China Macroeconomic and Market Outlook

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By special arrangement, this article is based on the views of Lirong Xu, General Manager and Chief Investment Officer of Franklin Templeton Sealand Fund Management Co., Ltd.

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Macro overview

We iterate our positive view of China economy supported by Chinese government's strong willingness and capability to underpin the economy and sustain a relatively high GDP growth from the macro perspective, and the strong motivation to expand business of enterprises from a bottom-up perspective.

GDP growth

Divergent views are held at home and abroad on China's economic growth. In our view, China's GDP growth target is likely to be at positive side:

- China's central bank remained prudent in the past 3 years compared to its global peers amid the massive liquidity injection of global central banks. In addition, though not comparable with decades ago, China remains a heathier balance sheet of government and household than global peers. Therefore, China has the resources and capability to provide support to underpin the economy from both fiscal and monetary side in the future.
- China has the most efficient top management with strongest execution compared with the past 40 years. It is undoubted that the China's government will be very proactive to shift back to boost the economy. We observed that many companies have already taken the lead to go overseas for business promotion, cooperation, and expansion. In fact, the overseas expansion of listed companies in various industries has never stopped even in the difficult time in 2022.

Infrastructure investment

Some investors expect a low single-digit growth of infrastructure construction out of concern for fiscal pressure. However, we expect a relatively high growth rate in 2023 from the perspective of liquidity support. Represented by U.S. and Europe, monetarization of fiscal deficits is widely used in the world, however China is quite restrained in using the tool. If it is really necessary, China will consider using it properly in 2023.

Consumption

As China's Covid policies are optimally adjusted, the recovery of the whole society far exceeded expectation. As such, China's economic recovery is likely to be faster and more robust.

However, we hold a relatively prudent view on consumption. Despite the probability of short-term consumption boom, the recovery of household disposable income still takes time, and the Chinese government seems unlikely to provide direct subsidies to boost consumption. Consequently, it still takes time for the recovery of consumption. Although consumption recovery is a matter of time rather than a yes-or-no question, it requires further observations for the speed and progress of recovery in the medium to long term, and we should not be overly optimistic about the consumption in the short term deluded by the short-term rebound.

China's exports

We hold a relatively neutral view:

- As a stock picker, we do have observed many listed companies we are tracking have expanded their market share thanks to increasing overseas demands resulted from their product competitiveness, cost-benefit advantages and brand awareness, etc.
- Although different drivers of China's exports in last three years, one thing in common is that the export to ASEAN are continuously increasing and has become the largest export destination of China. Looking forward to 2023, we expect China's export growth may stand at around zero or even record a very small positive growth based on our observations.

Market Overview

- Based on our on-the-ground observations as a bottom-up stock picker, there emerged more good quality names, enabling us to select those with more attractive risk-return profile in the longer term (3Yrs and above). After 40 years of rapid growth, China's economy has entered a stage of medium- to high-speed growth with volatilities decreased substantially. Most of the sub sectors have seen rising concentration with leading companies in the industry started to expand their market share in last 3 years. These companies have exhibited attractive earnings growth and valuation level compared to peers in emerging markets and developed markets. We are confident to see strong earnings growth of these companies in the upcoming years.
- From the perspective of liquidity, both the domestic household asset reallocation and overseas fund inflow of global investors will support liquidity to the China equity market. On one hand, the long-term trend of domestic household asset reallocation from real estate market to equity market has just started; on the other hand, foreign participation is still low, accounting for 4% of the total market cap of China A share market. We expect foreign participation in China A share is likely to double or more in the next few years.
- From the perspective of valuation, the current valuation level is relatively lower compared to historical average and vs. global peers. We believe now is good time to pick up good names for long term holding with good upside and limited downside.
- As a stock picker with bottom-up approach, we are confident to find more quality names with sustainable growth potentials, strong balance sheet and management team in almost every sector including old economy and traditional cyclical sectors represented by chemistry and machinery, as well as new economy including photovoltaic, new energy vehicles and Internet sectors. These companies will benefit from China's economic recovery in the next few years, and some of them have expanded their capacity and market shares against the headwinds in the past years. We believe these companies will support and lead the growth of China equity market to a more sophisticated and developed stage.
- In the medium to long term, we think the internal risks is limited. The soft landing of real estate is likely and the consumption recovery is also a matter of time rather than a yes-or-no question. The biggest challenges remain to be the geopolitical uncertainties and the ever more intensified competition between China and U.S. In our view, China and western economies will face a scenario that decoupling and recoupling coexisting in the future, while decoupling being the mainstream for high-tech represented areas and re-coupling more prevailing in financials and some other areas.

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