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Investing for a world of change

From challenges to clarity and change

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How did policymakers in China buck the global trend and what does that mean for the asset class?

Across a wide range of policy areas – spanning monetary, fiscal and even industrial policy – China's approach has been really different to what we have seen in the rest of the world, as has its response to COVID-19. This has resulted in divergent performance relative to many developed markets. China's onshore bond market in particular marches to its own beat, and that really highlights the powerful diversification benefit the asset class can bring to investors' portfolios.

What role have global events played in driving asset class performance?

In a tough year for bond markets across the world, the dominant driver has been the higher interest rates in the US as the Federal Reserve tightened monetary policy to tackle inflation. That has weighed on both the relative strength of China's currency and the performance of its US dollar-denominated offshore bond market. In contrast, domestic factors – muted growth and relatively benign inflation – have driven China's onshore bond market and that has helped to insulate that part of the asset class from major global headwinds.

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What has China's 'zero-COVID' policy meant for its economy and is it likely to change?

Lockdowns in response to COVID-19 outbreaks have put a cap on economic activity in China – weighing on the services sector, consumer spending and tourism – while keeping market sentiment weak. Given the staunch and frequent reiteration of this policy, markets have become conditioned to expect China to adhere to this position "unswervingly". That suggests that any potential softening of stance on China's COVID policy would represent a powerful signal of intent and could finally unleash animal spirits among market participants. Recent developments give cause for optimism.

Since the completion of the 20th Party Congress, we have observed a greater-than-expected divergence between the Chinese government's stated position and the actual implementation of COVID restrictions. China's leaders are travelling abroad again (including Xi's attendance at the G20 in Bali) and welcoming foreign delegations to the country. In early November, the Beijing Marathon took place for the first time since the outbreak of the pandemic. China has also reduced inbound quarantine requirements and many cities and provinces have announced further local loosening of restrictions and reductions in the frequency and intensity of testing requirements. While this is taking place against a backdrop of continued lockdowns, these have been much more targeted and shorter in duration than earlier in 2022. These tentative improvements have been well received by the markets and could potentially represent an important inflection point for China's 'zero-COVID' policy, setting the scene more constructively for 2023.

After a challenging year, what's the outlook for China's property market?

This very much depends on China's broader economic policy choices. Now that China's five-yearly Party Congress and associated change of personnel have taken place, we expect more clarity to start to emerge on this front. Given the importance of the property sector to China's economy, we expect further support measures to be forthcoming – building on what we have already seen in 2022. Supporting this view, in early November, the People's Bank of China, China Banking and Insurance Regulatory Commission, and Ministry of Housing and Urban-Rural Development jointly announced a slew of policies that sought to meaningfully improve onshore operating and financing conditions for property developers. These announcements are akin to the first tentative drops of rain after a long drought, and while a degree of scepticism among investors is understandable following such a challenging period for the most important corporate sector in China, the potential significance of this change in policy direction should not be ignored.

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While the overall tone and direction of recent policy changes are very much welcome, the success of policies in addressing challenges in the sector will depend on how swiftly and resolutely they are implemented and executed across the country in 2023. Real estate sector bond valuations have begun to react to the change in policy, but are broadly still pricing in excessively pessimistic scenarios, which we believe are now less and less likely to materialise, especially if the administration remains on this more constructive course. We think there are some fundamentally sound businesses here that will continue to operate even if challenging conditions persist. We also expect some of the more distressed firms to get back onto firmer footing in coming months and that could be a very interesting space for investors who are able to remain patient.

What are your thoughts on the US dollar and what does that mean for the renminbi?

We think the inexorable rise of the US dollar seen in 2022 will run out of steam at some point during 2023 for two reasons. First, the Federal Reserve's rate-hiking cycle is likely to come to an end during the year. Second, we think the global growth balance may well shift away from the West and towards Asia. We also see strong fundamentals underpinning the renminbi: China's trade surplus relative to Europe is double what it was pre-COVID, and relative to the US it's higher even than the level it reached during the 2018 trade tariff war. From the perspective of fundamentals, there is a lot going for the currency.

How is China reacting to climate-change risks and what does that mean for long-term investors?

While there are few if any nations that can say they are doing enough at this point, China's authorities would likely take the view that the country is making significant commitments and certainly not a laggard on climate policy. The droughts and heat waves that affected many parts of China in 2022 are only likely to harden its ambition. China sees climate change as one of the few areas where it has unchanneled opportunities for cooperation with the rest of the world, and we think it will continue to hold onto that in the years to come. This should present compelling opportunities for investors to profitably help fund the transition to net zero.

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