

March 2019

VanEck[®]

Access the opportunities.

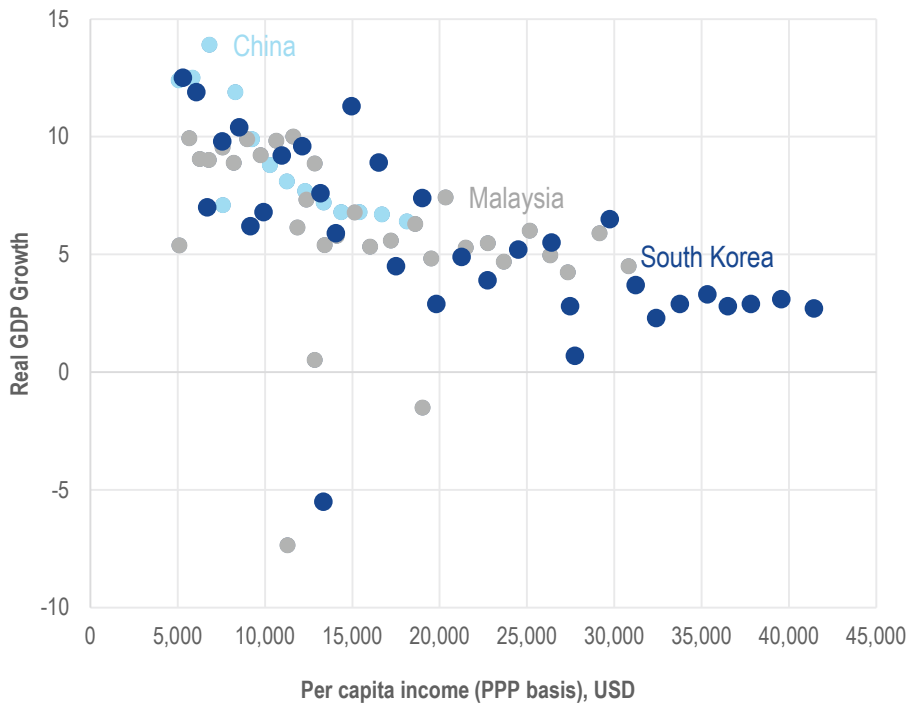
China in 2019: Pursuing a middle-income growth model

Big picture: China must slow down

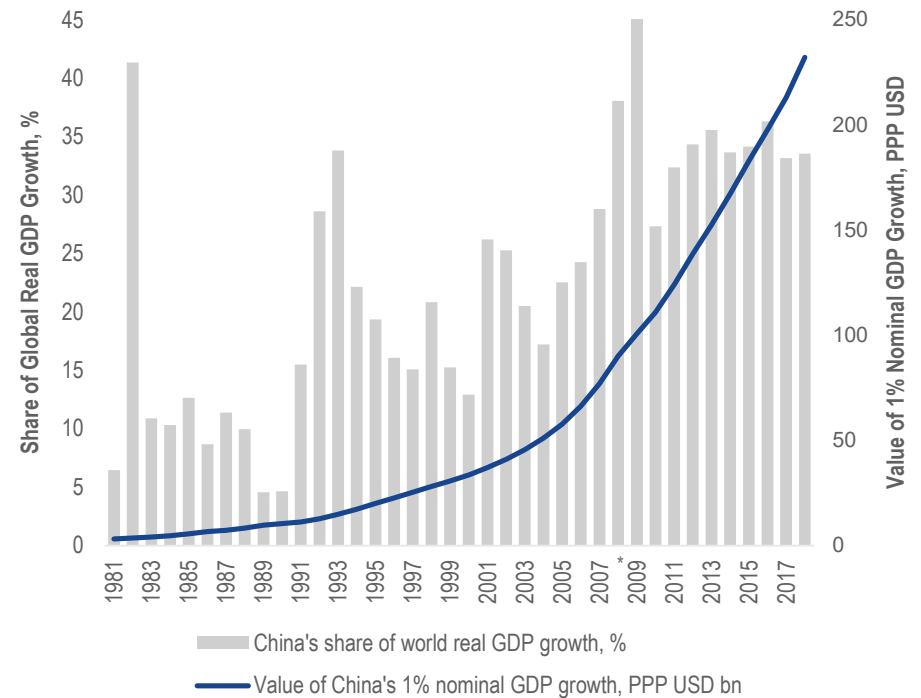
- China's economy is bound to slow as it matures and relies more on consumption – similar to what happened with regional peers
- China's contribution to global growth will still remain significant



China has high real GDP growth but low per capita income



China has been a major contributor to global growth

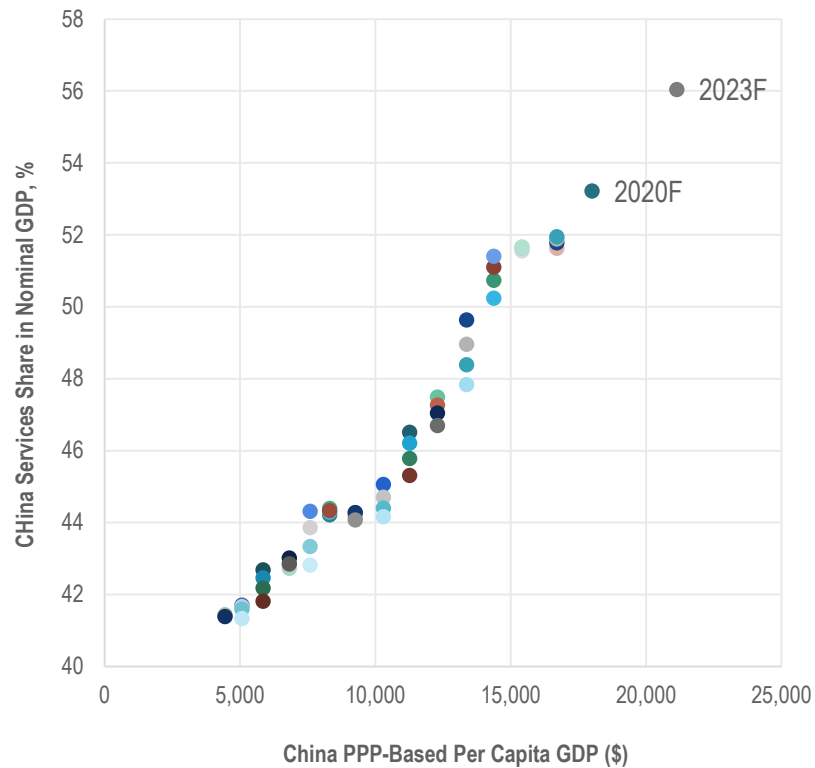


Source: VanEck; Bloomberg. GDP: gross domestic product. PPP basis: adjusted for purchasing power, which accounts for differences in price levels. *Although not shown, china accounted for 100% of Global Real GDP in 2009

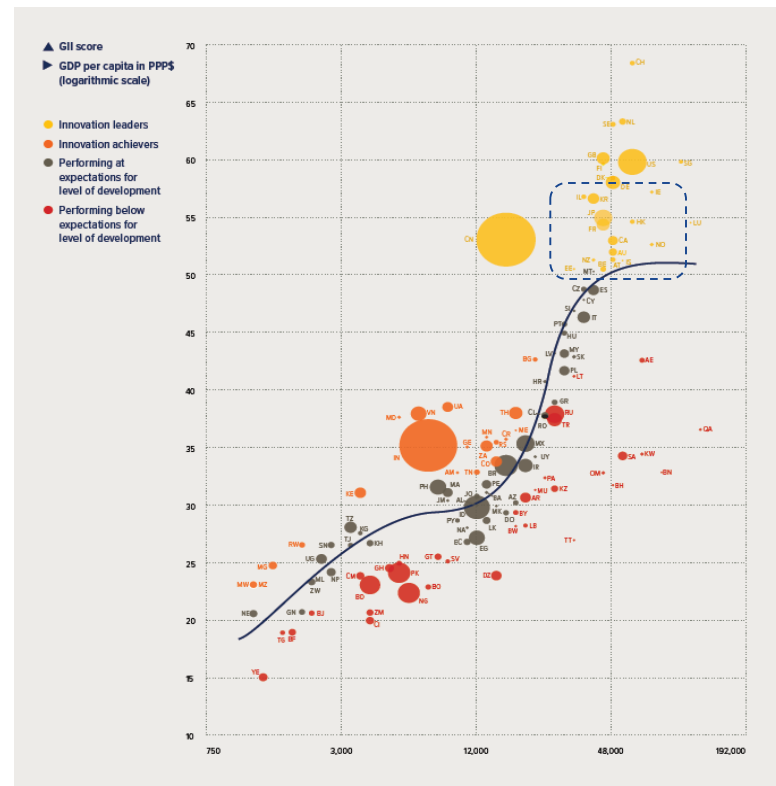
Innovation and rising middle class drive secular transformation

- Rising incomes are associated with a higher share of services in GDP
- China's innovation record is impressive

As income rises, so does services share



China: A leader in innovation

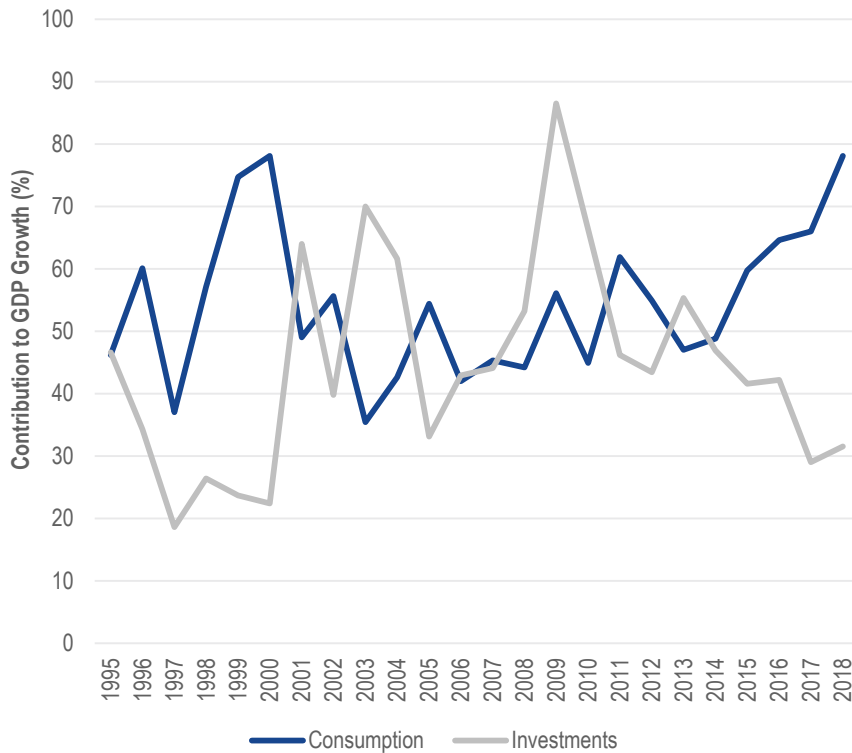


Source: VanEck, Bloomberg LP (left); Cornell University (right). Service share: service sectors' share of nominal GDP. GII: Global Innovation Index.

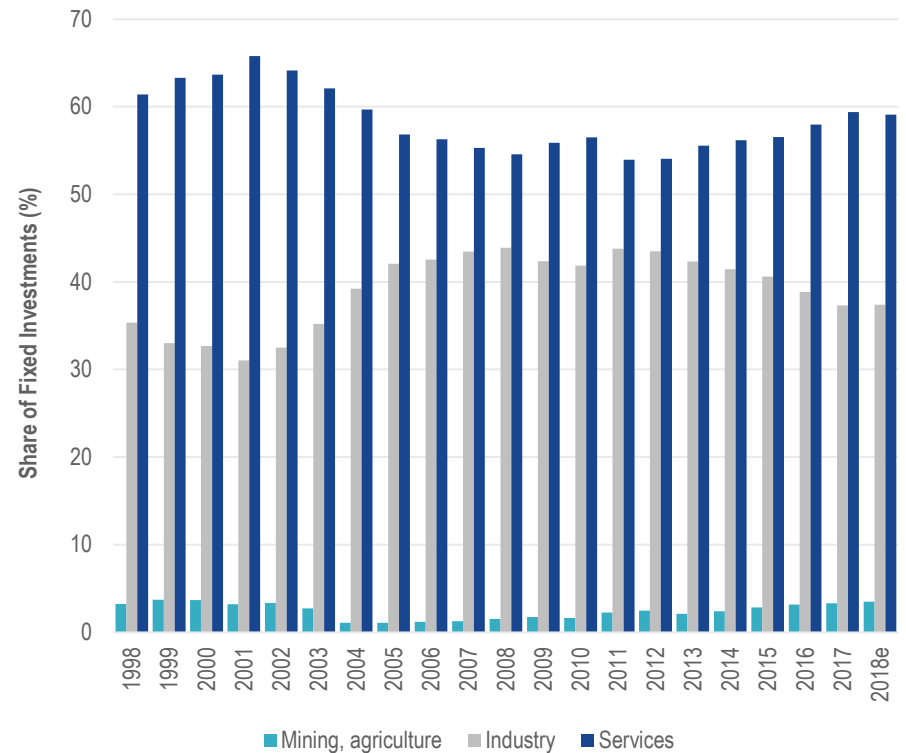
China is becoming a consumer-based economy

- Investments' share in GDP is slipping below 30%
- Services account for nearly 60% of fixed investments

China's growth increasingly driven by consumption



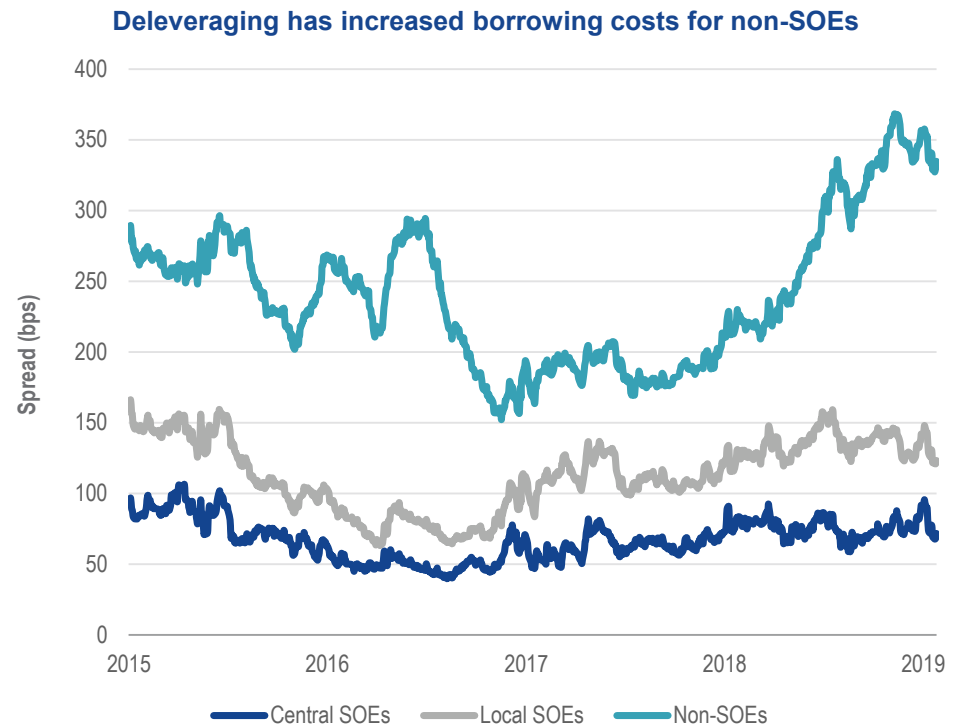
Structure of China's Investments



Source: Bloomberg LP

Dealing with imbalances is painful

- China accumulated multiple macroeconomic imbalances while getting richer
- It has started to address some of the most pressing ones – high leverage and shadow financing
- However, the deleveraging drive hit the private sector and smaller companies the hardest, while state-owned enterprise (SOE) borrowing costs remained almost untouched



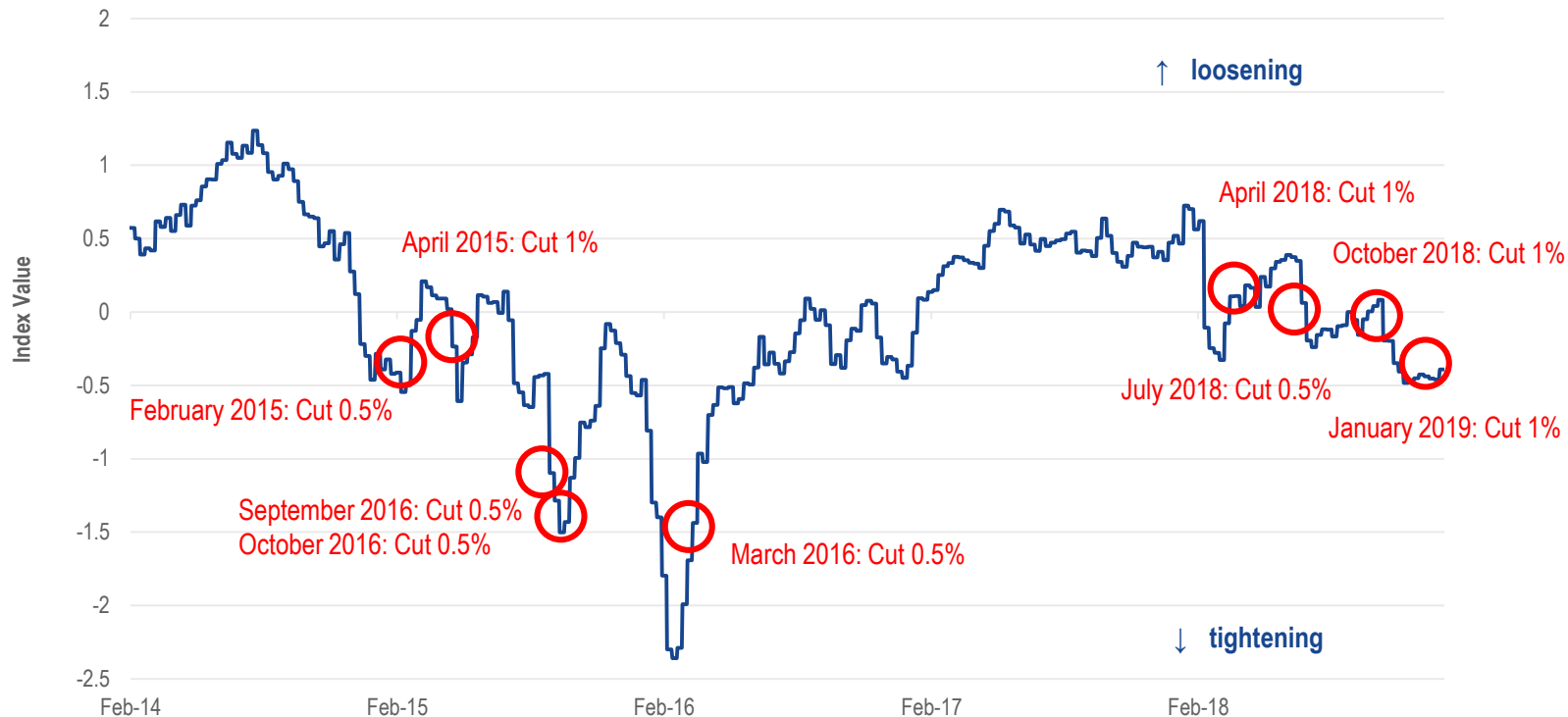
Source: VanEck, Bloomberg LP (left); UBS (right)

Some traditional policy tools look less effective



- The transmission mechanism is not working properly, as past policy moves (2018 RRR cuts) failed to ease China's financial conditions as they had in the past
- Notwithstanding, the “drip stimulus” approach is still in place

China's policy moves are not having the same impact as in the past

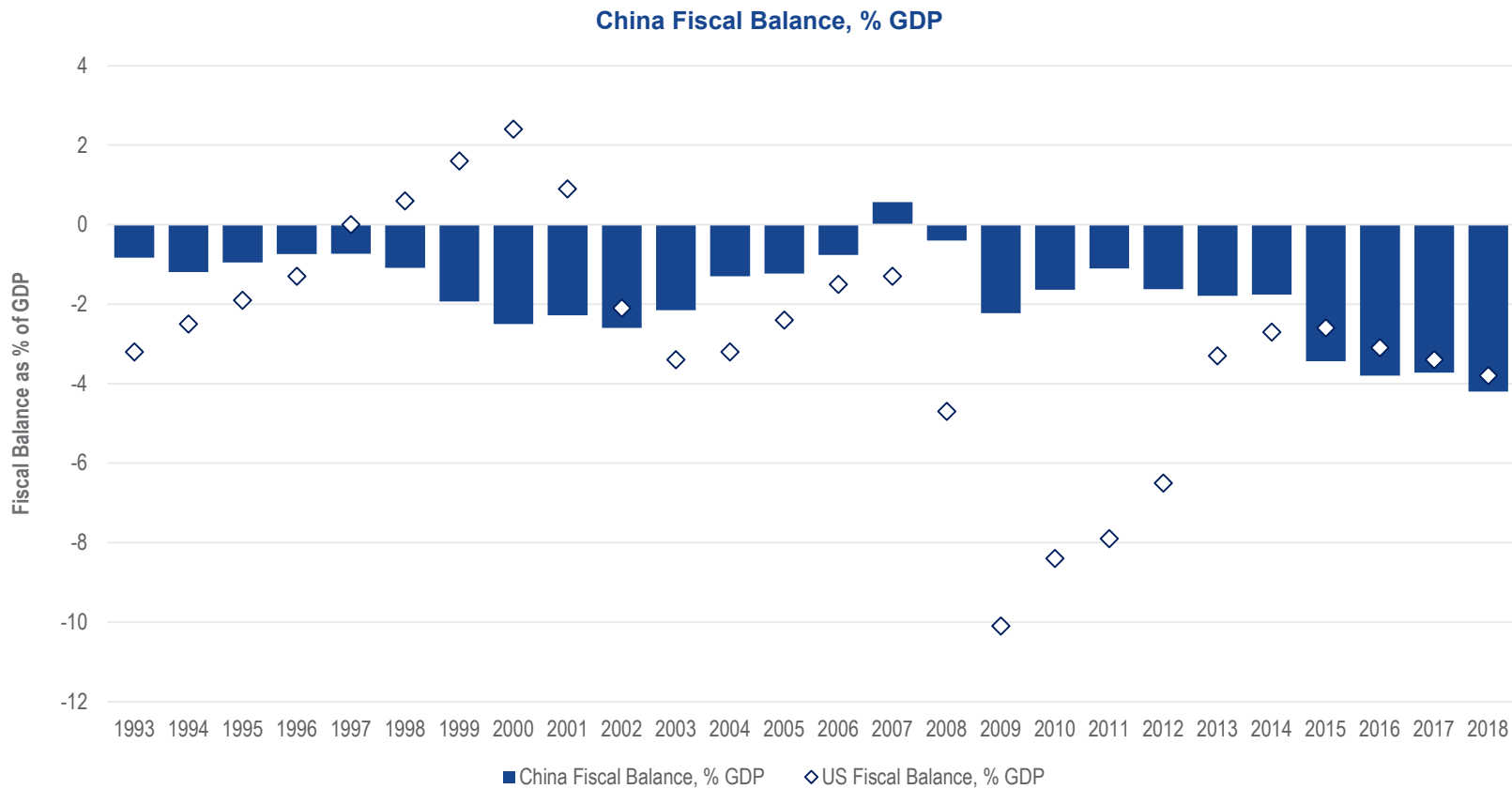


Source: Bloomberg. RRR: required reserve ratio

Fiscal stance remains stimulative



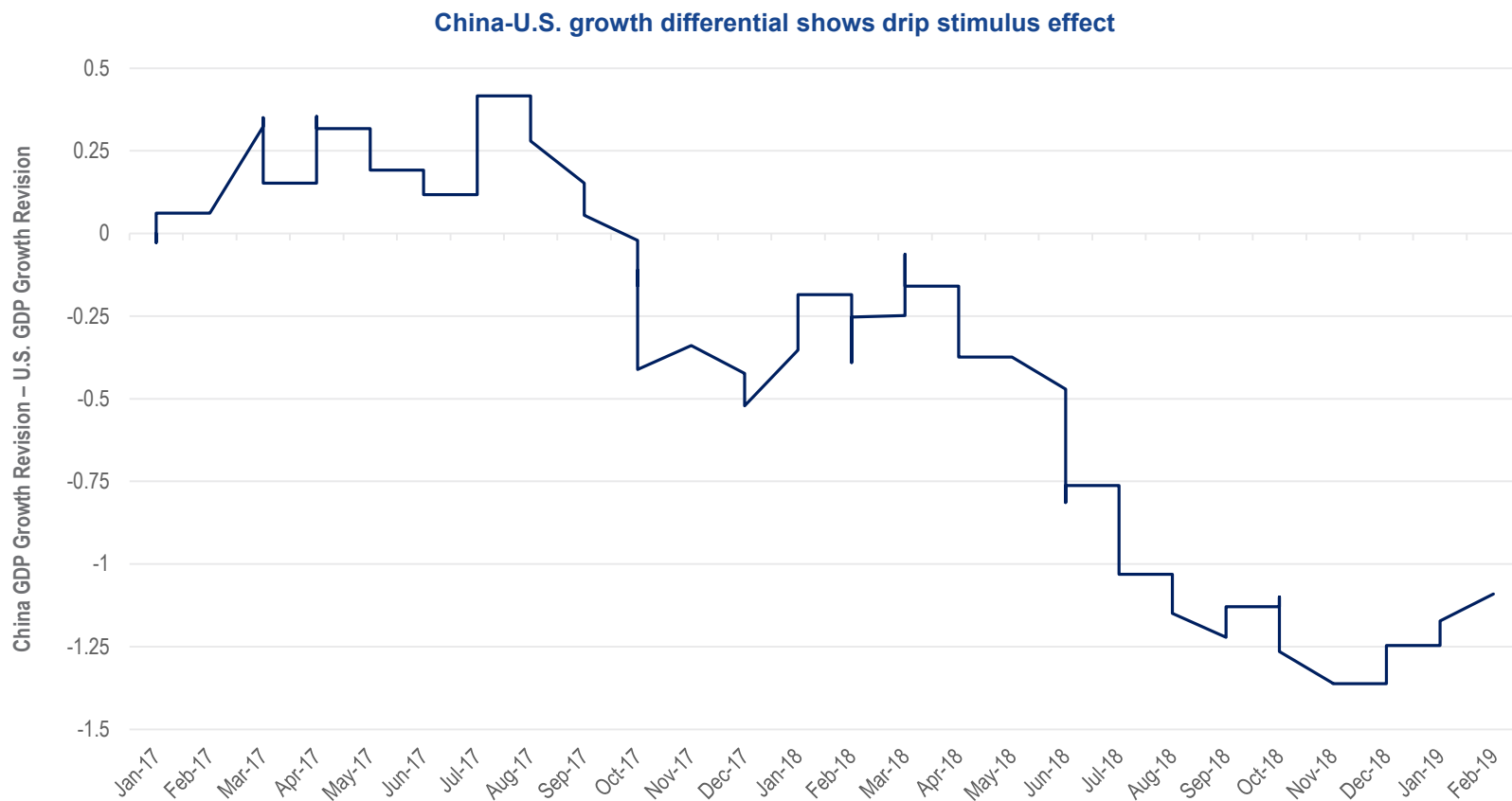
- Authorities are relying more on policy support through fiscal channels
- China's budget deficit was at a historic width in 2018, albeit not as wide as it was in the U.S. after the global financial crisis



Source: Bloomberg

China growth forecasts becoming less pessimistic

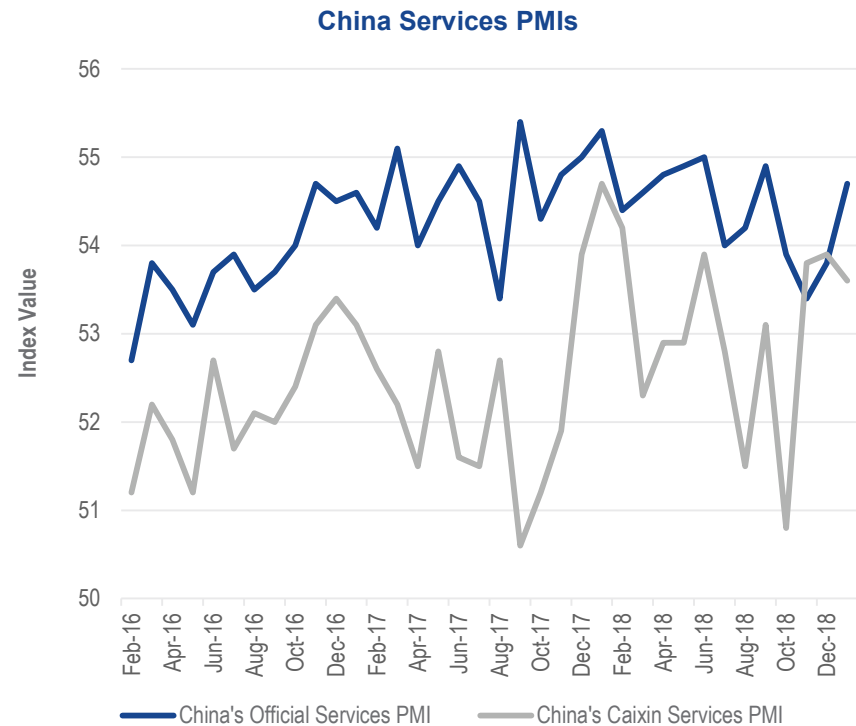
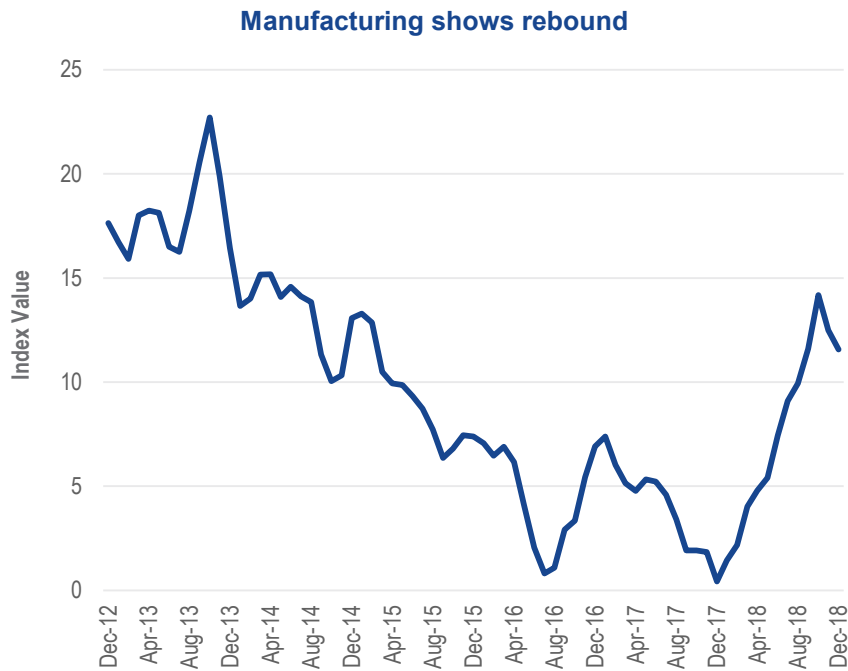
- The expected growth differential between China and the U.S. is bottoming out
- Drip stimulus is kicking in



Source: VanEck; Bloomberg LP

Services look fine and manufacturing may be turning

- China's manufacturing investments are already rebounding
- Other parts of the economy did not slow that much

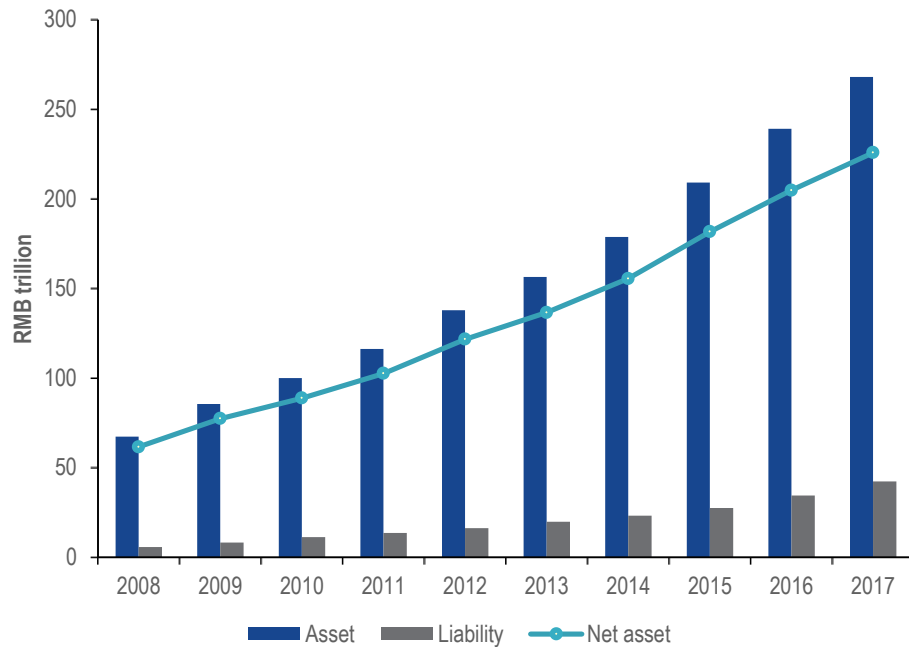


Source: Bloomberg. PMI: purchasing manager index, which is an indicator of economic health of a sector

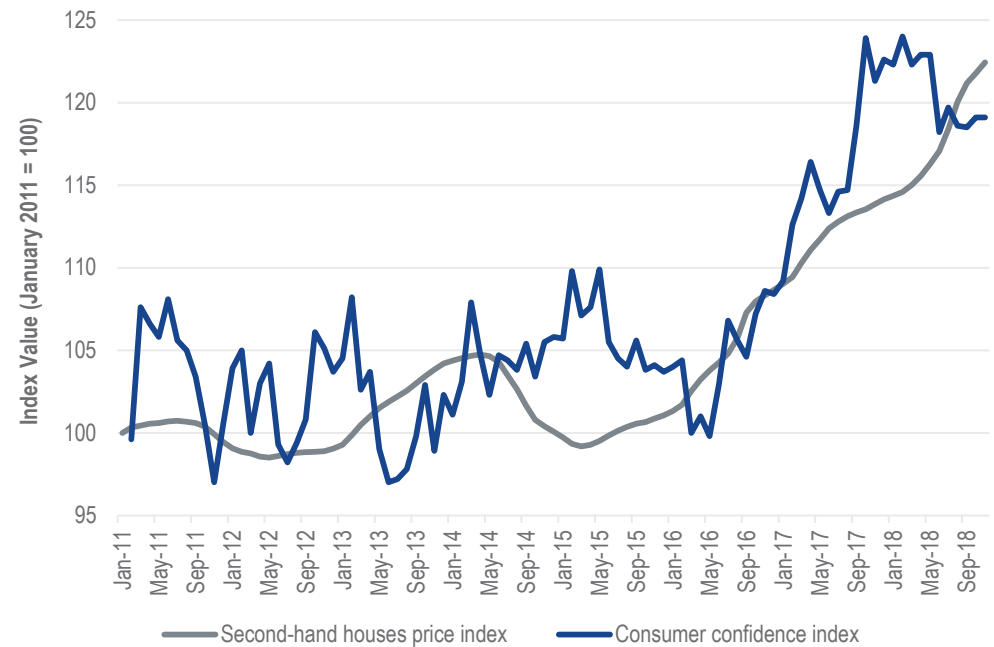
Important policy buffer: household balance sheets

- Household balance sheets are currently in good shape
- However, property comprises a large portion of household assets and consumer confidence shows strong correlation with housing sector
- A sustained drawdown in housing prices could have an outsized impact on consumer confidence and spending

Balance sheets have grown steadily



Consumer confidence and housing prices are closely linked



Left chart: Source: BofA Merrill Lynch Global Research, CEIC

Right chart: Source: BofA Merrill Lynch Global Research estimates, CEIC, Wind, PBoC. Other financial assets include stock, bond, insurance, trust and P2P investments.

Geopolitical considerations to grow in importance

- Trade dispute with the U.S. is affecting trade flows and confidence
- Geopolitical issues will not disappear any time soon as U.S. demands strike at the heart of China's growth/social model
- Some supply chains may shift out of China
- China establishing alternative geopolitical networks/structures



Sources: Bloomberg as of 1/25/2019. Past performance is not indicative of future results.

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