

## CIO Viewpoint

## China ups its economic ambitions

Investment Solutions

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2021 will see another shift in China's relations with the rest of the world. The globe's second-biggest economy is asserting itself with a [zero-carbon 2060 target](#), and has set out an economic goal to double the size of its economy within [15 years](#). These changes will alter the choices and opportunities available to investors.

On the face of it, China's 2035 Gross Domestic Product ambition looks unremarkable. The country's economy has expanded 6.7% a year on average since 2015, and it says that it needs an [average growth of 4.7%](#) over this decade to double. But as Michael Pettis, a finance professor at Beijing University wrote [recently](#), this is increasingly challenging as China's working population is ageing and historic growth was highly dependent on rising debt.

According to the United Nations, China's population is expected to fall by around 7% by 2035. Continued outperformance requires a massive investment-driven boom in industry and exports. That would generate an increase in debt. While GDP has doubled over the past decade, the nation's public debt-to-GDP ratio rose from 34% in 2010 to more than 63% in the third quarter of 2019, according to Institute of International Finance data. Adding the debt of households and non-financial corporates results in a surge in the debt-to-GDP ratio from 178% to 289% over the same period.

### Leading the recovery

China's experience of the COVID-19 crisis has looked significantly different from most economies outside Asia. After quickly imposing strict regional lockdowns and exiting the crisis faster than neighbours and other large economies, economic growth is expected to be 2% this year. We forecast that the country will record GDP growth of 8.4% in 2021 vs consensus expectations of 8.1%, before falling back to a level of 5.2% in 2022, which is more in line with its long-term trend growth.

That makes the Chinese economy the fastest to return to trend GDP of any major economy, even without the benefits of a widespread vaccination programme.



Stéphane Monier  
Chief Investment Officer, Lombard Odier Private Bank

### Key takeaways

- China plans to double its GDP by 2035 and targets a zero-carbon economy in four decades
- Its post-pandemic growth is outpacing other major economies and will be positive in 2020
- The nation's increasing share of the global economy justifies a stand-alone portfolio allocation
- We hold Chinese bonds, equities and a long-renminbi position.

**Important information:** Please read the important information at the end of the document.

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## Cash for COVID

The more limited impact of the COVID-19 pandemic on China's economy has made its fiscal response correspondingly less supportive than others', with measures equivalent to 4.6% of GDP, compared with 11.8% in the US, 5.5% in France and 8.5% in Germany.

In line with lower fiscal spending, the People's Bank of China (PBoC) has avoided the extraordinary monetary accommodation implemented by other central banks. A relatively stable Chinese economy suggests that policy makers will be able to keep interest rate policy on hold throughout 2021. For the Chinese economy, we believe that the key risk is a dramatic increase in corporate leverage. The PBoC should manage concerns about real estate debt levels, and any signs of imbalance in corporate credit, with targeted measures such as restrictions on property developers issuing US dollar-denominated bonds.

In addition, inflation pressures should stay limited. Food prices, which account for around one-fifth of consumer spending, should continue to decline next year. Food security in China has been a concern as pork prices rose since 2018 when the country saw an outbreak of African Swine Fever. With the disease now waning, prices are falling. In addition, prices for services, which account for more than half of the economy, should stabilise and be reflected in headline inflation numbers.

## Political stability, political tensions

Chinese President Xi Jinping has intensified his control of the Communist Party as the nation's very different experience of the COVID crisis has reinforced his position. In 2018, the National People's Congress removed the constitutional limit of two five-year presidential terms, suggesting that Mr Xi could remain in power longer than the traditional decade.

Meanwhile the country is showing less tolerance for dissent in Hong Kong and last week [jailed activists](#) for protests in 2019. In addition, tensions with the US over strategic issues and competition with American and European technology firms are intensifying.

"China poses the greatest threat to America today, and the greatest threat to democracy and freedom world-wide since World War II," wrote John Ratcliffe, the current US Director of National Intelligence last week in the [Wall Street Journal](#). "Beijing intends to dominate the US and the rest of the planet economically, militarily and technologically," he said. Although the Biden administration is expected to be more open to dialogue with China, the economic and geopolitical tensions underlying relations between the world's two superpowers will not go away.

Discussions about the source of the COVID-19 pandemic are also increasingly politicised. The World Health Organisation and The Lancet medical journal are both the investigating [origins](#) of the virus.

China's economy accounts for 16% of global GDP, according to the World Bank, and is expected to become the globe's biggest economy within a decade. Investors need to reflect its growing economic and geopolitical importance in their portfolios. Whether China's latest ambitions are strictly met matters less than the direction of its evolution.

For this reason, we consider China as a stand-alone allocation. We own Chinese bonds, which offer some diversification benefits to portfolios, as well as Chinese equities that add quality growth characteristics to our clients' portfolios and maintain a long position in the renminbi versus the US dollar.

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