

China: Coming out of COVID-19

Looking at the economic outlook for 2020 just a few months ago, there's no doubt times have changed. Many investors are wondering how to navigate the supply and demand shocks derived from the coronavirus, and questioning, where do we go from here? In this article we focus on COVID-19 impact on China, and how this might trigger an acceleration in the adoption of products or behaviours that some long-term themes will benefit from.



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China appears to have been successful in domestically containing the coronavirus. Overall, cases have declined, and economic activity is resuming. The government's focus has now shifted away from containment towards economic normalisation.

Economic data: Poised to rebound?

Short-term Chinese economic data is the worst seen in modern times. Despite the dire economic data, we expect recovery to begin in the second quarter, but overall gross domestic product (GDP) growth will be below 5% for 2020.

A welcome boost is the decline in oil prices, which benefits China as a net importer (~60% of oil is imported), providing a direct stimulus to consumers, most businesses and the central government. Oil prices below US\$40/barrel (bbl) provide a government windfall, and with prices of US\$20-\$30/bbl, we would anticipate US\$20billion-US\$40billion of extra revenue.

Policy stimulus

The focus of China's leadership is now on employment rather than GDP. We expect **more policy announcements** as the government saves its ammunition.

Monetary policy has already been loosened through cuts to reserve requirement ratios, supporting liquidity and financial markets. Furthermore, the Ministry of Finance is providing interest subsidies for small and medium enterprises (SMEs). In our view, SMEs will need greater assistance given their role as primary employers in China, especially in the service sector.

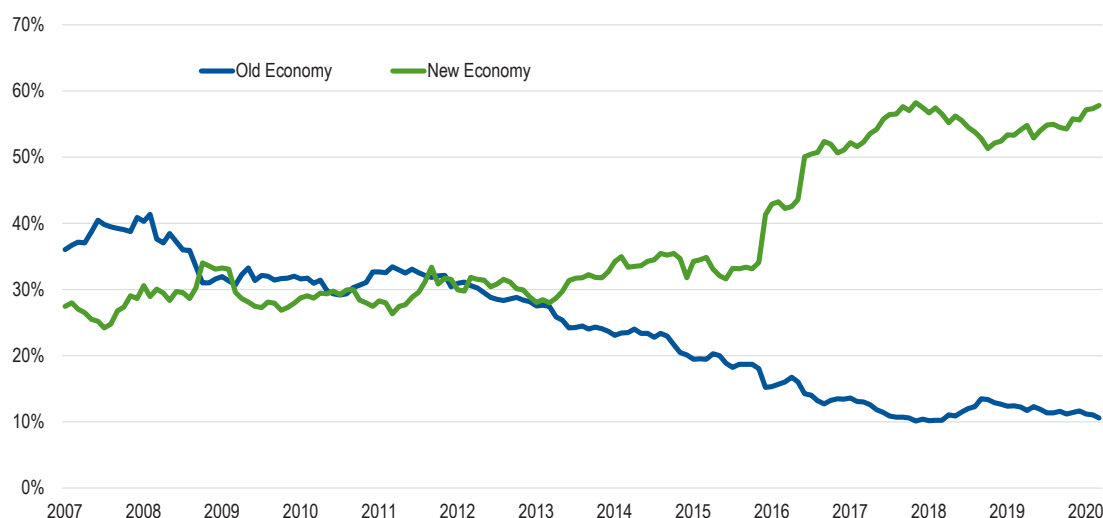
We also expect infrastructure investment to rise this year across sectors in both **"old economy"** (roads, rail, etc.) and **"new economy"** (5G, technology-related).

China: Economic Diversification

Acceleration of Change

Shrinking Old Economy, Growing New Economy

2007 - 2020



For illustrative and discussion purposes only. Past performance is not an indicator or a guarantee of future performance.

Source: FactSet, MSCI. Starting January 2007 to March 2020. As of 31 March 2020. Old Economy - Materials, Energy, Industrials; New Economy - Consumer Discretionary, Consumer Staples, IT & Communication Services

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In the property market, long-term reform remains intact while near-term flexibility is needed. Land sales are critical to local government income, construction supports job growth, and buoyant property prices boost consumption. Property developers may need financing support (or changed regulations) as they are largely restricted to shadow banking funding sources.

The Chinese government has more policy tools available, and substantially more dry powder. Thus far, China's leaders are employing a patient, data-led and targeted approach.

Domestic demand and growing new economy

The first quarter was dominated by supply chain issues within China, but we believe the second quarter will see challenges on the external demand side, driven by halting activity in the West. Revenues, net profits and market expectations will need to be revised downwards.

While near-term relocation of capacity back to China is possible, we think this will be offset by a longer-term shift of global supply chains back to the West. The Chinese economy, however, is now **primarily driven by domestic demand and companies within the new economy** (Consumer Discretionary, Con-

sumer Staples, IT & Communication Services), and we are positive on internally-orientated companies.

Across our portfolios, we are **positioned in long-term themes**, including **consumption upgrade, digitalisation, health care and technology**. We have seen remarkable examples of company resilience and adaptability. Medical equipment suppliers not only rapidly manufactured ventilators and intensive care unit equipment in response to the domestic crisis, but they are now at the forefront of supplying afflicted countries abroad. Internet and cloud computing businesses have seen massive user and data growth. In the short term, COVID-19 is accelerating the adoption of products or behaviours that some of these long-term themes, benefit from.

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