



Investment Perspective

Invesco Asia-Pacific



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Bump in the Road to Recovery?

China's growth rolls on despite economic traffic jam

After a 35.59% gain in the second quarter of 2009, China's lower-than-expected returns in the third quarter (7.82%) caused investors to wonder if China's economic recovery is headed for a breakdown.¹ But we believe government stimulus, a growing middle class and further investment opportunity should help the world's third-largest economy stay in the fast lane on the worldwide investment track.

Checking the temperature gauge

Why did China's quarter-over-quarter growth slow by almost 78%? After world markets plunged in 2008, China was one of the first economies to bounce back starting in March 2009. And it did so substantially, with the Chinese stock market, as represented by the MSCI China Index, returning more than 46% in six months.¹

Lending growth in China has also slowed recently, which concerned investors who believe an ebb in credit supply could derail economic recovery or possibly indicate an increase in bad loans. Given the potential for policy changes and the market turmoil many investors have endured, it's understandable that overall market sentiment cooled down.

While investors' concerns aren't unwarranted, slower growth doesn't mean China's economic engine has overheated.

Fueling the economy

The success of government stimulus packages across the globe may be debatable, but we see evidence of the effectiveness of China's plan in the country's economic stabilization and growth since the policy was enacted.

While factors such as quick decision-making, a banking industry largely unaffected by toxic assets and readily available resources to support stimulus measures helped the two-year \$585 billion package gain traction, we believe China's leaders will have to balance economic acceleration with potential inflation.

¹ Source: Lipper Inc.

A substantial portion of short-term growth has and will come from the long list of infrastructure projects that were slated prior to the November 2008 stimulus program launch and that benefited from the influx of government funds. Fixed-asset investing associated with these infrastructure projects grew by more than 30%¹ in the third quarter. Urbanization may not represent new growth per se, but it has helped boost the economy.

Slower lending may help burst bubbles before they form while infusing enough capital into the market to sustain the all-important annual 8% gross domestic product growth rate, a goal Chinese officials feel is attainable in 2009. That's why we believe substantial monetary policy tightening is unlikely until 2010, when global economic recovery could be more established.

Revvng up consumers

Government policies have done more than stimulate business. They've given the growing Chinese middle class, who have money to spend for the most part, the incentive and confidence to spend. Retail sales rose 15.5% year over year in September.² And, for the first time, year-to-date car sales are higher in China than they are in the U.S. The tax break on new car purchases is likely a big part of that.

Short-term stimulus measures may lend a hand in pushing along consumerism in China that can potentially spark economic growth, but deep-set social and political structures can hinder domestic demand. In China, the social security system isn't particularly strong, which drives many individuals to save at high rates to make sure they can fund retirement instead of using income for nonessential spending.

But the Chinese government has several initiatives in place to build adequate social welfare, improve medical and educational systems and develop banking products to ease commercial and personal lending. We believe these efforts can help accelerate consumer spending because people are more willing to spend when daily needs are adequately met.

With these demographic trends, we expect consumerism to become an increasingly important part of China's economic growth as the emphasis shifts from exports to domestic demand for goods and services.

Hitting with more cylinders

Consumer spending in China may help do more than ignite the economy; it may help increase investment opportunities. As the Chinese middle class grows, we believe more and more Chinese companies have the chance to build their brand presence and take their share of the market. In sports wear, for example, global conglomerates now face competition from local names, including Li Ning, Anta and X-Step. Li Ning runs more than 6,000 outlets to meet demand.

We see this trend with other businesses that produce staple items as well as technology-based consumer services, such as mobile instant messaging and online gaming.

Initial public offering (IPO) activity has ramped up since September, with several new businesses popping up in the pharmaceutical, sports apparel and entertainment industries. We believe IPOs are good for the Chinese market because they represent new investment opportunities and add to market capitalization.

Keeping it running

We believe China's healthy banking system, government stimulus and consumer base will help fuel the Chinese growth engine now and in the future. So we feel it's important to invest in companies that benefit from government stimulus, have good management teams and can capture market share. China is starting to develop out of economic infancy, and occasional bumps should be expected. While we believe China offers opportunities for long-term growth, investors should factor volatility into their decision to purchase Chinese equities.

1 Source: The New York Times, "A Year Later, China's Stimulus Package Bears Fruit," Oct. 23, 2009

2 Source: Business Times, "China's Economic Growth Quickens to 8.9%," Oct. 23, 2009

About risk

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All data provided by Invesco Aim unless otherwise noted.

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