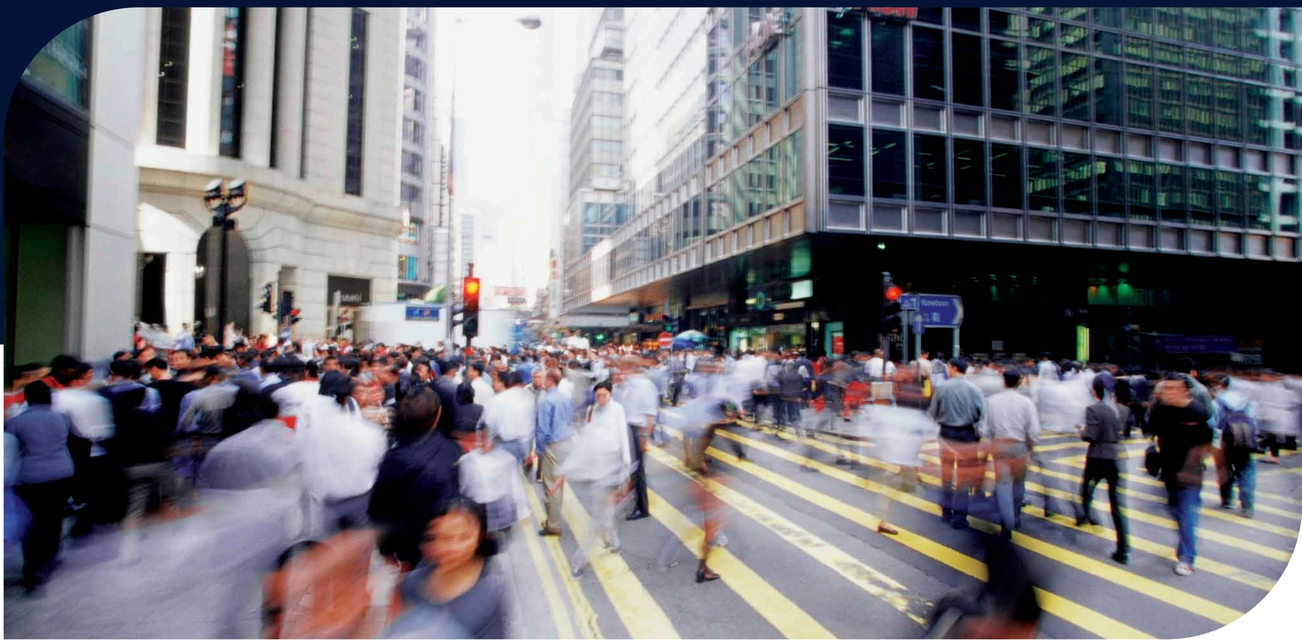
Teneo Survey Shows Mix of Optimism and Concern About China Among Global CEOs and Investors



This year is shaping up to be a pivotal one for the future of foreign investment in China.

Gabriel Wildau
Managing Director
gabriel.wildau@teneo.com

Economic growth slowed to 3% in 2022, the slowest annual pace since 1976, not including 2020, when Covid-19 first emerged. China's harsh zero-Covid policy was the main factor behind weak growth, but that policy has now ended, setting the stage for a growth rebound this year.

Still, the strength of this year's recovery remains uncertain, given other headwinds facing the economy. These include a depressed housing market, a tech sector still reeling from a two-year regulatory crackdown, weakening global demand for Chinese exports and rising geopolitical tensions. For global multinationals and investors, the key question is whether weak growth in 2022 was merely a temporary setback on China's inexorable march towards high-income status or whether the pandemic was a historical turning point, setting China on a new course towards stagnation and the "middle-income trap."

Teneo's recent survey of global CEOs and institutional investors, along with other survey data, broadly shows foreign multinationals in a wait-and-see mode. They no longer view China with the unbridled optimism that characterized the previous two decades, but they are also far from ready to abandon the Chinese market. Financial investors, by contrast, remain more resolutely optimistic.

Multinational CEOs are ambivalent

Somewhat surprisingly, only 20% of large company CEOs in the Teneo survey view China as "important" to their business strategy today. Over a ten-year timeframe, this ratio drops to 18%. This slight drop over the ten-year horizon may reflect some companies' intentions to diversify their supply chains away from China due to pressure from tariffs, export controls and geopolitical tension.

But these figures understate China's overall importance to multinationals given macro-level data showing that China remained the world's largest goods exporter and second-largest importer last year. In terms of foreign direct investment (FDI) inflows, China also ranked second behind the U.S. in the first half of 2022 according to the latest available OECD data. These figures suggest that the situation facing multinationals in China is more complex.

Other survey data illustrates the importance of the Chinese market to multinational companies today but also their ambivalence about the future of that market. In the latest survey by the American Chamber of Commerce in Shanghai conducted in mid-2022, three quarters of respondents reported profits in 2021, but the share of companies describing themselves as "optimistic" or "slightly optimistic" about the five-year business outlook fell to 55% – the lowest in the survey's history and a 23 percentage point drop from a year earlier. Given events in late 2022, including harsh lockdowns under zero-Covid followed by a sudden and chaotic exit from that policy in December, the next survey may show even greater ambivalence.

But a robust economic recovery this year could restore optimism. A variety of signals point to a shift away from ideology and state interventionism in favor of pro-growth pragmatism, which multinationals would welcome. At the Central Economic Work Conference in December, top leaders signaled that restoring growth is the main priority for 2023. The sudden exit from zero-Covid, though poorly planned, arguably demonstrated a degree of policy flexibility that was lacking earlier in 2022 when the leadership appeared stubbornly attached to lockdowns.

That sudden shift sparked a wave of infections, but recent evidence suggests China's population is already approaching herd immunity, enabling a recovery in consumption industries that suffered heavily during the pandemic. Meanwhile, policymakers have escalated support for the housing market, which may lead to a recovery of sales and construction activity. On tech policy, top leaders signaled that the two-year crackdown on platform companies like Alibaba, Ant Financial and Tencent is over, and regulators are developing new policies to revive the sector.

Portfolio investors are optimistic

In contrast to CEOs' cautious attitudes, Teneo's CEO and Investor Survey shows greater optimism among financial investors. Some 51% of respondents see China as important to their current strategy. This figure likely reflects the sharp drop in mainland and Hong Kong-listed equities in 2021-2022, which sent valuations to low levels and in turn sparked a strong recovery beginning in November.

Other survey data also shows optimism. A Bank of America survey of 80 fund managers showed that they were 84% net long and overweight on China, with 78% expecting a further 10-20% upside in China markets for the rest of this year. The MSCI China Index, which tracks more than U.S. $2 trillion of Chinese stocks listed in China and globally, rose 13% this year through late January. Sell-side analysts at major investment banks like Goldman Sachs, JP Morgan and Morgan Stanley are similarly bullish on China equities this year.

Investors' optimism over the long term is somewhat more surprising. Teneo's CEO and Investor Survey shows that China is important to 55% of respondents over a ten-year horizon. This figure may reflect investors' belief that China's long-term growth outlook remains strong, despite Covid-related disruptions and other headwinds, such as a declining population.

Greater optimism among portfolio investors may also reflect differences in the business outlook for multinationals versus local Chinese companies. Multinational CEOs worry about increasing competition from local players, discriminatory treatment by the Chinese government and geopolitical pressures, including policies by Western governments designed to promote "decoupling" from China. But these issues are of less concern to portfolio investors, who can simply shift their investment to the Chinese companies that continue to benefit from the country's economic growth, despite the more challenging environment for multinationals.

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