A postcard from China

Will Scholes reflects on findings from a trip to China, and explores its changing trade relationships

Small talk: traffic and the weather Late September proved a beautiful time to visit China. Blue skies, and broad-leaved Chinese oaks turning in colour. No sign of the floods that swept through Beijing, Hong Kong and other cities in the region the week before and killed hundreds. And, no smog. Which was surprising, because there was no shortage of traffic.

In fact, congestion measures are some of relatively few indicators pointing up in China. Chinese households are travelling domestically, but they are sticking to their cars. Could this represent a lingering fear of the virus, which in turn is holding back consumption? After all, the official rhetoric in China was considerably more strident than in the Western world. We saw not a bit of it: offices we visited were full. And, with China leading the world on electric vehicle penetration forecast at 31 per cent of auto sales in 2023, the impact on pollution is much less.

Levelling down

At this point, it's worth acknowledging the limited view of China any visiting investor can get. Full offices tell you little about stock lying un-sold in warehouses. And tier 1 cities such as we visited do not give you a picture of prosperity in tiers 3 and 4. Seen through the lens of property prices, this comes into focus: a large real estate agency we spoke to told us that house prices were down 5-10 per cent in tier 1 cities, and down 30-40 per cent in tier 3s and below. Rogoff and Yang's research paper, A tale of tier 3 cities, puts the contribution to Chinese GDP by tier 3 and below cities at more than 60 per cent.

Here the negative wealth effect has hit hardest, not least since Chinese households are estimated to have between 70-80 per cent of their wealth tied to, or up in, property. In markets with little social security or safety net, not to mention a workforce closer to retirement than the start of their career (like China), the price to be paid is deferral of consumption as cash is stashed on deposit rather than spent, and perhaps ultimately deflation.

The re-balancing act

China's trade surplus has grown to 4.8 per cent of GDP. Stripping out commodities and looking solely at the manufacturing balance, the levels are the highest since the mid-2000s. A lot has been made of global decoupling from China, and not nearly enough of China's efforts to decouple from the rest of the world. Rising imports to the US from Vietnam and Mexico are as likely from Chinese companies with new assembly in those locations, as they are 'new' trade partners.

China's trade with developed nations is now less than its trade with the emerging world. This was not the case just a few years ago. Emerging markets are less likely to complain of one-sided trade, which is useful when your relationship with the US and Europe has soured. All the while, China works tirelessly to replace imported goods with its own.

This policy approach is one cog in a global movement toward more regionalised economic centres. But, the protagonists – China and the US – are too big for that scenario to play out in full. Trade imbalances will continue to come to a head. Squaring that circle, we return to China's lack of consumer economy. Households need to feel that the economy is improving, job prospects are sound, and that the stores of value available to them – principally property – are underpinned. Without social security, or bold fiscal policy to reorient the economy, this is a tall order.

But, while the risks are high, in China's closed financial system the stock of unfinished housing can be cleared eventually, developer debts can probably be restructured and still more infrastructure can be built to sustain growth. China will do so from a position of economic resilience, with high cash reserves and buoyant exports. The cost will be economic value, and above all, time.

Written by Premier Miton emerging markets sustainable fund manager, Will Scholes

In association with

Premier Miton INVESTORS