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There are already signs economic powerhouse China is set for further strong growth

## Chinese dragon unlikely to slay global recovery



Russ Mould

**F**und management legend John Templeton always argued what he termed the four most expensive words in investment were 'It's different this time.' In 2011 the global economy has shown signs of deceleration and bears have seized upon the data to argue a highly unusual double-dip is upon us.

I am more inclined to see the current soft patch as just that, a mid-cycle slowdown at a time of rising inflation. This pattern has characterised most upswings, so it is hardly abnormal. To extrapolate from the current weakness could therefore be misleading and investors will be better served by focusing on the future. The key is to assess what could go right or wrong from here on in. And, given its official status as the world's second largest economy, China has a major part to play in this regard. China will go a long way to determining whether the global upcycle holds firm or fades and gives way to a double-dip recession.

### Look East

The Chinese authorities are fighting their own battle against inflation. A fierce round of monetary tightening has prompted fears of policy error and excessive rigour leading to a hard economic landing. *Shares* finds it hard to believe

such blunders will be perpetrated and believes instead China is doing a pretty good job at managing rapid growth while seeking to check rampant price rises.

We certainly do not believe in a sudden collapse in the Chinese economy. On the contrary, any re-acceleration in momentum in the second half could provide some interesting investment opportunities. Some of our preferred London-listed China plays include food and healthcare counter **Hutchison China Meditech (HCM:AIM)** and orange grower **Asian Citrus (ACHL:AIM)**. China continues to suffer power problems which should support energy prices to the benefit of oil major **BP (BP)** and also serial Mongolian investor **Origo Partners (OPP:AIM)**, which has stakes in several miners.

The picture in China is a complicated

one. The Shanghai Composite slid to a six-month low last week (see chart above) at a time when inflation stood at a two-year high of 5.5%, according to May's consumer price index reading. The People's Bank of China has already hiked one-year borrowing rates four times since October, to 6.31%. It has also increased banks' required ratio reserve five times this year, to a record high of 21% in an attempt to cool credit growth. Consensus calls for two more 25 basis point rate hikes before year end. The frequent moves to mop up liquidity are causing some economists to worry China is overdoing it and running the risk of a quite real economic slowdown.

The picture is further clouded as some provinces are suffering power shortages, to the detriment of production output in

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steel, iron and cement. A buffer of inventory should help see China through but second-quarter economic growth rates are likely to be lower than those of the first. This is especially so as fuel prices

remain elevated and the country is a net importer of more than five million barrels of oil a day.

#### Final frontier

Thankfully, *Shares* saw a lot of this coming. In our last detailed look at emerging markets (see *Cover, Shares*, 3 Mar) we warned fears of a loss of economic momentum would harm the performance of commodity importers relative to commodity exporters. Our thesis was emerging (EM) and frontier equity markets (FMs) would perform poorly relative to developed (DM) ones. So it has proved and the graphic shows how the less mature arenas have lagged markedly this year (see chart left). Yet the trend has become less marked on a month-by-month basis and the signs of life within frontier markets have offered some encouragement.

EM and FM central banks have been quicker to move on inflation than their Western counterparts. The Bank of England and US Federal Reserve have still yet to budge. A willingness to act early could mean we are near to the end of the rate-tightening cycle in emerging and frontier markets. A cessation of hikes in the cost of borrowing and stable (if still elevated) fuel prices could see EM and FM economic growth re-accelerate ahead of that of the DMs, to the benefit of their stock markets, too.

There are also signs it could be dangerous to downplay growth even in the short term. I am indebted to my former colleagues at UBS investment bank for pointing out how some May data from China looks particularly encouraging. A headline 13.3% year-on-year advance in industrial production beat consensus

forecasts, while fixed asset purchases soared 27% and even real estate investment surged 20%. That final point is particularly telling as fears of a property crash are central to the bear case on China. A few more good months like that and concerns over China should start to fade and give a timely boost to hopes for a resumption in the global economy's momentum once the summer lull is behind us.

