Why the recovery in China does not mean higher inflation

May 2, 2023

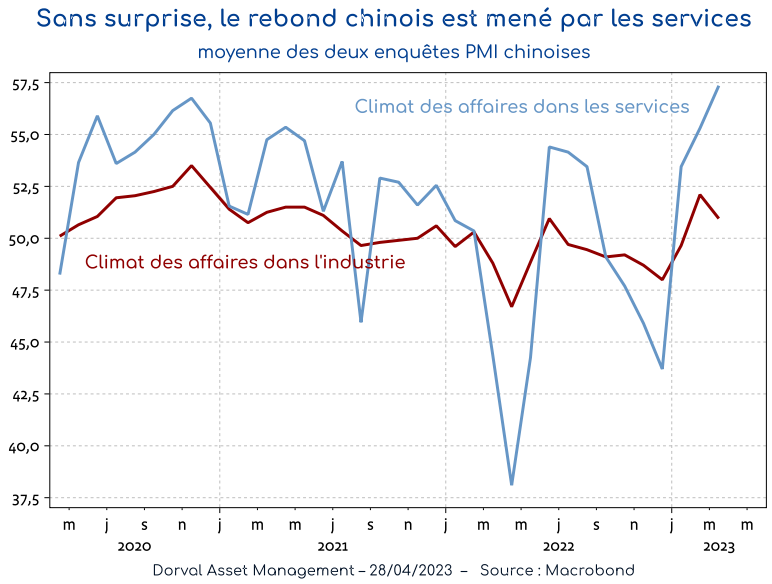
Dear Clients and Partners,

At present, all the signs point towards Chinese growth nearly doubling this year thanks to the reopening of its economy. The impact of this recovery on inflation in China and worldwide is nowhere near as bad as many investors have feared.

Unsurprisingly, the abrupt end of China's zero-COVID policy means that its economy is experiencing rapid renewed growth, primarily in the services sector (cf. chart 1). While manufacturing is almost at pre-COVID levels, the services sector, which accounts for just over 50% of the total value added, has potential to gain at least another 10%. The reopening of the economy is allied to monetary support that appears to be having its primary desired effect of stabilising the real estate sector after a two-year slump. The PBOC's most recent survey of banks also revealed considerable renewed demand for credit. As a result, the average of economists' growth forecasts for 2023 continues to rise, reaching +5.5% in April according to Bloomberg, versus +4.8% at the start of the year. We can now foresee growth of +6%, compared with +3% last year.

Services unsurprisingly driving the Chinese recovery

Average of the two Chinese PMI surveys



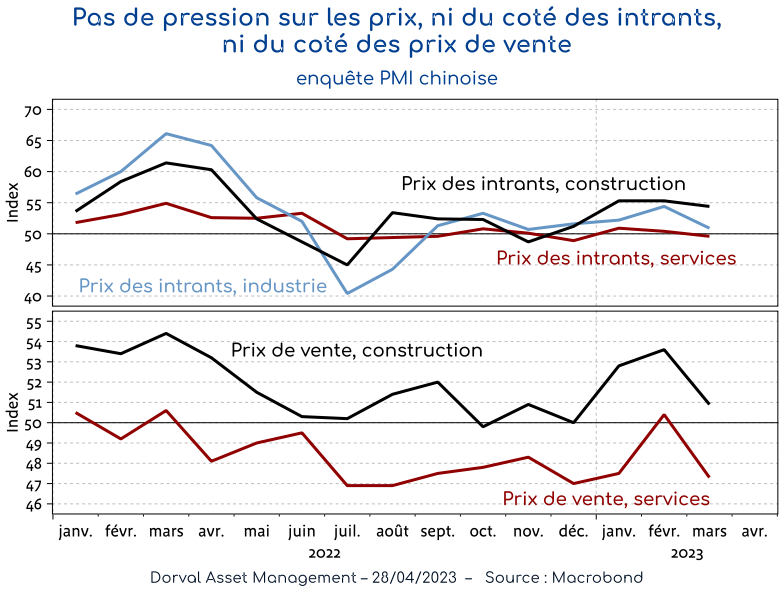
Dorval Asset Management – 28/04/2023 – Source : Macrobond

- *Business conditions in services / Business conditions in manufacturing*

Based on what happened in other countries in 2022, we could reasonably have expected this recovery to be accompanied by upward pressure on prices and salaries. Given China's considerable consumption of them, there were also fears that global commodity

prices would rise. However, business surveys indicate that this has not happened (cf. chart 2). There has been no considerable increase in input prices in any of three main sectors of business, and sales prices remain reasonable, including in services.

No price pressure on either inputs or sales
Chinese PMI survey

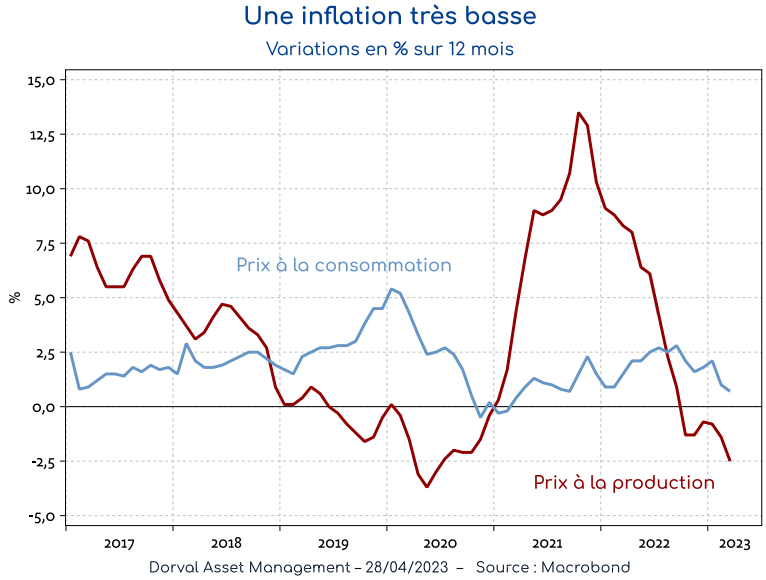


Dorval Asset Management – 28/04/2023 – Source : Macrobond

- *Price of inputs, construction / Price of inputs, manufacturing / Price of sales, services*
- *Jan. / Feb. / Mar. / Apr. / May / Jun. / Jul. / Aug. / Sep. / Oct. / Nov. / Dec. / Jan. / Feb. / Mar. / Apr.*

Price indexes have continued to slow in recent months, with production prices (PPI) dropping by 2.5% year on year in March and consumer price inflation amounting to just +0.7% (cf. chart 3). Lastly, global prices of industrial raw materials, of which China is the largest consumer, have so far barely reacted to the reopening of the Chinese economy.

Very low inflation
% change over 12 months



Dorval Asset Management – 28/04/2023 – Source : Macrobond

- *Consumer prices / Production prices*

Since it is being driven by services, the Chinese recovery is far less dependent on commodities than during previous periods of renewed growth (2009, 2012, 2016). Moreover, this recovery comes at a time when global production chains have essentially returned to normal and the effects of the war in Ukraine have been largely absorbed.

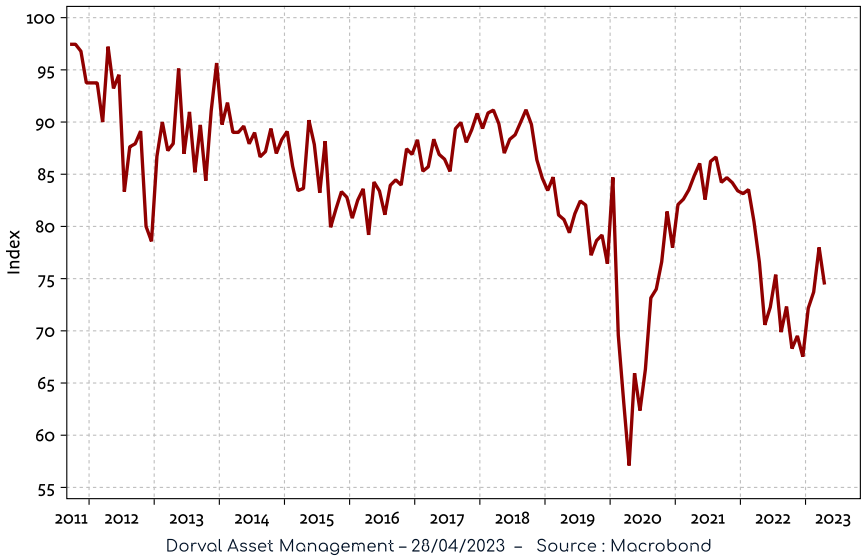
There is, however, a third key element at play: the jobs market. Although there is a lack of credible data, particularly regarding unemployment, it would appear as though China is not experiencing the same labour supply problems as many Western economies. Indeed, some surveys indicate that in spite of a recovery in the first quarter of 2023, higher salary costs remain far less likely than during the 2011–2019 period (cf. chart 4). For this reason, China is far removed from the recruitment problems facing many developed countries.

No overheating on the jobs market

Cheung Kong Graduate School of Business (CKGSB) survey on the six-month outlook for labour costs – diffusion index

Pas de surchauffe sur le marché du travail

Cheung Kong Graduate School of Business (CKGSB), enquête sur les perspectives à six mois pour le coût du travail - indice de diffusion



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As we can see, the news coming out of the Chinese economy is encouraging. It is in recovery without producing inflation, which is positive for sustainable growth both in China and worldwide. This also means that there is still scope for the authorities to support the economy if needed.

In our international portfolios, we do not invest directly in China, but there is a very significant weighting of developed-market equities from the Asia-Pacific area (Japan, Australia, South Korea, Hong Kong, Taiwan and Singapore), which are partially reliant on Chinese growth. As a result of our equal-weighting strategy, these markets account for 24% of the equity pocket, versus less than 10% for the traditional MSCI World Index.

Our exposure rates are as follows:

- Dorval Convictions: The equity exposure rate is 56%.

DORVAL ASSET MANAGEMENT

Public limited company with share capital of €303,025 Paris Trade and Companies
Register No. B 391392768 - APE 6630 Z - AMF accreditation no. GP 93-08
Registered office: 1 rue de Gramont - 75002 Paris
Tel +33 1 44 69 90 44 - Fax +33 1 42 94 18 37
www.dorval-am.com

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