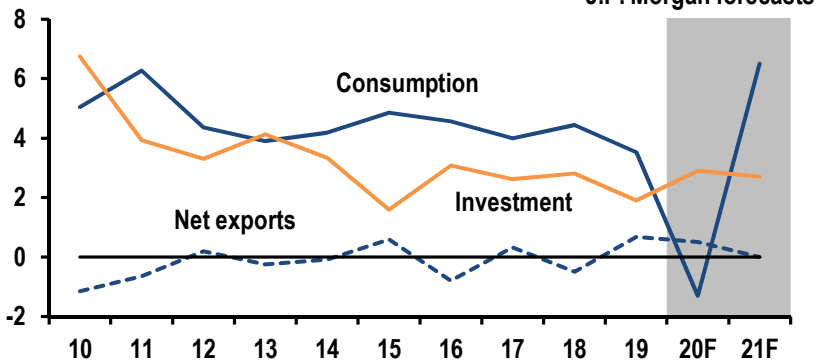
Source: China Customs, J.P. Morgan

2021 Outlook

Rotation from investment to consumption

Contribution to headline GDP growth

%-pt contribution to headline %oya growth

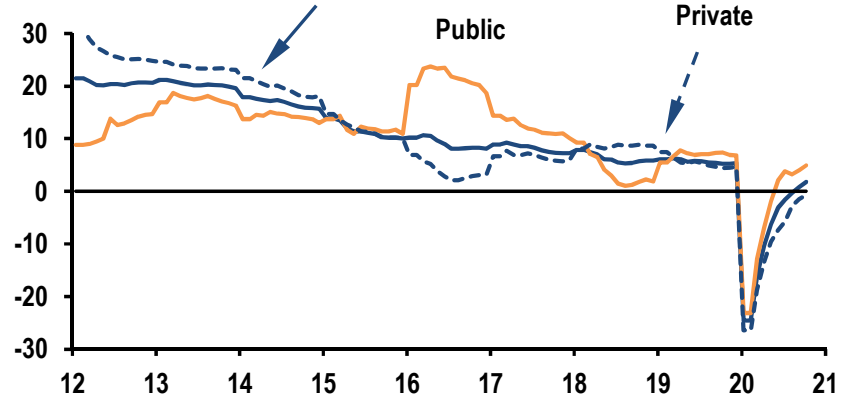


Source: NBS, J.P. Morgan

Rotation from public to private investment

FAI growth: Public vs private sectors

%oya, ytd



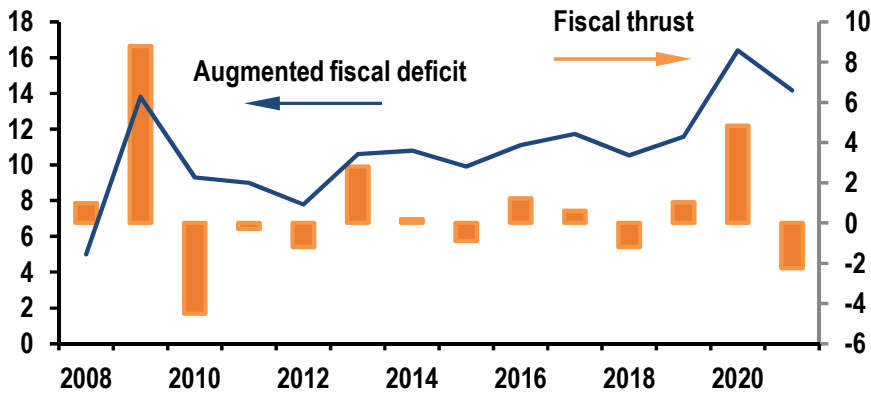
Source: NBS, J.P. Morgan

2021 Outlook

Fiscal consolidation: fiscal drag 2.7% of GDP

China's fiscal policy

% of GDP, both scales

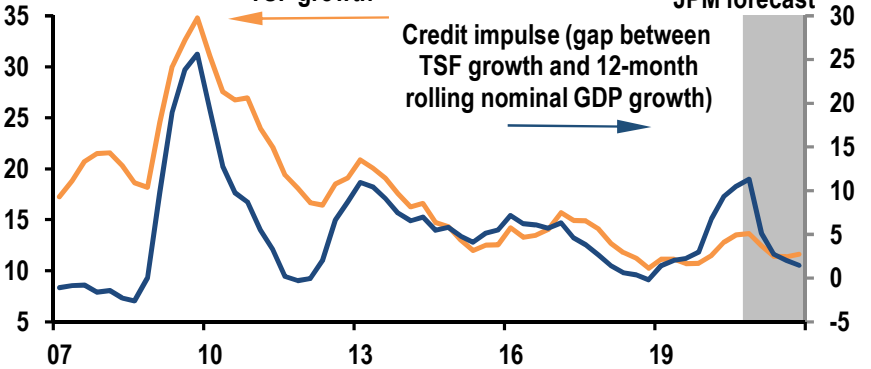


Source: J.P. Morgan

TSF growth will slow down by ~2%pts

China's credit policy

%



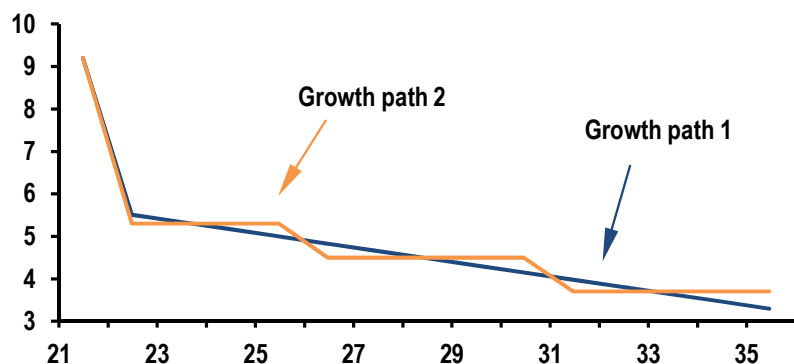
Source: NBS; PBOC; J.P. Morgan

China's Five Year Plan and long-term development

Double GDP by 2035

How can China double GDP by 2035?

%, growth rate



Source: J.P. Morgan

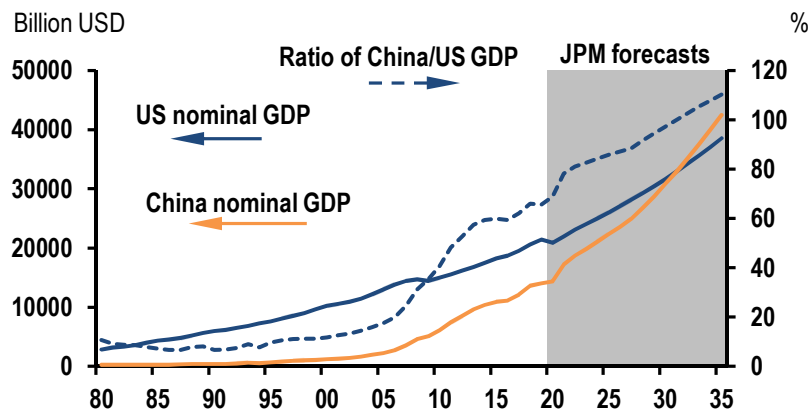
Dual-circulation theory and implementation

- Boost consumption / consumption upgrade: new urbanization; reduce income inequality; social safety net; common prosperity
- Digitalization of the economy
- Technology innovations and upgrade
- Green development

When can China catch up with the US?

China's catch-up with the US

Billion USD



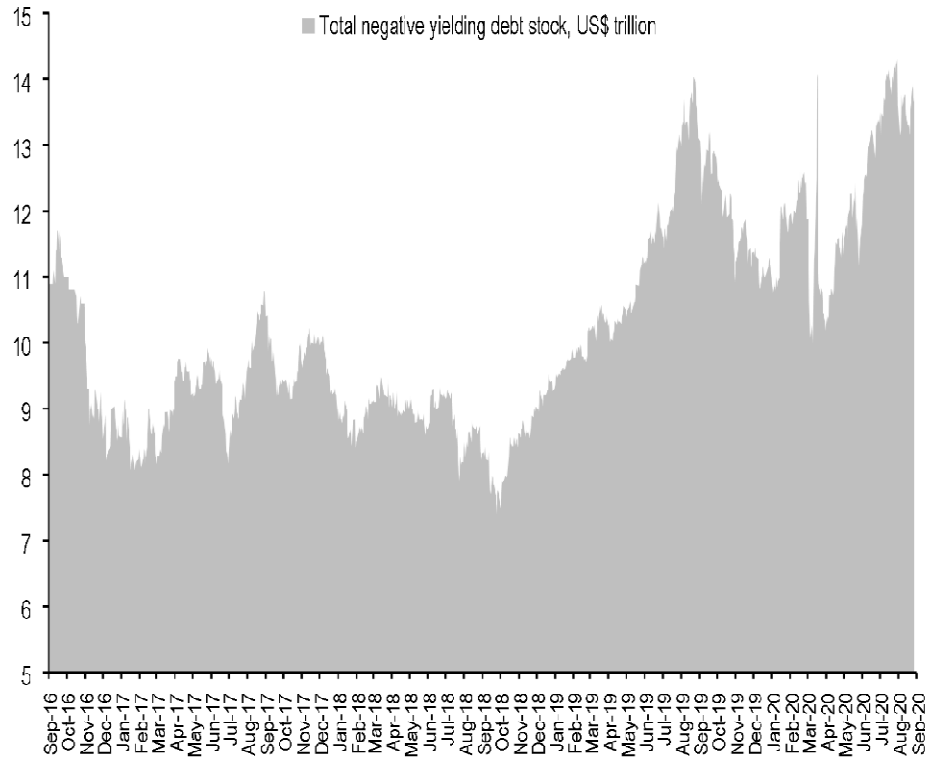
Source: J.P. Morgan

China's path to catch up with the US

- China: Double real GDP by 2035; GDP deflator 3%
- US: Nominal GDP growth 4%
- USD/CNY 7.10 in long run
- China will match the US around 2030

Global financial market

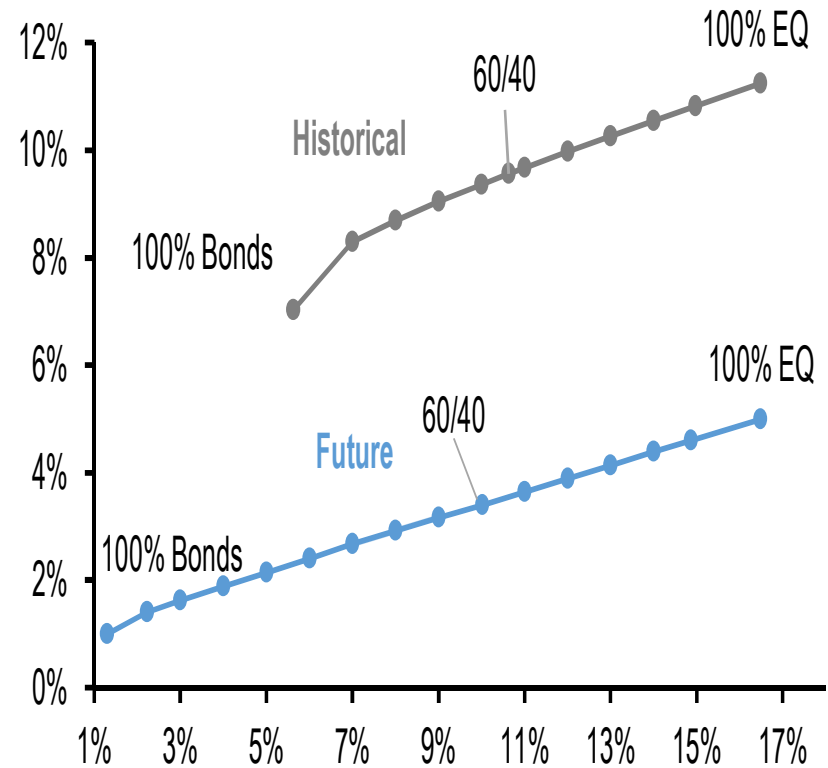
Total negative yielding debt stock



Source: J.P. Morgan (as of 9th September 2020)

Classic 60/40 asset allocation will only earn 3.0-3.5% annually; shift to 80/20

%, annual, 1983-2019, except for end-points, intermediate points have 10% allocation to any asset class

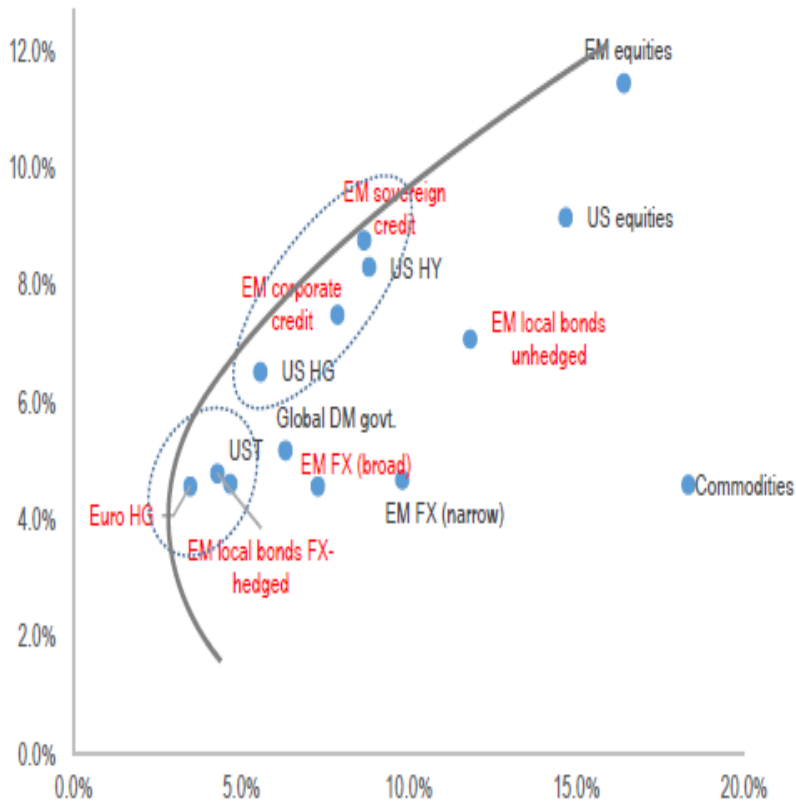


Source: J.P. Morgan

Global financial market

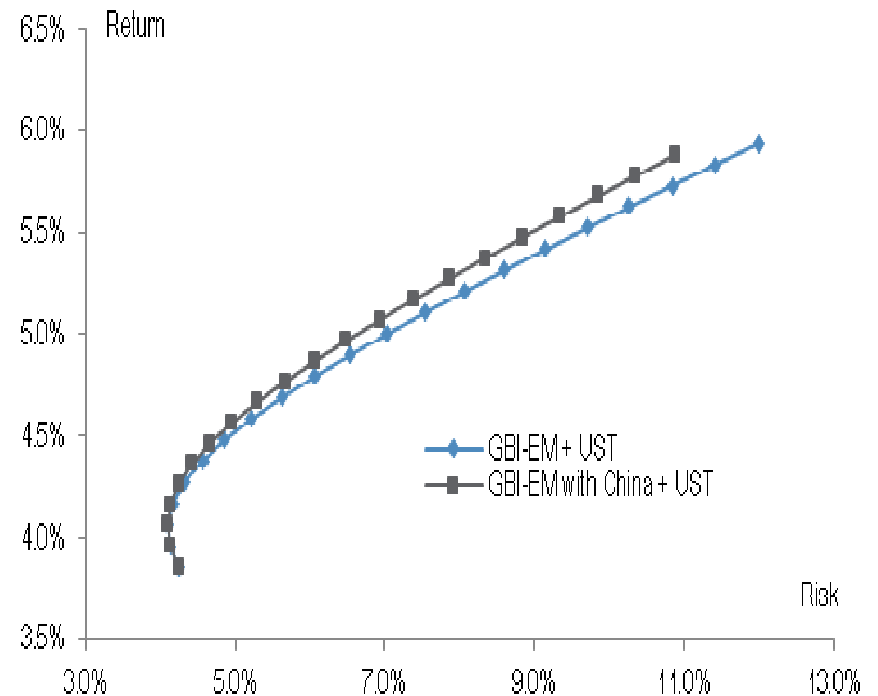
EM bonds have high Sharpe ratios, EM local bonds FX-hedged and EM credit comparing well within same asset classes

x-axis: Average annual volatility (%), y-axis: Average annual return (%), both since 2003



Source: J.P. Morgan

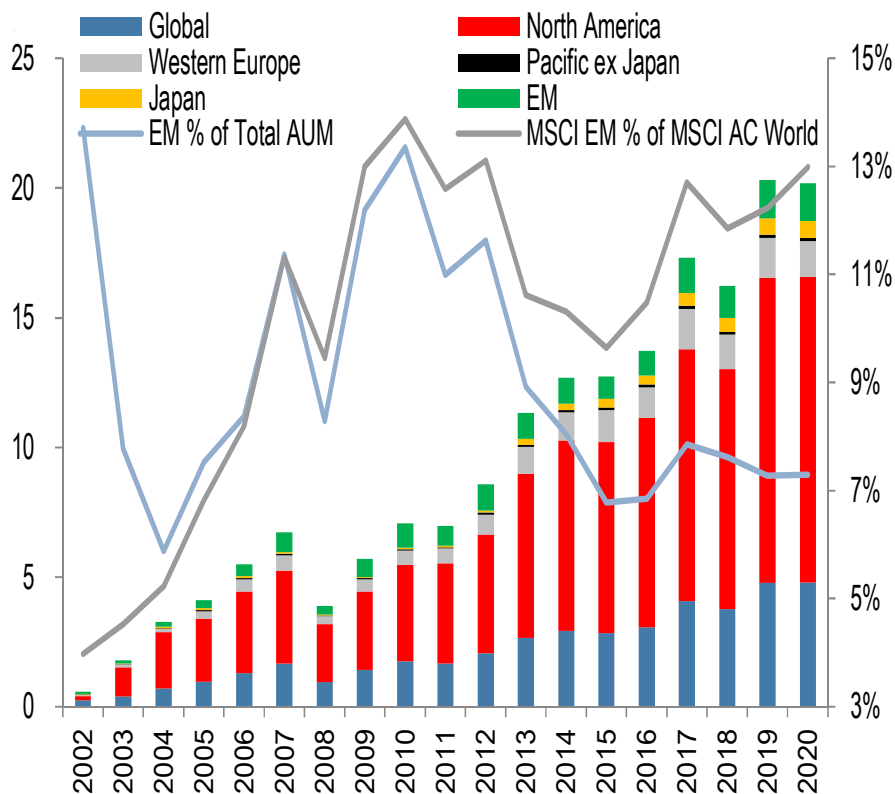
Adding China bonds to GBI-EM would have improved efficiency frontier of a UST+EM bond portfolio over the past decade



Source: A Guide to China's Local Market

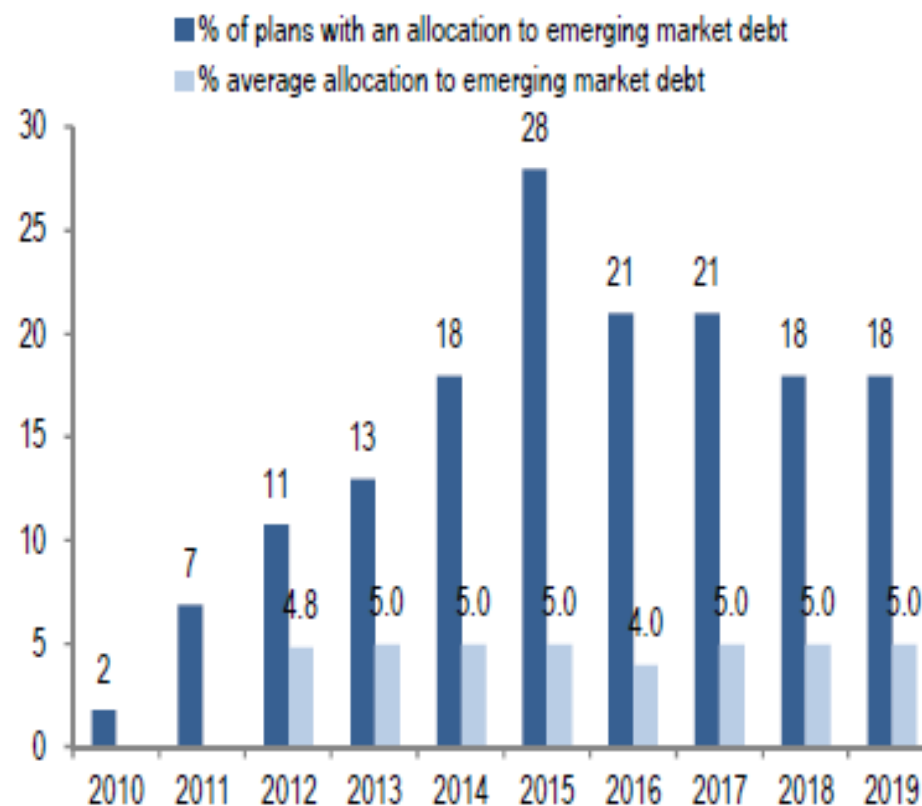
EM assets under-owned in global asset allocations

EM only 7.3% of global mutual fund AUM



Source: EPFR Global, MSCI, Datastream, J.P. Morgan. Note: Left axis: AUM in \$trn; Right axis: EM share of total AUM/MSCI AC World. Data as of end October 2020.

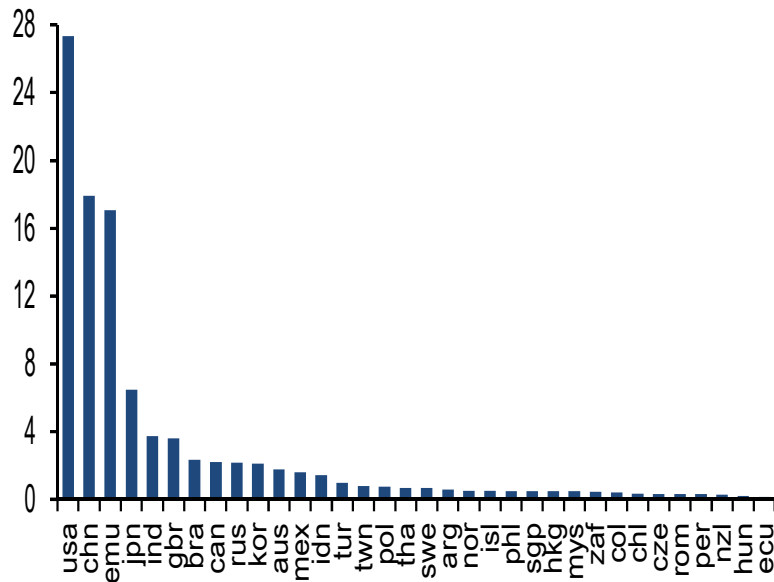
Allocations to EM debt stable around 5%



Source: J.P. Morgan, Mercer European Asset Allocation surveys

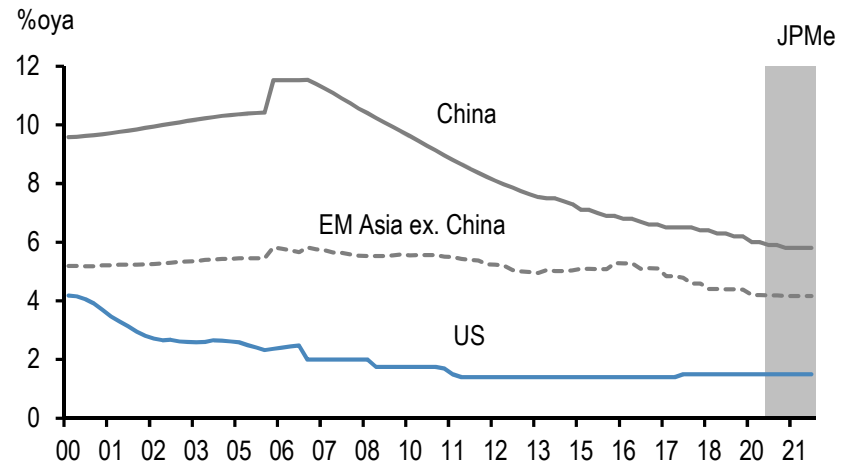
China's role in global financial market

China has surpassed EU to become second largest economy in the world



Source: J.P. Morgan.

Potential growth



Source: J.P. Morgan estimates

China's role in global economy

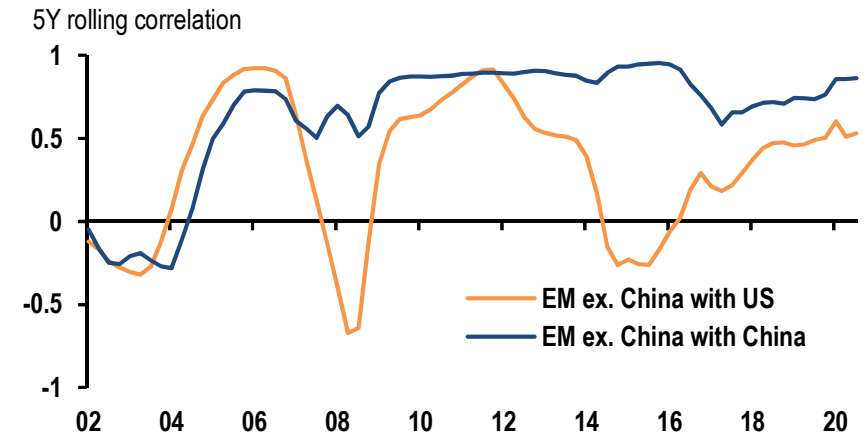
Contribution to global GDP growth: China vs. US



Source: J.P. Morgan

EM growth now more dependent on China

EM ex. China with US vs. with China

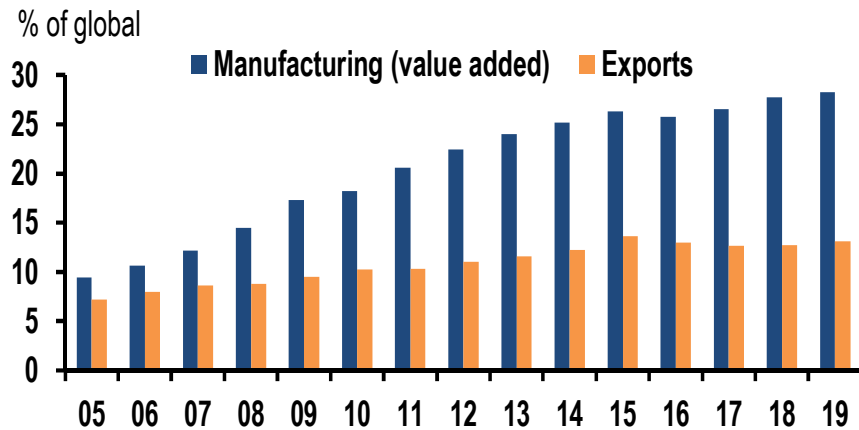


Source: Bureau of Economic Analysis, J.P.Morgan

China's role in global economy

World manufacturer and exporter

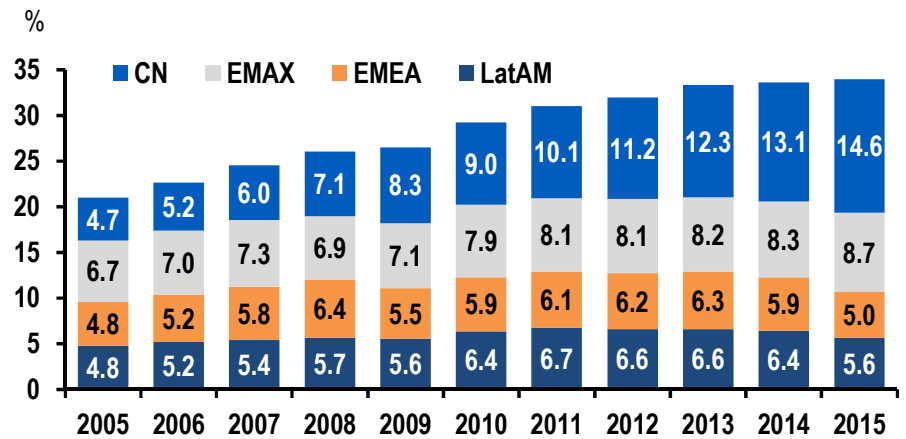
China manufacturing vs. exports



Source: World Development Indicators, J.P. Morgan

A global hub in value-added chain

Share of VA contribution to total final demand

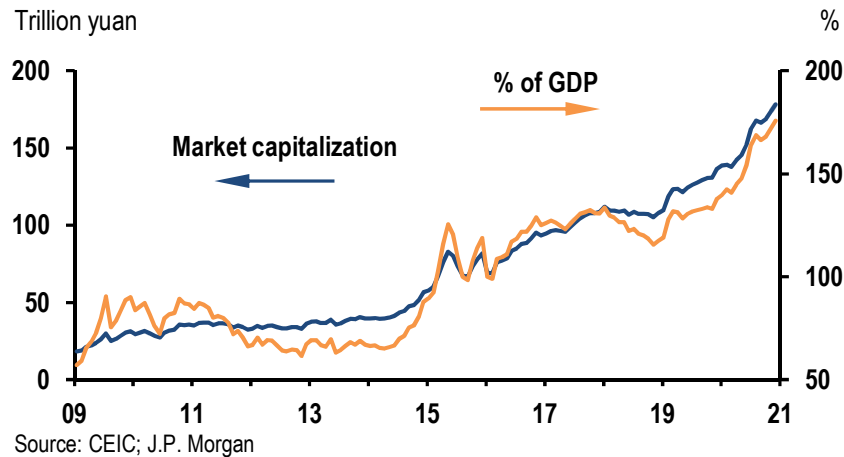


Source: OECD-TiVA, J.P. Morgan

Market capitalization of China's capital market

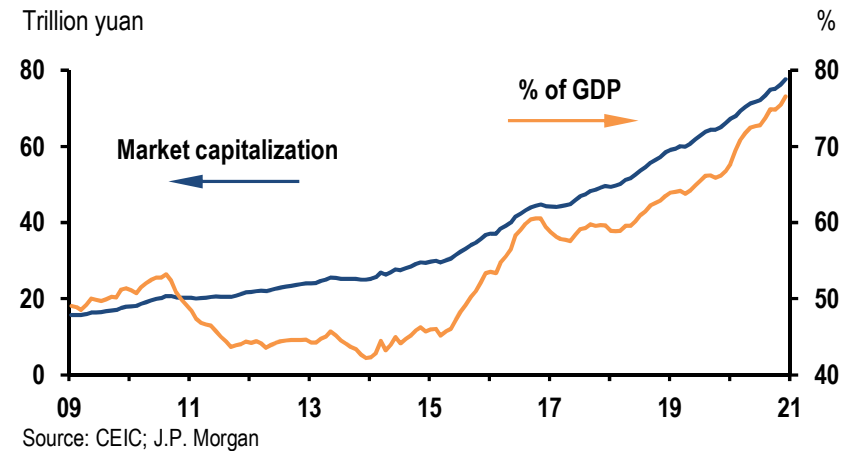
Stock market

China's stock market



Bond market

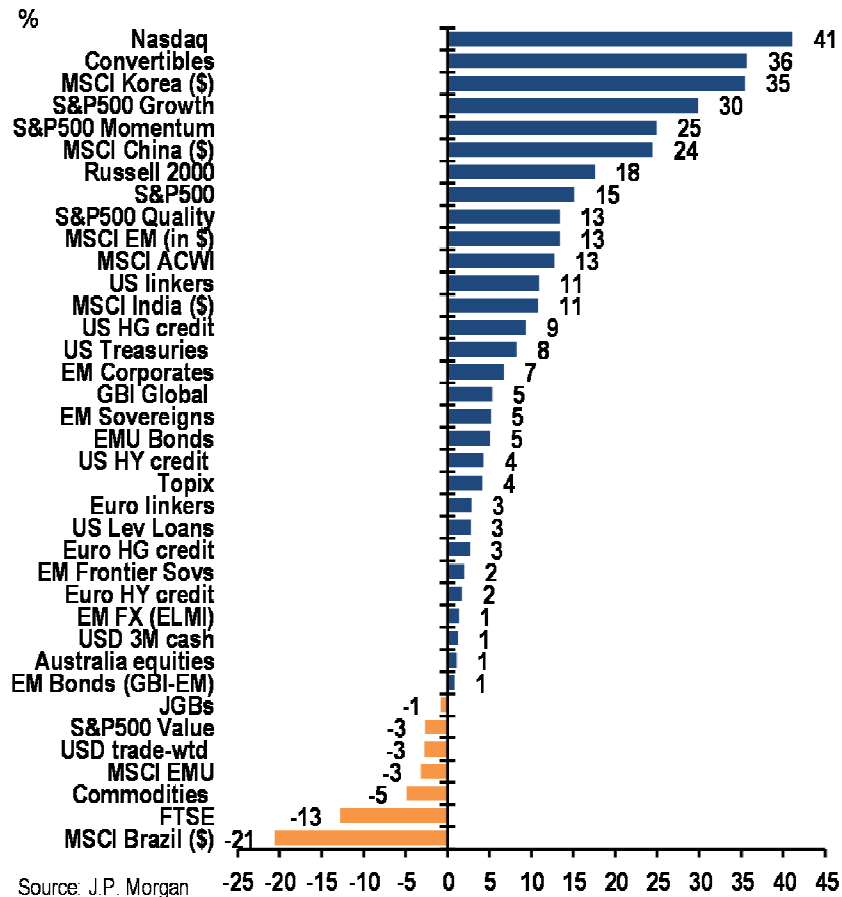
China's bond market



Attractiveness of China assets

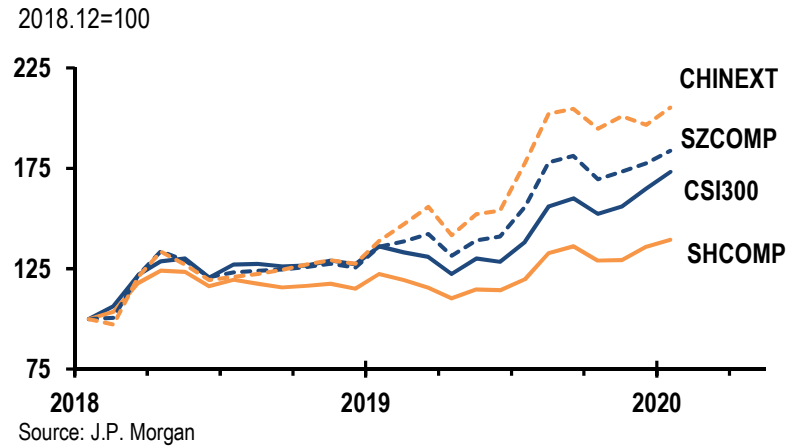
China equity performed well in 2020

Figure 1: Year-to-date returns



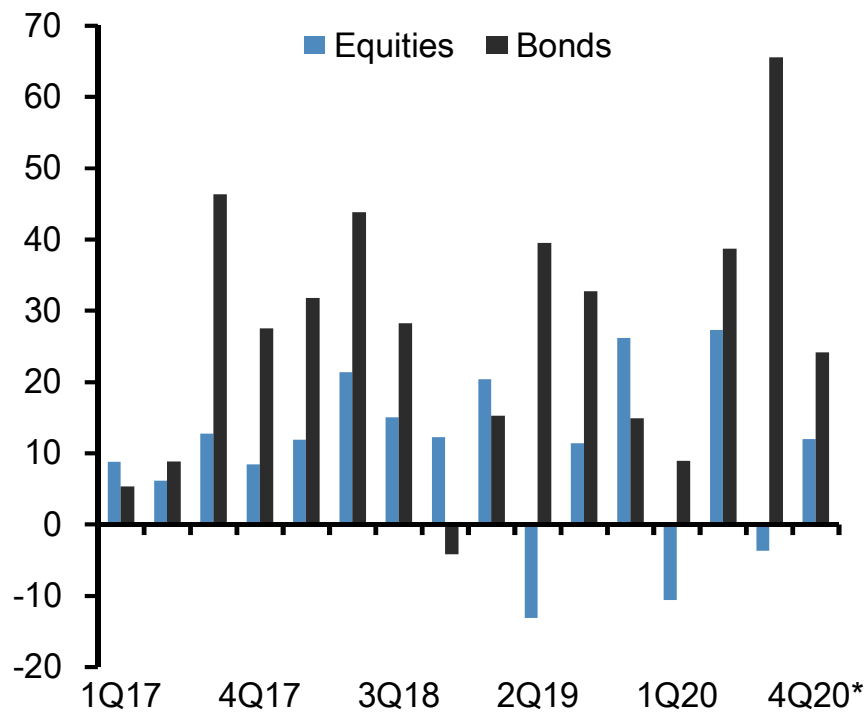
Bull market in past two years

Major China stock market indices



Inclusion of China in global indices will generate \$150-200bn of rebalancing flows

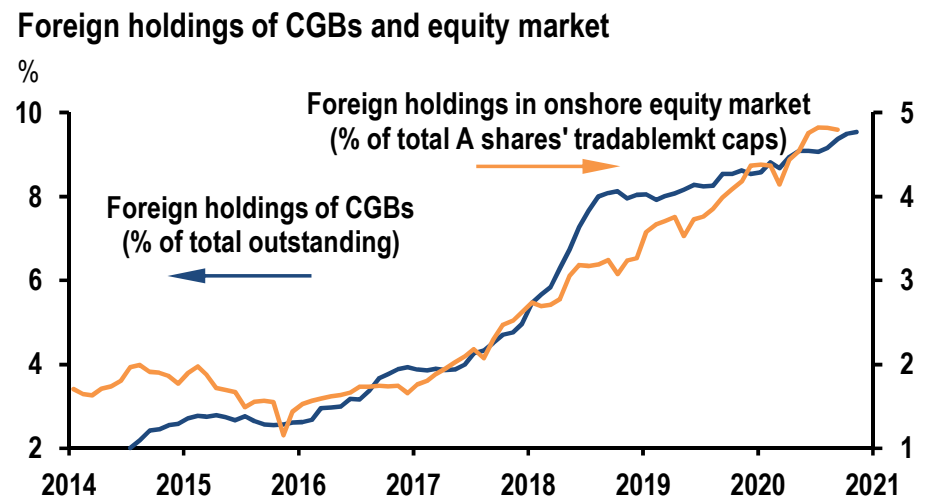
Net inflow into Chinese bonds and equities



* 3Q and 4Q proxied by Stock and Bond Connect flows, with 4Q data projected for the full quarter based on available data.

Source: PBOC, HKEX, CCDC, SHCH, J.P. Morgan

Foreign holding in onshore equity / bond markets



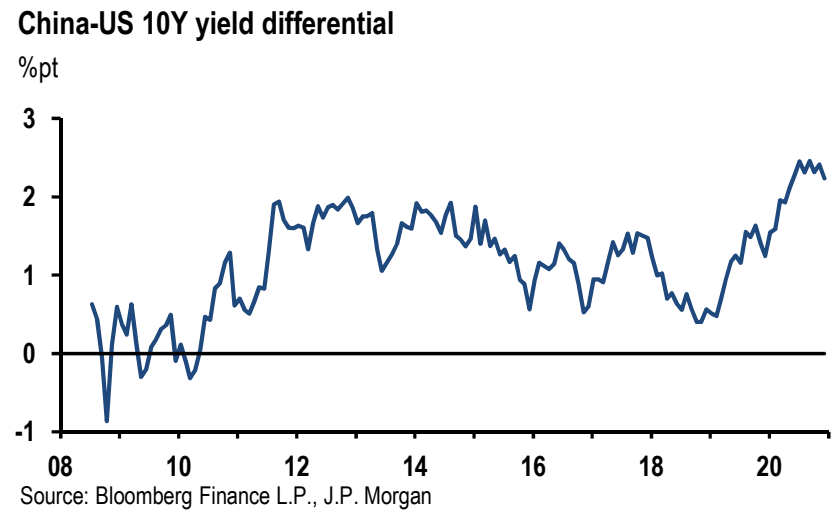
Source: People's Bank of China. J.P.Morgan

Attractiveness of China assets

US-China growth differentials



US-China interest rate differentials

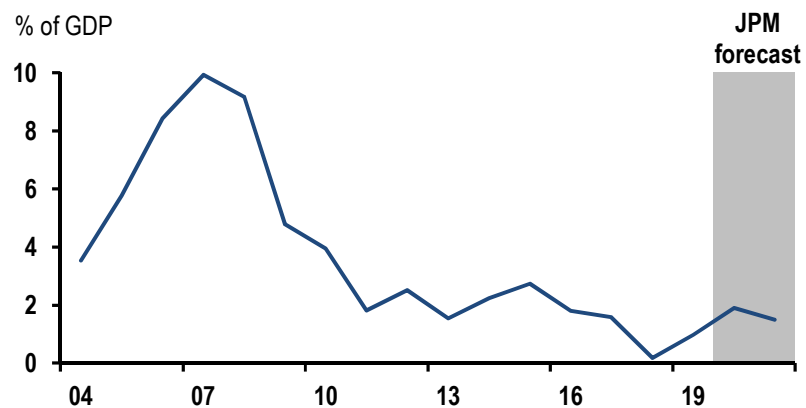


Attractiveness of China assets

China's current account surplus

China's current account balance

% of GDP

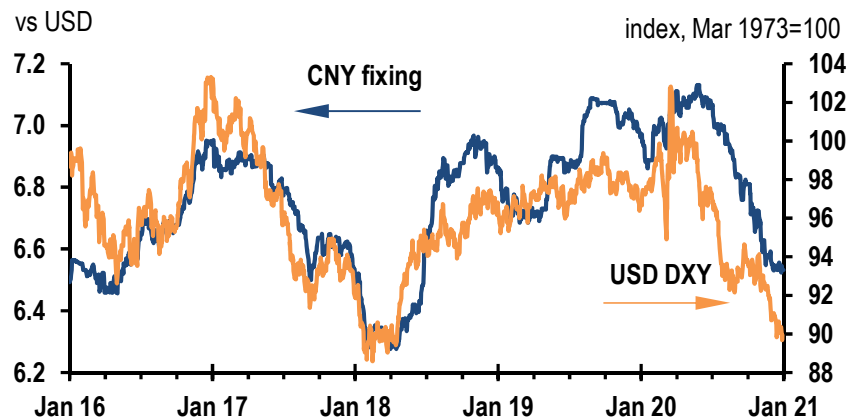


Source: SAFE, NBS, J.P. Morgan

CNY appreciation

China: CNY fixing and USD DXY

vs USD

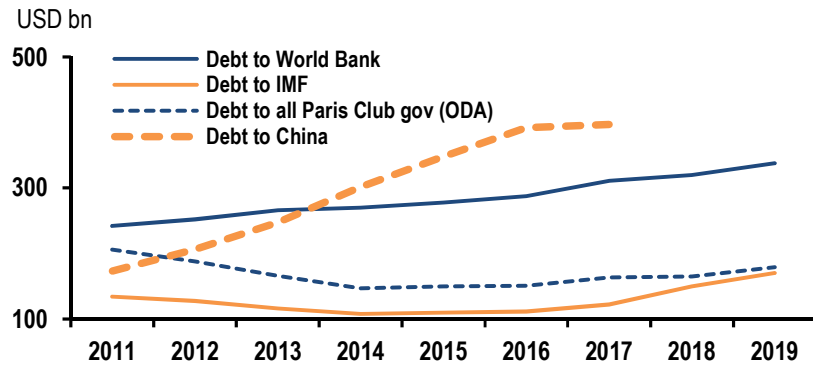


Source: Bloomberg, J.P. Morgan

China as a global creditor

China as the largest creditor to EM

External public debt owed to different official creditors to developing countries

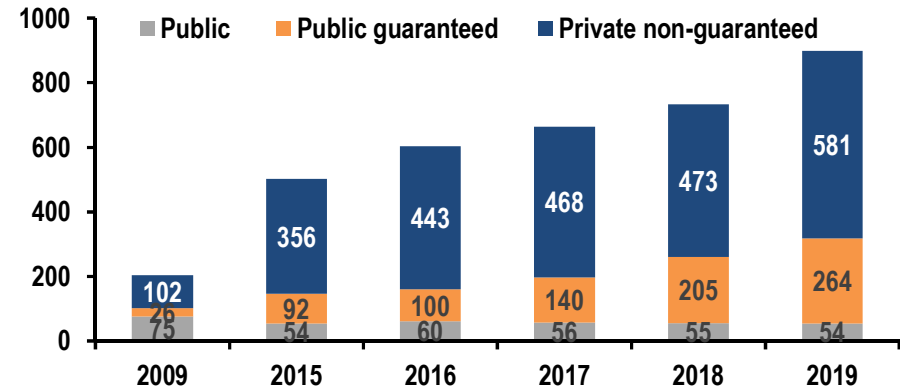


Source: World Bank IDS, Paris Club, J.P. Morgan. ODA=Official development assistance

China's external lending

China's external lending (as creditor)

US\$ bn



Source: World Bank Debt Statistics, J.P. Morgan

Conclusion

- China has surpassed EU to become the second largest economy in the world; China will catch up with the US around 2030 to become the largest economy in the world; China has also become an independent growth engine for the global economy
- Financial reform and financial openness are policy priorities, as a key element in China's structural reform
- China and EM provide a valuable asset class in a zero-yield world
- China's inclusion in global equity and bond indices gives an efficient alternative for global investors
- The notable bond inflow into China 2020 is just a beginning, not an end.
- China has also become a global creditor and an active participant in international financial architecture

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