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Craig Farley, Investment
Manager - Chindia Fund

China – ‘A Goldilocks Liquidity Result’

We vehemently disagree with the view that China is in ‘bubble’ territory but there is no doubt that the market is hot as far as current investor interest is concerned, reflecting the crucial role the economy is playing in the global recovery. September’s macro data has just been released, generating plenty of debate amongst commentators regarding potential policy ramifications and we felt it appropriate to briefly summarise our thinking.

All eyes were on the new bank lending figure which came in at RMB 517 billion (versus RMB 410 billion in August), above analyst expectations and clear evidence that Beijing is not engaging in any sort of policy ‘tightening’. We hate to sound like a broken record, but this is an outlook we have reiterated several times this year, one clearly signalled in both private and public statements from Chinese officials.

“Expect a degree of ‘fine-tuning’ as the government ensures a ‘Goldilocks liquidity result’ – not too much, not too little, but just the right amount.”

The People’s Bank of China (PBOC) is concerned about the sustainability of the economic recovery now underway, not asset price bubbles or overheating, supporting our view that Beijing will continue to gradually reduce the level of economic stimulus that has worked (via lower growth and infrastructure spending) and is no longer needed as both private investment and private consumption recover. Expect a degree of ‘fine-tuning’ as the government ensures a ‘Goldilocks liquidity result’ – not too much, not too little, but just the right amount.

From our perspective, the risk that the government will prematurely tighten and send the economy into a ‘W’-shaped recovery is minimal, given that there are no bubbles in residential property or the A-share market, inflation is well contained and real urban unemployment is c.7%. Instead, Beijing will be focusing on steering the economy towards the all-important 8% GDP growth figure whilst maintaining a healthy balance between government and private spending.

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We do not expect to see any genuine tightening measures until the second half of 2010, but the caveat would be a very strong export rebound, rampant wage inflation or soft commodity prices

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spiralling out of control. The government has managed expectations extremely well in 2009 but will be swift to respond if necessary. Stay tuned.

Craig Farley, Investment Manager

Chindia Equity Fund

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