BREAKOUT CAPITAL
in strategic partnership with Rockefeller Capital Management

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Outlook

As we have argued for the past few years, we think China looks like Japan in the 1990s, with an economy and market in secular decline, weighed down by heavy debt, weak demographics and sluggish productivity growth. Our analysis shows that, historically, only 19 nations have sustained a real GDP growth rate higher than 2.5% after reaching China's average income level ($12.5K). And on average, these economies had significantly less debt and much stronger population growth than China has today [see Chart 1]. In fact, no major nation has grown at an annual pace of more than 2 per cent when its population has been declining and China is set to lose about 80 million people (~6% of current population) over the coming decade.

In our view, China's potential GDP growth rate is at best 2.5-3.0%, which makes it unlikely that any amount of stimulus can generate sustained economic growth remotely close to the 5% official growth target.

Chart 1: Past Economic Stars, Compared to China at the $12,500 Income Level

	Avg. GDP growth in next decade	Working Age Population growth	Total Debt (% GDP)
China	**2.5-3.0%**	-0.2%	274
19 Developing stars*	3.5	1.2%	169
Korea	5.5	1.1%	145
Japan	3.2	0.9%	211
Singapore	7.1	3.0%	157

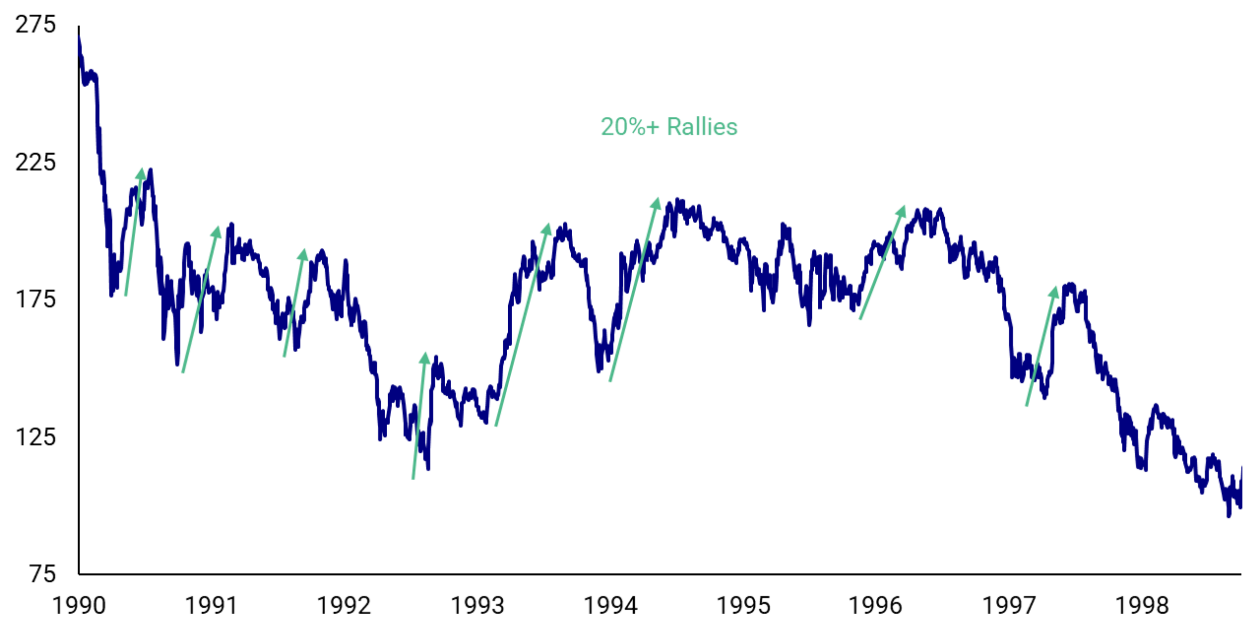
*Source: Haver Analytics, IMF, UN, World Development Indicators, Breakout Capital Calculations. * 19 countries are Andorra, Australia, Austria, Cyprus, Germany, Greece, Hong Kong, Japan, Korea, Latvia, Lithuania, Luxembourg, Netherlands, New Zealand, Norway, Singapore, Slovak Rep, Spain, and U.S.*

As the telling case of Japan shows, after its bubble crashed in 1990, heavy stimulus in 1992-93 led to a powerful rebound in the market, as GDP growth accelerated from near zero to 3 per cent. But this turned out to be just the first in a series of temporary rebounds. From early 1990 to October 1998, Japanese equities declined by almost 65 percent in US dollar terms—punctuated by eight rallies of more than 20 percent, some much more [Chart 2].

China has already experienced similarly ephemeral rallies. After hitting a cycle low in mid-October 2022, the equity market rose by almost 60 percent in just three months, in large part on faith that China's post-pandemic reopening would set off a consumption boom. Those gains vanished over the next year, as investors realized the boom was not coming—in fact consumer confidence remains historically depressed even today.

Now, the question investors are asking themselves is how much stimulus China can actually deliver, given the extremely stretched government balance sheet, particularly at the local level. Our view is that the scope and impact will be limited, but we have also never dismissed China as 'uninvestable'. We plan to continue the approach we have followed since our inception, maintaining exposure to around half a dozen high quality stocks in China, despite these wild swings in market sentiment toward the world's second largest economy.

Chart 2: Japan's False Dawns in the 1990s



Source: Bloomberg, Breakout Capital. Nikkei 225 Index in USD.

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