ASIA PERSPECTIVE

Investment Outlook

China // 2022

China's investment landscape

Despite a year with economic and financial tensions, and a plethora of restrictions on foreign technology transfers to China, the nation kept its attractiveness to foreign investors and reached a record-high amount of both foreign direct investment and inflows of portfolio investment into listed onshore Chinese companies and government bonds.

Economic Growth

The Chinese economy recovered substantially in 2021, recording a year-on-year (YoY) GDP growth of 8.1%, beating the government target of above 6%. The better-than-expected GDP growth indicates that the country is moving closer to supplanting the U.S. as the world's No 1 economy. However, the weakened growth in the closing months of the year also indicates more disruptions to come in 2022 amid the deepening real estate crisis, new Covid outbreaks, and Beijing's strict zero-covid strategy to controlling the virus.

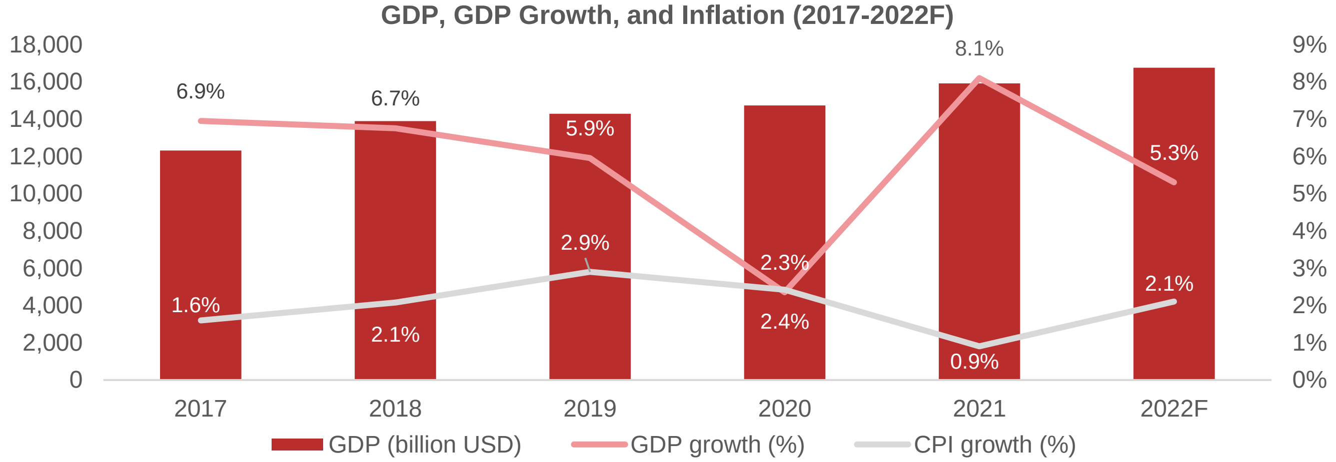
Going into 2022, the economic growth is expected to slow down after last year's strong rebound. The World Bank forecasts that China's GDP growth will slow down to 5.1% in 2022. Similarly, the Chinese government also set a GDP growth target of 5.5%.

Inflation

For the full-year of 2021, China's Consumer Price Index (CPI) rose by 0.9% YoY, far below the country's initial target of approximately 3%. However, while surging prices emerged as a major threat in many parts of the world, the country's inflation remained stable.

Looking ahead, China's CPI growth is expected to remain modest in 2022. According to the National Development and Reform Commission (NDRC), China's inflationary pressure is expected to weaken thanks to the country's economic recovery, as well as sufficient supplies of coal, oil and staple foods, including vegetables and meat.

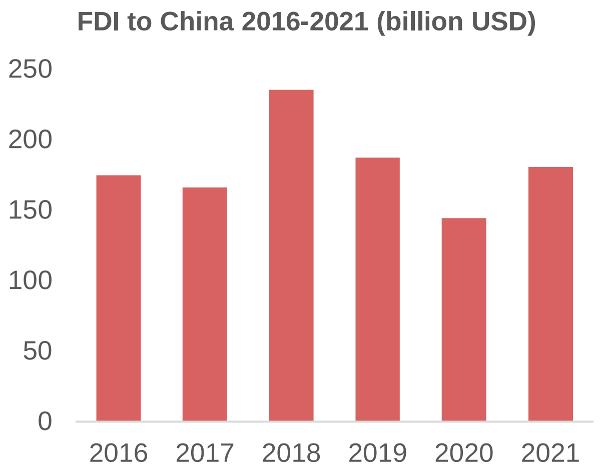
GDP, GDP Growth, and Inflation (2017-2022F)

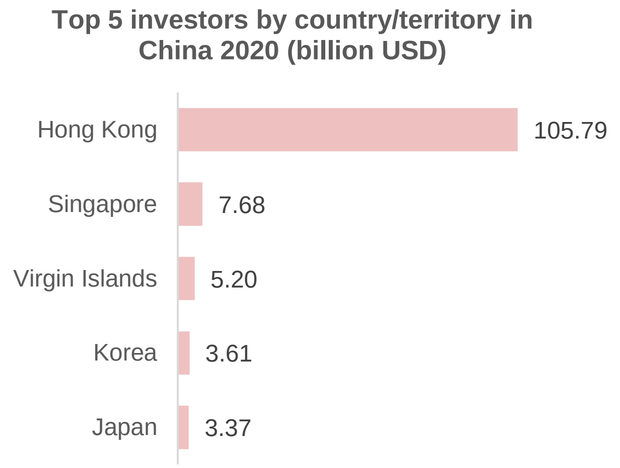


Source: World Bank, Trading Economics

Foreign Direct Investment (FDI)

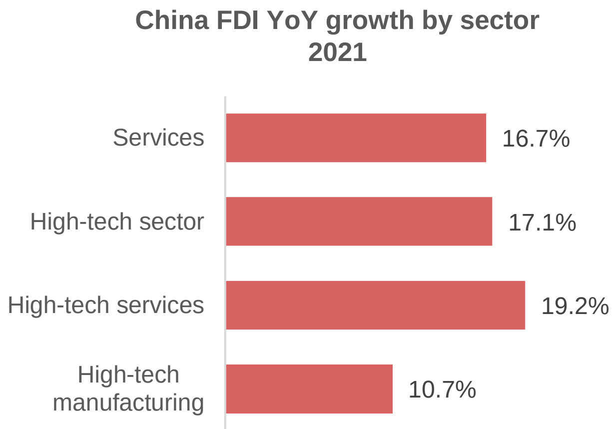
FDI into mainland China hit 1.15 trillion RMB (180.75 billion USD) this year, representing a 14.9% surge from the previous year. The aggressive growth is considered remarkable amid the ongoing global pandemic and the heightened geopolitical and economic tensions. According to Statista, the top 5 FDI partners to mainland China in 2020 were Hong Kong, Singapore, Virgin Islands, Korea, and Japan

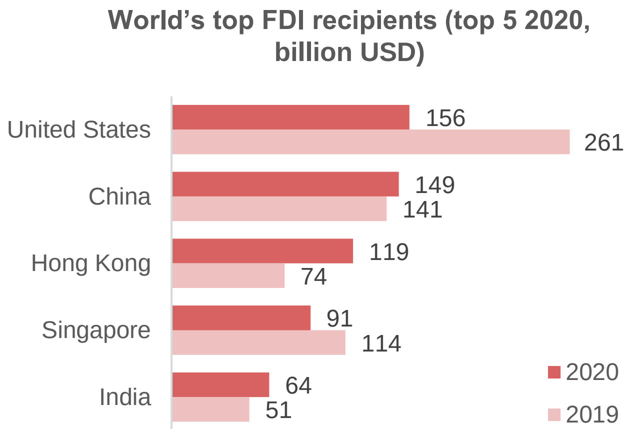




Source: The World Bank, Statista

The robust FDI growth in 2021 was mainly driven by the strong investment flows to its services and high-tech sectors. The total FDI inflows into the services sector jumped by 16.7% YoY, reaching 142.77 billion USD. Meanwhile, the high-tech sector continued to outperform, recording a strong growth of 17.1% YoY, in which high-tech manufacturing grow by 10.7% and high-tech services increased by 19.2%.





Source: China Statistical Yearbook, UNCTAD

China has remained as the world's second largest FDI recipient for four consecutive years, from 2017 to 2020, following just after the U.S.. Looking into 2022, China's FDI inflows from RCEP member countries, which include important FDI partners such as Singapore, South Korea and Japan, is expected to grow significantly as the agreement took effect on January 1, 2022. In addition, to promote FDI inflows, China will expand the coverage of the 2020 Catalogue of Industries for Encouraging Foreign Investment, and further leverage preferential land and tax policies. The measure are to direct the flow of more foreign capital into fields such as advanced manufacturing, modern services, high technology and digital economy. FDI into China is therefore expected to continue its robust growth in 2022.

China promotes FDI in various sectors

While China implemented new regulations in 2021 that tightened access to some industries, the nation has also been encouraging foreign investment in multiple other areas to help strengthen the country's infrastructure, supply chains, and sustainability.

The Chinese government has pledged to step up efforts to open its market and optimize support measures for foreign investment in 2022. This will include the implementing the 2021 version of the negative lists for foreign investment, which reduces the amount of sectors that foreign investors are restricted or prohibited to be involved in. Particularly, the government will allow full foreign ownership of passenger car manufacturing, to welcome new industry players into the country.

China will also expand the coverage of its 2020 Catalogue of Industries for Encouraging Foreign Investment. The current catalogue focuses on encouraging investment in three main areas:

- Advanced manufacturing industries;
- Production-oriented service industries; and
- Regional advanced industries in the central, western, and northeastern regions.

Foreign-invested enterprises (FIEs) engaged in advanced manufacturing, modern services, high-tech sectors, low-carbon and green industries, digital economy, and in the central and western regions of China, will be provided with favorable policies. These include tariff exemptions on imported equipment, access to preferential land prices and looser regulation of land uses. FIEs doing businesses in encouraged industries in designated regions can also receive lowered corporate income tax incentives of 15%.

China will also promote the implementation of the RCEP. Unprecedented level of access to its market will be allowed to help stabilize its foreign trade and investment, and promote infrastructure upgrading, while helping China meet the international standards of trade rules to further participate in the CPTPP. 42% of total FDI inflows to China in 2020 came from RCEP members. The number is expected to rise as the total FDI in China is projected to see more inflow from all 14 members of the RCEP.

Chinese policymakers also promised that the country will continue to optimize its business environment for foreign businesses, ensuring effective enforcement of the foreign investment laws and regulations, the establishment of the complaint mechanism for FIEs, the protection of intellectual property rights, and equal treatment for domestic and foreign companies.

Promising outlook for China’s M&A market despite economic turbulence

Key trends in 2022:

- **China’s M&A market will continue to grow stronger domestically.**
- **Foreign investors will need to learn to navigate through a changing regulatory environment.**
- **Investment in areas encouraged by the government will expand.**
- **There will be vast growth and buyout opportunities for private equity**

2021 saw a resilient M&A market in China despite multiple economic headwinds. M&A deals with any Chinese involvement grew up 2.8% (YoY) to 580 billion USD in 2021. A total of 2,381 deals were concluded in 2021, the highest number since records first began in 2006.

M&A activity was concentrated to mainland China during 2021. 2,179 deals, valued at 503.5 billion USD, were concluded domestically within the year. The domestic theme is expected to continue in China’s M&A market in the near future, supported by the government’s “dual-circulation” strategy, emphasizes sustaining growth through self-sufficiency.

While cross-border M&A will continue to be challenging due to the ongoing zero-Covid policy, there are opportunities for making deals; strong government incentives and market opportunities are offered in multiple areas. To navigate through the stricter regulatory environment, foreign strategic investors will need to plan further ahead of acquisitions and treat their Chinese entities separately from the organization.

Targeting areas where the government is encouraging investments is another key trend in 2022. Renewable energy, electric vehicles, and businesses related to sustainability received a lot of attention from both strategic and financial investors. As the government pushes to prioritize technological innovation, sustainable solutions, and the digital economy, acquirers and investors will be more aggressive in identifying attractive targets in these areas.

There is also a rise in the share of deal value from private equities. Private-equity-backed transactions in China rose 26% (YoY) in 2021 to 108 billion USD, a fifth of all deals by dollar value. There has been an increasing supply of asset sales by multinational companies, as international brands struggle to catch up with the ever-changing local consumer market. As corporate restructurings and multinational disposals generate more targets, the volume of private-equity-backed deals will likely expand in 2022.

Although economic challenges in China are expected to remain in the near future, the overall outlook is more than promising. As China has somewhat finished its introduction of regulatory changes, the country is expected to be back on a more sustainable growth trajectory. The Chinese central bank has also eased its monetary policy. These factors, coupled with investors’ confidence in the country’s growth opportunities, bode a positive outlook for China in 2022.



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