

Round-up: China in a global context

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Charts editor



The beginning of history

Chinese R&D – underappreciated or not very good?

China’s banks: what housing correction?

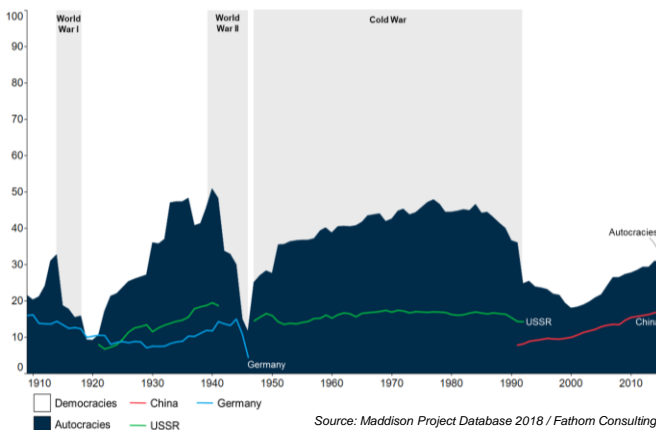
Renminbi lacks the macro credentials of reserve currency

The beginning of history (2 March 2022)

- Russia’s invasion of Ukraine came as a surprise to many observers and may eventually be regarded as heralding a new era of geopolitical tensions
- The share of world GDP accounted for by democracies has dropped since the late 1990s, as US unipolarity has given way to a new multipolarity with varied institutions
- Autocratic regimes now account for a level of world GDP that previously coincided with a world war and a cold war
- Investors can expect this new normal to lead to heightened volatility and increased military expenditure, perhaps weakening already meagre structural growth rates in DM economies
- We include a more detailed analysis of the consequences of Russia’s actions in our upcoming *Spring Outlook*

Share of world GDP by political institution

Per cent (PPP, multiple benchmarks)



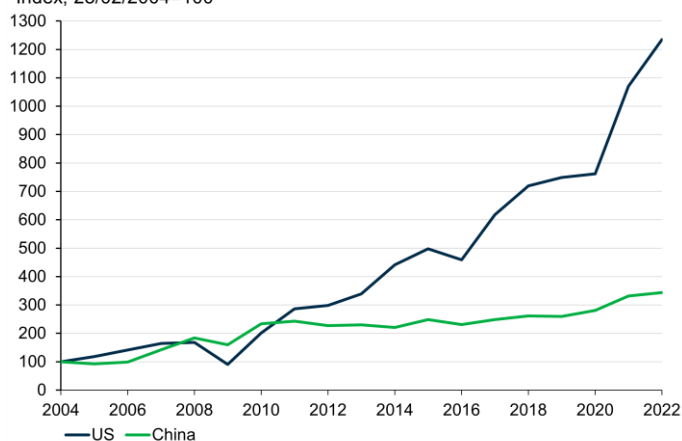


Chinese R&D – underappreciated or not very good? (16 March 2022)

- Firms that are skilled at converting their R&D investments to future sales should in theory enjoy high equity prices when the market recognises this innovative ability
- The chart below highlights the performance of US- and Chinese-listed firms that fall into this category — using financial statement data, we proxied innovative ability ($Ability^{R\&D}$) as the coefficient from the regression of sales growth on past R&D,¹ and used this to create indices for the most skilled innovators in the US and China
- Our estimates suggest that an equally-weighted portfolio of high $Ability^{R\&D}$ US stocks far outperforms its Chinese counterpart, even if we consider the survivorship bias in our approach
- There are a few possible explanations for this:
 - Investors simply don't recognise the revenue-generating potential of R&D in Chinese firms
 - China's skilled innovators cannot "exploit" innovations for long, as they spill over to others easily (in other words, private 'knowhow' depreciates more quickly)
 - R&D at Chinese firms doesn't produce the same turnover as it does at US firms
 - China's economy has a relative strength in less R&D-intensive sectors compared to the US, a point supported by Fathom's proprietary RiCARdo database
- None of these explanations casts Chinese technological innovation in a particularly favourable light, at least among its listed firms

Equity performance of US and China skilled innovators

Index, 28/02/2004=100



Source: Refinitiv Datastream / Fathom Consulting

¹ Specifically, for each firm and every year, we run time-series regressions of sales growth on the average of the past five years of R&D over sales. A back window of eight years is required, and $Ability^{R\&D}$ is the coefficient of every firm-year regression. The indices presented above include the stocks of firms for which $Ability^{R\&D}$ is above the 75th percentile of the distribution in each year and market

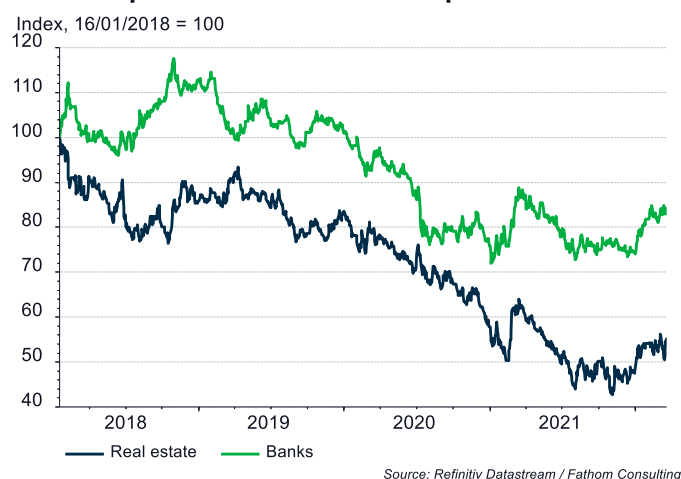




China's banks: what housing correction? (23 March 2022)

- The value of publicly-traded Chinese real estate firms continues to slump; our chart (below) shows relative losses in that sector of close to 50% since a cyclical peak in January 2018
- House prices have shown signs of weakness, and the value of housing sold in the first two months of this year is 22% below the same period in 2021, due largely to slumping transaction volumes amid falling confidence in the market
- Yet despite substantial exposure to real estate, Chinese banks' equity performance has held up relatively well
- Our interpretation? Investors believe that leveraged Chinese real estate developers, such as Evergrande, may be allowed to fail but large banks will not be – they are probably right

China equities relative sectoral performance



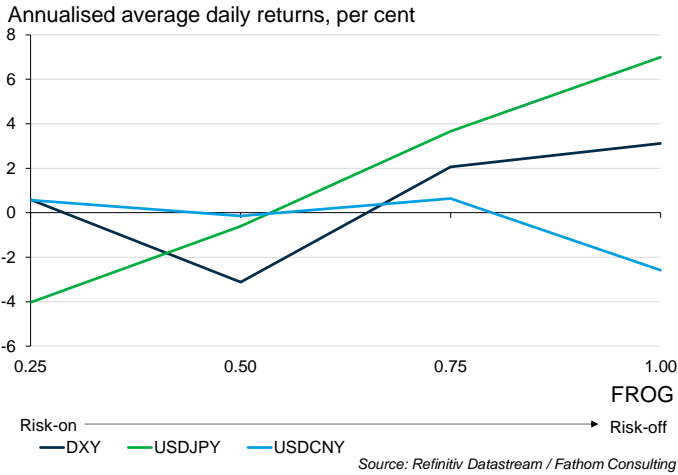
Renminbi lacks the macro credentials of reserve currency (23 March 2022)

- Since 2012, when the Chinese authorities widened the trading band of the currency to 1%, the renminbi has gained greater global acceptance and has been added to the SDR basket of currencies
- In spite of these important steps the renminbi still behaves more like an EM currency than a reserve currency, tending to weaken during risk-off periods in markets, as defined by the Fathom Risk-Off Gauge (FROG)
- This is in contrast with reserve currencies with long track records, such as the dollar (proxied by the dollar index) and the yen, which both tend to appreciate during bouts of risk aversion



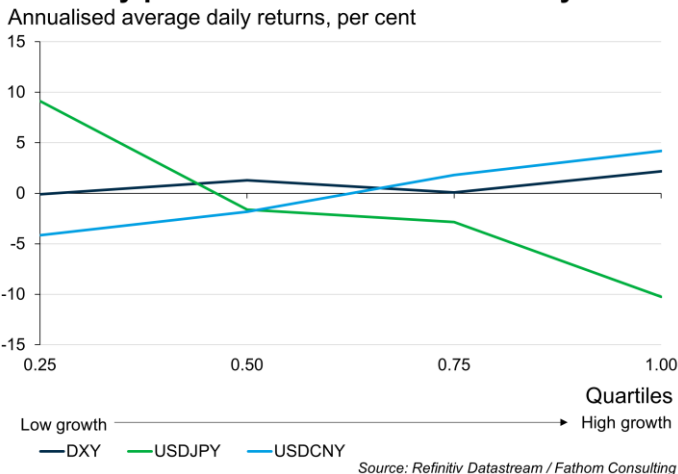


Currencies in risk-on and risk-off environments



- The main reserve currency, the US dollar, stands out as being generally insulated from gyrations in the macro cycle; by comparison, the yen shows a markedly countercyclical profile, strengthening relative to the dollar when the economic activity weakens, and vice versa
- The renminbi, however, shows a clearly procyclical pattern, appreciating during upswings in global economic activity and weakening during downturns. Part of this difference is due to the US and Japan's dominant roles in financial markets, while China's role remains curtailed by a relatively closed capital account and a greater focus on the development of domestic capital markets

Currency performance over the macro cycle





- Tracking the renminbi's trading patterns over economic and market cycles offers important clues about how it is viewed by investors, and thus its chances of offering a credible alternative to the current reserve currencies. For now, we find little evidence that the renminbi is regarded in this way²

Chart authors: Kevin Loane, Brian Davidson, Dimos Andronoudis, Andrea Zazzarelli

Further reading

[*China housing set for further easing*](#)

[*The renminbi: not as weak as it seems*](#)

In case you missed it, here's last month's round-up:

[*Inflation, inflation, inflation*](#)

² The renminbi suffers other structural factors that lessen its appeal, such as lack of full convertibility, and questions over China's rule of law.



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