GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

April 21, 2022

Ongoing omicron: What's next for China?

Frédérique Carrier – London & Jasmine Duan – Hong Kong

The omicron variant's spread has been a heavy blow to the Chinese economy as local governments are scrambling to contain COVID-19 by reimposing rigid lockdowns. We examine the zero-COVID policy's impact on the Chinese and global economies and assess how China's central government may react to stabilize its economy. We also highlight investment implications for equity investors.

Harsh lockdowns

China is struggling to contain its most severe wave of COVID-19 infections since winter 2020. Areas with some form of lockdown encompass almost 25 percent of China's economy. A strict lockdown was imposed on China's largest and wealthiest city, Shanghai, and its 26 million residents on April 5.

The government thinks a zero-tolerance policy nationwide is necessary to prevent hospitals from becoming overwhelmed. The population has no natural immunity given previous waves have been relatively subdued. Vaccination booster rates are low with just 50 percent of the population having received a third shot, and just 20 percent for those over 80 years of age. Using China's National Health Commission data and based on the current vaccination rates, we calculate it would take more than three months and seven months, respectively, to bring vaccination levels to above 70 percent for the two groups.

How long Shanghai remains in lockdown will be key to assessing the lockdown's economic damage. The city of Shenzhen (population 17 million) emerged from a lockdown in March after just 10 days, having imposed a full lockdown when the first COVID-19 cases appeared. Given the Shanghai lockdown was imposed when cases were already soaring, it may take a few more weeks to completely lift the lockdown.

We believe cities have learned from Shenzhen's and Shanghai's experiences, and are likely to double down on pandemic control as soon as initial cases are reported to minimize the time required to remain in lockdown.

Although some top health scientists admitted recently the country cannot maintain the zero-tolerance policy forever, we think China may choose to remain resolute in the near term. The policy has worked well in the past two years as China incurred the lowest COVID-19 mortality rate of any large country. Moreover, RBC Global Asset Management Inc. Chief Economist Eric Lascelles points out that a massive outbreak would not be a good look just before President Xi Jinping seeks a third term from the 20th Congress of the Communist Party this fall.

Lower growth

Signs suggesting the lockdowns are disrupting the economy are appearing. Q1 2022 GDP pointed to still-moderate growth of 4.8 percent year over year, but given the impact of the latest omicron wave only came late last month, it is not fully reflected in the Q1 GDP data.

For perspectives on the week from our regional analysts, please see pages 3–4.

Weak domestic demand led Q1 2022 retail sales to fall more than three percent year over year and imports to contract in March as lockdowns hampered freight arrivals. Imports of major industrial metals, including iron ore and copper, slowed particularly. Lower Chinese demand for these commodities could give some much-needed respite to their prices.

Without a major overhaul of quarantine rules, the economic damage due to omicron will likely increase. Premier Li Keqiang has repeatedly warned of growth risks this month, and the State Council and related government departments have ordered local authorities to minimize transportation and logistics disruptions when imposing local quarantines.

We expect policymakers to step up policy stimulus to cushion growth pressures. On April 15, the People's Bank of China (PBoC) cut its reserve requirement ratio (RRR) by 25 basis points for all banks and 50 basis points for certain small banks. These are smaller than the typical cuts of 50 or 100 basis points, perhaps due to weak credit demand and concerns regarding the inflation outlook. We think the RRR cuts may not be enough to revive the economy. Consumer spending is likely to retreat due to lockdowns, and individuals are likely to prefer to save given uncertain times. Therefore, we also expect policymakers to step up policy stimulus.

We think further tax cuts, city-level housing policy relaxations, and a pandemic relief package for COVID-19-sensitive industries and small and medium-sized enterprises are likely. We also expect more state-sponsored infrastructure development as Beijing continues to encourage local governments to front-load construction, and has granted provinces their full allocation of special bonds to be used for infrastructure investment. In fact, fixed asset investments grew more than nine percent year over year in Q1 2022 as a result.

RBC Global Asset Management maintains a growth forecast of less than five percent for 2022, compared to the official 5.5 percent growth target, largely due to the expected damage from COVID-19 lockdowns and a global pivot to services from Chinese-produced goods. Risk is skewed to the downside.

Further disruption of global supply chains

Domestic logistics and port operations disruptions may spill over to regional or global supply chains. In addition, some cities under lockdown in southern and eastern China are manufacturing hubs for electronic products, chips, and electric vehicles. Exports are likely to slow more meaningfully in the coming months.

Moreover, global companies are likely to increasingly diversify their supply chains out of China. According to a March survey by the American Chamber of Commerce in China, 49 percent of the respondents intend to reduce their investment if China's current COVID-19 restrictions remain in place into next year. The attraction of low manufacturing costs is being eclipsed by an increasing focus on ensuring critical materials and technologies are always available.

Number of subway trips fell abruptly in March as omicron cases expanded

Subway traffic in major Chinese cities*

* Index is the weighted seven-day rolling sum of subway trips in Beijing, Guangzhou, Nanjing, Shanghai, Suzhou, and Zhengzhou.

Source: Chinese metro agencies, Macrobond, RBC Global Asset Management; data through 4/19/22

An opportunity could emerge

The MSCI China consensus earnings growth estimate, which has been revised down since early March, stands at 15 percent year over year for 2022. However, because the omicron variant's impact is still hard to predict, the projection may be downgraded further as more companies factor in the impact of the outbreak. This will likely weigh on equities in the short term.

The uncertainty currently surrounding China equities seems to be mostly discounted in valuations which are depressed relative to both historical averages and global peers. The MSCI China Index is currently trading at 10.5x the forward 12-month consensus earnings estimate vs. its 15.8x five-year average.

This may present an opportunity. China is the only major global economy widely expected to loosen its monetary policy this year, and stocks typically rebound very quickly from depressed levels when monetary and fiscal stimulus kick in.

Within the Chinese equity universe, infrastructure-related sectors, such as construction, building materials, and energy and commodity-related stocks could outperform, as could sectors focusing on high-end manufacturing, such as those in the electric vehicle value chain and semiconductor-related companies.

UNITED STATES

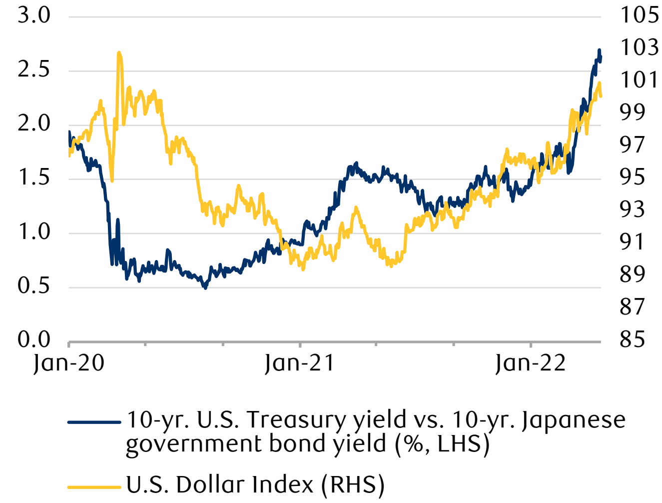
Atul Bhatia, CFA – Minneapolis

■ **Fixed income volatility remains high as Treasury yields continue to rise**. Over the five trading sessions ending April 20, yields increased by 0.2% on Treasuries maturing in two years and by nearly 0.15% on 10-year government securities, to reach 2.57% and 2.83%, respectively. The primary driver of bond losses continues to be the expectation that monetary policy will tighten further, with recent Federal Reserve speakers including San Francisco Fed President Mary Daly appearing favorable to the idea of a 0.5% rate hike at the central bank's May meeting. The overall Fed strategy of expeditiously raising rates to a neutral level before pausing seems intact, in our view.

■ **The Fed this week released its periodic survey of economic conditions in the U.S.** This edition of the so-called Beige Book was generally positive, citing a moderate pace of economic growth with consumer demand remaining stable even as firms passed along rising costs. The twin constraints of supply chain interruptions and labor shortages remain problematic across the country, with employers in several regions noting difficulties in attracting and retaining workers. On the negative side, the Beige Book noted the high degree of uncertainty caused by rising prices and geopolitics, factors that may weigh on future growth and potentially limit future Fed rate hikes.

■ **Rising bond yields have helped drive a rally in the dollar**, with the U.S. Dollar Index (DXY)—a roughly trade-weighted measure of the greenback's value—staying near multiyear highs. **Higher Treasury yields are also increasing the relative advantage of U.S. debt** compared to euro-denominated and (particularly) yen-denominated government bonds, potentially drawing overseas institutional investors to increase allocations to U.S. government debt. If it materializes, this source of demand could partially offset the effects of the Fed's pullback from quantitative easing.

U.S. yield advantage helps push dollar higher



Source - RBC Wealth Management, Bloomberg; data as of intraday 4/21/22

CANADA

Matt Altro & Sean Killin – Toronto

■ **Canadian consumer price inflation hit 6.7% y/y in March**, up from 5.7% in February and representing the largest price increase since January 1991. Consumers are enduring higher prices at grocery stores, as the price of food items climbed 8.7% y/y, the biggest jump since March 2009. Anxiety surrounding supply scarcity in global energy markets, which has been compounded by geopolitical risk premiums, remains one of the main factors driving inflationary conditions, with higher energy costs contributing 1.2 percentage points to overall inflation. **All three of the Bank of Canada's (BoC) core inflation metrics accelerated in March, highlighting the broadening of inflationary pressures** across the economy. On a positive note, higher energy prices have provided a lift to the commodity-heavy S&P/TSX Composite Index, with the Energy sector generating a total return of roughly 37% so far in 2022 and the index itself generating a 4.5% total return year to date. Looking ahead, inflation expectations remain elevated with the majority of firms surveyed by the BoC expecting inflation to remain above the central bank's 2% target over the next two years.

■ With inflation continuing to run hot and global central banks, including the BoC, charting a course to higher policy rates in response, the sensitivity of economic activity to rising interest rates is worth considering. On this front, we believe **Canada's economy may be more sensitive to higher rates than the economies of most other developed nations**, as Canadian household debt levels have increased meaningfully over the past decade. With mortgage rates rising significantly over the past year and more central bank rate hikes likely given the current inflationary environment, households may have to think twice about additional borrowing as the effects of the higher service costs are increasingly felt.

EUROPE

Rufaro Chiriseri, CFA, Thomas McGarrity, CFA, & Frédérique Carrier – London

■ **France's President Emmanuel Macron will face far-right candidate Marine Le Pen, who has focused on the cost of living, in the second-round runoff of the French presidential election on April 24**. Macron gathered close to 28% of the votes in the first round, more than any other incumbent president since 1988, and enjoys a comfortable lead of between 9% and 13% according to recent polls.

Markets are expecting a second Macron term, which they view as representing stability and continuity. The difference, or spread, between 10-year French and German government bonds remains moderate.

- **A surprise Le Pen victory would likely result in a negative market reaction**. While she no longer calls for France to leave the European Union and says she only wants to reform Brussels' institutions, the changes she proposes are incompatible with EU membership. Her alignment with some of President Vladimir Putin's ideas means current sanctions could be at risk.

- **Euro area headline inflation rose to 7.4%, a record high, in March**, due to surging energy costs—housing energy bills and road fuel costs rose significantly with increases of 38.9% y/y and 47.6% y/y, respectively.

- **The European Central Bank (ECB) Governing Council is becoming increasingly hawkish** as many members are now supportive of hiking rates to 0% by the end of the year. Furthermore, ECB Vice President Luis de Guindos sees asset purchases likely ending in July with the possibility of a hike as early as July or September.

- The combination of high inflation and hawkish commentary has led to the market pricing in around 75 basis points of policy tightening this year.

- **Q1 2022 reporting season has gotten off to a relatively upbeat start**. So far, results from companies in the Consumer Staples sector have come in better than consensus expectations. For example, Nestlé reported organic sales growth of 7.6% vs. the 5.0% consensus estimate. The company raised prices by 5.2% in the quarter (versus a consensus expectation of 3.8%) to compensate for significantly higher input costs. Elsewhere, luxury companies' results have been particularly strong, in our view, while semiconductor equipment manufacturer ASML said it continues to see demand above its current production capacity. Accordingly, ASML is actively working to significantly expand capacity together with its supply chain partners.

ASIA PACIFIC

Emily Li & Jasmine Duan – Hong Kong

- **Chinese stocks saw four straight days of declines as investors worried about the economic impact of the government's zero-COVID policy**. Smaller-than-expected policy stimulus added to investors' disappointment. The onshore CSI 300 Index has erased almost all of its mid-March rally, which was triggered by a sweeping set of policy promises from a committee led by Vice Premier Liu He that aimed to stabilize markets. Chinese Tech stocks, measured by the Hang Seng TECH Index, slid to their lowest level in more than a month.

Chinese equities' gains since March have been almost erased

CSI 300 Index

Source - RBC Wealth Management, Bloomberg; daily data through 4/21/22

- **The People's Bank of China (PBoC) rolled out almost two dozen measures and pledges to boost lending and support industries that have been affected by COVID-19 outbreaks**. The PBoC statement included lending guidance for banks and promises to make it easier for companies to expand the cross-border use of the yuan, as well as general promises of more credit and other financial support. The central bank said it would use monetary policy tools to provide sufficient liquidity and would guide banks to expand loan extension. However, **the recent required reserve ratio cut disappointed the market**. Investors are now looking for easing signals from the Chinese Communist Party's Politburo, its highest decision-making body, which traditionally meets at the end of April.

- **Japan's exports advanced at a slower pace in March** as car shipments fell, while imports continued to surge on higher energy prices, **extending the country's trade deficit to an eighth month**. Exports were up 14.7% y/y in March, below the 17.1% Bloomberg consensus estimate, while imports surged 31.2% y/y compared with 28.9% estimate. The yen's drop to a 20-year low is compounding Japan's trade difficulties. Typically, a weaker yen bodes well for Japan's economy because it makes exports more competitive and boosts the value of overseas earnings. However, **investors are increasingly concerned about the negative impacts of yen weakness**, as it could lead to higher energy costs and hurt the margins of companies that import raw materials from overseas.

MARKET
Scorecard

Data as of April 20, 2022

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,459.45	-1.6%	-6.4%	7.8%	58.0%
Dow Industrials (DJIA)	35,160.79	1.4%	-3.2%	4.0%	48.7%
Nasdaq	13,453.07	-5.4%	-14.0%	-2.4%	57.1%
Russell 2000	2,038.19	-1.5%	-9.2%	-6.9%	68.0%
S&P/TSX Comp	21,998.38	0.5%	3.7%	15.5%	52.9%
FTSE All-Share	4,236.24	1.2%	0.7%	8.1%	32.4%
STOXX Europe 600	460.10	0.9%	-5.7%	6.1%	37.1%
EURO STOXX 50	3,896.81	-0.1%	-9.3%	-1.1%	33.9%
Hang Seng	20,944.67	-4.8%	-10.5%	-28.1%	-13.9%
Shanghai Comp	3,151.05	-3.1%	-13.4%	-9.3%	10.5%
Nikkei 225	27,217.85	-2.2%	-5.5%	-6.5%	38.4%
India Sensex	57,037.50	-2.6%	-2.1%	19.6%	80.2%
Singapore Straits Times	3,335.32	-2.1%	6.8%	4.5%	28.4%
Brazil Ibovespa	114,343.78	-4.7%	9.1%	-4.8%	44.8%
Mexican Bolsa IPC	53,831.04	-4.8%	1.0%	10.9%	56.1%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	2.832%	49.4	132.2	127.3	222.7
Canada 10-Yr	2.820%	41.5	139.4	131.7	219.2
UK 10-Yr	1.915%	30.5	94.4	118.4	157.8
Germany 10-Yr	0.857%	30.9	103.4	111.9	130.5
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	3.44%	-3.7%	-9.4%	-8.5%	-8.5%
U.S. Investment-Grade Corp	4.18%	-4.8%	-12.1%	-9.8%	-5.5%
U.S. High-Yield Corp	6.59%	-2.1%	-6.9%	-3.5%	14.1%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,957.66	1.0%	7.0%	10.1%	15.5%
Silver (spot $/oz)	25.20	1.6%	8.1%	-2.5%	64.5%
Copper ($/metric ton)	10,281.50	-0.8%	5.6%	10.2%	99.3%
Oil (WTI spot/bbl)	102.75	2.5%	33.5%	64.6%	-373.1%
Oil (Brent spot/bbl)	107.27	-0.6%	37.9%	61.1%	319.5%
Natural Gas ($/mmBtu)	6.82	20.9%	82.9%	150.1%	254.5%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	100.3040	2.0%	4.8%	9.9%	0.3%
CAD/USD	0.8002	0.1%	1.1%	0.9%	13.2%
USD/CAD	1.2498	-0.1%	-1.1%	-0.9%	-11.7%
EUR/USD	1.0850	-2.0%	-4.6%	-9.9%	-0.1%
GBP/USD	1.3059	-0.6%	-3.5%	-6.3%	5.0%
AUD/USD	0.7449	-0.4%	2.6%	-3.6%	17.6%
USD/JPY	127.9100	5.1%	11.1%	18.3%	18.9%
EUR/JPY	138.7800	3.1%	6.0%	6.7%	18.7%
EUR/GBP	0.8310	-1.4%	-1.2%	-3.8%	-4.9%
EUR/CHF	1.0293	0.8%	-0.8%	-6.6%	-2.1%
USD/SGD	1.3629	0.6%	1.0%	2.5%	-4.1%
USD/CNY	6.4192	1.2%	1.0%	-1.2%	-9.2%
USD/MXN	19.9985	0.6%	-2.6%	0.1%	-16.8%
USD/BRL	4.6221	-2.5%	-17.1%	-17.0%	-13.1%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.80 means 1 Canadian dollar will buy 0.80 U.S. dollar. CAD/USD 1.1% return means the Canadian dollar rose 1.1% vs. the U.S. dollar year to date. USD/JPY 127.91 means 1 U.S. dollar will buy 127.91 yen. USD/JPY 11.1% return means the U.S. dollar rose 11.1% vs. the yen year to date.

Source - Bloomberg; data as of 4/20/22 market close

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Hold [Sector Perform]	569	39.03	172	30.23
Sell [Underperform]	48	3.29	3	6.25

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