JOHCM Funds

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Emerging Markets Spotlight

The Chinese economy remains weak but May and June have seen improving data and growing evidence of fiscal and monetary policy support. Data in July and August will be crucial to ascertain whether policymakers can reverse a slowdown that is largely of their own making.

First the good news: credit growth grew by more than expected in May. New social financing was 2.8tn Renminbi (RMB) for May, with growth in balances outstanding improving to 10.5% YoY from 10.2% in April. New RMB loans were RMB 1.8tn, again showing acceleration, with growth of 11.0%% YoY from 10.9% in April. In the credit growth mix, government borrowing was the key driver. Government bond issuance was RMB 1.06tn in May, two-thirds of which were local government bonds. Corporate short-term loans increased by RMB 264bn in May and corporate bills financing increased by RMB 713bn. Together, these reflect both increasing fiscal stimulus and growing private sector confidence in the economic outlook.

May and June also saw more signs of direct economic intervention by policymakers: the People's Bank of China and the banking regulator have repeatedly called for a stabilization in growth and encouraged financial institutions to boost lending. PBoC Deputy Governor Chen Yulu has said that stabilizing economic growth is a top priority and that the central bank will support the weakest sectors, and PBoC Governor Yi Gang met with major financial institutions and called on them to accelerate the delivery of approved loans and to maintain growth in property loans.

There is more good news in terms of some high-frequency indicators: passenger volume in the metro systems of most major cities has recovered to levels seen before the most recent Covid-19 wave. Air travel passenger numbers have also recovered, although not quite to the levels seen before the recent wave. In late June it was about 20% lower, compared to 80% lower in April. Cinema audiences have also bounced back, with 2.5 million visits per day in the last week of June. These activity recoveries have driven improved sentiment in service sectors. Services PMI was 54.3 in June, well into expansionary levels and higher than manufacturing PMI.

Secondly, though, the bad news: in the credit data, household long-term loans continued to decrease, reflecting the ongoing deep contraction in residential property sales. In major cities, home sales contracted by 48% YoY in May, having been down 54% YoY in April. June may have seen some recovery, on the back of significant policy support for the sector: the PBoC has cut mortgage rates by about 60bps and local governments have applied various measures to boost the sector. The June recovery does not yet look like more than the completion of delayed transactions and is nowhere near the bounce-back recovery we saw in mid-2020. Construction starts also remain weak. The consumer also looks in poor shape – retail sales in May were -6.7% YoY (better than -11.1% YoY in April).

With the Chinese government having got on top of this most recent wave, some recovery is evident. However, to turn more positive, we need to see either much more assertive fiscal and monetary policy driving growth, or a strong recovery in the property sector, or the kinds of vaccination coverage that will allow China to move on from its current zero-Covid policies. We continue to monitor Chinese data closely, looking for signs of a further positive shift, but in its absence, we remain underweight Chinese equities and defensively positioned within our Chinese sub-portfolio.

Source for all data JOHCM/Bloomberg (unless otherwise stated)

RISK CONSIDERATIONS:

The Fund invests in international and emerging markets. International investments involve special risks, including currency fluctuation, lower liquidity, different accounting methods and economic and political systems, and higher transaction costs. These risks typically are greater in emerging markets. Such risks include new and rapidly changing political and economic structures, which may cause instability; underdeveloped securities markets; and higher likelihood of high levels of inflation, deflation or currency devaluations.