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CHINA OUTLOOK 2024

CAPITAL FLOWS
Part of the Horizon Scanning series

Benita Yu
Senior Partner

Lisa Chung
Partner

MACROECONOMIC OUTLOOK

2023 was a year characterised by above-average global inflation and rising interest rates, tepid domestic demand, structural stresses in the property market and geopolitical tensions for China.

The first quarter of 2023 saw only US$3.2 billion of new greenfield investment deals, a decline of 34% compared to the same period in 2022 and a fall of 75% relative to 2021. This trend continued in Q3 2023, as China reported a foreign direct investment deficit of US$11.8 billion, the first quarterly deficit since figures were first published 25 years ago.

Unsurprisingly, dealmaking activity was subdued with Greater China (including Hong Kong, Macau and Taiwan) recording 702 M&A deals worth US$62.3 billion for the first eight months of 2023, with total deal volume declining by 124 deals and an aggregate decrease in transaction value of 13% versus the same period in 2022.

Analysts predict that similar macroeconomic factors will continue to inhibit M&A activity in 2024 with China's GDP forecast to grow by 4.6%. This matches forecasts for slower GDP growth in Asia's developing economies in 2024.

RECENT DEVELOPMENTS IN CHINA

Notwithstanding the economic headwinds, recent developments in China offer some optimism of a rebound in M&A activity in 2024.

"China + 1" Approach but Continued Significance of China

China remains the top trading partner for more than 120 countries. Its share of global GDP in 2022 was around 18.8%, and China is forecast to contribute around 35% of global growth in 2023, after the annualised GDP growth of China exceeded expectations in the third quarter of 2023.

Against this backdrop, many foreign investors still view access to China's market as crucial to their growth, even though they are increasingly looking to manage their exposure by diversifying their geographical footprint. This was reflected in the recent survey by the European Union Chamber of Commerce in China, which revealed that only 0.2% of respondents are looking to divest fully from China and that one in 10 respondents report that they plan to diversify their future supply chain-related investments but will not make changes to their existing supply chains in China.

Foreign investors are increasingly adopting a "China + 1" approach in a bid to diversify and strengthen the resilience of their supply chains. Countries such as Vietnam, Thailand, Indonesia and India are popular destinations for establishing alternative destinations. There are, however, some lingering concerns in some of these alternative destinations, including tariffs, the experience and skill of the labour force and the quality of the logistics infrastructure. It is probably unreasonable to expect, at least in the short to medium term, that any single country would be able to match the scale of China as the "world's factory".

While a "China + 1" approach suggests a reduced dependence on Chinese producers, due to the diversification of supply chains and reduced direct trade with China, data suggests that reliance on - and exposure to - Chinese producers may not have changed materially. The transshipment of goods through third party countries have correspondingly risen and Chinese companies have been embedding themselves in Southeast Asian supply chains. As an example, the Vietnamese government reported that Chinese firms invested in 45 new projects in Vietnam in the first 50 days of 2023 alone. The reduction of dependence on China's producers resulting from the "China + 1" approach may not have been as significant as expected and might only seek to deepen the links between China and its new trade partners.

China's Initiatives to Attract Foreign Investment

The Chinese government has rolled out a full range of initiatives in 2023 to attract foreign investment, boost the economic growth and improve investor confidence.

In March 2023, the "Invest in China Year" campaign was launched to give foreign investors a better understanding of the investment opportunities in China.

In July 2023, the Communist Party of China and the Chinese government vowed to improve conditions for private businesses, primarily by treating them in a similar way to state-owned enterprises.

In August 2023, the State Council released a new policy framework, titled "Opinions to Further Optimise the Environment for Foreign Investment and Increase Efforts to Attract Foreign Investment" which seeks, amongst other things, to improve the foreign business environment and ensure fair treatment of foreign investors so as to achieve an optimal investment environment and boost investor confidence. Key measures include: exempting foreign investors from taxes if the profits earned in China are reinvested; ensuring that foreign enterprises enjoy equal treatment as local enterprises; and clamping down on intellectual property rights infringements.

President Xi also pledged in November 2023 to remove foreign investment barriers and foster a market-oriented, law-based and world-class business environment.

While it remains to be seen how the slew of policies will be implemented - and while it will take time to restore the confidence of foreign investors - in a country where top-down signalling is both vital and effective for clearing of roadblocks, the developments in 2023 are a positive sign from the Chinese government to investors that it is open for business again.

Stabilising US – China Relations

Against a backdrop of tariffs, export controls and sanctions, both countries have recognised the need for stabilising their relationship following a prolonged period of heightened political tension. An agreement by the Chinese and US heads of state to continue on a path of diplomacy and co-operation, following a meeting which took place in November 2023, is an encouraging sign for investors.

Investments by New Economic Partners

A fall in foreign direct investment from companies in the US and nations with strong ties to the US, may allow other nations and economic blocs to partner with China. It is estimated that the Gulf Cooperation Council countries, whose sovereign wealth funds total around US$4 trillion in collective capital, will increase their investment in China, and may reach as much as 10% to 20% of total foreign direct investments by 2030. The signing of bilateral agreements worth US$10 billion between China and Saudi Arabia (a nation with traditionally close ties with the US) at the Arab-China Business Conference in 2023 is an indication of their willingness to deepen economic cooperation.

CAUTIOUS OPTIMISM FOR THE RETURN OF CHINA'S M&A MARKET

The macroeconomic difficulties are apparent but the continued significance of China to the global supply chain and recent developments such as the raft of policy measures introduced by the Chinese government to bolster an economic recovery and a recent Xi-Biden meeting do represent some reasonable bases for some cautious optimism for China's M&A dealmaking in 2024.

CONTACT US TO FIND OUT MORE

Benita Yu
Senior Partner
T +852 2901 7207
E benita.yu@slaughterandmay.com

Lisa Chung
Partner
T +852 2901 7268
E lisa.chung@slaughterandmay.com

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