



## GHASTLY CHINESE REOPENING



## TEN SURPRISES FOR 2023

## Ghastly Chinese Reopening

EM Leaders is offering insights distilled from our local network with non-consensus predictions for 2023 that are positive, actionable, and mutually consistent. We see a difficult winter followed by a ghastly Chinese reopening and continuing war in Ukraine that will have horrendous human tolls. The global recovery is likely to start in China which will be reflected in stronger equity markets and higher commodity prices, that may lead to stubborn inflation in Europe and the US and a downturn in credit markets. A bullish EM cycle could be re-ignited with stronger emphasis on domestic markets.

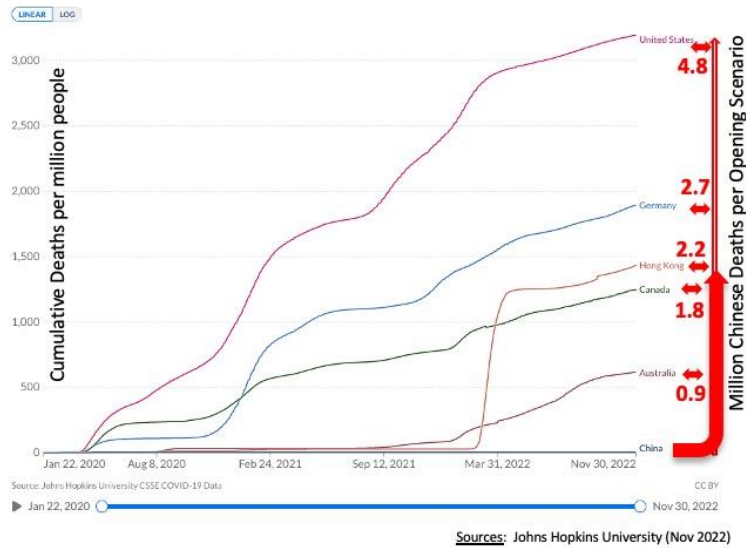
1. **China's zero-covid exit** may prove ghastly with two million deaths among seniors. But China may record less than half of the US pre-capita deaths from Covid (chart 1). China has a long history of political fallout from pandemics but may keep stability by heeding demands from the younger generation and businesses for a quick reopening. Growth may hit 5% and equity markets rally by 30% from historically depressed levels.
2. China's reopening may be bullish for **EM currencies**, especially the CNY and KRW, and propel interest in the digital renminbi. Both Chinese and Korean currencies may appreciate by 10% from their 2022 lows while the US dollar will continue its decline. Copper may ring in a **new supercycle for commodities** (chart 2) and rise to 4.50/lb in 2023 given its tight supply and strong demand plus the accelerating energy transition.
3. Russia may prolong the Ukraine war and keep **energy price volatility** through 2023. **China, India, and Turkey** stand to benefit from preferential Russian energy imports, whereas Europe, Japan, and Korea will face even higher energy prices as Brent oil may rise from \$80 to \$110 per barrel in 2023. Supply bottlenecks may further delay the energy transition but the use of coal/dirty energy may finally peak in winter 2023.

4. China may blunt the chips-trade-war by dividing the US and Europe as Europe is desperate to maintain trade with China. China may counter its technological squeeze with their effort to squeeze the US in commodity markets by building new alliances. **Saudi Arabia** now exports over 20% to China (versus 5% to the US, chart 3) and both may benefit from re-denominating oil prices from USD to CNY at the current peak.
5. US hopes for a quick decline in **inflation** may not happen in 2023 despite tighter financial conditions as geopolitical tensions from Russia and Iran may keep pressure on energy and food prices, that may be exacerbated by faster Asian growth and wage-price loops. Sectors with high pricing power may outperform during the recovery later in 2023, especially consumer staples and health care (also a long-term EM theme).
6. **Credit markets** may feel the full punch from higher rates during 2023. High yield corporate default rates may double to 4% and HYG spreads may widen by another 200 bps, trading through emerging markets debt (EMD). The FED may be pushed into more hawkish action with rates hitting 5.5% to counter dovish market psychology predicting a ‘caving FED’, which eventually may happen late in 2023 after a high-profile default.
7. **Europe** may face a severe and prolonged recession in 2023 as consumer confidence has already hit historic lows. Yet inflation remains in double digits and the ECB rates may need to rise substantially. Moody’s has Italy’s Baa3 rating on negative outlook as its debt levels are already unsustainable at current interest rates. The **ECB quagmire** may re-ignite EU political tension that may lead to a fiscal union and strong recovery.
8. **Japan** may finally get inflation and devaluation as the BOJ imposes losses on bond-holders and piles more government debt (already 250% of GDP) onto its balance sheet. The Yen may break 160/\$ and trigger a devaluation-inflation spiral as the BOJ cannot raise rates and fiscal deficits mount, proving the fallacy of modern monetary theory. Energy price caps and subsidies may be popular but become unsustainable.
9. A new bullish **EM cycle** may start in 2023, as emerging markets grow much faster than the G7 (4% versus 1%) and EM debt is much lower (70% versus 130%). India and Indonesia as well as Nigeria and Pakistan are having the fastest population growth. Most attractive markets, in terms of equity and currency valuations (chart 4), are China, Korea, and Brazil whereas Indian equities are overpriced and least attractive.
10. **Decoupling and near-shoring** may become big themes in 2023. Both the US and EU are shifting supply chains in technology and pharmaceuticals closer to home while EV, autonomous vehicles, and sensitive communications technology may soon follow. Main beneficiaries may be Mexico and Colombia, as well as Poland and Turkey. Supply chain diversification out of China may benefit Vietnam, other Asean, Korea and India.

<http://www.emleaders.com/pdf/eml-view-2023.pdf>

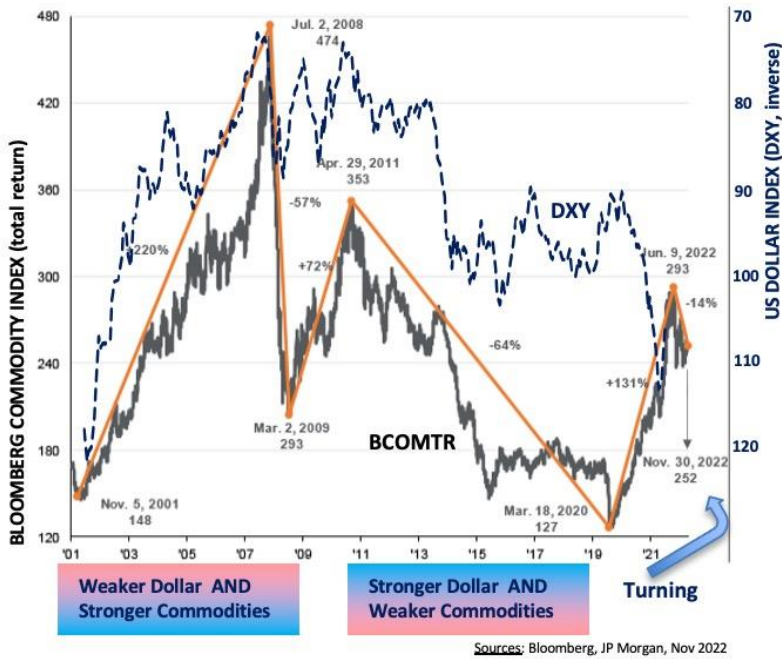
# Ghastly Chinese Covid Opening Chart 1

## Hong Kong Covid history pointing to two million deaths



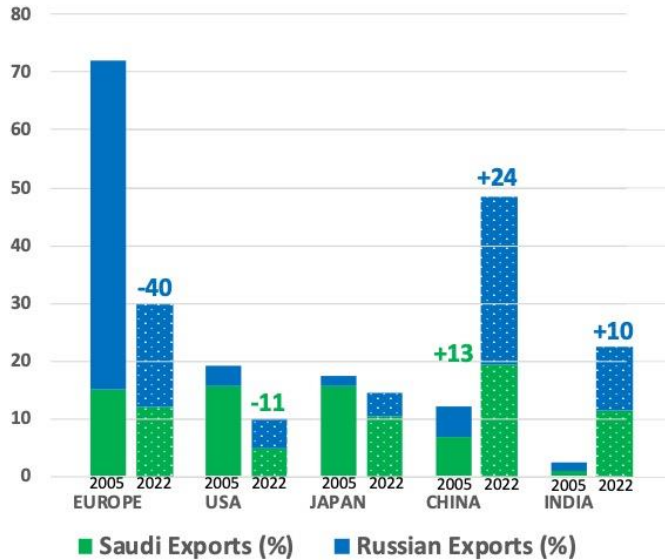
# New Commodities Supercycle Chart 2

## Weakening Dollar could drive commodities higher



## China's Hunger for Commodities - Chart 3

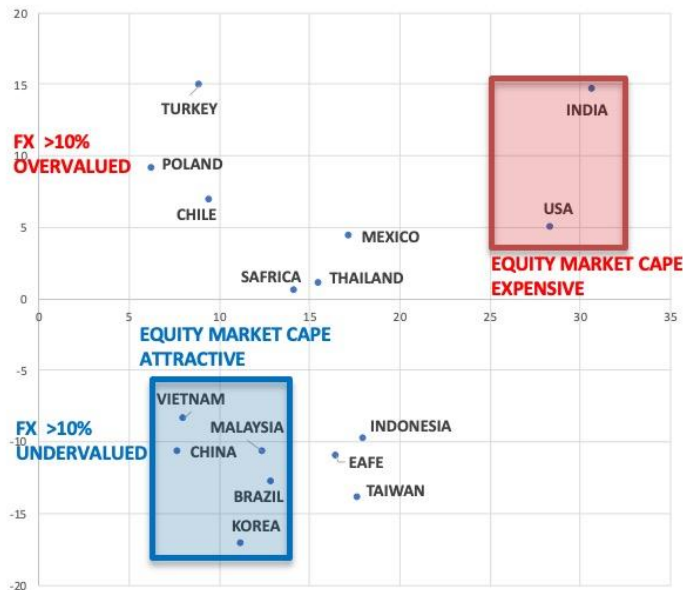
Majority of Saudi and Russian Exports now going to Asia  
China is largest trading partner for Russia and Saudi Arabia



Sources: Bloomberg, World Bank WITS, OEC Datawheel, Nov 2022

## Relative Equity and FX Valuations - Chart 4

Attractive Valuations in China, Korea, and Brazil



Sources: IIF, IMF, Research Affiliates (Nov 2022)