Update China – before, during and after COVID-19

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Before COVID-19

The moment the US started labelling China an enemy it became clear to the West that China was no longer an emerging market like many others but the most powerful competitor for world power. China was no longer seen as an attractive growth opportunity but rather as a threat to US supremacy and liberal-democratic ways of life. The US started attempts to subdue China and launched a trade war which found a tentative end in the January 2020 armistice called phase 1 agreement. Back in 2012, already under a previous administration, China embarked on its pivot away from being the low-cost manufacturer for the entire world to emphasizing the growth of local consumption. Xi Jinping proceeded to lay out China's plans for a prosperous and harmonious society based not on ideals imposed by the old colonisers but on China's own long and rich heritage. Rapid quantitative growth was traded for slower qualitative growth. In 2019, China's economy grew by around 6 percent, still markedly higher than the economies of the US and the EU which grew slightly above 2 percent and around 1 percent respectively. Facing increasing animosity from the West, China's resolve to develop all missing technological building blocks by themselves has strengthened. Last year, China's stock market performed well, albeit not as exuberantly as the markets in the West given China's more prudent stance on interest rates and other financial policies. Even though China is now the second largest economy in the world, its per capita GDP barely reached USD 10'000 last year, while the US's stood at USD 67'000. There remains a huge gap in this measure and China has the self-confidence, the plan, the institutions, the will and the people to close it over time.

During COVID-19

What started in the centrally located Chinese city of Wuhan has developed into a global pandemic under the name Covid-19 which has struck fear into all corners of the world and brought great suffering and death to many people. Unchecked the virus spreads easily and fast as the carrier can be contagious without experiencing symptoms of the disease and the observed transmission rates are high. In order to protect the healthcare systems from collapse and to gain time to learn and find remedies the spreading must be slowed. Disruption of economic and social life on an unprecedented scale becomes reality. Experience gained from a growing number of different countries seems to indicate that the earlier and the harsher shutdown measures are enforced the shorter is the duration required to bring down the transmission rate to a tolerable level. Readiness to react, comprehensive gathering and management of data, as well as discipline seem to be crucial in the effort to keep a lockdown short. A long lockdown raises the spectre of economic collapse. After a short period of initial hesitation China shut down the Wuhan area decisively other parts of the country selectively and ramped up testing, treatment facility as well as monitoring capabilities at great speed. In the process the transmission rate fell far below 1 enabling China to reopen its factories and gradually also its retail facilities towards the end of March. How effectively other parts of the world including Europe and the US will be able to respond remains to be seen. For the Chinese economy UBS estimates a contraction of 5 percent in the first quarter of 2020 compared to the same period last year. However, for the full year 2020 they expect China to grow by around 1 percent. The Economist Intelligence Unit (EIU) is more pessimistic for the world at large and forecasts a global recession. They see the global economy and the US economy contract by 2.2 percent and 2.8 percent respectively in 2020..

After COVID-19

While this disruption is and will be harsh for many people and will be remembered for a very long time, shocks tend to trigger progress. Governments are committed to soften the blow with whatever means they have, and people adjust and develop new patterns of behaviour thus creating new markets and opportunities. China is in a relatively good position to act. It has strong external reserves and a range of options thanks to its comparatively tight monetary policy and direct control over its huge policy banks. It also has the benefit of its experience with a sizeable stimulus package put in place in reaction to the global financial crisis of 2008. Unintended side-effects such as high-level corruption and malinvestments proved to be a drag for many subsequent years. The currently planned program will be smaller and more finely tuned. Instead of road and railroad infrastructure which were accelerated then, areas such as education and 5G deployment are favoured now. By contrast, conventional policy tools look exhausted in many Western countries as interest rates are at zero and budget deficits high. They will have to turn to free money, also known as helicopter money. The side-effects of such measures are currently unknown. However, it seems certain that our liberal democracies and capitalism as we knew it will be seriously tested. Carefully selected equities will remain the most attractive asset class under any scenario. The world simply cannot provide for what is needed and desired without relatively free enterprises. Attempts to time the market will remain futile as fear is a bad adviser and the market will anticipate any recovery. However, it may be a good time to review one's asset allocation and recognize China for what it will be. It is no longer an emerging market at deserves its own allocation in any well diversified portfolio. It is unwise to see China as an enemy for no good reason and much more advisable to remain curious about the Chinese perspective and to participate in the rise of this nation in a reasonable way.

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