



China focuses back on growth

April 2016

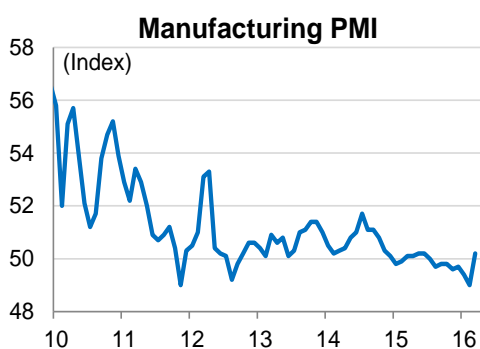
Chinese authorities embarked on an ambitious reform program in 2013 focused on government financing, corruption and the overall structure of the economy. Through 2015, it became clear that this was creating pressure on their economy. Authorities have since slowed the pace of reform and have undertaken a range of policy measures to support growth. These actions are now starting to have an impact and could have an important influence on Australian resource companies, commodity prices and emerging market assets throughout this year.

At the recent National People's conference, the Chinese leadership announced a change in focus on policy from reform back to supporting economic growth. This has been accompanied by a range of policy measures:

- + The central bank has lowered reserve requirements for Chinese banks, allowing them to lend more. Indeed, credit growth has picked up sharply in the first two months of 2016.
- + Restrictions on property markets transactions have been eased.
- + Fiscal spending is set to ramp up. The Government has stated that it intends to fast track a number of large-scale infrastructure projects in the first half of 2016.
- + Margin lending restrictions on Chinese shares have been removed. This is an important development because Chinese households are very large holders of mainland shares.

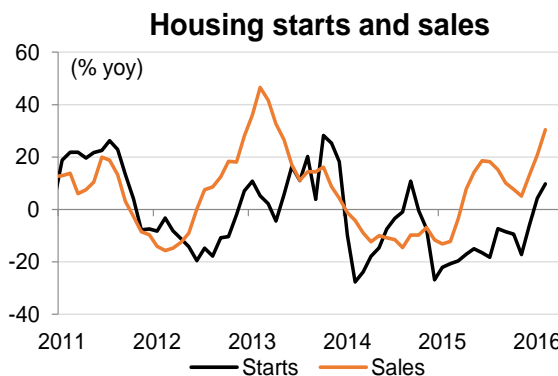
It will take a while for these measures to boost activity, but there are some early signs that they are working. The manufacturing sector rebounded sharply in March and property sector activity has also lifted. Housing starts are growing again as Chinese developers purchase land, while house prices are also higher. Meanwhile, Chinese steel mills have seen a big pick-up in orders.

Chart 1:



Source: Bloomberg

Chart 2:



Source: Bloomberg

We can turn to history to determine what an improvement in Chinese growth normally means for markets. Charts 3 - 6 look at the performance of asset markets around previous Chinese recovery scenarios. These last occurred in 2002, 2005 and 2008. Time 0 represents the trough in Chinese activity, the dark blue line shows the average performance of each asset class, the shaded area shows the range of historical outcomes and the black dotted line is the current episode.

There are a number of conclusions we can make from history:

- + Global equities rally following Chinese stimulus. Australian shares outperform other developed markets, particularly resources, but the strongest equity markets are emerging markets. Latin American shares are the big outperformers given their resources exposure.

- + Commodities rebound, which is unsurprising given that China is a major consumer of commodities. Base metals respond the most to Chinese stimulus.
- + The US dollar normally depreciates while the Australian dollar moves higher. Emerging Market (EM) currencies also appreciate.

Chart 3:

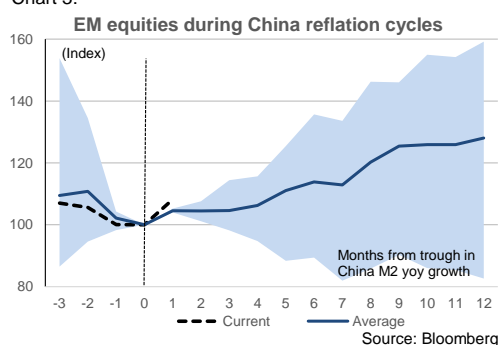


Chart 4:

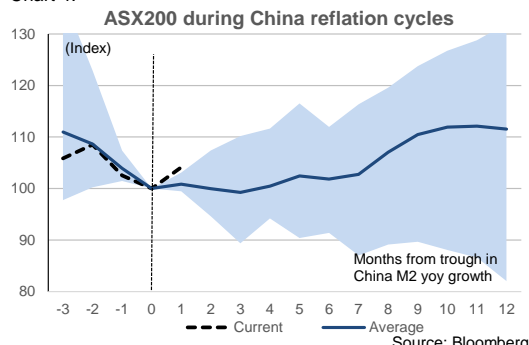


Chart 5:

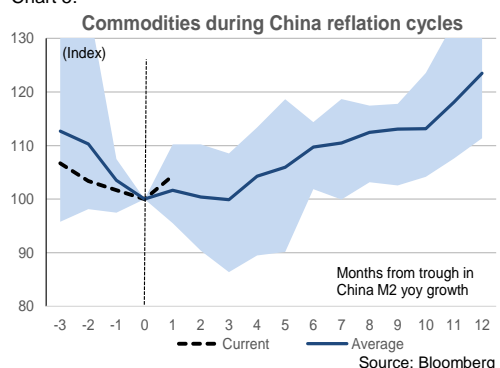
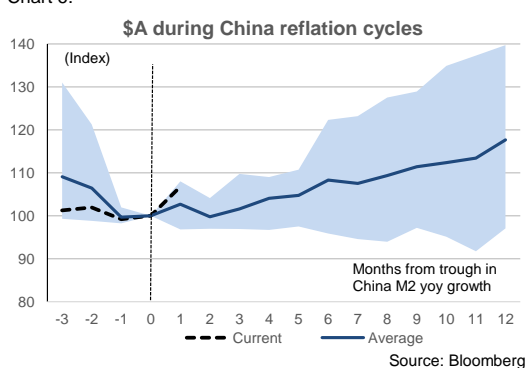


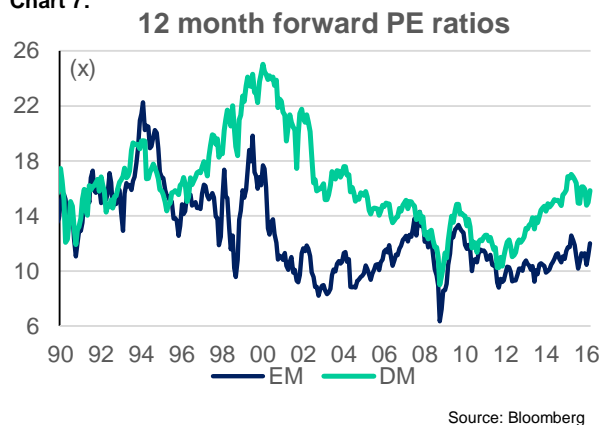
Chart 6:



History tells us that Australian shares, commodities and emerging market assets normally perform solidly around Chinese recovery episodes. But there are other preconditions for outperformance which have been met recently, particularly for emerging market equities. EM equity valuations are very cheap, earnings expectations have been rebased, commodity prices have ceased falling while the US dollar has stopped appreciating for the time being.

Of course, there are longer-term challenges which explain why investors have avoided these asset classes in recent times. China still has excess capacity in a number of sectors, commodity markets remain oversupplied and corporate debt levels are elevated. These have not gone away. But despite this, we think that investors will gain confidence from the Chinese policy measures as they will act to put a floor under Chinese growth. As such, we are tactically positive on the outlook for Australian shares, commodities and emerging market equities.

Chart 7:



For more information on Chinese growth and your investments, please contact BT Financial Group.

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