

---

## China update: “Common Prosperity” – what does it mean for credit investors?

November 2021

The Chinese authorities have announced a wave of new regulations over the last few months, which many commentators have collectively referred to as a Beijing “regulatory reset”. These changes are not to be taken lightly, and, in our opinion, represent a new governance paradigm that, at its core, will look to re-define the Chinese growth model and have a profound impact on global growth.

In order to understand these changes, we have to appreciate the key drivers for economic growth in China over the last 10 to 15 years and the structural changes that have ensued. In the decade from 2000 to 2009, Chinese GDP growth averaged 10.4% a year. This stellar performance abated during the following decade, but GDP still grew by an average of 7.7% a year. Indeed, over this period, China was the engine for global prosperity, contributing 28% of GDP growth worldwide from 2013 to 2018 (according to the IMF).

### Real estate: the key growth driver

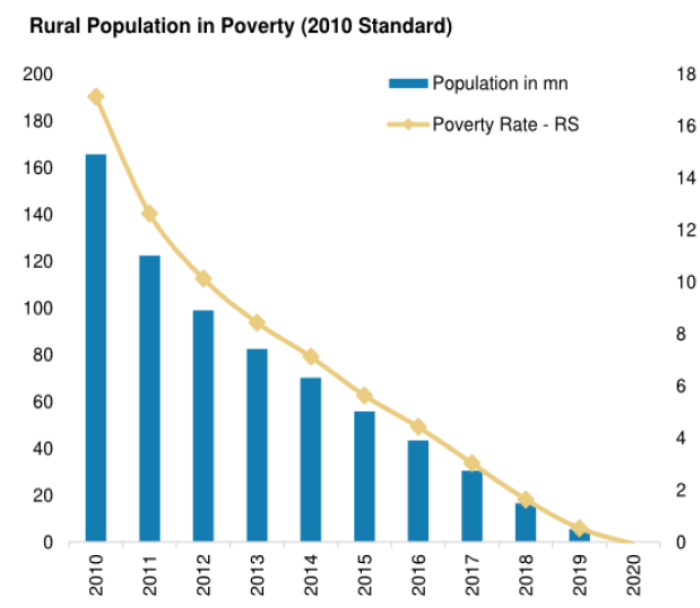
At the core of this growth engine was the “Build, Build, Build” model, as the Financial Times so aptly put it, with the real estate sector proving a dynamic force. At its height, the real estate sector accounted for close to 29% of Chinese GDP (we estimate this has fallen to 20-25% today). Developers were allowed to borrow almost indiscriminately to buy land, which in turn financed local governments’ capital budgets. This led to large-scale oversupply of property, which was used by Chinese citizens as a wealth accumulation tool. Indeed, the oversupply became so vast that it is estimated that the unsold housing inventory is 3 billion square metres, or enough to house 30 million families (the average Chinese family comprises 3 people). Much of this growth was debt financed, with no company exemplifying this excess more than Evergrande (China’s largest property developer), whose debt ballooned from USD 1.7bn in 2007 to USD 110bn at the end of 2020.

### Decline in demand for property as birth rate falls

This unprecedented growth also had profound effects on Chinese society, with the poverty rate dropping from close to 16% in 2010 to virtually zero currently (see chart 1). The largest migration in human living conditions arguably in history, and a stark contrast to India (for example), with only Brazil, under former president Lula da Silva, coming close to achieving such a transformation. However, this improvement in living conditions came at a cost, as China’s population growth stalled, with only 12 million babies being born in 2020. This trend will become more pronounced over the next decade as the number of women of peak childbearing age – between 22 to 35 – is due to fall by more than 30% (a legacy of the one-child policy). Some experts are predicting that the birth rate will fall further, pushing

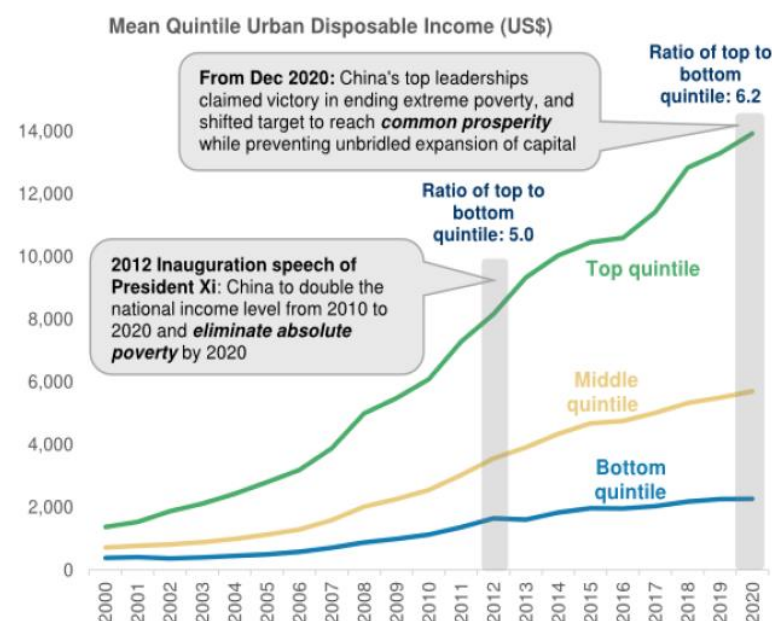
the Chinese population into absolute decline, further dampening the demand for property. In addition to these demographic shifts, there has been a marked increase in social inequality as highlighted in chart 2. Hence, Chinese authorities face a conundrum: How do they invigorate population growth, reverse social inequality and move the economy away from one reliant on debt-fueled property expansion to a more sustainable model?

**Chart 1: Decade-long journey to eliminate absolute poverty**



Source: CEIC, Morgan Stanley Research

**Chart 2: New policy priorities: social equality, data security and self-sufficiency**



Source: CEIC, Morgan Stanley Research

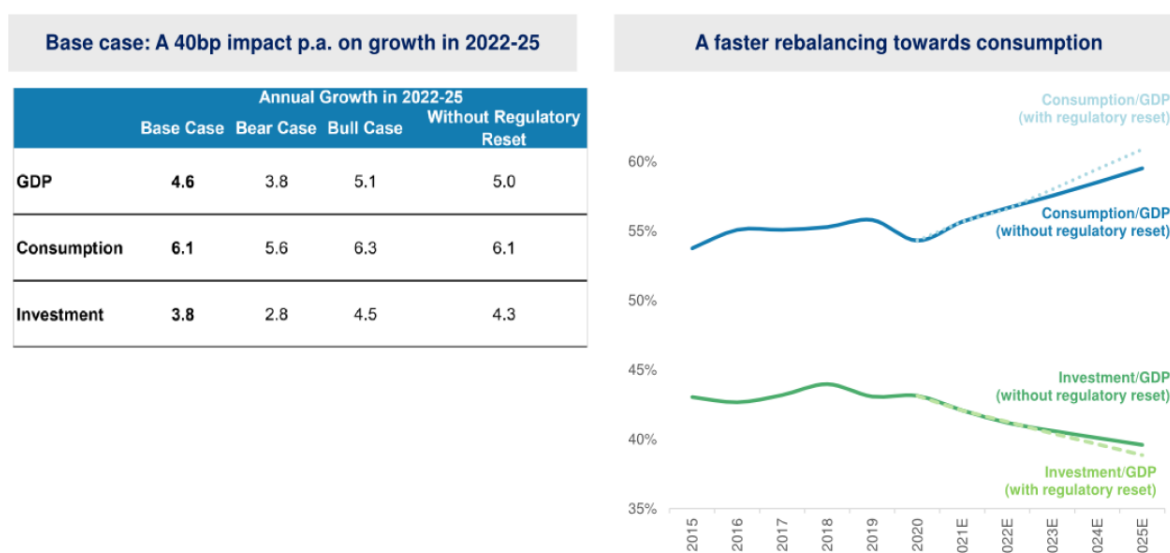
The Chinese Communist party's "Common Prosperity" campaign goes a long way to address many of the structural issues highlighted above. The policies, at their core, aim to address social inequality, sustainable growth and self-sufficiency. The policies targeting the education sector and property sector

are aimed at reducing the cost of raising children and supporting a family, while also removing real estate as a wealth creation vehicle.

### What does this mean for credit investors?

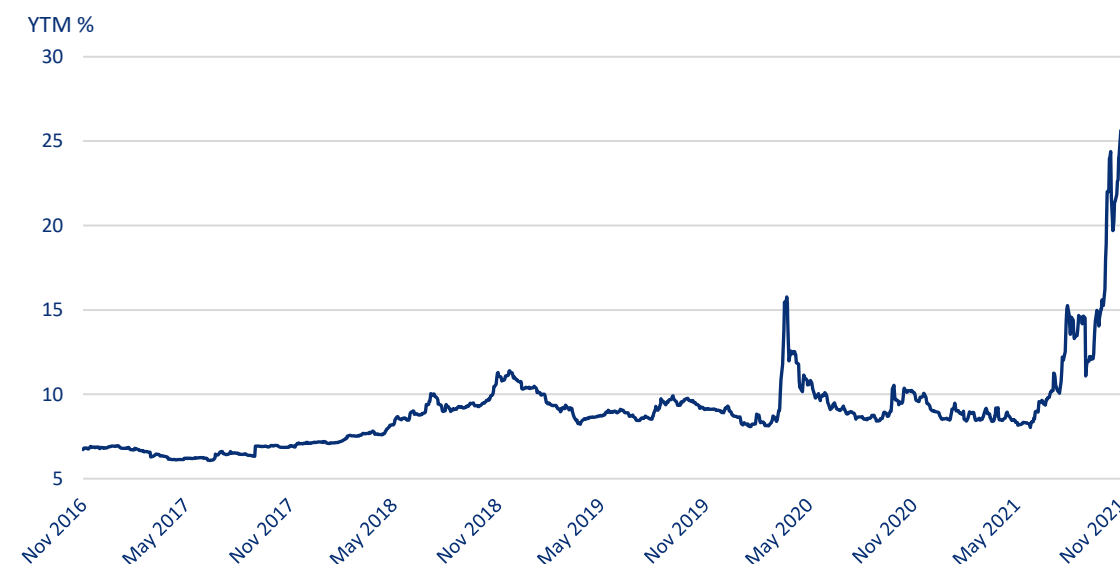
It is clear that China will have a lower growth rate over the next decade, and business models will have to adapt to this new economic and regulatory reality (chart 3). This has triggered a vicious repricing of capital, particularly in the high-yield, real estate sector (chart 4), as the market tries to differentiate between the 'haves' and 'have nots'. We feel that, for those willing to tolerate the associated higher volatility, the return profile in Chinese high-yield property bonds looks very interesting, with realizable returns compensating for the heightened business risk.

**Chart 3: China GDP growth under different scenarios – China's regulatory reset could weigh on investment and productivity growth**



Source: NBS, Morgan Stanley Research (E) estimates

**Chart 4: Chinese high yield property yields to maturity (YTM)**



Source: Bloomberg

## Conclusion

More than ever, it is essential to focus on bottom-up fundamentals, with a view to identifying those businesses possessing the right mix of balance sheet strength and liquidity to come through this challenging period. It is clear there is room for private capital in the sector, and we believe those that can survive will have opportunities to grab market share and grow in a more sustainable fashion than has proved possible in the past.

---

## The author



**Meno Stroemer, Senior Portfolio Manager**

Meno Stroemer heads up the Portfolio Management and the Emerging Market Corporate Bond team, where he shares responsibility for managing the emerging market strategies and also carries a research responsibility for the EM region. He joined Fisch Asset Management in 2014.

---

## Disclaimer

This documentation ("Document") is provided solely for information purposes and is intended for professional investors only. Non-professional investors who obtain this documentation are please asked to discard it or return it to the sender. This presentation is not a prospectus or an offer or invitation to buy financial products.

This Document is provided for marketing reasons and is not to be seen as investment research. This Document is not prepared in accordance with legal requirements designed to promote the independence of investment research, and that it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

HISTORICAL PERFORMANCE IS NO GUARANTEE OF FUTURE PERFORMANCE.

Investments in financial products are associated with risks. It is possible to lose the entire amount of the invested capital. In addition, financial products investing primarily in emerging markets and/or in high yield bonds carry higher risks in general. Emerging markets bonds are bonds from issuers with a registered office or primary activity in an emerging country ("EM"). They are exposed to higher political, social and economic risk that can manifest itself in restrictions on capital transactions or other constraints. This can make it impossible for the bond issuer to pay the coupon or repay the principal. Operating and supervision conditions may deviate from the standards prevailing in developed countries. Bonds with high yields entail a greater risk of issuer default, and are a riskier investment than higher quality investment grade bonds. Regarding the specific risks of an investment, please refer to the currently valid fund documentation.

Insofar as the information contained in this Document comes from external sources, Fisch Asset Management AG cannot guarantee that the information is accurate, complete and up to date.

Statements concerning future developments and estimates are based on assumptions that may be inaccurate, that could change or that are based on simplified models. Fisch does not know whether its statements concerning future developments will be correct. Fisch may also change its opinion concerning a future development. In such case, Fisch has no obligation to inform anyone about the change in opinion.

The purchase of a product managed by Fisch should only be based on the currently valid documents (fund prospectus, fund agreement, KIIDs, etc.). The currently valid documents are available at **[www.fundinfo.com](http://www.fundinfo.com)**. Before reaching a decision to buy, each professional investor must determine based on their specific situation whether they are even permitted to buy the product, and if yes, whether they have the necessary risk tolerance for the corresponding product. Fisch expressly states that this Document is not intended for private investors and advises professional investors to first consult financial, legal and tax experts who are familiar with their specific situation and understand the product.

This Document is especially not intended for US persons (private or professional) as defined by the FATCA legislation or under SEC regulations. US persons may not invest in any investment funds managed by Fisch, and Fisch is also not permitted to manage mandates from US persons. If Fisch learns that a US person is invested in a product it manages, it will inform the fund management company and, if necessary, other persons and demand that the US person sell the product.

Fisch has outsourced the storage and archiving of company data to a specialized third party firm. The outsourcing is limited to the storage and archiving of data and occurs abroad. The processing of data is done within Fisch and is not outsourced. The activity of the third party firm essentially consists of setting up and maintaining the corresponding servers. The regulatory authorities and the auditing firm have been informed by Fisch about the outsourcing, and the data protection and regulatory requirements are fulfilled.

Fisch accepts no liability for damages arising directly or indirectly as a result of this Document.