

## The China Platform for European Institutional Investors



### Resurgent China Sets Sights on Global Financial Markets Powerhouse Status post-Covid

China's successful early handling of the coronavirus pandemic through strict lockdowns has meant it was the only major economy to grow and not shrink in 2020, expanding its share of the world economy at triple the rate of 2019. The resurgence in economic growth has emboldened the Chinese government to drive forward in throwing open its domestic financial sector to create an irresistible magnet for international investors and establish China as an investment destination to match its status as a world trade powerhouse, while posing a challenge to the U.S. dominance of global capital markets and a dilemma for Europe, speakers at a recent online media roundtable hosted in Amsterdam concluded.

"China-U.S. rivalry will come to dominate financial markets as it does now global trade and European governments and investors will be pushed to resist American efforts to decouple from China, because a strong global economic recovery from Covid-19 requires strong economic cooperation with the Chinese. European institutional investors realise that Chinese markets will continue to offer them very important and increasingly growing opportunities and this will place them between a rock and hard place of the geopolitics of American pressure and the economics of Chinese growth," Ties Dams, research fellow at the Netherlands Institute of International Relations 'Clingendael,' told journalists.

Dams is the co-author of the Clingendael [research report](#): *Fire and Haze – Sino-U.S. rivalry, the Covid-19 crisis and financial markets*. The Clingendael Institute is a co-founder, along

with AXA Investment Managers, of [The China Platform for European Institutional Investors](#), which facilitated the media roundtable and has a particular focus on geopolitics and the dynamic field of Chinese 'green financing' and its role in international efforts to address [Global Climate Change](#).



17<sup>th</sup> Century watercolour print of the Dutch East India Company's (VOC) Fort Zeelandia on Formosa (Taiwan)

Dams said that the present U.S.-China rivalry had historical echoes 400 years ago in the 17<sup>th</sup> Century when the Dutch East India Company or the *Vereenigde Oostindische Compagnie* (VOC), the first public listed corporate in the world and also truly global combination of trading conglomerate and military power, was entangled in a series of conflicts with the Ming Dynasty over the company's attempts to impose its commercial system on China. A confrontation from the 1620s in which the VOC was ultimately defeated.

"The Dutch VOC tried to leverage its geopolitical might to enforce its model of globalization on Chinese society. This shows that geopolitics has dominated global trade and finance for centuries and, indeed, in far more violent and volatile ways than today. The difference these days is that China is writing the new chapter in the history of globalization, exporting its model of globalization to the world, and it's up to us (in the West) to answer the question of how we want to deal with that," he added.

Dams said the U.S. stand-off with China did not start with the Trump presidency and harks back to the previous Obama administration's 'pivot to Asia,' policy which was widely seen by the Chinese as an aggressive and assertive way to contain China and get the U.S.' allies in the Indo-Pacific to help with that effort:

"Trump and (president-elect) Biden show much continuity and, if anything, Biden will be more of a threat to China than Trump has been. Trump was a deal maker and Biden frames the conflict with China in a rather different way. Trump promised his electorate to get a better deal with China. Biden is talking about a global alliance of democracies to stand up to the Chinese to contain and confront China's authoritarian advance. This makes it an existential ideological conflict, rather than a deal-making conflict, or a negotiation, and therefore it's much harder to de-escalate," he said.

Dams also noted that China had so far shown little motivation to move on crucial trade issues that form the backbone of its conflict with the U.S., and the Chinese are doubling-down on their efforts to become a dominant global player in high tech. More

fundamentally, President Xi Jinping has implemented a more assertive foreign policy that assumes a measure of China-U.S. conflict will endure and escalate in decades to come.

For its part, the U.S. has signalled its willingness to use financial instruments to apply pressure on China, adding to the fears of European investors they will be caught in the middle. In May this year, Trump ordered the federal government retirement fund to divest from China, not at his own behest, but following bi-partisan pressure from Congress to do so. In the past week, Trump’s executive order barring Americans from investing in Chinese companies with suspected ties to the country’s military led to investment index provider MSCI removing these firms from its indices.

Dams said of the various scenarios The Clingendael Institute had modelled for U.S.-China rivalry and its implications for European institutional investors in Chinese markets, ranging from ‘mild to bad’ within ‘consolidation and escalation,’ he thought ‘Catch-22’ was most likely: Growing pressure from the U.S. and growing opportunities in China causing huge dilemmas for the Europeans.

		European economic aftermath of the COVID-19 crisis	
		Mild	Bad
Sino-US conflict	Consolidation	<b>Status quo</b> <i>Permanent higher levels of protectionism, but growing opportunities in China, steady going for Europe</i>	<b>Coming together</b> <i>Permanent higher levels of protectionism, great incentive for US and Europe to work together with China</i>
	Escalation	<b>Catch-22</b> <i>Growing pressure from the US, growing opportunities in China, causing huge dilemmas for European institutional investors</i>	<b>Double trouble</b> <i>Geopolitical conflict and economic headwind, leading to a vicious cycle that will hurt European interests significantly</i>

Source: (The Clingendael Institute) *Fire and Haze – Sino-U.S. rivalry, the Covid-19 crisis and financial markets*

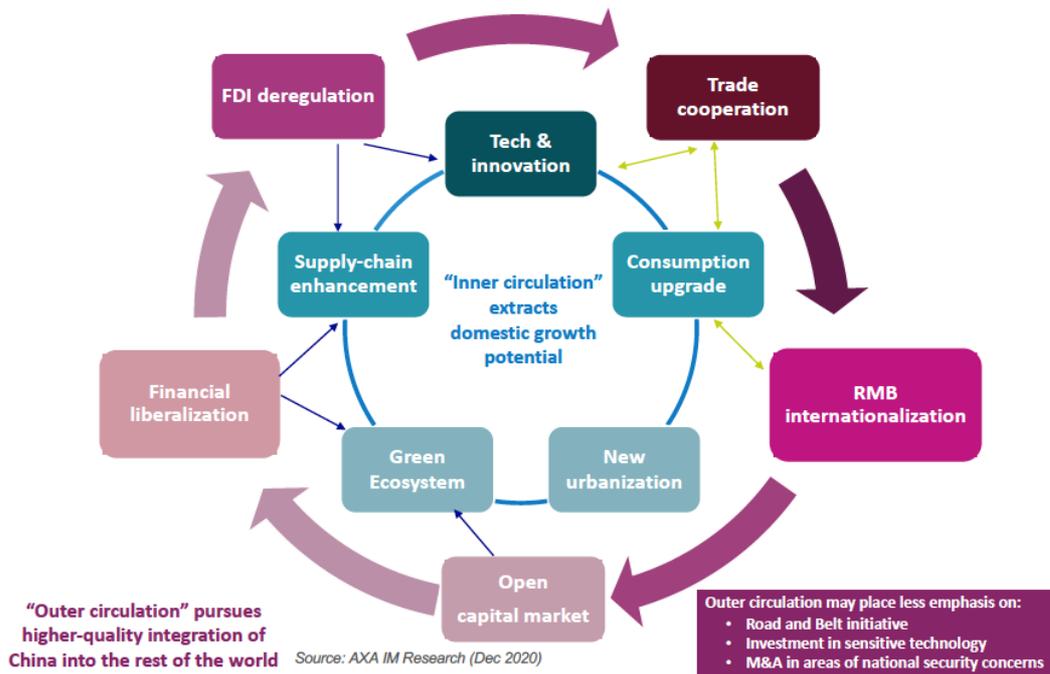
## China Economic and Financial Markets Outlook: Back to Normal – AXA IM

China’s effective containment of the coronavirus domestically will shape the country’s [economic outlook](#) for 2021-2022 and reviving growth in the ‘natural economy’ will take over from policy easing as the main driving factor in a return to pre-pandemic “normality,” with any lingering impact from Covid-19 likely to come from offshore, Aidan Yao, senior economist China at AXA Investment Managers told the media roundtable.

“There has been a very significant rebound in economic activity. We have essentially returned back to pre-Covid levels. By any measure, that it is a pretty impressive performance, but beneath the headline number is a pretty uneven recovery across the different parts of the Chinese economy. On the one hand, you have industrial production and exports staging a very strong economic rebound and on the other you’ve got consumer spending, retail sales, lagging behind, although this has accelerated in the last couple of months. This is a multi-speed economic recovery, which I think is going to make Beijing more cautious. We expect economic policies to normalise, but that this will be quite data dependent,” Yao said.

AXA IM forecasts Chinese GDP growth of 8.0% in 2021, compared with 2.3% in 2020, which is magnified by the year-on-year rebound from this year’s pandemic-depressed base.

## “Dual circulation” strategy responds to changing macro environment



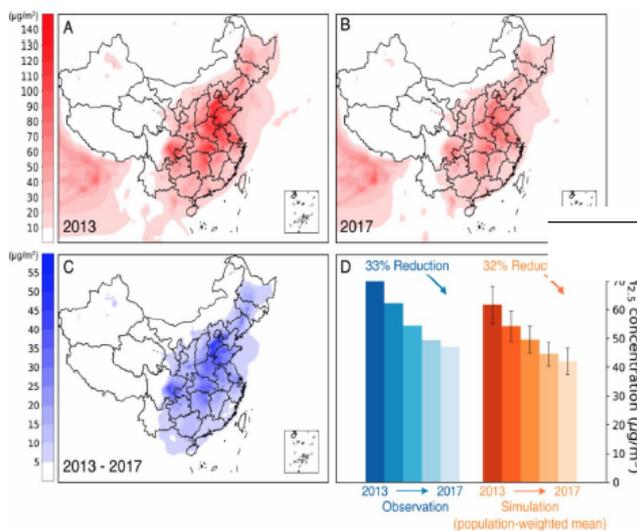
## China’s ‘Dual Circulation’ Guiding strategy for the Future

From 2021, Chinese geopolitical, economic and financial market policies are likely to be strongly influenced by two major strategic plans that Beijing has announced in recent weeks; the 14<sup>th</sup> five-year plan and a longer-term plan that takes China all the way to 2035. There are four major objectives to these plans summarised in the so-called ‘Dual Circulation’ response to the changing macro environment:

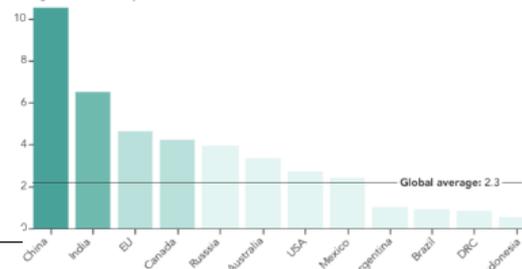
- **Self-sufficiency in core technology** – U.S.-China rivalry has made Beijing very conscious about its excessive reliance on the foreign supply of core technology. Within the ‘Inner Circulation,’ technological innovation and supply chain enhancement are aimed at achieving self-sufficiency in this area.
- **Higher quality and more sustainable domestic economic growth** – A consumption upgrade for the rising middle classes and a new phase of urbanisation.
- **Building a ‘green ecosystem’** – President Xi Jinping’s climate change pledge to the United Nations that China will target peak carbon emissions by 2030 and carbon neutrality by 2060.
- **Redefining China’s relationship with the rest of the world** – The essence of the ‘Outer Circulation’ where China continues to pursue globalization through trade and investment with like-minded countries, liberalizes its financial markets to integrate them with the global system and ‘internationalizes’ the use of its renminbi currency.

## Stars aligned for China to make great strides in fighting climate challenges

### China experiences 33% air-quality improvement since 2013



### China and India Lead in Greening Due to Human Activity



### Stars aligned for China to make a difference

- Top-down commitment from the highest political order
- Significant actions already taken with noticeable results
- China leads in “green” tech development and adoption
- “Green” financing grows at the fastest pace
- Fighting climate changes can win China friends

5 Source: NASA Ames Research Center, National Academy of Sciences, AXA IM Research (Dec 2020)



The strong commitment from the highest echelons of the Chinese political hierarchy to the country cleaning up its environment problems is a key element of the Dual Circulation strategy for European institutional investors considering investing in China, Yao said. Significant process has already been achieved with a 33% improvement in air quality nationwide in recent years and China accounting for a quarter of the total of global ‘greening’ in the past decade. China is also the world’s largest producer and adopter of renewable energy technology and clean infrastructure, as well as one of the largest manufacturers and markets for electric vehicles.

## China to shake up the World Again by Liberalizing its Financial System

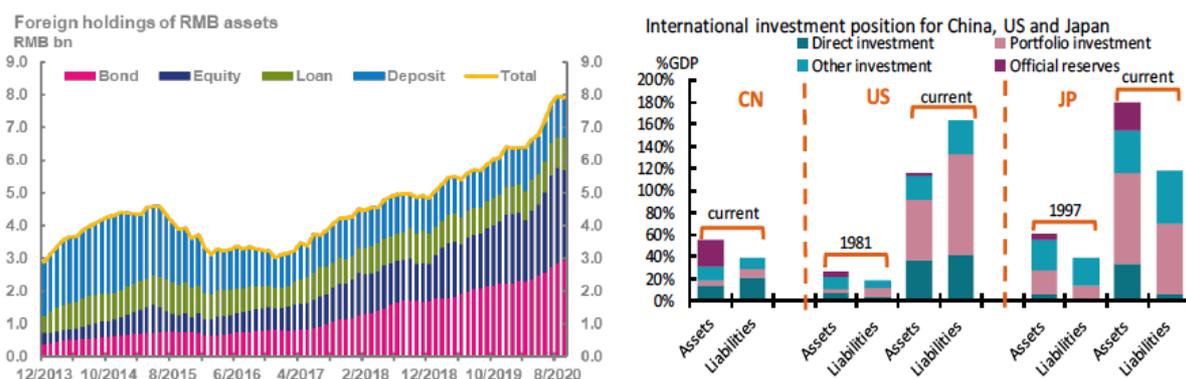
China’s international significance over the past four decades has really been manifested in its economic integration with the rest of the world and the injection of 800 million workers into the economic system since it launched its ‘open door’ policy in the 1980s, but this global megatrend has essentially run its course and in coming years China’s rise is going to manifest itself in financial integration, Yao said.

“If you look at China’s share in foreign direct investment, in global trade, it’s at levels unprecedented in human history and this is what really lies behind China’s collaboration now in the financial space. Even though China is the world’s second largest capital market it is still fairly isolated. We are seeing an acceleration in the opening up of the on-shore financial system, because the Chinese want to have direct financing for innovation in technology and for the markets to play a much more important role in allocating resources. The urgency of this financial liberalization has increased because of the potential for the United States to weaponize its control of the dollar as a global reserve currency.”

Yao said record foreign inflows into Chinese equity bond and markets in 2020 were supported by the very fast recovery in corporate earnings after the pandemic and wide bond yield differentials of over 3.0%, compared with less than 1.0% or zero in the U.S. and Europe, and also with the appreciation of the renminbi adding an extra level of returns. These international investment flows were also facilitated by the structural change of China's integration into global benchmark equity and fixed income indices.

"China has entered the global investment industry. Previously investing in China was an off-market bet. Now it is part of the benchmark and by not investing in China you're making a very significant off-market bet and I think that's going to be an important game-changer for investors' perceptions of renminbi assets. The United States has very strong incumbent power with the world's reserve currency, through its deep equity markets and being the dominant provider of safe haven assets through U.S. treasury bonds. I think the U.S. will remain a very important financial power, but incrementally changes are going to lean in China's favour," Yao concluded.

### China due to shake the world again by liberalizing its financial system



#### China enters a new phase of integration with the world:

- Financial liberalization could lead to as profound impacts as China's economic liberalization did in the past 4 decades
- Urgency of liberalisation has been raised by China's dollar dependence amidst the Sino-US strategic contest
- From global investors' perspective, RMB assets' attractiveness stems from its FIFO economy, fast earnings recovery, wide interest rate differential, and yuan appreciation
- Index inclusion is a game changer as it fundamentally changes China's role in an investor's strategic asset allocation
- China's pursuit of a digital currency could have profound impacts by linking the yuan to the most valuable asset of the 21<sup>st</sup> century