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**We expect China's economy to benefit from five major key trends in the coming decade that could generate potential investment opportunities. These are:**

## **1) Digitalization and artificial intelligence (AI)**

China has put dedicated efforts into developing its digital infrastructure in the last few years and this has started to bear fruit. For example, China's mobile payment adoption is among the highest in the world at close to 90%.<sup>i</sup> China's advanced digital infrastructure is well-positioned to benefit from next-generation technology, which includes automation, new materials, Blockchain, the Internet of Things, and 5G network. AI has become a major trend in technology and is increasing with a CAGR of 37% globally.<sup>ii</sup> We believe China is one of the key beneficiaries and expect that Generative Pre-trained Transformers (GPT) and AI technology will bring new opportunities to the technology, financial, consumer and industrial sectors, and improve efficiency.

## **2) Green energy transition leadership**

China has committed to achieving carbon neutrality by 2060, with an interim target to reach peak CO2 emissions peak before 2030. As part of this commitment, green infrastructure has been established including solar farms, industrial parks, and supply chain management firms. We believe this is a great opportunity to drive significant investment in green technology, infrastructure, and enablers. Specifically, we see potential in developing electric vehicles (EVs) and the EV supply chain, particularly given China's significant EV sales growth in the past few years. Moreover, renewable energy development is accelerating in China and we believe a higher level of wind and solar energy adoption will play a vital role in energy transition and strengthen the country's leadership in the renewable energy deployment space going forward.

## **3) New consumption patterns**

The consumption patterns of Chinese people have been evolving. Domestic brands have been gaining market share and the luxury goods sector has been flourishing. In particular local sportswear brands have been growing quickly and gathering momentum. We are seeing domestic brands adapt to local consumer preferences and tastes by incorporating aspects of Chinese culture into the products they are selling. As of March 2023, luxury product sales such as jewelry sales surged to more than three times that of the year prior given the rebound in overall retail sales.<sup>iii</sup>

## **4) China's localization expected to speed up in coming years**

We expect localization to rapidly speed up in the coming years. This is evident across several industries including automation, robotics, and solar equipment. We believe localization will benefit the consumer technology and industrials sector in enabling China to become self-sufficient in areas such as automation and chip manufacturing which in turn will create new investment opportunities.

We are also seeing localization being adopted in domestic consumption such as in coffee chains for example. This is because most of the value chain, from product ideas to creation, delivery, as well as packaging and marketing are conducted within China. Coffee has high penetration in major cities in the country at 67%<sup>iv</sup>, demonstrating the growing potential for localized coffee production.

## **5) Healthcare and the rise of the 'grey' economy**

China's population, like that of the rest of the world, is getting older. The number of Chinese people aged over 80 is expected to rise to around 159 million by 2050, creating strong healthcare and pharmaceutical demand.<sup>v</sup> Given these healthcare needs, we expect to see growing demand for specialty hospitals, medical devices, and equipment and medical supplies, particularly single use supplies. We believe the rise of the 'grey' economy will also create new opportunities outside of the healthcare sector. For example, increasing demand for insurance that covers health protection and medical care, and presenting opportunities for entertainment and tourism sectors which look to meet the spiritual, relaxation, and mental health needs of the elderly. We expect these sectors to present attractive investment opportunities in the future.

<sup>i</sup> businessofapps, January 2023

<sup>ii</sup> Morgan Stanley Research, May 2023

<sup>iii</sup> New York Times, May 2023

<sup>iv</sup> Deloitte, April 2021

<sup>v</sup> SCMP, March 2023

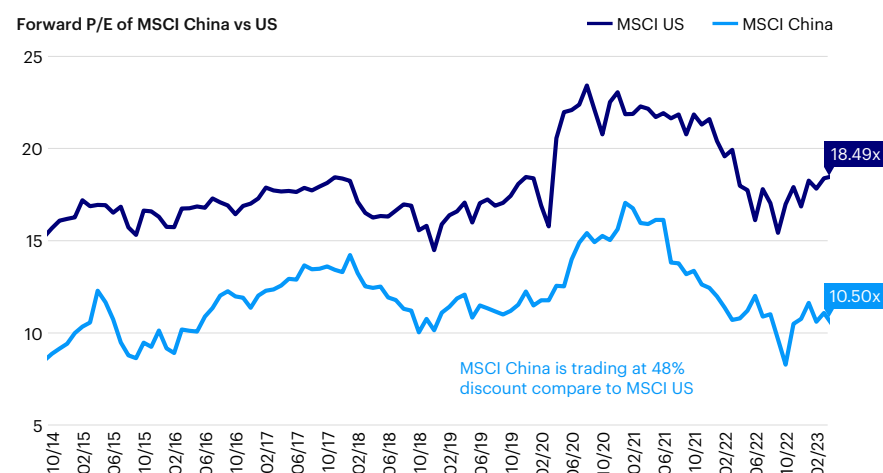
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## Outlook for 2H 2023

For the second half of 2023 we believe the **low interest rate environment will remain for longer**. China has maintained a low inflation environment for the past three years. For example, while US inflation peaked at 9% in 2022 and recently dropped to 4%, China's inflation has been at a low single-digit range of below 3%.<sup>vi</sup> This has made possible a relatively low interest rate environment, unlike the rest of the developing market world. China's reserve requirement ratio has been on a downward trend, with the aim to provide adequate liquidity. The loan prime rate has also been trending lower, reducing borrowing costs for businesses and individuals, and we expect this to encourage credit growth.

We also **expect targeted policy stimulus** to drive growth and ensure adequate liquidity. In the property sector, the government has rolled out supportive policies since late 2022, including policies supporting 'high-quality' developers and the easing of home purchase restrictions and mortgage rate cuts that favor buyers. We believe this will continue. There have also been talks of further reductions in down payments in certain cities and decreased real-estate commissions to encourage property uptake. Most recently, the People's Bank of China cut the interest rate by ten basis points on medium-term lending facility loans to financial institutions in June, injecting further liquidity into the market and supporting economic growth.

**Figure 1 – China equity valuations are at a comfortable level**



Source: Factset, Invesco, May 2023

In our view, **valuations of China equities are currently at a comfortable level** and look attractive when compared to developed markets. China's equity markets are currently trading at the lower end of historical valuations. The current P/E ratio stands at 2.12 standard deviations below the MSCI China's five-year, 12-month forward P/E average.<sup>vii</sup> MSCI China was trading at a significant 48% discount compared to the US market, as at end of May 2023.<sup>viii</sup> We believe China's earnings recovery is well on track with return on equity (ROE) expected to improve as the economy continues to strengthen. In terms of liquidity, we anticipate a structural uptrend in both northbound and southbound flows. If the Federal Reserve cuts or stabilizes rates this may help enhance southbound liquidity further.

<sup>vi</sup> Reuters, June 2023

<sup>vii</sup> Morgan Stanley, June 2023

<sup>viii</sup> Factset, May 2023

## Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

Investment in certain securities listed in China can involve significant regulatory constraints that may affect liquidity and/or investment performance.

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