

WHAT'S NEXT FOR CHINESE MARKETS?

WisdomTree ETFs
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Despite Q1's 6.9% growth rate in China, the 2017 target is 6.5%, a touch lower than the 6.7% GDP growth achieved in 2016. With these lower projections, should investors still be optimistic? Vania Pang of ICBC Credit Suisse Asset Management (International) Company Limited's Capital Markets and Investment Solutions, Index and Quantitative Investment team weighed in.

Pang: The softening growth target together with the goal of maintaining stability reflect the government's intention to rebalance the economy from credit-fueled growth to a more sustainable growth path.

Instead of pumping up economic activities by increasing credit supply, continuing structural reforms and expansionary [fiscal policy](#) are deployed. Encouraging improvement in [PMI](#) and [PPI](#) were found since Q4 2016 as a result of the structural reforms launched in 2015. Industrial enterprises' profits and revenue picked up significantly in January and February 2017, with 31.5% and 13.9% growth year over year, respectively. Both the profit margin and [return on assets \(ROA\)](#) grew while the [debt-to-asset ratio](#) lowered to 56.2% (2016: 56.8%).¹ Other policies such as "One Belt, One Road" and the recently announced Xiongan Special Economic Zone could boost the investment and demand in infrastructure, energy, construction and property in the medium term.

The [M2](#) and total social financing growth target are also at levels below that of 2016. What's your take on these numbers?

Pang: The total debt of China exceeds 250% of gross domestic product (GDP), which posed a threat to the financial system. Excessive borrowing could be curbed by lowering the M2 and social financial growth target. It is a clear step forward for risk control.

Controlling financial risks was set as the priority in the Central Economic Work Conference in December 2016. A "neutral and prudent" [monetary policy](#) is implemented to contain risk, deleverage and to deflate bubbles. The [PBoC](#) raised the medium-term lending facility and seven-day [reverse repo](#) for the third time in three months since the beginning of 2017.

The central bank has been cautious in managing [liquidity](#) through reducing money supply and adjusting the [short-term rates](#) instead of the benchmark rate in order to avoid adding burden to [corporates](#) with higher borrowing cost.

A lot has been said about upgrading the real economy through innovation. What does that mean and where will those impacts be felt most?

Pang: It means providing long-term support for [R&D](#), building infrastructure for science and technology and commercialization of new technology. Development of emerging industries such as artificial intelligence, new materials and new energy will also be accelerated this year.

Financial support is crucial in making the technological innovation and upgrading happen. On March 28, the PBoC said China will support the insurance companies to expand their scope to provide more low-cost and long-term funds for the manufacturers to upgrade. Furthermore, the government will provide monetary credit policy support for manufacturers

to modernize and expand overseas.²

The plan of upgrading China's manufacturing sector was first proposed by Premier Li Keqiang in 2015, known as "Made in China 2025." The country plans to develop smart manufacturing and build homegrown brands with both design and production capabilities that could compete against international rivals. The trend of increasing the application of information technology and automation would impact the manufacturing sector most and foster its evolution.

Looking at the next several months, what are some of the key events and risks that could potentially influence the markets?

Pang: China will host the first Belt and Road Summit in Beijing in May 2017. The Belt and Road initiative aims to achieve connectivity and economic integration to promote growth in the region. The interaction with other countries and takeaways from the summit are important in understanding China's influence on the world stage and what opportunities the initiative could bring to China.

In November, the 19th Party Congress will be held where a significant leadership reshuffle will occur, including major changes to the composition of the Politburo Standing Committee (PSC). The president and the new PSC may reassess the current development strategy and announce new policy direction. Attention should be paid on how the transition of power and new policy direction may impact the political and economic environment of China.

¹Source: National Bureau of Statistics of China, as of 3/28/17.

²Source: "China expands insurers' funding role in manufacturing sector upgrades," Reuters, 3/28/17.

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DEFINITIONS

Fiscal Policy : Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.

Purchasing Managers' Index (PMI) : An indicator of the economic health of the manufacturing sector. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. A reading above 50 indicates an expansion of the manufacturing sector compared to the previous month; below 50 represents a contraction while 50 indicates no change.

Producer Price Index : weighted index of prices measured at the wholesale, or producer level.

Return on assets (ROA) : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

Debt-to-Asset Ratio : a leverage ratio that defines the total amount of debt relative to assets.

M2 money supply : Contains all funds deposited in checking accounts as well as funds deposited in savings accounts and certificates of deposit. There are various ways to measure the money supply of an economy. This one is meant to broadly account for the majority of savings and checking accounts held by individuals and businesses across the economic landscape.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Reverse Repo Rate : Reverse repo rate is the rate of interest that banks get when they keep their surplus money with the RBI.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

Short-term rates : the rate of interest on a debt instrument maturing in two years or less.

Corporate Credit : compensation associated with the risk of lending to a corporation.

Research and development (R&D) : the investigative activities a business conducts to improve existing products and procedures or to lead to the development of new products and procedures.